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The world is undergoing a series of once-in-a-generation shocks and adjustments. Canada needs to adjust, too. Rapidly.

Some of the economic structures and patterns that brought Canada into this century may not live out this decade. Political and security alliances, so necessary to peace and order, are in the midst of a realignment. And advanced technologies are disrupting the very nature of work, commerce and human interaction—so much so, and so quickly, that even last year's assessments seem distant.

The compression of time and risks means no company or government, public enterprise or community organization, can afford to wait and watch.

Eurasia Group and RBC Thought Leadership created this report, the first of its kind, to help Canadians navigate those profound risks and sea changes in 2026. The following is a combination of five assessments from Eurasia Group's Top Risks 2026 outlook—the global ones most likely to impact Canada—and five assessments from RBC Thought Leadership, exploring the most significant domestic forces that may shape the year ahead. These are not predictions or forecasts: rather, they are carefully considered and researched analyses of the trends, forces and interests shaping our economy and policy environment, informed by economic data, market insights and interactions with leading businesses, investors and policymakers. They're designed as lighthouses, rather than navigation systems.

This report is also a foundation for a new global relationship between Eurasia Group and RBC, to help firms and governments assess and manage their own risks in these unprecedented and volatile times. In the year ahead, we will publish more on these issues and convene leading thinkers in the economy and government to advance our collective understanding of the risks around us. In June, we will host the annual Canada-U.S. Eurasia Group summit in Toronto, to help shed more light on the risks, and opportunities, as these two countries and neighbours—both extraordinary in their own right—advance, and as needed redirect, their economic relationship in this rapidly changing world.

The challenges ahead can seem daunting, even overwhelming. But as we've seen through history, including recent history, moments of uncertainty—that amorphous cousin of risk—are when those with clear heads and confident minds excel.

Gerald M. Butts, Vice Chairman and Senior Advisor, Eurasia Group

John Stackhouse, Senior Vice President, Office of the CEO, Royal Bank of Canada

RBC Thought Leadership Risks

Eurasia Group Risks

Remilitarizing the maple

Canada is looking to build its military, develop an industrial base and forge new commercial partnerships at a wartime pace. A failure to execute could lead to others, notably the U.S., stepping in.

Canada's enthusiasm for rapid militarization began the moment Donald Trump demanded more from America's NATO allies and deepened as he mused about taking over parts of the Western Hemisphere, from Panama to Greenland, even putting the idea of Canada as the 51st state on the table. For Canadians, the exercise was initially a budgetary one, finding ways to allocate tens of billions to its small and often overlooked military. But when Trump sent the U.S. military into Venezuela, the warning for Canada and its armed forces took on a sharper focus. Borders are no longer gates. They're hard lines that need to be defended.

For Canada, the task of building a big military—the biggest since the Second World War—is daunting. In war, extraordinary measures like state-run supply chains can be implemented quickly. In peacetime, each step needs more negotiation—that's made even harder with a public that barely remembers the losses of the Afghan mission and a military bureaucracy that has struggled with much smaller magnitudes of procurement and deployment. The industrial base is a further challenge. Mention the words "military-industrial complex" and most Canadians will say "no, thanks." Before Trump returned to power, Canada ranked 27th out of 31 NATO nations when it came to military spending as a share of GDP. In fact, defence spending had languished for the past 25 years at levels well below the late 20th century averages. Military enrolment has also been in terminal decline, with less than two service members for every 1,000 people. Even peacekeeping has declined to a few dozen blue helmets.

The Mark Carney government has taken the challenge head on. Its first budget injected $81.1 billion over five years. Now, Ottawa is trying to reduce the heavy concentration it spends in the United States, taking gunboat diplomacy in a very different direction: its ministers have travelled the world in search of equipment like submarines, and much more, from any ally other than the U.S. Relations with Japan and Germany have been transformed by the idea of peacetime rearmament. Same with South Korea and Sweden.

But now comes the hard part: making choices. Ottawa will inevitably irk an ally, and may very well irk its own military brass, by choosing boats, planes and weapons that aren't as effective, on the battlefield or the balance sheet, as those American options. The challenge of "interoperability" is even greater if the Canadian military is to continue to share responsibility with the U.S. for the defence of North America. Currently, 100% of Canada's fighter aircraft, 91% of helicopters, and more than 75% of other mission aircraft originate from the U.S. If the U.S. feels Canada's non-American equipment isn't up to the task of defending the Artic or, for that matter, the North Atlantic, they may just do it themselves, even if it means torpedoing Canada's sovereignty.

The vast web of red tape in Canada's defence procurement system—and a bureaucracy trained to say "maybe"—has contributed to draining the private sector of much of its entrepreneurial flex. In recent budgets, fully a quarter of the Industrial and Technology Benefits Policy, or $15.3 billion, was listed as unallocated, due to deployment frictions, certification gates and poor definitions.. Even the government admits it takes 15-plus years for a major fleet acquisition. And a recent study found that $18.5 billion in planned capital went unspent over a five-year period. A new 'Buy Canadian' military mandate may lead to, at least in the short term, more dollars chasing fewer producers. But greater cyber-security requirements—and a lot of the new spend will go to cyber defence—stands to cause further delays.

Canada's defence industrial base includes about 600 firms—compared to 60,000 in the United States.

To break through that bureaucratic blockade and boost military spending at home, the Carney team opened a new Defence Investment Agency to do something soldiers are trained to do on the battlefield but is less common in government: move fast. The new money hasn't even started to flow at speed or scale, and regions are insisting on their share, whether in the national interest or not. This will inevitably lead to lower efficiencies and higher costs, even if it does create more jobs for Canadians. It will also challenge Canada to be competitive in the growing global arms market, as it seeks to trade with allies in Europe and Asia—but will need scale and excellence to meet their standards.

Of course, missing in these equations is the sort of private capital that has helped the U.S. military-industrial complex grow. That new kind of military capitalism will be novel for many Canadian operators, and the military. Canada is seeking to play a leading role in the nascent Defence, Security and Resilience Bank—a kind of World Bank for NATO and its allies—which will draw on the strengths of members' balance sheets to help them borrow on capital markets to finance their own budgets and supply chains. The government's financial institutions, such as the Business Development Bank and Export Development Canada, will need to play an even greater role in helping small- and medium-sized Canadian businesses raise the capital needed to serve the so-called "primes"—or prime contractors—that sit at the top of every supply chain.

Canada's defence industrial base includes about 600 firms—compared to 60,000 in the U.S.—and most employ fewer than 250. Those small but mighty Canadian firms have an equally small capital base. Many have been lucky to survive through the demand shocks of various governments and militaries announcing programs and then delaying them, or even shutting them down. Adding to the challenge is the fact that half of Canada's military exports go to the U.S., which may decide to close the door if Canada snubs the big American primes. A more hidden risk for Canadian SMEs is entanglement. The IP in a complex defence product is often controlled by large operators, usually multinationals, that can shut down a small supplier.

Generals, and their political masters, love their toys, which is why so many photo ops are with big hulks of steel and not small groups of men and women doing the work behind the machines. Still, more of those people will be needed—but are harder to find. Canada's military employs only 0.38% of the national labour force—down from 0.56% a decade ago, and well below Britain (0.58%), Australia (0.60%) and the U.S. (1.69%). The Canadian military, which has struggled to get close to 100,000 personnel, may need to double or triple in size in the next decade. And it's not just fighter pilots and combat soldiers. It's base operators in the Far North and cyber coders across the south. Currently, the Canadian Armed Forces (CAF) is roughly 15,000 members short of its intended size, creating persistent readiness and sustainment gaps. A lack of speed is to blame. Median recruiting timelines are upwards of 271 days, more than double the official target. The delays are sometimes greater for Canada's large immigrant population, which needs to undergo an even longer security clearance. It's no wonder more than half the young Canadians who apply ultimately pull out. And then there's the hurdle of training. The CAF's training centres are running at 80% capacity due to a shortage of instructors. That pressure may only grow as the military becomes more STEM-driven. The defence sector is 2.5 times as STEM intensive as general manufacturing.

Remilitarization is central to Canada's effort to carve out a new relevance in the world, especially to allies, old and new. Even before Trump's second term began, Canada was significantly growing its military participation in eastern Europe in response to the Russian invasion of Ukraine. The Canadian deployment in Latvia is one of Canada's biggest peacetime missions anywhere and seen in Europe as a meaningful commitment to the continent's defence. A growing Canadian military may also play a role in defending the Caribbean from drug cartels, as well as unrest in places like Haiti. And, of course, it will define itself once again in the Arctic, on land, in the air, under the ice—and overhead in low orbit, where the next battlefields may play out.

A more sophisticated and better capitalized defence industry—and a more dynamic armed forces—may even help shape the next chapter of Canada-U.S. relations. As partners, not rivals, in taking on the greater threats of China, Russia and Iran. The Great White North's geographic sanctuary has long been a blessing. Any loss of that sanctuary will challenge the country anew. But for those Canadians who study their history, the role of conflict—present and hidden—has never been far from sight.

U.S. political revolution

The United States is experiencing a political revolution: President Donald Trump's attempt to systematically dismantle the checks on his power, capture the machinery of government, and weaponize it against his enemies. Last year, we warned about the "Rule of Don"; what began as tactical norm-breaking has become a system-level transformation beyond partisan hardball or executive overreach—qualitatively different from what even the most ambitious American presidents have attempted. With many of the guardrails that held in Trump's first term now buckling, we can no longer say with confidence what kind of political system the United States will be when this revolution is over.

In Trump's view, he overcame a rigged election, two partisan impeachments, dozens of unjust felony convictions, and two assassination attempts—one a whisker's breadth from killing him—to stage the greatest political comeback in American history. President Trump sees the principal threat to him and his allies as domestic, not external, and he believes he has a mandate for retribution. The administration views this project not as an assault on democracy but as its restoration, a necessary purge of a political system captured by a deeply corrupt establishment that had already weaponized government against them. Over 77 million Americans voted for Trump in 2024, and many of them sympathize with that diagnosis: Among 2024 voters who said democracy mattered to their decision, a majority chose Trump—not because they saw him as a champion of democratic values, but because they believed the system was already broken and wanted someone who would disrupt it. "Trumpism" is structural, and at this most fundamental level, Trump's supporters are getting what they asked for. In 2025, the administration moved to politicize the state accordingly. Career civil servants were purged for political rather than performance-related reasons, from investigating corruption and providing unwelcome intelligence assessments to having ties to political enemies. Inspectors general, ethics watchdogs, and independent agency leaders were sacked. The power ministries—especially the Justice Department and the FBI—became fully political arms of the White House, stripped of the operational independence that had insulated them since Watergate. Media companies, law firms, and universities faced investigations, lawsuits, and threats designed to force compliance. Eurasia Group's Governance Tracker captures this record, plotting high-profile administration actions along two dimensions: how much they break with established norms, and how much they erode institutional checks on presidential power (please see chart below). Actions that score high on both are the most "revolutionary." Many of the administration's tracked actions cluster in that quadrant.

