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Morning Briefing

O Canada

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Executive Summary: Canada's Prime Minister Mark Carney has been pushed into action by President Trump's tariffs and talk of making Canada the 51st state. Carney's plan: spend big to boost economic growth and span the globe to woo new trading partners. William takes a look at both elements. ... Canada's naysayers worry about a record budget deficit, growing inequality, and the lack of affordable housing. ... Carney is looking for new trading partners in Europe and Asia. Past squabbles with China and India are all but forgotten amid trade talks. A new deal linked with Indonesia is a start.

Weekly Webcast. If you missed Monday's live webcast, you can view a replay [here](#).

Canadian Economy I: Carney's Transformation a Work in Progress. Prime Minister Mark Carney of Canada is stepping up efforts to tariff-proof the world's 10th-largest economy. So far, though, he's off to a slow start.

The last year has been deeply challenging for America's neighbor to the north, which relies on US consumers for [three-quarters](#) of its exports ([Fig. 1](#)). From Donald Trump's "51st state" rhetoric to the US president slapping an [additional 10%](#) tariff on Canada on October 25, the shift in the relationship has been nothing short of seismic.

Carney is pursuing a two-pronged strategy to reduce Canada's reliance on a US that's turning inward. First, he has proposed making "generational investments" in Canada's \$2.2 trillion economy. Second, he's mending fraught relationships in Asia and buttressing commercial ties with Europe.

Let's explore why Carney faces an uphill climb to insulate Canada from the trade war:

(1) *Carney's big budget play.* The centerpiece of the first goal is the budget that Carney's Liberal Party unveiled last week. It generated headlines with plans to spend [\\$280 billion Canadian dollars](#) (\$200 billion) on new infrastructure, increasing productivity, improving housing, and boosting military spending. It also cuts \$60 billion Canadian dollars of government expenditures and 40,000 civil servant jobs.

Opposition parties, including Conservative leader Pierre Poilievre, slammed the budget for not scrapping taxes on energy, groceries, and homebuilding, and for increasing Canada's budget deficit to [\\$78 billion](#) Canadian dollars (\$55.3 billion), the second largest in history.

(2) *The plan is underwhelming.* However, the bigger concern is that there's nothing particularly bold or "generational" about a plan that focuses more on old-economy stimulus than on raising Canada's long-term competitiveness, particularly in artificial intelligence.

Business groups were quick to point out that Carney's budget does little to incentivize private investment, which is vital to transforming the economy to thrive in a rapidly changing global economic and financial system. "It goes in the [right direction](#) on some fronts, but I think Carney was not as ambitious as he could have been," said Theo Argitis at the Business Council of Canada.

(3) *Patience, please.* Of course, Carney confronts unreasonable expectations [242 days](#) into his premiership. For one thing, "Rome wasn't built in a day," wrote economists at CIBC Capital Markets. "The real challenge won't be to finance a few years of higher deficits, but to get money out the door and into large capital projects and housing developments in time to lift growth while the economy struggles to adjust to US tariffs."

Charles St-Arnaud at credit union Alberta Central argued Carney's budget isn't "[transformational](#)," but it is rather transitional," as it prioritizes "pivoting away from some policies of the previous government" led by Prime Minister Justin Trudeau from 2015-2025.

(4) *Deficit concerns.* Even so, few think Canada's AAA rating will be put at risk by Ottawa's foray into widening deficits. Outside the COVID-19 pandemic, the last time the nation's deficit reached 2.5% of GDP was amid the 2008-2009 global financial crisis. The difference today is that Canada's economy is growing, albeit modestly. And, for now, the Canada MSCI stock price index is buoyant, up 20.5% ytd in local currency ([Fig. 2](#)).

On October 29, the [Bank of Canada](#) (BOC) revised its 2025 GDP forecast to 1.2% from its previous projection of 1.8% in January. In 2026, the BOC expects GDP to grow 1.1% versus an earlier forecast of 1.8% ([Fig. 3](#)). BOC Governor Tiff Macklem's research team anticipates an average annual inflation rate of 2.1% in 2026 and 2% this year. ([Fig. 4](#))

This could give the BOC latitude to cut rates again if needed, following its 25 basis-point [easing move](#) late last month to 2.25%. For now, with short-term rates the lowest since July 2022, Macklem's board is signaling plans to hold its fire ([Fig. 5](#)).

