

Attract private investment: Canada's only way out

By Stéfane Marion

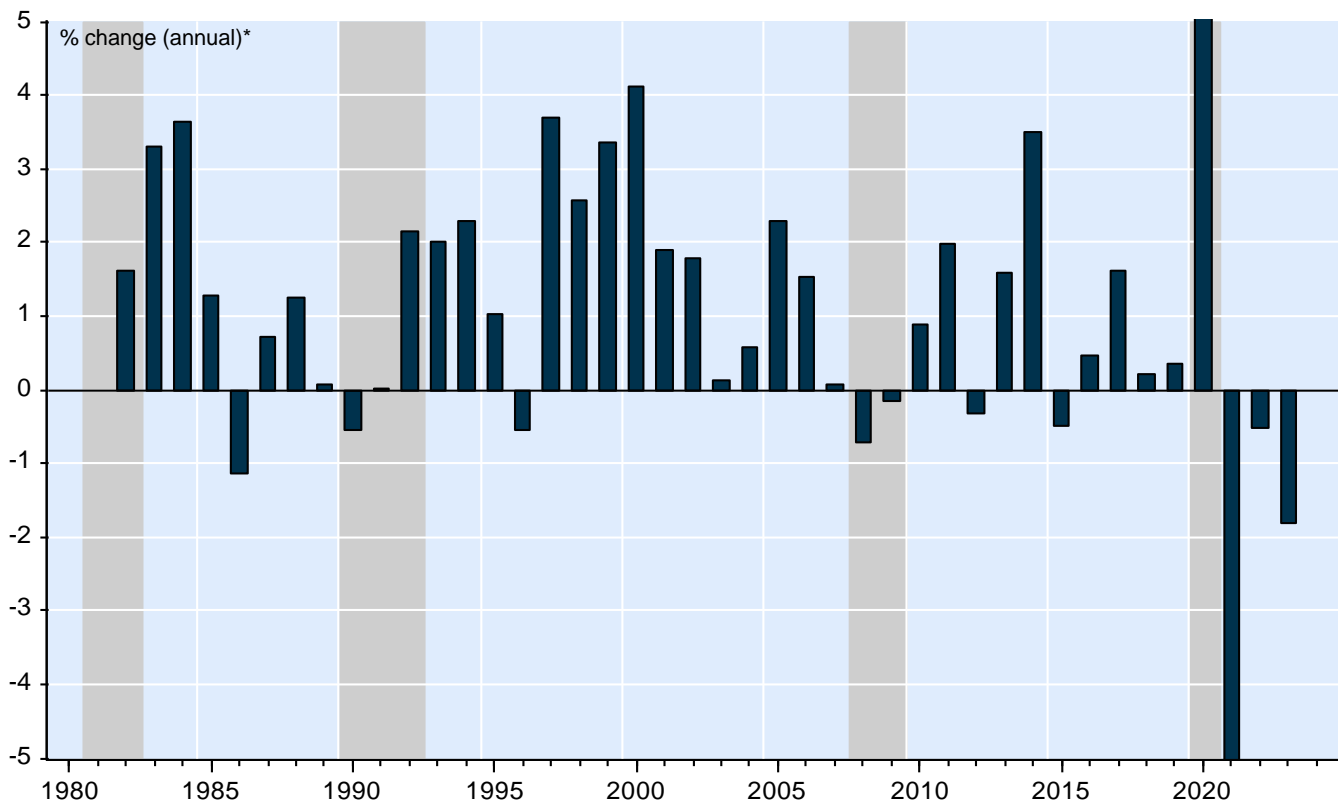
"Productivity isn't everything, but, in the long run, it is almost everything."

- Paul Krugman (2008 Nobel Laureate)

According to a just-released Statistics Canada [report](#), Canadian labour productivity posted its first gain in seven quarters in Q4 2023 (1.7% annualized). Unfortunately, this advance was not enough to salvage the year, and 2023 will go down in the record books as the third consecutive annual decline, the worst sequence in at least 41 years (chart).

