



**Inflation and Growth
in a Regime of
Fiscal Dominance:
Strategies for
Safeguarding Capital
from Accelerating
Sovereign Debt**

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EXECUTIVE SUMMARY:

The global financial system is entering a period of fiscal dominance, a condition in which government debt levels and fiscal pressures dictate central bank behavior. Rather than pursuing inflation stability, central banks are compelled to ensure that sovereigns can finance themselves.

With debt-to-GDP ratios at or above wartime levels in the G7, servicing costs now rival traditional government expenditures such as defense and healthcare. This dynamic constrains monetary independence, forces central banks into tolerance of higher inflation, and may encourage the use of “financial repression” – e.g. deliberately negative real yields, regulatory mandates for holding government bonds, capital controls or direct taxation of wealth.

For investors, fiscal dominance is a threat to wealth preservation. Traditional safe havens such as long-duration sovereign bonds may destroy capital in real terms. Equities, private markets, and real assets tend to perform unevenly depending on pricing power, jurisdiction, and policy decisions. We briefly explore the mechanics of fiscal dominance and its implications for investors in a world where monetary independence is increasingly subordinated to fiscal necessity.

THE BEGINNING OF THE END OF MONETARY INDEPENDENCE:

For decades, investors have benefited from a macro regime defined by monetary dominance. Central banks, armed with credibility won in the 1980s disinflation campaigns, pursued inflation targets without having to worry overly about economic stability. Fiscal policy was subordinated to monetary policy; deficits mattered less, and debt sustainability was assumed. That era is ending.

The global financial crisis, the COVID-19 shock, aging demographics, and the rapid growth of entitlement spending have combined with pressure to increase defense spending to impose unprecedented fiscal burdens on sovereign borrowers. As most developed market economies already have high debt levels this deteriorating fiscal path is worrisome.

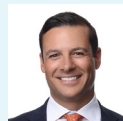
Evidence suggests that once debt and deficit levels exceed ~90% and ~4% respectively, growth begins to decelerate, and inflation begins to accelerate (stagflation) as central banks are pressured to control government servicing costs through yield curve suppression.



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Estimated Debt and Deficit Levels for Select Countries:

Country	Public Debt to GDP (2024)	Fiscal Deficits to GDP (2024)	Household Debt to GDP (2023)	Total Debt to GDP
China	300%	7.0%	57%	357%
Japan	250%	6.2%	65%	315%
Canada	113%	4.0%	99%	212%
USA	120%	6.4%	73%	193%
UK	96%	4.8%	86%	182%
France	113%	5.8%	59%	172%
Australia	50%	2.6%	118%	168%
Spain	104%	3.2%	55%	159%
Germany	63%	2.8%	52%	115%
Russia	20%	2.2%	18%	38%

The implications are clear, debt and spending levels are beginning to reach problematic levels in many of the world's key economies and central banks will be reluctant to allow interest rates to destabilize sovereign finances. Fiscal dominance is here, and historical precedents indicate that thereafter monetary independence is soon compromised.

THE MECHANICS OF FISCAL DOMINANCE:

Fiscal dominance arises when a government's financing needs overwhelm the central bank's inflation mandate. The dynamic begins with the debt burden and the interest costs that follow from it. In the United States, the annualized interest expense has already surpassed \$1 trillion and rising rates only compound refinancing stress.

As this pressure builds, policy subordination emerges. Although central banks are theoretically independent, in practice they become agents of fiscal policy. Their ability to raise rates is curtailed, yield curves are managed, and balance sheets are expanded to extend sovereign solvency.

This leads to financial repression, whereby governments and central banks create conditions of negative real yields. It also may lead to the capture of regulators in ways that compel institutions to hold government debt. In some cases, the repression extends even further to capital controls and direct taxation of wealth.

Most importantly, inflation tolerance becomes embedded in the system. Central banks begin to accept higher inflation as the "new normal" thereby eroding real wealth as a matter of policy.

IMPLICATIONS FOR INVESTORS:

The emergence of fiscal dominance transforms the risk and return profile of most major asset classes. Fixed income, a cornerstone of wealth preservation, shifts into a source of real wealth destruction – a shift that is wryly summed up in the saying "*rather than risk free return, bonds are return free risk*". Real assets and alternatives gain prominence, with infrastructure, commodities, gold, farmland and timber often serving as potential hedges. Private equity strategies focused on businesses with resilient, low-cost cash flows and scope for operational improvements – not leverage and financial engineering – may also hedge such risks.

INVESTING ENVIRONMENT:

With growth depressed and inflation a policy choice, eras of fiscal dominance tend to exhibit stagflation, the challenging combination of below trend growth and persistent above trend inflation. Traditional portfolios tend to underperform in such periods: equities suffer from earnings stagnation, bonds lose real value, and cash is silently taxed by inflation. In anticipation of fiscal dominance, investors should re-orient their portfolios toward strategies that emphasize inflation/stagflation protection and inflation hedged yield.

Moderate Stagflation Case:

- Inflation @ 3%–4%
- Growth 1%-2%
- Bond losses
- Yield curve control = mildly negative real rates
- Fiscal spending creates highly selective secular tailwinds - private capital positioned alongside government policy priorities (e.g. defense spending, onshoring etc) may outperform
- Real assets outperform

High Stagflation Case:

- Inflation @ 6%+
- Growth 0%-1%
- Bond losses
- Yield curve control = highly negative real rates
- Wealth taxes
- Existing income/capital taxes increase significantly
- Global capital mobility restricted
- Real assets outperform

CONCLUSION:

Fiscal dominance is structural, not cyclical, and tends to be stagflationary. History shows that debt overhangs are most often resolved by inflation, negative real rates, and materially increased taxation, rather than de jure defaults. Many traditional asset classes, including bonds, are compromised as inflation becomes a policy choice. In response, investors must consider stagflation-resilient strategies noting that those who adapt early should be able to purchase their "stagflation insurance" more cheaply.

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- Reinhart, Carmen & Rogoff, Kenneth. This Time is Different: Eight Centuries of Financial Folly.
- World Population Review
- IMF
- Canada sovereign debt and deficit is forecast 2025
- China sovereign debt BIS estimate of 300% vs BOC data
- Household Debt to GDP (2024): Based on the latest quarterly data from CEIC Data, TheGlobalEconomy.com, and IMF as of August 2025:
 - Japan: 65.1% (September 2024, CEIC Data).
 - USA: 73.2% (Q2 2024, Federal Reserve).
 - France: 58.9% (Q2 2024, Eurostat).
 - Canada: 99.0% (December 2024, CEIC Data).
 - UK: 85.6% (Q2 2024, Bank of England).
 - Germany: 52.3% (Q2 2024, Deutsche Bundesbank).
 - Spain: 54.7% (Q2 2024, Bank of Spain).
 - Australia: 117.5% (Q2 2024, Reserve Bank of Australia).
 - China: 57.2% (Q2 2024, People's Bank of China)
 - Russia: 17.8% (Q2 2024, Central Bank of Russia).



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