

Tariffs distract from the real financial war – one that Canada is losing badly

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Business investment in Canada has been declining for years.
ADETONA OMOKANYE/THE GLOBE AND MAIL

America's trade offensive may be incoherent and reckless, but the endgame has always been relatively clear: to revive U.S. manufacturing by ransacking trading partners of investment capital.

It's not very neighbourly, and it could easily backfire, but it's also working, in one sense at least.

Corporate Canada is in a state of paralysis. Business investment is being choked off by tariff chaos. And the country's manufacturing sector was among the world's weakest last month.

There's a war for investment capital under way and Canada's losing.

"There's a finite pool of capital and once it's been cannibalized, it's never coming back," said Stephen Johnston, director of Omnigence Asset Management in Calgary. "Time is of the essence."

The country sorely needs the business-level investment that has been lacking for years, in things like plant and equipment, and productivity enhancing technology.

The problem is, the Trump administration has so effectively poisoned the investing climate in Canada that businesses are in no position to be ambitious.

More than half of business leaders in Canada recently surveyed by KPMG said they had already cut into their capital investment and R&D budgets over the next year. A majority also reported reductions in sales outlooks.

Analysis: Trump's trade chaos has foreign creditors backing away from Canada

"American tariffs have put a stranglehold on revenue and are cutting off the funds earmarked for continued investment," KPMG said.

Manufacturers look especially vulnerable. On Monday, S&P Global published a snapshot of factory activity across 25 different countries in the month of May. Canada ranked dead last.

A slowdown in May was to be expected, after U.S. importers accelerated their purchases in prior months before tariffs took effect.

"There is reason to be worried in the medium term as well, given repeated threats from the U.S. administration on Canadian factories," Matthieu Arseneau, National Bank's deputy chief economist, wrote in a note.

U.S. President Donald Trump has threatened to “permanently shut down” auto manufacturing in Canada. And this week’s doubling of metals tariffs has piled more misery onto Canadian steel and aluminum producers.

Algoma Steel Group Inc. said the new tariffs could make the company’s U.S. business unviable.

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Blame for the ills of Canadian industry, however, does not fall solely on Mr. Trump’s shoulders.

Business investment in Canada has been declining for years. Spending on R&D has been dismally low.

The country’s factories now contribute less to global manufacturing value added than Ireland’s, which has about one-eighth the population and little of Canada’s energy abundance.

The past 20 years have seen a “profound atrophy of Canada’s manufacturing base – unmatched across the industrialized world,” Stéfane Marion, chief economist at National Bank, wrote in a recent note.

Most economists blame excessive regulation. Regulatory requirements for Canadian manufacturers have risen by about 40 per cent since 2005, according to Statistics Canada.

“The perception of Canada is that it’s hostile to capital,” Mr. Johnston said. “I speak to foreign capital allocators all the time, and they would not touch Canada with a 10-foot pole.”

Reducing internal trade barriers is a top priority for businesses, KPMG poll shows

That clearly needs to change if Canada is going to turn the page on its over-reliance on the U.S. economy.

Business leaders themselves acknowledge the need to be bolder. The KPMG survey showed that 92 per cent agreed that boosting investment in technology and innovation was needed to “build a more resilient, prosperous economy.”

They also called on policy makers to remove interprovincial trade barriers, improve tax competitiveness, and reduce regulation to expedite major projects.

Perhaps what is needed above all else is urgency. There is clearly momentum at the political level to course-correct the domestic economy.

With a capital war upon us, implementation is crucial in a country not known for being economically nimble.