

INDUSTRY UPDATE

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Food Products: Not Stale Dated!

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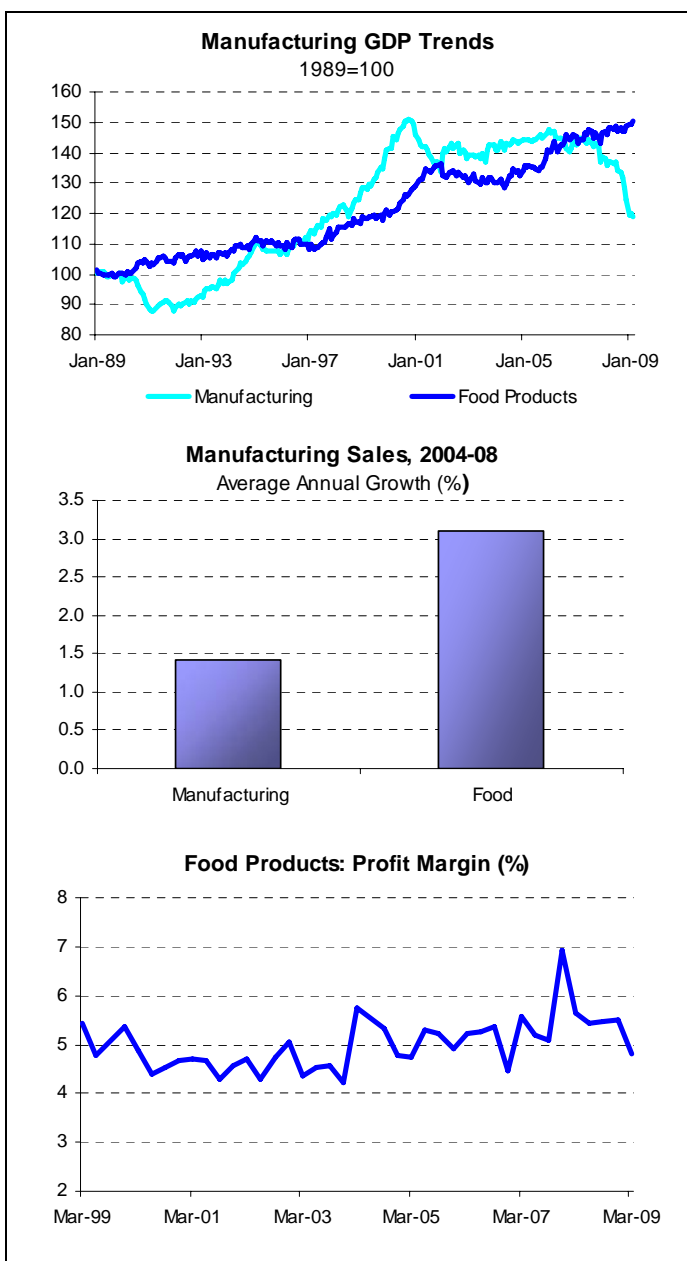
A number of factors have wreaked havoc with Canadian manufacturing, pushing output down a cumulative 18% over the past five years. These include a surging loonie, a run-up in commodity prices, increased foreign competition, and the recession and related financial turmoil. Against this dire backdrop, food products have been an impressive