Canada: Down for three consecutive years

Labour productivity in Canada's business sector

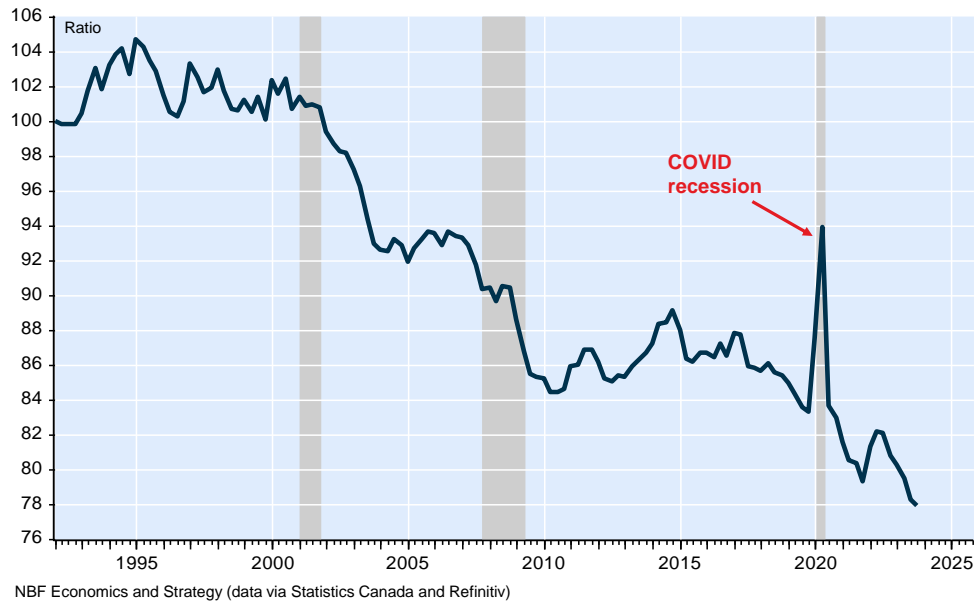


* truncated scale because of COVID recession
NBF Economics and Strategy (data via [Statistics Canada](#))

Meanwhile, south of the border, labour productivity rose for the second time in three years in 2023. The days of Canada keeping up with the Joneses in the 1990s are long gone. Canada's productivity gap with the United States has been on a downward trend for more than 20 years, with an acute worsening since 2018 that was briefly interrupted during the COVID recession (chart).

Canada: Productivity gap with the U.S. continues to widen

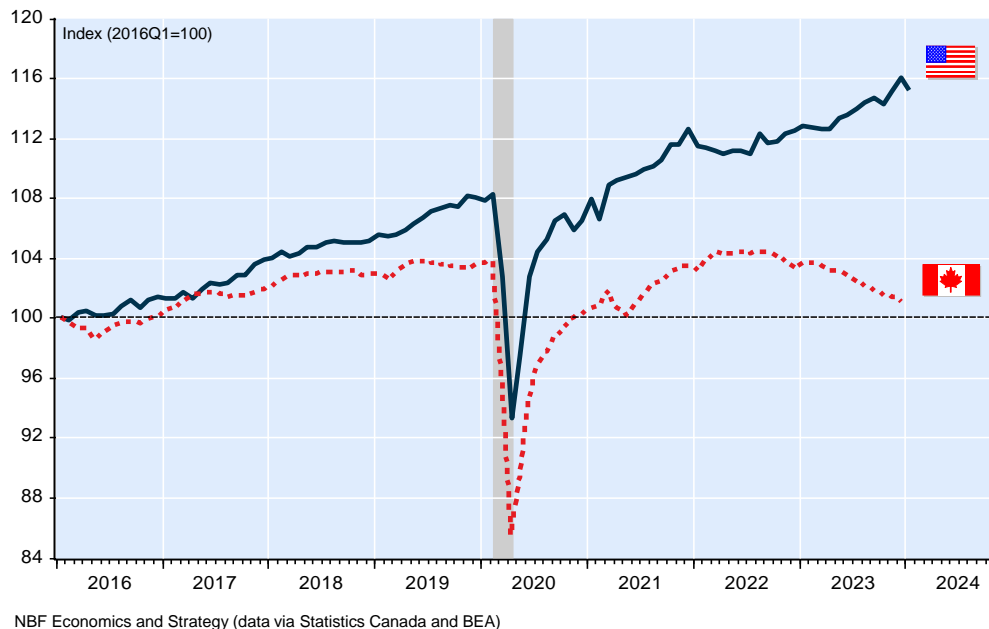
Ratio of Canada to U.S. business sector productivity



