Make Informed Decisions
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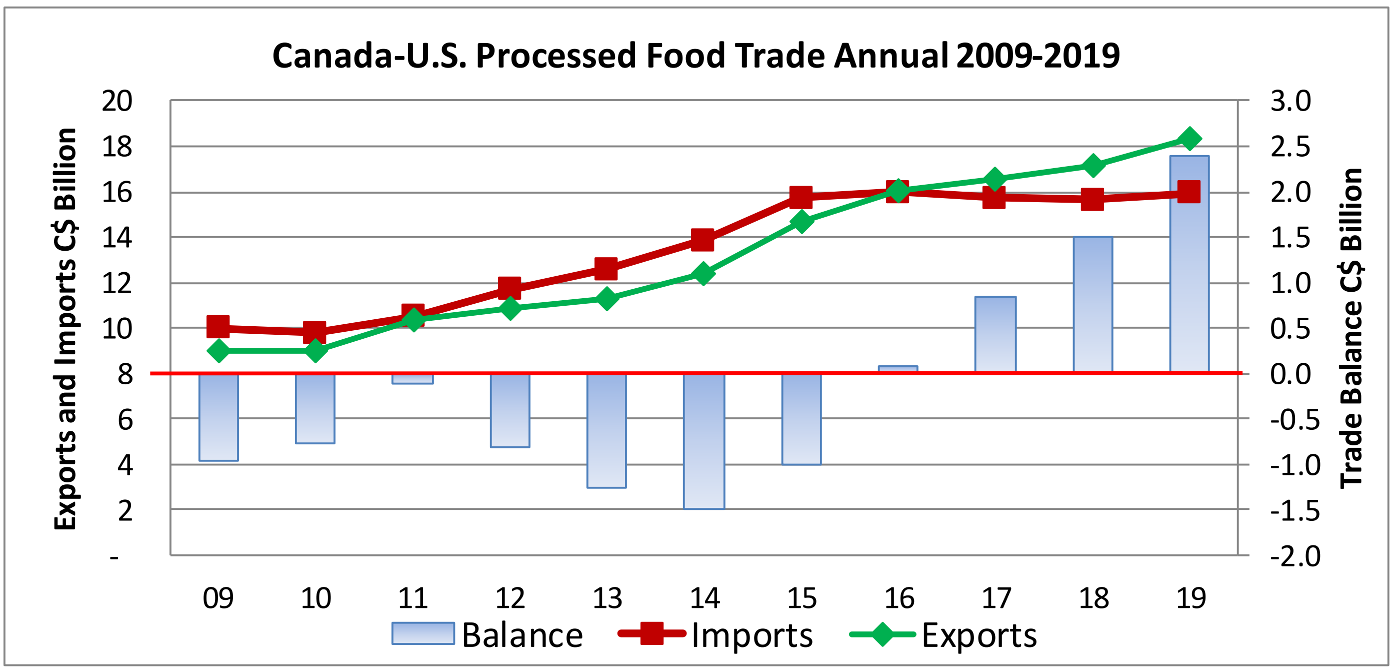
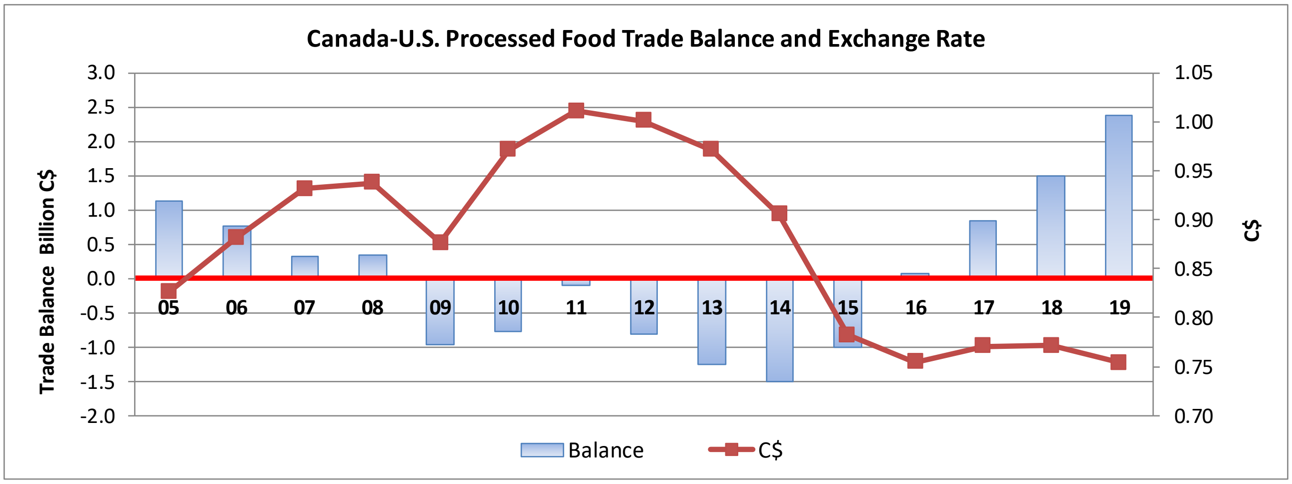
# Processed Food Trade Surplus Grows

