

A historical painting depicting a giant figure, likely representing a monarch or a powerful figure, standing on a high vantage point. The giant is wearing a red coat with gold trim and a white cravat. He is holding a miniature model of a city in his hands, looking down at it with a focused expression. Below him, a real city is visible, with a large crowd of people gathered in the foreground. The scene is set against a backdrop of a cloudy sky and distant hills.

## Addressing Canada's Stagflation Challenge: A Modest Proposal

Investments in farmland and  
mid-market private equity



## INTRODUCTION:

What is stagflation? Stagflation can best be described as the condition of material, positive annual inflation combined with nominal per capita growth which is lower leading to negative real growth per capita. Rather than anchoring on the outlier of very high absolute inflation environments like the 1970s stagflation our view is that the two example environments below should be considered equally stagflationary:

Inflation 10%	+	nominal GDP per capita 8%	=	real GDP per capita -2%
Inflation 3%	+	nominal GDP per capita 1%	=	real GDP per capita -2%

As illustrated, stagflation does not require the economy on an aggregate nominal basis to contract. Nominal overall growth can be relatively robust at the same time real GDP per capita is contracting sharply – Canada is an example. With this understanding of what stagflation is and is not, let's move on to agree some economic principles for growth:

**Principle 1)** Economies that inhibit capital formation have declining standards of living. Economies that prohibit capital formation have poverty.

**Principle 2)** Savings are the sole source of capital in an economy. Canadians under save and disproportionately spend savings on consumption goods rather than investing in production goods.

**Principle 3)** In order to ensure future prosperity, you must produce and invest more than you consume. Canada's economy is ~75% services/consumption with a material and persistent current account deficit – i.e. we consume much more than we produce or invest.

Omnigence recently published a detailed list of the variables we believe are driving Canadian stagflation risk "*Is Canadian Growth Dead – Preparing for Stagflation and the Socioeconomic Barbell*" Omnigence Asset Management Q1 2024. Canada's growth and inflation issues are not just a matter of poor performance in one or two areas – they are the result of consistently poor performance across a wide range of variables over decades:

	Description
<b>Inflation</b>	Elevated and trending back up? 1970s redux?
<b>Real GDP Growth</b>	Lowest GDP growth in OECD for next 30 years.
<b>Real GDP Growth per Capita</b>	Flat since 2015, trend is downwards.
<b>Regulatory Policy</b>	Net Zero cost estimate @ 3%-5% of GDP. What is the expected funding source? Deficit spending? Inflation?
<b>Capital Flows</b>	Net outflows, averaging ~\$40B-\$60B pa. Canada is experiencing persistent capital flight.
<b>Current Account</b>	Negative, steady at around ~\$40B pa. Consume more than we produce – anti-growth.
<b>Productivity</b>	Labor productivity poor compared to peers, stagnant/declining.
<b>Fiscal Account</b>	Large structural deficits, rapid increase in size of government, rapidly growing cost to service federal debt.
<b>Taxes</b>	High and rising, debt must be serviced, entitlement spending growth due to +65 group and new federal programs.
<b>Gross Debt</b>	High and growing, interest and principal repayments will increase, consuming tax revenues.
<b>Household Savings</b>	Low and declining. Savings = capital = future growth.
<b>Capital Formation</b>	Low, chronic underinvestment, overweight housing.

	Description
Population	Rapid population growth, highest immigration rate in developed world, entering population trap?
Demographics	Aging, 65+ cohort experiencing rapid growth, increases entitlement spending and dependency ratio.
Dependency Ratio	Increasing, dropping to two workers per dependent, drives need for tax increases.
Currency	Tendency to be weak against USD\$, twin deficits (current and fiscal), low capital investment, net capital outflows.
Housing Supply	Large supply/demand mismatch, 3+ million-unit structural shortage and growing, no clear path to resolution, decades to fix?
Housing Investment	Over-reliance, high percent of capital formation, consumption good – not highly productive capital investment, crowds out higher order capital formation.
Energy Costs	Trending upwards, materially above long-term average in G7 – from approximately 4% GDP to >8% GDP.

Will the Canadian stagflation of the last 10 years continue for another 10 based on current conditions, and if so, what is the solution?