Canadian Economy II: Tariffs Are Taking Their Toll. Yet the BOC's pause could be tariff-dependent. Trump's decision late last month to top up Canada's tariff matrix has politicians and businesspeople struggling to keep up.

Technically, Canadian goods now face a [45% tariff](#) after Trump's latest increase—35% plus the new 10%. It's complicated, though, because a large share of goods are exempt under the United States-Mexico-Canada Agreement (USMCA).

Trump's recent tariff boost came after a political ad for which Carney's government wasn't responsible. It was populist Ontario Premier [Doug Ford's team](#) that aired an anti-tariff clip quoting 1987 comments by Ronald Reagan. Trump called the advert a "fraud."

The response by Carney's government suggests a desire to bring down the geopolitical temperature. On November 1, Carney acknowledged: "I did apologize to the president" on the sidelines of the Asia-Pacific Economic Cooperation summit in South Korea.

Will it work? BOC chief Macklem seems reluctant to bet on Carney and Trump finding a workable way forward. "I think we need to be realistic," he [told lawmakers](#) on November 6. "I don't think this US administration is going to wake up and completely change their colors. They've demonstrated they like a certain amount of unpredictability."

This uncertain backdrop explains why many economists see Carney's nearly 500-page budget document as a missed opportunity. One worry is that the largest cuts to the federal public service since the 1990s might be poorly timed. The concern: they might make implementing large-scale reforms to society-wide problems even harder.

Here are some additional reactions to Carney's grand plan:

(1) *Inequality troubles.* Another concern: Carney's budget has little to say about record income inequality. In Q2, the income gap remained at the all-time high level of 48.4%. This measures the difference in the share of disposable income between households in the top 40% and the bottom 40% of the income distribution—and the current reading means income gains are skewed toward the rich. That comes, [Statistics Canada argued](#), "amid a weakening economy that negatively affected household income and net saving across the income distribution." And as "strong financial markets gains benefited the wealthiest, while a decline in real estate values weighed on the average wealth of younger age groups and the least wealthy."

(2) *Housing challenges.* Carney's budget does little to solve Canada's housing affordability crisis ([Fig. 6](#)). "The bottom line: even a decade-long surge in homebuilding—well beyond what's realistic—would still leave many Canadians struggling to afford a home," Jake Fuss and Austin Thompson at the Fraser Institute [wrote in July](#).

They argue that too few [homes](#) have been built for Canada's growing population. If homebuilding stagnated at today's levels, projects the Canada Mortgage and Housing Corp, average Toronto home prices would increase by 63% by 2035 compared to 20% if national homebuilding doubled.

Yet "housing affordability isn't just about prices—it's also about income," Fuss and Thompson explain. "If take-home pay rises faster than house prices and rent, Canadians will get ahead. But over the past [two decades](#), the opposite has happened—after-tax incomes have barely increased while housing costs have soared."

(3) *Bigger AI response, please.* Carney's budget is also light on productivity-increasing measures needed to compete globally. This problem is made more acute by the AI boom unfolding in real time.

On the surface, the budget does in fact increase AI-related [investments](#). But \$1 billion of Canadian dollars (\$711 million) over five years is hardly a big bet on a technology when US and Chinese companies are spending hundreds of billions of dollars today.

Canadian Economy III: Recalibrating the Trade Engine. The “rupture” with the US prompts Canadians to, as Carney puts it, “look out for ourselves.” Doing so will require Canada to increase its exports to nations other than the US ([Fig. 7](#)).

This push includes hastening the implementation of Canada’s recent strategic deals with the European Union. In June, Ottawa signed a defense and security partnership with the EU, which Carney hopes will act as a springboard for trade pacts. In August, Carney made the rounds in Germany, Poland and Ukraine to [boost ties](#) in trade, critical minerals and energy.

