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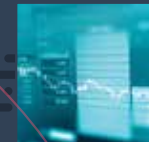
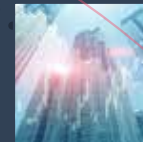
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Canada's State of Trade 2019

20th
Edition



About this document

This report provides a comprehensive summary of the main developments in Canada's commercial activities during the previous year. It describes the events that took place in the global economy and trade in 2018, the main developments in Canada's economy and those of its most important partner economies and regions. It reports the developments in Canada's trade in goods and services, as well as flows and stocks of foreign direct investment and Canadian direct investment abroad.

A special chapter is dedicated to Canada's trade diversification effort, its importance, evolution and prospects, as well as the different dimensions of trade diversification. In addition, the chapter describes various potential paths for further diversification, by summarizing the numerous research and analyses undertaken by the Office of the Chief Economist at Global Affairs Canada and elsewhere.

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Acronyms and Notes

\$B: Billion dollars	EDI: Electronic Data Interchange	pp: Percentage point
\$M: Million dollars	ESW: Electronic Single Window	R&D: Research and development
AI: Artificial intelligence	EU: European Union	ROW: Rest of the world
ASEAN-5: Malaysia, Indonesia, Philippines, Singapore, Thailand	FDI: Foreign direct investment	SAAR: Seasonally adjusted annual rate
BOS: Business Outlook Survey	FES: Fall Economic Statement	SME: Small and medium-sized enterprise
CAN\$: Canadian dollar	FTA: Free trade agreement	UIC: Ultimate investor country
CCAB: Canadian Council for Aboriginal Business	GDP: Gross domestic product	UK: United Kingdom
CDIA: Canadian direct investment abroad	HHI: Herfindahl-Hirschman Index	UNCTAD: United Nations Conference on Trade and Development
CETA: Canada-European Union Comprehensive Economic and Trade Agreement	HS: Harmonized System	U.S.: United States
CIS: Commonwealth of Independent States	ICT: Information and communication technologies	UN: United Nations
CKFTA: Canada-Korea Free Trade Agreement	IIC: Immediate investing country	US\$: United States dollar
CPI: Consumer Price Index	IMF: International Monetary Fund	USA: United States of America
CPTPP: Comprehensive and Progressive Agreement for Trans-Pacific Partnership	M&A: Mergers and acquisitions	US\$B: Billion United States dollars
CUSFTA: Canada-United States Free Trade Agreement	MMA: Major metropolitan area	WCS: Western Canada Select
CUSMA: Canada-United States-Mexico Agreement	NAFTA: North American Free Trade Agreement	WEO: World Economic Outlook
EDC: Export Development Canada	NAICS: North American Industry Classification System	WTI: West Texas Intermediate
	OCE: Office of the Chief Economist, Global Affairs Canada	WTO: World Trade Organization
	OECD: Organisation for Economic Co-operation and Development	“Hong Kong SAR” refers to the Hong Kong Special Administrative Region of the People’s Republic of China throughout this report.
	PMI: Purchasing Managers Index	

Message from the Minister



As Canada's Minister of International Trade Diversification, I am delighted to present the 20th annual edition of the State of Trade Report for 2019.

Trade has been at the centre of the world's attention during the past year. Globally, trade tensions, tariffs and uncertainty among many economies led to weaker economic growth and a slight slowdown in merchandise trade growth last year. However, in the midst of all this turbulence, Canada's exports and imports both rose in 2018, with the total value of trade in goods and services reaching a record high of **\$1.5 trillion**.

More trade and investment means more economic growth and good-paying jobs to help further strengthen Canada's middle class. While Canadian investment flows abroad fell, total inflows of foreign direct investment into Canada increased by **70%** to **\$55 billion**.

This year's State of Trade Report reflects our government's efforts to expand and diversify Canada's trade and investment and build bridges to dynamic markets. While the United States continues to be our most important trading partner, trade with other countries grew at a quicker pace. This bodes well for expanding global partnerships.

Diversification abroad means not only expanding our trading efforts with all regions, but also taking advantage of opportunities in emerging sectors. At home, diversification means making sure all regions of Canada and all members of our society can compete and succeed on international markets. Canada has led the way in advancing gender equality and women's empowerment through our international engagement. Our government is also playing a leading role in helping more Indigenous people, members of the LGBTQ2+ community and youth succeed in today's economy.

The 2019 State of Trade Report highlights results for both women- and Indigenous-owned exporting businesses: the numbers are very encouraging, with gains from trade spreading throughout Canada to all Canadians.

We strongly support free trade as a means to open foreign markets to Canadian goods and services, grow Canadian businesses, create good-paying jobs and contribute to middle-class prosperity. For this reason, we are working on increasing our overseas exports by **50%** by 2025.

The numbers for small and medium-sized businesses (SMEs) exporting goods and services outside of Canada show the most potential for expansion. As part of Canada's trade diversification strategy, we want to help SMEs navigate international markets and capitalize on market access gains achieved under Canada's trade agreements.

Canada currently has 14 free trade agreements in force with 51 countries, totalling a combined gross domestic product of **US\$52 trillion**. When the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) came into force at the end of last year, Canada became the only G7 country with free trade links to all of the other partners. The impacts of the CPTPP as well as the Canada-European Union Comprehensive Economic and Trade Agreement (CETA) are highlighted in this report. For both agreements, the report shows Canadian exports expanding after they came into force.

Our approach is to ensure that increased trade and investment and our trade diversification strategy support meaningful and sustainable growth for Canadian citizens, businesses and communities.

The Honourable Jim Carr, Minister of International Trade Diversification

Executive summary

After a period of broad-based and synchronized growth that lasted throughout 2017 and into early 2018, the global economy started to ease up. Global trade tensions combined with waning cyclical forces reduced economic momentum worldwide. Deceleration was widespread, even in countries like China and India. A notable exception was the United States, where tight labour market conditions and broad-based expansion bolstered the economy.

Against this backdrop of weaker economic growth, the expansion in global merchandise trade volumes slowed across both developed and emerging markets. Global merchandise trade value grew **10%** in 2018, a slight slowdown from the **11%** increase in the previous year. However, annual world merchandise trade still grew faster than at any time between 2012 and 2016, and global commercial services trade expanded by **7.4%** in 2018, a little more than an extra one percentage point over 2017.

This backdrop coupled with global trade tensions, political uncertainty and U.S. tax reforms had an important impact on global foreign direct investment (FDI) flows. FDI flows

declined by **13%** in 2018, with developed European economies experiencing the largest regional decrease at **55%**.

As with most major economies, Canada's growth cooled to **1.9%** in 2018, after reaching **3%** in 2017. A major factor was the slowdown in household consumption growth, weighed down by household debt. Non-residential business investment made a very small positive contribution, while residential investment negatively impacted growth due to tighter mortgage guidelines. An acceleration in the growth of real exports along with a deceleration in real imports allowed trade to contribute marginally to growth in 2018, after being a drag in 2017. The Canadian labour market continued to display tight conditions, with the annual unemployment rate (**5.8%**) reaching record lows dating back to at least 1976, while inflation stood at **2.3%** for 2018, its highest level since 2011.

On the trade front, Canada's exports of goods and services increased **6.2%** in 2018, while imports rose **5.4%**. The total value of trade in goods and services reached a record high of **\$1.5 trillion**. Canada's goods exports played an important

role in the increase, growing at **6.5%** in 2018 to reach **\$585 billion**. Energy led the way, advancing **\$14 billion (15%)** to **\$111 billion**, followed by consumer goods (**\$3.6 billion**) and forestry, building and packaging products (**\$3.4 billion**). By destination, goods exports to the United States climbed **5.4%** to **\$433 billion** in 2018. However, exports to non-U.S. destinations grew even faster, up **9.8%** to **\$153 billion**. Canadian services exports grew for the ninth consecutive year, up **5.8%** to **\$121 billion**.

Canada's goods imports rose **5.8%** to **\$607 billion** in 2018, with increases in all sectors, led by metal ores and minerals, energy products, and aircraft and other transportation equipment. Regionally, goods imports from the United States were up **5.4%** to **\$391 billion** in 2018, while imports from non-U.S. sources grew **6.5%** to **\$216 billion**. Since Canadian goods exports expanded at a faster rate than Canadian goods imports, the goods trade deficit narrowed by **\$2.7 billion** to **\$22 billion**.

Services imports expanded by **4.2%** to reach **\$146 billion**. Canada continued to run a services trade deficit with every broad region and most major trading partners; nearly half of the deficit was due to the United States.

Total inflows of FDI into Canada for 2018 increased by **70%** to **\$55 billion**, in contrast to the decrease experienced by most other developed economies, due to a **\$24 billion** increase in FDI from non-U.S. sources. Strong inflows of investment in Canada's manufacturing sector (**+45%**) made up for declines in trade and transportation (**-41%**) and finance and insurance (**-13%**).

By contrast, Canadian direct investment abroad (i.e. FDI from Canada to other countries) fell by **38%** to **\$64 billion**, notably due to investment in the United States contracting by **60%**. CDIA flows to the rest of the world increased by **48%** or **\$10 billion**. Overall, Canadian investors favoured the energy and mining, and manufacturing sectors, which were up by **\$13 billion** and **\$10 billion**, respectively.

Looking forward, continued weakness in Western Canada's resource sector, elevated household debt, and a backlash against trade and globalization are factors that could dampen Canadian economic, trade, and investment growth. However, the Bank of Canada expects economic growth to pick up in the second half of 2019 and be sustained into 2020.

Whether the global economic context is stable or uncertain, having multiple export destinations and/or many different products to export can certainly help Canadian companies prosper by hedging risk and taking advantage of high-growth markets. This year's State of Trade report also takes stock of research undertaken by the Office of the Chief Economist on trade diversification, both in its conventional sense as well as from the angle of diversity among exporter firms. It also features results from Export Development Canada's research.

In terms of geographic diversification (e.g. destinations of exports), Canada has room to further diversify, as Canadian exports are currently considered to be concentrated. In fact, data show that Canada's exports are the fourth most concentrated by destination out of 113 countries, principally due to a large share of exports going to the United States. This is not particularly surprising given Canada's close trade connections with its Southern neighbour. Recognizing the country's high export concentration, the federal government has set a target of increasing Canada's overseas¹ exports by 50% to **\$284 billion** by 2025. This objective requires an annual average growth rate of 5.2% from 2017, which is higher than the trend from recent years (2011–2017).

Free trade agreements (FTAs) are one way the government can help and encourage Canadian exporters to diversify into new markets as FTAs open opportunities by reducing trade barriers such as tariffs, quotas, and non-tariff barriers. Analysis shows Canadian exports increase after FTAs come into effect, especially for products benefiting from higher tariff declines. While Canada already has an extensive list of FTA partners,² signing new agreements and deepening existing FTAs could help further diversify Canadian trade, particularly in faster-growing emerging markets. Preliminary research results indicate that a one percentage point increase in the growth rate of an import market caused the level of Canadian exports to expand by 0.11%, with an additional gain of 0.16% if Canada was already active in that market prior to the growth. That said, encouraging Canadian firms to first export to emerging markets may not always be appropriate. A large majority of new exporters start with the U.S. and only later expand beyond that market. It is estimated that 20% of exporters to the United States expand or move into new markets each year on average. Therefore, encouraging firms to explore overseas markets might require them to first test the waters of the closer and more familiar U.S. market. Incidentally, some sixteen American cities are projected to be among the top 40 cities worldwide for Canadian business opportunities by 2030.

1 Overseas refers to non-U.S. destinations.

2 Once the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) is fully implemented, Canada will have 14 FTAs in force with 51 partner countries.

Although some traditional destinations will remain, the ways firms can sell their goods and services are changing with the Internet and digital technologies. Digital technologies facilitate transactions and reduce costs, for example, by optimizing route planning, reducing storage time, and improving distribution networks. Such improvements reduce the distance barrier for exporters. On the other hand, the Internet is increasingly being exploited for cross-border delivery of digital products.

Encouraging the use of these technologies could further advance the diversification agenda. This could be particularly important for small and medium-sized enterprises (SMEs). Despite accounting for **99.8%** of employer businesses and **89%** of all private-sector jobs, only **12%** of SMEs exported goods and services outside of Canada. Government programs aimed at helping SMEs navigate international markets could be another way to reach Canada's 2025 overseas exports goal.

As mentioned above, diversity in who exports is also worth paying attention to. Diversification in ownership of Canadian exporters is important to ensure that gains from trade are spread throughout Canada to all Canadians. One dimension is women-owned exporting firms. Research shows that the proportion of women-owned exporting SMEs in Canada doubled from **7.4%** of all SME exporters in 2011 to **15%** in 2017. Furthermore, within women-owned SMEs in Canada, the share of firms that export rose from **8.4%** in 2014 to **11%** in 2017.

The other ownership dimension explored is that of Indigenous-owned exporters. The results of a survey of Indigenous entrepreneurs show that in 2014, the proportion of Indigenous exporting SMEs was twice that of Canadian non-Indigenous exporting SMEs—**24%** versus **12%**, respectively. Diversity thus exists within the exporting community and this diversity is slowly growing.

Diversification hedges risks from shocks to Canada from abroad and allows Canadian businesses to take advantage of opportunities in fast-growing markets. There are various avenues to greater geographical diversification. These include using free trade agreements to give Canadian exporters better access to foreign markets; accessing fast-growing markets early; using the U.S. market as a stepping stone to overseas markets; leveraging digital technologies; increasing SME participation in international trade; and focusing on the future growth of cities to identify new export opportunities. Moreover, the gains from trade can be spread more evenly throughout Canada, notably through diversification of exporter ownership.





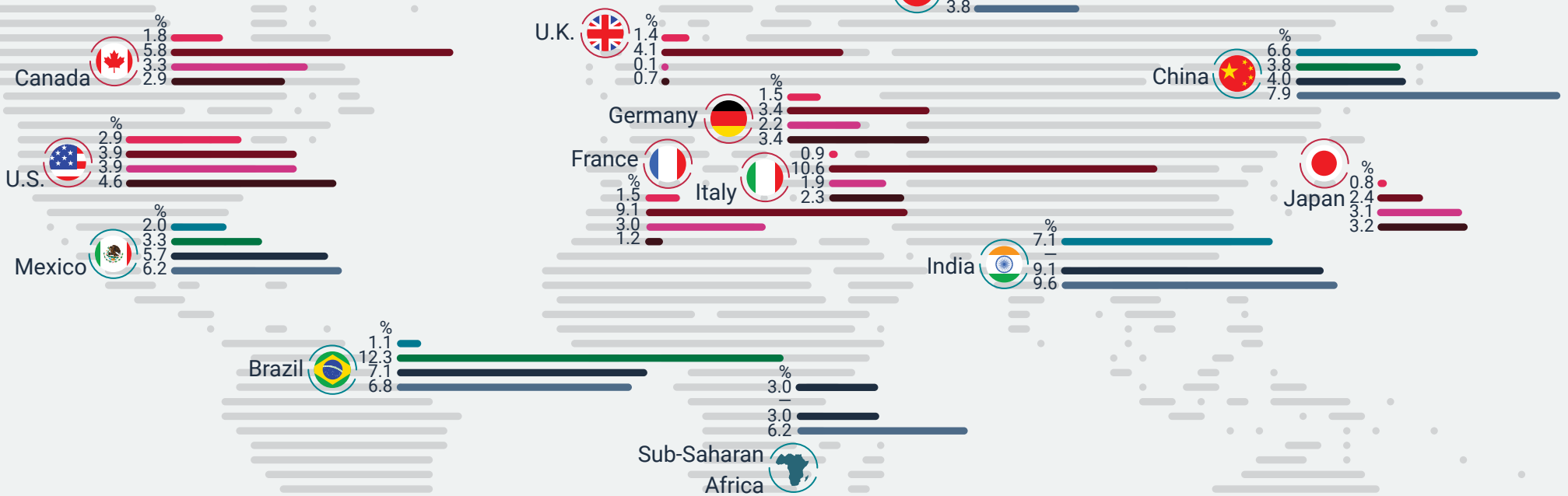
Global performance highlights

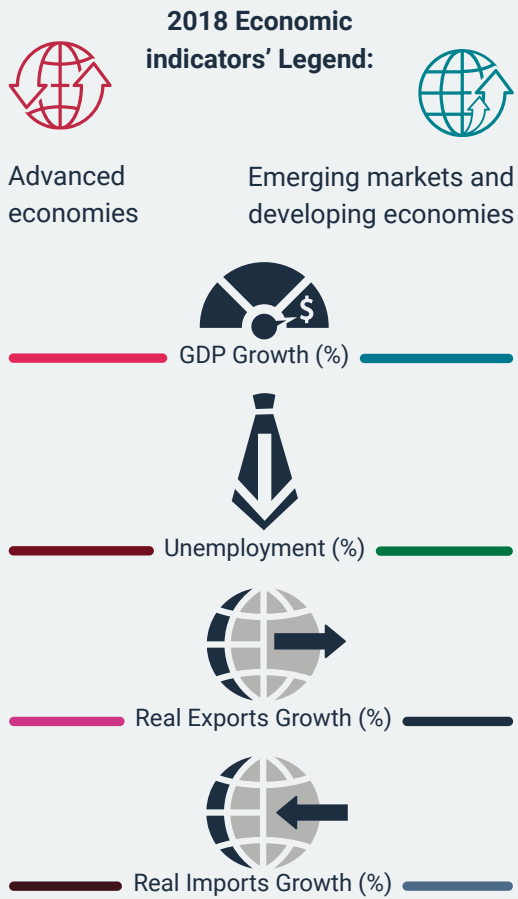
Global economic performance

At a glance

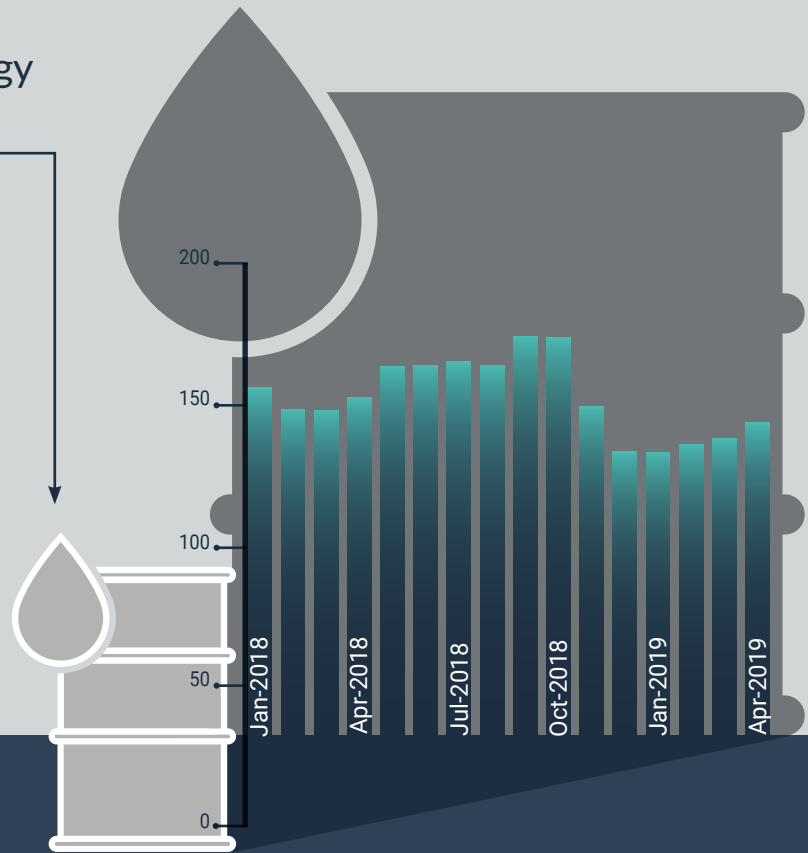


2018 Economic indicators





2018 Energy price index

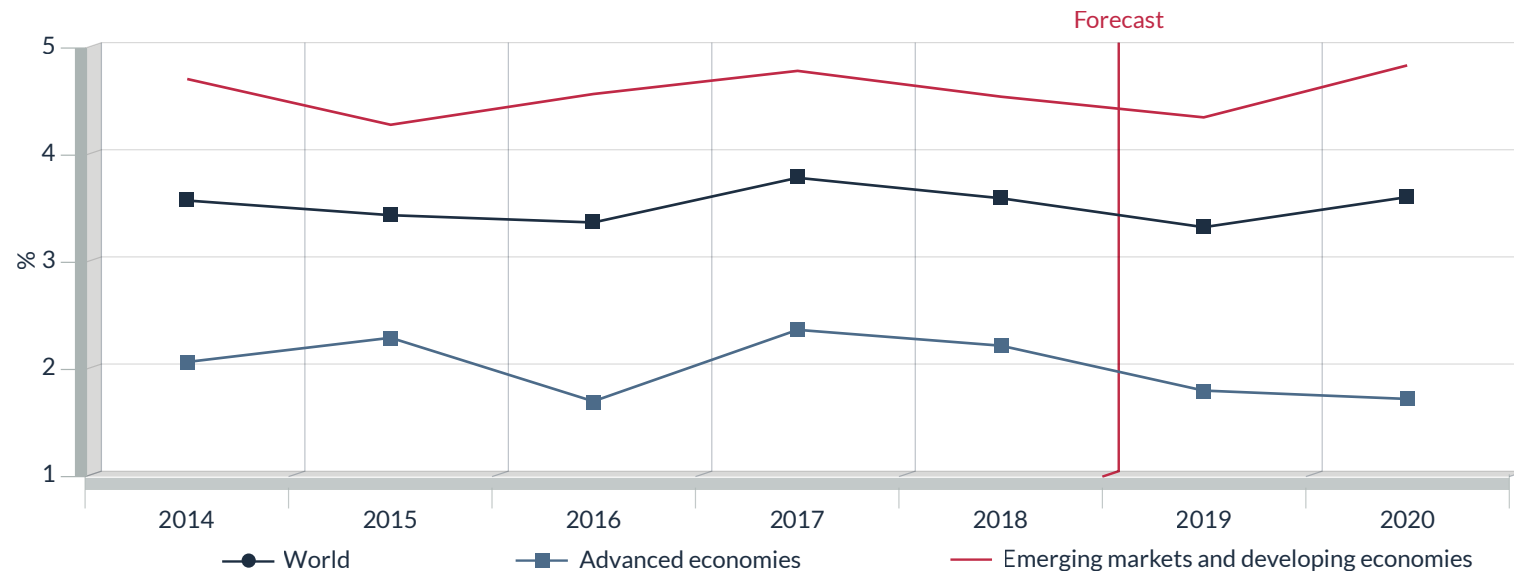


Global overview

After a broad-based upswing in growth that lasted nearly two years, the global economy started to decelerate in the second half of 2018, causing global growth in 2018 (3.6%) to be slightly lower than that for 2017 (3.8%). The deceleration in 2018 was fairly evenly spread between advanced economies and emerging economies. Rising trade tensions, lower

business confidence, tightening of financial conditions, higher policy uncertainty across many economies and waning cyclical forces were some of the factors behind the slowdown in global activities.

Figure 1: Global economic growth



Selected regions and countries overview

Growth among major advanced economies slowed in 2018, with the exception of the United States. Weakening consumer and business sentiment throughout 2018, along with other country-specific issues, caused 2018 gross domestic product (GDP) growth in the Euro area to decline to **1.8%** from **2.4%** in 2017. Germany grew **1.5%** in 2018, compared to **2.5%** in 2017, as subdued foreign demand from major trading partners and delays related to new fuel emission standards for diesel vehicles weighed on economic activity. In Italy, an elevated sovereign spread¹ continued to put downward pressure on the economy, and growth declined to **0.9%** in 2018 from **1.6%** in 2017. In France, street protests against rising fuel prices and high costs of living disrupted retail sales and consumption growth, and France's economic growth slipped to **1.5%** in 2018 from **2.2%** in 2017. Uncertainty surrounding Brexit

negotiations weighed on the United Kingdom, and growth weakened to **1.4%** in 2018, down from **1.8%** a year earlier. In Japan, economic growth declined to **0.8%** in 2018 from **1.9%** in 2017. Notably, however, the United States bucked the trend of decelerating growth, advancing **2.9%** last year compared to **2.2%** a year earlier. A tight labour market, strong consumption growth, and fiscal stimulus from tax reforms supported the acceleration in economic growth.

¹ Sovereign spread refers to the difference in 10-year government bond yields between a given country and the benchmark yield for safe assets in the same region. In Europe, the benchmark country is Germany. Italy's yield is higher than Germany's, reflecting the fact that investors believe Italy carries higher risks for investment.

1.1 Global economic performance

Table 1: 2018 Economic indicators for selected regions and economies

	GDP Growth (%)	Unemployment (%)	Real Exports Growth* (%)	Real Imports Growth* (%)
Advanced economies	2.2	5.1	3.1	3.3
Canada	1.8	5.8	3.3	2.9
Japan	0.8	2.4	3.1	3.2
United Kingdom	1.4	4.1	0.1	0.7
United States	2.9	3.9	3.9	4.6
Euro area	1.8	8.2	3.1	3.0
France	1.5	9.1	3.0	1.2
Germany	1.5	3.4	2.2	3.4
Italy	0.9	10.6	1.9	2.3
Emerging markets and developing economies	4.5		4.3	5.6
Commonwealth of Independent States	2.8		5.6	3.9
Russia	2.3	4.8	6.3	3.8
Emerging and developing Asia	6.4		5.5	8.5
China	6.6	3.8	4.0	7.9
India	7.1		9.1	9.6
ASEAN-5	5.2		7.3	9.7
Emerging and developing Europe	3.6		6.5	2.6
Latin America and the Caribbean	1.0		3.0	4.3
Brazil	1.1	12.3	7.1	6.8
Mexico	2.0	3.3	5.7	6.2
Middle East and North Africa	1.4		-1.0	-0.6
Sub-Saharan Africa	3.0		3.0	6.2
Nigeria	1.9	22.6	-0.7	17.7
South Africa	0.8	27.1	1.4	2.5

Source: International Monetary Fund, *World Economic Outlook*, April 2019; retrieved on 20-06-2019

*Volume of exports and imports of goods and services

1.1 Global economic performance

Growth in emerging markets and developing economies also slowed slightly in 2018, dropping to 4.5% from 4.8% in 2017. In China, economic growth slowed to 6.6% in 2018 from 6.8% the previous year. The slowdown was due to regulatory tightening, which led to slower growth in fixed asset investment, as the government attempted to put economic growth on a more sustainable path. Declines in automobile sales, along with U.S. tariff actions also weighed on the Chinese economy in 2018. India experienced a slight slowdown in economic growth in 2018 (7.1%) relative to 2017 (7.2%). Mexico, Canada's third-largest merchandise trade partner, saw a slight decline in economic growth in 2018, at 2.0%, from 2.1% in 2017. By the end of 2018, Mexico's sovereign spread² rose as economic sentiment weakened due to policy uncertainty from the new administration that cancelled a planned airport, in addition to the lack of clarity with regard to energy and education reforms.

According to the International Monetary Fund (IMF) in April 2019, the momentum of slower growth globally in the second half of 2018 is expected to carry over into the first half of 2019,

with a pickup in economic activity afterward. The IMF expects economic growth to slow to 3.3% in 2019, from 3.6% in 2018, before returning to 3.6% in 2020. The outlook reflects waning cyclical forces, a return to weak potential growth from advanced economies, and an uncertain recovery in emerging markets. Risks to the forecast tilt toward the downside as trade tensions between United States and various trading partners, uncertainty surrounding Brexit negotiations, stress on Italian banks, and other geo-political issues weigh heavily on the economic outlook. On the other hand, with growing evidence of slowing activity, many central banks have signalled a less aggressive path of monetary policy tightening.

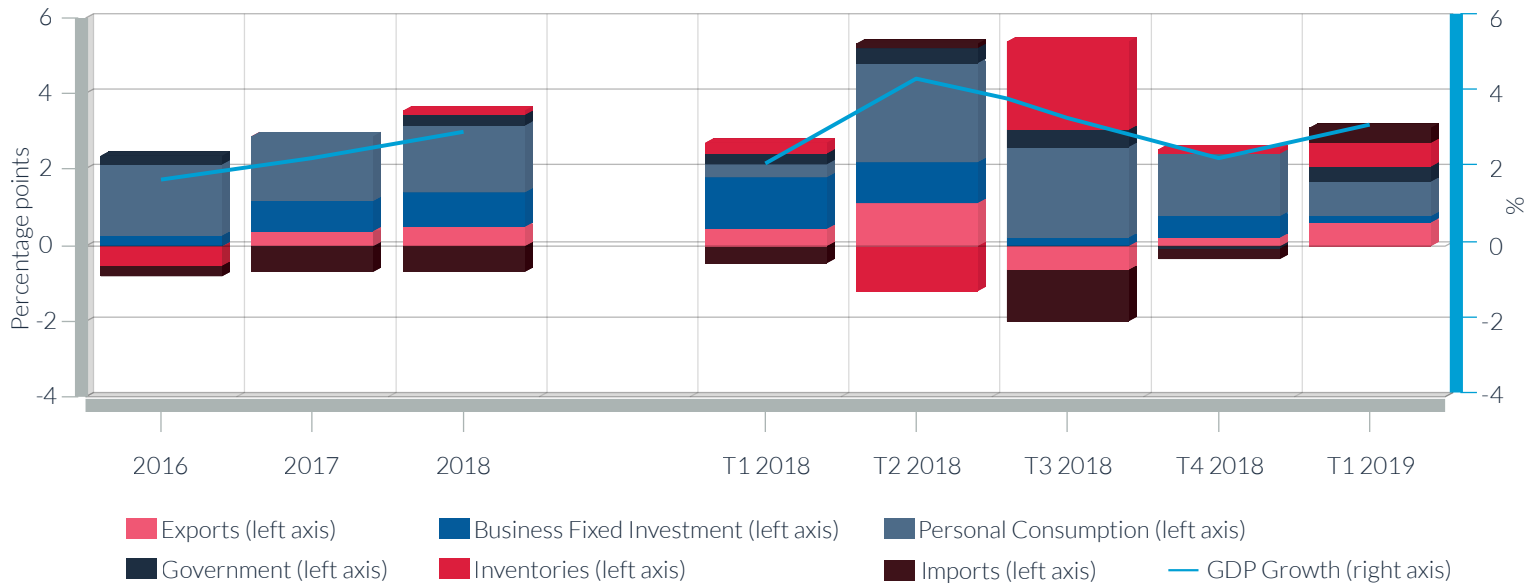
² The difference between the yield on Mexican government bond vs. the yield on U.S. government bond (the safer asset, see footnote 1).

United States overview

In 2018, while economic growth slowed in many advanced economies, it accelerated in the United States over the previous year. The U.S. expansion was broad-based, as personal consumption, investment, and exports all contributed to growth.

However, beginning in the second half of 2018, there were signs of softening investment brought about by increased uncertainty surrounding rising trade tensions with China.

