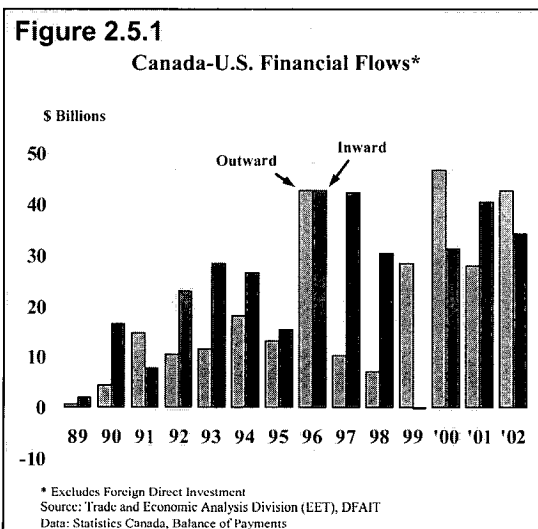


2.5 FINANCIAL INVESTMENT

Financial investment refers to the non-foreign direct investment component of the financial account. It includes: portfolio investment, other investment, and other assets/liabilities. Financial investment, unlike foreign direct investment, does not give rise to or constitute a significant say in how a company is run.¹² Portfolio investment consists of stocks (equity) or bonds (debt): an example of portfolio investment would be a person's private holdings in a RRSP or indirectly through a mutual fund. Firms can also hold portfolio investments for a variety of reasons, but along with governments, are the issuers of the portfolio investment. Other investments include foreign loans/deposits, foreign holdings by banks, and official international reserves. Other assets/liabilities include trade credits, short-term receivables and a variety of other miscellaneous financial holdings.



Financial investments are often significantly larger than foreign direct investments. In 2001, Canadians owned \$1.30 in U.S. financial assets for every dollar of direct investment assets. Foreign financial holdings in Canada are even larger, at \$2.20, for every dollar of foreign direct investment in Canada.

Financial flows, in both directions, picked up considerably in the later half of the 1990s. Between 1989 and 1995, financial outflows from Canada to the U.S. averaged \$10.4 billion compared to an average of \$29.3 billion between 1996 and 2002. The same is true for inflows which averaged \$17.1 billion prior to 1996 and \$31.5 billion after 1996. For both periods, inflows outweighed outflows, although the relative gap was smaller in the post-1996 period.

The U.S. share also increased significantly, from 45.6 percent for outflows and 51.6 percent for inflows in the pre-1996 period to 70.6 percent and 110.6, percent respectively, in the post-1996 period.

Portfolio investment accounts for the majority of Canadian international financial flows. Over the 1989-2002 period, portfolio flows accounted for 74.1 percent of financial outflows and 84.8 percent of inflows. Inflows from the U.S. picked up in the early 1990s, but it was not until the late 1990s that outflows also began to increase and actually surpassed inflows for four of the past five years. It is likely that the differences in business cycles – the U.S. recovering much earlier than

¹² Following international convention, Statistics Canada defines an investment constituting 10 percent or greater ownership of voting shares as foreign direct investment. All investments below this threshold are considered portfolio investment.