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Canada: 2001 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2001 Article IV consultation with Canada the following documents have been released and are included in this package:

- the staff report for the 2001 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **January 19, 2001,** with the officials of Canada on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on March 1, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of **March 23, 2001** updating information on recent economic developments.
- a Public Information Notice (PIN), which summarizes the **views of the Executive Board as expressed during its March 23, 2001 discussion** of the staff report that concluded the Article IV consultation.

The documents listed below have been or will be separately released.

Mission Concluding Statement
Selected Issues paper

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CANADA

Staff Report for the 2001 Article IV Consultation

Prepared by Staff Representatives for the 2001 Consultation with Canada

Approved by Claudio M. Loser and G. Russell Kincaid

March 1, 2001

Contents Page

I. Introduction....3

II. Economic Developments and Outlook....3
  A. Recent Economic Developments....3
  B. The Outlook....16

III. Policy Discussions....18
  A. Monetary Policy and the Exchange Rate....18
  B. Fiscal Policy....21
  C. Other Issues....25

IV. Staff Appraisal....30

Tables
1. Selected Economic Indicators....34
2. Balance of Payments....35
3. Federal Government Budget, Public Accounts....36
4. Net Government Debt....37
5. Indicators of Economic Performance....38
6. Staff Projections....39
7. Medium-Term Projections for Federal Government Budget....40
8. Indicators of Canadian Financial Institutions....41
9. Official Development Assistance....42
10. Indicators of External and Financial Vulnerability....43

Figures
1. Output and Demand....4
2. Unemployment....4

3. Employment and Output Gaps 5
4. Capacity Utilization Ratio 5
5. Core CPI Inflation 6
6. International Comparison: Labor Productivity Growth in Business and Manufacturing Sectors 6
7. International Comparison: Labor Productivity in the Total Economy 7
8. International Comparison: IT Expenditures 7
9. Interest Rate Differentials 8
10. International Comparison: Exchange Rates 8
11. Bilateral and Real Effective Exchange Rates 8
12. Federal Fiscal Policy Indicators 9
13. Federal Government Net Public Debt 9
14. General Government Net Debt 11
15. International Comparison: Relative Cost of Capital 12
16. Personal Sector Net Worth and Household Debt 12
17. Debt of Nonfinancial Corporations 14
18. Chartered Banks: Return on Total Shareholders' Equity 14
19. International Comparison: Total Support Estimate for Agriculture 29
20. International Comparison: Producer Support for Supply-Managed Goods 29

Boxes

1. Main Elements of the Federal Tax Reform 10
2. Saving and Investment in Canada: An International Perspective 13
3. Asset Prices in Canada and the United States 15
4. Reforms to the Canada Pension Plan 24
5. Disincentives and Employment Insurance 26

Appendices

I. An Update to the Main Issues and Recommendations of the FSSA 44
II. Fund Relations 47
III. Core Statistical Indicators 48

I. INTRODUCTION[1]

1. At the time of the 2000 Article IV consultation, Executive Directors commended the authorities for maintaining sound macroeconomic and structural policies over most of the past decade, which had underpinned the strong performance of the Canadian economy.[2] They noted that the Bank of Canada's successful inflation targeting policy has helped to maintain inflation at a level among the lowest of major industrial countries. While supporting the Government's intention to use prospective fiscal surpluses to continue bringing down the ratio of public debt to GDP, to reform the income tax system, and to increase spending moderately in priority areas, Directors recommended that debt reduction and income tax reform should be top priorities. Reducing the high burden of personal and corporate income taxes was seen as offering potentially large efficiency gains. Directors also welcomed Canada's participation in the pilot Financial System Stability Assessment Program.

II. ECONOMIC DEVELOPMENTS AND OUTLOOK

A. Recent Economic Developments

2. ***The Canadian economy ended the 1990s with a very strong performance, underpinned by the sound macroeconomic policies put in place during the decade.*** Inflation has been maintained at a low level under the inflation targeting policy introduced in 1991. All levels of government have achieved substantial improvements in their fiscal positions, helping to bring down public indebtedness. Policy efforts in such key areas as the employment insurance system and the financing of the public old-age support system have improved economic efficiency, lowered unemployment, and enhanced the economy's growth prospects.

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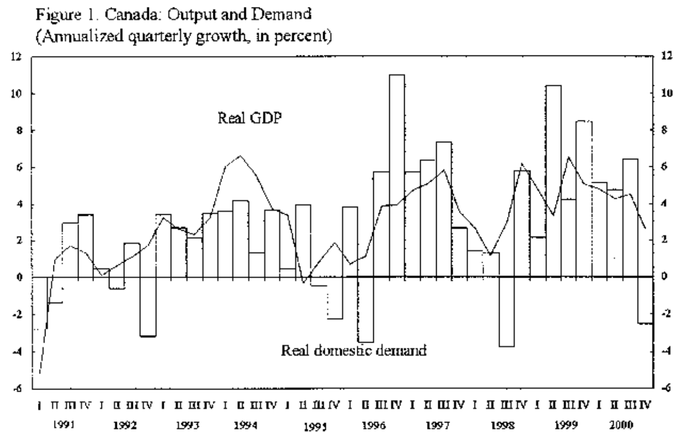
[1] The discussions were held in Ottawa on January 8–12, 2001 and were concluded at a meeting on January 19 with Deputy Finance Minister Kevin Lynch and Governor Thiessen. The staff team comprised D. Goldsbrough, S. Dunaway, V. Arora, M. Cerisola, M. Kaufman (all WHD), and O. Jeanne (RES). The Executive Director for Canada, Mr. Bernes, and his Advisor, Mr. Fenton, attended the meetings.

[2] The staff report (SM/99/314) and the selected issues paper (SM/00/6) were publicly released as IMF Staff Country Report Nos. 00/17 and 00/34, respectively. Canada has subscribed to the Fund's Special Data Dissemination Standard and has submitted metadata, which have been posted on the Fund's Data Standard Bulletin Board. The quality, coverage, periodicity, and timeliness of Canadian economic data are considered to be excellent both in the context of the Article IV consultation and for the purposes of ongoing surveillance.

3. ***Following a slowdown in growth in late 1997 and 1998 largely associated with the fallout from the Asian crisis, the pace of economic growth has been vigorous and broadly based.*** Real GDP has grown at an average annual rate of about 4¾ percent between the fourth quarter of 1998 and the third quarter of 2000, broadly in line with growth in the United States (Figure 1 and Table 1). During this period, the rapid expansion of demand has been supported by strong private consumption, buoyant private and public fixed investment, and by net exports. Consumption has risen at an average annual rate of 4¼ percent, reflecting strong employment gains and reduced taxes. Investment in machinery and equipment has also grown briskly, at an annual average rate of about 20 percent, owing to the strength of domestic demand and a stepped-up pace of adoption of new information technology equipment. While the ratio of public investment to GDP remains low, growth in such investment has also been significant. In the fourth quarter of 2000 real GDP growth slowed to 2½ percent, reflecting the effects of a slowdown in U.S. growth during the second half of the year.

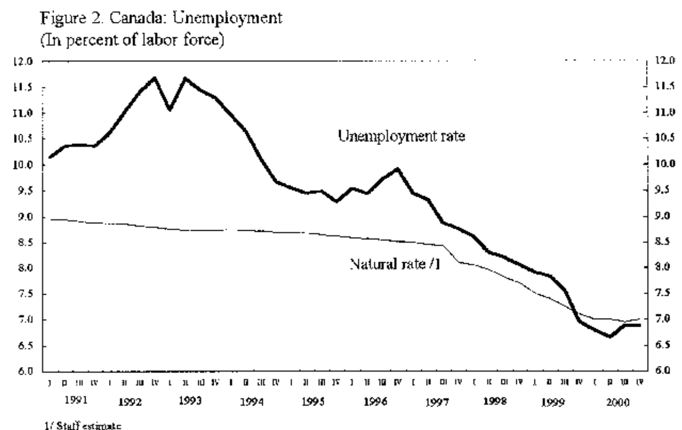
Figure 1. Canada: Output and Demand
(Annualized quarterly growth, in percent)



4. ***Strong U.S. demand growth, together with some recovery in commodity prices, helped to shift the external current account from a deficit of ½ percent of GDP in 1999 to a surplus of 1¾ percent of GDP in 2000*** (Table 2). A sharply improving trade surplus has been mainly propelled by buoyant export growth to the United States. The deficit in net investment income has also declined, partly reflecting the cumulative effects of lower interest rates and a more recent rebound in foreign earnings of Canadian corporations. As for the capital account, portfolio outflows rose markedly, as the strong demand for foreign stocks by Canadian residents continued. U.S. investors increased sharply their purchases of Canadian stocks, particularly in technology-related sectors. In addition, direct investment inflows and outflows both rose markedly, especially with the United States and Europe.

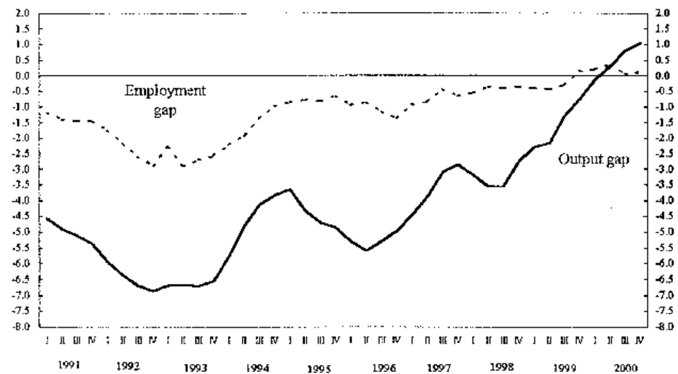
5. ***The strong pace of economic growth has pushed the economy to levels of resource utilization not seen during the past 25 years.*** The unemployment rate fell by about 1½ percentage points since end-1998, reaching 6½ percent in June, its lowest level since the mid-1970s (Figure 2). It has risen somewhat since then and stood

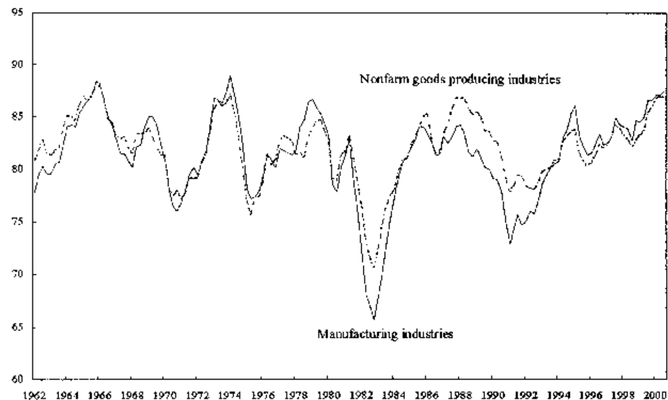
Figure 2. Canada: Unemployment
(In percent of labor force)



1/ Staff estimate.

at 6.9 percent in January 2001, partly reflecting an increase in the participation rate.[3] Employment rose by 2¾ percent on average in 1999 and in 2000; a significant part of these gains was in full-time jobs. The staff estimates that the output gap has moved from 2¾ percent below potential in the fourth quarter of 1998 to ½ percent above potential in the fourth quarter of 2000 (Figure 3). However, estimates of the level and growth rate of potential output are uncertain given the recent rapid rate of growth in equipment investment and the lack of indications of price pressures. Recent data suggest some moderate pickup in the growth rate of potential output from 2½ percent to 2¾ percent.[4] The index of capacity utilization for the nonfarm goods producing sector trended upward at a very rapid pace from mid-1999, before easing slightly in the third quarter of 2000 (Figure 4). Capacity utilization is particularly high in manufacturing, which in the third quarter of 2000 stood at a level not experienced since early 1974. As noted in the February 2001 *Monetary Policy Report Update*, the economy continued to operate close to capacity in the fourth quarter of 2000 and early 2001 as suggested by very





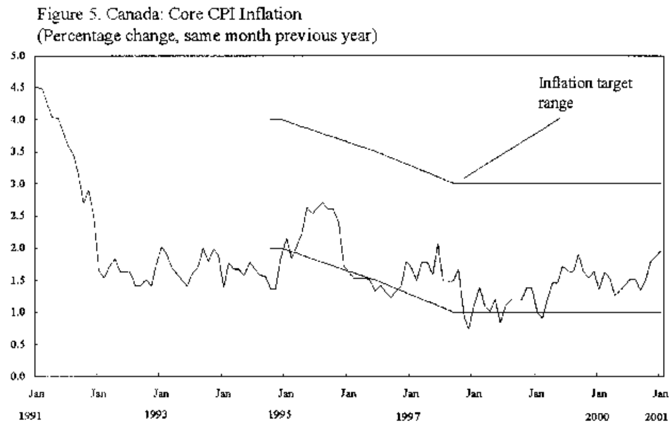
[3] Based on conventional time series techniques, the staff's estimate of NAIRU is 8 percent; however, reforms in the Employment Insurance system implemented over the past few years are expected to reduce structural unemployment from 8 percent to 6½ percent over the medium term. An alternative estimate, based on a structural Phillips curve model that accounts for recent inflation developments, suggests that NAIRU has fallen to around 6½ percent.

[4] The Bank of Canada's published estimates of potential growth range from 2¾ to 3¼ percent. See Box 1 in *Canada: Staff Report for the 2000 Article IV Consultation,* IMF Staff Country Report No. 00/17, March 2000, for a more detailed discussion of potential growth estimates. Staff estimates of potential output growth are based on long-term trends and do not reflect any cyclical or temporary increase in the growth rate. The estimates are based on time series techniques which may require a considerable period of time to identify any change in the trend growth rate.

low vacancy rates in the residential and commercial real estate sectors and by continuing reports of skilled labor shortages in several sectors.

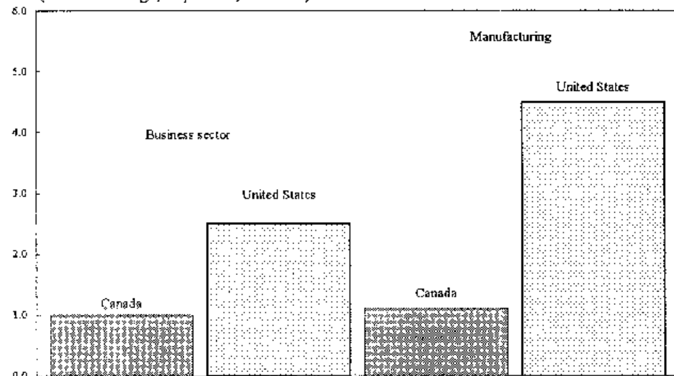
6. ***Despite indications of higher levels of resource utilization, inflationary pressures remain quiescent.*** Core inflation hovered within a narrow range around 1½ percent between mid-1998 and November 2000 (Figure 5), and rose to the mid-point of the authorities' 1–3 percent target range in January 2001. Overall inflation has risen more rapidly, largely reflecting the impact of energy prices. CPI inflation was 1¾ percent in 1999 and 2¾ percent in 2000. Wage pressures also remained well contained, as labor compensation per person hour rose by about 2½ percent in 1999 and by 3¼ percent in 2000. Unit labor costs, which remained virtually unchanged in 1999, rose at an annual rate of almost 1 percent in the first three quarters of 2000. Surveys indicate that inflationary expectations continue to be around the mid-point of the official target range, suggesting continued high credibility in the authorities' inflation target. In addition, the yield differential between fixed-rate and inflation-indexed government bonds has remained around 200 basis points since late 1999.

Figure 5. Canada: Core CPI Inflation
(Percentage change, same month previous year)



7. ***Canada has not yet experienced the same sharp upturn in labor productivity growth observed in the United States.*** Since end-1995, labor productivity for the business sector in Canada has risen by about 1 percent annually, 1½ percentage points below that for the United States.[5] This differential has largely

Figure 6. International Comparison: Labor Productivity Growth in Business and Manufacturing Sectors
(Annual average, in percent, 1996-99)



[5] This gap in productivity growth reflects in part revisions to the U.S. national income and product accounts in 1999, including the incorporation of computer software in investment, which have increased the measured growth rate of U.S. GDP—and of labor productivity—by almost ½ percentage point in the 1992–98 period. Statistics Canada is expected to release new figures for Canada's national accounts with similar revisions to those implemented in the United States in the first half of 2001.

reflected lagging productivity growth in Canadian manufacturing (Figure 6), in part because of the smaller size of the information technology sector, which has experienced especially strong productivity gains. According to OECD data, labor productivity growth for the total economy also has been somewhat smaller in Canada than that observed in some European economies (notably Germany and France), partly owing to less substitution of capital for labor in Canada (Figure 7). However, the share of information technology spending in GDP in Canada has been high relative to European countries and very similar to the shares observed in Japan and the United States over the past few years (Figure 8). Moreover, there are expectations that Canada may be set to experience an acceleration in productivity following the massive restructuring of firms undertaken in the 1990s and as a result of the large investment in equipment embodying new technology since 1996.[6] Recent data show a strong pickup in labor productivity growth in the business sector, which rose at an annual rate of 2¼ percent in the year through the third quarter of 2000.

Figure 7. International Comparison:
Labor Productivity in the Total Economy
(Real GDP per hour; index=1995)

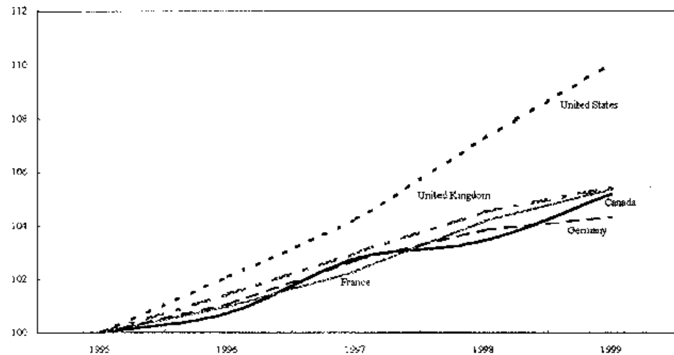
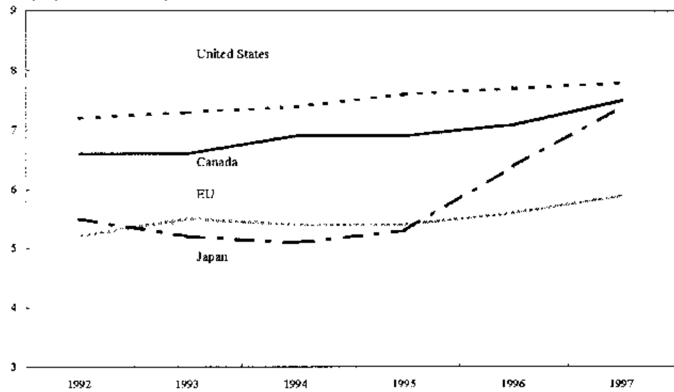


Figure 8. International Comparison: IT Expenditures
(In percent of GDP)



8. ***The Bank of Canada raised interest rates markedly in 2000 as estimates of slack in the economy were narrowing rapidly and owing to concerns about potential inflationary spillovers from faster-than-expected U.S. growth. However, following the sharp turnaround in the U.S. outlook, the Bank of Canada lowered interest rates in January***

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[6] See "Productivity Trends in Canada," in *Canada: Selected Issues,* IMF Staff Country Report No. 00/34, March 2000 for a more detailed account of productivity growth in Canada and comparisons with the United States. A recent study by the Bank of Canada shows that Canadian firms have restructured markedly during the past decade and are increasingly investing in new information technology. The forthcoming selected issues paper will explore these issues and other factors which may help explain the growth in labor productivity in Canada relative to that in the United States.

