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**Remarks by Mark Carney**  
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**Greater Kitchener Waterloo Chamber of Commerce**  
**Waterloo, Ontario**  
**2 April 2012**

## Exporting in a Post-Crisis World

### Introduction

It is an honour to help celebrate the 125th anniversary of the Greater Kitchener Waterloo Chamber of Commerce. Allow me to congratulate you for the work you have done and are doing to ensure that this is a “business building community.”

This economy has been transformed since your Chamber was established. From its original mix of agriculture and basic manufacturing, the Kitchener-Waterloo region has become one of North America’s most diverse economic clusters. Through such nimbleness, this region has contributed to the 100-fold expansion of the broader Canadian economy over the Chamber’s lifetime.

Of course, there have been occasional setbacks over the past 125 years, with more than 20 recessions, one depression and one near miss. In general, the recoveries that have followed have relied importantly on exports ([Chart 1](#)). However, this one is different. Exports still have not regained their pre-crisis peak, and in fact remain below their level of a decade ago. Canada has steadily lost global market share throughout this period.

In my remarks today, I will discuss why this is happening and what can be done both in K-W and across Canada to respond to the underlying challenges.

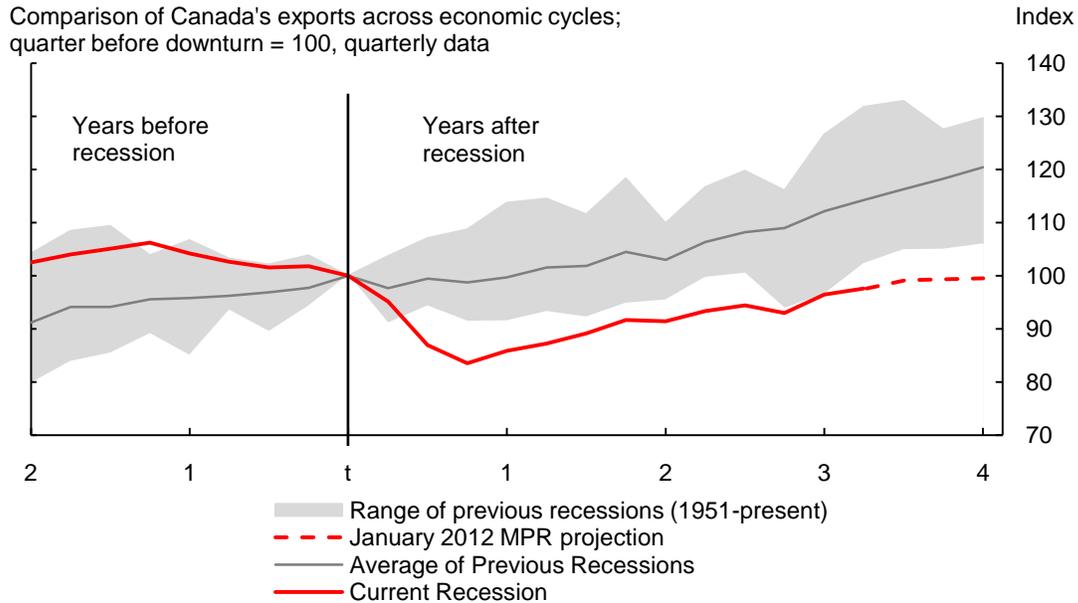
But allow me first to review Canada’s performance during the recession and recovery.

### A Unique Recession and Recovery

The broad economic strategy in response to the global financial crisis has been to grow domestic demand and to encourage Canadian businesses to retool and reorient to the new global economy.

On the former, we have been successful. Even as pressure on the export-oriented manufacturing sector has intensified, domestically oriented sectors such as services and construction have remained resilient. With strong domestic fundamentals and a well-functioning financial system, stimulative monetary and

### Chart 1: Weakest Post-War Export Recovery



Sources: Statistics Canada and Bank of Canada calculations

fiscal policies proved highly effective in supporting a robust recovery—and now expansion—in domestic demand.

Household expenditures have led the way, falling modestly through the recession and rebounding smartly since, to stand 6.5 per cent above their pre-recession peak. Owing to this resilience, Canada's economy was the first of the G-7 countries to recover its recessionary decline in output and expand anew.