Figure 2: U.S. GDP growth and contribution to GDP growth



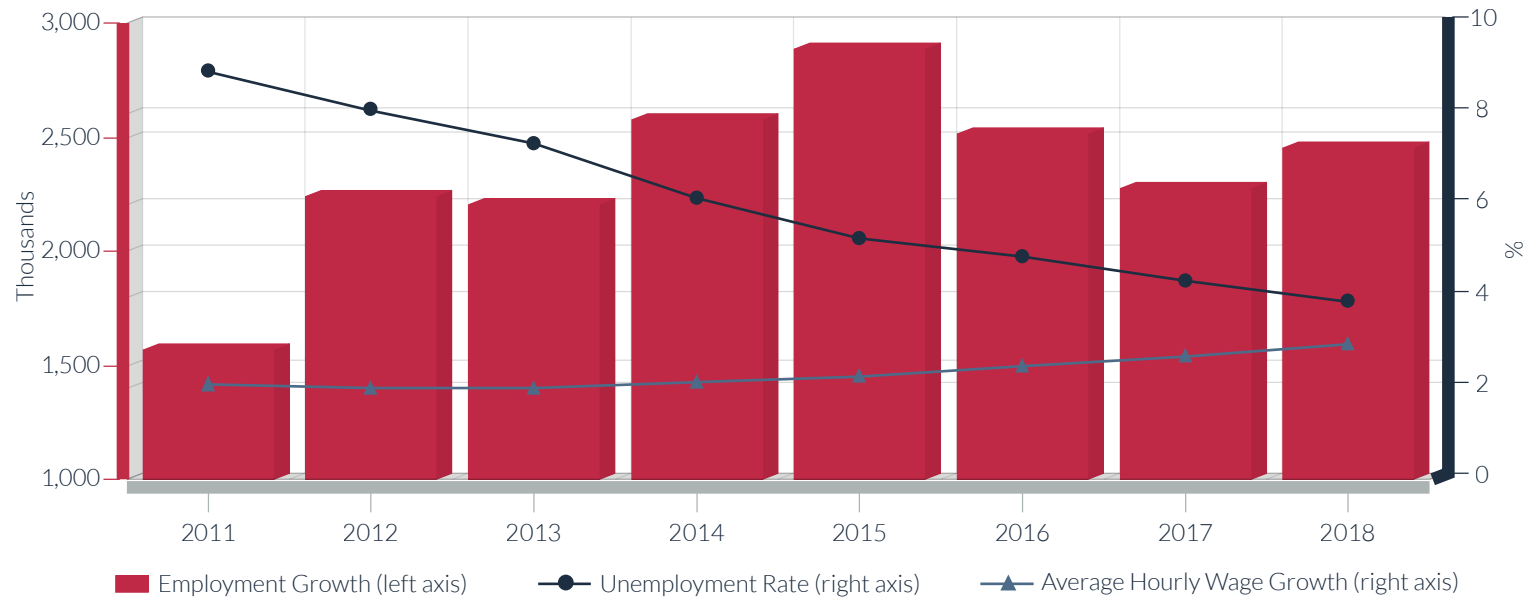
Source: U.S. Bureau of Economic Analysis, May 30, 2019; retrieved on 20-06-2019

1.1 Global economic performance

Consumption in the United States continued to be supported by a tight labour market (3.9% unemployment rate in 2018) and a slight pickup in wage growth (3.0% in 2018). According to the IMF forecast released in April 2019, U.S. economic growth is expected to decelerate to 2.3% in 2019 and 1.9% in 2020. The decline in growth reflects the negative impact of trade and political uncertainties, global cyclical forces and the waning positive impacts of fiscal stimulus. Furthermore, there

are risks to U.S. economic growth, which include further escalation of trade tensions with China and the slow ratification process for the new Canada-United States-Mexico Agreement (CUSMA). The U.S. economic outlook from the Organisation for Economic Co-operation and Development (OECD, May 2019) is slightly more positive, 2.8% in 2019 and 2.3% in 2020. The OECD believes that a strong labour market and increasing wages will support consumption growth.

Figure 3: U.S. employment performance



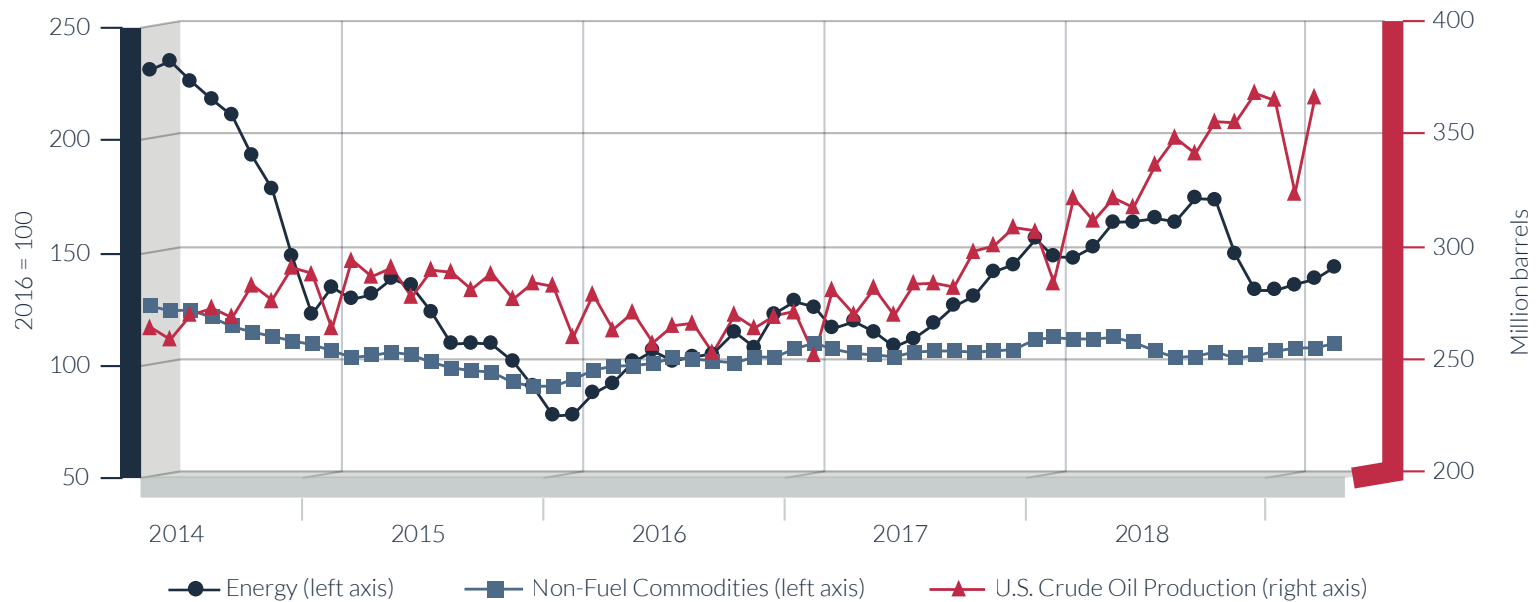
Source: U.S. Bureau of Labor Statistics and IMF, *World Economic Outlook*, April 2018; retrieved on 20-06-2019

Global commodity prices

Global energy prices started to decline in the latter part of 2018; the IMF energy price index dropped **23%** between September and December 2018. Slowing global growth, supply factors such as the temporary waiver of U.S. sanctions on Iranian oil exports to certain countries, and record high U.S. crude oil production were the main reasons for the decline. The average monthly West Texas Intermediate crude oil price

was **US\$70.75** per barrel in October 2018, but plunged to **US\$49.52** per barrel in December 2018. In recent months, crude oil prices have picked up slightly (to **US\$60.83** per barrel in May 2019), but still remain below their October 2018 level. Excluding energy, overall commodity prices have remained relatively stable.

Figure 4: Commodity price index



Source: IMF Primary Commodity Price System and U.S. Energy Information Administration; retrieved on 20-06-2019

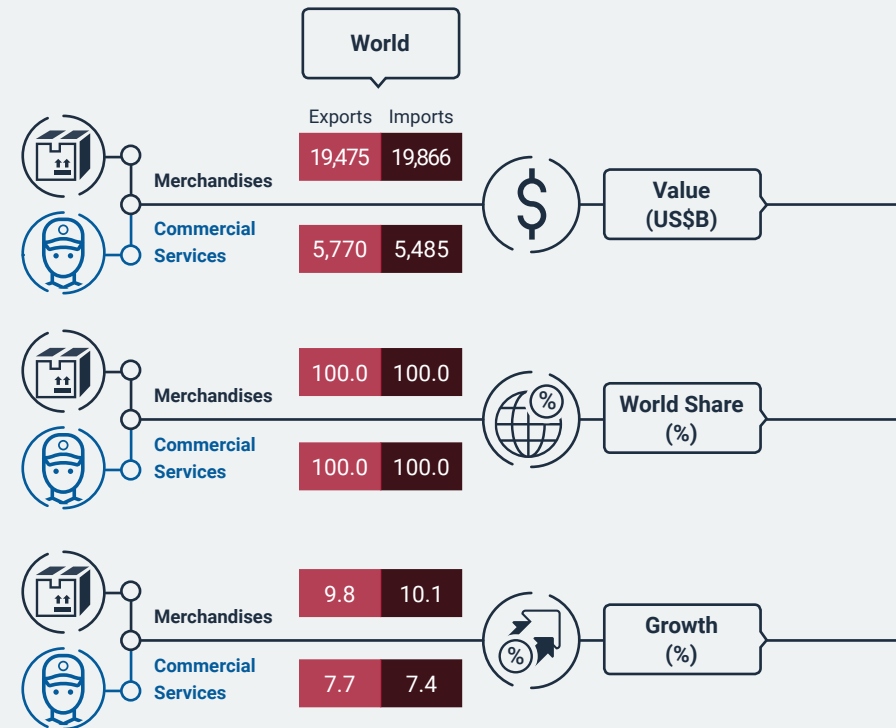


Global trade performance

At a glance



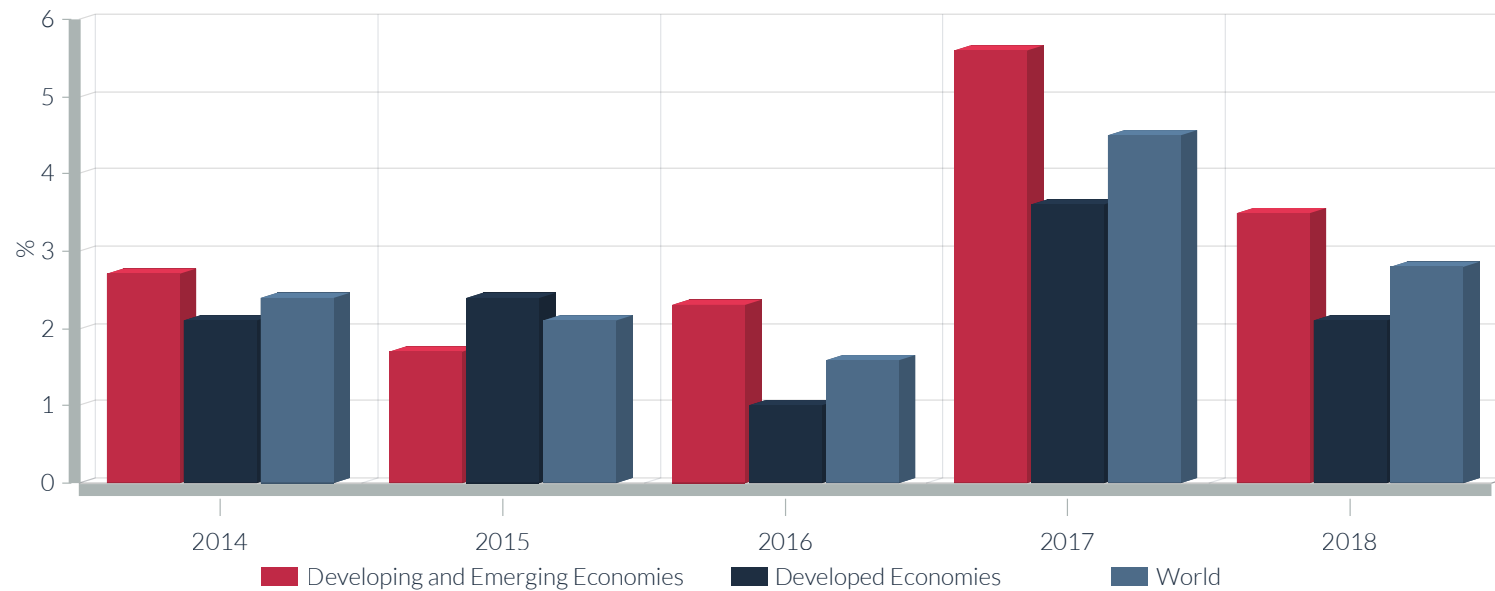
2018 Merchandise Exports and Imports Volume Growth (%)



International trade overview

As global economic growth lost momentum in 2018, growth in the volume of world merchandise exports also slowed in both developed economies and emerging markets. Since the 2009 recession, export volume growth in developing and emerging economies has been outpacing growth in developed economies, with the exception of 2015.

Figure 5: Merchandise exports volume growth

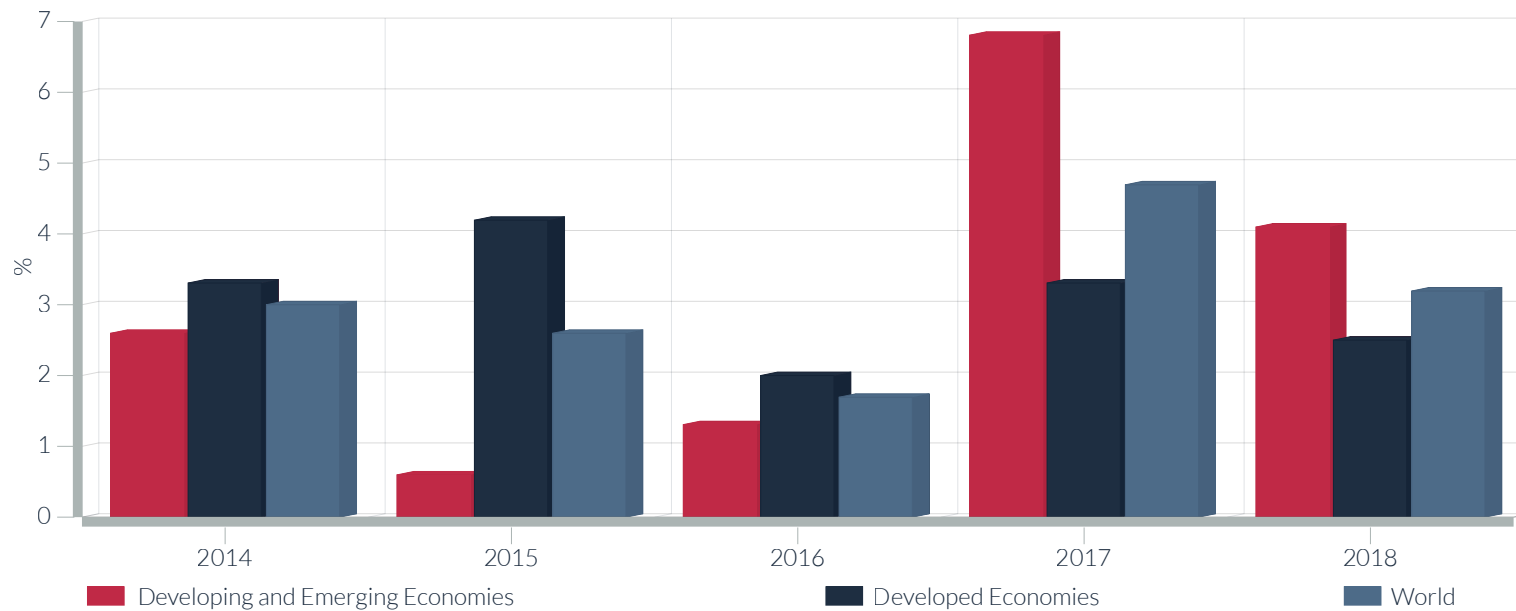


Source: WTO Database; retrieved on 21-06-2019

1.2 Global trade performance

Similar to exports, the growth in the volume of imports also slowed in 2018 across both developed economies and emerging markets. Merchandise import volumes grew faster in developed economies from 2014 to 2016, but the trend reversed beginning in 2017.

Figure 6: Merchandise imports volume growth



Source: WTO Database; retrieved on 21-06-2019

World merchandise trade overview

World merchandise exports³ grew **9.8%** in 2018 to reach over **US\$19 trillion**. Regionally, exports from the Commonwealth of Independent States grew the fastest at **24%**, followed by the Middle East at **21%**. North America had the lowest rate of merchandise export growth in 2018, at **7.9%**. Among the major North American economies, Mexico had the highest rate of merchandise export growth, and Canada the lowest. As a result, Mexican exports surpassed those of Canada, causing the two countries to switch rank (12th to 13th for Canada and 13th to 12th for Mexico) among the largest merchandise exporters to the world. The other change in ranking among top merchandise exporters was France overtaking Hong Kong SAR⁴ and moving into 7th place.

3 In this section, trade value is referred to instead of trade volume. Trade value includes both the volume and price components of trade.

4 Special Administrative Region



1.2 Global trade performance

Table 2: Regional and selected countries merchandise exports

	2018 Merchandise Exports				2017 Rank
	Value (US\$B)	Share (%)	Growth (%)	Rank	
World	19,475	100.0	9.8		
North America	2,565	13.2	7.9		
Canada	450	2.3	6.9	13	12
United States	1,664	8.5	7.6	2	2
Mexico	451	2.3	10.1	12	13
Europe	7,112	36.5	9.3		
United Kingdom	486	2.5	10.1	10	10
European Union (27)	6,448	33.1	9.4		
Euro area (19)	4,986	25.6	9.2		
Belgium	467	2.4	8.4	11	11
France	582	3.0	8.7	7	8
Germany	1,561	8.0	7.8	3	3
Italy	547	2.8	7.7	9	9
Netherlands	723	3.7	10.8	5	5
Commonwealth of Independent States	640	3.3	23.5		
Russia	444	2.3	25.6	14	15
Middle East	1,140	5.9	21.5		
Asia	6,905	35.5	8.2		
China	2,487	12.8	9.9	1	1
Hong Kong SAR	569	2.9	3.4	8	7
India	326	1.7	8.8	19	20
Japan	738	3.8	5.8	4	4
Korea, Republic of	605	3.1	5.4	6	6
South and Central America and the Caribbean	635	3.3	8.2		
Brazil	240	1.2	10.0	27	25
Africa	479	2.5	13.6		
Nigeria	61	0.3	36.4	50	52
South Africa	94	0.5	5.9	39	38

Source: WTO Database; retrieved on 21-06-2019

1.2 Global trade performance

World merchandise imports grew **10%**⁵ in 2018 to reach **US\$20 trillion**, with Asia leading growth at **13%**, followed by South and Central America and the Caribbean (**11%**) and Africa (**11%**). Merchandise imports in North America grew by **8.4%**, with Mexico growing the fastest (**10%**) among the major economies, and Canada the slowest (**6.1%**). As a result, Canada and Mexico switched places in the ranking of

global merchandise importers. Other movements among the top merchandise importers include the Netherlands overtaking Hong Kong SAR in 7th place, and India overtaking Italy in 10th place.

-
- 5 See [Imports, Exports and Mirror Data with UN COMTRADE](#) for an explanation of discrepancies in world imports and exports.



1.2 Global trade performance

Table 3: Regional and selected countries merchandise imports

	2018 Merchandise Imports				2017 Rank
	Value (US\$B)	Share (%)	Growth (%)	Rank	
World	19,866	100.0	10.1		
North America	3,561	17.9	8.4		
Canada	469	2.4	6.1	13	12
United States	2,614	13.2	8.5	1	1
Mexico	477	2.4	10.3	12	13
Europe	7,151	36.0	9.5		
United Kingdom	674	3.4	4.7	5	5
European Union (27)	6,466	32.5	10.4		
Euro area (19)	4,727	23.8	10.9		
Belgium	450	2.3	10.1	14	14
France	673	3.4	8.7	6	6
Germany	1,286	6.5	10.6	3	3
Italy	501	2.5	10.5	11	10
Netherlands	646	3.3	12.4	7	8
Commonwealth of Independent States	435	2.2	8.4		
Russia	249	1.3	4.6	22	20
Middle East	737	3.7	0.9		
Asia	6,764	34.0	12.7		
China	2,136	10.8	15.8	2	2
Hong Kong SAR	628	3.2	6.4	8	7
India	511	2.6	13.9	10	11
Japan	749	3.8	11.4	4	4
Korea, Republic of	535	2.7	11.9	9	9
South and Central America and the Caribbean	645	3.2	11.2		
Brazil	189	0.9	19.8	28	29
Africa	574	2.9	11.1		
Nigeria	42	0.2	33.9	59	63
South Africa	114	0.6	12.4	35	35

Source: WTO Database; retrieved on 21-06-2019

Commercial services trade overview

At **7.7%**, world commercial services exports grew slightly slower than the **9.8%** pace of world merchandise exports in 2018. By region, the Commonwealth of Independent States led growth in commercial services exports at **12%**, followed by Asia and Africa at **9.9%** each. North America was the second-slowest growing region (**4.1%**), expanding only faster than South and Central America and the Caribbean (**1.0%**). Canada's commercial services exports grew **5.6%** in 2018 and dropped one place to the 18th spot among the world's top

commercial services exporters. Both India and Japan dropped a place in the rankings as Ireland leapfrogged over them into 7th place, due to high growth (**14%**). China and India, the two largest emerging economies, experienced strong commercial services exports growth in 2018, at **17%** and **11%**, respectively. Among developed economies, the Netherlands increased its commercial services exports by **11%** to **US\$241 billion**.



Table 4: Regional and selected countries services exports

	2018 Commercial Services Exports				2017 Rank
	Value (US\$B)	Share (%)	Growth (%)	Rank	
World	5,770	100.0	7.7		
North America	930	16.1	4.1		
Canada	92	1.6	5.6	18	17
United States	808	14.0	3.8	1	1
Mexico	28	0.5	5.1	40	38
Europe	2,764	47.9	8.1		
Belgium	121	2.1	3.0	13	13
France	291	5.0	6.2	4	4
Germany	326	5.6	7.3	3	3
Italy	121	2.1	9.0	14	14
Netherlands	241	4.2	11.4	6	6
United Kingdom	373	6.5	5.6	2	2
Commonwealth of Independent States	117	2.0	12.1		
Russia	64	1.1	12.3	26	26
Middle East	219	3.8	5.4		
Asia	1,470	25.5	9.9		
China	265	4.6	17.1	5	5
Hong Kong SAR	114	2.0	9.3	15	15
India	204	3.5	10.7	8	7
Japan	187	3.2	3.1	9	8
Korea, Republic of	95	1.7	10.4	17	18
South and Central America and the Caribbean	159	2.8	1.0		
Brazil	33	0.6	-1.3	36	36
Africa	112	1.9	9.9		
Nigeria	4	0.1	-4.3	85	81
South Africa	16	0.3	1.4	49	48

Source: WTO Database; retrieved on 21-06-2019

World commercial services imports grew **7.4%** in 2018, with Africa leading the way at **13%** and accounting for **3.1%** of overall world commercial services imports. In North America, commercial services imports increased **3.2%**, recording the second-slowest regional growth rate. The United States remained the top importer of commercial services, at **US\$536 billion**. Canada's imports grew **4.6%**, to remain in 14th place among the leading commercial services importers. The large and fast-growing emerging economies of China and India saw high growth in commercial services imports, at **12%** and **14%**, respectively. Notable among developed economies, the Netherlands (**11%**), the United Kingdom (**11%**) and Belgium (**12%**) all saw high levels of growth in their commercial services imports.



Table 5: Regional and selected countries services imports

	2018 Commercial Services Imports				2017 Rank
	Value (US\$B)	Share (%)	Growth (%)	Rank	
World	5,485	100.0	7.4		
North America	686	12.5	3.2		
Canada	112	2.0	4.6	14	14
United States	536	9.8	3.0	1	1
Mexico	37	0.7	0.7	32	32
Europe	2,346	42.8	8.4		
Belgium	129	2.3	11.8	11	12
France	257	4.7	4.7	4	4
Germany	350	6.4	6.2	3	3
Italy	123	2.2	8.5	12	13
Netherlands	229	4.2	10.9	6	6
United Kingdom	230	4.2	10.9	5	5
Commonwealth of Independent States	144	2.6	7.4		
Russia	93	1.7	6.8	16	16
Middle East	300	5.5	6.1		
Asia	1,659	30.2	8.2		
China	521	9.5	12.2	2	2
Hong Kong SAR	81	1.5	4.9	19	18
India	175	3.2	14.0	10	10
Japan	198	3.6	3.8	8	8
Korea, Republic of	123	2.2	2.1	13	11
South and Central America and the Caribbean	181	3.3	0.8		
Brazil	66	1.2	-0.9	24	23
Africa	170	3.1	13.4		
Nigeria	31	0.6	70.1	37	43
South Africa	16	0.3	2.2	50	49

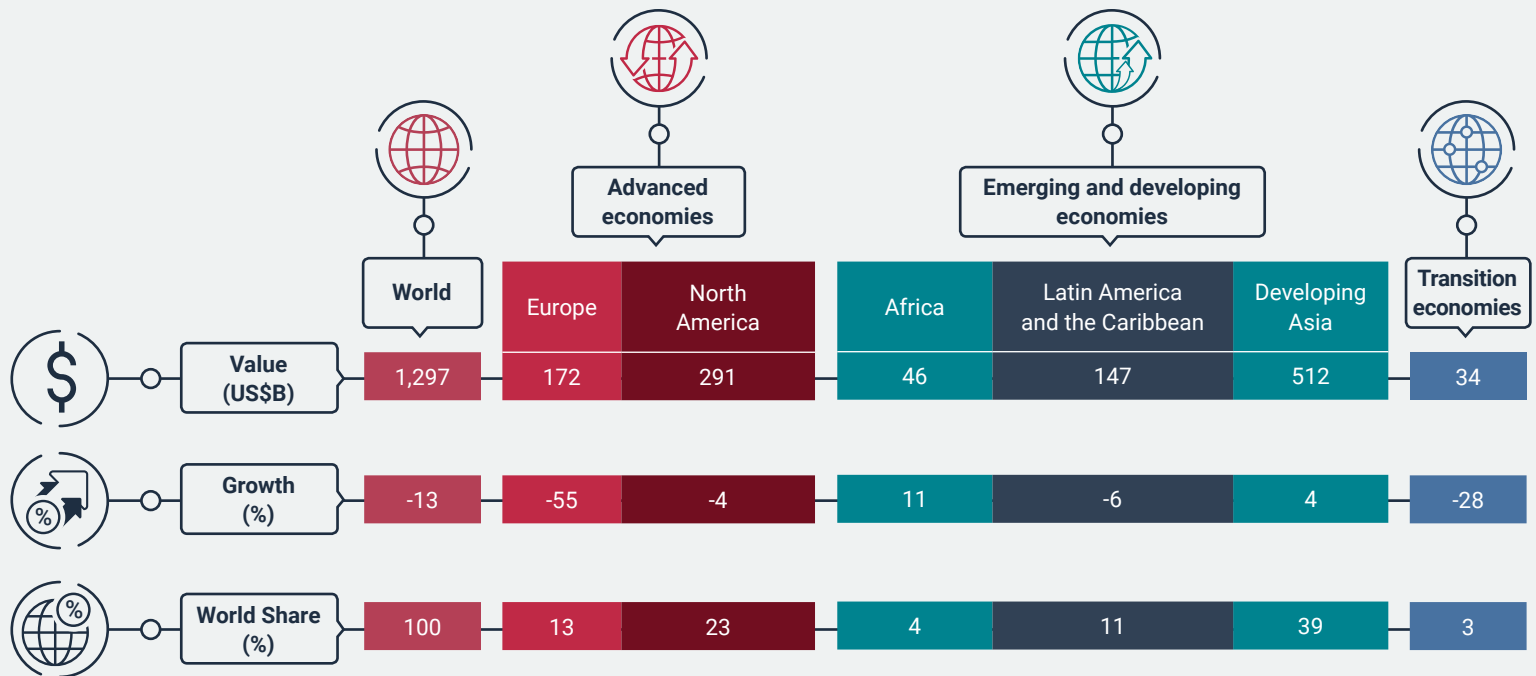
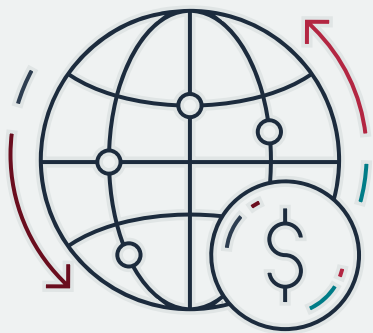
Source: WTO Database; retrieved on 21-06-2019

Global investment performance

At a glance



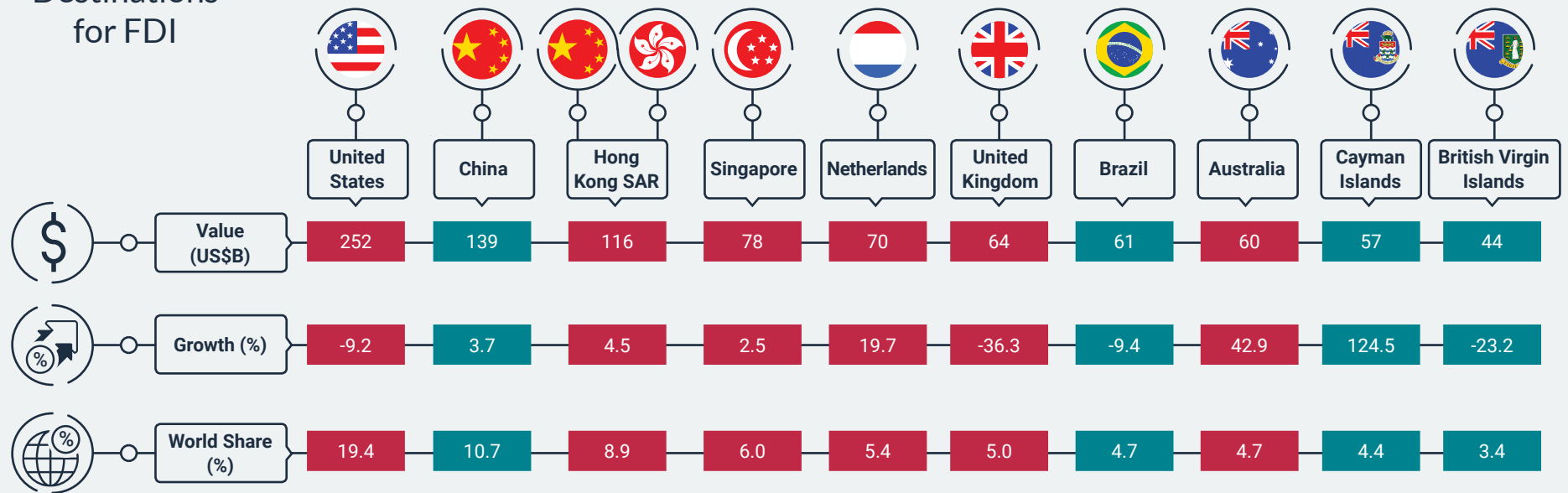
2018 FDI flow





TOP 10

Destinations for FDI



Foreign direct investment overview

Global foreign direct investment (FDI) inflows decreased for the third consecutive year, from **US\$1.5 trillion** in 2017 to **US\$1.3 trillion** in 2018. As a result, annual global FDI inflows are near their low point, reached after the global financial crisis in 2009.

Developed economies received an estimated **US\$557 billion** in new FDI in 2018, or **43%** of global FDI inflows. However, this was down **27%**, or **US\$202 billion**, from the previous year. European countries were responsible for almost the entire decrease, falling by an unprecedented **55%** to only **US\$172 billion**, mainly due to large repatriations of retained earnings by U.S. multinational enterprises following the *Tax Cuts and Jobs Act* enacted by the U.S. government in 2017. FDI inflows fell for the second consecutive year in the transition economies (Southeast Europe and the Commonwealth of Independent States), down **28%** to about **US\$34 billion**, mainly due to a **49%** decline in Russia.

In contrast, inward FDI flows to developing economies remained resilient, advancing **2%**, or **US\$15 billion**, to reach an estimated **US\$706 billion**. Combined with the sharp decline in developed economies, the share of developing economies in global FDI flows jumped from **46%** in 2017 to **54%** in 2018. Developing Asia (**+4%**) and Africa (**+11%**) were mainly responsible for this growth, while a decline in Latin America and the Caribbean (**-6%**) partially offset the gains.

The United States remained the top economic destination for FDI inflows in 2018, in spite of a **9.2%** decline. China (**+3.7%**), Hong Kong SAR (**+4.5%**), and Singapore (**+2.5%**) experienced relatively modest increases in 2018. Among the top European economies, the Netherlands registered a **20%** increase in FDI inflows, while the United Kingdom saw its FDI inflows decline by **36%** in 2018, likely due to uncertainty about the Brexit negotiations.

