Elbows Down

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Introduction

Canada’s investment outlook remains challenged. Historically, the country’s attractiveness has been closely tied to its economic and geographic alignment with the U.S. However, as this relationship evolves, particularly under an “America First” policy framework, the relative advantages of alignment are likely to diminish.

Over the past year, the Canadian narrative has been dominated by external threats, most notably tariffs and the shifting global order influenced by “MAGA” policies. Far less attention, however, has been paid to the underlying condition of the domestic economy.

Recent federal messaging has emphasized large-scale infrastructure ambitions and expanded trade relationships. While directionally constructive, the practical path to execution remains uncertain and these initiatives are unlikely to meaningfully alter Canada’s near-term economic trajectory. Efforts to diversify trade raise a more fundamental question: what competitive advantages does Canada offer on a global stage?

Natural resources (mainly oil, gas, and agriculture) remain core strengths. However, significant structural and political barriers persist. The likelihood of meaningful progress on east-west pipeline infrastructure remains low, particularly given regulatory complexity and uncertain Indigenous support. Even in a more favorable alignment of stakeholders, capital commitment remains a key constraint.

Recent commentary from two of Canada’s largest infrastructure operators underscores this dynamic:

- **Enbridge CEO Gregory Ebel** noted: “*We are prioritizing investments in the United States due to a more favorable policy environment and stronger customer demand for projects.*”
- **TC Energy** CEO François Poirier similarly stated: *“We are going to be allocating capital predominantly in the U.S. until competitive projects in other jurisdictions present themselves that compel us to allocate capital elsewhere.”*

A recently announced trade agreement with China to expand Canadian canola exports in exchange for permitting 50,000 electric vehicles under preferential terms has seen mixed domestic reception and heightened geopolitical sensitivity, particularly in the context of North American trade relations.

At a macro level, Canada faces a combination of elevated leverage, declining investment, and deteriorating competitiveness.

The USMCA framework is likely to be renegotiated or materially altered, with tariffs expected to re-emerge as a policy tool further deteriorating the competitive landscape. While recent legal developments have introduced temporary uncertainty, tariffs can be implemented under existing U.S. legislation, including Section 232 of the *Trade Expansion Act of 1962* and Section 301 of *The Trade Act of 1974*.

Canada's export-oriented economy is disproportionately exposed to these risks. Exports represent approximately 35% of GDP, compared to roughly 11% in the U.S. At the same time, the U.S. benefits from stronger consumer fundamentals, greater productivity, and a more competitive regulatory and tax environment. Canada's relatively high tax burden and regulatory complexity continue to act as a drag on business investment, contributing to ongoing capital outflows.

An opinion column published on January 10, 2026, by guest columnist John Rapley in *The Globe and Mail* provides a timely perspective on both U.S. policy and Canada derived from the previous global order.

But unfortunately, any chance that Canada can ride this one out and hope for the return in three years' time of a sane presidency can also be ruled out. The U.S. isn't turning on the world because Mr. Trump is President. Mr. Trump is President because the U.S. is turning on the world. The America First constituency is large and durable, and even if it loses some elections, it will win others. This is the world in which we now must live.

So Canadians, with minimal effort, attained a standard of living that other countries had to make greater sacrifices to reach. In effect, Canada got to be a rich Third World country – or rather, it got the benefits of being a 51st state without any of the attendant expenses. That era is gone. Henceforth, we will only sink or swim on our own effort. To maintain its sovereignty and prosperity, the country will

Federal & Provincial Deficits

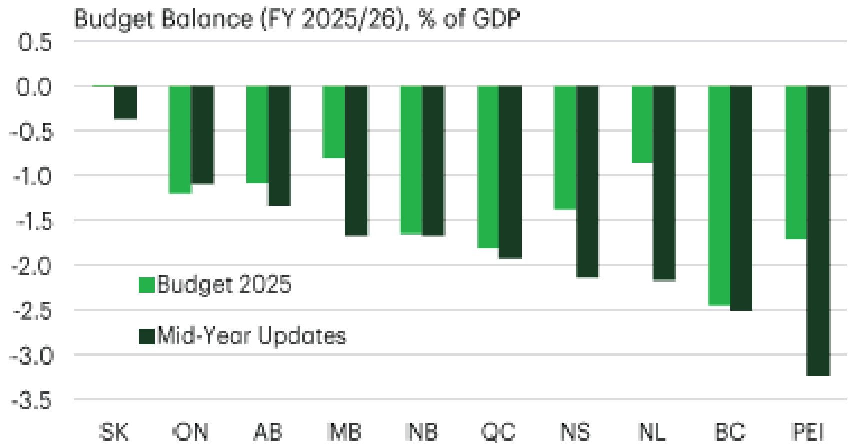
Canada has joined much of the developed world in abandoning the pursuit of balanced budgets. There is little indication of a credible path back to balance in the foreseeable future. Deficits are projected to average approximately $65 billion annually, as illustrated in the table below. While these projections imply a gradual narrowing relative to GDP alongside continued economic growth, the reliability of inputs are questionable. The independent Parliamentary Budget Officer has indicated that there is only a 7.5% probability that deficits, as a percentage of GDP, will decline as forecast, effectively calling into question the credibility of these assumptions.

