

Timothy Lane: Transport and logistics – connecting Canada to the global economy

Remarks by Mr Timothy Lane, Deputy Governor of the Bank of Canada, to the Chartered Institute of Logistics and Transport North America, Ottawa, Ontario, 30 April 2012.

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Good morning. It's a pleasure to be with you as you reflect on the challenges facing the North American transport and logistics industries in the current global economic environment. Your industries are inextricably linked with the wider economy: they enable other economic activity by connecting producers with their suppliers and markets elsewhere in Canada and around the world.

Throughout Canadian history, transport has played a critical role in the development of our nation, knitting together the economy over vast distances and forging strong trade links around the world. So as I speak to you today, I would first like to think back to the last great wave of globalization, a century ago. One of the giants of that time was Charles Melville Hays, whom Sir Wilfrid Laurier described as “the greatest railroad genius in Canada.” Hays, President of the Grand Trunk Railway, had a vision: to build a second transcontinental rail line across Canada with Prince Rupert as its western terminus, establishing a gateway to the Pacific.

Hays did not live to see his vision realized. One hundred years ago this month, after carefully seeing his wife and daughter onto a lifeboat and bidding them goodbye, Hays went down along with more than 1,500 other souls on the Titanic. Canada lost Hays's drive and leadership as well as the financing he had just secured in London to make his plans for Prince Rupert a reality.

But his broader vision of building transport to make connections with expanding markets—including those beyond our Pacific shores – remains relevant today as we consider the future of transport and logistics in the Canadian economy. It is also a reminder of the long-range thinking and strong leadership that are needed to build for that future.

For the past few decades, globalization has been a central force shaping transport and logistics – and indeed, Canada's economy as a whole. Canada is taking part in a worldwide transformation that has lifted hundreds of millions of people out of poverty and created the potential for millions more to share this destiny. Never in history has economic integration involved so many people, such a variety of goods, and so much capital. Between 1980 and 2005, merchandise exports grew to 20 per cent of global GDP, more than twice the level reached at the height of that last great wave of globalization a century ago.¹ Advances in transport and supply chain management have played, and will continue to play, a central role in enabling that expansion.

Today I would like to focus on two main themes. First, I would like to talk about economic prospects for Canada in the current global environment. Second, I would like to touch on the longer-term implications of that global environment for Canada's trade and transport.

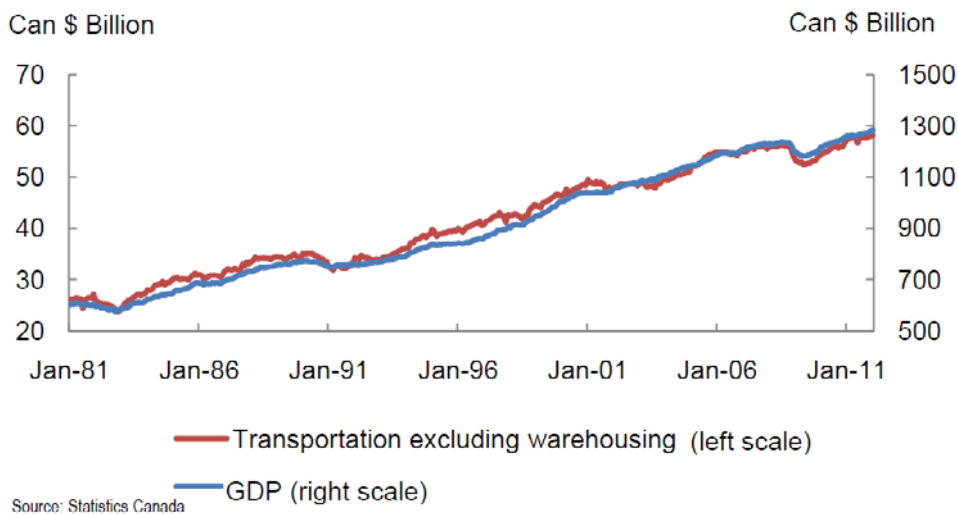
The crisis, trade and transportation

During the past five years, your industries have faced serious challenges. As a result of the global financial crisis and the Great Recession that followed, Canadian GDP declined by 4½

¹ M. Carney, “Rebalancing the Global Economy” (speech to the International Economic Forum of the Americas Conference of Montreal, 11 June 2009).

per cent but our exports plunged more than 16 per cent. As a result, transport experienced a 7 per cent drop in activity from peak to trough (**Chart 1**). For example, there was a severe decline in cargo volumes through ports and marine terminals: a drop of 20 per cent in domestic cargo and a cumulative drop of 10 per cent in international cargo in 2008–09.

