

ECONOMICS: CANADA PERSPECTIVES—FEBRUARY 26, 2010

Energy Drives Exports and Economic Outlook

■ **James Barrineau**
 Senior Economist—Global Economic Research

A sustained rebound in Canada’s energy exports could push the country’s trade account back into the black and brighten the economic outlook. But this is unlikely to happen without further increases in oil prices.

In this week’s commentary, we explore whether energy exports could strengthen enough to push Canada’s trade account back into surplus. Such an event, if sustained, would ease fears about the impact of the strong Canadian dollar and bolster the country’s GDP growth prospects. However, this outcome is unlikely unless oil prices move higher.

Energy is a growing component of the overall trade picture for Canada (**Display 1**), as evident in its solid 13% year-over-year gain in 2009. The large spike in these exports in 2008 stemmed mostly from the dramatic run-up in oil prices. But even putting that factor aside, energy is clearly a key driver of the Canadian export business.

We expect energy exports to continue cushioning Canada from further weakness elsewhere in the economy, especially in the US-dependent manufacturing sector. Manufacturing could continue to struggle if the US recovery loses steam. In that case, Canada’s trade deficit might increase but those increases would be held in check by steadier energy exports.

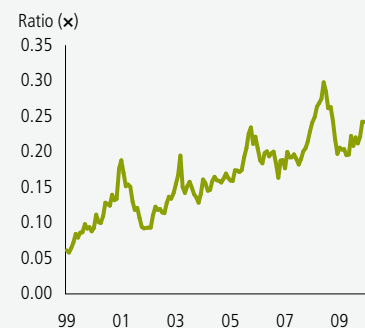
While we view energy exports as a key economic support for Canada, their ultimate impact is likely to be largely dependent on prices. As shown in **Display 2**, there has been a nearly perfect correlation between Canadian oil exports and oil prices over the past couple of years.

This suggests better news for Canada in the months ahead. In 2009, Canadian crude oil export growth actually lagged price increases. Oil prices soared 81% for the year, while oil exports only gained 66%. We attribute this near-term divergence to anemic demand for oil in the US, which trailed the rest of the world. Even so, Canadian energy exports have risen steadily. The benefit to Canada will be even greater once US oil demand returns to historical norms.

Moreover, the energy component as a whole has become increasingly dependent on crude oil. Natural gas exports essentially have been cut in half over the past year as a surge in US gas production has diminished the need for Canadian

Display 1
Energy Exports Are Gaining Prominence

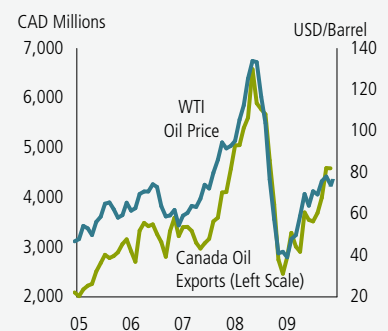
Energy as a Percent of Total Canadian Exports



Source: Haver Analytics and Statistics Canada

Display 2
Oil Exports Are Price Dependent

Canada Oil Exports vs. WTI Oil Price



WTI = West Texas Intermediate
 Source: Haver Analytics, Statistics Canada and The Wall Street Journal

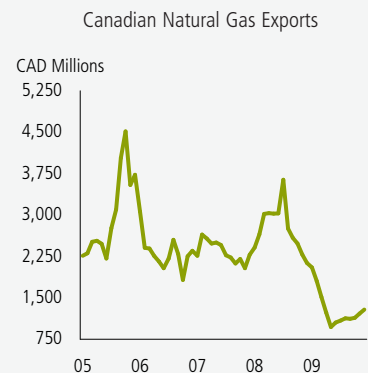
products (**Display 3**). Despite the downturn, the country's natural gas exports rose 9% in the fourth quarter from the prior quarter.

We are also seeing some promising developments in Canada's natural gas market. The unconventional shale-drilling techniques that sparked the US production boom have migrated north. The National Energy Board of Canada had predicted a sharp decline in conventional gas output less than a year ago, but is now expecting shale gas to satisfy domestic demand "far into the 21st century" and to spur liquefied-gas exports. A gas-shipping terminal on the west coast is being redesigned to export liquefied gas, and is slated to begin operation in 2014. This

should significantly bolster Canada's efforts to expand its presence as an energy exporter.

The other meaningful category in energy exports is petroleum and coal products. With the recent decline in natural gas exports, receipts of these products now roughly match those of gas—at around \$1.4 billion (Canadian dollars). This category rebounded much more sharply than gas last year, with exports climbing nearly 13% in December over the prior month, and strengthening each quarter as the year progressed. This improvement offers yet another small positive for Canada's energy export growth potential.

Display 3
Natural Gas Exports Have Suffered



Source: Haver Analytics and Statistics Canada

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