Importantly, these projections do not contemplate a recession or materially weaker outcome from USMCA renegotiations, both of which appear increasingly plausible. Either scenario would likely result in further deficit expansion without a corresponding increase in GDP. These deficits are now structural with no ability to rebalance.

	2025-2026	2026-2027	2027-2028	2028-2029	2029-2030
Budgetary balance – FES 2024	**-42.2**	**-31.0**	**-30.4**	**-27.8**	**-23.0**
Revised direct program expenses	-16.8	-14.6	-10.9	-12.3	-10.4
Other revisions	9.7	11.0	3.4	1.2	-2.2
Budgetary balance before measures	**-49.2**	**-34.5**	**-37.9**	**-38.8**	**-35.6**
Capital investment measures*	-2.2	-8.1	-10.0	-9.0	-9.4
Day-to-day operating measures*	-26.9	-22.8	-15.6	-10.1	-11.6
Budgetary balance – Budget 2025	**-78.3**	**-65.4**	**-63.5**	**-57.9**	**-56.6**

Source:
Finance Canada and Office of the Parliamentary Budget Officer.

At the provincial level, fiscal conditions are similarly challenged. For the current fiscal year, all provinces are expected to run deficits.



Source: Government Documents, TD Economics.

Structural headwinds point toward a weaker Canadian dollar over the longer term. The divergence in economic fundamentals between the U.S. and Canada continues to widen, and the foreign exchange market will ultimately reflect this imbalance. Canada's economy remains constrained, with growth heavily reliant on residential real estate and limited evidence of a more durable or diversified growth profile.

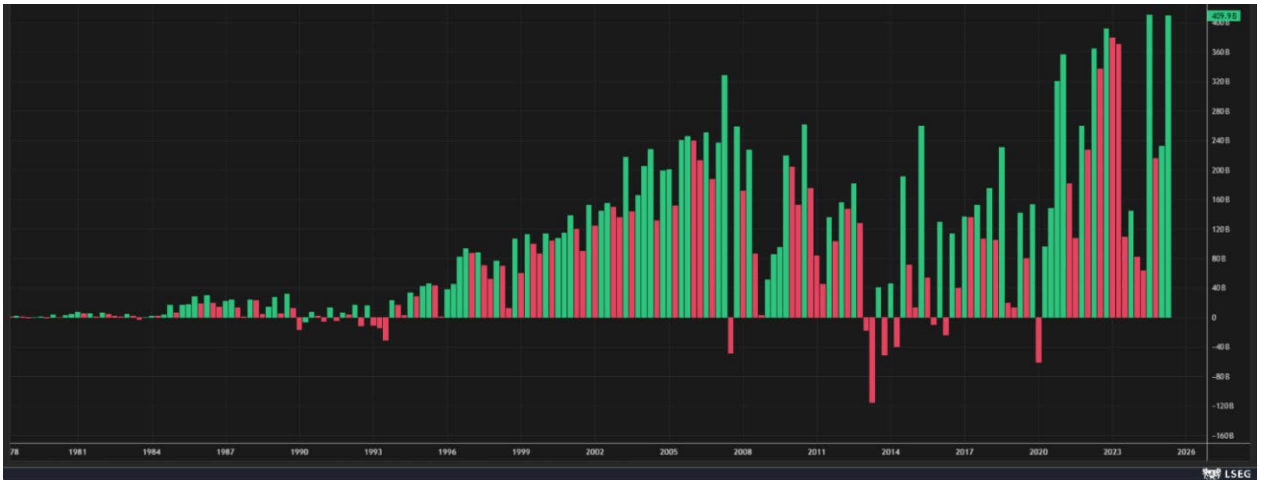
Capital Flows

Capital flows reinforce this narrative. Foreign investment in Canadian securities has turned sharply negative in recent periods.

