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Canadian Economic Observer

2010 in review

by Philip Cross

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.	not available for any reference period
..	not available for a specific reference period
...	not applicable
0	true zero or a value rounded to zero
0^s	value rounded to 0 (zero) where there is a meaningful distinction between true zero and the value that was rounded
^{p}	preliminary
^{r}	revised
x	suppressed to meet the confidentiality requirements of the *Statistics Act*
^{E}	use with caution
F	too unreliable to be published
*	significantly different from reference category ($p < 0.05$)

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Statistics Canada

2010 in review

by Philip Cross [1]

There were a number of notable developments in the Canadian economy during 2010. Both real GDP and employment had essentially recouped their recession losses, [2] indicating the business cycle had moved from the recovery to the expansion phase. The primary sources of economic growth also changed during the year. Initially, the recovery in the second half of 2009 was strongly supported by household and government spending, with exports recovering slowly. By the first half of 2010, growth began to slow in the government sector, offset by an upturn in business investment and inventory re-stocking. As 2010 progressed, the transition to private-sector led sources of growth was completed: fourth-quarter exports posted their largest increase of the recovery, real business investment ended the year 14% ahead of its year earlier level (with intentions showing growth continuing in 2011), and consumer spending rose steadily. These advances outweighed a drop in inventories, a levelling off of housing investment and a further slowing in government spending growth.

In a broader context, the economic trends which unfolded during the recovery in 2010 closely resembled the performance of the economy before the onset of the global recession. This article highlights some examples of how last year's developments marked a resumption of longer-term growth trends that emerged over the past decade. This was most evident in commodity prices, the stock and foreign exchange markets, as well as exports and employment by industry. However, the recent pattern of net lending and borrowing shows that a more fundamental shift occurred during the recession and into the recovery.

Commodity prices, the exchange rate and the terms of trade

Commodity prices in 2010 recovered about half their losses incurred during the recession. The recovery was most evident for non-energy commodities. The Bank of Canada non-energy commodity price index hit a record high by year-end, even though none of its components set new highs. [3] This paradox is explained by examining the components in more detail: by the end of 2010, metals and minerals were just shy of their peak set in 2007, forestry products were above their depressed levels in 2008 and 2009 [4] , and agriculture prices were the second highest on record. Elsewhere, crude oil drove a recovery in energy prices, but remained well below its high water mark set in 2008, while natural gas prices remained weak.

The rebound in commodity prices reverberated in currency markets. The Canadian dollar returned to parity with the US greenback by year-end, and for all of 2010 its average of 97.1cents (US) was the highest since 1976. The 10.8% appreciation from its average in 2009 was the largest annual appreciation of the Canada/US exchange rate on record back to 1951 (while the dollar hit a record high against the US dollar in mid-2008, it fell rapidly as recession took hold, such that its average of 93.7cents (US) for all of 2008 was little changed from 2007).

The stock market also reflected the rebound in commodity prices. While prices on the Toronto market remained below their monthly peak set in mid-2008, prices on average in 2010 were higher than in 2008, and just shy of their peak in 2007. This reflects more stability in the market in 2010 than the boom-bust cycle in 2008. Metals and minerals led the way, with stock prices one-third above their previous peak in 2007, while gold stocks also hit a new record. Energy posted double-digit gains but remained well below their 2008 high. For the first time since 2001, the increase in US stock market prices exceeded the Toronto market, but since 2001 the US market has fallen 3.2% while Toronto gained 56.4%. Foreign investors responded to this superior performance by purchasing a net $17.3 billion of Canadian stocks last year, after buying $26.2 billion in 2009.

The rise in the exchange rate and in commodity prices resulted in the largest annual increase on record in the terms of trade in 2010, up 6%, exceeding the gains posted in any one year during the commodity price boom earlier in the decade. Following a sharp drop in 2009, the rebound left the terms of trade at their second highest level ever. Export prices rose 2.1% in 2010, while import prices fell 3.8%, reflecting the appreciation of the Canadian dollar.

