Navigator

Now, next and how for business

Canada report

HSBC

Canada

Economy looks solid, but there are clouds on the horizon

Canada's trade prospects appear solid in the near term, buoyed by the upturn in the global economy. But there are risks on the horizon, the most significant being the US threat to pull out of NAFTA. Assuming this outcome is avoided, we expect Canada to maintain a strong relationship with its most important trading partners in advanced economies over the coming years and for the composition of trade flows to stay roughly stable. Importantly, emerging markets represent the largest opportunities for Canadian exporters to grow their businesses overseas.

Short-Term Snapshot

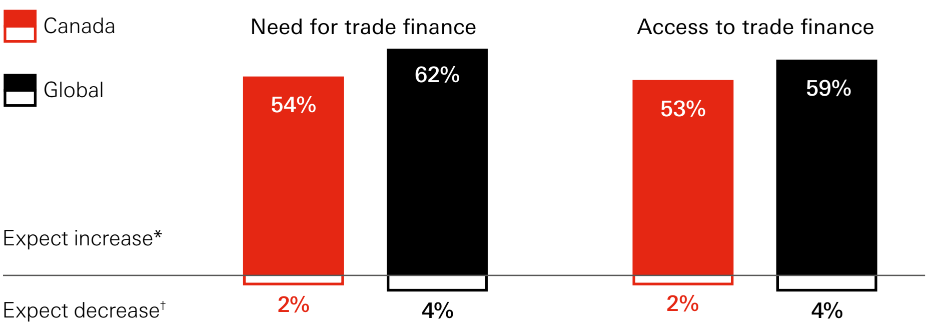
Canada's economy is on an overall firm footing. Looking ahead, we expect to see a gradual rotation in the economy's growth drivers. Cooler employment growth and rising interest rates will lead to some deceleration in consumer spending growth and housing activity, while the contribution of business investment and net trade should increase. Export performance has been somewhat disappointing recently, but an acceleration in global demand, particularly in the US, and a still fairly competitive currency should be supportive of growth in the coming year. But the outcome of the ongoing NAFTA renegotiation presents an important risk to the trade outlook.

This positive outlook for trade is confirmed by survey, with just over 70% of respondents expecting an increase in trade volumes over the next year. The US continues to rank as the most important target market for expansion, with Mexico ranking second, underscoring the interlinkages between the NAFTA economies. But Canadian firms do also recognise opportunities further afield, with China ranking in third place as a target export market.

Action points for business

- US withdrawal from NAFTA is an important near-term risk – has your business considered the potential implications for its supply chain?
- Fast-growing economies further afield present opportunities to grow and diversify your business. Have you considered the appropriate strategy to enter these new markets?

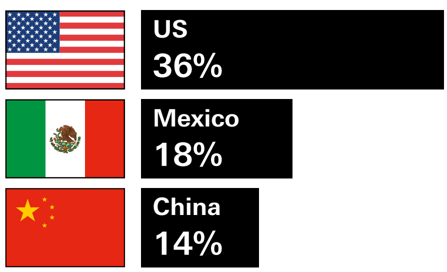
Outlook for trade finance need and access in the next 12 months



*Expect increase = Increase significantly + Increase slightly
†Expect decrease = Decrease significantly + Decrease slightly

Source: TNS Kantar

Which are the top 3 markets where your business will look to expand in the next 3-5 years?



