February 2003
IMF Country Report No. 03/33

Canada: 2003 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 Article IV consultation with Canada, the following documents have been released and are included in this package:

- the staff report for the 2003 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **November 14, 2002,** 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 January 9, 2003.** 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 **January 31, 2003** updating information on recent developments.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its January 31, 2003 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

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

CANADA

Staff Report for the 2003 Article IV Consultation

Prepared by the Staff Representatives for the
2003 Consultation with Canada

Approved by Charles Collyns and G. Russell Kincaid

January 9, 2003

- Discussions for the 2003 Article IV consultation with Canada took place in October–November 2002. During visits to Ottawa, Edmonton, and Toronto, the mission met with Bank of Canada Governor Dodge and Deputy Finance Minister Lynch; officials from Finance Canada, the Bank of Canada, the Office of the Superintendent of Financial Institutions, Health Canada, Human Resources Canada, the provinces of Alberta and Ontario, and the Ontario Securities Commission; and the major banks, the Toronto Stock Exchange, and the Canadian Labour Congress.

- The team comprised C. Towe (head), P. De Masi, M. Kaufman, R. Cardarelli, and I. Ivaschenko. Mr. Collyns participated in the policy discussions in Ottawa. Mr. Vermaeten (Advisor to the Executive Director) also attended the discussions.

- The staff report for the 2002 Article IV consultation was considered by the Executive Board on February 4, 2002 and was subsequently released as IMF Country Report No. 02/50.

- At the conclusion of the 2002 consultation, Executive Directors noted that Canada's strong policy framework had left the economy well-positioned to weather the global economic slowdown. Directors strongly endorsed the authorities' inflation-targeting framework and suggested that there remained scope for further monetary easing if economic prospects weakened. They noted that the achievement of fiscal surpluses had provided room for supporting activity through the working of the automatic stabilizers and previously enacted tax and expenditure measures, and they endorsed the continued commitment to lowering the government debt-to-GDP ratio. Directors continued to stress the need for reforms of the Employment Insurance system, as well as for further trade liberalization.

- Canada subscribes 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 process and for the purposes of ongoing surveillance. A Statistics ROSC mission is scheduled for January 2003.

- A summary of the results of the 2002 Fiscal ROSC and the 2000 FSSA is contained in Appendix I.

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I. Introduction

1. ***Canada's strong policy framework has brought impressive results.*** Beginning in the early 1990s, provincial and federal governments undertook major fiscal reforms that moved the general government balance from a deficit of 9 percent of GDP to a surplus of 3 percent of GDP in 2000. During the same period, in order to cement the authorities' commitment to price stability and policy transparency, inflation targets were established, providing an effective framework for responding to cyclical developments. A broad range of structural reforms was also introduced aimed at boosting productivity growth and ensuring financial stability, including: reforms of the public pension system; trade liberalization in the context of the North American Free Trade Agreement; tax reforms; an overhaul of the unemployment insurance system; and financial sector liberalization. The strength of policy implementation has been recognized by the Fund in the context of Article IV consultations since the mid-1990s (Appendix I), and has helped yield the fastest growth among the major industrial countries over the past five years.

2. ***Indeed, the Canadian economy has proven exceptionally resilient in the face of the recent global slowdown.*** Real GDP growth in 2001 slowed only modestly, and the subsequent recovery has been more robust than in the United States and other G7 countries. Notwithstanding weaker activity domestically and abroad, the combined federal and provincial governments will still register a sizable surplus in 2002, and the external current account surplus remained large. Looking forward, the prospects are for continued favorable macroeconomic performance.

3. ***Nonetheless, a number of policy challenges remain, which were the main focus for the consultation discussions.*** These included:

- ***Uncertainties surrounding the near-term outlook***—Monetary policy will need to continue to carefully balance the downside risks to recovery against signs that economic slack is being taken up.

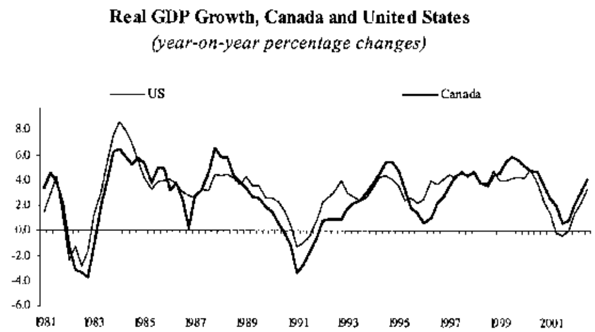
- ***Longer-term demographic pressures***—It will be important to sustain public debt reduction and to reform health care systems, in order to prepare for the fiscal consequences of population aging.

- ***Structural and other reforms***—Measures to improve labor market flexibility, to further liberalize trade, and to strengthen capital markets would help boost the economy's long-term potential and meet the challenge of an aging population.

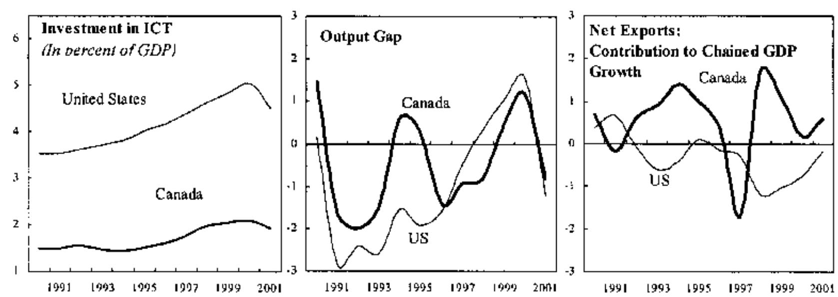
II. Recent Economic Developments

4. ***The Canadian economy slowed relatively modestly in 2001 in the face of the recent global slowdown, and has recovered strongly in 2002 (Box 1).*** Real GDP declined in only one quarter—falling by ½ percent (annual rate) in 2001Q3—and growth averaged 4 percent over the subsequent four quarters (Figure 1, Tables 1 and 2). The economy's strength

Box 1. Comparing the Canadian and U.S. Business Cycles



Canadian and U.S. GDP growth rates have been closely correlated in recent years, reflecting the close integration of the U.S. and Canadian economies. Around 85 percent of Canada's merchandise trade is with the United States. However, the Canadian economy performed surprisingly better than the United States in the most recent downturn, experiencing a shallower downturn and a stronger recovery. Several factors help explain these developments:



- ***Canada exhibited a more modest hi-tech investment boom and bust.*** With the lower share of the ICT sector in its economy, Canada has suffered less from the problem of excess capacity in ICT sectors than the United States.
- ***The Canadian economy did not reach the same level of excess demand.*** Although the Canadian economy exceeded its estimated potential in 2000, the output gap was smaller and shorter-lived than in the United States.
- ***Net foreign demand provided support in the downturn.*** Net exports from Canada continued to provide a positive contribution to GDP growth throughout the downturn, reflecting the effects of the weaker Canadian dollar, recoveries in Asia, and strong household demand from the United States. By contrast, net exports represented a drag on U.S. growth, partly in response to the strong U.S. dollar.

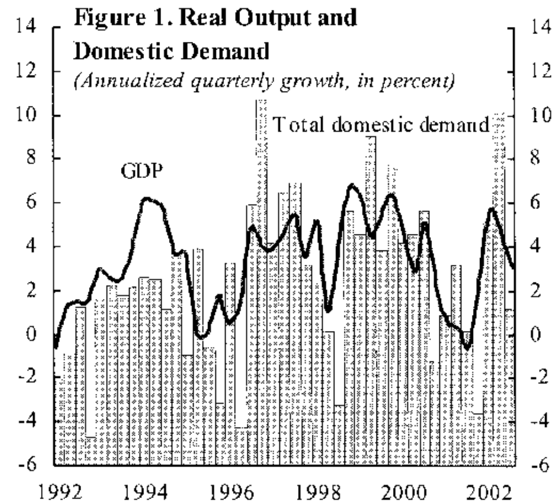
To what extent can Canada continue to outpace the United States, given the historical strength of trade and financial ties? The tabulation at the right illustrates the close correlation between both the real and financial sectors of the two economies. Not only does U.S. GDP growth tend to lead Canadian GDP growth, but the U.S. stock market, yield curve, and credit spread also tend to lead similar financial variables in Canada. Given the importance of these financial variables as indicators for Canadian GDP growth, the recent deterioration of U.S. financial markets suggests a risk for the Canadian economy going forward.

Canada-U.S. Cross Correlation 1/

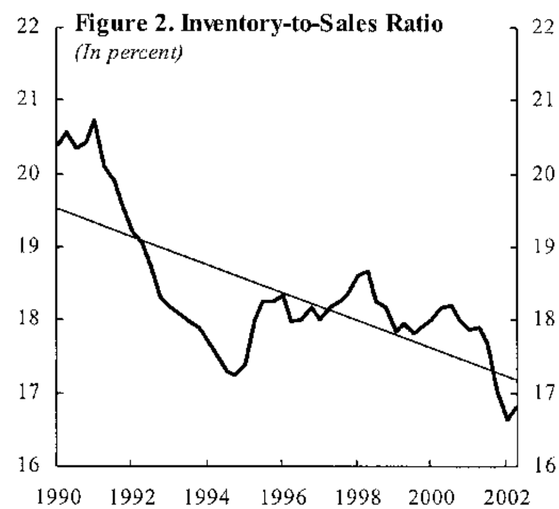
Lags	Real GDP Growth	Real Equity Return	Yield Curve	Credit Spread
0	0.65	0.84	0.72	0.51
1	0.58	0.32	0.61	0.47
2	0.32	0.11	0.46	0.40
3	0.27	-0.01	0.33	0.28

1/ Correlations are for quarterly data covering the period 1981:Q1–2002:Q3. The first column includes the correlation between real GDP growth in the United States and Canada, the second column contains correlations between Canada-U.S. stock market returns, etc. Real GDP change and real equity returns are in quarter-on-quarter percent. The yield curve and corporate bond spreads are in basis points.

compared with the United States—Canada's major trading partner—has reflected a number of factors: a relatively modest investment boom prior to the downturn and the smaller size of the information and communication technology (ICT) sector; robust consumer spending in response to sustained growth in labor income and employment; a depreciated Canadian dollar, which boosted competitiveness and spurred net exports; and timely monetary and fiscal stimulus.

