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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 19/52-2

11:30 a.m., June 19, 2019

2. Canada—2019 Article IV Consultation

Documents: SM/19/131 and Correction 1; and Correction 2 ; and Correction 3; and Supplement 1; SM/19/136; and Correction 1; SM/19/137; and Correction 1; and Correction 2

Staff: Lim, WHD; Shabsigh, MCM; Kramarenko, SPR

Length: 1 hour, 24 minutes

Executive Board Attendance

D. Lipton, Acting Chair

Executive Directors	Alternate Executive Directors
D. Mahlinza (AE)	
	H. Razafindramanana (AF)
	J. Di Tata (AG)
	G. Preston (AP), Temporary
A. Tombini (BR)	
Z. Jin (CC)	
	A. Guerra (CE)
L. Levonian (CO)	
R. Kaya (EC)	
	A. Castets (FF)
S. Meyer (GR)	
	M. Siriwardana (IN)
D. Fanizza (IT)	
M. Kaizuka (JA)	
	M. Daïri (MD)
	W. Abdelati (MI), Temporary
	V. Rashkovan (NE)
T. Ostros (NO)	
	L. Palei (RU)
M. Mouminah (SA)	
A. Mahasandana (ST)	
	P. Trabinski (SZ)
	D. Ronicle (UK)
	P. Pollard (US), Temporary

C. McDonald, Acting Secretary
O. Vongthieres, Summing Up Officer
A. Bala, Board Operations Officer
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
Communications Department: R. Elnagar. Legal Department: J. Swanepoel. Monetary and Capital Markets Department: A. Alter, F. Boumediene, M. Buessing-Loercks, H. Hoyle, P. Jeasakul, D. Laliotis, G. Shabsigh, P. Windsor. Research Department: M. Andrle. Strategy, Policy, and Review Department: V. Klyuev, V. Kramarenko. Statistics Department: J. Rodriguez Delgado, J. Rosales, P. Stokoe, Z. Zhan. Western Hemisphere Department:

J. Alvarez Garcia Tunon, I. Krznar, C. Lim, T. Matheson, K. Srinivasan. Executive Director: L. Villar (CE). Alternate Executive Director: R. Alkhareif (SA), P. Fachada (BR), C. Just (EC), A. McKiernan (CO). Senior Advisors to Executive Directors: G. Heim (SZ), Z.Mahyuddin (ST), R. Morales (AG), T. Nguema-Affane (AF), O. Odonye (AE), G. Vasishtha (CO), J.Weil (CO), C. Williams (CO). Advisors to Executive Directors: A. Abdullahi (AE), O. Bayar (EC), A. Grohovsky (US), G. Kim (AP), P. Mooney (CO), M. Mulas (CE), G. Nadali (MD), A. Nainda (AE), N. Vaikla (NO), Y. Zhao (CC), K. Hennings (BR).

2. CANADA—2019 ARTICLE IV CONSULTATION

Ms. Levonian, Ms. Vasishtha and Mr. Weil submitted the following statement:

On behalf of our Canadian authorities, we thank staff for their Article IV and Financial System Stability Assessment (FSSA) reports, and for the rich policy and technical discussions that preceded them. The reports' conclusions generally present an accurate picture of Canada's economy and the financial system, recognize that Canada's plan to invest in the middle class is working, and point to a sound and resilient financial system. The authorities support many of the recommendations that have been made.

Economic Outlook

At 1.9 percent, Canada's economic growth in 2018 was second only to the U.S. among G7 countries. Canada's economic performance was bolstered by a strong labor market in which the unemployment rate reached its lowest levels in over forty years, which supported solid wage growth. A gradual rise in interest rates and new macroprudential measures contributed to slower household credit growth and a moderation in household spending growth in 2018. Despite trade tensions and weaker foreign demand, business investment grew outside of the oil and gas industry. An uncertain global economic environment, lower oil prices, and higher interest rates contributed to a slowdown in late 2018 and early 2019. Recent data, however, point to a pickup in economic activity in the second quarter. The oil sector is beginning to recover as production and prices remain above recent lows. Meanwhile, housing market indicators point to a more stable national market, albeit with continued weakness in some regions. Continued strong job growth also suggests that businesses see the weakness in the past two quarters as temporary.

Canada is expected to remain among the leaders in economic growth in the G7 in both 2019 and 2020 as the dampening effects on growth of low oil prices, changes to housing policies, and increases in borrowing rates dissipate. While non-energy exports have grown little over the last two years, going forward, non-commodity exports will be supported by rising foreign demand, expanding production capacity, and new trade agreements. Exports of services are forecast to continue growing at a strong pace, further increasing services' share of non-commodity exports. The overall economic outlook is also supported by well-managed immigration, which in 2018 contributed to strong population growth of 1.4 percent.

The outlook is subject to several downside and upside risks. If trade tensions persist or escalate, exports and business investment could suffer, but trade disputes could also be resolved faster than expected. Financial conditions could tighten suddenly resulting in weaker growth. Still-elevated levels of household debt is a vulnerability that could impact on the financial system and the broader economy in the event of an income or house price shock. Energy producers are exposed to oil price uncertainty. On the upside, U.S. growth could be stronger than expected, which would benefit Canadian investment and exports.

Supportive Monetary Policy

Recent Canadian economic data are in line with the projections in the April 2019 Bank of Canada (BOC) Monetary Policy Report. Inflation has evolved in line with the BOC's projection. Core inflation measures have been stable and close to 2 percent for more than a year, consistent with an economy operating near capacity. The BOC expects CPI inflation to remain around the 2 percent target in the coming months. Meanwhile, medium- and long-term expectations remain well anchored.

Against this backdrop, the BOC left its target for the overnight rate unchanged at 1 ¾ percent in May. The degree of accommodation being provided by the current policy interest rate remains appropriate. In taking future policy decisions, the central bank will continue to evaluate the appropriate degree of accommodation as new data arrive.

Balanced Fiscal Policy

Canada's strong fiscal position has allowed the authorities to make growth-friendly investments to support the middle class in a responsible way that ensures long-term fiscal sustainability.

We agree that the pace of fiscal consolidation is appropriate at the federal level, where the debt-to-GDP ratio is expected to decline to 28.6 percent by 2023-24 down from 30.8 percent in 2018-19, and that the burden of adjustment remains with provincial governments. At around 26.8 percent, Canada continues to enjoy the lowest net debt-to-GDP ratio among G7 countries, a metric that includes all levels of government. With the deficit on a steady downward track and given the authorities' leadership in fiscal transparency and commitment to responsible fiscal management, an explicit federal fiscal rule or debt target may be of limited value and could hamper the authorities' ability to respond to potential shocks.

The authorities would like to express their concern, however, over the Fund's proposed changes to the reporting of Canada's debt statistics in IMF publications. Although these changes are designed to improve comparability across countries, the exclusion of accounts payable/receivable and equities in balance sheet reporting makes public debt statistics more opaque. This is fundamentally inconsistent with the direction of international accounting standards and the Fund's priority to promote transparency and comprehensiveness in public debt reporting.

The authorities have taken steps to ensure that new budgetary measures are more inclusive. The *Canadian Gender Budgeting Act* was passed by Parliament in December 2018 and enshrined a commitment to publish information on impacts of all new budget measures on all types of Canadians.

The authorities agree on the importance of continuing to review key elements of the Canadian tax system to make sure that it remains efficient and competitive. For example, to ensure that Canada maintain a strong competitive position in the manufacturing and processing sector, in 2018 the government introduced new capital expensing rules for manufacturing machinery and equipment. This change provides timely support to help fuel Canadian investments in this important sector of the economy.

Pursuing Free Trade within and beyond Canada's Borders

In a global environment characterized by rising trade tensions, the authorities remain committed to advancing free and fair trade.

Canada, the United States, and Mexico have reached an agreement-in-principle on the Canada-United States-Mexico Agreement (CUSMA). Canada is moving quickly to ratify the new agreement, with draft legislation already tabled in Parliament. When implemented, the CUSMA will help Canadians compete globally and prosper in a healthy, integrated North American economy. The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) entered into force in December 2018 for the first six countries to ratify the agreement, including Canada. Once fully implemented, the CPTPP will be one of the largest free trade agreements in the world bringing together 11 countries representing 13.5 percent of global GDP. Thanks to its trade diversification strategy, Canada is now the only G7 country to have free trade agreements with all other G7 nations.

The constitutional division of powers between the federal, provincial, and territorial governments can result in differing laws and regulations across the country that can lead to barriers to trade, investment, and labor mobility within Canada. The federal, provincial and territorial governments continue to work cooperatively to address these barriers. In 2017, the Canadian Free Trade Agreement (CFTA) came into force. It introduced advancements to enhance the flow of goods, services and investment, and promote labour mobility and regulatory cooperation among governments. In 2018, the federal government committed to work with the provincial and territorial governments to accelerate the removal of barriers in four areas: transportation, food regulations, construction regulations and building codes, and trade in alcohol. This strategy is bearing fruit – for example, the authorities made the National Code for Building, Fire, Plumbing and Energy available for free online in April 2019, and federal, provincial, and territorial governments recently agreed on an action plan to enhance interprovincial trade of alcoholic beverages. The federal, provincial, and territorial governments will continue to prioritize collaborative work to remove barriers to trade between provinces and territories.

Enhancing Canada's Potential

The authorities are creating long-term growth by investing in modern, resilient, and green infrastructure. Over 48,000 projects with a total value of $42.3 billion have been approved under Canada's historic Investing in Canada Plan. The authorities are working to accelerate projects to maintain this momentum while improving financial reporting and project prioritization. The new Canada Infrastructure Bank, which supports the Plan by attracting private-sector investments to new revenue-generating infrastructure projects, has made major investments in the past year.

Several initiatives are being pursued to foster a more productive workforce and a more competitive business environment. These include:

Investing in people through the Canada Training Benefit, a comprehensive collection of supports to help people develop the skills they need to succeed in a changing world by targeting the most pressing barriers to ongoing learning and retraining;

Introducing Regulatory Roadmaps which contain proposals for legislative and regulatory amendments as well as novel regulatory approaches to accommodate emerging technologies, including the use of regulatory sandboxes and pilot projects;

Implementing Canada’s Innovation and Skills Plan. Five industry-led innovation superclusters are now up and running in the areas of digital technologies, food production, advanced manufacturing, artificial intelligence in supply chain management, and ocean industries.

These structural reforms reinforce a Framework on Clean Growth and Climate Change to help meet Canada’s emissions reduction targets, grow the economy, and build resilience to a changing climate. Pricing carbon pollution is central to the Framework. The authorities have ensured that there is a price on carbon pollution across the country, while ensuring that Canadian companies can compete and succeed in a competitive global marketplace.

Sound and Resilient Financial System

Our Canadian authorities welcome the comprehensive FSSA report and the overall positive conclusion about the soundness and resilience of the financial system. The banking sector’s performance has been strong, and the insurance sector remains sound. System-wide liquidity conditions remain stable underpinned by the BOC’s comprehensive framework for liquidity provision and market operations. Our authorities welcome the staff’s view that macroprudential policy has been effective.

The main vulnerabilities in the financial system continue to come from elevated household indebtedness and imbalances in the housing market. However, new measures, such as a stress test on uninsured mortgages, combined with past increases in interest rates and provincial policies, have curbed household borrowing and reduced speculative behavior that has made the financial system more resilient. These measures have also contributed to a more subdued sentiment in the housing market and a softening in house prices, which positively impacts affordability conditions for new home buyers and renters, particularly in Toronto and Vancouver. The quality of new mortgage borrowing has improved and, most notably, the share of new mortgages going to highly indebted households has declined significantly. However, the authorities are staying vigilant as the overall level of household indebtedness continues to be high and housing imbalances in key markets remain.

To help address these imbalances, the authorities have introduced several supply-side housing measures to help improve housing affordability. One key initiative was investing an additional $10 billion in 2019 in the Rental Construction Financing Initiative, which provides low-cost loans for the construction of new rental housing for modest and middle-income

Canadians. The authorities also introduced the First-Time Home Buyer Incentive, a shared equity mortgage that allows eligible first-time home buyers to lower their borrowing costs by sharing the cost of buying a home with the Canada Mortgage Housing Corporation. With a more generous shared equity mortgage for new construction, the Incentive could help encourage the home construction needed to address some of the housing supply shortages, particularly in the largest cities.

With regard to stress tests, the BOC and the Office of the Superintendent of Financial Institutions have jointly conducted biennial macro stress testing exercises for banks and mortgage insurers, in line with the 2014 FSAP recommendations. In May, the BOC published the results of its top-down stress tests for the domestic systemically important financial institutions (D-SIFIs). The scenario underpinning this exercise, which was developed in collaboration with the FSAP's stress test scenario, is a combination of a severe nationwide recession, significant financial stress, and a sharp house price correction in overheated markets. The severity of this scenario is calibrated based on international experience with financial crises and is much worse than any economic shock in Canada in recent decades.

The BOC's results, which are consistent with the FSAP's findings, show that although D-SIFIs would suffer losses in this adverse scenario, they would remain resilient. This scenario, however, would not be severe enough to bring capital below the regulatory minimum or to trigger substantial fire sales, funding liquidity stress or interbank contagion effects. The capital buffers required by Canadian regulators provide the loss-absorbing capacity that allows these institutions to weather such a 'perfect storm' scenario. The support of the Canadian mortgage insurance system also limits the impact on banks by protecting them against losses on some of their riskiest mortgages.

The authorities have made overall good progress on implementing the 2014 FSAP recommendations. For example, measures were introduced that have successfully reduced the government's exposure to mortgage insurance. Various initiatives have also been undertaken to enhance the collection efforts and close data gaps, especially related to housing market and mortgage data. While the 2019 report makes recommendations for further improvements to contingency planning and coordination between federal and provincial authorities, it notes the progress made in these areas since the last FSAP.

Canada's existing regulatory and supervisory framework demonstrates strong compliance with international standards and current systemic risk oversight institutional arrangements have worked well. Overall, financial sector oversight remains of high quality, however the authorities continue to assess outcomes and make improvements.

The objectives of staff's recommendation in continuing to improve coordination of systemic risk oversight is welcome. The proposed federal Capital Markets Stability Act (CMSA) would strengthen Canada's capacity to identify and manage systemic risk in Canada's capital markets, with powers that would complement and strengthen the federal financial stability oversight framework. The CMSA would include national data collection powers to monitor activities in Canada's capital markets and support the identification and assessment of systemic risk, and regulatory powers to take decisive action across Canada to address threats to financial stability.

The authorities voluntarily participate in the IMF's Enhanced Governance Framework on the supply and facilitation of corruption and welcome the inclusion of the supply side of corruption in this year's Article IV consultations. Canada has a strong track record of fighting corruption and has taken significant steps to deter Canadian companies and persons from paying bribes to foreign public officials in the course of business. The House of Commons Standing Committee on Finance conducted a comprehensive review of Canada's AML/CFT regime in 2018 to further strengthen the regime. The government's response to this review includes plans to address recommendations from the 2016 Mutual Evaluation report by the Financial Action Task Force.

Conclusion

Amidst heightened global economic uncertainty, Canada has leveraged a sound financial system and strong institutions to employ a balanced policy mix that has driven continued solid economic performance. The authorities remain committed to free and fair trade and international cooperation and will continue pursuing a trade diversification strategy. Canada is moving forward with a plan to make growth-friendly investments in a fiscally responsible way that preserves Canada's low-debt advantage. The authorities will continue to take an inclusive approach, recognizing that the country is enriched when everyone can contribute their perspective, skills, and insights. Canada will also continue to make investments that build resilience to a changing climate.

Mr. Fanizza and Ms. Collura submitted the following statement:

We thank staff for their rich set of papers and Ms. Levonian, Ms. Vasishtha, and Mr. Weil for their helpful buff statement. We broadly agree with the staff's appraisal and offer the following comments:

Fiscal policy. The authorities have kept a prudent fiscal policy that succeeded in both supporting productivity and addressing social needs, in a favorable-growth context. Going forward, we agree with staff that the fiscal stance should stay neutral at the federal government level, but that the provinces with higher debt start to consolidate their fiscal position gradually.

We do not share the staff's views on the opportunity of introducing fiscal rules, which should be coordinated between the federal government and the provinces. The value added by a engineered set of rules is not at all evident, considering both how well fiscal policy has been managed so far and the medium-term fiscal outlook. We believe that with a triple-A sovereign rating and declining general government debt – projected to reach 75 percent of GDP in gross terms, and 23 percent in net terms by 2024 – it is hard to imagine that rules could help the authorities to send more favorable signals to financial markets. We also wonder if had fiscal rules been in place, they would have had a material impact on the current fiscal position. Therefore, we concur with the authorities that their commitment to fiscal discipline and transparency is already conveyed well, and that fiscal rules could introduce unnecessary rigidity to policy making. Finally, we would appreciate if staff could elaborate on these two issues:

Considering the Canadian constitutional setting, would it be at all feasible that all the provinces (while some of them have already adopted fiscal rules, as described in §31) accept introducing fiscal rules that are mutually compatible and consistent with one at the federal level?

In the event provinces violate their fiscal rules, there could be a need for the federal government to offset the impact on the general government debt. How could the fiscal rule at the federal level be devised to allow for the needed flexibility, without making it too complicated?

Monetary policy. Staff advise the authorities to gradually raise the Bank of Canada's policy rate towards its neutral nominal level. However, staff rightly point out to the particularly high uncertainty on the estimates of the long-run neutral nominal policy rate. Could staff explain why they believe these very estimates of the neutral rate of interest could be used as a policy guidance despite their limited level of confidence?

Financial stability. We welcome the findings of the 2019 Financial Sector Assessment Program that has assessed – among others – the proper functioning of the systemic risk oversight arrangements, while identifying areas for improvement. As household indebtedness and housing market imbalances remain substantial, we share the staff's view that the current tightened macro prudential stance – effective in mitigating these vulnerabilities – remains appropriate. Indeed, in case downside risks materialize, a severe recession would hit household and mortgage insurers. In this respect, we are somewhat surprised by the severity of the adverse scenario assumed by the stress test – which envisages a deterioration of the economic conditions substantially worse than the one experienced during the Global Financial Crisis. That might cast doubts about its realism. Staff's comments would be welcome. However, we are pleased to learn that even under this extreme scenario the system, but mortgage insurers, would prove resilient thanks to existing substantial buffers.

Structural measures. We congratulate staff for their insightful analysis on the internal trade barriers and the positive effect of liberalization, including the identification of the most suitable policy approach to achieve internal trade liberalization. In accordance with the buff statement, the authorities are moving into this direction and we are confident that they can achieve substantial progress. Finally, we take positive note of the assessment of Canada's actions in tackling the supply and facilitation of corruption, and encourage the authorities to continue making progress, including with respect to entity transparency, legal professions and the real estate sector.

Mr. Tombini, Mr. Fachada and Ms. Hennings submitted the following statement:

We thank staff for the reports and Ms. Levonian, Ms. Vasishtha, and Mr. Weil for their helpful statement. The Canadian economy continues to perform well, combining moderate economic growth with low inflation and robust public finances. We welcome that growth has slowed slightly to a more sustainable level, while job creation remains strong. In parallel, monetary and macroprudential policies have helped contain house price pressures and financial stability risks. Nonetheless, Canada continues to face important vulnerabilities in the housing sector, as well as structural challenges to increase labor productivity, enhance resilience against external shocks, and further strengthen financial stability.

The fiscal stance remains broadly neutral, consistent with the cyclical position of the economy. The favorable economic momentum in recent years has contributed to boost federal tax revenues, enabling some increase in spending to support business investment and in areas such as infrastructure and innovation, training, education, gender equality, and housing affordability. Although we understand that this increase in federal expenditure has been fully financed by windfall tax revenues, could staff comment whether it represents permanent or temporary spending, given the possibly transitory nature of the revenue gains? We take note that progress on fiscal consolidation at the sub-national level has been less stellar, and agree with staff that the burden of additional fiscal adjustment, if needed, should rely mostly on provincial governments.

Gross public debt ratio remains sustainable, while substantial assets bring the net debt ratio to among the lowest in advanced economies. Excluding accounts payable— which many economies do not report— Canada's general government debt ratio compares relatively well with other large advanced economies. We reiterate our concerns expressed last year that the Public Debt Sustainability Analysis and especially the Heat Map could better capture the peculiarities of Canada's public debt accounting, using internationally comparable measures. Although we see value in staff's advice to improve the fiscal policy framework by adopting a fiscal rule, we concur with the authorities that Canada's low debt, commitment to regular and transparent fiscal reporting, as well as long-standing fiscal credibility attenuates the need for a more explicit fiscal rule or debt target.

Monetary policy has been broadly appropriate. Inflation remains in line with the target and inflation expectations are well-anchored. The skilled conduct of monetary policy by the Bank of Canada (BOC) and the quality of its forecasting models are widely recognized. We welcome the monetary authorities' commitment to evaluate their future policy decisions guided by incoming data. We take note that staff's baseline scenario projects a gradual increase of the policy rate after 2019 towards the estimated neutral nominal rate (around 3 percent), compared to the current 1.75 percent rate. We wonder if this expected trend incorporates the more recent signaling by the US Federal Reserve on its policy stance. Staff's comments would be welcome.

The housing sector remains a source of vulnerability, with potential spillovers to the financial system. Macroprudential instruments, monetary policy normalization and measures taken by sub-national governments have successfully reduced housing market pressures since 2018. We welcome that the federal and local authorities are working on measures to stimulate housing supply, while promoting housing affordability, especially for first-time home-buyers. However, risks of a sharp house price correction have not been eliminated. Given the highly interconnected financial system, an abrupt and acute house price correction could affect financial stability. In this context, we encourage the national and sub-national authorities to persevere with their efforts to reduce housing market pressures, including through prudential tools and policy coordination.

The Canadian financial sector has grown remarkably since the 2014 FSSA, and expanded its international interconnectedness. The banking sector is highly concentrated and staff's stress tests show adequate resilience, in line with BOC results. Potential vulnerabilities reside mainly in smaller, non-prime lending segments, house sector exposure and increasing cross-border exposure. In this regard, we encourage the authorities to careful consider staff's recommendations to improve the financial stability architecture.

Canada is an open economy and the performance of its export sector has non-negligible effects on economic activity. We commend the leading role of Canada in efforts to improve the multilateral trade system. Even if it is still difficult to assess the possible outcomes of recent multilateral initiatives, the signing of the United States-Mexico-Canada Agreement (USCMA) and the ratification of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) are welcome developments. In parallel, continuing with the liberalization of inter-provincial trade will contribute to boost productivity growth, foster private investment, and balance income levels across provinces.

Ms. Riach, Mr. Rashkovan, Mr. Etkes and Mr. Hemingway submitted the following statement:

We thank staff for a rich set of papers and Ms. Levonian, Ms. Vasishtha and Mr. Weil for their informative buff.

We note the headline finding that growth has moderated to trend, in our view justifying the focus in the report on risks and raising potential. Recognising the output gap is close to zero, we share staff's view that further unexpected fiscal savings would be most appropriately used to reduce deficits and build buffers, particularly at provincial level where additional policy action could also be justified given persistent deficits and future pressures (e.g. from an ageing population). We also agree that fiscal transparency and accountability are crucial to fiscal sustainability in the long run.