Net Foreign Flows into Canadian Securities
(First Half of Each Year)

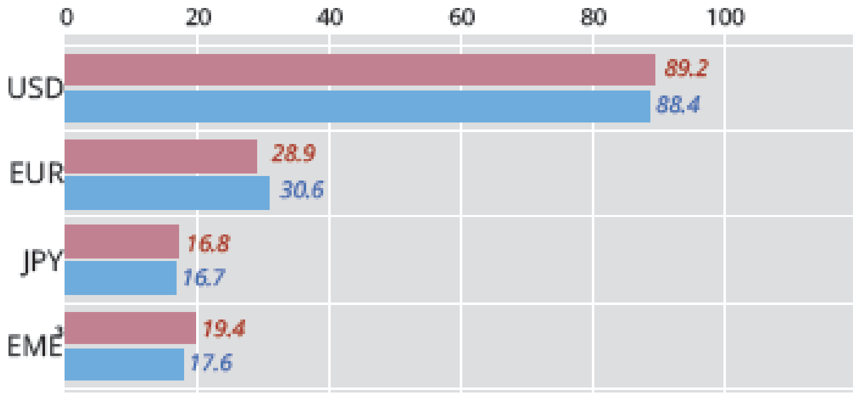
In contrast, despite “sell America” headlines following Liberation Day, foreign capital inflows into the U.S. remain exceptionally strong. In 2025, net inflows reached approximately $1.6 trillion across U.S. equities, Treasuries, agency, and corporate debt, tying a historical record. While full-year data for Canada is not yet available, Canadian investors alone allocated nearly $61 billion to U.S. equities through August 2025.

Net Long-Term Foreign Capital Inflows into U.S. Securities
($ Billions per Quarter)



Source: Treasury International Capital.

While the U.S. dollar faces its own long-term considerations, the notion that it is being displaced by gold or cryptocurrencies remains overstated. Diversification trends are evident, but the U.S. dollar continues to dominate global markets. A recent BIS Triennial Central Bank Survey indicated that the U.S. dollar was involved in over 89% of all foreign exchange transactions, up from 88% in 2022, underscoring its continued structural importance.

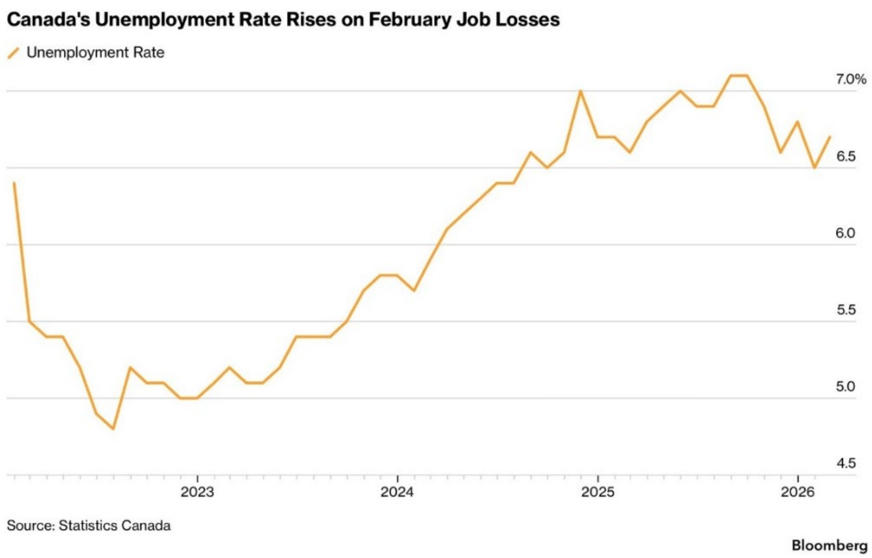


The US dollar continued to dominate global FX markets, being on one side of 89.2% of all trades, up from 88.4% in 2022. **The share of the euro fell to 28.9% (from 30.6%) and that of the Japanese yen** was virtually unchanged at 16.8%. The share of sterling declined to 10.2% (from 12.9%). The shares of the Chinese renminbi and the Swiss franc rose to 8.5% and 6.4%, respectively.

