

**FOR
AGENDA**

SM/10/304
Supplement 2

December 10, 2010

To: Members of the Executive Board

From: The Secretary

Subject: **Canada—Staff Report for the 2010 Article IV Consultation—
Supplementary Information**

The attached supplement to the staff report for the 2010 Article IV consultation with Canada (SM/10/304, 11/29/10), has been prepared on the basis of additional information and is now tentatively scheduled for discussion on **Wednesday, December 15, 2010**. Unless an objection from the authorities of Canada is received prior to the conclusion of the Board's consideration, the document will be published. Any requests for modifications for publication are expected to be received two days before the Board concludes its consideration.

Questions may be referred to Mr. Kramer, WHD (ext. 38491).

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the WTO Secretariat forthwith; and to the Caribbean Development Bank and the Organisation for Economic Cooperation and Development, following its consideration by the Executive Board.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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INTERNATIONAL MONETARY FUND

CANADA

Staff Report for the 2010 Article IV Consultation—Supplementary Information

Prepared by Western Hemisphere Department
(In consultation with other Departments)

December 10, 2010

1. **This supplement reports on developments since the staff report (SM/10/304) was issued.**
2. **Recent data point to a further weakening in the economic recovery.** In Q3 real GDP grew at 1 percent (s.a.a.r. annualized), below staff's forecast (1½ percent), with the undershoot largely reflecting weaker-than-expected residential construction and net exports. Employment rose in November, but by less than expected; nevertheless, the unemployment rate fell to 7.6 percent, the lowest since January 2009. Meanwhile, Canada's current account deficit widened to 4⅓ percent of GDP in the third quarter. Headline and core inflation edged up but remained within the Bank's control range.
3. **Recent measures smooth the medium-term fiscal adjustment path.** The government has announced additional details on infrastructure funding, namely that it will extend by six months the deadline for infrastructure projects to be completed under the economic stimulus, to October 31, 2011. Under staff estimates, the extension of the deadline for funding infrastructure projects significantly smoothes the change in the general government structural balance for CY2011, reducing it from 1.1 percent of GDP to 0.9 percent of GDP (and possibly lower). In the staff's view, this adjustment reflects a welcome recalibration of the balance between supporting the recovery and making a start toward medium-term deficit reduction, particularly as Canada has ample fiscal space to respond should downside risks materialize.
4. **Provincial budgets consolidation plans remain on track, with recent fiscal data more favorable than anticipated.** Recently released third-quarter figures on provincial economic accounts, as well as the release of Quebec's 2009–10 Public Accounts and the Update on the Economic and Financial Situation, indicate that both sub-national government net lending, and total government net lending have improved notably since the Q2 release.
5. **On December 8, as widely expected, the Bank of Canada left the overnight rate unchanged at 1 percent for a second consecutive meeting.** The Bank noted that the global economic recovery is unfolding as expected, although risks have increased, including the key risk that sovereign debt stress in several countries could trigger additional strains in global financial markets.

6. **Financial markets conditions have remained broadly stable.** Since the staff report was issued. The Canadian dollar has been broadly unchanged vis-à-vis the U.S. dollar, while the stock market has continued to rebound. Measures of financial strains remain subdued, with the measure of interbank spreads rising slightly. Interest rates on long-term government bonds have picked up slightly, trailing the rise in U.S. treasury rates. The Bank's December *Financial System Review* noted that financial risks remain elevated, while those from the external macrofinancial environment had increased since the prior report was issued in June.