Canada's processed food trade surplus with the United States hit a record high (at least going back to 2000) of C$2.4 billion in 2019. This is according to the USDA's Foreign Agricultural Service (FAS) data. The FAS defines processed foods as the typical packaged goods in the grocery department of a supermarket, as well as margarine, processed meat, and dairy. Not included are alcoholic beverages, fresh meats, seafood and produce. The dataset is a good representation of consumer-packaged goods trade between Canada and the United States.

The trade surplus was comprised of Canadian exports of C$18.3 billion and imports of nearly $16 billion. The surplus has grown at a compound annual rate of nearly 70% between 2017 and 2019. The surplus also stands in contrast to the $1.5 billion deficit just 5 years prior in 2014. In fact, it stands in contrast to a seven-year string of deficits running from 2009 through 2015.

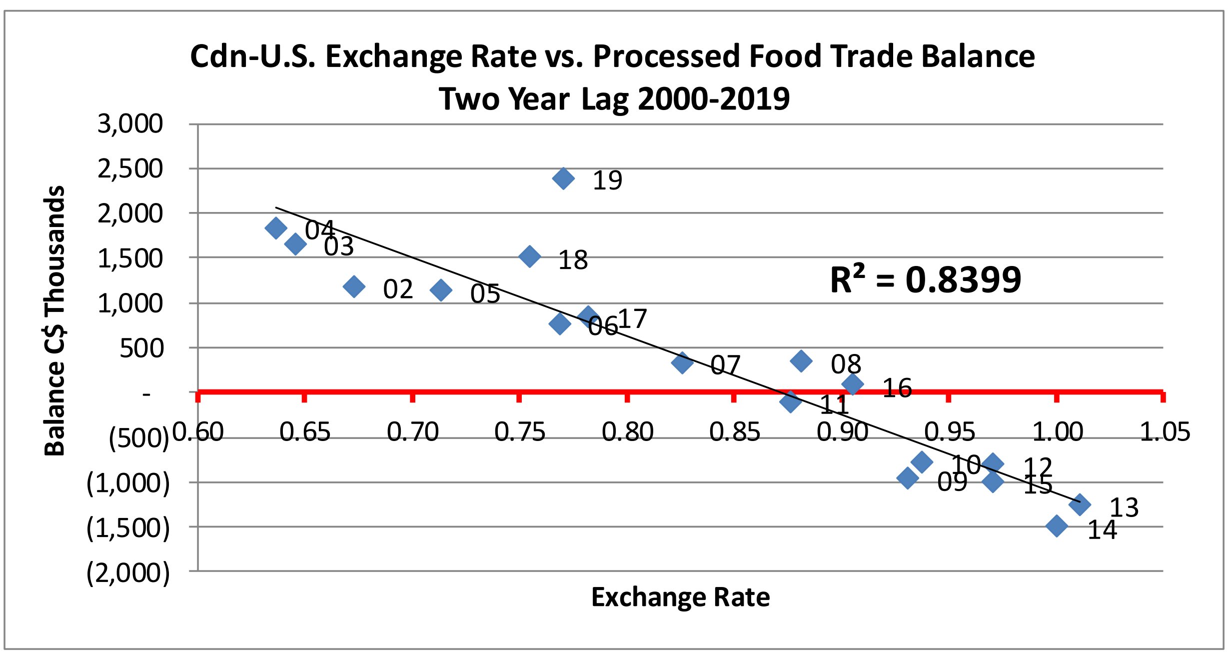



Credit for the surplus goes first to the depreciation in the exchange rate. The exchange rate was at roughly par value in 2010 and 2011 before beginning a depreciation from 2013 to 2016. The exchange rate has somewhat stabilized at about 0.75 since that time. The net result was the stagnation in imports starting in 2015 and the continued growth in exports. As noted, the surplus began in 2016 after the exchange rate dipped below 0.80 and settled into its current trading range.