2001. Between November 1999 and May 2000, the Bank of Canada raised the bank rate by 125 basis points. This tightening of monetary policy was reflected in a flattening of the yield curve through most of this period and a rise in the yield spread between long-term corporate and government bonds. At its scheduled monetary policy announcement date on January 23, 2001, the Bank of Canada lowered the bank rate by 25 basis points owing to concerns regarding near-term Canadian economic prospects stemming from indications that the U.S. slowdown would be more abrupt than expected. Canadian short-term interest rates have been below U.S. rates since May 1999, but the differential narrowed in late 2000 and in early 2001 (Figure 9). As for long-term yields, the small negative differential that prevailed throughout most of the past two years shifted to positive in December 2000, and has fluctuated around a positive 25 basis points so far in 2001.

Figure 9. Canada: Interest Rate Differentials
(In percentage points, Canada minus the United States)

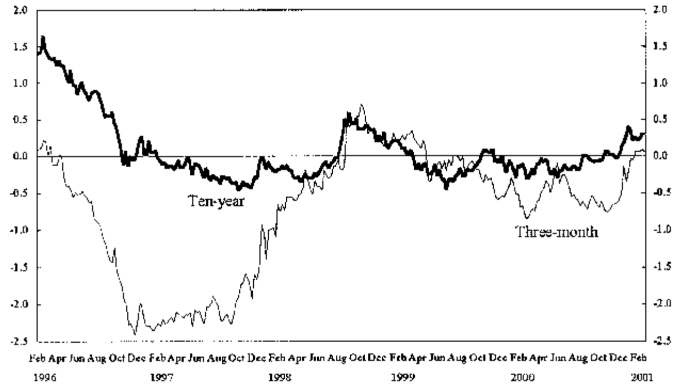
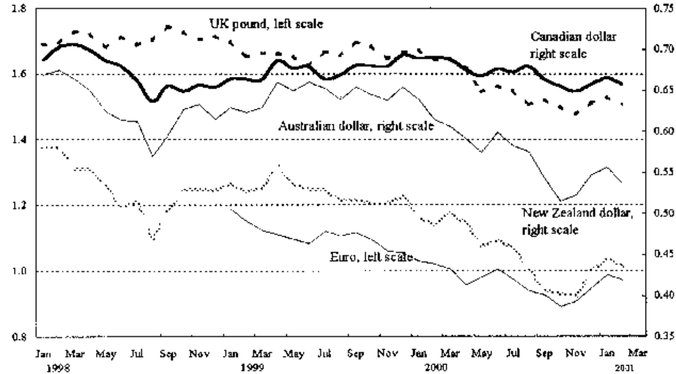
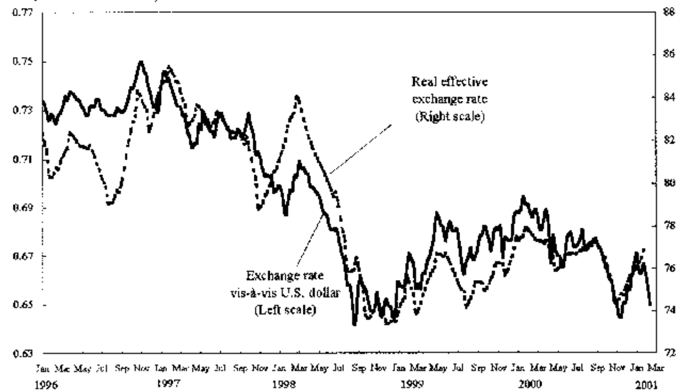


Figure 10. International Comparison: Exchange Rates
(US$ per national currency)



9. ***After peaking at 69 U.S. cents in December 1999, the Canadian dollar depreciated to about 65½ U.S. cents by late February 2001.*** The weakness in the bilateral exchange rate through end-2000 mirrored developments in the bilateral rates of other major industrial countries vis-à-vis the U.S. dollar (Figure 10). In real effective terms, the Canadian dollar depreciated slightly during 2000 (Figure 11).

Figure 11. Canada: Bilateral and Real Effective Exchange Rates
(Index 1990=100)



10. ***The authorities' commitment to promoting lasting fiscal discipline has been reflected in an impressive turnaround in the federal fiscal position, which shifted from a deficit of 5¾ percent of GDP in 1993/94 to a surplus of 1¼ percent in 1999/00*** (Table 3 and

Figure 12). Over two-thirds of this improvement is the result of significant cuts in program spending. Staff estimates suggest that, over this period, the structural balance shifted from a deficit of 4¾ percent of GDP to a surplus of 1½ percent. In *The Budget Plan 2000*, the Government presented a five-year tax-reduction plan for personal and corporate income taxes, while also allowing for modest new spending initiatives on health, education, public infrastructure, and environment, which build upon measures introduced in previous budgets. The budget recorded a larger-than-expected surplus of $12.3 billion in 1999/00, owing to strong growth in tax revenues, which suggested that prospective fiscal surpluses could be greater over the medium term than envisaged in *The Budget Plan 2000*. Given these developments, the Government in its *October 2000 Economic Statement and Budget Update* presented a mini-budget, where it expanded the tax reductions presented in *The Budget Plan 2000* and introduced some modest additional spending initiatives (Box 1). It also announced that a minimum of $10 billion in debt would be repaid in 2000/01, implying that the federal budget surplus would reach 1 percent of GDP. The budgetary improvements and economic growth achieved over the past few years have allowed the federal government net debt (on a public accounts basis) to be reduced from over 70 percent of GDP in 1994/95 to an estimated 52 percent in 2000/01 (Figure 13).

Figure 12. Canada: Federal Fiscal Policy Indicators
(In percent of GDP)

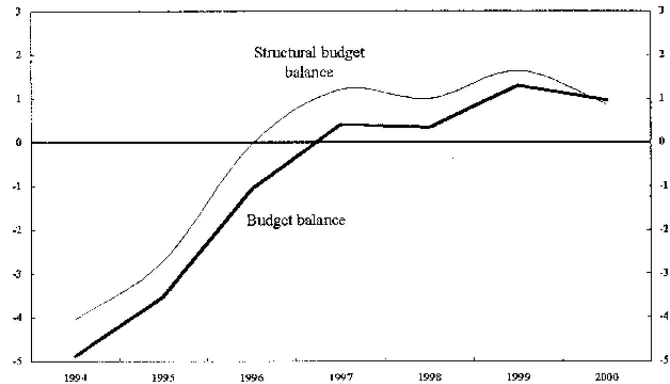
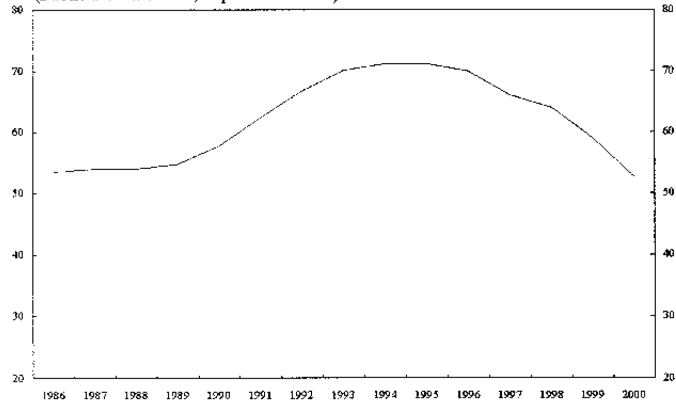


Figure 13. Canada: Federal Government Net Public Debt
(Public accounts basis; in percent of GDP)



11. ***With strong fiscal consolidation at the federal and provincial levels, the general government balance improved from a deficit of 6¾ percent of GDP in 1994 to a surplus of 3½ percent of GDP in 2000 (national accounts basis).*** The provinces have been able to improve their fiscal position through a combination of buoyant tax revenues and spending restraint. In 1999, Ontario achieved a surplus exceeding expectations and was envisaged to post another surplus in 2000. Quebec posted a modest budget surplus in 1999 for the second consecutive year, while Alberta is poised to eliminate its net public debt in the current fiscal year. In their 2000/01 budgets, many provinces have confirmed their intention to proceed with tax cuts and to increase health and education spending, but the provinces as a group are

Box 1. Main Elements of the Federal Tax Reform

In The Budget Plan 2000 and the October 2000 Update, the Government introduced and implemented a comprehensive reform to the personal and corporate income tax regime in Canada. The main elements of this reform were:

Personal Income Tax

- Full indexation of income taxes to inflation was restored and income thresholds at which marginal rates apply were raised.

- The marginal tax rate on middle income taxpayers was reduced from 26 percent to 24 percent effective July 2000 and to 22 percent as of January 2001.

- Tax rates for low-income bracket groups ($0 to $30,754) and for a new upper middle-income bracket ($61,509 to $100,000) were reduced from 17 percent to 16 percent and from 29 percent to 26 percent, respectively.

- The 5 percent surcharge on high-income taxpayers was eliminated as of January 2001.

- The taxation of gains on qualifying stock options was shifted to when the shares are sold from when the options are exercised or enriched.

After these changes, and effective January 1, 2001, the marginal tax rates that apply to taxable income brackets are: 16 percent for income less than $30,754; 22 percent for income between $30,754 and $61,509; 26 percent for income between $61,509 and $100,000; and 29 percent for income exceeding $100,000.

- The income inclusion rate for capital gains was reduced from three-quarters to two-thirds in February 2000 and to one-half in October 2000.

Corporate Income Taxes

- A plan was introduced to lower the highest tax rate from 28 percent to 21 percent by 2004 on corporate income not eligible for special tax treatment, comprising industries other than manufacturing and processing operations, which already benefited from the 21 percent rate or the resource sector which benefits from special tax preferences. Effective January 1, 2001, the corporate income tax rate was reduced by 1 percentage point, and the rate is to be cut by 2 percentage points in each of the following three years.

- Small businesses with income between $200,000 and $300,000 also had their tax rates reduced to 21 percent effective January 2001.

expected to continue to run an aggregate surplus. The improvement in federal and provincial fiscal positions has significantly reduced the ratio of general government net debt to GDP over the past few years to an estimated 67 percent of GDP in 2000 (Table 4 and Figure 14). Nevertheless, the ratio of net debt to GDP in Canada remains above the G-7 average (Table 5).[7]

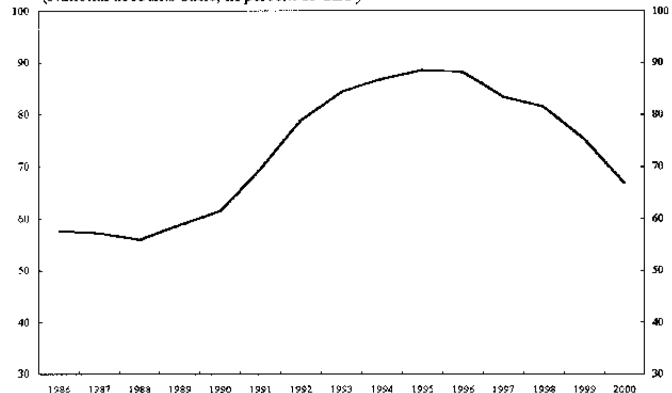


Figure 14. Canada: General Government Net Debt (National accounts basis; in percent of GDP)

12. ***While the ambitious fiscal consolidation has contributed to raise the share of gross national savings to GDP to its average during the 1980s, the falling cost of capital equipment has helped Canada achieve levels of real private investment that are significantly higher than those in the previous three decades.*** Gross national savings rose to 22¼ percent of GDP in 2000, as higher government and corporate savings more than offset a decline in personal savings.[8] Gross private investment, measured in nominal terms, has hovered around 18 percent of GDP since 1997, below its average for the 1970s and 1980s. However, in real terms, gross private investment is now well above its average since the

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[7] In mid-2000, Statistics Canada revised the treatment of federal and provincial government employee pension plans by counting them as part of the personal sector and recognizing them as government liabilities. This revision has resulted in substantial upward adjustments to personal savings and to the level of gross and net debt of the general government; for example in 1999 estimates of gross and net general government debt are now roughly 20 percentage points of GDP higher than previous data. According to the OECD, Australia, Canada, and the United States are the only countries that have modified their national accounts in this way, reflecting recommendations in the most recent revision of the System of National Accounts. For this reason and owing to other definitional differences, public debt comparisons across G-7 economies are very difficult to interpret.

[8] The personal sector savings rate declined from 13 percent of disposable income in 1990 to 4¾ percent in 1997 and to 3¼ percent in 2000—a similar phenomenon to that occurring in the United States. Empirical work by Bérubé and Coté from the Bank of Canada suggests that about 40 percent of the decline in the trend private savings rate between 1990 and 1997 is attributed to fiscal consolidation, 30 percent to lower inflationary expectations, and about 20 percent to rising household net worth. See Bérube, G. and Coté, D., *Long-Term Determinants of the Personal Savings Rate: Literature Review and Some Empirical Results for Canada,* Bank of Canada, Working Paper No. 2000-3.

1960s. In comparison with other G-7 countries, the relative price of capital equipment in Canada generally has declined faster, falling at an annual rate of about 1½ percent since 1994 (Figure 15 and Box 2).[9]

Figure 15. International Comparison: Relative Cost of Capital
(1990=100 Price index of fixed private investment relative to CPI)

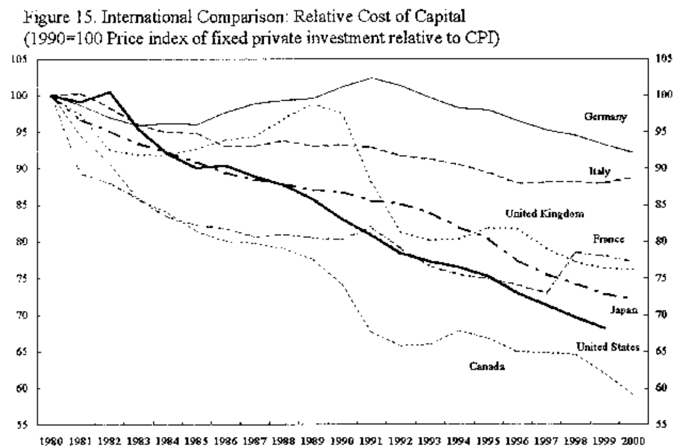
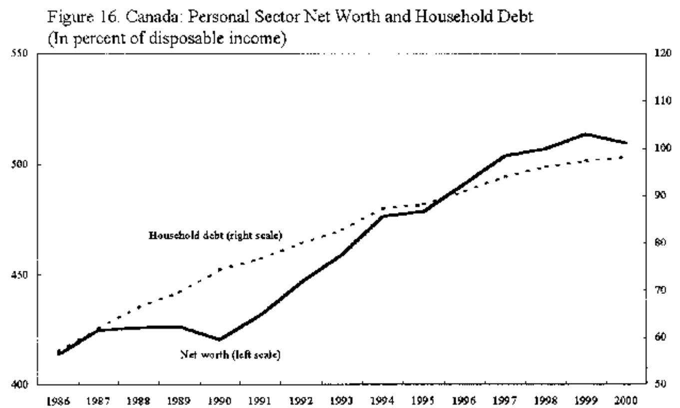


Figure 16. Canada: Personal Sector Net Worth and Household Debt
(In percent of disposable income)



13. ***Household and corporate balance sheets strengthened further during 1999, led by rising equity prices and a sharp improvement in corporate profits, before slipping modestly in the second half of 2000.*** Personal sector net worth rose by 5 percent in 1999 to reach a high of almost 510 percent of disposable income in 1999, spurred by increases in fixed assets such as land and residential property, as well as financial assets (Figure 16). The rise in personal sector net worth has been broadly in line with its average for the decade. More recent data suggest that the ratio of net worth to disposable income declined to 509 percent by the end of 2000, owing to a decline in equity prices. At the same time, household debt increased to 98 percent of disposable income, the highest level in the past 30 years; like in the United States, mortgage debt is the most important household liability, accounting for about two-thirds of the total. A rise in corporate profits of 23 percent in both 1999 and 2000 reduced the need for borrowing and helped bring

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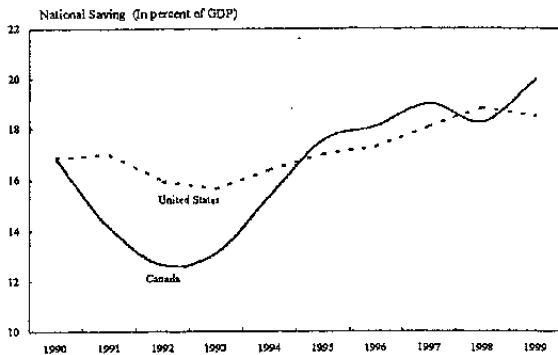
[9] The decline recorded in the United States was even faster. However, there are significant differences in the way the price deflators for equipment and machinery are constructed across G-7 countries. One important difference between Canada and the United States is in the construction of price deflators for some investment technology goods. The United States uses an hedonic approach to price measurement for all of these goods, while Canada has adopted the hedonic price approach for many of these goods and supplements Canadian price data with some U.S. series for specific goods. But for semiconductors, Canada continues to employ a more traditional method for constructing a price deflator that uses the change in the cost of production as an indicator of the change in quality.