Lower import prices were also the driving force behind the rise in Canada's terms of trade between 2001 and 2008, with a cumulative drop of 11.9% versus only a 4.8% increase in export prices. Only at the peak of the commodity price boom in 2008 did export prices dominate the increase in the terms of trade. The recovery of the terms of trade was reflected in faster growth for real gross domestic income (GDI) than real GDP, of 5.0% versus 3.1% in 2010 (GDI is GDP adjusted for changes in the terms of trade). As Figure 4 shows, changes in the terms of trade contributed to real income growth of 25.6% over the past decade, versus a 20.4% gain in real output. In the 1980s and 1990s, the terms of trade did not contribute to real income growth.

International trade

Despite the improvement in Canada's terms of trade, the current account deficit widened in 2010, as nominal imports grew slightly more than exports. The gap was much greater in volume, as real imports rose more than twice as fast as real exports (13.4% compared with 6.2%). This reflects the much stronger recovery of domestic spending in Canada than in most of our major trading partners. In particular, import volumes grew at double-digit rates for autos, machinery and equipment and travel.

Merchandise exports rose 10.0% in 2010, recovering nearly one-third of their record 24.6% drop in 2009. Exports to the US were slow to recover, rebounding 9.2% in 2010 to recoup less than one-fifth of their losses in 2009. Exports to continental Europe were even weaker, rising only 1.8% after a 25% drop in 2009. Emerging economies were one bright spot for export demand in 2010, recovering half their 2009 losses to reach their second highest level on record. Robust demand from emerging markets also played a key role in the rebound in commodity prices. Exports to the UK also bounced back sharply.

Industrial goods led the rebound in exports, rising 25% to $99.5 billion. In the process, industrial goods surpassed machinery and equipment to reclaim the mantle of Canada's largest export sector for the first time since 2007. In the past 12 years, four different sectors have been Canada's leading export: autos in 1999; energy in 2008; industrial goods in 2006, 2007 and 2010; and machinery and equipment in the other seven years. This reflects how diversified Canada's export base has become. By comparison, autos were Canada's leading export for 15 straight years starting in 1983.

Indeed, the last decade has seen some major shifts in the composition of exports. Exports of forestry products have dropped 49% from their peak in 2000, reflecting the slump in US housing demand and the shift away from printed materials. Even with a 30% rebound in 2010, auto exports remained 42% below their high water mark set in 2000. While the losses in forestry and auto exports are well-known, machinery and equipment exports have fallen 30% from their peak in 2000. About half of this decline reflected the ICT bust early in the decade, but nearly half has occurred during the last three years, when exports fell 19%. Despite some recent success stories in machinery and equipment exports (notably in wireless devices), these were outweighed by losses since 2000 of 68.9% (or $17.2 billion) for telecommunications equipment and 60.5% (or $6.5 billion) for office machinery.

While exports of forestry products, autos and machinery and equipment have all fallen sharply from their peak in 2000, other exports have moved to the fore of export demand. Energy exports have tripled since 1999, reflecting both higher prices and the expansion of output from the oilsands. [5] Exports of industrial goods rose 66% in the 2000s, led by metals. Their share of total exports rose to 24.6% last year, just shy of their record high in 1971. Agricultural products have expanded by 44% since 1999; despite small declines in the last two years, their share of exports was the highest since the early 1980s.

Employment

Long-term growth trends in employment by industry resumed in 2010. In particular, job growth resumed in construction (4.8%) and natural resources (3.5%), which posted the fastest rebounds of any industry except professional and related services. For construction, this capped a decade in which it led all industries with a 51% expansion in jobs. For natural resources, employment rose 20.5% in the 2000s, a marked turnaround from a 17.3% decline over the previous two decades.

Employment growth resumed in services with a 1.6% gain in 2010 after a near-stall the year before. Growth was led by professional and related services, as it had during the rest of the decade (its 35.4% increase was the most of any industry outside of construction). Employment in trade and accommodation and food bounced back from losses during the recession. Finance and real estate posted small gains in each of the last two years, capping a 27.7% increase in the decade (in marked contrast with a 0.7% loss in the US). Government services saw steady gains, with the largest increases again in the health care industry.