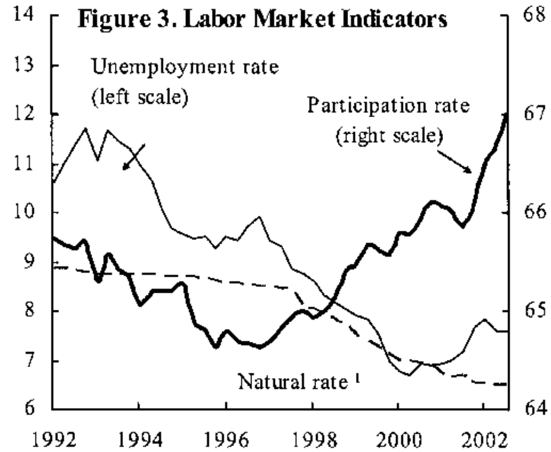


5. ***As in many other countries, business investment and inventory adjustments led the slowdown and subsequent recovery.*** Business investment, which had picked up in the latter half of the 1990s, especially in computer and related equipment, slowed sharply in early 2000 and subsequently declined through to end-2001. The inventory-sales ratio had also risen above trend by mid-2000, and destocking acted as a considerable drag on activity in the latter half of 2000 and in 2001 as a whole (Figure 2). In the first three quarters of 2002, however, inventory adjustments had been largely completed and business fixed investment rebounded strongly in response to lower interest rates, improved profits, and relatively comfortable corporate balance sheets (Table 3).[1]

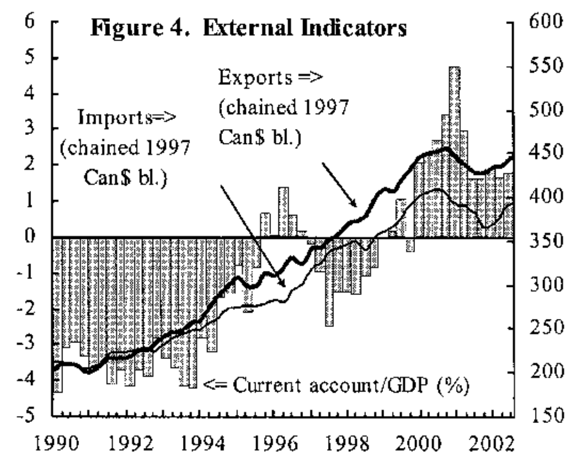


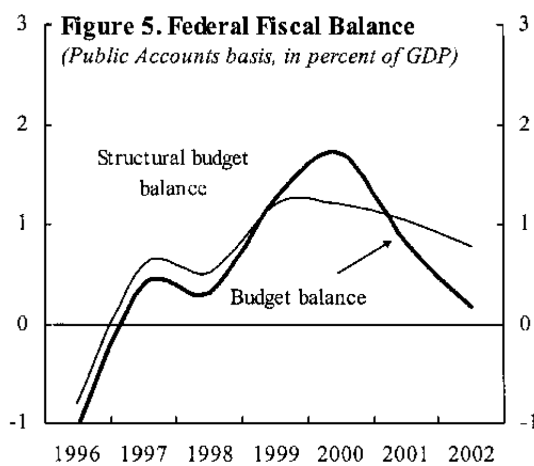
6. ***Household consumption and residential investment have remained relatively robust.*** Consumption growth eased to average 2¾ percent in 2000 and 2001, and continued at a solid pace during the first three quarters of 2002, despite decelerating in the third quarter. Residential construction—which had been stagnant during the mid-1990s—began to strengthen in 2000 in response to lower interest rates and pent-up demand, and accelerated further in late 2001 and into 2002. Gains in real estate prices helped mitigate the impact of stock market declines on household net worth—which remained high at 484 percent of disposable income (Table 3).

[1] The favorable performance of small and medium-sized firms, and low interest rates, have kept corporate balance sheets relatively healthy. Although corporate debt has increased as a share of GDP, corporate debt-to-equity ratios trended downward during the 1990s and stood at around 70 percent in early 2002. Moreover, while the dollar value of bankruptcies has increased, the number remains low.



¹Staff estimate.





7. ***Favorable labor market conditions and productivity growth have helped to support household and business demand (Figure 3).*** Employment rose by 2¼ percent during the first 11 months of 2002, after remaining broadly unchanged during 2001, and average weekly earnings also registered strong gains. However, the unemployment rate—which had fallen to a three-decade low of 6¾ percent in mid-2000—rose to 8 percent by December 2001 and remained at 7½ percent in November 2002, as a sharp increase in the participation rate helped offset the rapid employment growth. With labor productivity growth outstripping increases in labor compensation, unit labor costs fell during the four quarters ending in 2002 Q3 and profits have rebounded strongly.

8. ***Net external demand also remained supportive in 2001, but less so in 2002 (Figure 4).*** Although export volumes fell sharply in 2001, the reduction was more than offset by the decline in imports, particularly for industrial goods and machinery. Exports began to recover in early 2002, but the increase was again more than matched by a rebound in imports, in this case reflecting imports of both consumer and investment goods. Thus, the current account surplus fell to under 2 percent in the first three quarters of 2002, from 2¾ percent of GDP in 2001, despite an improvement in the terms of trade as world commodity prices firmed (Table 3). Nonetheless, continued surpluses have brought Canada's net foreign liability position to just under 19 percent of GDP by end–2001, half the level of the mid-1990s.

9. ***Fiscal policy cushioned the effects of the slowdown, through the working of the automatic stabilizers, as well as some discretionary measures (Figure 5 and Table 5).*** The federal fiscal surplus (public accounts basis) fell from 1¾ percent of GDP in FY 2000/01 to over ¾ percent of GDP in FY 2001/02

(the budget year begins April 1). A large component of the decline was attributable to cyclical effects, but discretionary measures included cuts in personal and corporate income tax rates announced in October 2000 and spending increases (totaling ¼ percent of GDP) introduced in the December 2001 budget.[2] The provinces' fiscal position also shifted from a surplus of 1 percent of GDP in 2000 to an estimated deficit of ¼ percent of GDP in 2002, reflecting the impact of the economic slowdown. As a result, the general government surplus declined to an estimated ¾ percent of GDP (national accounts basis) in 2002, from over 3 percent in 2000.

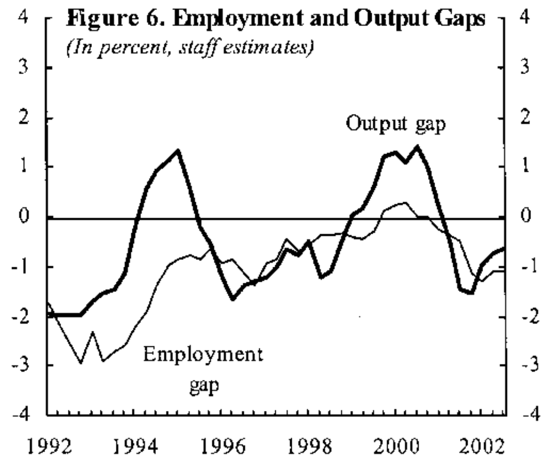


Figure 6. Employment and Output Gaps
(In percent, staff estimates)

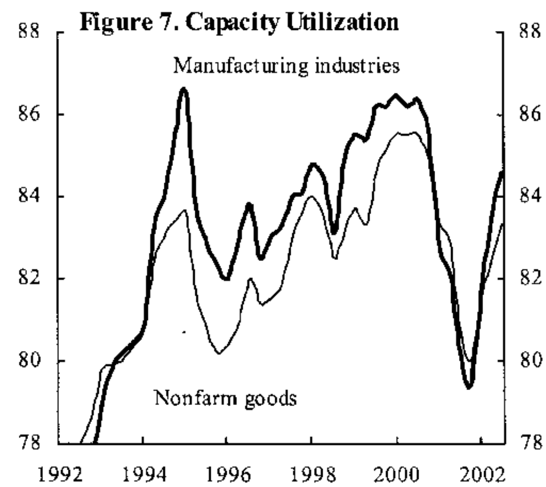


Figure 7. Capacity Utilization

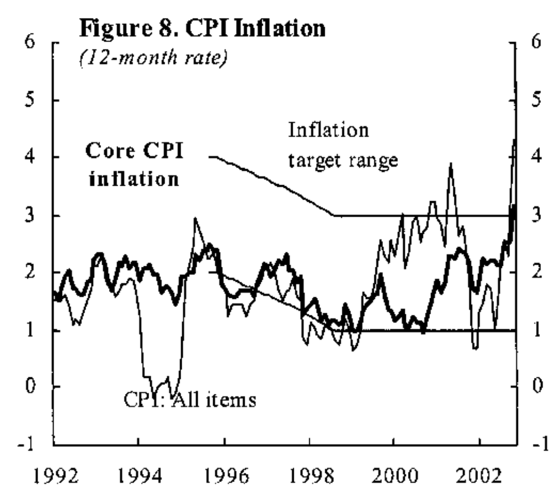


Figure 8. CPI Inflation
(12-month rate)

10. ***The rebound in activity is bringing the economy back toward potential (Figures 6 and 7).*** Staff estimates—which are consistent with those of the Bank of Canada—suggest that the excess supply gap narrowed from around 1½ percent of potential output at the end of 2001 to about ½ percent in mid-2002. However, considerable uncertainty surrounds such estimates. While the capacity utilization rate has also increased significantly, it remains well below the levels of late 1999, when output was considered at potential, and the unemployment rate remains above most estimates of the natural rate (Box 2).

