April 9, 2020
Approval: 4/16/20

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 18/65-1

2:30 p.m., July 13, 2018

1. Canada—2018 Article IV Consultation

Documents: SM/18/170 and Correction 1; and Correction 2; and Supplement 1; SM/18/173; and Correction 1; and Correction 2

Staff: Keen, FAD; Lim, WHD; Kramarenko, SPR

Length: 1 hour 11 minutes

Executive Board Attendance

D. Lipton, Acting Chair

Executive Directors	Alternate Executive Directors
M. Mkwezalamba (AE)	
D. Sembene (AF)	
A. Armas (AG)	
	C. Barron (AP)
A. Tombini (BR)	
Z. Jin (CC)	
C. Hurtado (CE)	
N. Horsman (CO)	
M. Erbenova (EC)	
H. de Villeroché (FF)	
S. Meyer (GR)	
S. Gokarn (IN)	
	M. Psalidopoulos (IT)
M. Kaizuka (JA)	
J. Mojarrad (MD)	
H. Beblawi (MI)	
	V. Rashkovan (NE)
	K. Virolainen (NO)
	L. Palei (RU)
H. Alogeel (SA)	
J. Agung (ST)	
M. Panek (SZ)	
	V. White (UK)
	P. Pollard (US), Temporary

C. McDonald, Acting Secretary
J. Morco, Summing Up Officer
M. Gislen, Board Operations Officer
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
Communications Department: Raphael Anspach, Maria Elena Candia Romano. Fiscal Affairs Department: Michael James Keen, Li Liu. Legal Department: Wolfgang Patrick Bergthaler, Kyung Kwak, Nataliia Stetsenko. Monetary and Capital Markets Department: Zsofia Arvai, Phakawa Jeasakul, Ghiath Shabsigh, J. Williams. Research Department: H. Berger. Strategy, Policy, and Review Department: Varapat Chensavasdijai, Vitaliy Kramarenko, Huidan Lin,

Misa Takebe. Western Hemisphere Department: Jorge Alejandro Alvarez Garcia Tunon, Yurani Arias Granada, Kotaro Ishi, Ivo Krznar, Cheng Hoon Lim, Troy Dale Matheson, Cristian Javier Ochoa, Krishna Srinivasan, Alejandro Mariano Werner Wainfeld. Alternate Executive Director: A. McKiernan (CO).

1. CANADA—2018 ARTICLE IV CONSULTATION

The staff representative from the Asia and Pacific Department submitted the following statement:

> This note provides information on the countermeasures introduced by the Government of Canada on July 1 in response to U.S. tariffs on Canadian steel and aluminum products. It is based on information that has become available since the staff report (SM/18/170) was issued and does not alter the staff appraisal.
>
> On May 31, 2018, the U.S. announced the imposition of tariffs on imports of certain steel and aluminum products from Canada (at the rates of 25 percent and 10 percent, respectively). The duties were applied by the U.S. following an investigation into the national security implications of aluminum and steel imports under section 232 of the Trade Expansion Act of 1962. Canada accounts for some 15 percent of U.S. steel imports and almost 40 percent of aluminum imports but steel and aluminum products represent less than 2 percent of Canadian exports and imports.
>
> In response, Canada introduced surtaxes on C$16.6 billion of imports of steel, aluminum, and 79 consumer products from the U.S, which the Canadian authorities indicate is equivalent to the value of 2017 Canadian exports affected by the U.S. tariffs. Steel products are subject to a 25 percent surtax. Aluminum and other products are subject to a 10 percent surtax.
>
> In addition, the Government of Canada will make available up to C$2 billion to support the steel, aluminum, and manufacturing industries. The measures will include: (i) extending the duration of work-sharing agreements to help employers retain their skilled workforce and avoid layoffs during challenging times; (ii) increasing funding to the provinces and territories to increase the capacity of current job and training programs available to workers affected by the U.S. measures; (iii) providing liquidity support to affected businesses; and (iv) offering up to $250 million in new support through the Strategic Innovation Fund to help bolster the competitiveness of Canadian manufacturers and better integrate the steel and aluminum supply chain within Canada.

Ms. Horsman, Ms. Young and Ms. Zorn submitted the following statement:

> On behalf of our Canadian authorities, we thank staff for a thorough report and constructive policy discussions during the Article IV mission. The

report presents a good picture of the current economic situation, prospects, and challenges for Canada, and the authorities will consider the helpful policy recommendations. The ongoing, candid dialogue between Canada and Fund staff is highly valued.

Economic Outlook

The strong increase in global economic activity experienced over 2017 helped to support a recovery in business investment and exports in Canada, lifting economic growth to 3 percent last year. This pace of growth was well above that of all other Group of Seven (G7) countries. The rate of job creation in 2017 was the fastest since 2002, driving a decline in the unemployment rate to a 40-year low, where it has since remained. Growth has moderated, as expected, to around 2 percent over the first half of 2018. While consumer spending has continued to drive the economy, housing activity has contracted sharply, owing to higher interest rates and the implementation of stricter mortgage underwriting guidelines in January. Elevated consumer and business optimism suggests that consumption and investment will make a strong contribution to growth this year.

Economic growth is expected to average slightly above potential output over the next three years, and the composition of growth will shift towards greater investment and exports, with a lower contribution from household spending. Monetary policy and fiscal policy are expected to support economic activity over this period, helping to offset the drag on business investment and exports associated with trade policy uncertainty and competitiveness challenges. That said, business investment is not likely to be as high as in past cycles. In April, the Bank of Canada revised up its estimates of potential output growth to 1.8 percent to end-2020.

The risks around the economic outlook appear to be broadly balanced. A global shift towards protectionist trade policies, including a breakdown of NAFTA, could cause investment and exports to disappoint. A sudden tightening in global financial conditions could reduce confidence and economic activity, while an external shock affecting income or housing markets could trigger financial instability and slower growth. However, stronger, more durable global growth would benefit the Canadian economy, and household spending and business investment could continue to surprise on the upside. Higher oil prices would also support export growth in Canada.

Trade Uncertainty

The authorities firmly believe that open, integrated, and transparent trade relationships serve the interest of the global economy. Historically, Canada and the U.S. have enjoyed a highly integrated, balanced, and mutually collaborative trade relationship. The authorities remain prepared to engage in a good faith negotiation towards a modernized NAFTA. However, this will be very difficult as long as Canada is subject to unjustified tariffs on steel and aluminum, or on any other products. In order for discussions to move forward, there needs to be a shared commitment to rules-based trade, improving North American competitiveness, and achieving an outcome that brings benefits to all three countries. On other fronts, the authorities are committed to ratifying CPTPP at the earliest, and, more generally, to forging ahead with new trade relationships with willing partners through the rules-based multilateral system.

Supportive Monetary Policy

Alongside the upward revisions to potential output, the economy is judged to have been operating close to capacity since last summer, with the industrial rate of capacity utilization close to its historical peak. The labor market has also improved overall, contributing to rising wages. These developments have been accompanied by a pickup in headline and core inflation measures, bringing them close to the Bank of Canada's 2 percent target. The Bank expects inflation to remain near its target over the next three years, with a transitory upward impact in the near term owing to higher gasoline prices. Medium and long-term inflation expectations remain well anchored.

The Bank of Canada has raised the policy interest rate three times since last July. Nonetheless, the policy stance has remained accommodative, given the presence of factors weighing on the economy and inflation forecast, with the real policy rate well below estimates of the neutral policy rate. Against the current outlook for economic growth, higher interest rates will be warranted to keep inflation near the target. The Bank of Canada will take a gradual approach to policy adjustments, guided by incoming data and an ongoing assessment of the economy's sensitivity to interest rate movements and the evolution of economic capacity.

Responsive Fiscal Policy

Canada benefits from a strong fiscal foundation anchored by low and consistently declining debt-to-GDP. At the ebb in the economic cycle three years ago, the authorities used the strong fiscal position to undertake targeted multiyear investments to strengthen the middle class and grow the economy. They chose to do so in a manner that was inclusive – with a strong focus on gender equality – and sustainable – with emphasis on a green economy. This has translated into stronger, more inclusive and sustainable growth.

Fiscal policy is now tightening with the output gap closing and growth-enhancing investments in train. The outlook for the budgetary balance shows deficits on a downward trajectory over the medium term, from 1.2 percent of GDP in 2017-18 to 0.9 percent of GDP by 2021-22. Over-performance in 2017 enabled modestly faster consolidation.

The authorities remain committed to a responsible approach to fiscal management that maintains Canada’s low-debt advantage. The federal debt-to-GDP ratio is expected to be 28.4 percent by 2022–23, down from 30.4 percent in 2017-18. The authorities agree that a simple, transparent fiscal rule could anchor the medium-term budget framework once the economy stabilizes around its potential, but heightened global uncertainty puts a premium on responsive and agile policy responses to unexpected shocks.

Fiscal federalism is a key tenet of the Canadian economy. Subnational authorities account for more than half of general government revenues and about two-thirds of overall government expenditures. The federal government works closely with its provincial and territorial counterparts towards shared goals of prosperous and inclusive economies. Most subnational governments have made considerable progress in consolidating their budgets, with general government net debt low and declining at 27.8 percent of GDP, the lowest among G7 economies.

Strengthening Canada’s Competitiveness

The authorities are acutely aware of the importance of maintaining and strengthening competitiveness. Firms choose to do business in Canada for a variety of factors: its educated workforce, its open immigration policies, its abundance of natural resources, its high quality of life, and, importantly, its stable and supportive policy environment.

Canada’s system of taxation is an important feature of its competitiveness. Its corporate tax system remains competitive vis-à-vis advanced economy peers, with statutory and effective tax rates among the lowest in the G7. The personal income tax system is progressive, with the highest earners shouldering their fair share of taxes and targeted benefits provided to low-income earners. Canada's corporate and personal tax regimes are integrated to ensure the integrity, consistency, and fairness of the system as a whole.

The authorities have undertaken regular reviews of the tax system over the years that have led to definitive improvements in the system. This includes, for example, a thorough review of tax expenditures in 2016, an assessment of R&D support in 2011, and a review of international taxation in 2008. Furthermore, tax policy measures are reviewed on a regular basis to ensure adaptation to an evolving environment.

Staff highlight the recent U.S. tax reform as a major development potentially affecting Canada's competitiveness. The U.S. over time had become an outlier with respect to corporate income tax. The present reform follows a direction already pursued by others, bringing U.S. rates roughly on par, for example, with Canadian corporate rates. The U.S. reform, however, is a complex package with tightening measures offsetting a substantial part of the static revenue impact of the corporate rate reduction. The new international measures could also have important impacts on business incentives, though sometimes in opposite directions. Some important ambiguities remain, including questions concerning consistency with international tax and trade standards.

Simplified modeling of the reform that takes into account a few selected features and past experience from different contexts can be illustrative of potential impacts. However, it is important to recognize that the real world departs from these models in very material ways, which suggests that such results should be treated cautiously.

The authorities have indicated that they do not plan to react in a knee-jerk fashion to the U.S. tax reform. They are carefully examining the impact of the U.S. changes for firms in different sectors and are listening to stakeholders to understand the varying impacts of the new developments.

Beyond Tax

The authorities remain focused on fostering a competitive business environment that will support greater economic growth and a stronger middle class. Competitiveness is a function of many factors and the authorities are already taking concrete steps in a number of areas that build the Canadian comparative advantage. These include:

Undertaking a comprehensive regulatory review to reduce inefficient, ineffective, or duplicative business regulations;

Investing in people through the Skills and Innovation Plan to ensure companies have access to a skilled, productive, and versatile workforce;

Improving the immigration system so that highly skilled workers from around the world can support a more productive economy;

Attracting new foreign direct investment in Canada through the recently launched Invest in Canada agency;

Fostering a culture of innovation across Canada, for example, through the Superclusters Initiative, the Strategic Innovation Fund, and the Economic Strategies Tables.

The authorities are committed to ensuring their policies and programs promote a level-playing field and competitive environment for all businesses to innovate, and that all Canadians have an opportunity to engage and prosper from an open, integrated, and modern economy.

Ensuring world-class infrastructure in Canada is another key tenet of the growth strategy that will enhance productivity, potential growth, and external competitiveness. The authorities have made steadfast progress in implementing a historic infrastructure investment of over $180 billion over 12 years. They do not perceive significant delays as the reprofiling largely reflects a change in federal cash outlays, not actual activity. They have also achieved significant milestones with respect to the new Canada Infrastructure Bank (CIB), with its launch, as well as the appointment of a Board and CEO, since its legislation was passed one year ago. More generally, the authorities recognize the importance of making strategic investments - with due processes underpinning their selection and execution - to ensure stronger outcomes.

A Stable Financial System

The main vulnerabilities in Canada’s financial system continue to be high household debt and imbalances in housing markets, but signs of easing have emerged recently. Greater restrictions on mortgage lending starting in late 2016, along with higher interest rates, have reduced household credit growth and, along with gains in employment and income, have pushed the household debt to an income ratio lower over two consecutive quarters, reaching 168 percent in the first quarter of 2018. Evidence thus far indicates that the quality of new mortgage loans has improved, with the share of new mortgages to highly-indebted borrowers dropping noticeably. Updated OSFI underwriting guidelines are having the biggest effects in those regions with highest house prices relative to income and where uninsured mortgages are more common. However, it is too soon to fully assess the impact of these latest changes. The authorities continue to be vigilant in their monitoring, aided by an expanded set of housing-related data. Of note, all lenders participating in government mortgage securitization programs are now required to provide loan-level data on their entire portfolio of loans, including uninsured mortgages, to the Canadian Mortgage and Housing Corporation so that it can better manage its guarantee risk.

There has also been a reduction in housing market imbalances over the past year. National house price growth has dropped to 1.5 percent from 20 percent just over a year ago, driven by price declines for single family homes in the greater Toronto area. Foreign buyer activity in both the greater Toronto and Vancouver regions has also declined in the wake of various measures imposed by provincial and municipal governments starting in 2017. These regional governments have also introduced comprehensive sets of measures aimed at increasing housing supply and affordability. In November 2017, the federal government announced an ambitious 10-year, $40 billion National Housing Strategy that will bring public, private, and non-profit sectors together to engage in affordable housing goals, including the creation of 100,000 new affordable housing units.

Against this backdrop, the resilience of the Canadian banking system, which continues to be the main provider of mortgage financing in Canada, has remained strong. Canadian banks are highly profitable, liquid, well-capitalized, and strictly supervised. In April, OSFI released final guidelines for total loss-absorbing capital (TLAC) for domestic systemically important banks (D-SIBs). Capital adequacy ratio guidelines that incorporate investment in TLAC, and related public disclosure requirements, will be effective before the end of January 2019. In November 2017, Royal Bank of Canada was designated as a global systemically important bank and is well-positioned to meet G-SIB requirements starting in January 2019.

Conclusion

Overall, the authorities believe that Canada’s strong fundamentals, including its strong institutions, a track record of consistent policies, and a flexible exchange rate and labor markets, provide a solid foundation for achieving stronger, more inclusive growth for current and future generations.

Its federation is another pillar of strength and the authorities reaffirm their commitment to foster a cooperative approach with all levels of government to advance shared-policy objectives, including in the areas of infrastructure, housing, innovation, and skills development. The authorities also emphasize the importance of working constructively in a coordinated and consistent manner in international fora towards mutually beneficial outcomes.

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

We thank staff for their clear set of papers and Ms. Horsman, Ms. Young and Ms. Zorn for their helpful buff statement. We welcome the substantive convergence of views between staff and the Canadian authorities, and the report's positive evaluation of the overall traction of the Fund's policy advice over time.

Canada has experienced strong and – importantly – inclusive growth. Supported by accommodative domestic policies and positive external conditions, the Canadian economy put in a notably strong performance in 2017. Importantly, growth was accompanied by strong gains in disposable incomes, driven by higher wages and a strengthened labor market. Full-time jobs have recorded strong gains, while part-time employment has contracted, thus apparently reducing inequality in labor earnings. Combined with the measures adopted by the federal government to promote social and gender equity – which we welcome – Canada's strong growth appears to have been broadly shared. Staff comments are welcome. Going forward, structural reforms are needed to address weak productivity growth, which – in limiting potential output – hampers further improvements in living standards.

Downside risks weigh on the outlook. Trade tensions, a shift of the global economy away from an open trade system, and a worse-case scenario of a failure of NAFTA negotiations would have a major impact on the Canadian economy. Uncertainty in the NAFTA negotiations is already affecting business decisions. While caution is warranted in estimating the economic impact of developments in this area, we note the asymmetry of more losses than gains in the scenarios of unsuccessful vs. successful NAFTA outcomes (page 24) and would appreciate some elaboration by staff. Restrictive FDI regulations stand in contrast to Canada's commitment to openness; we encourage the authorities to reduce such restrictions, which could also help mitigate the impact of U.S. tax reforms.

The U.S. tax reform could substantially reduce real investment and profit shifting toward Canada by U.S. companies. While the full effects of the reform are still unclear, and any preliminary assessment needs to be read with caution, staff analysis in the Selected Issues Paper is both comprehensive and rich. We concur with staff advice to conduct a holistic and independent review of the overall tax system so as to increase its efficiency and remove distortions. However, we tend to think that advice favoring possible reductions of statutory rates, and in general other measures that could intensify international tax competition, would be more appropriately proffered in the context of multilateral surveillance. In that setting, staff advice could be directed to benefit the international economy as a whole (in an area where – with the exception of anti-avoidance measures – there is insufficient international dialogue), rather than possibly contributing to a generalized race-to-the-bottom.

The authorities are making appropriate use of their available fiscal space, striking the right balance between debt reduction and priority spending. We concur with staff that a path of gradual fiscal consolidation is appropriate. However, we are not convinced of the usefulness of a more front-loaded adjustment at federal level to compensate for the slow pace of fiscal consolidation at the provincial level – considering that debt is on a downward trajectory and given the range of other risk-mitigating factors identified in the DSA. While we recognize that the effect of such more aggressive consolidation on growth would likely be relatively limited, the possible impact on federal expenditure on key social needs and redistribution should be kept in mind. We share staff advice on the importance of moving toward well-designed fiscal rules.

A sharp correction in the housing market could cause risks to financial stability and household debt remains a key macro-financial vulnerability. The authorities have adopted a wide range of macro-prudential measures to cool the housing market and we share the staff advice on how to move forward. Some of the measures target non-resident buyers and we look forward to staff assessment of whether they can be qualified as capital flow management measures, also in light of the forthcoming Board briefing on this topic. We note that, among the macro-prudential measures under consideration, there is apparently no reference to income-based instruments which could prevent the increase of vulnerabilities in certain segments, such as the young. Staff comments are welcome. Finally, we fully share staff advice to address the deficiencies in the AML/CFT framework to mitigate the money-laundering risks in the housing sector.

Mr. Armas and Mr. Vogel submitted the following statement:

We thank staff for the reports and Ms. Horsman, Ms. Young, and Ms. Zorn for their helpful buff statement. We broadly agree with staff's appraisal and offer the following comments for emphasis:

We are encouraged by Canada's growth rate during 2017 which was much stronger than in the two previous years. At the same time, we note that the country's rates for 2018 and 2019 will be lower than in 2017, more in line with Canada's potential growth. Precisely, one important challenge looking ahead is related to the number of structural reforms that the country should undertake, which is timely advised by the staff. Meanwhile, the staff report indicates many important challenges and risks especially linked to the fiscal area and financial systems, and Mr. Horsman's buff statement is reassuring of the authorities' awareness of them and willingness to tackle them. It is important to do it in a timely matter to clear the uncertainty in Canada, which in a few words is perfectly summed up in the staff report: "economic anxiety is high".

After two years of a timely support from the fiscal side, the output gap is closing and, considering the prevailed uncertainty and the need to reinforce confidence, the authorities are well advised on the need of rebuilding fiscal buffers. We congratulate the authorities for the policies waged over the past years which aimed at raising household disposable income and infrastructure investment. Looking forward, we note that one of the most urgent tasks in the fiscal area is related to restoring fiscal discipline at the provincial levels.

We noted from the staff report that the U.S. tax reform may trigger Canada to lose some of the tax competitiveness edge gained over the past decade. After assessing that the Canadian tax system is coming under increasing pressure, staff, in the Selected Issues' chapter on taxing business in a changing world, makes a sensitive recommendation of undertaking a fundamental and independent review of the Canadian tax system; which, according to the paper, would be the first one since 1966.

As underlined, the output gap is closing, unemployment rates are at historic low levels, and the inflation will be around the mid-point of the Bank of Canada's target range; thus, we agree with the staff that a tightening cycle of the monetary policy is needed. However, given the prevailing uncertainty and the downside risks Canada is facing, the recommendation of proceeding with caution is sensible and timely.

One critical challenge for Canada is in the financial system and is particularly linked to the banks' exposure to household and corporate debt. This entails a significant risk, especially in an environment of high uncertainty and with the new cycle of the monetary policy in which there would be higher interest rates. We welcome the staff for a set of interesting chapters in which there are helpful analysis on the policies related to macroprudential policies on one hand and on the need to increase housing supply. Likewise, another critical challenge for Canada mentioned by the staff is the need to attain an appropriate balance between reducing risk at the financial system and improving housing affordability.

We fully share the staff's recommendations for Canada and its partners to continue work constructively with the aim of reaching an agreement which could be of mutual benefits. We welcome the authorities' commitment to ratify CPTPP at the earliest and we also observe that the country has more room to improve trade policies.

With these comments, we wish Canada and its people every success in their future endeavors.