Checks have been weaker than expected. Congress largely went along with the administration's policies. The Democratic Party, divided and leaderless, struggled to mount effective resistance. Most would-be Republican dissenters were cowed by the threat of primary challenges and political exile. The corporate media, fearful of retaliation, self-censored and softened its coverage—normalizing behaviors that would have seemed outrageous in 2017. Large media and tech firms chose to pay Trump millions to settle winnable lawsuits rather than face retaliation. Business and financial leaders, privately uncomfortable but unwilling to risk the consequences of speaking out, stayed silent. The administration did repeatedly lose in court, but it also exploited the gaps in a legal system that couldn't keep pace with their actions. And the Supreme Court, one of the most effective and powerful checks on executive power, often acceded to Trump's revolutionary push—not least because the conservative majority appears receptive to the administration's maximalist conception of presidential power, known as unitary executive theory. The result, as the chart shows, is that most of the administration's tracked actions have succeeded so far, including several in the revolutionary quadrant. Even actions that face legal challenges have often already achieved their strategic purpose: law firms and news organizations have been chilled regardless of whether the suits ultimately prevail.

In 2026, the revolution will continue. With only three years left and Democrats favored to take the House of Representatives in November's midterm elections, Trump and his inner circle will grow more, not less, risk-acceptant in their efforts to entrench the president's power and cement his legacy before the window narrows. The machinery of government will be wielded aggressively against the president's enemies. The administration has already launched investigations into Democratic fundraising platforms, donors, officials, and candidates. Companies that employ prominent critics will face investigations and regulatory retaliation; executives who criticize the White House will be singled out; foundations that donate to Democrats risk dragged-out fights over their tax-exempt status. The effect will be to make public criticism of and opposition to Trump costlier.

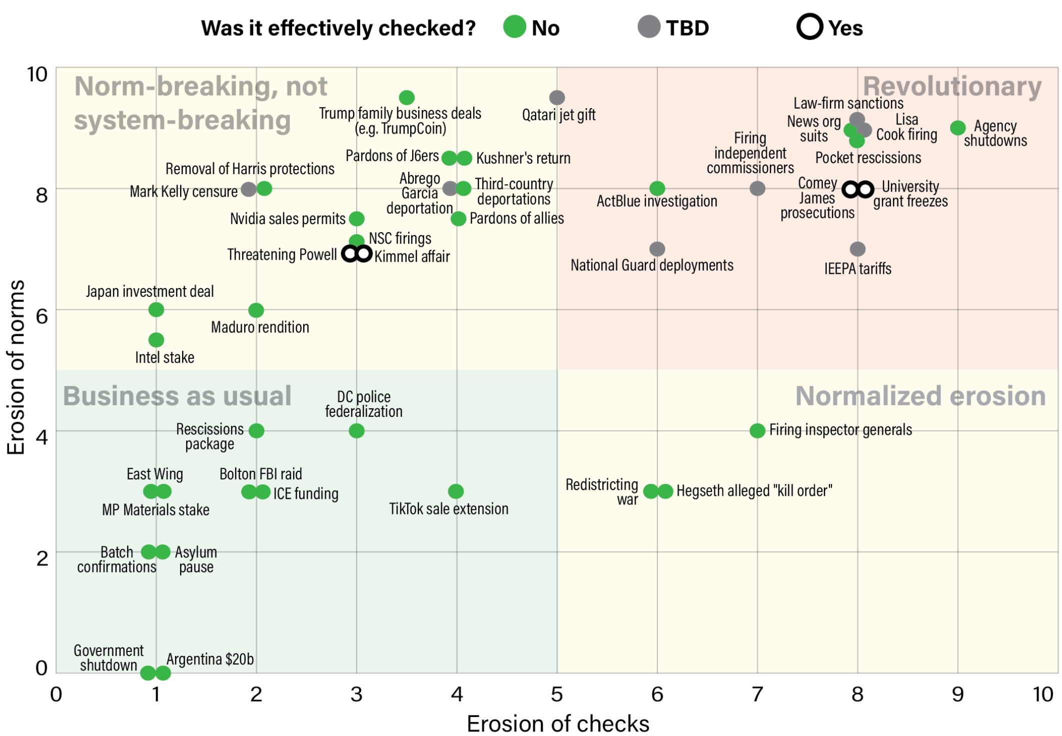
The jury system and the courts will remain a bulwark—convictions require indictments from grand juries and unanimous verdicts from randomly selected citizens, upheld by independent judges—but investigations and prosecutions will be draining enough to deter individual resistance and collective action at the margin. The strategy is already proving effective. Major Democratic donors face the threat of investigations and government retaliation. Foundations are scrutinizing grants that could be criticized as partisan. Large law firms are turning down clients who want to challenge Trump policies and doing billions of dollars in free legal work for the administration.

Media companies will be further cowed through lawsuits and regulatory threats—or co-opted as Trump-aligned investors win Washington's approval to acquire major platforms in exchange for favorable coverage. The Ellison family's takeover of Paramount gave it control of CBS; it signed a deal for TikTok's US operations and is now pursuing CNN's Warner Bros. Discovery. Combined with Elon Musk's X, Rupert Murdoch's Fox, and Trump's own Truth Social, much of legacy and social media in the United States will be in pro-Trump hands.

As the midterms approach, the administration will move to tilt the electoral playing field in its favor. The White House's unprecedented mid-decade redistricting push is a statement of intent, even if the net effect on the 2026 map will be small. So are the pardons for 2020 fake electors and the gutting of the Cybersecurity and Infrastructure Security Agency, the agency that helps states defend elections against cyberattacks. More consequential would be an assault on election infrastructure. An election denier now runs election security at the Department of Homeland Security. The Department of Justice has sued states that Trump lost in 2020, seeking voter roll data that could be used to purge voters or contest results. Federal monitors could be deployed to swing districts, as they were to California and New Jersey last November, for "election security." In a worst-case scenario, emergency powers could be

Stacking up Trump's executive actions on the *Governance Tracker*

Higher x-axis values indicate greater erosion of institutional checks on presidential power
Higher y-axis values indicate greater departures from established norms and precedent



Source: Eurasia Group

The chart plots select Trump administration actions along two dimensions. **Erosion of checks (x-axis):** How much each action weakens constraints on presidential power—courts, Congress, independent agencies, inspectors general, civil service protections, and societal checks like the press and legal profession—making similar actions structurally easier in the future. **Erosion of norms (y-axis):** How much each action departs from established practice and precedent in US federal government—things presidents haven't historically done, even if they legally could. **Color** indicates whether each action has been effectively checked: green means no (succeeded so far); gray means contested or uncertain; white means yes (blocked or failed to achieve objectives). The tracker is not comprehensive; actions were selected based on their significance to the administration's governance agenda. Scores reflect Eurasia Group analyst assessments. A detailed methodology note will be published separately, and the tracker will be updated as events develop.

invoked to deploy federal troops to polling places in an attempt to suppress turnout. No such powers exist, but National Guard troops have already been sent to blue cities under various pretexts, and Trump has shown a willingness to act first and worry about the courts later.

Federalism will limit President Trump's efforts. The Constitution gives Washington no role in elections, and state leaders of both parties have begun pushing back against federal overreach (though not without the administration threatening to withhold federal funding in retaliation). But if close races leave either the House or Senate in doubt, fraud allegations, contested certifications, and pressure on local officials to delay or refuse results will follow. Expect Trump to replicate his 2020 play, when he asked Georgia's secretary of state to "find" enough votes to overturn his loss—except this time, some election officials may be loyalists willing to comply.

For all these efforts, Republicans are still likely to lose the House in November. Trump's approval ratings are low, voters are unhappy with the economy, and history suggests the president's party almost always loses seats. News cycles would then shift to impeachment efforts, oversight hearings, and gridlock. Trump's support would erode, protests would grow, and his momentum would fade. But a Democratic House can only do so much to stop the revolution. It can subpoena but not compel; impeach but not convict; withhold funding, but Trump has found ways around Congress's power of the purse. A Senate majority would matter slightly more, but Democrats are unlikely to flip that chamber. They need four seats on an unfavorable map, and every deterred donor, volunteer, and voter would make the climb steeper. And without a veto-proof supermajority, even a unified Democratic Congress couldn't fully check a president who has proven willing to bypass it entirely—though such a result would further raise the odds the revolution fails by adding friction and signaling that resistance is popular, legitimate, and viable.

Some imagine that Trump's growing unpopularity will compel moderation. That's plausible: The Epstein files, Israel support, and redistricting have all exposed cracks in the MAGA coalition, and a souring economy or a blue wave could fragment it. Indeed, an increasingly multipolar global economy and China's rare-earth leverage will force more caution on tariffs than Trump would otherwise like. But Xi Jinping can check the president in ways that Marjorie Taylor Greene and other domestic opponents cannot. Trump is more likely to respond to domestic setbacks, from sinking poll numbers to a defeat in November, as he did to his 2020 election loss: by doubling down. Except that as a lame duck surrounded by loyalists who can't afford defeat any more than he can, the impulse to go for broke will be stronger.

Trump's political revolution is ultimately more likely to fail than succeed, undone by a combination of belated institutional resistance, limited coalition fracture, and, not to be underestimated, the president's own impulsiveness. But there will be no return to the status quo ante. The next president will inherit whatever expanded powers and weakened constraints Trump manages to entrench before 2029, and the grievances that fueled Trumpism will remain unaddressed. The result may not be Viktor Orban's Hungary, but it will be far from a healthy body politic.

