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NEW CANADIAN INTERNATIONAL TRADE PRICE INDEX: BRIEF OVERVIEW

Report prepared by

Statistics Canada

New Canadian international trade price index brief overview.

1.1 Project Purpose

The international import and export prices program was established over thirty years ago. At the time, exchange rates were relatively stable, total imports and exports represented around 20% of total economic activity, the bulk of Canada's exports consisted of resource-based commodities and most of our imports came from the United States and the United Kingdom. Given those economic realities, the import and export price indices were constructed using unit values, US domestic prices (as a proxy for import prices) and domestic prices (as a proxy for export prices).

Since 1970 Canada's economic landscape has changed significantly. The share of imports and exports as a percentage of GDP topped 45% in 2001. The commodity composition of Canada's trade has also undergone a marked transformation as Canadian exports can no longer simply be categorized as exports of lumber, wheat, fish and iron ore. Goods such as aircraft, circuit boards, computers, industrial equipment, chemicals, plastics and pharmaceutical products must be mentioned in the same breath. As the nature of Canada's trade has evolved over the last 30 years, so has the behaviour of the exchange rate. The average absolute yearly change in the Canada-US exchange rate in the 1970's was 2.6% compared with 6.2% so far this decade. Finally, Canada's trading partners are becoming increasingly diverse. Today a growing share of Canada's imports come from countries such as China and Japan and Thailand.

This evolution in Canadian international trade has led to a questioning of the assumptions which underlie the import and export prices program. While unit value based indexes may have been appropriate in the past they are becoming less meaningful as a measure of import and export price change in today's environment. Given increasing market specialization it is no longer correct to assume that import and export prices will behave in the same manner as domestic prices. With the changing origin of Canada's imports, we need to account for other exchange rate fluctuations than those with the US dollar.

With the growing volatility of the exchange rate it is becoming more and more important that we understand and quantify exchange rate pass through and how prices react to changes in the international marketplace. Since 2003 large BOP adjustments have been made to the real export series because the domestic prices that underlie our export price indexes have not properly captured Canadian business' reaction to the appreciation in the Canada-US exchange rate. Over the last two years Canadian businesses have had to reduce the price they charge foreigners for their goods in order to remain competitive in the international market place. The domestic price based export indexes have not been able to capture this phenomenon and in order to ensure a proper accounting of real exports has led to a large BOP adjustment within the quarterly income and expenditure accounts. Continued adjustments such as this could lead users to lose confidence in our estimate of real exports and imports.

While Statistics Canada has continued to increase the number of import and export prices it collects, much of this work has been accomplished by modifying existing programs or partnering in new initiatives. While this effort has improved the quality of the import and export price index, there are serious data gaps and data quality issues that need to be addressed.

The proposed project aims to re-tool our import and export price index and establish an international prices program within the context of Statistics Canada's overall price program.

1.2 Project Objectives

This project will lead to a much more rigorous approach to producing monthly import and export price indexes for trade in goods and less reliance on proxies (whether Canadian or foreign) to construct these indexes. The project will establish a framework by which the international import and export price indexes can be put on par with other statistical agencies (e.g. BLS and ABS), and with other Canadian prices indexes (e.g. CPI and IPPI). Failure to improve our export and import price program would impede us to measure properly the real GDP and explain the inflationary pressure in the economy. In addition this project will rebase the current import and export price indexes from a 1997=100 basis to a 2002=100 basis.

1.3 Project Scope

The level of funding that was received is not sufficient to develop an international price program which would be capable of calculating a total import and total export price index. Instead, only a selected set of import and export price indexes can be constructed on a monthly basis which will be integrated into the current import and export price index program within the International Trade Division.

The funding that was approved will permit for the development of approximately 100 import/export price indexes at the HS level. The project will also be run in tandem with the rebasing of the import and export price indexes to 2002=100.