

The background of the entire page is an impressionist landscape painting. It depicts a large, leafy tree in the center-right, a person in a hat and dark clothing walking away in the lower-left foreground, and a white dog lying on the ground in the lower-center. The brushwork is thick and textured, with a palette of greens, blues, yellows, and browns. The sky is a mix of light blues and whites, suggesting a bright, overcast day. The overall style is reminiscent of the Impressionist movement, focusing on light and color over fine detail.

**Canada's Growth-  
Inflation Regime  
Shift and What it  
Means for Allocators**

January 2026

## EXECUTIVE SUMMARY:

Since 2014-2015, Canada's cumulative net capital flows, fiscal balance, and current-account position have deteriorated in a manner that is inconsistent with prior cyclical slowdowns. Rather than mean-reverting, these trends point to a structural shift in Canada's macro regime, characterized by weaker potential growth and more persistent inflation pressure. The coincidence of sustained capital outflows, expanding fiscal deficits, and external imbalances reflects declining relative competitiveness, regulatory and policy constraints, reduced private-sector reinvestment, and outward allocations by domestic institutional investors.

Our investment thesis is that this "triple deficit" dynamic constrains supply and capital formation while supporting demand through deficit spending, creating an asymmetric growth-inflation outcome. Fiscal deficits increasingly support consumption rather than productive investment, raising the risk of fiscal dominance as debt burdens grow (see our paper "[Inflation and Growth in a Regime of Fiscal Dominance](#)"). At the same time, persistent capital outflows and current-account deficits increase currency vulnerability, elevating imported inflation risk even in periods of subdued domestic growth. The result is a macro environment in which inflation can remain sticky or re-accelerate despite mediocre economic momentum.

For allocators, the central risk is continuing to position portfolios as though Canadian growth and inflation dynamics remain mean-reverting in the medium term. Traditional 60/40 portfolio constructions are levered long aggregate GDP growth and short inflation, relying on stable capital inflows, benign fiscal constraints, and negative stock-bond correlation for diversification (see our paper "[Stock-Bond Correlation Inversions: Navigating Inflation-Driven Market Shifts](#)"). In a regime of structurally weaker growth and elevated inflation persistence, these assumptions become increasingly fragile. Allocators should therefore test portfolio resilience under scenarios of prolonged low growth, positive stock-bond correlation, and sustained inflation pressure, and consider exposures whose return drivers are less dependent on broad-based GDP growth and more resilient to inflationary regimes.



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## CANADA TRIPLE DEFICIT OVERVIEW:

Since 2014-2015, Canada's net capital flows, fiscal and current account deficits appear to have turned structurally negative.

Chart 1: Cumulative Net Investment Flows from 2000 (% of 2025E GDP)

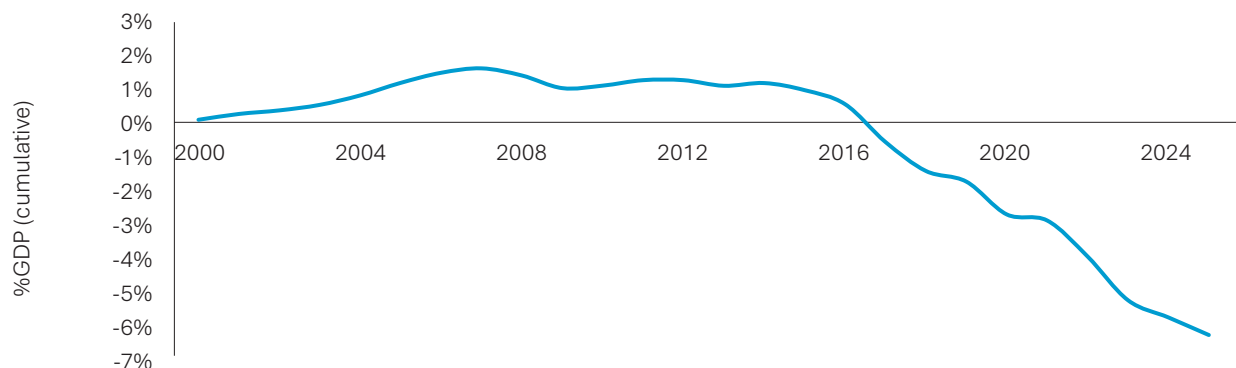


Chart 2: Cumulative Federal Fiscal Deficits from 2000 (% of 2025E GDP)