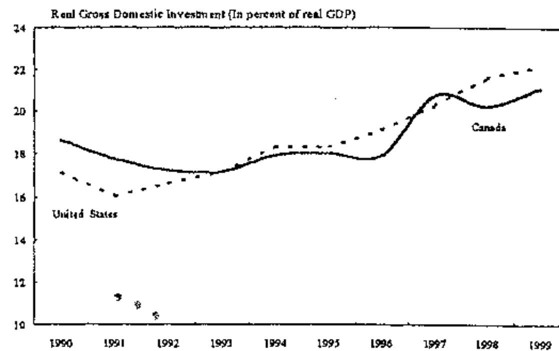
Box 2. Saving and Investment in Canada: An International Perspective

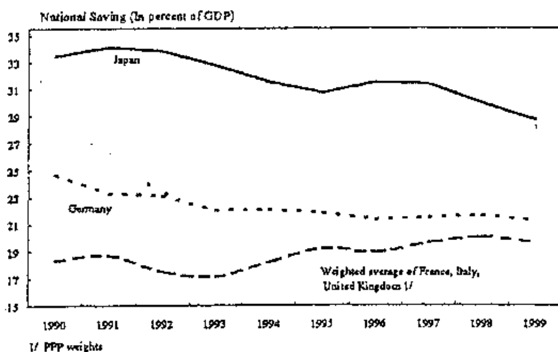
Overall trends in national saving and gross domestic investment (as a percent of GDP) during the 1990s were broadly similar in Canada and the United States (see figure). In both countries, national saving rose from the early 1990s through the end of the decade, as a strong increase in government saving offset a continued decline in private saving. Gross domestic investment also rose during the period, as roughly unchanged government investment was accompanied by a sharp rise in private investment. In both Canada and the United States, investment in machinery and equipment contributed significantly to the rise in private investment.

There were important differences between Canada and the United States during their economic expansions in the 1990s. In Canada, the increase in national saving started earlier and was larger than in the United States, while the recovery in investment started later and was smaller. Although both countries experienced a decline in net private saving (private saving less private investment), Canada's external balance strengthened, as the decline in net private saving was more than offset by a rise in net government saving, in contrast to the sharp deterioration in the U.S. external balance. These developments suggest that trends in the private saving-investment balance are not necessarily a good indicator of overall macroeconomic risks.

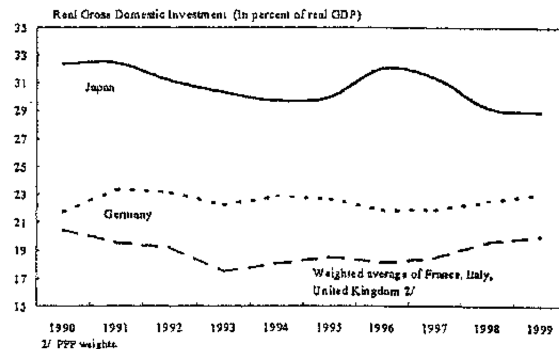
Other G-7 countries (except Germany and Japan) shared the North American trend of a rise in national saving and investment starting in the early 1990s. They also generally shared the pattern of a decline in private saving—especially in the household sector—that was more than offset by a rise in government saving, and a rise in private investment that more than offset a fall in government investment. Common factors contributed to the decline in household saving, including fiscal consolidation, reductions in inflationary expectations, wealth effects (arising from equity or real estate gains), and an easing of households' borrowing constraints.







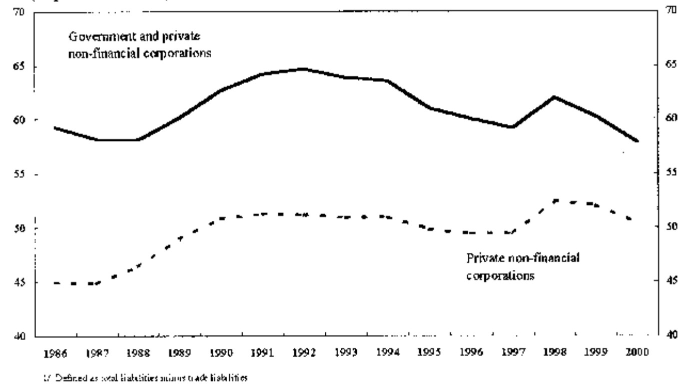
1/ PPP weights



2/ PPP weights.

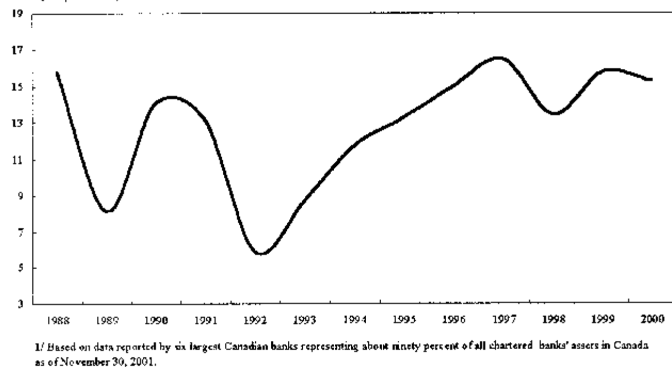
down the ratio of nonfinancial corporate debt to GDP to 58 percent in 2000 (Figure 17). The rebound in corporate profits, together with the upward trend in equity prices (Box 3), has kept the debt-to-equity ratio on a downward trend since 1992, declining from 90 percent to 72 percent in 2000. Since 1995, Canadian corporations have raised an average of $13½ billion per year in net new bond issues in U.S. markets. During 2000, net bond financing declined markedly to about $½ billion, but this decline was more than offset by increased net new issues in Canada, partly reflecting a tightening of credit conditions in U.S. markets.

Figure 17. Canada: Debt of Nonfinancial Corporations 1/
(In percent of GDP)



14. ***Over the past few years, the profitability and asset quality of financial institutions in Canada have remained high, enabling them to further strengthen their overall capitalization levels.*** In the past three years, the Big Six Canadian chartered banks had a return on total equity (ROE) of about 15 percent on average (Figure 18), as buoyant growth in fee-based income has helped to more than offset declining net interest earnings. Nonperforming loans net of provisions have declined steadily, from a peak of 2½ percent of average loans in 1993 to less than ½ percent in the fourth quarter of 2000. The total capital ratio for banks has also risen steadily, reaching almost 11 percent in the third quarter of 2000, comfortably above the Office of the Superintendent of Financial Institutions' benchmark of 10 percent. Other financial institutions, such as life insurance companies and credit unions, have also experienced above-historic average ROE, and also remain well capitalized.

Figure 18. Canada: Chartered Banks: Return on Total Shareholders' Equity
(In percent) 1/

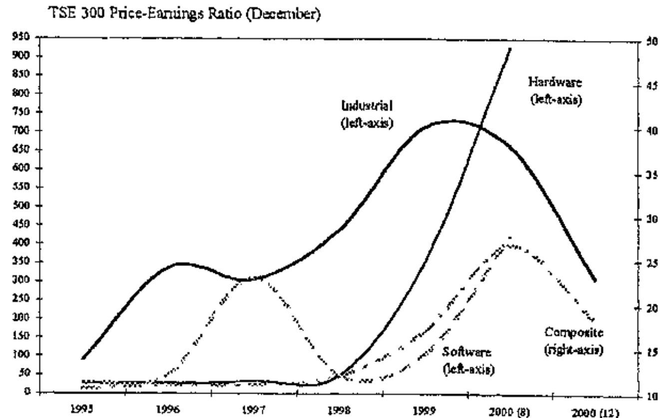


1/ Based on data reported by six largest Canadian banks representing about ninety percent of all chartered banks' assets in Canada as of November 30, 2001.

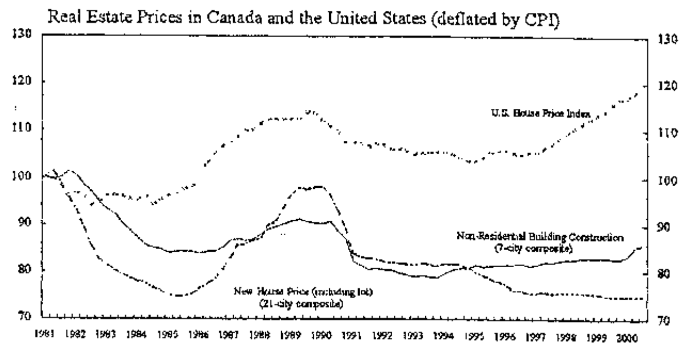
Box 3. Asset Prices in Canada and the United States

The sharp rise in asset prices in the United States over the past five years has raised considerable debate about the underlying factors driving U.S. equity prices, particularly the role played by the development and application of information technology. Given the high degree of financial and trade integration between the Canadian and U.S. economies, the recent large gains in Canadian equity prices have raised similar concerns about market valuations.

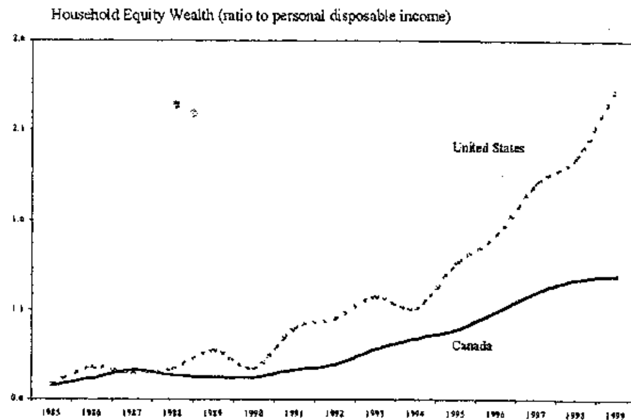
While current equity market valuations in Canada appear to be high relative to historical values, and difficult to reconcile with what they suggest in terms of expected growth in corporate profits and risk premia, several analyses suggest that current valuations in Canada and the United States are primarily a "high-tech phenomenon". Once the technology sector is excluded, current valuations would appear to be more reasonable and consistent with a combination of somewhat higher growth in corporate profits and lower risk premia than suggested by historical averages.[1] A sharp rise in the price-earnings ratio for the TSE300 since mid-1998 reflected a marked rise in the price index for the industrial subsector, especially in technology (hardware and software) stocks (see top figure). In recent months, the price-earnings ratio for the TSE 300 has declined sharply, from 38 in August 2000 to 23 in December, reflecting a marked decline in technology stock prices that outpaced a fall in earnings. In the fourth quarter of 2000, the high technology subsectors experienced significant negative earnings.



The rise in asset prices in Canada appears to be primarily confined to equity. Following a sharp decline in real estate prices in the early 1990s, prices for new houses and for nonresidential structures have remained largely unchanged in real terms, in contrast to the moderate pickup in new housing prices in real terms that has taken place in the United States since mid-1998.



Household equity wealth has risen rapidly in Canada since 1993, but its pace has not been as buoyant as in the United States. As of end-1999, the ratio of household equity wealth to personal disposable income was 1¼, significantly lower than the 2.3 for the United States. With estimates for the marginal propensity to consume out of equity wealth in Canada ranging from 2 to 4 cents per dollar, somewhat below those of the United States, the staff estimates that a 35 percent drop in Canadian equity prices would reduce equity wealth by roughly $250 billion from its-end-1999 level and consumption by $5-10 billion (½ to 1 percent of GDP) over the long-term.



[1] See Cerisola and Ramirez (2000), "U.S. Equity Prices and the Technology Boom" in *United States: Selected Issues*, IMF Staff Country Report No. 00/112, and Hannah (2000), "Approaches to Current Stock Market Valuations," in *Bank of Canada Review*, Summer 2000.

B. The Outlook

15. ***The staff envisages a "V-shaped" pattern for real GDP growth in 2001 primarily reflecting a temporary negative trade shock from the United States (Table 6).*** Growth is expected to slow to 1½ percent (annual average) in the first half of 2001, owing largely to the U.S. slowdown. The recently enacted tax reductions, the cut in short-term interest rates, and high levels of employment are expected to help sustain momentum in economic activity in Canada, and the staff expects economic growth to accelerate in the second half of 2001 to 3 percent (annual rate) along with a rebound in U.S. growth. Monetary conditions in Canada also are envisaged to ease further in the first half of 2001. For the year as a whole, GDP is projected to increase by 2½ percent. Subsequently, the economy is expected to grow at 2¾ percent, its estimated potential growth rate. Core inflation is expected to remain close to the 2 percent mid-point of the official target range through 2006.

16. ***Clearly, the uncertainty about the depth and duration of the U.S. slowdown and its potential impact on Canada is the main risk to the outlook.*** A sharper falloff in U.S. growth would result in a large negative trade shock for Canada (see tabulation below).[10] In this alternative scenario, it is assumed that the sharper U.S. slowdown would entail a 20 percent drop in U.S. equity prices and a significant depreciation of the U.S. dollar against the euro and the yen (on the order of 20 percent and 10 percent, respectively). Canadian equity prices are assumed to decline by 10 percent and the Canadian dollar would appreciate modestly against the U.S. dollar. Given that more than 80 percent of Canadian exports go to the United States, the appreciation against the U.S. dollar and the slowdown in U.S. growth would result in a marked decline in real net exports, the current account surplus, and real GDP growth during 2001–03. The Canadian authorities are expected to reduce short-term interest rates to cushion the impact of the sharper U.S. slowdown on the Canadian economy, reflecting the deflationary nature of the shock to Canada and the way in which the inflation targeting regime is implemented. Nevertheless, in this scenario, real GDP in Canada would remain below its baseline level over the five-year forecast horizon, owing to a weaker U.S. economy and some real effective appreciation of the Canadian dollar.

[10] This alternative scenario was constructed using Multimod.

A Sharper Slowdown in the United States and its Implications for Canada

(Percent deviation from baseline levels, unless otherwise noted)

	2001	2002	2003	2004	2005	2006
World						
Real GDP	-1.1	-1.2	-0.7	-0.4	-0.1	0.0
United States						
Real GDP	-1.9	-2.1	-1.1	-0.7	-0.8	-0.8
Domestic demand	-2.9	-3.3	-2.2	-1.7	-1.5	-1.5
CPI inflation	0.8	-0.7	-1.0	-0.8	-0.6	-0.3
Short-term interest rate (percentage points)	-0.9	-2.3	-1.8	-1.0	-0.6	-0.2
Real effective exchange rate	-10.4	-9.2	-9.1	-8.7	-8.1	-8.0
Canada						
Real GDP	-1.5	-2.2	-1.5	-1.1	-0.7	-0.3
Domestic demand	-0.1	-0.3	-0.3	-0.2	-0.0	-0.0
Current account (billions of U.S. dollars)	-9.0	-10.3	-5.2	-5.0	-6.0	-6.0
Real net exports (contribution to GDP)	-1.4	-1.9	-1.2	-0.9	-0.7	-0.3
CPI inflation	-0.1	-0.8	-1.1	-1.0	-0.9	-0.7
Short-term interest rate (percentage points)	-3.0	-3.0	-2.7	-2.2	-1.6	-1.2
Real effective exchange rate	2.2	2.8	2.5	2.3	2.0	1.0

17. ***The implications for the Canadian economy of this scenario are subject to considerable uncertainty, stemming primarily from the relative importance of trade and financial shocks, how these shocks unfold, and how they would affect the exchange value of the Canadian dollar.*** It is not clear whether increased financial uncertainty in the United States would lower or raise the international demand for Canadian financial assets and the value of the Canadian dollar. If instead of appreciating, the Canadian dollar depreciated in real effective terms, the impact of the U.S. shock on the Canadian economy would be reduced. At the same time, a potential squeeze in the U.S. corporate bond and loan markets, which are important sources of financing for many Canadian firms, would significantly affect investment in Canada. In addition, world growth would decelerate as a result of the slower growth in the United States, and this could precipitate a significant decline in commodity prices and consequently downward pressure on the Canadian dollar. The deterioration in the terms of trade would have additional negative effects on Canadian economic activity, which would be partially offset by the currency's decline.

III. POLICY DISCUSSIONS

18. There was broad agreement between the authorities and the staff on the course of macroeconomic and structural policies in the period ahead. The discussions centered on the following issues, which are key for sustaining the economic expansion:

- ***in the near term, how monetary policy should respond, in the context of the inflation targeting framework, to the potential risks of an excessive slowing in economic activity, related to shocks emanating from the United States.***

- ***the allocation of prospective fiscal surpluses to debt reduction, tax cuts, and higher spending in priority areas.***

- ***the need to maintain and further improve the flexibility and efficiency of the labor market in Canada, especially given recent and proposed changes to the Employment Insurance program.***

A. Monetary Policy and the Exchange Rate

19. ***In assessing the economy's near-term prospects, the authorities noted that activity in Canada has maintained considerable momentum through the second half of 2000 and into early 2001.*** Moreover, the tax cuts enacted during 2000, some of which became effective in January 2001, were expected to help sustain domestic demand growth in the first half of 2001. They felt that Canada was in a reasonably good position to weather the impact of the anticipated slowdown in U.S. economic growth. The authorities agreed with the staff that, although the timing of the tax cuts had turned out to be fortuitous, monetary policy was the preferred policy instrument to deal with an excessive slowing of economic growth in the near term. They stressed that monetary policy would be set to reflect economic conditions in Canada. While developments in the U.S. economy would certainly influence these conditions, they noted, and the staff agreed, that there was no need for monetary policy to respond to every shock stemming from events in the United States. However, the staff indicated that monetary policy would need to be eased in the event of a substantial U.S. slowdown. The authorities noted that by setting policy in the context of the inflation targeting framework they would, as a matter of course, respond appropriately to evolving conditions in a forward-looking manner, without attempting the sort of "fine tuning" that had been a major policy mistake in the late 1960s and 1970s. In light of a number of considerations bearing on the economic outlook and the expected trend of inflation in Canada, particularly the slowdown in the United States, the Bank of Canada lowered interest rates by a quarter of a percentage point in late January.

20. ***The Bank of Canada has recently established a fixed schedule for announcements on monetary policy decisions in an effort to reduce uncertainty in financial markets and to***

increase the focus of public attention on domestic economic conditions as the key factor in making these decisions. In October 2000, the Bank indicated the eight dates during 2001 on which it will make announcements regarding monetary policy. The Bank retains the option to change policy any time between these fixed dates, although this discretion would be used sparingly so as not to undermine the importance of the announcement dates. These dates were fixed primarily with reference to the release of important Canadian economic data. The move to regularly scheduled policy announcements also was prompted by the goal of avoiding the temporary market disruptions that had sometimes occurred under the previous arrangement where the Bank could potentially change interest rates on any business day.[11] Bank of Canada officials explained that the introduction of fixed announcement dates was part of the Bank's broader communication strategy that encompassed the semi-annual monetary policy reports and the two interim updates of these reports. They also noted that the timing of the move to fixed announcement dates had been fortuitous in that there had been no significant disruptions in domestic money markets after the U.S. interest rate cut on January 3, as market participants generally did not expect Canadian monetary policy to move before the January 23 fixed announcement date. Moreover, the public debate regarding the appropriate policy response had focused on economic conditions and prospects in Canada.