Manufacturing in 2010 shed jobs for the sixth straight year, leaving its total for the 2000s down 22.2%, the only industry outside of agriculture to post a decline in the decade.

Net lending by sector

While there were many similarities between economic developments in 2010 and their pre-recession patterns, there were also important differences, especially in the financial sector. The recession brought about a sharp break in net lending by sector, and this pattern persisted in 2010. Before the recession started late in 2008, the household and non-resident sectors consistently were net borrowers while the government and business sectors were net lenders. Since then, the government sector has switched from a net lender to borrowing nearly $90 billion in both 2009 and 2010. Conversely, non-residents flipped from being net borrowers to net lending (reflecting Canada's switch from a trade surplus to a trade deficit over this period). Much of this net lending by non-residents reflected significant purchases of government bonds.

The switch from a trade surplus to a deficit occurred as the recession spread around the globe in the fourth quarter of 2008. Before then, Canada had run trade surpluses throughout the 2000s.

Canada is the only major nation whose trade balance has reversed since the onset of the global economic crisis. Trade deficits have continued for the US and the UK, although at a lower level than their record shortfalls before 2008. Italy and France saw their trade deficits narrow slightly in 2009 and 2010. Meanwhile, surpluses have continued in China, Japan and especially Germany, which posted a record surplus in 2010.

Canada's change from a trade surplus to deficit reflects several influences. The initial switch late in 2008 reflected the severe drop in exports as the global recession affected global prices for natural resources exports and the volume of demand for autos. But the steady widening of the trade deficit in 2009 and 2010 also reflected the stronger recovery of domestic spending in Canada than in its major trading partners in the developed world. As a result, import demand in Canada has risen faster than exports.

Net borrowing by households increased to $31.6 billion in 2010, after declines in the previous two years. Mostly this reflected the rebound in spending, especially on big-ticket durable goods and homes. As well, some credit channels that closed during the financial crisis began to function more normally. For consumers, the most visible change occurred for buying autos under a lease programme: leases accounted for 42.4% of auto sales in 2007, falling to 24.0% in 2008 and 7.1% in 2009, before recovering to 14.7% last year. The drop in 2008-2009 for vehicles leased was equivalent to almost 500,000 vehicles: however, total sales only fell 110,000 units, as consumers found other loan sources or paid cash. [6]

GDP

Real GDP rebounded by 3.1% in 2010 after a 2.5% drop in 2009. This left the volume of output 20.4% above its level in 2000. Comparing GDP growth by industry to employment in the last decade shows some notable trends. [7] Like employment, construction led all industries in GDP growth with a 41.5% increase. And manufacturing also posted the largest decline, with output down 17.6%.

But there were some notable differences between output and employment growth in the 2000s. As noted earlier, jobs in the resource sector increased 20.7%. However, output rose only 7.0%, a reflection of how difficult it has become to find new, productive sources of metals and crude oil. This drop in output-per-employee in natural resources occurred despite a sharp increase in investment in mining. Utilities also saw a marked decline in output-per-employee, despite record high investment every year of the decade.

Elsewhere, retail trade led the expansion of services output with a 47.7% gain between 2000 and 2010. Finance and real estate expanded 36.0% in the decade, just ahead of the 35% gain in information, culture and recreation services. Professional services saw a sharp slowdown to 33% growth in the 2000s, after doubling output in the 1990s. Government sector output grew 26.4%, almost the same as employment growth in the decade. Transportation and accommodation and food saw the slowest gains in both output and employment.

The recession in Canada was characterized by record declines in exports and business spending, moderated by increased spending by households and governments. These trends were evident in the share of these various sectors in nominal GDP, which moved sharply in 2009 and were little changed in 2010.

Exports hovered around 29% of GDP in both 2009 and 2010. This was well below their pre-recession level of 35%, and far below their record high of 45.6% in 2000. The last time exports were less than 30% of GDP was in 1992 (when they were 27.1%).

A number of factors led to the decade-long drop in the share of exports in GDP. First, it is no coincidence that machinery and equipment and auto exports peaked at the same time as the share of exports in GDP. Both machinery and equipment and auto exports have a high import content of nearly 50%, which inflates their gross share of exports. [8] The steady decline of auto and machinery and equipment exports in the 2000s helped erode the share of gross exports in GDP.

