

## Elbows Down

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## Introduction

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Canada's economic and investment outlook has deteriorated significantly. By conventional measures, the country entered a recession following consecutive quarters of GDP contraction in Q4 2025 and Q1 2026. While the federal government has characterized the downturn as a "technical" recession, the economic implications remain the same. Historically, Canada's attractiveness has been closely tied to its economic and geographic alignment with the United States. However, as this relationship evolves, particularly under an "America First" policy framework, the relative advantages of alignment may diminish. Recent commentary from President Trump suggests that the United States-Mexico-Canada Agreement (USMCA) may not be renewed and could instead be replaced by shorter-term bilateral trade agreements that are likely to be less favorable to Canada.

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 initiatives 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 also raise a more fundamental question: what competitive advantages does Canada offer on a global stage?

On June 9, 2026, *The Japan Times* published an article examining Mark Carney's efforts to expand Canada's trade relationships. Two excerpts are particularly noteworthy:

- 1) "Mark Carney's trade push collides with reality."
- 2) "Canadian officials acknowledge that the main draw for many potential trading partners is the prospect of gaining tariff-free access to the world's largest market through Canada's participation in the U.S.-Mexico-Canada trade agreement."

Why is this important? **More than 77% of vehicles manufactured in Canada are produced by Toyota and Honda.** Put differently, if Canada were to lose its preferential access to the U.S. market, the long-term viability of automobile manufacturing in Ontario could come into question. More broadly, if most vehicles manufactured in Canada are produced by foreign-owned companies, it is worth considering the extent to which the sector can truly be characterized as a domestic industry. Natural resources (particularly oil, gas, and agriculture) remain among Canada's greatest competitive strengths. However, significant structural and political barriers persist, and changing global dynamics are creating new challenges. The likelihood of meaningful progress on east-west pipeline infrastructure remains low, particularly given regulatory complexity and uncertain Indigenous support. Even under a more favorable alignment of stakeholders, securing the capital required for large-scale infrastructure development remains a significant hurdle.

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

- **Enbridge CEO Gregory Ebel** stated: *"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."*

While Alberta and the federal government recently signed an MOU to advance another West Coast pipeline project, comments by Cenovus CEO Jon McKenzie at the Calgary Energy Show on June 10, 2026, provide additional perspective. McKenzie described the project as "un-investable" and challenged recent commentary from both Alberta Premier Danielle Smith and Federal Energy Minister Tim Hodgson regarding carbon intensity.

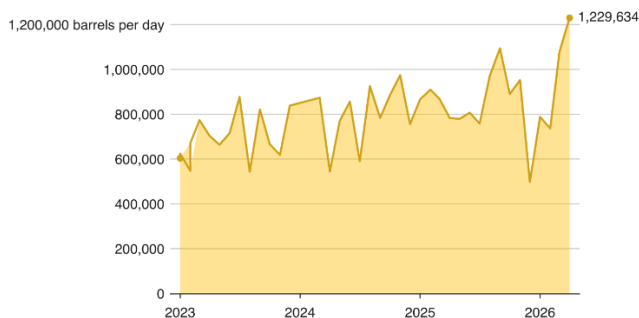
**"The certainty the Alberta-Canada deal provides is that it shows Canada is increasingly out of step and uncompetitive. None of our customers have ever suggested or even asked about the carbon intensity of our crude. If that was the case, pricing signals would be clear in the market and government intervention wouldn't be needed."**

These comments reflect broader concerns regarding Canada's competitiveness and its ability to attract long-term investment capital.

The energy discussion would not be complete without mentioning Venezuela. Oil production has rebounded materially, with exports averaging approximately 1.23 million barrels per day in March, which was a nine-year high.

### Venezuelan oil exports reached highest average since late 2018

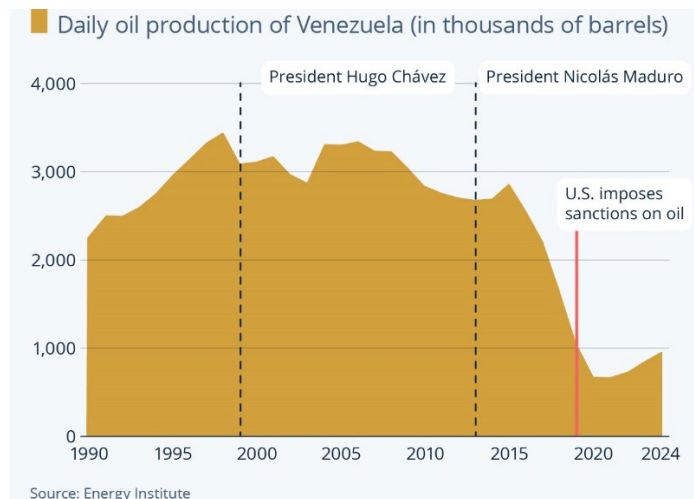
Crude and fuel exports from Venezuela rose to 1.23 million barrels per day in April as a Caracas-Washington supply pact encouraged more sales to the United States, India and Europe.