The United States can't be categorized as a representative democracy in 2026, not because it's heading toward dictatorship but because it's in the middle of a political revolution whose outcome will remain genuinely indeterminate for years. Trump and his supporters will take ever greater risks. Resistance will mount too, but neither side will land a decisive blow. The longer this plays out, the greater the risks—more substantial than they have any right to be in the world's oldest democracy. It's America's own late Gorbachev era: The country is careening toward something, but nobody knows what. And for millions of Americans, perhaps even a voting majority, the risks of uncertain revolution beat the certainty of continued decay under a system that wasn't working for them

Whatever the endpoint, the damage over the next year will be significant. As loyalists replace experts across the federal government, state capacity will weaken, and the government's ability to collect data, preempt crises, and respond to emergencies will erode. The administration has already fired the Bureau of Labor Statistics commissioner, canceled federal employee surveys, and reduced capacity in agencies like the National Oceanic and Atmospheric Administration that provide essential data, forcing the private sector to look elsewhere for statistical truth. Deep cuts at the Federal Emergency Management Agency, the Centers for Disease Control and Prevention, the Food and Drug Administration, and the National Security Council will degrade the government's ability to respond to disasters, track disease outbreaks, ensure food and drug safety, and coordinate national security. The next crisis will find a government less prepared to respond. Media consolidation will degrade the information environment, and the shared reality required for democratic deliberation will fray further. Corruption will become more overt, and political violence will continue to climb—threats against election officials, judges, and politicians have risen sharply, and the pardons issued to January 6 defendants signal that Trump-aligned rule breakers will enjoy executive protection.

As executive impunity expands and the rule of law erodes, the business environment will be put to the test. Companies will have to price their exposure to the US government into key decisions. Potential consequences for the disfavored include targeted investigations, loss of federal contracts and tax-exempt status, public rebuke by the president, demands for investment pledges, forced divestment of foreign partners, and partial government ownership or control. Targeted organizations will struggle to attract talent; employees won't want the professional risk. Inducements for the aligned include favorable regulatory treatment, subsidies, tariff protection, and preferential contracts. Litigation will become a growing burden; obedience will beget more extraction.

When political alignment rather than productivity determines economic outcomes, capital gets misallocated, investment grows riskier, and long-term growth suffers. If markets believe the Fed's credibility is compromised, the consequences for inflation, interest rates, and the dollar could be severe. The United States remains the world's deepest and most liquid market, and there's still no better alternative. But "least ugly" is not the same as safe, and the politicization of economic decision-making will gradually raise risk premia on US assets.

The instability will radiate outward. Even as external conflicts recede, the United States itself will be the principal source of global risk in 2026. Tariff threats will continue to be used to extract trade and non-trade concessions, if less liberally than last year. Military power will be wielded more assertively, especially in the Western Hemisphere. Alliance commitments will shift with the presidential mood. Soft power will erode; the United States will find it harder to build coalitions and attract global talent. Washington's retreat from multilateral cooperation will deepen our more fragmented and conflict-prone G-Zero world; when the next global crisis hits, there will be no "committee to save the world." And what happens in America won't stay in America—democratic backsliding in the United States will embolden autocrats elsewhere.

The United States was already the most structurally dysfunctional political system among advanced industrial democracies before Trump returned to office. He is a symptom, a beneficiary, and an accelerant of that dysfunction, but he didn't cause it—and he won't fix it. Whether Trump's revolution succeeds or fails, there is no going back to what came before.

"Whether Trump's revolution succeeds or fails, there is no going back to what came before."

A dependency trap

Canada is aiming to double non-U.S. exports through two of its biggest trade antagonists, China and India, even as Canadian investment continues to pour into the United States.

Since Mark Carney launched his "elbows up" campaign to get the country to trade more with the rest of the world, and with each other, Canadians have spent and invested more in the United States, even as Americans are doing less in Canada. The strong U.S. economy, and tax breaks under the Big Beautiful Bill, have reinforced the attractiveness of the world's largest market for Canadian investors. From pension funds to mutual funds, more Canadian dollars than ever have headed south. Business investment has done the same. Carney may need to do even more on taxes and regulations to keep Canadian investments at home.

For all the bark, and bite, of tariffs, Canadian consumers have been slow to change habits, too. Highly visible brands like Tennessee whiskey were perhaps an easy early target. Florida and Arizona vacations have taken a hit, too. But in large measure, Canadians are still watching Netflix, buying Fords and drinking Coke at the same rate as before the trade war.

A couple of generations ago, in the Trudeau 1 era, when Canada was trying to shift away from a Vietnam-era America, similar tensions reverberated through Canadian living rooms, and board rooms. The proverbial U.S. elephant and Canadian mouse was about more than sneezes and colds; it was about dependencies (plural) in the economy, culture and ultimately sovereignty. A new approach emerged to the binary option of dependence versus independence, known as the Third Option in which Canada would become more closely tied with a reconstructed Europe, a re-emerging Asia and a resurgent Third World.

Back then, there was strong concern about Canada as a branch plant economy—meaning American branch plants. But 50 years on, instead of playing from a position of strength, Canada's search for new global alliances comes at a moment of maximum dependence on, and maximum uncertainty about, the United States. That dependency has been built over the past century through defence and deterrence partnerships like the North American Aerospace Defense Command (NORAD), trade and investment cooperation and, for Canada, a profile that rested on being the ally most like—but not—America. Now, the central risk is not that Canada will suddenly "break" with its neighbour and ally but that attempts to diversify away from U.S. power will expose how little hard leverage Ottawa has with other partners—and how quickly a more transactional White House can weaponize asymmetry in defence, intelligence, and trade. Geography still is destiny.

Canada's struggle for more independence starts with the economy. The impact of Trump's tariffs has included the loss off tens of thousands of manufacturing jobs, and body blows to the auto, steel and lumber sectors and regions that depend on them. If those tariffs are sustained, most projections suggest a prolonged period of slow growth for the economy, which will further erode Canada's relevance on the world stage. The Trump tariffs were felt quickly and deeply, driving down Canada's overall exports by close to 10% by mid-2025.

Compounding the challenge of dependence, while Canada's trade deficit with the U.S. is worsening, its investment surplus is growing. The first year of the trade war made Canadians even more keen to invest in the U.S., despite the bourbon boycotts. Canadians injected $61 billion in U.S. securities in the first half of 2025. The country's biggest pension fund, the Canada Pension Plan, had raised its share of all investments in the U.S. from 35% at the start of the decade to 47% in 2025.

After decades of Canadian exports gravitating to the U.S., business is starting to find opportunities elsewhere. Britain is buying more unwrought gold as investors and central banks look for alternatives to the U.S. dollar. The rest of Europe has been buying more Canadian canola, aluminum, and oil. China is also buying more oil from Canada, thanks to the TransMountain pipeline expansion that fuelled an all-time high, in October 2025, of oil shipments outside North America. Even faraway Singapore and Indonesia saw a surge in Canadian sales, from oil to coal to potassium chloride.

Those successes speak to Carney's pledge to double exports to non-U.S. markets by 2035. To accelerate the early trend, the Carney government is focussed in 2026 on forging closer trade ties with China and India. The federal government also launched consultations on trade talks with several countries, including the United Arab Emirates, Qatar, Saudi Arabia. And the first Carney budget pledged $159 million over three years for trade-financing programs to assist firms trying to enter and grow in new markets. It will need to do a lot more to unglue the infrastructure bottlenecks that have made Canadian ports among the least efficient in the industrialized world.

To gain leverage in more overseas markets, Canada will need to do more to enhance its relevance to those countries—especially in countries and markets, like China, India and even continental Europe, that have a history of hitting Canada with non-tariff trade measures when a point needs to be made. That won't be easy. As global power has shifted to Asia and as Europe and the Middle East rearm and realign, Canada's relative salience has eroded. The risk is not outright exclusion from clubs, but quiet marginalization in the working coalitions that matter most for security, technology, and industrial policy—and ultimately trade. Consider Ottawa's Indo-Pacific Strategy and its deepening security partnership with the Philippines—politically effective, yet not enough to deliver big trade breakthroughs in a region where Japan, Australia, India, and ASEAN states look first to Washington, Beijing, and each other. In Europe, Canada's big contributions to helping defend Latvia, and a more assertive defence of the Arctic, is buying credibility. Closer to home, in the Caribbean, commitments to helping restore order in Haiti, while important and appreciated, aren't transforming Canada's place in the region.

Too often, these allies calibrate their engagement with Canada through the lens of Trump-era conditionality on NATO and trade. Ottawa is seen as tightly bound to U.S. markets and security but slow to invest in capabilities, enforcement, and industrial scale. To carve out a more independent and ambitious role in the world, Canada can build on some of the alliances and networks it's already part of. Take the Arctic Council, a group of regional players and powers that focuses on soft issues like science and environmental protection. Canada can deepen ties with Scandinavians and perhaps one day re-engage with Russia through those non-military efforts, while also building up military capacity in the region with like-minded allies like Sweden. It cuts to the new (and old) ethos of foreign policy being rooted in interests, not values.

A very different approach could be taken to the Francophonie and Commonwealth, if other members are willing to muscle up, especially with money. In Africa, for instance, where France's image has deteriorated, Canada can work with francophone partners to strengthen non-military defences against a resurgent ISIS in the Sahel. The Commonwealth can play its own pragmatic role, helping build trade bridges from Australia to India to South Africa while the U.S. doubles down on America First. More military commitments will be needed, too, as the U.S. pulls back from volatile regions and countries. Haiti crystallizes the risk. A Kenya-led mission with UN authority and rising pressure from the Organization of American States gives Canada a chance to be the training and standards hub for Caribbean contributors, focusing on ports, fuel logistics, and basic state functions—and perhaps with difficulty for Canadians to look the other way if the U.S. shows up in the dead of night to take out gangs or shut down migrant rings.

One of the biggest plays for Canada in gaining more leverage may be AUKUS—the security alliance of Australia, U.K. and U.S. The trilateral pact has focussed initially on nuclear submarines—not a Canadian strength—and is now widening its aperture to advanced capabilities, including undersea sensing, low-orbit satellites, and cyber defences, all of which are Canadian strengths. Canada can pitch itself as a serious member for the next stage of the alliance, which would build leverage overseas while also maintaining a respectful and relevant partnership with the U.S.

The year ahead will present plenty of opportunities to explore this sort of realpolitik diplomacy, as Canada helps design or join more strategic approaches based on interests more than values, and pragmatism more than principles. This will be a step back from those more idealistic approaches that emerged in that earlier time of Third Options. But as every nation knows, independence has a price.

Canada's struggle for more independence starts with the economy.

Europe under siege

The hollowing out of Europe's political center has been a decade in the making. France, Germany, and the United Kingdom each enter the year with weak, unpopular governments under siege from the populist right, the populist left, and an American administration and state-aligned social media openly rooting for their collapse. None face scheduled general elections. Yet all three risk paralysis at best and destabilization at worst—and at least one leader could fall. The consequences won't stay contained: Europe's ability to address its economic malaise, fill the security vacuum left by America's retreat, and keep Ukraine in the fight will suffer.