Our labour market has bounced back too. All of the 430,000 jobs lost through the recession had been recovered as of early last year, and a further 180,000 jobs have been added since then. Most of the jobs created have been in the private sector and in industries paying above-average wages.<sup>1</sup>

More recently, unemployment has edged higher, even as the number of job vacancies continued to rise. This is consistent with structural shifts in the labour market, where workers in declining industries may not have the skills or experience to match immediately the needs of employers in expanding industries.

The experience in Kitchener-Waterloo has broadly mirrored these national trends.<sup>2</sup>

As effective as the reliance on domestic demand in general and household spending in particular has been, the limits of this growth model are becoming clear. For example, the construction sector alone has accounted for about 100,000 of the new jobs created in Canada through the recovery, bringing its share of overall employment to its highest level in over 35 years.

More broadly, household spending in Canada has been growing strongly for over a decade, both outright and relative to the economy as a whole. This spending has been supported by strong increases in real incomes, which rose a full

percentage point faster than the rate of real GDP growth in the ten years leading up to the crisis.

However, even these strongly rising incomes were not enough to finance the rapid growth in household spending. Canadians bridged the gap by tapping the wealth in their homes to finance up to one-fifth of consumption growth. As a result, household debt levels rose steadily relative to income through this period.

Since the onset of the crisis, however, real income growth has been weaker and household spending has become more heavily dependent on stimulative financing conditions and high levels of net worth, notably house values. As a consequence, the debt burden has increased further. Moreover, much of the financing for the recent increases in household indebtedness has come from abroad.

These trends are unsustainable over the medium term.

What is needed now is greater focus on the second element of the broad economic strategy that I mentioned earlier—Canadian businesses retooling and reorienting to the new global economy.

A deeper analysis of our trade performance proves the point.

## **Export Performance Is Lagging**

As I alluded to earlier, among the most striking features of the recent Canadian recession was the performance of exports.

During the most intense phase of the Great Recession—a nine-month period beginning in the fall of 2008—the level of Canadian exports plunged more than 16 per cent, or more than twice the total drop during the previous two cycles. By the end of last year, exports still remained roughly 8 per cent below their pre-recession peak.

My core message today is that this recent performance brings into sharper relief major secular trends that have persisted over the past decade. As such, they will require a sustained response.

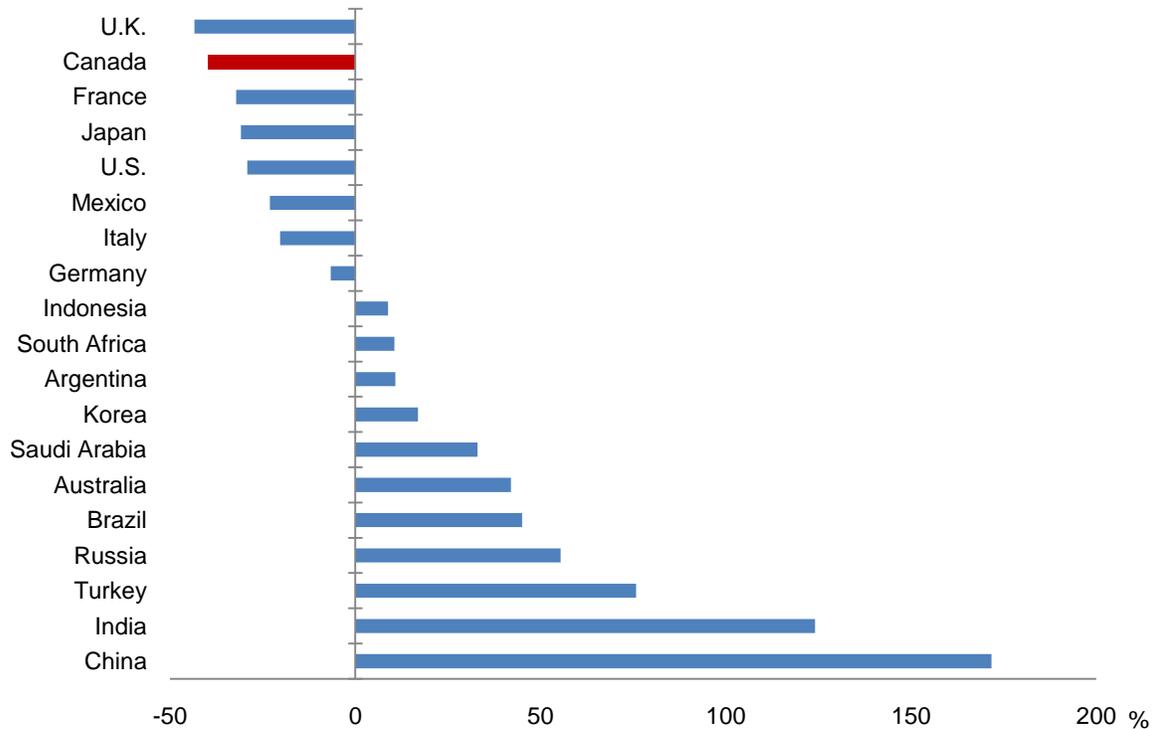
Canada's share of world exports has been declining since the turn of the millennium. In fact, our performance has been the second worst in the G-20 ([Chart 2](#)). Since 2000, Canada's export growth was almost 5 percentage points slower than global export growth on average per year. Our share of the world export market fell from about 4.5 per cent to about 2.5 per cent and our manufactured-goods export market share has been cut in half. Consistent with this drop, employment in Canada's manufacturing sector has fallen by more than 20 per cent, representing nearly half a million jobs.