1.3 Global investment performance

Table 6: World FDI inflows by major region, 2017 and 2018 (estimated)

	2017 (US\$B)	2018 (US\$B)	Change (%)	Share 2018 (%)
World	1,497	1,297	-13	100
Developed economies	759	557	-27	43
Europe	384	172	-55	13
North America	302	291	-4	23
Developing economies	691	706	2	54
Africa	41	46	11	4
Latin America and the Caribbean	155	147	-6	11
Developing Asia	493	512	4	39
Transition economies	48	34	-28	3

Source: UNCTAD, *World Investment Report*, June 2019; retrieved on 21-06-2019

Table 7: FDI inflows, top 10 host economies

	2017 (US\$B)	2018 (US\$B)	Change (%)	Share (%)
World	1,497	1,297	-13.4	100.0
United States	277	252	-9.2	19.4
China	134	139	3.7	10.7
Hong Kong SAR	111	116	4.5	8.9
Singapore	76	78	2.5	6.0
Netherlands	58	70	19.7	5.4
United Kingdom	101	64	-36.3	5.0
Brazil	68	61	-9.4	4.7
Australia	42	60	42.9	4.7
Cayman Islands	26	57	124.5	4.4
British Virgin Islands	58	44	-23.2	3.4

Source: UNCTAD, *World Investment Report*, June 2019; retrieved on 21-06-2019





Canada's performance highlights

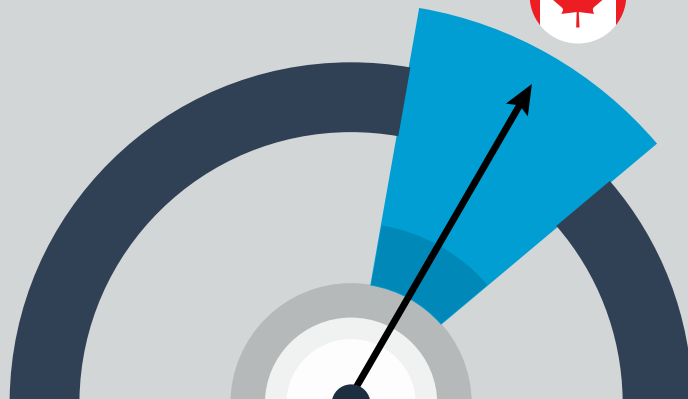
Canada's economic performance

At a
glance



2018 GDP Growth

1.9%
Annual Growth



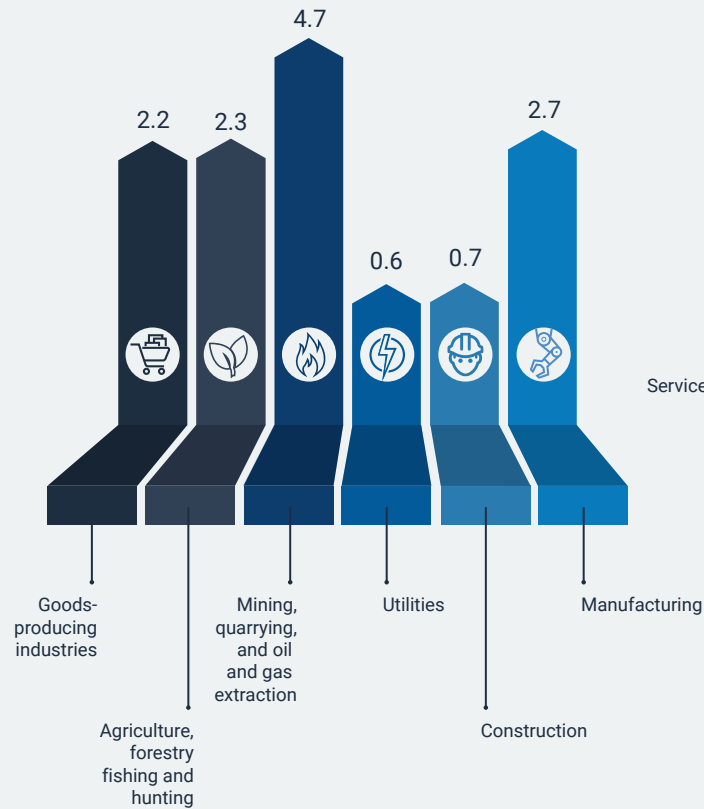
2.3%
Canada's
inflation
in 2018

5.8%

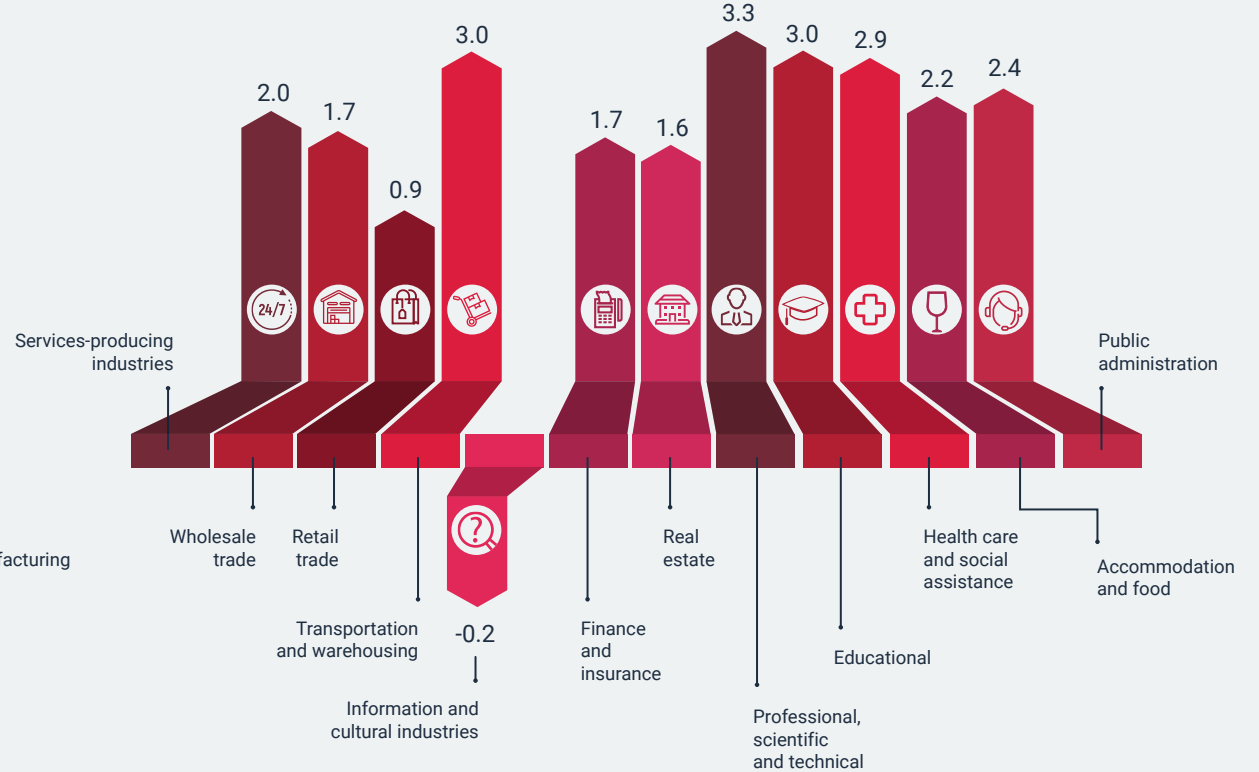
Canada annual
unemployment
rate 2018,
the lowest
annual
unemployment
rate on record
since 1976



2018 GDP Growth by goods sector (%)



2018 GDP Growth by service sector (%)

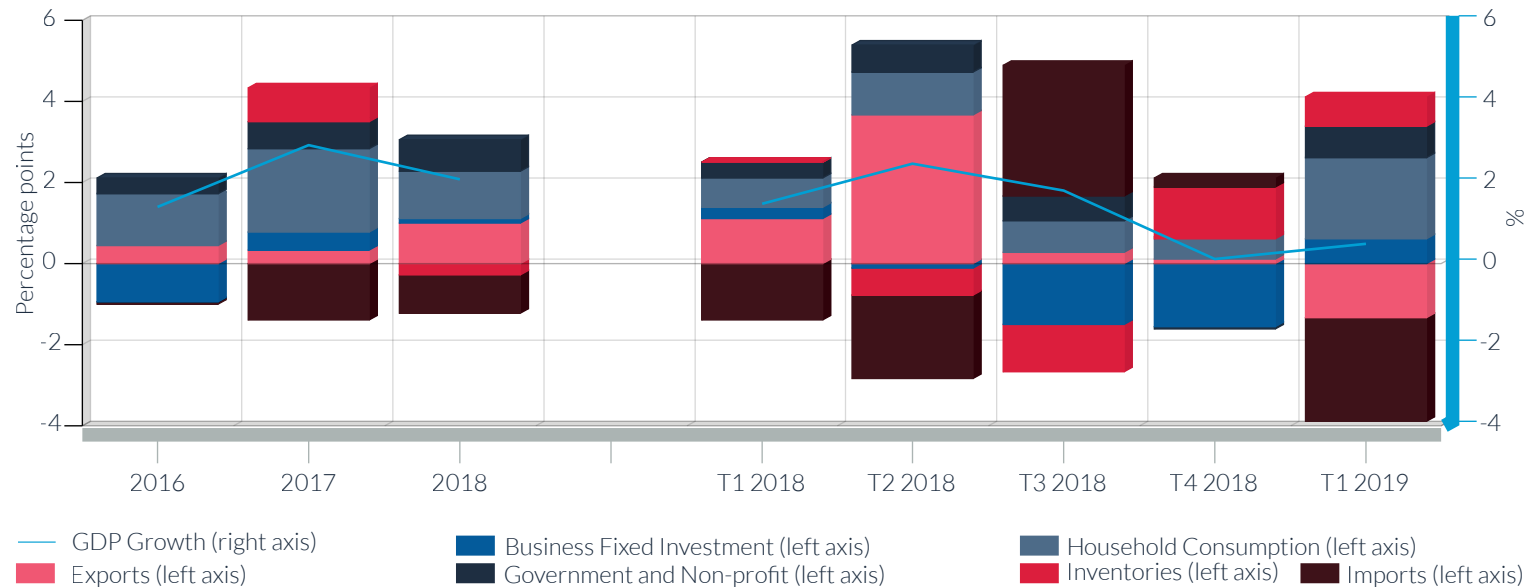


National overview

After expanding by 3% in 2017, the Canadian economy grew by a more modest 1.9% in 2018. Household consumption was the leading contributor to growth, but that contribution declined to 1.2 percentage points from 2.0 percentage points in 2017. High household debt relative to disposable income played a role in slowing down household consumption. The introduction of tighter mortgage financing guidelines weighed heavily on the housing sector last year as investment in residential structures declined and was a negative contributor to growth. Non-residential business investment contributed positively to growth, but its contribution was low at 0.2 percentage point. Trade, which had been a drag on growth in 2017, made a marginally positive contribution in 2018. An acceleration in the growth of real exports along with a deceleration in real imports combined to make the turnaround possible.

Economic output rose by 1.5% (seasonally adjusted at annual rates) in Q1 2018, then to 2.5% in Q2, before trailing off in the second half of the year (2.1% in Q3 and 0.3% in Q4). With high levels of uncertainty in global affairs (for example, Brexit, NAFTA/CUSMA negotiations and global trade tensions), non-residential business investment was lacklustre, contributing negatively to growth over the final three quarters of 2018.

Figure 7: Canadian GDP growth and contribution to GDP growth

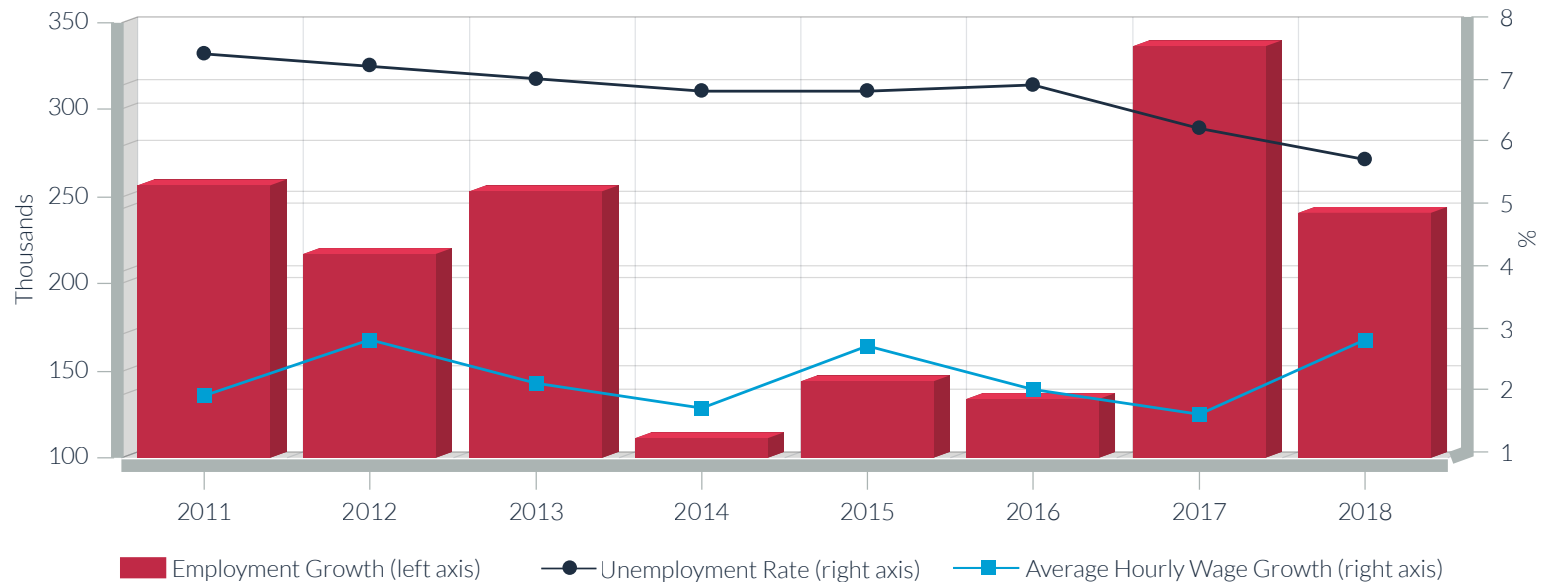


Source: Statistics Canada, Table 36-10-0104-01 and Table 36-10-0128-01; retrieved on 21-06-2019

Similar to economic growth, Canadian employment growth moderated in 2018—up by **241,100 jobs** compared to **336,500 jobs** in 2017. Despite the smaller increase in employment, the unemployment rate fell in 2018, averaging **5.8%**, the lowest annual unemployment rate on record since 1976 (and declined to **5.6%** in November and December 2018, the lowest monthly rate on record as of the end of 2018).

Concomitantly, average hourly wages grew by **2.9%** in 2018, the highest growth since 2012 (**2.9%**), responding to tighter labour market conditions.

Figure 8: Canada's employment performance



Source: Statistics Canada, Table 14-10-0064-01 and Table 14-10-0327-01; retrieved on 21-06-2019

Inflation, as measured by the Consumer Price Index (CPI), grew by **2.3%** in 2018, the highest growth since 2011, but within the Bank of Canada's targeted range of **1–3%** for inflation. Leading the growth was the transportation category (**4.7%**), dominated by the gasoline (**13%**) and air transportation (**15%**) sub-categories. Despite this growth, gasoline and

energy⁶ costs were slightly lower than in 2014, a peak year. Excluding energy, the CPI grew by **1.9%** in 2018.

⁶ Energy includes the following categories: electricity; natural gas; fuel oil and other fuel; gasoline; and fuel, parts and accessories for recreational vehicles.

Table 8: Percentage change in the Consumer Price Index (%)

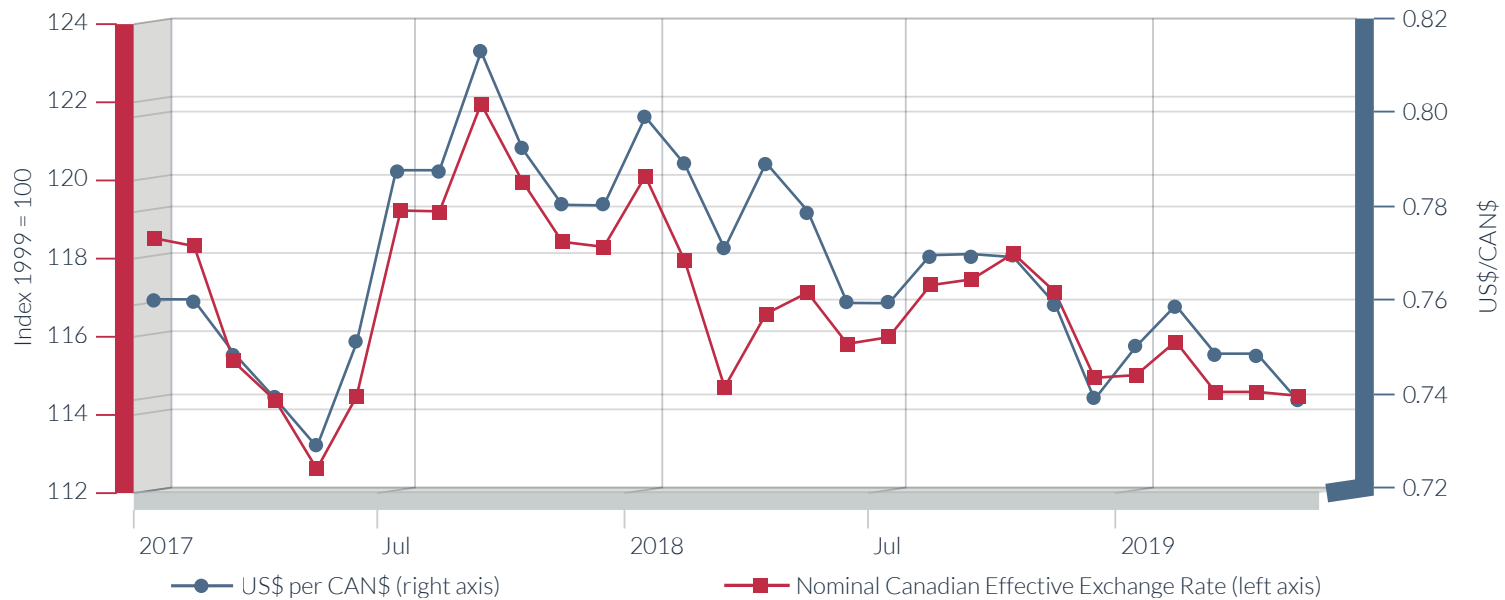
	2016	2017	2018
All items	1.4	1.6	2.3
Food	1.5	0.1	1.8
Shelter	1.6	1.7	2.0
Household operations	1.7	0.2	1.1
Clothing and footwear	-0.2	-0.7	0.9
Transportation	1.1	3.9	4.7
Gasoline	-6.0	11.8	12.6
Air transportation	4.0	6.8	15.3
Health and personal care	1.4	1.7	1.3
Recreation and education	1.7	2.4	1.1
Alcohol and tobacco	3.2	2.7	4.2
Special tabulations			
All items excluding food and energy	1.9	1.6	1.9
All items excluding energy	1.8	1.3	1.9
Energy	-3.0	5.3	6.7
All goods	0.9	0.8	1.9
All services	1.8	2.2	2.7

Source: Statistics Canada, Table 18-10-0005-01; retrieved on 21-06-2019

2.1 Canada's economic performance

On an annual average basis, the Canadian dollar remained relatively steady in 2018 when benchmarked against the US dollar, appreciating by **0.2%** compared to 2017. However, on a monthly average basis, the Canadian dollar has been on a depreciating trend since September 2017.

Figure 9: Canadian exchange rate

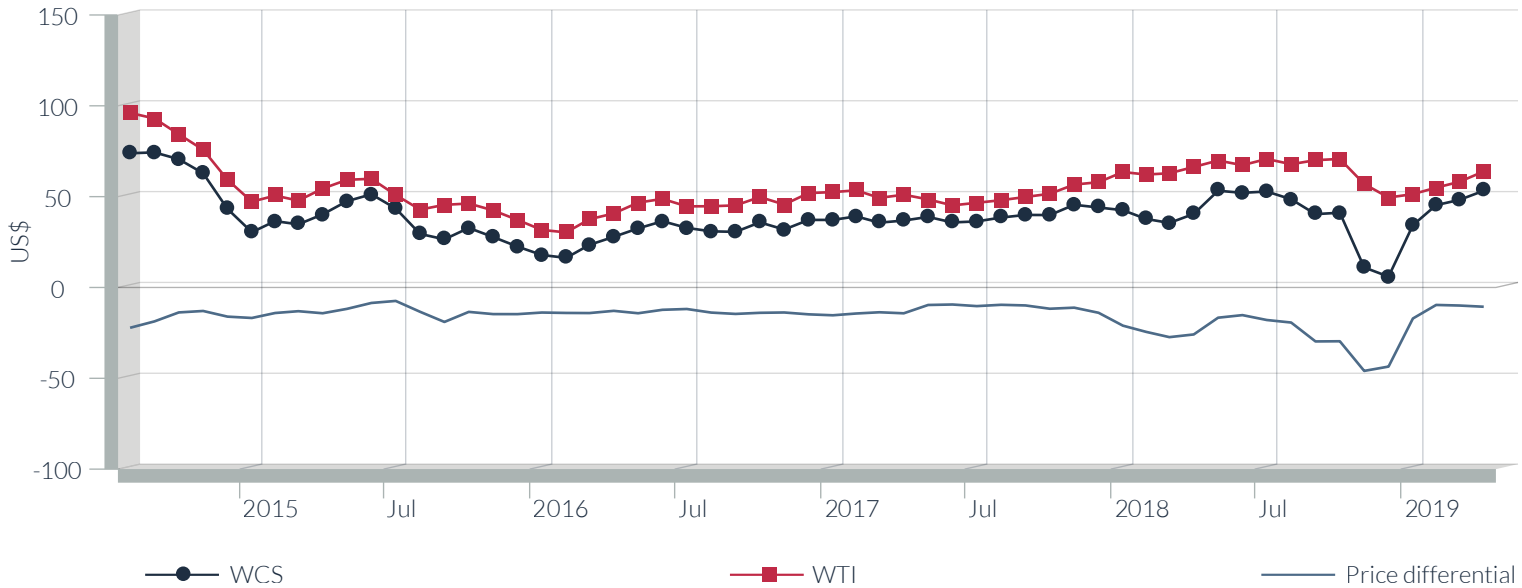


2.1 Canada's economic performance

The price of crude oil is of interest for the Canadian economy, particularly the price differential between WTI, which is representative of American crude oil pricing, and Western Canadian Select (WCS), which is representative of Canadian oil sands crude oil pricing. WCS oil is heavier than WTI and requires more refining. Because of this, WCS trades at a discount relative to WTI. Typically, the price differential is between **US\$10** and **US\$20**. However, in November 2018, the price differential

between WCS and WTI widened to **US\$45.93** per barrel, well beyond the historical average, due mainly to excess supply and the lack of export capacity resulting from transportation bottlenecks. To address these issues and to provide price relief to WCS, the Alberta government put in place mandated crude oil production cuts, and made public its intention to acquire locomotives and rail cars for crude oil transportation.

Figure 10: Oil prices, US\$ per barrel



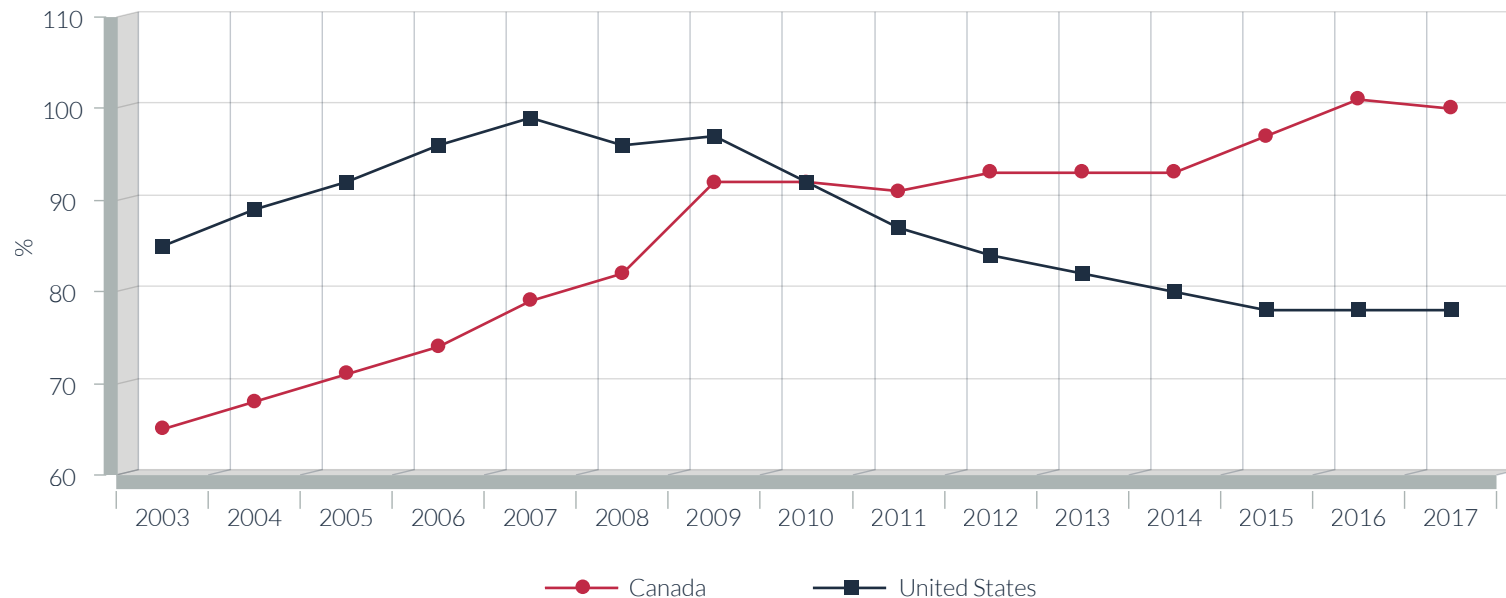
Source: Government of Alberta, Economics Dashboard; retrieved on 21-06-2019

2.1 Canada's economic performance

Another issue of interest is the high level of household debt in Canada. While households in the United States have been deleveraging since the 2009 financial crisis, dropping the household debt-to-GDP ratio to **78%** in 2017, Canadian households have not followed suit, and as a result household debt has exceeded **100%** of GDP since the second quarter of 2016.

A persistently high and increasing level of household debt can cause constraints to household consumption, an important driver of economic growth. On the other hand, continued strength in the labour market should mitigate some of the negative impact of household debt.

Figure 11: Household debt as a percentage of GDP



Industry overview

Goods-producing industries grew at **2.2%** in 2018, slightly faster than services-producing industries (**2.0%**). On the goods side, oil and gas extraction was up **7.1%** in 2018, causing its share of GDP to increase to **5.5%** from **5.3%**. Construction grew by a meagre **0.7%**, corresponding to slow-downs in housing activity. Within manufacturing, durables grew by **2.5%** in 2018, despite a **1.4%** decline in motor vehicle and parts manufacturing. Growth in non-durables was more robust at **2.9%**, but negative growth in petroleum and

coal product manufacturing mitigated some of the gain. In 2018, growth on the services side was led by professional, scientific and technical services (**3.3%**), transportation and warehousing services (**3.0%**), and educational services (**3.0%**). Growth in real estate services moderated to **1.6%** in 2018, after growing by **2.5%** the year before. The information and communication technology sector continued to be a bright spot in 2018, growing at **3.5%**, though slightly lower than the **4.0%** growth in 2017.



Table 9: GDP growth and share by industry

	GDP Growth (%)			Share of GDP (%)		
	2016	2017	2018	2016	2017	2018
Goods-producing industries	-1.2	4.5	2.2	29.4	29.8	29.8
Agriculture, forestry, fishing and hunting	4.3	-0.2	2.3	2.1	2.1	2.1
Mining, quarrying, and oil and gas extraction	-3.4	8.8	4.7	7.2	7.6	7.8
Oil and gas extraction	1.5	6.7	7.1	5.1	5.3	5.5
Utilities	1.2	3.4	0.6	2.2	2.2	2.2
Construction	-4.4	4.4	0.7	7.3	7.4	7.3
Residential construction	2.9	4.2	0.9	2.6	2.7	2.6
Manufacturing	0.7	3.8	2.7	10.3	10.4	10.5
Durable manufacturing	-0.8	4.0	2.5	5.5	5.6	5.6
Transportation equipment	-0.2	-2.6	1.0	1.5	1.4	1.4
Motor vehicles and parts	2.4	-2.8	-1.4	0.9	0.9	0.8
Non-durable manufacturing	2.5	3.5	2.9	4.8	4.8	4.9
Petroleum and coal	-1.0	6.0	-3.0	0.6	0.6	0.6
Petroleum refineries	-0.9	5.1	-3.2	0.5	0.6	0.5
Chemicals	5.1	0.2	3.6	1.1	1.1	1.1
Services-producing industries	2.0	2.8	2.0	70.5	70.2	70.1
Wholesale trade	0.9	5.9	1.7	5.2	5.3	5.3
Retail trade	3.0	5.9	0.9	5.1	5.2	5.2
Transportation and warehousing	2.9	4.6	3.0	4.4	4.5	4.5
Information and cultural industries	0.9	1.3	-0.2	3.1	3.1	3.0
Finance and insurance	4.1	3.1	1.7	6.6	6.6	6.6
Real estate	3.0	2.5	1.6	12.8	12.7	12.7

2.1 Canada's economic performance

	GDP Growth (%)			Share of GDP (%)		
	2016	2017	2018	2016	2017	2018
Professional, scientific and technical	0.2	2.6	3.3	5.7	5.6	5.7
Educational	1.6	1.3	3.0	5.4	5.3	5.3
Health care and social assistance	2.3	1.9	2.9	7.0	6.9	7.0
Accommodation and food	3.1	3.8	2.2	2.2	2.3	2.3
Public administration	1.3	1.9	2.4	6.7	6.6	6.7
Special industry tabulations						
Information and communication technology	2.0	4.0	3.5	4.4	4.4	4.5
Energy	-1.1	7.3	2.8	8.9	9.2	9.3
Cannabis	0.7	-0.9	20.0	0.3	0.3	0.3

Source: Statistics Canada, Table 36-10-0434-06; retrieved on 24-06-2019

Overall employment grew by **1.3%** in 2018, with goods-producing industries advancing by **1.4%** and services-producing industries by **1.3%**. On the goods side, utilities employment grew the fastest—at **9.2%**—but still only accounts for **0.8%** of employment. However, utilities had the highest average hourly wage, at **\$41**, and a low sectoral unemployment rate of **1.7%**. Employment in the forestry, fishing, mining, quarrying, and oil and gas sector grew by **3.3%** in 2018, but overall employment is still below the 2014 peak (**373,600**), and the sector had the

highest unemployment rate and a slower wage growth than average, despite being the second-highest paying sector in terms of average hourly wage. Employment growth in manufacturing was tepid at **0.2%** in 2018, but the unemployment rate (**3.6%**) and wage growth (**3.3%**) were solid. On the services side, transportation and warehousing led employment growth at **5.0%**, supporting a low unemployment rate of **3.3%**; however, wage growth was slightly below average at **2.7%**.

Table 10: 2018 Employment and wage information, by industry

Industry	Employment			Unemployment Rate (%)	Hourly Wage	
	Employees ('000s)	Growth (%)	Share (%)		Average (\$)	Growth (%)
Goods-producing industries	3,929	1.4	21.1	4.9	28.74	2.6
Agriculture	277	-0.8	1.5	4.0	19.59	8.3
Forestry, fishing, mining, quarrying, oil and gas	341	3.3	1.8	6.8	38.46	1.3
Mining, quarrying, and oil and gas extraction	272	3.1	1.5	4.7		
Utilities	145	9.2	0.8	1.7	41.03	2.5
Construction	1,438	2.0	7.7	6.6	29.05	1.1
Manufacturing	1,728	0.2	9.3	3.6	26.34	3.3
Durables	1,043	0.0	5.6	3.3		
Non-durables	686	0.6	3.7	4.1		
Services-producing industries	14,729	1.3	78.9	3.2	26.44	3.0
Wholesale and retail trade	2,795	-0.5	15.0	3.7	20.79	2.9
Wholesale trade	656	-2.5	3.5	2.6		
Retail trade	2,138	0.1	11.5	4.1		
Transportation and warehousing	991	5.0	5.3	3.3	26.59	2.7
Finance, insurance, and real estate	1,174	0.2	6.3	1.8	31.08	3.6
Finance and insurance	829	-0.3	4.4	1.8		
Real estate	345	1.5	1.8	2.1		

2.1 Canada's economic performance

Industry	Employment			Unemployment Rate (%)	Hourly Wage	
	Employees ('000s)	Growth (%)	Share (%)		Average (\$)	Growth (%)
Professional, scientific and technical	1,467	1.2	7.9	2.5	33.56	1.9
Business, building and other support services	777	2.7	4.2	5.6	20.91	7.4
Educational	1,325	3.1	7.1	3.4	33.4	2.0
Health care and social assistance	2,407	1.0	12.9	1.6	27.51	1.3
Information, culture and recreation	787	-0.3	4.2	4.8	24.9	2.6
Accommodation and food	1,235	2.0	6.6	5.4	15.9	5.7
Other services	803	2.8	4.3	2.9	23.42	4.6
Public administration	969	0.8	5.2	2.1	36.4	3.3
All Industries	18,658	1.3	100.0	5.8	26.92	2.9

Source: Statistics Canada, Table 14-10-0064-01 and Table 14-10-0023-01; retrieved on 24-06-2019

Provincial and territorial overview

Although Canada has the lowest level of national unemployment since 1976 (5.8% in 2018), disparities in regional employment performance continued to exist in 2018. Notwithstanding strong employment growth in Prince Edward Island (3.1%) and Nova Scotia (1.5%), the Atlantic provinces experienced persistent high rates of unemployment in 2018: Newfoundland and Labrador (14%), Prince Edward Island (9.4%), Nova Scotia (7.5%), and New Brunswick (8.0%). Quebec's unemployment rate reached a historical low of 5.5%, despite slower employment growth (0.9%). Furthermore, its wage growth was the highest among provinces, at 3.2%. Continued solid employment growth (1.6%) helped lower Ontario's unemployment rate to 5.6%, the lowest

since 1989, and supported wage growth of 2.9%. As a result of weak employment growth (0.6%), the unemployment rate in Manitoba rose to 6.0% in 2018, from 5.4% in 2017. However, wage growth in the province was solid, at 2.8%. Employment growth in Saskatchewan was the second-weakest among provinces and territories, and the unemployment rate was above the national average. Similarly, Alberta's unemployment rate was above the national average, however, the province posted the second-fastest employment growth among provinces and territories and had the highest average weekly earnings among the provinces. At 4.7%, British Columbia's unemployment rate was the lowest among provinces (and at its lowest level since 2008), but the province has the highest inflation rate among all provinces.

