

Canada weaning itself off exports to U.S.

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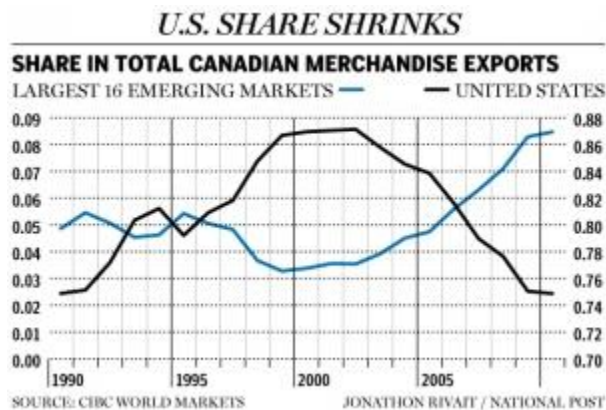
Reuters

Canadian companies are now 30% less dependent on exports south of the border than they were a decade ago, and if Canada's economy wants to avoid a U.S. recession the best bet is to keep that trend going, according to a new report from CIBC World Markets.

Canadian exports to the United States have slipped to pre-NAFTA levels, with emerging markets picking up the lion's share of the slack.

"You're a Canadian company stuck with capacity that used to go to the U.S., but you still have to do something with it. The key message for Canadian CEOs is this is now a necessity, not just a nice-to-have," Benjamin Tal, deputy chief economist with CIBC World Markets, said Monday. "In the past diversifying into emerging markets was a bonus but now it's a matter of survival."

This is key, as it also suggests that Canadian corporate balance sheets have become less sensitive to U.S. exports, which bodes well for Canada's ability to weather the debt storm brewing in the United States.



Andrew Barr/National Post

At the moment, about 75% of exports head south, but if current trends hold out that will slide to 60% by the end of the decade with emerging markets accounting for 90% of the gain on the other end.

Charles St-Arnaud, economist with Nomura Global Economics, said the United States actually became a drag on Canadian growth coming out of the last recession. Commodity prices and the rising loonie played key factors in this trend shift, he said, noting that while exports in value have been flat since 2000, volumes have been declining.

“If Canada was to diversify its exports, it would have likely benefited from both higher volume and higher prices,” he said from New York. “It would’ve had a bigger overall impact on the Canadian economy.”

Mr. Tal, however, does not see the loonie as the primary driver of change and investment in business growth, noting real imports of machinery and equipment have grown at about the same rate now as when the Canadian dollar was much weaker.

“It’s not a dollar story, but a necessity story,” Mr. Tal said. “The dollar is not just high against the U.S. dollar, but also the yuan.”

Peter Hall, chief economist with Export Development Canada, said it does not really matter what caused the shift, what’s important is that businesses are finally embracing the idea.

“Maybe it’s the catalyst, maybe not. But once they got a taste they did not go back,” he said.

What is apparent is Canada must promote closer export ties with Asia and Latin America, and China and Brazil in particular.

“Trade with China is outgrowing the rest, but it is still much less than it might be,” Mr. Hall said.

Overall diversification in the manufacturing and industrial products sectors has improved by 30% in the past decade. And in 30 of the past 36 quarters, Canadian companies have spent more on business investment growth than on growth in exports to the United States. This works out to an average annual growth rate of more than 4% compared with negligible growth in U.S. exports.

Canada’s best bet to match up with China is to focus investments on natural resources and in high-tech sectors producing quality, brand-name products, Mr. Tal said.

In Ontario, voters are currently faced with just such a decision, mulling between billions in investments in green energy as the industry of the future under the incumbent Liberals, or a more free-market approach with existing industries under the Progressive Conservatives.

“For Ontario, being a leader in green energy and technology we can export that knowledge to China,” Mr. Tal said. “China may be polluting but it is also investing in green energy.”

Mr. St-Arnaud warned that Ontario already faces steep competition from Quebec in energy production, and the issue of cost is a real one, especially with the Ontario government enticing green businesses to the province through expensive subsidies.

“Subsidies can be very helpful in the beginning to help the startups, but they cannot be permanent,” he said. “If businesses [eventually] leave because they do not receive the subsidy, that means they are not competitive enough.”