Make Informed Decisions
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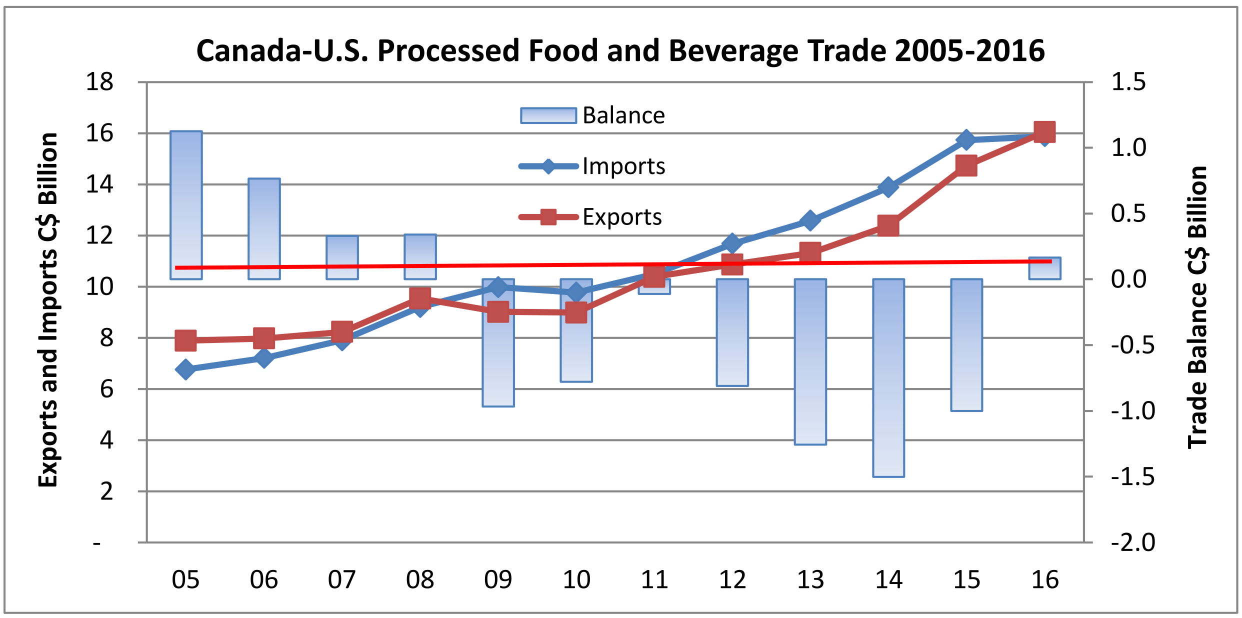
Canadian Processed Food Trade Goes Surplus