Figures in barrels per day (bpd)  
• Source: PDVSA's loading schedules, tanker tracking data, LSEG's Eikon

While many investors recognize that Venezuela possesses the world's largest proven oil reserves, fewer remember that production exceeded three million barrels per day not all that long ago.

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Two factors stand between Venezuela and a return to those production levels: time and capital. The resource base remains intact, and U.S. expertise and investment capital are beginning to return. While Canada may view energy as a strategic advantage, this leverage could diminish over time. The U.S. requires access to heavy oil, and Venezuela appears increasingly positioned to supply a larger share of that demand. As a result, Western Canada Select (WCS) differentials could face additional pressure over the longer term.

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 that further weakens Canada's competitive position. While recent legal developments have introduced temporary uncertainty, tariffs can still 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 account for approximately 35% of GDP, compared to roughly 11% in the United States. At the same time, the U.S. continues to benefit from stronger consumer fundamentals, higher productivity, and a more competitive regulatory and tax environment. Canada's relatively high tax burden and regulatory complexity continue to weigh on business investment and contribute to ongoing capital outflows.

An opinion column published in *The Globe and Mail* by John Rapley on January 10, 2026, provides a useful perspective on the changing global landscape and Canada's position within it.

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 fiscal balance in the foreseeable future. As illustrated in the table below, federal deficits are projected to average approximately \$65 billion annually over the coming years.

While these projections assume continued economic growth and a gradual decline in deficits as a percentage of GDP, the reliability of those assumptions remains questionable. The Parliamentary Budget Officer has estimated only a 7.5% probability that deficits, as a percentage of GDP, will decline as forecast, calling into question the credibility of the government’s projections.

Importantly, these forecasts do not contemplate a recession or materially weaker outcome from USMCA renegotiations, both of which appear increasingly plausible. Either scenario would likely result in larger deficits without a corresponding increase in economic output.

Federal deficits increasingly appear structural rather than cyclical in nature. Absent meaningful spending restraint or stronger economic growth, there is little evidence of a realistic path toward fiscal rebalancing.

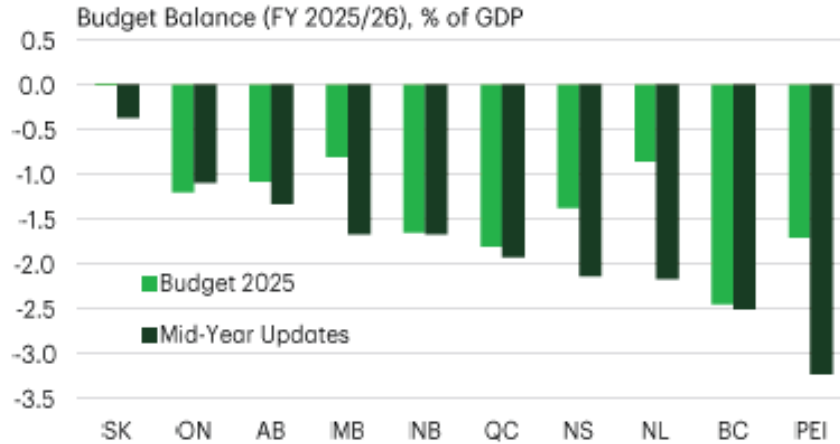
	2025- 2026	2026- 2027	2027- 2028	2028- 2029	2029- 2030
<b>Budgetary balance – FES 2024</b>	-42.2	-31.0	-30.4	-27.8	-23.0
Revised direct program expenses	-16.8	-14.6	-10.9	-12.3	-10.4
Other revisions	9.7	11.0	3.4	1.2	-2.2
<b>Budgetary balance before measures</b>	<b>-49.2</b>	<b>-34.5</b>	<b>-37.9</b>	<b>-38.8</b>	<b>-35.6</b>
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
<b>Budgetary balance – Budget 2025</b>	<b>-78.3</b>	<b>-65.4</b>	<b>-63.5</b>	<b>-57.9</b>	<b>-56.6</b>

Source:

Finance Canada and Office of the Parliamentary Budget Officer.

At the provincial level, fiscal conditions are similarly challenged. Every province is currently expected to run a deficit this fiscal year, further highlighting the broad deterioration in Canada’s public finances.