## **Decomposing the Losses**

Broadly speaking, there are three possible explanations for Canada's deteriorating export performance: we may be selling the wrong products; we may

## Chart 2: Canada's Export Performance Second Worst in G-20

% change in share of world exports, 2000 to 2010



Source: International Monetary Fund

be selling to the wrong markets; or we may have become less competitive because of changes in our exchange rate, wages and relative productivity.

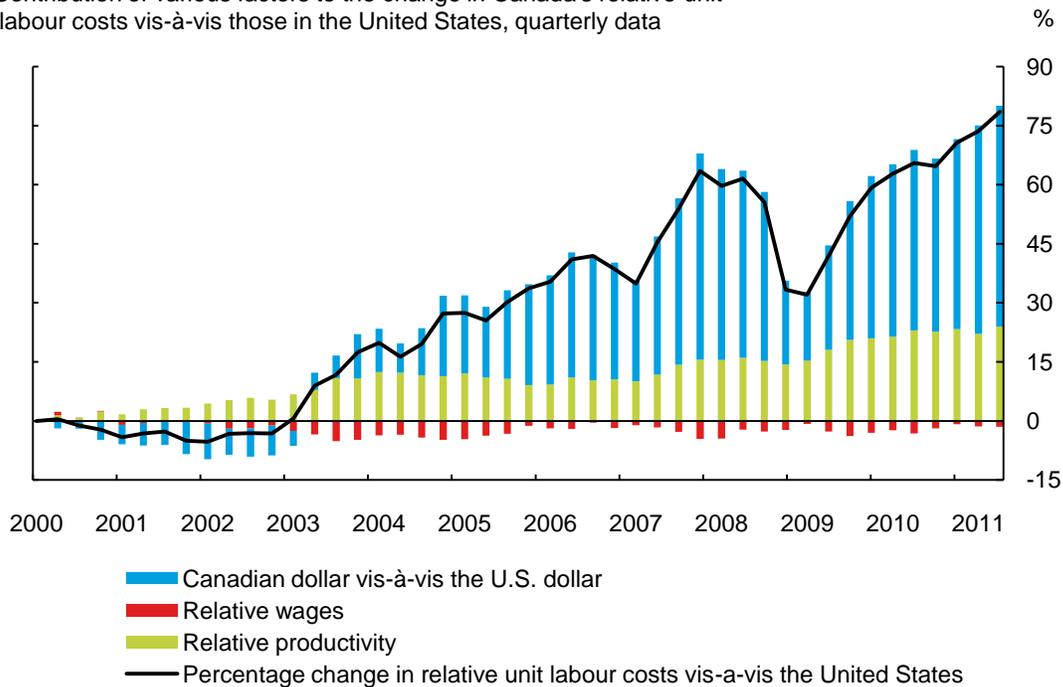
A commonly held view is that our poor export performance is the result of competitiveness challenges, particularly the persistent strength of the Canadian dollar. There is some truth in that ([Chart 3](#)).

Between 2000 and 2007, Canada's unit labour costs rose 80 per cent relative to our trading partners—the largest such increase among OECD countries. Compared with the United States, Canadian unit labour costs rose by roughly 65 per cent. The majority of this increase reflected the appreciation of the Canadian dollar, although lower productivity growth in Canada versus the United States also played a significant role, a phenomenon seen across export sectors ([Chart 4](#)).