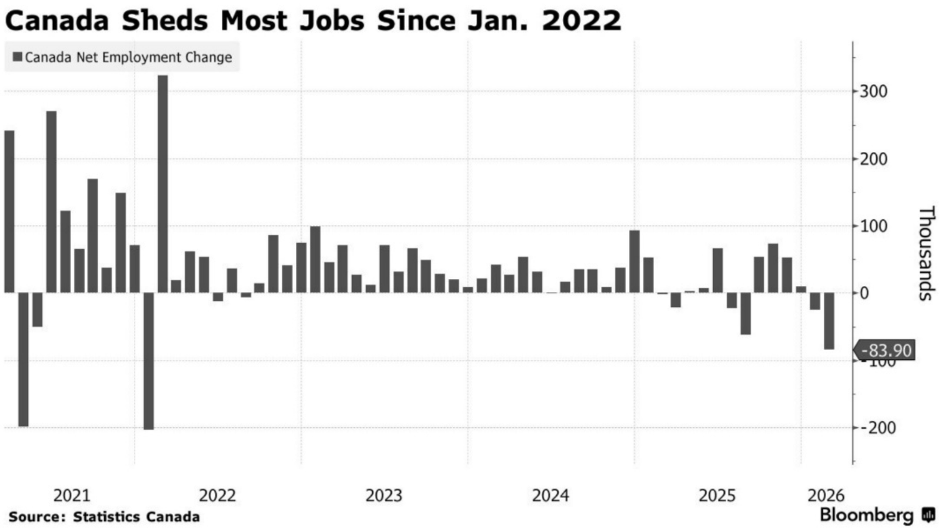
Labor Market Woes

Turning back to Canada, labor market conditions appear to be weakening. While the unemployment rate declined modestly to 6.5% from approximately 7.0%, this was largely driven by a reduction in labor force participation rather than by an increase in hiring. More recent data from January and February suggest that unemployment is beginning to rise again.

Elbows Down

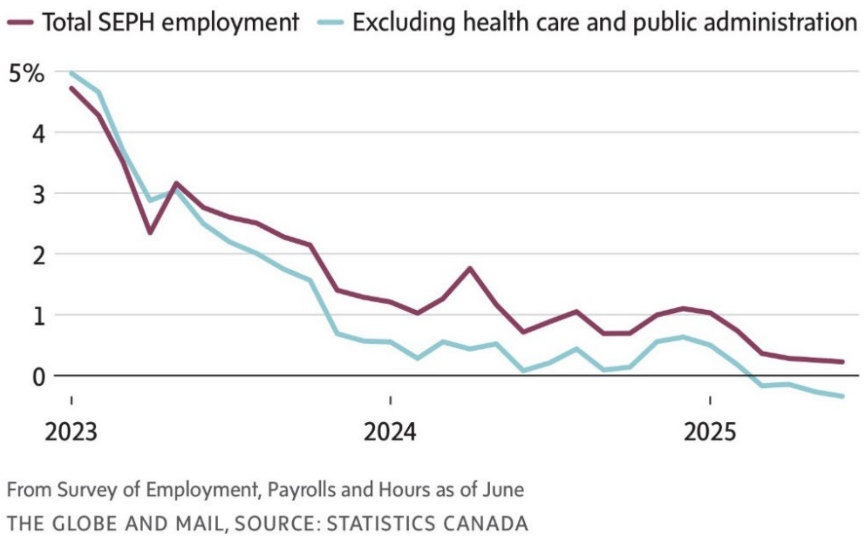


February data was particularly weak. More than 84,000 jobs were lost during the month, with the underlying composition even more concerning – more than 108,000 full-time positions were eliminated, marking the weakest print in over four years.



