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## Canada's (im)balance of payments

By Warren Lovely

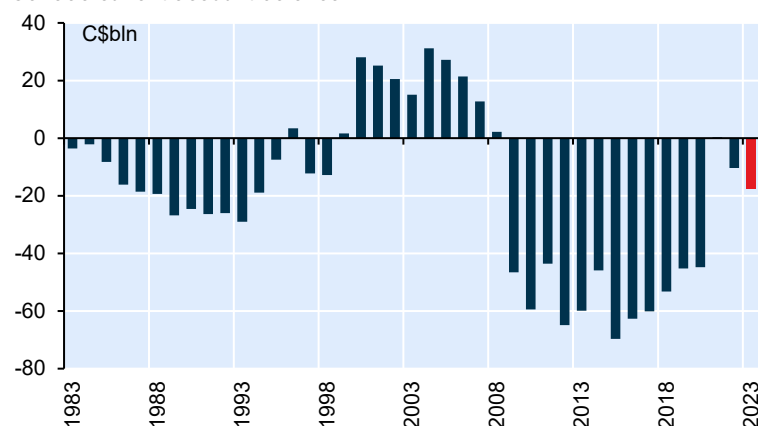
Canada ran a current account shortfall in 2023:Q4 and for the year as a whole. The country has now registered a current account deficit for 14 of the 15 years in the post-GFC era (i.e., starting with 2009).

Balance of payments accounting rules thus require that Canada was once again a net international borrower last year. On direct investment and portfolio flows, Canadians were eager to steer capital abroad last year. In contrast, non-residents were more apprehensive when it came to investing in Canada. We sold barely half as many Canadian bonds to foreign investors in 2023 vs. the prior year. And non-residents dumped nearly \$50 billion of Canadian shares. With our bonds less coveted and our stocks seemingly unappealing, Canada was heavily reliant on 'hot money' in 2023, as evidenced by large-scale currency and deposit inflows. That's not the most stable means of financing a current account shortfall and could serve as a potential vulnerability were this relatively untethered cash to depart quickly.

Beyond apparent vulnerabilities in Canada's international financing strategy, the magnitude and composition of the nation's international assets and liabilities warrant growing attention.

### Chart 1: Current account in deficit for 14 of 15 post-GFC years

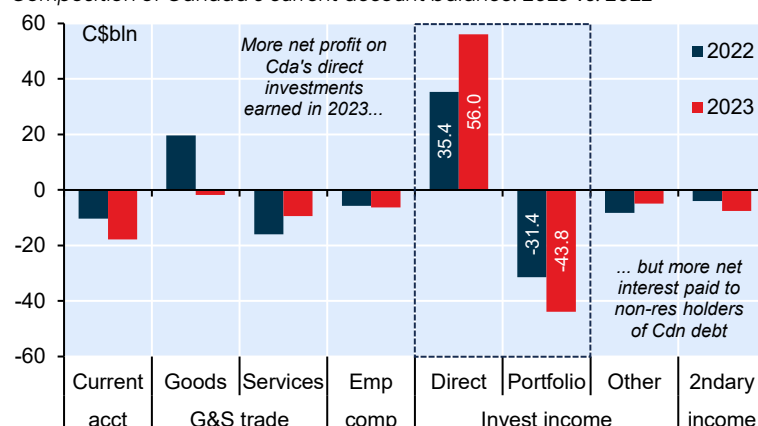
Canada current account balance



Source: NBF, StatCan

### Chart 3: More revenue from profits, more interest paid out

Composition of Canada's current account balance: 2023 vs. 2022



Source: NBF, StatCan

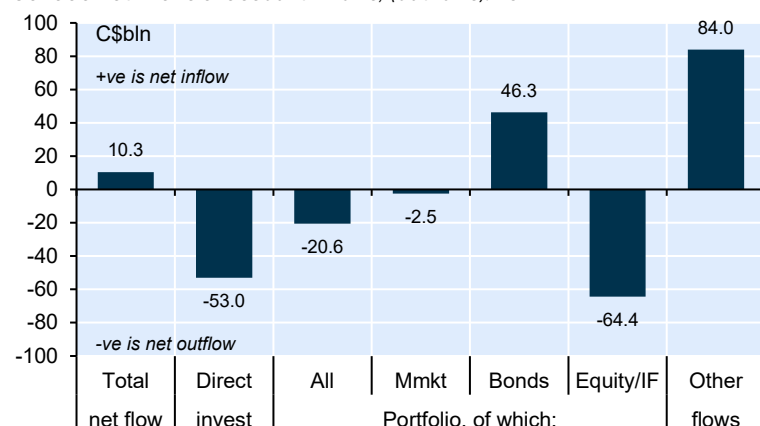
Dissecting the international balance sheet, you will see that (on balance) more of Canada's international assets take the form of direct investment and/or equity holdings. In contrast, the country has a sizeable net international liability in debt securities (mainly bonds).

In practical terms, this has seen Canada earning hefty profits on out-of-country direct investment, while simultaneously paying more interest to non-resident bondholders. To be clear, a much-enlarged interest bill is more recently a function of a higher average coupons. In a perfect world, Canada's direct investment profits could serve to offset the interest paid on foreign-held debt, leaving the current account balance on a fairly steady plane, all else equal. In some respects, that's sort of how things played out in 2023.

Good thing we don't have to worry about stagflation risks. You know, the type of situation where a material slowdown in economic growth weighs on earnings potential (thereby clouding the outlook for a key current account revenue stream)... while structural stickiness in consumer price inflation limits the extent of policy rate relief (thus keeping international interest payments elevated). Oh wait. That's actually a very real worry for 2024 after all.

### Chart 2: Direct/portfolio investment no help financing deficit

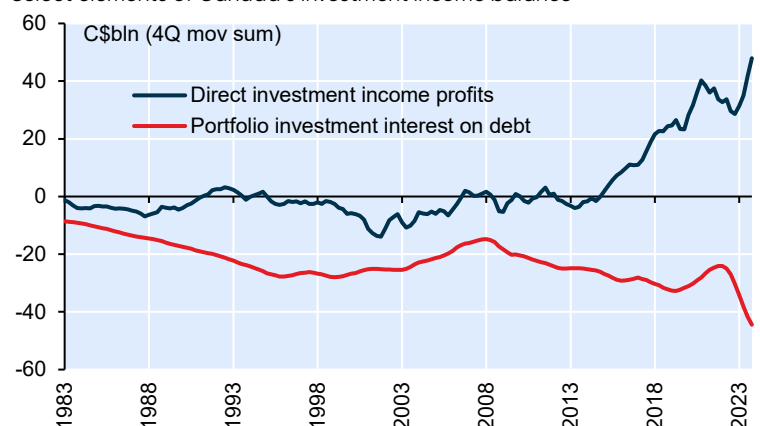
Canada net financial account inflows/(outflows): 2024



Source: NBF, StatCan | Note: Shows how '23 CA deficit was financed; excl. discrepancies

### Chart 4: Profit pressure *without* rate relief would be a problem

Select elements of Canada's investment income balance



Source: NBF, StatCan | Note: Part of broader investment income balance



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