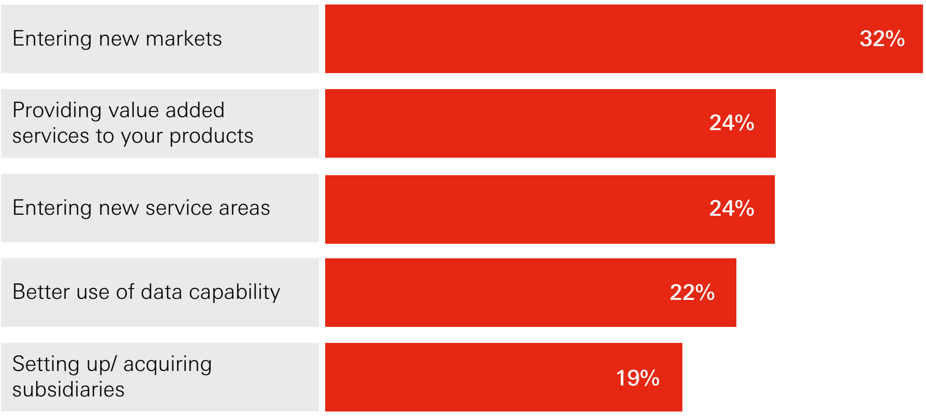
Source: TNS Kantar

In light of the positive trade outlook, over half of respondents to our survey expected an increased need for trade finance over the coming year (albeit slightly lower than the global average of 62%). Respondents believe the financial system to be able to meet their demands, with a similar proportion expecting an improved ability to access trade finance.

Services are an increasingly important driver of Canadian trade flows, reflecting Canada's competitive advantages as a knowledge-based economy with a highly-skilled workforce. Similar to goods, the outlook for services exports appears fairly upbeat, with nearly 60% of respondents anticipating increased services trade. Respondents see important opportunities to expand service trade in tapping new markets and new service areas, as well as enhancing the value of their existing services shipped abroad.

Fiscal stimulus in the US and the strong upswing in global growth are bolstering Canada's trade prospects.

How do you plan to grow your services business?



Source: TNS Kantar

Interestingly, respondents also identified better use of data capabilities as an important strategy for boosting their cross-border services sales. About 75% of respondents are open to the idea of easing access to data, but they are also concerned about the threat from unauthorised exploitation of systems, networks and technologies – around three-quarters identified cyber security as a significant risk.

Despite the storm clouds around NAFTA, a sizeable share of survey respondents are upbeat on the outlook for trade.

Trade Policy Developments

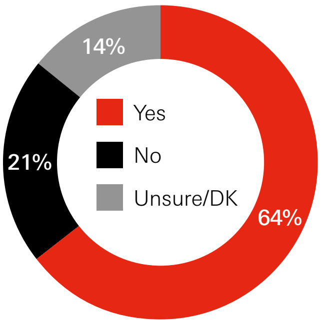
In light of the US administration's protectionist stance, it is not too surprising that almost two-thirds (64%) of survey respondents believe that governments are becoming more protective of their businesses. A particular concern will be the ongoing threat to pull the US out of NAFTA. The Canadian autos industry looks particularly exposed to this risk, given the US administration's desire to change the NAFTA rules of origin to increase the share of US-made parts in vehicles manufactured within the free-trade area. The timeline for negotiations remains unclear, highlighting that this uncertainty is likely to weigh on the Canadian economy for some time.

On a more positive note, Canadian policy makers are taking steps to open up markets outside the US. The recently negotiated EU-Canada Comprehensive Economic and Trade Agreement (CETA) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) may help to offset the blow to Canadian businesses if President Trump decides to break up NAFTA.

Action points for business

- Does your business fully understand the policy and tariff changes that will arise from recently negotiated CETA and CPTPP deals? Do you have a strategy to exploit the resulting opportunities in these markets?
- Does your business have an early warning system in place to alert you to potential shifts in trade policy?

Are governments becoming more protective of their domestic business?



