export market to expand—while imports from Japan increased by 10.9%. As a result, the merchandise trade balance with Japan declined by $925 million in 2002. Merchandise exports to the EU fell by 4.9% in 2002, led by a 10.1% decrease in exports to the U.K. Imports from the EU increased by 3.0% as a 13.1% reduction in imports from the U.K. dragged down the 11.2% expansion in imports from the remaining EU countries. With fewer exports and more imports from the EU, the merchandise trade deficit with the EU worsened from $12.8 billion in 2001 to $14.9 billion in 2002. Shipments to Mexico declined by 13.1% over 2001, while imports from Mexico expanded by 4.8%. Exports to China fell by 5.2% in 2002, while merchandise imports from China grew rapidly, up 25.6%. In 2002, China moved ahead of Japan to rank as the second-largest source country for imports.

Merchandise Trade by Commodity Group

Merchandise exports experienced mixed developments in 2002, with declining exports in energy (down 8.5% over 2001), forestry (down 6.8%), machinery and equipment (down 5.0%) and agriculture (down 1.1%), and increased exports for consumer goods (up 8.6%), autos (up 4.5%) and industrial goods (up 3.9%).

Increased merchandise imports in 2002 reflected strong expansion in autos (up 12.3% over 2001), forestry (up 8.6%), consumer goods (up 8.1%) and agriculture (up 7.0%). At the same time, imports of energy fell by 7.3% and imports of machinery and equipment dropped by 5.9%. The deterioration of the merchandise trade balance in 2002 for autos (down $4.7 billion), energy (down $3.4 billion) and agriculture (down $1.8 billion) explains most of the decline in the overall merchandise trade balance in 2002. Gains and losses in the other sectors largely offset one another.

Reduction in the Services Trade Deficit

Growth in services exports outpaced growth in services imports (2.8% compared with 1.8%), resulting in a narrowing of the services trade deficit to $7.9 billion in 2002 from $8.4 billion a year earlier. Growth was led by commercial services trade—exports of commercial services in 2002 increased by 4.2% over 2001 and imports of commercial services expanded by 2.8%. On the export side, the expansion in commercial services was accompanied by a modest increase in transport services and a reduction in travel services.

Foreign Direct Investment

Both inward and outward FDI flows slowed in 2002, with each about 20% lower than their respective levels a year earlier. As in 2001, outward FDI flows in 2002 outpaced inward FDI flows. However, with inward FDI at $43.8 billion in 2002 and outward FDI at $33.6 billion, the difference narrowed to $10.3 billion compared with $12.4 billion in 2001. Reductions in outward FDI flows were predominantly in the wood and paper and the services and retail sectors, while the machinery and transport sector registered an increase. A drastic decline in inward FDI in the energy sector, coupled with a more modest decline in the wood and paper sector, explains most of the overall decline in inward FDI. On a regional note, the declines in FDI flows to and from the U.S. were the principal reasons for the reduced inward and outward FDI flows observed in 2002. Outward FDI flows to the U.S. fell from $33.7 billion to $15.5 billion, as the U.S. share of outward FDI plummeted to 35.2% from 61.4% a year earlier—predominantly in favour of outward FDI to the EU (other than the U.K.).

Inward FDI from the U.S. declined from $38.7 billion in 2001 to $25.0 billion in 2002, as the share of annual inward FDI flows originating from the U.S. declined from 91.0% in 2001 to 74.7% in 2002. Inward FDI flows from the U.K. saw a sharp decline from 2001 to 2002, while there was a substantial increase in inward investment from the non-U.K. EU countries. Overall, the EU maintained its position as the second-largest source of inward FDI in 2002, after the U.S.

Portfolio Investments

Canadian net investment in foreign securities (bonds and stocks) was $24.7 billion in 2002, down from $37.7 billion in 2001—large reductions in stock holdings (to about half of the 2001 levels) were only partially offset by modest increases in bond holdings. Similarly, foreign investments in Canadian securities declined from $30.1 billion in 2001 to $17.9 billion in 2002.

Official International Reserves Reduced

Canada reduced its holdings of official international reserves by $298 million in 2002. In contrast, $3.3 billion was added to the reserves in 2001.

Area of opportunity

NAFTA and the Tex-Mex region

Since its inception in 1994, the NAFTA has transformed the way business operates. The traditional definition of the border no longer holds true for small and medium-sized enterprises (SMEs). The phenomenon of integration is taking place at the most basic level within the NAFTA community.

The 3,141 kilometre border that separates the powerful U.S. and emerging Mexican economies can no longer be viewed in the same way. The Texas-Mexico border region is a culture and an economy unto itself—neither entirely Mexican nor American. The presence of Canadian trade commissioners on both sides of the border provides Canadian exporters with the tools and support slightly need to be successful in this burgeoning part of the world.

The Tex-Mex region

The Canadian Consulate General in Dallas covers six states (Texas, Arkansas, Kansas, Oklahoma, Louisiana and New Mexico), which are home to more than 37 million people. Texas accounts for 60% of the area population and 90% of the purchasing power. Texas has outpaced U.S. gross domestic product (GDP) growth in nine out of the last ten years, and is second only to California. The Consulate, with its dedicated staff, is well-placed to provide market intelligence and assistance to Canadian companies.

Nuevo Leon, often described as the jewel of Mexico's north, has been Mexico's economic engine in recent years. Its capital, Monterrey, is at the heart of this tremendous growth. Nuevo Leon has less than 4% of Mexico's population but generates 8% of its GDP. Monterrey is the centre of the region and is responsible for 96% of the commercial activity in the state. In 2001, *Fortune Magazine* ranked Monterrey as the best city in Latin America in which to do business. Monterrey is also headquarters for the Grupos—some of the largest companies in the world—of which the 10 most prominent generated over $47 billion in revenue in 2001.

The Canadian Consulate in Monterrey is responsible for the states of Nuevo Leon, Coahuila and Tamaulipas, home to close to 9 million people. The staff at the Consulate, along with the those at the newly opened Export Development Canada office, are committed to assisting Canadian companies in finding opportunities in this area.

Importance of the border region

Geography still matters. The four U.S. states along the Mexican border accounted for 65% of all U.S.-Mexico trade flows. Canadian trade offices in Dallas and Monterrey, the Embassy in Mexico City, and other partner institutions are working in concert to promote Canadian interests in the region. The environmental technologies sector is growing steadily as is indicated by the increased scope of the North American Development Bank—the environmental infrastructure institution that operates on both sides of the U.S.-Mexico border. Further, PEMEX—Mexico's state-owned petroleum company—has a procurement office in Houston, which welcomes Canadian bids to assist in the development of the vast oil and gas resources in Mexico.

Additionally, the Dallas Market Center—the world's largest trade show venue—represents a great opportunity for Canadian companies to display their goods and services to American, Mexican and other international buyers. Canadian trade commissioners' sector-specific knowledge, market intelligence and expertise in doing business in the region make them perfect partners to assist Canadian companies in maximizing opportunities in the region.

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