Britain's May local elections will be the first test. Not for Labour, which is bracing for losses, but for Nigel Farage's Reform UK. The insurgent party has led national polls for much of the past year. The key question: Can it translate polling strength into votes? A strong Reform showing would help cement the fragmentation of UK politics, giving Farage momentum for the next general election and pulling both Tories and Labour away from the center. Prime Minister Keir Starmer himself probably won't survive the spring. He's deeply unpopular, and a successful leadership challenge from his left flank is all but certain. His successor will be weaker and more leftist. Either way, Labour's thin mandate—a "landslide" built on just 33% of the vote—offers no cushion. The Conservatives had already imploded before that: three prime ministers in 2022 alone. The two-party system that defined British politics for a century is fracturing. Starmer promised to hold things together. There's little chance of that.

France is already ungovernable. By October 2025, the country had cycled through three prime ministers in twelve months, none able to pass a budget through a hung parliament—the second straight year without a proper budget deal, unprecedented in the Fifth Republic. President Macron may limp through 2026 without calling another snap election.

But if Prime Minister Sébastien Lecornu's government falls in 2026, the pressure on President Emmanuel Macron to dissolve parliament and call fresh elections will grow. Marine Le Pen's Rassemblement National (RN) would increase its seat count, worsening the parliamentary gridlock or potentially winning an outright majority. Should the RN and its allies secure around 250 seats, Jordan Bardella—Le Pen's 30-year-old lieutenant—would become France's first populist prime minister in modern history, forcing an unstable cohabitation with a lame-duck Macron and marking a rupture in French politics. Even if that scenario is avoided, France remains paralyzed—unable to pass budgets, enact reforms, or lead in Europe.

Germany holds five state elections by September, but two matter most: Saxony-Anhalt and Mecklenburg-Western Pomerania. After coming in second in last February's federal election, the hard-right Alternative for Germany (AfD) now leads national polls, and outright majorities in both eastern states—a rare feat in a country where coalitions are the norm—are no longer out of reach. A strong AfD showing and a weakening of the Social Democrats (SPD) would intensify pressure on the conservative Christian Democratic Union (CDU) to abandon the firewall that has excluded the far right from any governing coalition since World War II, especially in the east. Such a move would be toxic at the national level and a dealbreaker for the CDU's federal coalition partners. Chancellor Friedrich Merz's alliance with the SPD is already riven by ideological disputes over pensions, welfare reform, and spending. A firewall breach, combined with further SPD losses, could tear it apart.

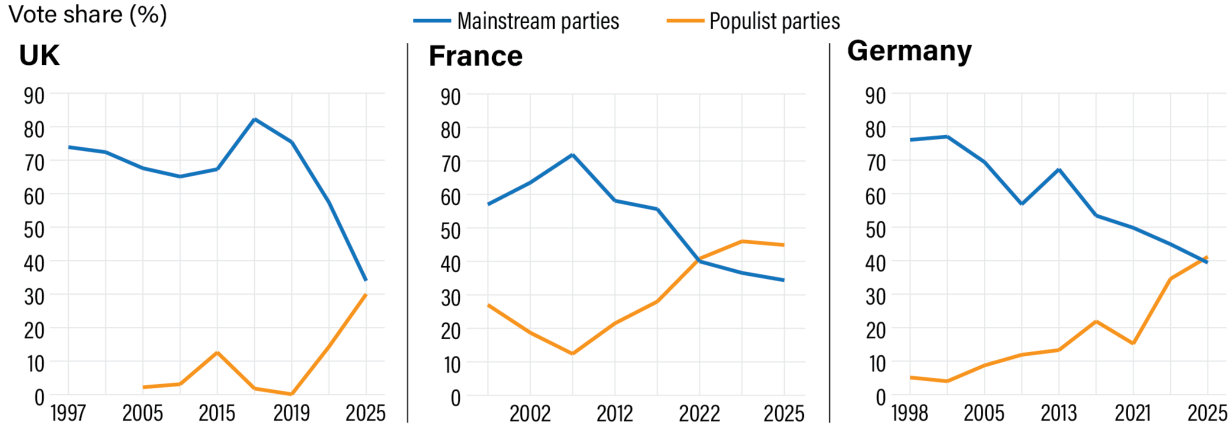
None of this happened overnight. The center has been crumbling for a decade—Brexit, Jeremy Corbyn's takeover of Labour, the implosion of France's traditional parties, the AfD's steady rise in eastern Germany all signaled the trend. But the damage is now acute in all three countries at once. The UK's 2024 election produced the lowest combined Labour-Tory vote share since 1910. In France, Macron's 2017 victory masked rather than reversed the collapse of the Socialists and the center-right Republicans; now his own movement has imploded, leaving a hopelessly hung parliament dominated by the far left and far right. Germany's February 2025 election saw CDU and SPD record their worst combined result since unification. The political forces driving this fragmentation are the same across all three: fury over immigration, stagnant living standards, deindustrialization, and a widening gulf between urban elites and everyone else. Younger voters are particularly disillusioned with the establishment and open to populist alternatives.

Pressure from a euroskeptic Washington will compound the fractures. President Donald Trump's administration seeks a more fragmented, decentralized Europe and will openly back the populist right that would deliver it. Whether US challenges to European sovereignty—from Greenland annexation threats to sanctions on EU officials regulating US tech and outright election interference—will succeed or backfire is unclear. But the intent, especially as the US draws down offensive troop deployments in Eastern Europe and resists burden-sharing on Ukraine and NATO, amounts to an American bet against the European center and the European Union itself.

The result: three governments that can't govern. To be sure, Starmer could limp through. Reform UK could underperform the polls in May. Macron could muddle through another year; he's defied political

The center cannot hold

Vote share (%)



Source: Eurasia Group calculations based on legislative election results (through 2024) and recent polling data (2025); Politico and Macrobond. Populist vote share includes AfD, Die Linke, and Bündnis Sahra Wagenknecht (Germany); RN, La France Insoumise, and the Communist Party (France); and UKIP/Reform (UK).

gravity before. Merz's coalition partners have nowhere else to go. But surviving isn't governing. Even if all three leaders hang on, they'll be too weak to do more than manage their own decline.

The implications start at home. Decisive action to boost competitiveness, investment, and productivity is impossible when governments are fighting for survival. These three won't drive European growth—they'll drag it down. The UK and France face spiraling debt with no prospect of the reforms needed to address it. A lurch left in Britain or fresh elections in France could spook bond markets. Every failure of the center to deliver reinforces the narrative that only outsiders can fix the system, entrenching populist momentum for years to come.

The E3 are Europe's core; when their center weakens, so does the continent's. Without alignment in Paris and Berlin, policy confusion spreads to Brussels—undermining Europe's ability to build consensus, complicating trade policy, and making the next EU budget fight uglier. European efforts to coordinate on defense, trade, regulatory, or fiscal policy will face not just internal paralysis but active US hostility. Europe's ability to fill the security vacuum left by American retrenchment depends on vigorous leadership from the E3. That'll be in short supply this year. Ukraine will be exposed, too. Sustained support for Kyiv requires political will and public spending that weakened governments will struggle to deliver—and populist ones won't. European aid is likely covered for 2026, but if politics in any of the E3 becomes destabilized, the outlook beyond that darkens considerably. Ukrainians can't afford that.

The G-Zero leadership vacuum at the heart of international politics is widening, and Washington is now accelerating rather than resisting it. Trump has made it clear he views the current E3 leadership as more adversarial than Russia, emboldening Moscow. A weakened E3 that cannot rely on the United States to stand up to Russian aggression leaves Europe more exposed to hybrid attacks than at any point since the Cold War. And if Washington overtly interferes in European elections and territorial integrity, the transatlantic relationship enters uncharted territory. The postwar alliance framework, already strained, could fracture.

Europe's center has been crumbling for a decade, but the damage is now acute in all three countries at once.

A cruder world

A shift in global oil and gas prospects, from Venezuela to Qatar, changes the investment outlook for Albertan exports—and the big infrastructure projects designed to get them to overseas markets.

Canada's ambitions to be an energy superpower—including oil and gas—is being tested after the U.S. intervention in Venezuela. But the challenges lie well beyond Canada's immediate neighbourhood. Long-term demand for oil and gas remains an open question, especially as Asia continues to turn to electrons to power growth. A global surplus of supply, including American LNG, clouds the picture further. And then there's the question of global growth. No growth, no need for more energy, from Canada or anywhere else.

In one strategic swoop in Caracas, U.S. President Donald Trump has attempted to ringfence the Americas with Washington as its most consequential capital. In that respect, Trump may have weakened Canada's most valuable negotiating card—energy exports. A resurgent Venezuela crude production could displace Canadian oil in the U.S. and leave it scrambling for market share with Saudis and others elsewhere. It's a potential competitive shock. Over the past 25 years, Canada had solidified its position as the foremost supplier of oil and gas to the world's biggest oil market, accounting for nearly three out of every five imported barrels entering the U.S. An industry built to serve America now pumps out a record five million barrels per day, compared to just over two million bpd in 2000, with more than 90% of its exports ending up in refineries in the U.S. Midwest, West Coast and the Gulf Coast.

With the U.S. moving at lightning speed on securing its energy and resource needs, Canada needs to pivot quickly, not just to capture a portion of the investment dollars being spent in a hurry, but also to defend its turf and diversify its exports (hello, Xi)—everything all at once to match the American blitz.

Disruptions to the north-south energy flow could deal an economic and political blow to Canada. The industry generates close to $100 billion in annual revenues. A decline in energy exports could also test national unity. Failure to build out Alberta's oilsands will be seen by the province as a national declaration of political war, at a time when the province's independence movement is louder than it's been in a generation. Land-locked Alberta is also at odds with neighbouring British Columbia, which is opposed to building an oil pipeline across its territory to tidewater.

Canada has a few strong cards to play. Venezuela may be home to the world's largest proven crude oil reserves, but Canada boasts the world's third largest, with the added advantages of a world-class infrastructure, ready expertise, technology and the capital to deliver on America's oil needs. After decades of dithering, Ottawa, under Mark Carney, seems to have the will to follow through.