21. ***The Bank of Canada aims at keeping inflation around the mid-point of the 1–3 percent official target range over six to eight quarters***. The authorities explained that the band is regarded as a "range of uncertainty" and not a "range of indifference." The band was established to reflect uncertainties in achieving a specific point inflation target owing to the difficulties in forecasting inflation and the effects of monetary policy changes. However, the Bank was not indifferent to all inflation outcomes within the band. As inflation moved away from the middle of the band, monetary policy would be expected to respond with increasing force to bring inflation back in line with the mid-point. With heightened uncertainty surrounding estimates of the economy's productive capacity and the extent of remaining slack in resource utilization, the Bank of Canada has attributed less usefulness to estimates of the output gap and the NAIRU in predicting inflationary pressures and guiding monetary policy. The Bank has relied on a broad range of indicators (such as core and trend inflation, data on wage settlements, unit labor costs, and evidence of inflationary expectations embedded in financial assets) to assess the degree of pressure on capacity and inflation.

22. ***At the time of the last extension of the official inflation target in 1998, it was announced that before the end of 2001 the Finance Minister and the Governor of the Bank would jointly determine a new target range.*** The authorities have been engaged over the past year in extensive research on the merits of changing the inflation target and/or making

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[11] When a change in policy was anticipated, the money market would tend to stop operating for a short period every morning around 9:00 am, the time that the Bank would usually intervene if it intended to change interest rates.

other refinements to the inflation targeting regime to enhance its effectiveness.[12] The staff agreed with the authorities that it was useful to continue assessing options for further refining the current inflation targeting framework. At the same time, the current 1–3 percent inflation target range had served Canada well, and the empirical literature suggested that the additional net benefits of moving from very low to even lower inflation were probably small, especially in comparison to the significant gains already achieved. Therefore, the staff held the view that, in making a decision this year, there was no reason for a major change, although some refinements were possible. It would be useful to consider steps to increase the accountability of the Bank of Canada with respect to its performance in meeting the inflation target—for example by requiring a report in the event of sustained cumulative deviations from the mid-point target—as a means of potentially anchoring longer-term price expectations more firmly.

23. ***The credibility established in the inflation targeting framework for setting monetary policy has contributed to enhancing the effectiveness of Canada's floating exchange rate regime. In turn, the floating exchange rate provides Canada with the scope to pursue an independent monetary policy and buffers the effects of external shocks to the economy.***[13] The authorities and the staff agreed that the costs arising from a flexible exchange rate (mainly related to the effect of currency volatility on trade and investment) need to be weighed against the benefit of retaining monetary independence in the presence of asymmetric shocks, especially vis-à-vis the United States. The Bank of Canada's success in maintaining inflation near the mid-point of the target range has helped to anchor inflation expectations and reduce the likelihood of a loss in confidence in the Canadian dollar. At the same time, Canada's experience since the inception of free trade with the United States in 1989 demonstrates that exchange rate fluctuations have not significantly impeded economic integration between the two countries.

24. ***Following the change in intervention policy in September 1998, Canada has not intervened unilaterally in the foreign exchange market.*** At that time, it was decided that the practice of intervening in a symmetrical fashion to ensure that there was sufficient liquidity in the market would be discontinued. Instead, intervention would be conducted on a discretionary basis in exceptional cases when the exchange rate was considered to be significantly out of line with its fundamental value and a substantial government presence in the market could influence market perceptions about the currency's value. In such cases, intervention would be announced. In September 2000, the Bank of Canada joined the European Central Bank and other central banks for a concerted intervention in the foreign exchange market to bolster the

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[12] The forthcoming selected issues paper discusses issues to consider in modifying the inflation target.

[13] The forthcoming selected issues paper discusses the main conclusions from a recent Bank of Canada conference on exchange rate regimes and examines what effects the exchange rate regime may have had on economic integration with the United States, as well as potential lessons for other countries.

value of the euro. Over the past year, the value of the Canadian dollar has been affected by the weakness in non-energy commodity prices and by the relative cyclical positions of Canada and its trade partners, especially the United States. The Bank's internal models show that the value of the Canadian dollar is well in line with its fundamental determinants. With continued strong macroeconomic fundamentals and a projected current account surplus, the currency is expected to appreciate somewhat over the medium term.[14]

B. Fiscal Policy

25. ***In the October 2000 Economic Statement and Budget Update, the Government presented a "mini-budget" which expanded the income tax reductions of The Budget Plan 2000, introduced some modest new spending initiatives in the areas of education, research, and the environment, and further refined the approach to debt reduction.*** The reductions in personal and corporate taxes presented in *The Budget Plan 2000* were accelerated and a specific schedule was set for lowering the basic federal corporate income tax rate. The authorities saw these reforms as a major step to boost incentives to work and invest. In particular, the reductions in tax rates on nonmanufacturing and on nonprocessing, nonresource corporations will help to promote the spread of new technologies and entrepreneurship and to enhance the competitiveness of Canadian firms. When the tax cuts are fully implemented in 2004, the combined federal-provincial corporate and capital gains tax rates would be below current U.S. rates. Despite the significant reductions enacted, personal income taxes in Canada would remain higher than in the United States. To some extent, this was seen as inevitable, reflecting Canada's choice to provide a higher level of public services. In 2001/02, the tax cuts are estimated to amount to nearly \$13½ billion, equivalent to about 1¼ percent of GDP.[15]

26. ***With regard to debt reduction, the authorities explained that the current practice of establishing each year a \$3 billion contingency reserve in the budget will be continued and these funds will be used, in the absence of adverse economic shocks, to repay debt.*** In addition, the Minister of Finance will announce in each October budget update whether an additional amount should be dedicated to paying down debt, depending on the projected outcome for the current fiscal year. In 2000/01, a minimum of \$10 billion (1 percent of GDP) will be targeted for debt repayment.

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[14] The estimates of the Consultative Group on Exchange Rates (CGER), as of February 2001, suggest that the Canadian dollar would appreciate in real effective terms by about 10 percent on a multilateral basis.

[15] In addition, provincial tax cuts are estimated to amount to \$9.2 billion, almost another 1 percent of GDP.

27. ***The authorities and the staff agreed that the federal government's fiscal position remains sound over the medium term, even after full implementation of the measures enacted and proposed in the past year.*** Factoring in the impact of all measures legislated or proposed since *The Budget Plan 2000*, and after allowing for the \$3 billion contingency reserve and an explicit factor for economic prudence to offset the effects of potentially less favorable economic conditions, the staff estimates that a surplus of about \$2 billion would remain in 2000/01. Such "remaining surpluses" would range between \$4–5½ billion (roughly ½ percent of GDP) over the medium term (Table 7).[16] The staff commended the authorities for their pragmatic and sound fiscal policy framework and welcomed the new approach to debt reduction and the fiscal measures taken during 2000.[17] The uncertainties in the near-term economic outlook underscored the wisdom of the authorities' approach to budgeting and of their decision not to allocate all of the "planning surpluses" in prospect. In the event that economic developments are less favorable than envisaged, the staff believed that there was ample room to allow the automatic stabilizers to work to support the economy and latitude for discretionary action, if needed.

28. ***The authorities and the staff also discussed what might be an appropriate longer-term objective for fiscal policy.*** The staff noted the difficulty in pinning down such an objective. In Canada's context, with a relatively high government debt-to-GDP ratio, steady progress in reducing debt was appropriate, but economic theory did not offer concrete conclusions on how far or how fast the debt-to-GDP ratio should be brought down. The staff judged the authorities' current fiscal policy framework as being a satisfactory and pragmatic approach. It allows for the debt-to-GDP ratio to steadily fall, while still providing sufficient flexibility for the automatic stabilizers to work to support the economy and some latitude for discretionary actions in difficult economic circumstances. Moreover, the Government in adopting its new debt reduction approach had decided to seize opportunities provided by favorable economic conditions to accelerate the pace of debt reduction. Consistent with this new approach, the staff recommended that, in the event that the medium-term fiscal outlook evolved as envisaged in the *October 2000 Update*, the bulk of any surplus funding realized each year be dedicated to reducing government debt.

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[16] Given the contingent nature of the additional debt reduction measures to be announced each October, the staff has conservatively assumed in its medium-term projections a minimum debt reduction of \$3 billion per year, equivalent to the contingency reserve. In 2001/02, if economic developments evolve as envisaged and the economic prudence factor and the remaining balance were used to repay debt, the federal budget surplus would amount to \$8½ billion, equivalent to ¾ percent of GDP, and the structural budget balance would be largely unchanged.

[17] The Canadian authorities have agreed to participate in an assessment of observance of standards and codes on fiscal policy to be conducted in March 2001.

29. ***Reforms to the Canada Pension Plan (CPP) introduced in late 1997 put the plan on a sound financial footing, primarily through a phased increase in contributions (Box 4).*** The reforms also mandated the diversification of the CPP's accumulated surplus into private assets in order to increase the plan's rate of return. The CPP Investment Board is responsible for managing the plan's new net cash flow, and started to invest these funds passively in equities (by replicating major market indexes) in early 1999. In February 2000, the Board was permitted to increase the share of foreign equities in its portfolio, and it was allowed to follow active investment strategies in domestic equities beginning in August 2000. The authorities did not foresee major risks to the CPP from a sharp correction in equity prices, as the exposure of CPP's portfolio to stock market risk was still limited, accounting for only one-sixth of the total assets, and the CPP's holdings were long term. The establishment of an independent CPP Investment Board was seen as sufficient to ensure that decisions on how to invest CPP assets were based on sound investment practices and not influenced by other considerations.

30. ***With their budgetary positions generally on a sound footing, the provinces and territories are considering their options for new tax and spending initiatives.*** The authorities pointed out that high regional disparities in taxation levels and factor mobility have increased the pressure on provincial and territorial governments to reduce their tax burden. The pressure was more pronounced on personal income taxes, as certain provinces, such as Alberta, have aggressively cut taxes in recent years. The drive to lower provincial taxation was expected to be facilitated by a recent agreement with the federal government, that allows provincial and territorial governments to restructure their personal income tax system, by shifting from the current tax-on-tax system to a tax-on-income system.[18] The authorities expected most provinces would opt for the new tax-on-income system since it provided them greater flexibility.

31. ***The staff argued that the options for new tax and spending initiatives by provinces and territories needed to be framed in a longer-term perspective, reflecting the potentially large fiscal costs arising from population aging and to meet the major provincial responsibility of providing adequate health care.*** With increased grants from the federal government and their own resources, the provinces and territories planned to raise spending to deal with current problems, but the health care system faces rising demand and cost pressures over the long term that are difficult to predict. The authorities and the staff agreed that it was important to begin to take steps to address the potential long-term fiscal implications and to continue improving the delivery and control the cost of providing medical services.

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[18] Under the current tax-on-tax system, provincial governments collect a provincially set portion of an individual's federal income tax liability. Under the tax-on-income system, the provinces can apply provincially set tax rates, refundable and nonrefundable tax credits, and surtaxes to a federally defined taxable income.

Box 4. Reforms to the Canada Pension Plan

Canada is one of the few major industrial countries that has taken action to deal with the long-term financing problems of its public pension plan. By end-1996, the present value of unfunded liabilities of the Canada Pension Plan (CPP) were estimated to be $588 billion, equivalent to 70 percent of GDP. If the plan had continued on its basic pay-as-you-go basis, payroll taxes would have had to be increased even more substantially than the sizable increases that had been already been legislated to meet the plan's obligations, as the rate would need to have increased from 5.6 percent in 1996 to 14¼ percent after 2015. To address the CPP long-term financing needs without such a sharp rise in payroll taxes, the Government decided in 1997 to partially prefund the plan's future liabilities. This was in large part to be accomplished by accelerating payroll tax rate increases, with the rate rising to 9.9 percent by 2003 (instead of by 2015 under the previous legislation). As a result, the CPP is expected to build up assets equivalent to roughly one-fifth of its future liabilities by 2020, and these assets would be used subsequently to help meet benefit payments so that payroll tax rates will remain largely unchanged. In addition, a formal review of the financial condition of the CPP is required every three years.

Additional funding for the CPP was to be derived by investing a portion of the plan's funds in private securities in order to raise its return on assets. The CPP Investment Board (CPPIB) was set up to manage the plan's assets based solely on sound investment practices. Previously, CPP assets had been invested in federal and provincial government bonds at below market rates. Beginning in 1999, provinces were allowed a "one-time" roll over of their maturing borrowings from the CPP at market rates. In addition, the CPPIB started to invest the new net cash inflow in equities, following a passive investment strategy, whereby its holdings broadly replicated the key domestic (the TSE 300) and foreign stock market indexes. In line with Canadian regulations governing private pension funds, the CPPIB allocated 80 percent of its assets to domestic equities and 20 percent to foreign. Since August 2000, the Board was authorized to invest actively up to 50 percent of its assets allocated to domestic equities. The restriction on pension fund holdings of foreign equities was also liberalized, with the ceiling on the share of plan assets invested in foreign securities rising to 25 percent in 2000 and to 30 percent in 2001.

The CPP is the only public pension plan among the G-7 countries that invests directly in private securities. Among other advanced countries, Sweden allows individuals to allocate part of their payroll tax contributions to the public pension plan to a privately managed individual account which can invest in private securities. Singapore allows the Central Provident Fund to invest a limited share of its assets in privately managed funds.

Public Pension Plan Contribution Rates 1/
(percent of taxable wages)

Country	Rate
Canada 2/	7.0
France	16.5
Germany	19.5
Japan	17.3
Mexico	12.2
Sweden	13.3
Switzerland	9.8
United States	12.4
United Kingdom	22.0

Source: Social Security Programs Throughout the World, 1999, U.S. Social Security Administration.

1/ 1999 figures.
2/ Rates will increase gradually to 9.9 percent by 2003.

C. Other Issues

32. ***Comprehensive reforms in the 1990s to the EI system have improved the flexibility and efficiency of the labor market, helping to reduce structural unemployment; however, recent measures and proposals would partially reverse these efforts.*** Increases in maternity and parental leave benefits and a relaxation of eligibility requirements enacted in mid-2000 will create new incentives for casual labor force participation.[19] In addition, the Government has proposed to roll back some elements of the reforms enacted in 1996, including the elimination of the intensity rule.[20] The authorities explained that improving parental benefits would help to achieve their objective of strengthening families. Other proposed changes primarily involved specific elements of the 1996 reforms that were judged not to have had their intended effects. The intensity rule did not appear to have significantly deterred frequent use of the system, especially since workers in seasonal industries in some regions of Canada had limited alternative employment opportunities. The staff viewed the elimination of the intensity rule as sending the wrong signal. Frequent use of the system, along with the provision of extended EI benefits for high unemployment regions for prolonged periods of time, has had serious adverse effects on the behavior of both workers and employers, has raised reservation wages in high unemployment regions, and has reduced labor mobility (Box 5). The staff continued to endorse curbing frequent use by implementing experience-rating of the EI premium rate (which would link the rate for individual firms to the frequency of use of the system by their workers) and eliminating regional extended benefits.[21]

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[19] Effective end-December 2000, the combined duration of maternity and parental leave and sick benefits, was increased to a maximum of 50 weeks, as a result of an increase in parental leave from a maximum of 10 to 35 weeks. The eligibility requirement was reduced from 700 hours of insurable employment to 600 hours. In addition, under the proposed legislation, the rules to qualify for EI benefits would be eased for parents re-entering the work force.

[20] Proposed changes also would ensure that the clawback provision applies only to higher-income workers and would eliminate repayment of EI benefits for all first-time recipients.

[21] See "Experience Rating of Employment Insurance Premiums," in *Canada: Selected Issues*, IMF Staff Country Report No. 00/34, March 2000.

Box 5. Disincentives and Employment Insurance

The growing generosity of Canada's unemployment insurance system during the 1970s–1980s created significant disincentives to work and encouraged casual labor force attachment, resulting in higher structural unemployment in Canada, particularly relative to the United States. During the 1990s, changes in unemployment benefits, culminating in the comprehensive reforms to the employment insurance (EI) system in 1996, reduced the extent and duration of benefits, tightened eligibility criteria, and introduced an intensity rule to penalize frequent users of the system. These changes lessened work disincentives and contributed to a decrease in structural unemployment. In particular, the Department of Finance estimates that the 1996 EI reforms would contribute to a reduction in the natural rate of unemployment from 8 percent to 6½ percent, as the reforms had their full impact over time.

Nevertheless, substantial disincentives to work remain in the EI system. The provision of benefits for an extended period to individuals in regions with levels of unemployment above the national average has impeded economic adjustment through its effects on labor mobility. Empirical work by the staff suggests that since 1977, when the regional extended benefits were introduced, there has been a significant negative relationship between the unemployment rate and gross migration and a significant declining trend in the migration rates in all provinces.

Another source of disincentives in the EI system relates to the absence of experience rating. Canada's system relies on uniform contributions from employers that are not linked to the costs that their employment practices may impose on the program. The result is cross-subsidization of employees in industries that are more prone to generating unemployment by those with more stable employment. A Department of Finance working paper estimated that the introduction of an "ideal" experience-rated EI premium would lower the rate of unemployment by 2 percentage points, and the introduction of a less-than-ideal system (such as that used in the United States) would lower the natural rate by 1 percentage point.

33. ***The authorities also noted that labor market flexibility has been enhanced by reforms to provincial social assistance programs that have been introduced in recent years.*** These reforms include mandatory participation in training and job-seeking programs, tighter provisions with respect to single parents, and greater use of student loans (as opposed to social assistance) for educational financing. These reforms have increased the incentives to move from social assistance to work by reducing marginal effective tax rates. The authorities said that the National Child Benefit also had helped significantly to level the playing field between low-income working families and those on social assistance.[22]

34. ***The staff met with representatives from the Canadian Labor Congress (CLC). While recognizing the significant gains in employment over the past few years, the representatives viewed those gains as primarily driven by cyclical rather than structural***

[22] The National Child Benefit provides financial support to all low-income families with children, regardless of whether they are on social assistance or working. The support is gradually withdrawn as family income rises above a threshold level. Prior to the National Child Benefit, child benefits were part of the social assistance program, so that when moving from welfare to work families faced the prospect of losing child benefits.

factors, and they expressed concern about an increase in income inequality in Canada. In their view, the diffusion of the benefits from improved macroeconomic conditions among working families had been far from satisfactory, partly because of the cuts in social spending implemented in the early 1990s. They said that the EI system and social assistance programs played important roles in protecting working families, and saw a need for the EI system to provide job training. The staff agreed that the EI system was an important social safety net, but care had to be taken in its design and implementation to ensure that major distortions were not introduced into the labor market. In the staff's view, EI reforms in the 1990s had been important in enhancing incentives to work, boosting labor force participation, and in contributing to the buoyant growth in employment.