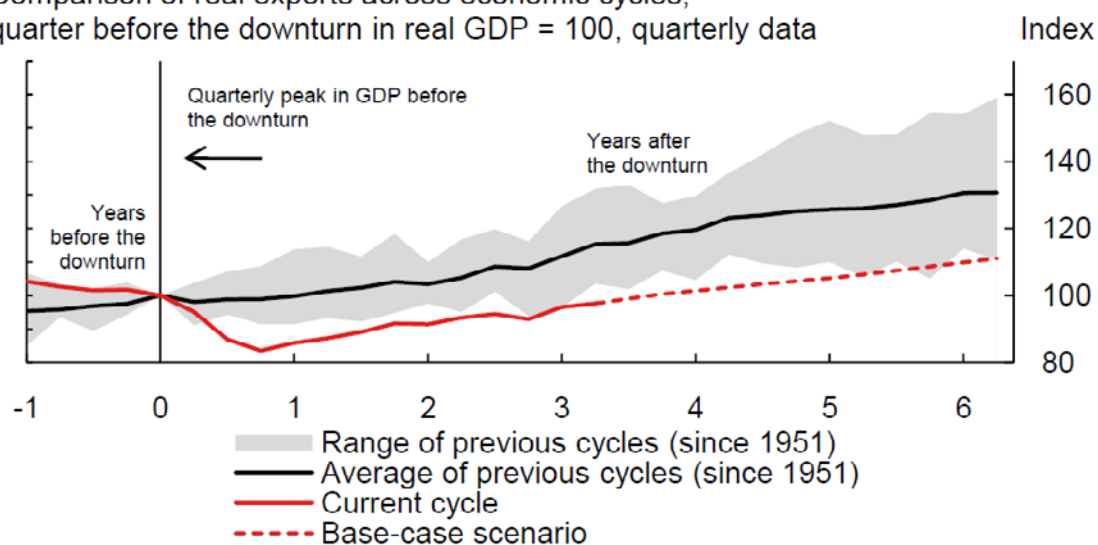
Chart 1: GDP of transportation industry, in \$BN, 2002 constant prices



Canada's economy is now in an expansion phase: economic activity and employment passed their pre-crisis levels in the fall of 2010 and have continued to grow since then. Canada's transport industry has shared in this recovery. However, a major challenge – both to transport and to the economy as a whole – has come from exports, which are experiencing their weakest recovery since World War II (**Chart 2**).

Chart 2: Recovery in exports expected to remain weak

Comparison of real exports across economic cycles;
quarter before the downturn in real GDP = 100, quarterly data