Time is not on Canada’s side, though, as US tariffs bite and “the outlook for the external sector [remains bleak](#),” said Bradley Saunders at Capital Economics. Risks include the ways in which tariffs are boomeranging on the US economy, undermining confidence and boosting inflation.

The latter concern has Fed Chair Jerome Powell signaling a possible pause in the rate cut cycle. With the US [consumer price index](#) rising at a 3% y/y annual rate in September, well above the Fed’s preferred 2%, it’s unclear Powell & Co. will be easing again in 2025 ([Fig. 8](#)).

Carney faces an uphill climb expanding Canada’s relationships in Asia. But here are some of the steps he has taken to date:

(1) *Pivot to ASEAN.* Trump’s decision to impose an additional 10% levy on Canada came the same week Carney was in Asia working to recalibrate the nation’s trade flows. In Malaysia, Carney turned to finalizing a free-trade deal with the 11-member Association of Southeast Asian Nations (ASEAN), which is now China’s top export destination.

In Malaysia’s business capital on October 26, Carney [told ASEAN leaders](#) that “we have all been reminded of the importance of reliable partners—who honor their commitments, who are there in tough times, and who engage collaboratively to fix something that isn’t working. Canada is such a partner, a dependable partner, and I have come to Kuala Lumpur to say clearly that we want to play a bigger role in this region.”

Canada recently inked a free trade deal with Indonesia, Southeast Asia’s largest economy. While not China or India, Indonesia is a nearly [\\$2 trillion economy](#) growing at 5% per annum, with almost 300 million people and one of the fastest-growing middle classes investors will find.

(2) *China ties.* Days later, Carney was off to South Korea for a meeting with Chinese leader Xi, on the sidelines of the APEC summit. The Xi tete-a-tete was part of Carney’s strategy of repairing China ties that were flatlining 12 months ago. The rupture began in 2018, with the arrest of Huawei Technologies’ chief financial officer, Meng Wanzhou, on a US extradition request. Though the Trudeau government [released Meng](#) in 2021, Ottawa-Beijing relations remained in a deep freeze.

In recent years, Canadian citizens also have been [detained and executed](#) in China. Ottawa’s security authorities allege that Xi’s Communist Party interfered in at least two national elections.

As China is Canada's second-largest trading partner, any progress in [strengthening trade ties](#) could be a boon to 2026 growth. In Gyeongju, Korea, Carney and Xi discussed trade issues, increasing trade in electric vehicles, seafood, agriculture, and agri-food products such as canola. Carney also accepted Xi's invitation to visit China in short order.

(3) *India, too.* Carney's back-to-business strategy also has his government wooing Prime Minister Narendra Modi's India. That's quite an about-face from one year ago when Canada and India expelled each other's most senior diplomats over the [alleged assassination](#) of a Sikh separatist on Canadian soil.

The effort at detente began a few months after Carney took office in March. In June, Carney cajoled Modi to attend the Group of Seven meeting in Alberta. There, during Modi's first visit to Canada in a decade, the two leaders discussed ways to restart trade talks as tariffs that are upending global trade.

Yet equally important, Team Carney must devise ways to raise Canada's innovation game without imperiling Ottawa's pristine credit rating while reining in government bloat. Failure to pass the budget in the next couple of weeks could lead to a Christmas election for Canadians. Carney's government is a few seats shy of a majority. The budget is considered a confidence vote. If Carney's budget fails, coalition partners would demand an election.

The bigger failure, though, would be missing another opportunity to build economic muscle at home.