We welcome the application of the growth-at-risk approach in the staff report, seeing this as a very useful tool to communicate the risks around the central forecast. The rapid increase of housing prices in Canada is the key risk for both the real economy, including labor markets, and for financial stability. We agree with staff that a combination of macro-prudential measures and increasing the supply of housing is the adequate policy mix. In this context we note that while overall Canada has a high ranking in the Doing Business index, it has relatively low rankings regarding construction permits and electricity supply, which may adversely reflect obstacles to increase the supply of housing.

We also welcome the introduction of the "attainable price" as a statistic, which captures a household's ability to buy a housing unit, as an improvement over estimates based on regressions and long run averages. However, this statistic disregards investors in the housing market, whose adequate price is captured by the NPV of housing rents. Staff kindly shared with us preliminary estimates of the NPV-base prices, which better explain much of the divergence between the attainable and observed prices in apparent over valued metro-areas (Toronto, Vancouver and Hamilton). We believe that policy advice in Article IV and SIP should address both types of housing buyers as they are affected differently by various policy tools. In addition, the choice of the most suitable statistic or set of statistics for adequate house prices should also include statistical comparisons of the difference between various measures and the observed price. Staff comments are welcome.

With the economy close to potential, we welcome consideration of steps to increase productivity, particularly further trade liberalisation. We commend the Canadian authorities for their commitment to free trade, including through new trade agreements (the USMCA and CPTPP) and their efforts in multilateral forums. Staff analysis on the scope for productivity gains from liberalizing internal trade barriers is very striking, and we also welcome efforts to achieve this through the Canadian Free Trade Agreement. This analysis further highlighted the role non-tariff barriers (NTBs) play in restricting trade, while we also note the impact of liberalisation would be largest in service sectors. We encourage staff to reflect on the lessons from Canadian efforts in reducing these barriers for other contexts.

The FSSA provides a valuable assessment of the vulnerabilities and risks in the Canadian financial sector, as well as its architecture, oversight and safety net. We welcome the finding that the Canadian financial system could manage a severe adverse scenario. However, we also note the financial stability assessment is primarily focused on the Canadian financial system, similar to the Bank of Canada's assessment. As staff note, Canada's financial system is highly interconnected, so – consistent with the IEO findings on financial surveillance – we wonder whether the value added of the Fund's stress tests would have been greater had there been more focus on cross-border spillovers, noting that the interconnected analysis only includes bond and equity markets in the 29 systemically important financial centres. For example, we note the important role Canadian banks play in some markets outside of this group, something we understand is not covered by staff analysis. Staff comments would be appreciated.

The FSSA also highlights the coordination challenges created by a fragmented architecture, reflecting the role of federal and provincial supervisors, and we note staff recommendation for a more formalised arrangement for systemic risk oversight, including their preference for a single body. We endorse the central recommendation to strengthen the system, though consider there to be several ways to achieve this.

Finally, we welcome the voluntary evaluation of the supply and facilitation of corruption by the Canadian authorities, under the IMF's enhanced governance framework. We concur with staff advice on mitigating risks related to foreign tax crimes and the real estate sector. We encourage staff to develop quantitate tools to evaluate the effectiveness of the measures to combat supply and facilitation of corruption.

Mr. Geadah and Ms. Abdelati submitted the following statement:

We thank staff for a comprehensive set of papers and Ms. Levonian, Ms. Vasishtha, and Mr. Weil for their informative buff Statement. We commend the Canadian authorities for continuing to adapt policies to support inclusive growth and reduce financial system vulnerabilities. The authorities have used available fiscal space and kept monetary policy accommodative, gradually increasing policy rates in the last two years. Macroprudential policies were adjusted more than once to address housing sector vulnerabilities. Infrastructure investments and structural reforms have aimed at raising productivity and potential growth. We concur with staff advice that Canada should continue to focus on supporting long-term growth and on preserving financial stability.

We note the uncertainty surrounding the output gap in general, which somewhat complicates policy decision making, so it is important to carefully assess new data. It is not clear from Figure 6 if most sectors were operating at full capacity, as staff suggests. Nevertheless, unemployment is at one of the lowest levels in 40 years and the overall outlook continues to be positive, with Canada expected to be one of the strongest G7 performers in 2019 and 2020.

Overall gross public debt, though still high, is on a declining path and is expected to decline further over the medium-term. However, greater consolidation efforts are needed at the provincial level, with more attention on contingent liabilities. Staff points to the lack of traction on their advice to develop an explicit fiscal rule or debt target, but Ms. Levonian reminds us of its limited use given the authorities' leadership in fiscal transparency and commitment to fiscal management, and the fact that Canada has the lowest net debt-to-GDP among G7 countries. We see merit in this view.

Investing in Canada Plan holds great promise for long-term growth, by investing in modern, resilient, and green infrastructure. Similarly, we commend the plans to invest in people, introduce novel regulatory approaches to accommodate emerging technologies, and promote innovation. However, we find surprising the weakening of business climate indicators for Canada and seek more staff elaboration. Figure 9 shows that business investment and productivity growth have been sluggish, with productivity growth lagging that of the US since 2002. Is this mainly due to low business investment? Business investment has severely lagged G7 countries since 2014. Canada slipped by 4 places in the Doing Business Rankings, and within that, the lowest sub-rankings were recorded for "trading across borders, dealing with construction permits, enforcing contracts, and getting electricity." Staff has discussed the challenges associated with interprovincial trade and the constraints underlying housing supply shortages. Similarly, we are surprised that with respect to the Global Competitiveness Index, the lowest scores were for "Infrastructure and ACT adoption." Could staff comment on the shortcomings with respect to the latter, as well as reinforcing contracts and getting electricity. These topics may deserve attention in the next Article IV report.

The 2019 FSAP provides an overall positive conclusion on the implementation of the 2014 FSAP recommendations and reaffirms the soundness of the system. Nevertheless, it finds imbalances in the housing market a key macrofinancial vulnerability, since various parts of the financial system are exposed to the housing market and vulnerable to shocks to mortgage credit. We take positive note of the various initiatives to address housing supply shortages. However, housing imbalances in key metropolitan areas remain significant. We also welcome the rounds of macroprudential measures that have helped reduce mortgage finance and household indebtedness, but household indebtedness still ranks high by global standards. We, therefore, welcome the authorities' continued focus on addressing housing affordability and housing market imbalances. What is the authorities' view of the staff's recommendation to complement macroprudential oversight with stronger mircroprudential supervision and safety nets?

We commend the Canadian authorities for their leadership role in reaffirming the importance of a multilateral trading system, as well as organizing efforts on the WTO. We also welcome their initiatives to combat the supply side of corruption. With regards to interprovincial trade, we join staff in calling for more concerted efforts to address any investment bottlenecks and see merit in a strategic plan that prioritizes projects, as well as better federal and provincial collaboration.

Mr. Di Tata and Mr. Morales submitted the following statement:

We thank staff for the comprehensive set of papers, including the Financial System Stability Assessment (FSSA) report, and Ms. Levonian, Ms. Vasishtha, and Mr. Weil for their insightful buff statement.

The Canadian authorities should be commended for the sound mix of policies they have maintained over the last five years, which aimed at supporting inclusive growth and strengthening the financial system. Following strong economic growth in 2017, the government pressed ahead with several important reforms in 2018, including signing the Canada-United States-Mexico Agreement (CUSMA), opening the Canada Infrastructure Bank, and expanding tax allowances for business investment to preserve Canada's tax competitiveness.

Real GDP growth slowed to 1.8 percent in 2018 because of a deceleration in consumption and a decline in business investment in the oil and gas industry. However, as noted in the buff statement, this growth was second only to the United States among G-7 countries and was accompanied by the lowest unemployment rate in forty years. Core inflation hovered around 2 percent in 2018 and the current account deficit declined slightly. Based on the staff's projections, growth would converge to a potential rate of 1.7 percent over the medium term, like that envisaged for the United States. Could staff comment on the main assumptions regarding structural reforms behind the staff's medium- term growth projections, as well as on the authorities' views about medium-term growth? The main domestic downside risk to the economic outlook is a sharp correction in the housing market, while external risks include a larger-than-expected slowdown in global growth, a sharp decline in oil prices, an escalation of trade tensions, and a sudden tightening of global financial conditions.

We welcome the focus of the consultation discussions on policies to secure sustainable growth and a resilient financial system. As a general point, we would have liked a more detailed discussion on inward spillovers, particularly from possible adjustments in macroeconomic policies in the United States. One key issue that permeates the Article IV report is the need to strengthen coordination between the federal and provincial authorities in several areas, particularly with regards to internal trade barriers, the supervision of financial institutions, and fiscal policies.

We concur with staff that fiscal policy should continue to focus on rebuilding buffers and improving productivity. Given slowing growth, fiscal consolidation should be gradual at the federal and provincial levels, with any unexpected fiscal savings targeted to reduce the debt. We support the focus of the 2019 budget on initiatives supporting the middle class, including those related to education, gender equality, infrastructure, and housing affordability. We also welcome the planned adjustment of the federal government deficit following its slight expansion in 2019, as well as the authorities' intention to continue reviewing the tax system to reduce distortions. At the same time, we share the view that the burden of adjustment remains with those provinces with high deficits or debt and support the staff's recommendation to incorporate fiscal rules both at the federal and provincial levels. In this connection, we notice that some provinces (British Columbia and Quebec) already have fiscal rules that appear to be working well. Could staff elaborate further on the differences of views with the authorities, who see limited value in introducing fiscal rules? Also, what are the mechanisms (formal or informal) in place to coordinate fiscal policy between the federal and provincial governments?

We concur with the authorities and staff that the degree of accommodation provided by the current monetary policy stance remains appropriate. As the output gap closes, monetary tightening should proceed in a gradual manner, given prevailing uncertainties about the level of the output gap and the neutral policy rate. Could staff comment on the implications for Canada's monetary policy of changes in the U.S. Fed's interest rate policy?

We welcome the comprehensive FSSA report and its overall conclusion that the financial system remains sound and resilient. As noted in the buff statement, the banking sector's performance has been strong and system-wide liquidity conditions are underpinned by the BOC's framework for liquidity provision. We concur with staff that there is room to lift risk weights for mortgage exposures and further improve the framework for emergency liquidity assistance by unifying support to securities markets and broadening coordination with key provinces.

At the same time, we fully agree with staff on the need to resist pressures to ease macroprudential policy or introduce additional initiatives to support housing activity. Several rounds of macroprudential measures, tighter monetary policy, and provincial tax policies have contributed to a reduction in housing-related financial risks. However, housing market imbalances remain a key vulnerability, with staff estimating that house prices in Toronto, Hamilton, and Vancouver remain overvalued by around 50 percent.

FSAP stress tests consisting of a combination of severe shocks, including a sharp housing market correction, show that the financial system is in general resilient to downside risks, although there are some weaknesses. Staff indicates that domestic systemically important financial institutions would remain resilient and the corporate sector would be able to withstand large profitability and funding cost shocks, but that the impact on households could be significant and mortgage insurers would need a capital injection. Other emerging vulnerabilities stem from a rising risk appetite among non-banks; banks' increased reliance on external funding; non-prime mortgage lending; and the use of repos and derivatives. Although existing safety nets mitigate these vulnerabilities, could staff comment on whether there is scope for introducing further changes in macroprudential policies to address these risks? We take positive note of the several supply-side housing measures being introduced by the authorities to help improve housing affordability as well as of the progress made in implementing the 2014 FSAP recommendations.

On a more general point, although financial sector oversight remains of high quality, we fully agree with staff that developing a comprehensive framework for systemic risk surveillance and macroprudential policy implementation is essential, as the responsibilities for systemic risk oversight are currently spread over multiple levels of governments. In particular, it would be important to tackle significant data gaps and unregulated nonbank financial supervision, enhance transparency around policy decisions, and improve policy coordination between federal and provincial authorities. In this regard, we notice from the buff statement that the proposed federal Capital Markets Stability Act seeks to strengthen the federal financial stability oversight framework. At the same time, as noted by staff, the Heads of Agencies (HOA) Committee could play a valuable role in improving coordination and formulating policies in a more formalized setting. We also concur with staff on the importance of complementing effective macroprudential oversight with stronger micro prudential supervision and safety nets.

Canada continues to play a prominent role at the global level by supporting free and fair trade and has recently been involved in several trade initiatives. Following the signing of CUSMA, draft legislation has been tabled to Parliament for its ratification. At the same time, the new CPTPP, which is expected to cover 11 countries, would encourage Canada's exports and diversification, and the country is playing a leading role in organizing efforts to improve the WTO. Could staff comment on the timeline for legislative approval of CUSMA?

We encourage the authorities to intensify their efforts to reduce domestic barriers to inter-provincial trade. We take note that lowering these barriers could generate a much larger gain than expected from the international trade agreements. In this regard, we are pleased to learn from the buff statement that the Canadian Free Trade Agreement that came into force in 2017 introduced several changes to enhance the free flow of goods and labor, as well as regulatory cooperation among governments. We encourage the authorities to accelerate cooperative work in this area and address several outstanding problems identified in the report, including by considering the valuable suggestions included in paragraph 45.

We take positive note of ongoing growth-supporting structural reforms, such as the efforts to encourage infrastructure investment and foster a more productive work force by implementing the Innovation and Skills Plan and the Canada Training Benefit. At the same time, we encourage the authorities to address pending restrictive regulations that affect product markets and FDI, improve project selection and execution at the provincial and municipal levels, and develop a more detailed strategic plan to prioritize infrastructure projects. We commend the authorities for Canada's voluntary participation in the IMF's Enhanced Governance Framework and encourage them to continue enforcing actions to deter foreign bribery and further enhance the effectiveness of the AML/CFT framework. In addition, we welcome Canada's efforts to meet the emissions reduction targets, including by ensuring that there is a price on carbon pollution across the country.

With these comments, we wish the Canadian authorities every success in their future endeavors.

Mr. Gokarn and Ms. Dhillon submitted the following statement:

We thank staff for the well written set of reports and Ms. Levonian, Ms. Vasishtha, and Mr. Weil for their informative buff statement.

Growth has slowed to a more sustainable levels, marked with a strong labor market and 40-year low unemployment levels. Canada is expected to remain among the leaders in economic growth in the G7 and its performance will continue to be synchronized with the global economy. Still, the country faces risks, internally from the financial sector and housing market corrections, and externally from the trade tensions, and tightening of the global financial conditions. Overall, we agree with the thrust of staff's recommendations, and would like to offer the following points for emphasis.

The authorities have judicially calibrated their fiscal policy to make growth-friendly investments. With growth being at sustainable levels, gradual fiscal consolidation over the medium term will create fiscal space to deliver productivity-enhancing inclusive growth. New initiatives in skilling, education, gender equality, infrastructure and innovation, are commendable. This, along with the efforts to evaluate the effectiveness of the tax system, converges with the broader objective of well-targeted allocation of resources. At the same time, a well-designed fiscal rule to enhance the credibility and transparency of fiscal policy is desirable and we agree with staff that the rule should include both a debt anchor and operational rules for budget decisions. In the buff the authorities have expressed their concern related to the Fund's proposed changes to the reporting of Canada's debt statistics in IMF publications. We invite staff comments on this.

The accommodative monetary policy stance appears appropriate. We align ourselves with staff in recommending a maintenance of the stance, bearing in mind the below-target core inflation and the negative and widening output gap. We would like to hear some perspectives on the consequential impact on imports and inflation, stemming from the uncertainty over U.S. trade policies. We invite staff comments.

The financial sector, overall, is sound, with solid profitability and sound buffers. We welcome the findings of the 2019 FSAP and commend the authorities for the robust regulatory and supervisory framework and the oversight arrangements. In response to macro-prudential measures, the housing sector has shown a slowdown in house prices, better affordability and mortgage quality. Going forward, like staff, we would urge the authorities to maintain the effectiveness of the policies. Further, to manage financial stability risk from household indebtedness and to improve affordability, we do see value in a housing supply strategy. In the previous Article IV report, staff had assessed the non-resident property tax measures as Capital flow measures. Could staff offer deeper insights on the impact of those measures? Canada has made good progress on the 2014 FSAP recommendation and should steadfastly maintain their commitment to 2019 FSAP recommendations too. In this context, we support further synchronization of provincial regulatory frameworks and modernizing the Financial Stability Architecture, especially on the data gaps and AML/CFT framework.

Finally, we agree with the authorities' focus on pursuing free trade within and beyond Canada's borders, and more reforms to improve competitiveness, innovation and productivity. On trade, the initiatives to affirm the importance of a multilateral trading system are reassuring. The selected issues paper offers a convincing analysis for breaking the barriers for interprovincial trade, with estimates suggesting increase of a GDP per capita by about 4 percent. Given that this has been a longstanding issue with complex dimensions, what is staff's assessment of the political traction for and related timelines involved to achieve a common minimum platform for internal trade? Also, the authorities had undertaken remarkable and pioneering measures to encourage female labor force participation, ensure pay equity, and enshrine gender budgeting in the federal-budget making process. We would like to hear more from staff on the progress of these initiatives for increasing female labor force participation. Staff comments are welcome.

Mr. Rosen, Ms. Pollard and Mr. Grohovsky submitted the following statement:

The Canadian economy continues to expand, supported by a strong policy mix over the past several years. Inflation remains low and monetary policy is accommodative, while the financial sector remains sound with sizable buffers and improved bank capitalization. However, risks from the housing market and high household indebtedness persist, along with political pressure to loosen macroprudential measures. Combined with risks from oil price volatility, the authorities will need to remain vigilant to vulnerabilities while continuing to build buffers in advance of the next downturn. We thank staff for a report that focuses on appropriate macro-critical issues and a well-integrated set of Selected Issues Papers.

As the report notes, housing imbalances in major metropolitan areas remain significant, and the housing sector was rightly a main focus of the Article IV. There are a number of direct exposures to housing in the financial system, and we welcome the box on the Housing Finance Ecosystem that maps these exposures. Macroprudential policies have been well-calibrated to reduce risks, although this reduction of risks should not allow for complacency or a weakening of the policies. Macroprudential policies should also continue to be complemented with sound microprudential supervision. While finding that regulation and supervision are generally good, the FSAP helpfully identifies priorities for improving the bail-in process and bank resolution framework; the Bank of Canada's contingency planning for market-wide support and liquidity provision; enhanced powers for the Office of the Superintendent of Financial Institutions; and improved oversight of pension funds and capital markets.

Turning to other policy areas, given the slight slowdown this year we agree with staff's assessment that the pace of fiscal consolidation should be gradual. The roughly balanced federal budget combined with a contained provincial budget deficit means that general government debt levels will continue to decline without much additional consolidation. This places Canada in a unique position of being able to have a growth-supporting fiscal stance while still building fiscal space for the next downturn. However, could staff comment on the difference in views with the authorities on the appropriate reporting of debt statistics, as outlined in the buff by Ms. Levonian, Ms. Vasishtha, and Mr. Weil? We welcome the spending measures that were in the 2019 budget focused on boosting potential growth, including training, education, and infrastructure, as well as the additional detail in the buff statement on the Canada Training Benefit, the Regulatory Roadmaps, and the Innovation and Skills Plan. To support the expansion, the slow pace of monetary tightening and current pause in rate hikes is also appropriate.

Staff note the external position is weaker than implied by medium-term fundamentals and advocate addressing productivity underperformance. We agree that structural reforms are critical to boosting lagging productivity but note that raising productivity will increase the current account norm as well as the actual current account. We also note that for the second year, staff reduced the EBA current account gap because of a steeper-than-usual discount between Canadian oil prices and international prices and a difference between the authorities' demographic projections and the UN projections used in EBA. How long does such a discount need to persist before it is considered the new normal and how long does a difference in demographic projections need to persist before staff either use the Canadian authorities' projections in the EBA model or decide no adjustment is needed? Relatedly, can staff indicate if national demographic projections in other countries differ significantly from the UN projections?

We welcome the focus on eliminating internal trade barriers, which are a long-standing issue but key for removing frictions in the economy. The Selected Issues paper on internal trade helpfully laid out the benefits and prospects of increased internal trade liberalization. We also welcome the integration of other structural reforms with the goal of reducing internal barriers to trade, including transportation infrastructure projects that facilitate trade across provinces.

Mr. Trabinski and Mr. Heim submitted the following statement:

We thank staff for their insightful set of reports and Ms. Levonian, Ms. Vasishtha, and Mr. Weil for their comprehensive buff statement. Canada's economy has performed well over the past few years, supported by a mix of well-targeted policies, e.g. to promote inclusive growth and enhance productivity. This said, growth lost some momentum last year and is projected to remain moderate in 2019, despite the stimulus stemming from a robust US economy. External downside risks for the Canadian economy include a slowdown in global growth associated with an escalation of trade conflicts, geopolitical tensions and a tightening of global financial conditions. Domestically, persistent housing market imbalances, notwithstanding the recent decline in activity in this market, and high household debt constitute vulnerabilities.

Gradual fiscal consolidation should be continued, with an intensification of adjustment efforts at the provincial level. The overall solid macroeconomic conditions provide an opportunity to rebuild fiscal buffers, which would create room to respond in case of a future downturn. We agree with staff that the pace of adjustment at the federal level is appropriate but that provinces, notably those with large deficits or high debt, should strive for a more ambitious pace. To facilitate medium-term consolidation efforts and enhance their credibility, we see merit in staff's suggestion to introduce fiscal rules. Fiscal rules would also be beneficial at a provincial level, which would allow for addressing the specific sources of imbalance.

The current monetary policy stance is appropriate. Following the gradual increases of the policy rate since mid-2017, inflation is expected to remain close to the Bank of Canada's (BOC) target. Given that risks to economic growth and inflation are skewed to the downside and considering staff's estimate of a negative and widening output gap, we agree that the BOC's current accommodative policy stance remains appropriate at this time.

We commend the authorities for their commitment to intensify international and domestic trade relations. The signing of the United States–Mexico–Canada Agreement (USMCA) and the ratification of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) are important steps in this regard and should help to stimulate economic activity. Similarly, we welcome the authorities' efforts to remove domestic trade barriers by implementing the Canadian Free Trade Agreement (CFTA) signed in 2017. We share staff's view that the continuous reduction of trade barriers is key to enhance productivity gains and boost potential growth.

The financial sector is healthy overall, but risks related to the housing market call for vigilance. We welcome that the FSAP stress test results confirm the overall resilience of the Canadian financial system. Risks of a build-up of systemic vulnerabilities in the banking sector have declined as banks' capitalization has improved and profitability remains strong. Nevertheless, we concur with staff that a tight macroprudential policy stance should be kept for the time being. In this respect, we take comfort from the buff statement that new measures have contributed to a more subdued sentiment in the housing market and the easing of house prices. We also concur on the merits of replacing provincial real estate taxes by measures that target speculative activity more generally, provided that feasible alternatives are available. Furthermore, we encourage the authorities to adapt to the increased financial sector complexity and to continue addressing new challenges, including digitalization and fintech.