2.1 Canada's economic performance

Table 11: 2018 Provincial and territorial employment and inflation

Provinces/Territories	Employment		Unemployment Rate (%)	Weekly Earnings		Inflation (%)
	Employees ('000)	Growth (%)		Average (\$)	Growth (%)	
Canada	18,658	1.3	5.8	1,001	2.6	2.3
Newfoundland and Labrador	225	0.5	13.8	1,038	0.3	1.6
Prince Edward Island	76	3.1	9.4	841	2.3	2.3
Nova Scotia	456	1.5	7.5	871	1.2	2.2
New Brunswick	354	0.3	8.0	911	2.8	2.1
Quebec	4,262	0.9	5.5	932	3.2	1.7
Ontario	7,242	1.6	5.6	1,021	2.9	2.4
Manitoba	648	0.6	6.0	937	2.8	2.5
Saskatchewan	570	0.4	6.1	1,014	0.5	2.3
Alberta	2,331	1.9	6.6	1,148	1.7	2.4
British Columbia	2,494	1.1	4.7	969	2.7	2.7
Yukon	21	0.5	2.7	1,118	2.1	2.4
Northwest Territories	21	0.5	7.3	1,420	1.5	2.3
Nunavut	14	0.7	14.1	1,376	3.2	3.0

Source: Statistics Canada, Table 14-10-0090-01, Table 14-10-0204-01 and Table 18-10-0005-01; retrieved on 24-06-2019

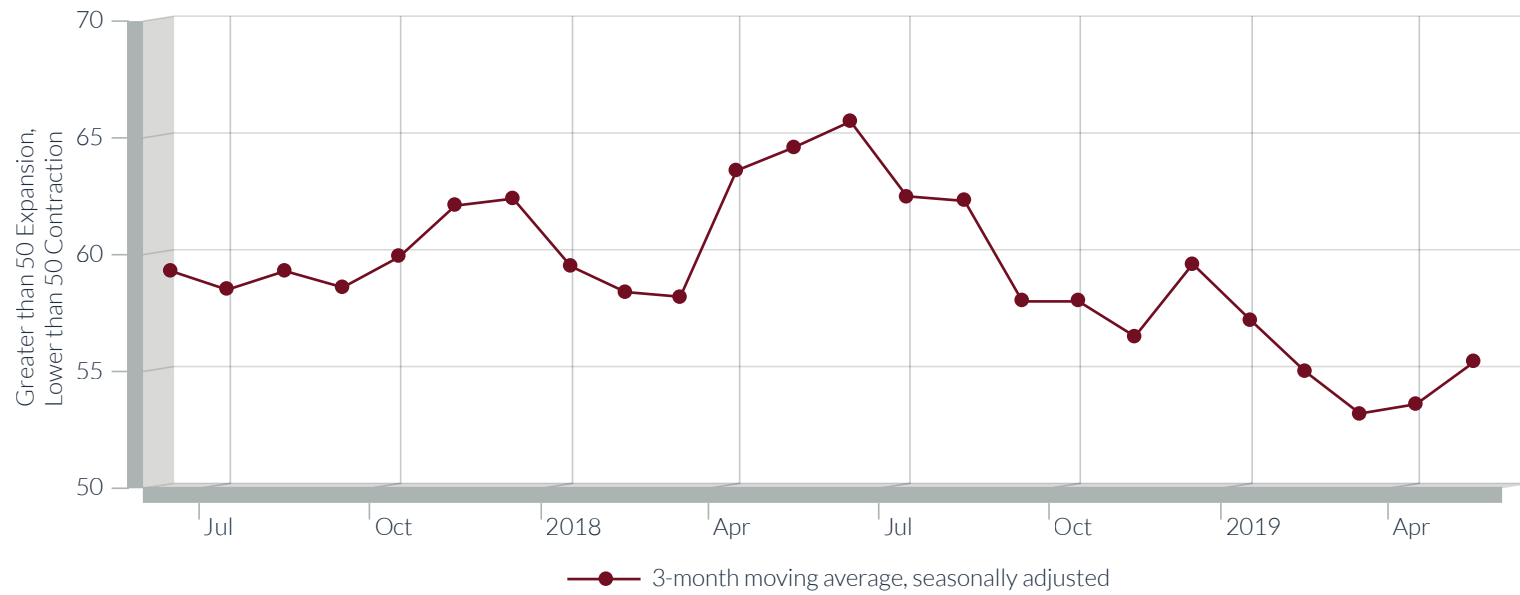
Looking forward

In conjunction with slowing growth toward the end of 2018, forward-looking economic indicators, such as the Ivey Purchasing Managers Index (PMI) and the Bank of Canada's Business Outlook Survey (BOS) Indicator, point to a decline in economic sentiment among Canadian businesses. The Ivey PMI, which measures the month-to-month variation in economic sentiment as indicated by a panel of purchasing managers from across Canada, has been trending downward to sit at **50.6** in February 2019, indicating that firms with positive outlooks continue to outnumber firms with negative outlooks, but the gap has been declining.⁷ In recent months, the Ivey PMI has improved slightly to **55.9** in May 2019, but sentiments in the first five months of 2019 are still lower than for

the same period last year. Another indication of softening business sentiment can be seen in the Bank of Canada's BOS indicator, which has declined since the second half of 2018 from positive levels to a negative one. Results for several BOS survey questions in the spring 2019 edition were below historical averages. The latest edition of the BOS (summer 2019) points to a slight improvement in business sentiment, but weakness tied to Western Canada's oil industry and global trade tensions continue to dampen the outlook.

⁷ Ivey PMI: a value of 50 means a neutral outlook, greater than 50 means more firms have a positive outlook than a negative outlook, lower than 50 means more firms have a negative outlook than a positive outlook.

Figure 12: Ivey Purchasing Managers Index



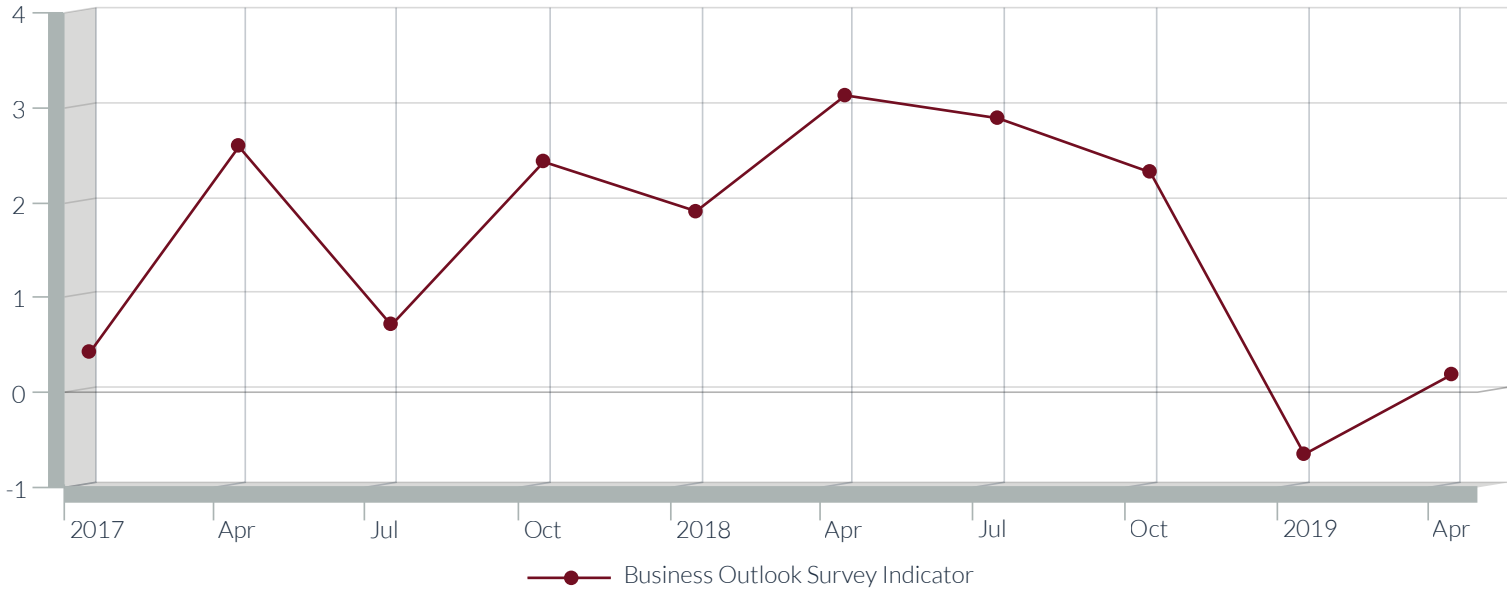
Source: Ivey Business School; retrieved on 24-06-2019

2.1 Canada's economic performance

Soft economic conditions persisted into early 2019, but the Bank of Canada expects activity to pick up later in 2019, resulting in an economy forecasted to grow by **1.2%** for the year (April 2019 Monetary Policy Report). The negative effects of low oil prices, housing policy changes, and 2017-18 increases in borrowing rates should fade out later in 2019. The pickup in economic activity is expected to spill over into 2020, supporting Canadian economic growth of **2.1%**. Global trade

tensions, for example between the United States and its trading partners, along with tensions between the parties to Brexit are sources of great uncertainty in the economic forecast, as persistent or escalating tensions can reduce foreign demand, disrupt global value chains, lower business confidence and depress commodity prices. On the other hand, if trade tensions are resolved, economic activity could be stronger than expected.

Figure 13: Bank of Canada's Business Outlook Survey Indicator



Source: Bank of Canada, *Business Outlook Survey*, spring 2019; retrieved 28-06-2019

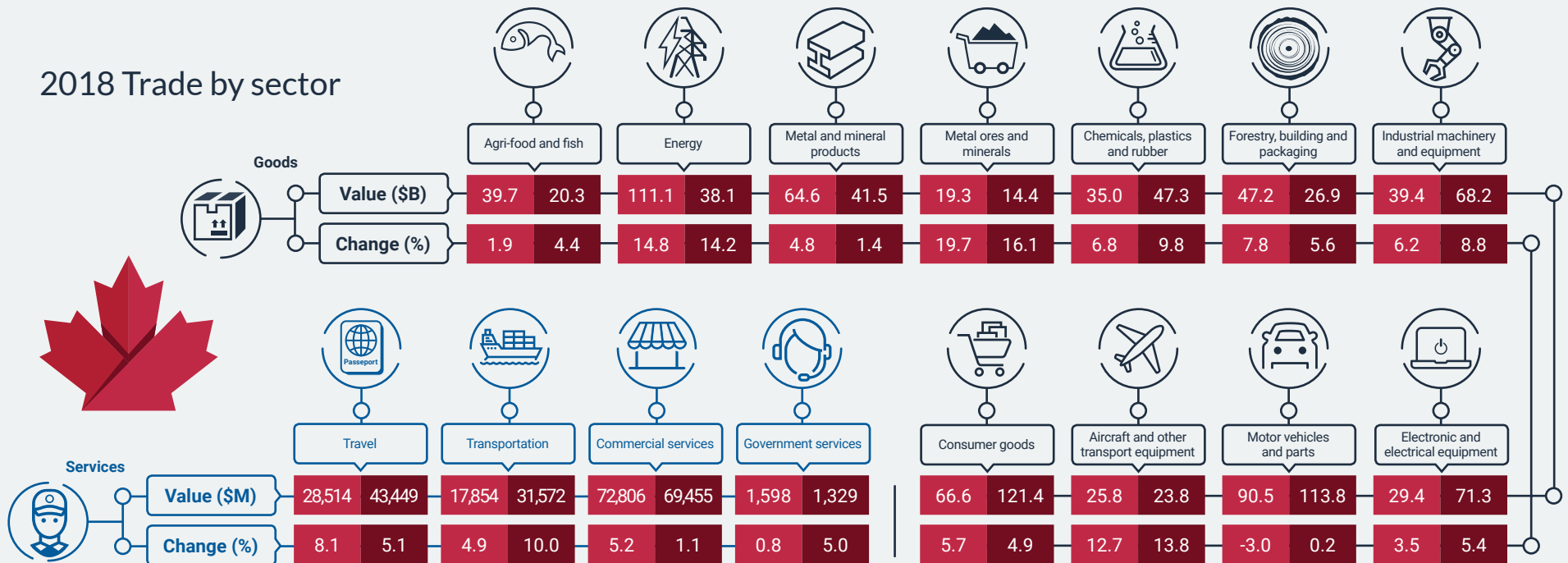


Canada's trade performance

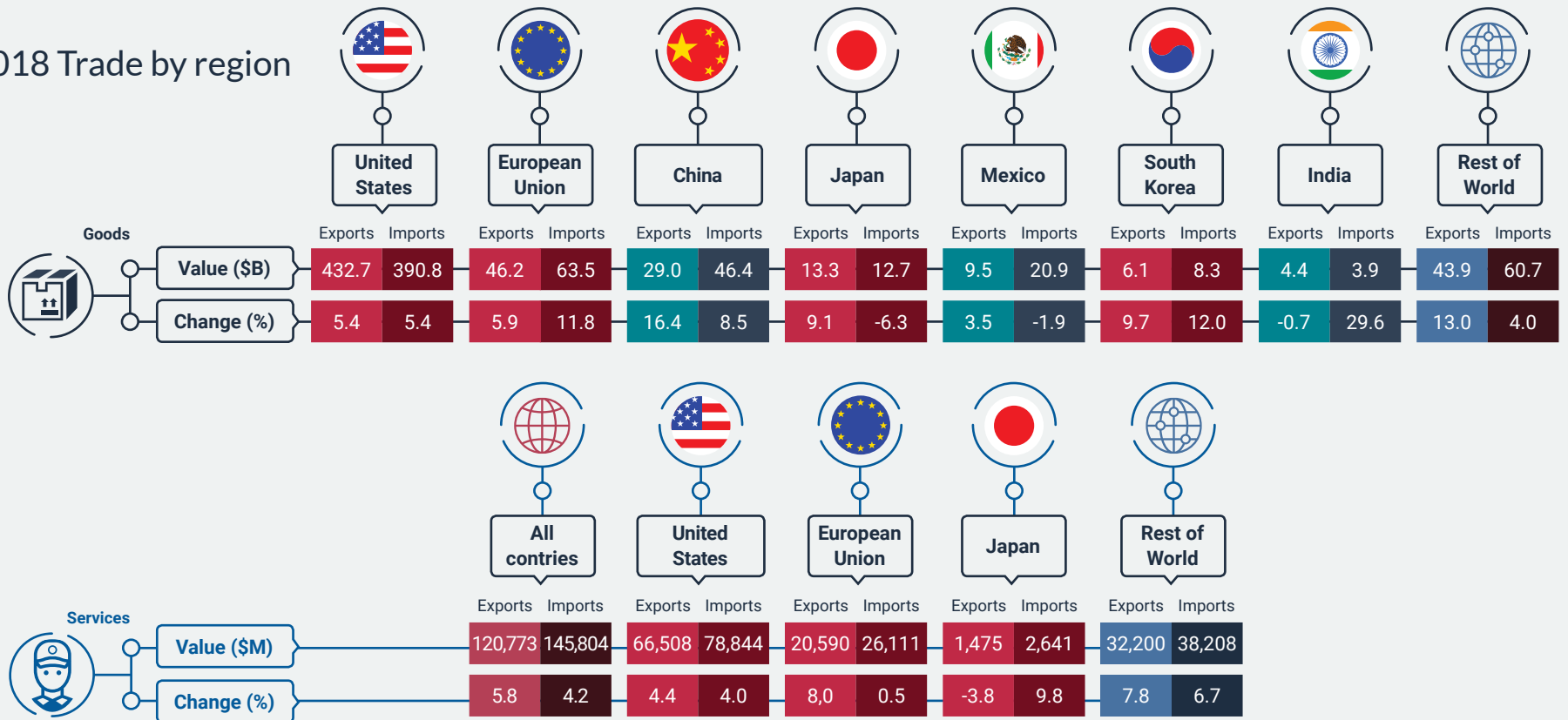
At a glance



2018 Trade by sector



2018 Trade by region



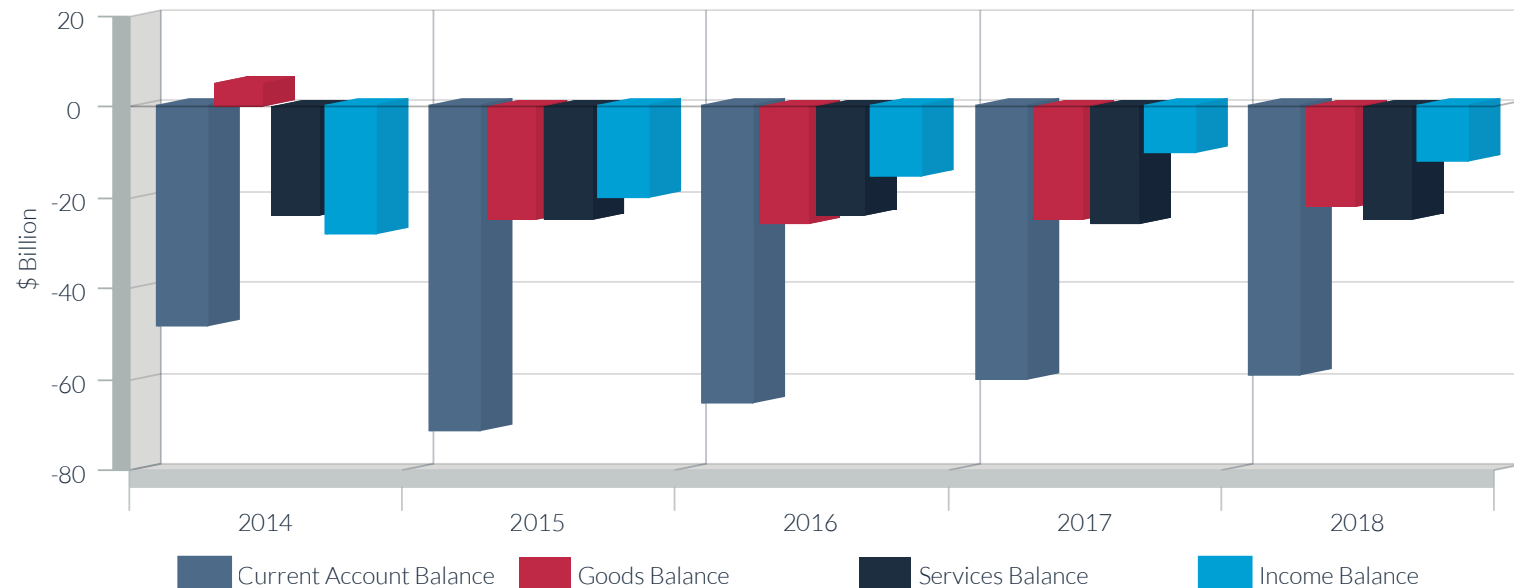
Canada trade overview

Canada's current account balance⁸ recorded a deficit of **\$59 billion** in 2018. This was **\$1.6 billion** smaller than in 2017. The lower trade deficit was mainly due to a narrowing of the goods trade deficit by **\$2.7 billion**. However, these gains

were partially offset by the combination of a widening income deficit and the services trade balance moving sideways.

⁸ The current account balance is a net measure of the flow of international goods and services, investment income, and transfers.

Figure 14: Canada's current account balance and components



Source: Statistics Canada, Table 36-10-0014-01; retrieved on 24-06-2019

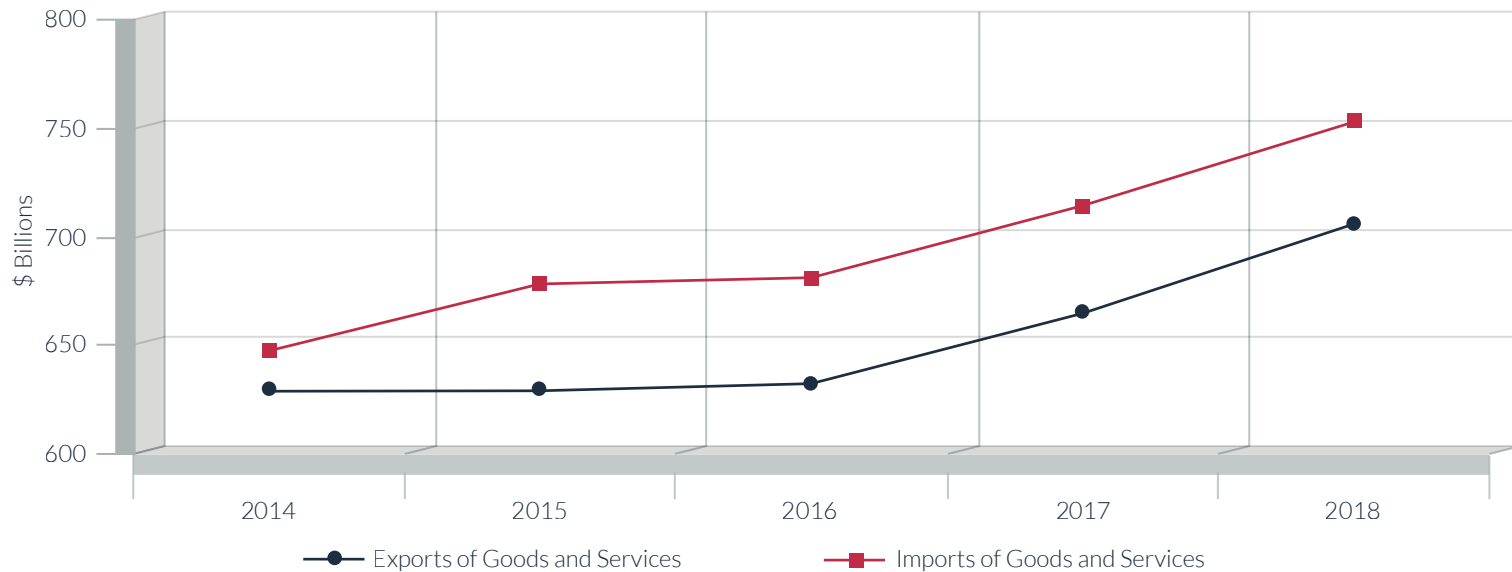
2.2 Canada's trade performance

In 2018, Canada's exports of goods and services to the world increased 6.2%, or \$41 billion, to reach \$706 billion, while imports rose 5.4%, or \$39 billion, to \$753 billion. As both exports and imports expanded, the total value of trade in goods and services reached a record high of \$1.5 trillion, or 66% of GDP. Overall, export prices increased 2.9% while import prices grew 2.4%, and Canada's terms of trade⁹

improved for the second consecutive year to 94.5, an improvement of 0.4 percentage point over the previous year.

⁹ The terms of trade are a measure of the amount of imports that each export can purchase and is calculated by dividing the price of exports by the price of imports and multiplying the result by 100.

Figure 15: Canadian Trade of Goods and Services



Source: Statistics Canada, Table 36-10-0104-01; retrieved on 24-06-2019

Trade in goods

Canada's goods¹⁰ exports continued to grow in 2018, up **6.5%** to **\$585 billion**, with export prices increasing by **2.2%** and export volumes expanding by **4.1%**.¹¹ Concurrently, Canada's goods imports advanced **5.8%** to **\$607 billion**, as both import prices and import volumes increased, up **2.4%** and **3.3%**, respectively. As a result, total goods trade reached a record high of **\$1.2 trillion**. Moreover, since exports out-paced imports in 2018, Canada's goods trade deficit narrowed by **\$2.7 billion** to **\$22 billion**.

Exports

Canadian goods exports grew for the second consecutive year in 2018, with export up in all sectors, except motor vehicles and parts. Energy exports growth led the way, advancing **\$14 billion**, or **15%**, to reach **\$111 billion** in value, followed by consumer goods (**+ \$3.6 billion**) and forestry, building and packaging products (**+ \$3.4 billion**). Unlike the previous year, the growth of Canadian exports was driven more by an expansion in volumes than in export prices, as volumes were up **4.1%** compared to a **2.2%** growth in prices. Notable increases in export volumes were registered for metal ores and minerals (**+17%**), aircraft and other transportation equipment (**+12%**), and energy products (**+8.2%**). On the price side, prices of forestry, building and packaging products were up **9.7%**. However, the growth of energy prices slowed from **22%** in 2017 to **6.2%** in 2018. Crude oil, the main component of this category, experienced large price fluctuations,

as its average price rose steadily in the first five months of 2018 and then trended downward slightly until October, before falling sharply in November.¹² Other sectors that posted strong price increases were metal and mineral products (**+5.9%**) and chemical, plastic and rubber products (**+5.4%**). Exports of motor vehicles and parts fell by **\$2.8 billion**, or **3.0%**, in 2018, due mainly to a **3.1%** decline in export prices.

¹⁰ International trade in goods is reported on a balance of payments basis. For a more detailed analysis of merchandise trade, which is reported on a customs basis, see [2018 Merchandise Trade Highlights](#).

¹¹ Prices were measured by the Paasche current weighted index and volumes were measured by the Laspeyres fixed weighted index.

¹² Based on Western Canada Select (WCS) prices.

2.2 Canada's trade performance

By destination, goods exports to the United States increased **5.4%**, or **\$22 billion**, to **\$433 billion** in 2018. However, goods exports to non-U.S. destinations grew even faster, up **9.8%** (or **\$14 billion**) to **\$153 billion**. As a result, Canada's goods exports continued to diversify away from the United States. Among Canada's major non-U.S. trading partners, exports to China recorded the fastest growth (**+16%**), followed by South Korea (**+9.7%**) and Japan (**+9.1%**). Goods exports to the European Union rose modestly (**+5.9%**), but exports to the Netherlands and Italy posted strong growth, up **51%** and **33%**, respectively. However, due to falling gold exports, these strong gains were partially offset by declining exports to the United Kingdom (**-9.7%**).



Table 12: Goods exports, 2018

	Value of Exports, 2018 (\$B)	Change in Value (%)	Change in Volume (%)	Change in Price (%)
Total	585.3	6.5	4.1	2.2
By product				
Agri-food and fish	39.7	1.9	2.5	-0.7
Energy	111.1	14.8	8.2	6.2
Metal ores and minerals	19.3	19.7	17.2	2.1
Metal and mineral products	64.6	4.8	-1.0	5.9
Chemicals, plastics and rubber	35.0	6.8	1.4	5.4
Forestry, building and packaging	47.2	7.8	-1.7	9.7
Industrial machinery and equipment	39.4	6.2	4.9	1.2
Electronic and electrical equipment	29.4	3.5	3.5	0.1
Motor vehicles and parts	90.5	-3.0	0.2	-3.1
Aircraft and other transport equipment	25.8	12.7	11.8	0.8
Consumer goods	66.6	5.7	4.2	1.4
By region/country				
United States	432.7	5.4		
European Union	46.2	5.9		
China	29.0	16.4		
Japan	13.3	9.1		
Mexico	9.5	3.5		
South Korea	6.1	9.7		
India	4.4	-0.7		
Rest of World	43.9	13.0		

Source: Statistics Canada, Tables 36-10-0020-01, 12-10-0126-01 and 36-10-0023-01; retrieved on 24-06-2019

Imports

Canada's goods imports rose **5.8%**, or **\$33 billion**, to **\$607 billion** in 2018. Imports increased in all sectors, led by metal ores and minerals, energy products, and aircraft and other transportation equipment—all of which posted double-digit growth rates. Volumes expanded by **3.3%**, led by metal ores and minerals (**+13%**) and aircraft and other transportation equipment (**+12%**), while those for metal and mineral products fell by **12%**. At the same time, import prices rose **2.4%** on the back of higher prices for metal and mineral products (**+15%**) and energy products (**+11%**).

Regionally, imports from the United States were up **5.4%** to **\$391 billion** in 2018, while imports from non-U.S. sources grew **6.5%** to **\$216 billion**. Of Canada's major non-U.S. trading partners, imports from India recorded the fastest growth at **30%** in 2018, followed by imports from South Korea (**+12%**) and the EU (**+12%**).



Table 13: Goods imports, 2018

	Value of Imports, 2018 (\$B)	Change in Value (%)	Change in Volume (%)	Change in Price (%)
Total				
By product	607.2	5.8	3.3	2.4
Agri-food and fish	20.3	4.4	6.5	-2.0
Energy	38.1	14.2	2.9	11.0
Metal ores and minerals	14.4	16.1	13.1	2.6
Metal and mineral products	41.5	1.4	-11.9	15.2
Chemicals, plastics and rubber	47.3	9.8	1.6	8.1
Forestry, building and packaging	26.9	5.6	1.1	4.4
Industrial machinery and equipment	68.2	8.8	7.4	1.3
Electronic and electrical equipment	71.3	5.4	7.8	-2.2
Motor vehicles	113.8	0.2	2.3	-2.1
Aircraft and other transport equipment	23.8	13.8	12.4	1.2
Consumer goods	121.4	4.9	3.8	1.1
By region/country				
United States	390.8	5.4		
European Union	63.5	11.8		
China	46.4	8.5		
Japan	12.7	-6.3		
Mexico	20.9	-1.9		
South Korea	8.3	12.0		
India	3.9	29.6		
Rest of World	60.7	4.0		

Source: Statistics Canada, Tables 36-10-0020-01, 12-10-0126-01 and 36-10-0023-01; retrieved on 24-06-2019

Trade in services

In 2018, Canadian services exports grew for the ninth consecutive year, up **5.8%**, or **\$6.6 billion**, to reach **\$121 billion**, while services imports rose **4.2%**, or **\$5.8 billion**, to reach **\$146 billion**. Since services exports slightly outperformed imports, the services trade deficit narrowed by **\$743 million** to **\$25 billion** in 2018. Nevertheless, Canada continued to run a services trade deficit with every broad region and most major trading partners; nearly half of this deficit was with the United States.

By sector

Travel exports accounted for nearly one quarter of services exports in 2018 and were once again the fastest-growing sector, up **8.1%** in 2018 to reach **\$29 billion**. Personal travel exports accounted for all the growth in this sector (**+9.9%**), while business travel declined (**-3.6%**). Exports of transportation services increased moderately, up **4.9%** to **\$18 billion**, with water transportation growing faster than air transportation.

Commercial services exports continued to be the central component of services exports, accounting for over **60%** of total services exports. In contrast to last year, commercial services exports rose modestly in 2018, up **5.2%**, or **\$3.6 billion**, to

reach **\$73 billion**. Gains were led by technical, trade-related and other business services (**+\$1.2 billion**, up **10%**), financial services (**+\$1.0 billion**, up **10%**) and telecommunications, computer, and information services (**+\$879 million**, up **8.3%**), while a **\$1.2 billion** decline in exports of professional and management consulting services partially offset the advance.

On the import side, travel imports rose **5.1%** to **\$43 billion**, with imports of both business and personal travel growing at roughly the same rate. Transportation services added **\$2.9 billion** (**10%**) in 2018, with nearly two thirds of the increase coming from water transportation. Imports of commercial services grew much slower than commercial services exports, only up **1.1%** to **\$69 billion**. Imports of financial services fell **7.3%** or **\$895 million**, while two small sub-sectors recorded double-digit growth—research and development services (**+29%**) and personal, cultural, and recreational services (**+12%**). Other major sub-sectors posted minor changes in 2018.