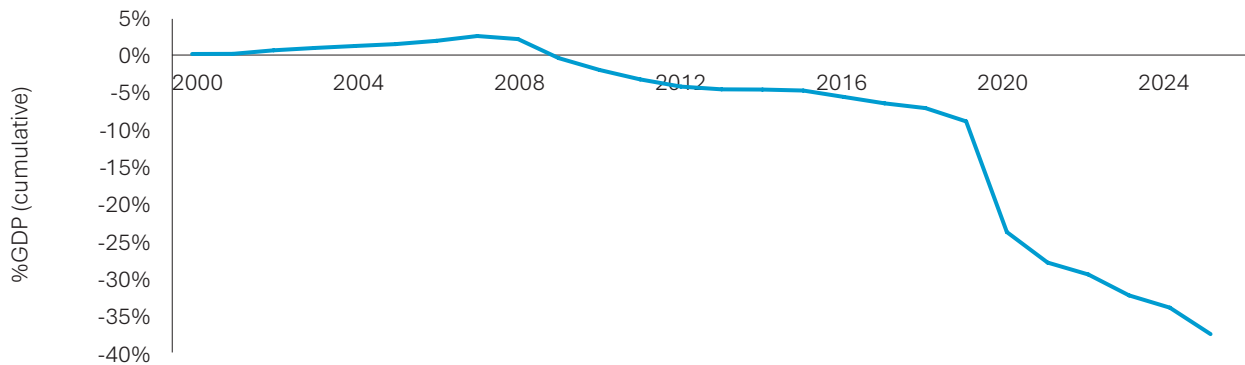
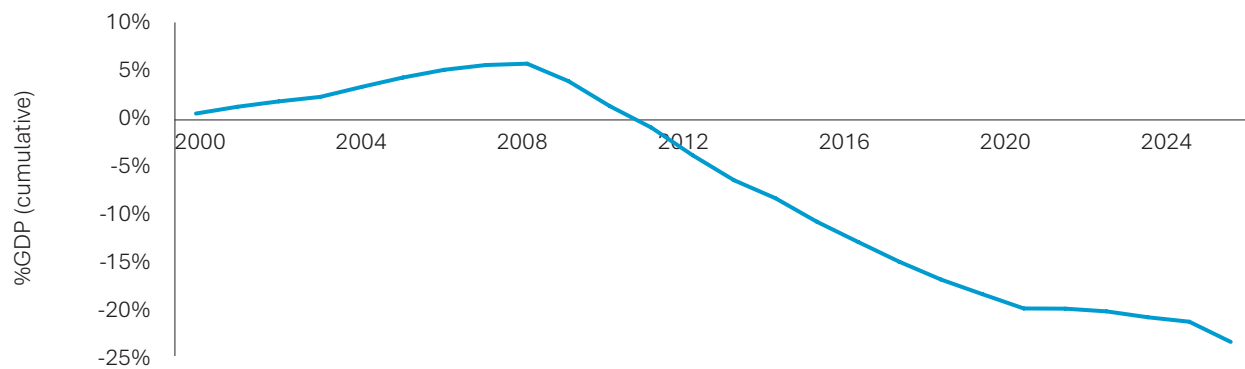


Chart 3: Cumulative Current Account Deficits from 2000 (% of 2025E GDP)



### IS THIS STRUCTURAL OR CYCLICAL?

A central question for allocators is whether Canada's recent growth and inflation dynamics represent a temporary deviation from historical patterns, or a more durable regime shift. We believe the evidence points to the latter.

- Historically, periods of weak growth in Canada were accompanied by cyclical capital retrenchment that reversed as global growth recovered or domestic valuations improved. Since 2014–2015, however, cumulative net capital flows have continued to deteriorate through multiple economic cycles, commodity price regimes, and interest-rate environments. The absence of meaningful mean reversion over a decade suggests a structural erosion in Canada's relative attractiveness as a destination for fixed capital investments rather than a temporary risk-off episode.
- The post-2015 period is characterized not only by reduced foreign investment inflows, but also by persistent outward flows from domestic institutional investors, including pension funds. These allocations reflect long-horizon policy, regulatory, and opportunity-set decisions rather than short-term market timing. Capital that exits domestic productive investment reduces the future capital stock, lowering potential output and productivity growth in a manner that is slow to reverse.
- Canada's fiscal deficits have expanded materially over the same period, but without a commensurate increase in productive public investment that might raise the economy's supply potential. Instead, deficits have increasingly supported consumption and public-sector growth that outpaces underlying GDP growth. This dynamic temporarily supports demand while weakening the national balance sheet over time, increasing reliance on continued deficit financing and raising the risk of fiscal dominance. Unlike cyclical fiscal stimulus, this process embeds inflation pressure while constraining future growth.
- Persistent current-account deficits require ongoing external financing. In the presence of net capital outflows, this imbalance places downward pressure on the currency, increasing the risk of imported inflation even when domestic growth is subdued.