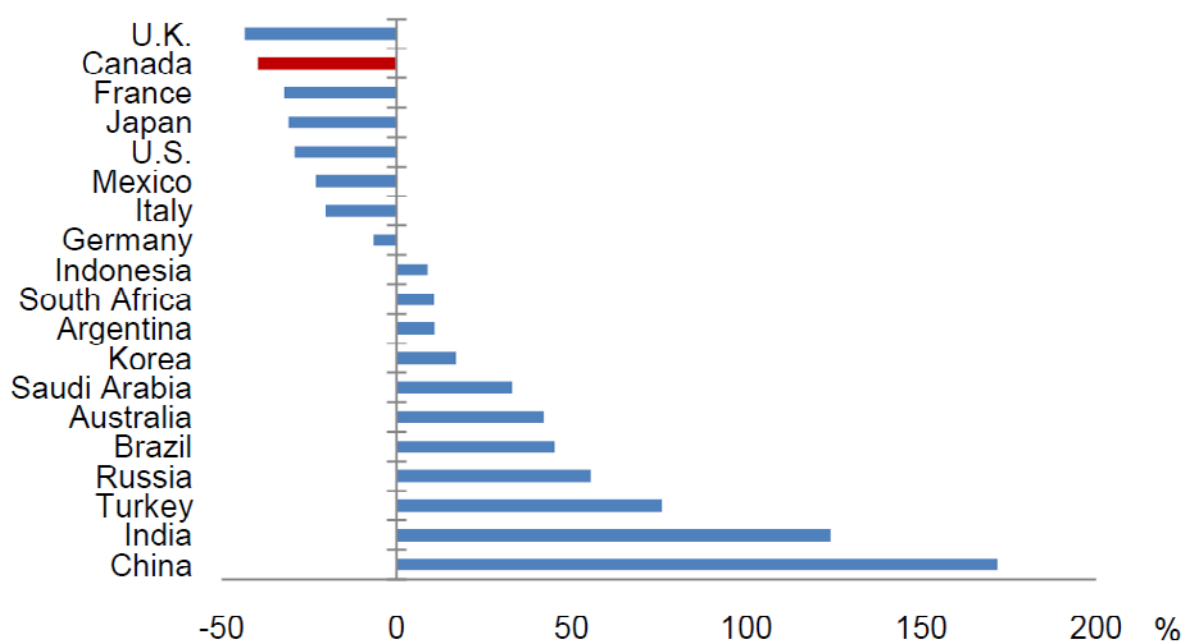


Sources: Statistics Canada and Bank of Canada calculations and projections

The sluggish recovery of Canada's exports, in turn, reflects a combination of current macroeconomic conditions and longer-term trends. First, it reflects the weakness of the recovery in other advanced countries – notably the United States, still by far our largest trading partner. But Canada's share of global exports has been declining since the turn of the millennium as we have lost competitiveness and market share to China and other export economies (**Chart 3**). Canada's diminishing competitiveness is the result of disappointing productivity growth together with the considerable strengthening of the Canadian dollar over this period.

