# Canada’s trade deficit hits new high

OTTAWA — Canadian exporters continued to take it on the chin in July as a weak U.S. economy and the strong loonie combined to produce a record trade deficit of $2.7 billion.

Analysts said the widening deficit — it was $1.8 billion in June — will take another big bite out of the economy this quarter as the North American economy continues to cool.

And the prospects aren’t getting any better, with the Bank of Canada raising interest rates Wednesday, giving another boost to the dollar, and a new forecast from an international think-tank pointing to a slowing global recovery.

“The dominant force is we went through a (temporary) global growth spurt in the initial stages of the recovery, but that effect has dropped out,” said economist Derek Holt of Scotia Capital. “Then overlaid on top of that (is the loonie).”

In the July report, Statistics Canada noted that exports of machinery and equipment fell 1.9 per cent on lower volumes, with aircraft, engines and parts leading that decline.

Finance Minister Jim Flaherty said he is concerned with weakness in exports, but found some optimism in the machinery and equipment numbers.

“Business investment is starting to come back in Canada, not strongly, but it’s starting to come back. That, in the longer term, is encouraging,” he said during a media conference in Kitchener. “We need the private sector to continue to step up (and) start to invest. They’ve been making some profits, they’ve got some cash; we need to them to start investing, help creating more jobs than we’ve already seen in Canada, more investment in machinery and equipment.”

Meanwhile, consumer goods exports fell 7.3 per cent to a 10-year low of $1.3-billion on weaker exports of medicines and drugs. Exports of forestry products fell 5.3 per cent as lumber shipments dropped, mainly on continued weakness in the U.S. housing and construction sectors.

A strong dollar is not only a drag on exports, but also tends to boost imports as Canadians take advantage of the currency’s additional spending power to buy foreign goods.

Thursday’s report showed both factors at play in July, as exports declined 0.7 per cent to $32.8 billion and imports rose two per cent to $35.5 billion.

The gap was even more pronounced in trade with the United States. Exports fell 2.2 per cent, while imports rose by 2.9 per cent, narrowing Canada’s trade surplus with its biggest economic partner to $1.2 billion from $2.4 billion in June.

Jayson Myers of the Canadian Manufacturers and Exporters said he was “extremely concerned” about the health of the Canadian recovery.

“We are seeing higher interest rates when the government is cutting back on stimulus and employment insurance premiums are going up,” he said. “We are not out of the woods yet and won’t be until U.S. economy recovers.”

Exports to countries other than the U.S. rose 3.7 per cent, mostly as a result of higher exports to the European Union, while imports increased 0.2 per cent. Canada’s trade deficit with countries other than the U.S. shrank to $3.9 billion in July from $4.2 billion in June.

“The trade balance has sagged by nearly $3 billion in the past three months alone as the gap between solid imports and stumbling exports has lurched wider. Outsized current account deficits look here to stay in Canada,” said Douglas Porter, deputy chief economist with BMO Capital Markets.

Holt said the trade gap took about 1.2 percentage points out of gross domestic product in the second quarter, accounting for the discrepancy between rosy forecasts and the disappointing two per cent growth that occurred.

The slowdown in the global economy also contributed to lower prices and demand for Canadian commodities, which also contributed to the record trade gap.

In a new forecast Thursday, the Organization for Economic Co-operation and Development said the world economic recovery may be slowing faster than previously anticipated.

The OECD predicted global growth will be only be about 1.5 per cent in the second half of 2010, a quarter point lower than its previous projection.

In regards to Canada, the Paris-based organization said the third quarter and fourth quarters would advance at a snail’s pace of 2.2 and 2.3 per cent, more than half a point lower than the Bank of Canada’s expectations.

Myers noted that the growth in imports has a bright side, indicating a strong domestic economy, and shows that Canadian firms are preparing for the future by buying new machinery and equipment, most of it imported.

But he added that over the long term, Canada cannot continue to import more than it exports without paying a price in output and jobs.