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Canada

OFFICE OF THE CHIEF ECONOMIST

QUARTERLY ECONOMIC AND TRADE REPORT

Q2 2022

SECOND QUARTER 2022

	% change, Q2 2022 vs Q1 2022	% change, YTD
Global real GDP*	-0.6	3.5
Global merchandise trade volume	0.8	4.3
Canadian real GDP*	3.3	3.7
Canadian exports (goods & services)	11.6	25.1
Canadian imports (goods & services)	10.7	21.2

Notes:
*GDP is quarterly changes at annualized rates. "YTD %" is the year-to-date change compared to the same period in the previous year.
Source: Oxford Economics, Netherland Bureau for Economic Analysis, Statistics Canada.

HIGHLIGHTS

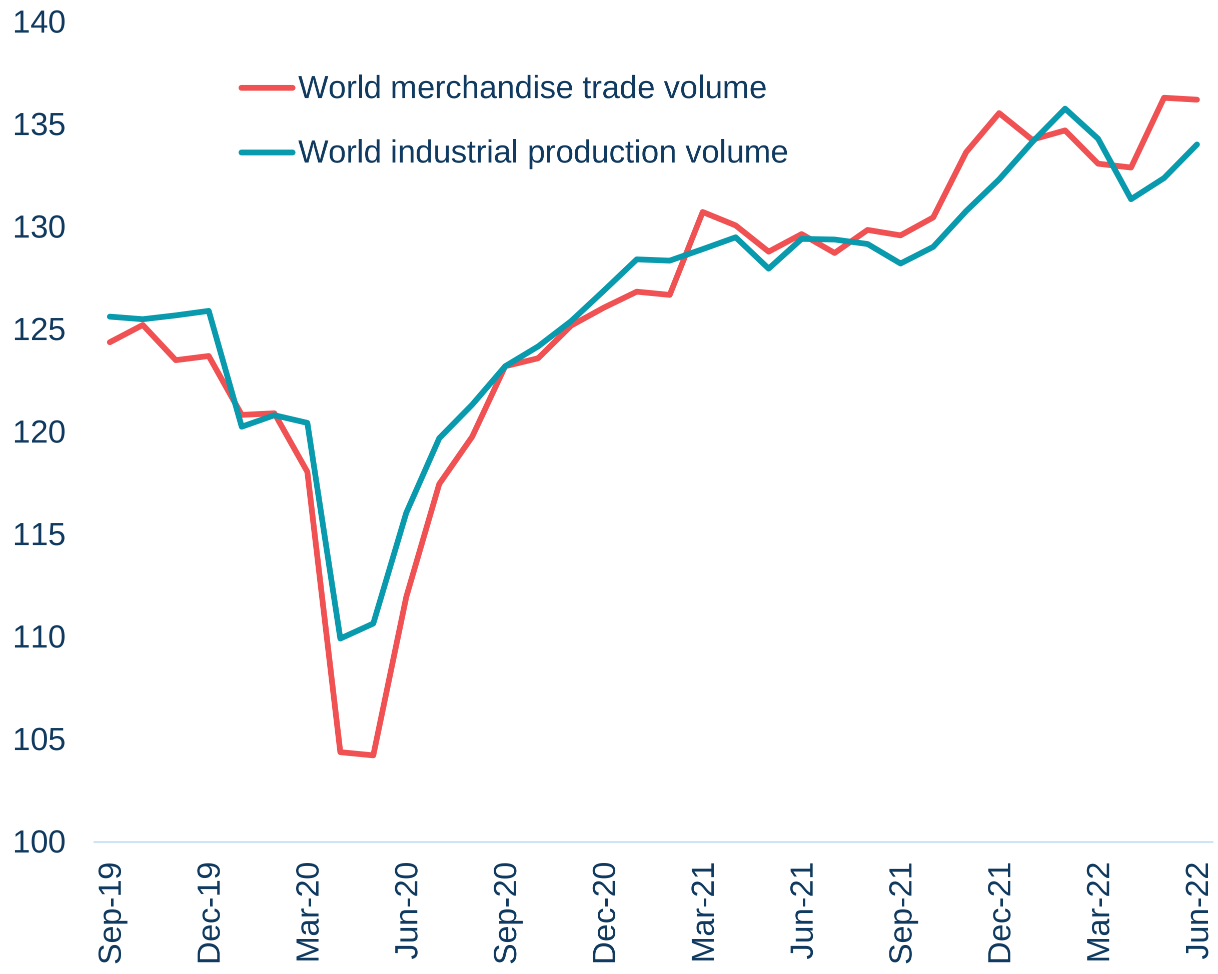
- World merchandise trade volume growth was subdued in Q2 (0.8%), and the global economy is estimated to have contracted slightly (-0.6%). The second quarter was marked by the continuation of Russia's invasion of Ukraine, and the lockdowns of major cities and factories in China. The U.S. economy also contracted for the second consecutive quarter, meeting the definition of a technical recession.

- Increased spending on services and inventory investment supported a 3.3% increase in the Canadian economy in Q2, but rising interest rates left their mark as residential investment contracted substantially. Investment in inventory and machinery and equipment resulted in a large increase in import volumes, with the resulting negative net trade subtracting from real GDP growth.

- Growth in the value of Canadian goods and services trade was substantial in Q2 (+11.2%). On the goods side, energy products played a major role as prices strengthened. On the services side, as travel services trade continued to trend toward pre-pandemic levels, the trade surplus in travel that occurred throughout the pandemic returned to a deficit.

- Higher than expected inflation worldwide, tighter financial conditions, a worse than expected slowdown in China, and negative spillovers from the war in Ukraine are some of the headwinds facing the global economy in the short-term. For the Canadian economy, rising interest rates to combat inflation have already taken a bite out of residential investment. Furthermore, weak global economic growth forecasts do not bode well for international trade; but in the short-term, elevated commodity prices should continue to support the value of exports.

World merchandise trade and industrial production volume
(Index 2010 = 100)



Sources: Netherland Bureau for Economic Analysis, retrieved on 08/26/2022.

WORLD MERCHANDISE TRADE VOLUME GREW MODESTLY IN Q2

World merchandise trade volumes continued to grow at a modest pace (0.8%) in the second quarter of 2022, slightly better than the growth (0.6%) experienced in the first quarter. The second quarter was marked with the continuation of Russia's invasion of Ukraine, and lockdowns of cities and factories in China early in the quarter. Consequently, import volumes from emerging Eastern Europe and the Commonwealth of Independent States declined 5.1%, while export volumes declined 3.7%. As well, import volumes from China decreased 4.5% but export volumes held up, increasing 1.4%.