Second, the volume of exports in 2008 was exactly the same as in 2000, partly as a result of weak exports of manufactured goods. This reflects the end of the ICT boom in 2001, how the commodity boom raised the price but not the volume of many exports, and how key export sectors (such as autos and lumber) followed the US into recession starting late in 2007 (export volumes fell 4.6% in 2008). Third, exports were dampened by the appreciation of the Canadian dollar, which offset much of the boost export prices received from the commodity price boom that lasted most of the decade. Between 2000 and 2007, merchandise export prices rose 3.3% in total (less than 0.5% a year), before jumping 10.6% in 2008.

Together, these three factors steadily reduced the share of exports in GDP from 45.6% in 2000 to 35.3% in 2008. The global recession then lowered the share of exports to 28.7% in 2009, and it recovered only slightly to 29.4% in 2010.

Meanwhile, the share of business investment (excluding housing) fell to 11.0% in 2010, its lowest since 1996. Investment in 2010 was evenly-split between structures and machinery and equipment. Investment in structures as a share of GDP remained at historically-elevated levels compared with the past two decades, reflecting the importance of the energy industry in this component. [9] For machinery and equipment, the 5.5% share of GDP was the lowest since 1963.

The housing recovery in 2010 lifted the share of residential construction in GDP to 6.9%, just below its peak of 7.1% in 2007 (equalling its share in 1989 and shy of its record high of 7.2% in 1976). However, while this suggests that a 7% share appears typical for housing at a cyclical peak, examining the components of residential construction shows how housing dynamics have shifted significantly over time.

In particular, the 1989 peak in residential construction was due to new construction, which increased from 2.4% of GDP in 1985 to 3.8% in 1989. By comparison, new construction was steady at about 3.3% of GDP from 2004 to 2008. It fell to 2.7% in 2009 before recovering to 3.0% last year.

Instead, renovations have driven the increase in the share of residential construction in recent years. Their share of GDP hovered at 2.0% or less throughout the 1980s and 1990s, but then rose steadily from 2.0% in 2003 to a record 2.7% in 2010. In both 2009 and 2010, the volume of spending on renovations exceeded house construction. Transfer costs on home sales rose from 1.0% of GDP in 2003 to 1.2% in 2010.

Consumer spending as a share of GDP jumped 3.1 percentage points to 58.8% in 2009, before easing to 58.1% last year. Much of this reflects the stability of consumer outlays relative to the large fluctuations in nominal GDP (the latter was due to the sharp drop of exports and business investment in 2009 and their subsequent recovery in 2010).

Government spending's share of GDP rose during the recession, as it invariably has during past downturns. What was different in this downturn was the marked increase in fixed investments by governments, which rose a full point relative to GDP from 3.2% in 2008 to 4.2% in 2010, its highest share since 1971. This compares with increases in past cyclical slowdowns of 0.1 points in 1975, 0.3 points in 1981-1982, 0.2 points in 2001 and a drop of 0.2 points in 1991-1992. The rapid increase in government investment occurred mostly in 2009 (rising to 3.9% of GDP), reflecting higher spending on infrastructure projects.

Notes

1. Current Analysis (613-951-9162).
2. LFS employment in December 2010 was 0.2% below its pre-recession high, but surpassed it in January 2011.
3. The annual average for non-energy commodity prices was 4% below its 2008 peak.
4. Forestry product prices peaked in 1996.
5. The increase in energy exports occurred despite a drop in natural gas from $36.0 billion in 2005 to $15.5 billion in 2010, its lowest of the decade, mostly due to lower prices. Crude oil exports quadrupled in the past decade to $50.0 billion last year.
6. From Dennis DesRosiers, Year in Review, No. 37 Financing of New Light Vehicles bought by Consumers, March 23, 2011.
7. The industry trends in output-per-employee are consistent with the detailed estimates for labour productivity, which includes more precise measures of hours worked by industry. For example, productivity in the mining sector fell 28% between 2000 and 2009. However, these estimates are not yet available for 2010.
8. See P. Cross and Z. Ghanem, "Tracking value-added trade: Examining global inputs to exports". CEO, February 2008.
9. The energy sector accounts for 58.9% of intended investment in non-residential construction for 2011.