The country-wide systemic risk oversight seems to work well, but some improvements may be warranted. We agree that steps to improve coordination among the involved agencies, particularly between the federal level and provincial authorities, should be considered. At the same time, we note—as do staff in their reports—that the current systemic risk oversight arrangement has worked well. This begs the question of how strong the need for fundamental reform is. In this context, we also note staff's view in the FSSA that a "single body in charge of systemic risk oversight would be the first-best solution". As there is no further explanation on this in the report, we would welcome staff's comments on how they come to this conclusion. In our view, macroprudential policy frameworks have to account for country-specific institutional setups to be effective, and there is no one-size-fits-all solution.

Mr. Mojarrad and Mr. Nadali submitted the following statement:

A judicious mix of policies has helped Canada enjoy favorable macroeconomic outcomes over the past few years. In 2019, growth has continued, albeit at a more moderate pace; inflation is below the midpoint of the target range with a negative output gap; and unemployment is close to its lowest level in decades. The federal budget is balanced but provincial and local governments finances are less favorable; the current account deficit is broadly unchanged; and gross public debt continues to decline but remains high relative to triple A-rated peers, although net debt is much lower and is also on the decline. The financial system continues to develop while remaining broadly sound and resilient to shocks. While growth is expected to pick up in 2020, downside risks to the outlook are significant, including from persistent housing market imbalances, slower global growth, a tightening of global financial conditions, and escalating global trade tensions. These risks place a premium on enhancing cooperation between federal and provincial authorities to consolidate public finances, strengthening financial sector resilience, and advancing productivity-enhancing structural reforms. We concur with the thrust of staff appraisal.

Gradual and growth-friendly fiscal consolidation should help balance growth and adjustment objectives. While the planned adjustment is appropriate at the federal level, a more ambitious retrenchment is necessary at the provincial and local levels to create space for priority social and investment outlays, rebuild buffers for looming fiscal pressures, and place public debt on a firm downward trajectory. We agree that any fiscal overperformance should primarily target deficit and debt reduction. If downside risks materialize and growth disappoints, however, automatic stabilizers should be allowed to operate fully and, if needed, discretionary measures used, including bringing forward the infrastructure program and cutting PIT. While the authorities see limited value for an explicit federal fiscal rule or debt target, we agree with staff that a debt anchor combined with an enforceable, flexible, and simple expenditure rule could bolster fiscal credibility, provide clear guidance to market participants, and mitigate the risk of fiscal slippage over time. We welcome ongoing efforts to remove tax distortions to ensure that the tax system remains efficient and internationally competitive. Could staff indicate if the authorities are open to removing tax deductibility of interest for debt-financed investments? What has been the authorities' reaction to recommendations to eliminate provincial real estate taxes on nonresidents or harmonizing them into broad-based tax measures targeted at speculative activity? Ms. Levonian, Ms. Vasishtha, and Mr. Weil indicate in their helpful buff statement that the Fund's proposed exclusion of accounts payable/receivable from Canada's debt statistics is inconsistent with the direction of international accounting standards. Did staff consider reporting debt statistics under the two presentations, which would preserve international comparability while maintaining and incentivizing adequate level of transparency?

The below-target inflation, well-anchored inflation expectations, and a negative output gap argue for maintaining the current accommodative monetary stance in the near term. While monetary tightening might be warranted after 2019 as the output gap closes, uncertainty about the level of output gap and the neutral policy rate suggests that the central bank's gradual, cautious, and data-dependent approach to adjusting its policy settings is appropriate. Should the outlook deteriorate, however, we agree that a cut in the policy rate may be warranted.

The large and developed financial system is sound with sizable capital buffers, adequate liquidity, solid profitability, and low NPLs. Stress tests performed under the recent FSAP corroborate the system's resilience to severe adverse shocks. However, elevated household indebtedness and housing market imbalances, banks' increased reliance on short-term, foreign-currency wholesale funding, rising risk appetite among nonbanks, non-prime mortgage lending, and growing cross-border financial interconnectedness pose financial stability risks and warrant close vigilance. Could staff explain why FSAP stress tests did not cover repos and derivatives whose use has increased cross-sectoral linkages and counterparty risk? The authorities are encouraged to expand housing supply to improve affordability, enhance systemic risk oversight and crisis preparedness, and complement macroprudential oversight with stronger microprudential supervision and safety nets.

Lifting growth potential hinges on structural reforms aimed at boosting productivity. Canada's commendable leadership in international efforts to improve the multilateral trade system should go hand in hand with reducing domestic barriers to inter-provincial trade. Work should continue to fully operationalize the infrastructure bank and better prioritize infrastructure investment, including transportation projects, upgrade human capital, and address restrictive regulations in product markets and FDI to promote a more competitive business environment. We welcome Canada's voluntary participation in the IMF's enhanced governance framework on the supply and facilitation of corruption and encourage further efforts to strengthen the effectiveness of AML/CFT framework.

We wish the authorities continued success in their endeavors.

Mr. Meyer and Ms. Kuhles submitted the following statement:

We thank staff for a well-written report and Ms. Levonian, Ms. Vasishtha and Mr. Weil for their informative buff statement. We concur with the thrust of staff's assessment and policy recommendations. Canada's authorities are to be commended for a prudent macroeconomic policy mix, which has supported inclusive growth and helped to reduce vulnerabilities in the financial system. While recent growth performance has been solid, risks to the outlook remain somewhat tilted to the downside. Against this backdrop, rebuilding policy buffers, unwinding still high household leverage as well as advancing structural policies to address lagging productivity remain the key challenges ahead. Not least in light of ongoing uncertainty, we welcome the Canadian authorities' steadfast commitment to multilateralism, especially its leadership in efforts to reaffirm the importance of a multilateral trading system.

On fiscal policy, we concur with staff that benign macroeconomic conditions should be used to rebuild buffers while supporting productivity-enhancing and inclusive growth. Many of the federal government's new spending initiatives such as initiatives to support training and education, gender equality, or infrastructure appear to be well suited to support business investment and the middle class. At the same time, a faster reduction of high debt levels would create more leeway to let automatic stabilizers operate freely in case of a downturn and also provide more options to respond to prospective spending pressures from population ageing compounding the increase in health care spending. In this context, staff rightly accentuates that the burden of adjustment remains first and foremost with provincial governments, in particular those running large deficits or with high debt levels.

It is encouraging to learn that macroprudential policy has been effective in reducing housing imbalances and containing financial stability risks. Canadian house prices appear to have stabilized and the share of highly indebted households has declined. At the same time, household indebtedness remains high by global standards and house price valuation still seems to be stretched in some major cities. Against this background, we take note of staff's concern that some recently introduced policy initiatives might dilute the effectiveness of the macroprudential measures. We therefore encourage the authorities to carefully monitor possible effects of the First-Time Home Buyer Incentive on aggregate house prices. Moreover, staff and the authorities rightly underline the importance of supply-side policies – including initiatives to raise the amount of land available for construction – in order to alleviate housing supply constraints and hence lower elevated house prices. More generally, we take positive note of the financial and macrofinancial analysis in the report, in particular the closer integration with the recent FSAP.

According to staff's analysis, significant benefits – including productivity gains – could be reaped by reducing domestic barriers to inter-provincial trade. We therefore support staff's call on federal, provincial and territorial governments to further direct their efforts towards reducing such barriers in a concerted manner. In this context, we welcome staff's attempt to quantify potential gains resulting from a reduction in measured internal trade costs. At the same time, we would be more cautious in drawing specific policy recommendations on prioritizing the liberalization of certain individual sectors from the model simulation. This holds especially true as standard models used to analyze the impact of trade reforms not only tend to under-predict changes in trade patterns but also frequently fail to predict which industries experience the largest trade increases. On a related point, we would appreciate staff's elaboration as to what extent its findings are consistent with the existing literature which documents that products that were not traded or were traded very little before liberalization ("least traded products") grow faster than the relatively heavily traded products following trade liberalization.

Regarding staff's finding of a sizable productivity gap relative to the U.S., could staff provide additional comments on the evolution of GDP per capita in Canada relative to other major advanced economies?

As highlighted in the 2019 FSAP, Canada's AML/CFT framework achieves satisfactory results in several areas, such as supervision, but requires improvements in others, notably with respect to the real estate sector. We therefore encourage the authorities to continue their efforts in further enhancing the effectiveness of AML/CFT frameworks also with a view to tackling the proceeds of crime, including foreign corruption and drug smuggling.

Mr. Ostros and Mr. Vaikla submitted the following statement:

We thank staff for the comprehensive set of papers and Ms. Levonian, Ms. Vasishtha, and Mr. Weil for their insightful buff statement. Canada´s strong economic growth is expected to decelerate this year, while more positive backwinds will accelerate growth momentum in 2020. Given the external and domestic risks to the near-term outlook, an appropriate policy mix is to implement gradual fiscal consolidation, rebuild policy buffers, and address imbalances in the housing market. We broadly agree with staff's appraisal and offer the following comments for emphasis.

Gradual fiscal consolidation and the build-up of buffers enables the mitigation of downside risks. We welcome that the authorities make growth-friendly investments to support the middle class in a responsible way that ensures long-term fiscal sustainability. Due to the overall negative risks balance, especially related to uncertain trade developments, we agree with staff that Canada should use the current favorable environment to rebuild policy buffers. Going forward, it is important to implement gradual fiscal consolidation and use windfall revenue gains to lower the deficit and debt level. We note that there are divergent views between staff's and the authorities' views on the need for fiscal rules. We find merit in the establishment of fiscal rules, but they must consider Canada-specific factors and need to strike the right balance between effectiveness, flexibility, and simplicity. Given that fiscal rules vary across different provinces, and there are significant differences between the federal and provincial fiscal stance, we agree with staff that there is the need to address the specific sources of fiscal imbalances.

Macrofinancial vulnerabilities have somewhat eased, while the housing market imbalances remain as the main risk to financial stability. We appreciate new measures that have decreased household borrowing and reduced speculative behavior, as well as measures to help improve housing affordability. We take positive note from staff´s assessment that the Canadian financial system would be able to manage severe macrofinancial shocks. However, as pointed out by the FSSA, the main vulnerabilities to the financial system continue to come from elevated household indebtedness and imbalances in the housing market as various parts of the financial system are directly exposed to the housing market. Furthermore, the downside risk to house prices in the medium term are sizeable given the existing overvaluation. While the authorities overall macroprudential policy stance is appropriate, vulnerabilities related to the housing market call for additional required capital for mortgage exposures and measures to increase risk-based differentiation in mortgage pricing and strengthening the capacity to conduct Canada-wide surveillance. We also note that significant data gaps exist related to cross-sectoral exposures and unregulated nonbank financial intermediation, which require further attention.

We highly appreciate the authorities volunteering to be assessed under the IMF´s Enhanced Governance Framework on the supply and facilitation of corruption. We take positive note that Canada has an adequate framework for ML/TF financing, while efforts are being taken to further strengthen the AML/CFT regulation. We concur with staff that additional intensive supervision would help mitigate risks related to foreign tax crimes, corruption, the real estate sector, and third-party money launderers.

Ms. Mahasandana and Mr. Mahyuddin submitted the following statement:

We thank staff for the comprehensive set of papers and Ms. Levonian, Ms. Vasishtha and Mr. Weil for the helpful buff statement. The Canadian economic growth performance remained positive, albeit at a more moderate and sustainable pace of 1.8 percent in 2018. Growth is expected to remain moderate in 2019 due to the more subdued global growth, with risks tilted to the downside. In this regard, we commend authorities' commitments to maintaining a sound financial system and a balanced policy mix that have driven the positive economic performance so far. We welcome the Canadian authorities' steadfast commitment to free and fair trade and encourage authorities to implement long-term structural measures in an inclusive and fiscally responsible manner. As such, we agree with the broad thrust of the staff appraisal and offer the following comments for emphasis.

Gradual fiscal consolidation amidst moderating growth, would support the rebuilding of fiscal space and promote long-term growth's resilience. We take positive note that staff and authorities agree on the importance of lowering debt, including in the provincial governments. We therefore welcome authorities' commitment to ensure that investment and spending targeted to the middle class is implemented in a fiscally responsible way and to ensure that the Canadian tax system remains efficient and competitive. While we see merits in establishing fiscal rules to strike the right balance between accountability and flexibility in principle, we acknowledge authorities' concerns that such rules may have limited benefit for Canada, given its leadership in fiscal transparency and responsible fiscal management, and may hamper policy flexibility under current heightened levels of uncertainty. We welcome staff's comments and further elaboration on this. Moreover, we would like to seek staff's clarification on the authorities' concern over the Fund's proposed changes to the reporting of Canada's debt statistics in IMF publications.

We are encouraged that macroprudential policy has been effective in addressing financial vulnerabilities and we agree on the need to maintain the current stance, given the elevated household indebtedness and imbalances in the housing market. To this end, we welcome the various measures implemented by the authorities to address these imbalances as highlighted in the buff statement. We take note on the First-Time Home Buyer Incentive, which lower the borrowing costs through cost sharing mechanism with the Canada Mortgage Housing Corporation. Given the size and targeted nature of this program, we welcome staff's further elaboration on the concerns raised in the report, with regard to the impact of debt accumulation and the perverse effect of inflating prices in other cities.

We welcome the comprehensive FSSA report and the positive findings on resilience of the financial system. We commend the authorities' good progress in implementing the 2014 FSAP recommendations. We take positive note that the findings from the joint BOC-OSFI biennial macro stress testing exercises for banks and mortgage insurers are consistent with the FSAP's findings. We also note from the buff statement that Canada's current systemic risk oversight institutional arrangements have worked well and welcome authorities' commitment to assess its outcomes and make improvements. Going forward, we agree with staff that growing cross-border financial interconnectedness can general stronger spillovers (para. 22). Could staff elaborate any plan on incorporating this area in the future?

We support the authorities' efforts to preserve open trade in a global environment of rising trade tensions. We commend Canada for being among the first six countries to ratify the CPTTP agreement and welcome the efforts to expedite the ratification of the new CUSMA agreement. We also commend staff for the comprehensive assessment on the costs of inter-provincial trade barriers and policy proposals to improve internal trade. To this end, we positively note the authorities' progress in promoting inter-provincial trade and we welcome authorities' firm commitment to prioritize collaborative work to remove trade barriers between provinces and territories.

We also welcome authorities' reform efforts to promote long-term growth through investment in modern, resilient, and green infrastructure and authorities' voluntary participation in the IMF's Enhanced Governance Framework on the supply and facilitation of corruption.

With these remarks, we wish the authorities well in their endeavors.

Mr. Kaya, Mr. Just and Mr. Bayar submitted the following statement:

We thank staff for their comprehensive set of reports and Ms. Levonian, Ms. Vasishtha, and Mr. Weil for their insightful buff statement. Canada continues to register robust growth rates, albeit with some moderation toward its potential. Unemployment is at its lowest levels in four decades, wage growth is solid, and the economy continues to benefit from well-managed immigration. Nevertheless, challenges remain including from housing-sector imbalances, rising trade tensions, persistent barriers to inter-provincial trade, uncertainty around energy prices, and population ageing. The authorities should, therefore, continue to implement sound macroeconomic policies to improve the resilience of the economy and address structural bottlenecks hindering potential growth. On that note, we broadly agree with the thrust of the staff's appraisal and would like to emphasize the following points.

Fiscal policy should continue to strike a careful balance between rebuilding buffers and supporting growth, and inclusivity. The authorities judiciously used their fiscal space to support business investment as well as the middle class through a number of initiatives, while at the same time, keeping the public debt on a gradual downward path. Given Canada's relatively comfortable debt position, we believe that the authorities' fiscal policy stance at the federal level is appropriate. Nevertheless, fiscal pressures in a number of provinces call for a steadfast policy response, putting the effective burden of adjustment on the local level. We agree with staff that any windfall savings should be used for deficit and debt reduction and likewise, in case of a downturn, automatic stabilizers should be allowed to work. While acknowledging the authorities' caveats, we tend to see merit in considering a rules-based fiscal framework, particularly at the provincial level, provided that an adequate degree of flexibility is embedded in the design of the rules. We note the recent changes in the tax policies, allowing for immediate and accelerated expensing of capital investments, aiming among other things to help preserve Canadian companies' competitiveness vis-à-vis the changes in the U.S. tax policy. In this respect, we wonder whether there is an intention to withdraw the recent expansion of tax allowances for investment in synch with the prospective unwinding of tax incentives in the U.S.? We also note the authorities' concern about the staff's proposed changes to the reporting of the debt statistics which aim to improve cross-country comparability. Could staff comment on the issue, with particular respect to the concern about the perceived inconsistency with the direction of international accounting standards?

The accommodative monetary policy stance has served the economy well. Over the years, the Bank of Canada (BOC) has established an impressive track record of attaining inflation objectives, which helps firmly anchoring the expectations. Similarly, we see the three policy rate hikes over the last year as a timely response by the BOC to emerging inflationary pressures. We agree that any changes to the current policy setting should be data driven, and gradual to reflect the uncertainties around the estimates of output gap and neutral policy-rate.

The macro-prudential policy framework appropriately addresses financial stability risks, particularly emanating from the housing market imbalances. We welcome the indications of a rebalancing in house prices, especially in large cities where median prices have been well-above the “attainable price” levels. The skillful combination of macroprudential policies and new mortgage lending guidelines has contributed to removing the froth from house price increases. Nevertheless, imbalances remain significant, still exposing the housing market to large corrections with possible system-wide ramifications. We, therefore, welcome staff’s thematic focus on this subject and encourage the authorities to continue to closely monitor the risks, emanating including from the `non-prime` market served by smaller financial institutions. We concur with staff that a more durable solution hinges on the supply-side efforts, requiring an effective cooperation between different levels of government. We look forward to the guidance by the newly founded Expert Panel on the Future of Housing Supply and Affordability.

The existing regulatory and supervisory framework appears to be in strong compliance with international standards. We welcome the detailed analyses presented by the Financial System Stability Assessment Report and take positive note of the overall positive findings about the soundness of the Canadian financial system. While appreciating that the banking sector is well-capitalized, profitable, and has low non-performing loans, we remain concerned about the elevated household indebtedness and housing market imbalances which pose macro-financial vulnerabilities. We take positive note of the resilience of the financial system as demonstrated by the results of the stress tests, while acknowledging pockets of possible stress, including the mortgage insurers, life insurance companies, and non-prime mortgage lending market. We encourage the authorities to address the identified gaps in the financial stability architecture, particularly by addressing the data gaps related to cross-sectoral exposures, improving policy coordination between federal and provincial authorities, devising a single mechanism to monitor and mitigate build-up of systemic risks, and improving the transparency of systemic policy decisions. To this end, we look forward to the promulgation of the federal Capital Markets Stability Act and its effective implementation. We welcome the authorities’ strong track record in fighting corruption and voluntary participation in the Fund's Enhanced Governance Framework. We encourage further steps to tackle the proceeds of crime, including in the real estate sector.

More generally and against the background of the ongoing FSAP review, we note that high leverage will continue to be an important vulnerability not only for Canada but many other IMF members due to the linkages to the global financial system. Running stress tests on the different aspects of the financial system appears increasingly necessary and more needs to be done to extend this type of analysis to newer players in the system, such as asset managers and other non-bank financial institutions. We acknowledge that this is quite challenging and complex because of the domestic and cross-border interlinkages. However, without more sectoral stress tests also in FSAPs, we may increasingly miss important financial system vulnerabilities.

Structural reform efforts should aim to enhance productivity and promote domestic and international trade. Canada needs to boost its economic potential, inter alia to sustain its prosperity as the population ages. We commend the authorities' efforts in this regard to address critical infrastructure bottlenecks, enhance human capital, upgrade the regulatory frameworks, and advance on climate mitigation objectives. We note in this regard that the authorities have devised a carbon-pricing mechanism, which also aims to preserve the competitiveness of Canadian companies. We would appreciate if staff could elaborate on the details of this scheme. We also appreciate Canada's commitment to free and fair trade, as exemplified by the free trade agreements with major bilateral and regional trading partners. Beyond the benefits of international trade, we agree that removing the non-tariff barriers to provincial trade heralds significant efficiency and prosperity gains and we are encouraged by the authorities' commitment in this regard.

Mr. Raghani and Mr. Nguema-Affane submitted the following statement:

We thank staff for the set of comprehensive reports and Ms. Levonian, Ms. Vasisthta and Mr. Weil for their informative buff statement.

Canada's macroeconomic situation continues to be positive in 2018 amid a challenging international environment. Growth moderated at 1.9 percent while inflation remained stable, job creation strengthened and the external position improved. The reduction in macro-financial vulnerabilities is also a welcome development. The country's economic growth is projected to improve over the medium-term, supported by expected higher demand following the recent business-friendly tax changes, trade arrangements, including the ratification of the CTPPP and the signing of the USMCA, and continued immigration-fueled population growth.

In light of elevated risks to the outlook, we encourage the authorities to remain vigilant and pursue steadfast implementation of their reform agenda. We broadly share staff assessment of risks to this outlook stemming notably from the unfavorable direction of trade tensions and, oil prices, and negative developments in the real estate sector. We commend the authorities for their effective policy implementation. We welcome their leading efforts to improve the multilateral trade system. The strong traction of Fund advice in Canada is also noteworthy and the authorities and staff's agreement on most policies going forward to further support economic activity and reduce macro-financial vulnerabilities is encouraging.

The envisaged growth-friendly fiscal policy at the federal level is appropriate but fiscal consolidation should be pursued over the medium-term at all levels of government. We take good note of the improvement of the fiscal performance at the federal level in 2018 driven by better macroeconomic and fiscal conditions. We note the federal authorities' decision to use their fiscal savings to support business investment and the middle class through several initiatives aimed at, among others, supporting training, education and housing affordability, and accelerating capital expensing and tax allowances for business investment to maintain tax competitiveness following the adoption of the US Tax Cuts and Jobs Act. We find these initiatives appropriate given Canada's very low debt and strong policy framework, and the authorities' commitment to gradual fiscal consolidation over the medium-term. That said, further efforts are particularly needed in some provinces with high deficits or debt to bring their fiscal finances at a more sustainable level. Considering the authorities' sound public financial management, we would agree that setting a fiscal rule might not be a priority at the moment and that focus should be on ensuring the effectiveness and efficiency of the tax system, as stressed by Ms. Levonian, Ms. Vasisthta and Mr. Weil in their buff statement.

Current monetary and financial sector policies are appropriate but financial supervision should be enhanced along the lines proposed by the recent FSAP. The monetary policy is appropriately accommodative given the economic conditions. The financial system remains solid according to stress tests conducted in the recent FSAP. The recent macroprudential measures have been effective in containing financial stability risks stemming from housing finance. Going forward, the financial supervision framework could be further strengthened in line with the 2019 FSAP recommendations on modernizing the architecture of systemic risk oversight and enhancing microprudential supervision and safety nets. The Capital Markets Stability Act under preparation will be a positive step in that regard. We particularly see merit in staff recommendations on redefining the terms of reference of the Heads of Agencies (HOA) Committee chaired by the central bank and the Senior Advisory Committee (SAC) to perform country-wide financial surveillance and crisis preparedness.