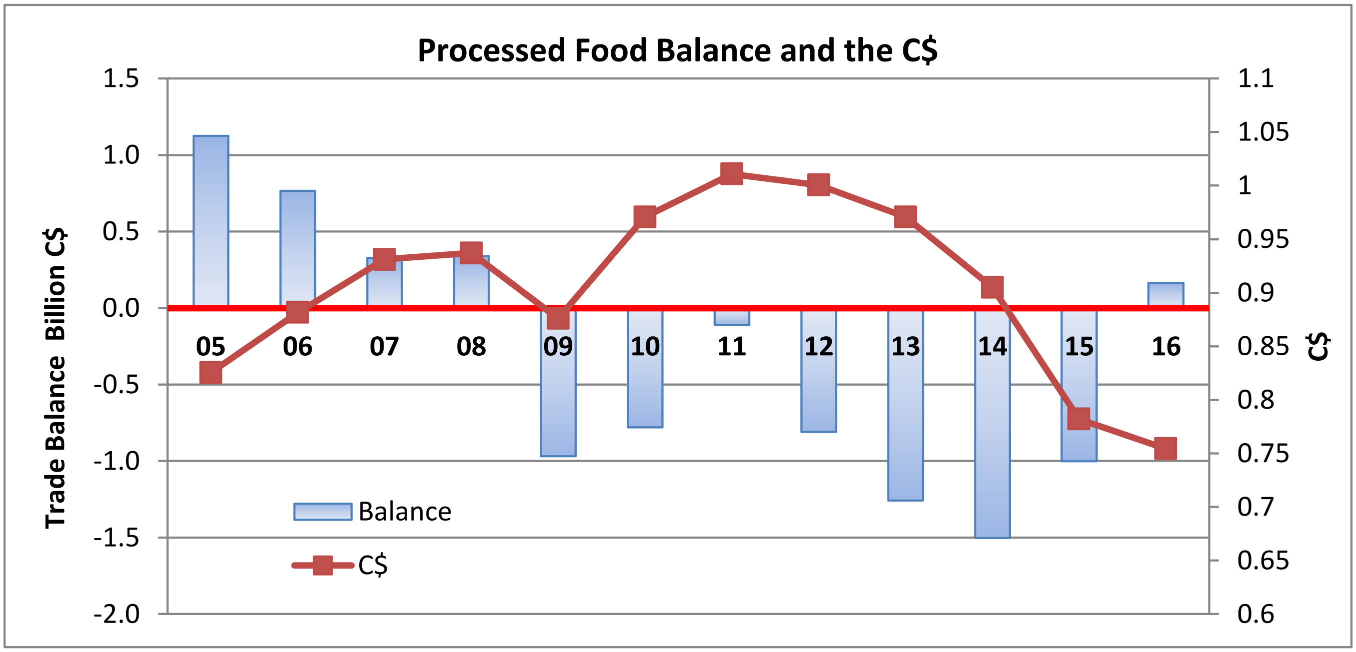
Canada ended 2016 with a small processed food and non-alcoholic beverage trade surplus with the United States, according to data compiled by the USDA's Foreign Agricultural Service. The processed foods, which do not include fresh meat and fresh vegetables, were in surplus with the United States by about C$165 million in 2016. In 2016 Canada's exports amounted to C$16.1 billion, an increase of 9% while imports tallied C$15.9 billion an increase of 1%. The 2016 surplus compares to a deficit of about a billion dollars in 2015. Canada had been in a deficit position with the United States since 2009. From 2009 to 2015 deficits averaged just over C$900 million a year.