Table 14: Canada's services trade by sector, 2018

	2018 Exports (\$M)	Change (%)	2018 Imports (\$M)	Change (%)
Total Services	120,773	5.8	145,804	4.2
Travel	28,514	8.1	43,449	5.1
Business travel	3,464	-3.6	5,434	5.4
Personal travel	25,052	9.9	38,016	5.1
Transportation	17,854	4.9	31,572	10.0
Water transport	3,768	9.2	14,455	14.5
Air transport	8,388	5.9	12,720	6.5
Land and other transport	5,700	0.7	4,396	6.0
Commercial services	72,806	5.2	69,455	1.1
Maintenance and repair services	2,510	26.3	986	3.6
Construction services	300	8.7	294	6.9
Insurance services	2,168	10.3	5,394	9.0
Financial services	10,839	10.3	11,410	-7.3
Telecommunications, computer, and information services	11,471	8.3	6,239	-0.1
Charges for the use of intellectual property	6,270	12.5	15,317	-0.8
Professional and management consulting services	16,050	-6.9	14,479	2.6
Research and development services	6,759	0.3	1,612	28.5
Technical, trade-related, and other business services	12,918	10.1	10,258	2.3
Personal, cultural, and recreational services	3,522	7.3	3,468	11.5
Government services	1,598	0.8	1,329	5.0

Source: Statistics Canada, Table 36-10-0021-01; retrieved on 24-06-2019

By region

The overall increase in the value of services exports was led by a **\$2.8 billion (4.4%)** increase in services exports to the United States. Increased commercial services exports accounted for nearly **65%** of the growth to the United States, followed by travel services exports. Canadian services imports from the United States also rose by **\$3.1 billion (4.0%)** to reach **\$79 billion**, mainly on higher imports of travel services (**\$1.6 billion**, or **7.5%**) and transportation services (**\$1.2 billion**, or **11%**). As a result of these balanced movements, the services trade deficit with the United States widened marginally in 2018 to **\$123 billion**.

Services trade with the EU posted a large gain, with Canadian exports rising **\$1.5 billion**, or **8.0%**, to reach **\$21 billion**. Most of the gain was in commercial services, which advanced **\$1.2 billion**. At the same time, services imports advanced marginally, up **0.5%**, or **\$131 million**, to reach **\$26 billion**.

A decline in services exports and an increase in services imports resulted in a widening of the services trade deficit with Japan to **\$1.2 billion**. The bulk of the movements for both exports and imports occurred in travel services.

In 2018, services exports to the rest of the world (ROW) climbed **7.8%** to **\$32 billion**, mainly from an expansion in travel services exports. However, total services exports declined to Australia (**-15%**), South Korea (**-15%**), Mexico (**-7.1%**) and China (**-1.8%**). On the import side, services imports from ROW rose **6.7%** to **\$38 billion**, led by the **\$1.3 billion** increase in imports of transportation services.

2.2 Canada's trade performance

Table 15: Canada's services trade by region, 2018

	Exports (\$M)	Change (%)	Imports (\$M)	Change (%)	Balance (\$M)	Change (\$M)
All Countries	120,773	5.8	145,804	4.2	-25,031	742
Travel	28,515	8.1	43,450	5.1	-14,934	11
Transportation	17,854	4.9	31,571	9.9	-13,717	-2,030
Commercial services	72,805	5.2	69,455	1.1	3,350	2,811
Government services	1,598	0.8	1,328	4.9	270	-50
United States	66,508	4.4	78,844	4.0	-12,336	-279
Travel	11,096	8.1	23,318	7.5	-12,222	-795
Transportation	8,322	2.0	11,274	11.5	-2,952	-997
Commercial services	46,661	3.9	43,759	0.6	2,902	1,513
Government services	428	3.4	493	3.1	-64	0
EU	20,590	8.0	26,111	0.5	-5,520	1,404
Travel	3,764	2.1	6,672	-3.9	-2,908	347
Transportation	4,069	6.1	5,749	8.6	-1,680	-220
Commercial services	12,519	10.8	13,394	-0.6	-875	1,299
Government services	239	1.3	296	9.2	-57	-21
Japan	1,475	-3.8	2,641	9.8	-1,166	-294
Travel	435	-16.3	605	146.9	-170	-444
Transportation	568	2.7	822	-6.4	-254	71
Commercial services	441	2.3	1,193	-5.5	-752	79
Government services	32	3.2	22	0.0	10	1
Rest of world	32,200	7.8	38,208	6.7	-6,009	-89
Travel	13,220	11.0	12,855	3.2	366	903
Transportation	4,895	9.2	13,726	10.4	-8,831	-884
Commercial services	13,184	4.9	11,109	6.6	2,075	-80
Government services	899	-0.7	517	4.4	381	-30

Source: Statistics Canada, Table 36-10-0014-01; retrieved on 24-06-2019

2.2 Canada's trade performance

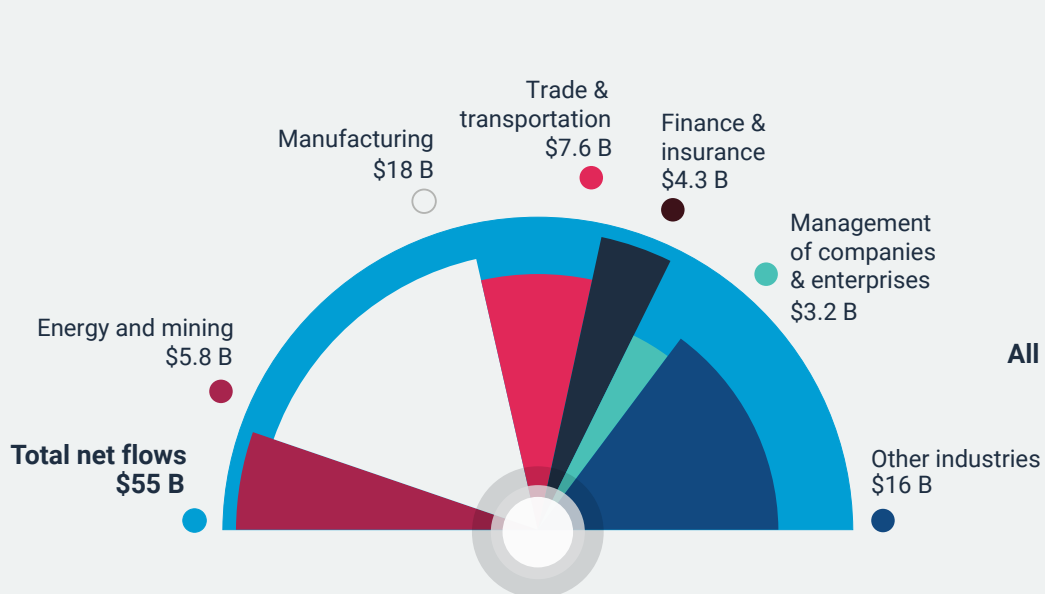


Canada's foreign direct investment performance

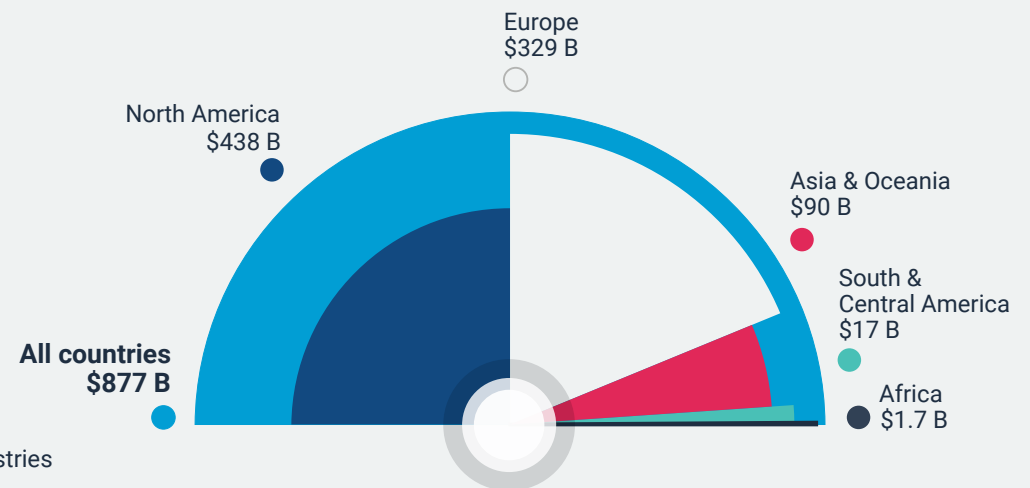
At a
glance



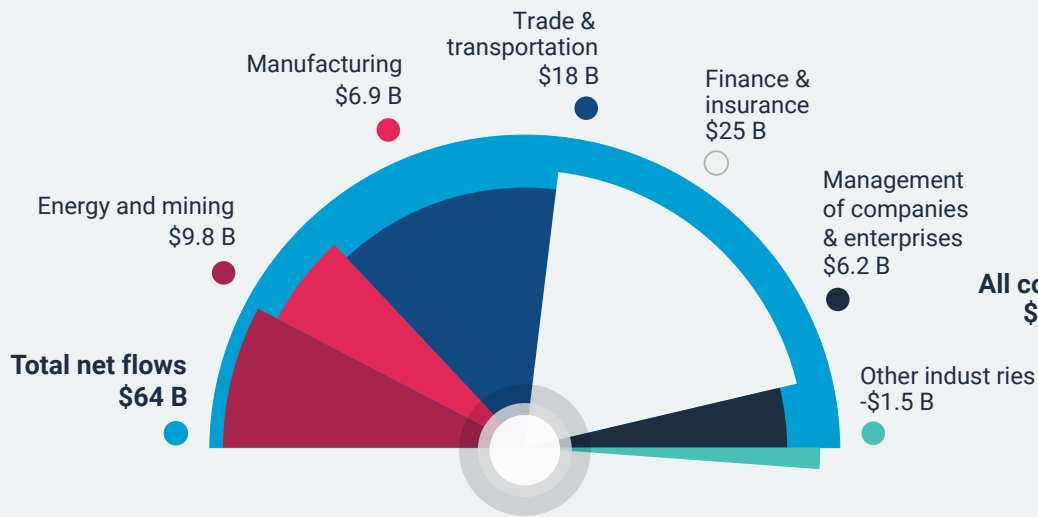
2018 FDI flow by industry



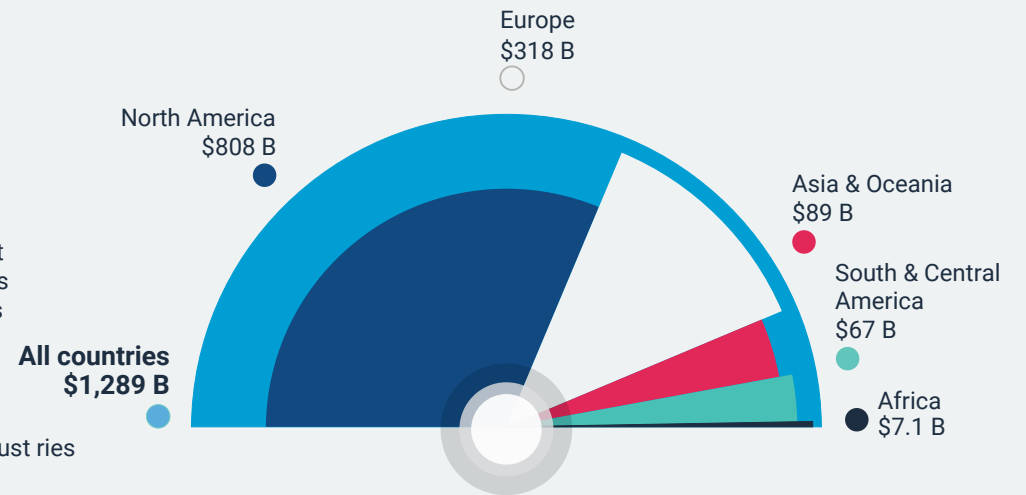
2018 FDI stock by region



2018 CDIA flow by industry

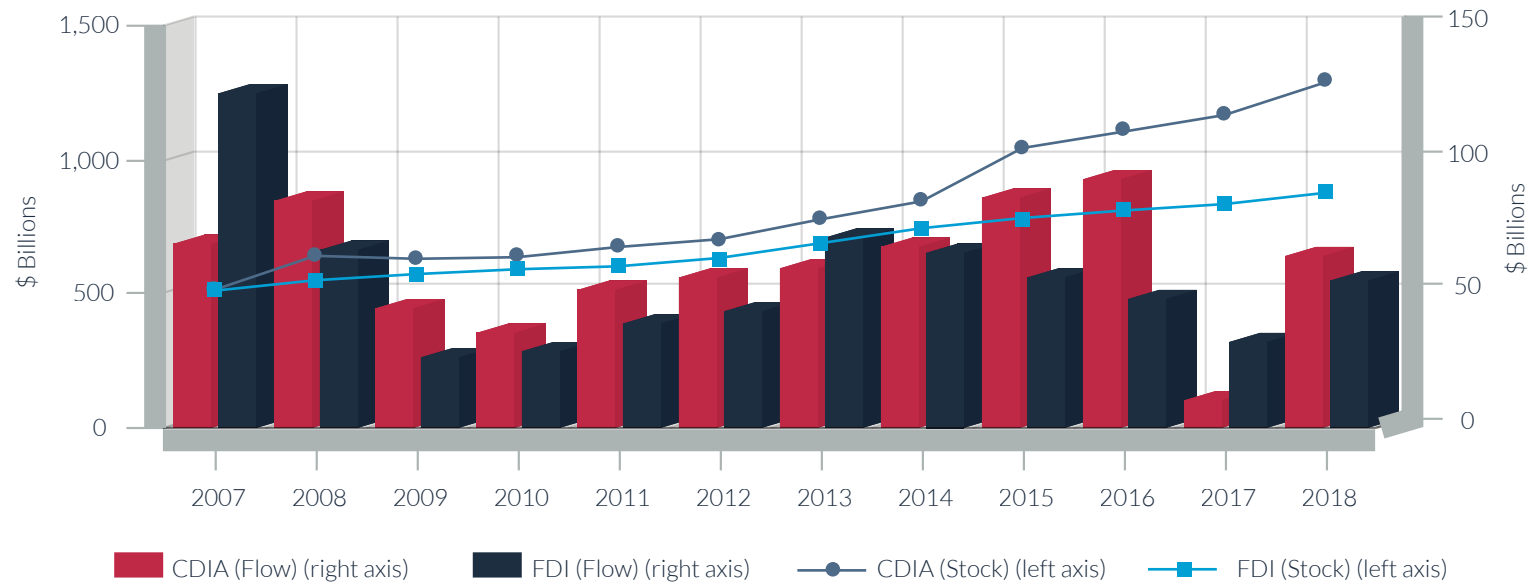


2018 CDIA stock by region



2.3 Canada's foreign direct investment performance

Figure 16: Inward (FDI) and outward (CDIA) foreign direct investment stocks and flows, 2007-2018



Source: Statistics Canada, Tables 36-10-0025-01 and 36-10-0008-01; retrieved on 24-06-2019

FDI into Canada

In 2018, total flows of FDI into Canada increased by **70%** to **\$55 billion**, compared to declines in most other developed economies. This sharp increase was due to a **\$24 billion (+262%)** growth in FDI from non-U.S. sources, mainly from European countries such as Switzerland and the Netherlands, while flows from the United States declined by **6.8%**. The largest total FDI inflows gain came from mergers and acquisitions (M&A) turning positive in 2018, with a net increase of nearly **\$20 billion**. Reinvested earnings also climbed **\$3.0 billion**, while other FDI inflows declined marginally.

By sector, strong flows of investment into Canada's manufacturing sector (**45%**) made up for the declines in trade and transportation (**-41%**) and finance and insurance (**-13%**). Moreover, investment in other industries nearly doubled. After two major divestitures totalling **\$9.3 billion** in 2017, inflows into Canada's oil sector turned positive in 2018 to reach **\$5.8 billion**.



2.3 Canada's foreign direct investment performance

Table 16: Foreign direct investment flows to Canada

Type of FDI Inflows	2017 (\$M)	2018 (\$M)	Change (%)	Change (\$M)
From the world				
Total net flows	32,226	54,736	69.9	22,510
Mergers and acquisitions	-4,892	15,029	n/a	19,921
Reinvested earnings	23,055	26,069	13.1	3,014
Other flows	14,062	13,638	-3.0	-424
From the United States				
Total net flows	23,055	21,495	-6.8	-1,560
Mergers and acquisitions	-4,315	4,314	n/a	8,629
Reinvested earnings	14,736	13,776	-6.5	-960
Other flows	12,633	3,406	-73.0	-9,227
From the Rest of the world				
Total net flows	9,171	33,240	262.4	24,069
Mergers and acquisitions	-576	10,715	n/a	11,291
Reinvested earnings	8,317	12,294	47.8	3,977
Other flows	1,430	10,232	615.5	8,802
Sectors of FDI inflows from the world				
Energy and mining	-9,333	5,776	n/a	15,109
Manufacturing	12,222	17,719	45.0	5,497
Trade and transportation	12,856	7,632	-40.6	-5,224
Finance and insurance	4,891	4,261	-12.9	-630
Management of companies and enterprises	3,280	3,208	-2.2	-72
Other industries	8,312	16,140	94.2	7,828

Source: Statistics Canada, Tables 36-10-0025-01 and 36-10-0026-01; retrieved on 24-06-2019

2.3 Canada's foreign direct investment performance

Foreign investors' cumulative holdings of direct investment (stock) in Canada expanded by **\$42 billion**, or **5.0%**, to reach **\$877 billion** in 2018. Because the stock of FDI grew slightly faster than Canada's nominal GDP (**+3.6%**) in 2018, the ratio of FDI stock to GDP increased from **39%** in 2017 to **40%** in 2018.

All regions except Africa increased their FDI stock in Canada in 2018. The FDI stock from North America, comprising the United States, Mexico and the Caribbean region, was up **5.2%** over the previous year and accounted for exactly half of Canada's FDI stock. The United States remained Canada's largest foreign investor by far, with a FDI stock totalling **\$406 billion** in 2018.

The level of inward FDI stock from Europe (**4.9%**) and Asia and Oceania (**4.2%**) grew slightly slower. In contrast, the FDI stock from South and Central America recorded the fastest regional expansion in 2018, advancing by **10%** to reach **\$17 billion**, almost entirely due to Brazilian investment. However, investment from Africa declined by **12%**.



2.3 Canada's foreign direct investment performance

Table 17: Foreign direct investment stock in Canada, by region

	2017 (\$M)	2018 (\$M)	Share 2017 (%)	Share 2018 (%)	Change (%)
All countries	834,757	876,856	100	100	5.0
North America	416,758	438,443	49.9	50.0	5.2
United States	386,869	406,051	46.3	46.3	5.0
Bermuda	15,520	16,604	1.9	1.9	7.0
Cayman Islands	8,002	8,912	1.0	1.0	11.4
British Virgin Islands	3,011	2,928	0.4	0.3	-2.8
Mexico	2,696	2,730	0.3	0.3	1.3
Europe	314,006	329,438	37.6	37.6	4.9
Netherlands	101,861	106,706	12.2	12.2	4.8
Luxembourg	54,627	55,828	6.5	6.4	2.2
United Kingdom	46,988	50,353	5.6	5.7	7.2
Switzerland	44,010	46,147	5.3	5.3	4.9
Germany	16,617	17,008	2.0	1.9	2.4
France	11,545	13,509	1.4	1.5	17.0
Ireland	7,100	8,094	0.9	0.9	14.0
Belgium	7,669	8,015	0.9	0.9	4.5
Asia and Oceania	86,269	89,910	10.3	10.3	4.2
Japan	28,162	28,871	3.4	3.3	2.5
Hong Kong SAR	20,075	21,802	2.4	2.5	8.6
China	16,226	16,959	1.9	1.9	4.5
Australia	9,296	9,682	1.1	1.1	4.2
United Arab Emirates	3,156	3,441	0.4	0.4	9.0
India	2,723	2,561	0.3	0.3	-5.9
South Korea	2,561	2,398	0.3	0.3	-6.4
Kuwait	2,180	2,158	0.3	0.2	-1.0
South and Central America	15,749	17,328	1.9	2.0	10.0
Brazil	13,185	14,628	1.6	1.7	10.9
Africa	1,975	1,737	0.2	0.2	-12.1

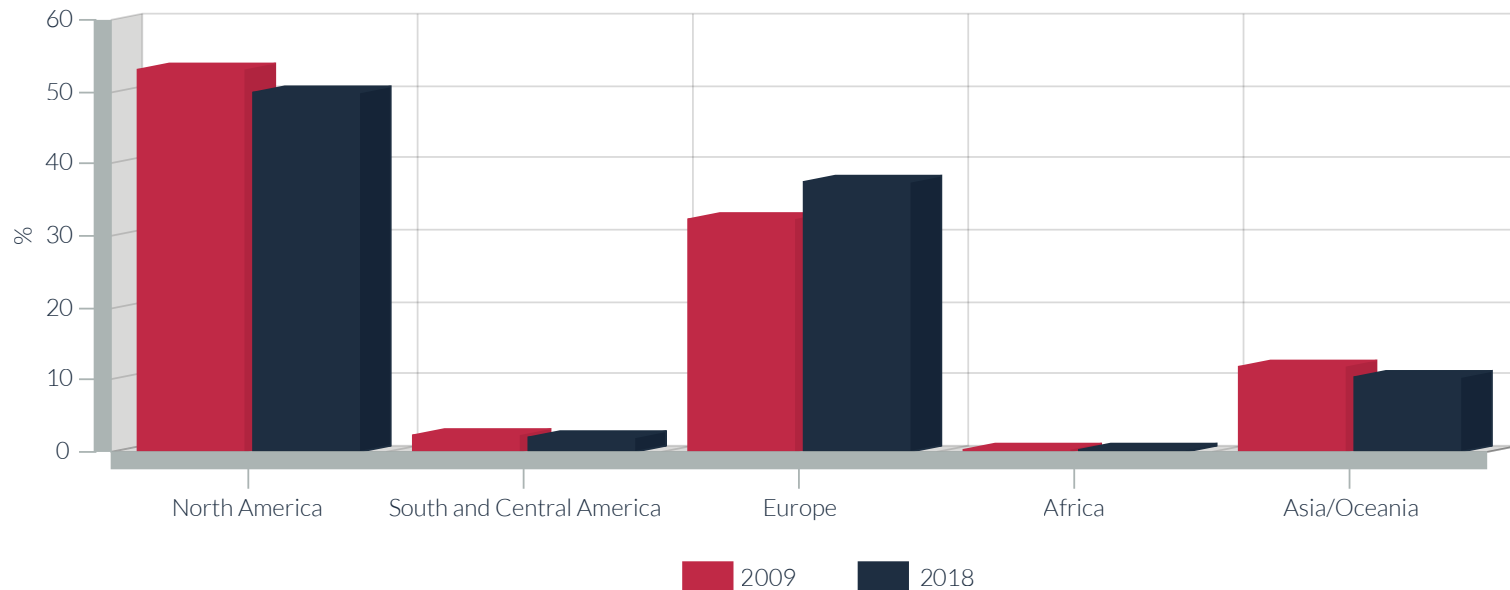
Source: Statistics Canada, Table 36-10-0008-01; retrieved on 24-06-2019

2.3 Canada's foreign direct investment performance

Compared to a decade ago, the distribution of foreign investors in Canada is slightly more diverse but still dominated by North America and Europe. North America's share of FDI stock declined **3.1 percentage points**, mainly from the decline in

the share of U.S. investors from **52%** in 2009 to **46%** in 2018, while Europe's share increased **5.2 percentage points** due to increasing investment from the Netherlands and Luxembourg.

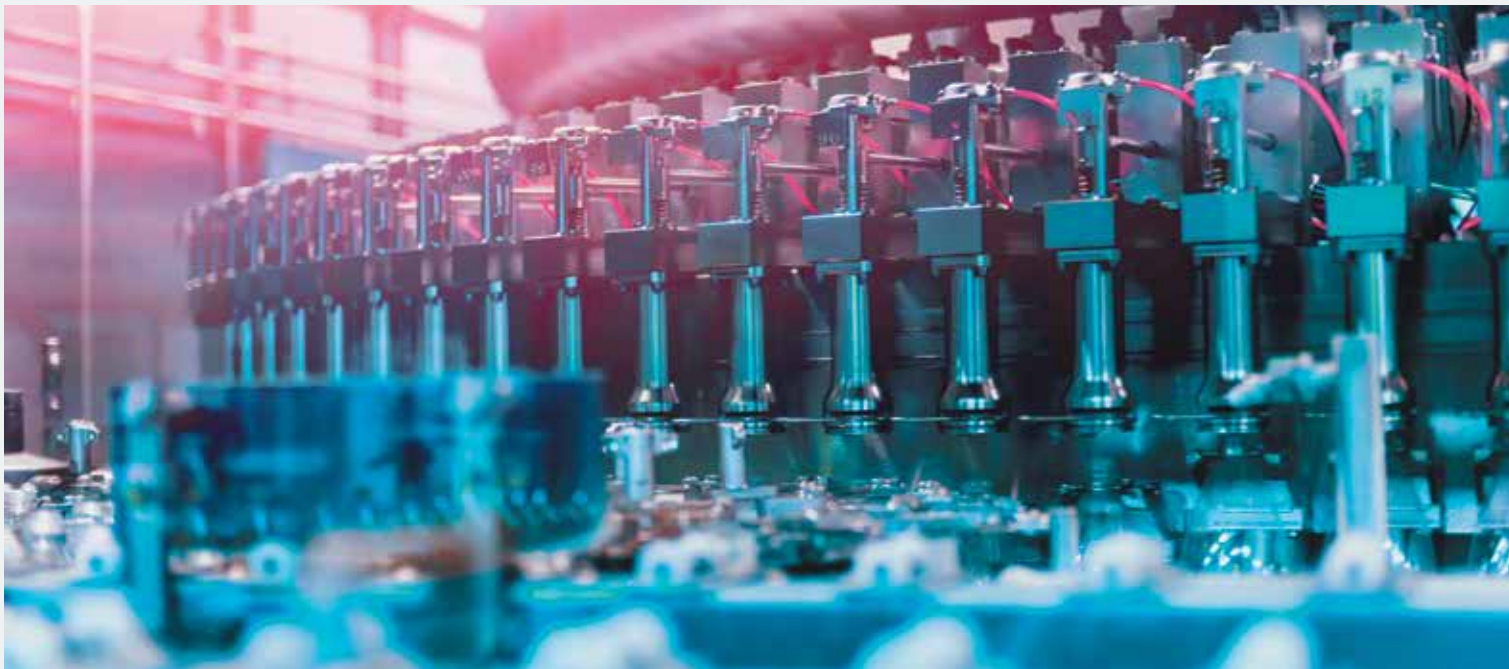
Figure 17: Distribution of FDI stock in Canada by region, 2009 and 2018



2.3 Canada's foreign direct investment performance

By industry, over **40%** of the overall increase in Canada's inward FDI stock in 2018 came from manufacturing, which added **\$17 billion (+9.4%)** to reach **\$202 billion** in 2018 and reinforce its number one spot with a **23%** share of the total FDI stock. Investment in agriculture, forestry, fishing and hunting reached historic levels last year, by expanding nearly 26 times over from **\$182 million** in 2017 to **\$4.7 billion** in 2018. Growing FDI in the finance and insurance sector, which was responsible for approximately one quarter of total FDI stock growth in 2017, only contributed **7.5%** of FDI stock growth in 2018.

The information and communication technologies (ICT) sector is a specialized R&D-intensive category that is an important driver of productivity growth. Although FDI stock in Canada's ICT sector expanded **21%** to reach **\$16 billion** in 2018, its share of total FDI stock has been trending downward since the early 2000s, from a peak of **9.7%** in 2000 to only **1.8%** in 2018.



2.3 Canada's foreign direct investment performance

Table 18: Foreign direct investment stock in Canada, by industry

	2017 (\$M)	2018 (\$M)	Share 2017 (%)	Share 2018 (%)	Change (%)
Total, all industries	834,757	876,856	100.0	100.0	5.0
Agriculture, forestry, fishing and hunting	182	4,698	0.0	0.5	2,481.3
Mining and oil and gas extraction	173,700	175,543	20.8	20.0	1.1
Utilities	1,510	1,356	0.2	0.2	-10.2
Construction	3,566	4,300	0.4	0.5	20.6
Manufacturing	184,915	202,352	22.2	23.1	9.4
Wholesale trade	72,166	78,084	8.6	8.9	8.2
Retail trade	34,253	33,979	4.1	3.9	-0.8
Transportation and warehousing	13,702	14,219	1.6	1.6	3.8
Information and cultural industries	3,928	5,728	0.5	0.7	45.8
Finance and insurance	132,096	135,250	15.8	15.4	2.4
Real estate, rental and leasing	12,820	15,032	1.5	1.7	17.3
Professional, scientific and technical services	18,042	19,031	2.2	2.2	5.5
Management of companies and enterprises	172,286	174,756	20.6	19.9	1.4
Accommodation and food services	3,964	4,343	0.5	0.5	9.6
All other industries	7,627	8,186	0.9	0.9	7.3
Information and communication technologies (ICT)¹³	13,275	16,060	1.6	1.8	21.0

Source: Statistics Canada, Table 36-10-0009-01; retrieved on 24-06-2019

¹³ Includes NAICS codes 3341 to 3344, 4173, 5112, 5171, 5172, 5174, 5179, 5182, 5415 and 8112.

2.3 Canada's foreign direct investment performance

FDI by ultimate investor country

In line with international standards, statistics on source countries of FDI have traditionally been compiled according to the immediate investing country (IIC), which is the last country through which the FDI transited before entering the domestic economy. While this measure is appropriate for evaluating the direct investment flows and corresponding funds exchanged between countries, it does not shed light on the real FDI source country where the ultimate investor originates.

Measuring FDI according to the ultimate investor country (UIC) attempts to rectify this problem.

The U.S. share of Canadian FDI by UIC is **51%**, larger than its **46%** share of FDI by IIC. The United Kingdom, Japan, Switzerland and Brazil round off the rest of the top five UIC rankings, and all these countries rank higher under UIC than under IIC. On the other hand, three of the top five countries under IIC ranking, such as the Netherlands and Luxembourg, play a smaller role in Canadian FDI under UIC ranking. Under UIC, China accounted for **3.3%** of Canadian FDI (sixth in the ranking), compared to IIC, where it accounted for **1.9%** (ninth in the ranking).

Table 19: Canadian FDI by ultimate investor country (UIC) vs. immediate investing country (IIC), 2017

UIC Rank	Country	Share (%)	IIC Rank	Country	Share (%)
1	United States	51.2	1	United States	46.3
2	United Kingdom	6.3	2	Netherlands	12.2
3	Japan	4.7	3	Luxembourg	6.5
4	Switzerland	3.5	4	United Kingdom	5.6
5	Brazil	3.3	5	Switzerland	5.3
6	China	3.3	6	Japan	3.4
7	Germany	3.2	7	Hong Kong SAR	2.4
8	Luxembourg	2.7	8	Germany	2.0
9	Netherlands	2.4	9	China	1.9
10	France	2.1	10	Bermuda	1.9

Source: Statistics Canada, Table 36-10-0433-01 and Table 36-10-0008-01; retrieved on 20-06-2019

Canadian direct investment abroad

In 2018, CDIA presented a completely different picture compared to inflows. CDIA fell **38%** to **\$64 billion**, with M&A decreasing by **48%**, or **\$31 billion**, and divestment in other flows growing to over **\$15 billion**.

Decreasing CDIA was mostly due to lower investment in the United States, down **60%** to **\$33 billion**, mainly caused by the decline in M&A (**-77%**). In contrast, CDIA flows to the rest of the world surged, up **48%**, or **\$10 billion** (almost entirely due to increases in M&A). As a result, the share of CDIA to the United States accounted for only **51%** of overall CDIA outflows in 2018, down from nearly **80%** the previous year.

By sector, unlike in the previous year, Canadian investors diverted investment from every sector to energy and mining, and manufacturing, adding **\$13 billion** and **\$10 billion**, respectively. Trade and transportation lost the top spot for Canadian investors, as investment flows into this sector were cut by **68%** to **\$18 billion** in 2018. As a result, finance and insurance became the new number one sector as CDIA flows declined relatively less, by **12%**, to **\$25 billion**.

2.3 Canada's foreign direct investment performance

Table 20: Flows of Canadian direct investment abroad

	2017 (\$M)	2018 (\$M)	Change (%)	Change (\$M)
To the world				
Total net flows	103,591	64,277	-38.0	-39,314
Mergers and acquisitions	64,846	33,654	-48.1	-31,192
Reinvested earnings	39,312	45,980	17.0	6,668
Other flows	-568	-15,358	n/a	-14,790
To the United States				
Total net flows	82,492	32,944	-60.1	-49,548
Mergers and acquisitions	58,657	13,638	-76.7	-45,019
Reinvested earnings	16,630	22,368	34.5	5,738
Other flows	7,205	-3,061	n/a	-10,266
To the rest of the world				
Total net flows	21,099	31,331	48.5	10,232
Mergers and acquisitions	6,188	20,018	223.5	13,830
Reinvested earnings	22,682	23,611	4.1	929
Other flows	-7,774	-12,297	n/a	-4,523
Sectors of CDIA outflows				
Energy and mining	-3,014	9,836	n/a	12,850
Manufacturing	-3,558	6,889	n/a	10,447
Trade and transportation	56,571	17,893	-68.4	-38,678
Finance and insurance	28,310	24,935	-11.9	-3,375
Management of companies and enterprises	9,439	6,215	-34.2	-3,224
Other industries	15,842	-1,491	n/a	-17,333

Source: Statistics Canada, Tables 36-10-0025-01 and 36-10-0026-01; retrieved on 24-06-2019

2.3 Canada's foreign direct investment performance

The stock of CDIA grew for the ninth consecutive year. Following last year's gain of **5.6%**, Canadian investors added **\$122 billion (+10%)** to their direct investment holdings abroad to reach a record high of **\$1,289 billion** in 2018, with CDIA stock in both North America and Europe posting double-digit growth.