11. ***Inflation has picked up over the past year* (Figure 8).** Headline inflation breached the Bank of Canada's 1–3 percent target range, reaching 4¼ percent on a 12-month basis in November. The Bank of Canada's measure of core CPI inflation has also increased, rising to just over 3 percent in November from an average of 2 percent in 2001. The pickup has reflected a number of special factors, including the base

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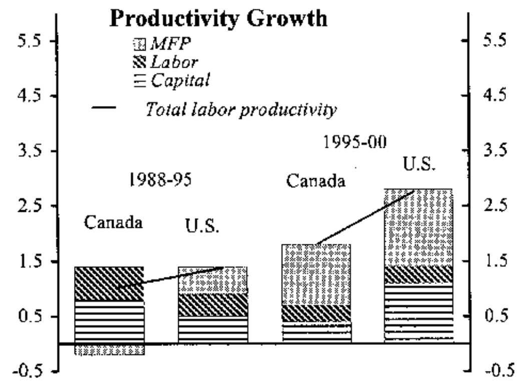
[2] The budget is normally presented in February, but was advanced owing to the lack of a formal budget presentation in the previous year. The 2001 Budget covered the remainder of 2001/02 and 2002/03–2003/04.

Box 2. Labor Productivity and the Structural Unemployment Rate

Considerable uncertainty surrounds assessments of recent and prospective Canadian productivity growth and measures of the structural rate of unemployment. These uncertainties—which have important implications for longer- and shorter-term macroeconomic and structural policies—have been heightened by the marked differences between the recent performance of the U.S. and Canadian economies.

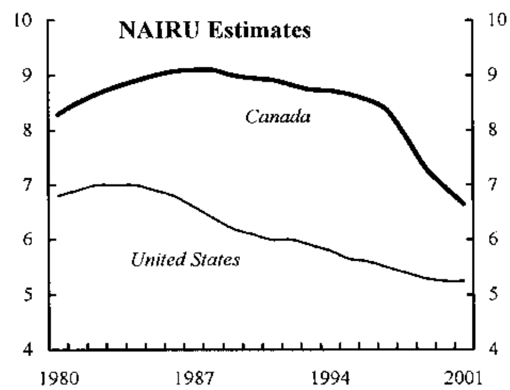
In particular, although Canadian labor productivity accelerated in the late 1990s, the Canada-U.S. productivity gap widened, largely owing to differences in the rate of capital accumulation.

- During the 1988–1995 period, annual labor productivity growth in Canada was roughly ¼ percentage point below that in the United States. More rapid rates of capital investment and improvements in the quality of labor inputs were more than offset by substantially weaker growth of multi-factor productivity (MFP), which proxies for technological and other efficiency gains.
- Since the mid-1990s, Canadian productivity growth accelerated, but lagged that in the United States by an even greater margin. However, in this latter period the difference mostly reflected stronger rates of U.S. capital accumulation, and MFP growth in Canada surged to close to the U.S. rate.



- Perhaps more significantly, sectoral data suggest that MFP growth in Canada has been broad-based, while recent studies have shown that most of the MFP growth in the United States occurred in ICT industries.

The difference between the U.S. and Canadian structural rates of unemployment has also remained significant. Although most estimates suggest that the structural rate in Canada declined markedly during the 1990s, reaching a level of around 6½ percent in 2001, it remained over 1 percentage point above the U.S. rate.[1] Possible explanations for the gap include:



- Despite the reforms since the mid-1990s, the Canadian employment insurance system remains relatively more generous than in the United States.
- The decline in the U.S. structural unemployment rate has been argued to reflect the lagged response of wage demands to the surge in productivity growth. The Canada/U.S. productivity gap, therefore, may have also contributed to a structural unemployment rate gap.
- Other structural factors may also have played a role, including the higher participation rate in Canada of demographic groups that tend to have higher unemployment rates—e.g., younger and female workers—and the greater role of temporary help agencies in the United States.

These developments leave estimates of Canada's potential growth rate and the output gap highly uncertain. There would seem considerable room for productivity growth and structural unemployment rates in Canada to converge to U.S. rates and, if so, the challenge would be to ensure that structural and other policies are supportive of this process. However, to the extent that this process is protracted, or that recent U.S. developments cannot be sustained, a more cautious macroeconomic policy stance may be required.

[1] A. Sharpe and T. Sargent, 2000, "Structural Aspects of Unemployment in Canada," *Canadian Public Policy.*

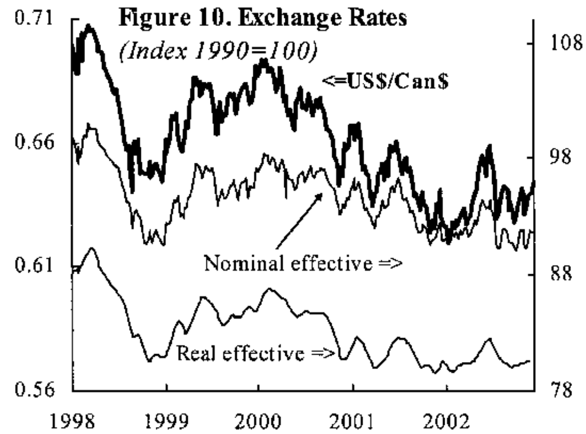
effect of discounting in the wake of the September 11th attacks, the effect of deregulation of electricity prices, automobile insurance price hikes, and tobacco price increases. Inflation expectations, nevertheless, appear to remain well anchored—the spread between nominal and inflation-indexed bonds has narrowed to close to 2 percentage points and private sector consensus forecasts are for inflation to return to 2 percent by 2004.

12. ***The Bank of Canada began to withdraw monetary stimulus in early 2002 but has paused since July.*** During April–July, the Bank raised its target overnight rate by a cumulative 75 basis points, to 2¾ percent, citing the need to act preemptively given the narrowing of the output gap. However, at its three meetings since July, the Bank's Governing Council left the target rate unchanged, stating that, while further reductions in monetary stimulus would eventually be required, weaker near-term prospects for the U.S. and global economy and the unsettled circumstances in global financial markets argued for a pause.

Figure 9. Interest Rate Differentials
(In basis points, Canada minus the U.S.)

13. ***Despite a favorable macroeconomic performance, capital outflows and the strength of the U.S. currency have contributed to continued weakness of the Canadian dollar (Figures 9 and 10).*** Large current account surpluses were mirrored by net portfolio outflows, reflecting the effects of an easing of restrictions on investment by retirement funds in non-Canadian assets, as well as the world-wide appetite for U.S. equities. The dollar reached historical lows against the U.S. currency in January 2002, and has stayed close to these levels despite the recent widening of interest rate differentials. In real effective terms, the Canadian dollar remains roughly 5 percent below its average of the mid-1990s, and undervalued relative to levels suggested by medium-term fundamentals.[3]

Figure 10. Exchange Rates
(Index 1990=100)



[3] CGER calculations based on July 2002 exchange rates put the medium-term equilibrium saving-investment balance at -1.7 percent of GDP, compared with the WEO projection of a current account surplus of nearly 3 percent of GDP, suggesting an undervaluation of 10 percent or more on a multilateral basis.

14. ***Canadian stock prices also fell sharply from their peak in late-2000, but real estate prices have been buoyant (Figure 11).*** Following the collapse of the U.S. equity price bubble, Canadian stock prices fell by over 30 percent between September 2000 to end-2001. The broad TSX composite index fell a further 25 percent during the first nine months of 2002, before recovering somewhat in October and November. Recent stock market declines seemed to have stemmed in large part from spillovers from the weakening of investor sentiment in the United States following Enron's collapse and subsequent corporate scandals, and the weaker outlook for the telecom sector. Despite the absence of major accounting scandals in Canada, the market valuation of a number of prominent hi-tech companies was particularly hard hit. However, residential real estate prices have firmed—the national average of new home prices rose by nearly 5 percent in September from a year ago, but still remained below its 1990 peak.

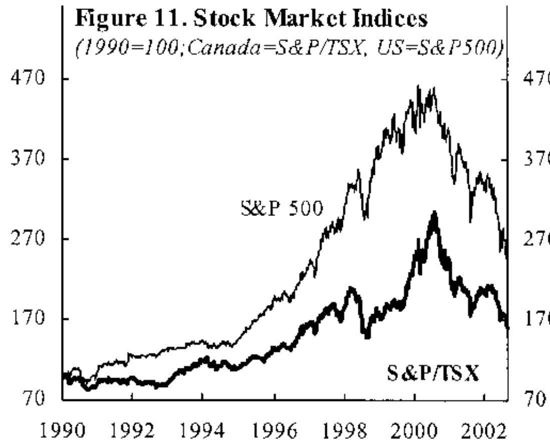


Figure 11. Stock Market Indices
(1990=100; Canada=S&P/TSX, US=S&P500)

15. ***Bank balance sheets have weakened somewhat with the recent slowdown.*** In the face of a deterioration in asset quality, mainly reflecting banks' exposures to the telecom and U.S. corporate sectors, loan-loss provisions have been boosted significantly—by 80 percent in 2002 Q3 (four-quarter rate). Higher provisions, as well as the poor performance of investment banking and asset management business lines, have lowered bank profits (Figure 12 and Table 3).[4] However, lower funding costs and the solid performance of banks' retail business have kept profits still well above the previous cyclical low. Moreover, despite an increase in the loan-loss rate, this ratio remains low and the system's capital adequacy ratio rose further to 12½ percent by mid-2002, well above the regulatory benchmark of 10 percent.