C$ Impact

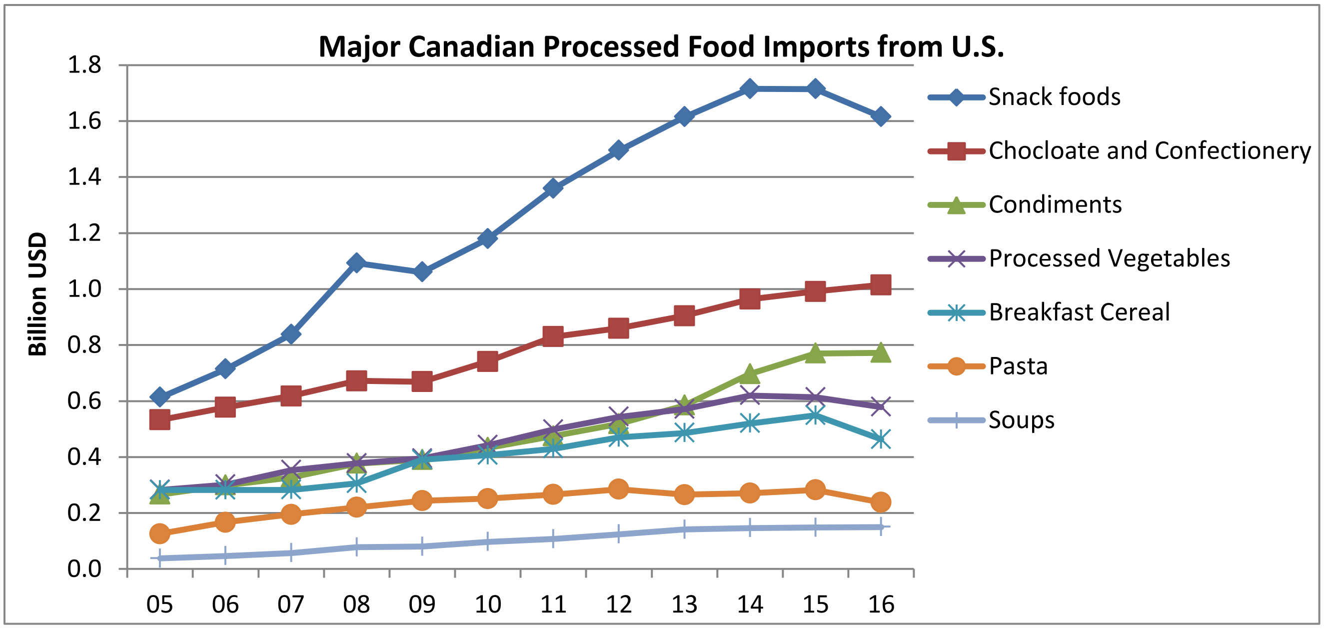
At least part of the reason for the move from trade deficit to surplus is the depreciation of the C$ versus the USD. The years from 2010 through 2014 when the C$ averaged over C$/US$0.90, Canada saw significant deficits. Those deficits continued through 2015 as the advantage of the weaker C$ were not yet significantly impacting trade flows. With two years of a sub 0.80 dollar, the buying and selling trade adjustments became more apparent.

This, of course, is not to say that Canada cannot compete unless the dollar is weak. Even in 2011, when the dollar averaged above par with the U.S., Canadian food companies were shipping over C$10 billion worth of processed food to the U.S. In fact, in that year the deficit was minimal. Further to that point, the Canadian companies that have survived and prospered during the period of the above par dollar are those that are competitive leaders. These companies would have taken advantage of the strong C$ and would have invested in plant and equipment. Those companies that can compete with a strong dollar would be the same companies that prosper with a weaker dollar.