However, it is telling that, despite these developments, competitiveness effects were less important than the drag coming from market structure.<sup>3</sup> Our exports are concentrated in slow-growing advanced economies, particularly the United States, rather than fast-growing emerging markets. This concentration reduced the annual average rate of export growth by around 3.3 percentage points between 2000 and 2007 ([Chart 5](#), [Table 1](#)). By comparison, the drag from competitiveness effects was about 2.5 percentage points.

### Chart 3: Canadian Competitiveness has Deteriorated Sharply

Contribution of various factors to the change in Canada's relative unit labour costs vis-à-vis those in the United States, quarterly data



Sources: Statistics Canada, U.S. Bureau of Economic Analysis

Last observation: 2011Q3

In short, our underperformance prior to the crisis was more a reflection of who we traded with than how effectively we did it.

This is even more the case since the onset of the Great Recession. Canadian export growth has continued to lag the global average by about 5 percentage points annually. Competitiveness effects have remained relatively stable. The combination of overexposure to the U.S. market and underexposure to faster-growing emerging markets is almost entirely responsible for Canada's further loss in world market share over the last several years.

It does not have to be this way. Many advanced countries have been more successful at capitalizing on the immense opportunity that emerging markets in general and China in particular represent. For example, Germany has maintained its market share in manufactured goods by exporting capital goods and autos to China, and more broadly to emerging-market economies. Australia has gained substantial market share in its exports of commodities to fill rising demand from China.

### Expect These Trends to Continue

The obvious question is whether we can expect these trends to continue. The answer is yes.

#### ***A New Normal for the United States***

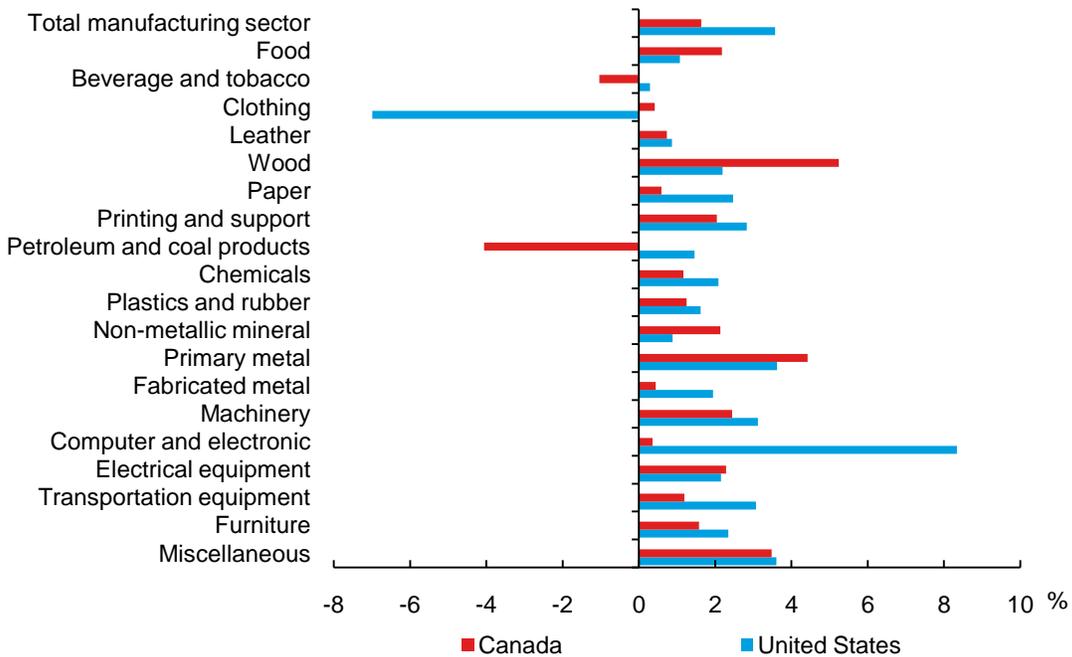
Our reliance on the United States is an issue only if we expect U.S. underperformance relative to both history and the rest of the world to continue.

Unfortunately, that is what we must expect as, to a degree, the U.S. economy is not what it used to be. Allow me to explain.

The trend in U.S. potential growth—the “speed limit” if you will of the U.S. economy—was already falling in the year leading up to the crisis, reflecting both an aging population and slower productivity growth. In the meantime, emerging markets were increasingly living up to their name, with large productivity increases raising their speed limits. The result was the increasing underperformance of the U.S. economy relative to the rest of the world.