**Principle 4)** If it is accepted that taxing alcohol reduces alcohol consumption, taxing tobacco reduces tobacco consumption, taxing carbon reduces carbon production then the tax system must be examined to see if it is encouraging or discouraging capital formation. If it is found to be discouraging capital formation and encouraging consumption, then this must be addressed.

## DISCUSSION:

While it would be possible to fill hundreds of pages with complex legislative and tax proposals, at a high level the policy changes required to begin to address stagflation could be quite simple. Focus on three tools – GST, capital gains tax, and income tax – with these it is possible to create a tax environment that diverts savings from consumption goods to production goods.

**Step 1: Incentivize Domestic Capital Creation** – We should consider 1) increasing GST on consumption goods, and decreasing on production goods, 2) allowing accelerated depreciation on production goods, 3) providing tax credits for investments in new machinery, technology, or infrastructure and 4) reducing income taxes. Savings should now tend to move from consumption into production goods.

**Step 2: Retain Domestic Capital** – We need to make sure that the savings/capital we divert from consumption are retained in the Canadian economy and invested in Canadian production goods. Unfortunately, Canada has consistent capital outflows. To reverse this trend may require 1) an absolute reduction in capital gains taxes and 2) adjusting capital gains for inflation so that investors are not taxed on nominal gains (particularly if Canada is entering a period of above trend inflation).

**Step 3: Attract Foreign Capital** – We need to build on Steps 1 and 2 to attract additional non-domestic savings/capital. However, Canada is not perceived as being an investment friendly jurisdiction and such perceptions are difficult to change. We may therefore want to consider targeted, high-profile changes to federal and provincial regulatory frameworks to begin to rebuild confidence and just as importantly signal to foreign capital allocators that such changes are likely to persist over the long-term.

## CONCLUSION:

Canada appears to be at a high risk for an extended period of stagflation with the attendant risks of the erosion of the middle class via socioeconomic barbell effects. The factors that brought Canada to this point are multivariate and unfortunately may prove somewhat intractable and time consuming to correct. This short discussion paper is meant to initiate a discussion about some potential policy changes that might accelerate the correction process. We do not have the luxury of continuing to ignore Canada's stagflation challenge as Aldous Huxley prophetically observed '*Facts do not cease to exist because they are ignored.*'



**Stephen Johnston**

Director – Omnigence 




**Matt Barr**

Director – Omnigence 



**Barclay Laughland**

Director – Omnigence 



**Kerri Furlong**

Director – Omnigence 





Toronto Office:  
TD Canada Trust Tower, 161 Bay St.  
27th Floor, P.O. Box 508  
Toronto, ON, M5J 2S1

Calgary Office:  
Suite 300, 4954 Richard Road SW  
Calgary, AB, T3E 6L1

[www.omnigeneam.com](http://www.omnigeneam.com)

#### **DISCLAIMER**

Our reports, including this paper, express our opinions which have been based, in part, upon generally available public information and research as well as upon inferences and deductions made through our due diligence, research and analytical process. The information contained in this paper includes information from, or data derived from, public third-party sources including industry publications, reports and research papers. Although this third-party information and data is believed to be reliable, neither OmniGenence Asset Management nor its agents (collectively "OmniGenence") have independently verified the accuracy, currency or completeness of any of the information and data contained in this paper which is derived from such third party sources and, therefore, there is no assurance or guarantee as to the accuracy or completeness of such included information and data. OmniGenence and its agents hereby disclaim any liability whatsoever in respect of any third-party information or data, and the results derived from our utilization of that data in our analysis. While we have a good-faith belief in the accuracy of what we write, all such information is presented "as is," without warranty of any kind, whether express or implied. The use made of the information and conclusions set forth in this paper is solely at the risk of the user of this information. This paper is intended only as general information presented for the convenience of the reader and should not in any way be construed as investment or other advice whatsoever. OmniGenence is not registered as an investment dealer or advisor in any jurisdiction and this report does not represent investment advice of any kind. The reader should seek the advice of relevant professionals (including a registered investment professional) before making any investment decisions. The opinions and views expressed in this paper are subject to change or modification without notice, and OmniGenence does not undertake to update or supplement this or any other of its reports or papers as a result of a change in opinion stated herein or otherwise.