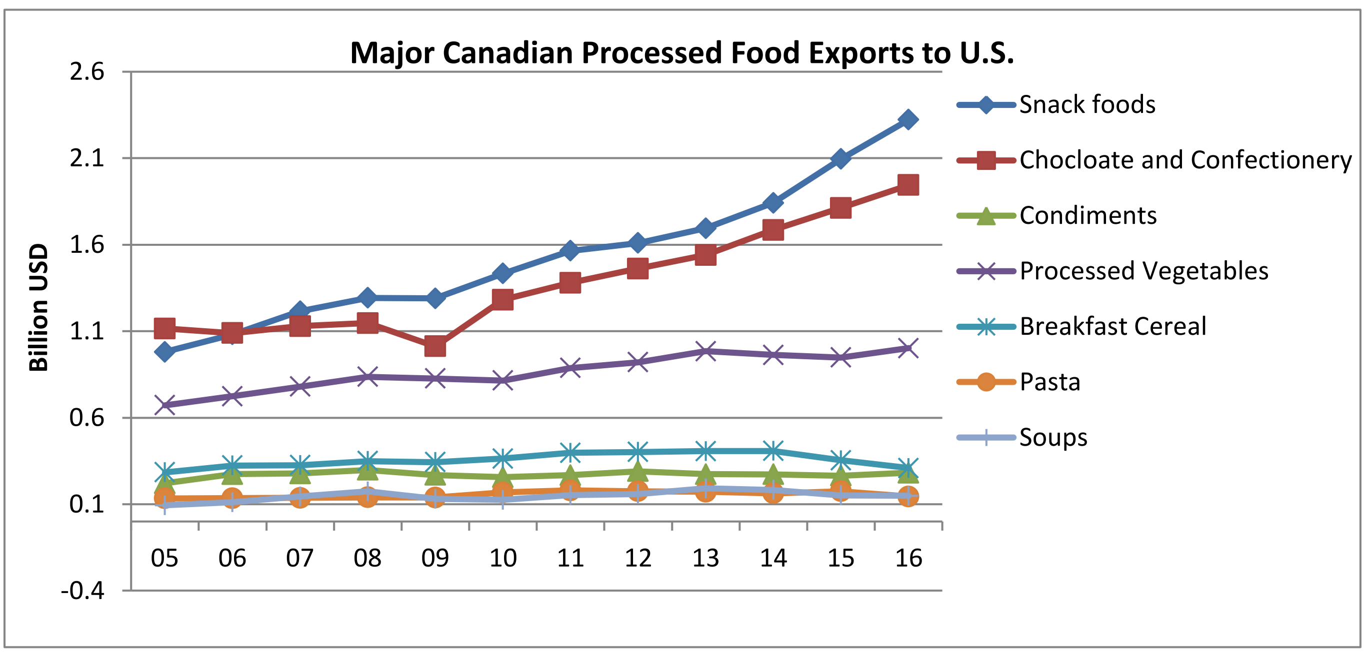


Imports and Export Trends

Within that overall context, the total trade picture is comprised of numerous diverse industries. In that regard, many of the largest volume U.S. trade sectors saw decreases in exports to Canada last year. Snack foods is one of the largest Canadian imports from the U.S. and that industry has seen imports decline by nearly US$100 million since 2014. Processed vegetable imports have declined by US$41 million since 2014 while breakfast cereals have fallen US$57 million. In the meantime, chocolates and confections have increased by US$51 million and condiments and sauces have increased US$76 million.



In the meantime, Canadian processed exports to the United States are also dominated by snack foods and chocolate/confectionery products. From 2014 to 2016 exports to the U.S. increased by US$480 million and US$260 million respectively. Of the major product lines or industries, exports of breakfast cereals declined by nearly US$100 million and soups went down by US$34 million.



Exchange Impact

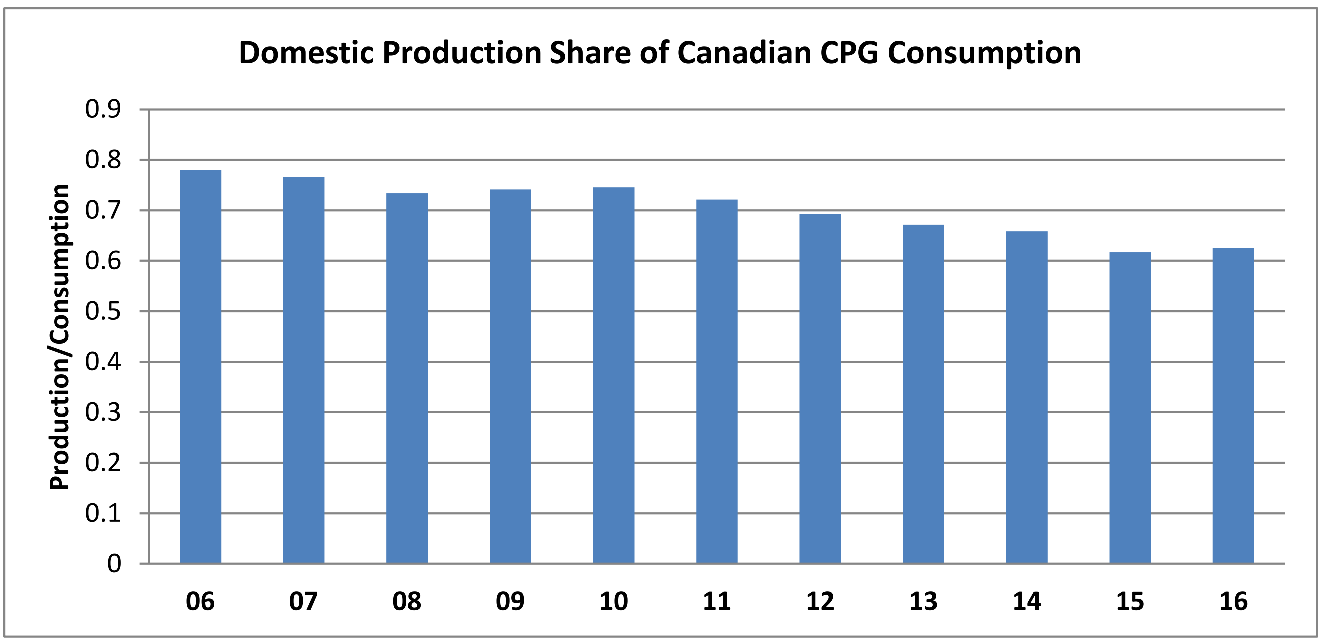
Returning to the discussion of the exchange rate impact, note that the U.S. dollar value of Canada's CPG exports were US$1.71 per kilogram last year. That is, total dollars divided by total tonnage equalled US$1.71/kg. In Canadian dollars that brought back C$2.27/kg at the 2016 average exchange rate of