35. ***While financial institutions in Canada have increasingly engaged in new and complex transactions to boost profitability and optimize capital, their balance sheets have remained strong. Even though profitability would clearly be affected in the event of a downturn, the authorities did not foresee any major vulnerabilities.*** Macroprudential indicators show that Canadian banks remain highly profitable, as indicated by their return on assets and equity, and they enjoy relatively comfortable levels of intermediation spreads (Table 8). Their asset quality has improved in recent years, as evidenced by the declining share of nonperforming loans, while their capital levels exceed regulatory benchmarks. At the same time, the banks have experienced rapid growth in asset securitization and off-balance sheet and derivative transactions, and they have diversified into new business areas and markets, especially to the United States. Chartered banks' claims on U.S. residents booked worldwide rose from about 13¾ percent of total claims in 1995 to 17½ percent in 1999. More recently, against a backdrop of heightened uncertainty about the economic outlook in the United States, the authorities noted that financial institutions in Canada appear to have tightened credit standards and raised loan provisions. They expected that a major U.S. slowdown would entail losses and adversely affect the profitability of Canadian financial institutions, but saw the system as well positioned to cope with such shocks.

36. ***New legislation to reform the financial services sector was tabled in Parliament in February 2000 to establish a new framework along the lines of that laid out in the Government's policy paper issued in 1999.***[23] The authorities explained that, under this new framework, commercial banks will be allowed to enter into a wider range of joint ventures and strategic alliances; the ownership structure will be made more flexible, in part by easing the widely held requirement for major banks and allowing the banks to form financial holding companies; a more transparent merger-review process will be established; and regulatory processes streamlined. Competition in the financial services sector will be bolstered by reducing minimum capital requirements to encourage new entrants, by allowing other financial

[23] This legislation was originally introduced in June 2000 but was not enacted prior to the dissolution of Parliament before the November 2000 elections. The forthcoming selected issues papers discusses the major elements of the legislation in more detail.

services companies to step into traditional banking activities, and by providing more flexibility for foreign banks to operate as branches in Canada. Access to the payments system will be expanded to securities dealers, money market mutual funds, and life insurance companies. The authorities also noted that updated legislation on money laundering was enacted in June 2000. The new law mandates the reporting of suspicious transactions, harmonizes the cross border monitoring instruments with the United States, and extends the coverage of the Money Laundering Act to most professionals in the financial sector. It also establishes a financial intelligence unit which was created in July 2000.

37. ***The staff discussed with the authorities the status of the main issues identified by the Financial Stability Assessment (FSSA) undertaken in conjunction with the 2000 Article IV consultation (Appendix I).*** The Office of the Superintendent of Financial Institutions (OSFI) has announced the imposition of new capital requirements for life insurance segregated funds, which are expected to be fully in place by end-2001. In the staff's view, this measure will address the risks associated with the complex guarantees embedded in the segregated funds noted by the FSSA. Some further steps have also been taken to enhance the coordination and harmonization of the regulatory and supervisory frameworks between federal and provincial regulators, particularly in the securities industry. In addition, the authorities noted that the new financial sector legislation would further strengthen Canada's already high degree of implementation of international core principles and standards.

38. ***The authorities did not foresee any major changes in domestic financial markets as a result of recent and prospective reductions in public debt.***[24] In contrast to the United States, the stock of federal government debt in Canada was still large relative to the size of the economy, and given the size of the budget surpluses in prospect, they thought that it would be a long time before any shortage of government paper might occur. The reduction in government debt has thus far been largely concentrated on treasury bills. The Government's debt management strategy has been shifted to try to maintain liquidity in government securities markets by reducing the frequency of auctions of government securities, increasing the size of benchmark issues, and expanding the debt buyback program. The authorities viewed the strategy as successful thus far in maintaining adequate liquidity in benchmark issues. Moreover, the money market had quickly adjusted to the reduced stock of treasury bills by expanding issuance of bankers' acceptances and developing new forms of low-risk short-term papers such as asset-backed notes.

39. ***Canada has continued to make progress with the reduction of interprovincial barriers to the free flow of goods, services, workers, and capital under the Agreement on Internal Trade (AIT).*** In February 1999, an agreement was reached in the context of the

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[24] The selected issues paper will review how changes in the stock and composition of public debt have influenced the conduct of monetary policy and the functioning of financial markets in Canada.

Social Union Framework Agreement to ensure full compliance, by July 1, 2001, with the labor mobility provisions of the AIT, including mutual recognition of occupational qualifications and the elimination of residency requirements for employment. The authorities indicated that about two-thirds of the professions involved in mutual recognition agreements will meet the deadline, with the remainder completed shortly thereafter. In a number of major areas where agreements have not been reached or finalized (including in government procurement, energy, and achieving a code of conduct governing provincial investment incentives), discussions were continuing and progress was being made.

40. ***Canada is a leader in trade liberalization initiatives at multilateral, regional, and bilateral levels.*** Canada has supported a new round of multilateral trade negotiations under the WTO. In spite of Canada's open trade regime, some exceptions remain in traditionally sensitive sectors, including agriculture and textiles and clothing.[25] In particular, while overall support levels for agriculture in Canada are lower than in Europe, Japan, and the United States, they remain high for the so-called "supply managed products" (dairy, poultry, and eggs) (Figures 19 and 20). The authorities indicated that liberalization of international trade in agricultural products was a high priority. In the supply managed sectors, Canada has extended the benefits granted under NAFTA on a multilateral basis. They explained that their policy has been to let these industries adjust to the reforms, while making it clear that in time they will face increased trade liberalization.

Figure 19. International Comparison: Total Support Estimate for Agriculture (as percent of value of production)

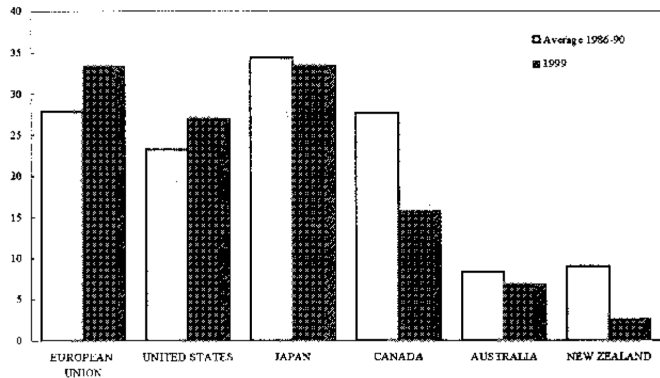
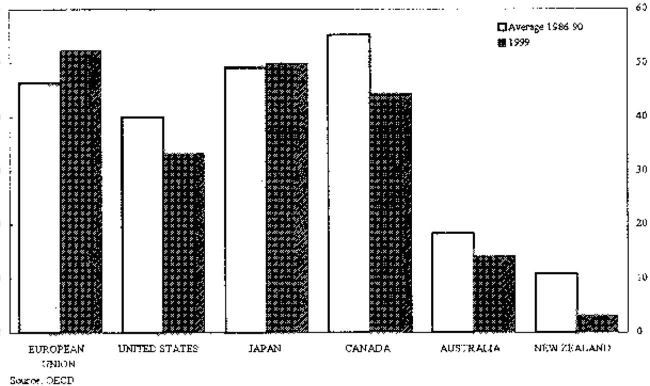


Figure 20. International Comparison: Producer Support for Supply-Managed Goods (as percent of value of production)



Source: OECD

On regional agreements, the Free Trade Agreement of the Americas (FTAA) was a high priority for the government. The next FTAA summit will be held in Quebec in April, and the Government would support the position of accelerating the end-date for the conclusion of

[25] Canada's rating on the IMF's trade restrictiveness index is 4 (on a scale ranging from 1 to 10, with 1 being the least restrictive) and has been relatively stable over the past few years. Its rating is broadly similar to most industrial countries.

negotiations from 2005 to 2003. With respect to improving access for less-developed countries, the authorities noted that progress was made last August with tariff reductions in 500 lines and improvement in Canada's fairly generous rules of origin. However, the staff noted that significant barriers remain largely owing to restrictions on agricultural products and clothing and textiles.

41. ***Canada's official development assistance (ODA) as a share of GNP has continued falling to 0.28 percent in 1999 (Table 9).*** In recent years, the Prime Minister has indicated the Government's intention to increase foreign aid. The authorities indicated that they remained committed to improving the effectiveness of ODA and to moving toward the ODA target of 0.7 percent of GNP as a long-term objective as Canada's fiscal situation allows.

IV. Staff Appraisal

42. ***The sound macroeconomic and structural policies put in place over the past decade have provided a solid foundation for the sustained expansion of the Canadian economy.*** Fiscal consolidation by both the federal and provincial governments has brought budgets into surplus and contributed to a sharp reduction in government debt as a ratio to GDP in recent years. Monetary policy has been successfully implemented using an inflation targeting framework. Among structural reforms, continuing efforts to remove barriers to interprovincial trade, improvements in the employment insurance system and in incentives for low-income working families, and the measures taken to bring the public old-age support system into actuarial balance have enhanced economic efficiency. All of these policies have paid off in the past few years with inflation and inflation expectations being maintained at low levels despite a marked acceleration in output and employment growth and a sharp decline in unemployment. Moreover, there are indications of a recent acceleration in labor productivity growth. The strong policy framework in place has positioned the real and financial economy to cope with any new major economic shock. The Canadian authorities are to be highly commended for their policy accomplishments.

43. ***The rapid pace of economic growth in recent years pushed the Canadian economy to a high level of resource utilization, raising the prospect that any remaining slack in the economy might quickly be exhausted, even given the uncertainty in estimating the economy's productive potential.*** In these circumstances, the risks stemming from capacity being absorbed at a very rapid pace have been appropriately considered in setting short-term economic policies. Inflationary pressures have been largely absent, as growth in unit labor costs and second-round effects from higher energy prices remain well contained. Moreover, economic activity in Canada has maintained considerable momentum, which now appears useful in providing some protection from the effects of a slowdown in the United States. The uncertainty about the depth and duration of a U.S. slowdown and its impact on Canada raises a new set of issues for macroeconomic policy. Although the recently enacted tax cuts are fortuitously well timed, the staff believes that monetary policy should be the main instrument

used in attempting to sustain the economic expansion, in the context of Canada's forward-looking inflation targeting framework.

44. ***The staff agrees with the authorities that monetary policy should be set to reflect economic conditions in Canada and should aim to allow the economy to seek its productive potential without compromising the official inflation target.*** The past success in maintaining low inflation has established the credibility of the inflation targeting regime, giving the Bank of Canada room to maneuver and enhancing further its ability to follow an independent monetary policy. The Bank appropriately remains forward looking in setting policy, focusing on a range of indicators of inflation and capacity pressures and the likely impact on Canada of external developments. In the period ahead and consistent with the inflation targeting framework, the Bank will have to be flexible, poised to act promptly and firmly should indications of an excessive slowing in economic activity begin to emerge. While there is no need for policies to respond to every shock emanating from the United States, monetary policy would need to be eased in the event of a substantial U.S. economic slowdown.

45. ***By the end of 2001, the Finance Minister and the Governor of the Bank of Canada will have to jointly determine whether the official inflation target should be modified. The current 1–3 percent inflation target, with the authorities' focus on keeping inflation around the mid-point of this range, has served Canada well, and its credibility has helped to enhance the effectiveness of the floating exchange rate regime in buffering the economy against external shocks.*** While there is only limited empirical evidence on the net benefits of moving from very low to even lower inflation rates, these additional benefits are probably relatively small, especially in comparison to the significant gains already achieved. The staff is of the view that it would be useful to continue assessing options for further refining the current inflation target framework; however, in making a decision this year, there do not appear to be compelling reasons for more than moderate refinements to the inflation target. One option that merits further consideration would be to increase the accountability of the authorities by establishing periodic reviews of their performance in meeting the inflation target, so as to help anchor longer-term price expectations more firmly. The Bank of Canada in the past year also has strengthened its communications strategy by providing updates to the semi-annual monetary policy reports twice a year and by establishing fixed dates for announcing monetary policy decisions. In particular, the staff welcomes the move to fixed announcement dates, which has helped to focus the discussion of monetary policy actions more on economic conditions in Canada.

46. ***The staff commends the authorities for the comprehensive income tax reforms and reductions introduced in The Budget Plan 2000 and in the October 2000 Economic Statement and Budget Update and strongly endorses the fiscal policy framework that has been put in place.*** In light of the relatively high burden and significant distortions of income taxation in Canada, the tax reductions will offer considerable economic efficiency gains in the period ahead by increasing returns to work and investment and by contributing to the spread

of new technology and entrepreneurship. The corporate income tax cuts, when fully implemented, will help bring average business taxation below current levels in the United States, significantly enhancing the competitiveness of Canadian firms. The staff also welcomes the authorities' decision to commit themselves to trying to bring down the debt-to-GDP ratio more rapidly than previously envisaged by announcing each year, as economic conditions permit, a target for additional debt reduction. However, if economic developments were to unfold less favorably than expected, the automatic stabilizers can be allowed to work and there is some latitude for discretionary action, if necessary.

47. ***The federal government's medium-term budget position remains sound, even with full implementation of the major reforms to income taxation and new spending initiatives in priority areas such as health care and education that have been enacted or announced over the past year.*** The fiscal projections continue to incorporate a contingency reserve to allow for unanticipated developments and explicit economic prudence factors to offset the effects of potentially less favorable economic conditions. Uncertainties in the near term economic outlook underscore the wisdom of this approach to budgeting and also the decision in the *October 2000 Update* not to allocate all of the "planning" surpluses in prospect. The staff recommends that the bulk of any surplus funding realized each year (largely reflecting the economic prudence factors in the fiscal estimates and the unallocated portion of prospective planning surpluses) be dedicated to reducing government debt.

48. ***With their budgetary positions generally on a solid footing, the provinces and territories are considering their options for new tax and spending initiatives. Such decisions, however, need to be framed in a longer-term perspective, reflecting the large potential fiscal costs arising from population aging and continuing growth in demand for health care, which is a major provincial responsibility.*** With increased grants from the federal government and their own resources, the provinces plan to raise spending on medical services to deal with current problems, but the health care system faces rising demand and cost pressures over the long term that are difficult to accurately predict. The staff believes that it is essential for the provinces to begin to take steps to provide for these future needs, while at the same time continuing to improve the delivery and control the cost of medical services. The role of the federal government in providing resources to help meet these future needs also should be established.

49. ***Comprehensive reforms enacted during the 1990s to the Employment Insurance system and to social assistance programs and the introduction of the National Child Benefit, have enhanced the flexibility and efficiency of the labor market, boosting employment growth and helping to reduce structural unemployment.*** Pressures to ease the impact of some of these reforms—particularly the 1996 EI reforms—have intensified as they have become more binding. The Government has mitigated the intended effects of some of the reforms and has proposed to rollback others. In particular, the staff sees the proposed elimination of the intensity rule, which was designed to discourage frequent use of the system, as sending the wrong signal. Frequent use of the system, along with the provision of extended

EI benefits for high unemployment regions for a prolonged period of time, has had adverse effects on the behavior of both workers and employers, has significantly raised reservation wages in high unemployment regions, and has reduced labor mobility. In addition, the recent experience in the United States suggests that labor market flexibility is an important factor in fostering the rapid adoption of productivity-enhancing new technologies. Therefore, the staff continues to endorse the implementation of new measures to reduce the frequency of EI use (such as experience rating of the EI premium rate, which would tie the rate for individual firms directly to the use of the system by their workers) and the elimination of regional extended benefits.

50. ***Canada has a highly advanced financial system that is among the soundest in the world.*** The profitability, asset quality, and capitalization levels of Canadian financial institutions remain high. In recent years, these firms have embarked on new and highly complex activities to optimize regulatory capital and maximize returns. While the complexity of some of these new activities pose significant challenges, the Financial Sector Stability Assessment undertaken last year concluded that the regulatory and supervisory structure in Canada is well developed, complies with the major international principles and standards, and is a source of international best practice in a number of areas. With its emphasis on a consolidated, risk-centered approach to supervision, the Office of the Superintendent of Financial Institutions has been well positioned to address the challenges that it has faced, as illustrated by its recent decision on establishing capital requirements for the guarantees on life insurance segregated funds. Steps also have been taken to provide for closer coordination and harmonization of regulation and supervision at all levels of government, especially in securities regulation. The staff welcomes the thrust of the new financial sector legislation, re-introduced in Parliament in February 2000. The proposed financial sector framework is intended to enhance efficiency and competition in financial services, make the review process for bank mergers more transparent, further improve the regulatory framework, and strengthen consumer protection.

51. ***On numerous occasions, Canada has demonstrated its commitment to liberal trade through initiatives at the multilateral, regional, and bilateral levels, and the staff urges the authorities to continue to pursue trade liberalization vigorously.*** Great strides have been made in reducing Canada's barriers to trade for a wide range of products, and Canada has been generous in providing favorable access to its market for the least developed countries. However, high rates of protection have been retained in some sensitive sectors, such as in certain agricultural products and textiles and clothing. The staff encourages the authorities to accelerate the reduction of tariffs on these products and, in the meantime, to provide unrestricted access for the exports of the least developed countries. Such actions would improve resource allocation in Canada and promote growth in the neediest countries.

52. ***Canada's official development assistance (ODA) as a share of GNP has fallen in recent years, reaching 0.28 percent in 1999.*** In line with the Prime Minister's statement of the Government's intention to raise foreign aid and now that the fiscal situation has strengthened, the staff encourages the authorities to begin to raise the level of ODA spending in line with Canada's long-standing commitment toward the target level of 0.7 percent of GNP.