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Chart 3.1
Commodity prices

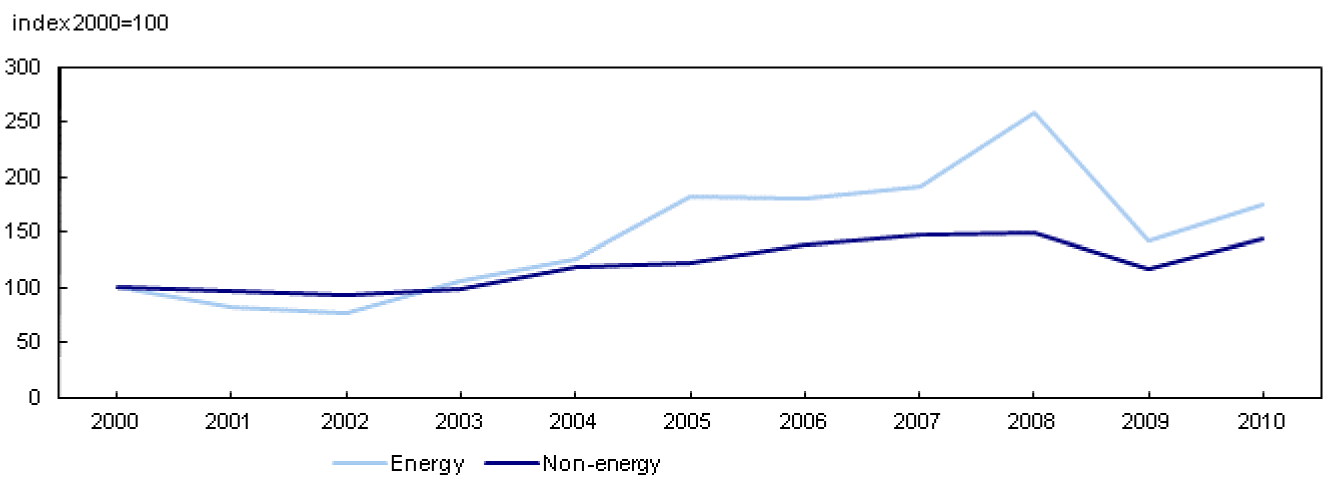

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Chart 3.2
Stock exchanges

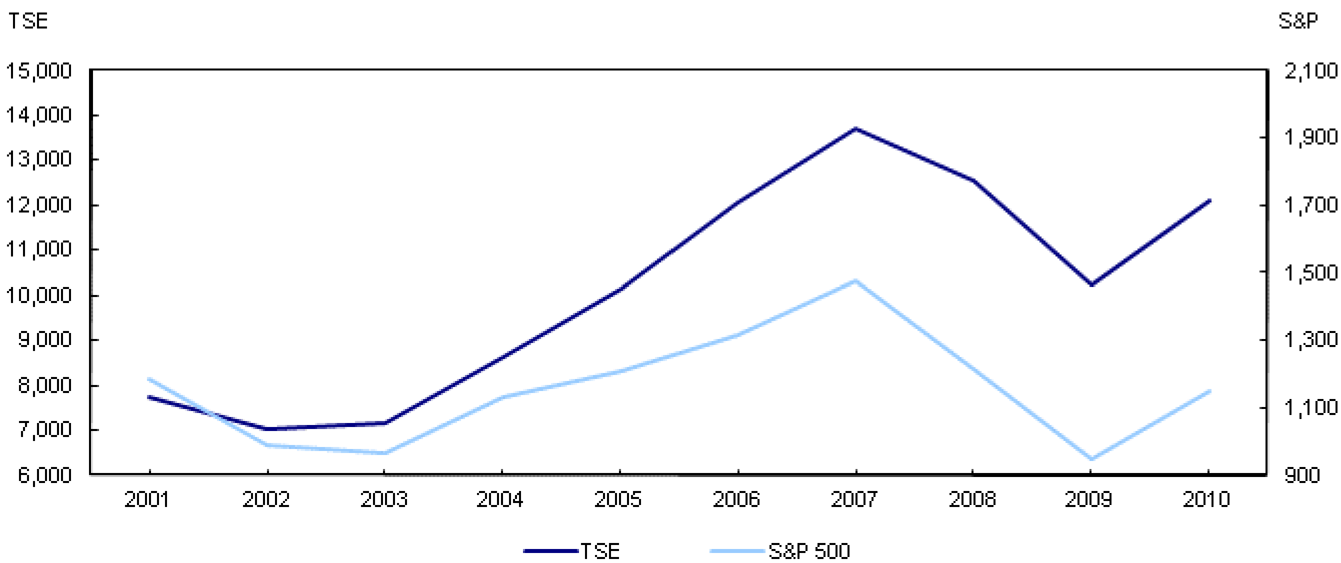