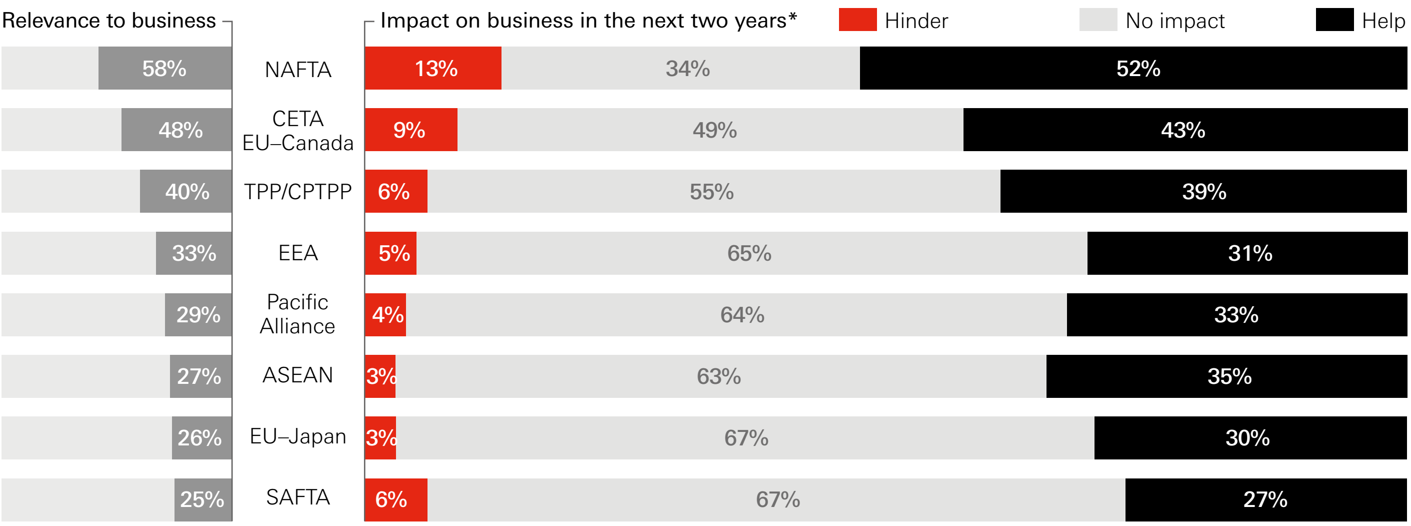
Note: may not total 100% due to rounding

Source: TNS Kantar

Top 3 impacts of protective policies on my business

Source: TNS Kantar

Relevance and impact of trade agreements



Source: TNS Kantar

*May not total 100% due to rounding

Interestingly, over half of respondents believe that NAFTA will help their business in the next two years, which is a larger share than for the same question regarding CETA and CPTPP. It may be that respondents do not currently see a material risk of the existing NAFTA trading framework being disrupted, while they are only gradually learning of the potential opportunities granted by these newer trade deals.

Long-Term Outlook for Trade

Assuming the NAFTA pact remains intact, the long-term outlook for Canadian exports appears positive. Goods exports are forecast to grow at a fairly healthy pace over the coming decade, buoyed by upbeat demand in existing trading partners and also by our expectation that Canadian firms will increasingly tap into new markets. Growth in services trade is likely to slightly outpace goods trade over the coming years, led by business-to-business (B2B) service exports to the US.

Overall, emerging markets are projected to increase their share of Canadian trade flows over the coming years, a trend that would be further encouraged by the implementation of the recently-approved CPTPP deal. With the CETA also helping to improve trade relations with Europe, this will help to gradually reduce Canada's heavy reliance on US demand.

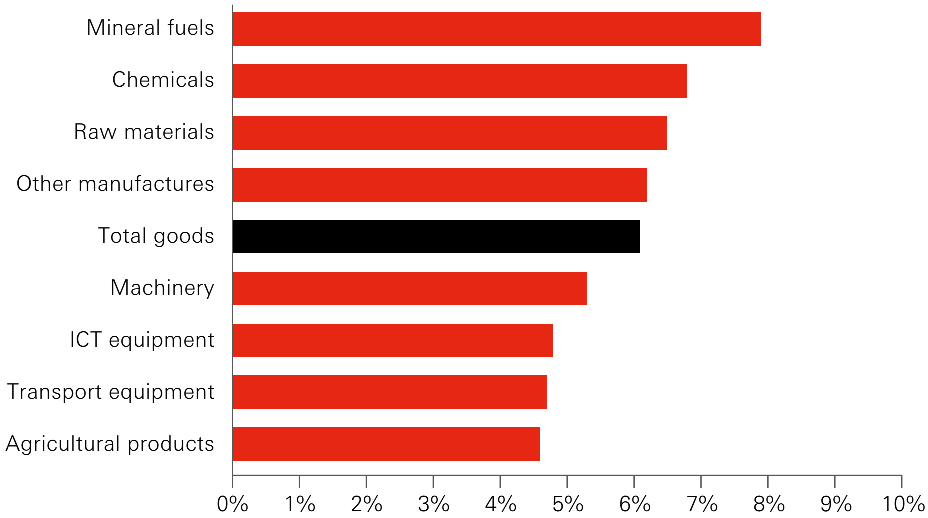
Exporters gradually diversify away from the US market
The composition of Canada's merchandise exports is not predicted to change very significantly in the years to 2030, with natural resources, machinery and transport equipment expected to retain the largest share of total exports. Mineral fuels alone are projected to contribute about one-fifth of export growth in the years to 2030. The expected recovery in commodity prices will provide a boost to petroleum exports in value terms, while we also assume new investment in the sector (including improvements to transportation infrastructure) will help to support steady growth in volumes. This does represent a downside risk to the forecast, however, as few projects are currently left in the construction phase. Also building on Canada's natural resource endowments, exports of chemicals are expected to post robust growth.