Mr. Agung and Mr. Shaari submitted the following statement:

We thank staff for the comprehensive set of reports and Mmes. Horsman, Young, and Zorn for their insightful buff statement. We welcome the good performance of the Canadian economy in the recent period which has benefited from the authorities' accommodative macroeconomic policies, a strong U.S. economy, and higher oil prices. However, combinations of domestic challenges and negative external risks provide headwinds to Canada's medium-term outlook. In this regard, the current favorable environment presents a good opportunity for the authorities to pursue further policy action to rebuild policy buffers and enhance economic resilience. Reform efforts to raise productivity and competitiveness should also be pursued more urgently to further improve Canada's economic sustainability going forward. Given this background, we agree with the broad thrust of the staff appraisal and would like to offer the following additional comments for emphasis.

Timely calibration and well-coordinated fiscal and monetary policy actions are essential to build policy buffers and anchor price stability. We take positive note that the accommodative fiscal policy stance at both federal and provincial levels has contributed to the strengthening of domestic economic activities in the last two years. As the growth trajectory is now more durable and converging towards a sustainable path, we commend the authorities for their prudent policy approach in gradually reducing fiscal stimulus and rebuilding fiscal buffers. In this regard, given the balance of risks on the Canadian economic outlook, we see the authorities' medium-term fiscal consolidation plan for the federal level to be appropriate. In contrast, at the provincial level, we see merit in staff's recommendations on the need to accelerate fiscal consolidation efforts for provinces with high deficits or debt. To enhance policy credibility and communication, we also support staff's suggestions for the federal and provincial authorities to explore the benefits of adopting a suitable debt anchor and operational fiscal rules. On the monetary policy front, we support the Bank of Canada's pragmatic stance in keeping inflation on target and appreciate its readiness to calibrate the monetary stimulus, consistent with economic developments and outlook.

A multi-pronged approach is needed to manage imbalances in the housing market. We welcome the development that house prices in Canada's major cities grew at a more moderate pace in the recent period. Given the recent moderation in property price, can staff comment on the pace of this adjustment? Is the moderation pace too fast, increasing the likelihood of a "hard landing" in the Canadian housing market? The moderation suggests that the authorities' multipronged approach that combines macroprudential, tax and supply-side measures has been effective in cooling escalating housing prices. We also concur with the authorities' view that the current macroprudential setting is appropriate to contain housing market risks to the financial sector. To minimize the risk of overcorrection in the housing market, we also support the authorities' proactive approach and openness to take additional measures if needed. To complement this positive development, continued efforts to address housing market imbalances and housing affordability in the long run should also be pursued. In this regard, we encourage the authorities to explore the viability of a broader set of supply side policies that staff presented in their Report and SIPs.

Signs of rising vulnerabilities in the banking system require extra vigilance. We take note of staff's assessment that the banking system's large exposure to household debt, particularly mortgage loans, as a key macro-financial vulnerability of the Canadian economy. In addition, rising corporate indebtedness and the rapid growth of external debt of financial institutions also expose the banking sector to greater macro-financial risk. While we welcome staff's assessment that the financial indicators of the six largest banks (D-SIBS) are strong, efforts to further enhance the resilience of the financial sector should be heightened. In this regard, staff's suggestions for the authorities to strengthen monitoring and improve coordination and information exchange between federal and provincial regulators are worth considering, particularly to better scrutinize the increasing use of home-equity lines of credit, the rise of less regulated mortgage lending, and the rapid growth in exchange-traded funds. We also look forward to the comprehensive assessment of the Canadian financial sector in the upcoming FSAP exercise.

Improving trade and tax policies, together with advancing comprehensive structural reforms, are essential to enhance competitiveness and productivity. Like most of advanced countries, the Canadian economy also experienced similar structural challenges related to low labour productivity growth, aging population and weak trade competitiveness. Sustained structural policy efforts focusing on promoting innovation and competition, upgrading labor force skills, and advancing a holistic review of the tax system would assist Canada in addressing these challenges. In addition, to restore competitiveness and attract more foreign direct investment to the country, accelerated efforts to revise and implement improved multilateral trade policies should also be given priority. A more efficient delivery of infrastructure investment will also provide a welcome lift to productivity and enhance long-term growth for the Canadian economy.

Mr. Alogeel and Mr. Rouai submitted the following statement:

We thank staff for a well-written set of reports and Ms. Horsman, Ms. Young, and Ms. Zorn for their informative buff statement. The Canadian economy is performing well, registering the highest growth rate among G7 countries and the lowest unemployment rate in 40 years. Looking ahead, while risks associated with the housing market are receding, trade tensions are fueling uncertainties and may cloud growth prospects. Against this background, we broadly agree with the thrust of the staff appraisal and will limit our comments to the following issues.

We agree with staff that Canada should use the current favorable environment to rebuild policy buffers. We welcome, in this regard, the indication that the authorities will be using half of the windfall gain from stronger-than-expected GDP growth to reduce the federal debt and the rest to boost social spending to support inclusive growth. Going forward, staff considers that the size of fiscal consolidation for the federal government is appropriate, while that of the subnational authorities is low, noting that on balance the aggregate level of the general government deficit will only decline from 1.1 percent of GDP in 2017 to 0.9 percent of GDP in 2023. Staff therefore suggests that a more frontloaded fiscal consolidation should be operated by the federal government. Is there a risk that such an approach would weaken the consolidation efforts at the provincial level and result in a higher burden of adjustment on the federal government? Staff elaborations would be welcome. We welcome the authorities' support for staff suggestion for fiscal rules to anchor the medium-term budget framework.

As pointed out in the RAM, with highly-indebted households, a sharp house price correction remains the key domestic risk that may affect financial stability. In this regard, it is encouraging to note that recent macroprudential measures were effective in reducing household credit growth and dampening house prices in major cities. As already pointed out in the last year's Article IV consultation, some of the measures discriminate between residents and non-resident buyers and are judged by staff as capital flow management measures (CFMs). In this regard, we look forward to the forthcoming briefing on the IMF Institutional View on Capital Flows (IV), which should help to better understand recent country practices.

We encourage the authorities to address the deficiencies in the AML/CFT framework noted by staff and we look forward to the forthcoming FSAP for additional recommendations to strengthen financial stability.

Finally, on trade and structural issues, we endorse staff's call on Canada and its partners to continue working constructively on NAFTA to further improve trade opportunities and promote competition. We encourage the authorities to reduce inter-provincial barriers to trade and labor mobility. We also agree on the importance of infrastructure investment and further deregulation of product markets in boosting productivity.

With these remarks, we wish the authorities all the success.

Mr. Rashkovan and Mr. Jost submitted the following statement:

We thank staff for the comprehensive set of papers and Ms. Horsman, Ms. Young, and Ms. Zornfor their informative buff statement. We welcome the sound economic developments in Canada. We share staff's assessment that the current favorable economic environment presents an opportunity to rebuild policy buffers, also given the increased uncertainty linked to global trade developments and the potential impact of the U.S. tax reform on Canada's economy. We agree with most of staff's recommendations and would like to make the following comments for emphasis.

We welcome the progress with fiscal consolidation at the provincial level but agree with staff that efforts should continue. Long-term liabilities, such as those linked to healthcare could impact the budgetary performance of provinces significantly. We take note of staff's explanation that health care costs might also adversely affect the federal budget under the Canada Health Transfer System. More generally, we support staff's suggestions to enhance fiscal governance at the federal level, i.a. via a debt anchor or operational rules. In this context, we welcome the authorities' commitment to maintaining a downward deficit and debt ratio track.

While staff recommends that Canada, displaying growth slightly above potential, should build up buffers and reduce debt levels as a contingency measure –in line with 2018 WEO recommendations– staff's recommendation for Germany is to use the entire available fiscal space. Some of the risks enumerated in both Article IV reports, in particular those linked to trade tensions and policy uncertainty, appear to be faced by both countries to a similar extent. Could staff briefly explain what the main rationale is behind the diverging recommendations?

We welcome the strong performance of the majority of Canadian banks and the authorities' efforts to step up macroprudential measures in recent years. Acknowledging the challenging political economy aspects of the matter, we encourage the authorities to monitor private indebtedness and housing prices, which are often interlinked. In particular in a low interest rate environment, downside risks continue to exist. In this sense, we agree with staff that monetary policy normalization should happen gradually. We welcome the authorities' acknowledgement of the risks in the housing sector. Finally, we concur with staff that increased coordination and information exchange between federal and provincial regulators would likely render financial supervision more effective.

Ms. Barron and Ms. Preston submitted the following statement:

The Canadian economy has performed well in recent years, underpinned by strong fundamentals, an open and flexible economy, a highly educated population and sound institutional settings. Since the time of the Article IV consultation the high impact risks such as the retreat from cross border integration and further policy uncertainty have continued to materialize. We encourage the Canadian authorities to stand ready to adjust the macro-policy mix, should globally-sourced risks evolve further. In the face of ongoing uncertainty, we welcome the Canadian authorities' steadfast commitment to multilateralism especially on issues of trade and taxation. Domestically, authorities should seek to tackle long standing structural issues that would help improve competitiveness, boost productivity and lift potential growth. We thank staff for a helpful set of reports, that recognize the political context, and to Ms. Horsman, Ms. Young and Ms. Zorn for their informative buff statement.

With the output gap closing and an increasing net debt trajectory in the provinces, fiscal policy should focus on rebuilding buffers to help protect against future uncertainty. Importantly staff and authorities agree on the need for, and direction of, fiscal consolidation to lower debt and provide the government with more options to handle future challenges. We note staff's advice that a more front-loaded trajectory at the federal level, and an additional consolidation of 0.1 percent of GDP over five years at the provincial level, would reduce general government debt by an additional 2 percent of GDP, over five years. While well intended, we see limited value in such advice to 'fine tune' fiscal policy given the agreement about fiscal policy choices. Such over-precision in the advice can limit its traction with the authorities. Exponentially increasing subnational debt over the longer term (up to 2050) without policy action calls attention to the importance of pursuing structural reforms to boost potential growth and address longer term challenges. Staff also note that contingent liabilities loom on the horizon at the provincial level. What are the most significant of these contingent liabilities and what is staff's assessment of the likelihood and impact of these crystalizing?

Fiscal rules need to strike the right balance between accountability and flexibility. In principle there is considerable merit in establishing such rules, but country specific factors relevant to Canada need to be further considered. Given the current heightened levels of uncertainty, the macro-policy mix needs to remain agile and responsive to changes in the external environment. Now may not be the right time to introduce fiscal rules that are too prescriptive.

Continued openness to trade, reducing internal trade barriers and undertaking much needed product market reforms, will help restore competitiveness, attract more foreign direct investment, boost productivity and lift potential growth. We encourage the Canadian authorities and their NAFTA trading partners to stay at the table and work together towards a successful resolution to the NAFTA negotiations. We note the table on page 10 that indicates the effects for Canada of an unsuccessful NAFTA. Can staff provide similar analysis of the impacts for all members of NAFTA? We support the efforts of the authorities to swiftly ratify the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) to help solidify deeper trading relationships outside of North America and seize the benefits offered by greater market access and export diversification. In addition, we support staff's calls for more to be done to increase FDI especially in innovative technologies, further deregulate product markets, as well as address inter-provincial trade barriers to enhance labor mobility and boost productivity and competitiveness. Further deregulation and removing barriers to competition is particularly important in product markets that are not exposed to international competition.

The US tax reform includes several novel features whose spillover effects will take more time to assess. Against this background we question staff's advice to move to a cash-flow system or adopt an Allowance for Corporate Equity. Staff note that such a radical approach would be politically difficult in the short term. It would also be technically difficult, face many implementation challenges and transition costs would be difficult to eliminate. We agree with the Canadian authorities to not react in a knee-jerk fashion to the US tax reform given the considerable ambiguities that remain.

Finally, we welcome some of the structural changes to the staff report that have provided a better experience for the reader. In particular, we like the integration of the risk assessment matrix into the discussion of risks. We also appreciate having the authorities' views consolidated and put alongside the staff assessment to facilitate a clear line-of-sight on the issues of agreement.

Mr. Tombini and Mr. Fuentes submitted the following statement:

We thank staff for the reports and Ms. Horsman, Ms. Young, and Ms. Zorn for their comprehensive statement. After weathering the oil price shock, the Canadian economy is back on solid footing, undergoing a broad-based expansion across provinces and sectors. An accommodative policy mix has supported private consumption and helped drive the unemployment rate to a 40-year low. Nonetheless, growth is projected to moderate slightly in 2018-19 as monetary policy normalization gets underway, and exports slowdown amid uncertainty emanating from recent trade tensions.

Public finances remain strong. The recovery in economic activity during 2017 bolstered tax revenue and improved the medium term fiscal outlook. We commend the authorities for their intention to earmark part of the projected windfall to reduce the federal debt ratio, and use the remaining fiscal space to support social needs. On public debt, we take note that, excluding accounts payable which most economies do not report, Canada's general government debt ratio is relatively moderate, and sizable public-sector assets bring the net debt ratio to among the lowest in advanced economies. These factors could better be captured in staff's Debt Sustainability Analysis (DSA), especially in the Heat Map (page 54). Notwithstanding the favorable prospects, we see merit in staff's advice to buttress the policy framework by adopting a debt anchor combined with an operational rule. At the provincial level, there are some challenges that can require supplementary measures to support fiscal responsibility and reduce debt.

Extended NAFTA renegotiations continue to generate uncertainty over the outlook. Despite progress in updating and modernizing NAFTA, talks are expected to extend beyond the initial timeframe, as the US and Canada engage in a retaliatory tariff exchange. Reaching a timely and mutually beneficial agreement is critical for Canada's highly open economy. Furthermore, an escalation of trade tensions could have significant implications on business confidence and growth. Against this background, renewed government efforts towards expanding into new markets are key to support growth in the medium term. In this regard, we welcome the entry into force in September 2017 of the EU-Canada Comprehensive Economic and Trade Agreement (CETA), as well as the signing in March 2018 of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

The US tax reform has increased the urgency for a comprehensive assessment of Canada's tax competitiveness. While the full consequences of the reform are still undetermined, a more tax-competitive environment in the US may lower Canada's attractiveness as an investment destination in the medium term. Therefore, we associate ourselves with staff's recommendation to embark on a comprehensive review of the federal and provincial tax systems in order to safeguard competitiveness. A careful revision of statutory CIT rates and tax allowances for investment could support these efforts.

NAFTA negotiations and US tax reform spillovers could play important roles in determining the pace of ongoing monetary policy normalization. Accommodative monetary conditions have supported the recovery in recent years. Nevertheless, as the labor market shows signs of tightening and the output gap becomes positive amid significant tariff and trade uncertainty, inflation is expected to converge back to target. Therefore, we see merit in the Bank of Canada's current approach to monetary policy normalization.

High and rising household debt remains a threat to financial stability. The timely use of macroprudential and tax measures have contributed to stabilize house prices in major cities. Nonetheless, the banking system's significant exposure to household debt persist, amid the ongoing monetary policy normalization. Higher debt service by households could weaken consumption growth and hinder economic activity. Under these circumstances, we encourage the authorities to continue to closely monitor the housing market, and to strengthen coordination between federal and provincial levels.

Mr. Panek and Ms. Wehrle submitted the following statement:

We broadly share the staff's assessment of the Canadian economic outlook. Canada's economy remains robust, but the outlook is subject to uncertainty. Growth has been supported by an upswing in the service-sector, strong private sector demand, as well as higher oil prices. Unemployment has declined to record lows. However, the outlook is surrounded by elevated uncertainty, as the outcome of NAFTA negotiations and the impact of the U.S. tax reform on Canada are yet unclear. Moreover, the latest U.S. tariffs on imported steel and aluminum, which prompted Canada to introduce equivalent retaliatory measures, further increase unpredictability. Additional uncertainties stem from tighter global financial conditions and a potential sudden downturn in the domestic housing market.

Given the cyclical position of the Canadian economy, fiscal policy should focus on rebuilding buffers both at the federal and provincial level. We agree with staff that, against the background of an economy growing at around its potential, there is no need for further stimulus for the time being. Rather, fiscal buffers should be rebuilt to create policy space that could be used in case of a future downturn. We also support the introduction of fiscal rules to strengthen the credibility of the medium-term fiscal framework. It is particularly important to consider such rules also at the provincial level, given that the fiscal positions of some provinces remain weak and require further consolidation efforts.

The current monetary policy stance seems appropriate, given the various risks to the outlook. The Bank of Canada (BOC) has started to withdraw monetary policy stimulus since mid-2017. We agree with staff's assessment that further monetary policy tightening is warranted, but that a cautious and data-dependent approach should be maintained. Having increased interest rate four times since July last year, the BOC will need to strike a balance between a stronger economy and the uncertainties to the outlook.

While we agree that the macroprudential policies to address housing sector risks are adequate for the time being, vulnerabilities need to be monitored closely. There has been some cooling-off in the housing market in recent months, and measures taken by the authorities, such as stress tests for borrowers, have been effective in slowing overall mortgage credit growth. Nevertheless, household debt remains high, and vulnerabilities in the housing market are expected to persist for some time. Regarding the macroprudential and crisis management frameworks more generally, we agree with the authorities that the existing frameworks and approaches are appropriate, as they have proven effective. Nonetheless, we concur with staff that the authorities should strive to use non-discriminatory measures that are in line with the Fund’s Institutional View on capital flows. In particular, supply-side measures could be an effective way to improve housing affordability. We highlight once again that macroprudential frameworks and policies have to account for country-specifics.

The economy’s strong fundamentals provide momentum for accelerating structural reforms to bolster Canada’s productivity and competitiveness, as well as boost potential growth. Structural reforms are key in the face of stagnant labor productivity and the uncertainties around the U.S. tax cuts and NAFTA negotiations. We encourage the authorities to step up efforts to deregulate product markets, reduce preferential treatment to domestic firms, as well as remove barriers to foreign direct investment (FDI) and to intra-provincial trade. Reducing the relatively restrictive FDI regulations may help mitigate the impact of U.S. tax reforms and would seem particularly important, given that net FDI dropped considerably in 2017. Moreover, we agree that the effectiveness of the investments in infrastructure and innovation should be monitored carefully, and that any overlaps and inefficiencies between federal and provincial governments should be addressed promptly.

Mr. Virolainen and Ms. Anni submitted the following statement:

We thank staff for the comprehensive set of papers and Ms. Horsman, Ms. Young and Ms. Zorn for their insightful buff statement. Canada’s robust GDP growth is expected to moderate at a time when the economic outlook is clouded by the still lingering imbalances in the domestic housing market and more recently emerged significant external risks. The yet to be assessed full impact of policy changes in the US, the uncertainty about the outcome of prolonged NAFTA renegotiations, and a range of competitiveness challenges all weigh on Canada’s growth prospects. We broadly concur with staff’s appraisal and offer the following remarks on public finances, taxation, competitiveness and the housing market.

With the output gap closing, we find the focus on rebuilding fiscal space appropriate and take positive note of the authorities' commitment to maintaining a downward deficit and debt ratio path. We agree that formalizing the reduction of a deficit bias via a medium-term federal fiscal rule would make this commitment explicit and strengthen accountability. At the subnational level, the provincial fiscal aggregates can be somewhat misleading due to the sizeable fiscal performance gaps between the provinces and territories. We note that at the general government level, the inclusion of the unfunded pension liabilities raises the debt ratio to over 105 percent of GDP on a gross basis but are wondering if this takes into consideration future tax revenues. In Canada's case particularly, we would see merit in applying the intertemporal balance sheet approach and expanding the analysis of public finances to include all stocks and future flows in one comprehensive framework, including capturing future aging costs.

The changing competitive environment since the recent US tax reform is well noted and we recognize the complexity of gauging the full potential impact, not least considering some of the temporary effects. While acknowledging that Canada's formerly favorable position in North American corporate taxation is eroding, we note that there are also other aspects to consider when determining competitiveness, e.g. maintaining longer-term fiscal sustainability and relaxing restrictive FDI regulations. Nevertheless, we share staff's view that the continuing changes in the global corporate taxation landscape present an opportune time for Canada to review their own tax system. The obvious pressure towards a reduction in corporate tax revenues is understandable but raises the risk of amplifying distortions. Like staff, we see the need to ultimately also consider other revenue sources, like heavier reliance on indirect taxation. With rate reductions merely risking intensified international tax competition, we would appreciate staff elaborating on the effects of increasing the efficiency of the tax system via revenue-neutral reforms.

With the majority of Canada's national income tied to trade, the rising global protectionism in the context of the currently elevated trade policy uncertainty adds to the mix of not unexpected, but more recently emerged risks. However, it also highlights and fast tracks the need for prioritizing trade infrastructure investment, reversing its decline, and improving trade competitiveness. We support an open and rules-based international trading system and share staff's view that in renegotiating NAFTA, Canada and its partners should work constructively to further improve trade opportunities and promote competition. While the successful ratification of international trade agreements would enhance market access and export diversification, it is also the domestic barriers to trade which need to be eliminated to become more competitive and not lose ground to competitors.

We note that the current macroprudential measures have mitigated the housing-related financial sector risks for the time being, but agree with staff that continued vigilance is needed against the risks associated with a possible sharp correction in the housing market and the vulnerabilities related to household debt. The signs of easing imbalances in the Canadian housing market are encouraging, particularly the moderating house price growth in parts of the most dynamic urban areas of the country. Nevertheless, it is the severe unaffordability of housing in some regions which has become a primary concern. We find the ambitious National Housing Strategy a timely step in addressing the housing sector’s supply and demand imbalance and in complementing the broad set of macroprudential and tax-based policies.