That's a very big deal. As Nobel Laureate Paul Krugman once said: "Productivity isn't everything, but, in the long run, it is almost everything. A country's ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker." Case in point: Canada's dismal productivity has coincided with an erosion of living standards in recent years (chart).

Canada: Standard of living is declining

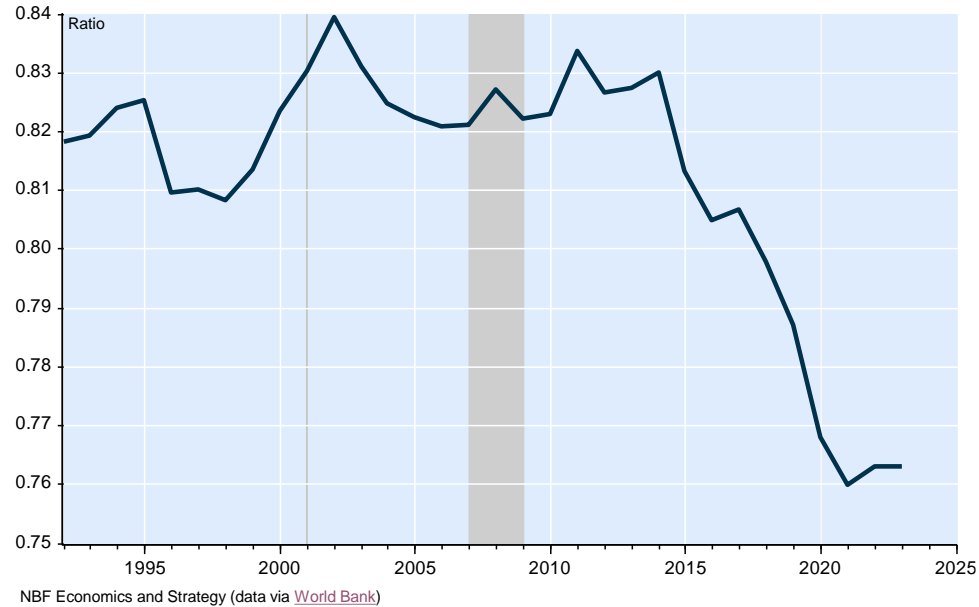
Real GDP per capita: Canada vs. the U.S.



This underperformance has led to our GDP per capita falling to 76% of that of Americans according to the World Bank (chart).