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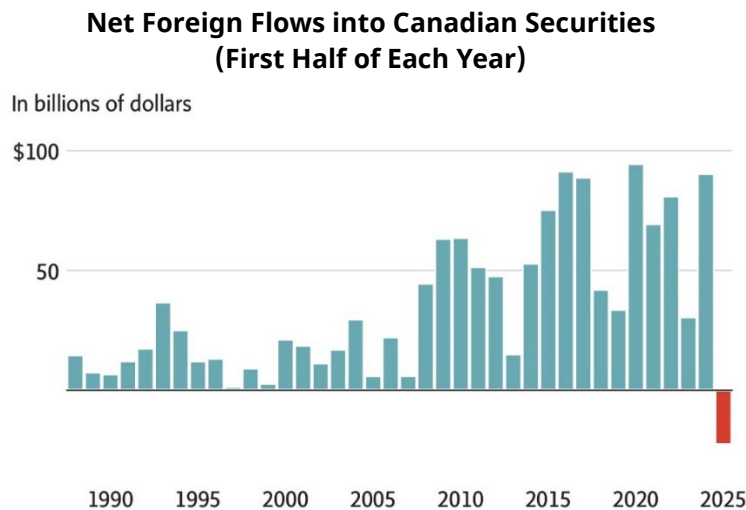


Source: Government Documents, TD Economics.

Structural fiscal weakness is one of several factors contributing to a less favorable long-term outlook for the Canadian dollar. As economic fundamentals between Canada and the United States continue to diverge, foreign exchange markets will ultimately reflect those differences. Canada's economy remains heavily reliant on residential real estate, with limited evidence of a more diversified or sustainable growth profile.

## Capital Flows

Capital flows reinforce this narrative. Foreign investment in Canadian securities has turned sharply negative in recent periods, reflecting growing concerns regarding Canada's economic outlook and competitiveness.



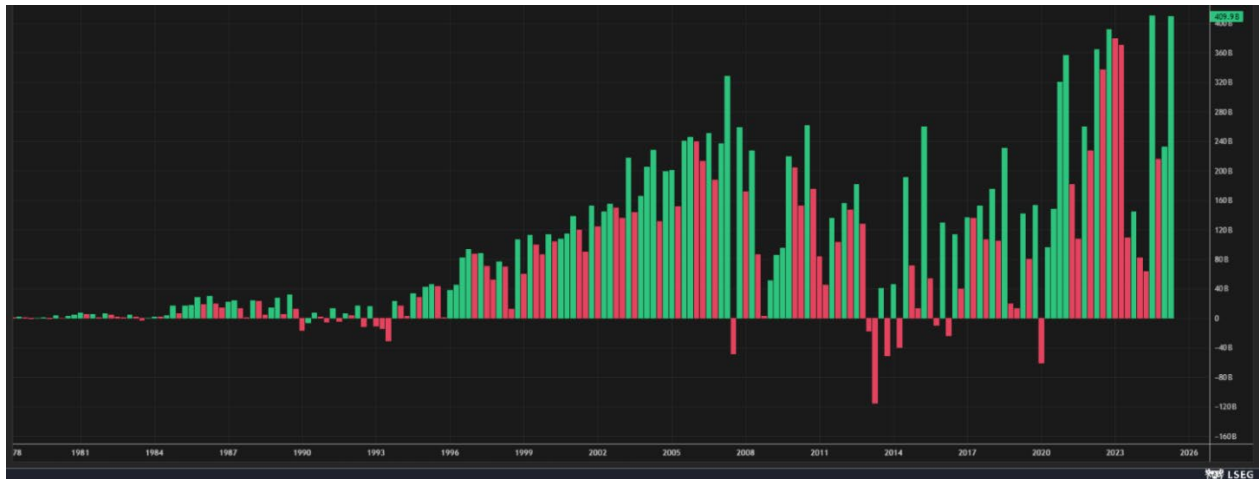
THE GLOBE AND MAIL, SOURCE: STATISTICS CANADA

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In contrast, despite widespread “sell America” headlines following Liberation Day, foreign capital continues to flow into U.S. financial markets at a remarkable pace.

Net foreign inflows into U.S. equities, Treasuries, agency debt, and corporate bonds reached approximately in 2025, matching historical highs. While complete Canada data is not yet available, Canadian investors alone allocated nearly \$61 billion to U.S. equities through August 2025.

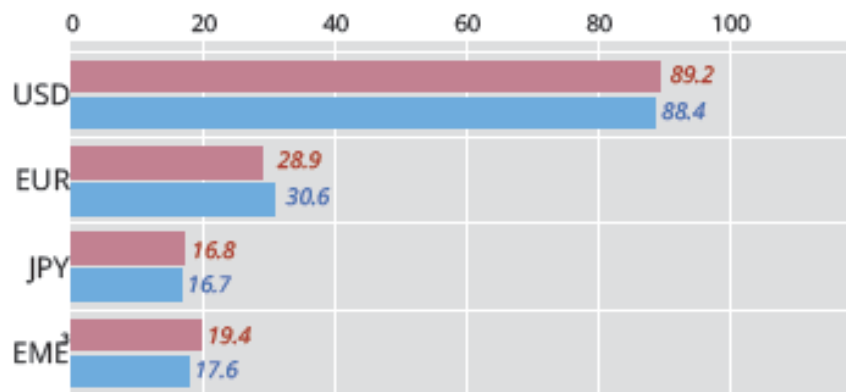
### Net Long-Term Foreign Capital Inflows into U.S. Securities (\$ Billions per Quarter)



Source: Treasury International Capital.