Mr. Claver-Carone and Ms. Svenstrup submitted the following statement:

The Canadian economy has recovered from the oil price shock of 2014 thanks to sound economic management and favorable external conditions. Growth is strong, driven by private consumption, and unemployment is at a 40-year low. Still, the country faces economic and financial sector risks, and low productivity growth and deteriorating demographics continue to weigh down potential growth. In this context, we agree with the thrust of staff’s recommendations – mainly that the Canadian authorities should only gradually tighten fiscal and monetary policies, while at the same time carefully evaluating and implementing policies to raise productivity, efficiency, and resilience.

Fiscal Policy

The authorities have rightly calibrated their fiscal policy to smooth the economic cycle and support growth, with a focus on raising household incomes and financing infrastructure. With growth at potential, gradual fiscal consolidation over the medium term will help rebuild buffers and create space for measures to support inclusive growth and productivity-enhancing measures. At the same time, a well-designed fiscal rule would help support credibility and transparency, and we agree with staff that any rule should aim to strike the balance between enforcement, flexibility, and simplicity. We look forward to seeing the results of the authorities’ pioneering measures to encourage female labor force participation, ensure pay equity, and enshrine gender budgeting in the federal-budget making process.

We welcome the discussion of Canada's corporate taxation policy in the staff report and the highly detailed selected issues paper. Corporate tax reform is not a "race to the bottom," but rather a race to better policies. In this context, we urge all countries to consider what structural reforms they could undertake to promote a more efficient allocation of resources.

Monetary Policy and External Sector

The Bank of Canada's accommodative monetary policy stance appears appropriate, and we agree with staff that the tightening cycle should proceed cautiously until higher inflation emerges.

Staff determines that Canada's external position is moderately weaker than implied by medium-term fundamentals and desired policies. While we agree with this conclusion, we found the presentation in the staff report lacking in clarity. First, it is unclear why staff adjusted the demographic variable based on "methodological differences" between the authorities and UN demographic projections, as this undermines efforts to promote multilateral consistency across Fund external assessments. Second, while the adjustments based on permanent immigration targets and temporary oil price differential may be merited, we would have appreciated more details about how these adjustments were made in the model – e.g., was the underlying data modified or were the model coefficients adjusted? Third, we urge staff to consistently clearly articulate how much of the cyclically adjusted CA gap reflects policy gaps versus the unidentified residual. Staff comments on these three points would be welcome.

Financial sector. The Canadian financial sector is generally sound. Macroprudential policies have shown some success in reducing risk in the housing sector. While on the decline, the still-high level of household debt remains a concern, and a longer period of retrenchment is needed to restore confidence. Going forward, conditions in the housing market will require further monitoring, and we urge the authorities to stand ready to further employ macroprudential measures should rising housing prices begin to pose a real financial stability risk. Staff's discussion of the need for a broad set of policies to address the supply-side constraints in the housing market is welcome. We recognize the difficulties that Canadian families in certain metropolitan areas have faced as real estate values have skyrocketed. Canada, along with other countries, over the last several years has absorbed significant investment from abroad in residential properties. We encourage the relevant authorities to carefully consider measures in line with the Institutional View on the Liberalization and Management of Capital Flows to accomplish their policy objectives.

Structural. Finally, we agree with the authorities' focus on structural reforms to improve competitiveness and support the growth agenda. On trade, the United States and Canada are among each other's largest trading partners, and we will continue to work toward ensuring a more balanced trade relationship.

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

We thank staff for a comprehensive set of reports and Ms. Horsman, Ms. Young, and Ms. Zorn for their informative buff statement. We note the continued solid performance of Canada's economy with robust growth in 2017 and a cooling down in the housing market. As the output gap is filled, growth is expected to moderate, and staff raise concerns about sluggish manufacturing export growth, lower rate of investment and of labor productivity growth than peers, as well as shortage in some skills. The staff discussions also appropriately focused on the impact of the U.S. Tax Cuts and Jobs Act on medium-term competitiveness.

Trade tensions and uncertainties pose a significant risk to the outlook. The potential impact of a worse-case scenario is well-presented by staff. We also appreciate the analysis in the Selected Issues Paper on the potential for reduced investment and profit shifting to Canada from the U.S. tax reform, although the full effects are unclear and may be difficult to model. Nevertheless, even before the U.S. tax reform, the staff points to underperformance of nonoil-related exports which raises competitiveness concerns, which the authorities recognize. We agree that firms choose to do business in Canada for a variety of reasons.

The Bank of Canada's cautious approach to monetary policy is appropriate, since the economy is operating close to capacity, and given the recent pickup in inflation. The raising of interest rates, together with macroprudential policies, has helped contain household credit growth which has helped ease housing price pressures. Yet, the policy stance remains accommodative, and given the risks around the outlook, gradual policy normalization, guided by incoming data, is appropriate to keep inflation near the target.

We acknowledge the strong fiscal foundations and the strong focus on gender equality and agree with staff and the authorities that fiscal policy should continue to gradually rebuild buffers, with a greater effort from the provincial governments. We see less of a case for a more front-loaded adjustment by the federal government. The buff statement highlights the low and declining net debt-to-GDP, which is the lowest among G7 economies, and presents a more nuanced view of the collaborative process between the federal and sub-national authorities. Are there adequate mechanisms in place to prompt the provinces with high deficits or debt to pursue fiscal consolidation more forcefully?

High household debt remains a key area of vulnerability. We note the authorities' agreement that additional measures may be required, if housing vulnerabilities continue to rise despite current measures in place. One of the Selected Issues Papers sheds light on ways to improve housing affordability in the dynamic regions through both demand-side and supply side measures. We agree with staff that a broader set of tax and supply-side policies is needed to durably manage housing affordability concerns.

The focus on structural reform is well-placed. Staff and the authorities agree on the need to focus on fostering a competitive business environment to support greater and inclusive economic growth. We are particularly concerned about the weaker labor productivity than its neighbor, references to regulatory barriers to FDI and inter provincial operations, and the shortage of skills necessary to cope with the knowledge-based economy. The deceleration of productivity growth is more pronounced in manufacturing and mining, and staff points to particularly low investment growth in those sectors. Paragraphs 44-48 highlight some reform priorities to promote productivity growth and competitiveness. At the same time, staff note that several new initiatives were launched by the authorities, and additional concrete steps are mentioned in the buff statement. It seems that quite a lot is being done to tackle these issues. We would welcome staff views on the adequacy and effectiveness of these many initiatives. Further staff attention to this topic is warranted. Is this envisaged for the next Article IV?

Mr. Mkwezalamba and Ms. Nainda submitted the following statement:

We welcome that the Canadian economy has continued to perform well, recording the highest growth among the G7 countries in 2017, supported by accommodative fiscal and monetary policies, strong growth in the U.S., and a rebound in oil prices. Growth has been broad-based and unemployment has fallen to below 6 percent, the lowest level in four decades. Meanwhile, the outlook is clouded by significant domestic and external risks, including a global shift towards protectionist policies, a sudden tightening of financial conditions, and adverse shocks to the housing market. Therefore, broadening macro-structural reforms remains paramount in mitigating the risks and tackling the longstanding structural challenges. We thank staff for a well-focused set of reports, we broadly concur with the thrust of their appraisal, and wish to make the following comments.

Uncertainties arising from the delays in negotiations toward a renewed North American Free Trade Agreement (NAFTA) could impact investment and growth for an extended period. As a highly open economy, with total trade accounting for over 60 percent of GDP, developments in the global economy, particularly in the U.S., have direct bearing on Canada's performance. We note that the country has enjoyed close trade ties with its NAFTA partners, and acknowledge that the prolonged period of negotiations on key aspects of a revised NAFTA raises key risks. Further, the rising trade tensions with the U.S. have created a cloud over the negotiations. In this regard, we commend the authorities for their ongoing efforts to diversify trade relations, including within the framework of the recently enacted Canada-European Union Comprehensive Economic Trade Agreement (CETA), and the yet to be ratified Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). Within this context, we urge the authorities to swiftly ratify the CPTPP. On the domestic front, we urge authorities to continue to reduce the inter-provincial trade barriers under the Canadian Free Trade Agreement (CFTA). That said, apart from financial services, could staff list the rest of the selected sectors to be liberalized under the CFTA to improve trade between/among the provinces in future?

We welcome that the overall fiscal stance remains broadly supportive of inclusive and sustained growth. In this regard, we commend the authorities' efforts aimed at fiscal consolidation, and take, therefore, positive note of the improvements in the federal fiscal balance. However, we are of the view that the authorities take further efforts at the provincial level to reduce fiscal pressures. In addition, we agree with staff that, going forward, focus should be on rebuilding buffers to create room for fiscal support in case of a downturn and to finance growth-friendly projects. To reinforce credibility, we note that the authorities are keen on considering staff's advice to introduce a few operational rules to reduce risks and strengthen fiscal accountability. Since this was recommended during the last Article IV Consultation, could staff shed more light on what could be prolonging the establishment of these rules, especially at the federal level? On tax developments, while the recent U.S. tax changes might have implications for Canada, we agree with the authorities that a careful assessment of the overall Canadian tax system would be warranted before any modification is considered. As emphasized in Ms. Horsman, Ms. Young, and Ms. Zorn's informative and helpful buff statement, any discussions on changes at this moment will be premature without thorough consultations with the key stakeholders in the various sectors.

Monetary policy has been appropriate, with the output gap closing and inflation rising toward target. That said, we note that the Bank of Canada (BoC) has committed to a gradual approach in monetary policy tightening, guided primarily by the developments in key indicators. With consumer prices edging up past the midpoint, the central bank increased rates on July 6, owing to strong domestic momentum. In this regard, we would be interested in staffs' views on the recent hike and the high prospect of the BoC increasing the rates further, despite rising trade tensions and uncertainties.

While the new macroprudential and tax measures have led to moderate house price increases in the major cities, the financial indicators of the six largest banks (D-SIBS) appear strong. This notwithstanding, the financial sector risks stemming from household leverage and reversals in house prices should be monitored closely. Relatedly, provincial tax measures to mitigate speculative activity and improve housing affordability appear to have contained the speed of property price increases. Going forward, we share staff's view that if housing vulnerabilities continue to rise, broad-based measures, such as those set out in paragraph 33, would be more effective relative to measures targeting non-resident home owners. Finally, we note that the recent AML/CFT assessment revealed that the real estate sector faced higher risk of money laundering. Thus, while agreeing that improving access to more granular data and financial intelligence information would help mitigate risks, we look forward to the outcome of the forthcoming FSAP, that will conduct a more comprehensive assessment of the financial sector.

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

We thank staff for the excellent reports and Ms. Horsman, Ms. Young, and Ms. Zorn for their candid buff statement.

Canada's economy has been growing well at 3 percent with rising levels of employment, better than the other G-7 countries. However, Canada's performance has been and will continue to be synchronized with the global economy. Trade tensions, NAFTA uncertainty and high levels of household debt could impact the outlook. Further, the United States' decision to lower the corporate tax rate could also make Canada a less attractive business location. Nonetheless, with Canada's strong fundamentals, a track record of consistent policies, a flexible exchange rate and labor markets, we remain optimistic that the economy will be able to sustain its momentum. We agree with the thrust of the staff report and offer the following remarks for emphasis.

On the fiscal side, the strong near-term performance should be used for rebuilding buffers. Canada has championed stronger, more inclusive and sustainable growth with a solid focus on gender and the green economy, for which it deserves praise. Staff has suggested fiscal rules, including a debt rule, to anchor the course of medium-term fiscal policy and operational rules to guide annual budget decisions. While recognizing that the fiscal rule could anchor the medium-term budget framework, authorities have also mentioned that heightened global uncertainty puts a premium on responsive and agile policy responses to unexpected shocks. We welcome staff comments on this with illustrations from the advanced country peers. We would also like to know more on the discussions held with the authorities on this. We note that the authorities have articulated their stance for not immediately reacting to the U.S. tax changes and instead are carefully assessing the impact. We agree with this prudent approach, especially as taxation may be just one element influencing investment and corporate decision making.

We agree with the staff recommendation that the monetary policy tightening cycle should remain gradual, given below-target core inflation and the balance of risks around the outlook. Here we take note of the uncertainty stemming from U.S. tax and trade policies and the consequential impact of further increases in tariffs on imports and inflation. Beyond this, we are reassured by the Bank of Canada's gradual approach to policy adjustments, guided by incoming data and an ongoing assessment of the economy's vulnerabilities.

Canadian banks are highly profitable, liquid, well-capitalized, and firmly supervised. We commend the authorities for the wide-ranging measures taken to address the housing-related financial sector vulnerabilities. Restrictions on mortgage lending and higher interest rates, have reduced household credit growth. Separately, housing market imbalances have lessened and regional governments have taken actions to increase housing supply and affordability. Authorities have indicated that national house price growth has dropped to 1.5 percent from 20 percent just over a year ago. Could staff comment on the role of the capital flow measures in this moderation? From a risk perspective, with interest rates higher and that in turn impacting refinancing, have staff assessed the potential negative fallouts especially with the parallels to America a decade ago and the recession that ensued? Beyond this, the stock of household debt remains high and coordinated monitoring to mitigate risks to financial stability must continue, especially for beneficial ownership and money laundering risks in the real estate in line with AML/CFT.

The world economy is expanding and this offers significant opportunities for Canada to take advantage of the global momentum. We positively note the concrete steps in a number of areas to strengthen Canadian comparative advantage including the Regulatory Review, Skills and Innovation Plan, improving the immigration system for skilled workers, the Invest in Canada Agency and progress on infrastructure investment, including the progress with the Canada Infrastructure Bank. However, headwinds, especially on the trade and US tax changes continue to be unsettling. Going forward, we hope that the Canadian authorities can enhance trade relationships through an open, integrated rules-based multilateral system that serves the interest of the global economy.

With these comments, we wish the authorities the best in their endeavors.

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

We thank staff for a very clear and comprehensive report, as well as Ms. Horsman and Ms. Zorn for their insightful buff statement. Canada is experiencing strong economic growth, with unprecedented low unemployment levels, but at the same time faces potential conjunctural risks, notably linked to the future of the NAFTA and the US tax reform, and structural issues, as several factors negatively weigh on their growth potential over the medium term, requiring structural reforms. In this regard, the depiction of the likelihood of the materialization of the risk of retreat from cross border integration appears outdated. We broadly agree with the recommendations made in the staff report and make the following comments for emphasis:

Fiscal Policy

We agree with staff that, as the output gap is closing, the gradual reduction in public deficit contemplated by the federal government is appropriate, but more efforts from provincial entities are needed. We agree that the current favorable economic environment should be used to rebuild buffers and the counter-cyclical capacity of the fiscal policy. At the same time public action remains warranted in several areas (fight against poverty, investment needs, actions in favor of women), and the choice made by the federal government to devote only half of the windfall revenues to public debt reduction seems to strike the appropriate balance, though we agree with staff that it could have been slightly more frontloaded considering the situation of the economy in the economic cycle. On the contrary, we note that consolidation plans remain to be implemented for the sub-national entities.

As for the tax policy, we thank staff for their efforts to provide a comprehensive analysis of the issues at stake, but we remain puzzled by the approach taken as regards corporate tax reforms in the aftermath of the adoption of the US tax reform. We note that, while Canada had a comparative advantage over the US in terms of corporate taxation, the recent US reform leads to put the two countries on par. As a consequence, staff estimates that the Canadian economy is likely to suffer from significant decreases in investment and increased profit-shifting behaviors. Yet, while indicating that "the scope for potentially significant impact is clear (p.17)", staff remains rightly cautious in their analysis, which for a large part remains inconclusive, though it seems that, overall, staff promotes cuts in Canada's CIT rates and alignment with some of the US tax features. This is notably explicitly mentioned in the Risk Assessment Matrix. Given the level of uncertainty around the assumptions made, we invite them to refrain from providing such recommendations. In any case, we keep wondering how to reconciliate staff's past statement minimizing the risk that the US tax reform fuels negative international spillovers, notably enhanced tax competition, as this is precisely what the analysis and recommendations of the team for Canada show (notably when recommending a cut in Canadian CIT rates) and is explicitly mentioned in this Article IV report. Moreover, we reiterate, as mentioned during the US article IV consultation, that we deem that the lack of thorough analysis over the introduction of a cash-flow tax or of an immediate expensing mechanism prevents from recommending it to countries at this point in time, as more in-depth debate over their pros and cons, including by the board of directors, is warranted. In this regard, the analysis presented in staff's report confirms our feeling that staff analysis derives mostly from tax competition considerations and we see no mention in the analysis of the distributive and sectoral effects of the recommended effects, neither on the tax resources and welfare in Canada. Staff comments are welcome.

Monetary Policy and External Sector

We concur with staff that the gradual tightening of the monetary policy is appropriate, and should be pursued cautiously. The central bank rightly initiated monetary tightening 12 months ago as the output gap closed. Yet, the inflation is still below central targets and the uncertainties caused by US trade and tax measures plead for a very gradual tightening in the coming months.

Financial Sector and Housing Market

We positively note that the recent macroprudential measures helped cooling the housing market, but concur that supply-side reforms should complement these efforts. Indeed, in addition to financial stability risks, the rise in housing prices in Canada raise both social concerns, as Canadians face increasing difficulties to find affordable housing, and economic issues, as this situation prevents from a fluid mobility of workers. Therefore, in addition to the tax measures targeting non-residents decided by the authorities, we support their policy efforts to increase housing supply.

External Sector and Trade

We support the authorities' efforts to preserve open trade amongst North American countries, and invite them to make their regulations more FDI-friendly. As rightly pointed out by staff, unsuccessful negotiations on modernizing the NAFTA would prove costly for all parties, and, in the meantime, uncertainties weight on business decisions and investment in Canada. Could staff provide an update on the cost for Canada of the US decision to impose tariffs on steel and aluminum? We therefore encourage all parties to reach a positive outcome on this issue. Concomitantly, as highlighted by staff, we encourage the authorities to improve their legal framework to attract FDIs, to pursue their efforts to conclude other trade agreements and to reduce remaining trade barriers inside Canada.

Structural Reforms

We concur with staff that, in response to various negative pressures (low productivity, aging), structural reforms to raise the growth potential are warranted. In this regard, we fully support the government's efforts to increase much needed investment, and commend them for their infrastructure plan. We also encourage them to pursue their efforts to streamline product markets regulations, and to pursue their ambitious immigration policy, which would raise Canada's long-term GDP, provided that appropriate policies are in place to successfully integrate immigrants into the local communities.

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

We thank Ms. Horsman, Ms. Young and Ms. Zorn for their insightful buff statement and staff for its interesting and comprehensive set of reports.

We largely concur with staff's main message that the Canadian economy is performing well but that important risks are clouding the outlook. After two years of slow growth, growth figures have rebounded, mainly driven by private consumption, while business investment remains sluggish. Housing activity has slowed down. Yet, household debt is still a key macro-financial vulnerability and can potentially pose a risk to the banking system. Canada is facing near- to long-term downside risks such as trade uncertainties, potential spillover effects from the U.S. tax reform or an aging society coupled with weak productivity growth.

Against this background we support staff's call to use the favourable economic situation to rebuild policy buffers and to strengthen competitiveness.

We broadly agree to staff's current macro-economic policy advice:

The monetary policy stance is broadly appropriate in our view. To keep growth rates on their positive path, Canada should strike a prudent balance between debt reduction and monetary policy tightening. Yet, especially with rebounding inflation rates and high asset prices, a further (gradual) tightening is warranted.

Fiscal policy should rebuild buffers. Within their medium-term budget framework Canada should remain committed to reducing the debt-to-GDP ratio by following a steadfast approach both at the federal and provincial level. Any windfall gains at both the federal and the provincial level that can be utilized to reduce deficits at an earlier point in time are highly welcomed.

We are concerned about staff's "on-off" approach regarding its fiscal policy advice. Last year, staff recommended an expansionary fiscal stance with fiscal stimulus being the first line of defence in the event that downward risks materialize. This year, despite remaining downward risks to the economic outlook, staff suggests a more determined fiscal consolidation and frontloaded fiscal adjustment (with which we agree). Against the backdrop of these diverting recommendations, we encourage staff to not overly focus on the short-term and on discretionary policy advice. We consider a medium-term approach to fiscal policy advice appropriate which will help creating confidence and will stabilize expectations. Staff comments are welcome.

Recent US policies on tax and trade and related remaining political uncertainties are a significant challenge for Canada. Canada should not engage in a race to the bottom and should at the same time remain attractive for investment. In this regard, we welcome that the authorities will continue to review the Canadian tax system. A holistic approach, that does not focus on the statutory rate and the marginal effective tax rate alone, should be taken. Efforts to reduce the complexity of the tax system with the aim of enhancing efficiency and improving incentives to invest are desirable, while advantages and disadvantages of specific reforms need to be carefully weighed.

Removing distortions should become a primary goal for the government to prevent revenue losses and remain attractive for investment and boost competitiveness. In that respect, measures against profit shifting and more targeted tax allowances for investments could also play a role. In addition to the risks of lower investment and profit shifting by US companies, there is also a risk of investment diversion: NAFTA is currently not perceived as durably assured and the relative tax situation in the US has improved from the viewpoint of third-country investors. Hence, Canada might look less well-suited as a platform to serve the North-American market. A holistic tax review approach should consider these interlinkages.

It is important for Canada as a relatively small and open economy to strengthen its trade competitiveness and diversify its export sector. The share of total exports has declined significantly and Canada’s competitive advantage in the service sector is waning. We therefore fully agree that the Canadian authorities should remain prepared to engage in good faith negotiation towards a modernized NAFTA and to work towards new trade agreements. We appreciate the authorities’ commitment, as communicated in the buff statement.