Canada: Down to 76% of U.S. level

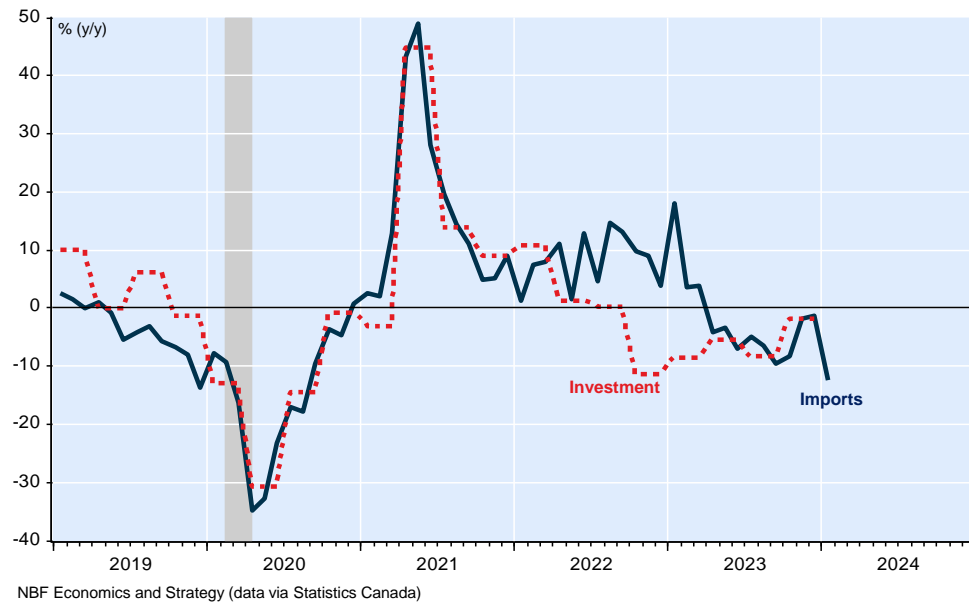
Ratio of Canada and U.S. real GDP per capita on a PPP basis



So how do we stop this erosion? Canada has one of the most educated workforces in the world, but what we make up in human talent is more than offset by a lack of private investment in our country. On this front, recent trends remain a cause for concern. For example, business investment in machinery and equipment has been declining since mid-2022. Unfortunately, the just-released January trade data does not suggest a rebound in early 2024, as the volume of investment goods imports fell 12% from a year ago, the worst performance since the COVID recession (chart).

Canada: Business investment continues to fall

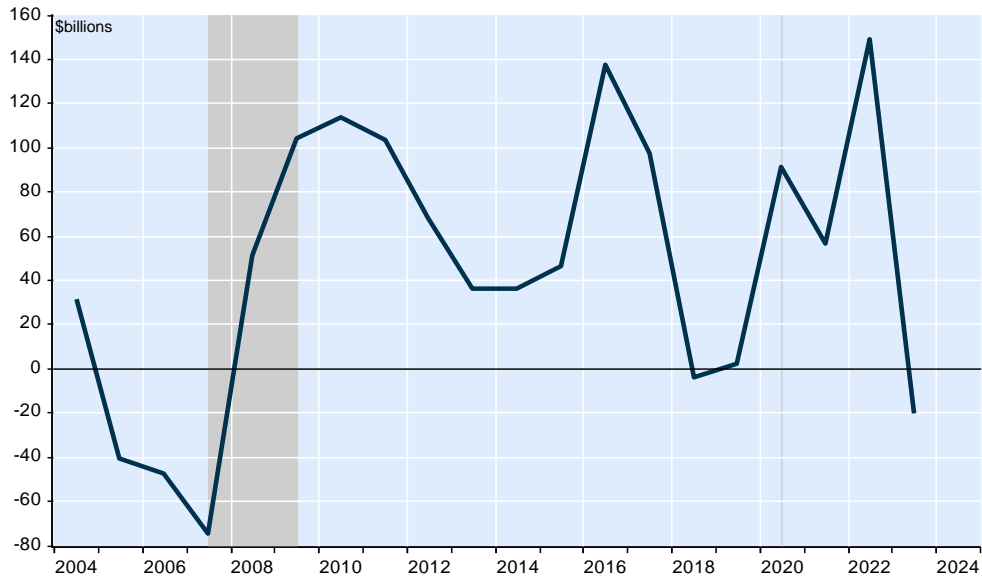
Volume imports of machinery & equipment vs. business investment in machinery & equipment



This follows a bad year for international portfolio flows. In 2023, Canadian investors acquired \$53 billion in foreign securities. Meanwhile, foreign investors purchased only \$32 billion of Canadian securities, the smallest amount in 16 years. As a result, international securities transactions resulted in a net outflow of \$20 billion (or 0.7% of GDP) – chart.

