It's uncertainty over trade policies, not just NAFTA, that's undermining business investment in Canada

By Pedro Antunes

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At first glance, Canada's investment environment is positive – corporate profits are strong, firms are operating at peak capacity and global growth is robust. This economic environment has allowed private-sector firms to post strong gains in investment in 2017 and through the first half of this year. But private investment levels remain well below normal. The troubled state of the North American free-trade agreement, trade wars, and government policies north and south of the border have created uncertainty that has significantly eroded business investment in Canada – leaving us unable to take advantage of robust U.S. growth.

The climate of trade uncertainty is something that businesses despise. Because access to American consumers is at risk, investment dollars have favoured the United States rather than Canada. Add to that the uncertainty created around the future of the energy sector because of our inability to reach global markets, and business investment overall is likely to stay below what is needed to pick up the pace of growth. Prior to 2015, business investment as a share of GDP was on par with that of the United States, at about 13.5 per cent. Currently, the U.S. share has remained steady, while Canada's share has collapsed to 11.6 per cent – roughly US$44-billion in additional investment would be required to put us back on par.

While business investment posted strong gains in recent quarters, the level of investment is currently barely above what is required to replace depreciated assets. Indeed, the amount of real productive private capital (net of depreciation) fell in Canada in 2017. Since private capital is what drives future productivity, production and real income, this is a significant concern for the Canadian economy.

Furthermore, the effects of low investment levels are now clear. The United States is currently experiencing robust growth in household spending and business investment. This situation would have typically resulted in a surge in Canadian exports, especially at a time when the value of the loonie remains favourable. But the lack of investment has left us at peak capacity, unable to increase exports. The volume of Canadian merchandise exports (excluding oil) has been flat since 2015 and we're expecting another poor performance this year – disappointing for an export-dependent economy.

Uncertainty continues to undermine investment. The policy whims loosely expressed in presidential tweets have slowly translated into an economic agenda that could punish Canada. With the United States and Mexico reaching a framework for agreement last month, the time frame to preserve our access to the U.S. market seems to be shrinking. The situation remains difficult for our trade negotiators. But while we are all anxious and hopeful for a resolution on NAFTA, the uncertainty associated with the current U.S. administration will undoubtedly continue. So, while Canada's economy has historically been tied to that of the United States, currently we drift apart, in more ways than one.

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