Calendars

US: Tues: NFIB Business Optimism Index 98.3; Barr. **Wed:** MBA Mortgage Applications; OPEC Monthly Report; Williams; Bostic; Paulson; Waller; Miran; Collins. (Source: FX Street)

Global: Tues: Eurozone & Germany ZEW Economic Sentiment 23.5,41.2; UK Average Hourly Earnings Including & Excluding Bonus 5.0%,4.6%; UK Unemployment Rate 4.9%; Lagarde; Dhingra; Jones. **Wed:** Germany CPI 0.3%/m,m,2.3%/y/y; Germany WPI 0.1%; Italy Industrial Production 1.5%; De Guindos; Schnabel. (Source: FX Street)

Strategy Indicators

S&P 500/400/600 Forward Earnings ([link](#)): During the November 7 week, forward earnings rose simultaneously for all three of these indexes for the 20th time in 24 weeks. LargeCap's forward earnings rose for a 25th straight week, its longest winning streak since it did so for 38 weeks through the September 13, 2024 week. MidCap's recovery has slow-walked at times, rising in 21 of the 25 weeks since it bottomed during the May 16 week. SmallCap's has risen in 23 of the 24 weeks since it bottomed during the May 23 week. LargeCap's forward earnings posted its biggest gain in 51 months, soaring 1.1% w/w to its 23rd straight weekly record high. MidCap's rose 0.1% w/w to its second straight record high, but only its eighth of the year. SmallCap's soared 0.9% w/w to a 24-month high and improved to 7.5% below its June 2022

record. Forward earnings had bottomed in early 2023 for these three indexes following 2022's year of cost-cutting. Since then, LargeCap's forward earnings has soared 34.1% from its 54-week low during the week of February 1, 2023; MidCap's has slowly gained 11.0% from its 55-week low during the week of March 10, 2023; and SmallCap's has jumped 8.3% from a very recent 42-month low during the May 23 week. These three indexes' forward earnings downtrends from mid-2022 to early 2023 and again during Trump's Tariff Turmoil were relatively modest compared to their deep double-digit percentage declines during the Great Virus Crisis and the Great Financial Crisis. Here are the latest consensus earnings growth rates for 2024, 2025, and 2026: LargeCap (9.7%, 11.5%, 13.8%), MidCap (0.4, 1.1, 16.7), and SmallCap (-10.2, 5.7, 15.4).

S&P 500/400/600 Valuation ([link](#)): Valuations were lower for these three indexes during the November 7 week, but more so for LargeCap. LargeCap's forward P/E dropped 0.6pt w/w to 22.2 from a 25-year high of 22.8. It's now 5.2pts above the seven-month low of 17.0 during the October 27, 2023 week. That compares to a 30-month low of 15.1 at the end of September 2022 and an 11-year low of 11.1 during March 2020. MidCap's forward P/E fell 0.1pt w/w to 15.9, and is now 0.5pt below its 32-week high of 16.4 during the September 5 week. It's also 1.2pts below its 40-month high of 17.1 during the November 29 week and 3.7pts above the 12-month low of 12.2 in October 2023. That compares to a record high of 22.9 in June 2020 when forward earnings was depressed and an 11-year low of 10.7 in March 2020. SmallCap's forward P/E fell 0.1pt w/w to 15.2, and is down 0.6pt from a nine-month high of 15.8 the week before that. It's 2.3pts above its 17-month low of 12.9 during the April 4 week and 4.6pts above its 14-year low of 10.6 in September 2022, but remains 1.9pts below its 41-month high of 17.1 during the November 29 week. That compares to a record high of 26.7 in early June 2020 when forward earnings was depressed, and a record low of 10.2 in November 2009 during the Great Financial Crisis. The forward P/Es for the SMidCaps have been mostly below LargeCap's since August 2018. MidCap's P/E improved to a 29% discount to LargeCap's P/E from a 26-year low 30% discount a week earlier. That compares to a 19% discount during the March 2, 2023 week, which matched its best reading since October 14, 2021. SmallCap's P/E is at a 32% discount to LargeCap's P/E, up from a 16-month-low 33% discount a week earlier. That compares to a 23% discount during the November 29, 2025 week, which was its best reading since the March 2, 2023 week. It's now just 1ppt above its 24-year-low 34% discount during the July 5, 2024 week. SmallCap's P/E is at a 4% discount to MidCap's, up from a 13-month low 6% discount at the end of July and a 20-year-low 10% discount in late 2021. Prior to that, from 2003 to 2018, SmallCap's P/E had been mostly above MidCap's, and both were above LargeCap's.

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