While the U.S. dollar faces its own long-term challenges, 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.

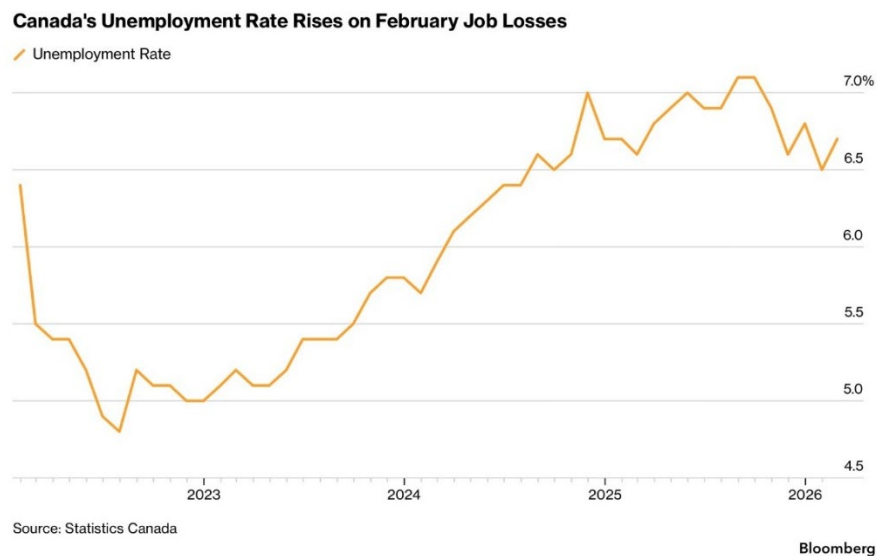
According to the latest BIS Triennial Central Bank Survey, the U.S. dollar was involved in more than 89% of all foreign exchange transactions, up from 88% in 2022. Despite recurring predictions of its decline, there remains no viable alternative that can match the depth, liquidity, and institutional support underpinning the U.S. dollar.



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

Canada's labor market is showing increasing signs of weakness. While the unemployment rate declined from approximately 7.0% to 6.5%, the reduction was driven largely by a fall in labor force participation rather than by stronger hiring activity. More recent data suggest that unemployment may once again be moving higher.

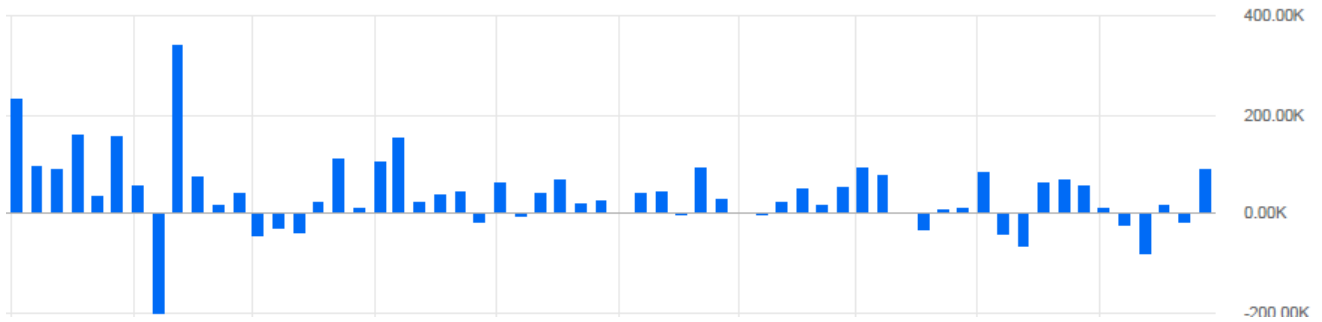


February was particularly weak, with more than 84,000 jobs lost during the month. More concerning was the composition of those losses: over 108,000 full-time positions were eliminated, representing the weakest monthly employment report in more than four years.

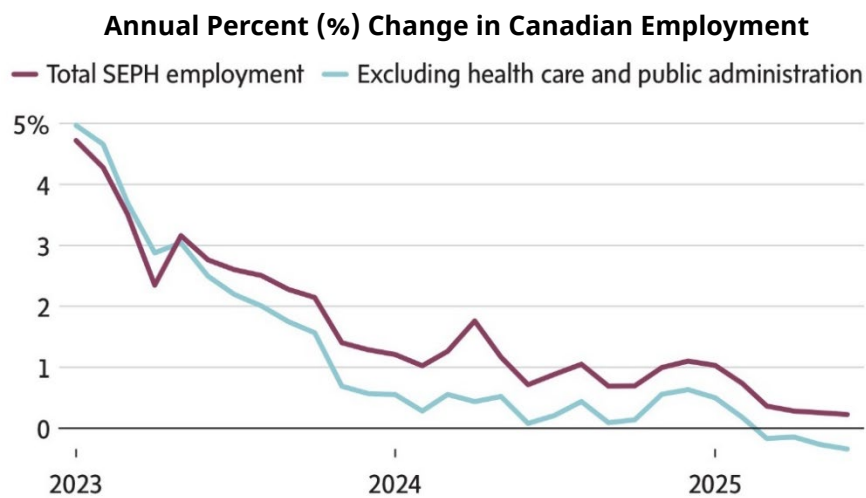
March recorded a modest gain of 14,000 jobs before employment declined by another 18,000 positions in April. Taken together, these results are broadly consistent with recessionary conditions.