World industrial production volumes declined 1.6% in the second quarter of 2022, after growing 3.1% in the previous quarter. While industrial production volumes in advanced economies held up (+0.4%), it declined 3.4% in emerging economies, led by a 7.2% decline in China, partly due to lockdowns, and a 2.3% decline in emerging Eastern Europe and Commonwealth of Independent States, partly due to the war in Eastern Europe.

THE GLOBAL ECONOMY IS ESTIMATED TO HAVE CONTRACTED IN Q2

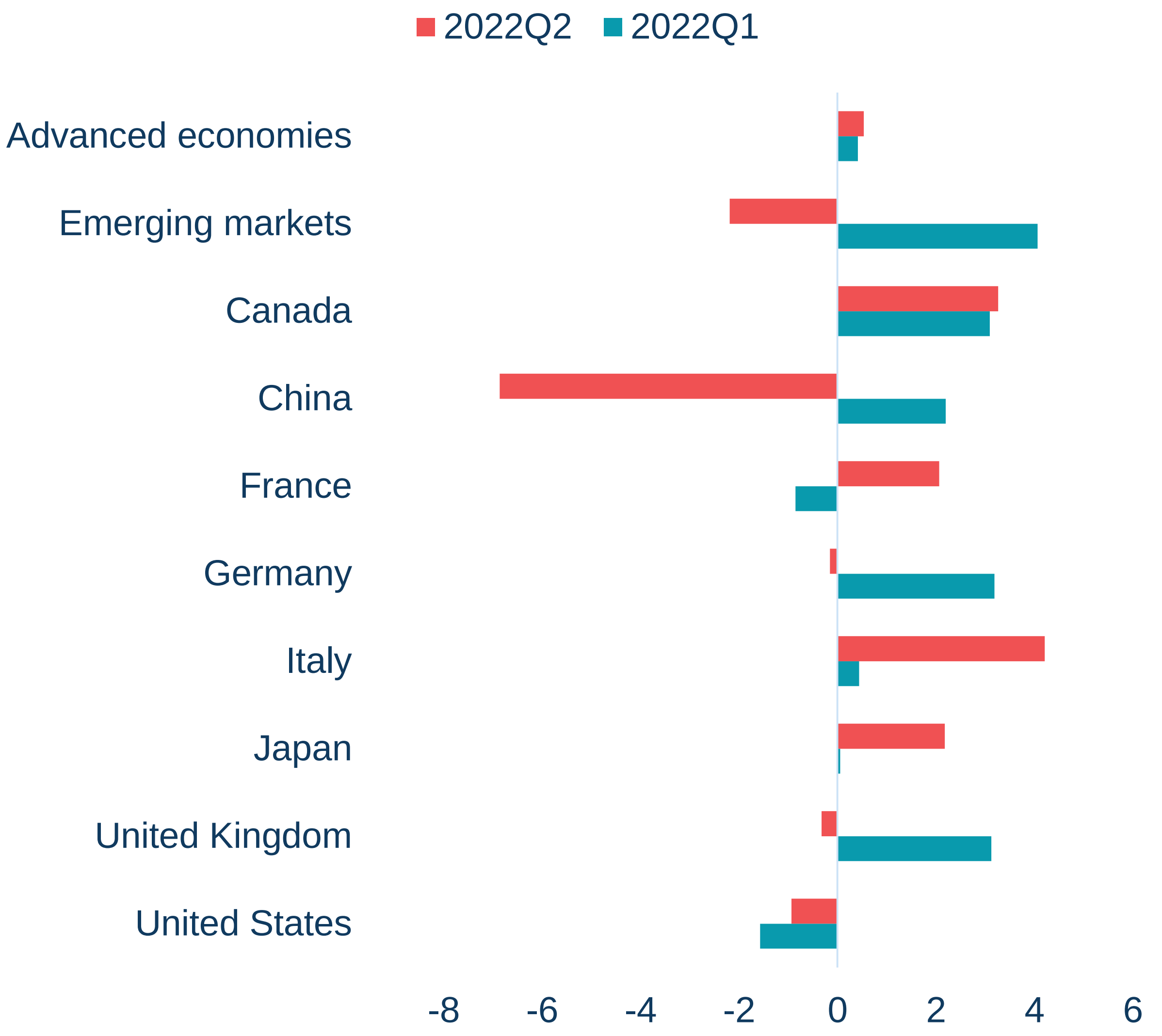
After experiencing subdued growth in Q1, the global economy is estimated to have contracted in Q2 by 0.6% (annualized). Advanced economies grew by a modest 0.5% and emerging markets contracted by 2.2% following strong growth in Q1.

The second quarter in China was marked by lockdowns of major cities early in the quarter, followed by more localized lockdowns that tracked the emergence of Covid-19 cases. The real estate downturn added further pressure on the Chinese economy, causing a 6.9% (annualized) contraction on a quarter to quarter basis.

In the U.S., GDP contracted for two consecutive quarters, plunging the economy into a technical recession. The decrease in inventory investment was a major reason for the decline in Q2. However, industrial output and employment indicators are still showing strength. Inflation, 8.5% in July, remains a major concern and as the Federal Reserve commits to the fight against inflation, rising interest rates have the potential to depress economic activity. Residential investment has already felt the effect of rising interest rates, collapsing 16.2% (annualized) in Q2.

The Eurozone economy surprised on the upside in Q2, as it benefited from the re-opening of some services activities and an earlier start to the tourism season. However, inflation remains high and the recent surge in gas prices continue to weigh on economic sentiment. On the positive side, the prospect of hard energy rationing over the winter have declined, given the progress seen in European gas storage levels, but the potential for demand reductions stemming from high energy prices remain.

Real GDP growth, top economies
(quarterly % change, annualized)



Sources: Oxford Economics, Statistics Canada. Seasonally adjusted. Retrieved on 2022-09-01.