- Structural drivers of capital allocation, including regulatory complexity, taxation, permitting timelines, and sectoral constraints, evolve slowly and are not easily reversed within a typical business cycle. As a result, the conditions necessary for rapid mean reversion in capital flows and productivity growth are unlikely to materialize in the short to medium term.

## PORTFOLIO IMPLICATIONS:

Traditional 60/40 portfolios are almost universally levered long aggregate GDP growth and short inflation. Absent a sustained reversal in net capital flows and the fiscal and current account deficits, we believe Canada remains biased toward stagnation rather than simply cyclical slowdowns, and persistent, above trend inflation. Allocators would, therefore, be well served to consider allocations that benefit from inflation persistence and poor aggregate growth dynamics. In practice, this could mean:

- Increasing exposure to assets with strong pricing power or that have below trend growth as a positive return driver or lack correlation to aggregate GDP (i.e. sectors that see a growth pick-up in recessions or that are driven by regulatory requirements)
- Allocating to productive real assets (see our paper [“Improving the Efficient Frontier of Mixed Asset Portfolios with Farmland in Positive Stock/Bond Correlation Regimes”](#))
- Emphasizing returns tied to operational alpha rather than aggregate GDP growth (see our paper [“Improving the Efficient Frontier of Mixed Asset Portfolios with LMM PE in Positive Stock/Bond Correlation Regimes.”](#))

## CONCLUSION:

Canada’s cumulative capital flow, fiscal, and current-account deficits point to a balance-sheet-constrained macro regime characterized by structurally weaker growth and persistent inflation pressure. These dynamics are not cyclical deviations but reflect slow-moving shifts in capital allocation, fiscal structure, and external financing that are unlikely to mean-revert in the short to medium term.

For allocators, the central risk is continuing to position portfolios as though Canadian growth and inflation dynamics remain unchanged or mean-reverting in the medium term. Traditional portfolio constructions implicitly assume stable capital inflows, benign fiscal constraints, subdued inflation coupled with broad-based GDP growth, all supported by reliable diversification from domestic bonds. Absent a sustained improvement in these conditions, those assumptions warrant reassessment. Allocators should explicitly test portfolio resilience under scenarios of prolonged low growth, elevated inflation persistence, and positive stock-bond correlation. Sample allocator sensitivity analysis:

- Growth Dependence: To what extent are portfolio returns implicitly reliant on above-trend, broad-based Canadian GDP growth, productivity recovery, or capital reinvestment that may not materialize?
- Inflation: How does the portfolio perform if inflation remains structurally above target for an extended period rather than mean-reverting after cyclical slowdowns?
- Stock–Bond Correlation: What is the impact on portfolio volatility and drawdowns if domestic stock–bond correlations remain persistently positive due to inflationary dynamics?
- Currency: How exposed is the portfolio to sustained Canadian dollar weakness driven by current-account deficits and net capital outflows?
- Fiscal Dominance Scenarios: How resilient are return assumptions if fiscal deficits constrain monetary policy flexibility and suppress real bond returns?
- Real Return Drivers: Which assets deliver returns primarily through pricing power or operational improvement rather than simply broad-based nominal GDP growth?
- Diversification: Are diversification benefits driven by structural independence of return drivers, or by historical correlations that may no longer hold?
- Liquidity Assumptions: How do portfolio liquidity needs align with potential periods of elevated volatility, weaker growth, and reduced market depth?

## **SOURCES:**

StatsCanada

World Bank

OECD Economic Outlook

Omnigence papers

- “Improving the Efficient Frontier of Mixed Asset Portfolios with LMM PE in Positive Stock/Bond Correlation Regimes.”
- “Improving the Efficient Frontier of Mixed Asset Portfolios with Farmland in Positive Stock/Bond Correlation Regimes”
- “Stock–Bond Correlation Inversions: Navigating Inflation-Driven Market Shifts”
- “Inflation and Growth in a Regime of Fiscal Dominance”



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