There's a strong correlation between Canadian oil's supremacy in the U.S. coinciding with Venezuelan crude's steady decline (see chart below). Both trade primarily in what's known in the business as "heavy oil," which has the consistency of peanut butter—it's harder to extract from the ground, is energy and carbon-intensive to produce, and needs thinning diluents to push through pipelines, adding to shipping costs. Canadian oil's viscous nature makes it ideal for making gasoline/diesel, jet fuel and plastics, compared to the light blend pumped out from American shale basins.

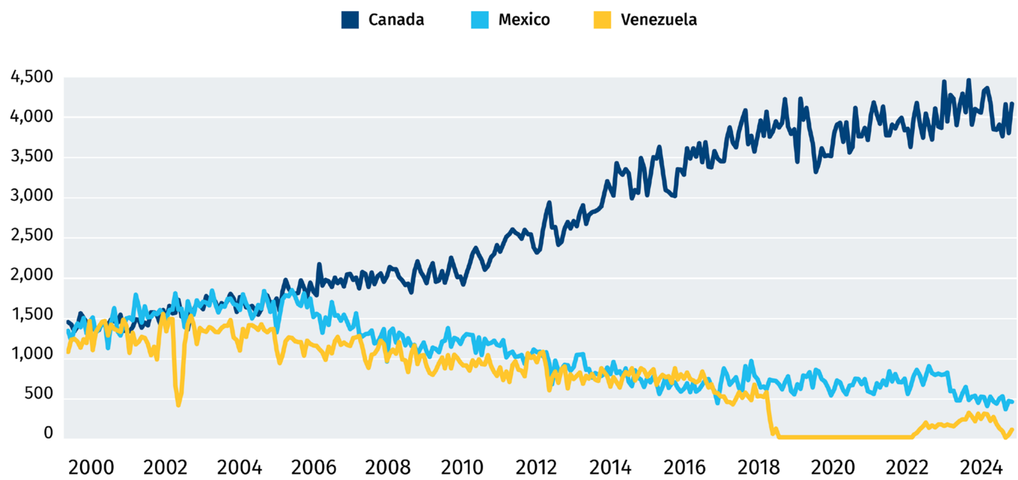
As Canadian oilsands firms innovated over the past decade to overcome cost and emissions intensity, Venezuela's state-owned Petróleos de Venezuela (PDVSA) fell into a state of neglect, mismanagement, and corruption. Another blow: in 2018, the company was looted by thieves, stripping the oil company of vital equipment, including copper wiring, and its skilled workers fleeing to neighbouring states. If U.S. firms return to Venezuela, they will have to start from scratch in many ways, with some suggesting it will cost upwards of US$100 billion over 10 years to get the Venezuelan oil sector up and running. In a best-case scenario, it would take at least a decade to displace some of Canada's 4.5 million bpd of oil shipments to the U.S. from Venezuela, which currently produces around 750,000 bpd. That would give Canada a head start to adjust to the new energy paradigm.

Heavy oil is deeply integrated into U.S. refinery systems, which should give oil executives in Calgary some comfort. As early as the 1990s, U.S. refiners began investing billion in heavy-sour configurations to run Canadian and Latin American barrels, given the proximity of both energy sources. Total refining capacity in Gulf Coast refineries (known as PADD 3) rose 2.9 million barrels per day, while Midwest refineries (PADD 2) grew 700,000 bpd. Both regions boosted coker capacity of 1 million bpd during the period.

U.S.-Canadian joint ventures also started to spring up, such as Cenovus and ConocoPhillips collaborating on two refineries in the U.S. as cross-border upstream and downstream flows became entrenched. Meanwhile, Canadian pipeline

Canada's oilsands has displaced Mexican and Venezuelan heavy oil in the U.S.

Oil exports to the U.S. by country, million barrels per day



Source: U.S. Energy Information Administration (EIA)

operators Enbridge and South Bow (spun off from TC Energy) cast a wider system of pipeline spurs and added capacity to reach the Gulf Coast and the Midwest.

Canada's heavy oil is prized in other markets. While much is made of China becoming an electro-state and other Asian markets switching to renewables, there are few viable substitutes for heavy oil as a critical ingredient for plastics. Rising income levels across Asia is set to fuel ever more demand for TVs, refrigerators, electronics, and Labubu dolls, even as population growth in many emerging markets tapers off. The federal government-owned TMX pipeline expansion has already demonstrated a market for Canadian oil outside the U.S. While overall more than 90% of Canadian oil exports are destined for the U.S., only a third of TMX's shipments ended up across the border with the rest shipped to refineries in China, Singapore, South Korea and India.

After all, Asia is where the growth's at, especially with Europe set to see declining demand. The continent is forecast to account for 80% of total net oil demand growth until 2030, according to the IEA. Indian demand alone is expected to grow almost one million bd, with emerging Asia also is the market for more barrels.

There's also the perennial question of the value of Canada spending billions on an industry presumed to be slowing down—in a crowded market. While the International Energy Agency recently retreated from its "peak oil" forecast, global demand is inching up only slowly while producers ramp up. New player Guyana, led by production from a three-way ExxonMobil-Chevron-CNOOC venture, has quickly boosted production to around 900,000 bpd in a short span of time. Several OPEC producers and independents such as Brazil, Mexico and Norway also have ambition to pump up oil volumes. While the Saudis, the most influential OPEC producer, have been quiet as U.S. moves threaten to drive down oil prices, Brent crude prices of around US$60 per barrel are nowhere near Saudi government's fiscal breakeven prices of around US$90.

For Canadian oil firms, which spent roughly $25 billion in dividends and buybacks in 2025, the risk is to embark on a new capital-intensive project without a new pipeline proposal or much visibility when it comes to market direction. Another caveat: Ottawa would insist companies contribute to a much-anticipated and expensive carbon capture storage and utilization (CCUS) project to offset new emissions. Indeed, it's in writing as part of the Ottawa-Alberta Memorandum of Understanding.

The MoU, which offers a path for the oil industry's expansion and inject a new investment wave in the country, is an iconic symbol of what Canadian energy can achieve. If it succeeds, the MoU could serve as a model for how Canada can deliver its resources, assets and expertise to a customer base beyond the United States.

China's deflation trap

China's deflationary spiral will deepen in 2026, and Beijing won't do anything to stop it. With the 21st Party Congress looming in 2027, Xi Jinping will prioritize political control and technological supremacy over the consumption stimulus and structural reforms that could break the cycle. Beijing has the means to prevent a crisis, but living standards will deteriorate, the fallout will spread abroad, and the world's second-largest economy will remain stuck in a trap of its own making.

Home prices in China have been falling for four and a half years—a household wealth destruction on par with America's 2008 crash, except it's still accelerating. Consumer confidence, investment, and domestic demand have cratered with it. Beijing bet big that high-tech manufacturing would fill the gap left by property. Instead, state-driven investment has created overcapacity, and weak domestic demand means there aren't enough buyers to absorb it.

The result is "involution": too many Chinese firms chasing too little demand, slashing prices to survive. Margins collapse, forcing even well-run firms to cut wages and jobs to stay afloat. Workers spend less. Demand weakens further, so firms cut prices again. Meanwhile, debts grow harder to service with each turn of the cycle. Banks and local governments keep zombie firms alive—rolling over loans, protecting local champions—which keeps overcapacity entrenched. The debt-deflation spiral feeds on itself. Donald Trump's tariffs last year made the situation worse, closing off a critical export market and confronting Chinese firms with a grim choice: slash prices to find buyers outside the United States, or transship goods through third countries to reach America anyway. Either path squeezes margins further. Over a quarter of listed Chinese companies are now unprofitable, the highest share in 25 years.

The result: China enters 2026 with ten straight quarters of deepening deflation, the longest such slump any major economy has suffered in decades. Disposable income has stalled at $5,800 per person, while consumption accounts for just 39% of GDP—half the US share. China faces the prospect of a Japanese-style "lost decade" but without Japan's social safety nets or per capita wealth. Escaping that kind of trap requires decisive action. Beijing won't deliver it.

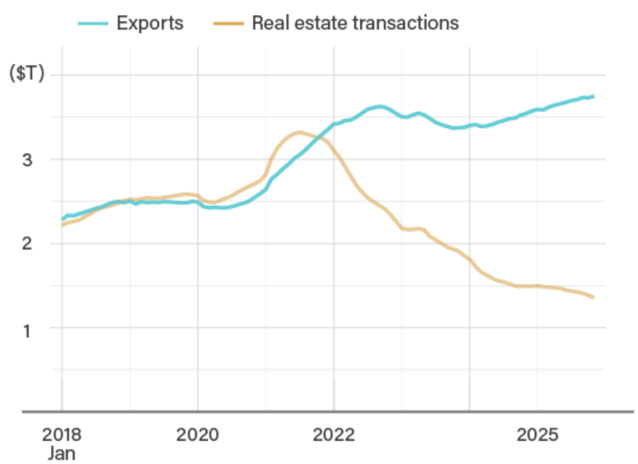
Xi's vision for China's economy—long-term discipline, technological self-reliance, state control, and a rejection of short-term stimulus he views as Western-style "welfarism"—makes a course correction hard to imagine. He'll keep pouring state investment into manufacturing and high-tech sectors, not consumption. But more investment in saturated industries will only aggravate gluts and drive prices down further. The advanced sectors Xi is betting on lift headline GDP but create few jobs. Any stimulus will remain modest and targeted, tilted toward manufacturing rather than the broad demand boost needed to break the cycle.

The political calendar makes a pivot especially unlikely in 2026. This year marks the launch of the 15th Five-Year Plan and the final run-up to the 21st Party Congress, where Xi will secure his fourth term. Bureaucrats are anxious about hitting growth targets and terrified of taking political risks. Beijing's widely touted "anti-involution" campaign—ostensibly intended to curb the destructive price wars—won't change anything. Raising prices requires curbing industrial production, which means less investment and slower GDP growth. Xi won't accept that tradeoff before the Party Congress.