May's reported gain of 88,000 jobs represented a notable outlier relative to recent trends. A closer examination of the data helps explain the divergence. Approximately 32,000 positions were temporary census jobs, while additional gains represented temporary hiring related to FIFA World Cup preparations and government-supported construction projects. Many of these positions are unlikely to represent permanent additions to Canada's labor force.

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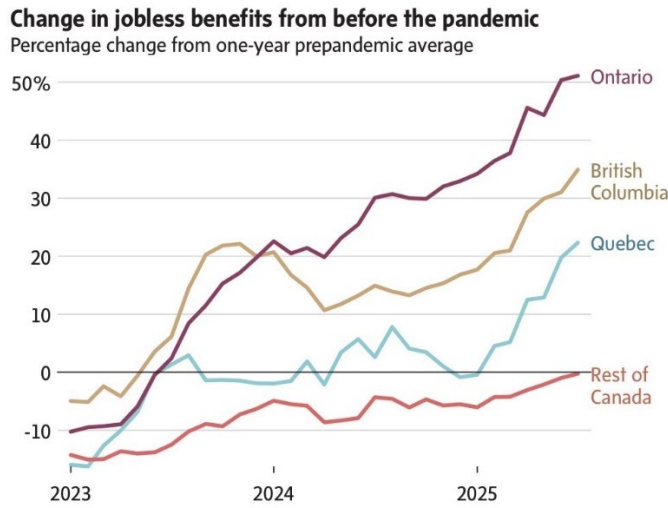
While some observers attribute Canada's slowing economy primarily to trade tensions, labor market data suggests a broader and more persistent deterioration that has been unfolding for several years.



From Survey of Employment, Payrolls and Hours as of June  
THE GLOBE AND MAIL, SOURCE: STATISTICS CANADA

This trend is further reflected in unemployment benefit claims, particularly in Ontario, which have increased sharply over the past several years.

### Annual Percent (%) Change in Canadian Employment



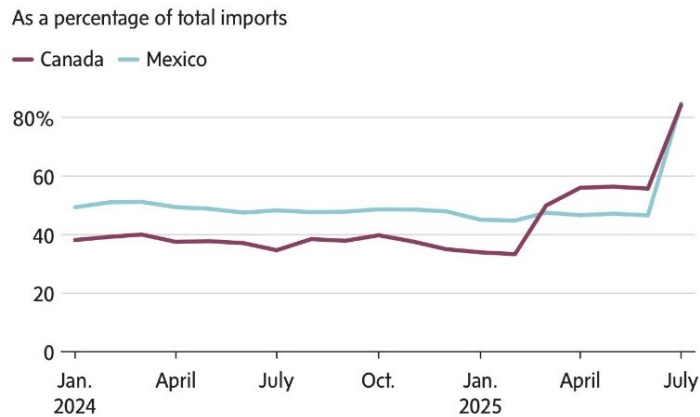
THE GLOBE AND MAIL, SOURCE: STATISTICS CANADA

The deterioration in labor market conditions predates recent trade disputes and points to deeper structural challenges within the Canadian economy.

## Trade & Tariffs

Tariff and trade disputes have dominated economic headlines over the past year. However, the majority of Canadian exports continue to move tariff-free under the USMCA, with steel and aluminum representing notable exceptions.

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



THE GLOBE AND MAIL, SOURCE: U.S. CENSUS BUREAU

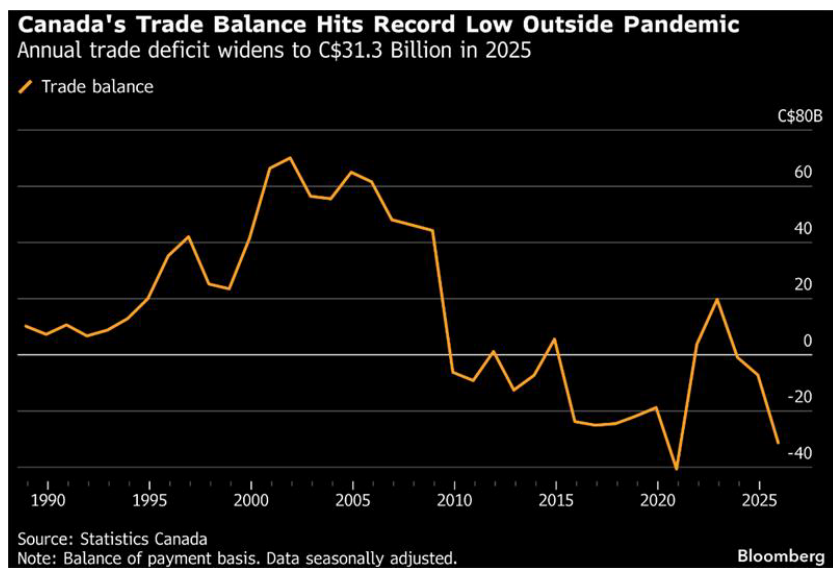
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That said, the outlook remains uncertain. Trade negotiations are likely to result in a less favorable framework for Canada than existed under previous arrangements. Even when tariffs have not yet materially impacted trade flows, the uncertainty surrounding future trade agreements has already begun to affect business investment and economic confidence.