Canada will also continue to capitalise on its manufacturing strengths in areas such as construction machinery, agribusiness equipment and environmental systems. Although exports of industrial machinery & equipment have struggled in recent years against a background of weak demand, the forecast improvement in global investment should support a gradual recovery in coming years. Overall, the value of total goods exports is predicted to grow by around 6% pa on average in the years through 2030.

Action points for business

- Growing your export business and diversifying away from traditional markets may require efforts to make the corporate culture more international – have you considered recruiting managers with experience of different markets?
- Is your business attuned to the rapidly changing market for goods and services in Asia, including new consumer trends?
- Is your business prepared to handle increased competition from abroad – for assets, talent, resources and customers?

Exports of goods by sector, 2017-30 (average annual growth)



Source: Oxford Economics

Top 5 Hotlist destinations of goods exports

Rank	2016	2030
1	USA	USA
2	China	China
3	UK	UK
4	Japan	Japan
5	Mexico	India

Note: Ranking among the 24 trade partners covered in the forecast

Source: Oxford Economics

Asian emerging markets will be an important driver of Canadian export growth in the coming years as rising prosperity in the region supports import demand. Amongst these rising stars, prospects for exports to Vietnam and India look particularly bright; we forecast these countries to be the fastest-growing markets for Canadian exports over the long-term, with growth averaging 10% pa in the decade through 2030. In fact, India is expected to push into the Top 5 Hotlist Export Destinations by the end of the forecast period, displacing Mexico.

While the emerging markets will grow in importance, the US is sure to remain the largest single market for Canadian exports over the coming decade. Still, we expect growth in Canada's exports to its southern neighbour to be limited to around 5% pa in the decade to 2030, meaning that its dominance as an export market will be eroded over time. Conversely, China will consolidate its position as Canada's second-largest export market, with growth averaging 9% a year over the same period. The UK is forecast to remain in third place, although this position would be under threat if the recent sub-par performance of non-gold exports is maintained.

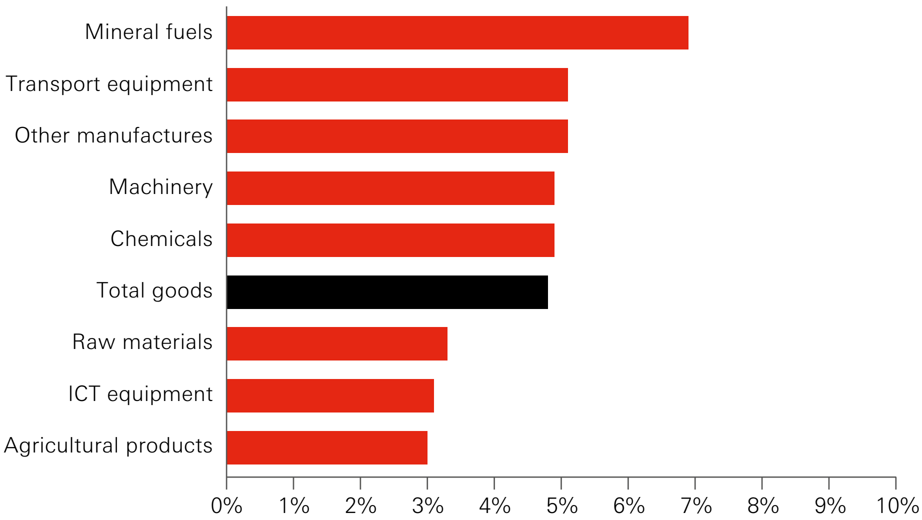
Supply chain linkages will keep a steady pull on imports

