Is the Canadian economy weakened by its southern neighbor?

By Peter Grandich

Like it or not, Canada is still quite dependent on the health of the U.S. economy. They are, after all, the world's two largest trading partners. In 2009, about 73 per cent of all of Canada's exports and 63 per cent of its imports came from its neighbor to the south. While China has the U.S. in its sight for largest economy in the world (recently surpassing Japan to rank 2nd), we mustn't forget that Canada has the tenth largest economy in the world (measured in U.S. dollars at market exchange rates). Americans may think only natural resources and cold fronts come from Canada but the fact is, thanks to being mostly fiscally sound while others on the world stage went off the deep end, Canada is well positioned for growth for years to come.

International trade is a very significant part of Canada's economy with natural resources playing a major role. Agriculture, energy, forestry and mining exports were almost 60 per cent of total exports in 2009. Machinery, equipment, automotive products and other manufacturers made up most of the rest. In 2009, exports as a whole made up about 30 per cent of Canada's GDP.

With the United States facing its most difficult economic, political, social and spiritual challenges in its entire history, and the world heading for major trade and currency wars, Canada finds itself in the middle of all this. It needs to be on guard as there's already talk about excluding it from a potentially new alignment of the Big Three or so nations (U.S., China and Japan). The argument is that the G-20 is too big and the G-7 not efficient. That, at least, is what the International Institute of Finance (whose membership includes Canada's top banks) said at an emergency meeting of a "core group" of the world's major economies. The meeting was convened to work out a new global economic agenda for an "unprecedented level of multilateral coordination." In a letter outlining the banking group's objectives, its managing director, Charles Dallara, suggested the core group of top nations should meet before the G20 to "broker agreement on a number of sensitive macroeconomic and exchange-rate issues." In an interview quoted in *The Wall Street Journal*, Mr. Dallara said, "the G20 is simply too large and unwieldy to practically handle some of these complex and delicate issues.... You need a smaller group as a stepping stone to the G20." That smaller group (presumably the United States, Japan, China and maybe one other country) would leave Canada and other G7 members out in the cold.

Canada's Minister of Finance, Mr. Jim Flaherty, recently said: "We are at the stage that we have a recovery that is modest and fragile," adding now was not the time for China to be manipulating its currency. Canada has openly joined a growing list of countries that are blaming China for manipulating its currency and giving it an unfair advantage in world trade. The IMF said: "There is clearly the idea beginning to circulate that currencies can be used as a policy weapon. Translated into action, such an idea would represent a very serious risk to the global recovery."

Despite (and perhaps due) to its weakened condition, the U.S. is attempting to pass trade sanctions against China in Congress that would allow American companies to seek import duties on Chinese exporters using an artificially weak currency. The measure has passed the House of Representatives but still has to get through the Senate.

China has assailed those efforts, calling them protectionist. China, however, is refusing to swiftly free up its currency, and Chinese officials recently in Washington remain insistent that their plans to slowly revalue the yuan is the best approach. "China will move the exchange rate gradually," Zhou Xiaochuan, head of China's central bank, said during a panel discussion. "We will do it in a gradual way rather than shock therapy."

Despite a modest rebound, the world remains in a fragile state thanks to a financial earthquake that still has major aftershocks and no one can safely assume the tremors are over. Thankfully, Canada is in much better shape than most, but due to being still pretty much tied to the hip of its neighbor to the south, it can't rest on its laurels. | ABM

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