Chart 3: Canada losing market share

Percentage change in share of world exports, 2000 to 2010

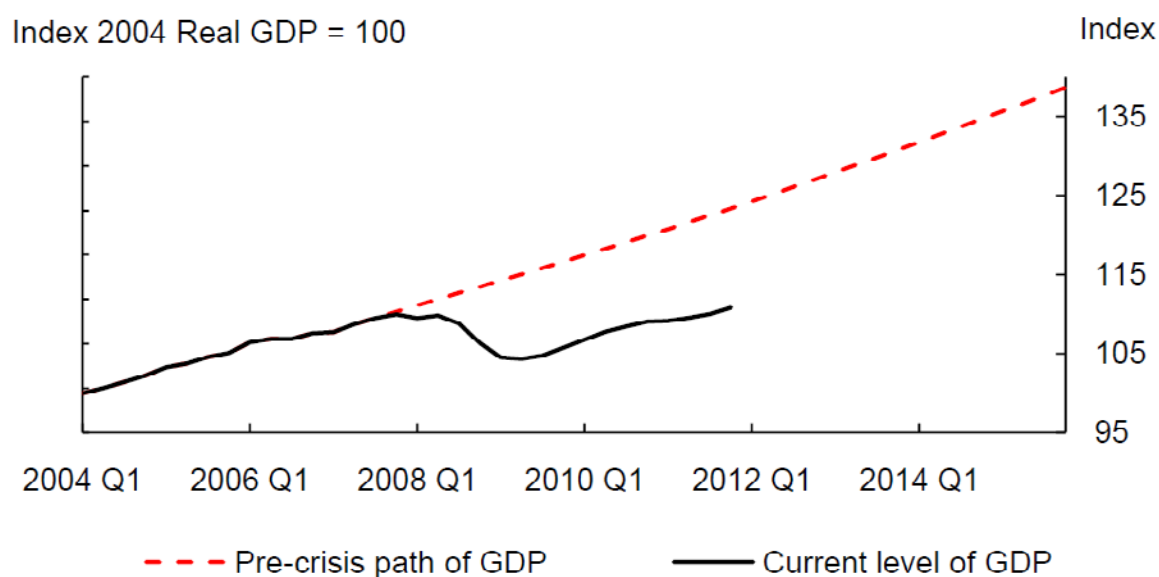


Source: International Monetary Fund

The shift of global growth from advanced economies to emerging economies is tectonic in its scope. While it began a few decades ago – stemming from the economic transformation taking place in China and other emerging-market economies – it has become even more pronounced as growth in the United States and other advanced economies has been dampened in the wake of the financial crisis. Since the recession, emerging-market economies have accounted for two-thirds of global economic growth – up from just one-third at the turn of the millennium. Emerging market economies also account for one-half of the growth in global imports. Compare this with the United States where the economy is now well below its pre-crisis path and is likely to remain so even once the economy recovers its cyclical losses² (**Chart 4**). Clearly, exporters need to refocus their efforts to the fast-growing economies.

² M. Carney, "Exporting in a Post-Crisis World" (speech to the Greater Kitchener- Waterloo Chamber of Commerce, Waterloo, Ontario, 2 April 2012).

Chart 4: U.S. economy not what it used to be



Sources: Bureau of Economic Analysis and Bank of Canada calculations

Current outlook: where we are today

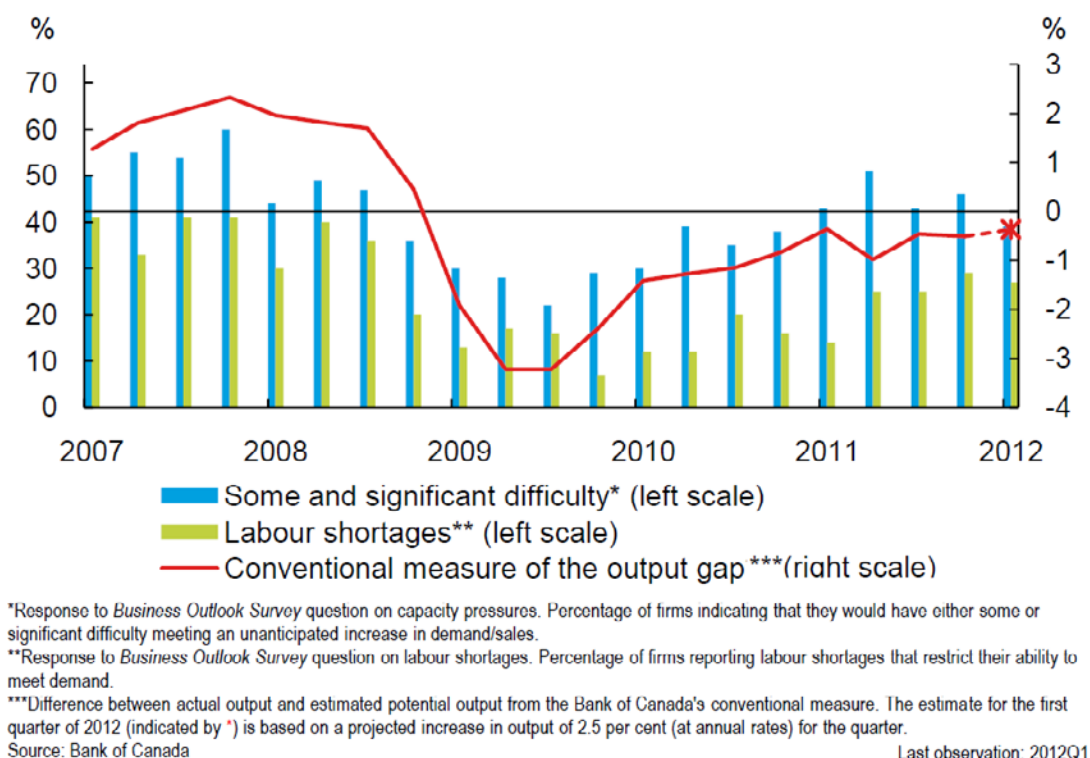
The global economy continues to face significant challenges. In the major advanced economies, especially the United States and Europe, deleveraging by households and financial institutions and fiscal consolidation continue to weigh on growth. In the United States, the protracted dislocation of the housing market has been a drag on the recovery, despite some recent improvement. The debt crisis in the euro area, which intensified late last year, triggered a recession there and has had negative spillovers to many other countries, including the United States. In emerging market economies such as China, growth is moderating from the rapid pace of recent years, as exports to Europe have fallen off and domestic demand has also cooled. However, economic growth is expected to gain momentum over 2013–14, as exports to advanced economies recover.