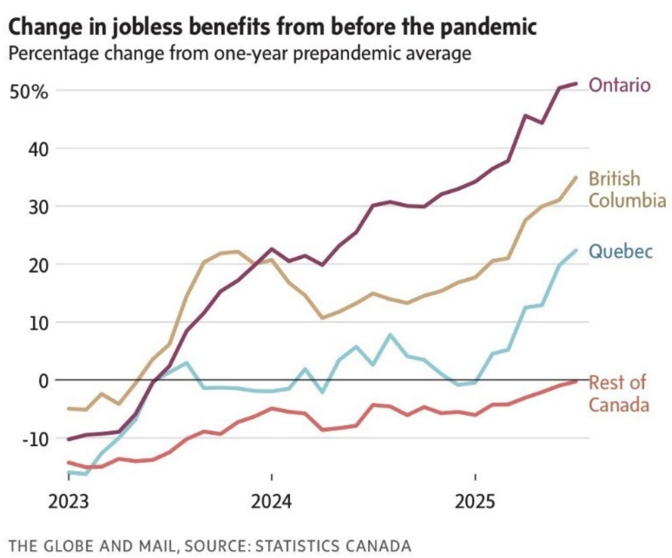
While some attribute Canada's slow growth to trade tensions, the data suggests a broader and more persistent deterioration in labor conditions that has been unfolding over several years.

Annual Percent (%) Change in Canadian Employment



This trend is further supported by a sharp increase in unemployment benefit claims, particularly in Ontario, which have risen significantly over the past several years.

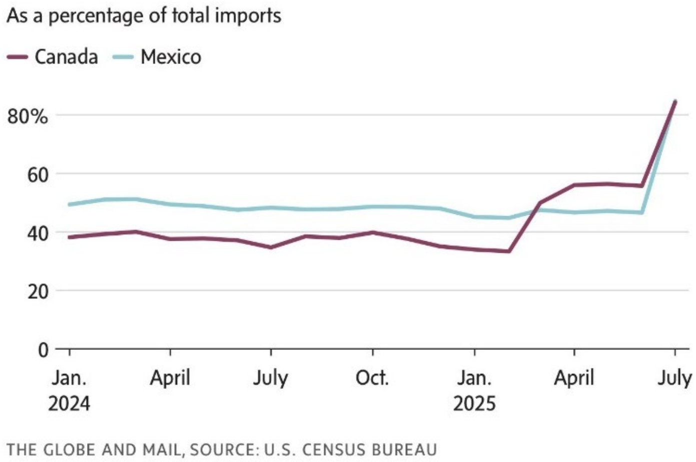
Annual Percent (%) Change in Canadian Employment



Trade & Tariffs

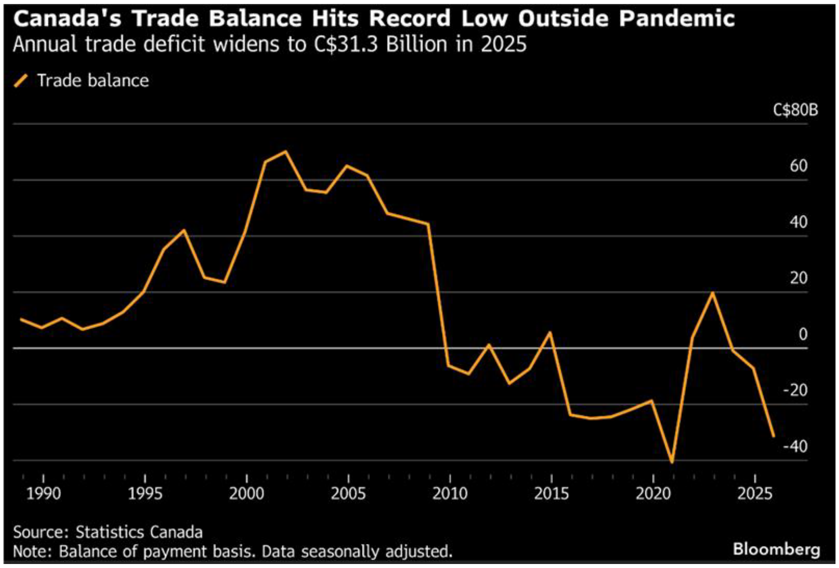
Although tariff discussions have dominated headlines, the majority of Canadian exports continue to move tariff-free under the USMCA, with the exception of sectors such as steel and aluminum. However, this dynamic is likely to deteriorate as trade negotiations progress, further exacerbating economic weakness.

U.S. Share of Imports from Canada & Mexico Complying with USMCA



To date, much of the tension has remained rhetorical; however, it has already had measurable economic impacts. Canada's trade deficit has widened materially and now represents the largest annual shortfall outside of the pandemic period in 2020. Uncertainty is not what capital wants.