The recent softening of the housing market is welcome and efforts to address housing imbalances should be actively pursued in a collaborative manner. The adoption of macrofinancial regulations, and specific provincial real estate tax measures have contributed to contain mortgage credit growth and household debt risks. However, housing affordability remains an issue. The recent initiatives by the Canada Mortgage and Housing Corporation (CMHC) to promote construction of affordable housing and homeownership across Canada, including the Rental Construction Financing Initiative and the First-Time Home Buyers Incentive, are appropriate. That said, the authorities need to ensure that those initiatives are complementary and coordinated nationwide while preserving financial stability. The establishment of an Expert Panel on the Future of Housing Supply and Affordability is an encouraging step in that regard.

Structural reforms to improve productivity should be accelerated in order to raise potential growth. We note from the staff report that the potential growth will be constrained by weak external competitiveness, low productivity growth and population aging. Against this background, we welcome the ongoing initiatives to foster a more productive workforce and a more competitive business environment as indicated in the buff statement. We encourage the authorities to pursue relentlessly their efforts to implement the Canadian Free Trade Agreement in order to remove domestic trade barriers that are holding back productivity growth. Likewise, further progress is needed to facilitate federal infrastructure funds and accelerate the infrastructure investment envisaged under the Investing in Canada Plan, notably through the new Canada Infrastructure Bank. Greater collaboration between all levels of governments will be essential to this end.

Finally, we welcome the ongoing efforts to further strengthen the country’s AML/CFT and anti-foreign bribery framework and Canada’s voluntary participation in the IMF’s Enhanced Governance Framework on the supply and facilitation of corruption.

With these remarks, we wish the Canadian authorities' success in their endeavors.

Mr. Ray, Ms. Preston, Mr. Kim and Ms. Park submitted the following statement:

We thank staff for a helpful set of reports and to Ms. Levonian, Ms. Vasishtha, and Mr. Weil for their informative buff statement. Although the Canadian economy has slowed recently, it has still performed well among G7 counties, underpinned by strong fundamentals, an open and flexible economy, a highly educated population and sound institutional settings. Authorities have taken the opportunity of the upswing in economic conditions to push through several important reforms to boost growth. We agree with the thrust of the staff appraisal and add the following comments for emphasis.

Article IV

A gradual pace of fiscal consolidation is necessary to rebuild buffers, increasing the capacity of the authorities to respond to adverse shocks. We agree with staff that any further unexpected fiscal savings should flow through to improvements in the bottom line. We take note of the different adjustment tasks facing federal and provincial governments. Noting staff advice that provincial governments could double the pace of consolidation, even given the large deficit in Alberta in the face of lower oil prices, can staff elaborate as to whether provincial governments have a role in the delivery of counter cyclical fiscal policy, or if this is the responsibility of the federal government? Can staff explain the fiscal burden-sharing measures among the federal and provincial governments given their heterogeneous revenue sources?

We note the difference in view between the staff and authorities regarding the merits of a more explicit fiscal rule. We recognize Canada's strong track record of debt management and solid debt metrics as compared to G7 countries. We sympathize with the authorities' view that a fiscal rule that is too rigid could limit the authorities' flexibility to respond to adverse shocks. However, we see merit in exploring options that help to strengthen the fiscal framework to signal the government's commitment to reducing debt over time or over the business cycle.

We encourage the Fund and the authorities to adhere to the agreed international standards for public debt statistics as articulated in the IMF's Government Financial Statistics Manual 2014. The GFS Manual 2014 is the internationally recognized statistical reporting framework, aimed at helping national authorities to strengthen their capacity to formulate fiscal policy, monitor fiscal developments and enhance international comparability in a transparent and consistent framework. Other GFS aggregates such as 'net worth' and 'net financial worth' provide a broader and internationally comparable measure of a government's financial position.

We welcome the authorities' steadfast commitment to tackle long standing structural issues that would help improve competitiveness, boost productivity and lift potential growth. According to staff's analysis, lowering internal barriers to trade could increase real GDP per capita by around 4 percent. We encourage the authorities to take further action to liberalize internal barriers to trade, investment and labor mobility that will help improve the flexibility and resilience of the economy. We are reassured by the buff statement that all levels of government are committed to taking this seriously. More broadly, we commend the authority's commitment to free and open trade and welcome the ratification of the CPTPP. We look forward to Staff's further analysis of impact of the USMCA on the Canadian economy including the extent to which trade diversification is limited as a result of the provisions that discourage free trade with non-market economies.

Financial System Stability Assessment

Given Canada's systemic role in the global financial system, we welcome the positive assessment of financial system stability. We note staff's finding that Canadian banks are profitable and have sizeable capital buffers, insurers are financially sound and system-wide liquidity conditions are stable. Stress tests show that the core financial system would be resilient to a severe nationwide recession, significant financial stress, and a sharp house price correction in overheated markets – but identifies vulnerabilities for households and mortgage insurers. We welcome the finding that Canadian financial sector oversight is high quality and that the authorities have made progress on implementing the 2014 FSAP recommendations. As we broadly agree with the FSAP recommendations, comments on a few specific aspects are below.

With elevated household debt and imbalances in the housing market representing a key vulnerability, we welcome continued close monitoring of this area and the authorities' proactive policy approach. A combination of prudential measures and monetary tightening have seen a moderation of growth in household borrowing, reduced speculative behavior and improved the quality of new mortgage borrowing. Nonetheless, we agree that enhanced monitoring of non-prime mortgage lending outside the mortgage perimeter and home equity lines of credit would be valuable. We also share staff's view that measures to increase risk-based differentiation of mortgage pricing should be considered. Supply-side measures will also be important to address housing market imbalances over the long term, and we welcome recently announced measures in this area.

On systemic risk oversight, we note the staff and authorities' view that current arrangements have worked well and welcome the authorities' commitment to continue to assess outcomes and make improvements. In particular, we see the value of ensuring that current shared arrangements do not lead to gaps in coverage or impede inclusive and effective policymaking or transparency. As the IEO have highlighted, IMF advice is most useful when fully anchored in the local circumstances and not overly reliant on off-the-shelf "international best practice" more suited in other contexts. From this perspective, we note that specific staff suggestions on the systemic risk oversight framework may not be the only way to achieve effective policy outcomes. Ultimately, an effective systemic risk oversight framework relies upon agencies having a clear shared perspective on meeting their objectives, taking a broad approach to meeting their mandates, engaging with each other in a culture of cooperation, dialogue and mutual respect, and with ministerial powers being used very sparingly. Canada's approach would seem to score very well in these regards.

Mr. Guerra and Ms. Arevalo Arroyo submitted the following statement:

We thank staff for the comprehensive set of papers and Ms. Levonian, Ms. Vasishtha, and Mr. Weil for their helpful buff statement. A sound economic policy mix by the Canadian authorities has successfully allowed for inclusive and stable growth and has established the foundations for more sustainable growth in the long term. However, despite the positive momentum of the past years, risks are tilted to the downside and potential external shocks pose challenges to growth prospects. Continued commitment to strong policies, fiscal adjustment at both the federal and provincial level, and a focus on structural reforms to boost productivity will allow to support long-term growth.

We take note of the difference in views between staff and the authorities regarding the introduction of a fiscal rule. While we consider fiscal rules could be useful in certain contexts, governments should have the discretion to determine the need, characteristics and timing of these mechanisms. In this regard, we agree with the Canadian authorities that given their fiscal transparency and commitment to responsible fiscal management, the inclusion of a fiscal rule or debt target in this case is not warranted and could constrain their ability to respond promptly and flexibly to shocks. Additionally, although for international comparison different measures could be used, we support the authorities' views related to proposed changes to the reporting of Canada's debt statistics. The exclusion of accounts payable/receivable and other concepts go against fiscal transparency. Furthermore, the IMF should continue to strive for a comprehensive public debt reporting by advanced economies, including unfunded pension liabilities.

Further trade diversification and reduction of internal trade barriers could contribute to increase prospects of long-term growth for Canada. We commend the Canadian authorities for their commitment to the multilateral trading system and look forward to the upcoming ratification of the USMCA. Nevertheless, given that rising protectionism is deemed as having a high relative likelihood in the risk assessment matrix for Canada, we would appreciate it if staff can elaborate on the impact of trade disruptions to the Canadian economy, for example due to the imposition of automotive tariffs, including through increased trade policy uncertainty. On internal trade, reducing barriers will be necessary for increased productivity in the medium term. In this regard, we welcome the introduction of the Canadian Free Trade Agreement (CFTA) as well as the commitment and progress made by the federal government in accelerating the removal of barriers in several areas. However, as mentioned in the buff statement, we recognize and agree with the authorities that the country's constitutional arrangements entail a challenge to these efforts.

The financial system in Canada is resilient and macroprudential policy has contributed to reduce housing imbalances, although some challenges remain. We commend staff for the high-quality analytical and comprehensive work in the FSSA. We welcome the resilience of the Canadian financial system and the finding that it would be able to manage severe macro financial shocks. Despite emerging vulnerabilities and that household debt is still very high, credit growth has moderated due to monetary tightening and prudential measures put in place by the authorities to curb mortgage lending. We recognize the authorities' efforts that have been reflected in a smaller credit-to-GDP gap and considerable increase in the quality of mortgage lending. Related to the latter, we appreciate the work regarding house prices in Canada by using the "borrowing" capacity approach that points to the need for continued surveillance of housing markets and to prepare for possible shocks. Although we concur with staff on the need to take steps to improve the current framework for systemic risk oversight, we stress that the authorities should have the flexibility to choose timing and specific institutional arrangements—

according to their reform agenda—as well as the coordination efforts at different government levels and across supervisory institutions.

We welcome Canada’s voluntary participation in the IMF’s Enhanced Governance Framework. We note Canada’s strong record on fighting corruption, in particular regarding supply and facilitation. In this regard, we consider that addressing the supply side of corruption must also be one of the main objectives of the Fund’s involvement in governance issues.

Mr. Mahlinza and Mr. Odonye submitted the following statement:

We thank staff for the comprehensive report and Ms. Levonian, Ms. Vasishtha, and Mr. Weil for their insightful buff statement.

In 2018, Canada’s economic growth moderated owing to an uncertain global economic environment, lower oil prices and higher interest rates, which affected private consumption and non-residential investment. The combination of high household debt, tighter global financial conditions and global growth slowdown poses a major threat to the outlook, with potential risks to financial stability and growth. In this context, we broadly agree with the staff’s recommendations that the authorities should stay the course and focus policies on preserving financial stability and cushioning long-term growth.

We agree that the pace of fiscal consolidation should be gradual with the burden of adjustment largely carried by the provincial governments. In this regard, we commend the federal government for the exemplary fiscal prudence with debt-to-GDP ratio expected to decline to 28.6 percent by 2023-24, down from 30.8 percent in 2018-19. We also see merit in utilizing any unexpected fiscal savings to target deficit and debt reductions. This should contribute to the rebuilding of buffers, which will provide more options to handle future challenges including those related to aging and weak productivity growth. Further, whilst we note the authorities’ views on the introduction of an explicit fiscal rule and debt target, we concur with staff that the fiscal rule would enhance clarity in fiscal management.

We welcome the recent FSAP assessment and recommendations, which noted that macroprudential policy has been effective in containing financial stability risks and that the current stance is appropriate. We would however, urge the authorities to continue to be attentive to the overall level of household indebtedness given the imbalances in the housing market. We also take note that the authorities have introduced several supply-side measures to help improve these imbalances including the Rental Construction Financing Initiative and the First-time Home Buyer Incentive scheme, as articulated in the buff statement. Nevertheless, risks to a housing market correction remain and could affect financial stability and growth. Further, we support the authorities' plans to modernize the framework for systemic risk oversight and crisis management, and the efforts to complement macroprudential oversight with stronger microprudential supervision and safety nets. The recent Supreme Court decision giving the federal government authority over systemic risk oversight in the Canadian capital markets will enhance systemic risk oversight and improve its governance arrangements.

We commend the Canadian authorities for taking notable steps towards trade integration and leading an international effort to improve the multilateral trade system. In this connection, the signing of the new USMCA and accelerated ratification of the CPTPP are a strong reflection of the authorities' commitment towards free trade. That said, we would encourage the authorities to prioritize efforts towards reducing internal trade barriers. Breaking barriers to internal trade can unleash significant opportunities especially resulting from the elimination of rigidities in inter-provincial trade. In this respect, we note that liberalizing internal trade in goods can increase GDP per capita by about 4 percent. Does staff have estimates of the macroeconomic impact of CPTPP on the Canadian economy?

Finally, we welcome the authorities' participation in the assessment on supply and facilitation of corruption and encourage efforts to strengthen the anti-foreign bribery legal framework as well as its enforcement. We believe that such efforts will contribute towards the global initiatives to eliminate illicit financial flows.

Mr. Palei and Mr. Snisorenko submitted the following statement:

We thank staff for their insightful Article IV and Financial System Stability Assessment (FSSA) reports and Ms. Levonian, Ms. Vasishtha, and Mr. Weil for their helpful buff statement. Economic growth in Canada has moderated in 2018 to 1.8 percent and remains low in the first quarter of 2019 (0.1 percent). The economy is in a somewhat weak external position, residential investment is anemic, the oil sector contributes to a more general growth slowdown. At the same time, financial vulnerabilities have eased in response to macroprudential measures and tighter monetary policy. We broadly agree with the thrust of staff's recommendations. Fiscal consolidation should be gradual, while the slightly accommodative stance of monetary policy is appropriate. The Canadian authorities should continue to foster financial stability and focus on policies supporting long-term economic growth.

While fiscal outlook remains stable and output gap is widening, the new spending initiatives targeted at supporting business investment are welcome. At the same time, at the provincial level the progress on fiscal consolidation has been mixed. In this context, we agree with staff that well-designed fiscal rules could enhance fiscal accountability and credibility and should be considered by the federal government and provinces. At the federal level, a fiscal rule would mitigate the risk of fiscal slippages, at the same time setting an example for the provincial authorities. At the provincial level, fiscal rules should address fiscal imbalances specific to a province. We noted from the report that the balanced operating budget rules in British Columbia and Quebec work well, the fiscal rule in Ontario could be strengthened, while Alberta doesn't have one. We welcome staff comments on the current prospects of adoption of the fiscal rules at the federal level and in the provinces that currently do not have one.

Financial stability risks require continued vigilance with housing market imbalances. High household indebtedness remains among the key vulnerabilities. At the same time, we note that, according to the CMHC's February report, already introduced macroprudential measures and somewhat tighter monetary policy have moderated price dynamics in Toronto. The chapter of Selected Issues paper on assessing house prices in Canada also points to a significant house price overvaluation in such areas as Hamilton, Toronto, and Vancouver, while the gap between actual and "attainable" prices is narrowing. In this respect, could staff comment on whether the housing overvaluation issue remains macrocritical for Canada? Did staff verify the results with other valuation methods, such as the intrinsic-value approach?

We welcome the findings of the FSSA. Since 2014, the financial system in Canada has experienced substantial growth and international expansion. At present, it is generally sound and could manage a severe adverse scenario. The Canadian banking sector is liquid, well capitalized and highly profitable, although highly concentrated. Could staff comment on whether high concentration poses an additional risk for financial sustainability?

We commend the authorities for their attention to the structural reforms aimed at raising productivity and potential output. We agree that full operationalizing of the Canada Infrastructure Bank remains important for the success in improving growth prospects. Could staff provide an update on the implementation of the Innovation and Skills Plan and Superclusters Initiative?

We concur with staff that reducing barriers to trade within the country may further boost Canada's economic potential. In this respect, we welcome the chapter on internal trade in the Selected Issues paper, which illustrates the significant economic benefits of increased trade liberalization. We encourage the authorities to improve coordination among all stakeholders with the goal of reducing internal barriers to trade.

With these remarks, we wish the Canadian authorities success in facing the challenges ahead.

Mr. Kaizuka and Mr. Naruse submitted the following statement:

We thank staff for the comprehensive reports and Ms. Levonian, Ms. Vasishtha, and Mr. Weil for their informative statement. While weaker foreign demand and the decline in oil prices have weighed on business investment and exports, it is encouraging that Canada's economy has grew at a sustainable level. Also, we welcome that core inflation has remained stable, unemployment rate has fallen to a record low, and the housing market is softening. However, the country still faces important challenges, such as addressing high household debt and pursuing fiscal consolidation in provinces with high deficits or debt. The authorities need to implement necessary measures to address structural issues, such as boosting productivity and trade diversification. As we broadly concur with the thrust of the staff's appraisal, we will limit our comments to the following points:

Fiscal Policy

With growth slowing to a more sustainable level, we agree with the staff's view that fiscal policy should focus on rebuilding buffers and supporting productivity-enhancing growth. At the provincial level, we note that progress on fiscal consolidation has been mixed. As staff say, we believe that those provinces running large deficits or with high debt should take the lead in making the necessary fiscal adjustment, including through strengthening the commitment to fiscal sustainability. On the federal side, we welcome that the federal deficit is also expected to decline over the next five years, and the federal debt-to-GDP ratio is expected to decline. In addition, we see merit in the staff's view that to enhance the credibility and transparency of fiscal policy, the federal government could explicitly incorporate a fiscal rule. On the other hand, the authorities think that Canada's low debt advantage, declining debt-to-GDP ratio and commitment to regular and transparent financial reporting, obviates the need for a more explicit federal fiscal rule or debt target. How do staff assess this authorities' view?

Monetary and Financial Sector Policy

On monetary policy, given a negative output gap and slowing pace of wage growth, we agree with the staff's appraisal that the accommodative stance of monetary policy has been appropriate and monetary policy should remain on hold in the near term.

On financial sector policy, we positively note that FSAP stress tests, including the adverse scenario, show that the financial system is resilient. Also, we welcome the staff's assessment that the banking sector posted strong profits and sizable capital buffers. While staff say that universal banking business models have generated solid earnings, could staff elaborate more on how these business models contribute to the Canadian banks strong profits even in the low interest rate environment? What are the prominent characteristics of Canada's universal banking business models compared to other advanced economies with the low interest rate environment? On the other hand, the FSAP recommends to further improve the framework for financial supervision, including through strengthening the oversight of pension funds, enhancing policy coordination between federal and provincial authorities, and strengthening the AML/CFT framework. We expect the authorities' successful policy implementation in line with the FSAP recommendations.

Housing Market

We are pleased to see the staff's appraisal assessment that macroprudential policy has been effective in reducing housing imbalances. We welcome the fact that residential mortgage credit growth has slowed and the credit gap has declined. However, we note with concern that the stock of household debt is still high, so we agree with the staff's view that the authorities should refrain from diluting macroprudential policy's effectiveness. Together with macroprudential policy, we agree with the staff's view that the government should address affordability concerns by expanding housing supply. On provincial real estate taxes on non-residents, we support the staff's appraisal that they should be replaced by broad-based tax measures that target speculative activity more generally. Could staff describe the possible alternative tax measures more in detail?

Structural Reform

We agree with the importance of enhancing productivity and trade diversification for long-term growth. We welcome the elimination of U.S. tariffs on steel and aluminum imports and Canada's retaliatory measures. Also, we commend the authorities to ratify the Comprehensive and Progressive Agreement for Trans-Pacific Partnership which may well provide a boost to Canadian exports and greater opportunities for diversification. Furthermore, we welcome the authorities' efforts to fight money-laundering and terrorist financing, including making amendments to the AML/CFT regulations. Going forward, we encourage the authorities to reduce non-tariff trade barriers and to facilitate infrastructure investment.

Tax Policy

After the recent changes to tax policy in the U.S., do staff see any impact of the U.S. tax changes on capital flows between Canada and the U.S.? Also, could staff explain if Canada has changed its tax policy in response to the U.S. tax cuts?

Mr. Jin and Ms. Zhao submitted the following statement:

We thank staff for the insightful set of papers and Ms. Levonian, Ms. Vasishtha, and Mr. Weil for the informative buff statement. Thanks to the mix of policies to support inclusive growth and reduce vulnerabilities, the Canadian economy continues to perform well. We welcome that growth has slowed slightly to a more sustainable level and financial vulnerabilities have eased. We broadly concur with staff's assessment and offer the following for emphasis.

We strongly support the authorities' efforts to improve the multilateral trade system. Given the risk of rising protectionism, we see merit in the Canadian leadership organizing an effort to improve the WTO and to reaffirm the importance of a multilateral trading system.

We see the need for the Canadian authorities to continue monitoring and evaluating the effectiveness and efficiency of the tax system. In this regard, recent tax changes that allow for immediate and accelerated expensing are a step in the right direction and are conducive to preserve Canada's tax competitiveness following the 2018 U.S. Tax Cuts and Jobs Act. One year after the U.S. tax reform, could staff share their assessment of the impact of the U.S. tax reform on Canada's economy?

Strong fiscal position has allowed the authorities to make growth-friendly investments. We note that the net public debt is only about 26.8 percent of GDP, as the government has sizeable highly-liquid financial assets, making Canada enjoy the lowest net debt-to-GDP ratio among G7 countries. We welcome staff's further analysis on the pros and cons of holding liquid financial assets on the government's balance sheet as opposed to repaying public debt. We praise staff for analyzing both the assets and liabilities on the government balance sheet and encourage them to apply this comprehensive approach to other countries where appropriate. In addition, we notice that the compensation of employees takes up 12.1 percent of GDP. Could staff provide more information on the employee distribution by sector (i.e., how many in the civil service and how many in SOEs) and by industry? What industries are SOEs mainly concentrated in?

On the housing market and financial stability, we commend the authorities in implementing effective macroprudential policy to contain financial stability risks. We note that housing prices in some provinces are still well-above estimated attainable levels and there is a risk of further price corrections. In case the price corrections are triggered in the future, whether and if so, what appropriate policy measures should be taken to stabilize the housing price and the financial system? How likely would the vulnerabilities facing some smaller banks and private lenders finally cause systemic risk in case of the pullback in market funding during economic downturns?

With these remarks, we wish the authorities every success in their policy endeavors.

Mr. de Villeroché, Mr. Castets and Mr. Rozan submitted the following statement:

We would like to thank staff for the clear and comprehensive set of reports, including for the very interesting selected issues paper on the housing prices, on inflation forecasting and on trade liberalization, as well as Ms. Levonian, Ms. Vasishtha and Mr. Weil for their thorough buff statement. While Canada is enjoying positive economic momentum, and vulnerabilities in the financial sector have been gradually reduced, policy-makers should continue a gradual, growth-friendly fiscal consolidation in the medium term, and focus their efforts on structural reforms to unlock higher productivity growth. We share the thrust of the staff's messages, and would like to offer the following comments:

We share staff appraisal on the gradual slowdown of the Canadian economy towards a moderate growth rate. Going forward, the risks remain tilted to the downside, which warrant careful attention by policy makers, in particular regarding the possible impact of a sharp correction in the real estate market, a materialization of external risks (and especially, further trade disruption), and a sudden tightening of the global financial conditions. Given the strong interconnexion between the US and Canadian economy, we were wondering why the risk assessment matric for the US article IV estimates that the tightening in financial conditions represents a low risk, compared to a medium risk in the case of Canada. We would also be interested by staff analysis on the impact of the new tax provision on investment expensing, and whether it can weather off the impact of the US tax reform.