Elevated house prices pose a risk to the financial system through the banking-housing-nexus and can also have societal effects. Despite an increasing number of low-ratio mortgages, risks to the financial sector remain elevated: household credit especially to vulnerable groups has increased over the last years. At the same time, the banking system has a large exposure to household debt and, consequently, a sharp house price correction is classified as a high-impact risk in the RAM. We agree that worsening housing affordability can bring about socially and economically undesirable consequences. In that regard, supply-side measures like new zoning laws and a shortening of the approval process for building permits are desirable.

It is challenging to find the right policy mix to alleviate pressures on the housing market, particularly in the most dynamic metropolitan regions. We take note that staff assesses non-resident property transfer tax as a CFM measure, because it discriminates between residents and non-residents of Canada and limits capital flows. Yet, we acknowledge the underlying reasoning for imposing provincial non-resident property transfer taxes: With the promotion of inclusive growth being a cornerstone of Canadian policymaking, affordable housing is an important societal goal. Staff suggests that broader-based measures would be more effective in achieving the authorities' objective and in contributing to domestic stability. While, in principle, tax measures to mitigate speculative demand should be broad-based rather than targeted at non-residents alone, the specific design of the alternative measures proposed by staff remains somewhat unclear. Different designs, particularly different target groups (e.g. all homebuyers vs. "speculative" buyers or second home buyers), will have different and maybe opposite economic effects. Additional staff comments on the design would be welcome.

We agree with staff that the labor market outcome of immigration should be improved. Amongst others, dynamics in the economy towards certain sectors, access to training and education and the condition of local property markets need to be considered in order to ensure a beneficial outcome for the economy as a whole. Staff rightly points out that immigrant flows should be managed carefully to maintain public support. On the labor market in general, could staff comment on possible explanations of the steady decline in the labor force participation rate in recent years?

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

We thank staff for a set of well-focused papers on Canada and Ms. Horsman, Ms. Young, and Ms. Zorn for their insightful BUFF statement. The Canadian economy is going through a cyclical rebound and, at this stage, the short-term economic outlook appears to be bright. Higher oil prices and fiscal stimulus in the United States will improve current account balance. Relatively low public debt with small structural fiscal deficit point to a strong fiscal position. Inflation is getting closer to the center of the targeted band, while inflation expectations are well-anchored.

The main risks to the outlook are external. They are linked to policy uncertainty in the U.S., including the extent and timing of fiscal relaxation, the future of the NAFTA, and the broader U.S. approach to other international trade agreements. In addition to these new and immediate risks to the economic outlook, the Canadian authorities' must address long-standing domestic challenges of ageing population, tackle low labor productivity, and diversify the economy to make it more dynamic and competitive.

According to staff, the output gap has already closed last year. Hence, at this stage of the cycle, fiscal stance should be gradually tightening. We note, however, that staff expect some fiscal loosening due to the developments at the provincial level. While we agree that a strengthening of the provincial fiscal frameworks is highly desirable, we would like to better understand how such reforms can be achieved. Does federal government have any leverage in nudging the provincial counterparts toward the rules-based policies? We agree that the federal government can lead by example in embedding the fiscal rule(s) in the policy-making (paragraph 20). We also believe that the fiscal councils at the provincial level could be instrumental in this respect. Are there any entities at the provincial level similar to the office of the Parliamentary Budget Officer?

Staff reiterated their previous call for a comprehensive review of taxation in Canada and offered compelling arguments in favor of a more comprehensive approach instead of the current piecemeal improvements. Yet, from the BUFF statement, we understand that the Canadian authorities find such an approach to be inappropriate under current circumstances. Is there any traction of the Fund's advice in this area?

In the monetary policy area, we agree with staff that the Bank of Canada has room to react to unfolding developments and to proceed cautiously. On balance, we are less concerned than staff about the macroeconomic risks to the banking sector and the economy in general stemming from the regional housing markets. In this respect, we recall that the banking sector in Canada and the supervisory authorities have an unblemished track record of vigilance necessary for maintaining financial stability, although past outcomes do not guarantee future performance. Overall, we believe that macroprudential measures applied so far have worked well.

At the same time, we agree with staff that the authorities should revisit the use of the CFMs and eliminate discrimination of non-residents. We also note the references to the persistent deficiencies in the AML policies detected in the real estate sector. In the forthcoming FSAP this set of issues deserves an in-depth evaluation.

We welcome the special attention in the staff report and the Selected Issues paper to the reasons for anemic labor productivity growth and declining competitiveness in Canada. According to staff papers, the Canadian government intends to play a prominent role in attempting to reverse the worrisome trends through a series of initiatives mentioned in paragraph 45. In paragraph 56, staff noted that the authorities also launched several targeted reviews to identify bottlenecks to growth. We would be interested in additional information on the key topics of these reviews, their time schedule, and to what extent they address issues identified by staff. Also, given the lack of regional diversification of trade as well as the lack of product diversification in the Canadian exports, are there any initiatives in this area?

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

Ms. White and Ms. Myers submitted the following statement:

We thank staff for an insightful set of paper, and Ms. Horsman, Ms. Young and Ms. Zorn for their informative buff statement. The economy has continued to perform well, posting the highest growth among G7 countries at 3 percent in 2017. This was enabled by accommodative fiscal and monetary policies which in turn boosted private consumption growth, as well as strong growth in the US and higher oil prices. CPI inflation remained low at an average of 1.6 percent in 2017, but is starting to pick up as the output gap closes. Against a backdrop of rising trade tensions, tightening global financing conditions and the vulnerability of the housing market to sharp corrections, it will be important that Canada seizes present opportunities to rebuild its policy buffers and pursues key structural reforms to enhance its global competitiveness and resilience to shocks.

We broadly agree with the thrust of staff's appraisal and wish to make the following points for emphasis:

Fiscal Policy

We highly appreciate staff's detailed analysis of the fiscal situation at both federal and provincial levels, which could be a model for analysis other countries with similar political, economic and financial structures. The federal fiscal balance has improved, driven in large part by stronger-than-expected

GDP growth. We welcome Canada's decision to only spend half of the windfall gains on new measures, with the other half allocated towards the reduction of the debt-to-GDP ratio. There is nevertheless a strong case for a more explicit fiscal rule to anchor debt to better support Canada's fiscal credibility and the soundness of its public finances. Staff have provided a good overview of operational options that balance the need for enforcement, flexibility and simplicity in the report, and we welcome the indication in Ms. Horsman's, Ms. Young and Ms. Zorn's gray that such a rule could be of value. We wonder whether authorities desire to retain a certain degree of agility to respond to shocks could not also be accommodated with a fiscal rule? Staff comments welcome. We strongly welcome the 2018 first "Feminist" Budget, and would encourage staff and the authorities to, in due course, share the lessons learned more widely.

At the provincial level, progress has been much more mixed. We agree with staff on the increased need for provincial authorities to monitor contingent liabilities, while pursuing their public investment objectives.

We understand that staff have estimated the impact of the US tax reform package on Canada to be substantial. Even though the consequences of the reform require further analysis to be fully understood and quantified, staff's preliminary analysis suggests that real investment in and profit shifting towards Canada by US companies might fall by as much as 6 and 15 percent, respectively, and payments of Corporate Income Tax by about one-quarter. While we welcome the Canadian authorities' plan to not respond in a knee-jerk fashion, we do see merit in staff's 2017 recommendation to launch a holistic, independent review of the overall tax system to improve efficiency and preserve Canada's tax position globally. Corporate taxation would obviously play a key role within that, alongside the personal tax regime and other forms of taxation.

Monetary and Financial Sector Policies

With the output gap entering positive territory, inflationary pressures are expected to rise. Nevertheless, given the relatively low transmission of demand to inflation and a tendency of inflation to undershoot its target, the current accommodative monetary policy stance remains appropriate. Going forward, a tightening of the stance would help build policy space for future downturns and keep inflation near its target. In light of the uncertainty surrounding US tax and trade policy developments, we concur with staff's advice for the Bank of Canada to take a more gradual approach to policy adjustments than would otherwise be the case.

With regards to financial sector policies, we are encouraged by the fact that the introduction of macro-prudential policies have kept mortgage credit growth at moderate levels and slowed the pace of house price inflation. Housing affordability remains a key concern, however. Authorities efforts to improve affordability through the introduction of measures targeting non-resident buyers have been classified by staff as a form of capital flow measure. We remain supportive of staff endeavors to implement the Fund's Institutional View (IV) in a consistent and even-handed manner, but believe that broader work on housing affordability in Advanced Economies and appropriate policy responses that are consistent with the IV would be valuable. In this vein, we welcome staff's analysis in the report on the effectiveness of Canada's measures to achieve their prime purpose of alleviating affordability and social concerns alongside the proposition of viable alternatives.

Structural Reforms

We agree with staff that sensible trade policies and structural reforms aimed at boosting productivity and medium-term growth should remain a key focus of the government's policy agenda. The uncertainty surrounding the re-negotiation of NAFTA presents risks, but we take heart from the fact that a successful negotiation could boost Canada's output by as much a 0.4 percent. We positively note the Canadian authorities' commitment to open, integrated and transparent trade relationships and agree that these serve the interest of the global economy. The successful ratification of CPTPP could further boost Canada's output by 0.1 percent, irrespective of the outcome of NAFTA negotiations.

Mr. Sembene and Mrs. Boukpessi submitted the following statement:

We thank staff for their report and selected issues paper as well as Ms. Horsman, Ms. Young and Ms. Zorn for their insightful buff statement.

The Canadian economy has continued to strengthen in 2017, reflecting supportive macroeconomic policies, strong growth in the US, and higher oil prices. Unemployment is low while price developments in the housing market are encouraging. Despite these welcome developments, the economic outlook remains subject to a number of downside risks arising from both domestic and external fronts. These include housing market related risks, the banking sector's high exposure to household debt, uncertainties related to the renegotiation of the North American Free Trade Agreement (NAFTA) as well as potential effects of the US Tax reform.

We welcome the authorities' commitment to continue to deliver on decisive policies needed to address the challenges facing the country. In this regard, we agree that policy priorities should remain focused on gradually rebuilding fiscal buffers, maintaining financial stability and accelerating the reform momentum, notably to increase labor productivity and the country growth potential.

We welcome their commitment to further reduce the debt-to-GDP ratio and the federal government's decision to use part of its windfall gain to this end. While Canada's strong economic performance has contributed to improving the federal fiscal balance in 2017, continued fiscal consolidation particularly at the provincial level will be key to rebuilding buffers over the medium-term. Moreover, the introduction of fiscal rules at both the federal and provincial levels could be helpful to strengthen the credibility of the medium-term fiscal framework. In an evolving international tax and trade environment, we agree that Canada should undertake a comprehensive review of its tax system to support the economic transformation, improve efficiency, competitiveness and broadly preserve the country's tax position.

The Bank of Canada's prudent monetary policy approach to normalization remains appropriate in view of the significant risks to the outlook. While the monetary policy stance continues to be broadly appropriate, we concur with staff that should stand ready to tighten the monetary policy stance if warranted by the evolution of the growth outlook and inflation expectations.

We commend the Bank of Canada for the effectiveness of the macroprudential measures implemented to address financial sector vulnerabilities. Going forward, we are of the view that the authorities should stay vigilant and stand ready to adjust their macroprudential tools as appropriate. The staff's SIP lays out relevant analyses and various policy options that the authorities could consider in their efforts to maintain financial stability, while enhancing housing affordability. In this connection, we would appreciate it if staff could share the authorities' views on the proposed measures on housing policies to tackle the supply-side and affordability issues over the long-term (Box 2 p.22).

We welcome the broad agreement that the authorities and staff have reached on trade and structural issues. We are reassured by the authorities' commitment to a swift ratification and implementation of the CPTPP, as indicated in the buff statement by Ms. Horsman, Ms. Young, and Ms. Zorn. It is reassuring that they are committed to continue their negotiations with their partners to secure a new NAFTA agreement. We concur that a reinforced structural reform agenda is key to raising labor productivity growth and strengthen the country's competitiveness. Finally, we commend the authorities for their inclusive measures, including in terms of gender equality, that have contributed to positive economic outcomes in recent years.

Ms. Erbenova, Mr. Just and Mr. Hagara submitted the following statement:

We thank staff for the well-written and comprehensive reports, and Ms. Horsman, Ms. Young, and Ms. Zorn for their informative buff statement. We broadly agree with staff's assessment and policy recommendations.

The strong economic performance should be used to rebuild buffers and boost potential growth. Canada outperformed expectations in 2017, with growth reaching 3 percent on the back of an accommodative policy mix, strong US growth, and higher oil prices. The unemployment rate declined to a 40-year low. Nevertheless, while the growth outlook remains positive, it is clouded by low productivity growth, population aging, high private indebtedness, as well as the medium-term impact of the US' tax and labor policies. In addition, the imposition of tariffs, as well as the NAFTA renegotiations, could dent economic sentiment and expectations. We encourage the authorities to take advantage of the currently still favorable conditions to strengthen buffers and progress substantially with structural reforms in order to enhance competitiveness and boost the potential of the Canadian economy.

Against the backdrop of a future rise in aging costs and the positive output gap, fiscal policy should increasingly focus on the rebuilding of buffers. The authorities used their fiscal space in response to the oil price shock but also to address inequality concerns, including through recent tax cuts for low/middle-income families and measures to encourage female labor force participation. With the economy back on a strong footing, the rebuilding of fiscal buffers should be given higher priority, both on the federal and provincial levels of government, before population aging begins to feed into the greater needs of healthcare expenditure. The introduction of transparent and prudent fiscal rules, such as a debt anchor and operational rules, would further strengthen the fiscal credibility. We wonder whether the authorities have considered the adoption of new fiscal rules since the balanced budget rule was repealed in 2016. While the gross public debt remains relatively high, the net debt is much lower, and the general government holds sizable assets that are deemed liquid. The authorities also consider fiscal federalism to be one of the fundamentals of the Canadian economy. We would welcome staff's comments on the benefits and costs of holding such sizable liquid financial assets. Furthermore, we would like more detail about the distribution of assets among the federal and other government bodies, and whether debt and liquidity management coordination is possible within the current fiscal federalism framework.

The US tax reform can have a substantial impact on investment and revenues in Canada, although there is uncertainty around the estimates. We welcome the authorities' approach to monitoring the situation and carefully examining the possible effects. However, the US tax reform also provides an incentive for the authorities to holistically review the complex Canadian tax system, with a view to incentivize potential growth and bolster the social and environmental credentials of the authorities.

Current macroprudential measures seem sufficient for now, but supply-side policies would help improve house affordability. House price growth has substantially slowed after the introduction of macroprudential and tax measures. Moreover, the growth of the share of highly indebted households in new mortgages has stopped, hence, further macroprudential measures do not seem warranted at this stage. However, house affordability in some of Canada's dynamic, metropolitan areas is low in international comparison. We welcome staff's extended focus on how to balance house affordability with financial stability. The authorities should consider a comprehensive set of supply-side measures alongside an assessment of the effectiveness of the current funding and tax incentives.

We take positive note of the high profitability and low non-performing loans of the largest banks. Nevertheless, the high household debt remains a key vulnerability, considering among others the elevated share of mortgage debt and the ongoing shift to uninsured mortgages. In addition, the authorities should remain vigilant and appropriately monitor the rapidly growing exchange-traded fund market. At the same time, money laundering risks in the real estate sector should be addressed. We would welcome staff's update on the authorities' measures in AML/CFT since the 2017 Article IV Consultation and the last FATF Mutual Evaluation. Further, we are interested in staff's views on whether gaps in the existing AML/CFT framework could be aggravated by the move to lenders not subject to the same regulation as banks, and an emergence of fintech competition. We are looking forward to a more comprehensive assessment of the financial sector within the upcoming Financial Sector Assessment Program.

The favorable economic situation should be used to bolster structural reform endeavors. We welcome the authorities' ongoing efforts to improve the business environment, including a comprehensive review to streamline business regulations and improve the immigration system. Nevertheless, we encourage the authorities to increase competition in product markets through their further deregulation. We commend the authorities for their emphasis on multilateralism over unilateralism, also on trade, and for promoting open trade within the NAFTA and CPTPP negotiations. Reducing domestic inter-provincial trade barriers under the Canadian Free Trade Agreement should be advanced.

Mr. Hurtado and Mr. Gonzalez submitted the following statement:

We thank staff for the report and Ms. Horsman, Ms. Young, and Ms. Zorn for their buff statement.

The economy remains stable and is performing well although in a new environment under much more uncertainty. In our view, the maintenance of sound economic policies is a crucial pillar of this solid performance.

There has been a shift in policy priorities. While last year's Article IV consultation put significant emphasis on tackling housing market imbalances, this year the focus has shifted to dealing with a more uncertain external environment. Canada's economy is facing the twin threats of NAFTA renegotiation and an escalating global trade war at a time when there is considerable uncertainty on the effects of the US tax reform, when banks are highly exposed to corporate and household debt, when monetary policy will be constrained by capacity utilization, and with still significant risks of sharp corrections in house prices.

The focus is therefore on fiscal policy. We welcome the cautious approach to monetary tightening and the success of macro-prudential measures to deal with housing market imbalances. The focus must now be on fiscal policy. Economic growth has improved the fiscal outlook thus amplifying the opportunities to rebuild buffers, to eventually facilitate public spending that might be required to deal with current uncertainties and promote productivity growth, which has been stagnant and below that of its main trading partner. Nevertheless, since this fiscal effort falls heavily on the provinces, in staff's opinion, what are the chances that provinces cooperate in this respect?

We take note of the recommendation to adopt a debt anchor on the part of the federal government, however, do authorities agree with the use of this specific fiscal rule? Staff comments are welcome.

Public debt is presented according to various definitions in the report. For example, net and gross public debt, General Government's and Provinces', and adjusted for accounts payable. Can staff please provide clarity on the differences among those definitions? Also, we are puzzled by the apparent size difference between general government gross debt (76 percent of GDP, according to paragraph 19) and Federal Government (presumably net debt of around 30 percent of GDP - figure in paragraph 20), could staff clarify?

Recommendations to rethink corporate taxation should be more cautious. Although the report warns that the full consequences of the US tax reform are complex and require careful analysis, it notes that US real investment and profit shifting towards Canada could fall significantly, reducing CIT payments by one-quarter. Yet, it also argues for a rethink of Canada's Corporate taxation—including changing CIT structure. Without the full effects of the US tax reform well understood, and when trade is subject to the uncertainty of NAFTA renegotiations and an impending global trade war, we wonder if this is a good time to fundamentally change corporate taxation. We would welcome staff's as well as the authorities' position on this.

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

We thank staff for the insightful set of papers, and Ms. Horsman, Ms. Young and Ms. Zorn for the informative buff statement. Supported by appropriately accommodative macroeconomic policies and favorable external developments, the Canadian economy posted solid growth in 2017. However, the near-term outlook is clouded by uncertainties, notably stemming from U.S. trade and tax policies. Staff has also rightfully pointed out the need to improve productivity and competitiveness to raise medium-term growth. We broadly concur with staff's assessment, and offer the following for emphasis.

We strongly support Canada's multilateral approach to trade issues. Given the risk of retreat from cross-border integration and the significant uncertainties it would bring about on business decisions, we see merit in the authorities' current strategy of reaping benefits from diversifying trade to the EU and Asia, and lowering domestic barriers to goods and services. Could staff share their assessment of the impact of the U.S. steel and aluminum tariffs, and Canada's retaliatory tariffs? We appreciate staff's description of contentious issues in the NAFTA negotiations. What is staff's assessment of the prospect of this negotiation?

The U.S. tax reform has changed the relative tax competitiveness between Canada and the U.S. While based on empirical analysis, the reduction in the U.S. statutory rate could have significant implications for Canada, the impact of the international provisions remains uncertain. On balance, we tend to side with the authorities that the impact on profit shifting could be less severe than staff estimates, and will depend on MNCs' tax planning decisions after more operational rules of the Tax and Job Creation Act (TJCA) are unveiled. Given the difference in personal income tax, there might be possible implications of the U.S. tax reform on brain drain or migration of high net worth persons. Could staff share their assessment?

In staff's projection, the U.S. tax reform will boost Canada's growth by 0.2-0.3 percentage points in 2018-20, and reduce it by 0.1 percentage points in 2021-22. In the U.S. Article IV report, staff notes that a gradual fiscal consolidation starting in 2020 when monetary tightening is at the peak bears the risk of triggering a technical recession. We therefore wonder whether under such a scenario, the boost to the Canadian economy, would turn negative in 2020 rather than in 2021. What is staff's projection of Canada's economic growth beyond 2020?

With a low net public debt-to-GDP ratio, fiscal policy could afford to be nimble and "responsive". Given Canada's gross debt of about 90 percent of GDP, we generally agree with the direction of rebuilding fiscal buffers. While noting that the net public debt is only about 28 percent of GDP—as the government has sizeable financial assets, around 40 percent of which are highly liquid—we see enough space for fiscal adjustment to accommodate government priorities and calibrate the pace with the balance of risks. 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 particular when analyzing fiscal vulnerability, where the difference is large and liquid assets are significant. Since provincial fiscal performance is uneven and poses contingent liabilities, provincial governments with high debt need to make more strenuous efforts in fiscal adjustment. Could staff explain the division of labor between the federal and provincial governments in delivering social services and capital spending, and how strengthened coordination could help improve fiscal prudence?

The monetary policy tightening needs to be vigilant to risks. As inflationary pressures are well anchored, tighter monetary policy is appropriate to bring inflation back to target and build space for future downturns. A measured pace is warranted, considering the uncertainties on the horizon and the potential impact of appreciation on exports. It is good to note that house price growth has moderated. Macro-prudential and supply-side policies are essential to cool down the house market, and close monitoring on household debt is warranted.