Exporting the slump

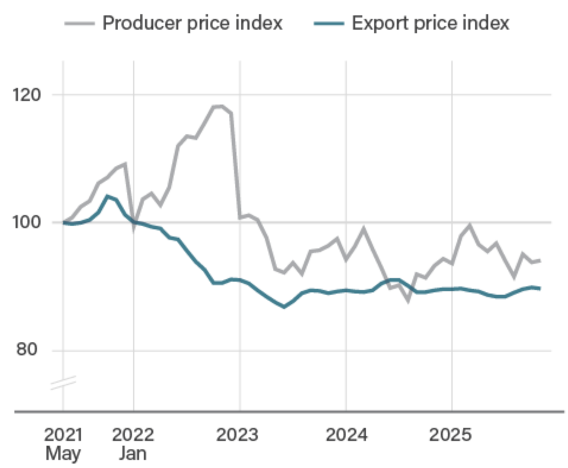
The great substitution

China, property sales and exports (in USD, 12m rolling sum)



Deflation at home and abroad

China, producer prices and export prices (May 2021 = 100)



Source: Eurasia Group, Macrobond, NBS; China Customs, Wind

The consequences will be felt across Chinese households and firms alike. With real incomes weakening, housing collateral losing value, margins getting crushed, and real interest rates rising, debt-service burdens will squeeze everyone. There's limited room for interest rate cuts, so neither families nor private companies can restructure their way out. Mortgage defaults and hidden bank bad debts will surface as major problems in 2026.

Rising small and medium-sized enterprise failures and nonperforming loans will strain social stability. The private sector accounts for 80% of urban jobs, so trouble for small businesses translates quickly into trouble for workers. Deflation and corporate distress will mean fewer jobs, lower wages, and brutal hours for those lucky enough to remain employed.

The pain will fall hardest on the young. Youth unemployment is high and rising, and even graduates who land jobs face the "996" grind—9am to 9pm, six days a week—with little hope of advancement. While young Chinese won't riot, a growing number are opting out altogether. The "lying flat" movement reflects a generation's rejection of China's culture of overwork and hyper-competition in service of "national greatness." They did what they were told: studied hard, got degrees, chased good jobs. The rewards never came. Now, a cohort raised on promises of prosperity is tuning out the Chinese Communist Party's calls for collective sacrifice. For a generation of young urban Chinese, the social contract is fraying and the "China Dream" appears an illusion.

To be sure, Beijing has enough firepower and political control to prevent systemic economic damage and social unrest. But there's a real risk of policy overreaction reminiscent of the zero-COVID pivot or Shanghai's 2022 lockdown before the 20th Party Congress—abrupt, opaque interventions like forced restructurings, sudden nationalizations, regulatory crackdowns without warning. A harsher political climate would deter private investment, undermining China's main engine of job creation. Even without that scenario, the economy will keep tilting in the wrong direction: more manufacturing, less consumption; more state, less private sector. The housing slump will drag on. The structural imbalances will deepen.

China's economic dislocations will ripple outward as Beijing continues to export its way out of the property crisis. This will unleash an even bigger wave of cheap goods on overseas markets than last year, when China's trade surplus surpassed $1 trillion. Xi's industrial policy is fundamentally beggar-thy-neighbor, aiming to make other countries reliant on Chinese supply chains while making China self-sufficient. Chinese goods exports have risen by 40% since the start of the housing crash, while import volumes have flatlined. For most countries, trade with China now delivers deindustrialization and a drag on growth, not shared prosperity.

Some trading partners, such as the European Union, will respond to the flood of Chinese exports with tariffs, subsidies, and other protectionist policies. But with few alternative supply chains in place, China's export-led model will stand largely unchallenged this year. Beijing will nonetheless move to leverage its supply chain dominance more assertively, extending its export control threats from rare earths to more critical minerals, lower-grade chips, and key chemicals—though not against Washington as long as the Korea truce holds—to raise the cost of decoupling and safeguard its export engine. The goal will be to deepen partner dependence and reinforce China's global economic leverage, ensuring the world remains too reliant on Chinese imports to push back effectively even as trade frictions rise.

But Beijing can't export its way out of trouble indefinitely. China's trade surplus now exceeds Japan's 1987 peak as a share of world GDP—the imbalance that helped trigger the Plaza Accord and forced Tokyo into a wrenching rebalancing. History suggests there are limits to how long trading partners will absorb another country's overcapacity, even if they lack the leverage to push back in the short term. Higher tariffs from fed-up partners, a return to unmanaged decoupling with the United States, or a global downturn would choke off foreign demand, leaving China with no fallback. Xi would then have little choice but to shift substantial resources toward stimulating consumption. But with each year of deflation making debts heavier and escaping the trap harder, it may be too late by then.

Xi Jinping will prioritize political control and technological supremacy over the consumption stimulus and structural reforms that could break the deflationary cycle.

A failure of immigration

An over-correction to the recent surge in irregular immigration is squeezing employers, hammering colleges and universities, and threatening to delay a new wave of resource projects and infrastructure builds—at the same time as Canada is nearing a demographic cliff.

Canadian public and political sentiment toward immigration is increasingly negative. But the sentiment is running contrary to the country's needs: Canada's aging population is facing declining fertility rates, leaving immigration central to the expansion of the skilled workforce. Cutting back on immigration drastically could lead to a rapid dip in population, hurting efforts to maintain living standards, drive economic and business activity and meet near-term economic ambitions.

The Mark Carney government's plan to clamp down on immigration comes after years of expansionary policy. Temporary residents increased beyond capacity during Justin Trudeau's decade-long tenure that began in 2015. Housing infrastructure and community services were overloaded, and productivity declined as temporary low-wage workers removed the incentive from some businesses to invest in technology, training or equipment. Targets for new temporary residents, including students, are down by over 550,000 in 2026 compared to 2024. And permanent resident targets are down by over 100,000 from 2024 admissions. Even with these reductions, Canadians feel immigration levels are too high.

The government crackdown may face challenges advancing its broader agenda. The 2025 federal budget allocates billions for nation-building projects to jumpstart the economy and insulate Canada from geopolitical threats. It dedicates funding to scaling Canadian businesses, recognizing larger firms create more jobs and contribute disproportionately to economic growth and productivity. And the budget seeks to capitalize on major opportunities like growing Canada's space economy—specifically launch capabilities.

Making good on these investments, and seizing opportunities before the country, will rely on a skilled workforce—without a smarter immigration strategy, Canada has little hope of attracting that skilled labour. Economic immigrants bring skills experience, innovation, and financial investments. They will be essential to addressing labour shortages in critical sectors like healthcare, technology, skilled trades, and agriculture, as they have done in the past. Global talent will also be key to scaling Canadian companies in key sectors and avoiding population declines in rural parts of the country.

Attracting the talent Canada needs will also be increasingly difficult given growing global competition for talent. By some estimates, the global population is set to peak by mid-2080 and is already shrinking in Europe and China. Other countries will be rolling out the red carpet to prospective citizens as their domestic populations shrink. Canada's approach to immigration needs to be as much about recruiting as it is selecting.

Competing globally to recruit the best and brightest will require a strong international brand, which recent policy volatility is jeopardizing. Changes to Canada's immigration point system in recent years have created back doors and side doors, making the system less predictable and transparent—deterring the people needed to build a strong economy from applying. The system has been described as a "lottery" depending less on merit and more on timing and has been criticized for long processing times—over two years for those entering through the entrepreneurial program.

Even if Canada addresses these recruitment challenges, there is little guarantee the newcomers will stay. New research shows one in five immigrants leave within 25 years of arriving in Canada, and the most highly skilled are the biggest flight risks. Whether newcomer or Canadian-born, many of Canada's graduates from degree programs in science, technology, engineering and math (STEM) disciplines, emigrate after graduation, primarily to the U.S. And Canada's three largest startup cities—Toronto, Vancouver, Montreal—lag far behind global leaders, pulling in less than 5% of the venture capital investment that flows into places like San Francisco, New York and Boston. Attracting and retaining the best and brightest will require more transparent, predictable

Canada's approach to immigration needs to be as much about recruiting as it is selecting.

pathways, faster processing times and investment in infrastructure and services—like housing and health care—to ensure a high standard of living. With a steady inflow of talent, Canada will be better placed to grow businesses and invest in the innovation needed to retain top talent.

In addition to attracting world-class talent, Canada can train for it. International students represent an important opportunity that Canada should be careful not to overlook. Foreign students who graduate from reputable programs in in-demand fields offer needed skills and recognized credentials, making them great candidates for permanent residency. They are also more likely to stay in the country and see higher earnings than immigrants who pursue permanent residency directly. That is, of course, if they come in the first place.

The latest federal budget cut international student numbers drastically for the next two years, by almost half of 2025's target. Even at its new low, the target is unlikely to be met. International applications have declined significantly as frequent changes to post-graduate work permit eligibility have prospective students doubting whether their studies will provide a path to staying in Canada. The new system is also clunky and cumbersome for applicants. It features new hoops that students and institutions must jump through, namely Provincial Attestation Letters to enforce annual permit caps.

Canada can re-open student pathways and make them appealing again by rebuilding its brand as a country that welcomes foreign students and offers transparent immigration pathways after graduation. With guardrails to ensure colleges and universities maintain integrity, Canada could focus on welcoming students who pursue credentials (e.g., diplomas, degrees) in fields of study (e.g., STEM) that yield positive outcomes after graduation, including higher transition rates to permanent residency. (Rather than constantly revising a list of specific programs eligible for work permits after graduation—feeding into an image of instability).

As the global population contracts and competition for immigration grows, reactive policies hurt Canada's brand as a stable and desirable destination. Many Canadians acknowledge the need for immigration to fill labour market gaps, and most concerns about immigration are tied to capacity rather than culture or ideology. A revised immigration strategy with stable targets for both temporary and permanent residents, an international brand strategy, and investments in infrastructure and services can set Canada on a positive course.

AI eats its users

Under pressure to generate revenue and unconstrained by guardrails, a number of leading AI companies will adopt business models in 2026 that threaten social and political stability—following social media's destructive playbook, only faster and at greater scale.

We remain bullish on AI's revolutionary potential. Today's frontier models reason through complex problems, show their work, and are embedded in coding, research, and knowledge workflows. The hyperscalers are offloading large chunks of software development to AI, accelerating their own R&D cycles. In biotech and materials science, AI is opening new research pathways—though commercial breakthroughs remain mostly ahead of us. Hundreds of millions of people now use chatbots daily for everything from drafting emails to debugging code and learning new skills. This is real, and it's just the beginning.

But AI can't live up to investors' expectations in the short term. Even after hundreds of billions of dollars of investment, the most advanced models still hallucinate. Their capabilities are jagged: dazzling at some tasks, unreliable at others (and often unpredictably so). That inconsistency makes them hard to deploy in high-stakes applications where errors are costly. Business adoption has been uneven, with only about 10% of US firms using AI to produce goods and services, according to the Census Bureau. Many companies report significant productivity gains, but surveys suggest most have yet to see meaningful bottom-line impact. Real productivity increases will arrive through wide diffusion of the technology across the economy, but that takes time. Yet markets have priced in revolution, not evolution.