Table 1. Canada: Selected Economic Indicators

	Averages							
	1960s	1970s	1980s	1996	1997	1998	1999	2000
(In percent change from previous period at annual rates, unless otherwise indicated)								
Economic activity and prices								
Real GDP	5.6	4.4	2.9	1.5	4.4	3.3	4.5	4.7
Real net exports 1/	0.3	0.0	-0.3	0.2	-1.8	1.1	0.4	-0.7
Real final domestic demand	5.2	4.6	3.4	2.2	5.2	2.8	4.4	5.2
Consumer spending	4.8	4.5	3.0	2.5	4.4	2.9	3.5	4.0
Nonresidential fixed investment	4.3	5.9	1.7	1.9	16.6	1.7	2.0	4.8
Labor market								
Labor force	...	...	2.0	1.0	1.7	1.8	2.0	1.8
Employment	...	...	2.0	0.8	2.3	2.7	2.8	2.6
Unemployment rate (period average)	...	...	9.4	9.6	9.1	8.3	7.6	6.8
Labor productivity	...	2.2	0.9	0.0	2.0	1.2	0.8	...
Capital stock	5.0	3.9	3.0	1.5	2.5	2.2	1.8	...
Prices								
GDP deflator (fixed weights)	...	...	6.0	1.7	1.1	0.0	1.8	4.2
Implicit price deflator for GDP	5.7	8.1	5.8	1.6	1.0	-0.6	1.6	3.6
Core consumer price index	...	...	...	1.5	1.5	1.2	1.5	1.5
Unit labor cost	...	7.8	5.7	1.4	2.7	1.3	0.0	...
Exchange rate								
U.S. cents/Canadian dollars (closing spot rate)	93.5	96.4	79.5	73.3	72.0	67.1	67.5	67.3
Percent change	-1.1	-0.8	0.0	0.3	-1.8	-6.8	0.6	-0.3
Nominal effective exchange rate 2/	-1.1	-1.3	0.0	1.7	0.2	-6.0	-0.6	1.2
Real effective exchange rate 3/	...	...	1.5	-0.3	1.3	-4.9	-4.0	1.5
Interest rates								
Three-month Treasury bill rate	...	7.0	11.3	4.3	3.2	4.7	4.7	5.5
Ten-year Treasury bond rate	...	...	...	7.2	6.1	5.3	5.6	5.9
(In percent of GDP or NDP)								
Balance of payments								
Current account balance	-2.2	-2.6	-2.2	0.6	-1.6	-1.8	-0.4	1.8
Merchandise trade balance	0.9	1.7	2.9	5.1	2.7	2.1	3.5	5.2
Invisible balance	-3.1	-4.3	-5.1	-4.5	-4.3	-3.9	-3.9	-3.4
Real net exports 4/	2.4	2.3	1.3	3.0	1.2	2.2	2.5	1.8
Fiscal indicators								
General government fiscal balance (NIA)	-1.0	-1.9	-6.0	-2.8	0.2	0.2	2.2	3.4
Federal government fiscal balance (NIA)	-0.9	-2.2	-5.3	-2.0	0.5	0.5	0.6	1.4
Provincial government fiscal balance (NIA) 5/	-0.6	-0.9	-1.3	-0.5	0.1	-0.2	1.5	1.6
Saving and investment 6/								
Gross national saving	21.9	22.3	20.1	18.1	19.0	18.3	20.0	22.3
General government	3.9	2.2	-2.3	-0.6	2.0	1.9	3.6	5.2
of which: Federal government	-0.2	-1.7	-4.8	-1.8	0.8	0.8	0.9	1.7
Private	18.0	20.1	22.4	18.7	17.0	16.3	16.4	17.1
Personal	7.7	10.7	13.1	7.5	5.9	5.9	5.2	4.8
Business	10.3	9.4	9.2	11.1	11.0	10.4	11.1	12.3
Gross domestic investment	23.5	23.6	21.4	17.5	20.3	19.9	19.9	20.0
Private	18.9	20.0	18.6	15.2	18.2	17.9	17.8	17.8
Public	4.6	3.6	2.8	2.3	2.1	2.0	2.1	2.2
of which: Federal government	0.7	0.5	0.5	0.4	0.3	0.3	0.3	0.3
Net foreign investment	1.8	1.8	1.9	-1.0	1.9	2.4	0.0	-3.0
Net national saving	13.5	14.3	10.8	7.3	8.6	7.3	10.0	13.6
Net private investment	12.1	14.0	11.6	6.0	10.1	9.5	9.5	9.9
In real terms								
Gross domestic investment	15.4	15.7	17.6	17.9	20.7	20.2	21.1	22.7
Private	12.3	13.3	15.5	15.5	18.5	18.1	18.7	20.0
Public	3.1	2.4	2.1	2.4	2.2	2.2	2.4	2.7
				Fiscal Years				
Memorandum item:				1996/97	1997/98	1998/99	1999/00	2000/01
Federal fiscal balance (public accounts)	...	...	...	-1.1	0.4	0.3	1.3	...

Sources: Statistics Canada; and Fund staff estimates.

1/ Contribution to growth.
2/ Constructed using 1989-91 trade weights.
3/ Defined in terms of relative normalized unit labor costs in manufacturing, as estimated by the IMF's Competitiveness Indicators System, using 1989-91 trade weights.
4/ Based on NIA data.
5/ Includes local governments and hospitals.
6/ Gross national saving does not equal the sum of gross domestic investment and net foreign investment because of statistical discrepancy.

Table 2. Canada: Balance of Payments

(In billions of Canadian dollars)

	1995	1996	1997	1998	1999	2000
Current account balance	-6.1	4.6	-13.9	-16.3	-3.4	18.9
In percent of GDP	-0.8	0.6	-1.6	-1.8	-0.4	1.8
Merchandise trade balance	35.4	42.4	23.8	19.1	33.8	54.5
Exports, goods	265.3	280.1	301.5	322.5	360.6	417.7
Imports, goods	229.9	237.7	277.8	303.4	326.8	363.2
Services balance	-10.1	-9.1	-9.4	-7.0	-6.1	-6.6
Investment income balance	-31.2	-29.4	-29.1	-29.2	-32.2	-30.2
Transfer balance	-0.2	0.7	0.8	0.8	1.0	1.2
Capital and financial accounts balance	1.3	-12.2	16.4	11.2	-6.3	-16.6
Direct investment, net	-3.0	-4.7	-14.9	-14.2	10.8	31.5
In Canada	12.7	13.1	16.3	32.2	37.2	93.2
Abroad	-15.7	-17.9	-31.2	-46.4	-26.5	-61.7
Portfolio accounts, net	17.9	-0.6	4.1	2.9	-17.6	-44.0
Canadian securities	25.2	18.7	15.9	25.4	5.3	18.8
Bonds	30.7	18.0	5.5	11.7	4.6	-17.5
Stocks	-4.2	8.0	7.6	13.6	14.1	35.2
Money market	-1.3	-7.3	2.8	0.1	-13.4	1.1
Foreign securities	-7.3	-19.3	-11.8	-22.5	-22.9	-62.9
Bonds	-1.1	-2.1	-6.6	-7.1	-2.4	-4.0
Stocks	-6.2	-17.2	-5.2	-15.4	-20.5	-58.9
Other investment 2/	-16.6	-7.3	16.3	25.1	4.3	-3.6
Assets	-11.6	-28.6	-22.3	15.1	12.8	-2.0
Liabilities	-5.0	21.3	38.6	10.0	-8.6	-1.6
Other flows, net	6.8	8.0	7.5	4.9	5.1	5.0
Changes in official international reserves	-3.8	-7.5	3.4	-7.5	-8.8	-5.5
Statistical discrepancy	4.8	7.6	-2.5	5.0	9.7	-2.3
Memorandum item:						
Net external debt	-332.0	-318.2	-314.0	-326.3	-300.3	...
In percent of GDP	-41.1	-38.2	-35.8	-36.2	-31.4	...

Source: Statistics Canada.

1/ Includes bank, nonbank, and nonofficial reserves transactions.

Table 3. Canada: Federal Government Budget, Public Accounts 1/

(In billions of Canadian dollars; unless otherwise indicated)

Fiscal Years	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00
Total revenues	**123.3**	**130.3**	**140.9**	**153.2**	**155.7**	**165.7**
In percent of GDP	16.1	16.1	16.9	17.4	17.3	17.3
Total spending	**160.8**	**159.0**	**149.8**	**149.7**	**152.8**	**153.4**
In percent of GDP	20.9	19.7	18.0	17.0	16.9	16.0
Program spending	118.7	112.0	104.8	108.8	111.4	111.8
In percent of GDP	15.5	13.9	12.6	12.4	12.4	11.7
Interest payments	42.0	46.9	45.0	40.9	41.4	41.6
In percent of GDP	5.5	5.8	5.4	4.7	4.6	4.3
Budget balance	**-37.5**	**-28.6**	**-8.9**	**3.5**	**2.9**	**12.3**
In percent of GDP	-4.9	-3.5	-1.1	0.4	0.3	1.3
Net public debt	**545.7**	**574.3**	**583.2**	**579.8**	**576.8**	**564.5**
In percent of GDP	71.1	71.2	70.0	66.0	64.0	58.9
Memorandum items:						
Structural budget balance	-31.1	-21.9	-0.3	10.5	8.9	15.5
In percent of GDP	-4.0	-2.7	0.0	1.2	1.0	1.6
Primary balance	4.6	18.3	36.1	44.4	44.3	53.9
In percent of GDP	0.6	2.3	4.3	5.1	4.9	5.6
Structural primary balance	11.0	25.1	44.6	51.4	50.3	57.1
In percent of GDP	1.4	3.1	5.4	5.9	5.6	6.0

Sources: Department of Finance; and Fund staff estimates.

1/ On a fiscal year basis, which ends on March 31.

Table 4. Canada: Net Government Debt

(In percent of GDP)

	1980	1993	1994	1995	1996	1997	1998	1999
National accounts basis 1/	**26.1**	**84.3**	**86.8**	**88.5**	**88.2**	**83.4**	**81.4**	**75.3**
Federal	23.5	67.6	68.5	69.8	68.9	64.9	62.3	58.2
Provincial 2/	10.6	24.6	25.5	25.5	25.7	24.5	24.7	22.5
CPP and QPP 3/	-8.0	-7.8	-7.2	-6.8	-6.4	-5.9	-5.6	-5.4
Public accounts basis 4/	**37.5**	**96.5**	**98.2**	**98.7**	**97.5**	**94.9**	**92.4**	**...**
Federal	29.2	70.1	71.1	71.2	70.0	66.0	64.0	58.9
Provincial	8.3	26.4	27.1	27.5	27.5	28.9	28.4	...
Memorandum item:								
Government of Canada marketable securities held by nonresidents 5/	9.5	27.4	25.6	25.9	25.2	24.9	23.4	22.2

Sources: Statistics Canada, National Balance Sheet Accounts (13-214) and Canada's International Investment Position (67-202); Department of Finance, Canada; and Fund staff estimates.

1/ Calendar year.

2/ Also includes local government and hospital sectors.

3/ Canadian Pension Plan and Quebec Pension Plan.

4/ Fiscal year, beginning April 1. The public accounts measure of net debt includes government indebtedness to the public service pension plans, the CPP, and the QPP as a government liability. Note that data on intergovernmental holdings of net debt are not available on a public accounts basis so that the totals may be biased upward.

5/ As a percent of total marketable debt.

Table 5. Canada: Indicators of Economic Performance

	Average 1985-95	1996	1997	1998	1999	2000	Projections 2001	2002
		(Annual percent change)						
Real GDP								
Canada	2.6	1.5	4.4	3.3	4.5	4.7	2.5	2.8
United States	2.9	3.6	4.4	4.4	4.2	5.0	1.7	3.1
Japan	3.2	5.0	1.6	-2.5	0.2	1.4	1.8	2.6
Germany	5.2	0.8	1.4	2.1	1.6	2.9	3.3	3.0
G-7 countries	2.8	3.0	3.2	2.5	2.9	3.9	2.9	2.8
Real fixed private investment								
Canada	3.2	7.4	18.2	3.7	9.4	10.6	3.9	4.3
United States	3.1	9.3	9.6	11.8	9.2	9.2	4.1	4.7
Japan	4.4	11.8	3.1	-8.9	-4.6	5.7	7.9	7.8
Germany	1.2	-0.6	1.5	3.3	3.1	2.7	4.2	4.0
G-7 countries	3.0	7.6	6.7	6.1	5.6	7.1	4.9	4.9
Consumer prices								
Canada	3.4	1.6	1.6	1.0	1.7	2.7	3.0	2.2
United States	3.6	2.9	2.3	1.6	2.2	3.4	2.7	2.5
Japan	1.4	0.1	1.7	0.6	-0.3	-0.2	0.5	0.5
Germany	2.4	1.2	1.5	0.6	0.7	1.7	1.5	1.5
G-7 countries	3.2	2.2	2.0	1.3	1.4	2.2	1.9	1.9
Unit labor cost in manufacturing								
Canada	2.0	0.4	0.0	3.1	-0.7	0.6	0.2	0.5
United States	0.9	-2.1	-1.8	-0.8	-1.2	-1.9	0.6	1.0
Japan	1.4	-2.0	-1.6	5.4	-3.9	-3.0	-0.3	-0.2
Germany	1.0	-1.1	-5.5	-2.7	-0.1	0.3	0.3	1.0
G-7 countries	1.4	-1.1	-1.2	1.4	-1.3	-1.3	0.2	0.3
		(In percent)						
Unemployment rate								
Canada	9.6	9.6	9.1	8.3	7.6	6.8	6.7	6.5
United States	6.4	5.4	5.0	4.5	4.2	4.0	4.3	4.5
Japan	2.5	3.3	3.4	4.1	4.7	5.0	5.3	5.3
Germany	6.4	8.6	9.5	9.0	8.3	7.9	7.6	7.3
G-7 countries	6.7	6.7	6.4	6.2	6.0	5.7	5.8	5.7
		(In percent of GDP)						
General government revenues								
Canada	43.8	45.6	46.4	46.6	46.2	46.3	46.0	45.6
United States	27.8	29.0	29.3	29.8	30.0	30.3	30.1	29.5
Japan	32.5	31.7	31.6	31.6	30.7	31.0	31.1	30.9
Germany	45.7	46.8	46.5	46.5	47.1	49.2	45.6	45.7
G-7 countries	35.1	35.5	35.8	35.9	36.0	36.5	35.9	35.4
General government expenditures								
Canada	50.5	48.4	46.2	46.4	44.0	42.9	43.2	43.1
United States	32.3	31.5	30.6	29.8	29.3	28.9	28.8	28.5
Japan	32.3	35.9	34.9	36.3	38.1	39.3	37.4	36.3
Germany	47.7	50.2	49.2	48.6	48.6	47.6	46.8	46.3
G-7 countries	38.7	38.9	37.7	37.2	37.0	36.8	36.3	35.8
General government financial balance								
Canada	-6.8	-2.8	0.2	0.2	2.2	3.4	2.7	2.6
United States	-4.6	-2.4	-1.3	0.0	0.7	1.5	1.3	1.1
Japan	0.2	-4.2	-3.3	-4.7	-7.4	-8.2	-6.3	-5.4
Germany	-2.1	-3.5	-2.7	-2.1	-1.5	1.6	-1.2	-0.6
G-7 countries	-3.7	-3.5	-2.0	-1.4	-1.1	-0.2	-0.4	-0.4
General government net debt								
Canada	68.4	88.2	83.4	81.4	75.3	66.9	60.8	55.6
United States	52.2	59.2	57.1	53.4	48.8	44.0	41.1	37.9
Japan	13.7	16.4	17.9	30.6	38.2	46.3	51.5	55.4
Germany 1/	28.0	51.1	52.2	52.0	52.3	49.8	48.3	46.8
G-7 countries	42.9	53.6	52.9	53.4	51.9	49.8	48.5	46.7
Current account balance								
Canada	-3.0	0.6	-1.6	-1.8	-0.4	1.8	1.2	0.9
United States	-1.8	-1.6	-1.7	-2.5	-3.6	-4.4	-4.1	-4.1
Japan	2.8	1.4	2.2	3.2	2.5	2.6	2.6	2.5
Germany	1.8	-0.3	-0.1	-0.2	-0.9	-0.2	0.0	0.3
G-7 countries	-0.4	-0.2	0.0	-0.4	-1.3	-1.5	-1.3	-1.3

Source: Fund staff estimates. Projections for G-7 countries except for Canada and the United States are from the World Economic Outlook (October 2000).

1/ Germany's net debt starts in 1986.

Table 6. Canada: Staff Projections

	1999	2000	2001	2002	2003	2004	2005	2006
(In percent change from previous period; unless otherwise indicated)								
NIPA in constant prices								
Real GDP	4.5	4.7	2.5	2.8	2.7	2.7	2.7	2.7
Net exports 1/	0.4	-0.7	-0.2	0.1	0.0	0.1	0.0	0.0
Total domestic demand	4.2	5.5	2.8	2.7	2.8	2.7	2.8	2.7
Private consumption	3.5	4.0	3.2	2.6	2.5	2.5	2.6	2.6
Private domestic investment	9.4	10.6	3.9	4.3	4.3	4.2	4.2	4.1
Change in business inventories 1/	-0.2	0.3	-0.4	-0.1	0.0	0.0	0.0	0.0
Final domestic demand	4.4	5.2	3.3	2.8	2.8	2.7	2.8	2.8
GDP (current prices)	6.2	8.4	4.6	4.7	4.6	4.6	4.7	4.7
Employment and inflation								
Unemployment rate (percent)	7.6	6.8	6.7	6.5	6.5	6.5	6.5	6.5
Consumer price index	1.7	2.7	3.0	2.2	2.0	2.0	2.0	2.0
GDP deflator	1.6	3.6	2.1	1.9	1.9	1.9	1.9	1.9
Indicators of financial policies 2/								
Federal fiscal balance								
(public accounts) 3/ 4/	12.3	10.0	3.0	3.0	3.0	3.0	3.0	3.0
(in percent of GDP)	1.3	1.0	0.3	0.3	0.3	0.2	0.2	0.2
Federal fiscal balance (NIA) 3/	5.9	14.9	10.2	7.1	6.4	6.1	5.9	6.0
(in percent of GDP)	0.6	1.4	0.9	0.6	0.5	0.5	0.4	0.4
Provincial fiscal balance (NIA) 3/ 5/	14.1	16.2	11.9	11.7	9.3	6.8	5.9	3.8
(in percent of GDP)	1.5	1.6	1.1	1.0	0.8	0.5	0.4	0.3
General goverment fiscal								
balance (NIA) 3/	20.7	35.0	29.9	29.1	26.7	24.9	24.3	23.1
(in percent of GDP)	2.2	3.4	2.7	2.6	2.2	2.0	1.9	1.7
General goverment net debt (NIA)								
(in percent of GDP)	75.3	66.9	60.8	55.6	50.8	46.6	42.7	39.1
Three-month treasury bill rates (percent)	4.7	5.5	4.9	4.8	4.8	4.8	4.8	4.8
Ten-year government bond rates (percent)	5.6	5.9	5.1	5.0	5.0	5.0	5.0	5.0
Balance of payments								
Current account balance 3/	-3.4	18.9	13.5	10.5	9.5	8.7	9.1	8.2
(in percent of GDP)	-0.4	1.8	1.2	0.9	0.8	0.7	0.7	0.6
Merchandise trade balance 3/	33.8	54.5	42.4	39.1	36.4	35.4	36.0	34.7
(in percent of GDP)	3.5	5.2	3.9	3.4	3.1	2.8	2.8	2.5
Invisibles, net 3/	-37.2	-35.6	-28.9	-28.6	-26.9	-26.7	-26.9	-26.5
(in percent of GDP)	-3.9	-3.4	-2.7	-2.5	-2.3	-2.1	-2.1	-1.9

Source: Fund staff estimates.