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Chart 3.3
Export and import prices

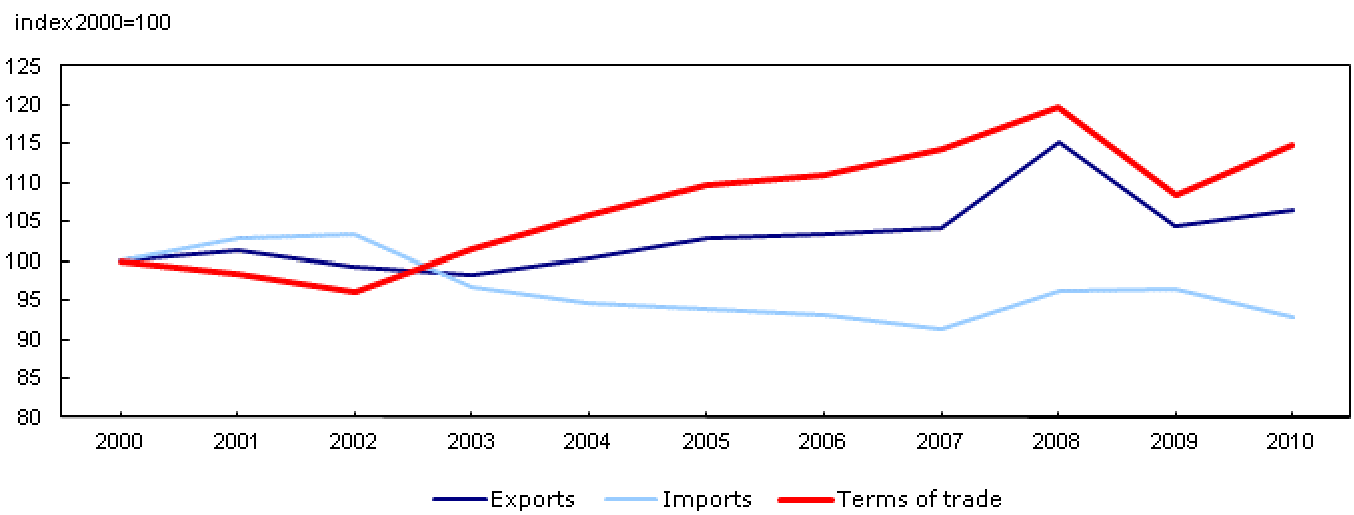

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Chart 3.4
Terms of trade, GDI and GDP