Some of these companies are caught in a bind. Promises of Artificial General Intelligence and the massive capital expenditures needed to build ever-larger models have driven investor expectations to stratospheric levels. Cumulative AI-driven investment is likely to exceed $3 trillion by 2030. As some frontier model-makers prepare for IPOs in 2026 or 2027, they will come under growing pressure to show they can deliver returns on this capital—especially given intensifying competition from cheaper Chinese open-source alternatives like DeepSeek, which offer "good enough" performance at a fraction of the cost.

To justify current investment levels and valuations, AI revenue will need to grow by an order of magnitude. Absent regulatory constraints or commonly agreed rules of the road—the scenario Eurasia Group warned about in our Top Risk 2025 #8: AI unbound—some companies will do whatever it takes to keep the party going. Aggressive monetization schemes based on user data, ads woven into interactions, erotica to keep users hooked, engagement-maximizing algorithms regardless of psychological and social harms—these business models may make financial sense, especially in the short term. They're also corrosive for society and democracy.

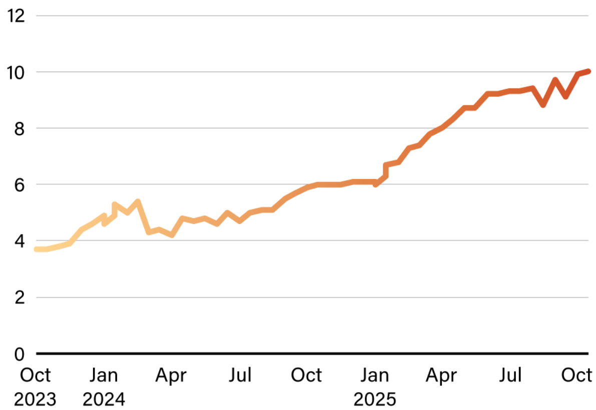
We've seen this movie before. Cory Doctorow calls it "enshittification": platforms attract users with attractive "free" products, lock them in, then systematically degrade the experience to extract maximum value—leaving just enough to keep people stuck. Social media transformed from tools for connecting with friends and family into engagement-optimized rage machines. Now nearly half of young people wish social media had never been invented, but network effects make it costly to leave, and accordingly almost nobody does.

AI is following the same trajectory—only faster, and with a technology far more strategically important to the global economy than social media ever was. And AI isn't just another platform. Social media captures your attention. AI programs your behavior, shapes your thoughts, and mediates your reality. Unlike scrolling through a feed, where you know you're consuming content, hyper-personalized AI companions become trusted confidants—entities that "know" you better than anyone else in your life. When that entity's primary purpose is not to serve you but to keep you engaged and extract value, you become the product. Ask such a chatbot a question, and it follows up with questions of its own—not because you want conversation but because that's what the chatbot has been optimized to do. An AI companion that's learned your insecurities can recommend products calibrated to exploit them, and you'll never know the difference between advice and advertising. If the AI appears free or cheap, you're paying with something more valuable: your autonomy, your privacy, your cognitive capacity, and your ability to think independently.

Growing pressure for many AI labs to demonstrate a path to profitability will accelerate the shift to extractive and socially dysfunctional business models.

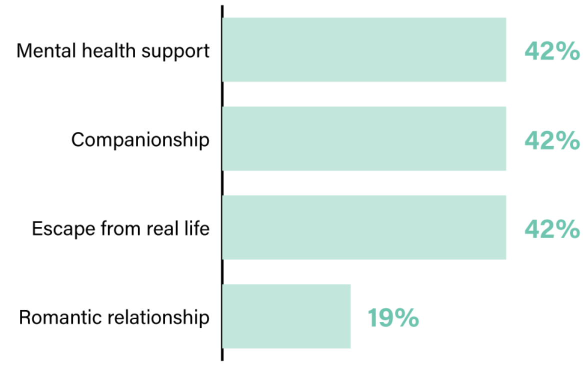
Businesses aren't biting yet

% of US firms using AI to produce goods and services



But teens are all in

% of US high-school students who said they or their friends used AI for



Source: Euraisa Group, U.S. Census Bureau, Business Trends and Outlook Survey (BTOS) 2023-2025, Center for Democracy and Technology (June-August 2025 survey, n=1,030)

In 2026, growing pressure for many US AI labs to demonstrate a path to profitability will accelerate the shift to extractive and socially dysfunctional business models. Major platforms are already experimenting with ads embedded in conversations where—unlike traditional search—there's no way to distinguish neutral information from paid influence. AI companions will nudge users toward purchases, beliefs, and behaviors that serve the interests of the highest bidder. Personalized AI will stifle normal social and emotional development, particularly in young people, creating an angry and alienated generation.

The downstream consequences extend to cognition. AI removes the need to concentrate on anything for extended periods. It makes already-addictive platforms more so, ensuring fewer people read books, engage with long-form content, or develop critical thinking skills. Achievement scores in literacy and numeracy are declining across the West for the first time in decades; the threat is not superhuman machines but the decline of thinking, feeling, social humans. Deliberative democracy requires informed, engaged citizens capable of independent thought. AI risks producing the opposite: a population optimized for engagement, extraction, and manipulation.

At current valuations, AI is priced to "eat" the economy, unlocking spectacular productivity gains by displacing jobs on a scale that would trigger significant social and political backlash. But mass labor substitution doesn't appear imminent, even if it may come later. Should investors come to believe that disruption—good and bad—will come more slowly than they anticipated, a sharp market correction could follow. In the meantime, AI will "eat" its users as companies subject hundreds of millions of people to real-time psychological experiments with no clinical trials, safety monitoring, or informed consent.

None of this is inevitable. China's government is deliberately restricting the deployment of consumer-facing, engagement-maximizing AI, assessing that the psychological, societal, and political risks outweigh the potential strategic benefits. President Xi Jinping views personal chatbots much as he views TikTok: as "spiritual opium." Washington, by contrast, allows short-term private profits to take precedence over citizen well-being. President Donald Trump's administration—its senior ranks staffed by Silicon Valley allies and its political fortunes tied to the AI boom—is more likely to backstop the AI sector than to force it to internalize the negative social externalities of its business models.

AI will unleash incredible advances in domains from biotechnology to robotics, advanced materials, energy efficiency, and space exploration. Much of this will come from smaller, leaner, purpose-built models, not consumer behemoths designed for viral adoption and maximum engagement. The combination of inflated near-term expectations, pressure to monetize, and lack of regulatory and governance guardrails means that American AI is set to impose its costs on society before it delivers its promised gains.

The charter strikes back

Canada's economic prospects are threatened not just by external shocks and demanding neighbours; they're up against a deepening asymmetry of federalism that makes a unified economic strategy harder to design, sell, and implement.

Different views among Ottawa, the provinces, and Indigenous governments over how to use natural resources, fund and deliver education, and stabilize a strained health-care system are pulling Canada further toward a patchwork of policy regimes just as it confronts tough trade talks with a more transactional United States and intensifying global competition. Constitutional tools that were once seen as last resorts—the notwithstanding clause, aggressive jurisdictional challenges, demands for exemptions from national regulations and standards, even provincial votes on autonomy—are becoming more commonplace, raising the odds that provinces and Indigenous groups will weaponize hard and soft vetoes on national priorities. One Canada, maybe, but many nations within.

The consequences for national unity are more serious than at any point since the 1990s because fragmentation now comes with cheerleaders and sponsors abroad. A divided global order gives foreign governments, activist networks, and corporate actors more opportunities to exploit jurisdictional tensions, whether by privileging particular provinces in supply-chain decisions, funding litigation and media campaigns around resource projects, or amplifying separatist narratives. For geopolitical rivals, anything that weakens Canada's coherence as a U.S. ally and G7 partner could even become a feature, not a bug, as sub-national players and Indigenous rights-holders seek to express their voices more assertively over energy, climate, industrial policy, internal trade and, most critically, bilateral trade with the U.S.

Canada's federation was designed to balance provincial autonomy with federal authority over certain shared concerns, including trade. But over time, the Charter of Rights and Freedoms has pulled the courts into the heart of that balance. The Charter gives individuals and groups—including Indigenous communities and provinces themselves—powerful tools to challenge federal or provincial legislation on rights grounds, forcing policy choices in areas like language, education, and social programs to survive constitutional scrutiny. In practice, this has extended the Supreme Court's role as an arbiter of federal-provincial and Crown–Indigenous relations, as governments on all sides use the Charter not only to protect rights but also to constrain fiscal and regulatory initiatives they oppose.

Among those weapons, the most contentious is the notwithstanding clause. Once rarely invoked, the clause has been used or seriously threatened in recent years by Quebec, Ontario, Saskatchewan, and Alberta in disputes over language, religious symbols, election finance, labour rights, and education, signalling to voters that governments can bypass courts when rights protections collide with political objectives.

The regional nature—and divergences—of Canada's economy only serves to sharpen the competing interests of the provinces, each under a different threat from the Trump trade war and global divisions. Ontario's economy remains anchored in autos and steel; British Columbia relies heavily on lumber and Asia-facing trade; Saskatchewan depends on canola and other agricultural exports; and Alberta's prosperity hinges on oil and gas. Canada's negotiating position struggled through much of 2025 as premiers tried to argue for their patch in Washington. They may reemerge as soon as CUSMA negotiations begin in earnest.

Bill C-5, the One Canadian Economy Act, and political backlash, has become a focal point for federal-provincial tensions over resource governance and Indigenous rights. The legislation allows the federal cabinet to declare projects—ports, pipelines, mines, dams—to be in the national interest and fast-track approvals. Provinces that resent federal intrusion into natural-resource jurisdiction view C5 as Ottawa reaching over their heads, while many Indigenous groups see the act as a direct attack on their constitutionally protected right to be consulted and accommodated on decisions affecting their lands. The result is a wave of legal challenges and protests that further politicize big-ticket projects the Carney government counts on to diversify away from the United States.

In the wake of C-5, the Canada–Alberta Memorandum of Understanding on energy and climate is both a template for cooperation and a sign of how transactional federalism has become. The MOU commits Ottawa and Edmonton to work together on net-zero by 2050, build major transmission interties, streamline regulatory timelines to roughly two years, and negotiate equivalency agreements on carbon pricing and methane reductions by April 2026. It also sketches pathways for a new export pipeline and carbon capture infrastructure, with explicit references to Indigenous participation and economic benefit-sharing. But the fact that these national priorities are being handled on a project-by-project basis, with one province at a time, underlines how much of the Carney agenda now runs through bilateral deals rather than pan-Canadian frameworks, inviting other resource-rich provinces to demand similar side arrangements or carve-outs—and the growing urban parts of the country, where the ruling Liberals have their political base, to question if their own aspirations are being met, too.