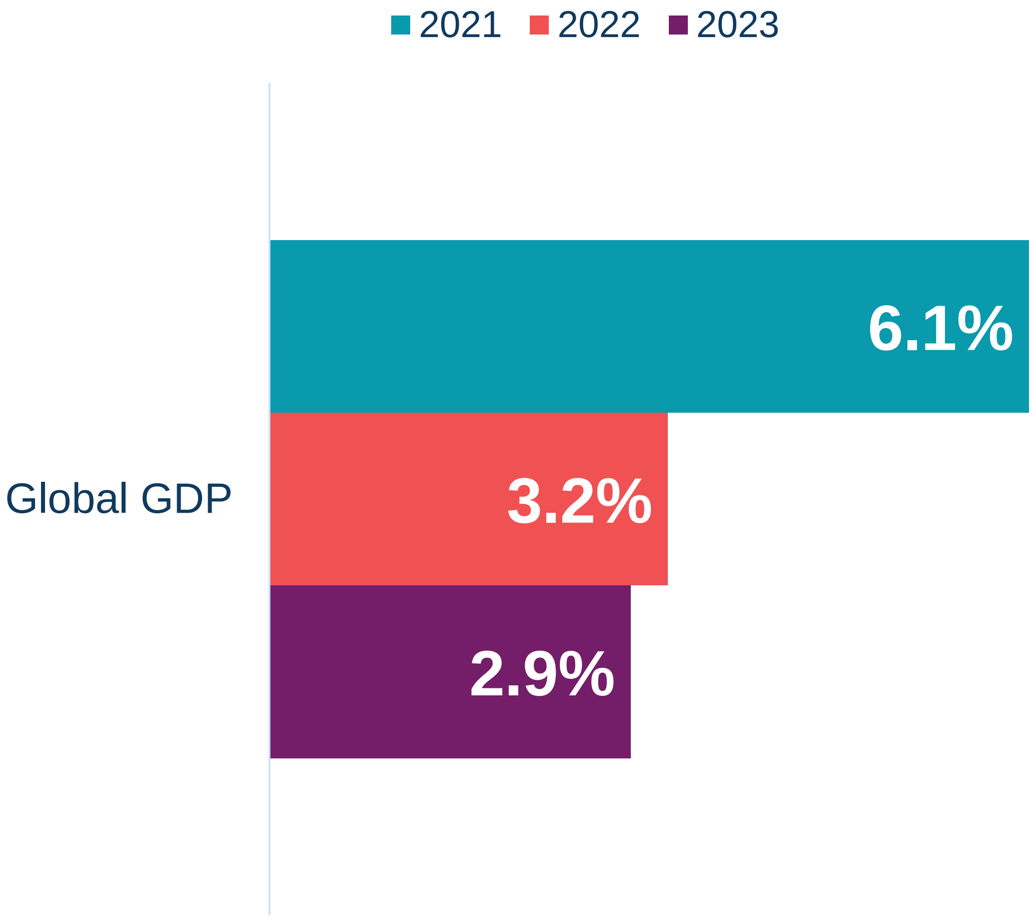
WEAK GROWTH EXPECTATION FOR THE GLOBAL ECONOMY

After successive quarters of economic recovery, the outlook for the global economy has become more gloomy due to the Q2 contractions in GDP in some major economies and multiple risks that have arisen. Higher than expected inflation worldwide, tighter financial conditions, a worse than expected slowdown in China, and negative spillovers from the war in Ukraine are some of the headwinds facing the global economy. The International Monetary Fund (IMF) has repeatedly lowered its expectations for global economic growth in 2022, from 4.9% in its October forecast to 3.2% in its July outlook.

Headwinds in the U.S. include persistent high inflation, reduced household purchasing power and tighter monetary policy as the Federal Reserve commits to the fight against inflation. In China, further lockdowns, although smaller in scale, and the deepening real estate crisis weigh on the economic outlook, with the potential for major global spillovers. In Europe, headwinds include spillovers from the war in Ukraine, high inflation, tighter monetary policy, and the potential for demand destruction from high energy prices.

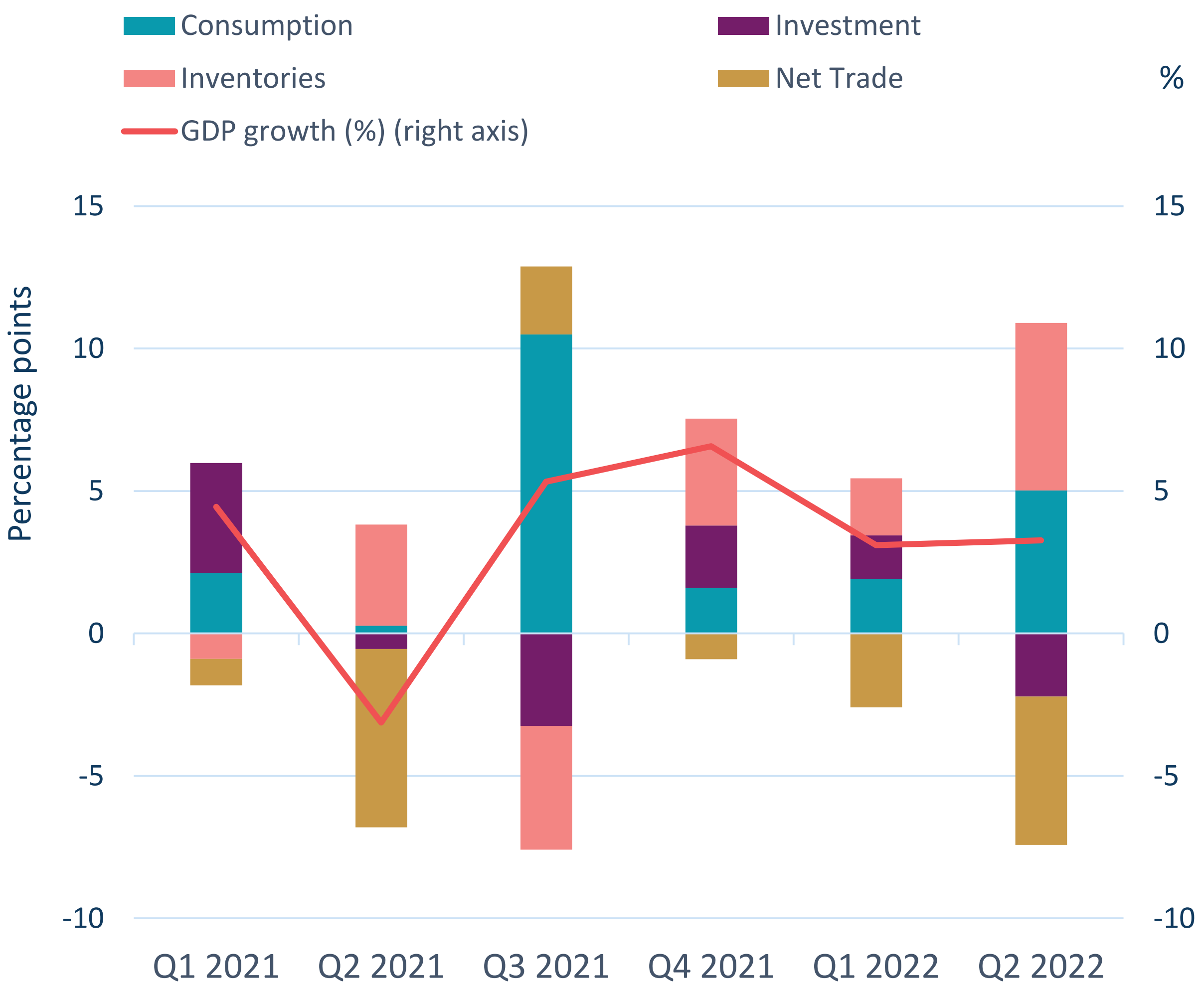
In 2023, the IMF expects that disinflationary monetary policy will take a bite out of global output, reducing growth to just 2.9%.