Canada's imports are forecast to grow at a slightly slower pace than exports in the years to 2030, which will help to narrow the budget deficit. At the sector level, machinery and chemicals are likely to experience rapid growth, reflecting strengthening domestic business investment and demand from manufacturers for intermediate inputs. But there is also likely to be strengthening demand from consumers for imports of final goods.

> Demand for Canadian goods and services will stay buoyant into the long-term.

Although Canada's petroleum exports are likely to grow rapidly in coming years, imports of these products are also likely to see solid growth. In part, this reflects the import of various refined products to meet demand from domestic industry and consumers, but it also reflects ongoing demand for different grades of crude oil from abroad. Unlike the heavy bitumen from Canada's oil sands, US crude is light and therefore an alternative that remains in demand from Canadian businesses and east coast refineries.

Imports of goods by sector, 2017-30 (average annual growth)



Source: Oxford Economics

Top 5 Hotlist origins of goods imports

Rank	2016	2030
1	USA	USA
2	China	China
3	Germany	Mexico
4	Mexico	Germany
5	Japan	Japan

Note: Ranking among the 24 trade partners covered in the forecast

Source: Oxford Economics

Emerging markets - Asia in particular - will account for the fastest growing source of imports to Canada in coming years. Within this region, Vietnam and India are expected to be the fastest growing source of imports, seen to grow about 9% pa on average over the decade to 2030. This reflects both the low-cost production of final consumer goods in these countries as well as their increased integration into global supply chains.

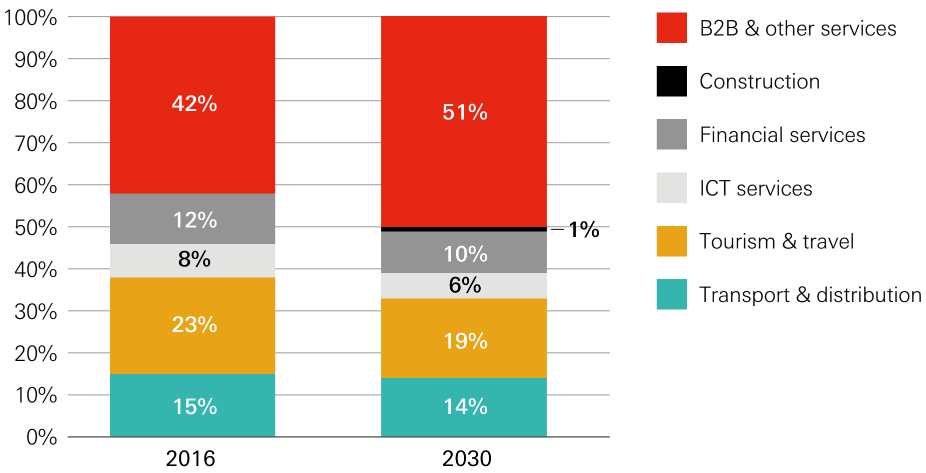
But traditional trading partners will continue to be most important in terms of overall share of Canada's imports in the years to 2030. The US will remain by far the top source of imports, reflecting the close economic integration of Canada with its neighbour to the south. And the remaining four countries making up our Top 5 Hotlist Origins ranking are also expected to remain unchanged over this period.