Despite these challenges, the profile for global economic growth has improved since the beginning of this year.³ In particular, economic conditions in the United States have improved, with employment gains and better consumer and business confidence. The euro area, however, is still in recession, and is projected to show only a modest recovery later this year, although the risks around this projection are high. Overall, global economic growth is now projected to moderate in 2012 to 3.2 per cent and to recover to 3.4 per cent in 2013 and 3.8 per cent in 2014.

Here in Canada, economic momentum is slightly firmer than a few months ago. Since Canada's economic growth has also turned out stronger than expected in recent quarters, we estimate that there is now less slack in the Canadian economy than previously anticipated (**Chart 5**).

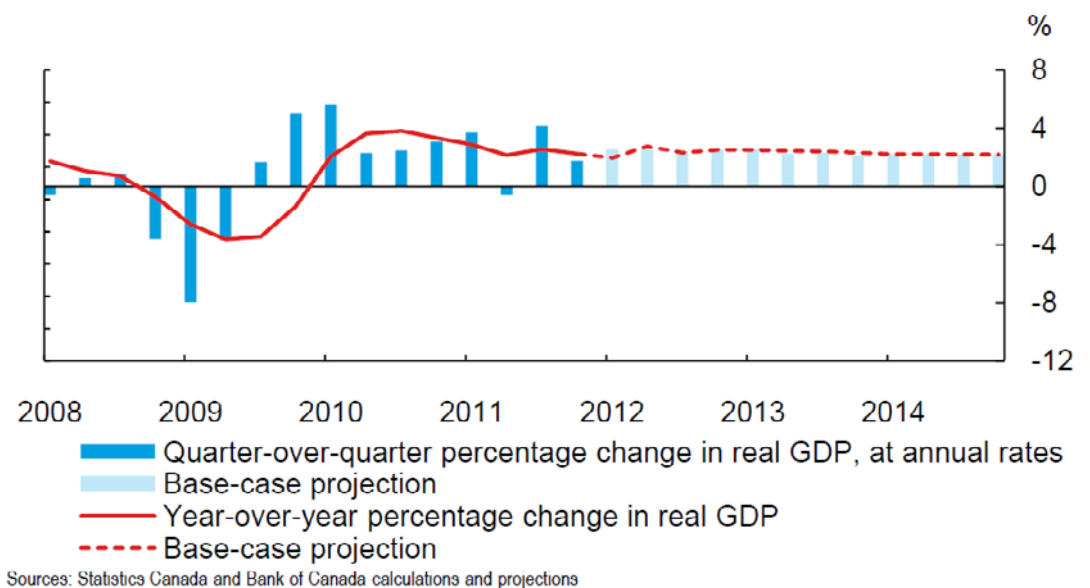
³ The discussion in this section is based on the Bank of Canada's April 2012 *Monetary Policy Report*.

Chart 5: Less slack in the Canadian economy



In addition, growth is expected to continue in the period ahead – at 2.4 per cent in 2012 and 2013, easing to 2.2 per cent in 2014. These growth rates may seem relatively modest, but over the 2012 to 2013 period, they are somewhat above the rate at which the potential of the economy is expanding, estimated at 2 per cent in 2012 and 2.1 per cent in 2013. As a result, we expect the Canadian economy to return to full capacity by early next year (**Chart 6**).