By country, the United States continued to be Canadian investors' number one destination, with a CDIA position of **\$595 billion**, or **46%**, of the overall CDIA stock at the end of 2018. The United Kingdom remained the second-largest destination, with the CDIA stock expanding by **12%** to reach **\$109 billion**; Luxembourg, Barbados and Bermuda rounded out the top five. The stock of Canadian investment in Asia and Oceania grew at a relatively slower rate, up **4.3%** to **\$89 billion** in 2018. CDIA in Australia contracted slightly, but the stock of investment in other top Asian destinations grew faster than the **10%** average, as China, Hong Kong SAR, and Japan all recorded double-digit growth rates. By comparison, Canadians decreased their investments in South and Central America and Africa, down **1.0%** and **1.5%**, respectively.

Canadian investors increased their direct investment holdings abroad in all sectors except information and culture (down **\$6.2 billion** to **\$38 billion**). CDIA in finance and insurance led all sectors, up **\$53 billion** (or **13%**) to **\$471 billion**, with half of the increase in the United States. This sector comprised **37%** of the overall stock of CDIA in 2018. The transportation and warehousing sector CDIA stock position posted the second-largest growth, up **\$18 billion** to **\$84 billion** in 2018. Other sectors that saw significant growth in their CDIA stock were management of companies and enterprises (**+11%**), mining and oil and gas extraction (**+5.4%**), and manufacturing (**+11%**).

2.3 Canada's foreign direct investment performance

Table 21: Stock of Canadian direct investment abroad, by region

	2017 (\$M)	2018 (\$M)	Share 2017	Share 2018	Change (%)
All countries	1,167,243	1,288,869	100.0	100.0	10.4
North America	719,020	807,734	61.6	62.7	12.3
United States	524,976	594,994	45.0	46.2	13.3
Barbados	56,027	64,824	4.8	5.0	15.7
Bermuda	45,461	47,007	3.9	3.6	3.4
Cayman Islands	40,245	39,624	3.4	3.1	-1.5
Bahamas	24,131	27,096	2.1	2.1	12.3
Mexico	19,534	22,495	1.7	1.7	15.2
British Virgin Islands	6,415	9,617	0.5	0.7	49.9
Europe	287,802	317,773	24.7	24.7	10.4
United Kingdom	97,611	109,331	8.4	8.5	12.0
Luxembourg	81,692	90,069	7.0	7.0	10.3
Netherlands	34,647	36,475	3.0	2.8	5.3
Germany	9,162	10,481	0.8	0.8	14.4
Ireland	9,200	9,969	0.8	0.8	8.4
France	6,743	7,395	0.6	0.6	9.7
Asia and Oceania	85,232	88,923	7.3	6.9	4.3
Australia	31,926	31,205	2.7	2.4	-2.3
China	11,182	12,736	1.0	1.0	13.9
Hong Kong SAR	7,839	9,053	0.7	0.7	15.5
Japan	6,546	7,560	0.6	0.6	15.5
South and Central America	67,889	67,197	5.8	5.2	-1.0
Chile	22,728	21,501	1.9	1.7	-5.4
Peru	13,566	14,246	1.2	1.1	5.0
Brazil	14,006	14,119	1.2	1.1	0.8
Africa	7,300	7,190	0.6	0.6	-1.5

Source: Statistics Canada, Table 36-10-0008-01; retrieved on 24-06-2019

2.3 Canada's foreign direct investment performance

Table 22: Stock of Canadian direct investment abroad, by industry

	2017 (\$M)	2018 (\$M)	Share 2017 (%)	Share 2018 (%)	Change (%)
Total, all industries	1,167,243	1,288,869	100.0	100.0	10.4
Agriculture, forestry, fishing and hunting	2,140	2,412	0.2	0.2	12.7
Mining and oil and gas extraction	184,758	194,727	15.8	15.1	5.4
Utilities	38,042	44,551	3.3	3.5	17.1
Construction	2,218	3,153	0.2	0.2	42.2
Manufacturing	93,444	103,271	8.0	8.0	10.5
Wholesale trade	23,279	25,316	2.0	2.0	8.8
Retail trade	12,752	13,060	1.1	1.0	2.4
Transportation and warehousing	66,816	84,460	5.7	6.6	26.4
Information and cultural industries	44,201	37,989	3.8	2.9	-14.1
Finance and insurance	418,743	471,318	35.9	36.6	12.6
Real estate, rental and leasing	72,251	77,803	6.2	6.0	7.7
Professional, scientific and technical services	26,416	29,763	2.3	2.3	12.7
Management of companies and enterprises	154,172	171,311	13.2	13.3	11.1
Accommodation and food services	3,343	3,595	0.3	0.3	7.5
All other industries	24,668	26,141	2.1	2.0	6.0
Information and communication technologies (ICT)	17,774	18,975	1.5	1.5	6.8

Source: Statistics Canada, Table 36-10-0009-01; retrieved on 24-06-2019





Diversifying Canadian exports

Introduction

Canada is a trading nation: in 2018, Canadian exports and imports of goods and services totalled **\$1.5 trillion**, placing the share of trade in the economy at **66%**. The Canadian economy, and by extension Canadians, gain from this trade in many ways, with the growth of trade linked to higher incomes and living standards (State of Trade, 2012). However, the large share of trade in the Canadian economy also raises Canada's exposure to external shocks. This exposure can be mitigated through trade diversification.

There are several dimensions to trade diversification, with geographic and product diversification being the two most commonly thought of, and usually more so with regard to a country's exports than with imports. Geographic diversifica-

tion refers to the spread of destination markets for a country's exports, while product diversification applies to the range of products being exported. Other dimensions include regional diversification (for instance, provincial spread of Canadian exporters), type of exporter (small, medium, and large enterprises), and diversity in ownership or control of an exporting firm, with women ownership and Indigenous ownership being two facets of this diversification dimension. This section of the "State of Trade" report presents research by the Office of the Chief Economist (OCE) which shows that the first two dimensions (geographic and product) are important for mitigating Canada's vulnerability to external shocks, but are not the only dimensions of trade diversification.



What does trade diversification mean?

At a
glance



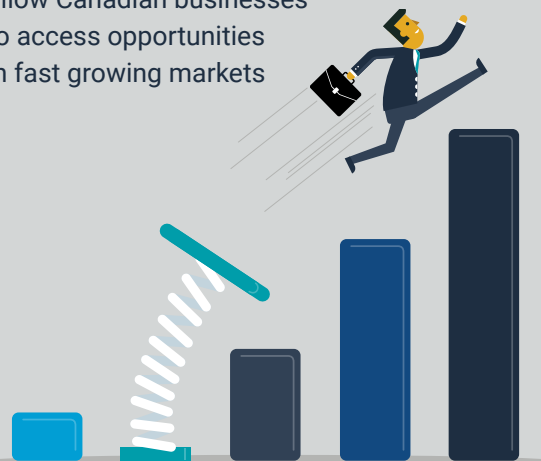
Dimensions of Trade Diversification



Importance of diversification

Geographic and product diversification:

- hedge risk
- allow Canadian businesses to access opportunities in fast growing markets



Ownership diversification

Spreads gains of trade across Canada to all Canadians








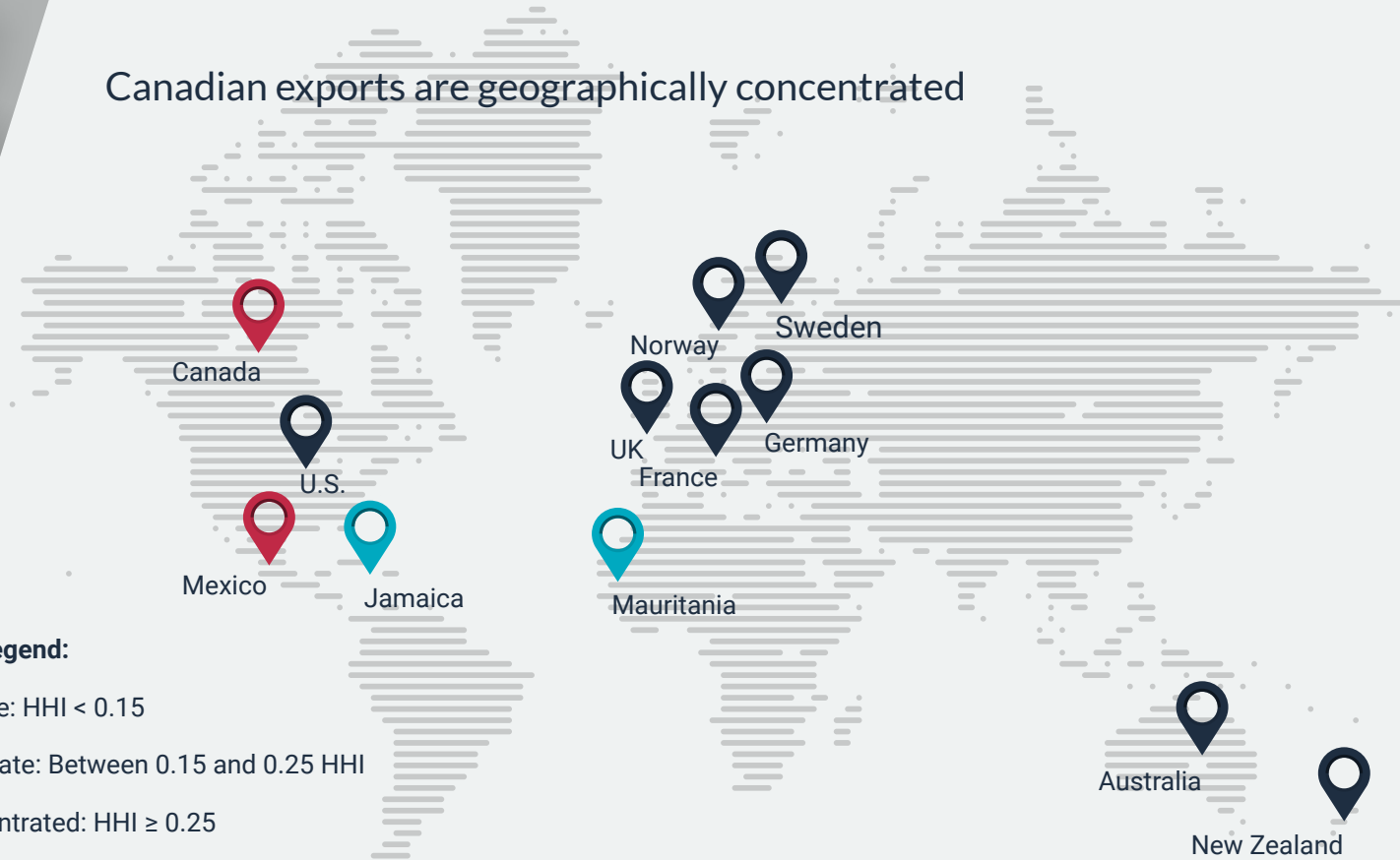
2025 Target

Expand Canada's overseas exports by **50%** by 2025

Canadian exports are geographically concentrated

HHI Legend:

-  Diverse: $HHI < 0.15$
-  Moderate: Between 0.15 and 0.25 HHI
-  Concentrated: $HHI \geq 0.25$



Why is export diversification important?

Trade diversification, or export diversification more specifically, is important because it helps mitigate a country's exposure to shocks from abroad. Additionally, it allows Canadian exporters to take advantage of opportunities in new and expanding markets. Exactly how this is accomplished depends on the dimension of diversification considered.

Geographic diversification of exports helps hedge risks related to a particular export market; these risks can include, but are not limited to, political risks such as trade protectionist policies, country-specific economic shocks, and exchange rate volatility.¹⁴ It is important to note that, much like using diversification to limit risk in portfolio investment, diversification will only mitigate unsystematic risk. In the case of geographic export diversification, spreading exports across a wide range of markets will limit an exporting country's risk to specific events or actions in individual markets; it will not help mitigate systematic risk, i.e. risks that affect multiple markets at once. For example, in the global economic and financial crisis of 2007–2009, the vast majority of developed countries saw their economies contract, thus lowering their demand for imports. Following the crisis, Canadian goods and services exports saw a significant decline, dropping **21%** from 2008 to 2009. The contraction in Canadian exports matched the global trend in

declining trade at the time,¹⁵ and greater geographic diversification of Canadian exports would likely have been of little help in mitigating Canada's vulnerability to this systematic risk.

A greater geographic diversification of exports can also be beneficial to the Canadian economy in ensuring that Canadian exporters do not miss out on opportunities in emerging, fast-growing economies, and that Canadian exports are not overly focused on slower growing developed economies. Accessing new and fast-growing markets also provides a feedback effect of further diversifying Canadian exports; OCE research shows that entering fast-growing markets earlier gives an additional positive boost to exports in those markets. This research is discussed further in part two of this chapter.

14 The ability of geographic diversification to hedge against these types of risks is also identified by Statistics Canada (2018a).

15 According to World Trade Organization (WTO) trade statistics, world merchandise exports fell 22% and imports fell 23% from 2008 to 2009.

3.1 What does trade diversification mean?

Product diversification can also help abate risks from external shocks. In this case, exporting a wider range of products limits the exporting country's exposure to risks from fluctuations in prices and shocks to demand or supply of specific products or services.¹⁶ Once again, it is important to note this diversification is only a hedge against unsystematic risk, i.e. the risk of a negative shock to a specific or small subset of exported products.

Having a diverse range of export products and services also shields an exporting country from a problem often referred to as "Dutch disease". This problem occurs when a single commodity makes up a large portion of a country's exports. A sharp increase in external demand for the product may appreciate the country's currency, making imports relatively cheaper and exports more expensive—both of which reduce the competitiveness of other industries and further concentrates the economy on the dominant export.

A final benefit of product diversification, again akin to geographic diversification, is that it allows greater access to new and fast-growing markets, but in this case product markets as opposed to geographic markets. The wider range of products exported will allow a country to take advantage of faster growing product sectors.

Diversification in the **regional distribution of exporters, type of exporter, and ownership of exporting firms** is important because these dimensions of diversification spread the gains from trade across Canada and among Canadians. For instance, firms that export have been shown to be more productive and, on average, pay higher wages than non-exporting firms (State of Trade, 2012). Having exporting firms dispersed across Canadian regions and communities will help economic benefits and opportunities distribute evenly throughout the country. Additionally, lowering barriers to exporting for small and medium firms will help them grow and prosper, while providing support for women-owned or Indigenous-owned enterprises to export will make the gains from trade more inclusive.

¹⁶ Product diversification as a hedge to these risks is also identified by Statistics Canada (2018a).

3.1 What does trade diversification mean?

These different dimensions of diversification do not stand alone but intersect: each is related to the others and bolster their mutual benefits. For example, if a specific country imposes a tariff on a specific Canadian export, the damage could be reduced by both geographic and product diversification. That said, it may not always be possible to achieve perfect diversification; every country has comparative advantages in

producing certain products and services, and it is often economically efficient to specialize in producing some goods and services while importing those for which other countries have their own comparative advantages. Further, some regions of Canada will specialize in particular sectors, and the demand for these products may be stronger in some markets than others.

Box 1 : Herfindahl-Hirschman Index (HHI)

$$HHI^t = \sum_{i=1}^N S_i^2$$

Where S_i is the share of nominal exports at time t and i can be market or product.

This index constructs a score from zero to one. The closer the index is to one, the more concentrated is Canada's trade. For example, if Canada only traded with one country, the share of exports heading to that country would be 1 and the index would equal 1.0. Alternatively, if Canada's trade was divided evenly between 100 different countries, the index would equal 0.01.

Statistics Canada provides the following internationally accepted guidelines:

- Diversified export products or markets:
HHI < 0.15
- Moderately concentrated products or markets:
0.15 ≤ HHI < 0.25
- Highly concentrated products or markets:
HHI ≥ 0.25

Are Canadian exports diversified?

With the benefits of diversification established, an important question is: how diversified are Canadian exports? This can be asked in regard to all dimensions of diversification, but for simplicity we will first look at the well-established concepts of geographic and product diversification and return to the other dimensions of diversification in part three of this chapter.

To assess the level of diversification in Canada's trade requires a proper measure. While there are many ways one can measure diversification, the most common measure, which will be used here, is the Herfindahl-Hirschman Index (HHI). This measure of diversification is used by Statistics Canada, the United Nations, and the Organisation for Economic Co-operation and Development (OECD). Box 1 provides more details on the HHI.

Using this measure we find that, on a geographic basis, Canadian merchandise exports are highly concentrated (with an HHI of **0.57** in 2018). Scarffe (2019a) finds that Canada's exports are the fourth most concentrated by destination out of 113 countries.¹⁷ Based on the HHI, in 2017, only Kuwait, Bermuda, and Mexico had a higher geographic concentration of exports than Canada.¹⁸ Moreover, compared to countries thought to have similar dependence issues, such as Hong Kong SAR with its dependence on China, and

New Zealand with its dependence on Australia, Canada's exports are much more concentrated (Scarffe, 2019b).

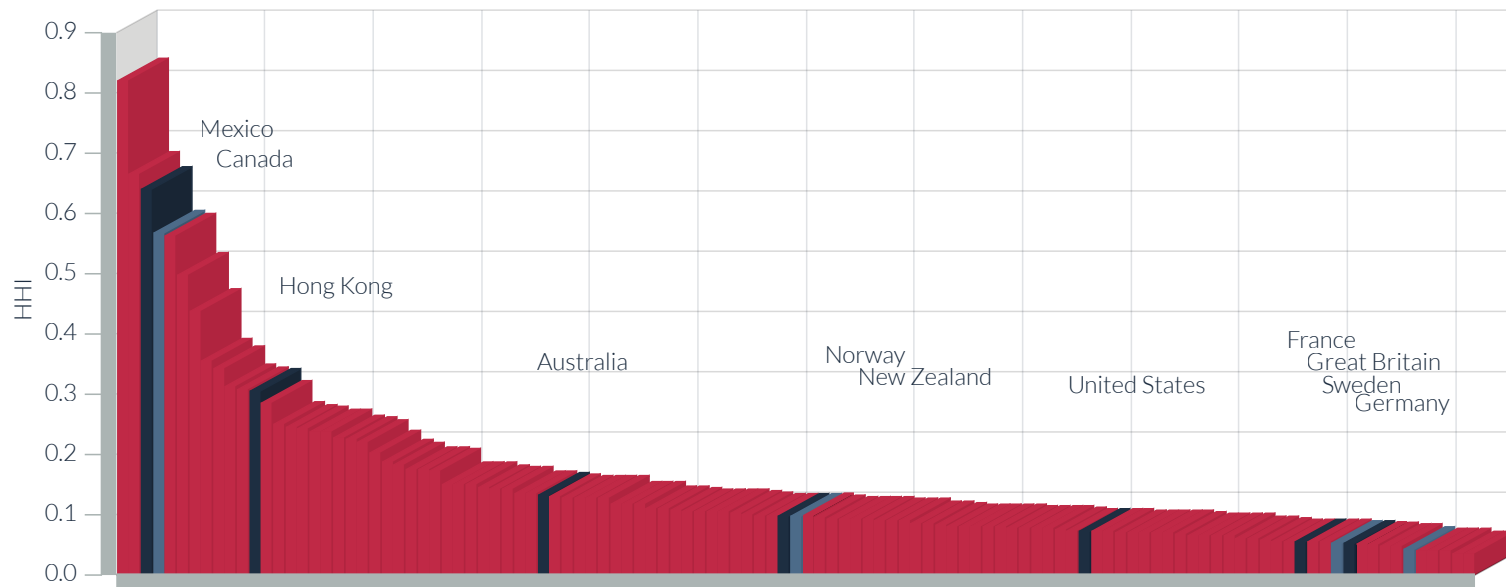
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- 17 If the HHI analysis is applied to geographic regions (Europe, North America etc.), rather than countries, Canada ranks better. While still high on the list, Canada is in line with other countries such as Sweden (with exports concentrated on Europe) and Hong Kong SAR (exports concentrated on East Asia and Asia/Pacific).
- 18 A cross-country comparison requires that all countries have reported their exports. While Canada has export data for 2018, not all countries had reported their export data for 2018 at the time of analysis, and accordingly 2017 was used for the comparison.

3.1 What does trade diversification mean?

The geographic concentration of Canadian exports is not surprising given the high level of exports destined to the United States (Scarffe, 2019a). In fact, the HHI tracks the U.S. share of Canadian exports extremely closely—with a correlation of **0.9997**. The HHI increases (a rise in concentration) when the U.S. share of Canadian exports rises, and the HHI decreases,

becoming more diverse when the U.S. share declines. In 2018, the U.S. share of Canadian merchandise exports was **75%**; while down from **87%** in 2002, this is similar to levels seen in the early 90s (the U.S. share of Canadian exports was **75%** in 1990).

Figure 18: Geographic export concentration (measured by HHI)



Data: UN Comtrade

3.1 What does trade diversification mean?

If the United States is excluded from the geographic HHI calculation, we find that Canada scores much better, with an index of **0.07**, meaning that outside of the U.S. market, Canadian exports are diversified. Thus, for Canada to improve geographic diversity, Canadian exports need to be less concentrated on the United States. However, the concentration of Canadian exports to the United States is predicated on economic theory. The gravity model of trade tells us that economic size and geographic proximity are the most important determinants of bilateral trade patterns. Having a similar culture (indicated, for example, by language), a common land border, and a free trade agreement further draw Canadian exports to the United States. Also important, there are no other alternatives for Canadian exports nearby as the United States is the only country adjacent to Canada by land. The country that is in a situation closest to Canada, in terms of gravity model determinants, is Mexico—one of the few countries with an HHI higher than Canada. Hence, as with Mexico, it is only natural for Canadian exports to concentrate on the large economy within close proximity to the Canadian border. Thus, diversifying Canada's exports will require additional and concerted efforts to work against the economic factors that pull Canadian exports toward the United States.

At the HS2¹⁹ product level, Canadian exports are found to be diversified, with an HHI score of **0.09** in 2018. This HHI score has changed little over the past 28 years, fluctuating between **0.07** and **0.12** since 1990, but always remaining under the **0.15** benchmark, and thus Canadian exports are considered

diversified by product. Box 1 provides details on how to calculate the HHI benchmarks.

That Canadian exports are diversified by product may not have been the *ex ante* expectation since Canada is known for its energy and auto exports. These sectors are both critical to the Canadian economy, but because Canada's overall exports are so large, they make up a relatively small share of exports; in 2018, their respective shares of exports were **22%** and **14%**.²⁰ The U.S. impact on Canadian exports is clear as Canada sends approximately **90%** of both auto and energy sector exports to the United States. Again, this underlines how the product and geographic dimensions of diversification intersect.

19 Canada's merchandise trade is most commonly reported using the Harmonized System (HS) of Trade Classification, an international system for codifying traded commodities.

20 The share of energy in Canadian exports rose from 13% in 2000 to 27% in 2014; it then fell to 16% in 2016 before rising again to 22% in 2018. The auto sector has seen its share of Canadian exports steadily decline from a high of 24% in 1999 to the current 14% share, although this is up slightly from a low of 11% in 2009.

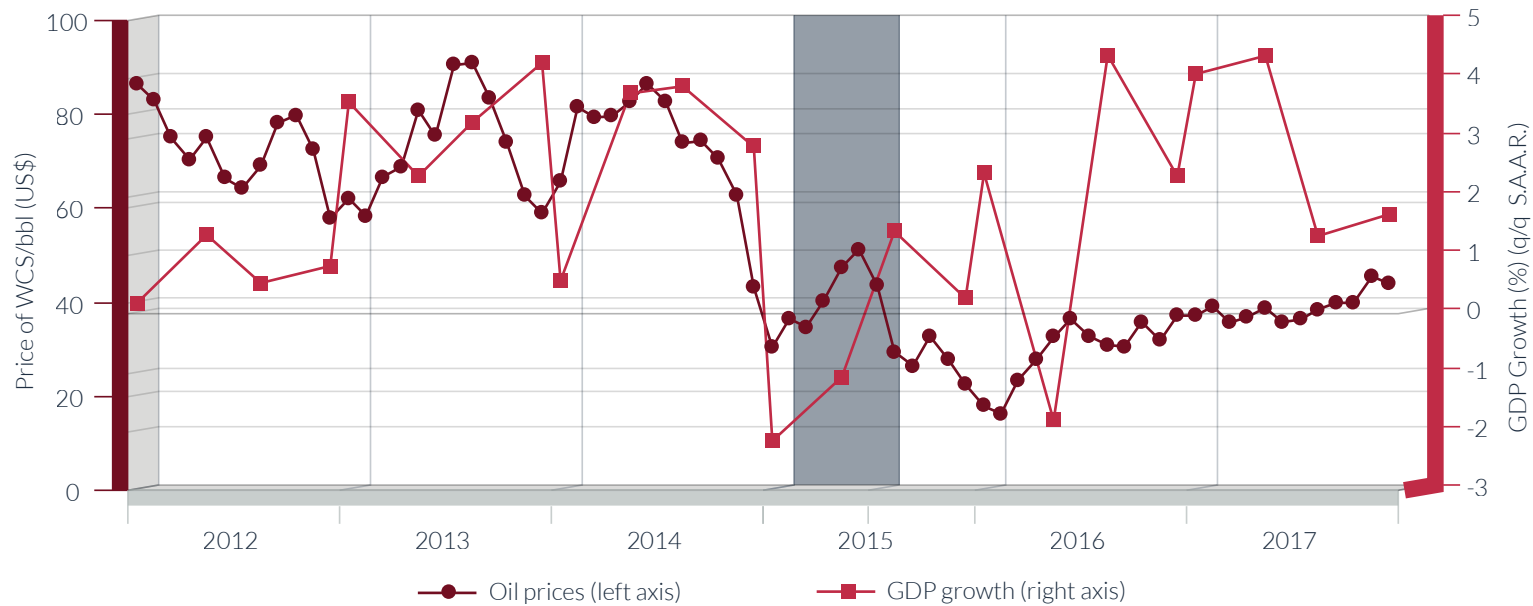
3.1 What does trade diversification mean?

An HHI indicating that Canadian exports are diversified by product does not mean that Canada is immune to industry-specific shocks. The price of Western Canada Select crude oil went from **\$US86.56/bbl** in June 2014 to **\$US16.30/bbl** in February 2016, causing a shallow recession that lasted two quarters and led the Bank of Canada to cut interest rates twice at the beginning of 2015.²¹ Yet, Canada's export diversity by product meant that the oil price shock only led to a small economic contraction,

and Canada's economy was able to adjust and resume growth despite the price of oil remaining low.

²¹ Oil prices were taken from the Government of Alberta website.

Figure 19: Oil prices and GDP growth



Data: Government of Alberta, Statistics Canada

Canada's 2025 target

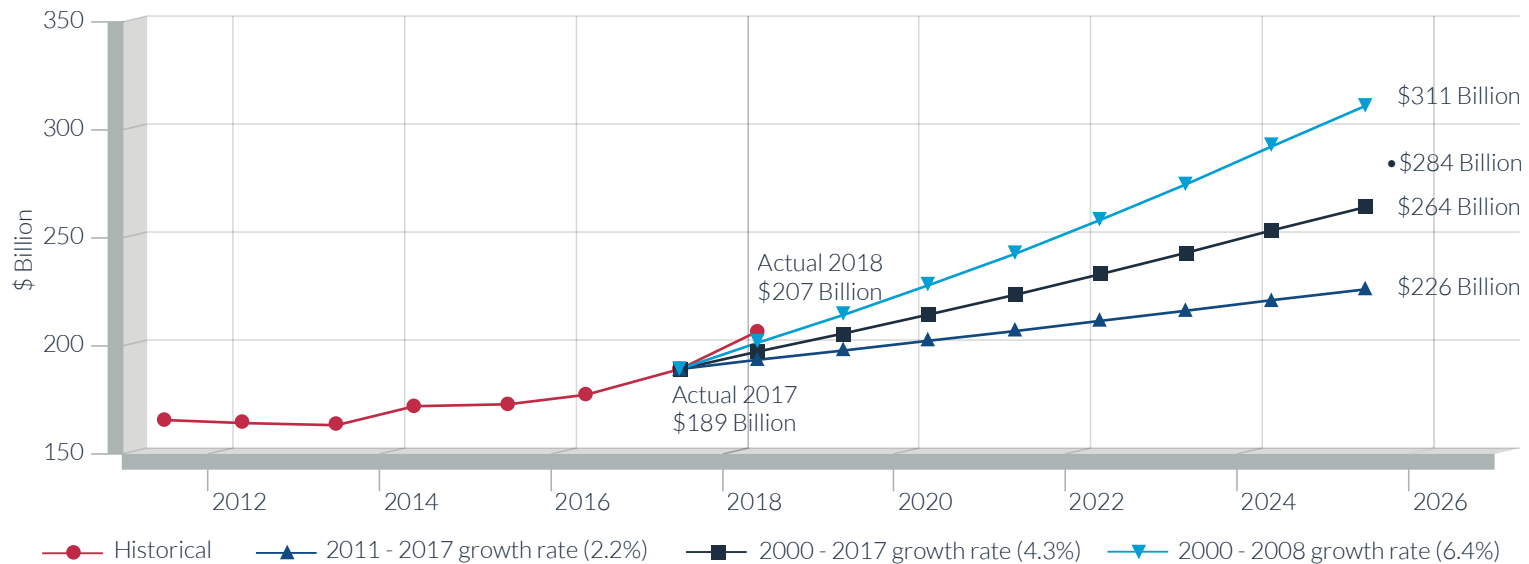
The Canadian government has recognized the need to further diversify Canadian exports. In its *Fall Economic Statement (FES) 2018*, the government launched an export diversification strategy, with a target of increasing Canada's overseas²² exports by **50%** by 2025. As stated in the FES, "The Export Diversification Strategy will invest **\$1.1 billion** over the next six years, starting in 2018-19, to help Canadian businesses access new markets. The Strategy will focus on three key components:

investing in infrastructure to support trade, providing Canadian businesses with resources to execute their export plans, and enhancing trade services for Canadian exporters".²³

²² Overseas refers to non-U.S. destinations.

²³ [Fall Economic Statement 2018](#), Department of Finance Canada

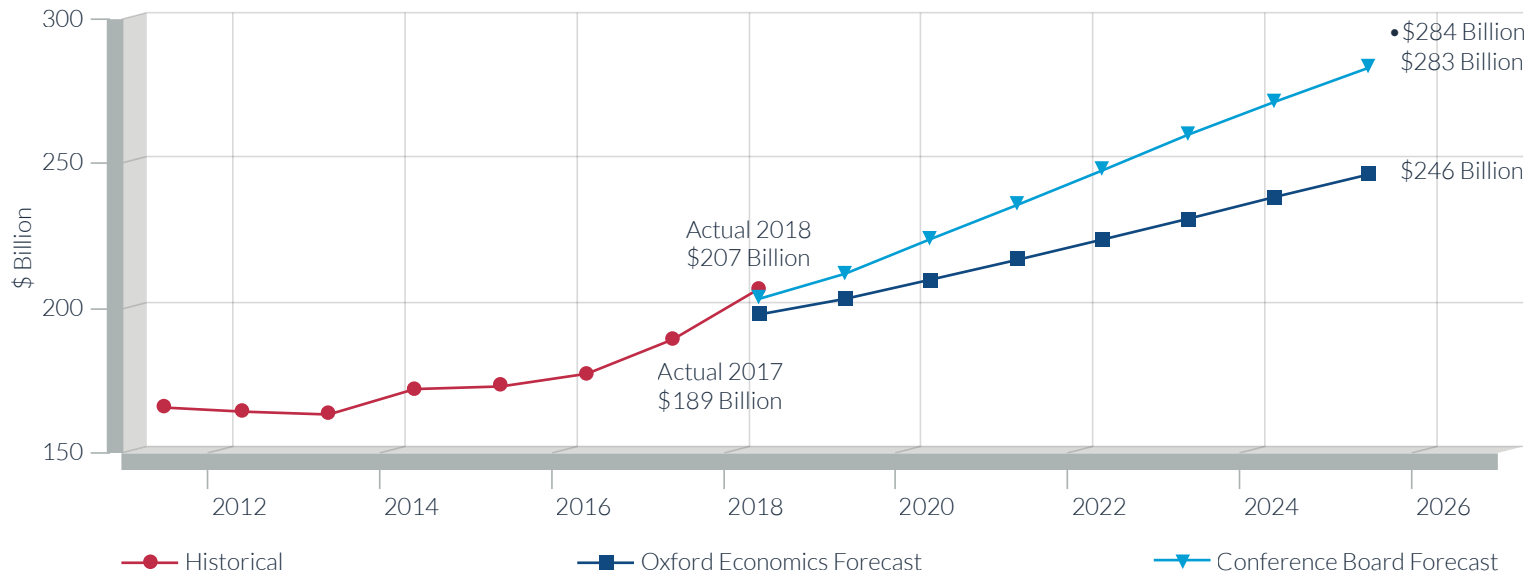
Figure 20: Value of Canada's overseas goods and services exports, based on historical growth



Data: Statistics Canada, Table 36-10-0014-01

3.1 What does trade diversification mean?

Figure 21: Forecast scenarios for growth in Canada's overseas goods and services exports



Data: Statistics Canada Table 36-10-0014-01, Oxford Economics Global Forecast November 2018, Conference Board Forecast March 2018.