Global forecasted GDP growth
(annual % change)



Sources: IMF World Economic Outlook July 2022, retrieved on 2022-08-26.

Real Canadian GDP growth and contribution to growth



Source: Statistics Canada Table 36-10-0104-01, retrieved on 2022-08-31.

CANADIAN ECONOMIC GROWTH IMPROVED SLIGHTLY IN Q2

The Canadian economy grew 3.3% (annualized) in Q2, a small improvement from the 3.1% increase in Q1. Consumption contributed 5.0 percentage points to the growth as consumers increased spending on services after the winter pandemic lockdown. However, the biggest contributor to growth was inventories, 5.9 percentage points, as firms replenished stocks.

While investment subtracted from growth (-2.2 percentage points), this is entirely due to residential structure investment which is feeling the effects of rising interest rates. Investment in non-residential structures, machinery and equipment, and intellectual property all contributed positively to growth. However, some of the investment in machinery and equipment and inventory restocking came from abroad, causing real imports to increase 30.5% (annualized), much faster than export growth (10.9%). As a consequence, net trade subtracted 5.2 percentage points from growth.

The bulk of economic growth in Q2 came earlier in the quarter and advance estimates point to a decline in economic activity for July.

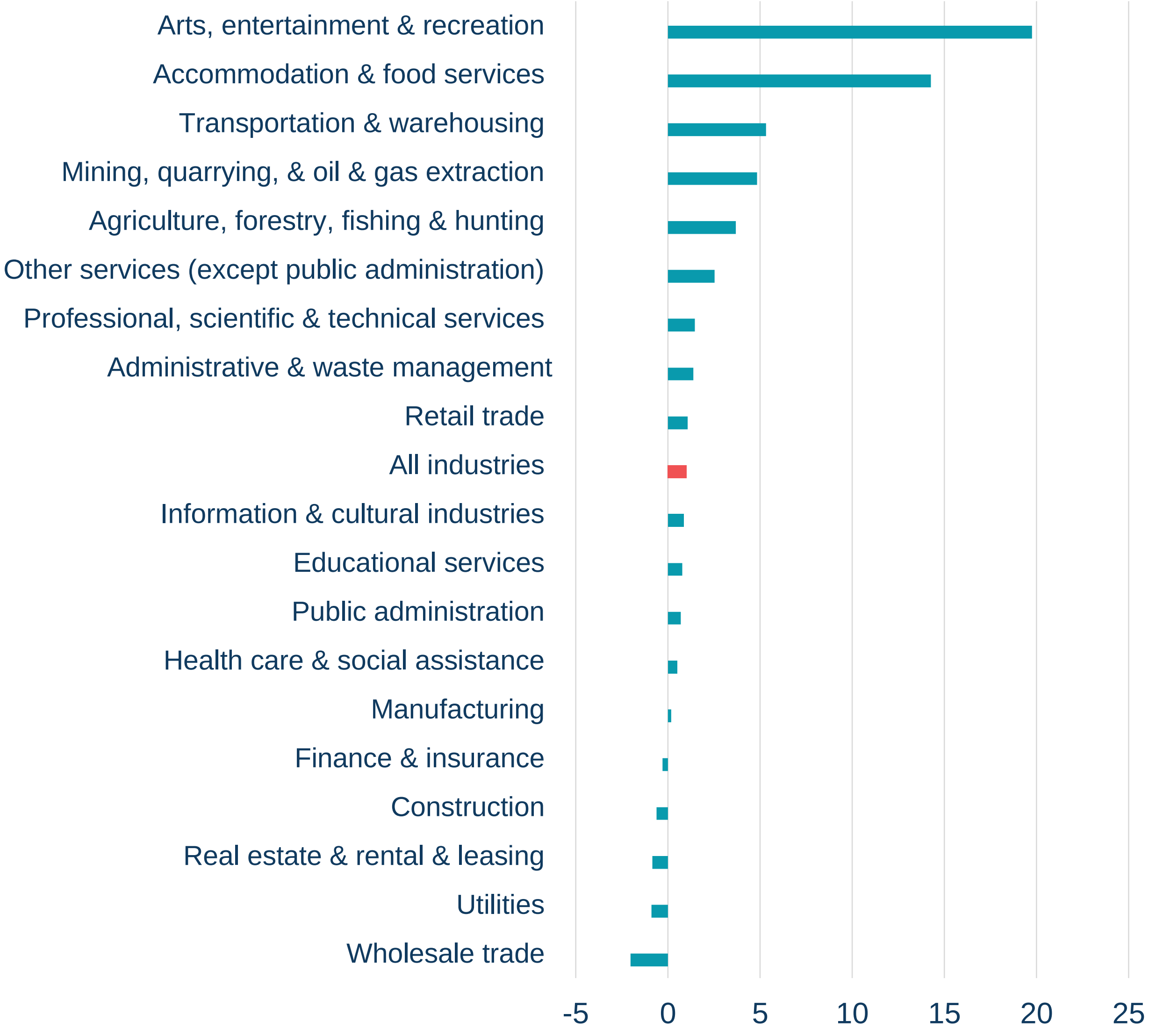
LARGEST GROWTH CAME FROM CLIENT-FACING INDUSTRIES

Real GDP by industry expanded 1.0% in Q2, with both goods- and services-producing industries increasing equally by 1.0%.