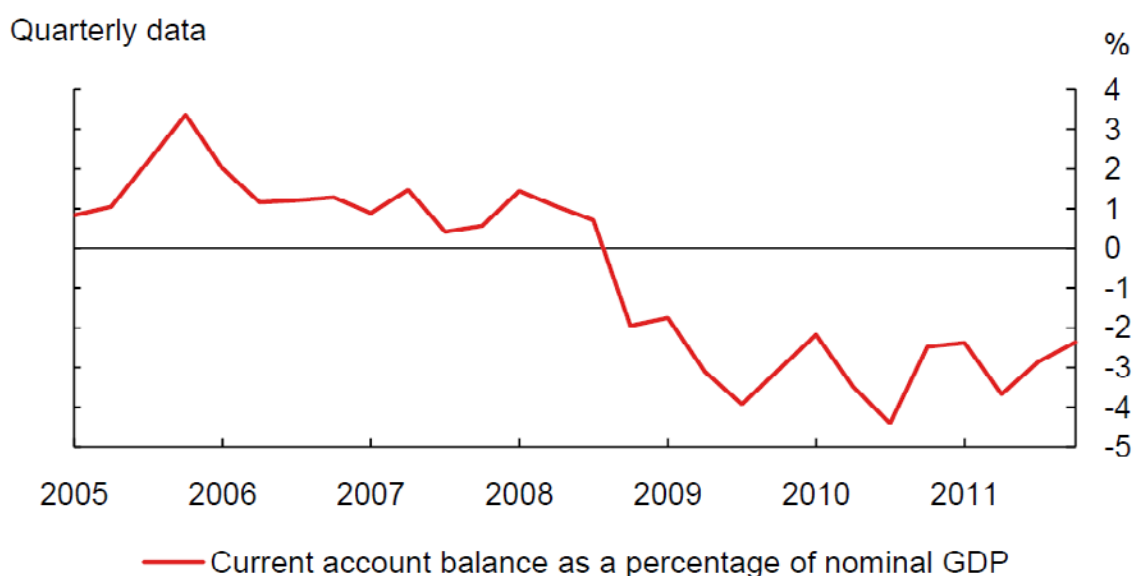
Chart 6: Real GDP is expected to grow at a moderate pace



Most of the growth in the period ahead is expected to come from private domestic demand. In particular, that growth relies on continued spending by Canadian households on consumption and housing. It also reflects a continued strong rise in investment spending as Canadian firms seek to expand, replace, and modernize their capacity.

On the other hand, we are still seeing weak growth in Canada's net exports. That in turn reflects factors I mentioned earlier: notably the protracted recovery of demand in the United States, Canada's major trading partner, and Canada's weak competitiveness. The Bank forecasts that Canada's exports will regain their pre-recession peak only at the end of 2013. In contrast, the level of imports has already regained its pre-recession peak. This divergence has contributed to a decline in Canada's current account balance, which has dropped from a pre-recession surplus to a deficit of approximately 2 per cent of GDP – a trend that is projected to persist (**Chart 7**).