Canada builds on its strengths in B2B services
We forecast services exports to grow at an average annual pace of over 5% in the years to 2030, somewhat faster than corresponding goods trade. This is illustrative of Canada's relative strength as a knowledge-based economy and the increased tradability of services. Canadian service providers will also be able to benefit from increased demand for services, particularly in Asia, as the region's economies grow in wealth and sophistication. Implementation of the CPTPP deal would further reinforce this very gradual shift in services trade towards Asia.

Business-to-business activity will become an increasingly dominant driver of services exports over the coming years.

We can expect to see an increase in Business-to-business (B2B) services as a share of total service exports; by 2030, we expect this category to account for just over 50% of total services exports, up from 42% currently. Tourism and travel-related services are expected to retain their position as Canada's second most important services export, reflecting Canada's ongoing attraction to visitors from around the world. The most popular provinces for international visitors will likely continue to be Ontario, British Columbia and Quebec.

Sectoral shares in total services exports



Source: Oxford Economics

Top 5 Hotlist destinations of services exports

Rank	2016	2030
1	USA	USA
2	UK	UK
3	China	China
4	France	France
5	Germany	Australia

Note: Ranking among the 23 trade partners covered in the forecast

Source: Oxford Economics

The US will remain the most import destination for Canadian services flowing overseas, although it is worth noting that Canada is likely to maintain a trade deficit with the US on the services side. While the UK will retain its position as the second-largest market for Canadian services, the dominance of developed economies in general will be gradually eroded by faster-growing demand from emerging markets. In particular, we expect India and China to be the fastest-growing sources of demand for exports in the years to 2030, with growth averaging 9-10% pa.

About the HSBC Navigator

The HSBC Navigator presents a blend of survey evidence, policy analysis, and economic modelling to generate unique and timely insights into the changing landscape for global trade.

The business survey is a quantitative indicator of the short-term outlook for global trade. The survey, which is the largest of its kind, is conducted on behalf of HSBC by Kantar TNS. It is compiled from responses by decision-makers at over 6,000 businesses – from small and mid-market to large corporations – across a broad range of industry sectors in 26 markets. Interviewees were polled on a range of questions including expectations around future growth in trade, trade finance needs, attitudes toward trade policy developments and strategic business plans.

The survey represents a timely source of information on the fast-evolving trade environment. And it can provide a useful contextual setting for interpreting developments in official data. In this way, economists at Oxford Economics are able to blend insights from the survey with their own analysis and modelling of developments in trade.

Oxford Economics has tailored a unique service for HSBC which forecasts bilateral trade in goods and services, in part based on HSBC's own analysis and forecasts of the world economy. A top-down approach is employed, with Oxford Economics' suite of models used to ensure consistency between HSBC's forecasts for economic growth and exchange rates in key countries and the more granular projections for bilateral trade flows presented here.

Oxford Economics employs a global modelling framework, with headline bilateral trade forecasts constructed as a function of demand in the destination market and the exporter's competitiveness (as measured by unit labour costs in nominal USD terms). Exports, imports and trade balances are identified, with both historical estimates and forecasts for the periods 2017-20 and 2021-30.

These headline bilateral trade forecasts for goods and services are also disaggregated by sector, using Oxford Economics' Industry forecasts to inform future production trends and taking into account the historic relationship between output and exports in each sector, by market:

- For trade in goods, sectors are classified according to the UN's Standard International Trade Classifications (SITC) system at the two-digit level and grouped into 30 sector headings.
- For trade in services, we identify five broad sectors: B2B and other services, tourism & travel, transport & distribution, financial services, ICT services and construction.

Drawing on the Kantar TNS survey results and Oxford Economics' long-term forecasts, Oxford Economics produces in consultation with HSBC a global report and specific reports on the following 23 markets: Argentina, Australia, Bangladesh, Canada, China, Egypt, France, Germany, Hong Kong, India, Indonesia, Ireland, Japan, Malaysia, Mexico, Poland, Saudi Arabia, Singapore, Turkey, UAE, UK, USA and Vietnam. The analysis of trade in goods also includes trade with Brazil and Korea for a total sample of 25 key trading markets; for trade in services the analysis also includes Korea for a total sample of 24 key trading markets.

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