To date, much of the conflict has remained rhetorical. Nevertheless, the economic consequences are becoming increasingly visible.

Canada's trade deficit has widened materially and now represents the largest annual shortfall outside of the pandemic period. As is often the case, uncertainty discourages investment and delays capital allocation decisions.

### Canadian Trade & Deficit



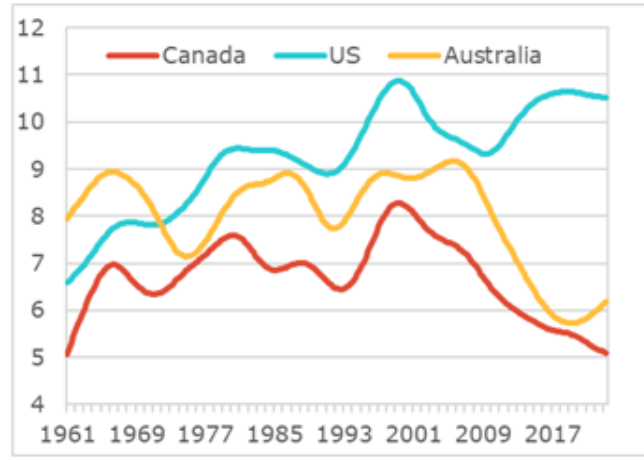
While trade policy remains an important consideration, it should not distract from the broader reality that many of Canada's economic challenges predate current tariff disputes and are rooted in longer-term structural issues.

## Investment & Productivity

At the same time, investment patterns remain increasingly misaligned with long-term economic growth objectives.

Capital directed toward machinery, technology, and intellectual property – key drivers of productivity growth – have steadily declined as a percentage of GDP.

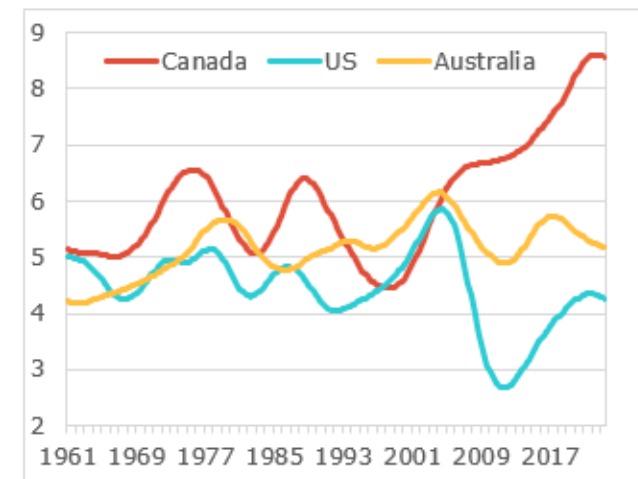
### Investment, Machinery, & Intellectual Property (% of GDP)



Source: ABS, BEA, Statistics Canada, Alberta Central

In contrast, residential real estate investment continues to expand.