3.1 What does trade diversification mean?

To attain this target, Canada's overseas exports of goods and services need to reach **\$284 billion** by 2025, requiring an average annual growth rate of **5.2%** from 2017.²⁴ Tran (2019a) looked at both historical growth and leading forecasts to analyze the prospect of reaching the target set in the *Fall Economic Statement 2018*.

As this analysis was undertaken before 2018 data was available, it looks at historical growth up to 2017 and extends this growth from 2017 to 2025. Figure 20 shows three scenarios of extended historical growth using different historical growth periods. Between 2000 and 2017, Canadian overseas goods and services exports grew **4.3%** per year. If this growth trend is extended out to 2025, Canadian overseas exports would reach **\$264 billion**, **\$20 billion** short of the **\$284 billion** target. However, in the period prior to the global financial crisis (2000–2008), Canada increased its overseas exports by **6.4%** per year; if we apply this growth rate out until 2025, Canadian exports to overseas markets would be **\$311 billion**, **\$27 billion** higher than the target. In more recent years (2011–2017), Canadian exports to overseas markets only grew by **2.2%** per year, which, if extended to 2025, would give Canada **\$226 billion** in overseas exports, **\$58 billion** below the target.

For this OCE analysis, independent forecasts of Canadian goods and services exports from two leading economic forecasters, Oxford Economics and the Conference Board of Canada, were also used. Both forecasts expect global economic conditions between 2017 and 2025 to be more supportive of Canadian exports than global economic conditions prevailing between 2011 and 2017. According to Oxford Economics, Canadian overseas exports are expected to reach **\$246 billion** by 2025, growing **3.3%** per year from 2017.²⁵ This is **\$38 billion** short of the 2025 target of **\$284 billion** (see Figure 21). The Conference Board of Canada's forecast points to a **5.2%** per year growth in Canadian overseas exports, thus reaching **\$283 billion** by 2025, just slightly below the target.

24 2017 is the base year for this calculation as it was the latest year for which full-year data was available at the time of the announcement.

25 November 2018 forecast. Oxford Economics forecasts Canadian nominal exports of goods and services to the world. To estimate the value of exports to U.S. and overseas destinations, 2017 shares were applied to total export growth. Various other historical shares were also used, but all produced similar results to using the 2017 shares. This method would potentially understate growth in exports to overseas markets that might be expected to see their share increase.

3.1 What does trade diversification mean?

While global economic conditions are forecasted to be more supportive between 2017 and 2025 than in the recent past, risks to the forecast exist. First, the difference between U.S. GDP growth and overseas GDP growth will be a driving factor to overseas export growth. If overseas growth continues to underperform U.S. growth, Canadian businesses will more likely be drawn to the U.S. market, and overseas exports will underperform. Simply put, the better the U.S. economic performance, the harder it is for Canada to diversify exports. Second are the geopolitical risks and the fact that a developed economy like the United States tends to have lower geopolitical risks due to a strong legal and financial system, democratic institutions, and a market-based economy, in addition to strong historical ties with Canada. The opposite can be found in certain emerging overseas markets. Lastly, there are risks of trade disruption, as rising anti-trade sentiments have led to tensions among major economies in the world, many of which are Canada's main trading partners. It is difficult to predict the outcome of trade tensions. Potential negative impacts could include disruptions to global value chains, declines in income and world demand, and the creation of competing trade blocs,

all of which would harm Canadian exports. On the other hand, resolving the issues that led to rising tensions in the first place could create a stronger trade relationship that would be beneficial for global trade.

Chapter 3.1 Key Take-aways:

- There are several dimensions to trade diversification. These include but are not limited to: geographic, product, regional spread of exporters, type of exporter, and ownership.
- Canada has room to diversify, especially in the geographic dimension where currently Canadian exports are considered concentrated.
- The Canadian government has made trade diversification a goal, with the target of increasing overseas exports by 50% by 2025.

3.1 What does trade diversification mean?



What can we do to further diversify Canadian exports?

At a
glance



Road to Diversification

1. Lower trade barriers through FTAs

FTAs can reduce tariffs, quotas and non-tariff barriers.

2. Get in early on fast growing markets

Emerging markets and developing economies grew annually by **9.1%** between 2000 and 2018, far outpacing advanced economies.

3. Diversify through U.S.

Most exporters move into new markets after exporting to the U.S. first.

4. Digital trade

Between 2006 and 2016 exports of ICT-enabled services grew **67%**.

5. Facilitate SMEs

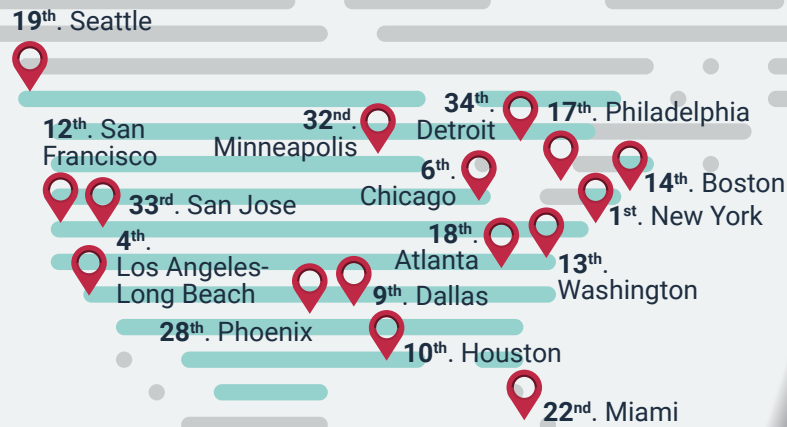
In 2017 SMEs made up **99.8%** of Canadian employer businesses, but only **11.7%** exported.

6. Cities



TOP 40

In 2030, **16** cities in the U.S. and **8** in China are projected to be among the **top 40** cities of opportunity for Canadian businesses.



3.2 What can we do to further diversify Canadian exports?

Countries don't trade, firms and people within countries do. What the Canadian government can do is try to foster an environment that allows Canadian firms to engage in global markets and take advantage of the opportunities they present. The Government of Canada can also help reduce trade frictions (costs) by, for example, negotiating tariff reductions and harmonizing standards in trade agreements, providing exporters with market intelligence, or offering export insurance. The government can also help lower barriers faced by Canadian exporters and provide support and tools to aid Canadian firms looking to expand in markets abroad. The following looks at some possible ways in which Canadian exports could be further diversified.

Lowering trade barriers through free trade agreements

According to Global Affairs Canada, "Free Trade Agreements (FTAs) open markets to Canadian businesses by reducing trade barriers, such as tariffs, quotas or non-tariff barriers. They create more predictable, fair and transparent conditions for businesses operating in foreign countries. Canada's FTAs cover substantially all trade between parties to the agreement. Many of Canada's FTAs also go beyond 'traditional' trade issues to cover areas such as services, intellectual property and investment."²⁶

26  [Global Affairs Canada](#)

3.2 What can we do to further diversify Canadian exports?

With the implementation of the Canada-European Union Comprehensive Economic and Trade Agreement (CETA) and the ratification of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), Canada has 14 FTAs with 51 countries. These FTA partners accounted for 62% of world GDP in 2018. By lowering barriers to trade, these FTAs can help diversify Canadian exports and expand overseas trade. Two recent OCE analytical reports looked at the benefits of FTAs to Canadian exporters; the first report analyzed the benefits from CETA, and the second investigated the benefits from the Canada-Korea Free Trade Agreement (CKFTA).²⁷

CETA entered into force on September 21, 2017. At the time, CETA was by far Canada's most ambitious trade agreement since NAFTA, both due to the importance of the EU as a trading partner (collectively, the EU is Canada's second-largest trading partner after the United States) and the scope of the agreement, which set new standards in trade of goods and services, non-tariff barriers, investment, and government procurement, as well as in other areas like labour and the environment.

Boileau (2018) analyzed the performance of Canadian merchandise exports to the EU for the first twelve months CETA was in force.²⁸ The analysis found that Canadian exports rose 3.8% (compared to the 12-month period a year earlier), and that if precious stones and metals (HS 71) were excluded,

Canadian exports rose 13%. However, there were some sectors where Canadian exports to the EU saw much greater gains, the five largest being aluminum (up 280%), motor vehicles and parts (81%), inorganic chemicals (73%), mineral fuels and oil (63%) and miscellaneous base metals (56%).²⁹

27 As of writing, no comprehensive analysis of the benefits from the CPTPP had yet been undertaken by the Office of the Chief Economist. Given that the agreement has only been in effect since December 30, 2018, not enough data was available to produce a meaningful analysis of the impact of the CPTPP on Canada's trade.

28 From October 2017 to September 2018.

29 These are the fastest-growing exports at the HS 2 level. Exports with a value of less than \$150 million over the October 2017 to September 2018 period were excluded.

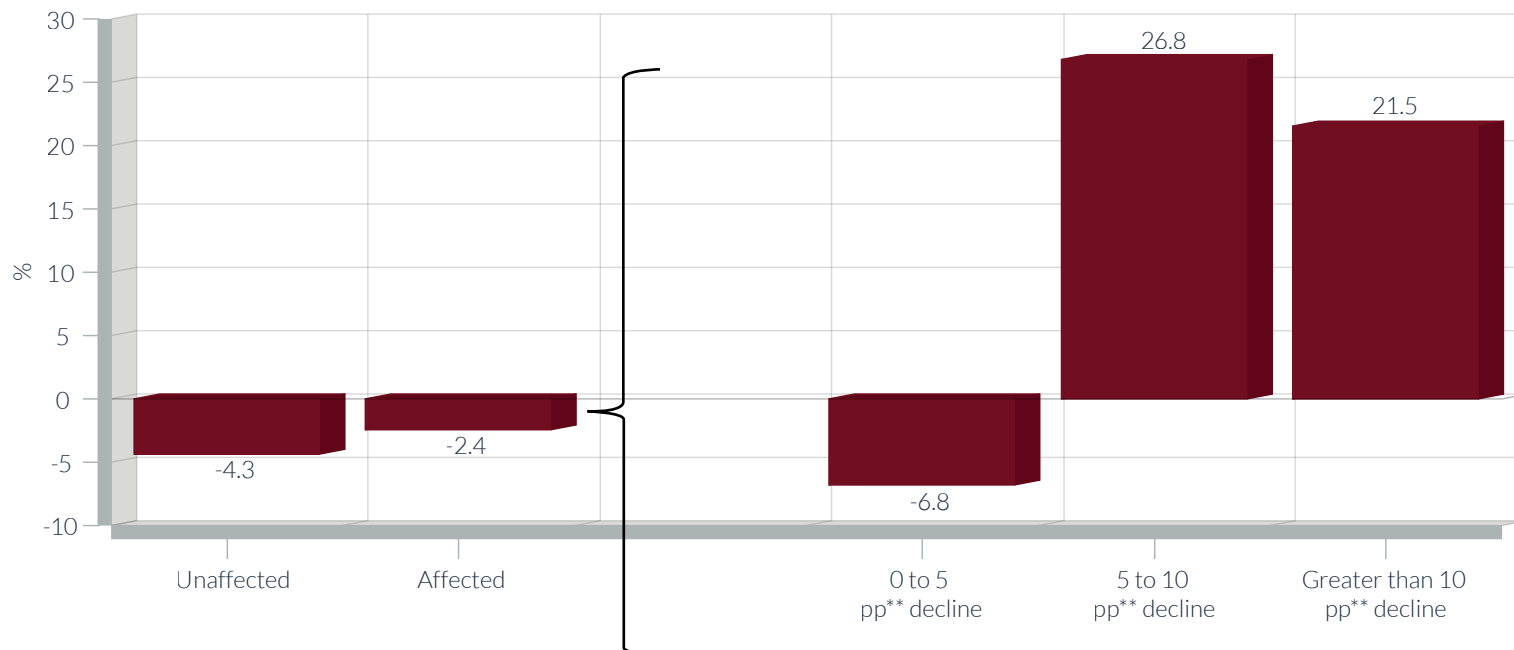
3.2 What can we do to further diversify Canadian exports?

The analysis also looked at the impact of the elimination or reduction of tariffs on Canadian merchandise exports to the EU.³⁰ The analysis revealed that products that saw the largest declines in tariffs as a result of CETA also showed the largest trade gains. Focusing on the same 12-month period, products exported from Canada to the EU with a greater than **5 percentage point (pp)** tariff rate decline were up by **25%**

compared to products exported without any tariff reduction, which fell **4.3%**.

³⁰ Export increases were calculated using EU imports data from Eurostat.

Figure 22: Growth in Canadian exports to the EU by level of tariff reduction* (Oct. 2017 - Sept. 2018 vs year earlier)



*Export increases were calculated using EU imports data from Eurostat / **Percentage point
Data: Eurostat, Office of the Chief Economist calculations

3.2 What can we do to further diversify Canadian exports?

A closer look at the affected products (those on which tariffs were reduced or eliminated) showed that products subject to a **5 to 10 pp** decrease in tariffs saw their exports to the EU increase **27%**, while those with a greater than **10 pp** tariff reduction saw exports rise **22%**. Products with a **0 to 5 pp** tariff decline fell by **6.8%**. Further details on the products leading the gains in these categories can be found in the 2018 report posted on Global Affairs Canada's website.

While the benefits from CETA are already evident, the agreement has only been in force since October 2017, and it can often take time for the gains from FTAs to accrue. The CKFTA, which entered into force January 1, 2015, offers a longer period to assess the benefits of an FTA.

Michaelyshyn and Yu (2019) analyzed the effect of the CKFTA on both Canadian exports and imports to/from South Korea over the four years the agreement has been in force (2015 to 2018). The analysis found that total merchandise exports from Canada to South Korea rose from **\$6.0 billion** in 2014, the year prior to the CKFTA entering into force, to **\$7.5 billion** in 2018, an increase of **25%**, after overcoming initial declines in 2015 and 2016.³¹ Canadian imports from Korea rose from **\$7.2 billion** to **\$9.4 billion** over the same period, up by **30%**.

When looking at the impact of tariff cuts, the report found that exports of all affected products to Korea grew by **36%** in the post-CKFTA period (2015 to 2018), compared to a rise of **22%** in the pre-CKFTA period (2012 to 2014). Products with the highest tariff cuts had the strongest post-CKFTA growth. This can be observed for products that benefited from tariff reductions of over **10 pp**. Exports of these products from Canada to Korea grew by **46%** in the post-CKFTA period, compared to **3.4%** in the pre-CKFTA period.

31 Export increases were calculated using Korean import data from the Ministry of Strategy and Finance Korea.

3.2 What can we do to further diversify Canadian exports?

Table 23: Growth in trade between Canada and Korea by level of tariff reduction

Growth in Canadian Merchandise Exports to Korea				
Tariff Reduction (percentage point)	Between 2012 and 2014		Between 2015 and 2018	
	\$ million	%	\$ million	%
0.1 to 5	160.6	22.0	608.9	100.9
5.1 to 10	194.7	26.7	-54.2	-5.4
Above 10	7.1	3.4	110.0	46.2
All affected products	362.4	21.7	664.7	35.9
All unaffected products	392.4	11.0	1,718.0	53.3
All products	754.8	14.4	2,382.7	47.0

Growth in Canadian Merchandise Imports from Korea				
Tariff Reduction (percentage point)	Between 2012 and 2014		Between 2015 and 2018	
	\$ million	%	\$ million	%
0.1 to 5	65.0	24.3	187.3	45.6
5.1 to 10	400.4	14.6	350.5	10.2
Above 10	2.7	7.0	7.5	14.8
All affected products	468.1	15.3	545.3	14.0
All unaffected products	410.7	12.4	646.8	14.9
All products	878.8	13.8	1,192.2	14.5

Data: Statistics Canada and Ministry of Strategy and Finance Korea

3.2 What can we do to further diversify Canadian exports?

Looking at Canadian imports from Korea, the report found that both affected and unaffected products had similar growth in the post-CKFTA era. There was a strong increase in import growth of products that benefited from tariff reductions of **0.1 to 5 pp**. Imports of these products grew by **46%** in the post-CKFTA period, compared to **24%** in the pre-CKFTA period.

Both OCE analyses indicate that free trade agreements are effective means of lowering barriers for Canadian exporters to access foreign markets, with Canadian exports gaining in post-FTA periods, especially for products with higher tariff reductions. While Canada already has an extensive array of FTA partners, entering into an FTA with countries that have not yet signed such agreements with Canada and deepening existing FTAs are other ways Canada may be able to help further diversify Canadian trade.

Global Affairs Canada is actively engaged in promoting CETA, CKFTA and Canada's other free trade agreements to make sure Canadian exporters are aware of their benefits, and how their products and services would be treated under these agreements. Canadian companies are encouraged to visit Global Affairs Canada's website to find out how they can benefit from [CETA](#), [CKFTA](#), [CPTPP](#) and Canada's numerous other [free trade agreements](#).



Getting in early in fast-growing markets

A country's economic size plays a large role in its demand for imports, and thus growth in a country's imports is driven by its GDP growth. But not all countries grow at the same rate. GDP data³² indicates that world output expanded at an average annual rate of **5.2%** between 2000 and 2018. However, there was a large disparity between growth in advanced economies, which posted an average rate of **3.7%** over this period, and emerging market and developing economies,³³ which grew at a much faster rate of **9.1%**. The two largest emerging markets, China and India, experienced real GDP average annual growth of **9.1%** and **7.3%**, respectively. Conversely, Canada's main trading partner, the United States, grew at an annual average rate of **1.9%** over the same period. One would presume that faster growing markets such as China and India would provide a great opportunity for Canada to further diversify its exports and gain from expanding GDP and demand for imports in these economies. While economic theory suggests that Canadian exports will naturally gravitate to large markets, Scarffe (2019c) investigates whether or not there is a benefit to trading with fast-growing economies; specifically, is there a benefit for Canada to make a strategic effort to increase exports to these economies, and is it better to access these markets early on in their growth.

The study uses a gravity model framework and preliminary results suggest that there are benefits to exporting to fast-growing economies; specifically over a five-year period, the study found that a **1 pp** increase in the growth rate of a foreign country's product specific import market caused the level of Canadian exports to increase by **0.11%**, and there was an additional gain of **0.16%** if Canada was active in this market prior to its growth.³⁴ Based on these results, the study concluded that "considering the strong correlation between the growth of import markets and GDP growth, Canada should continue to encourage firms to trade with fast-growing emerging markets".

Helping Canadian exporting firms engage with and navigate fast-growing emerging markets, particularly at early stages of their growth, appears to be another strategy that could help Canada further diversify its exports.

32 International Monetary Fund, *World Economic Outlook Database*, April 2019

33 "Advanced economies" and "emerging markets and developing economies" are country groupings defined by the International Monetary Fund. A list of the countries in each grouping can be found on the [IMF WEO website](#).

34 Calculations done at the HS4 product level.

Diversifying through the United States

Encouraging Canadian exporters to engage in new and fast-growing markets is not a simple proposition. Firm-level research by Yu (2019) reveals particular patterns as to what paths Canadian exporters take to exporting to new markets. First, 70% of existing exporters sell to a single market, usually the United States. Then, only 20% sell to between two and five markets, and 9.3% sell to six or more markets³⁵. These findings corroborate the research by Export Development Canada (EDC) which indicates that most Canadian exporters sell a select few products to only one export market (see box Export Development Canada's findings on diversification "Patterns and benefits of Canadian export diversification").

Each year, roughly 20% of Canadian exporters cease exporting and a somewhat larger number begin to export for the first time. Approximately 80% of new exporters are small and medium-sized enterprises (SMEs) that export to a single market and almost 70% of new exporters choose the United States as their first export destination. Survival rates for these first-time exporters are low with roughly half stopping

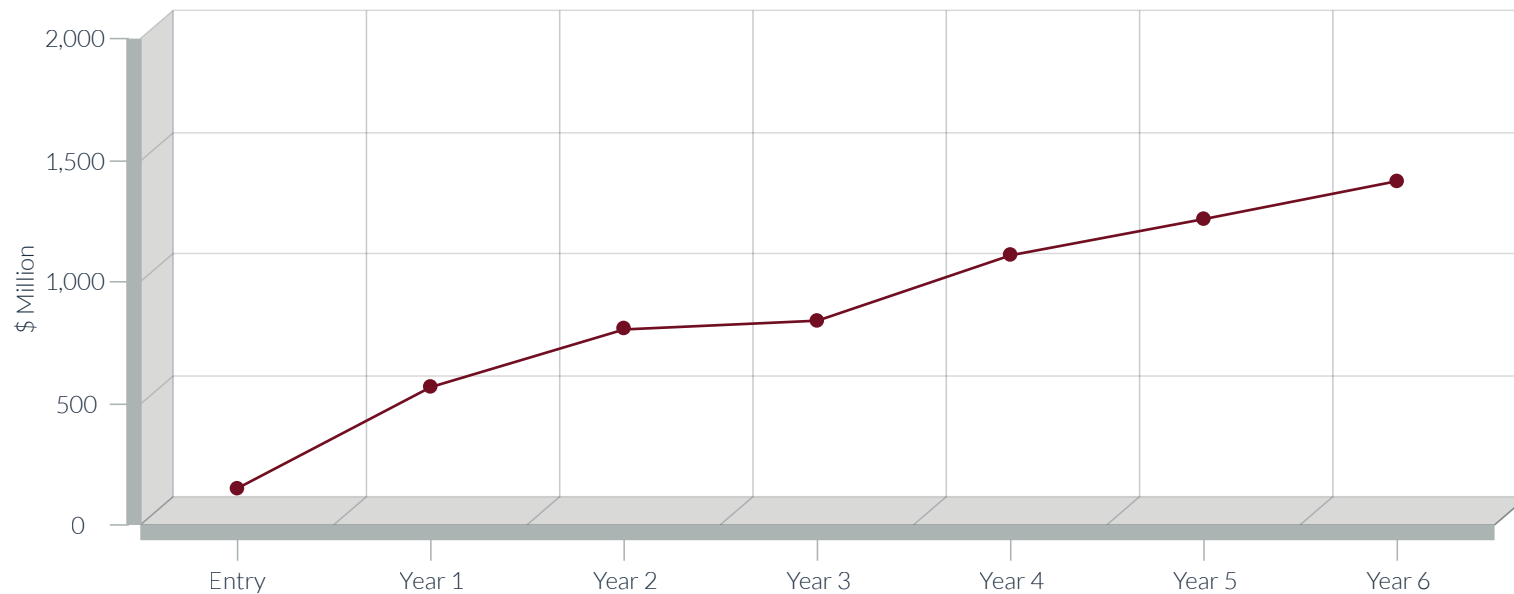
exporting after their first year. Only 30% of first-time exporters are still exporting four years later, on average. The survival rates are even lower for exporters selling to more distant regions.³⁶ However, for exporters that became established, export levels rose rapidly (see Figure 23).

35 Due to rounding, numbers do not add up to 100%.

36 The average survival rate for exporting to the United States was 5.5 years, compared to 4.9 years for exporters to Asia and 4.6 years for exporters to Latin America.

3.2 What can we do to further diversify Canadian exports?

Figure 23: Average export value per firm after initial entre (in \$ million)



Data: Statistics Canada, Office of the Chief Economist calculations

Those exporters that survive begin to diversify into other markets beyond the United States. Each year, **20%** of all exporters move into new markets. The diversification strategy of Canadian exporters predominantly takes the form of a series of sequential moves with the same product starting in the U.S. market followed by expansions to either Europe or Asia. This research highlights that the U.S. market is an important first market for most SME exports as well as a proving ground for many that go on to diversify into overseas markets.

What this firm-level research seems to be telling us is that few exporters (**20%**) move into new markets, and most move to a new market after exporting to the United States first. Although it may seem counterintuitive, a big piece of the puzzle for increasing Canada's overseas exports may be to encourage and help new Canadian firms to first export to the United States.

Export Development Canada's findings on diversification

Patterns and benefits of Canadian export diversification

Export Development Canada (EDC) research* finds that most Canadian merchandise exporters (**89%**) sell to five or fewer markets, typically the United States. At the same time, most

companies export only a few products, with **75%** of exporters exporting five or fewer products. However, the pattern for Canadian merchandise export value is quite different; most merchandise exports by value (**42%**) are generated by a small subset of firms (**4%**) that export many products (11+) to many export markets (11+).

Table A: Canadian merchandise exporters and exports, by number of markets and products (percentages of totals)

Number of exporters				
Number of export products	Number of export markets			
	1 to 5	6 to 10	11+	Total
1 to 5	72%	2%	1%	75%
6 to 10	10%	2%	1%	13%
11+	6%	2%	4%	12%
Total	89%	6%	6%	100%

Export values				
Number of export products	Number of export markets			
	1 to 5	6 to 10	11+	Total
1 to 5	13%	1%	2%	16%
6 to 10	8%	2%	3%	13%
11+	17%	11%	42%	71%
Total	38%	14%	47%	100%

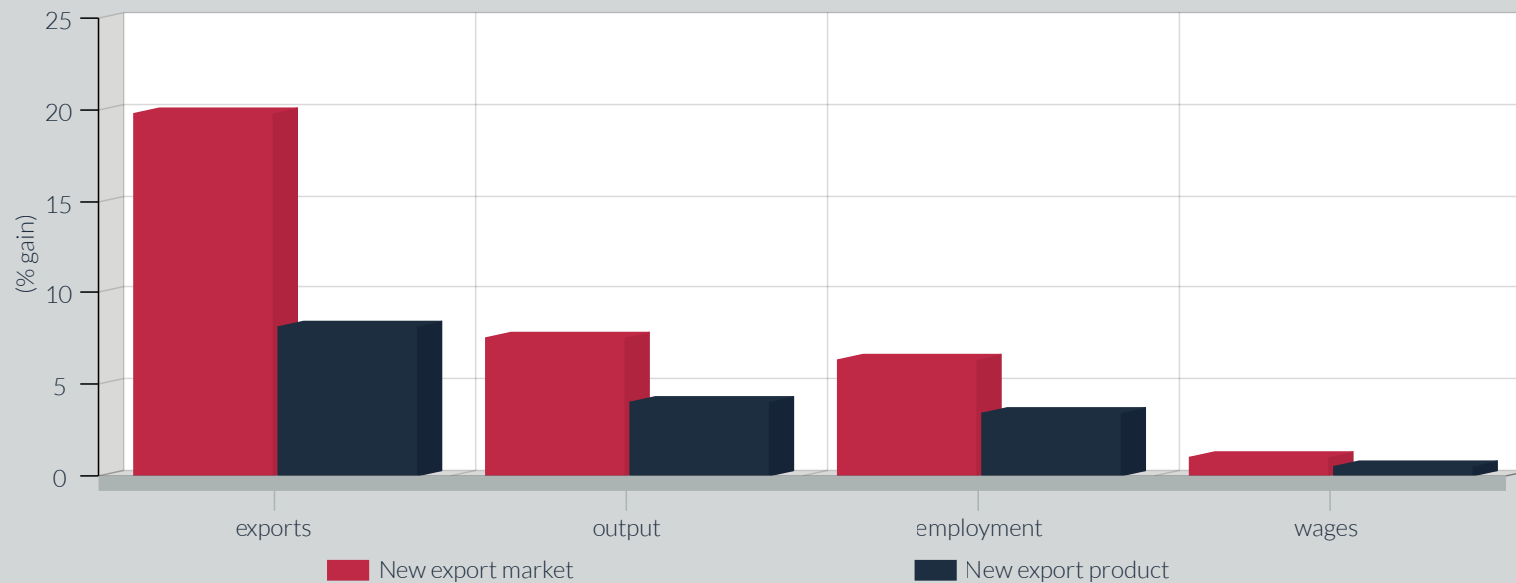
Source: Statistics Canada data with EDC calculations
 Note: Annual averages using 2010-15 firm-level data.

3.2 What can we do to further diversify Canadian exports?

EDC research also finds that those exporters able to reach new markets and export more products exhibit superior firm performance. Along with greater exports, they also have

higher output, employ more workers and pay higher wages than firms of similar size and in similar industries that export to fewer markets or export fewer products.

Figure A: Diversification dividends: superior performance for firms exporting more products to more markets (% gain)



Source: Statistics Canada and EDC Economics

Note: Regression results controlling for year, industry and employment, using 2010-15 annual data.

* Tapp, Stephen and Yan, Beiling 2019 "Patterns and Benefits of Canadian Export Diversification", Export Development Canada (EDC), Research and Analysis Department, work in progress.

Digital trade and diversification

While it is important to look at past and current trends in how Canadian exporters access markets, we must also realize that the way Canadian firms export and reach foreign markets is ever changing and evolving. This may be truer today than ever before. The Internet, digital technologies and the movement of data within an economy and across borders are changing the nature of activities, patterns and actors in the economy at large, with notable implications for international trade in goods and services.

Research by Tran (2019b) has identified two major ways technology and digitization are affecting international trade: 1) digital technologies enable international trade through facilitating transactions and reducing costs; and 2) the Internet is also a delivery mode for international trade.



3.2 What can we do to further diversify Canadian exports?

Digital trade-enabling technologies

Digital technologies enable trade through reductions in time and costs, in addition to being a channel that facilitates transaction processes. From a reduction in time and costs perspective, digital technologies have improved transportation and logistics, effectively shortening distances. Furthermore, new technologies facilitate more efficient route planning and allow exporters to make real-time adjustments en route. They also allow for optimizing storage and distribution networks. Digital technologies also make it easier to cross borders. With Electronic Data Interchange, exporters/importers can file documents electronically at the border, and Electronic Single Window lets exporters/importers submit all their documentation at one place instead of several, reducing time and costs. Moreover, digital technologies provide more and better information for both sellers (exporters) and buyers (importers) as the Internet makes it less costly to search, verify, track and translate information, which can potentially increase trust in cross-border transactions. Finally, advances in *fintech*³⁷ facilitate cross-border payments, making them cheaper and more

secure. Along with time and cost reductions, the Internet also facilitates transaction processes by giving consumers the ability to order goods and services globally, either directly from a producer or via a digital platform.

³⁷ Fintech stands for financial technologies, that is technologies used and applied in the financial services sector.

3.2 What can we do to further diversify Canadian exports?

The enabling effect of digital technologies may benefit trade in some goods more than others, potentially changing the composition and altering the product diversification of Canadian trade. The World Trade Organization identifies three types of goods that might benefit more from digital technologies' enabling effect: time-sensitive, certification-intensive and contract-intensive goods. Examples of time-sensitive goods include intermediate goods in just-in-time inventory systems, perishable foods, and life-saving medical supplies. Cross-border trade in these types of products benefits from routing items more efficiently, predicting arrivals and even integrating artificial intelligence into the complex web of production and distribution. Products that need certification benefit from reduced information asymmetries and search costs. While the Internet of Things, sensors, and blockchain technology can make the production and certification process more transparent, contract-intensive products can use digital technologies to increase trust (for example, with rating and matching systems), which reduces the need to use intermediaries as trust facilitators. Blockchain-smart contracts also have the potential to further enhance trust and reduce the need for inefficient paperwork.

Even with the enabling promise of the Internet and digital technologies, measurements need to catch up in order to improve our understanding of digital trade. Current measurements are either plagued with missing data, misallocated data, or are unable to capture certain aspects of digital trade. For example, current measurements capture all goods that cross a border, but are unable to identify whether or not these goods were digitally ordered. A similar problem exists for services, in addition to the fact that some services data are currently missing from the picture. For example, an individual Canadian delivering language translation services to foreigners over the Internet might not be included in current services trade statistics since these statistics focus on transactions by businesses.