We commend the authorities for a raft of initiatives to enhance competitiveness. Regarding infrastructure construction, we call on staff to assess and draw experiences from the operations of the Canada Infrastructure Bank.

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

We thank staff for a well-written set of papers, and Ms. Horsman, Ms. Young, and Ms. Zorn for their insightful buff statement.

The Canadian economy continues to perform well. After posting the highest rate among G7 countries in 2017, growth is moderating to more sustainable levels; inflation has risen toward the mid-point of the target range with the output gap entering positive territory; and unemployment rate has dropped to a record low. The federal fiscal balance has improved but progress at the provincial level is mixed; and the current account deficit has narrowed; and the gross debt-to-GDP ratio is declining, although it remains relatively high compared to triple-A rated peers. The banking system appears strong but is heavily exposed to household and corporate debt, which have climbed to historic highs. While the positive momentum in the economy is expected to continue in the near term, the outlook is subject to significant domestic and external downside risks, including from a sharp correction in the housing market and further escalation in trade tensions. We concur with the thrust of staff appraisal, and encourage the authorities to consolidate public finances, strengthen financial system resilience, and advance growth-enhancing structural reforms.

The current cyclical upswing presents an opportunity to proceed with more front-loaded fiscal consolidation at the federal level and more ambitious adjustments at the provincial level to maintain public debt on a firm downward trajectory, rebuild buffers, and create room for much-needed public investment and mounting population aging outlays. We welcome the decision of the federal government to use the likely fiscal overperformance over the next five years to amortize debt and address key social outlays. If downside risks materialize, however, full operation of automatic stabilizers and deployment of discretionary measures should be contemplated. Explicit incorporation in the fiscal framework of a debt anchor combined with an enforceable, flexible, and simple expenditure rule could bolster fiscal credibility, and we wonder if this recommendation is being duly considered. Staff comments are appreciated. We also see merit in a holistic review of the corporate income taxation to improve efficiency with changes to be undertaken in a fiscally responsible manner.

Despite the well-contained inflationary pressures, growing employment, peak capacity utilization, and rising core and headline inflation support the current cautious approach to monetary policy normalization. We agree that monetary policy should balance the temporary inflationary impact of likely higher import tariffs against the prospect of a fall in output, and endorse the central bank's data-based and gradual approach to withdrawing policy stimulus.

The rapid rise in housing prices has led to financial stability concerns and worsening housing affordability. While the latest round of macroprudential and tax measures appear to have contributed to a cooling in the housing market in major urban areas, the elevated household debt remains a key vulnerability. The authorities have indicated the need for additional measures should household indebtedness and housing vulnerabilities continue to rise, and we wonder if these include introducing loan-to-income limits as well as tax measures targeting the speculative demand of residents and nonresidents alike. Staff comments are welcome. Given potential risks from the increasing use of home-equity lines, the rise of less regulated uninsured mortgage lending, and the rapid growth in exchange-traded funds, we underscore the need for close and coordinated monitoring between federal and provincial regulators. It is also important to improve housing affordability through a broad set of supply-side policies and housing strategies at all levels of government. We look forward to the upcoming FSAP for a more comprehensive assessment of the financial sector.

Improving medium-term growth prospects and boosting labor productivity hinges on trade policies and structural reforms. Greater market access and export diversification will be facilitated by finalizing the new NAFTA agreement within a reasonable timeframe, quickly ratifying and implementing the CPTPP agreement, and reducing inter-provincial barriers to trade. We welcome the authorities' commitment to open, integrated, and transparent trade relations through a rules-based multilateral system, as reiterated by Ms. Horsman, Ms. Young, and Ms. Zorn. More also needs to be done to attract FDI and innovative technologies, enhance the efficiency of infrastructure investment, and further deregulate product markets. Canada has an impressive track record in absorbing and assimilating immigrants, and policies should continue to improve their labor market outcomes.

We wish the authorities continued success.

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

We thank staff for the comprehensive reports and Ms. Horsman, Ms. Young, and Ms. Zorn for their informative statement. It is encouraging that Canada's economy has continued to perform well with the highest growth rate among G7 countries, with private consumption as the largest contributor. We note that private consumption has been supported by strong gains in disposable incomes. We would welcome the staff's elaboration on the reason behind the increase in disposable incomes. Do staff think that the increase in the marginal propensity to consume has also supported private consumption? We welcome the strengthening labor market with the low unemployment rate. Also, we are pleased to see a cooling in the housing market. However, trade tensions, uncertainty related to NAFTA negotiations, and the impact of the U.S. tax reform might pose downside risks to Canada's economy. In addition, the authorities need to implement necessary measures to address structural issues, such as low labor productivity growth. In order to tackle several challenges, coordination between federal government and provinces would be appreciated. As we broadly concur with the thrust of the staff's appraisal, we will limit our comments to the following points:

Fiscal Policy

Under the current favorable economic environment, we agree with the staff's view that fiscal policy should focus on rebuilding policy buffers. Given the closed output gap and stronger-than-expected GDP growth, we support the staff's appraisal that fiscal stimulus is unnecessary now. Instead, the focus should be on rebuilding fiscal buffers to create room for fiscal support in case of a downturn and to finance growth-friendly policies. In this regard, we positively note that the federal government decided to use gains from higher economic performance to reduce debt and support inclusive growth. In addition, at the provincial level, we note that progress on fiscal consolidation has been mixed. We agree with the staff's appraisal that provinces with high deficits or debt should restore fiscal discipline and implement necessary fiscal adjustments. Moreover, we would like to underscore the importance of maintaining fiscal discipline over the medium term. Therefore, as staff recommend, the authorities could consider adopting a debt target to guide the medium-term fiscal policy.

On the U.S. tax reform, according to the staff's report, Canada's growth is expected to boost by 0.2-0.3 percentage points between 2018-20, and reduce growth by around 0.1 percentage points between 2021-22. We take note of staff's view that the impact of the U.S. tax reform on Canada is subject to considerable uncertainty on the near term, and heightened uncertainty on medium-term. The lower tax rates in the U.S. may negatively affect real investment in and facilitate profit shifting from Canada. As the authorities also acknowledge, the implications of the U.S. reform are complex. Therefore, we encourage staff to continue careful analysis on the spillover effects and implications of the U.S. tax reform for Canada.

More broadly, we agree with the need to carefully assess the impact of the international tax developments, while it would be better for the authorities to consider pros and cons prudently, as the impact of changing the tax system would be substantial. Amid a changing international tax environment, including the BEPS implementation and digitalization, there is uncertainty as to the likely impact on Canada. We encourage staff to analyze the potential spillover effects from the international tax developments on Canada's macroeconomy.

Monetary and Financial Sector Policy

On monetary policy, we support the authorities' approach toward monetary policy normalization. We note that the central bank has begun monetary tightening with increases in its policy interest rate. With the closed output gap and rising core inflation, we agree with the staff's view that further monetary tightening is warranted. At the same time, given the uncertainties stemming from the U.S. tax reform and trade policies, we support the central bank's gradual approach to withdrawing from an accommodative monetary policy.

On financial sector policy, we positively note that the overall banking sector is well capitalized and has high profitability. And non-performing loan ratios are low. We also note that Canada's big banks have maintained high net interest margins. We would appreciate the staff's view on the reasons why Canada's big banks have been profitable under an accommodative monetary policy, and what kind of business models they have taken to maintain profits.

Housing Market

We note that the authorities have taken a broad set of measures to contain housing-related financial sector risks and address housing affordability concerns. We note that the federal government has introduced macroprudential measures and the BC and Ontario governments have taken tax measures. Regarding the effectiveness of these measures, as the authorities say, both federal and provincial measures appear to be having their effect to contain vulnerabilities in the housing market. While we observe that staff assess that macroprudential policy can be more effective, the property transfer taxes on non-residents have played a certain role to stem speculative activity and improve affordability, admitting that we fully agree that the authorities' property transfer taxes on non-residents are classified as capital flow management measures. We would welcome the staff's view on the effectiveness of the property transfer taxes on non-residents. Also, a set of measures, such as macroprudential measures and tax measures, are available for the authorities when facing the housing prices dramatically go up. Against this backdrop, we believe that it might be necessary to accumulate takeaways and formulate an appropriate policy mix so that the authorities will be able to respond to the rising house prices effectively. We would welcome the staff's comments.

Structural Reform

We encourage the authorities to implement a necessary structural reform agenda to enhance productivity and growth prospects. In this light, we support the recent authorities' innovation initiatives, such as promoting investments in R&D. Also, we welcome the authorities' long-term infrastructure plan and encourage its steady implementation. In addition, we agree with the importance of reducing regulatory burdens on businesses, such as fewer competition-friendly registration and licensing requirements as well as restrictive FDI regulations. Moreover, immigration could help counteract population aging and strengthen the labor force, and we encourage the authorities' continuous efforts to integrate immigrants into local communities. Lastly, on trade policy, as we said in the Board meeting on the Managing Director's Statement on the Work Program of the Executive Board, we support that the IMF emphasizes the importance of the open and rule-based trade system. And we encourage staff to strengthen their analytical work to show the quantitative evidence on the merits of the open and rule-based trade system. In this context, we thank staff for the statement on the Canada regarding the countermeasures introduced by the Government of Canada on July 1 in response to U.S. tariffs on Canadian steel and aluminum products. We would like to ask the staff's view on the impact of countermeasures on the bilateral trade and domestic market. Also, do staff see any prospects for both the U.S. and Canada to widen the coverage of measures, including autos, going forward? In addition, we note the staff's assessment that the Canadian non-energy export sector has been losing competitiveness for some time. In this regard, we positively note the signing of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which would offer Canada greater market access and export diversification. As the authorities rightly indicate, the CPTPP should be ratified and implemented as soon as possible.

Mr. de Villeroché made the following statement:

I will focus my intervention on two issues, first on the macroeconomic outlook, and second, on the issues regarding the tax reform and the staff's recommendations. On the economic outlook, Canada is experiencing strong growth, very low unemployment levels, which is good news, and we commend the authorities for their policy actions that have helped them achieve this. At the same time, we see some changes, if not risks. Definitely the future of the North American Free Trade Agreement (NAFTA) agreement is one, as are the spillovers from the U.S. tax reform, and some structural issues as several factors negatively weigh on the country's growth potential over the medium term.

We encourage the authorities to pursue their gradual adjustment strategy to gradually and cautiously tighten monetary policy and to stay engaged to reach a positive outcome on the NAFTA negotiation. Of course, it is not an issue that only depends on Canada.

Turning to the tax reform, we have some unease with the recommendations formulated by the staff. More generally, we believe that the Fund's position regarding the consequences of a U.S. tax reform should be worked out further. Let me explain our concern.

When we discussed the U.S. tax reform during the U.S. Article IV consultation and on several other occasions, this chair argued strongly that many countries face the risk of negative spillovers due to tax competition. I used the phrase "race to the bottom." What I have understood is that the Fiscal Affairs Department (FAD) was in disagreement with this risk. Yet in this Article IV report for Canada, there are strong recommendations to cut corporate income tax rates and to align with some of the U.S. tax features. We would like to raise the consistency of the staff's recommendations regarding this issue.

The recommendations go far, and the situation created by a 21 percent tax rate in the United States leads to complex issues for all G7 countries. Cutting the rate or getting less from corporate income tax raises some issues in terms of social contracts in Canada. In this regard, I find Ms. Horsman's reservation understandable. I invite the staff to pursue the analysis by taking into account this element, and I wonder whether there is a full-fledged reflection on this new normal created by the U.S. tax reform.

On the issue of introducing a cash flow tax, my authorities do not have a final position, but one has to recognize it would be a quite significant change from our current taxation models; and this needs an in-depth discussion of the pros and cons, including at the Board level. I encourage FAD to engage with the Board on this issue. We have a new normal, and how countries will adapt to this new normal is a huge and important issue.

Mr. Meyer made the following statement:

We thank the staff for the report and Ms. Horsman, Ms. Young, and Ms. Zorn for the helpful buff statement. I commend the Canadian authorities. The economy is performing well. Growth figures have rebounded. Unemployment is at a historic low. The output gap is closing or closed, and inflation is rising toward the target.

We fully appreciate Canada's leading role in promoting global trade issues around gender, the environment, climate change, and promoting the rules-based international system in general. Unfortunately, important risks are clouding the outlook, as the staff has highlighted. Canada is facing a tectonic shift in the North American economic landscape, as the staff puts it. Against this background, we fully support the staff's main message to use the current favorable economic situation to rebuild policy buffers and to improve competitiveness.

I will elaborate on two points that we have touched upon in our gray statement—fiscal policies and the Canadian tax environment. On fiscal policy, we agree that the current favorable economic situation should be used to rebuild fiscal buffers, and if I am not mistaken, almost all, if not all, Directors agree with that. We fully support using discretionary fiscal measures when unexpected and large shocks hit the economy. However—and this is what we were aiming to address in our technical questions—we are more concerned about making significant and discretionary use of fiscal policy during the normal ups and downs of the usual business cycle, and this is what we are seeing in Canada now and in the last few years, where we just see an on-off of consolidation or supporting the economy. While we welcome that the staff advises fiscal consolidation where it is needed, we would like to echo Ms. Barron that finetuning fiscal policy advice might have limited value. Instead, fiscal policy should be anchored in the medium term. Against this background, like many other Directors, we see merit in establishing a credible debt anchor and implementing operational fiscal rules in the medium term.

What I just said should also address the concerns of the Canadian authorities. Having a fiscal rule in place does not interfere with using discretionary fiscal stimulus when the economy is hit by an unexpected shock. One could have a responsive and agile policy reaction, as Ms. Horsman put it in her buff statement.

My second point relates to reviewing the Canadian tax system. When we recommended to take a holistic approach to review the tax system in our gray statement, we meant that the Canadian authorities should move carefully, particularly in this uncertain environment. When thinking about potential tax reforms, any effect should be thoroughly understood before putting a reform in place. In this regard, we agree with Mr. de Villeroché's concern spelled out earlier in the Board, as well regarding the advice to implement specified tax reforms that have not been thoroughly analyzed so far. We also see the danger of negative externalities and a potential race to the bottom. The value of specific tax policies recommended by the staff should be assessed also with an explicit international view. This could feature in multilateral surveillance, as also pointed out by Mr. Leipold, or to consider the importance of the topic in a standalone product that would be discussed by the Board.

I know that in February 2019 corporate taxation and the global economy is on the work program. One idea could be to bring that forward and put it on the table.

Mr. Virolainen made the following statement:

I thank the staff for the set of reports and Ms. Horsman, Ms. Young, and Ms. Zorn for their helpful buff statement. We issued a gray statement, so I just want to highlight a few points.

Canada finds itself in a challenging situation with robust GDP growth moderating amid still-lingering domestic imbalances, and more recently emerged significant external risks. With the output gap closing, we find the focus on rebuilding fiscal space appropriate and take positive note of the authorities’ commitment to maintaining a downward deficit and debt ratio path.

The current global developments highlight the need to raise productivity and competitiveness through structural reforms. While the tax system understandably gets the most attention in the staff reports, we underline that there are also other aspects to consider, for example, maintaining longer-term fiscal sustainability and relaxing restrictive FDI regulations. We share the staff’s view that the changes in the global corporate taxation landscape present an opportune time for Canada to review their own tax system, but I also share some of the concerns raised earlier by Mr. de Villeroché in this respect.

We welcome the Canadian authorities’ strong commitment to an open and rules-based international trade system and share the staff’s view that in renegotiating NAFTA, Canada and its partners should work constructively to further improve trade opportunities and promote competition.

Finally, we welcome the macroprudential measures that have been introduced to contain housing market-related risks and urge continued vigilance by the authorities. We find the ambitious national housing strategy a timely step in addressing the supply and demand imbalance in the housing market and in complementing the broad set of macroprudential measures.

Mr. Kaizuka made the following statement:

I thank the staff for the excellent papers and Ms. Horsman, Ms. Young, and Ms. Zorn for the informative buff statement. Since we issued a gray statement, I only have two issues to raise.

First, with regard to the housing market, we appreciate the authorities’ effort to increase housing supply and affordability. On another controversial issue, the non-resident property transfer tax, in the staff’s written response to the technical question on this issue, the staff is advocating measures such as higher property transfer taxes on property sold within a relatively short period for investment purposes, and/or an empty house tax. That would contain the speculative activity in the housing market, which may be sensible, so I hope the staff can have a constructive dialogue and keep discussing the detailed policy options, and the design of taxation in the housing market.

The other issue is broader—as Mr. de Villeroché and Mr. Meyer suggested—namely, how to overhaul the corporate income tax. We do not want Canada to engage in any tax competition, and the situation is very unclear situation when it comes to the impact of the U.S. tax reform so far. There are certain measures in international taxation in the tax reform which may contradict in terms of investment allocation, profit shifting, and how that will be affected. There are some contradictory implications in the whole package, so we have to take time to see how multinationals will react to the tax reform by the U.S. authorities. We should not jump into any particular concrete action before having ample data and information about those implications.

On the rent taxation recommendation, the Allowance for Corporate Equity (ACE) for example, yes, certain countries have adopted the ACE, but there are other countries that are not adopting the ACE since they have concerns about reducing the tax basis and inducing tax avoidance activities.

On the cash flow tax, and this is rather conceptual so far. There is no practical precedent for adopting the cash flow tax as laid out here. We need more analytical work, as Mr. de Villeroché mentioned, listing the pros and cons of the cash flow tax. Moreover, Canada has already adopted the VAT already, so I am puzzled how the VAT and the cash flow tax can be reconciled because the tax base is identical.

That reminds me of our discussion on the debt bias and taxation back in October 2016, and no consensus has emerged, and the important line is that the Fund is not providing any institutional views on international corporate tax and the debt biases. We have to have more discussion how those corporate income taxes will be formulated. To echo to Mr. Meyer, I look forward to the discussion we will have on corporate taxation. We should not take any practical actions before having a substantial discussion.

Ms. Barron made the following statement:

We thank the staff for an interesting set of papers and Ms. Horsman, Ms. Young, and Ms. Zorn for a clear statement of their authorities’ views set out in their buff statement. We issued a gray statement, but I would like to build on a few points that we made in it.

Fund policy advice operates in a contested environment. In this crowded marketplace of advice, the Fund can gain traction through its insights from strong theoretical analysis and cross-country experience; but these insights cannot in themselves deliver precise policy advice. Over-precision in fiscal policy and tax policy advice provided by the staff to the Canadian authorities in the staff report could undermine its traction. As we noted in our gray statement, we see limited value in advice to fine-tune fiscal policy settings when there is overall agreement with the authorities on the direction of policy.

We support the concern raised by Mr. Meyer about on-off fiscal policy advice and that Fund advice should not overly focus on the short term. Fiscal policy cannot turn on a dime from one year to the next, and it is not a single decision, but a series of decisions made by a number of agencies and offered across different levels of government.

Like Mr. Kaizuka, we also questioned the advice to consider a cash flow tax allowance for corporate equity. Australia has considered both of these options twice in recent years, and while acknowledging the theoretical neutrality and efficiency benefits, we also caution that such a move will involve considerable risks. For example, the practical implications from a tax administration and compliance perspective are unknown. There might also be opportunities for tax arbitrage if only a few countries use such a system. We support the comment from Mr. de Villeroché and Mr. Kaizuka that the lack of thorough analysis of these options should prevent it from being recommended to countries at this time. We also support their call for more in-depth analysis and debate of the pros and cons, including by the Board.

Like others, we would firmly like to commend Canada for its commitment to multilateralism on trade but also on a range of other issues, in particular, gender diversity.

Mr. Just made the following statement:

We thank the staff for the comprehensive set of reports and answers to our technical questions. We issued a gray statement and would like to add a few points for emphasis.

Overall, Canada's economy is performing well against a backdrop of sound macroeconomic policies. However, high household debt and housing prices continue to be key vulnerabilities of the Canadian economy. We welcome that the authorities' prudential measures have been effective in reducing the pace of price increases. Vigilance is still warranted as risks could shift to currently relatively safe segments of the market, but at this stage we do not see a need for further macroprudential measures. Nevertheless, we agree with the staff that there is scope for improvement in the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) area.

Following up on our technical question, we invite the staff to provide more details about amendments to the AML/CFT regulations being discussed by the authorities. We would also welcome the staff's comments on how the Canadian authorities should address AML in non-regulated businesses that finance real estate.

Like Mr. Meyer, Ms. White, Mr. Kaizuka, Ms. Barron, we encourage the authorities to rebuild fiscal buffers and strengthen the structural policy efforts to boost potential growth, especially given the still-favorable economic situation. At the same time, the credibility of the fiscal framework can be further improved by the introduction of a transparent debt rule combined with operational rules. We also share the gist of Mr. de Villeroché's and Meyer's points on the staff's corporate tax proposals.

Mr. Psalidopoulos made the following statement:

I thank the staff for a useful set of reports and Ms. Horsman, Ms. Young, and Ms. Zorn for the buff statement.

We issued a gray statement, but I want to briefly repeat the following points due to the fact that Mr. de Villeroché has practically covered everything I wanted to say. Although in our gray statement we took issue with what we felt was a scattered approach to corporate tax policy advice to the detriment of a multilateral perspective, we believe that advice favoring possible reduction of statutory rates and in general other measures that could intensify international tax competition could be more properly suggested in the context of multilateral surveillance. The staff's advice could be directed to benefit the international economy as a whole, rather than possibly contributing to a generalized race to the bottom. In this context, we also find that recommending a cash flow tax or other tax-related interventions before we see how the private sector in Canada reacts to U.S. tax changes, for example, is purely theoretical. The recommendations for policy changes and reforms, should be based on concrete facts and not anticipation.