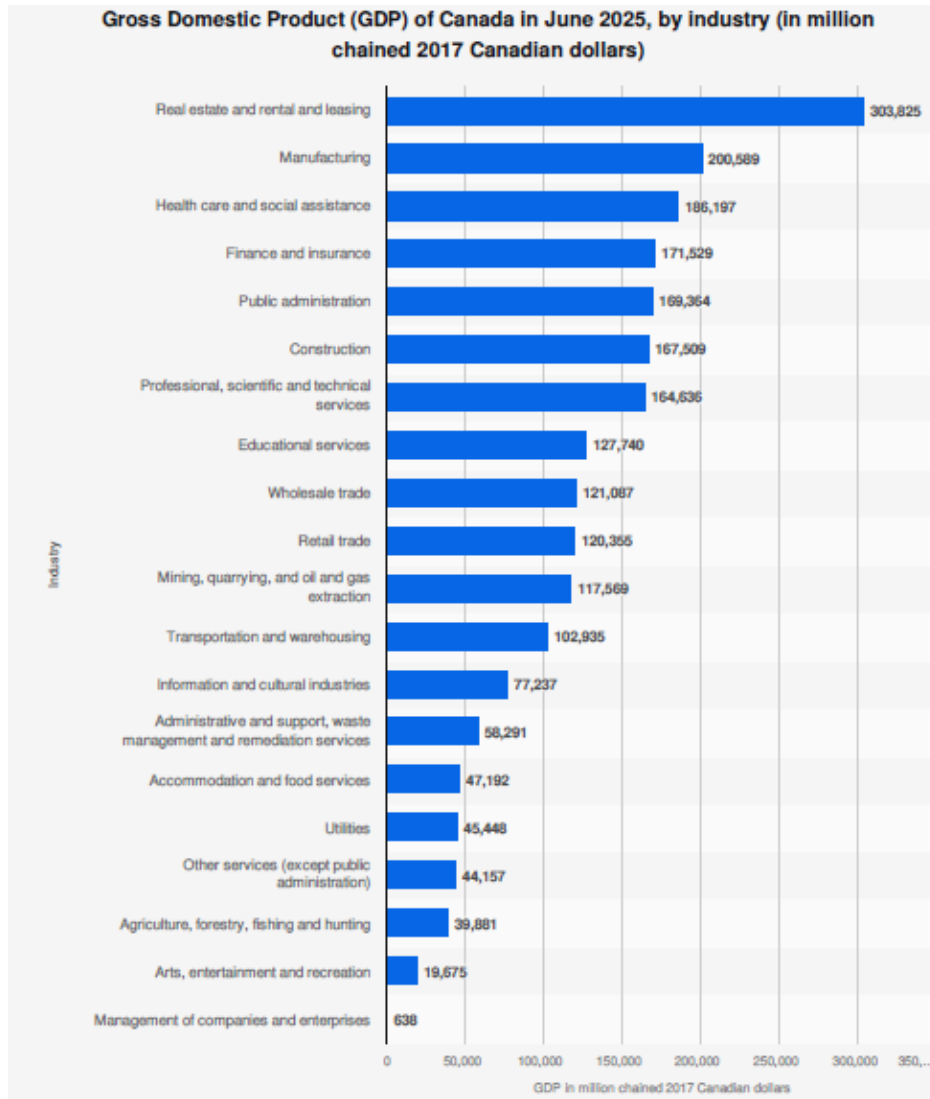
### Residential Investment (% of GDP)



Source: ABS, BEA, Statistics Canada, Alberta Central

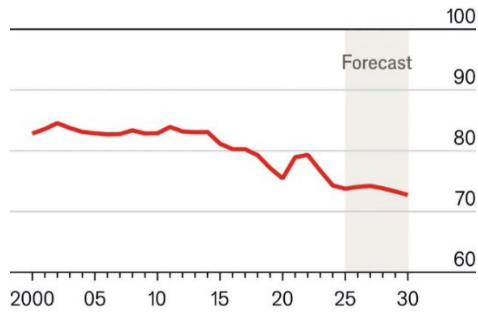
The Canadian economy has become increasingly concentrated in housing-related activity. Residential investment now accounts for approximately 15% of GDP. **When related sectors such as construction, financing, and real estate services are included, the broader housing complex represents more than one-quarter of total economic output.**

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This growing concentration has come at the expense of productive investment elsewhere in the economy. As a result, it is not surprising that productivity growth continues to lag. Measured on a GDP-per-capita basis, Canada's performance relative to the United States has steadily deteriorated.

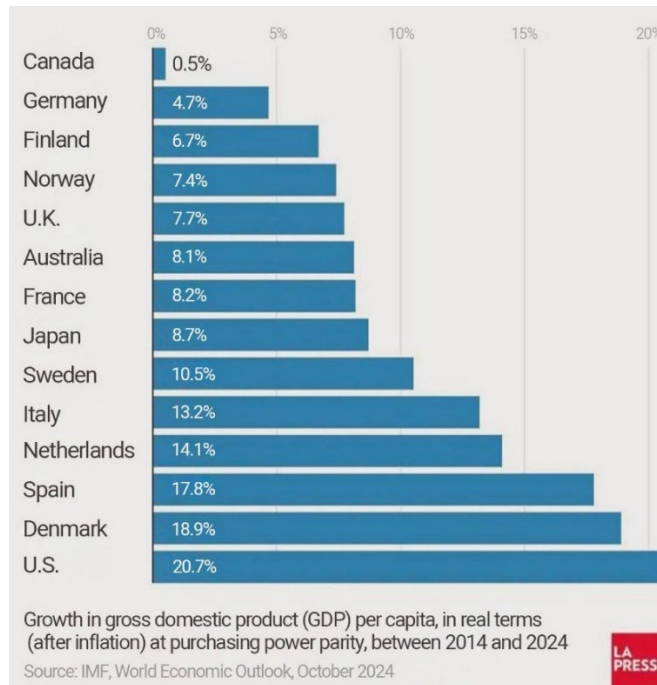
### Canadian GDP versus the U.S. (U.S. = 100)