### Chart 4: Competitiveness Fell Across Industries

Average annual labour productivity growth in the manufacturing sector  
Period average, 2000 to 2008



Note: Sectors categorized by NAICS classifications. Textile and textile mills (NAICS 313-314) are not included.  
Sources: Statistics Canada and U.S. Bureau of Labor Statistics

The Great Recession has made things worse. History suggests that the output lost following a severe financial crisis is never recovered, implying that the United States will not get back on its old path. Moreover, the post-crisis potential rate of output growth also tends to be slower for some time, in part reflecting less capital investment and more structural unemployment. As a result, even once the U.S. economy recovers its cyclical losses, the Bank estimates that it will remain over \$1 trillion smaller in 2015 than we had projected prior to the crisis (Chart 6).

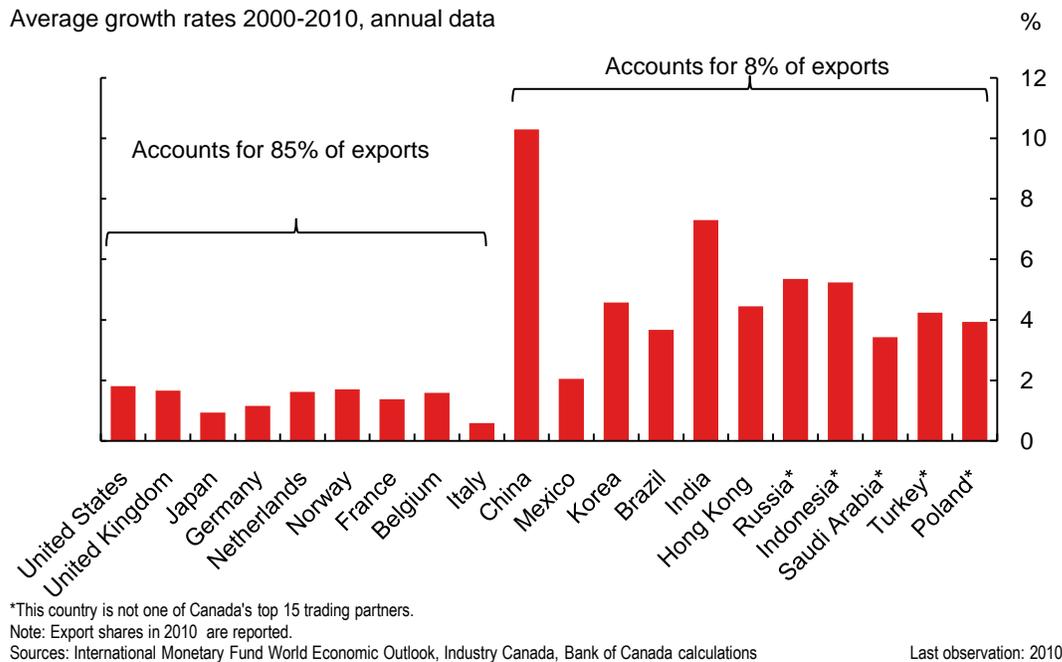
Now, it is important not to overstate this. The United States remains the largest economy in the world but, going forward, the game there will be more about taking market share than participating in a rapidly growing market.

### Emerging-Market Opportunity

Emerging markets represent the greater opportunity for Canadian exporters. Since the recession, these economies have accounted for roughly two-thirds of

global economic growth and one-half of the growth in global imports. In a process that can be expected to continue for decades, emerging Asia is rapidly urbanizing. China and India are housing the equivalent of the entire population of Canada every 18 months. In parallel, a massive new middle class is being formed, growing by 70 million people each year and representing a fast-rising share of global demand for all types of goods. This is where Canadian businesses must increasingly look for export growth.

### Chart 5: Canada's Trade Directed Toward Slow-growing Economies



### Commodity Prices Are Expected to Remain Elevated

The expanding urban middle class in emerging economies is having a marked impact on a wide range of commodities. Yet, whether it is travel, housing or protein, consumption levels in major emerging markets are still only fractions of those in advanced economies.<sup>4</sup> With convergence a long way off, the demand for commodities can be expected to remain robust.

As a result, commodity prices have risen well above their historical averages, and are likely to remain there for some time. Canada is benefiting from this both directly and via spillovers across our economy.