On the fiscal policy, we share staff assessment regarding the need for a gradual consolidation. We note that efforts are uneven at the provincial level. We encourage authorities to put in place a coordinated approach between the federal level and provinces to put in place a growth friendly reduction in the overall fiscal deficit. The design of a fiscal rule could be useful in this regard, to better guide budget decisions and improve transparency, as well as to help the policy coordination between different levels of government.

On the monetary policy, we agree that the policy stance remains adequately accommodative and should remain on hold in the near term. The Bank of Canada should remain prepared to cut the policy rate if risks materialize and the outlook deteriorates.

The financial system appears generally sound and strong, with strong bank profitability and buffers. We note the good progress on implementing the recommendations from the 2014 FSAP. We share the assessment that household indebtedness remains a vulnerability, with risks materializing in the case of a severe downturn. Raising required capital for mortgage exposure would be useful, as well as increasing risk-based differentiation in mortgage pricing. Given its complexity, and its detrimental effect on foreign investment, the financial stability architecture could be enhanced, drawing on the FSAP recommendations. Oversight could be further improved, in particular through a clarification of the roles and responsibilities between the different supervisory bodies, and through efficient cooperation. Enhancing systemic risk monitoring and policy dialogue, as well as the monitoring of policy decisions, will be useful going forward. We are encouraged by the steps highlighted in the buff statement in this regard, and in particular the proposed federal Capital Markets Stability Act.

We share staff recommendations contained in the selected issues paper to increase housing supply as well as affordability. We share the conclusions presented in analysis of the housing market prices that market valuation seems to be too elevated in certain localized urban areas, with a strong connection between housing prices and households' ability to borrow; in the short term, mortgage interest rates should more clearly differentiate households' borrowing capacity and underlying risk profile; over the long-term supply-side policies should be encouraged. We would welcome staff comments on current government plans in this regard.

Declining productivity growth and a subdued long-term outlook is a cause of concern going forward. The focus on trade diversification is key, and we commend the authorities for the new trade agreements signed, and their commitment to the improvement the multilateral trade system. Reducing intra-Canada barriers also have the potential to raise productivity level and per capita income. The selected issues paper gives a useful analytical underpinning to inform the policy debate. Useful steps have been taken in 2017 through the CFTA, and we hope that federal and provincial authorities can leverage this tool to make regular progress. The enhancement of its operational and enforcement capacity would be useful in this regard. We also encourage the authorities to continue to implement their Innovation and Skills Plan as well as to address restrictive regulations on product markets and foreign direct investment. Competition could also be strengthened, building on recent useful efforts launched in February 2019 in the telecommunication sector.

Ms. Pollard made the following statement:

We thank staff for a well-written report focused on true macrocritical issues and Ms. Levonian for her helpful buff statement. Our countries are neighbors, and we are neighbors here at the Board table, and in the spirit of neighbor friendliness, we wanted to simply commend the Canadian authorities for their good macroeconomic management over the past several years; and I would be remiss if I did not congratulate my Canadian colleagues on the Toronto Raptors' first NBA championship.

In all seriousness, there are risks remaining in the Canadian economy, particularly in the housing sector, so the authorities need to be vigilant and build on the good progress they have made recently. We asked a question in our gray statement about the differences in views on debt statistics, and we welcome the staff's detailed response in the answers to technical questions, as well as Canada's clear approach to comprehensive and transparent reporting of statistics. We also welcome the staff's alternatives in their responses to the real estate taxes on non-residents, which are classified as a capital flow management measure (CFM). It is important for the staff to present alternative measures when identifying CFMs that can be used to achieve the same goal.

Mr. Ronicle made the following statement:

I thank the staff for an analytically rich and thought-provoking set of papers. We issued a joint gray statement with Mr. Rashkovan, and I sure do not want to revisit the details of that this morning. Rather, I wanted to offer a few more general observations, which we might want to reflect on.

First, this is a good week for those like me who are fans of growth at risk. I was pleased to see it applied in this Article IV and even more pleased to see it applied in the case of Benin, which we will talk about at the end of the week. This chair thinks we need a more quantitative approach to risk assessment in a country context, so this is a welcome step forward. It would be good to reflect on any lessons learned from its application so that we can ask in the Comprehensive Surveillance Review (CSR) whether we can apply this framework more broadly.

Second, the analytical work on internal trade barriers was absolutely fascinating and a striking illustration of just how important non-tariff barriers are.

Finally, we often talk about the role that the Fund has in analyzing spillovers. In that context, I thought the Canadian Financial Sector Assessment Program (FSAP) posed an interesting challenge. We know the Canadian banks have a substantial footprint in the Caribbean, but the largest spaces for Canada’s financial system are the United States, Europe, and East Asia. As a consequence, the Canadian FSAP focuses on the implications of stress in those markets, and that is the right place for it to focus. But it begs the question of in which forum we would consider the consequences for Caribbean countries of financial stress in Canada. It is not obvious that in the course of a normal bilateral surveillance of an individual Caribbean country it would be possible to access the data required on Canadian banks, nor is it clear that in the context of surveillance on Canada, this would be a priority issue. Again, that is something to reflect on for the CSR.

I wanted to thank the Canadian authorities for undertaking the voluntary evaluation of supply and facilitation of corruption under the Fund’s enhanced governance framework.

Mr. Kaizuka made the following statement:

Echoing Ms. Pollard, we are still neighbors in this section of the table, and so I would like to congratulate Ms. Levonian for the very strong performance of the economy.

I issued a gray statement, and we got the answer to the technical questions, and I would like to follow-up on three answers to the questions. First, on the impact of U.S. tax reform on the Canadian economy, I recognize it is an evolutionary measure, and it is rather difficult to single out the impact, as there are many other policy developments by Canada or the United States, but still, we encourage the staff to keep monitoring the impact in the future.

Having said so, I did note with interest the answer to my question on the possible impact of the U.S. tax reform on capital flows between the United States and Canada. This is the answer No. 5. It says while overall capital flows have been broadly stable as a share of GDP since the tax changes came into effect, the composition of the flows have changed with a reduction in portfolio inflows offset by the rising inflows of other forms of investment, other equity, currency, and the deposit loans. I am curious to know the possible mechanism behind this particular change in the composition of the flow, so I really appreciate some elaboration by the staff on this answer.

Again on the tax measures, echoing Ms. Pollard’s comment, with regard to the housing market policies, the staff recommended eliminating the provincial real estate tax on non-residents or harmonizing them into the broad-based tax measures targeted at speculative activities, which is sensible. The answer to the questions said that the federal authorities are comfortable with this recommendation, so could the staff elaborate further on the possible materialization of the recommendation to the real policy change with the certain timeframe.

Lastly, on trade, the answer in paragraph 41, yes, there is an analysis of the macroeconomic impact for the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) on the Canadian economy. This is a valuable analysis. I encourage other staff to engage in similar assessments of the regional trade agreement and possible macroeconomic implications. It is interesting to see that the impact of the CPTPP is significantly larger, positively larger, for the Canadian economy compared with the Trans-Pacific Partnership (TPP), which includes the United States, so the CPTPP’s impact is positively bigger than the TPP. I still hope the United States has the intention to join the TPP, Canada will not oppose that for this particular reason, but I would like to know the specific mechanism behind this difference in the estimation.

Mr. Rashkovan made the following statement:

We join other Directors in commending the authorities on their prudent macro-fiscal and financial sector policies. We issued a gray statement with Ms. Riach and would like to make two additional comments for emphasis.

Canada is one of the leaders in fintech activities and artificial intelligence (AI) technologies, and the Bank of Canada is among the world leaders in research of digital currencies and other financial innovations. Their work is widely quoted by different standard-setters and research centers. With the recent Board meeting on fintech in mind, dedicating only one paragraph in 96 pages of the Financial System Stability Assessment (FSSA) seems slightly thin to understand better what the Fund has learned from the advantages of the new technologies in various segments of Canadian financial sector, and what the Fund has observed about risks related to fintech, including but not limited to cyber risks. The comments of staff on the reasons for such thin coverage of fintech are welcome.

Second, we welcome the voluntary evaluation of the supply-side of corruption in Canada under the Fund's enhanced governance framework, and frankly, we did not have many concerns about the governance issues in Canada. At the same time and in similar recent cases of Switzerland and Japan, we note the evaluation itself in the report is mainly descriptive and again pretty thin. We understand that the analysis was done by a third-party like OECD, but at least a separate box in the report would probably have been more appropriate, and the staff's comments are welcome.

Ms. Mahasandana made the following statement:

We issued a gray statement, and we would like to emphasize two points. First, given the rising trade tension, we would like to commend the authorities for showing great leadership in supporting the greater multilateral trade system by being one of the first to ratify the CPTPP and showing a strong commitment to expedite the ratification process of the United States-Mexico-Canada agreement. We take positive note that Canada is now the only G7 country to have a free trade agreement with all other G7 nations.

We also would like to congratulate the staff for the comprehensive work on the selected issues paper on interprovincial trade, and we are happy to hear that the federal government is committed to work with the provincial and territorial government to accelerate the removal of barriers within Canada's borders.

Second, we noticed divergence in views with regard to financial rules among Directors. We agree that financial transparency and accountability are crucial to financial sustainability in the long run. However, it is also crucial for any policy designed to take into account country-specificity, the track record of its country policy performance, and the timing of the policy implementations. Considering Canada's constitutional setting and the different performance at the provincial level, implementation of the fiscal rule can be challenging tasks. In the current challenging environment, we sympathize with the authorities' view that a fiscal rule that is too rigid could limit the authorities' flexibility in response to adverse shocks. In this regard, we would like to encourage the staff to continue engaging the authorities and work closely in formulating and exploring options that are well tailored to Canada's country specifics and help policy coordination between different levels of government.

Ms. Preston made the following statement:

I thank the staff for the comprehensive report and Ms. Levonian and colleagues for the helpful buff statement. We also want to recognize Canada's strong record of economic management. We have issued a gray statement and will touch on a few areas.

Firstly, we would like to explicitly recognize Canada's leadership role in global trade issues. It is an important area for all of us, and we echo Ms. Mahasandana's comments.

Secondly, on fiscal policy, we agree that with growth slowing, a very gradual fiscal consolidation seems appropriate, and following staff's helpful responses to technical questions, we can see that in the provinces currently running large deficits or with high debt levels, there may be scope to do more to build buffers.

Thirdly, on housing market imbalances, we welcome the staff's assessment that prudential measures and monetary tightening have seen speculative behavior recede and the quality of lending improve. We still see this as an area that warrants close monitoring given the elevated risks associated with household debt and house prices, and as the FSAP highlights, the significant linkages to the financial system. We recognize, as pointed out in the buff statement, that the authorities intend to stay vigilant in relation to these risks, and that is very welcome.

On systemic oversight, it can be difficult to make a case for change whereas the staff and the authorities agree that current arrangements have worked well in the past, and so the case for change relies on potential gaps for inaction biases. The staff's approach of identifying first- and second-best solutions is useful, and even there we note that the specific staff suggestions on the systemic risk oversight framework may not be the only way to achieve the effective policy outcome.

Finally, on the issue of Canada's debt statistics as reported in the World Economic Outlook (WEO) or otherwise, I noted the staff's response to technical questions, and I wonder if the Statistics Department (STA) also shares this view. Notwithstanding the Canadian authorities' very open and transparent approach, since the Fund sets the standards for international government financial statistics, I must admit it is a bit surprising that we are relaxed about not applying our own standards, including in our own publications. So if the point is to have international comparability, the current approach does not seem to allow for this, which is a bit odd.

Mr. Di Tata made the following statement:

We thank the staff for a comprehensive set of papers and Ms. Levonian for her insightful buff statement. We issued a detailed gray but would like to emphasize some points.

The authorities should be commended for the sound mix of policies they have maintained over the last five years, which has been aimed at supporting inclusive growth and strengthening the financial system. Based on the staff's projections, growth could converge to a potential rate of 1.7 percent over the medium term, like that envisaged by the staff for the United States. In addition to external risks, the main domestic risk is a sharp correction in the housing market.

We welcome the focus of the consultation discussions on policies to secure sustainable growth and a resilient financial system. As a general point, we would have liked a more detailed discussion of inward spillovers, particularly from possible adjustments in macroeconomic policies in the United States.

One key issue raised in the Article IV report is the need to strengthen coordination between the federal and provincial authorities, particularly with regards to internal trade barriers, the supervision of financial institutions, and fiscal policies.

We concur with the staff that fiscal policies should continue to focus on rebuilding buffers. Given slowing growth, fiscal consolidation should be gradual. We welcome the focus of the 2019 budget on initiatives supporting the middle class, the planned adjustment of the federal government deficit following a slight expansion in 2019, and the authorities' intention to continue reviewing the tax system to reduce distortions. We share the view that the burden of adjustment remains with those provinces with high deficits or debt.

The FSSA report concludes that the financial system remains sound and resilient. The Financial Sector Assessment Program (FSAP) stress tests consisting of a combination of severe shocks, including a sharp housing market correction, show that the system is in general resilient to downside risks but that the impact on households could be significant and mortgage insurers would need a capital injection. In this regard, we fully agree with the staff on the need to resist pressures to ease macroprudential policy or introduce additional initiatives to support housing activity.

On a more general point, although financial sector oversight is of high-quality, developing a comprehensive framework for systemic risk, surveillance, and macroprudential policy implementation, including better coordination between federal and provincial authorities, is essential as the responsibilities for systemic risk oversight are currently spread over multiple levels of government.

Canada continues to play a prominent role at the global level by supporting free and fair trade and has recently been involved in several trade initiatives. Going forward, we encourage the authorities to intensify their efforts to reduce domestic barriers to interprovincial trade. We take note that lowering these barriers could generate a much larger gain than expected from the international trade agreements.

Lastly, we take positive note of ongoing growth-supporting structural reforms, such as the efforts to encourage infrastructure investment and foster a more productive workforce. At the same time, we commend the authorities for Canada's voluntary participation in the Fund's enhanced government framework and for their efforts to meet the emissions reduction targets, including by ensuring there is a price on carbon pollution across the country.

Mr. Kaya made the following statement:

My first point is on the financial sector. We appreciate that the FSAP finds that currently the financial system is in overall good shape. We take positive note that against very severe stress scenarios, the banking system has shown remarkable resilience while some vulnerabilities are confined to smaller and newer segments of the financial sector.

Like Ms. Riach and Mr. Rashkovan, I would like to highlight the growing interconnectedness of the Canadian financial system, and we are concerned that the current stress tests presented in the FSSA might have missed some possibly important sources of risks emanating from cross-border operations. We are confident that the authorities will continue to closely monitor the emerging risks and address the identified gaps.

Second, we noted with interest the emphasis of Ms. Levonian's buff statement on the carbon pricing scheme, which apparently aims to serve both climate mitigation objectives while at the same time preserving the competitiveness of Canadian business. We believe Canada's experience will provide valuable lessons for the international community by relieving manufacturing industries directly exposed to rigorous international competition, as well as a sizeable commodity sector. In that regard, we appreciate the staff's technical response to our related questions and look forward to deeper thematic analysis on this issue in future surveillance engagements.

With these remarks, we wish the authorities continued success in their endeavors.

Mr. Meyer made the following statement:

We mostly share the staff's analysis and policy recommendations. Let me highlight some points for emphasis.

First, and I am truly happy that I can just repeat the words of Canada's neighbor, we commend the Canadian authorities for a prudent macroeconomic policy mix and reforms which have supported inclusive growth and helped to reduce financial vulnerabilities. However, risks are tilted to the downside, including from rising protectionism and further escalation of trade tensions. In this context—and I really want to emphasize that—we welcome the Canadian authorities' steadfast commitment to multilateralism and international cooperation and respective leadership with regard to improving the multilateral trade system, as also highlighted in Ms. Levonian's buff statement.

As regards policy recommendations, we agree with the staff that the benign macroeconomic condition should be used to strengthen fiscal buffers. Higher-than-anticipated revenues or lower-than-expected expenditures should be used to reduce debt faster. Moreover, the staff rightly emphasizes that provincial governments could intensify fiscal consolidation efforts, in particular those with large deficits or high debt levels. In our gray statement, we did not comment on the question of the fiscal rule. I want to make one or two comments, and I have seen that in the buff statement. It is questioned if there is added value to a rule at the federal level. Maybe the added value is not there at this time, but a fiscal rule, and certainly we are talking about a second-generation fiscal rule that gives flexibility, can give longer-term credibility to future governments. Against that background, we are in favor of that. It seems to be a no-brainer that on the provincial level, there are already discussions ongoing for some of the provinces to have a smart fiscal rule as well, so we are overall supportive there.

Second, owe commend the authorities for their efforts to reduce housing-related financial stability risks. Still, household indebtedness remains high, and house price valuations seem stretched in some major cities. This calls for continued vigilance and possibly further macroprudential measures and underlines the importance to increase housing supply. Moreover, the authorities should be mindful of not diluting the effectiveness of existing macroprudential instruments by other policy initiatives such as the first-time home buyer incentive program.

We share the staff's view that reducing domestic barriers to interprovincial trade could bring substantial benefits in terms of growth and productivity growth. Actually, I think it did not come up in the last couple of years. It seems strange as these are low-hanging fruits that should be tackled.

Finally, we thank the Canadian authorities for the participation in the Fund's enhanced governance framework on the supply and facilitation of corruption. With this, I wish the authorities all the best.

Mr. Fanizza made the following statement:

I thank the staff for an excellent set of papers and Ms. Levonian for the very useful buff statement. I must say reading the paper and the statement, I could not help but feel a sense of envy for Ms. Levonian, not only because of the Raptors, but also because how well Canada is doing and how sound the policy is. I enjoyed the risk analysis of the staff, but at the same time I could not help also but think of a famous movie quote in *Charade*, when Audrey

Hepburn looks at the dashing Cary Grant and asks him, “Do you know what is wrong with you?” He answers no. She looks at him and says, “Absolutely nothing.” The risk analysis is useful and welcome, very interesting, but we end up saying if everything goes bad, all things turn for the worst, and we do scenario analyses which are worse than what has happened during the crisis, and then we realize that there are buffers to deal with it, we have a bit of a problem.

I would like to thank the staff for the answers on the fiscal rules. I must say the answers are well detailed, but they reinforce my conviction that fiscal rules actually are not implementable in the institutional setting of Canada.

Another point I wanted to make is that I really liked the analysis on trade liberalization within the country. I wanted to highlight a point. Canada is maybe the country which experienced the least backlash against globalization.

While you go ahead with liberalized trade between provinces, do you expect to have any problems because people will lose sight of this? Will there be any policies that they need to develop to minimize any possible backlash against globalization and for creating a truly national market.

Finally, I wanted to second the point raised by Mr. Guerra of not exaggerating the prescriptive size on systemic risk oversight. The staff did a very good job, but we should not get into the details, and we should leave the authorities scope for that. Again, thank you very much to everybody, and good luck to the Canadian authorities, although they do not need it.

Mr. Jin made the following statement:

On trade, we support the authorities’ efforts to improve the multilateral trade system. Given the rising risk of protectionism, we commend Canada for its leadership in international efforts to improve the World Trade Organization (WTO) and to reaffirm the importance of a multilateral trading system.

On tax policy, we see the need for Canadian authorities to continue monitoring and evaluating the effectiveness and the efficiency of the tax system. We see value in more in-depth research on the impact of U.S. tax reform on Canada, especially taking into consideration the recent Canadian tax changes in November 2018. We encourage the staff to closely monitor and evaluate the impact of tax reforms in the United Sates on Canada’s economy in this context and report to the Board.

On fiscal policy, we praise the staff for analyzing both the assets and the liabilities on the government balance sheet and encourage them to apply this same comprehensive approach to other countries. We have noted that Canada's net public debt is only about 26.8 percent of GDP as the government has sizeable, highly liquid financial assets. We welcome the staff's further analysis on the rationale of holding a large portion of their liquid financial assets on the government's balance sheet against a seemingly higher-than-necessary public debt. With these remarks, we wish the authorities every success in their endeavors.

Mr. Castets made the following statement:

I thank the staff for the very comprehensive set of papers. Like Mr. Ronicle, we appreciated the technical analysis on growth at risk and the impact of internal trade within Canada. We also thank Ms. Levonian for the very convincing and clear buff statement.

We share the thrust of the staff's analysis as Canada is enjoying a very positive economic momentum, and vulnerabilities in the financial sector have been gradually reduced. A significant development is also that since 2015, the dependence on commodities has been significantly decreased, and we see that as a major development. We will just make a few additional points today for emphasis.

On fiscal, we agree with the staff that a very gradual consolidation is adequate to recreate buffers in a context where growth is also projected to slow down slowly in the coming years, and that the burden of this adjustment, as mentioned by many Directors this morning, should be well coordinated between the provincial and the federal levels while preserving growth and enhancing reform.

On the impact of the U.S. tax reform, I had the same question as Mr. Kaizuka. We read in the staff's technical answers that the update of the assessment has not been fully done yet, and we know how complex it is, but we would just underline that this would be very helpful from our perspective to better understand what this impact is. We also read in Ms. Levonian's statement and in the staff's answers, that the staff is ready to keep adapting its own corporate income tax framework. On that, this chair's message has been consistently to say that we fear that this tit-for-tat can lead to a race to the bottom as regards corporate taxation. Once again, it would be helpful to ask the staff for a more complete assessment when ready.

On potential growth, once again in the context where we see that the growth level will decline gradually in the coming years, it is good to see that there is a shared assessment from the authorities and the staff on the necessary steps, and these include external trade diversification and internal trade. Like Directors before me, we would like to commend the Canadian authorities for their commitment to multilateralism and a rules-based trade system. It was very interesting for us to read that reducing internal barriers would bring huge potentialities for Canada.

One word on the financial system, we commend the steps taken by the authorities, highlighted in both the FSAP and Ms. Levonian's buff statement, to support the sound and resilient financial system. It appears that positive traction from past FSAPs is strong, which is also positive news for this institution; but there are still vulnerabilities linked with household indebtedness and also the risks related to the real estate sectors. Steps could include raising required capital for mortgage exposures, as well as increasing risk-based differentiation in mortgage pricing, as recommended by the staff.

Finally, one word, like Mr. Kaya on the carbon pricing mechanism, we will expect the staff to cover a bit more in-depth this very important issue going forward in the next reviews. It was particularly interesting for us, as Mr. Kaya said, and it is a heavily debated issue, to learn that 90 percent of the tax revenues raised through this carbon pricing mechanism are given back to taxpayers. It is clearly an example where we could have cross-fertilization within this Board on a quite heavily debated issue.

Mr. Tombini made the following statement:

Let me start by thanking Ms. Levonian and her colleagues for their detailed and helpful buff statement. I also thank staff for the Article IV reports, the interesting selected issues paper, and the valuable FSAP report. Once again, I note that the FSAP tends to receive less attention than deserved when the discussion comes to the Board together with the Article IV, and I reiterate that the FSAP exercise will gain prominence if some are discussed in standalone Board meetings. Of course, this is an issue that we will discuss in the context of the FSAP review.

I join other Directors in commending the Canadian authorities for their skillful conduct of macroeconomic and financial policies. Canada's economy continues to expand, albeit at a more moderate level, supported by a strong policy mix. At the same time, inflation remains subdued. At this juncture, I just want to highlight three main issues.