As COVID-19 restrictions were removed at restaurants, casinos and sporting events across several provinces, economic activity rebounded by 14.3% in the accommodation and food services sector in Q2. Likewise, activities in the arts, entertainment and recreation sector increased 19.8% in Q2, supported by the removal of restrictions in addition to various Canadian franchises making the playoffs in their respective leagues. Transportation and warehousing grew 5.3%, with air transportation growing by 63.0%, supported by an easing of travel restrictions, and urban transit growing by 26%, supported by the return to in-person work and rising fuel prices. On the goods side, mining, quarrying, and oil and gas extraction (+4.8%) and agriculture, forestry, fishing and hunting (+3.7%) both posted solid growth, supported by elevated commodity prices.

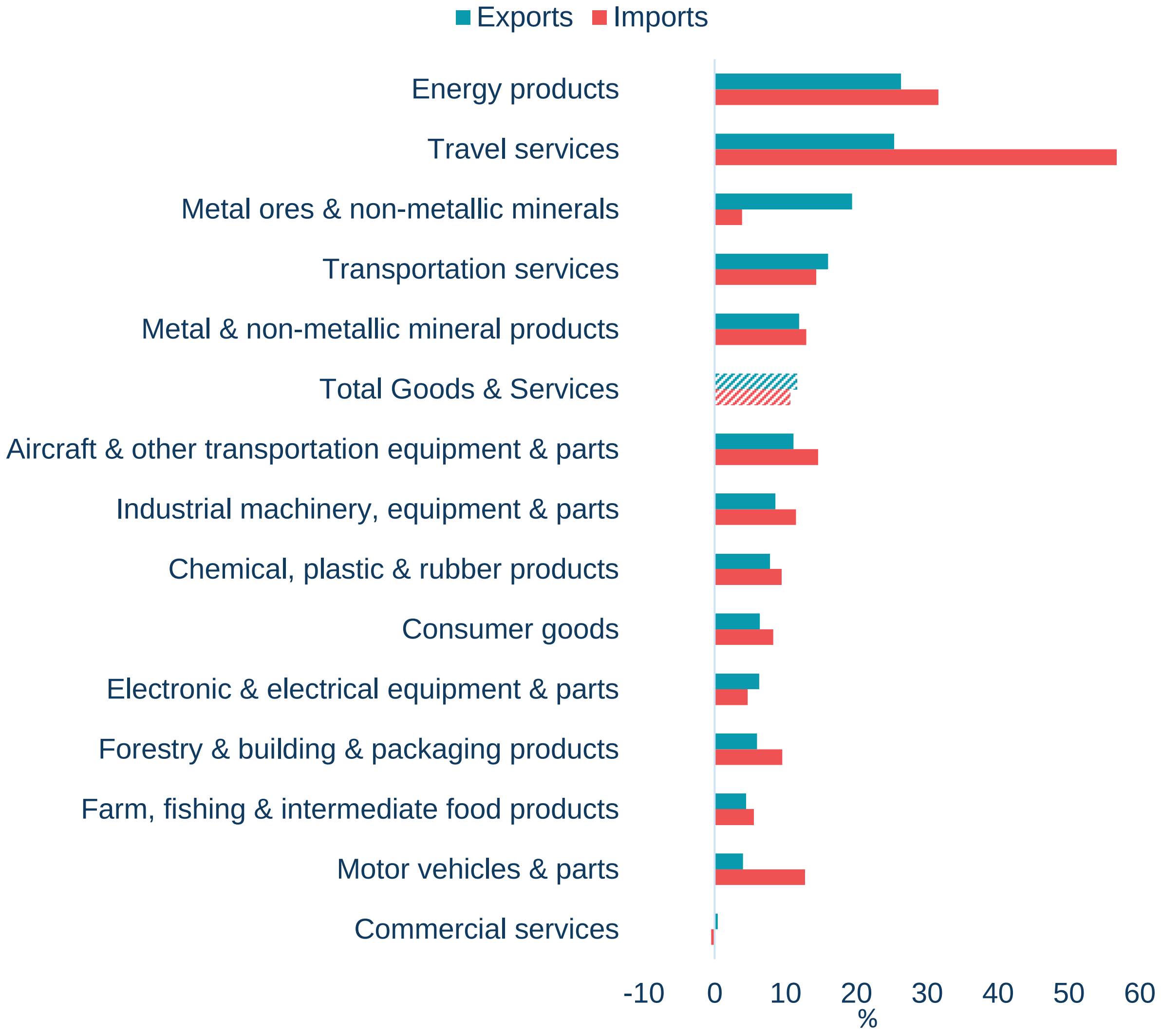
The real estate and rental and leasing sector posted a 0.8% contraction as rising interest rates reduced real estate activities. This spilled over into the wholesale sector (-2.0%) as wholesale of building materials and supplies contracted. Declines in equity asset values and higher-than-expected inflation hurt investors' confidence, causing a 0.3% contraction in the finance and insurance sector.

Canada's GDP at basic prices by industry for Q2 (Quarterly % change)



Sources: Statistics Canada Table 36-10-0449-01. Retrieved 2022-08-31.

Canada's international trade by product
(2022 Q2, quarterly % change)



Sources: Statistics Canada Table 36-10-0019-01 & Table 36-10-0021-01.
Balance of payments basis, seasonally adjusted.

EXPORTS WERE DRIVEN BY ENERGY PRODUCTS

Exports of goods and services increased 11.6% in Q2 to reach $242 billion, an all time high. Exports of goods were up 12.7% to reach $205 billion, also a record high. The largest contributor to the growth in goods exports was energy products, up 26.3%. However, the growth in energy products was due entirely to elevated prices as volumes actually decreased slightly. Metal and non-metallic mineral products also contributed to the growth with an increase of $2.4 billion, due to higher volumes. Exports of services increased 6.0%, led by a 25.4% growth in travel services as travel restrictions continued to be lifted and non-resident visitors doubled in Q2. Transportation services also benefited from non-resident visitors as exports increased 16.0%.

Imports of goods and services increased 10.7% to reach $233 billion, on the strength of energy products (+31.6%), motor vehicles and parts (+12.8%) and consumer goods (+8.3%). Services imports increased 9.8% to reach $41 billion. The number of Canadians travelling abroad doubled compared to the first quarter, leading travel services imports to increase by 56.8%, and transportation services imports to increase by 14.3%, although the growth in transportation services imports was also partially due to higher imports of marine transportation.