### Persistent Strength of the Currency

Canada is likely to remain a relatively attractive investment destination, owing to the strength of our financial system, competitive tax system, sound public finances and credible monetary policy. Given this and elevated commodity prices that have raised our terms of trade, a sustainable export strategy cannot rely on expectations of a more favourable exchange rate.

## How to Take Advantage

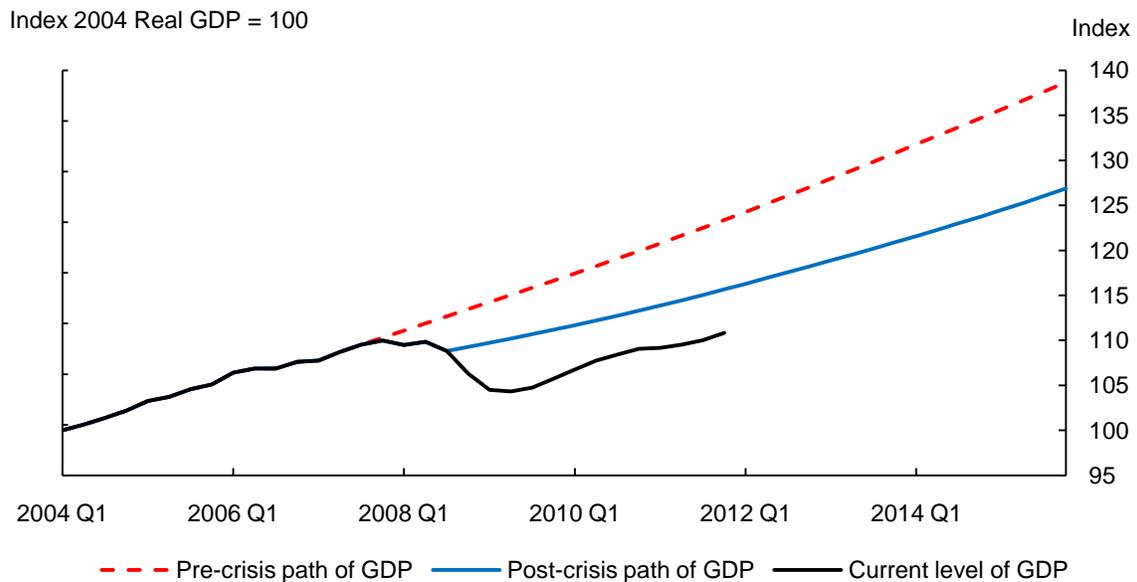
To take advantage of these shifting patterns of global demand, our businesses need to refocus, retool and retrain.<sup>5</sup>

**Refocus** on developing new markets and new products. While the United States will always loom large in Canadian trade, geography need not be destiny. For many firms, the most attractive option is now to expand into emerging markets. Canada's aggressive trade strategy promises to enhance these prospects.

There are other opportunities.

For many firms, there are openings to become part of new, networked supply chains that are being created in response to the demonstrated fragility of single-source, lean alternatives, the proliferation of end products and the volatility of regional demand.

### Chart 6: U.S. Economy Not What It Used To Be



Source: Bureau of Economic Analysis and Bank of Canada calculations

Canadian firms could also further exploit the tremendous opportunities in mobile computing and customer-focused applications that capture more of the value in the shift to digital commerce that is occurring across the globe.

New markets can also be found at home. It is clear that K-W cannot directly satisfy China's growing appetite for commodities, but you can and are taking advantage of other areas of the country that do. One out of twelve oil sands manufacturers and suppliers are from this region, and Ontario's exports to Alberta of mining-related services grew 44 per cent in the last year measured. The opportunity to capture more of the value added in commodity production from energy to agriculture remains a tremendous opportunity for all of Canada.

**Retool** by investing in plant, equipment and ICT (information and communications technology) and developing new processes. The competitiveness imperative to invest in productivity-enhancing M&E (manufacturing and equipment) and ICT is clear, and the conditions to do so have rarely been so favourable. Canadian corporate balance sheets are extremely healthy, with record low leverage and very high levels of liquidity. Businesses are further supported by a well-functioning financial system and extremely supportive financial conditions.

Businesses across Canada are stepping up, including here in the K-W region, where there are numerous examples of firms responding to the decline of traditional manufacturing industries, such as autos and clothing, by moving up the value chain. Overall, business investment has rebounded smartly since its dramatic decline in the wake of the Lehman collapse. However, it still has a long way to go.