First, the Canadian economy is highly linked to the United States and to global financial conditions as well as to commodity markets. As many Directors noted, Canada is one of the few large advanced countries that seems to have some fiscal space to accommodate an unexpected slowdown in economic activity. Given the uncertainty in the global macroeconomic environment as we speak, this is certainly an important advantage of Canada.

Second, I commend the authorities for the implementation of macroprudential policies to reduce price pressures in the housing sector. House market pressures and high household debts seem to be the main domestic risks faced currently by the Canadian economy, with significant potential impact on financial sector stability. The Canadian authorities are well aware and taking action to contain these risks. However, given the uncertain global environment, high interconnectedness, and high financial volatility worldwide, it is important that the Canadian financial stability architecture be further improved and that financial institutions preserve and strengthen their buffers.

Third, I appreciate the staff's assessment of the meaningful benefits that can be obtained by eliminating barriers to interprovincial trade in Canada and encourage the authorities to advance the agenda focusing on low-hanging fruits. At the same time, like others, I recognize the leading role of Canada in promoting open international trade and in modernizing the multilateral trade system with the formation of the Ottawa Group, of which my own country, Brazil, is a participant.

Finally, on a more specific note, I commend the Canadian leadership on gender policies, and I underscore the approval of the Canadian Gender Budgeting Act and the creation of the Department of Women and Gender Equality. This is an example of good policy that can be followed by other countries.

Mr. Mahlinza made the following statement:

I would also like to commend the authorities for the prudent macroeconomic management and the notable steps toward trade integration, and particularly their leadership role in improving the multilateral trading system.

I would like to also express appreciation to staff for their focus on in the report on trade and non-tariff barriers. We found this analysis quite interesting. We also want to thank them for the response to our technical question on the macroeconomic impact of the CPTPP, and we look forward to the staff’s response to the question raised by Mr. Kaizuka on this point.

Finally, we also thank the authorities for their participation in the voluntary assessment on supply and facilitation of corruption. However, we note differences in the depth of coverage between the assessment that has been done for Denmark, Switzerland, and now on Canada and would like the staff to look at this with a view to harmonize the assessment.

Mr. Razafindramanana made the following statement:

We join other Directors in thanking the staff for the insightful set of reports and Ms. Levonian for her helpful buff statement. We commend the Canadian authorities for their leadership in international efforts to improve the international trading system, especially multilateralism, also for continued economic expansion and reduction in financial vulnerabilities amid heightened uncertainty in the international environment. We have noted the broad agreement between the authorities and the staff on the outlook and risks thereto, as well as policies going forward to support sustainable growth, strengthen the financial system, and improve productivity. We particularly encourage the authorities to remain vigilant to financial vulnerabilities stemming from housing finance while pursuing policies to increase housing supply and affordability. We also encourage them to accelerate implementation of structural reforms to boost productivity and competitiveness. Reducing internal trade barriers will be helpful in this regard while boosting Canada’s international efforts to improve the international trade system. We wish the Canadian authorities all the best for their endeavors.

Mr. Guerra made the following statement:

We also congratulate the Canadian authorities for the strong policy performance that has been reflected in high growth and a reduction in financial risks. Mexico is not a neighbor of Canada, but we are basically, with the United States, very strong trading partners, productive partners, and we also face very similar challenges as Canada going forward. In this regard, we want to also join other Directors in commending the Canadian authorities for their commitment and leadership in keeping the multilateral trade system open and in good shape.

Also, we look forward to the upcoming ratification of the USMCA agreement, or like the Canadian authorities like to call it, the “CA-US-M” agreement. We also notice in our gray statement that the financial system in Canada is resilient and that macroprudential policies have contributed to reducing housing imbalances, although some important challenges remain. In this regard, we appreciated the work regarding house prices in Canada by using what the staff calls the borrowing capacity approach. In reading through the technical responses and reading the staff paper, we have a question. Given that there is a strong relationship between the financial system in Canada and the United States, and given this analysis of borrowing capacity, has the staff seen any relationship between the real estate cycles in Canada vis-à-vis the United States, controlling for energy booms and busts and some other regional aspects? We also want to thank the staff for the FSSA work, which was high quality and comprehensive.

Mr. Ostros made the following statement:

There are so many positive things to say about the Canadian economy, so I will just concur with my colleagues and commend the authorities for their commitment to open and free trade in a pretty difficult environment. I am very glad also that we have a free trade treaty in place between the European Union and Canada that I think is beneficial for all of us.

I would like to highlight two issues. On financial markets, it is very interesting to follow Canada because it belongs to a group of advanced economies, and I also have countries in my constituency, where in the environment of very low interest rates and some constraints in housing supply, have been struggling with containing rising house prices, and Canada has effectively introduced several macroprudential measures and thereby is also contributing to our data set of macroprudential effectiveness. I earlier had the view that it seems like some of the macroprudential measures have first-round positive effects containing house prices, but the basic forces behind the rising house prices come back after a while, and there is only a short-run effect of a macroprudential measure. Is Canada an example of macroprudential measures that have had more persistent effects in containing house prices? It would be interesting to hear the staff's views on that and what we can learn from that experience. I also agree with the staff that the authorities should carefully monitor possible effects of the first-home-buyer incentive on aggregate house prices.

The other issue is fiscal policy. It is hard to be critical when it comes to the net position of Canada when it comes to fiscal policy. It has a strong net position. I tend to agree with Mr. Meyer when it comes to the usefulness of the fiscal rule in the medium and long term giving a bit more stability to long-run fiscal policy, especially when it comes to the relation between the federal government and the provinces. It is interesting to see that a province like Ontario has during the last decade increased its net debt from 26 to 40 percent. Is that a trend that the local authorities try to contain? It is a development that could give rise to some concern in the medium and long term. How does this system work? Is there an expectation of an implicit guarantee from the federal government to the provincial level? Does the staff see interest rate differentials between different regions when they borrow? How could the fiscal rule contain that type of tendency? I would not exaggerate my worry. I am just interested in the relation between federal and provinces when it comes to fiscal policy.

Mr. Daïri made the following statement:

We join other Directors in commending the authorities for their outstanding performance and also for their leadership in many core areas that are crucial for global stability and inclusive growth.

I would only comment on the issue of data statistics that we raised with other Directors in our gray statement. Ms. Levonian said that the authorities were concerned by the intention to change the way the Fund treats debt statistics, and from the response of staff, I understand that there is no intention to change the way it is done. Maybe I missed something. Does this mean that the issue is over, at least for the time being? That it is very important to avoid giving the impression that Canada is behind the curve in terms of statistics. On the contrary, they are ahead of the curve in this very important area, and the way that the issue is mentioned in the footnote in the staff report may give the impression that Canada is behaving worse than other countries. It is important to avoid such a wrong perception, and in fact, it would be useful maybe to indicate somewhere that Canada’s statistical practices are very advanced, even compared to the best practices that the Fund is using.

Mr. Palei made the following statement:

I congratulate the Canadian authorities for a very good performance, and I just wanted to add a few comments or questions. The first one is on the use of a fiscal rule. Canada is an energy exporter, and the authorities did rely on a fiscal rule for a long time, but now they seem to have had a change of heart, and it would be useful for the staff to reiterate the arguments about the costs and benefits of having fiscal rule at the federal level versus not having it.

Another question I have is about the Risk Assessment Matrix (RAM). As I understand it, we have this Global Risk Assessment Matrix (G-RAM) that is prepared Fund-wide, and then it is used as a source for presenting global risks. When I look at the Risk Assessment Matrix for Canada, on page 13, it is mostly red and yellow, and I understand the red color. It is rising protectionism and retreat from multilateralism. But then the question is about the green color, and the G-RAM has sharp tightening of global financial conditions. It has the green and yellow. It is not clear what is the probability of global financial conditions tightening. But I thought the country RAM should follow the G-RAM, and in this case, I see some differences. Could the staff clarify the approach here?

The staff representative from the Western Hemisphere Department (Ms. Lim), in response to questions and comments from Executive Directors, made the following statement:[1]

I thank the staff for all the excellent questions that were raised this morning and in the gray statements. We have provided a lot of details in our technical responses, so I will just touch on four issues that generated the most questions, and the first one is the fiscal rule. Nobody is perfect, so we are going to have to go through some of the motivation of why we recommended the fiscal rule, the impact of the US. tax reform, macroprudential policy, and net debt accounting.

On the fiscal rule, I think there was a 60/40 split between those in favor and those who opposed, so this is a legitimate debate that we are having, and the team understands where the objections are coming from. We agree that federal finances have been managed well, but the bottom line of our message is that just because it is managed well today, does not guarantee that it will be managed well tomorrow.

We have, in fact, already seen an erosion in the government's commitment to maintaining a downward debt trajectory in successive budget statements. The Parliamentary Budget Officer (PBO), the equivalent of the Fiscal Council in Canada, has noted that the government has not been consistently reporting its current and projected fiscal status against any clear deficit and debt objectives. Over time, there is a risk that markets and credit rating agencies will interpret this as an erosion of the government's commitment to fiscal discipline, particularly since both provincial and federal governments have been guilty in the past of procyclical fiscal policy.

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[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

We have seen a lot of experience around the world in the Fund and around this table, and the Fund collective experience in this regard was well documented in the Fiscal Affairs Department's (FAD) Staff Discussion Note (SDN) last year on second generation fiscal rules. That body of work shows that rules can help to mitigate the risks of fiscal slippage and deficit bias, allowing buffers to build in good times and more room to maneuver should economic conditions deteriorate. That body of work also shows that if rules are accompanied by well-designed escape clauses, they may not overly restrict policy flexibility when large downside risks materialize.

Let me bring this closer to home, to Canada. Rules have worked well in some of the key provinces. They have worked well in British Columbia. They have worked well in Quebec. Ontario is now proposing new legislation to improve the fiscal framework. There is no reason to think that rules will not work at the federal level. A question was raised earlier whether or not there is a connection between federal and provincial support. There is in terms of how credit rating agencies look at credit and provincial finances. Implicit in the credit ratings of provincial debt is the implicit support of the federal government. That actually helps in terms of provinces' borrowing rates in the markets.

Why are we recommending a fiscal rule? There is no better time than now when the economy is doing well. The government itself is projecting deficits to gradually narrow and debt to decline. Against this favorable backdrop, it would be easy to formulate a rule that satisfies both the government's objectives and bolsters the credibility of the fiscal framework at the same time.

We are not dogmatic about fiscal rules. If we were to concede that a fiscal rule is not necessary, at a minimum, the staff would recommend that the government publicly communicate more specific details of its fiscal objectives and provide more regular and realistic reporting on progress against consistent and measurable fiscal anchors in its annual budgets and fall economic statements.

Let me move on to the second question on the impact of U.S. tax reform on the Canadian economy. I hear you, and I think this is an issue that we need to look at in the next Article IV consultation. In this Article IV, it was difficult for us to disentangle the effects of the U.S. tax changes for two reasons. First, the ongoing trade policy uncertainty is affecting business investment. Second, it is still too early to assess the effects of the recent Canadian tax reforms, which was only introduced in November 2018, and this tax reform was to allow capital expensing for certain asset classes, and that could dampen the effects of the U.S. tax reform. We have these two opposing effects, and it was hard to disentangle the two, but I agree that this is something that the staff should clearly monitor going forward.

On the question about the scope for introducing further changes in macroprudential policies should financial vulnerabilities increase, the short answer is yes. There is considerable scope to do so. Currently we view the macroprudential stance as appropriate. We are not recommending any changes to the macroprudential stance. If vulnerabilities were to increase, further macroprudential or tax measures could be considered, and in some of the technical responses we try to give some flavor of what instruments can be considered. Let me reiterate them here. The government has the ability to tighten loan-to-income (LTIs), loan-to-value (LTVs), debt-service-to-income (DSTIs). They can also—and we would very much like to see—harmonize provincial and municipal real estate taxes such as CFMs into broad-based measures targeted at speculative activity, and this could essentially include a stem duty on second or third properties for both residents and non-residents, no differential rates, just on second or third properties. There could be a vacancy tax on empty properties. That is what British Columbia has done, except that they have differential rates for residents versus non-residents, and we are asking for that to be harmonized. Or there could be a speculative tax on properties that are resold in less than 24 months. All of this will require federal provincial coordination because some of these tools belong to different authorities.

On the debt accounting issues, as many of you have noted, the main issue of contention relates to how accumulated equity assets are treated when computing net debt statistics. I wanted to reiterate that the staff have no plans to change the way Canada's debt is reported in the staff report or for the WEO. We have consulted with the Research Department (RES) in preparation for the Board meeting, and we are told that going forward, after the fall 2020 WEO, RES will look into the feasibility of reporting public sector liabilities, public sector assets, and public sector net worth to provide a more comprehensive and transparent picture of public sector balance sheets.

Let me respond to a few other questions that were raised. On the CPTPP, I believe there was an assessment that was done by the Global Affairs in Canada, and what was noted is that unlike TPP, the CPTPP will not result in any erosion of Canada's preferential access to the U.S. market established under the North American Free Trade Agreement (NAFTA). That accounted for the difference in terms of the economic impact.

On the question about the capacity to borrow approach that we used to estimate house prices in Canada and whether or not the real estate cycle in the United States and Canada are in sync, we actually have not applied that approach. This is work that was done by our colleague in RES who joined the mission. That would be an interesting exercise to do, particularly since that approach showed that in Canada, households almost always max out the ability to borrow. If you give them the ability to borrow US$100, they will borrow up to US$99.99. There was a question that was raised earlier about the persistence of macroprudential policy, and why does it work so well in Canada. That might explain it. The latest macroprudential measures that the regulator introduced was a 200 basis point stress test. In effect, borrowers have to qualify for a higher rate when they borrow, so that hits directly at the heart of the ability of households to borrow, and that is why it was effective. Whether or not this applies to the United States, it would be useful to see, and I would encourage my colleagues in RES to apply that approach and to see whether or not in some ways the real estate cycles are synchronized or at least can be explained by this particular approach.

In terms of the composition of portfolio flows, most of that reduction was because of a reduction in inflows of investors buying corporate bonds and money market instruments in Canada. What is exactly driving it is something that we are looking at.

The staff representative from the Monetary and Capital Markets Department (Mr. Shabsigh), in response to questions and comments from Executive Directors, made the following statement:

On fintech, our approach has been slightly different from what we have done in the other two FSAPs that were recently conducted where fintech issues were raised. Canada has been quite active on the research side, quite advanced on this front, particularly on the payment system and financial market infrastructure (FMI). We are producing a technical note that will detail all of our findings there. The development there is not yet macrocritical, so it did not feature in our FSSA analysis with one exception, it is noted in the context of Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) issues with regard to crypto assets. But we will be producing a technical note detailing our findings.

On the stress testing, the stress test was conducted on the Canadian banks' full balance sheet, which includes foreign operations as well, and also it featured shocks to key markets for Canadian financial systems in Canada, in the United States, in China, and Europe. In that sense, we are capturing the spillover effects on the Canadian banks.

On the systemic risk oversight architecture, yes, we concur there is no one formula that fits everybody. We were following on the previous FSAP recommendation on establishing a single body. It became clear that under the current constitution legal framework, this may be difficult to achieve. Nevertheless, there was a broad recognition that the system needs to be modernized in light of the evolution of the banking system becoming more international, more complex, and the elevated risks in the non-bank sector, which we highlighted in the FSSA. Many of these issues are under the oversight of provincial regulators. After extensive discussions with all the stakeholders, we proposed an incremental improvement to existing institutions, and we presented it as one option, as was clearly stated in paragraph 49.

The staff representative from the Strategy, Policy, and Review Department (Mr. Kramarenko), in response to questions and comments from Executive Directors, made the following statement:

I would like to address two questions that were raised. There were a few questions about the net debt and the question was whether STA was consulted. The expectation is that staff would use the most relevant concept for macroeconomic analysis, and that is how net debt definition for Canada was constructed. According to the guidance from STA, the staff provided full disclosure about the definition, so Footnote 16 on page 16 provided the disclosure of how we exactly define the macroeconomic that is relevant for the analysis, and Table 4 on page 45 provides an even fuller picture about the net worth of the government; and readers could see for themselves all the components that go into the asset and the liability side. In terms of disclosure, we followed all the good practices, and there is no misunderstanding about what is included and what is not included in the concept of net debt.

There was also a question about the RAM. I would like to confirm the understanding that the global risks and their descriptions should be uniformly provided for the membership, and we made our effort to make sure that everything is consistent, and it looks like in this particular case we have the correct matrix. But we will have another look just to make sure that the color coding is exactly the same.

There was a question about risk No. 2, and if you look at column No. 3 on impact, it says low and medium. Low risk applies to changing global risk appetite due to market expectations of tighter U.S. monetary policy, and the medium risk apply sustained rise in the risk premium, so this is a double assessment. But we will have another look to make sure that the color coding is fully consistent.

Mr. Palei noted that the G-RAM referred to relative likelihood as low-medium, so presentation was confusion.

Mr. Jin remarked that on the balance sheet of the public sector, there was a large portion of illiquid financial assets on the asset side. He wondered why the government borrowed so much and invested in liquid financial assets.

The staff representative from the Western Hemisphere Department (Ms. Lim), in response to further questions and comments from Executive Directors, made the following additional statement:

A significant share of the general government assets are not liquid. Non-financial assets constitute around 40 percent of total assets. This is based on data in 2019 first quarter. A significant share of the other assets that might be liquid are matched with liabilities on the other side of the balance sheet. For example, accounts receivable is 13 percent of total assets, but that broadly matches accounts payable on the liability side. Similarly, the whole discussion we have been having on net debt, the equity holdings on the asset side largely match liabilities related to public pension funds, and that is about 18 percent of total assets.

Ms. Levonian made the following concluding statement:

I want to start off by thanking Directors for their kind, insightful comments, and I am sure my authorities will be very appreciative of the input provided. In particular, I am blushing over the comparison to Cary Grant. But having said that, given this chair, maybe Marilyn Monroe would have been a better comparator.

I also want to sincerely thank Ms. Lim and Mr. Shabsigh and their team for their very hard work and constructive feedback throughout the process. It has been a very good experience. There is so much to address, and I am going to try and limit my comments, but given that it was an FSAP year, this might go a little bit longer than otherwise.

Despite heightened global economic uncertainty, Canada continues to perform strongly in 2019, registering the second-highest growth rate among

G7 countries. Canada's fiscal policy stance tries to balance the need to put debt on a steady downward track with the goal of boosting productivity through targeted investments. After a series of policy rate increases in 2017 and 2018, the current accommodative stance on monetary policy is appropriate in view of the balance of risk around the outlook. A balanced macroprudential stance has reined in housing-related vulnerabilities while avoiding a disruptive hard landing in the housing market.

The financial system continues to balance the policy goal of stability, innovation, and competitiveness while ensuring that consumers are protected. Authorities will continue to monitor developments and are prepared to adjust as required, leveraging their strong position and institutions.

I will pick up on a few subjects that we have talked about. First, on trade, I just want to thank everybody for their kind comments with respect to Canada's leadership. In 2018, we did see a significant trade uncertainty resolved for Canada's economy. We reached agreement in principle on a new free trade deal that will enhance North American competitiveness. Canada and the United States also resolved some of their trade differences cooperatively, which resulted in the recent lifting of tariffs on both sides of the border. These steps were in the right direction, but just as we have discussed, trade tensions continue to weigh.

Looking at trade from a different perspective, and that is internal trade to Canada, Canada as a federation has its constraints as well, and as this year's excellent paper on internal trade highlighted, free trade is not just a matter of foreign policy, but an important domestic policy issue as well. Differing regulations across provincial and territorial borders can act as a barrier to internal trade. This is why authorities are absolutely committed to keeping domestic trade barriers on a steady decline by working cooperatively. This is a perennial issue in Canada, and we are steadfastly working toward it, and the recommendations by staff are extremely helpful in that respect.

On the topic of the fiscal rule, which clearly generated a healthy debate, I am simply going to say that one size does not fit all in Canada, and we have clearly outlined our position at the federal level and at the sub-national level. Several provinces do have fiscal rule, while others do not, but this does not lessen Canada's commitment to sound management of public finances at all levels of government.

A few words on housing, the staff's positive assessment of Canada's macroprudential stance is welcome, validating my authorities' efforts to take the so-called froth out of the housing market. We also understand the need to prioritize supply-side housing measures to promote an affordable market. While the Article IV consultation shows that Canada is on the right track, I want to reassure you that my authorities are not getting complacent in any way in containing housing-related vulnerabilities. On the first-time home buyers plan, analysis done shows that the impact is going to be extremely minor to housing prices. It is 0.02 percent to 0.04 percent, a very negligible cost to support the policy objective of helping first-time home buyers.

On tax issues, Canada has a competitive, broad-based and efficient tax system. Its corporate rates are among the lowest in the G7, and when you live next to a very friendly, very neighborly, but extremely innovative elephant, you really do have no choice but to ensure that you are continuously monitoring the tax landscape to make sure that we remain efficient and competitive.

Lastly, on the FSAP, given it is an FSAP year, I would like to take a few moments to talk about the financial sector. First, our authorities welcome the comprehensive FSAP exercise and the overall conclusions about the resilience and soundness of the financial system. Second, the staff's stress tests and those conducted by the Bank of Canada confirm that the banking system would remain resilient even under an extremely stressed scenario.

Third, Canada has made overall good progress on implementing the 2014 FSAP recommendations, and our authorities remain committed to further enhancing the resilience of the financial system and press ahead with further reforms. Overall, financial sector oversight is of high-quality. The regulatory and supervisory framework are in strong compliance with international standards. I would like to emphasize that the institutional arrangements currently in place for the systemic risk oversight have worked well. While our authorities welcome the objectives behind the staff's recommendations to continue to strengthen coordination of systemic oversight, it is important again to keep in mind that one size does not fit all.

Having said that, I would say that the proposed Federal Capital Market Stability Act would further strengthen the capacity to monitor and manage systemic risks in capital markets.

Finally, the voluntary assessment of supply-side governance issue was a valuable exercise that my authorities look forward to continuing, and we encourage other members to do the same. I would just close by again thanking staff for their incredible collaboration and helpful recommendations.

The Acting Chair (Mr. Lipton) noted that Canada is an Article VIII member, so no decision was proposed.

The following summing up was issued:

Executive Directors broadly agreed with the thrust of the staff appraisal. They commended the Canadian authorities for their sound management of the economy and progress in reducing financial sector vulnerabilities. They noted that growth has slowed to a more sustainable level and inflation is well contained. The economic outlook is nevertheless susceptible to risks, including from housing market imbalances, high household debt, and continued trade tensions. Going forward, it would be important to rebuild policy buffers, preserve financial stability, and boost productivity and competitiveness.

Directors agreed that fiscal consolidation should remain gradual and growth-friendly. They welcomed the authorities' commitment to preserve Canada's low debt advantage and recommended using unexpected fiscal savings to reduce deficit and debt. They encouraged provinces with high deficits or high debt to make the necessary fiscal adjustment. Many Directors saw the benefits of well-designed fiscal rules in strengthening the credibility and transparency of the fiscal framework, although a number of Directors noted that, given Canada's sound fiscal management, an explicit fiscal rule has limited value added and could limit the ability of fiscal policy to respond to shocks. Directors concurred that if downside risks materialize, automatic stabilizers should be allowed to operate fully. They welcomed ongoing efforts to review key elements of the tax system, with a view to enhancing its efficiency and competitiveness.