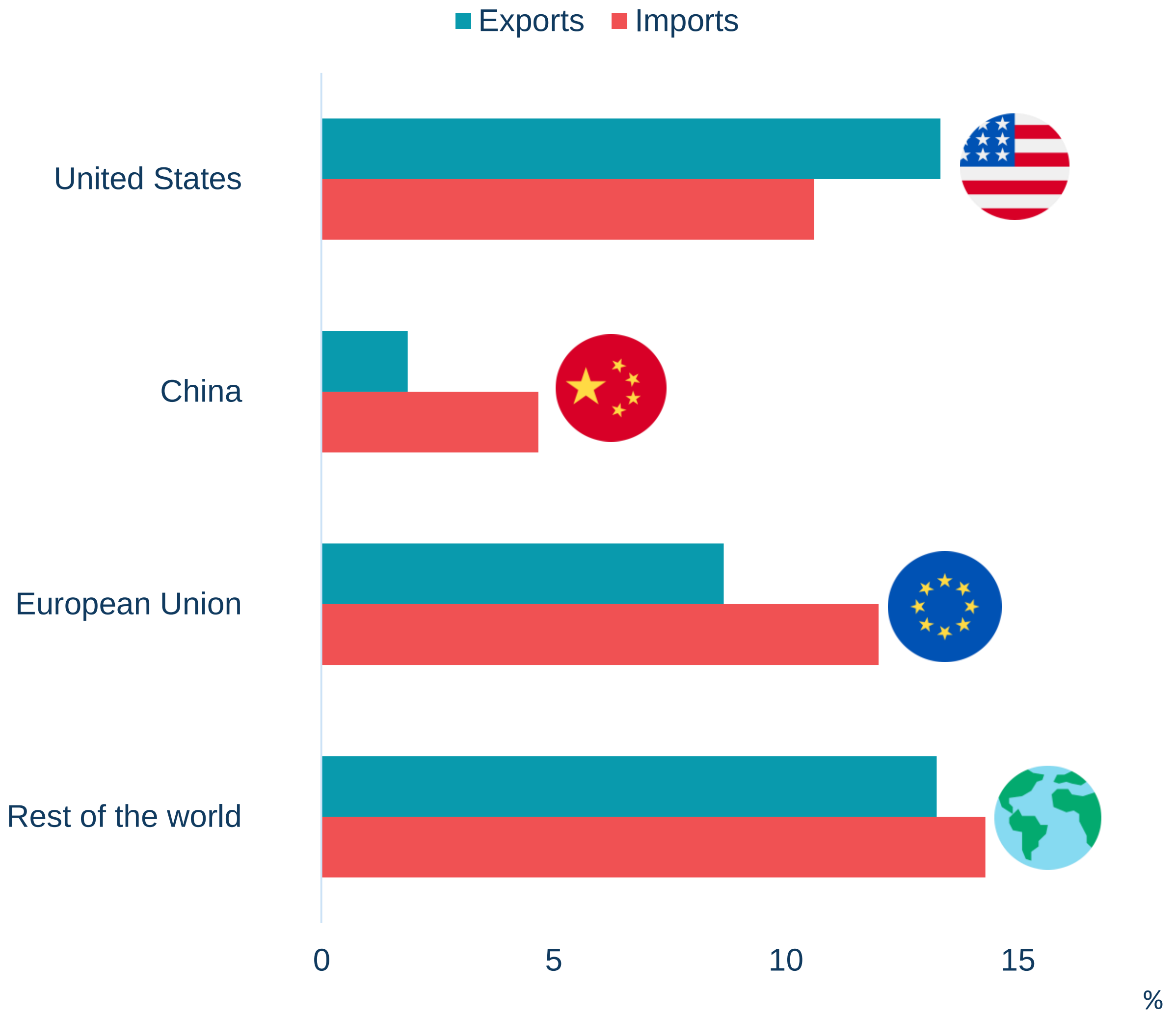
The trade in goods and services balance posted a $9.1 billion surplus in Q2, a level not reached since Q3 2008, as the goods trade surplus reached $12.5 billion, also the highest level since 2008. Of note, as border restrictions receded and international travel picked up, travel services trade posted its first deficit since Q1 2020. Furthermore, travel services trade is one of the few major categories to have not recovered to pre-pandemic levels. Export of aircraft, and other transportation and equipment is another category that has not moved beyond pre-pandemic levels.

EXPORTS TO THE U.S. DRIVEN BY ENERGY PRODUCTS

In Q2, exports to the U.S. (+13.3%) increased faster than imports (+10.6%). There was broad-based growth in exports to the U.S. but the main driver was energy products, which benefited from high prices. Import growth from the U.S. was also broad-based, led by growth in energy products and motor vehicles and parts. Imports of industrial machinery and equipment also showed strength as firms increased investment in machinery and equipment in Q2. The goods trade surplus with the U.S. increased $7.3 billion to reach a record of $40.0 billion.