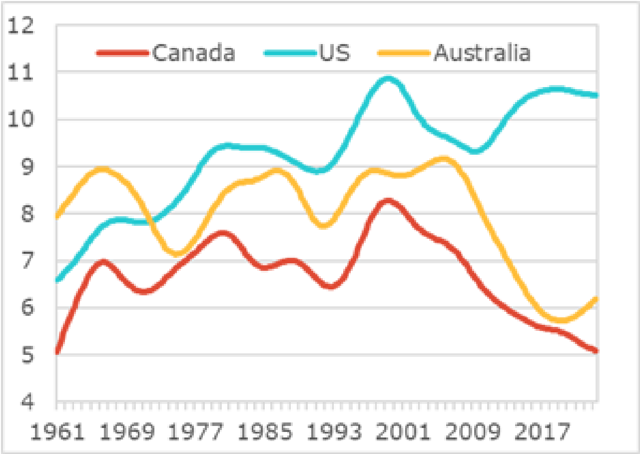
Canadian Trade & Deficit



Investment & Productivity

At the same time, investment trends remain misaligned with long-term growth objectives. Capital allocation toward machinery, technology, and intellectual property – key drivers of productivity – continues to decline as a share of GDP.

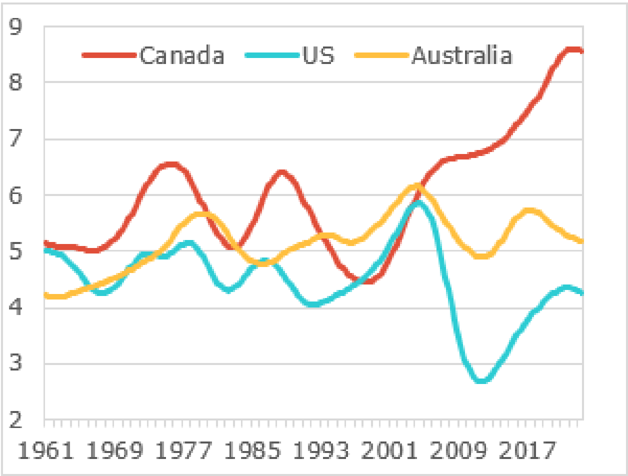
Investment, Machinery, & Intellectual Property (% of GDP)



Source: ABS, BEA, Statistics Canada, Alberta Central

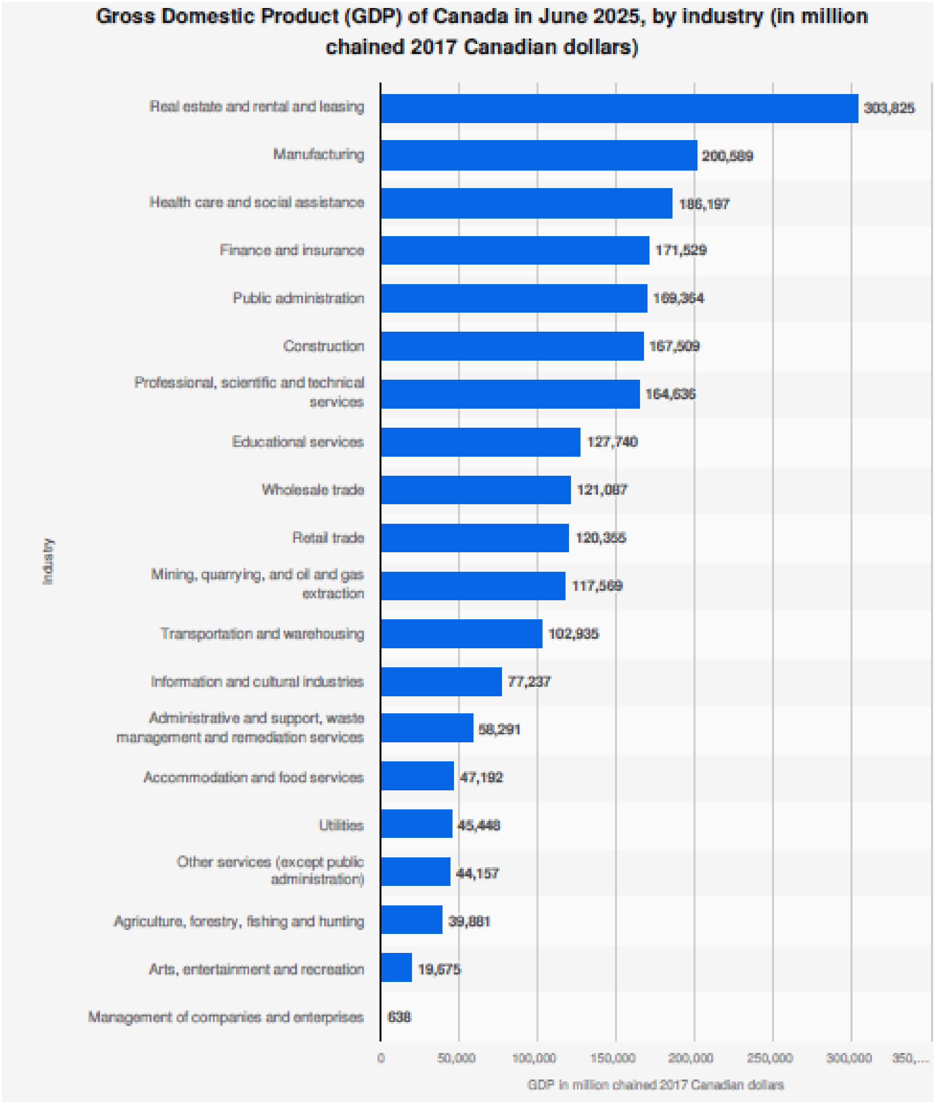
In contrast, residential investment continues to expand.