Directors supported the current accommodative stance of monetary policy. Given the balance of risks and uncertainty around the outlook, they agreed that monetary tightening should proceed with caution, guided by incoming data.

Directors noted that macroprudential measures have mitigated housing-related risks to financial stability. They encouraged the authorities to stand ready to adjust macroprudential tools if needed, and to harmonize provincial and municipal tax measures into broad-based tax measures targeted at speculative activity more generally. Supply-side policies to improve housing affordability would help address housing imbalances on a more durable basis.

Directors welcomed the assessment that the overall financial system is healthy and resilient. They also noted that the informal framework for systemic risk surveillance and crisis management has served Canada well. While acknowledging that there is no one-size-fits-all solution, Directors encouraged continued efforts to modernize the arrangement, and strengthen microprudential oversight and safety nets along the lines of the FSAP recommendations. They welcomed Canada's voluntary participation in the Fund's enhanced governance framework on the supply and facilitation of corruption. They looked forward to further progress on strengthening the AML/CFT and anti-foreign bribery frameworks.

Directors welcomed the authorities' commitment to trade diversification and free trade. They commended Canada for leading an international effort to improve the multilateral trade system and for rapid ratification of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership. Directors encouraged all levels of government to work together to continue reducing internal trade barriers and better facilitate infrastructure investment.

Directors stressed the importance of boosting long-term growth. They supported recent initiatives to promote a more productive workforce, a more competitive business environment, and greener infrastructure.

It is expected that the next Article IV consultation with Canada will be held on the standard 12-month cycle.

APPROVAL: April 22, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Fiscal Policy

1. ***In the buff the authorities have expressed their concern related to the Fund's proposed changes to the reporting of Canada's debt statistics in IMF publications. We invite staff comments on this.***

- The key issue relates to whether accumulated equity assets associated with public sector pension plans are accounted for in net debt calculations, where differing treatments across countries can complicate comparisons. Canada takes account of these assets when computing its net debt statistics, while most other countries in the WEO database do not. During the recent Article IV mission, staff discussed areas in which Canada's debt definitions differ from WEO reporting guidelines and noted that country teams for several other advanced economies have recently revised the way they report debt to the WEO to be closer to the guidelines.
- While excluding equity in pension funds from Canada's public debt statistics (as suggested by WEO reporting guidelines) would improve cross-country debt comparisons, it could also be viewed as weakening incentives for other countries to ensure that public pension and social security plans are properly funded over the long term. Given the strong push back from the authorities and that the WEO database does not currently include public net worth—Canada's preferred definition of its fiscal position—staff will continue to treat Canada as an exemption to WEO debt reporting standards.
- Canada should be commended for its comprehensive and transparent approach to reporting its public sector balance sheet. While there are definitional differences between the way Canada's debt statistics are reported in the WEO database relative to many other countries, the IMF has no plans to change the way Canada's debt is reported for the WEO. The IMF continues to strive to set the appropriate statistical standards and to ensure that national statistical agencies adhere to these standards to the best of their ability.
- Staff will elaborate more on this at the Board meeting.

2. ***However, could staff comment on the difference in views with the authorities on the appropriate reporting of debt statistics, as outlined in the buff by Ms. Levonian, Ms. Vasishtha, and Mr. Weil?***

- Please see answer to 1. above.

3. Did staff consider reporting debt statistics under the two presentations, which would preserve international comparability while maintaining and incentivizing adequate level of transparency?

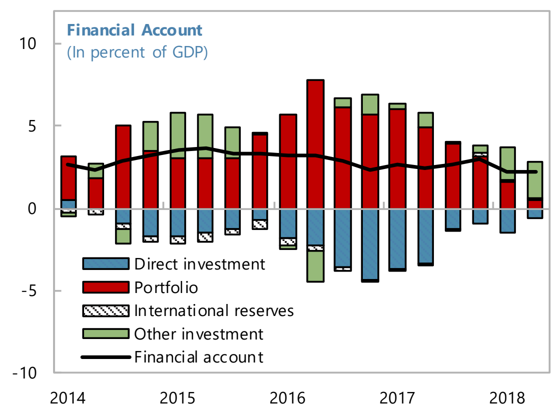
- Please see answer to 1. above.

4. Could staff comment on the issue, with particular respect to the concern about the perceived inconsistency with the direction of international accounting standards?

- Please see answer to 1. above.

5. After the recent changes to tax policy in the U.S., do staff see any impact of the U.S. tax changes on capital flows between Canada and the U.S.? Also, could staff explain if Canada has changed its tax policy in response to the U.S. tax cuts?

- While overall capital flows have been broadly stable as a share of GDP since the tax changes came into effect, the composition of flows has changed, with a reduction in portfolio inflows offset by rising inflows of other forms of investment (e.g. other equity, currency and deposits, loans etc). It is difficult to disentangle the effects of the US tax changes because of ongoing trade policy uncertainty and the impact of the recent Canadian tax reforms.



- The 2018 Fall Economic Statement motivates the Canadian tax changes as follows:
- *"The Government is committed to ensuring that Canada continues to innovate in the face of international developments such as the recent U.S. tax reform and to responding in a fiscally responsible way. Because the full effect of U.S. tax reform on Canada's economy can only be determined over time, going forward businesses and governments will continue to consider the implications of the U.S. tax changes on the Canadian economy and the integrity of the Canadian tax system, including the details of different elements as they are established through regulation. To that end, the Government is taking steps now to support Canada's competitiveness, while continuing to monitor the impact of the U.S. tax reform on Canada's business sector."*

6. In this respect, we wonder whether there is an intention to withdraw the recent expansion of tax allowances for investment in synch with the prospective unwinding of tax incentives in the U.S.?

- Both countries initially scheduled the tax allowances to be in place for five years. The U.S. allowances are more generous by allowing immediate expensing for all assets, while Canada allows for immediate expensing for plant and machinery and clean energy investment, with investment in other asset classes benefiting from accelerated expensing (up to three times normal rates). In the U.S., the provisions are scheduled to be phased out between 2022 and 2026. In Canada, the provisions will be phased out between 2023 and 2027.

7. Although we understand that this increase in federal expenditure has been fully financed by windfall tax revenues, could staff comment whether it represents permanent or temporary spending, given the possibly transitory nature of the revenue gains?

- The increase in federal expenditure largely reflects temporary spending. The federal government projects spending to gradually decline as a share of GDP over the next five years. Revenue is projected to remain broadly stable as a share of GDP. Looking ahead, downside risks to revenue projections are a key reason behind staff's recommendation that future positive surprises should be saved and used for deficit and debt reduction.

8. Considering the Canadian constitutional setting, would it be at all feasible that all the provinces (while some of them have already adopted fiscal rules, as described in §31) accept introducing fiscal rules that are mutually compatible and consistent with one at the federal level?

- Given provinces' constitutional rights over their own fiscal positions, it is difficult to imagine that they would accept fiscal rules proposed by the federal government. Moreover, appropriate rules would likely be quite different across provinces, and depend on each province's specific source of fiscal imbalance, natural resource endowment, and need for protecting infrastructure investment. Overall, fiscal rules that enhance credibility, transparency, and fiscal sustainability across provinces and the federal government could be viewed as being mutually compatible.

9. In the event provinces violate their fiscal rules, there could be a need for the federal government to offset the impact on the general government debt. How could the fiscal rule at the federal level be devised to allow for the needed flexibility, without making it too complicated?

- Tying the federal government's fiscal rule to achieving a general government debt target would be a moral hazard problem that could ultimately put the onus of achieving fiscal sustainability for all governments on the federal government. This is because the federal government has very limited power to dictate and enforce fiscal policy decisions made at the provincial level. Hence, we recommend rules that achieve fiscal sustainability in a transparent and credible way for each province. During downturns, automatic stabilizers would be allowed to freely operate, and the rules would incorporate well-defined contingencies and escape clauses for exceptional circumstances. The view here is that if the federal government and the provinces independently credibly commit to achieving sustainable fiscal positions, the fiscal position of the general government would also be sustainable.

10. While we see merits in establishing fiscal rules to strike the right balance between accountability and flexibility in principle, we acknowledge authorities' concerns that such rules may have limited benefit for Canada, given its leadership in fiscal transparency and responsible fiscal management, and may hamper policy flexibility under current heightened levels of uncertainty. We welcome staff's comments and further elaboration on this. Moreover, we would like to seek staff's clarification on the authorities' concern over the Fund's proposed changes to the reporting of Canada's debt statistics in IMF publications.

- While Canada has an enviable fiscal position, there is some scope for improving fiscal reporting at the federal level. We understand that the federal government has social objectives, and that it is committed to maintaining its low-debt advantage. Yet, the government does not consistently report its current and projected fiscal status against any clear deficit and debt objectives. The government could provide more regular and realistic reporting on progress against consistent and measurable fiscal anchors in its budgets and Fall Economic Statements.
- Simple, transparent fiscal rules could better anchor the medium-term budget framework. Rules can help to mitigate the risk of fiscal slippage and "deficit bias," particularly during election cycles, allowing buffers to build in good times and more room to maneuver should economic conditions deteriorate. They also may not overly restrict policy flexibility if large downside risks materialize, if accompanied by well-designed escape clauses.
- Staff will elaborate more on this at the Board meeting.
- On Canada's debt statistics, please see answer to 1. above.

11. The authorities think that Canada's low debt advantage, declining debt-to-GDP ratio and commitment to regular and transparent financial reporting, obviates the need for a more explicit federal fiscal rule or debt target. How do staff assess this authorities' view?

- Please see answer to 10. above. Staff will elaborate more on this at the Board meeting

12. Could staff elaborate further on the differences of views with the authorities, who see limited value in introducing fiscal rules? Also, what are the mechanisms

(formal or informal) in place to coordinate fiscal policy between the federal and provincial governments?

- On fiscal rules, please see answer to 10. above.
- Fiscal federalism is a key tenet of the Canadian economy, and the constitution set the division of powers between the federal and provincial governments. As such, there is no single institution which oversees public finance at the general government level. That said, there are informal mechanisms in place for coordination. For example, Finance Ministers from the federal and provincial government meet regularly (at least once a year) to discuss and better coordinate fiscal, tax, and other matters. These meetings are complemented and supported by the Continuing Committee of Officials (CCO), a Deputy Minister level group, and various CCO sub-committees (Tax, Federal-Provincial Relations, Economic and Fiscal Affairs), which meet twice a year.

13. We welcome staff comments on the current prospects of adoption of the fiscal rules at the federal level and in the provinces that currently do not have one.

- Since the explicit commitment to a balanced budget was abandoned in 2016, the federal government has stated that Canada's low debt advantage, declining debt-to-GDP ratio and commitment to regular and transparent financial reporting, obviates the need for a more explicit federal fiscal rule or debt target.
- At the provincial level, the new government in Ontario appears to be committed to shoring up the province's public finances and has announced its intention to balance the budget by 2024. It has also proposed legislation to replace the Fiscal Transparency and Accountability Act with a new, modernized legislative framework that emphasizes fiscal sustainability, enhances transparency, and strengthens accountability and compliance Alberta still has not adopted a fiscal rule.

14. Could staff indicate if the authorities are open to removing tax deductibility of interest for debt-financed investments? What has been the authorities' reaction to recommendations to eliminate provincial real estate taxes on nonresidents or harmonizing them into broad-based tax measures targeted at speculative activity?

- The authorities appear to be open to the prospect of removing the tax deductibility of interest for debt-financed investment in combination with permanently allowing immediate expensing of all capital investments. However, they are also aware that such a move would require careful analysis to ensure that implementation does not create disincentives for longer-term forms of investment, notably infrastructure investment.
- The federal authorities are comfortable with the recommendation to eliminate provincial real estate taxes on nonresidents or harmonizing them into broad-based tax measures targeted at speculative activity. They also recognize that to durably address

housing affordability concerns, greater efforts across all levels of government are needed to support housing supply.

15. Noting staff advice that provincial governments could double the pace of consolidation, even given the large deficit in Alberta in the face of lower oil prices, can staff elaborate as to whether provincial governments have a role in the delivery of counter cyclical fiscal policy, or if this is the responsibility of the federal government? Can staff explain the fiscal burden sharing measures among the federal and provincial governments given their heterogeneous revenue sources?

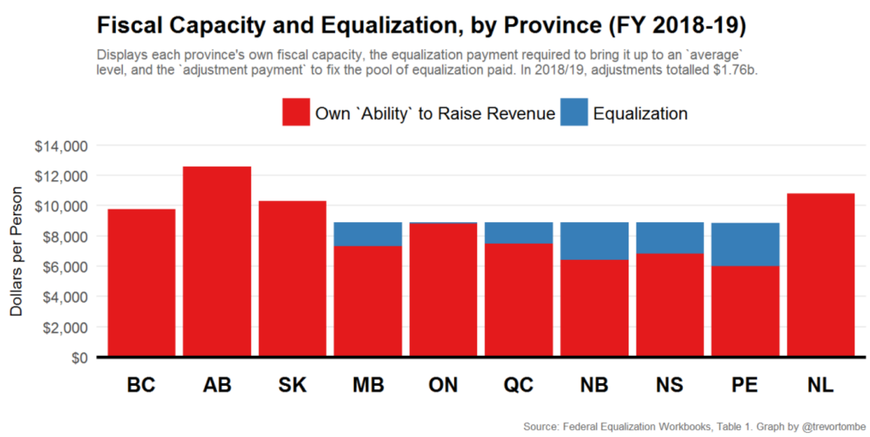
- Rebuilding fiscal space creates room in the budget to finance policies that promote growth and enhance the economy's resilience to adverse shocks. As such, counter-cyclical fiscal policy should play a role at all levels of government. Both the federal and provincial authorities (notably Alberta and Ontario) have been guilty in the past of procyclical fiscal policy, which can weaken their ability to react should adverse risks eventuate.
- The Government of Canada provides significant financial support to provincial and territorial governments on an ongoing basis to assist them in the provision of programs and services (ranging from 16 to 20 percent of provincial revenues for the four largest provinces). There are three main transfer programs: the Canada Health Transfer (CHT), the Canada Social Transfer (CST), and Equalization.

Federal Transfers, % of Own Revenues, 2018	
Alberta	16.6
British Columbia	17.4
Ontario	16.6
Quebec	20.7

- The CHT and CST are federal transfers which support specific policy areas such as health care, post-secondary education, social assistance and social services, early childhood development and child care. Both the CHT and the CST are allocated to provinces on an equal per-capita cash basis. Total CHT cash grows in line with a three-year moving average of nominal GDP, with funding guaranteed to increase by at least 3 percent per year.
- The Equalization program provides unconditional transfers to the provinces. The purpose of the program was entrenched in the Canadian Constitution in 1982. Equalization enables less prosperous provincial governments to provide their residents with public services that are reasonably comparable to those in other provinces, at reasonably comparable levels of taxation.
- Equalization entitlements are determined by measuring provinces' ability to raise revenues. Equalization asks a simple question: How much revenue would each province raise with tax rates equal to the national average? This is a province's "fiscal capacity".
- Before any adjustments, a province's per capita Equalization entitlement is equal to the amount by which its fiscal capacity is below the average fiscal capacity of all

provinces – known as the "10 province standard". Total equalization cash grows in line with a three-year moving average of nominal GDP.

Federal Support to Provinces and Territories (millions of dollars)			
	2017-18	2018-19	2019-20
Major Transfers			
Canada Health Transfer	37,150	38,584	40,373
Canada Social Transfer	13,748	14,161	14,586
Equalization	18,254	18,958	19,837
Offshore Offsets	36	-72	-64
Territorial Formula Financing	3,682	3,785	3,948
Total - Federal Support	**72,870**	**75,416**	**78,680**
Per Capita Allocation (dollars)	*1,997*	*2,038*	*2,097*



16. ***In the previous Article IV report, staff had assessed the non-resident property tax measures as Capital flow measures. Could staff offer deeper insights on the impact of those measures?***

- The provincial taxes on non-resident buyers and the B.C. speculation and vacancy tax amount to capital flow management measures (CFMs), because they limit capital flows. Staff's view is that provincial and municipal real estate taxes on non-residents should be eliminated or harmonized into broad-based tax measures targeted at speculative activity more generally (see paragraph 36). While Staff have not assessed the quantitative effects of the measures, the Bank of Canada recent study (Staff Analytical Note 2019-8) shows that provincial and municipal tax measures have dampened price expectations in the Vancouver and Toronto areas. The effect of the taxes on expectations is estimated to be immediate, negative and statistically significant in Vancouver. The immediate impact observed in the Toronto area is also negative, albeit not statistically different from zero. The study also finds that the policy's peak effect occurs one quarter after its introduction, the negative effect being highly significant in both Vancouver and Toronto areas. By the fourth quarter of 2016, the tax had decreased expectations by approximately 5 percentage points in Vancouver. In other words, the tax cut house price expectations by half.

17. On provincial real estate taxes on non-residents, we support the staff's appraisal that they should be replaced by broad-based tax measures that target speculative activity more generally. Could staff describe the possible alternative tax measures more in detail?

- As mentioned in answer to 16. above, provincial and municipal real estate taxes on non-residents could be eliminated or harmonized into broad-based tax measures targeted at speculative activity more generally. This could include a stamp duty tax on second or third properties, a vacancy tax on empty properties, or a speculative tax on properties resold in less than 24 months. See the 2018 Selected Issues Paper "Balancing Financial Stability and Housing Affordability: The Case of Canada" for more details.

18. We note in this regard that the authorities have devised a carbon-pricing mechanism, which also aims to preserve the competitiveness of Canadian companies. We would appreciate if staff could elaborate on the details of this scheme.

- Carbon pricing in Canada is a tax levied on the carbon content of fuels at the Canadian provincial, territorial or federal level. The federal Greenhouse Gas Pollution Pricing Act, which passed in December 2018, implemented a revenue-neutral tax which applied only to provinces and territories whose carbon pricing system did not meet federal requirements. In provinces where the tax is levied, 90 percent of the revenues are returned to tax-payers. Some provinces (Ontario, Manitoba, Saskatchewan and New Brunswick) have opted out of previous provincial carbon tax systems. The Province of Saskatchewan challenged the constitutionality of the federal Act in the Court of Appeal for Saskatchewan and lost in May 2019. Recently, Alberta passed a Bill to repeal its provincial carbon tax. Canada's government intends to impose a federal carbon tax on Alberta, effective Jan. 1, 2020.

19. One year after the U.S. tax reform, could staff share their assessment of the impact of the U.S. tax reform on Canada's economy?

- Staff has not made a recent assessment of impact of U.S. tax reform on Canada. Staff will elaborate more on this at the Board meeting but key points to note are as follows.
- As discussed in the 2018 Staff Report, the potential economic and fiscal impact of the U.S. tax reform could be substantial, but the full consequences of the reform are complex, uncertain, and require careful analysis. Using aggregate cross-country data on asset holdings in Canada, staff estimates suggested that, as a result of changes in the average statutory rate and METR in the U.S., real investment in and profit shifting towards Canada by U.S. companies might fall by around 6 and 15 percent, respectively, and their payments of Canadian CIT by about one-quarter.

- Importantly, it is worthwhile noting that these estimates are subject to many caveats and were made prior to the Canadian tax changes in November 2018, which will dampen the effects of the U.S. reform on Canada.
- Interestingly, both the Canadian authorities and market analysts have been surprised by the recent strength of corporate revenues—a key source of the positive fiscal surprises experienced by the federal government over the past 2 years.

20. We would also be interested by staff analysis on the impact of the new tax provision on investment expensing, and whether it can weather off the impact of the US tax reform.

- Please see answer to question 19. above.

Financial Sector

21. We are somewhat surprised by the severity of the adverse scenario assumed by the stress test – which envisages a deterioration of the economic conditions substantially worse than the one experienced during the Global Financial Crisis. That might cast doubts about its realism. Staff's comments would be welcome.

- The impact of the global financial crisis (GFC) on Canada was relatively limited compared with the United States. There were no bank failures. Since then, macrofinancial vulnerabilities have increased, notably elevated household indebtedness and housing market imbalances, making the financial system more vulnerable now than prior to the GFC. Hence, any credible stress testing scenario would have to be more severe than the GFC experience.

22. As staff note, Canada's financial system is highly interconnected, so – consistent with the IEO findings on financial surveillance – we wonder whether the value added of the Fund's stress tests would have been greater had there been more focus on cross-border spillovers, noting that the interconnected analysis only includes bond and equity markets in the 29 systemically important financial centers. For example, we note the important role Canadian banks play in some markets outside of this group, something we understand is not covered by staff analysis. Staff comments would be appreciated.

- The stress tests of banks and life insurers captured businesses in Canada as well as overseas, using a macrofinancial scenario that features shocks in all key markets that major Canadian banks and life insurers are operating (see Table 5 of the FSSA). The impact of macrofinancial shocks abroad was thus captured by stress test results.
- Foreign-owned banks and life insurers operating in Canada are relatively limited. The stress tests did not capture smaller institutions, including these foreign-owned entities.

In the adverse scenario, these institutions could be affected. However, spillovers would unlikely be significant given that their operations in Canada are small relative to their entire groups' operations.

- Due to limitation on granular data, the FSAP was not able to analyze cross-exposures among major Canadian and foreign financial institutions (mostly, in the United States). Existing aggregate data suggest that interbank linkages among Canadian banks are more limited than those between major Canadian and U.S. banks.

23. What is the authorities' view of the staff's recommendation to complement macroprudential oversight with stronger mircroprudential supervision and safety nets?

- There is a broad agreement on the need for an institutional modernization to ensure effective systemic risk oversight going forward. There are different views in terms of approaches, and these views differ between federal and provincial authorities, as well as across agencies.
- While the BOC's role in systemic risk surveillance should be formalized, the Heads of Agencies Committee (HOA) could serve as a federal-provincial platform to discuss systemic issues and formulate policy responses. In staff's view, this is the only inter-agency committee that has the potential to bring all relevant federal and provincial authorities together.
- In addition, the adoption of the Capital Markets Stability Act can help close an important gap, namely in the area of securities markets, which are overseen by multiple provincial securities market regulators.

24. Although existing safety nets mitigate these vulnerabilities, could staff comment on whether there is scope for introducing further changes in macroprudential policies to address these risks?

- Staff views that the current macroprudential policy stance is appropriate. This view reflects the findings that major deposit-taking institutions would be resilient in the face of severe macrofinancial shocks. At the same time, the FSAP called for additional required capital for mortgage exposures at deposit-taking institutions (as risk weights for mortgage exposures are too low) and mortgage insurers (which would face capital shortfalls). This set of measures are largely from the microprudential perspective.
- Regarding emerging vulnerabilities, these new risks do not pose significant stability risks yet. It is important that the authorities enhance risk monitoring and conduct further analysis in these areas. If a buildup of risks continues, prudential measures could be considered. This may require significant efforts given that such prudential tools belong to multiple authorities, including at the provincial level.
- Staff will elaborate more on this at the Board meeting.