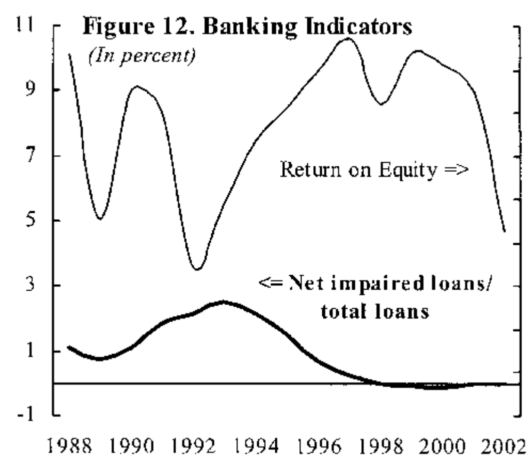


Figure 12. Banking Indicators
(In percent)

III. Outlook

16. ***The staff projects real GDP growth to moderate from 3¼ percent in 2002 to 3 percent in 2003 (Table 6).*** Household spending and a continued recovery of business fixed investment are expected to support final domestic demand, but the completion of inventory

[4] Banks account for about 70 percent of total domestic assets held by the financial services sector in Canada. The six major domestic banks account for over 90 percent of banking sector assets.

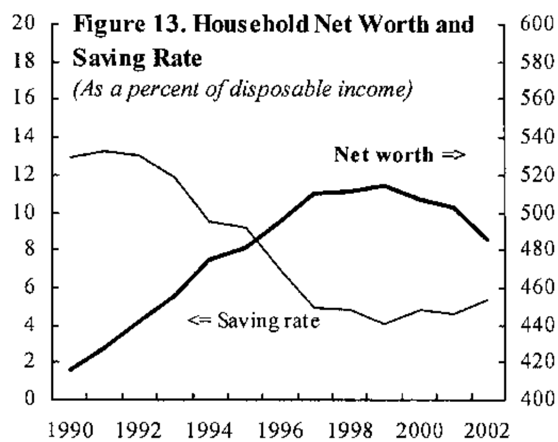
adjustments and softer net external demand are projected to weigh on overall GDP growth through to mid-2003. With external demand expected to recover and an anticipated acceleration of business investment, GDP growth would then begin to pick up, closing the excess supply gap by early 2004. As one-off factors dissipate, inflation would settle back to around 2 percent by 2004. Modest gains in world commodity prices and gradual recoveries abroad are expected to leave the current account surplus around 3 percent of GDP. Fiscal surpluses would be maintained, reflecting existing policy commitments.

17. ***Officials at the Department of Finance and the Bank of Canada broadly concurred with the staff's growth projections, and discussions centered on the potential risks.*** Officials viewed domestic vulnerabilities as relatively modest, and emphasized that the key uncertainties were with regard to the underlying strength of the U.S. recovery and financial market headwinds:

- ***External risks:*** Staff and officials agreed that the Canadian economy was unlikely to continue to outpace the United States by such a margin and was vulnerable to a U.S. slowdown, especially since exports to the United States were roughly 30 percent of GDP. Moreover, the threat of war in the Middle East, broader geopolitical risks, and the possibility of a spike in oil prices also weighed on the outlook, although the latter concern was mitigated by the fact that Canada is a small net exporter of oil and gas products.[5]

- ***Household balance sheet vulnerabilities***: Officials and market participants discounted risks related to household balance sheets. Although the personal saving rate—at around 5 percent of disposable income—was close to historical lows, it remained broadly in line with household net worth (Figure 13). Despite strong growth in household debt, debt service ratios also were comfortable and delinquency rates were below previous cyclical peaks. Although housing prices had risen strongly during the past year, this partly reflected a recovery from the sharp declines in the early 1990s and prices did not appear out of line with longer-term income and demographic trends.

Figure 13. Household Net Worth and Saving Rate
(As a percent of disposable income)



[5] Simulations of the Oxford Economic Forecasting Model suggest that a ½ percent reduction in U.S. output would lower Canada's GDP by ¼ percent, and a 10 percent oil price shock would lower GDP by 0.1 percent, after six quarters. Interest rate and exchange rate movements could provide an offset: a 10 percent depreciation would raise GDP by 1¼ percent, and a 50 basis point interest rate cut would raise GDP by nearly ½ percent.

- ***Business investment and financial headwinds:*** Officials viewed corporate balance sheets as relatively sound. With the exception of the ICT sector, which represented a smaller share of the economy than in the United States, profits had remained at high levels and debt levels were manageable. However, prospects for the North American auto sector were a concern, given signs of overcapacity, and the broader climate for business investment had been clouded by increased risk aversion in financial markets and weaker business confidence. This seemed to partly reflect spillovers from U.S. financial markets; the recent announcement by some major banks of large loan losses and restructurings involving a reduction in corporate lending; and concern in the oil and gas sector regarding the costs of implementing the Kyoto Protocol.

18. ***Assessments of the longer-term outlook hinge on Canada's underlying potential output growth.*** Bank of Canada estimates suggested that Canada's potential output growth was around 2¾–3 percent, and that productivity growth had lagged that in the United States mainly owing to a more modest investment rate, the smaller size of the ICT sector, and the greater prevalence of smaller firms in Canada (see Box 2). Indeed, the slower rate of technology diffusion among small- and medium-sized firms—which were more prevalent in Canada than the United States—meant there was possible upside risk to both the current level and the future rate of growth of Canadian productivity. Officials agreed that these estimates had important implications for both shorter-term monetary policies and assessments of the longer-term fiscal outlook.

IV. Monetary Policy and the Exchange Rate

19. ***Discussions with the Bank of Canada centered on the factors that led to the recent pause in interest rate hikes and the risks to the outlook for inflation and growth.*** Bank officials noted that the decision to raise the target for the overnight rate three times between April and July—by a cumulative 75 basis points—had reflected signs that the output gap was closing rapidly, a recognition that monetary conditions were highly accommodative, and the need to act preemptively to avoid a buildup of inflation pressures given the usual transmission lags. However, by mid-year, there was growing concern that the weaker U.S. and global economies, geopolitical risks, and financial market developments would soon dampen aggregate demand. As a result, the Bank held off further tightening at its subsequent fixed announcement dates, while also announcing a downward revision to its growth projection.[6]

20. ***Bank of Canada officials acknowledged that policies were seeking to maintain a delicate balance between the threat of inflation and the potential risks to the recovery.*** The mission observed, in particular, that with the Bank's estimate of the output gap close to zero, core inflation rising above the mid-point of the 1–3 percent target range, and real interest

[6] The October Monetary Policy Report suggested that growth would average slightly less than 3 percent through to the middle of 2003, and that the output gap would close only in the second half of 2003.

rates still very accommodative, further increases in interest rates would normally have been warranted. Officials acknowledged this concern but responded that the more uncertain global outlook and several other factors had argued for a more cautious approach to withdrawing stimulus. For example, several indicators—including the unemployment rate and wage pressures—suggested that economic slack was larger than indicated by the Bank's standard measure of potential output. The apparent emergence of financial market headwinds also meant that the current setting of interest rates was likely to be less stimulative than otherwise. Moreover, the recent pickup in inflation also appeared to have largely reflected temporary factors, which were expected to dissipate soon, and inflation expectations still seemed well anchored. Officials saw little sign of pass through of the Canadian dollar's weakness to consumer prices, possibly reflecting the offsetting effects of restructuring in the retail sector on productivity and margins.

21. ***Nonetheless, the team and authorities agreed that further interest rate hikes would eventually be necessary.*** Indeed, the Bank officials emphasized that they were ready to act decisively if needed to avoid price pressures becoming embedded in expectations. They also did not view the recent cut in U.S. interest rates as limiting their room to maneuver, given the flexible exchange rate system and the overarching commitment to domestic price stability.

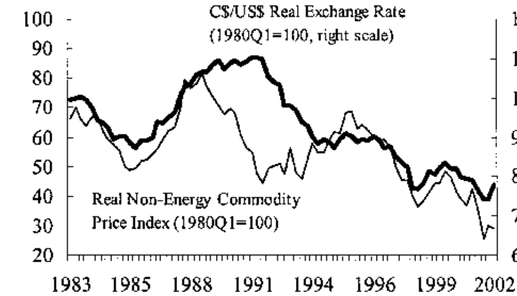
22. ***Bank of Canada officials expressed broad satisfaction with the monetary policy framework.*** Although they acknowledged that the new index of core inflation that had been introduced last year had suffered unexpectedly from the volatility of electricity prices, they felt that it would be premature to amend the series so soon after its introduction. Officials noted that the increased emphasis that had been placed on achieving the mid-point of the inflation target band upon its renewal in May 2001 had improved transparency, while still leaving sufficient flexibility to respond to the cycle. The establishment of a fixed schedule for interest rate policy announcements in 2001 had also been effective in improving market stability and policy transparency. In response to the mission's query whether there was scope to provide further information on the analysis underlying monetary policy decisions, officials noted that considerable information was already provided in the Monetary Policy Report and, in their view, including detailed macroeconomic forecasts could lead to an undue emphasis by markets on the projections, including for interest rates. However, they noted that the Bank had decided to publish a semi-annual review of financial system developments beginning in December 2002.

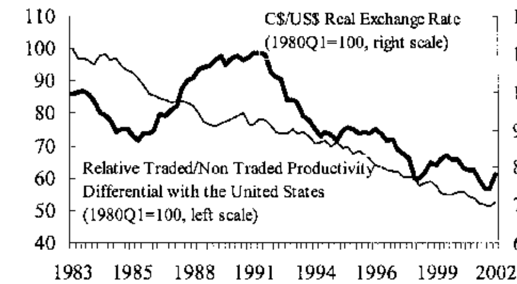
23. ***Bank of Canada officials agreed that the continued weakness of the Canadian dollar was difficult to explain, given Canada's strong fundamentals (Box 3).*** However, they suggested that the downward trend in non-energy commodity prices, as well as the global appetite for investing in U.S. assets, appeared to have played an important role. The team and Bank officials agreed that the Canadian dollar was likely to strengthen over the medium term, especially given Canada's large current account surplus and the continued decline in Canada's net international liability position that this implied.