Canada: Bleeding capital by the most since 2007

Net international transactions in securities (foreign less Canadian purchases of all securities)

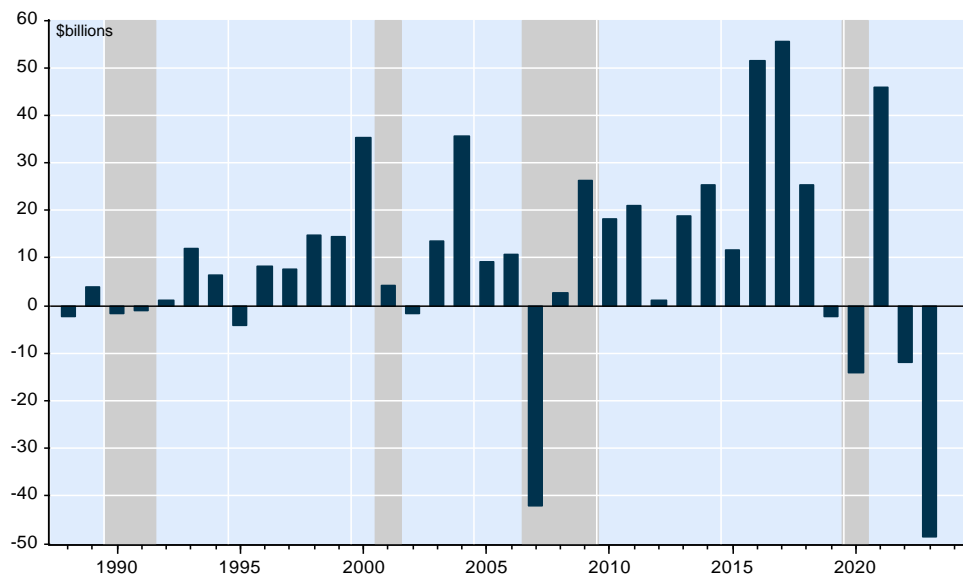


NBF Economics and Strategy (data via [Statistics Canada](#))

This dismal performance was exclusively driven by a complete shunning of Canadian equities by foreigners, who reduced their holdings of Canadian shares by a record \$48.7 billion (1.7% of GDP) - chart.