\*At purchasing-power parity  
Source: IMF

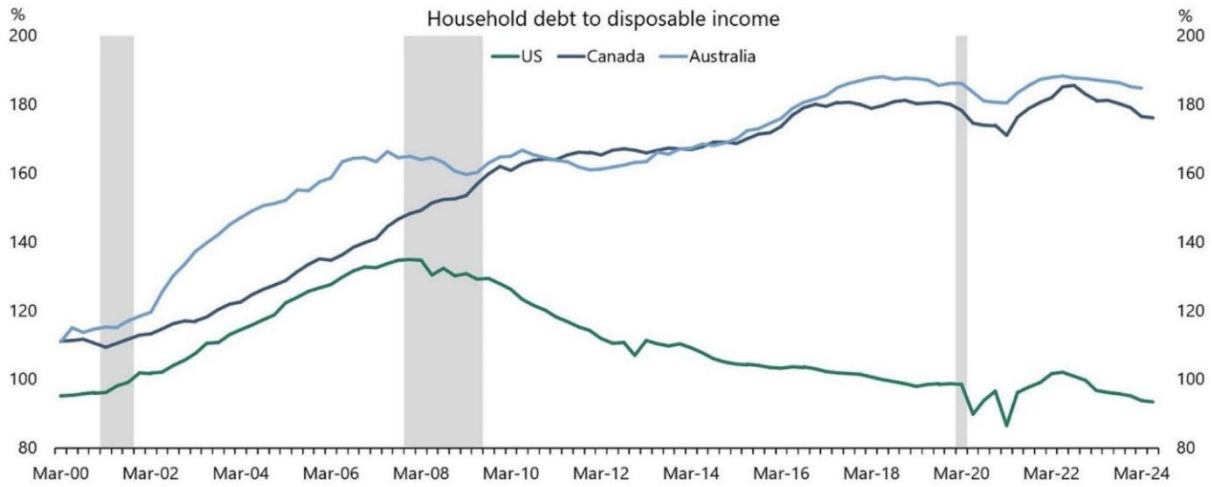
Nor is this underperformance limited to comparisons with the United States. Canada ranks last among developed economies in per-capita GDP growth over the past decade.

### Per Capita GDP Growth for 10 Years



Adding to these challenges, Canadian household debt levels remain among the highest in the developed world, alongside Australia. By contrast, U.S. households have steadily deleveraged since the 2008-2009 financial crisis.

### Household Debt to Disposable Income



High levels of household leverage, combined with weak productivity growth and declining business investment, represent significant structural headwinds for Canada’s long-term economic outlook.

## Conclusion

The Canadian dollar traded within a relatively narrow range for much of 2026, despite a growing divergence between economic fundamentals in Canada and the United States. Traditional correlations to both equities and oil appeared to break down for a period. More recently, however, those relationships have begun to reassert themselves as the Canadian dollar moves back toward the 1.40 level.



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Part of the currency's relative stability was driven by market expectations that the Bank of Canada could eventually begin raising interest rates. We viewed that outcome as unlikely, given Canada's dependence on residential real estate and increasing signs of weakness within the labor market. Our expectation remains that economic conditions will continue to deteriorate as 2026 progresses, ultimately requiring additional monetary easing.

Should trade negotiations produce a less favorable outcome for Canada, fiscal deficits are also likely to increase. Additional government spending, combined with lower interest rates, would place further downward pressure on the Canadian dollar through both increased government borrowing and a widening interest rate differential relative to the United States.

Recent policy proposals suggest that this process may already be underway. Initiatives such as a sovereign wealth fund, government support for artificial intelligence champions, and targeted industry assistance programs point toward greater reliance on public spending as a tool for economic growth. Whether these initiatives will materially improve Canada's long-term competitiveness remains uncertain.

The response from Canada's private sector has been telling. When discussing government assistance for the airline industry, WestJet stated:

*"We do not take government loans and instead advocate for a competitive environment where airlines can succeed based on their own strength. Canada should stay away from distorting markets, both within our country and across the border to the U.S., especially at this sensitive time between our nations."*

The broader issue is not a lack of government programs or spending initiatives. Rather, Canada continues to face structural challenges related to competitiveness, productivity, taxation, regulation, and capital formation. These issues have contributed to declining business investment, weaker productivity growth, and persistent capital outflows.

Until meaningful progress is made in addressing these underlying challenges, we believe Canada will remain at a competitive disadvantage relative to the United States. In our view, the economic and investment outlook remains challenging, and the Canadian dollar is likely to face continued downward pressure as these structural weaknesses become increasingly difficult to ignore.

## About the Author

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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

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Invico Credit Partners ("ICP") is a U.S.-based credit research firm providing specialized market insight and underwriting support across the institutional leveraged loan market. Guided by a disciplined and active investment process, ICP focuses on identifying persistent inefficiencies in corporate credit markets while supporting family offices, multi-family offices, and other institutional investors through bespoke investment structures and portfolio solutions.