24. ***The popular debate over a possible monetary union with the United States seems to have waned recently.*** The authorities and staff agreed that the flexible exchange rate system

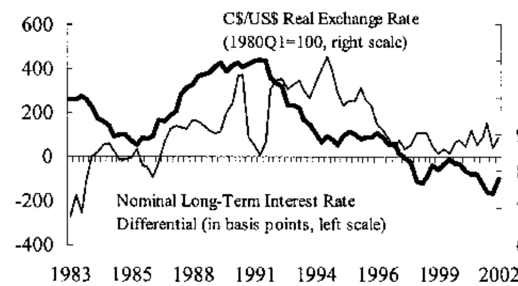
Box 3. The Canadian Dollar

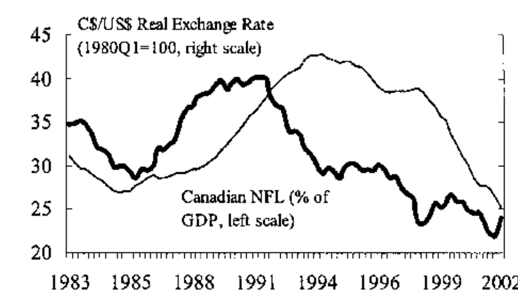
The Canadian dollar has steadily lost ground against the U.S. dollar for almost a decade, reaching an unprecedented low of US$0.62/Can$ in January 2002 and recovering only modestly since then. More recently this has reflected U.S. dollar-specific factors, as the Canadian dollar has appreciated slightly against other major currencies since the mid-1990s. Nevertheless, the weakness of the Canadian-U.S. exchange rate has puzzled many observers, especially given Canada's strong growth performance, favorable interest rate differentials, fiscal consolidation, low inflation, and improved current account position. Although institutional and other factors—including the relaxation of restrictions on foreign investment of pension savings—have been offered as explanations, other important factors may include:





Commodity prices: A significant statistical relationship exists in the long run between the Canadian dollar's exchange rate and non-energy commodity prices, which have weakened in recent years.[1] This is consistent with the view that the Canadian dollar is still largely a "commodity currency" as is the case for other commodity exporters such as Australia and New Zealand, whose currencies are heavily influenced by commodity price shocks. However, commodities represent a declining share of Canadian merchandise exports—30 percent in 2002 versus 55 percent in 1970. Moreover, regression analysis in which commodity prices and real exchange rates are assumed to be stationary, or to exhibit separate trends, leave open the question whether commodity prices are the main driver of the real exchange rate.[2]





Productivity differentials: The relative strength of U.S. versus Canadian productivity growth has also been cited in explaining the Canadian dollar's trend decline. However, this view is not easily supported by econometric analysis, possibly reflecting the statistical problems inherent in estimating productivity gaps, or that the causality may work at least partly in the opposite direction. For example, some research suggests that a weaker exchange rate may have contributed to lower productivity growth, by increasing the cost of imported capital goods and new technologies, and by shielding producers from foreign competition.[3]

Net foreign indebtedness: An alternative explanation may center on the large buildup of net foreign liabilities (NFL) by Canada in the early 1990s. Although the dollar's short-term movements do not appear linked to the NFL position, regression analysis has shown a long-term relationship.[4]

[1] The Bank of Canada relies on this equation for its internal forecasting exercise.
[2] K. Rogoff, and Y. Chen, 2002, "Commodity Currencies and Empirical Exchange Rate Puzzles," IMF Working Paper No. 02/07.
[3] R. Harris 2000, "Is there a Case for Exchange Rate Induced Productivity Changes?" Bank of Canada.
[4] M. Cerisola, P. Swagel, and A. Keenan, 1999, "The Behavior of the Canadian Dollar," in IMF Country Report No. 99/14.

continued to serve Canada well, and Bank of Canada officials observed that the recent experience had underlined the helpful role that exchange rate flexibility had played in offsetting the effects of the recent slowdown and weakness in commodity prices. The Bank's view remained that considerably greater integration of North American labor markets, as well as deeper integration of the markets for goods and services, would be necessary for the economic benefits of monetary union to outweigh the costs.

V. Fiscal Policy

25. ***Fiscal policies in Canada have effectively balanced the long-standing commitment to debt reduction against the need to support economic activity (Box 4).*** The surpluses achieved during the 1990s had created room for comprehensive personal and corporate tax reforms in 2000, which significantly lowered personal and business taxes and provided a fortuitously timed boost to demand. As the economy slowed, the December 2001 budget introduced modest additional stimulus—including increases in security-related outlays in the aftermath of the September 11th attacks. Nonetheless, a budget surplus of over ¾ percent of GDP was still achieved in 2001/02.[7]

26. ***The government's October fiscal update re-affirmed the commitment to fiscal prudence and continued debt reduction.*** Accordingly, the $3 billion annual Contingency Reserve—which had been reduced last December in the face of the weaker economic outlook—was restored for 2002/03.[8] This implied a surplus of at least that amount for the current fiscal year, notwithstanding post-budget measures (including assistance for the agricultural and softwood lumber sectors). Fiscal projections presented at the same time pointed to modest planning surpluses—i.e., surpluses after taking into account the economic prudence and contingency factors—of just over $3 billion (¼ percent of GDP) in the following two fiscal years. Thereafter, planning surpluses were projected to rise to just over 1 percent of GDP by 2007/08, as the effects of the recent slowdown and tax cuts had worked their way through, existing programs expired, and debt was paid down.

27. ***The team commended the authorities' sound fiscal management, but noted that important challenges remained.***

- In the near term, the team noted that the September 2002 Throne Speech had signaled a number of new priorities—including in the area of health care reform, social assistance, ratification of the Kyoto Protocol, as well as defense and infrastructure spending—all of which could have significant budgetary costs. However, the October fiscal projections had illustrated there was limited room to accommodate new

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[7] The better-than-expected fiscal outcome stemmed mainly from lower-than-budgeted direct program spending and debt charges, as well as higher-than-projected personal income revenues.

[8] See Box 4 for a description of the Contingency Reserve. Appendix III illustrates the robustness of the fiscal projections to macroeconomic shocks.

Box 4. Recent Fiscal Policy and the Fiscal Framework in Canada

The **federal government's budget framework** is aimed at facilitating achievement of several key goals, which are embodied in the Department of Finance's Sustainable Development Strategy and include commitments to maintaining the debt-to-GDP ratio on a permanent downward track and to ensuring intergenerational equity. In order to achieve these goals, the following framework applies to government budgets:

- **A balanced-budget rule**: Budget projections are predicated on achieving a balanced budget. However, projections typically include a \$3 billion contingency reserve and an economic prudence factor that increases from \$1 to \$4 billion over the five-year planning horizon. These reserves are intended to guard against unforeseen economic or other budgetary shocks, and the unused portion of the contingency reserve is intended to be applied to debt reduction.

- **Use of private forecasts**: In order to enhance the transparency and credibility of the budget process, macroeconomic and fiscal projections are based on an average of private sector forecasts, rather than official projections.

- **Short-term budget horizon**: Two-year rolling forecasts are used to make budgetary decisions, although five-year fiscal projections are also presented.

Consistent with these objectives and the fiscal framework, the **February 2000 Budget** and the **October 2000 Economic Statement and Budget Update** introduced a five-year tax reduction plan, which significantly lowered personal and corporate tax burdens. Measures included:

- **Personal tax cuts**: Marginal tax rates were lowered from 17 percent to 16 percent on lower incomes, and from 26 to 22 percent for middle incomes. The top 29 percent rate was reduced to 26 percent for incomes between \$60,000 and \$100,000. In addition, the deficit-reduction surtax on middle incomes was eliminated, tax thresholds were increased and re-indexed to inflation, and the Canada Child Tax Benefit was enriched.

- **Corporate tax cuts**: These included the phased reduction of the corporate income tax rate from 28 percent to 21 percent over five years and a cut in the effective tax rate on capital gains by lowering the inclusion rate from three-quarters to one-half. The lower inclusion rate applied to capital gains for both corporate and personal income taxes.

A **September 2000 agreement** between the provinces and the federal government also resulted in a federal commitment to significantly boost block payments to the provinces under the Canada Health and Social Transfer, as well as targeted assistance to provincial health care spending in the area of medical equipment, health information, and primary care.

The **December 2001 Budget** upheld the previously-announced tax reduction plan and new measures were principally geared toward addressing economic and security concerns. These included:

- **Spending increases**: Additional outlays were provided for security, health, education, infrastructure, and international assistance.

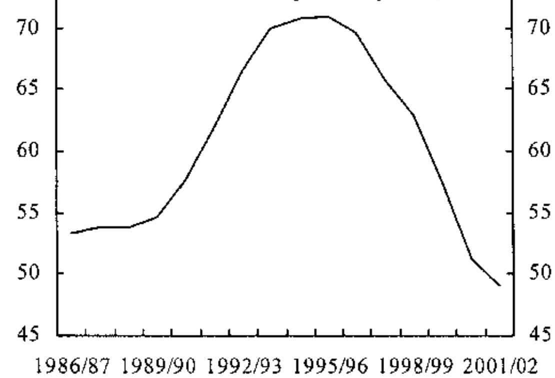
- **Limited tax measures**: The principal measure was to provide a one-time six-month deferral of tax payments for small businesses.

