

Deterioration of two-way trade in July

July trade balance:

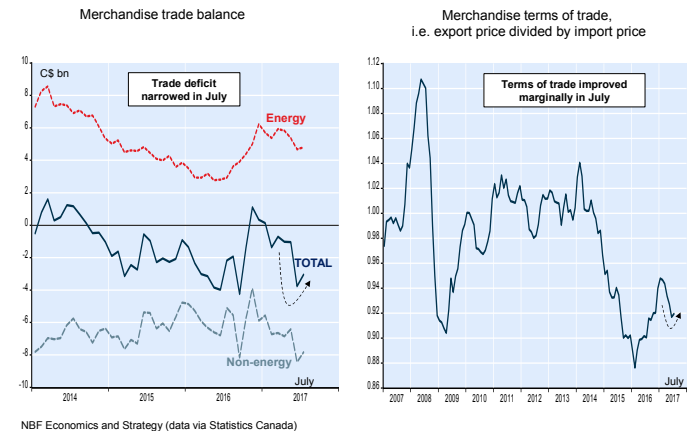
Latest: -3.04\$ bn (actual), -3.30 bn (expected)

Previous: -3.76 bn (revised from -3.60 bn)

FACTS: Canada's merchandise trade deficit narrowed to C\$3 bn in July from an upwardly revised deficit of C\$3.8 bn the prior month. The improvement was due to imports (-6%) falling faster than exports (-4.9%). Most export categories saw decreases including a 9.6% slump for autos and a 3.7% drop for energy. But imports of energy fell even faster (-14.7%), allowing the energy trade surplus to increase to C\$4.8 bn. The non-energy trade deficit also improved to C\$7.8 bn. Terms of trade improved slightly during July (top chart). The goods trade surplus with the U.S. rose to C\$2.9 bn. In real terms, Canada's imports slumped 2.5%, while exports were down 1.6%.

OPINION: While Canada's goods trade deficit was smaller than expected, the details of the report were less encouraging given the deterioration in two-way trade. The drop in exports was disappointing (particularly those of autos and parts), and the only reason the goods trade deficit narrowed was because of an even faster decline in nominal imports during the month. Assuming no change in August and September, real merchandise exports are on track to fall 10% annualized in the third quarter, while real imports are slated for a smaller decline of 3% or so during the quarter (middle chart). So, after contributing to Canada's real GDP growth in Q2, merchandise trade is set to subtract from it in the third quarter. However, there's some good news. While imports were down overall in July, real imports of machinery and equipment continued to rise — import volumes of electronic equipment even hit an all-time high in July —, suggesting the recovery of business investment spending extended to Q3 (bottom chart). Real imports of consumer goods rose again in July, highlighting the healthy state of the Canadian consumer. All in all, the July trade data is much in line with our view that Canada's real GDP growth is set to soften in the third quarter after a hot first half of 2017.

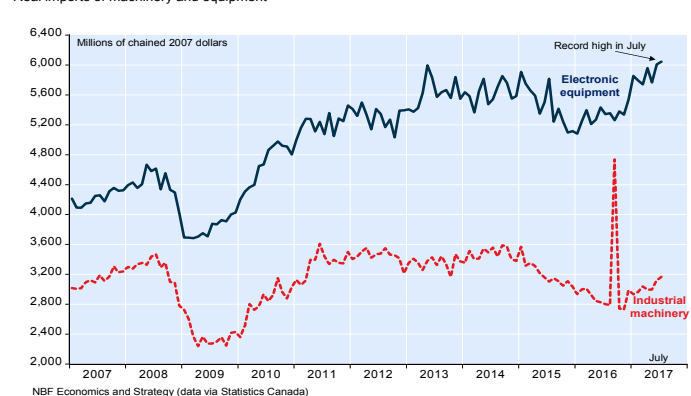
Canada: Goods trade deficit narrowed slightly in July



Canada: Merchandise trade likely a drag on the economy in Q3



Canada: Rising imports of machinery point to rebound in business investment



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