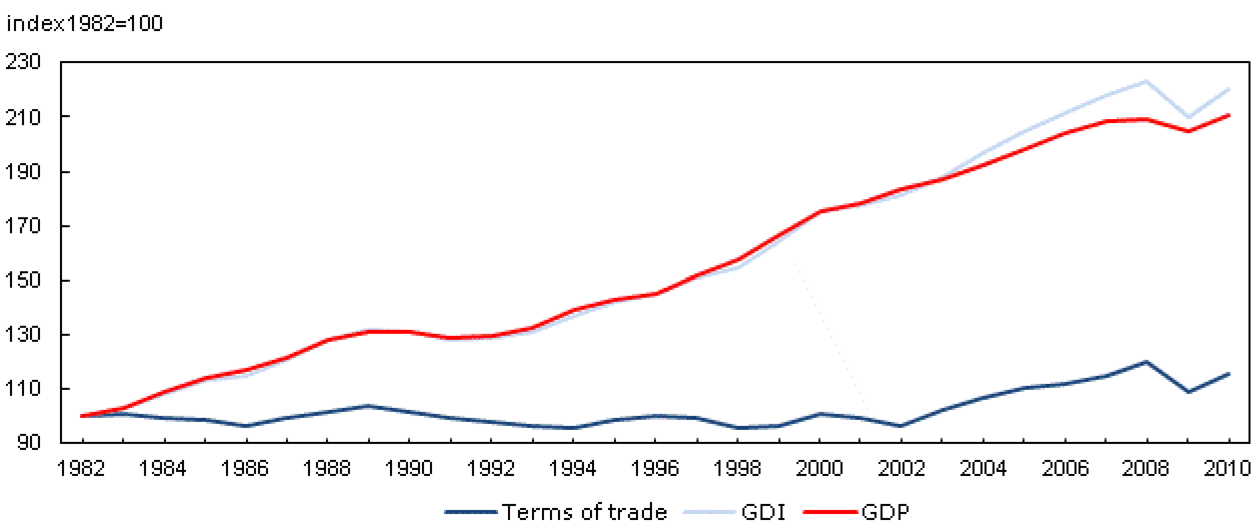
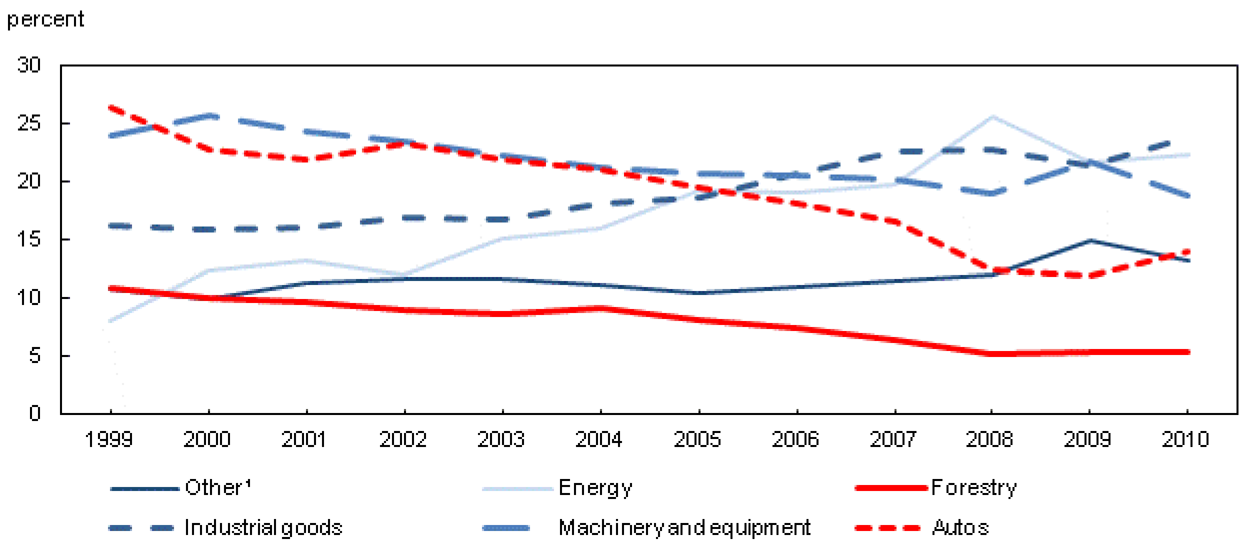