- **Lower reserves**: Although the budget continued to aim for a balanced budget, in view of the difficult cyclical situation it signaled a willingness to see a lower fiscal balance by eliminating the prudence factor and reducing the contingency reserve in 2001/02 through 2003/04.

initiatives in the coming two years without eroding the fiscal surplus, especially if growth was somewhat less robust than expected (Table 7).[9]

- As for the longer term, although net federal debt had already been reduced from a peak of 71 percent in the mid-1990s to 50 percent in 2002, further declines would need to be sustained in order to prepare for the fiscal pressures arising from the retirement of the baby-boom generation (Figure 14). While projected increases in the old-age dependency ratio were less severe than in other industrial countries, substantial increases in health care and other age-related spending were expected. In view of the economy's cyclical strength and the importance of preparing for longer-term demographic trends, the team cautioned against relaxing the fiscal stance in the 2003/04 budget and encouraged the introduction of reforms to ensure the longer-term sustainability of the health care system (Section VI below contains a discussion of health care reform issues).

Figure 14. Federal Government Net Debt
Public Account basis, in percent of GDP)



28. ***The authorities underscored their firm commitment to continued debt reduction and stressed that budgetary demands would be contained to fit within available resources.*** They acknowledged that the planning surpluses that were projected to arise in future years, as well as recent proposals for health care reform, had helped fuel expectations of new spending initiatives. However, the authorities were especially mindful of the uncertainties surrounding longer-term budget projections and would not take policy actions that were assumed to be funded by future surpluses. Moreover, the existing budget framework—and the broad-based social consensus on which it was built—precluded the introduction of revenue or spending measures that resulted in deficits within a two-year horizon. Therefore, in the period leading up to the February 2003 budget, emphasis had been laid on requiring departments to carefully prioritize their existing programs in order to free up as much resources as possible.

29. ***Budgetary constraints also meant that only modest tax reform measures could be considered at present.*** Although the overall tax burden remained relatively high in Canada—especially in light of recent U.S. tax cuts—under the February 2000 tax reform, corporate tax rates were already scheduled to fall by an additional 4 percentage points in the coming two years—to below U.S. levels—and considerable tax relief had also been introduced for

[9] Staff fiscal projections also show a somewhat smaller level of available fiscal resources at the end of the medium term, owing to the assumption of slower growth and less rapid decline in program spending.

households last year.[10] Thus, the emphasis would likely be on more narrowly targeted measures that had the potential for improving the overall efficiency of the system and for promoting saving and incentives to work

30. ***While recognizing the success of the present budget framework, the mission suggested that consideration be given to also adopting a more explicit long-term anchor.***[11] Further substantial reductions in the debt-to-GDP ratio—even beyond that envisaged in the October 2002 update—seemed warranted in order to avoid the burden of demographic trends falling unduly on future generations.[12] A clearer statement of the amount of debt reduction being sought over the next decade could prove useful in ensuring the achievement of this objective in the face of competing tax and expenditure priorities, including health care proposals, that might have significant long-term implications, while also facilitating a more transparent fiscal response to cyclical developments.[13]

31. ***Canadian officials saw no advantage to amending the fiscal framework at this stage.*** There already existed a strong and credible social consensus for maintaining the debt/GDP ratio on a clear, downward track. This consensus was not likely to be strengthened by opening a debate on a specific longer-term target for the ratio, especially in the absence of a well-established analytical basis for defining that objective. Moreover, the experience in Canada and elsewhere illustrated that longer-term fiscal targets were too often used to postpone, rather than strengthen, fiscal adjustment. They also argued that the existing

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[10] Although combined federal and provincial personal income tax revenues in Canada are only about 1 percentage point of GDP higher than in the United States, top marginal tax rates are in the range of 46-48 percent and apply at much lower levels of income in Canada, with the gap expected to widen with the further cuts in U.S. income tax rates that are scheduled.

[11] International examples of fiscal debt objectives include: the Maastricht Treaty, which requires member states to maintain gross debt below 60 percent of GDP; the U.K. government is committed to maintaining net debt at stable and prudent levels, presently defined as below 40 percent of GDP; New Zealand's Fiscal Responsibility Act requires the achievement of "prudent" levels of debt, which the authorities define as gross debt below 30 percent of GDP; Australia's Charter of Budget Honesty also requires the maintenance of debt at prudent levels—net debt is presently expected to be erased in four years. The 2001 Fiscal ROSC concluded that Canada met or exceeded fiscal standards, but also suggested the need for more timely data on general government fiscal operations and a more comprehensive fiscal strategy that took into account longer-term developments. See Appendix I for details.

[12] The *Selected Issues* paper addresses the question of long-term fiscal pressures in a generational accounting framework and presents simulations that suggest that fiscal solvency and intergenerational equity would require applying most of the projected planning surpluses to debt reduction in coming years.

[13] Rather than explicitly easing the fiscal stance in the face of the 2001 cyclical slowdown, the December 2001 budget continued to project budget balances to 2003/04, and reduced the "contingency reserve" by $1.5 billion in 2001/02 and eliminated the "economic prudence" factor. In addition, measures were introduced that also seemed aimed at smoothing the budget outturn, including the provision of a nine-month tax deferral to small businesses and the commitment to place the 2001/02 surplus in two new arms-length funds for infrastructure projects and aid in Africa.

framework had been applied in a wholly transparent fashion last year—the system had enabled a modest fiscal response to economic weakness while maximizing the room for monetary policy to respond to the cycle.

32. ***The provinces have substantially improved their finances since the mid-1990s.*** Most provinces operate under some form of balanced budget legislation and, although earlier surpluses and flexibility embodied in the legislative constraints left some room to maneuver in the face of the economic slowdown, some provinces have opted to delay previously announced tax cuts.[14] Officials acknowledged that British Columbia, in particular, was suffering budgetary stresses, partly related to the effects of the Canada-U.S. softwood lumber dispute on the provincial economy. There were also questions about the possible fiscal impact of Ontario's decision to roll back the deregulation of electricity prices. Looking ahead, consultations were underway for the 2004 renewal of the formulas for equalization payments to the provinces, which presently were based on the extent that a province's tax capacity fell below a benchmark level. Although some provinces were pressing for more fundamental changes—including by shifting the emphasis from tax capacity to expenditure needs—a key goal would be to simplify the system.

VI. Health Care Reform and the Public Pension System

33. ***The mission and authorities agreed that the longer-term fiscal outlook hinged critically on the health care system (Box 5).*** The system has come under strains in recent years—public dissatisfaction over the quality of service had grown, despite rapid spending increases that left the health care outlays at around 9½ percent of GDP in 2000, one of the highest ratios among the industrial countries. There was growing concern that cost pressures would intensify with population aging and technological advances. With the public sector responsible for funding roughly 70 percent of total health care outlays, and a political consensus building toward extending the range of services covered by the system, the fiscal consequences could be substantial. Reflecting concerns about the sustainability of the public system, the government announced that measures would be introduced in the February 2003 budget, following the report of a Royal Commission and consultations with the provinces.

34. ***Against this background, the mission encouraged consideration of a broad range of reform options.*** In particular, although there seemed to be a political consensus in favor of expanding the public system to cover pharmaceuticals and long-term care, the possibility of introducing fees or other mechanisms to encourage efficient use of the system by consumers seemed to be receiving little attention. Experience in other countries suggested that cost-sharing mechanisms could be designed in a way that protected the poor, while allowing a

[14] Provincial fiscal rules typically require balanced annual budgets, although in two cases, the rule is defined over a four-year period, and in a number of other cases, deficits can be offset by surpluses in previous years. A number of provinces maintain debt reduction/elimination objectives, require referenda to raise taxes, and impose penalties on legislators if targets are unmet. For details see S. Kennedy and J. Robbins, 2001, "The Role of Fiscal Rules in Determining Fiscal Performance," Department of Finance Working Paper No. 2001-16.

Box 5. The Canadian Health Care System: Key Features

The Canadian health care system—known as Medicare—provides universal, comprehensive coverage for "medically necessary" services—typically hospital in-patient and out-patient physician services. Although the system is largely funded through general tax revenues, services are primarily delivered by non-government providers that are paid on a fee-for-service basis. The key elements of the system include:

- ***Shared federal/provincial responsibilities.*** The provincial and territorial governments are responsible for health care under Canada's constitution, and each maintains separate "health insurance" plans that are operated on a non-profit basis. The federal government also plays a significant role, funding roughly 70 percent of provincial health care spending through fiscal transfers; setting national health care policies and standards; and delivering health services to specific groups such as veterans, native Canadians, and military personnel. The federal government's role is guided by the Canada Health Act of 1984, which sets out minimum standards of health care that the provinces and territories must meet in order to receive full cash contributions.

- ***Universality.*** All persons in a province or territory are covered by public health insurance. Provincial plans are required to provide comparable levels of service and coverage, which is portable across Canada.

- ***Tax financing/absence of co-payments and deductibles.*** Provincial health care programs are funded by tax revenues and federal transfers. Users do not pay premiums based on age or other factors related to potential usage. Typically, health-related services are 100 percent covered and no deductibles or co-payments are required.

- ***Public versus private administration.*** Physicians are typically self-employed or employed by hospitals. Health insurance plans are administered and operated on a non-profit basis by a public authority, and hospitals are generally also run on a not-for-profit basis.

- ***Public price setting.*** Provincial insurance plans establish the fees that medical practitioners and hospitals charge to provincial plans. Additional or separate user fees are prohibited, and under the Canada Health Act provinces permitting "extra-billing" face a reduction in transfers from the federal government.

Relative to other industrialized countries, OECD data indicate that the Canadian system scores well in terms of life expectancy, but scores less favorably in a number of other areas. For example, health expenditures reached 9¼ percent of GDP in 2000, the fifth highest in the OECD. Out-of-pocket expenses are also relatively high (since only "medically necessary" services are covered), and in-patient beds and physicians per capita are relatively low.

Is Canada spending too much on health care relative to health outcomes? Simple cross-country regressions illustrate the relationship between health expenditures as a share of GDP and key determinants including the old-age dependency ratio, life expectancy, and the share of total health expenditures by the private sector.[1] These estimates, as well as other recent studies, suggest that spending levels in Canada are considerably higher than what would be predicted by these variables.