Chart 7: Canada's current account deficit reflects weak exports



Sources: Statistics Canada and Bank of Canada calculations

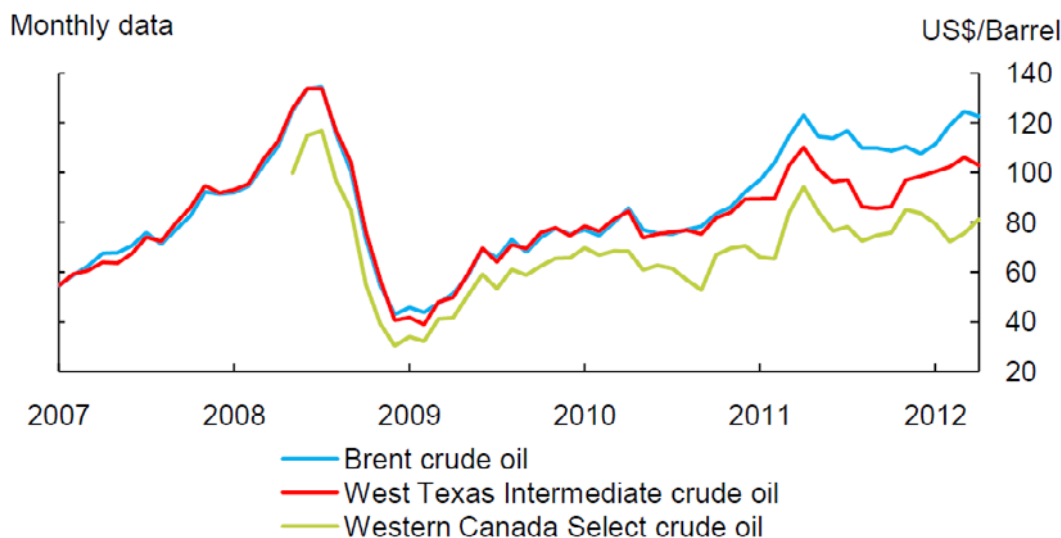
Last observation: 2011Q4

Oil prices are one important factor underlying the economic outlook for Canada – and here is a story in which transport has been playing an important role. Canada as a whole usually benefits when oil prices rise. As a net oil exporter, Canada gains from higher incomes in the industry, higher production and investment and the resulting spillovers to other parts of the economy. Those benefits typically outweigh the effects of more expensive gasoline on the cost of living and the effects on production costs. In recent months, this balance of costs and benefits has shifted because of an unprecedented spread between the price of oil that Canada imports and the price of oil that Canada exports – a spread that peaked at about \$50 a barrel earlier this year (**Chart 8**).

There are many reasons for this, some of which are temporary. Growing global demand – especially from emerging-market economies – together with supply disruptions and rising political tensions in the Middle East have driven up the world price of oil that Canada imports. At the same time, shale-oil development in the United States, together with other factors, has led to ample supply at Cushing, Oklahoma, where the North American price for West Texas Intermediate (WTI) is set. The Canadian price for Western Canada Select (WCS) has been driven down further by outages in some pipelines and refineries equipped to handle Canadian oil. Underlying these divergences is a basic fact: the transport system determines

the ability of Canadian producers to move goods such as oil to those markets where it commands a higher price, and thus to benefit from participating in a global market.

Chart 8: North American crude oil prices remain well below their global counterparts

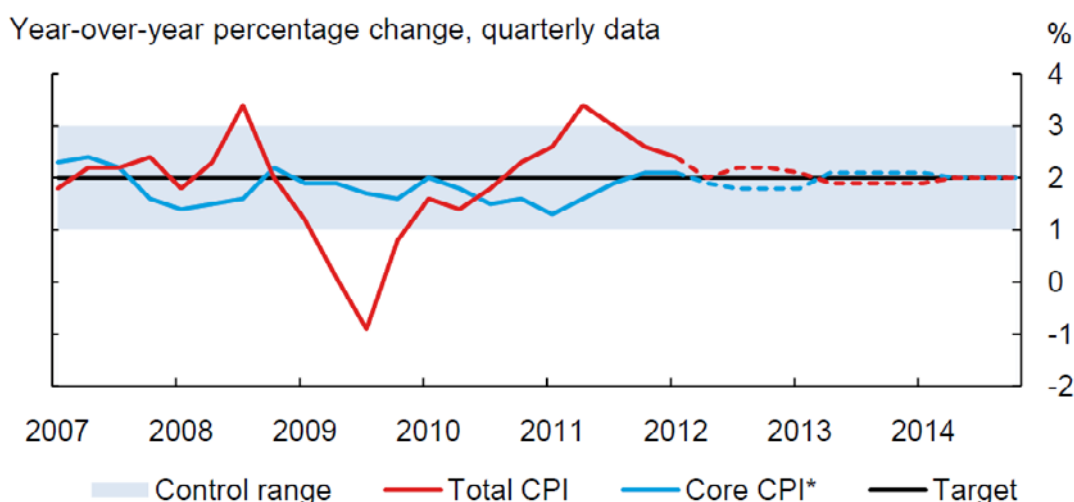


Sources: Bank of Canada and Bloomberg

Last observation: April 2012

The various aspects of the macroeconomic outlook I have been describing come together in the outlook for inflation. Because there is less slack in the economy and gasoline prices are also higher, the profile for inflation is expected to be somewhat firmer than anticipated by the Bank in January. Both overall inflation and underlying inflation are expected to remain close to 2 per cent through to the end of 2014 (**Chart 9**).

