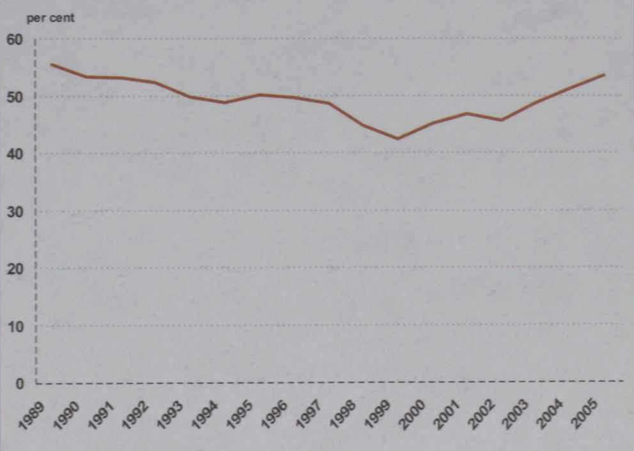
BOX A: THE IMPACT OF HIGHER COMMODITY PRICES ON CANADA'S TRADE BALANCE

Introduction

Canada has historically been a net exporter of commodities, particularly energy, industrial goods and forestry products. The commodity sector has always played an important role for Canada's economic prosperity. In 2005, the commodity sector accounted for 12 per cent of GDP and over 50 per cent of exports (see Figure A1).[1] Recently, robust economic growth in economies such as China and India, along with other geopolitical and supply/demand factors, have been creating upward pressure on global commodity prices. The objective of this short section is two-fold; firstly, to analyze the impact of recent price booms in energy and industrial commodities on Canada's trade balance and secondly to provide an estimate of the impact of commodity price changes on Canada's trade balance going forward.

Figure A1
Commodities Share in Canada's Exports, 1989-2005



Source: Statistics Canada

Background and Assumptions

Commodity prices have been rising sharply in recent years. Since 2002, when the prolonged price increases began, the commodity price index had risen 78 per cent by the end of 2005, while the energy index rose 137 per cent over the same period.[2] Crude oil prices hit an all time monthly high of US$65.6 per barrel[3] in September, 2005, while natural gas prices also reached a high of US$10.97 per thousand cubic feet in October, 2005. The peaks recorded during these two months were due to the disruptions caused by hurricane Katrina; however, crude oil and natural gas prices since then have not dropped to their pre-Katrina levels. The industrial material index also increased by 43 per cent since 2002. All major industrial metal prices have been increasing since 2002, especially copper, iron ore and nickel, which have each more than doubled in price. Aluminium, gold, silver and zinc have also appreciated in value by more than 40 per cent during this period.

According to forecasts from the IMF, industrial commodity prices are expected to increase further, up 12.3 per cent in 2006 followed by a slight decrease in 2007.[4] The U.S. Energy Information Administration (EIA) estimates that oil prices will remain high, averaging US$65 per barrel in 2006 and $61 in 2007 under the assumption that the current demand for oil will be sustained and that there will be a modest increase in oil production capacity while geopolitical risks continue.

Canada's top net exports[5] have been dominated by resource-based commodities for some time; this is more apparent in recent years—10 of the top 12 net export of goods[6] in 2005 were energy and industrial goods and materials as can be seen in the Table A1.

[1] Sectors included for computations are: agriculture, forestry, fishing and hunting, mining and oil and gas extraction, wood product manufacturing, paper manufacturing, petroleum and coal products, chemical manufacturing, non-metallic mineral product and primary metal manufacturing.
[2] Bank of Canada's commodity price index.
[3] Cushing, OK WTI Spot Price FOB (USD per barrel).
[4] IMF World economic outlook database, April 2006
[5] Net exports are computed by subtracting imports from exports.
[6] The data is at the HS6 level.