The sleeping giant of Canada's asymmetrical agitations is Crown–Indigenous relations that sit at the intersection of rights, resources, and legitimacy. Indigenous nations and communities have become sophisticated in their use of both the courts and direct action to halt or reshape major projects, winning injunctions, forcing governments back to the negotiating table, and mobilizing public opinion when they've deemed consultation to have been inadequate. B.C. First Nations pose a particular challenge, as they are central to both resource development and expanded exports to the Pacific—and they have different legal standing, given the province came into Confederation without treaties.

Under these pressures, several provinces and Ottawa have started to experiment with exemptions from environmental rules, electricity regulations, and interprovincial trade norms, and some are pushing to further decentralize immigration and demanding more respect for their jurisdiction over housing policies, which remains the country's political hot potato. As a result, international investors are beginning to price Canadian federalism—once a quirky part of the Great White North—as an operational risk. "Can you get it done?" is still the global response to many Canadian proposals, whether it's pipelines, mines or large export infrastructure. At the same time, some view this web of rights protections and multi-level consent requirements as a signal of rule-of-law robustness and social licence, especially compared with more arbitrary regimes. The balance between speed and certainty will be measured, in part, by how the Carney government navigates high-profile disputes over C-5 projects and the project commitments under the Canada-Alberta MOU.

The PMO's highly centralized style is both an asset and a vulnerability. A strong prime ministerial centre can coordinate economic, climate, and foreign policy to respond quickly to U.S. shocks and mobilize federal spending behind a coherent industrial strategy. But governing through a tight PMO and bilateral deals with premiers risks sidelining intergovernmental forums and parliamentary scrutiny, feeding the narrative that Ottawa is imposing its will and prompting provinces to retaliate through the courts, the notwithstanding clause, or their own referendums on autonomy. That's not to mention the risk of cabinet and caucus, especially in a fragile parliament. Any over-reliance on executive bargains could leave national policy dependent on a handful of political relationships rather than anchored in durable institutions.

The 2026 political calendar heightens the risk that constitutional and jurisdictional disputes move from background noise to full-blown flashpoints. A possible federal election, a scheduled Quebec election, and ongoing battles in Alberta and B.C. over resource policy, climate targets, and revenue-sharing all create incentives for leaders to campaign against Ottawa or against other provinces. This politics of permanent grievance erodes the goodwill necessary for joint economic projects. Without more signals of progress, the summertime meme of "elbows up" is at risk of melting into a wintertime mood of confidence down.

Bridging these gaps will require a deliberate strategy of political choreography as much as policy design. Federal-provincial-territorial summits on health, housing, and climate can still set common baselines—but are always at risk of becoming provincial shakedowns of the federation. Advertising, public campaigns and town halls, led not only by the prime minister but also premiers, Indigenous leaders and CEOs, can further strengthen a shared narrative around a united and confident Canada.

The consequences for national unity are more serious than at any point since the 1990s

Regulatory reform will be a key test of whether the Carney government can use federal powers to unite the country. Efforts to reduce interprovincial trade barriers, harmonize or mutually recognize skills accreditation, and streamline immigration pathways for in-demand occupations all promise gains in productivity and labour mobility, but each step touches sensitive provincial prerogatives. The new cooperation mechanisms embedded in the Canada-Alberta MOU—single-window assessments, clear timelines, and equivalency agreements—offer a model that could, in theory, be extended to other provinces and sectors if trust can be built. Without such reforms, Canada risks leaving significant internal market efficiencies on the table just as it tries to compensate for a less reliable U.S. partner. Businesses and investors should treat jurisdictional tensions as an enduring feature—and potential strength—of the Canadian landscape. The need to secure multi-level consent and navigate overlapping legal regimes raises transaction costs and lengthens project lead times, but it can also produce more resilient outcomes with stronger social licence and lessen the risk of abrupt reversals. For firms willing to invest in local relationships with provinces, Indigenous governments, and municipalities, Canada's complex federalism can be a source of differentiated advantage, insulating long-term bets from the whims of any single political actor, including the U.S. The risk in 2026 is that escalating constitutional brinkmanship turns this complexity from a managed challenge into a systemic vulnerability—just when Canada needs a coherent, collective strategy to build a stronger economy, and country.

Zombie USMCA

North American trade will be stuck in limbo in 2026. The United States-Mexico-Canada Agreement (USMCA) won't be extended, updated, or killed. It will stagger on as a zombie, keeping businesses and governments guessing while President Donald Trump continues negotiations with America's two largest trading partners.

The agreement is up for its mandated review this year, when the parties can extend it for an additional 16 years. But Trump wants to avoid the constraints of a new trilateral deal so he can keep using bilateral leverage to squeeze economic and political concessions from both countries. Canada already scrapped its digital services tax. Mexico is imposing tariffs on China. Both are cracking down on fentanyl flows. Washington gave up nothing in return. Why lock into an agreement when the current approach keeps delivering for the US president? Neither Canada nor Mexico can afford to walk away. The United States is the destination for roughly 75% of Canadian exports and 80% of Mexican exports. Trump holds most of the cards and he knows it.

The result will be a "zombie USMCA" that is neither fully dead nor alive—and a North American trade zone buffeted by chronic uncertainty. Tariff exemptions for USMCA-compliant goods will hold. Covering roughly 80% of US goods imports from Canada and Mexico, these exemptions will limit the average effective US tariff rate and keep the agreement technically alive. But in the key industrial sectors the Trump administration wants to reshore—autos, steel, aluminum, which are subject to Section 232 national security tariffs—North American free trade will be dead. Everything in between will be up for grabs amid evolving US demands and increasingly bilateral negotiations.

This approach suits Trump's domestic politics. He can exempt the bulk of US imports—including energy, with roughly 60% of US crude coming from Canada and 10% from Mexico—to limit the cost-of-living hit to American households while turning the screws on Canadian and Mexican manufacturers, whose production he wants to move to the United States.

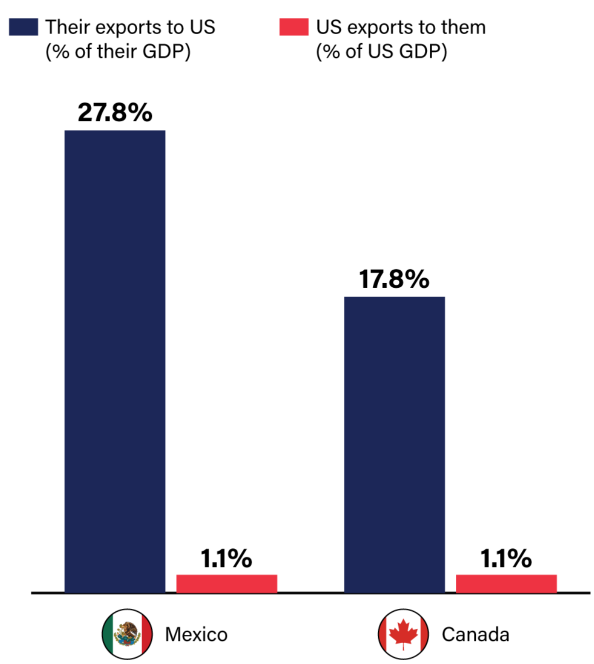
American demands on both neighbors will be extensive. For Canada, they will center on tariff rate quotas on Canadian autos, steel, and aluminum; expanded access to Canada's banking and dairy markets; an end to what Washington calls discriminatory taxes and regulations targeting US tech and entertainment firms; tighter border security; higher defense spending; and more purchases of US military hardware. For Mexico, the emphasis will be on crackdowns on Chinese investment and transshipment; updated energy regulations to favor US companies; ramped-up enforcement against cartels, illegal immigration, and border security; and increased water deliveries to US border states. And hanging over all of it: the threat of targeted US military intervention against cartels.

Mexico and Canada will respond very differently. President Claudia Sheinbaum wants a quick deal, even a subpar one, and she's working pragmatically to get there. By contrast, Canada is betting that time is on its side—that cost-of-living pressures in the United States and Republican midterm anxieties eventually force Trump to moderate. A tough stance toward Washington is also popular at home, giving Prime Minister Mark Carney political cover to hold the line. For Ottawa, no deal might be better than a bad deal this year.

That calculation sets up a rough ride for Canada and Carney in 2026. Trump apparently likes Carney personally but doesn't like Canada's tough, detail-oriented approach to negotiations—or Canadian retaliatory tariffs and consumer boycotts. Canada isn't willing to make the concessions on market access or military purchases that would give Trump an obvious win, and Trump isn't willing to back down. With talks stalled, tariffs will stay elevated and weigh on growth. Ontario's auto and steel heartland will sputter, leaving Carney and Premier Doug Ford facing political headwinds in the vote-rich province.

North America's asymmetric dependence

Exports, 12m rolling sum, % of GDP



Source: Eurasia Group, Macrobond

Promises of new infrastructure projects and "buy Canadian" procurement won't ease the near-term tariff pain. Canadian firms in unrelated sectors risk becoming collateral damage.

Mexico faces a different calculus. Sheinbaum will focus on negotiating exemptions within the existing sectoral tariff regime ahead of broader talks. But trade uncertainty combined with domestic fiscal consolidation will keep FDI flows tepid and public investment at record lows. Growth will slow in an economy that's already losing steam. Sheinbaum's public popularity and Morena's dominance will shield her politically—but they won't protect Mexican businesses or workers.

To be sure, the United States will feel pain too. Automakers have spent three decades building continent-wide production lines; unwinding that won't be cheap. And in the unlikely (but not inconceivable) event that that Trump formally withdraws from USMCA to pursue fully separate bilateral deals, the market and economic fallout would be severe. The threat alone will shadow investment decisions throughout the year.

Canada and Mexico will still face lower effective tariff rates than most of the world. But preferential treatment won't make navigating North American trade any easier this year; the days of free and predictable North American trade are over. Sectoral tariffs designed to reshore production will develop constituencies that benefit from and lobby for them. For firms trying to plan beyond the next quarter, 2026 will be a year of renegotiating contracts, hedging bets, and delayed investments. That's the cost of doing business when the rules keep changing.

"Why lock into an agreement when the current approach keeps delivering for the US president and neither Canada nor Mexico can afford to walk away?"

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