1.326. At the exchange rate in 2015 (1.28), those same exports would have been valued at just C$2.19/kg. The depreciation generated higher margins and made Canadian product more competitive in the U.S. With regard to imports, Canadian CPG imports were valued at US$2.65/kg last year. In Canadian dollars, the product cost C$3.52/kg to importers such as brokers, distributors and retailers. That import cost would have been only C$3.39 at the 2015 exchange rate.

The above is just an example of the obvious fact that the change in the value of the C$ over the last few years makes exporting more lucrative and imports more costly. It makes export markets more attractive and makes Canadian processors less dependent on the domestic buyers. Conversely the higher cost to bring U.S. product into Canada provides pricing protection to domestic producers.

Canadian Food Processor Share

Consumer Packaged Goods (CPG) sales including processed meats and non-alcoholic beverages in Canada totaled about $42.6 billion in 2016. That is a 6% increase in 2016 compared to 2015. In the ten years between 2015 and 2006 the compound rate of growth in those sales in Canada has been just 2%. That of course indicates that 2016 was a relatively strong year. For the purposes of this discussion, Canadian consumption of CGP is defined as Canadian processed production, less exports to the U.S. plus imports from the U.S. Based on that definition Canadian consumption of CPG amounted to about $42.4 billion. Of that $42.4 billion, about $26.5 billion was supplied by domestic processors (production less exports). That amounts to 62.5% of the domestic consumption. The domestic supply share of consumption was about 61.6% in 2015 and about 78% in 2006.



The decline of the domestic processor’s share of the Canadian market from 2006 to 2015 is a signal of declining competitiveness. The domestic processors are losing share of the domestic market to U.S. competitors. This can take the form of a multinational moving production out of a Canadian plant and into a U.S. plant for shipment to Canada. It could also mean that U.S. competitors are taking business away from Canadian-based firms. The modest reversal of the share loss in 2016 versus 2015 is encouraging but within the longer term picture the loss of share remains stark.

In any event, while Canadian firms have managed to erase the trade deficit with the United States the competitive challenge in the Canadian market remains robust. With that noted the logic of the depreciated dollar's assistance to competitiveness in export markets holds in the domestic market. The modest gain in share in 2016 in the domestic market will likely continue in 2017.

Why it Matters

The bottom line for Canadian processed food manufacturers is that from a sales perspective they had a good year in 2016. At least part of the reason is the robust growth in exports to the United States. Those exports generated more Canadian dollar value revenue. In the meantime the depreciated currency provides pricing protection for Canadian producers in their own market. The weaker currency should help processor returns through 2017 and provide greater bargaining leverage.

A version of this report first appeared in Grocery Trade Review. For a free two month trial subscription to Grocery Trade Review, email kevin@KevinGrier.com

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