Chart 3.5
Shares of merchandise exports



1. Includes agricultural products and consumer goods.

Chart 3.6
Employment growth 2000 to 2010

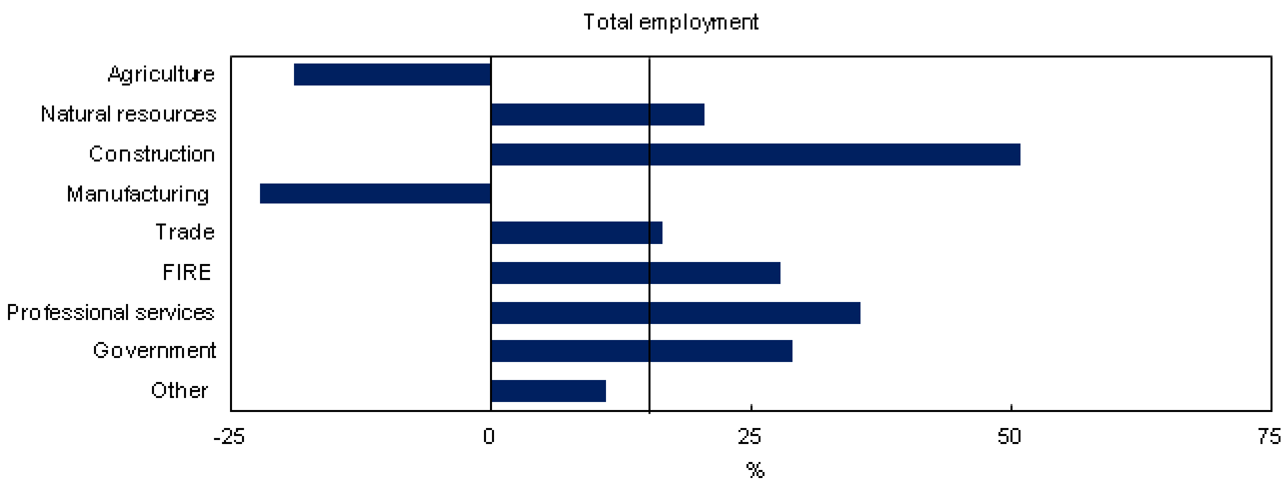


Chart 3.7
Net lending by sector

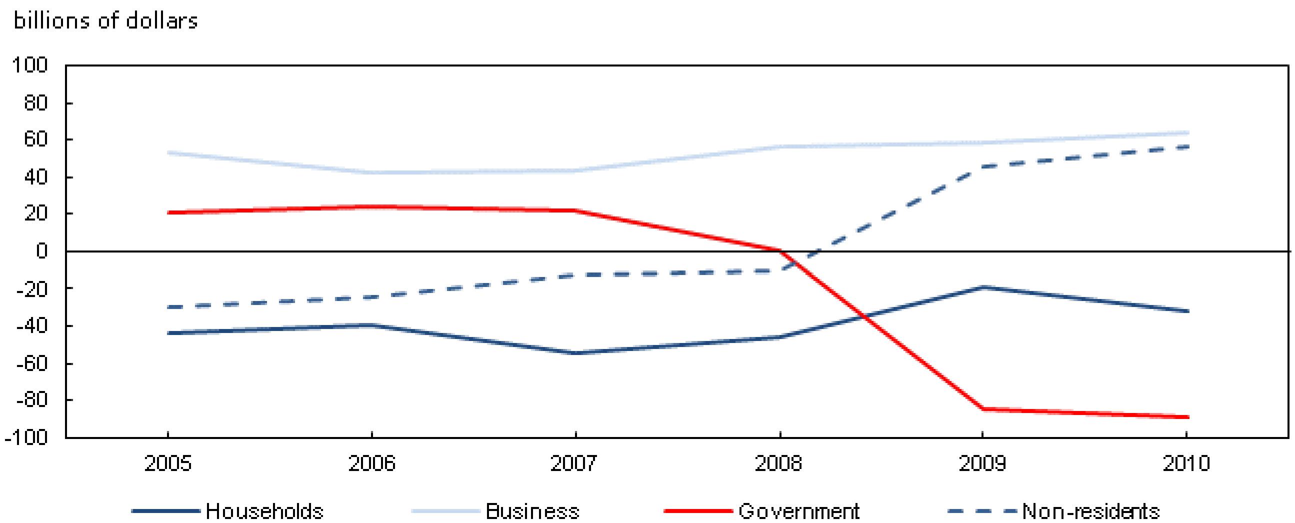


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Chart 3.8
Investment shares of GDP