1/ Contribution to growth.

2/ Projections are based on the WEO assumption of unchanged fiscal policy. After FY 2000/01, it is assumed that new measures of Can$5-7 billion (around ½ percent of GDP) are introduced each year, aimed at reducing taxes and implementing new spending initiatives. This would imply that the federal government would maintain budget surpluses that would reach Can$3 billion annually. The consolidated fiscal projection for the provinces is assumed to be consistent with their stated medium-term targets.

3/ In billions of Canadian dollars.

4/ Fiscal year (April-March).

5/ Includes local governments and hospitals.

Table 7. Canada: Medium-Term Projections for Federal Government Budget

(In billions of Canadian dollars)

		Projections					
	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
The 2000 Economic Statement and Budget Update (ESBU) 1/							
Revenues	165.7	173.7	174.5	178.4	182.9	186.4	194.2
Total spending	153.4	161.8	166.3	170.8	175.2	179.7	183.7
Program spending	111.8	119.7	124.6	129.6	133.9	138.5	142.8
Interest payments	41.6	42.2	41.7	41.2	41.3	41.2	40.9
Prudence	...	...	4.0	5.0	6.0	6.5	7.0
Contingency reserve	...	...	3.0	3.0	3.0	3.0	3.0
Economic prudence	...	...	1.0	2.0	3.0	3.5	4.0
Debt reduction	12.3	10.0	...	...	...	...	...
Remaining balance	...	1.9	4.3	2.6	1.6	0.1	3.6
Percent of GDP	...	0.2	0.4	0.2	0.0	0.0	0.3
Memorandum items:							
Net public debt (in percent of GDP) 2/	58.9	53.6	50.5	48.0	45.6	43.3	41.0
Three-month Treasury bill rate 3/	4.7	5.5	5.8	5.4	5.4	5.4	5.4
Ten-year government bond rate 3/	5.6	6.0	5.9	5.9	5.9	5.9	5.9
Nominal GDP growth 3/	6.2	8.8	5.5	5.0	5.0	5.0	5.0
Staff projections							
Revenues	165.7	172.2	173.8	179.2	184.3	189.0	195.9
Total spending	153.4	160.4	165.5	169.8	173.5	178.7	183.3
Program spending	111.8	119.9	125.6	130.5	134.8	140.2	144.9
Interest payments	41.6	40.5	39.9	39.2	38.8	38.5	38.4
Prudence	...	...	4.0	5.0	6.0	6.5	7.0
Contingency reserve	...	...	3.0	3.0	3.0	3.0	3.0
Economic prudence	...	...	1.0	2.0	3.0	3.5	4.0
Debt reduction	12.3	10.0	...	...	...	...	...
Remaining balance	...	1.8	4.3	4.4	4.8	3.8	5.5
Percent of GDP	...	0.2	0.4	0.4	0.4	0.3	0.4
Memorandum items:							
Net public debt (in percent of GDP) 2/	58.9	53.4	50.7	48.2	45.8	43.5	41.4
Three-month Treasury bill rate 3/	4.7	5.4	4.9	4.8	4.8	4.8	4.8
Ten-year government bond rate 3/	5.6	5.9	5.1	5.0	5.0	5.0	5.0
Nominal GDP growth 3/	6.2	8.4	4.6	4.7	4.6	4.6	4.7

Source: Fund staff estimates.

1/ Projections for revenues in 2005/06 are staff estimates based on the average of private sector forecasts in the ESBU.

2/ Based on the assumption that the contingency reserve is applied to debt reduction, except for 2000/01.

3/ Annual, in percent.

Table 8. Canada: Indicators of Canadian Financial Institutions

	1994	1995	1996	1997	1998	1999	2000 1/
	(In percent)						
Six largest chartered banks 2/							
Return on total shareholders' equity	11.7	13.3	15.0	16.4	13.4	15.8	15.3
Return on average assets	0.6	0.7	0.7	0.7	0.6	0.7	0.7
Average intermediation spread	3.3	3.1	2.7	2.6	2.2	2.4	2.6
Loan loss provisions (in percent of average total assets)	0.5	0.3	0.2	0.2	0.2	0.2	0.3
Net interest income (in percent of average earning assets)	2.9	2.6	2.5	2.3	2.2	2.2	2.1
Total capital ratio	9.9	9.7	9.3	10.2	10.6	11.4	11.8
Of which: Tier 1 capital ratio	6.8	7.0	6.8	7.0	7.4	8.3	8.4
	(In percent of total assets unless otherwise indicated)						
All chartered banks 3/							
Total assets 4/	841.0	911.7	1104.8	1321.1	1432.1	1397.7	1508.6
Canadian dollar liquid assets	10.4	10.1	7.9	5.9	5.4	5.7	6.1
Total Canadian dollar assets	68.1	67.0	61.8	58.5	53.6	59.8	60.1
Total Foreign currency assets	31.9	33.0	38.2	41.5	46.4	40.2	39.9
Banks exposure to commercial real estate sector 5/	1.8	1.4	1.1	1.0	0.9	1.0	1.0
Banks exposure to resource sector 6/	1.4	1.4	1.2	1.2	1.2	1.3	1.2
Total liabilities and shareholders' equity 4/	841.0	911.7	1104.8	1321.1	1432.1	1397.7	1508.6
Total deposits	48.3	47.6	40.7	37.1	34.2	37.3	39.7
Total Canadian dollar liabilities	65.6	65.7	60.4	56.5	52.3	57.7	58.5
Total foreign currency liabilities	34.4	34.3	39.6	43.5	47.7	42.3	41.5
Total foreign currency deposits	29.0	27.8	28.0	30.7	32.2	31.3	29.3
Other foreign currency liabilities	5.4	6.5	11.7	12.9	15.5	11.0	12.2

Sources: Bank of Canada; BankScope; and Canadian Bankers Association.

1/ Data as of end September 2000.
2/ Based on data for six largest chartered Canadian banks representing about 90 percent of all chartered banks' assets in Canada as of November 30, 2001.
3/ Based on consolidated data.
4/ In billions of Canadian dollars.
5/ Proxied by nonresidential mortgages.
6/ Composed of agriculture, fishing, forestry, mining, oil, and gas sectors.

Table 9. Canada: Offical Development Assistance 1/

	1992	1993	1994	1995	1996	1997	1998	1999
				(In billions of U.S. dollars)				
Total	**2.5**	**2.4**	**2.3**	*2.1*	**1.8**	**2.0**	**1.7**	**1.7**
Bilateral	1.7	1.6	1.5	1.4	1.4	1.2	1.2	1.2
Multilateral	0.8	0.8	0.8	0.7	0.4	0.8	0.5	0.5
				(In percent of GNP)				
Total	**0.46**	**0.45**	**0.43**	**0.38**	**0.32**	**0.34**	**0.29**	**0.28**
Bilateral	0.31	0.3	0.28	0.25	0.24	0.2	0.21	0.19
Multilateral	0.15	0.15	0.15	0.13	0.08	0.14	0.08	0.09
				(In percent of total ODA)				
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Bilateral	68	67	65	67	76	59	71	70
Multilateral	32	33	35	33	24	41	29	30

1/ Includes traditional ODA measured on a DAC basis, and excludes aid programs for transition economies.

Table 10. Canada: Indicators of External and Financial Vulnerability

(In percent of GDP, unless otherwise indicated)

	1995	1996	1997	1998	1999	2000 1/
External indicators						
Exports (annual percentage change)	15.4	6.3	7.8	7.6	11.0	14.9
Imports (annual percentage change)	9.3	3.9	15.3	8.7	7.1	10.7
Terms of trade (annual percentage change)	3.2	2.5	-1.1	-3.2	3.2	6.6
Current account balance	-0.8	0.6	-1.6	-1.8	-0.4	1.8
Capital and financial account balance	0.2	-1.5	1.9	1.2	-0.7	-1.6
of which: Inward portfolio investment (debt securities, etc.)	3.1	2.2	1.8	2.8	0.6	1.8
Inward foreign direct investment	1.6	1.6	1.9	3.6	3.9	9.0
Other investment liabilities (net)	-0.6	2.6	4.4	1.1	-0.9	-0.2
Official reserves (in billions of U.S. dollars)	15.2	20.6	18.0	23.4	28.6	32.2
Broad money (M3) to reserves ratio 2/	25.1	19.5	22.4	16.6	14.9	13.7
Central bank foreign liabilities (in billions of dollars)	0.2	0.1	0.2	0.2	0.5	0.1
Official reserves in months of imports	0.9	1.2	0.9	1.2	1.3	1.8
Net international investment position (in billions of dollars) 3/	-332.0	-318.2	-314.0	-326.3	-300.3	...
of which: General government debt (in billions of dollars) 4/	117.9	117.5	108.8	99.6	96.3	83.3
External debt to exports ratio	1.1	1.0	0.9	0.9	0.7	...
External interest payments to exports (in percent) 5/	19.0	17.4	17.5	16.1	15.5	14.4
Nominal effective exchange rate (percent change)	-2.0	1.7	0.2	-6.0	-0.6	1.2
Financial markets indicators						
General government gross debt	120.6	120.9	117.4	116.2	111.6	...
Three-month Treasury bill yield (percent)	7.0	4.3	3.2	4.7	4.7	5.5
Three-month Treasury bill yield (percent, real) 6/	5.9	3.2	2.1	3.6	3.6	4.3
Change in stock market index (TSE 300, annual percentage change)	3.5	18.8	22.6	4.6	4.5	36.1
Banking sector risk indicators 7/8/						
Total loans to assets	65.3	63.9	61.6	61.2	59.0	57.8
Total loans to deposits	84.8	91.1	92.5	90.2	86.8	84.2
Share of nonperforming loans in total loans	2.0	1.6	1.0	0.8	0.8	1.1
Loans to the rest of the world as percent of total loans 9/	18.7	20.0	20.0	21.7	21.7	21.0
Return on total shareholders' equity	13.3	15.0	16.4	13.4	15.8	15.3

Sources: Bank of Canada; BankScope; Canadian Bankers Association; Department of Finance Canada; and Statistics Canada.

1/ Official reserves, broad money, nominal effective exchange rate and TSE 300 are available for the entire 2000. Bank of Canada foreign liabilities and data for the six largest chartered Canadian banks are reported as of end-November 2000.

2/ Defined as ratio of M3 to foreign exchange reserves of the Bank of Canada, both in U.S. dollars.

3/ Current cost valuation.

4/ Defined as Government of Canada securities held by nonresidents.

5/ External interest payments: income payments on foreign-owned assets (other private payments plus Canada government payments).

6/ Constructed using the implicit GDP price deflator.

7/ Unless otherwise indicated, based on data reported by six largest chartered Canadian banks representing about 90 percent of all chartered bnks' assets in Canada as of November 30, 2000.

8/ Ratios in percent.

9/ Data are for all chartered Canadian banks.

An Update to the Main Issues and Recommendations of the FSSA[1]

1. The assessment concluded that Canada has a stable and highly advanced financial system, which is among the soundest in the world and is supported by a well-developed regulatory framework which shows a high degree of compliance with major international standards. Despite the overall soundness and stability, ongoing domestic and international developments could pose significant challenges to the resilience of the Canadian financial system and to the regulatory and supervisory frameworks. As in other advanced financial systems, the Canadian financial sector has embarked on new and highly complex activities that have raised risks and made these risks more difficult to assess. The FSSA mission found substantive compliance with and a high degree of implementation of the recommendations of the Basel Committee's reports and other codes and standards.[2] However, a peer review concluded that there was only partial compliance with 2 core principles: some minor shortcomings were noted with regard to Core Principle 14 and 22, owing to limits on the ability of Office of the Superintendent of Financial Institutions (OSFI) to legally remove members of a financial institution's Board of Directors and to bar the appointment of an individual from serving as a financial institution's senior officer once the person has been hired.

2. ***The authorities emphasized that financial institutions in Canada have strengthened their risk management models and have tightened considerably their levels of risk tolerance in recent years.*** OSFI meets with market participants on a quarterly basis to discuss developments in the area of risk management, and changes to risk management models are usually subject to OSFI's approval. One important recent change in risk management has been the incorporation by financial institutions of a "liquidity crunch" scenario in their standard stress testing scenarios. To enhance the understanding of market and credit risks, OSFI has encouraged financial institutions to intensify the communication between those responsible for developing and testing an institution's value-at-risk (VAR) models and those responsible for trading operations. The authorities felt that this "preemptive approach" would help institutions to better assess the underlying assumptions in stress tests and the potential magnitude of the risks involved. Financial institutions, and in particular banks, have maintained prudent levels of credit-risk exposure in off-balance sheet transactions. Between October 1997 and July 2000, the notional amount of off-balance sheet transactions increased from about \$6 trillion to roughly \$7.5 trillion; however, the risk-adjusted exposure declined from \$153 billion to \$141 billion.

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[1] FO/DIS/00/2 and FO/DIS/00/2 Supplement 1, and Report on the Observance of Standards and Codes (ROSC), June 2000.

[2] The assessment also included the IOSCO Objectives and Principles; IAS Insurance Supervisory Principles; the CPSS Core Principles for Payments Systems; and the Code of Good Practices on Transparency.

3. ***With its emphasis on a consolidated risk-centered approach to supervision, OSFI has been well positioned to address the challenges that it has faced, as demonstrated by the recent establishment of capital requirements for life insurance segregated funds—an issue that had been flagged in the FSSA.*** Recognizing the need by life insurance companies in Canada to better measure and manage risk, OSFI announced in late 1999 its intention to introduce capital requirements for the guarantees in life insurance segregated funds (LISFs), with half of the estimated capital requirement effective by end-2000 and the full requirement applying by end-2001.[3] In September 2000, OSFI also announced that it was adopting the methodology to determine capital requirements for LISFs proposed by the Canadian Institute of Actuaries, which relies on stochastic investment modeling techniques, albeit with somewhat more conservative risk factors than in the Institute's original proposal. The authorities noted that the regulatory changes have had significant effects on the life insurance companies' risk management practices. Large companies had provisioned for the risks embedded in the guarantees and should not be affected by the new capital requirements, but small- and medium-size companies had not and should be more affected, but the authorities contemplated no solvency problems. As a result of these changes, OSFI officials noted that most firms have decided not to continue offering full guarantees on the LISFs, have reduced the implicit benefits offered, and have increased management fees sharply. Moreover, life insurance companies have also stopped offering investors the possibility to reset the dates of the guarantee to lock in the returns as part of the original capital invested.

4. ***While significant steps have been taken to strengthen the regulatory framework governing the securities industry, the Canadian authorities recognized that additional efforts were needed to establish more regular procedures for coordination between federal and provincial regulators.*** The authorities expected that the establishment of the Mutual Funds Dealer Association as a self-regulated organization, to be approved in early 2001, will help to improve the efficiency and effectiveness of the regulatory framework and oversight of dealers in the Canadian market. The Canadian Securities Association (CSA) is expected to release a proposal for new rules and regulations in the fall of 2001 aimed at improving the governance of mutual funds. The main areas include the requirement for mutual fund groups to have a governance regime independent of the mutual fund manager; requiring mutual fund managers to register with the CSA; establishing a compensation fund for mutual fund investors; and strengthening disclosure. Since end-2000, a new regulatory framework has been in place, which harmonizes and updates the disclosure regime for issuing securities in Canada and replaces previous requirements that differed by jurisdiction and by the nature of the business of the issuer. The authorities also noted that, following the establishment in early 1999 of the Joint Forum of Financial Market Regulators between the CSA, the Canadian Council of Insurance Regulators, and the Canadian Association of Pension Supervisory Authorities, the majority of securities and insurance regulators have agreed on principles for

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[3] See Box 1 in FO/DIS/00/2 for a more detailed description of life-insurance segregated funds.

enhancing information sharing among jurisdictions, and they expected to incorporate provincial pension supervisors into the agreement in the period ahead.

5. ***The authorities noted that the new financial sector legislation will help to resolve the minor shortcomings associated with Core Principles 14 and 22.*** In particular, the new legislation would provide OSFI with the legal authority to require changes in the composition of a financial institution's board of directors and management, as well as to bar the appointment of an individual once the person has been hired.

Canada - Fund Relations
(As of January 31, 2001)

I. **Membership Status:** Joined 12/27/45; Article VIII

II. **General Resources Account:**	**SDR Million**	**Percent of Quota**
Quota	6,369.20	100.0
Fund holdings of currency	4,379.35	68.8
Reserve position in Fund	1,989.85	31.2
Operational budget transfers (net)	-83.00	

III. **SDR Department:**	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	779.29	100.0
Holdings	440.64	56.5

IV. **Outstanding Purchases and Loans:** None

V. **Financial Arrangements:** None

VI. **Projected Obligations to Fund:** None

VII. **Exchange Rate Arrangements**

The Canadian authorities do not maintain margins with respect to exchange transactions, and exchange rates are determined on the basis of demand and supply conditions in the exchange market. However, the authorities may intervene to maintain orderly conditions in the exchange market. There are no taxes or subsidies on purchases or sales of foreign exchange. On February 28, 2001 the exchange rate of the Canadian dollar was 65¼ U.S. cents per Canadian dollar.

Canada has notified the Fund, pursuant to Decision No. 144, of restrictions imposed vis-à-vis Iraq (EBD/90/279) and the Federal Republic of Yugoslavia (Serbia and Montenegro) (EDB/92/162).

VIII. **Last Article IV Consultation**

The staff report for the 2000 consultation with Canada was considered by the Executive Board on February 2, 2000 (EBM/00/11). Canada is on a 12-month consultation cycle.