Mr. Mkwezalamba made the following statement:

We also would like to thank the staff for a well-written set of papers and Ms. Horsman, Ms. Young, and Ms. Zorn for their clear and insightful buff statement. We issued a gray statement but also wish to make a few points for emphasis.

First, we agree with the staff that fiscal consolidation at both the federal and provincial levels is crucial to enhance the economy's resilience to adverse shocks and reduce income inequality. For this reason, we welcome the Canadian government's commitment to a responsible approach to fiscal management that aims to maintain the country's low debt advantage, as outlined in the buff statement. The federal government should continue to work closely with provincial and territorial counterparts to achieve a common goal of stronger and more inclusive growth while consolidating their budgets.

Second, rising trade tensions have created a cloud over trade negotiations. As conveyed in the staff's response, we agree that the threat of escalation of trade tensions that leads to broadening of tariffs on more products presents key risks to the outlook, further increasing business and investment uncertainties. Although the current escalation is likely to prolong NAFTA negotiations, we are encouraged by the authorities' commitment to continue engaging in good faith negotiations toward a modernized NAFTA. In the meantime, we take positive note that Canada and 10 other countries have signed the comprehensive and progressive agreement for Trans-Pacific Partnership, an opportunity for the country to further diversify its export market.

Third, we join other Directors in reiterating our support for a careful and holistic approach when assessing the overall Canadian tax system against the recent year's tax reforms. In this context, we are of the view that focusing on the marginal effective tax rate alone would give a narrow interpretation, as changes of any kind should be carefully weighed. Furthermore, we agree that a peer review of the impacts of the U.S. tax system would be warranted before a recommendation for policy changes. That being said, we welcome the authorities' commitment to continue to engage with stakeholders on the ground to get insight on the implications of the U.S. tax reform.

Mr. Gokarn made the following statement:

We join others in thanking the staff for an excellent set of reports and Ms. Horsman, Ms. Zorn, Ms. Young for their useful buff statement. We issued a gray statement in which we appreciated the sound macroeconomic management of the Canadian authorities and also noted the risks that the report was highlighting in relation to trade and other factors.

We would like to make three points. The first is to follow up on a question we raised in our gray statement on the staff's assessment of the effectiveness of the capital flow measures that were introduced last year, which was an issue that dominated the discussion during the last Article IV consultation. The staff's response was essentially that it had a temporary impact, but subsequent developments suggest that it was not. The macro fact that provides the backdrop to this is the sharp deceleration in housing prices over the last year, 20 percent or so increase in the year prior, and 1.5 percent or so increase now. It requires more rigor in terms of determining how much of a role the capital flow measures play in this. That was the objective to begin with, to cool down the housing market; and if they did, and this has become significant given that a number of other countries that we discussed in recent months have also applied similar measures, general lessons from this experience are important, and I would like to hear more on this issue.

The second is the new institution, the Canada Infrastructure Bank, and we have followed a similar model in trying to create a public-private structure to attract solid investment to infrastructure, and we would be interested in hearing how this institution is faring and what challenges it has faced and its ability to fulfill its mission.

The third point reflects concerns and issues on the tax debate that many Directors have raised both in the gray statements and in their interventions. The selected issues paper was interesting and detailed. It has two clear components, and these are not necessarily related to each other. One is the argument in favor of a comprehensive review of the tax system itself, and the other specific recommendations with respect to new forms of corporate income taxation. The buff statement makes the point that the authorities are waiting and watching to see how the new U.S. tax rules play out and then will take a course of action which fully incorporates its impact. In that context, it was not clear whether these recommendations on the general review and the specific initiatives are in response to how the United States has changed its tax regime, or do these have merit in and of themselves? There is a bit of inconsistency that we would like some clarity on.

Ms. White noted that her statement's reference to a holistic tax review was intended to be understood in the same way that Mr. Meyer had just clarified. She commended the Canadian authorities for their commitment to the global public good and to gender equality.

Mr. Hurtado made the following statement:

We asked the staff to clarify the difference between the several definitions of debt, because it is a bit confusing, and there was an answer that clarified several of our questions. But I would like more clarity on another question we asked. The gross debt of the general government is around

90 percent of GDP; whereas net debt is around 28, so that is a difference of 3 to 1. I may be wrong, but this is a little unusual. It is very big. The staff's answer states that the difference is according to the manual, and that is right. It is assets and so on, but I wanted more information about why this difference is so big.

My other point concerns what seems to be a recommendation for fiscal reforms. There was an answer to our question, also in No. 20, which is very clear. The only point is that when one reads the report and sees paragraph 24, there is a caution in the beginning of the paper that says that the government should be cautious in exploring this option and so on, but then when one sees paragraph 24, it seems like a long list of recommendations that appear to be straightforward recommendations, not a suggestion to explore different options once there is more clarity on other things.

Mr. Palei made the following statement:

I am a bit surprised by my colleagues' comments on the staff's advice on tax reform. When I was reading the report, my understanding was that the staff reiterated its longstanding recommendation to conduct a thorough, careful, and holistic review, not to jump to any hasty measures in response to the developments in the neighboring country. The point about the tax reform in the United States increasing the urgency of such review is rather straightforward, so I do not understand controversy about this issue. But maybe I misread the staff's report, or I misunderstood my colleagues, and maybe the staff could clarify its position on the recommendations in the area of tax reform.

There are many options considered in the paper, but I thought those were proposals for a tax review but not a recommendation to introduce them right away. However, I may be mistaken, and the staff may clarify this point.

Another thing I wanted to mention was that we support Mr. Just in his call for more clarity on AML/CFT issues. Last year, the staff raised these issues in relation to the real estate sector, and I would like to better understand how these gaps in the AML/CFT framework will be addressed by the authorities, and in what format. Will it be done in the direct relation to the Fund, or will it be a part of the Financial Sector Assessment Program (FSAP) report, and how will the Board be informed about the progress in this area?

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 Board for the good questions that were raised in the gray statements and in Directors' interventions.
>
> Several concerns were raised about our recommendation for fiscal policy, in particular to frontload the federal fiscal adjustment, and the concern was whether this was too much fine-tuning in light of uncertainty about trade and tax issues. Is this consistent with our previous advice on fiscal policy to be the first line of defense against downside risks? Would this let provincial governments off the hook in sharing the burden of fiscal adjustment? I will tackle these questions from a broad, big-picture perspective.
>
> The federal government has run an expansionary fiscal policy for the past two years, and this was to support the economy in the aftermath of the oil price shock in 2014. At that time, policy rates were near zero, and in the absence of short-term supply constraints, there was considerable slack in the economy. This strategy worked well. The economy gradually recovered and significantly overperformed in 2017.
>
> In last year's Article IV report, we said that no additional fiscal stimulus should be required in 2018, as we expected the output gap to close. Our current position remains consistent with this view. The fiscal stimulus has been withdrawn, and we also agree that the size of the planned fiscal adjustment over the next five years is appropriate.
>
> The nuance in this year's policy advice is that we ask the federal government to seize the opportunity of the strong economy now to frontload the fiscal adjustment. Is this too much fine-tuning? The markets pay attention to what happens in the short-term in terms of fiscal finances. The credit rating agencies pay attention to what happens in the short-term. The public pays attention to what happens in the short-term, mainly because of the economic and political trauma of past episodes when governments had run high fiscal deficits and high debt. We believe that the focus on short term is important for these reasons and also for another reason—the level of uncertainty over the medium term has increased precisely because of trade and tax issues. Compared to last year, we have revised down our growth projections beyond 2020 from 1.8 percent to 1.6 percent. We believe the fiscal multiplier

[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.

effects are smaller while the economy is booming, so building buffers today rather than later in the cycle will have less of a drag on the economy. We believe that short-term focus is prudent.

Will frontloading affect the provincial government's commitment to fiscal discipline? We do not believe that this is a systemic issue. Provinces like British Columbia and Quebec have made significant fiscal adjustments over the years irrespective of the federal fiscal position. We have also made very clear in the staff report that we are asking for a far greater fiscal adjustment on the part of the provincial governments, at least double what is currently planned—up to 0.6 percent of GDP—especially for those provinces that are running high deficits or debt, namely, Ontario and Alberta. Having said this, I recognize that there is an element of moral hazard risk. Credit ratings agencies implicitly assume that there is a federal backstop. When they rate Canada, they rate on the general government debt. They do not rate on the federal government debt. This is why it is important that at the provincial level, governments adopt fiscal rules to demonstrate their commitment to fiscal discipline and to mitigate the moral hazard risks.

Let me turn to the housing question and the tax on non-resident buyers. I believe that the main concern of the British Columbia and Ontario governments when they introduced this tax in 2016 and 2017 was that to the extent that the marginal buyer can influence price increases, then having a tax on speculation should work. When they introduced the tax, it affected price expectations, so there was a drop in house prices, and a drop in sales activity. But the problem is that a tax measure that is so narrowly defined, meaning that it is narrowly defined on a non-resident base—and we did a selected issues chapter in which we assessed the effectiveness of such a tool compared to, say, a loan-to-value (LTV) measure—it becomes too volatile. In order to achieve the same degree of effectiveness, one would have to jack up considerably the tax rate; and this is precisely what happened with British Columbia, where this year the non-resident tax increased from 15 percent to 20 percent, and they expanded the geographic coverage of the non-resident tax.

In terms of the question on the gross debt versus the net debt, I am sorry that in our technical response we provided a statistical definition of why there is a difference; but the short response to the question is that Canadians hold a significant amount of financial assets, mainly through the pension funds, and that is why we have this big gap.

Finally, on the question of AML/CFT, we are working closely with Legal Department (LEG) to have a dialogue with the authorities about how they are making progress on the recommendations in the 2016 AML/CFT assessment, and there will be a report sometime in October this year in which we will have the authorities' assessment of the status of some of these specific recommendations.

The staff representative from the Fiscal Affairs Department (Mr. Keen), in response to questions and comments from Executive Directors, made the following statement:

I will pick up on some of the helpful and thoughtful remarks on the tax side, and I will do it within the framework of addressing one of the important questions we were asked in the gray statements, which is how our analysis fits in with our general approach to the U.S. tax reform that we discussed with the Board, including with the presentation in February. Within that framework, I can pick up some of the other comments that have been made.

If we think back to the discussion of the U.S. reform, and the key messages we were sending, there were four that are particularly relevant here. One was in terms of the rate cut from 35 percent to 21 percent, and we noted that it puts the United States back in the middle of the pack. In that sense it is a normalization. That does not mean there is no possibility of rate responses elsewhere, as and we reported that some analysis suggested that looking at past experience and looking only at the rate effect, there might be cuts elsewhere on the order of 4 percentage points. We have done a little more work on that since, and I will come to that at the end.

The second point we also stressed is that the U.S. reform is much more complicated than a rate cut. There are many other things going on, more complicated even than the movement in the cash flow direction, and recognizing that some of these elements match the reduced pressures to cut rates and may even encourage U.S. companies to locate tangible investments outside the United States.

A third feature we stressed was the complexity of the reform. Details are not still fully presented. We noted that stakeholders are still considering the reform, still working out what it means. That is as true now as it was in February.

Fourth, we noted that the effects were likely to be very country-specific, and very firm-specific. Those were some of the general messages we were sending, and they are consistent with the approach that we have adopted here. The overarching headline recommendation is for a holistic review of the tax system, and our sense is, as has been expressed by many Directors, that this would be a measured reflection that would not simply be about U.S. tax reform. The urgency has been increased by the U.S. tax reform, but our understanding is exactly as was described.

Related to that, we are definitely not advocating knee-jerk reactions or rushing in. Quite the opposite. As was described, the headline recommendation is for a review, and then we are pointing out some issues and options that might feed into the review. We were trying to be helpful in suggesting what we thought might be some issues that were worth thinking about. The main thrust of the selected issues paper is to provide granularity to those thoughts. In that context, we are not recommending cash flow taxation. We are recommending that among the options to consider, as Mr. Kaizuka said, would be rent taxes, of which a cash flow tax is one variant. There are others. We note in the selected issues paper that there clearly are issues with cash flow taxation. I do not believe it is quite correct to say there is no experience with cash flow taxation. In the resource sector, in particular, there is a significant amount of experience with cash flow taxation. Nonetheless, the key point is that we are not recommending it. It is hard to think about tax reform without thinking about how we will treat acquisition of capital assets, and immediate expensing is clearly something to think about. Again, I emphasize that we are not recommending it. I will maybe come back to that in the context of future work.

One should think about the analysis we provided for Canada against the background of what our general messages have been for the U.S. tax reform. On the tax rate, we certainly found that to be an issue of discussion in Canada. Therefore, we needed to say something about it, but we try to highlight the need for caution in many respects in the area. We note in the staff report potential implications of tax competition, and we also stress that there are many other instruments to think about, not just the rate.

On the second point, we do draw attention to the novel features of the U.S. tax reform, and we qualify a number of our conclusions by drawing attention to those, noting that there is still little experience of their impact, and the stakeholders are still figuring out how they might react.

Third, on the complexity issue, we carry over the complexity of the U.S. reform issue. I believe that is reflected in our thoughts on Canada and is another issue pointing us toward a holistic review. We are perfectly aware that we cannot address every issue in a selected issues paper.

Fourth, in terms of country-specificity, we certainly did our best to tailor our analysis to the circumstance of Canada. There was a kind of empirical exercise. We recognize that is not the end of the work, but we nonetheless thought that was illustrative of potential impacts and hoped it would be helpful in that context.

I would like to comment on the work underway that relates to this. We do have two working papers on U.S. tax reform underway. One was particularly focused on spillover issues. We are completing another one jointly with Western Hemisphere Department on a broader appraisal of the U.S. tax system, obviously drawing on the work done for the U.S. Article IV consultation. We do have a Board paper coming in February which will focus on international issues, and it would be an opportunity to talk about cash flow issues, the idea of an adjusted current earnings (ACE) tax, and other possibilities. The only point I would add is that the issues are going to be much larger than whether one goes to a cash flow tax or not, because a cash flow tax in itself does not solve a whole range of the issues of transfer pricing and base erosion and profit shifting. Those issues will be there, but we should be prepared for something even more fundamental to address some of the problems that exist and that are not going away. They may be changed a bit by the U.S. tax reform. That may change the structure of the debate, but we see deeper issues that we will need to take up then.

Mr. Palei asked when the mandatory FSAP assessment for Canada would take place and whether the AML/CFT model would be a part of it.

Mr. Meyer made the following statement:

I thank the staff for the elaborations, but I have one more comment on the fiscal policy, and it is a good example where we have concerns with what we called on-off. We looked at the Article IV reports going back 2014, and in 2014 the advice was to consolidate. In 2016, the advice was to be more pro-growth, reflecting the slowdown that happened in 2015. Now in 2018, it is again to consolidate. The point that I want to make is that we should focus only on bigger shocks for discretionary policy advice. The staff now looks at the output gap, and the output gap was always relatively small; but in 2016, we said do more, assuming an output gap of -0.9 percent, and that was not a projection, that was the outcome as we saw it. In today’s report, we see that the output gap in 2015 was not -0.9 percent, but a positive 0.1 percent. The only point I want to make is we quickly get it wrong, and if we are talking about an output gap that is roughly zero-point-something or maybe 1 percent, I would not consider that a big shock. Against that background, we believe expectation in markets with citizens is really improved if we take a medium-term view and if we do not run behind a 0.1 to 0.3 percent output gap.

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:

The FSAP is happening this year, but it might be too soon for a full assessment of the AML/CFT framework, given that the last assessment was done in 2016, and it was a big undertaking. But we could have—and this is something that I would need to speak to the FSAP mission chief about—a staff member from the Legal Department who joined the team assess the progress that has been made with respect to the recommendations.

I take the point about the output gap, and I understand the perception that we always get our forecast wrong, and it is not unique to the Canada team, although our forecast errors are among the smallest in the fund. We agree that we need to have a medium-term view. That goes without saying. What we have in the staff report is not a heavy-handed recommendation to frontload by this much by this date. The table in the staff report is an illustration, and I hope that is clear to everyone. It is an illustrative scenario. What we are saying to the government is fix the roof while the sun is shining. They should take the opportunity to do it because we do not know what will come up in two or three years' time, but the economy is growing strongly now. That is all we are saying, and the table in the staff report gives an illustration of how could front-load their adjustment.

Mr. Meyer remarked that he was only making a general point about fiscal policy advice given by the Fund.

The Acting Chair (Mr. Lipton) made the following statement:

Since Mr. Meyer has made a general point, I would say that there is often more going on than just what is called a normal business cycle, and that means we have to think and analyze more broadly than just looking at the output gap.

If we take the period of time that Mr. Meyer spoke about, Canada experienced some significant swings in the price of its principal export, in commodity prices, and now it is engaged in discussions of trade, and we do not know what the outcome will be. It is our job to take all of this into account when considering, roughly speaking, GDP at risk. We must think about future risks and think about how policy is best positioned to guard against those. I do not want to discuss, defend or not, any particular recommendations, but just to say that as a general matter, we should be looking at this with a fairly broad perspective.

Ms. Horsman made the following concluding statement:

I want to complement the mission team on its solid review and constructive engagement with my authorities and with our office. I thank Directors for their thoughtful gray statements and comments.

The year 2017 was a strong year for Canada. Growth was north of 3 percent, the highest in G7 economies, as well as in most other advanced economies, fueled by both the global recovery and supportive domestic policies. Now, against a backdrop of strong growth and low unemployment, my authorities are appropriately adjusting their policy mix. Both fiscal and monetary policy tightening is underway, including a policy interest rate increase two days ago. These, together with a strong financial sector and regulatory environment and measured macroprudential measures, are reining in financial sector vulnerabilities.

My authorities are not complacent with respect to major developments in the global economy, but they are confident that the country has the resilience to weather through a potentially volatile period.

Today I want to focus on two developments that have important implications for Canada, namely, trade and tax. On trade, Canada is concerned with recent trade developments that threaten to undermine the global trade order and destabilize the global economic recovery. The Fund is taking the right approach by advocating for open, fair, and transparent trade, underpinned by multilaterally agreed rules. My authorities believe that we must focus on promoting domestic and external policies that are not only consistent, but that reinforce positive, multilateral outcomes. In this vein, they believe that a modernized NAFTA could enhance the overall competitiveness of North America and benefit all of our economies.

Turning to tax, Canada has a competitive, broad-based, and efficient tax system. Its corporate tax rates are among the lowest in the G7. The United States has moved forward with tax reform with the legitimate objective of bolstering its own competitiveness, not unlike many other countries have done in recent years. My authorities are carefully studying the recent changes to the tax landscape, but it is premature to definitively conclude that Canada has or will lose competitiveness. It is important to remain vigilant while avoiding setting off potentially self-reinforcing tax cuts around the world that are not likely desirable or sustainable. In this regard, my authorities reaffirm their commitment to multilaterally consistent approaches to international taxation.

I have to pick up on some of the comments made today by my colleagues on tax. I will start by saying that we appreciate the extensive work on tax done by staff for the Article IV consultation, and we found the discussions and debates to be productive and enlightening. At the same time, we have some misgivings on the conclusions and recommendations, which we also found a bit prescriptive and perhaps inconsistent with the call for a holistic review of the tax system. Like others, we are not convinced that the Fund should be advocating a cash flow tax, and we wonder whether there is merit in discussing this at the Board, so I support the comments from other Directors about a discussion on the Fund's position on corporate tax policy and international tax more generally.

Turning to vulnerabilities related to housing and household debt, a series of recent macroprudential measures, along with tightening monetary policy, are having their intended effect of engineering a soft landing. House price growth in Toronto and Vancouver has cooled. Household debt levels are declining and their quality increasing. More generally, Canada's banks have strong buffers, including robust balance sheets and profitability, as well as strong regulatory oversight, which underpin financial stability.

Let me conclude on a few general reflections. The fundamentals of the Canadian economy, along with the country's institutions and financial system, are solid. The flexible exchange rate regime and flexible labor markets have served the country well. The policy mix is appropriate, recalibrating to an environment of solid growth and full employment. At the same time, in an environment of heightened uncertainty, there is policy space to respond to unexpected shocks, and importantly, the policy environment is stable and predictable.

Finally, as a highly decentralized federation, a cooperative model is the only way forward. This is an ongoing challenge but one that the country continues to manage in a constructive manner.

Before thanking Ms. Lim and her team, I want to celebrate the fact that our buff statement on Canada's Article IV was written by an all-female team.

Ms. Young and Ms. Zorn are my coauthors on the buff statement, and it is the last Canada Article IV consultation for both of them. Many Board members will have interacted with these two senior advisors in my office and will be aware of their considerable intellect and dedication to the work of the Fund and to our constituency. We have also been lucky in Canada to have a talented female mission chief, Ms. Lim. I want to thank Ms. Lim and her strong team for their work, and I want to make a special mention of Mr. Keen and his team, in whom the Fund has formidable tax expertise; and I hope he will see this as an appetite to discuss the issues that are close to his heart, because the appetite is here.

I thank Directors for their contributions to the discussion. I will report diligently to my authorities their comments and views.

The Acting Chair (Mr. Lipton) remarked that he read the staff report as a set of suggestions for debate about important tax issues rather than a list of recommendations. He remarked that Ms. Horsman's suggestion to address tax issues in a more holistic way was useful.

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

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended the impressive performance of the Canadian economy in 2017. They noted that the growth momentum is expected to continue in the near term, but that the outlook is subject to significant downside risks, including from uncertainties related to trade and the impact of recent U.S. tax changes. Directors urged the authorities to rebuild policy buffers and forge ahead with reforms to boost competitiveness and productivity.