Canada: Foreigners sell record amount of Canadian stocks in 2023

Foreign investment in Canadian equity and investment fund shares

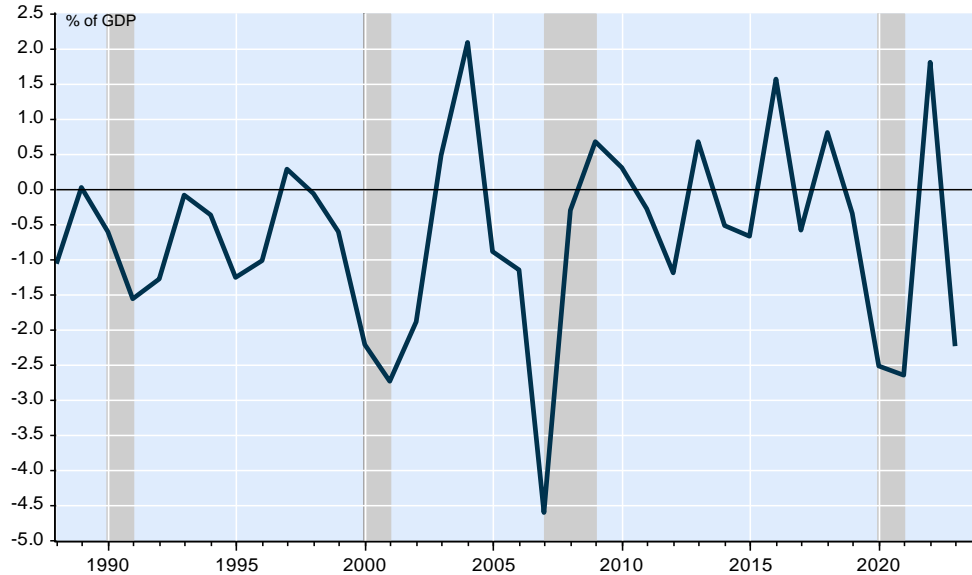


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While foreigners were busy selling our country's stocks in 2023, Canadians were busy buying a net \$15.7 billion worth of foreign stocks. As a result, international equity transactions generated a net outflow of \$64.4 billion last year. As a percentage of GDP, that's 2.2%, the worst performance on record outside of a recession – chart.

Canada: Worst performance ever outside a recession

Net international transactions in equities and investment fund shares (foreign less Canadian purchases)

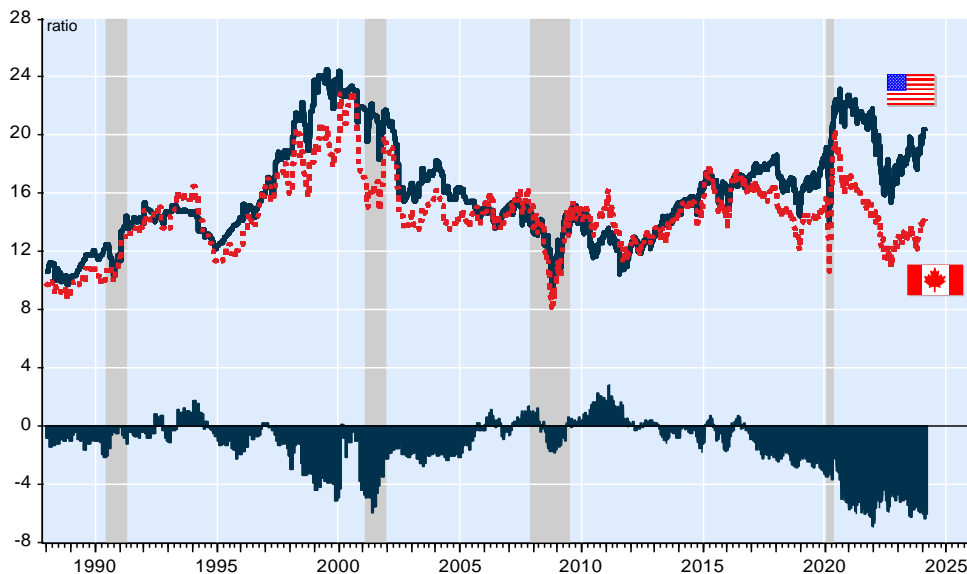


NBF Economics and Strategy (data via [Statistics Canada](#))

Not surprisingly, this dynamic is weighing on Canada's stock market, an important tool for allocating capital in the economy. While the S&P 500 trades at more than 20 times forward earnings, the forward P/E on the S&P/TSX is only 13 times (chart). This is a near-record discount to the S&P 500, and it is widespread, with forward P/E's for 9 of the 11 major S&P/TSX industries currently trading below their 20-year average differential to the S&P 500. This is not conducive to much-needed business investment, as the cost of capital for public companies in Canada is significantly higher than in the United States.

Canada: Stock market trading at near historic discount to U.S.