Residential Investment (% of GDP)



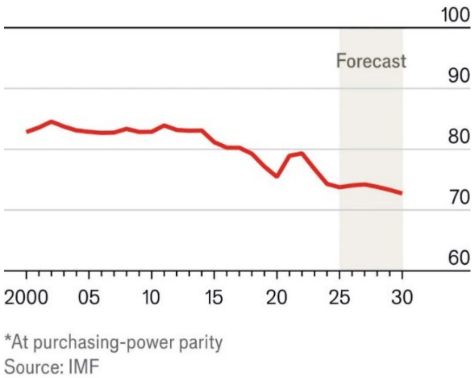
Source: ABS, BEA, Statistics Canada, Alberta Central

The Canadian economy remains heavily concentrated in residential real estate, which now accounts for approximately 15% of GDP. **When incorporating related sectors, including construction, financing, and associated services, the broader real estate complex accounts for more than 25% of total economic output.**



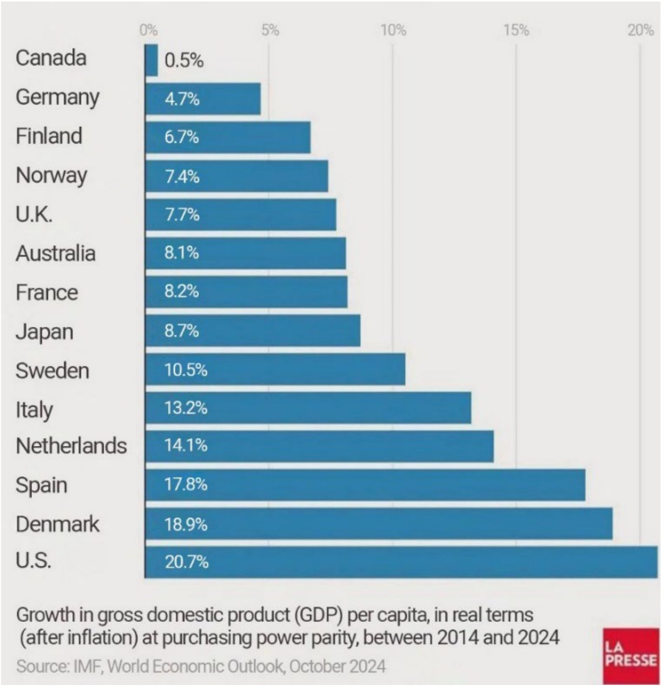
Against this backdrop, it is not surprising that productivity, as measured by GDP per capita, continues to decline compared to the U.S.