[1] See the *Selected Issues* paper for details and further discussion.

greater role for private purchases of health care services could relieve some of the pressure on the publicly funded system.

35. ***The officials responded that there was a strong public consensus in favor of preserving the current system, and reforms were likely to be incremental.*** User fees and other incentives were viewed as unlikely to have a significant impact on demand and, more importantly, were seen as antithetical to the principle of universal access. Similarly, easing entry restrictions on for-profit hospitals and clinics would not yield significant efficiency gains, and would cause an undesirable drift toward a two-tier system that enabled wealthier individuals to obtain faster/higher-quality service. Although agreement on specific measures was still pending, they argued instead for an emphasis on other types of supply-side reforms to encourage efficient delivery of services. For example, expanding the scope of the public system to cover pharmaceuticals would help ensure cost containment, and they viewed as promising proposals that would encourage providers to give a greater emphasis on preventative primary care.

36. ***The officials noted that health care reform had significant implications for the fiscal position of the provinces and the Canadian system of fiscal federalism***. The provinces had called for significant increases in the Canada Health and Social Transfer—which was a block, per capita grant intended to support provincial health, post-secondary education, and social programs—and had also called for greater predictability regarding the future size of this transfer. Department of Finance officials acknowledged that there seemed to be a political consensus for increasing the amount of government spending on health care, and for a larger amount to be provided by the federal government. A key issue, however, was the manner in which these federal funds would be provided, especially given the important role they played in enforcing national health care standards. The provinces tended to prefer unconditional transfers, and the federal authorities also agreed that the shift to a block grant had worked well to encourage the provinces toward efficiencies in the delivery of services, especially compared to previous systems of shared-cost financing. At the same time, however, they also saw a role for targeting a portion of transfers to specific provincial programs that promoted efficient service delivery, and there were pressures on the federal government for a more careful accounting of how these transfers were ultimately used.

37. ***The Royal Commission on health care reform released its report in late November, subsequent to the discussions***. The report called for a permanent increase in annual transfers to the provinces of \$6.5 billion (around ¾ percent of GDP), and one-time targeted outlays on health care programs of \$8.5 billion over 2003–06. The report ruled out a role for enhanced role for private sector participation in delivering health care services, and it called for extending the coverage of the public insurance system to include home care and prescription drugs; establishing a separate health care transfer to the provinces; targeted programs to improve access, reorganize primary care delivery, and reduce wait times for diagnostic services. The federal government has pledged to act quickly to reach an agreement with the provinces on how reforms should proceed, keeping in mind fiscal constraints.

38. ***Department of Finance officials confirmed that the Canada Pension Plan (CPP) was well-positioned to meet the challenges of population aging.*** Reforms in 1997 had introduced gradual increases in contribution rates, which would reach $9.90 per $100 of insurable earnings in 2003, a level consistent with the system's longer-term solvency. Although recent stock market declines had reduced the value of CPP assets, losses were mitigated by the fact that only one-third of CPP investments were in equities. Moreover, the system was running large cash-flow surpluses and maintained conservative assumptions regarding the return on assets, so its longer-term position remained comfortable. The officials responded that they saw no need for further significant programmatic changes to the system, such as raising the normal retirement age to 65. However, they saw some scope for minor adjustments to the pension formula to ensure that the system did not unduly discourage continued labor force attachment by the elderly.

VII. Financial Sector Issues

39. ***Regulatory officials and private sector analysts expressed confidence in the soundness of the banking system.*** The officials acknowledged that Canadian banks have suffered from an erosion of asset quality during the past year—and some further worsening might still be expected—mainly reflecting exposures to the U.S. corporate sector and the weakness of the power generation, automobile, ICT, and aircraft sectors in both Canada and the United States. However, they noted that capital is high and the banks' core retail business remains profitable (Table 8). Risk management systems also involved internal controls and measures to mitigate potential future risks related to interest rate and housing price volatility and remaining exposures to Latin America. Nonetheless, officials agreed that the recent losses suffered by banks on their U.S. exposures offered lessons to both supervisors and banks on the importance of diversified loan portfolios.

40. ***The broader financial system has also fared well.*** The life insurance industry has weathered the slowdown, and has remained profitable and well capitalized; property and casualty insurers have experienced significant profitability pressures—like their peers worldwide—but this seems unlikely to pose systemic risks. The officials acknowledged that recent stock market declines have likely affected adversely the fundedness of defined-benefit pension plans in the corporate sector, but also noted that supervision of these plans fell under provincial jurisdiction and data were not available to allow a comprehensive assessment of the magnitude of possible shortfalls.[15]

41. ***The mission observed that the financial sector reforms of 2001 appear to have been implemented effectively.*** The new consumer protection agency is up and running, a framework for bank mergers has been established, and measures had been taken to encourage entry in the payments and banking systems, including by branches of foreign banks. The

[15] Although some analysts have put cumulative losses of Canadian plans at 28 percent since end-1999, much larger losses are estimated for plans in other G7 countries.

officials noted that, while some applications by new banks were close to approval, there had been relatively modest interest by potential entrants, possibly reflecting the dominant role of the existing major banks and the fact that reforms were relatively new. The officials also acknowledged that the "public interest" criterion for approval of bank mergers still needed to be clarified, and that a process had been launched to analyze this issue.[16]

42. ***The team welcomed the proactive steps taken by the Canadian authorities to strengthen corporate governance and accounting standards (Box 6).***[17] In explaining these measures, the officials commented that there had been no evidence that Canadian firms had engaged in the level of malfeasance recently uncovered in the United States. Nonetheless, the close integration of North American capital markets and the spillover to investor sentiment in Canada following the U.S. scandals had required steps to strengthen confidence and avoid major inconsistencies between the two regulatory systems. Accordingly, measures had been introduced to improve investor protection, auditor oversight, accounting standards, and corporate governance. At the same time, however, officials noted that the recent U.S. initiatives in this area (e.g., the Sarbanes-Oxley Act) were not wholly consistent with Canada's more principles-based governance and accounting frameworks. Consultations were ongoing with market participants, therefore, to explore how these new requirements would be implemented, including with a view to minimizing the regulatory burden, especially for smaller and closely held firms, which represented a relatively large proportion of companies listed on the Canadian exchanges.[18]

43. ***The mission noted the concerns that had been raised regarding the existing system of separate provincial securities regulators.*** Although the system had functioned well, some analysts had argued that it imposed an excessive regulatory burden on firms, and that a fragmented system would eventually reduce the ability of Canadian markets to attract and intermediate capital.[19] The officials responded that considerable progress had already been made toward harmonizing and coordinating provincial regulations, and the current system helped accommodate the regional heterogeneity of the Canadian business sector. Nonetheless, they acknowledged the potential advantages of a more unified and streamlined system, and a report to analyze this issue had been commissioned by the Minister of Finance. They also noted that creating a single securities market regulator would best be achieved through a consensus with the provinces.

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[16] Subsequent to the discussions, a December 2002 Senate Committee report was issued that called for easing constraints on bank mergers, including by limiting the scope for rejecting bank mergers on public interest grounds and by further reducing barriers to entry for both domestic and foreign entities.

[17] See the forthcoming *Selected Issues* paper for details.

[18] A significant number of large Canadian corporations are cross-listed on the U.S. stock exchanges and would be required to comply with U.S. accounting and corporate governance requirements.

[19] For a survey, see A. Harris, 2002, *A Symposium on Canadian Securities Regulation: Harmonization or Nationalization*, Capital Markets Institute, University of Toronto, October.

Box 6. Measures to Improve Corporate Responsibility in Canada

Recent corporate scandals in the United States have adversely affected global investor confidence, with significant spillovers to Canadian equity markets. Although no significant revelations of corporate malfeasance have occurred in Canada during the past year, regulators have taken steps to strengthen confidence in capital markets and improve the credibility of financial statements.

Audit Oversight. The new independent Canadian Public Accountability Board (CPAB), whose creation was announced in July 2002, will administer and enforce a new system of auditor oversight. The main elements of the new system include:[1]

- ***More rigorous inspection of auditors of public companies,*** including annual review of major audit firms with a report issued to the public. The cost of inspection will be borne by the industry.
- ***Tougher auditor independence rules,*** including limits on the types of consulting services provided by auditors, restrictions on financial interest on the part of auditors, and requirements for audit partner rotation.
- ***Strengthened quality control for firms auditing public companies,*** including a second partner review on every audit and consultations on sensitive and difficult issues.
- ***Audit and assurance standards*** will be overseen by a newly established independent public body, the Auditing and Assurance Standards Oversight Council (AASOC).

Accounting Standards and Disclosure. New draft guidelines by the Accounting Standards Board (AcSB) and securities regulators aim at improving the transparency of financial statements. The new guidelines require greater disclosure of significant business acquisitions, new equity compensation plans for staff, special purpose entities (SPE), and loan guarantees; prohibit selective disclosure; and shorten deadlines for annual and interim financial statements. The AcSB also has announced plans to require the expensing of stock-based compensation granted to company employees.

Corporate Governance. The Toronto Stock Exchange (TSX) has announced changes to its corporate governance guidelines. The principal changes include: measures to strengthen the boards of directors, especially the role of outside directors; enhance the "financial literacy" of audit and compensation committees; and expand the requirements for disclosure of corporate governance practices to non-corporate issuers, such as trusts and limited partnerships. The TSX's listing requirements will be amended to strengthen the independence of boards of directors and audit committees. Banking sector regulators have also strengthened corporate governance and disclosure requirements that apply specifically to financial institutions, especially in the areas of risk management oversight and the relationship between the audit committee and auditors and actuaries.

Enforcement. The Ontario government has passed new legislation that toughens penalties for corporate wrongdoing; broadens investor rights; and grants greater powers to the securities regulator, including to hold management responsible for the accuracy of financial statements. The Quebec government has amended existing legislation to toughen penalties and expand powers of the securities regulator. Other provinces are considering similar rules.