Moreover, it is not merely a question of how much we invest in new tools but also what we do with them. Indicators of how well we use labour and capital to produce output (such as multi-factor productivity) have been exceptionally weak for years. We can do better. For example, the brainpower in this region appears well-suited to analyse the “big data” necessary to seize such opportunities as optimizing production processes and mass customization.

In an era of persistently elevated resource prices, enhancing operating efficiency, improving resource management and developing products with a more sustainable environmental footprint make commercial and social sense. Moreover, advances in building-energy efficiency, enhanced farm yields and power plant efficiency would pay immediate domestic dividends. However, once again, the real prize may be in emerging markets, which contain an estimated 85 per cent of the resource productivity opportunities in the world.<sup>6</sup>

Innovation is critical to our success and Canada’s record is only average. Today, Canada’s business R&D investment is at the lower end of OECD countries. As highlighted in the Jenkins report, particular attention must be paid to the commercialization of R&D—taking innovative ideas from universities and turning them into commercial successes.<sup>7</sup> The symbiosis here in K-W between strong educational institutions and a cluster of innovative technology companies is a model for other parts of the country.

**Retrain** by continuing to invest in our greatest resource—our people.

Technology and trade are transforming the workplace. For years, routine tasks have been automated, such as the substitution of robots for assembly-line workers and ATMs for tellers. Now the same is happening to interaction work, which has been the fastest-growing employment category. Disaggregation of tasks, such as professional services, to separate out the routine components can lead to outsourcing and job displacement.<sup>8</sup>

The need to improve skills across the spectrum of work has never been greater. With world-class educational institutions pumping out highly qualified graduates, you are already making an enormous contribution to raising the skill level of the Canadian workforce. Business and governments need to continue to focus on

workplace training as the competitiveness of our industries and the very nature of work continue to evolve.

The more Canadian businesses refocus, retool and retrain, the more they can take advantage of opportunities in Canada and around the world.

## **Current Economic Conditions in Canada**

Let me conclude with some comments on current economic conditions in Canada, which reflect a number of the themes I have discussed.

The recoveries in Canada's major trading partners continue to be dampened by the ongoing need to repair sovereign, bank and household balance sheets. As a consequence, the level of external demand for our products in advanced economies remains weak.

That said, in recent months, the considerable external headwinds have abated somewhat. European bank funding and sovereign debt markets have stabilized, global financial conditions have improved and risk aversion has decreased. This creates a window for European authorities to address the deep structural issues in their monetary union. While the European situation is far from resolved, the challenges have moved from the acute to the chronic.

The U.S. economy remains on the modest growth path typical of recoveries following financial crises. Given that context, recent data have been encouraging. Monthly employment gains in the past three months have been the fastest in a year. Consumer and business confidence have rebounded. And fundamentals for household spending have improved with higher personal income and household net worth.

Although activity in a number of emerging-market economies has slowed, the emerging world remains the engine of global growth. In particular, past tightening of policy and weaker external demand are slowing activity in China to a still-robust pace.

Improving global economic conditions have contributed to higher commodity prices, with geopolitical risks adding a further premium on crude oil prices.

Conditions in the Canadian economy have also been somewhat stronger and the degree of slack somewhat smaller than the Bank had expected. Growth has been a bit quicker in recent quarters, reflecting a combination of temporary factors as well as improved confidence and better financial conditions. Although net exports have picked up somewhat due to stronger U.S. activity, their contribution to growth will be limited by a still-weak level of foreign demand and ongoing competitiveness challenges, including the persistent strength of the Canadian dollar.

As a consequence, growth remains largely reliant on private domestic demand. Business investment is expected to be an important source of growth going forward, reflecting highly favourable conditions and the competitive need to refocus, retool and retrain. Momentum in household spending remains solid. However, in an environment of more modest growth in employment, wages and net worth, households' dependence on debt financing remains the biggest domestic risk.

As the Bank noted in its March decision, the profile for core and total CPI inflation is somewhat firmer than previously anticipated, reflecting reduced economic slack as well as higher oil prices.

Over the next few weeks, the Bank will update its outlook for growth and inflation in Canada to reflect these factors and other developments, such as recent federal and provincial budgets. As always, this analysis will inform our monetary policy decisions. The Bank will take whatever action is appropriate to achieve the 2 per cent CPI inflation target over the medium term. This is our contribution to ensuring that Canadians can save and invest with confidence.