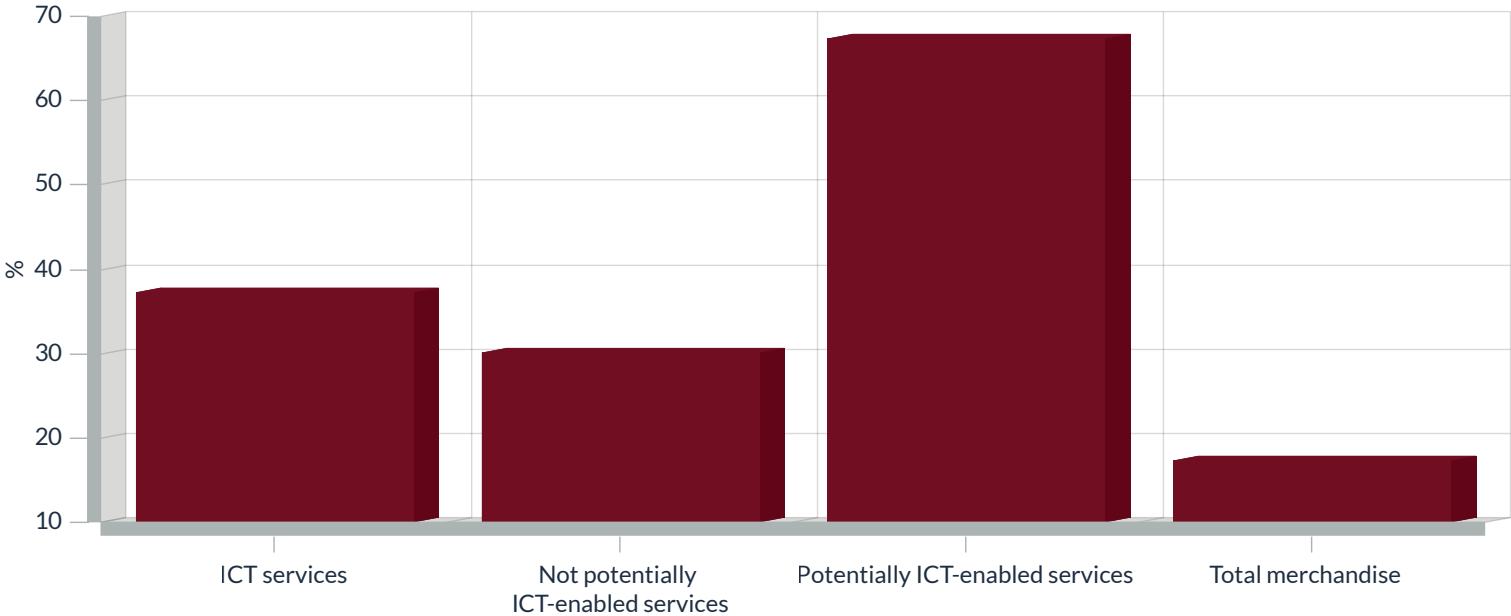
3.2 What can we do to further diversify Canadian exports?

The Internet as trade-enabler

The Internet is increasingly being used as a cross-border delivery method for digital goods and services. Due to the data limitations mentioned above, there is not a clear and comprehensive picture of digitally-delivered products trade, but some illustrative

data show how information and communication technology (ICT) can enable greater trade in services.

Figure 24: Canadian export growth, 2006-2016



Data: Statistics Canada

3.2 What can we do to further diversify Canadian exports?

Rostami (2018) identifies three types of services exports: ICT services, potentially ICT-enabled services, and not potentially ICT-enabled services.³⁸ The first category includes telecommunication services, computer services and charges for the use of intellectual property related to computer software. The second includes services that could potentially be delivered remotely over an ICT network (examples include insurance, financial services, information services, management services, advertising and related services, and research and development, to name a few). The third category includes services that are not likely to be exported over the Internet (e.g. maintenance/repair services, postal/courier services, construction, non-financial commissions, and equipment rental).

The report illustrates the impact of digitalization on Canadian exports. Between 2006 and 2016, Canadian exports of potentially ICT-enabled services grew **67%**, compared to **37%** for ICT services exports, **30%** for not potentially ICT-enabled services exports, and **17%** for total merchandise exports.

Digital technologies and the Internet are both enabling international trade, and many services (and even some goods) are delivered across borders through the Internet. This, in turn, is lowering the effect of distance on trade, and in some cases

making it easier for exporters to reach distant markets. Accordingly, it is reasonable to look at digital trade as a useful tool for diversification and increasing overseas exports. Encouraging Canadian exporters to adopt digital technologies and ensuring that all Canadians have access to new and emerging technologies may be another path to diversification. Some early evidence shows that Canadian exporters are more likely to adopt technologies than non-exporters (although the impact of size on technology adoption and exporting status requires further analysis),³⁹ and according to Bédard-Maltais (2018), digitally advanced companies are **70%** more likely to export.

38 Defined by the United Nations Conference on Trade and Development (UNCTAD) and Statistics Canada as “services that have the possibility to be delivered remotely over ICT networks, but that could also be delivered otherwise.”

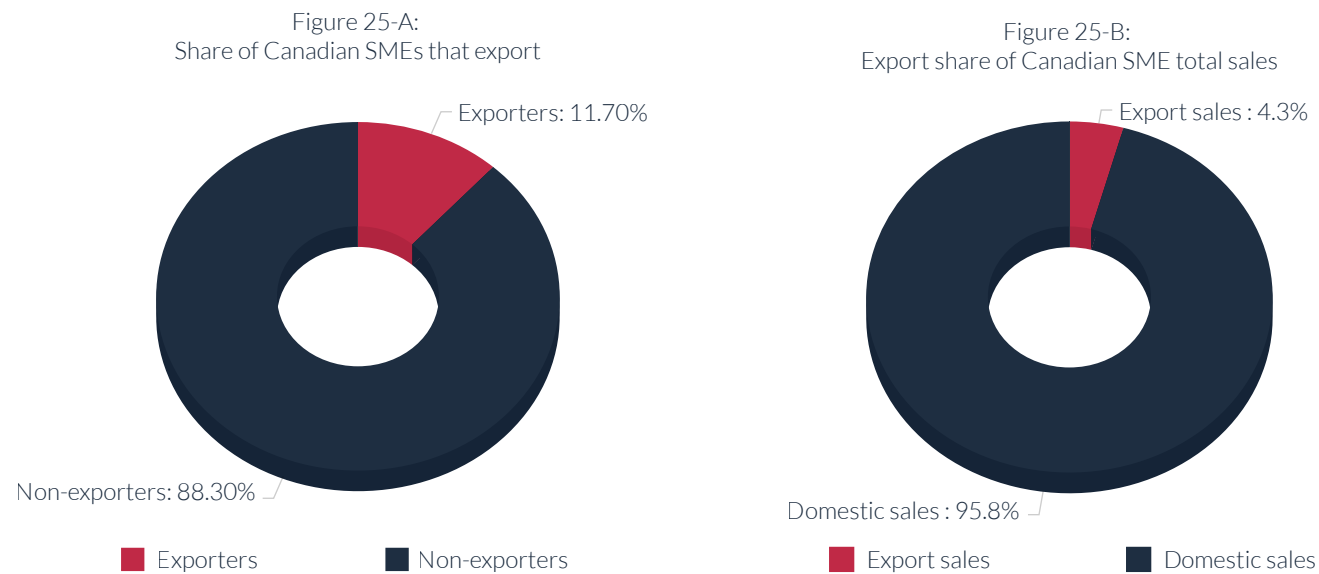
39 For example, the *Survey on Financing and Growth of Small and Medium Enterprises* indicates that SME exporters have a higher propensity than non-exporters to use cloud computing (51% vs 26%), data analytics (37% vs 19%), client relation management (27% vs 15%), enterprise resource planning (15% vs 6.4%), and application programming interfaces (22% vs 7.8%).

SMEs and export diversification

A recent study by Sekkel (2019) looked at the participation of SMEs in international trade. Using the *Survey on Financing and Growth of Small and Medium Enterprises* as the main source

of data, the report found that despite their great importance to the domestic market, SMEs in Canada have little participation in exporting.

Figure 25: Canadian SME exporters, 2017



Data: Statistics Canada, *Survey on Financing and Growth of Small and Medium Enterprises* 2017

Note: Due to rounding, the total does not add up to 100%

3.2 What can we do to further diversify Canadian exports?

SMEs comprise the majority of Canadian companies and make a substantial contribution to the economy. In 2017, there were about **1.2 million** SMEs in Canada, representing more than **99%** of all employer businesses.⁴⁰ SMEs were responsible for **89%** of all private sector jobs in 2017, and they accounted for about **50%** of GDP between 2012 and 2014. The importance of SMEs to the overall economy is not unique to Canada. Globally, SMEs represent **95%** of all firms, and they account for approximately **50%** of GDP and around **60%** of employment (World Trade Organization, 2016).

However, significant participation of SMEs in the overall economy is not reflected in exporting. In 2017, only **12%** of SMEs, or **85,631 enterprises**, exported goods or services outside of Canada.⁴¹ This relatively low participation of SMEs in international trade is also observed in other OECD economies, where SMEs' participation ranges between **10%** and **25%** (OECD, 2018).⁴² Not only is the proportion of exporting SMEs low, but so too is their export intensity.⁴³ An average of **4%** of the sales of SMEs resulted from exports of goods and services.

This study also identifies various challenges and barriers associated with international activities that smaller and less productive firms are less likely to overcome, relative to large firms. While trade agreements can be mostly effective in reducing tariffs and costs associated with non-tariff barriers, fixed costs

such as advertisement and product distribution networks affect smaller firms disproportionately (OECD, 2018).

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- 40 Does not include self-employment or businesses that have no employees.
 - 41 Among the different sectors, the proportion of SME exporters ranges from a high of 35% in manufacturing and 20% in professional services, to as low as 2% in the construction sector.
 - 42 There is no international standard definition of SMEs. In Canada, SMEs are defined as enterprises having from 1 to 499 employees, whereas in Europe, SMEs are generally enterprises with 1 to 249 employees.
 - 43 Defined here as the average percentage share of SMEs' export sales in total SME sales.

3.2 What can we do to further diversify Canadian exports?

The international trade literature shows that even though larger and more productive firms have a higher likelihood of exporting (Bernard et al., 2007), there is also evidence of positive spillovers from participating in global markets, where exporters can enhance their productivity and innovation through learning-by-doing. While there is a great deal of heterogeneity among SMEs and opportunities to engage in global markets may not be perceived equally across sectors, the internationalization of SMEs as a policy objective can generate great benefits to the economy.

Encouraging SMEs to export could also help Canada realize its 2025 goal of increasing overseas exports by **50%**. Although we have seen from Yu (2019) that most new exporters will first begin exporting to the United States, and many will not survive after one year of exporting, some will succeed and grow and reach out to further markets abroad. The vast number of SMEs in the Canadian economy represents an untapped source of exporters; while some, by their nature, can only focus on domestic markets (for example, restaurants and hair salons), others may be successful exporters waiting for the right opportunity. Government programs that help and support these SMEs could be a further means to diversify Canadian exports, not just along the geographic and product dimensions, but also in spreading the gains of exporting across Canada and among all Canadians.

Cities not countries

As for the geographic dimension of export diversification, the analysis so far has focused on the country level as the destination market of Canadian exports, as this is the common reference for geographic diversification and also the usual basis for tracking international trade statistics.⁴⁴ Yet, Vesselovsky (2019) points out that between now and 2030, cities will be the driving engines of growth and innovation.

To support Canada's diversification strategy, the study assessed the future location of economic opportunities for Canadian businesses at the city level worldwide. The analysis takes into consideration the future economic growth of some 780 cities and Canada's current economic ties with them.

44 While trade data is available at the provincial and state level in Canada and the United States, obtaining trade data at sub-national levels is difficult for most countries, and city-level data is sparse at best.

3.2 What can we do to further diversify Canadian exports?

The study found that in 2030, the top 40 global cities from a Canadian perspective will be dominated by the influence of the United States and China, which are projected to account for **40%** and **20%** of these cities, respectively. Regionally, Asia and Oceania are projected to account for **45%** of the top 40 cities, leaving only **15%** outside the U.S. or the Asia and Oceania regions. Among the top 100 global cities, the number of cities from the United States and China is projected to be approximately equal and account for just over half of the total. Regionally, Asia and Oceania are expected to account for almost half of the top 100 cities. Figure 26 presents the projected top 40 cities of importance to Canada in 2030.

Three key take-aways can be gleaned from this city-level analysis for Canada's export diversification strategy. First, even in 2030, the United States remains important for Canada, with sixteen of the top 40 cities located there. Second, emerging markets are well represented in the top 40 cities; China in particular will have large fast-growing cities that will be important markets for Canadian goods and services. The third take-away is that diversification is not just about emerging markets. Canada can also diversify by further expanding its exports to some developed overseas markets: the United Kingdom, Japan, France and Australia all have major cities predicted to be of importance to Canada in the future.

Chapter 3.2 Key Take-aways:

Potential avenues for further diversifying Canada's exports include:

- Lowering trade barriers through free trade agreements;
- Accessing fast growing markets early on;
- Diversifying through the United States;
- Encouraging Canadian exporters to adopt digital technologies;
- Facilitating SMEs in exporting; and
- Focus on cities as drivers of economic growth.

3.2 What can we do to further diversify Canadian exports?

Figure 26: Top 40 cities in 2030 for Canada



The study found that in 2030, the top 40 global cities from a Canadian perspective will be dominated by the influence of the United States and China.

3.2 What can we do to further diversify Canadian exports?



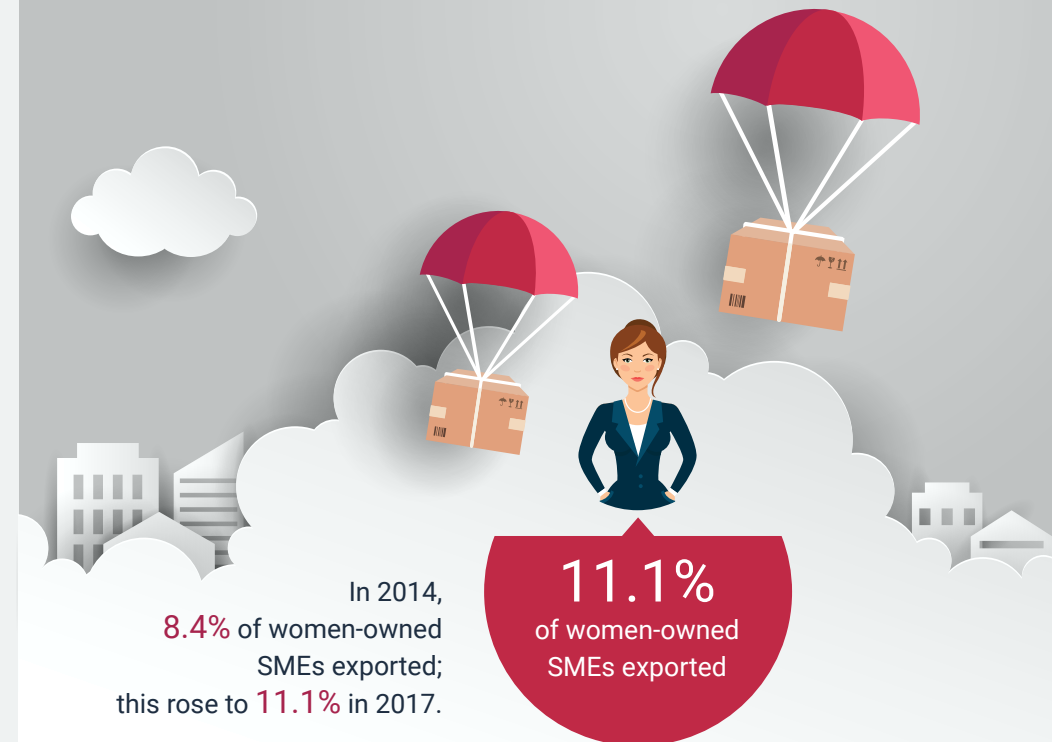
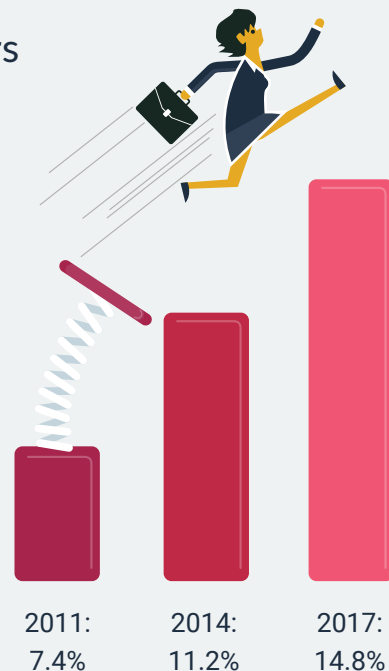
New dimensions of export diversification

At a
glance



Women-owned Exporters

The proportion of exporting SMEs that are women-owned in Canada doubled from 2011 to 2017, rising from **7.4%** of all SME exporters in 2011 to account for **14.8%** of SME exporters in 2017.





Indigenous-owned Exporters

10.5%
of equally-owned SMEs exported

24.4% of Indigenous-owned SME export, versus 11.8% for total Canadian SMEs

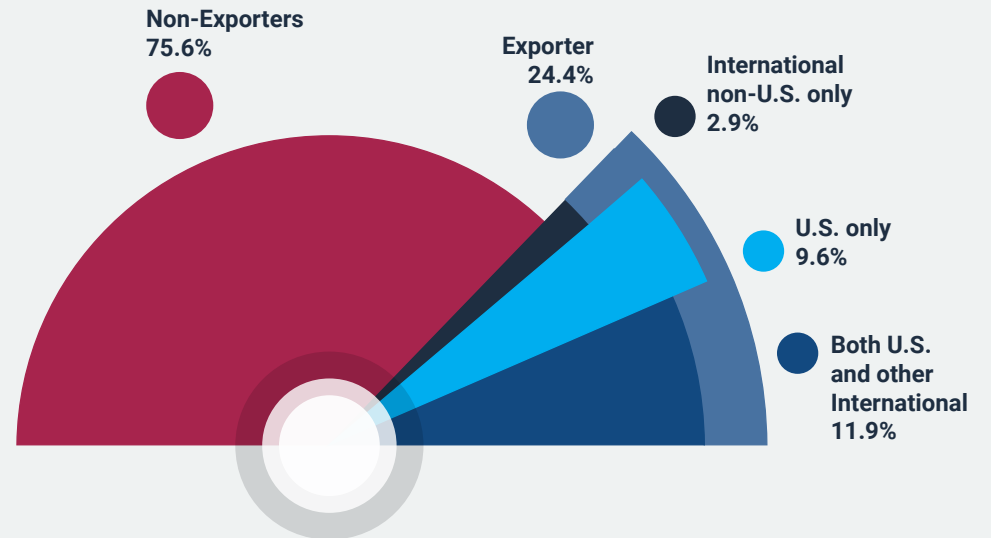


12.2%
of men-owned SMEs exported



24.4%
of Indigenous-owned SMEs exported

Breakdown of Indigenous-owned Exporters by Destination Markets, 2014



As mentioned at the beginning of this chapter, geographic and product diversification are not the only dimensions of diversification. Diversification in ownership of exporting firms is another one. While geographic and product diversification hedge against risk and encourages access to fast-growing markets, ownership diversification has the benefit of spreading the gains of exporting throughout Canada, to all Canadians. Two OCE studies look at exporter ownership. The first examines women-owned small and medium exporters, while the second, a joint research project with the Canadian Council for Aboriginal Business (CCAB), looks at Indigenous-owned exporters.

Women-owned exporters

Bélanger Baur (2019a) analyzed the characteristics and internationalization performance of Canadian exporting SMEs based on majority-gender ownership of the firm using data obtained from Statistics Canada's *Survey on Financing and Growth of Small and Medium Enterprises*, 2017. The proportion of exporting SMEs that are women-owned in Canada doubled from 2011 to 2017, rising from **7.4%** of all SME exporters in 2011 to **15%** in 2017.

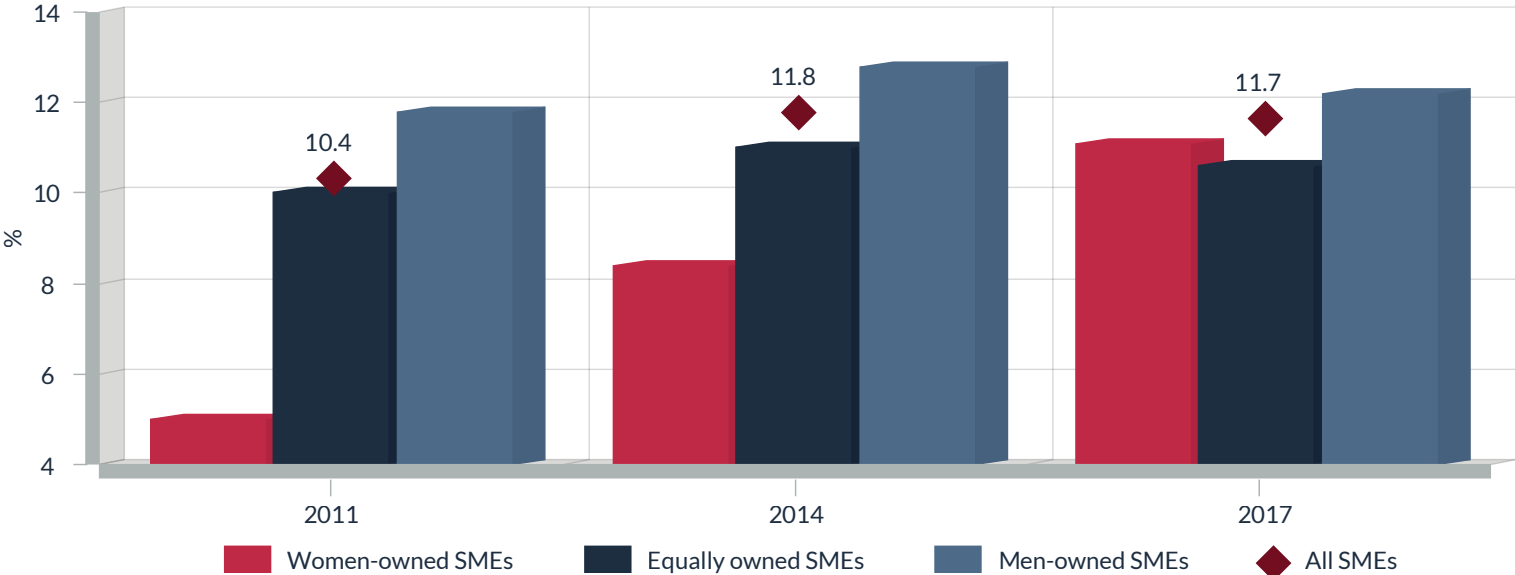
The study also indicated that, from 2014 to 2015, and without gaining a larger proportion of all SMEs in the domestic Canadian economy, women-owned SMEs increased their propensity to export such that they are no longer underrepresented among exporter SMEs. In 2014, **8.4%** of women-owned SMEs exported; this proportion rose to **11%** in 2017. In comparison, **12%** of men-owned SMEs exported and **11%** of equally-owned (by both men and women) SMEs participated in exporting in 2017.

3.3 New dimensions of export diversification

The study also looked at the barriers faced by SME exporters when trying to sell goods and services abroad. Although the *Survey on Financing and Growth of Small and Medium Enterprises* did not include gender-specific obstacles to exporting, the study found that gender-specific patterns were noticeable. Some **11%** of women-owned SMEs reported domestic administrative obstacles as an important barrier to exporting

at a greater rate, compared with **10%** of men-owned SMEs and **7.6%** of equally-owned SMEs. As such, there may be a number of domestic policies that could address barriers to exporting for women-owned SMEs. Additionally, men-owned SMEs report at a lesser rate foreign administrative obstacles to exporting as an important impediment to exports than both women-owned and equally-owned SMEs. These administrative barriers

Figure 27: Export propensity (%) of SMEs by majority gender of ownership, 2011-2017



Note: The export propensity is the percentage of businesses that export.

Data: Statistics Canada, *Survey on Financing and Growth of Small and Medium Enterprises*, 2011, 2014, 2017.

3.3 New dimensions of export diversification

outside of Canada may take a number of forms, including logistical issues and border obstacles, which women-owned SMEs reported to be important impediments to exporting, at a rate significantly higher than both their counterpart SMEs. The study suggested that federal programs designed to support the internationalization of women-owned SMEs could address the border export requirements of businesses as well as provide additional support with logistical issues.

Interestingly, coming back to the geographic diversification of exports, the study found that a significantly higher proportion of women-owned SMEs export to Europe (including the United Kingdom), India, and the rest of the world (not otherwise mentioned)⁴⁵ compared to men-owned SMEs and equally-owned SMEs. Thus, women-owned SMEs further contribute to the diversification agenda of the Government of Canada.⁴⁶

45 The survey lists the United States, Europe, the United Kingdom, Asia, India, Mexico, China, Latin America, Japan and Brazil as export destinations. The rest of the world comprises all other markets not listed.

46 Note that this only refers to the proportion (share) of women-owned SMEs; this does not mean that the absolute number of women-owned SMEs exporting to these regions is greater than the number of men-owned or equally-owned SMEs exporting to these regions.



Indigenous-owned exporters

A joint study by the Office of the Chief Economist at Global Affairs Canada and the Canadian Council for Aboriginal Business (Bélanger Baur, 2019b) took a closer look at Indigenous-owned SMEs and their propensity to export.

The study capitalized on data produced by the CCAB using their organization's register of **10,000** Indigenous-owned businesses, creating a sample of 1,101 Indigenous entrepreneurs, including nearly 650 Indigenous-owned SMEs. Using this unique data set, the author found that a high percentage of Indigenous-owned SMEs sell products and services internationally (**24%**), compared to Canadian non-Indigenous-owned SMEs (**12%**) and SMEs in other developed economies.⁴⁷ The author further writes "*Indigenous SMEs, based on these results, demonstrate a strong ability to access broader markets compared to non-Indigenous Canadian SMEs. Given that, according to The Canadian Encyclopedia, Indigenous communities are generally no larger than 1,000 individuals, we suspect Indigenous business strategies may include reaching non-local markets at an early stage, and that the additional cost to sell throughout a province and nationally is relatively small compared to selling to other nearby communities and cities. As such, Indigenous-owned SMEs, notably those owned by First Nations, once operating, would benefit from productivity gains through economies of*

scale and product specialization as they are forced to become more efficient and overcome challenges related to distance, logistics and connectivity at an early stage."

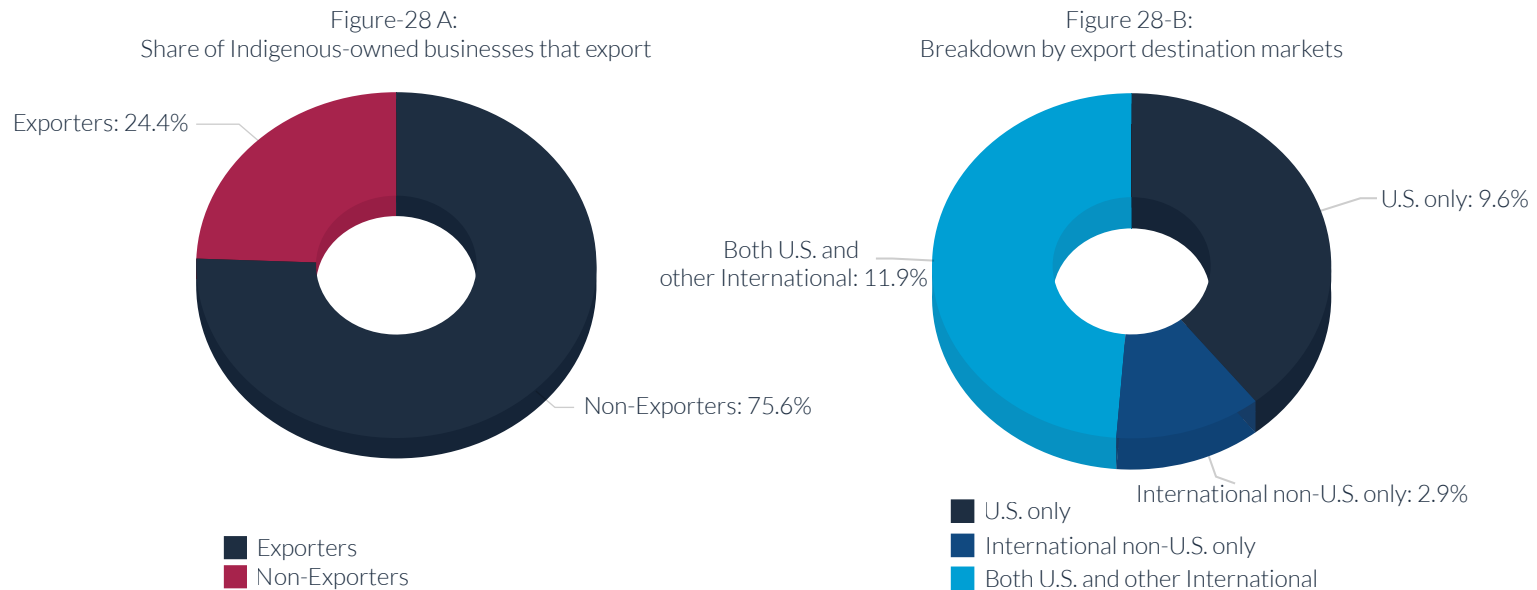
47 For example, European SMEs with 0 to 250 employees have an extra-EU export propensity of 9.7 percent according to the *European Competitiveness Report 2014 – Helping firms grow*. See chapter 3 [factsheet](#)

3.3 New dimensions of export diversification

The author also looked at the destinations served by Indigenous-owned exporters and found that the most popular destination market of Indigenous-owned exporters, similar to non-Indigenous-owned Canadian exporters, was the United States, with **22%** of Indigenous-owned SMEs selling goods or services to our Southern neighbour. Nearly half sell exclusively

to the United States, and the other **55%** sell to both the United States and other international markets. A small proportion of Indigenous-owned SMEs (**2.9%**) sell internationally without also exporting to the United States.

Figure 28: Export activities of Indigenous-owned businesses, 2014



Data: Office of the Chief Economist calculations using data obtained from the Canadian Council for Aboriginal Business.

More details on the characteristics of Indigenous-owned SMEs can be found in the joint [study](#), including what types of industries Indigenous-owned SMEs are involved in, how these SMEs differ by Canadian region and by Indigenous identity (First Nations, Métis, Inuit). The study also identified obstacles to growth for Indigenous-owned SMEs, notably access to financing and connectivity issues, and how these businesses use social media. This study is the first of its kind to support the development and expansion of Indigenous-owned SMEs into the global trading system. While it indicates Indigenous-owned firms already have a high propensity to export, it also shows that their exports are focused on the United States. Like overall Canadian exports, Indigenous exports could gain from geographic diversification, and in turn having a robust Indigenous export community throughout Canada would help diversify the benefits of trade across the country and to all Canadians.

Chapter 3.3 Key Take-aways:

- Diversification in ownership of exporting firms is another dimension of trade diversification.
- While geographic and product diversification hedges against risk and encourages access to fast growing markets, ownership diversification has the benefit of spreading the gains of exporting throughout Canada, to all Canadians.
- The proportion of women-owned exporting SMEs in Canada doubled from 2011 to 2017, rising from 7.4% of all SME exporters in 2011 to account for 15% of SME exporters in 2017.
- A high percentage of Indigenous SMEs export goods and services (24.4%), compared to Canadian non-Indigenous SMEs (12%).

Conclusion

This chapter has looked at various dimensions of trade diversification, including geographic and product diversification as well as less traditional forms of diversification such as exporter ownership. These dimensions of diversification were shown to be important in hedging risk, allowing access to faster growing markets and helping better distribute the gains of trade.

While Canadian exports were found to be diversified by product, they are concentrated by geographic market. This is the impetus behind Canada's goal of increasing overseas exports by **50%** by 2025.

As for reaching the 2025 goal, part two of this chapter looked at various avenues to greater geographic diversity of Canadian exports. These included using free trade agreements to give Canadian exporters better access to foreign markets; accessing fast-growing markets early; using the U.S. market as a stepping stone to overseas markets; leveraging digital technologies; increasing SME participation in international trade; and focusing on cities' future growth to identify new export opportunities. All of these areas appear promising for boosting Canadian export diversity and should be considered further in the Government of Canada's trade diversification strategy.

Finally, the third chapter investigated a new dimension of trade diversification, that of exporter ownership, summarizing two reports on women-owned exporters and Indigenous-owned exporters, respectively. In both cases, the studies are a good first step in identifying the characteristics of these exporters and what can be done to help women-owned and Indigenous-owned firms in Canada better access global markets. This dimension of trade diversification is particularly important because it is vital in spreading the gains from exporting throughout the Canadian economy, ensuring that they are not concentrated among certain groups of Canadians or regions of Canada, but spread equally across the country.



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