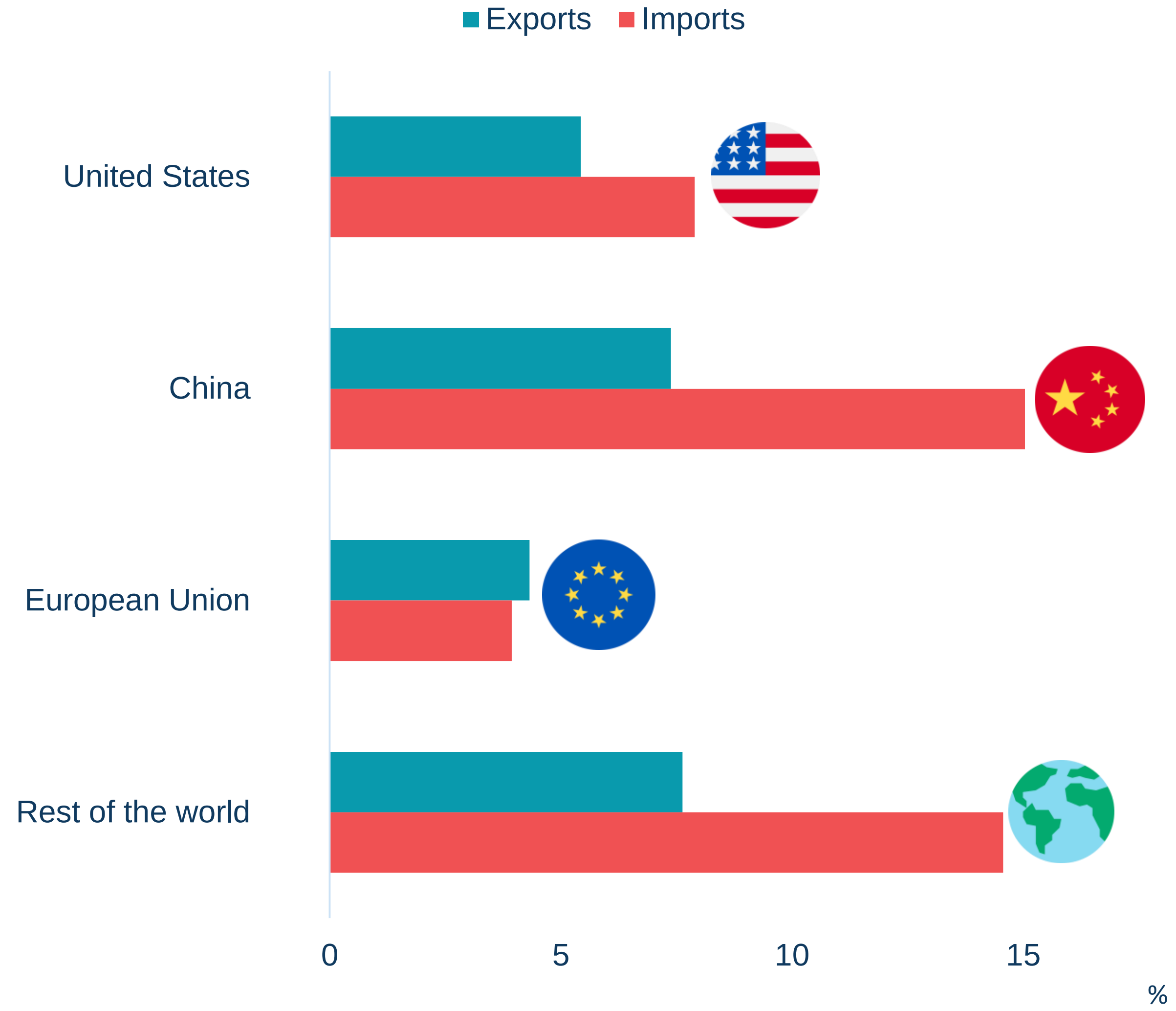
Imports from countries other than the U.S. increased 11.3% in Q2, outpacing exports which grew 10.6%. Trade growth with China was weaker than trade growth with other regions as lockdowns affected Chinese cities and ports. Export highlights include exports to the United Kingdom (crude oil and gold), the Netherlands (pharmaceutical products), Australia (pharmaceutical products). Import highlights included imports from India (various products), the United Kingdom (motor gasoline), Switzerland (non-ferrous metals), and Brazil (various products). The goods trade deficit with countries other than the U.S. increased by $3.0 billion.

Canada's goods trade, by major trading partner
(2022 Q2, quarterly % change)



Source: Statistics Canada Table 36-10-0023-01, balance of payments basis, seasonally adjusted. European Union does not include the United Kingdom.

Canada's services trade, by major trading partner (2022 Q2, quarterly % change)



Source: Statistics Canada Table 12-10-0157-01, balance of payments basis, seasonally adjusted. European Union does not include the United Kingdom.

A DOUBLING OF INTERNATIONAL TRAVELLERS SUPPORTED SERVICES GROWTH

Services exports to the U.S. grew 5.4% and imports grew 7.9% in Q2. Travel services were a driver of growth as the number of travellers between Canada and the U.S. more than doubled in Q2, but the amount of travellers is still significantly below 2019 levels. Transportation services trade with the U.S. improved and exceeded Q2 2019 levels. Since services exports grew slower than imports, services trade with the U.S. experienced a deficit for the first time since Q2 2020.

For countries other than the U.S., services exports increased 6.7%, slower than imports which increased 11.9% in Q2. As a consequence, the services deficit with countries other than the U.S. increased to $3.1 billion, the largest deficit since Q1 2020. The number of travellers between Canada and non-U.S. countries also doubled in Q2, but is still significantly below 2019 pre-pandemic levels. As a result, travel services trade with non-U.S. countries is still lagging 2019 levels. Transportation services export to non-U.S. countries are also still below pre-pandemic levels but imports have exceeded the amount seen in Q2 2019, supported partially by the rise in marine shipping costs.

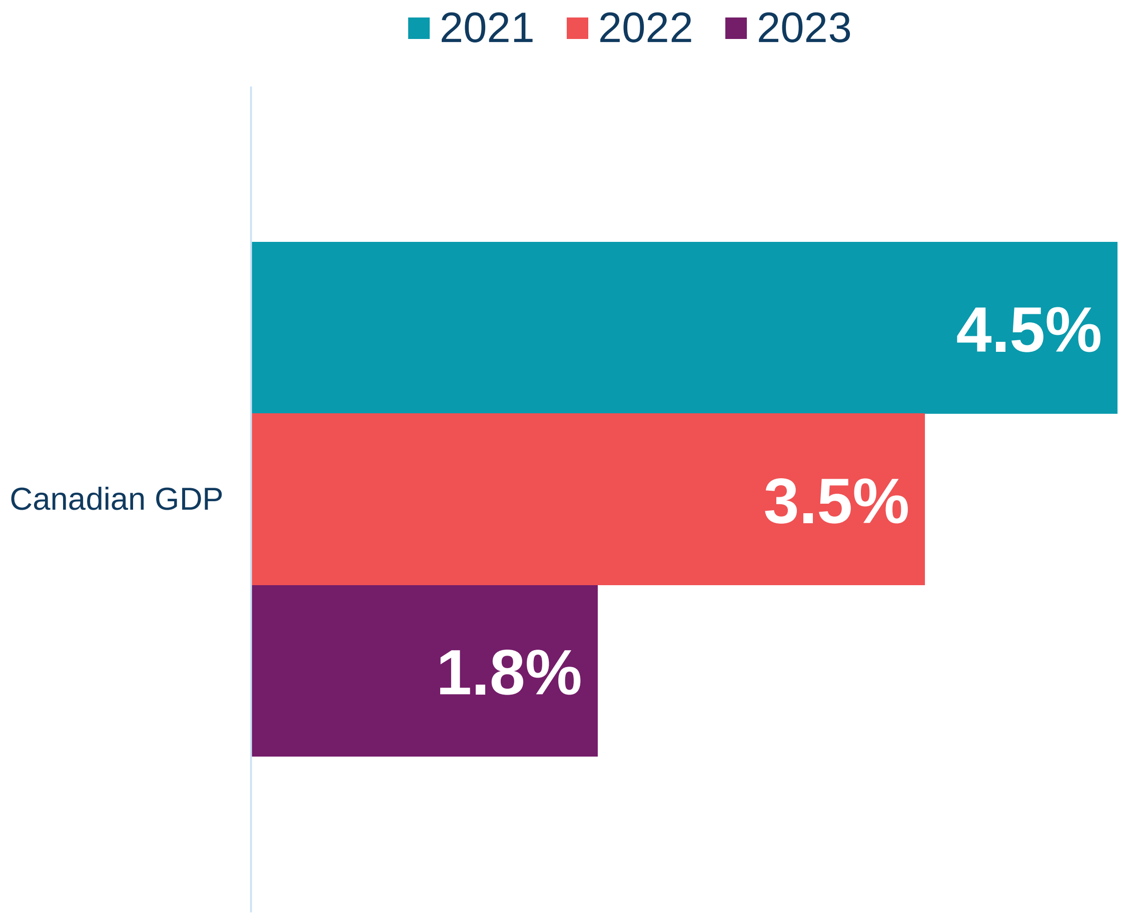
HIGHER PRICES AND INTEREST RATES ARE EXPECTED TO SLOW DOWN CANADIAN ECONOMIC GROWTH