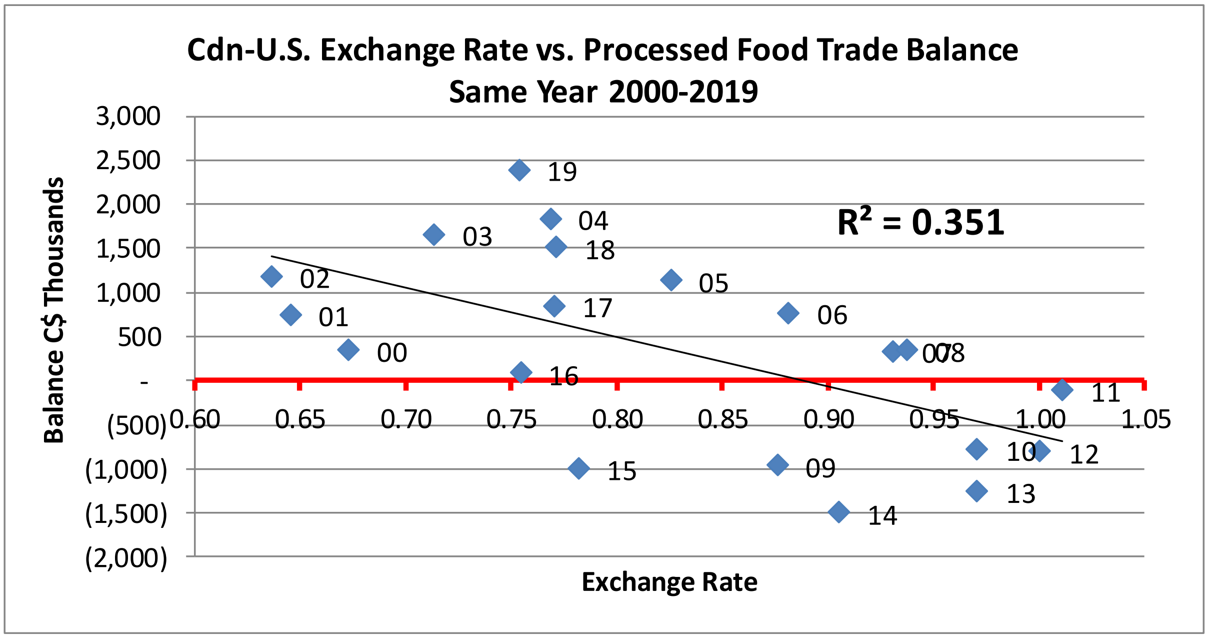

The impact of the exchange rate change is far from immediate. In non-commodity trade markets manufacturers take time to adjust to the exchange rate changes. Unlike commodity sellers, manufacturers need time to adjust to the marketing, costing and profit incentives created by the exchange rate changes. Manufacturing and marketing changes must be adopted once the impact of the exchange rate becomes apparent on costs and profits. Firms will want to ensure that the change is not temporary. Contracts are entered with new partners in the United States.

The following graph shows the quarterly statistical relationship between the exchange rate and the processed food trade balance. The statistical relationship is with a two-year lag between the exchange rate and the balance. The points on the graph show the trade balance for the year noted compared to the exchange rate two years prior.



This two-year lag is indicative of a time frame that allows companies to adopt to the changing currency and its opportunities or its detriments to trade, depending on direction. The lagged relationship is statistically strong between the two variables. The weaker the currency, the higher the trade surplus for Canada; with a two-year lag. The stronger the currency, the trade balance is lower or in negative territory; with a two-year lag.

The next graph shows the relationship between the two variables when there is no time difference between the exchange rate and the trade balance. In this case there is little statistical relationship between the exchange rate and the trade balance. The graph shows that when there is no adjustment time, there is very little statistical relationship between the exchange rate and trade performance.




The difference in statistical relationships between the lag and the immediate indicates that processed foods manufacturers need time to adjust to the signals generated by exchange rates.

**<u>Why it Matters</u>**
**Exchange rates are nearly impossible to predict. Despite this, there is little reason to expect a strengthening of the currency given the investment climate in Canada. In fact, exchange rate erosion is a more logical expectation. Furthermore, even if there is an appreciation of the currency, it would take a year or two for Canadian processed food manufacturers to adjust. As such, the U.S. can be expected to be a major destination for Canadian processed foods for at least another two years. This provides opportunities and negotiation leverage for Canadian manufacturers in relation to Canadian retailers.**

Kevin Grier, February 2020

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