Forward PE ratio for the S&P 500 and the S&P/TSX

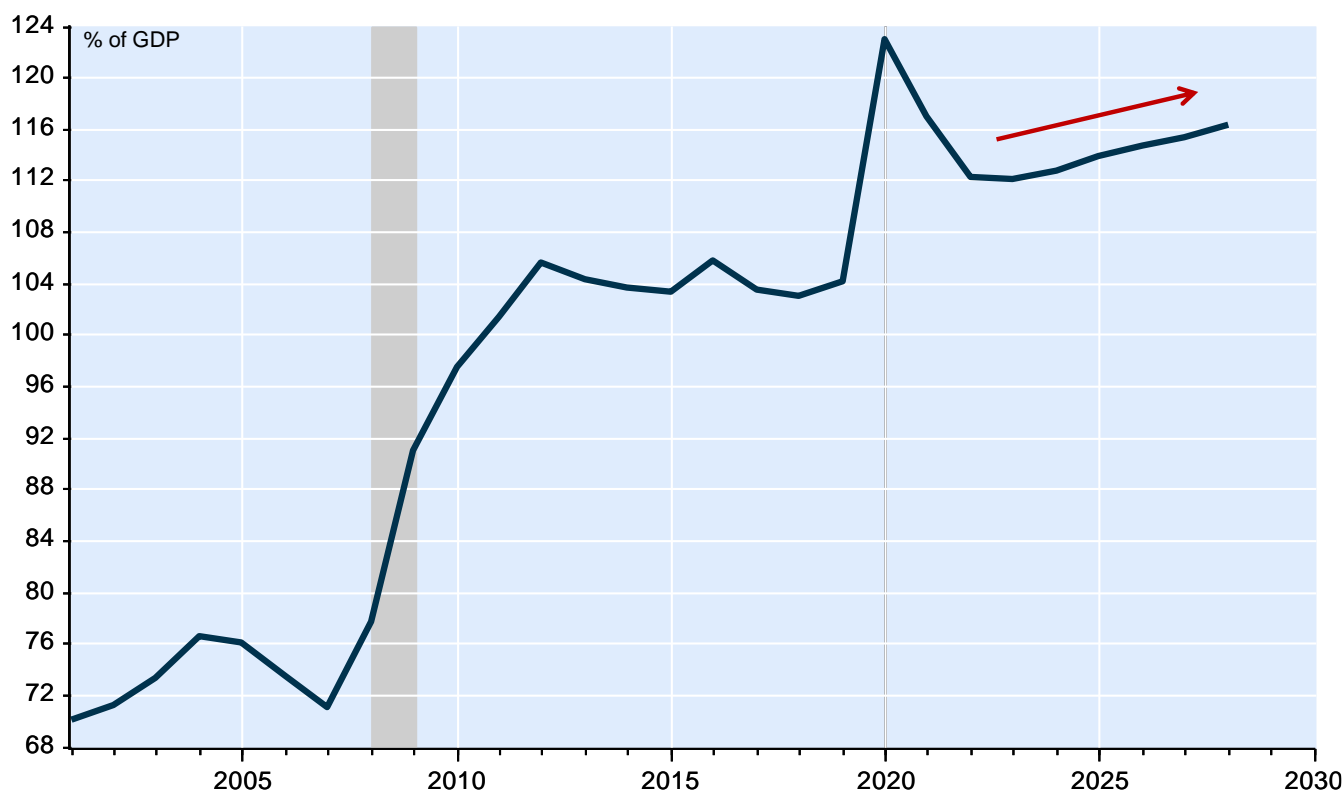


NBF Economics and Strategy (data via Refinitiv)

Could the government fill the investment gap in the future? Hardly. With the IMF forecasting unprecedented levels of public debt in all advanced economies, there is no longer any room for large government spending initiatives. This means that the global race among countries to attract private capital will become even more competitive.

World: More government debt for as far as the eye can see

General government gross debt for the Advanced Economies



NBF Economics and Strategy (data via [IMF](#))

Conclusion

Private investment is the lifeblood of any economy. Without it, growth, development and innovation stall and the potential for progress diminishes. But it's hard to revive business investment and productivity in Canada when foreign and domestic investors prefer to place their assets outside our borders. A friendlier business environment is urgently needed in this country if we are to close our productivity gap. In particular, large institutional investors must be offered attractive opportunities for long-term domestic investment across various asset classes. That's the only way to avoid further erosion of our standard of living.



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