Canada: Core Statistical Indicators

(as of end-February 2001)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance 1/	GDP/ GNP	External Debt/ Debt Service 2/
Date of latest Observation	Same day	January 2001	February 2001	February 2001	February 2001	Same day	January 2001	December 2000	2000 Q4	2000 Q4	2000 Q4	end-1999
Date received	Same day	02/05/01	03/02/01	03/02/01	03/02/01	Same day	02/15/01	02/21/2001	02/28/01	02/28/01	02/28/01	May 00
Frequency of data	Daily	Monthly	Weekly	Monthly	Monthly	Daily	Monthly	Monthly	Quarterly	Quarterly	Quarterly	Annual
Frequency of reporting	Daily	Monthly	Weekly	Weekly	Weekly	Daily	Monthly	Monthly	Quarterly	Quarterly	Quarterly	Annual
Source of Update	Various	Finance Canada news release	BOC financial statement	BOC financial statement	BOC financial statement	Various	Statistics Canada	Statistics Canada	Statistics Canada	Statistics Canada	Statistics Canada	Statistics Canada
Mode of Reporting	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic
Confidentiality	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted
Frequency of Publication	Daily	Monthly	Weekly	Weekly	Weekly	Daily	Monthly	Monthly	Quarterly	Quarterly	Quarterly	Annually

1/ National accounts.
2/ Net international investment positio

Statement by the IMF Staff Representative
March 23, 2001

1. Since the staff report (SM/01/81) was issued, some additional data have become available on the current economic situation in Canada. The unemployment rate remained unchanged in February at 6.9 percent, following a slight rise in January; employment, however, declined in February, after posting only a modest rise in January. Most of the decline was accounted for by the manufacturing sector. A substantial fall in the participation rate in February kept the unemployment rate from rising. Also in February, core consumer price inflation remained unchanged at 2 percent (12-month rate), the mid-point of the official target range of 1–3 percent. The overall CPI declined slightly to 2.9 percent, largely reflecting lower energy prices. Growth in retail sales remained strong in January, rising by 0.6 percent, broadly in line with the growth experienced in the closing months of 2000.

2. The most recent consensus forecast for Canadian GDP growth in 2001 has been reduced from 2¾ percent in February to just under 2½ percent in March, broadly in line with the staff's forecast. However, uncertainty regarding prospects for the Canadian economy has increased, particularly as the risk of a more pronounced downturn in U.S. economy activity appears to have risen in light of the events of the past couple of weeks. Notwithstanding these developments, the thrust of the appraisal in the staff report remains unchanged. In particular, monetary policy should be the main instrument used in attempting to sustain the economic expansion, and the authorities will have to be flexible, poised to act promptly and firmly to lower interest rates should indications of an excessive slowing in Canadian economic activity begin to emerge. The Bank of Canada reduced interest rates by 50 basis points to 5¼ percent on its scheduled monetary policy announcement date of March 6, 2001. The next scheduled monetary policy announcement date is April 17.

3. Following the recent Canadian and U.S. interest rate cuts, short-term yields on Canadian government securities declined, but they continue to slightly exceed those in the United States. The differential for long-term yields has widened from about 25 basis points in late February to about 40 basis points in mid-March. The Canadian dollar has depreciated from about 65½ U.S. cents in late February to 63¾ U.S. cents in mid-March, partly reflecting the continued weakness of non-energy commodity prices in early 2001.

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 01/38
FOR IMMEDIATE RELEASE
April 23, 2001

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with Canada

On March 23, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Canada.[1]

Background

The Canadian economy ended the 1990s with a very strong performance, underpinned by the sound macroeconomic policies put in place during the decade. Following a slowdown in growth in late 1997 and 1998 largely associated with the fallout from the Asian crisis, the pace of economic growth has been vigorous and broadly based. Real GDP grew at an average annual rate of about 5 percent between the fourth quarter of 1998 and the third quarter of 2000, broadly in line with growth in the United States. In the fourth quarter of 2000, growth slowed to 2½ percent, reflecting the effects of a slowdown in U.S. economic activity in the second half of the year. The strong pace of economic growth in the last two years has pushed the economy to levels of resource utilization that have not been seen during the past 25 years. The unemployment rate fell to 6½ percent in June, its lowest level since the mid-1970s, but it rose somewhat subsequently to almost 7 percent in the first two months of 2001, partly owing to an increase in the participation rate. Despite indications of higher levels of resource utilization, inflationary pressures remain quiescent. Core inflation hovered within a narrow range around 1½ percent between mid-1998 and November 2000, but was at the mid-point of the official 1-3 percent target range in the first two months of 2001. Overall inflation has risen more rapidly, largely reflecting the impact of energy prices. CPI inflation was 1¾ percent in 1999, 2¾ percent in 2000, and 3 percent (annual rate) in early 2001. Wage pressures remained well contained, and unit labor costs, which remained virtually unchanged in 1999, rose at an annual rate of

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the March 23, 2001 Executive Board discussion based on the staff report.

almost 1 percent in the first three quarters of 2000. Inflationary expectations continue to be anchored around the mid-point of the official target range, suggesting continued high credibility in the authorities' inflation target.

The external current account shifted from a deficit of ½ percent of GDP in 1999 to a surplus of 1¾ percent of GDP in 2000, reflecting strong U.S. demand growth, together with some recovery in commodity prices. A sharply improving trade surplus has been mainly propelled by buoyant export growth to the United States. The deficit in net investment income has also declined, partly reflecting the cumulative effects of lower interest rates and a more recent rebound in foreign earnings of Canadian corporations.

The Bank of Canada raised interest rates markedly in 2000 as estimates of slack in the economy were narrowing rapidly and owing to concerns about potential inflationary spillovers from faster-than-expected U.S. growth. However, following the sharp turnaround in the U.S. outlook, the Bank of Canada lowered the bank rate by 25 basis points, 50 basis points, and 25 basis points on its scheduled monetary policy announcement dates of January 23, March 6, and April 17, 2001, respectively. The Bank of Canada's decision was motivated by concerns regarding near-term Canadian economic prospects stemming from indications that the U.S. slowdown would be more abrupt than expected.

The authorities' commitment to promoting lasting fiscal discipline has been reflected in an impressive turnaround in the federal fiscal position, which shifted from a deficit of 5¾ percent of GDP in 1993/94 to a surplus of 1¼ percent in 1999/00 (on a public accounts basis, fiscal year ending March 31). In the *October 2000 Economic Statement and Budget Update*, the authorities presented a mini-budget, which expanded the comprehensive reductions in personal and corporate income taxes presented in *The Budget Plan 2000*, introduced some modest additional spending initiatives, and announced a minimum of Can $10 billion in government debt to be repaid in 2000/01. Strong fiscal consolidation at the federal and provincial levels, have allowed the general government balance to improve from a deficit of 6¾ percent of GDP in 1994 to a surplus of 3½ percent in 2000 (national accounts basis). As a result, the general government net debt declined from about 87 percent of GDP in 1994 to 75 percent in 1999.

Executive Board Assessment

Directors commended the authorities for maintaining sound macroeconomic and structural policies over most of the past decade, which had provided a solid foundation for the sustained expansion of the Canadian economy. Fiscal consolidation by both the federal and provincial governments has brought budgets into surplus and led to a sharp reduction in government debt as a ratio to GDP in recent years. Monetary policy has been conducted very successfully, within an inflation-targeting framework. Economic efficiency has been enhanced by the adoption of important structural reforms, including continuing efforts to remove barriers to interprovincial trade, improvements in the employment insurance system and in work incentives (especially for low-income families), and measures to bring the public old-age support system into actuarial balance. Directors considered that these policies have paid off in the past few years with low

and stable inflation and inflation expectations; a sharp decline in unemployment; and indications, more recently, of an acceleration in labor productivity growth. The strong policy framework has put the real and financial economy in a good position to cope with any major economic shock.

Directors indicated that, looking forward, the major uncertainty facing Canadian policymakers was the depth and duration of the U.S. economic slowdown and its impact on Canada. They considered that Canada is in a good position to cope with the challenges of an uncertain global economic environment. In particular, Directors noted that the momentum that has been maintained in Canadian economic activity and sustained strength in consumer and business confidence appear likely to provide some cushion against the effects of the slowdown in the United States. They also noted that the recently enacted tax cuts are fortuitously timed. At the same time, Directors noted that the Canadian economy would be adversely affected if the slowdown in the United States proved to be sharper and more prolonged than envisaged. They agreed that monetary policy should be the main instrument used in attempting to sustain the economic expansion, and welcomed the recent lowering of interest rates by the Bank of Canada. In addition, if economic developments turned out to be less favorable than expected, the automatic fiscal stabilizers should also be allowed to work. Directors also commended the forward-looking measures introduced in the public pension plan aimed at dealing with its long-term financing problems, including the decision to invest part of the funds in private securities.

Directors agreed with the authorities' view that monetary policy should be set to reflect economic conditions in Canada and should aim to allow the economy to seek its productive potential without compromising the official inflation target. The past success in maintaining low inflation has established the credibility of the inflation-targeting regime, enhancing the Bank of Canada's ability to follow an independent monetary policy. Directors noted that, consistent with the inflation-targeting framework, the Bank should be flexible, poised to act promptly to lower interest rates, should indications of a significant slowing in economic activity begin to emerge.

Directors observed that, in the context of reaching a decision this year on a new inflation target, the current 1–3 percent range has served Canada well, and its credibility has helped to enhance the effectiveness of the floating exchange rate regime in buffering the economy against external shocks. While Directors thought that, at this juncture, there appeared to be no compelling reasons for a major change in the inflation-targeting framework, they were of the view that it would be useful to continue assessing options for further refining the framework. They welcomed the move to strengthen the Bank of Canada's monetary policy strategy in the past year by providing updates twice a year to the semi-annual monetary policy reports and by establishing fixed dates for announcing monetary policy changes. In particular, Directors thought that the move to fixed announcement dates had usefully served to focus the debate on monetary policy more on economic developments in Canada.

Directors welcomed the Canadian authorities' prudent fiscal policy framework with its emphasis on continued debt reduction, efficiency-enhancing tax reforms, and limited new spending initiatives focused on investments in education, research, and health care. In particular, they

commended the authorities for the comprehensive income tax reforms and reductions that were introduced in 2000. These reforms will offer considerable economic efficiency gains in the period ahead by increasing returns to work and investment, and by contributing to the spread of new technology and entrepreneurship. They further noted that corporate tax changes will help to enhance the competitiveness of Canadian firms. Directors also welcomed the authorities' decision to commit themselves to trying to bring down the debt-to-GDP ratio more rapidly than previously envisaged by announcing each year, as economic conditions permit, a target for additional debt reduction. In this context, they commended the authorities' use of this mechanism to condition tax cuts on changing economic conditions. Directors welcomed the fact that the federal government's medium-term budget position remains sound, even with full implementation of the major reforms to income taxation and new spending initiatives in priority areas such as health care and education.

Directors observed that the budgetary positions of the provinces and territories are generally on a solid footing, but they recommended that the options for new tax and spending initiatives being considered be framed in a longer-term perspective, reflecting the large potential fiscal costs arising from population aging and continuing growth in demand for health care. Since health care is a major provincial responsibility, Directors indicated that the provinces should begin taking steps to provide for the rising demand and cost pressures that the medical services system will face over the longer term. They added that the role of the federal government in providing resources to help deal with these costs would also need to be evaluated.

Directors noted that the comprehensive reforms enacted during the 1990s to the Employment Insurance (EI) system and to social assistance programs and the introduction of the National Child Benefit have enhanced the flexibility and efficiency of the labor market, boosting employment growth, and have helped to reduce structural unemployment. They called on the authorities to resist pressures to ease the impact of some of these reforms and expressed concern at the proposals to roll back some of the reforms. Directors supported new steps to improve labor market efficiency, including by reducing the frequency of EI use and eliminating regional extended benefits.

Directors indicated that Canada has a highly advanced financial system, with high levels of profitability, asset quality, and capitalization. The regulatory and supervisory structure is well developed, complies with the major international principles and standards, and is a source of international best practice in a number of areas, as shown by the Financial Sector Stability Assessment (FSSA) undertaken last year. Canada's emphasis on a consolidated, risk-centered approach to supervision has put the supervisory and regulatory authorities in a good position to address the challenges faced in recent years with financial institutions embarking on new and highly complex activities. Directors noted that the authorities have moved to address most of the issues discussed in the FSSA, most notably the strengthening of prudential requirements for insurance segregated funds. They also welcomed the thrust of the new financial sector legislation, which is intended to enhance efficiency and competition in financial services, make the review process for bank mergers more transparent, further improve the regulatory framework, and strengthen consumer protection.

Directors commended Canada's demonstrated commitment to liberal trade. Canada has made great strides to reduce barriers to trade for a wide range of products, and has provided favorable access to its markets for the least-developed countries. However, high rates of protection have been retained in some sensitive sectors, notably in certain agricultural products, textiles, and clothing. Directors encouraged the authorities to accelerate the reduction of tariffs on these products and to provide more duty-free access for the least-developed countries, both to improve resource allocation in Canada and to promote growth in the neediest countries.

Directors welcomed the technical and financial assistance that Canada has provided to low-income countries, including through the HIPC Initiative. Noting the Prime Minister's statement that the government intends to increase foreign aid, they encouraged the authorities to begin raising the level of Official Development Assistance (ODA) spending towards Canada's long-standing commitment to reach a level of ODA spending equivalent to 0.7 percent of GNP.

Directors noted that the quality, coverage, periodicity and timeliness of Canadian economic data were excellent both in the context of the Article IV consultation and for purposes of ongoing surveillance.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Table 1. Canada: Selected Economic Indicators

	Averages 1960s	1970s	1980s	1996	1997	1998	1999	2000
(In percent change from previous period at annual rates, unless otherwise indicated)								
Economic activity and prices								
Real GDP	5.6	4.4	2.9	1.5	4.4	3.3	4.5	4.7
Real net exports 1/	0.3	0.0	-0.3	0.2	-1.8	1.1	0.4	-0.7
Real final domestic demand	5.2	4.6	3.4	2.2	5.2	2.8	4.4	5.2
Consumer spending	4.8	4.5	3.0	2.5	4.4	2.9	3.5	4.0
Nonresidential fixed investment	4.3	5.9	1.7	1.9	16.6	1.7	2.0	4.8
Labor market								
Labor force	...	...	2.0	1.0	1.7	1.8	2.0	1.8
Employment	...	...	2.0	0.8	2.3	2.7	2.8	2.6
Unemployment rate (period average)	...	...	9.4	9.6	9.1	8.3	7.6	6.8
Labor productivity	...	2.2	0.9	0.0	2.0	1.2	0.8	...
Capital stock	5.0	3.9	3.0	1.5	2.5	2.2	1.8	...
Prices								
GDP deflator (fixed weights)	...	...	6.0	1.7	1.1	0.0	1.8	4.2
Implicit price deflator for GDP	5.7	8.1	5.8	1.6	1.0	-0.6	1.6	3.6
Core consumer price index	...	...	...	1.5	1.5	1.2	1.5	1.5
Unit labor cost	...	7.8	5.7	1.4	2.7	1.3	0.0	...
Exchange rate								
U.S. cents/Canadian dollars (closing spot rate)	93.5	96.4	79.5	73.3	72.0	67.1	67.5	67.3
Percent change	-1.1	-0.8	0.0	0.3	-1.8	-6.8	0.6	-0.3
Nominal effective exchange rate 2/	-1.1	-1.3	0.0	1.7	0.2	-6.0	-0.6	1.2
Real effective exchange rate 3/	...	...	1.5	-0.3	1.3	-4.9	-4.0	1.5
Interest rates								
Three-month Treasury bill rate	...	7.0	11.3	4.3	3.2	4.7	4.7	5.5
Ten-year Treasury bond rate	...	...	...	7.2	6.1	5.3	5.6	5.9
(In percent of GDP or NDP)								
Balance of payments								
Current account balance	-2.2	-2.6	-2.2	0.6	-1.6	-1.8	-0.4	1.8
Merchandise trade balance	0.9	1.7	2.9	5.1	2.7	2.1	3.5	5.2
Invisible balance	-3.1	-4.3	-5.1	-4.5	-4.3	-3.9	-3.9	-3.4
Real net exports 4/	2.4	2.3	1.3	3.0	1.2	2.2	2.5	1.8
Fiscal indicators								
General government fiscal balance (NIA)	-1.0	-1.9	-6.0	-2.8	0.2	0.2	2.2	3.4
Federal government fiscal balance (NIA)	-0.9	-2.2	-5.3	-2.0	0.5	0.5	0.6	1.4
Provincial government fiscal balance (NIA) 5/	-0.6	-0.9	-1.3	-0.5	0.1	-0.2	1.5	1.6
Saving and investment 6/								
Gross national saving	21.9	22.3	20.1	18.1	19.0	18.3	20.0	22.3
General government	3.9	2.2	-2.3	-0.6	2.0	1.9	3.6	5.2
of which: Federal government	-0.2	-1.7	-4.8	-1.8	0.8	0.8	0.9	1.7
Private	18.0	20.1	22.4	18.7	17.0	16.3	16.4	17.1
Personal	7.7	10.7	13.1	7.5	5.9	5.9	5.2	4.8
Business	10.3	9.4	9.2	11.1	11.0	10.4	11.1	12.3
Gross domestic investment	23.5	23.6	21.4	17.5	20.3	19.9	19.9	20.0
Private	18.9	20.0	18.6	15.2	18.2	17.9	17.8	17.8
Public	4.6	3.6	2.8	2.3	2.1	2.0	2.1	2.2
of which: Federal government	0.7	0.5	0.5	0.4	0.3	0.3	0.3	0.3
Net foreign investment	1.8	1.8	1.9	-1.0	1.9	2.4	0.0	-3.0
Net national saving	13.5	14.3	10.8	7.3	8.6	7.3	10.0	13.6
Net private investment	12.1	14.0	11.6	6.0	10.1	9.5	9.5	9.9
In real terms								
Gross domestic investment	15.4	15.7	17.6	17.9	20.7	20.2	21.1	22.7
Private	12.3	13.3	15.5	15.5	18.5	18.1	18.7	20.0
Public	3.1	2.4	2.1	2.4	2.2	2.2	2.4	2.7

	Fiscal Years 1996/97	1997/98	1998/99	1999/00	2000/01
Memorandum item:					
Federal fiscal balance (public accounts)	-1.1	0.4	0.3	1.3	...

Sources: Statistics Canada; and Fund staff estimates.

1/ Contribution to growth.
2/ Constructed using 1989-91 trade weights.
3/ Defined in terms of relative normalized unit labor costs in manufacturing, as estimated by the IMF's Competitiveness Indicators
4/ Based on NIA data.
5/ Includes local governments and hospitals.
6/ Gross national saving does not equal the sum of gross domestic investment and net foreign investment because of statistical discrepancy.