Chart 9: Total and core CPI inflation in Canada are projected to remain close to 2 per cent over the projection horizon



Note: Dotted lines indicate projections.

*CPI excluding eight of the most volatile components and the effect of changes in indirect taxes on the remaining components

Sources: Statistics Canada and Bank of Canada calculations and projections

Reflecting all of these factors, the Bank has decided to maintain the target for the overnight rate at 1 per cent. In light of the reduced slack in the economy and firmer underlying inflation, some modest withdrawal of the present considerable monetary policy stimulus may become appropriate, consistent with achieving the 2 per cent inflation target over the medium term. The timing and degree of any such withdrawal will be weighed carefully against domestic and global economic developments.

Opportunities for transport and logistics

I would now like to touch on the longer-term trends in the global economy and what they mean for your industries. In 1902, Charles Melville Hays saw opportunity in the waves of immigrants pouring into the West. Prairie agriculture was expanding rapidly. Mining and forestry camps were springing up in the North. The rate of growth was fast and it was clear that success depended on moving people and goods across this vast land quickly and efficiently.

Today, we can look across the Pacific Ocean where Asia is urbanizing at a breakneck pace. China and India are housing the equivalent of the entire population of Canada every 18 months. A massive middle class is being formed, growing by 70 million people each year – people who represent a rapidly-rising share of global demand for all types of goods. By shifting trade from slow-growing economies to fast-growing ones, Canada can participate more fully in the global economic transformation that we are living through. That's where the strongest potential import markets are. The opportunities are vast. In view of the scope of these changes and the speed with which they are taking place, it will be critical to anticipate change and make the long-term investments needed to prepare for it. Transport and logistics will be an integral part of all of these efforts.

I started by mentioning the critical role transportation played historically, in bonding Canada together as a country spanning great distances. It must continue to play that role now and in the future, creating and supporting an integral, efficient Canadian economy. Our domestic transport systems must evolve to make it easier to move goods within Canada. We will need to pick up our game domestically to remain competitive in a challenging global environment.

The forces of globalization together with advances in technology necessarily drive important innovations in logistics activities, which have become more global, complex, and sophisticated. To an increasing extent, Canadian businesses are part of supply chains that frequently cross and re-cross national boundaries. Such activities are also interconnected across various sectors, such as natural resources, manufacturing and services.⁴ Through these developments, globalization has progressively become a more pervasive feature of the production process. The increasing complexity of supply chains also means that Canadian businesses can benefit from trade with India and China, not only by selling their final products there, but by supplying and adding value to firms here at home that do.

For transport and logistics, opportunities to contribute abound and these will change as technology advances and businesses invest in plant, equipment and information and communication technologies, establish new facilities and develop new processes. These areas are now so strongly knowledge-based that developing the requisite skills and technologies is critical to success. This is why all sectors of the economy must continue to invest in Canada's greatest resource – our people.

⁴ Industry Canada, "Global Business Strategy and Innovation: A Canadian Logistics Perspective" (2011).

Conclusion

As I said at the outset, the transport industry was of fundamental importance in building Canada and connecting it with the world beyond. So, too, is your sector vital to the re-building of Canada's economy in the post-crisis world. Your institute provides scope to introduce state-of-the art analytical tools to shape the transport and logistics of tomorrow. Conferences such as this one provide opportunities for professionals from your industries to discuss and explore options for the future.

Trade and transport have been integral to the nature of Canada, long before the arrival of Europeans and after. It will be forever thus, so I encourage you to think big and bold and continue to guide us into the future.

Thank you very much.