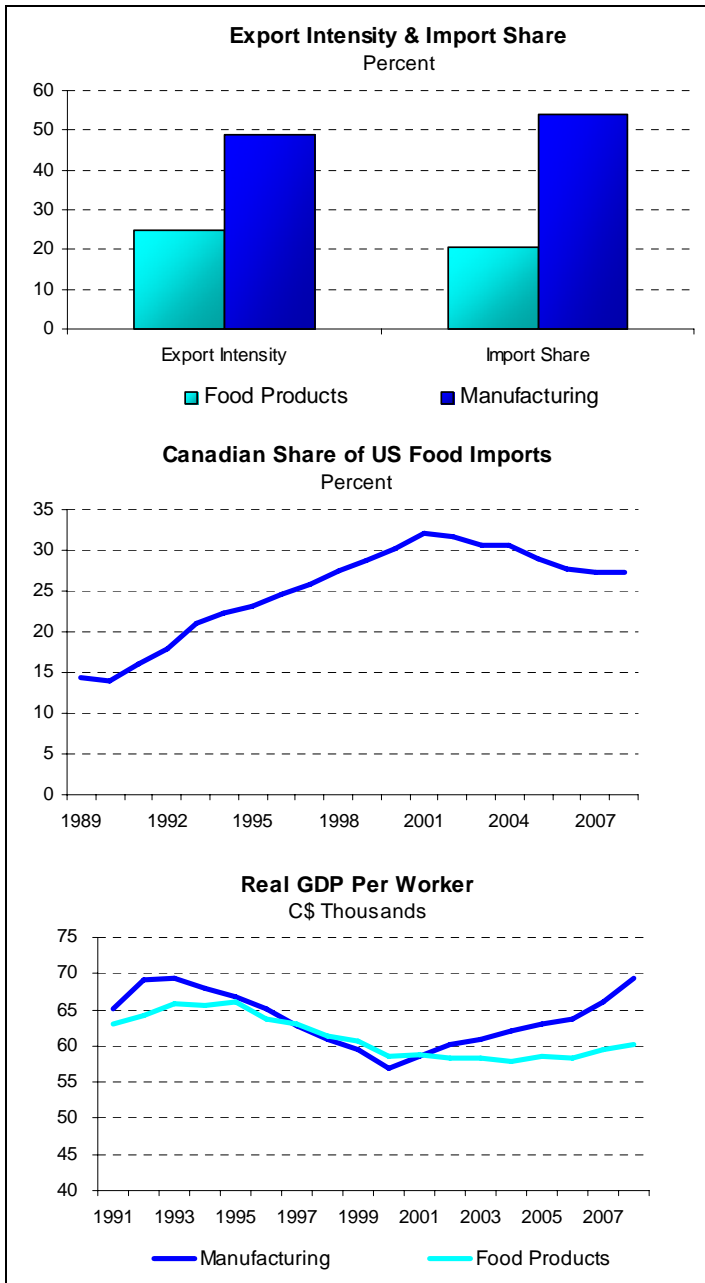
standout. Output has continued to grow, sales have been brisk, plant capacity utilization remains high, and there has been no undue build-up of inventories. Accordingly, the industry's finances have held up well.

This outperformance does not mean that the manufacturing headwinds wholly passed the food products industry by. Indeed, the recession has suppressed demand, the loonie's strength has restrained exports and heightened competition at home and abroad, and high input prices have pinched margins.

However, the recession's impact has been muted by the limited income sensitivity of food demand and relatively solid income growth in Canada, which account for the bulk of the industry's sales. Notwithstanding its current reliance on the domestic market, a rising share of food exports is destined for faster-growing developing countries, unlike the case in other manufacturing industries (e.g., autos).

The loonie's strength hurt the industry's competitiveness, making exports more expensive and imports cheaper. This caused its share of U.S. food imports to slip and its trade surplus to shrink. However, despite the rising significance of emerging markets for exports, the strong currency has been far less a millstone than in other parts of manufacturing, given the industry's limited dependence on external markets. Moreover, food processors' dominant position in the domestic market is unlikely to be assailed anytime soon given





Canada's natural advantages in agriculture and the political sensitivity of food production.

The run-up in commodity prices, no doubt, posed a major challenge for some segments. However, its impact on the industry as a whole was not especially great. Farm and energy prices are a fairly small share of total expenses, so that the effect of high commodity costs on product prices was muted. In addition, given food's basic nature and its limited sensitivity to price changes, producers have been able to pass on cost increases to consumers.

Lastly, some positive longer-term trends are also supporting product innovation and value added in the industry, including growing demand for convenience; greater ethnic diversity in advanced-country markets; concerns about wellness, food safety and sustainability; and brisk demand growth in developing countries due to rising incomes and expanding populations.

Although its recent performance has been quite sanguine, the industry is lacking in some areas. Productivity has been sub-par since the turn of this decade, in terms of its level and growth, partially reflecting weak investment and low capital intensity. In addition, the industry remains fragmented, which has inhibited improvements on both counts. If the industry could right things in these areas, it, along with its stakeholders, would be assured of sustained solid performance.



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