25. ***In this context, we also note staff's view in the FSSA that a "single body in charge of systemic risk oversight would be the first-best solution". As there is no further explanation on this in the report, we would welcome staff's comments on how they come to this conclusion. In our view, macroprudential policy frameworks have to account for country-specific institutional setups to be effective, and there is no one-size-fits-all solution.***

- The recommendation that a "single body in charge of systemic risk oversight would be the first-best solution" is based on the 2014 FSAP. The authorities have not implemented this particular recommendation.
- The financial system has been evolving rapidly, with new exposures and instruments, complex interconnectedness, and fintech developments blurring traditional financial sector boundaries. These factors create significant gaps in the current setup, which include (i) the lack of an integrated surveillance framework that is critical to monitor and analyze emerging risks that do not clearly belong to particular agencies, and (ii) the lack of a federal-provincial platform to discuss systemic issues and formulate policy responses.
- As recommended in the 2014 FSAP, there should be a single body established by law with a clear mandate and appropriate powers to be in charge of systemic risk oversight. The authorities note that this is difficult to be set up within the current constitutional/legal framework.
- As a result, this FSAP while re-affirming that the 2014 FSAP recommendation is still the first-best option provided a set of recommendations that would help lead to incremental improvement of systemic risk oversight in Canada. This could be achieved in three broad steps as outlined in paragraph 49 of the FSSA.

26. ***Could staff explain why FSAP stress tests did not cover repos and derivatives whose use has increased cross-sectoral linkages and counterparty risk?***

- A full analysis of the risks associated with repos and derivatives and repos would require highly granular bank-level data (including the breakdown of exposures by counterparty type and name). The FSAP mission did not have access to this information given their highly confidential nature. The analysis on this issue could be done by individual banks in the context of bottom-up stress tests, which were not in the scope of the FSAP.

27. ***Going forward, we agree with staff that growing cross-border financial interconnectedness can general stronger spillovers (para. 22). Could staff elaborate any plan on incorporating this area in the future?***

- The FSAP analyzed risks related to growing cross-border financial interconnectedness from a number of perspectives. First, stress tests of banks and life insurers captured significant overseas businesses of major financial institutions. Second, cross-border spillovers through stock and bond markets were analyzed using market data. Third, the review of banking and insurance supervision looked at how the Office of the Superintendent of Financial Institutions (OSFI) supervise globally active banks and life insurers. As we highlighted in paragraph 39, these are areas the authorities should work on to close the identified gaps.

28. Could staff comment on whether high concentration poses an additional risk for financial sustainability?

- The high concentration of the financial system could positively and negatively contribute to financial stability. On the positive side, the concentrated system implies an oligopolistic market structure that allows major banks to enjoy some competitive edges, including the ability to attract cheap deposit funding and maintain decent mortgage lending margins. On the negative side, the concentrated system means a small number of large institutions that are all systemically important. Staff analysis as mentioned in paragraph 10 of the FSSA suggested that potential contagion effects have increased over the past decade.

29. While staff say that universal banking business models have generated solid earnings, could staff elaborate more on how these business models contribute to the Canadian banks strong profits even in the low interest rate environment? What are the prominent characteristics of Canada's universal banking business models compared to other advanced economies with the low interest rate environment?

- There are four broad sets of factors that support Canadian banks' strong profitability. First, Canadian banks generate sizeable non-interest income, and the sources of non-interest income are also diversified, ranging from wealth management and payment services to capital market activities. Second, favorable macrofinancial conditions in Canada and to a lesser extent in the United States have contributed to low credit impairments and thus robust net interest income. Third, major Canadian banks enjoy an oligopolistic market structure, with a strong position to attract cheap deposit funding. Fourth, certain Canada-specific features contribute to profitable mortgage lending such as low capital charges and government support to housing finance.

30. We were wondering why the risk assessment matric for the US article IV estimates that the tightening in financial conditions represents a low risk, compared to a medium risk in the case of Canada.

- In the Risk Assessment matrix, the likelihood of this risk low (see the text under "Impact") and is consistent with the US AIV.

31. In case the price corrections are triggered in the future, whether and if so, what appropriate policy measures should be taken to stabilize the housing price and the financial system? How likely would the vulnerabilities facing some smaller banks and private lenders finally cause systemic risk in case of the pullback in market funding during economic downturns?

- As mentioned in the Risk Assessment Matrix, Staff would recommend the following policies in case of a large house price correction: (i) ensure adequate loss absorbing buffers in the banking and insurance sectors, (ii) provide emergency liquidity, (iii) ensure proactive supervisory and effective crisis management frameworks are in place, (iv) loosen macroprudential policy if credit falls significantly and (v) loosen monetary and fiscal policies if the effects are widespread.
- Smaller banks and particularly private lenders are very small relative to the overall financial system, and only a portion are comparatively less resilient due to funding and business model vulnerabilities. Nevertheless, problems at these institutions could impair the flow of credit to non-prime mortgage borrowers, who face difficulty securing credit from other lenders. This could amplify the procyclical effects of falling house prices during a severe downturn.

Monetary Policy

32. Could staff explain why they believe these very estimates of the neutral rate of interest could be used as a policy guidance despite their limited level of confidence?

- There is always significant uncertainty around estimates of neutral interest rates. From a policymaking perspective, central banks typically look at estimates from variety of different models when determining the particular neutral interest rate used to formulate policy decisions. The decision on which neutral rate estimate to use could be based on any one of many methods, including taking a simple average of viable estimates, a Bayesian model average of all estimates, or choosing the average estimate from the model with the best historical forecasting performance. In any case, monetary policy transparency is enhanced with some acknowledgement of the uncertainty around neutral rate estimates, either through the publication of endogenous interest rate projections and associated fan charts or, less explicitly, through central bank communications around the appropriate policy stance.

33. Could staff comment on the implications for Canada's monetary policy of changes in the U.S. Fed's interest rate policy?

- Staff take the assumptions on the future Fed's interest rate path from the U.S. team. This future path assumes one hike in 2019 and one in 2020.

- Staff use a semi-structural model of the Canadian economy to inform their forecast including from changes in the U.S. output gap and Fed's interest rate policy. The transmission mechanism is via output gaps. In other words, any change in Fed's interest rate policy is reflected in the U.S. output gap which in turn affects Canadian output gap and the Bank of Canada's policy rate. The recent change in assumptions regarding Fed's stance by the U.S. team (from two hikes in 2019 to one hike) and slight downward revision of the U.S. output gap in 2019 could potentially widen the current small negative output gap in Canada. This is one of the reasons why Staff do not project any increase in Bank of Canada's policy rate in 2019.

34. We take note that staff's baseline scenario projects a gradual increase of the policy rate after 2019 towards the estimated neutral nominal rate (around 3 percent), compared to the current 1.75 percent rate. We wonder if this expected trend incorporates the more recent signaling by the US Federal Reserve on its policy stance. Staff's comments would be welcome.

- Please see answer 33. above.

Housing Market

35. We also welcome the introduction of the "attainable price" as a statistic, which captures a household's ability to buy a housing unit, as an improvement over estimates based on regressions and long run averages. However, this statistic disregards investors in the housing market, whose adequate price is captured by the NPV of housing rents. Staff kindly shared with us preliminary estimates of the NPV-base prices, which better explain much of the divergence between the attainable and observed prices in apparent over valued metro-areas (Toronto, Vancouver and Hamilton). We believe that policy advice in Article IV and SIP should address both types of housing buyers as they are affected differently by various policy tools. In addition, the choice of the most suitable statistic or set of statistics for adequate house prices should also include statistical comparisons of the difference between various measures and the observed price. Staff comments are welcome.

- The Staff Report and the SIP focused on the "borrowing-capacity" model due to its robustness and its relevance to most households who buy housing for their own housing services consumption. Both approaches (borrowing capacity and the NPV) give similar estimates of "fundamental" housing values for most periods and regions. The policy advice in the Article IV is fully consistent with both methodologies.

36. We take note on the First-Time Home Buyer Incentive, which lower the borrowing costs through cost sharing mechanism with the Canada Mortgage Housing Corporation. Given the size and targeted nature of this program, we welcome

staff's further elaboration on the concerns raised in the report, with regard to the impact of debt accumulation and the perverse effect of inflating prices in other cities.

- First, the targeted nature of the program makes it easily identifiable the likely borrowers under the program and what their housing choices would have been without the program (mortgage size, value of the property, etc.). This opens a way for sellers or developers to set higher prices for this clearly-identifiable housing segment (or, simply house prices not declining in this segment, as they might have if demand was constrained; observed prices need not increase). Thus, borrowers in this segment could end up with higher debt than initially intended. Second, the upper limit on income also introduces another distortion at the margin (i.e. for households who do not qualify by a small margin, there is zero subsidy). In the United Kingdom, where the Help-to-Buy program was much broader and larger, the real-estate transactions and prices started to "bunch" around the program's income and value limits. Similar bunching of real-estate deals around the program limit is likely in Canada too.

37. In this respect, could staff comment on whether the housing overvaluation issue remains macrocritical for Canada? Did staff verify the results with other valuation methods, such as the intrinsic-value approach?

- Indeed, staff have compared the results with the "intrinsic-value" approach. The results are similar. Housing over-valuation in selected metropolitan areas persists. The overvaluation in these cities will persist unless income grows significantly faster than current rates or interest rates decline. Given that interest rates may not fall as they did after the GFC (the experience of Edmonton and Calgary), the likelihood of a price correction increases. A sharp adjustment in house prices in these large metropolitan areas could have macro-critical consequences.

38. We share staff recommendations contained in the selected issues paper to increase housing supply as well as affordability. We share the conclusions presented in analysis of the housing market prices that market valuation seems to be too elevated in certain localized urban areas, with a strong connection between housing prices and households' ability to borrow; in the short term, mortgage interest rates should more clearly differentiate households' borrowing capacity and underlying risk profile; over the long-term supply-side policies should be encouraged. We would welcome staff comments on current government plans in this regard.

- Provincial programs for affordable housing and the recently expanded Rental Construction Financing Initiative to increase the supply of rental units for middle income households are welcome. However, only a limited number of units have been built so far and demand for rental housing continues to outpace supply. Municipal, provincial, and federal governments need to work together to identify why delivery has been slow and develop a coherent housing supply strategy. The recent establishment of an Expert Panel on the Future of Housing Supply and Affordability is a step in the right direction.

Trade

39. Could staff comment on the timeline for legislative approval of CUSMA?

- For the deal to come into force, it needs to be ratified by all three countries in their respective legislative bodies. In Canada, the bill—C-100 or the "Canada United States Mexico Agreement Implementation Act"—was tabled in the House of Commons on May 29.
- According to the text of the legislation tabled, the bill is set to allow the federal cabinet to set regulations after the bill passes Parliament, should there be changes made during the ratification processes in the U.S. and Mexico. With limited sitting days left in the parliamentary calendar before the House of Commons rises for the summer, reports suggest that it is an open question whether the agreement will be ratified in Ottawa before the federal elections in October.

40. We would appreciate it if staff can elaborate on the impact of trade disruptions to the Canadian economy, for example due to the imposition of automotive tariffs, including through increased trade policy uncertainty.

- As mentioned in the Risk Section a shift toward protectionism and economic isolationism would reduce global trade, capital and labor inflows, and global growth. A further escalation of trade tensions between the U.S. and its major trading partners would negatively affect Canada’s exports, impact global value chains and lower business confidence and investment.

41. Does staff have estimates of the macroeconomic impact of CPTPP on the Canadian economy?

- Staff estimates suggest that the successful implementation of CPTPP could boost Canada’s output by around 0.1 percent (see the 2018 Canada Staff Report). This is in line with the authorities’ estimate. Their study suggests that joining the CPTPP is expected to provide a net advantage to Canada resulting from increased market access and greater regional economic integration with Asia-Pacific countries. The CPTPP is projected to boost Canada’s GDP by $4.2 billion in the longer term (i.e. by 2040) or about 0.2 percent of GDP. This is significantly higher than the GDP gains of $3.4 billion that were projected under the TPP that included the United States. This increase in GDP is driven by increases in exports of goods and services, and by increases in investment.

42. ***We also note that for the second year, staff reduced the EBA current account gap because of a steeper-than-usual discount between Canadian oil prices and international prices and a difference between the authorities' demographic projections and the UN projections used in EBA. How long does such a discount need to persist before it is considered the new normal and how long does a difference in demographic projections need to persist before staff either use the Canadian authorities' projections in the EBA model or decide no adjustment is needed? Relatedly, can staff indicate if national demographic projections in other countries differ significantly from the UN projections?***

- The sharp increase in the discount at the end of last year was temporary. This was indeed confirmed by the sharp reduction of the discount seen in 2019 (shown in Figure 4). Regarding the use of UN projections, RES uses this for the estimation of their multi-country model since their goal is to use a database of population dynamics that is available and comparable across countries. For the case of Canada, the vintage used in the baseline estimation does not include the immigration projections used by the authorities, which has implications for the CA norm. We are not aware of any systematic cross-country analysis documenting differences between UN and local population projections.

43. ***We would like to hear some perspectives on the consequential impact on imports and inflation, stemming from the uncertainty over U.S. trade policies. We invite staff comments.***

- Uncertainties over U.S. trade policies are assumed to dissipate in the baseline and their effects are assessed in the risk section. A further escalation of trade tensions between the U.S. and its major trading partners would negatively affect Canada's exports and business investment. In turn, this would lead to lower output growth and lower inflation.

44. ***On a related point, we would appreciate staff's elaboration as to what extent its findings are consistent with the existing literature which documents that products that were not traded or were traded very little before liberalization ("least traded products") grow faster than the relatively heavily traded products following trade liberalization.***

- Our findings are consistent with this argument. Least traded products –as well as least trading provinces– are estimated to have larger trade barriers in our framework. As a result, full trade liberalization implies a greater reduction in these barriers and therefore greater growth in trade flows.

45. The selected issues paper offers a convincing analysis for breaking the barriers for interprovincial trade, with estimates suggesting increase of a GDP per capita by about 4 percent. Given that this has been a longstanding issue with complex dimensions, what is staff's assessment of the political traction for and related timelines involved to achieve a common minimum platform for internal trade?

- Internal trade barriers are indeed a longstanding issue and nothing short of a sustained and concerted collective effort will be necessary to break down barriers that are impeding Canadian businesses from competing on a level playing field and scaling-up. Staff welcome the recent initiatives from the authorities that aim to make progress on this issue. Their stated intention to promote inter-provincial collaboration for the removal of barriers in transportation regulation, construction regulation and building codes, and trade in alcohol is a step in the right direction The timeline for this, however, has not been specified. Staff believe the authorities should push further to set clear targets for reducing the number of exemptions included in the new Canadian Free Trade Agreement and strengthen the process of reconciling regulatory differences between provinces.

Structural Issues

46. Figure 9 shows that business investment and productivity growth have been sluggish, with productivity growth lagging that of the US since 2002. Is this mainly due to low business investment?

- When decomposing long-term growth in Canadian productivity, we find that weak business investment has indeed driven lower productivity growth during the last decade. This weakness has in fact partially offset a recovery in multi-factor productivity growth. Last year's Selected Issues Paper entitled "A Closer Look at Labor Productivity in Canada" provides a more detailed discussion on the importance of business investment in driving these productivity dynamics.

47. Similarly, we are surprised that with respect to the Global Competitiveness Index, the lowest scores were for "Infrastructure and ACT adoption." Could staff comment on the shortcomings with respect to the latter, as well as reinforcing contracts and getting electricity.

- According to 2018 Global Competitiveness Report Canada ranks 12th overall, with a score of 79.9 (out of 100). Yet its level of *ICT* (Information and Communication Technologies adoption is very low (68.6, 34th) and represents the weakest aspect of Canada's competitive ranking. The poor score on "Infrastructure" is due to low railroad density, low efficiency of train, seaport and air transportation services, and low electric power transmission and high distribution losses (as a percent of output).

However, the score might be skewed by the small sample size. In addition, the low "ICT adoption score" is due to low mobile cellular telephone, mobile broadband and fiber internet subscription.

48. We would like to hear more from staff on the progress of these initiatives for increasing female labor force participation. Staff comments are welcome.

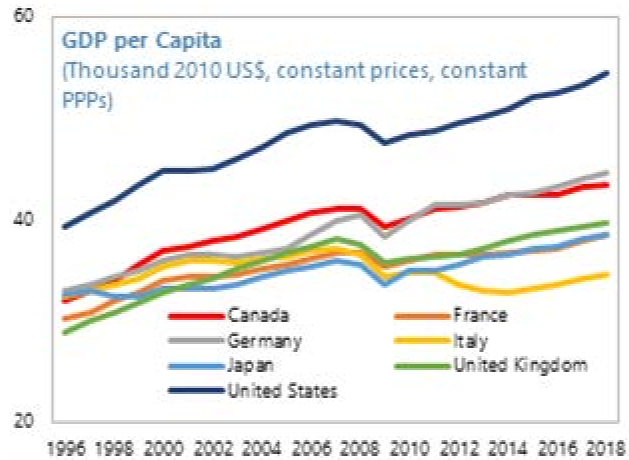
- The federal government has implemented a series of progressive measures to encourage women to actively participate in the workforce. The measures include: (i) a new "Employment Insurance Parental Sharing Benefit that provides two-parent families who agree to share parental leave to receive an additional five to eight extra weeks of leave; (ii) amendments to the Canada Business Corporations Act to require federally incorporated firms to make annual disclosures about the diversity of their senior management teams and boards of directors; (iii) new pay equity legislation to ensure that female and male employees in federally regulated businesses receive equal pay for work of equal value; (iv) a new Canadian Gender Budgeting Act and Results Framework to enshrine the government's commitment to take into consideration the impact of policies on both men and women; and (v) the creation of a new Department of Women and Gender Equality.

49. Could staff comment on the main assumptions regarding structural reforms behind the staff's medium- term growth projections, as well as on the authorities' views about medium-term growth?

- The Bank of Canada assumes that growth in Canadian potential output will be 1.8 percent over 2019 through 2021 and 1.9 percent in 2022. Softer business investment relative to the April 2018 Monetary Policy Report reduces the projected growth rate of trend labor productivity. This effect is largely offset by strong immigration, which boosts growth of the working-age population and contributes to a forecast of higher trend labor input growth. Over time, growth of trend labor productivity is expected to improve as the drag on investment growth from the oil sector and elevated trade policy uncertainty wanes. However, trend labor input growth will continue to slow because of population aging. Staff's growth rate assumption of potential GDP is slightly lower than the Bank of Canada's estimate but the underlying narrative is fully consistent with the Bank's assumptions.

50. Regarding staff's finding of a sizable productivity gap relative to the U.S., could staff provide additional comments on the evolution of GDP per capita in Canada relative to other major advanced economies?

- The chart below shows the evolution of GDP per capita for Canada and other major advanced economies. Similar to productivity dynamics described in the staff report, Canadian productivity slow-down has led to a widening gap with respect to the United States. Germany has also recently surpassed Canada's GDP per capita levels. Nevertheless, Canada's GDP per capita level is still higher than most other G7 economies.

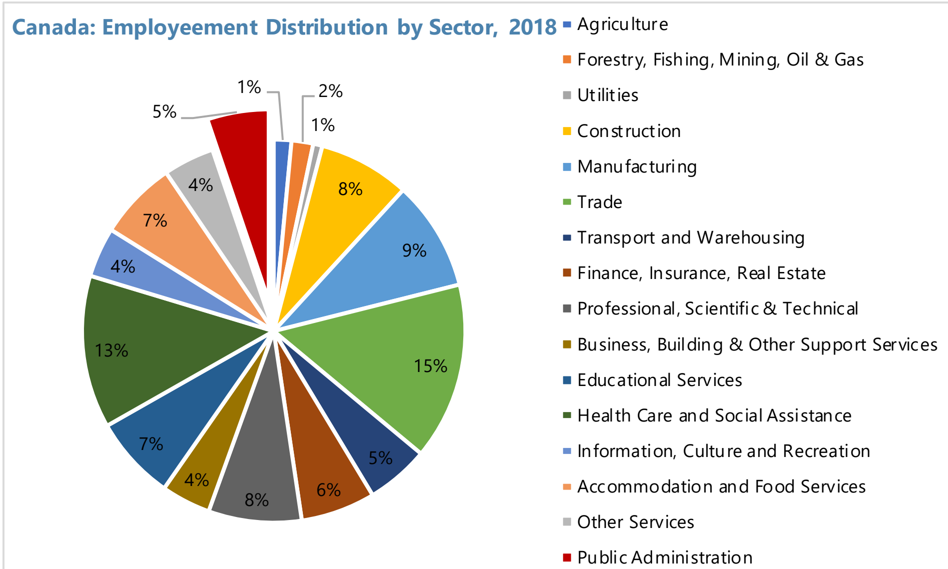


51. ***Could staff provide an update on the implementation of the Innovation and Skills Plan and Superclusters Initiative?***

- As indicated in footnote 38, the authorities have made significant progress on the implementation of the Innovation and Skills Plan. This includes the approval of immigrant applications, the approval of high-skill immigrant applications, the streamlining of business innovation programs from 92 to 35, and the completion of project selection for the Superclusters initiative. Five superclusters were selected (expected 10-year GDP impact in parentheses): (i) the Ocean Supercluster in Atlantic Canada (Can$14 bn); (ii) the AI-Powered Supply Chains Supercluster in Quebec (Can$16.5 bn); (iii) the Advanced Manufacturing Supercluster in Ontario (Can$13.5 bn); (iv) the Protein Industries Supercluster in the Prairies (Can$4.5 bn) and, (v) the Digital Technology Supercluster in British Columbia (Can$5 bn). All of these are still at early stages of implementation. The authorities have also committed Can$795 million of public money for the Strategic Innovation Fund to leverage a total investment of Can$8.1 bn, and investment commitments of Can$1.5 bn for the Venture Capital Catalyst Initiative.

52. ***Could staff provide more information on the employee distribution by sector (i.e., how many in the civil service and how many in SOEs) and by industry? What industries are SOEs mainly concentrated in?***

- In terms of employee distribution by sector, the Trade and Health Care and Social Assistance are the two largest employers.



- In terms of SOE employment in Canada, there are a total of 194,984 employees (104,608 for provincial and 90,376 for federal) in 2010, accounting for around 1 percent of the country's total employment. The power/electricity/utilities sector has the largest number of SOE employees at the provincial level.
- The SOEs are highly concentrated in the financial sector. according to “Daria Crisan and Kenneth J. McKenzie (2013): Government owned enterprises in Canada”, there were 44 federal Crown corporations holding $386.2 billion in assets (23 percent of GDP) for the fiscal year ending in 2010. The vast bulk of the assets are held by Crown corporations in the financial sector. The Canada Mortgage and Housing Corporation holds around 75 percent of all Crown corporation assets, followed by Export Development Canada (8 percent), Farm Credit Canada (5 percent) and the Business Development Bank (5 percent). In total, these four corporations account for 94 percent of federal Crown Corporation assets.
- There are also around 180 provincial government-owned enterprises which hold $554.5 billion in assets (the largest being Caisse de dépôt et placement du Québec, an institutional investor that manages several public pension plans and insurance programs in Quebec). The financial sector also accounts for the largest share of provincial Crown assets (70 percent of total assets).