Canadian GDP versus the U.S.
(U.S. = 100)



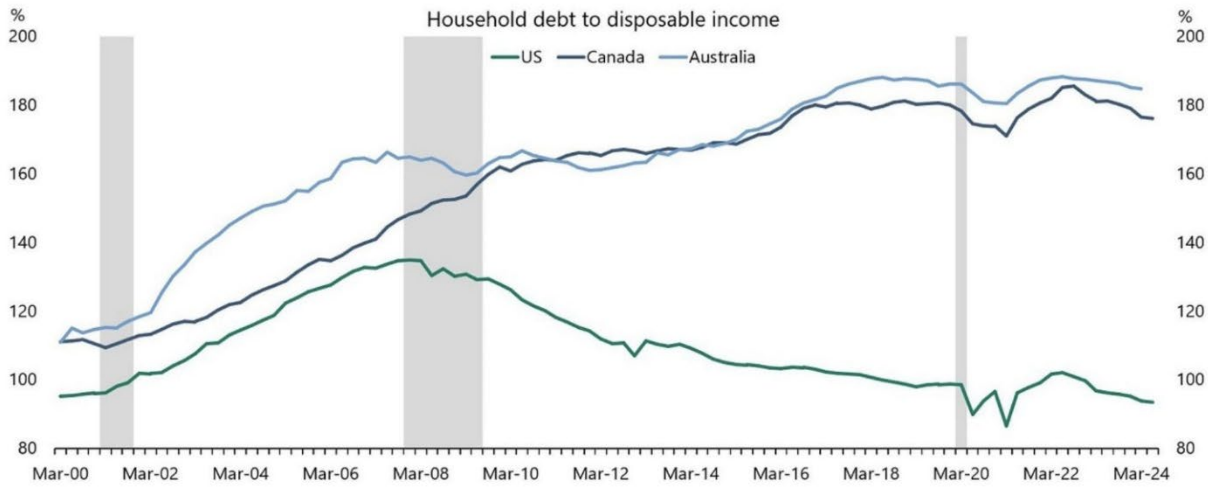
However, this underperformance is not limited to the United States; Canada ranks last among developed economies in per capita GDP growth over the past decade.

Per Capita GDP Growth for 10 Years



Household debt levels in Canada remain among the highest in the developed world (alongside Australia), while U.S. consumers have continued to deleverage since the 2008-2009 financial crisis.

Household Debt to Disposable Income



Conclusion

The Canadian dollar has traded within a relatively narrow range in recent months, with traditional correlations to equities and oil breaking down. We do not interpret this as a sign of underlying strength, but rather as a period of relative stability and lack of market focus on the underlying fundamentals of the country. Part of this "stability" can be traced to market expectations suggesting the Bank of Canada is likely to raise rates in 2026. We find this notion absurd, given the country's exposure to residential real estate and a labor market that is clearly rolling over. Our view is for continued deterioration in the data as 2026 progresses, forcing another round of cuts. If trade negotiations go as poorly as we expect, more deficit spending will be on the docket, exacerbating the decline in the Canadian dollar.

While efforts to diversify trade are directionally positive, they are unlikely to materially alter Canada's very weak economic trajectory in the near term.

About the Author

Timothy J. Gramatovich serves as Principal of Invico Credit Partners and brings more than 40 years of experience in the leveraged finance and high yield markets.

He was the Co-Founder and former Chief Investment Officer of Peritus Asset Management, where he spent 23 years developing investment strategies, leading portfolio construction, and making investment decisions across high yield bonds and leveraged loans. During his tenure at Peritus, Mr. Gramatovich launched and managed several cash flow CDOs and was instrumental in the creation of the first actively managed high yield bond ETF, which grew to more than $1.2 billion in assets within its first three years. He also oversaw bespoke high yield credit portfolios for both individual and institutional clients.

Prior to founding Peritus, Mr. Gramatovich served as a Portfolio Manager at Travelers Asset Management in Los Angeles, managing high yield portfolios for high-net-worth and institutional investors. Earlier in his career, he was a Senior Vice President at Aegis Asset Management Inc., where he established the firm's buy-side high yield investment platform.

Throughout his career, Mr. Gramatovich has acted as a qualified expert on financing and valuation matters for the U.S. Trustee in the Federal Bankruptcy Courts of Los Angeles County. He began his career at Drexel Burnham Lambert in 1986, supporting the development and marketing of high yield corporate cash management products.

Mr. Gramatovich is a CFA Charterholder and a graduate of the New York Institute of Finance.

About Invico Credit Partners

Invico Credit Partners ("ICP") provides specialized macro, fundamental, and risk analysis of the U.S. institutional term loan market to support the syndicated credit strategies of Invico Capital Corporation, including Invico Credit Opportunities LP. Guided by a disciplined and active investment process, ICP focuses on identifying and capitalizing on persistent inefficiencies in corporate credit markets with the objective of delivering attractive, risk-adjusted returns and consistent alpha.