Over the next few years, Canadian businesses will also have to analyse and act. Their decisions to refocus, retool and retrain will do much to determine how rapidly our prosperity grows in the decades ahead. For Canada to grow in the future as it has in the past, businesses will need to draw on similar resourcefulness that the membership of the K-W Chamber has demonstrated over the years.

## Appendix

**Table 1: Decomposition of the difference between the growth of country and world exports of goods (in percentage points, annual average)**

	Total effect	Competitiveness effect	Combined structure effect	Structure effect		
				Product effect	Geographical market effect	Mixed structure effect
<b>Canada</b>						
2001-2007	-4.8	-2.4	-2.3	0.9	-3.3	0.1
2008-2010	-5.0	-0.1	-4.9	1.4	-4.6	-1.8
<b>2001-2010</b>	<b>-4.8</b>	<b>-1.7</b>	<b>-3.1</b>	<b>1.1</b>	<b>-3.7</b>	<b>-0.5</b>
<b>Australia</b>						
2001-2007	1.0	-2.5	3.4	1.4	0.2	1.9
2008-2010	12.0	7.5	4.5	2.4	3.2	-1.1
<b>2001-2010</b>	<b>4.3</b>	<b>0.5</b>	<b>3.8</b>	<b>1.7</b>	<b>1.1</b>	<b>1.0</b>
<b>China</b>						
2001-2007	14.7	15.5	-0.9	-0.8	0.8	-0.8
2008-2010	5.8	6.5	-0.6	-1.4	0.5	0.3
<b>2001-2010</b>	<b>12.0</b>	<b>12.8</b>	<b>-0.8</b>	<b>-1.0</b>	<b>0.7</b>	<b>-0.5</b>
<b>Germany</b>						
2001-2007	2.5	1.5	1.0	-0.3	0.8	0.5
2008-2010	-5.0	-3.0	-2.1	-0.6	-2.0	0.5
<b>2001-2010</b>	<b>0.2</b>	<b>0.2</b>	<b>0.1</b>	<b>-0.4</b>	<b>0.0</b>	<b>0.5</b>
<b>Mexico</b>						
2001-2007	-3.6	-0.1	-3.5	0.0	-3.6	0.1
2008-2010	0.3	3.4	-3.1	0.0	-3.8	0.7
<b>2001-2010</b>	<b>-2.4</b>	<b>0.9</b>	<b>-3.4</b>	<b>0.0</b>	<b>-3.7</b>	<b>0.3</b>
<b>United States</b>						
2001-2007	-5.0	-3.6	-1.4	-0.4	0.2	-1.2
2008-2010	-0.4	-1.5	1.1	-0.1	0.8	0.4
<b>2001-2010</b>	<b>-3.6</b>	<b>-3.0</b>	<b>-0.6</b>	<b>-0.4</b>	<b>0.4</b>	<b>-0.7</b>

## Endnotes

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<sup>1</sup> 83 per cent are in the private sector; 90 per cent are in industries paying average or higher wages.

<sup>2</sup> A net 30,000 jobs have been created in the region since the trough of the cycle—almost double the number of jobs lost through the recession. The unemployment rate has fallen from a peak of more than 10 per cent to just below 7 per cent.

<sup>3</sup> D. de Munnik, J. Jacob, and W. Sze, “The Evolution of Canada’s Global Export Market Share,” Bank of Canada Working Paper, forthcoming.

<sup>4</sup> See M. Carney, “The Paradigm Shifts: Global Imbalances, Policy, and Latin America,” speech delivered to the Inter-American Development Bank, Calgary, Alberta, 26 March 2011.

<sup>5</sup> For a comprehensive and accessible analysis of Canadian productivity, see R. Martin and J. Milway, *Canada: What It Is, What It Can Be* (University of Toronto Press: Toronto, forthcoming), which draws on their decade-long analysis of these issues.

<sup>6</sup> R. Dobbs, J. Oppenheim, F. Thompson, M. Brinkman and M. Zornes, “Resource Revolution: Meeting the World’s Energy, Materials, Food, and Water Needs, McKinsey Global Institute Report, November, 2011.

<sup>7</sup> Innovation Canada: A Call to Action, Review of Federal Support to Research and Development,” Expert Panel Report, October, 2011. Available at [www.rd-review.ca](http://www.rd-review.ca).

<sup>8</sup> J. Manyika, S. Lund, B. Auguste, and S. Ramaswamy, “Help Wanted: The Future of Work in Advanced Economies,” McKinsey Global Institute Discussion Paper, March 2012.