Just like in many other economies around the world, inflation is elevated and broad in Canada, affecting a large number of products. Global factors that have increased the prices for energy, food, and tradable goods are driving most of the surge but according to the Bank of Canada, excess demand is also playing a role. Inflation expectations can also lead to future inflation and Canadian consumers and businesses increasingly expect higher inflation in the short-term. Fortunately, long-term inflation expectations remain relatively stable. The Bank of Canada forecasts that inflation will return to its targeted range by the end of 2024.

Canadian economic growth is expected to slow in the short-term as the Bank of Canada continues to hike interest rates in the fight against elevated inflation. The effects of higher prices and interest rates are expected to weigh on household spending, and have already started to affect the housing market, which has experienced a sharp slowdown in recent months. Exports and business investment expectations are also weighted down by a weaker outlook for the global economy. However, in the short-term, elevated prices will continue to support the value of commodity exports.

The Bank of Canada expects the Canadian economy to grow 3.5% in 2022 and 1.8% in 2023, down from its previous forecast of 4.2% and 3.2% back in April.

Canadian forecasted GDP growth
(annual % change)



Source: Bank of Canada, Monetary Policy Report, July 2022.

Table 1: Canadian trade by industry sector
($ millions)

	Exports			Imports		
	Q2 – 2022	Q/Q %	YTD %	Q2 - 2022	Q/Q %	YTD %
Goods	204,841	12.7	27.1	192,376	10.9	20.4
Resource products	131,640	16.7	38.1	69,165	13.2	31.2
Energy products	61,118	26.3	91.2	13,515	31.6	71.8
Non-resource products	68,244	6.4	11.7	115,737	9.5	15.3
Industrial machinery & equipment	11,180	8.6	17.4	21,128	11.5	20.0
Electronic machinery & equipment	7,912	6.3	17.5	21,127	4.7	14.9
Motor vehicles and parts	20,190	4.0	9.7	27,723	12.8	13.5
Aircraft & other transportation equipment	5,684	11.1	-17.6	5,846	14.6	16.3
Consumer goods	23,278	6.4	18.9	39,913	8.3	14.4
Services	37,136	6.0	15.5	40,536	9.8	24.7
Travel	6,575	25.4	69.9	6,957	56.8	326.0
Transportation	4,807	16.0	27.6	9,555	14.3	50.1
Commercial	25,395	0.4	6.0	23,576	-0.5	1.1
Government	359	-0.3	3.8	449	2.7	17.2
Total Goods and Services	241,977	11.6	25.1	232,912	10.7	21.2

Note: “Q/Q %” is the change from the previous quarter; “YTD %” is the year-to-date (Q1 to recent quarter) cumulative change compared to the same period in the previous year.
Source: Statistics Canada Table 36-10-0019-01 & 36-10-0021-01.Balance of payments basis, seasonally adjusted.

Table 2: Canadian goods trade by trading partner
($ millions)

	Exports			Imports		
	Q2 – 2022	Q/Q %	YTD %	Q2 – 2022	Q/Q %	YTD %
United States	158,471	13.3	32.9	118,504	10.6	20.2
Mexico	2,386	-2.5	8.3	5,973	9.6	21.7
European Union	9,042	8.7	15.3	17,411	12.0	19.0
France	984	11.1	10.3	1,450	8.1	8.0
Germany	1,863	12.4	4.5	4,606	13.3	13.2
United Kingdom	5,531	7.8	17.4	3,001	26.8	16.0
India	1,328	15.5	94.0	1,684	34.0	36.7
China	6,403	1.9	-13.6	17,907	4.7	23.0
Japan	4,858	6.5	37.4	2,911	1.5	-1.4
South Korea	2,506	5.7	58.2	2,780	4.3	29.7
Rest of the world	14,316	22.9	2.7	22,205	16.1	22.5
Total Goods Trade	204,841	12.7	27.1	192,376	10.9	20.4

Note: “Q/Q %” is the change from the previous quarter; “YTD %” is the year-to-date (Q1 to recent quarter) cumulative change compared to the same period in the previous year.
Source: Statistics Canada Table 36-10-0023-01.Balance of payments basis, seasonally adjusted.

Table 3: Canadian services trade by trading partner
($ millions)

	Exports			Imports		
	Q2 – 2022	Q/Q %	YTD %	Q2 – 2022	Q/Q %	YTD %
United States	20,691	5.4	14.9	20,998	7.9	19.3
Mexico	541	2.3	17.2	734	41.4	143.8
European Union	4,368	4.3	15.5	5,041	3.9	14.6
France	1,037	4.5	14.6	789	1.5	19.8
Germany	753	3.6	18.1	839	6.5	20.3
United Kingdom	1,677	5.2	14.3	2,126	2.9	9.3
India	1,228	11.1	15.8	718	7.2	23.5
China	1,556	7.4	23.4	1,151	19.2	93.9
Japan	503	8.9	21.1	727	0.4	10.8
South Korea	371	43.2	40.9	157	19.8	50.8
Rest of the world	6,201	6.4	14.2	8,884	17.9	43.0
Total Services Trade	37,136	6.0	15.5	40,536	9.8	24.7

Note: “Q/Q %” is the change from the previous quarter; “YTD %” is the year-to-date (Q1 to recent quarter) cumulative change compared to the same period in the previous year.
Source: Statistics Canada, Table 12-10-0157-01. Balance of payments basis, seasonally unadjusted.