With output above potential, Directors agreed that the focus now should be on rebuilding fiscal buffers. They urged provinces that are running high deficits or debt to take the lead in making the necessary fiscal adjustment. They welcomed the federal government's commitment to set federal debt-to-GDP on a declining path, and broadly noted that the planned consolidation could be frontloaded to take advantage of the favorable performance of the economy. Directors agreed that the authorities could strengthen the credibility of their fiscal framework by explicitly incorporating fiscal rules, although a few Directors questioned whether now is the right timing, as they saw a need for fiscal policy to be able to respond nimbly in the current conjuncture. In the event downside risks materialize, automatic stabilizers should be allowed to operate fully and discretionary measures could be deployed.

Directors noted that the overall impact of the recent U.S. tax reform needs to be fully studied and assessed. In this context, many Directors considered that a review of Canada's tax system could usefully evaluate the scope for improving efficiency while maintaining competitiveness. Directors stressed the need to avoid a hasty reaction to recent developments and to carefully consider the implications of any potential tax changes.

Directors agreed that the monetary policy stance has been broadly appropriate and inflation is well contained. Against the backdrop of elevated levels of uncertainty, the tightening cycle should proceed with caution and be guided by incoming data on economic activity.

Directors concurred that current macroprudential measures are appropriate and appear to have contributed to a cooling in the housing market. If housing vulnerabilities continue to rise, the authorities should consider introducing additional measures. Directors stressed that a broad set of supply-side policies is needed to address housing affordability concerns and reduce demand pressures.

Directors emphasized the importance of close coordination and information exchange between federal and provincial regulators to mitigate risks to financial stability. Gaps identified in the AML/CFT assessment will need to be addressed. Directors looked forward to the upcoming FSAP for a comprehensive assessment of the financial sector.

Directors urged Canada and its NAFTA trade partners to continue to work constructively to reach an agreement within a reasonable timeframe that further opens trade and promotes competition. Directors commended the authorities for signing the Comprehensive and Progressive Agreement for Trans-Pacific Partnership and urged them to ratify the agreement as soon as possible.

Directors stressed that revitalizing productivity is key to boosting long-term growth and commended the authorities for making this a priority. They recommended reducing barriers to inter-provincial trade, facilitating infrastructure investment, and further deregulating product markets to attract FDI. These steps should be implemented in coordination between federal and provincial authorities.

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

APPROVAL: April 16, 2020

JIANHAI LIN
Secretary

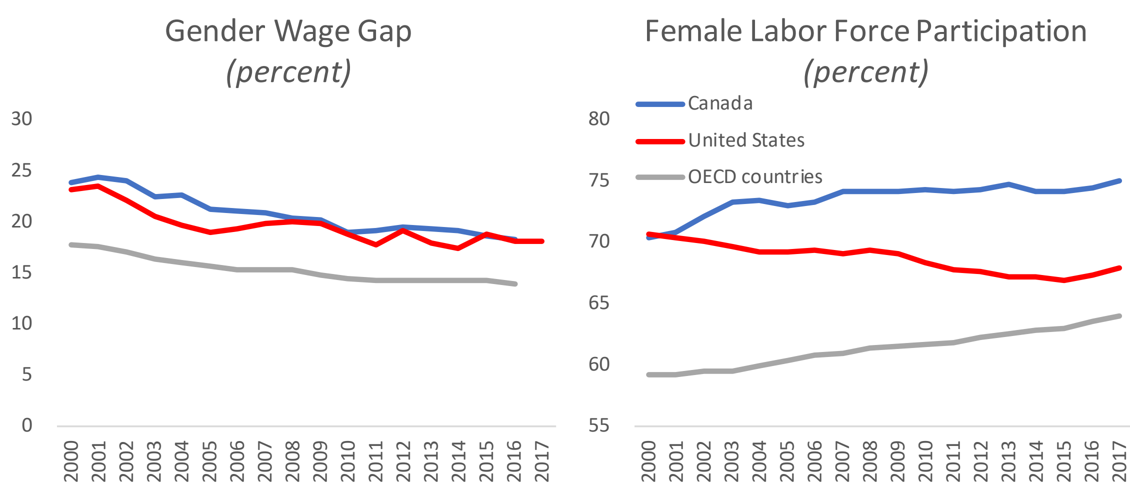
Annex

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

Outlook/Risks

1. ***Combined with the measures adopted by the federal government to promote social and gender equity – which we welcome – Canada's strong growth appears to have been broadly shared. Staff comments are welcome.***

- We agree that Canada's strong growth performance has been broadly shared. Annual wage growth was 4 percent in 2017, the highest growth rate since 2012 and minimum wages have been rising across all provinces. In addition, metrics of income inequality for Canada compare favorably to the U.S. and the OECD using 2015 data (see table), and more recent data on incomes and employment for Canada suggest this trend has continued. Nevertheless, there is still wage inequality between genders as the gender wage gap remains high relative to the OECD average, even though female labor force participation has been edging up.



Source: OECD

Income Inequality Indicators 2015

	Canada	U.S	OECD 1/
Gini (disposable income)	31.8	39.0	36.3
Gini (gross income)	43.5	50.6	50.2
P90/P50 disposable income 2/	1.9	2.3	2.3
P50/P10 disposable income 2/	2.3	2.7	2.5
Poverty rate (before taxes and tranfers)	25.3	26.7	29.2
Poverty rate (after taxes and transfers)	14.2	16.8	14.4

Source: OECD Statistics

P90/10 is the ratio of the upper bound value of the ninth decile (i.e. the 10% of people with highest income) to that of the first decile; P90/P50 of the upper bound value of the ninth decile to the median income; and P50/p10 of median income to the upper bound value of the first decile.

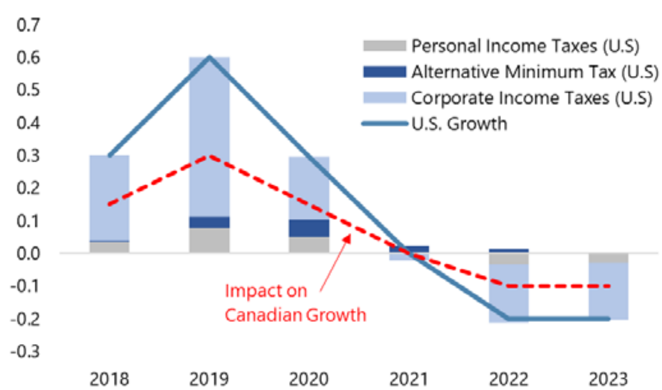
1/ The OECD aggregate indicators are weighted by population

2. ***In the U.S. Article IV report, staff notes that a gradual fiscal consolidation starting in 2020 when monetary tightening is at the peak bears the risk of triggering a technical recession. We therefore wonder whether under such a scenario, the boost to the Canadian economy, would turn negative in 2020 rather than in 2021. What is staff's projection of Canada's economic growth beyond 2020?***

- We agree that Canada would be adversely affected if the U.S. falls into recession. While this risk is not explicitly built into the baseline growth projection, the projection fully incorporates all developments in the baseline U.S. growth projection, including the fiscal consolidation. For example, the baseline U.S. growth projection incorporates a positive boost to growth from tax reforms between 2018-21 and a drag on growth over 2022-23 as some of the tax measures expire. These

Impact of U.S. Tax Reform on Real GDP Growth

(percentage point contribution to growth)



Source: Staff Estimates.

effects are projected to have spillover effects on Canada, including negative effects over 2022-23 (see chart). Canada's growth projections beyond 2020 are below:

	2020	2021	2022	2023
Real Growth	1.8	1.8	1.6	1.6

3. ***We note that private consumption has been supported by strong gains in disposable incomes. We would welcome the staff's elaboration on the reason behind the increase in disposable incomes. Do staff think that the increase in the marginal propensity to consume has also supported private consumption?***

- Fiscal transfers contributed to the initial boost in incomes in 2017, but more recent increases have been the result of a strengthening labor market. The employment rate has increased steadily, and the unemployment rate has fallen to its lowest level in 40 years. The personal saving rate rose from 3.5 to 3.8 percent of disposable income between 2016 and 2017, suggesting that an increase in the marginal propensity to consume was not a key factor in the rise in private consumption over this period.

Fiscal Policy

Fiscal Stance

4. ***We are concerned about staff's "on-off" approach regarding its fiscal policy advice. Last year, staff recommended an expansionary fiscal stance with fiscal stimulus being the first line of defence in the event that downward risks materialize. This year, despite remaining downward risks to the economic outlook, staff suggests a more determined fiscal consolidation and frontloaded fiscal adjustment (with which we agree). Against the backdrop of these diverting recommendations, we encourage staff to not overly focus on the short-term and on discretionary policy advice. We consider a medium-term approach to fiscal policy advice appropriate which will help creating confidence and will stabilize expectations. Staff comments are welcome.***

- Staff will respond to this question during the Board meeting.

5. ***Staff therefore suggests that a more frontloaded fiscal consolidation should be operated by the federal government. Is there a risk that such an approach would weaken the consolidation efforts at the provincial level and result in a higher burden of adjustment on the federal government? Staff elaborations would be welcome.***

- Staff will respond to this question during the Board meeting.

6. ***While staff recommends that Canada, displaying growth slightly above potential, should build up buffers and reduce debt levels as a contingency measure –in line with 2018 WEO recommendations– staff's recommendation for Germany is to use the entire available fiscal space. Some of the risks enumerated in both Article IV reports, in particular those linked to trade tensions and policy uncertainty, appear to be faced by both countries to a similar extent. Could staff briefly explain what the main rationale is behind the diverging recommendations?***

- While we cannot speak to the policy advice for Germany, we understand that the recommendation to use all available fiscal space is motivated by a rapidly aging society, with low productivity growth and the low investment growth. We also understand that even if Germany uses all of its fiscal space (as assessed by staff), it would still be building buffers (public debt would still decline, but at a less rapid pace).
- Canada started using its fiscal space in 2016 and 2017 to support the economy, with a focus on inclusive growth, investment in infrastructure, skills and innovation, and expanded child care benefits.
- It also worthwhile noting that the two countries also have different fiscal positions. In Germany, the general government balance position is a surplus of 1.2 percent of GDP in 2017, whereas in Canada, it is a deficit of 1.1 percent of GDP.

Federal-provincial relations

7. ***Could staff explain the division of labor between the federal and provincial governments in delivering social services and capital spending, and how strengthened coordination could help improve fiscal prudence?***

- The constitutional distribution of legislative powers between federal and provincial governments is set as follows.

1) The powers of the Parliament of Canada concern matters of national interest. For example:

o Public property
o Regulation of trade and commerce
o Unemployment insurance
o Direct and indirect taxation
o Defense

2) The exclusive powers of provincial legislatures concern matters of a local nature. For example:

o Direct taxation within province

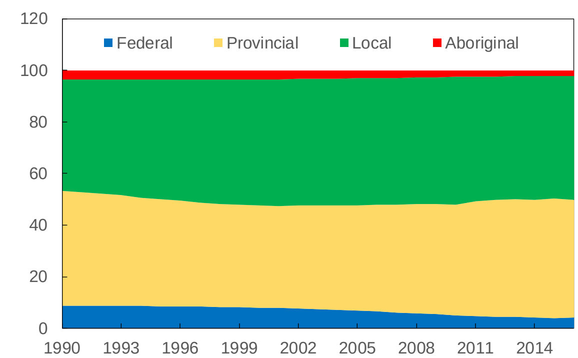
- o Management and sale of public lands belonging to province
- o Prisons
- o Hospitals
- o Education
- o Natural resources

3) Concurrent and shared powers

- o Old age pensions
- o Immigration
- o Agriculture

- Infrastructure. The bulk of economic infrastructure assets is owned and managed by provincial and local authorities. The federal government's share of infrastructure assets has halved to 7 percent since 1990, while provincial and local governments have increased their share to more than 90 percent of total assets today.

Figure 2. General Government Economic Infrastructure Assets 1/
(Percent share)



Sources: Statistics Canada, CANSIM Table 378-0121; and Haver Analytics
1/ Book value.

- Coordination. As Ms. Horsman indicated in her statement, fiscal federalism is a key tenant 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. This said, there are 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.

8. ***Are there adequate mechanisms in place to prompt the provinces with high deficits or debt to pursue fiscal consolidation more forcefully?***

- Among the major provinces, British Columbia and Quebec have balanced budget rules. British Columbia has maintained low deficits and debt, while Quebec has made major progress in consolidating its fiscal positions in recent years.

- Ontario has the Fiscal Transparency and Accountability Act, which requires that if the Ontario government plans for a deficit in a fiscal year, it must provide a recovery plan for developing a balanced budget in the future. Ontario's 2018 budget indeed envisaged a return to a balanced budget, but only by FY2024/25. In addition, the escape clause is not clearly defined. Therefore, we see scope for reviewing the current fiscal rule to assess its effectiveness to maintain fiscal credibility and sustainability.
- Alberta currently has no fiscal rule.

9. ***While we agree that a strengthening of the provincial fiscal frameworks is highly desirable, we would like to better understand how such reforms can be achieved. Does federal government have any leverage in nudging the provincial counterparts toward the rules-based policies? We agree that the federal government can lead by example in embedding the fiscal rule(s) in the policy-making (paragraph 20). We also believe that the fiscal councils at the provincial level could be instrumental in this respect. Are there any entities at the provincial level similar to the office of the Parliamentary Budget Officer?***

- See response to question 7. The federal government does not have legislative powers to force provincial governments to set up fiscal rules.
- Among the major provinces, we believe that only Ontario has its own fiscal council, the Fiscal Accountability Office of Ontario.[2]

10. ***Staff also note that contingent liabilities loom on the horizon at the provincial level. What are the most significant of these contingent liabilities and what is staff's assessment of the likelihood and impact of these crystalizing?***

- The most significant "contingent liabilities" as noted in paragraph 16 are age-related liabilities, particularly health care cost and pension liabilities. These liabilities will have a substantial impact on provincial finances within a 10 to 20-year time frame.

Fiscal rules

11. ***To reinforce credibility, we note that the authorities are keen on considering staff's advice to introduce a few operational rules to reduce risks and strengthen fiscal accountability. Since this was recommended during the last Article IV Consultation, could staff shed more light on what could be prolonging the establishment of these rules, especially at the federal level?***

- The authorities agree that simple, transparent fiscal rules could anchor the medium-term budget framework, but they are concerned that fiscal rules would

[2] http://www.fao-on.org/en/

constrain their ability to respond quickly to unexpected shocks. In response, staff have suggested that including a well-defined escape clause would be one way to deal with this problem.

12. ***We wonder whether the authorities have considered the adoption of new fiscal rules since the balanced budget rule was repealed in 2016.***

- The authorities have not adopted a new fiscal rule since the balanced budget rule was repealed in 2016, but are open to considering a new rule when the economy stabilizes at its potential.

13. ***Explicit incorporation in the fiscal framework of a debt anchor combined with an enforceable, flexible, and simple expenditure rule could bolster fiscal credibility, and we wonder if this recommendation is being duly considered. Staff comments are appreciated.***

- The authorities are committed to lowering the debt-to-GDP ratio over the budget forecast horizon (i.e., 2022). However, they don't have a specific debt target.

14. ***Staff have provided a good overview of operational options that balance the need for enforcement, flexibility and simplicity in the report, and we welcome the indication in Ms. Horsman's, Ms. Young and Ms. Zorn's gray that such a rule could be of value. We wonder whether authorities desire to retain a certain degree of agility to respond to shocks could not also be accommodated with a fiscal rule? Staff comments welcome.***

- See answer to question 11.
- As discussed in the recent SDN on fiscal rules (SDN/18/04), escape clauses need to be precisely defined to cover events that are truly outside the government's control. This is because without well-designed escape clauses, rules are often put in abeyance following large shocks, or countries resort to ad hoc measures to accommodate them.

15. ***While recognizing that the fiscal rule could anchor the medium-term budget framework, authorities have also mentioned that heightened global uncertainty puts a premium on responsive and agile policy responses to unexpected shocks. We welcome staff comments on this with illustrations from the advanced country peers. We would also like to know more on the discussions held with the authorities on this.***

- Please see our response to Q14.
- In addition, the SDN on fiscal rules provides several country examples where well define escape clauses have been adopted.

- EU. In the European supranational framework, new escape clauses were created in 2011, including a general crisis clause that allows deviations in the event of a severe economic downturn in the euro area or the EU as a whole.
- Switzerland. An escape clause, approved by parliamentary supermajority under "exceptional circumstances", allows for "extraordinary expenditures" through supplementary budgets. The escape clause can itself contain a correction mechanism requiring authorized deviations to be subsequently corrected.

16. ***Nevertheless, since this fiscal effort falls heavily on the provinces, in staff's opinion, what are the chances that provinces cooperate in this respect? We take note of the recommendation to adopt a debt anchor on the part of the federal government, however, do authorities agree with the use of this specific fiscal rule? Staff comments are welcome.***

- Staff will respond to this question during the Board meeting.

Fiscal assets

17. ***The authorities also consider fiscal federalism to be one of the fundamentals of the Canadian economy. We would welcome staff's comments on the benefits and costs of holding such sizable liquid financial assets. Furthermore, we would like more detail about the distribution of assets among the federal and other government bodies, and whether debt and liquidity management coordination is possible within the current fiscal federalism framework.***

- Sizable financial assets reflect the setup of the Canadian federal system. Provinces have autonomous powers to conduct fiscal policy and manage their own assets and liabilities. As we understand, there is no liquidity management coordination mechanism at the level of the general government.
- Subnational governments hold about a half of total financial assets, and the remaining is equally split between the federal government and social security funds (see text table).

General Government Financial Assets
(Unconsolidated, end-2017)

	C$ billion	Percent share
Federal government	353.4	23.7
Subnational governments	776.5	52.0
Social security funds	362.5	24.3
Total general government	1,492.3	

Source: Statistics Canada; and Haver Analytics

Definition of net and gross debt

18. ***Public debt is presented according to various definitions in the report. For example, net and gross public debt, General Government's and Provinces', and adjusted for accounts payable. Can staff please provide clarity on the differences among those definitions? Also, we are puzzled by the apparent size difference between general government gross debt (76 percent of GDP, according to paragraph 19) and Federal Government (presumably net debt of around 30 percent of GDP - figure in paragraph 20), could staff clarify?***

- Where there are no specific remarks, public debt numbers are presented consistent with IMF Public Sector Debt Statistics Guide for Compilers and Users ("IMF guide) and 2008 SNA. The IMF guide defines that gross debt consists of all liabilities that are debt instruments including debt securities, loans, insurance, pension, and other accounts payable, and net debt should be calculated as gross debt minus financial assets corresponding to debt instruments. However, we have made some adjustments. Main adjustments are as follows.
- For cross-country comparability, gross and net debt data exclude unfunded pension liabilities of government employees' defined-benefit pension plans (similar to the WEO and Fiscal Monitor presentation for Hong Kong Special Administrative Region and the United States).
- Financial assets include equity.
- Paragraph 19 refers to staff's forecast of general government gross debt (76 percent of GDP) in 2023. This is consistent with the number reported in Table 3 (see "Consolidated General Government, Gross public debt, in 2023). An equivalent gross debt number for the federal government is 33.2 percent of GDP in 2023 (see "Federal Government, Gross federal debt, in 2023) in Table 3. These numbers are consistent with 2008 SNA and IMF guide.
- The authorities' debt projections presented in paragraph 20 (text chart) are based on authorities' definition which are consistent with Canada's Public Sector Accounting Standards (PSAS). There are some differences between IMF guide/2008 SNA and Canada's PSAS, including the definition of the federal government and various accounting treatments.

19. ***Could staff comment on the difference between the domestic fiscal policy gap (significantly negative) and the total fiscal policy gap for Canada used for EBA (positive gap)?***

- The overall fiscal balance was -1.1 percent of GDP in 2017, while the fiscal policy gap used for the EBA was positive. The fiscal policy gap used for the EBA is defined to be the difference between the overall fiscal balance and the debt-stabilizing overall balance. The debt-stabilizing overall balance was estimated to be less than the overall fiscal balance in 2017, implying that the fiscal policy gap was estimated to be positive. As discussed in the SR, staff recommends that fiscal policy should focus on rebuilding policy buffers and reducing debt, rather than maintaining current levels of debt as a share of GDP.

Tax Policy

20. ***Without the full effects of the US tax reform well understood, and when trade is subject to the uncertainty of NAFTA renegotiations and an impending global trade war, we wonder if this is a good time to fundamentally change corporate taxation. We would welcome staff's as well as the authorities' position on this.***

- The SR indeed cautions against rushed changes to the tax system, but rather recommends that now is an appropriate time for a comprehensive and independent review of the overall tax system. The SR and SIP highlight issues and options that staff believe such a review should consider, including quite fundamental (but in many case not unprecedented) restructuring.
- See also 22 below

21. ***Like staff, we see the need to also consider other revenue sources, like heavier reliance on indirect taxation. With rate reductions merely risking intensified international tax competition, we would appreciate staff elaborating on the effects of increasing the efficiency of the tax system via revenue-neutral reforms. (Oral)***

- Staff will respond to this question during the Board meeting.

22. ***Given the level of uncertainty around the assumptions made, we invite them to refrain from providing such recommendations. In any case, we keep wondering how to reconciliate staff's past statement minimizing the risk that the US tax reform fuels negative international spillovers, notably enhanced tax competition, as this is precisely what the analysis and recommendations of the team for Canada show (notably when recommending a cut in Canadian CIT rates) and is explicitly mentioned in this Article IV report. (Oral)***

- Staff will respond to this question during the Board meeting.

