

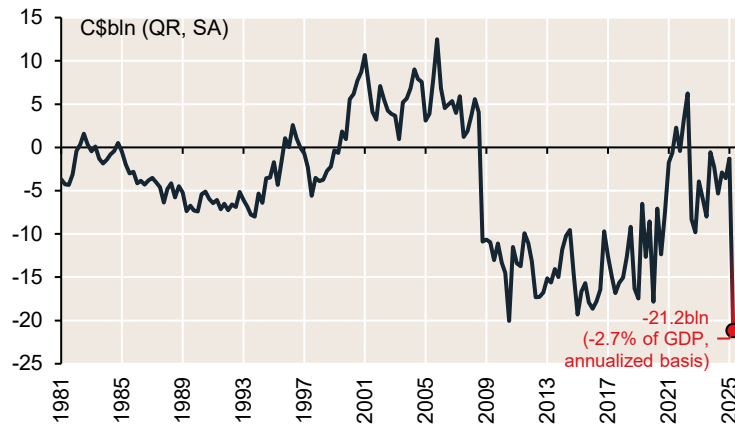
How (not) to fund a record current account deficit

By Warren Lovely

Records, as the saying goes, are meant to be broken. But some records we could presumably do without, like the unprecedented current account shortfall Canada racked up in 2025:Q2. Canada's current account balance deteriorated sharply in the second quarter; the seasonally adjusted deficit topped \$21 billion (widest ever), which on an annualized basis was equivalent to 2.7% of GDP (significant, though not a record) (Chart 1). As per StatCan, the substantial erosion of the current account balance in Q2 was down to a "rapid widening of the trade in goods deficit and was largely due to weaker exports" (as U.S. tariffs took hold).

Chart 1: A record current account as U.S. tariffs hit

Canada current account balance

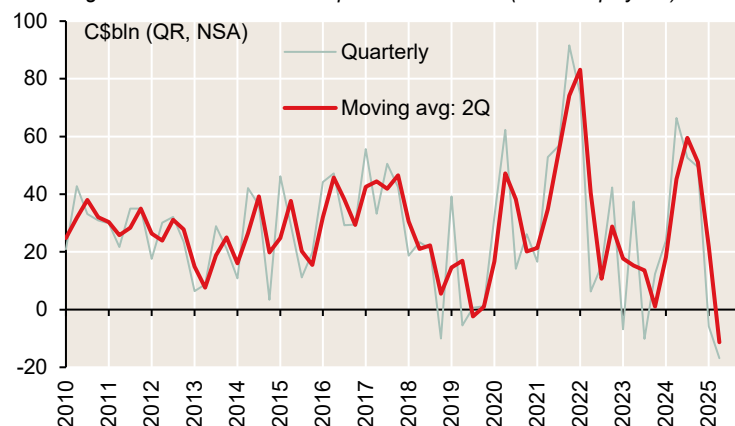


Source: NBC, StatCan | Note: 2025:Q2 balance as % of GDP is NBC estimate (at AR)

As your former international finance prof would likely have remarked at some point: a country's balance of payments has to, well, balance. Which is to say, a current account deficit—whether unprecedented or not—must be offset by a net inflow in the financial account (setting aside statistical discrepancies of course). We have some prior experience with current account shortfalls in Canada. In the past, the predominant funding strategy (for lack of a better word) was to sell loads of paper (mostly bonds) to foreign investors. But those investors have cooled on Canada (our bonds *and* our stocks), leading to net divestment in the first two quarters of 2025—the first back-to-back setback since the GFC (Chart 2).

Chart 2: Foreign investors pass on Canadian securities

Net foreign investment in Canadian portfolio securities (debt + equity)/IFs

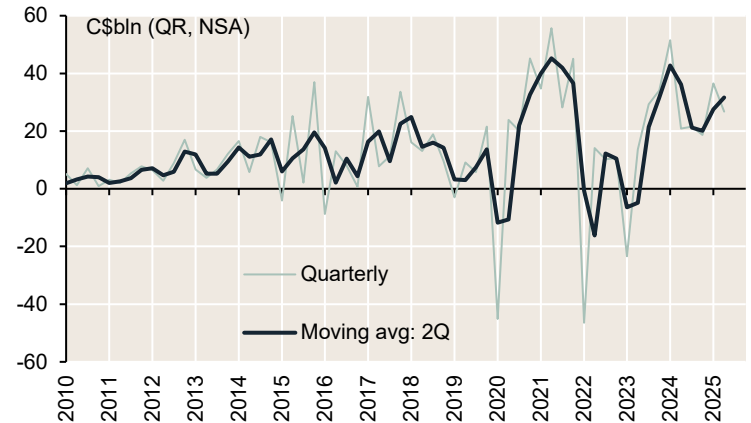


Source: NBC, StatCan | Note: Quarterly to 2025:Q2

Even as foreign investors were backing away, Canadians eschewed any 'buy Canada' bias, opting instead to load up on foreign securities... including, interestingly, U.S. assets (Chart 3). We earlier explored this somewhat curious state of play, including in this [Market View \(link\)](#).

Chart 3: Canadians still buying foreign securities (incl. U.S.)

Net Canadian investment in foreign portfolio securities (debt + equity)/IFs

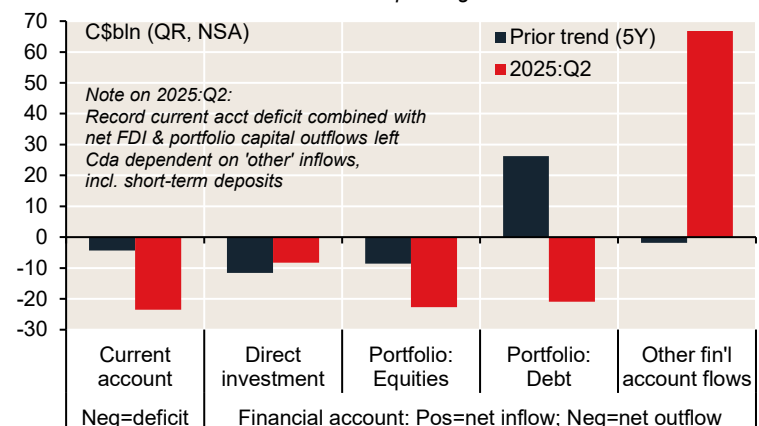


Source: NBC, StatCan | Note: Quarterly to 2025:Q2

Let's summarize... StatCan confirms that Canada ran a record current account shortfall in the second quarter, as U.S. tariffs saw exports nosedive. In financing a yawning current account deficit, direct investment flows were (on balance) no help (i.e., net FDI was an outflow in Q2). Portfolio investors took a hard pass on Canadian securities in Q2, shying away from our stocks (not uncommon) but also lightening up on our bonds (a new and potentially unnerving development). Meantime, Canadians funneled investment dollars abroad. The balance on portfolio transactions was thus a major outflow, essentially compounding the current account shortfall. In the final analysis, financing came via a massive short-term IOU in the form of foreign investor deposits (Chart 4). This is the very definition of 'hot money' and perhaps not the most stable way to fund a current account deficit. The ultimate deployment (or redemption) of these hefty foreign deposits could have material bearing on Canadian asset valuations, be it in rates, credit or currency markets.

Chart 4: A less-than-stable BOP financing model in Q2

Canada current account balance & corresponding financial account balance



Source: NBC, StatCan | Note: Prior trend based on 5-year period through end of 2024



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