23. ***In this regard, the analysis presented in staff's report confirms our feeling that staff analysis derives mostly from tax competition considerations and we see no mention in the analysis of the distributive and sectoral effects of the recommended effects, neither on the tax resources and welfare in Canada. Staff comments are welcome.***

- Staff recognize that the effects of tax reform, both in Canada itself and indirectly from the U.S. may differ substantially across sectors—and indeed across firms within sectors. A meaningful analysis, however, was beyond the resources of the mission. There was some discussion focused on the manufacturing sector, but staff did not feel the conclusions sufficiently clear to take up in the SR or SIP. A full analysis of distributional effects and options raised in the SR and SIP would also have required extensive analysis to be useful; in terms of the U.S. reform, equity impacts on the U.S. itself remain less than fully clear, and it would even more difficult to assess their indirect distributional effects in Canada.

24. ***Staff reiterated their previous call for a comprehensive review of taxation in Canada and offered compelling arguments in favor of a more comprehensive approach instead of the current piecemeal improvements. Yet, from the BUFF statement, we understand that the Canadian authorities find such an approach to be inappropriate under current circumstances. Is there any traction of the Fund's advice in this area?***

- Staff found support for such a review in its discussions with academics and business. The 2018 survey by Ernst and Young cited in the SIP finds considerable business support for a comprehensive review of taxation in Canada; 90 percent of 165 surveyed executives thought that Canada needs a comprehensive tax policy review, with many respondents seeing the US tax moves as a significant new impetus for such a review. The authorities stressed that they have long been mindful of the need to take stock of their tax arrangements and produced several reviews of aspects of the tax system over many years. Staff is urging a more holistic review, embracing for instance both personal and corporate tax. They indicated too that Minister Morneau is planning to undertake a roadshow to engage with key stakeholders on reforming the tax system in Canada, and that the SR and SIP will be useful to the authorities in helping shape the dialogue on tax issues.

25. ***Given the difference in personal income tax, there might be possible implications of the U.S. tax reform on brain drain or migration of high net worth persons. Could staff share their assessment?***

- The SIP notes that the generous treatment of small businesses in Canada means that they may be less affected by the TCJA. Even with the rate reduction and FDII for C-corporations and the top federal marginal rate for eligible pass throughs in the U.S. of 29.6 percent, the low CIT rates in Canada for small corporations combined with the dividend tax credit and 50 percent exclusion of capital gains will often preserve more favorable treatment in Canada. On the other hand, the impact of the U.S. tax reform on brain drain or migration, though beyond the scope of our current analysis, would be an essential part of the wider review.

Monetary Policy

26. ***With consumer prices edging up past the midpoint, the central bank increased rates on July 6, owing to strong domestic momentum. In this regard, we would be interested in staffs' views on the recent hike and the high prospect of the BoC increasing the rates further, despite rising trade tensions and uncertainties.***

- Given recent growth and inflation developments, staff welcome the Bank of Canada's recent move to increase its policy interest rate by 25bps. Staff's advice is that further monetary tightening is warranted. However, against the backdrop of elevated levels of uncertainty emanating from U.S. tax and trade policies, there is merit in pursuing a more gradual tightening phase. This is consistent with the Bank of Canada's recent announcement in which it stated that it "expects that higher interest rates will be warranted to keep inflation near target and will continue to take a gradual approach, guided by incoming data".

Trade and External sector

27. ***While caution is warranted in estimating the economic impact of developments in this area, we note the asymmetry of more losses than gains in the scenarios of unsuccessful vs. successful NAFTA outcomes (page 24) and would appreciate some elaboration by staff.***

- The difference in the magnitude of the outcomes between the unsuccessful and successful NAFTA scenarios is the result of a number of factors, including non-linearities in the model that generated the results, larger tariff movements in the unsuccessful scenario (i.e. the change in tariffs from NAFTA rates to zero tariffs in the successful scenario is smaller than the change in tariffs from NAFTA rates to MFN rates in the unsuccessful scenario), and larger movements in trade efficiency/trade costs in the unsuccessful scenario (i.e. trade efficiency is assumed to increase by 1 percent in the successful scenario and it is assumed to decrease by 2 percent in the unsuccessful scenario).

28. ***We encourage the Canadian authorities and their NAFTA trading partners to stay at the table and work together towards a successful resolution to the NAFTA negotiations. We note the table on page 10 that indicates the effects for Canada of an unsuccessful NAFTA. Can staff provide similar analysis of the impacts for all members of NAFTA?***

- See table below.

Effects of Unsucessful NAFTA Negotiations 1/

Trade Costs (assumed) *% change*	Real GDP *% change*	Trade Balance *$US mil. change*
Canada		
-2	-0.45	-33.87
-5	-1.04	-198.29
-10	-1.94	-409.57
-15	-2.74	-547.47
Mexico		
-2	-0.48	-1447.45
-5	-0.99	-2755.04
-10	-1.79	-4714.74
-15	-2.53	-6407.03
United States		
-2	-0.09	-493.79
-5	-0.20	-1317.68
-10	-0.37	-2656.74
-15	-0.53	-3964.67

Source: Staff estimates
1/ Tariffs revert to MFN rates

29. ***First, it is unclear why staff adjusted the demographic variable based on "methodological differences" between the authorities and UN demographic projections, as this undermines efforts to promote multilateral consistency across Fund external assessments. Second, while the adjustments based on permanent immigration targets and temporary oil price differential may be merited, we would have appreciated more details about how these adjustments were made in the model – e.g., was the underlying data modified or were the model coefficients adjusted? Third, we urge staff to consistently clearly articulate how much of the cyclically adjusted CA gap reflects policy gaps versus the unidentified residual. Staff comments on these three points would be welcome.***

- Staff adjustments for demographics reflect new immigration targets that have not been fully reflected in the authorities' and UN projections. We do not see this as undermining multilateral consistency efforts, but rather as necessary to properly assess Canada's external position.
- Bear in mind that through the vetting of the External Sector Coordinating Group, adjustors proposed by country teams are subject to significant scrutiny and are required to be conceptually grounded and reasonably quantified. When adjustors to a given country point to a clear counterpart, mirroring adjustors are introduced in the corresponding counterpart economy. In most instances, however, a counterpart is not directly identified. Multilateral consistency is preserved by ensuring that

staff-assessed gaps add up to zero, including by introducing a multilateral-consistency adjustment across all countries if needed. In recent years, however, such adjustment has not been necessary as individual country adjustors have been small or cancelled out for the most part. For example, measurement adjustments are of certain sign for Canada (and other economies) and the opposite sign for Switzerland.

- The adjustments based on new immigration targets were made to the norm (0.4 percent of GDP), while that for the oil price differential was made to the cyclically-adjusted balance (0.6 percent of GDP), which helped to reduce the EBA estimated CA gap by around 1.0 percent of GDP. Adjusting for the statistical treatment of retained earnings on portfolio equity and inflation reduced the CA gap by a further 1.7 percent of GDP.
- Identified policy gaps explain only a small portion (-0.3 percent of GDP) of the overall gap, suggesting that other factors are at play and highlighting inherent uncertainties in the assessment. In this regard, the ranges around the staff-assessed CA gap (-3.4 and -0.4 percent of GDP), reflects not only the standard error of the estimated norm, but also the fact that the model can explain only a small portion of the overall gap.

30. ***We would like to ask the staff's view on the impact of countermeasures on the bilateral trade and domestic market. Also, do staff see any prospects for both the U.S. and Canada to widen the coverage of measures, including autos, going forward?***

- On May 31, the US administration announced the end of tariff exemptions granted to Canada on steel and aluminum imports. On June 1, it began to levy tariff s of 25 percent and 10 percent, respectively, on imports of these products from Canada. The value of exports now subject to the US tariff s was $16.6 billion in 2017, about 2.5 percent of total Canadian exports. Together, the primary steel and aluminum sectors represent about 0.5 percent of Canadian GDP and directly account for around 35,000 jobs. In response to these measures, the Government of Canada imposed tariff s on imports from the United States worth $16.6 billion, mainly on aluminum, iron and steel products, as well as various consumer products. These countermeasures took effect on July 1. The federal government also announced that it would make available up to $2 billion to support Canadian workers and businesses in the steel, aluminum and manufacturing industries
- According to the Bank of Canada,[3] the direct impact of U.S. tariffs on steel and aluminum could reduce Canadian real exports by 0.6 percent, and the impact of Canadian countermeasures could reduce Canadian real imports by 0.6 percent (see table). The Canadian countermeasures are also expected to upward pressure on CPI inflation, increasing it by around 0.1 percent until late 2019.

[3] See https://www.bankofcanada.ca/wp-content/uploads/2018/07/mpr-2018-07-11.pdf, box 2.

Table 2-A: Recently announced tariffs will have a negative impact on trade

Direct impact (in per cent) of the US and Canadian tariffs on the level of	2018Q4
Canadian exports (from US steel tariff)	-0.4
Canadian exports (from US aluminum tariff)	-0.2
Canadian imports (from Canadian tariffs)	-0.6

- A further escalation of trade tensions that leads to a broadening of tariffs across the economy (for example, to the auto sector) represents a key downside risk to the outlook, not only through its direct effects on trade but also due to its effects on uncertainty and business investment. This would also represent a further setback to NAFTA negotiations.
- We encourage the U.S. and Canada to work constructively together to resolve trade disagreements without resort to emergency measures. Everybody loses in a protracted trade war.

31. ***Could staff provide an update on the cost for Canada of the US decision to impose tariffs on steel and aluminum?***

- See response to 30.

32. ***Could staff share their assessment of the impact of the U.S. steel and aluminum tariffs, and Canada's retaliatory tariffs?***

- See response to 30.

33. ***We appreciate staff's description of contentious issues in the NAFTA negotiations. What is staff's assessment of the prospect of this negotiation?***

- The most contentious issues in the NAFTA negotiations are proposals put forward by the U.S., including minimum U.S. content requirements in the auto sector, eliminating the investor-state dispute resolution framework (which allows trade disputes to be settled in U.S. courts), a cap on government procurement, and a five-year sunset clause on the agreement (meaning the agreement would need to be renegotiated every 5 years). While there has been some progress in modernizing NAFTA over the course of the negotiations, progress has stalled recently with the U.S. decision to impose tariffs on Canadian steel and aluminum and the Canadian decision to impose retaliatory measures on an equivalent value of U.S. imports of steel, aluminum, and other products. While this is a setback for the negotiations, staff's baseline projection assumes that a NAFTA agreement will be reached within a reasonable timeframe.

Housing and Financial Sector

34. ***We note that, among the macro-prudential measures under consideration, there is apparently no reference to income-based instruments which could prevent the increase of vulnerabilities in certain segments, such as the young. Staff comments are welcome.***

- While the staff report suggests that the authorities should hold off on any new macroprudential measures to allow the recently introduced measures to work, staff has advocated the introduction of loan-to-income limits over the past few years. Moreover, the staff report states that "If housing vulnerabilities continue to rise, the authorities should consider introducing loan-to-income limits in line with previous staff advice." The authorities have considered the existing macroprudential toolkit sufficient to contain vulnerabilities.

35. ***Given the recent moderation in property prices, can staff comment on the pace of this adjustment? Is the moderation pace too fast, increasing the likelihood of a "hard landing" in the Canadian housing market?***

- We welcome the moderation in property price increases as it eases the build-up of vulnerabilities in the household and financial sector and helps affordability. We do not consider the pace of moderation too fast: at the national level, property prices continue to increase, albeit at a much slower pace. While the formerly overheating markets around Vancouver and Toronto have experienced significant corrections, there are signs of stabilization and price growth, and price inflation in condo markets has remained robust.

36. ***In this connection, we would appreciate it if staff could share the authorities' views on the proposed measures on housing policies to tackle the supply-side and affordability issues over the long-term (Box 2 p.22).***

- Supply-side housing market policies have not been discussed in detail in previous consultations, and the authorities welcomed the attention to this macro-critical issue and agreed with the recommendations.

37. ***We would welcome staff's update on the authorities' measures in AML/CFT since the 2017 Article IV Consultation and the last FATF Mutual Evaluation. Further, we are interested in staff's views on whether gaps in the existing AML/CFT framework could be aggravated by the move to lenders not subject to the same regulation as banks, and an emergence of fintech competition.***

- Our understanding is that the authorities are working on implementing the recommendations of the 2016 assessment (e.g., amendments to the AML/CFT regulations on customer due diligence requirements—amongst others—are currently being discussed. Canada is scheduled to provide the FATF a Follow-Up Report on its progress in enhancing the AML/CFT framework in October 2018 during the next Financial Action Task Force (FATF) Plenary.
- Gaps in existing AML/CFT framework could be further aggravated by the move to lenders not subject to the same regulation as banks, and an emergence of fintech competition.
- While fintech was not discussed in this Consultation, fintech-related issues could be discussed with authorities in the next AIV Consultation if necessary.

38. ***The authorities have indicated the need for additional measures should household indebtedness and housing vulnerabilities continue to rise, and we wonder if these include introducing loan-to-income limits as well as tax measures targeting the speculative demand of residents and nonresidents alike. Staff comments are welcome.***

- See response to 34. Regarding tax measures, staff's advice is any measures that are adopted should not discriminate between residents and non-residents.

39. ***On financial sector policy, we positively note that the overall banking sector is well capitalized and has high profitability. And non-performing loan ratios are low. We also note that Canada's big banks have maintained high net interest margins. We would appreciate the staff's view on the reasons why Canada's big banks have been profitable under an accommodative monetary policy, and what kind of business models they have taken to maintain profits.***

- Canadian banks appear relatively profitable compared with international peers. A number of factors contribute to their performance:
- Canadian banks have had fairly clean balance sheets with low NPLs for many years. Currently, the average NPLs to total loans for D-SIBs is around 0.5 percent.
- Their income is well diversified, from both interest and non-interest income sources. Net interest income (net of provisions) has been strong, benefiting from good asset quality, healthy credit growth, and relatively higher interest rates compared with other advanced economies. The oligopolistic market structure for the large financial institutions also likely contributes to their good performance. Non-interest income is relatively large—D-SIBs have capital markets/asset management operations.

40. ***Authorities have indicated that national house price growth has dropped to 1.5 percent from 20 percent just over a year ago. Could staff comment on the role of the capital flow measures in this moderation? From a risk perspective, with***

interest rates higher and that in turn impacting refinancing, have staff assessed the potential negative fallouts especially with the parallels to America a decade ago and the recession that ensued?

- Statistics Canada only began compiling data on nonresident homebuyers last year, after the provincial tax measures had already come into effect. Macroprudential and monetary policy have also been tightened since the taxes were implemented. This makes it difficult to quantify if the measures have had a meaningful impact on the share of nonresident homebuyers and house prices. That said, there were data collected by the BC government in 2016 that showed nonresident buyers at about 13 percent versus a much lower number published by Statistics Canada after the tax (less than 5 percent). While these data are not directly comparable, taken broadly they suggest the Vancouver tax may have contributed to a reduction in the presence of foreign buyers. However, it appears that the effect on house-price inflation was temporary, with house-price inflation slowing immediately after the tax and then rising again after several months.
- Staff see a sharp correction in the housing market as being the key domestic risk. A sharper correction in domestic housing markets could be triggered by a sudden shift in price expectations or a faster-than-expected increase in mortgage interest rates. It is difficult to draw parallels between this scenario and the collapse in the U.S. housing market in 2007:
- Unlike the U.S., Canadian law requires home buyers to purchase insurance for lenders on all mortgages with less than a 20 percent down payment, and insured mortgages account for roughly two-thirds of all Canadian mortgages. That insurance is guaranteed by the Canadian Mortgage Housing Corporation (CMHC), a government-sponsored enterprise;
- Unlike in the U.S., in most provinces, Canadian banks have full recourse to take legal action to recoup money from the homeowner if a foreclosed home is sold for less than the amount owed on the mortgage;
- The subprime mortgage lending is much less prevalent in Canada than it was in the U.S. prior to the 2007 housing market crash.

41. ***The IV focuses on macro-critical measures; we would welcome if staff could provide an explanation how the provincial non-resident property transfer tax is macro-critical and contradicts the IV.***

- The Guidance Notes on the Institutional View and Surveillance under Article IV Consultations stipulate that if capital flows and related policies are assessed to be macro-relevant, i.e. having implications for the member's domestic or BOP stability, they should be discussed. In the case of Canada, the housing market imbalances are a key macroeconomic concern with house prices remaining higher than the level consistent with fundamentals. The property transfer taxes in question affect housing demand and price expectations of the large metropolitan areas in two provinces, where around 50 percent of the country's housing stock by value is located and around 1/3 of the population live. This measure is thus macro-relevant from the domestic stability point of view and needs to be discussed. Consistent with the Institutional View, the staff advised the authorities that tax measures should be broad-based rather than targeted at non-residents alone.

42. ***Staff suggests that broader-based measures would be more effective in achieving the authorities' objective and in contributing to domestic stability. While, in principle, tax measures to mitigate speculative demand should be broad-based rather than targeted at nonresidents alone, the specific design of the alternative measures proposed by staff remains somewhat unclear. Different designs, particularly different target groups (e.g. all homebuyers vs. "speculative" buyers or second home buyers), will have different and maybe opposite economic effects. Additional staff comments on the design would be welcome.***

- Our analysis shows that deploying more policy instruments can lead to better outcomes. Tackling housing market imbalances should be a joint responsibility of both the federal and provincial authorities given the regional divide in housing imbalances and differing objectives between federal and provincial governments. Specific measures to target speculative demand could include a higher property-transfer tax on properties sold within a relatively short period or bought for investment purposes (i.e. not a primary residence) and/or an empty home tax. The appropriate policy mix for each province will depend on local circumstances and policy settings at the federal level.

43. ***We would welcome the staff's view on the effectiveness of the property transfer taxes on non-residents. Also, a set of measures, such as macroprudential measures and tax measures, are available for the authorities when facing the housing prices dramatically go up. Against this backdrop, we believe that it might be necessary to accumulate takeaways and formulate an appropriate policy mix so that the authorities will be able to respond to the rising house prices effectively. We would welcome the staff's comments.***

- See response to 42.

Structural Issues

44. ***At the same time, staff note that several new initiatives were launched by the authorities, and additional concrete steps are mentioned in the buff statement. It seems that quite a lot is being done to tackle these issues. We would welcome staff***

views on the adequacy and effectiveness of these many initiatives. Further staff attention to this topic is warranted. Is this envisaged for the next Article IV?

- The authorities have made concrete steps to boost productivity growth and competitiveness. Staff sees the signing of trade agreements, such as CPTPP, and increases in immigration targets as very positive developments. In addition, the authorities have implemented several programs to boost investment and innovative industries as part of an extensive Innovation and Investment Plan. Many of these programs, however, are still at early stages of implementation, and it is thus difficult to evaluate their effectiveness at this point. Staff does emphasize that public support for these programs should be stage-gated conditional on performance with clear monitoring and evaluation frameworks. Furthermore, staff considers these programs to be complementary and not substitutes of deeper reform that addresses current barriers to foreign investment, inter-provincial trade, and product market development. In this vein, we view as positive the planned review of the regulatory environment that is part of the 2018 Federal Budget. Staff will follow-up on these efforts and elaborate on the extent of regulatory barriers in the next Article IV.

45. ***In paragraph 56, staff noted that the authorities also launched several targeted reviews to identify bottlenecks to growth. We would be interested in additional information on the key topics of these reviews, their time schedule, and to what extent they address issues identified by staff. Also, given the lack of regional diversification of trade as well as the lack of product diversification in the Canadian exports, are there any initiatives in this area?***

- The Minister of Finance established the Advisory Council on Economic Growth in March 2016. Following the recommendations of this council, the Budget 2018 allocated $11.5 million over three years, starting in 2018-19, for the Government to pursue a regulatory reform agenda to support innovation and business investment. This includes targeted reviews of regulatory requirements and practices that are bottlenecks to innovation and growth, a process that is envisaged over the next three years. The approach also calls for improvement of internal trade using the CFTA, the development of an e-regulation system to increase efficiency, and the streamlining of Canada’s Customs Tariff legislation. The focus on boosting investment and productivity through the simplification of regulatory red-tape (and inter-provincial trade barriers in particular) is in line with staff recommendations.
- There are several initiatives to promote geographical diversification of exports through trade agreements, as well as sectoral diversification through the adoption of technologies for the development of nascent sectors. For example, the Supercluster Initiative is attempting to form new industrial clusters in AI-powered supply chains, advanced manufacturing, agroindustry technologies, and other sectors that have the potential for future gains from integration.

46. ***That said, apart from financial services, could staff list the rest of the selected sectors to be liberalized under the CFTA to improve trade between/among the provinces in future?***

- The CFTA is a step in the right direction but there are still significant barriers as outlined in the 130+ pages of exemptions. The main contribution of the CFTA is that it establishes a process by which, through multi-party negotiation, the now explicit list of barriers could be addressed. Beyond financial services, it is expected that the new Regulatory and Reconciliation and Cooperation Table will tackle business registration rules, professional services licensing, trucking rules, and product market regulation. Staff encourages the authorities to use the framework of the CFTA to work towards an eventual standardization of regulation at the national level.

47. ***On the labor market in general, could staff comment on possible explanations of the steady decline in the labor force participation rate in recent years?***

- Labor force participation for those over 15 years of age has been steadily declining over the past several years, but labor force participation for those between 15 and 64 years of age has been gradually rising over the same period (see chart). This suggests that older Canadians (above 64 years of age) have been steadily leaving the labor force. This likely reflects a number of factors, including discouraged worker effects as the result of the tight labor market; the unemployment rate has steadily declined from around 8.5 percent to 6 percent in between 2009 and 2018.