Analyst Conflict of Interest. The Investment Dealers Association of Canada has announced new conflict of interest rules for securities analysts, focusing on the full disclosure of the relationship between analysts and their employers and the firms they are making recommendation on or issuing a research report about; best practices for research; analyst compensation; and corporate governance practices ensuring analyst independence. Provincial securities commissions are currently reviewing these rules.

[1] Canada's major chartered accounting firms voluntarily agreed to implement the new requirements in October 2002. The requirements will apply to all other firms auditing public companies within three years.

44. ***The team commended the authorities for the significant progress in strengthening anti-money laundering (AML) and counter-terrorist financing (CTF) requirements.***[20] The implementation of the new AML legislation of 2001 is almost complete, which the Financial Action Task Force on Money Laundering (FATF) judges will bring Canada to full compliance with 27 out of 28 of its recommendations requiring action.[21] In addition, a number of new measures are planned for implementation in early 2003, including the reporting of large cross-border movements of currency and monetary instruments, non SWIFT international electronic fund transfers, and large cash transactions. The extension of the new AML requirements to nonfinancial institutions has progressed smoothly, although challenges have been raised by the legal profession and aboriginal businesses. The new legislation governing counter-terrorism financing has also been largely implemented, and improved cooperation and information sharing between different domestic government agencies and financial institutions has been achieved.

VIII. Structural Policies and Other Issues

45. ***The structural reforms of the past decade have been an important contributor to Canada's strong macroeconomic performance.*** Notable achievements included tax reforms adopted in 2000 that substantially lowered the tax burden on households and firms; reforms of the Employment Insurance (EI) system in 1996 that significantly reduced the disincentives to work and lowered structural unemployment; continued progress toward eliminating barriers to interprovincial trade in the context of the 1995 Agreement on Internal Trade (AIT); and the phased elimination of tariffs between Canada, the United States, and Mexico under the North American Free Trade Agreement of 1994.

46. ***The Canadian officials noted that the government continued to place an emphasis on policies to boost productivity, especially education and labor market policies.*** Despite one of the highest post-secondary education participation rates among industrial countries, enrollment in university-level science and engineering courses and adult training programs was low.[22] The resultant skills shortage—particularly in knowledge-based occupations—was expected to worsen as the baby-boom generation retired. In order to address these concerns,

[20] Canada has also ratified and implemented the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, and an OECD review confirmed that Canadian legislation met the requirements under the Convention.

[21] In the case of entities not regulated as financial institutions, Canada has adopted an approach that tailors AML regulations to the size of AML risk. With respect to money service businesses, Canada is in partial compliance with the FATF recommendation that calls on countries to take necessary measures to guard against the control or acquisition of a significant participation by criminals. Although currency exchanges are subject to the full range of AML/CTF regulations, currency exchanges are not required to be registered. Since registration is not required for money transfer businesses, Canada is also in partial compliance with one of the FATF CTF recommendations.

[22] Canada ranks 14th out of the 47 countries surveyed by the 2002 World Competitiveness Yearbook in terms of the availability of skilled labor. OECD data also suggest that a much smaller proportion of Canadian employees receive job-related skills training than in the United States or the United Kingdom.

the 2001 budget had increased financial assistance for post-secondary students and adult learners, and measures had been taken to increase the proportion of immigrants with post-secondary education to 65 percent by 2010.[23]

47. ***The mission suggested that there remained scope for further improving the efficiency of the Employment Insurance (EI) system.*** The larger benefits paid in high-unemployment regions seemed likely to discourage labor mobility, the fact that EI premiums were not experience-rated implied a subsidy to seasonal and other industries where employment was more unstable, and the use of EI premiums to fund training and other programs also boosted the overall level of payroll taxes and discouraged employment.[24] Some of these concerns had been compounded by the decision in 2000 to eliminate penalties for frequent users and extend EI benefits for new parents to up to 50 weeks.

48. ***The officials did not agree that the EI system imposed significant economic costs.*** They emphasized that the extended benefits that applied to high unemployment regions reflected a social consensus for supporting areas that were highly dependent on seasonal, resource-based employment. In their view, with the benefit cuts and the shift to an hours-based system in 1996, the EI system no longer acted as a significant impediment to labor mobility or labor market flexibility. Therefore, only modest further amendments were being considered at the present time—the emphasis continues to be on establishing a framework for setting the premium rate at a level that would balance the system's finances over the business cycle, which studies suggested would be achieved by reducing the premium rate from $2.10 in 2003 to around $1.90 per $100 of earnings.

49. ***Remaining barriers to interprovincial trade are minor.*** Efforts are underway to extend the AIT to public entities that had not been covered in the original agreement—i.e., municipalities, the academic community, school boards, health and social services. Agreements covering energy also still had to be negotiated, and there was scope to harmonize provincial transportation standards.

50. ***The Canadian trade officials reiterated their strong commitment to trade liberalization.*** As of January 2003 all products from the least developed countries became eligible for duty and quota-free entry, with the exception of over-quota dairy, poultry, and egg products. Progress had also been made in eliminating quotas on textiles and apparel ahead of the 2005 deadline under the Agreement on Textiles and Clothing. Regarding priorities for the Doha Round, Canada is seeking the complete elimination of all forms of agricultural subsidies and has proposed reductions in production and trade distorting domestic support to accepted minimum levels. Negotiators have also called for tighter

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[23] Government discussion papers released in February 2002 established a range of goals and policy measures aimed at: improving the quality of education; increasing opportunities to acquire and upgrade skills; raising the participation rates of older workers; and attracting skilled immigrants.

[24] The *Selected Issues* paper illustrates the impact of the EI system on regional income disparities.

disciplines on exemptions in the WTO Agriculture Agreement. As for anti-dumping remedies, officials noted that Canada's actions had been concentrated in a small number of sectors (e.g., footwear, agriculture, and steel), and they looked forward to seeing improved discipline over the use of these types of remedies being introduced as part of the Doha Round.

51. ***The officials expressed satisfaction with recent regional trade initiatives.*** The North American Free Trade Agreement had been highly successful, and while recent U.S. complaints in the areas of softwood lumber and grain were unfortunate, they did not detract from the broader benefits of the agreement. Officials looked forward to continued progress on the Free Trade Agreement of the Americas, which they thought had been lent further impetus by the agreement reached at the November 2002 ministerial in Quito to accommodate differences in levels of development and size of participants.

52. ***The mission raised concern with the decline in Canada's overseas development assistance (ODA) to just 0.2 percent of GNP in 2001 (Table 9).*** The officials responded that the authorities had recently committed to doubling the Canadian dollar amount of ODA by 2010, although this would still leave ODA short of the U.N. target. Funding for Africa remained a priority, and the December 2001 budget had established a vehicle—the Africa Fund—to finance projects in the region over the next five years, with an emphasis on health and education. Funds would be increasingly directed to countries according to performance-based criteria—including those based on governance—but the details were not yet developed

53. ***The government's recent commitment to ratifying the Kyoto Climate Accord has raised difficult implementation issues***. For example, officials in the province of Alberta expressed concern that meeting the Accord's emissions targets would impose a significant burden on the oil and gas sector and, given the U.S. refusal to ratify, would also place Canada at a significant competitive disadvantage. Federal government officials indicated that the draft implementation plan sought to balance these concerns through the use of a broad range of instruments, including tradable emissions permits, regulations, and incentives to invest in new technology. They acknowledged that ruling out emissions-related taxes limited the scope to minimize output losses and the fiscal cost. Nevertheless, their estimates suggested that the approach being taken would achieve significant emissions reductions by 2010, while keeping possible output losses manageable.

IX. Staff Appraisal

54. ***The Canadian economy has shown remarkable resilience in the face of the global downturn, reflecting the sound policy framework and its skillful implementation.*** Inflation targets have helped to anchor expectations and permitted a forceful injection of monetary stimulus. Fiscal consolidation and debt reduction since the mid-1990s had provided room to ease tax burdens, to allow the automatic stabilizers to work, and to introduce modest discretionary stimulus measures. The structural reforms and sound macroeconomic policies since the early 1990s have helped foster productivity gains and have laid the foundation for strong and sustained economic growth.

55. ***Despite Canada's favorable macroeconomic prospects important policy challenges remain***. The global macroeconomic environment remains highly uncertain, and the authorities will need to continue to be mindful of these shorter-term risks. At the same time, policies should remain firmly geared toward boosting Canada's long-run productive potential and preparing for the fiscal consequences of population aging.

56. ***In the face of these uncertainties, the Bank of Canada's measured approach to withdrawing monetary stimulus has been appropriate.*** Against the background of the uncertain global recovery and financial headwinds, the gradual and pragmatic approach to raising interest rates toward a more neutral level has been consistent with the forward-looking, inflation-targeting framework. Although the recent pickup in core inflation appears largely to reflect temporary factors and inflation expectations seem well anchored, monetary stimulus will need to be withdrawn further in the period ahead as economic slack is taken up. The authorities' commitment to act decisively if needed to ensure that price pressures do not become embedded into inflation expectations is welcome.

57. ***Canada's flexible exchange rate regime has been effective in cushioning the economy from external shocks.*** The depreciation has played a helpful role in offsetting the effects of world commodity price movements and in mitigating the impact of the global cyclical decline. Canada's fundamental strengths continue to favor an appreciation of its currency over the medium term.

58. ***The authorities' re-affirmation of their commitment to budget surpluses and debt reduction is commendable, especially in the face of looming demographic pressures.*** This policy approach has paid important dividends in recent years. Lower debt and debt service costs have provided room for tax cuts and enhancements to spending programs, while at the same time providing scope for a measured fiscal response to the recent downturn. Looking ahead, with the retirement of the baby-boom generation starting later this decade, rising health care costs, and the debt/GDP ratio still high, it will be important to maintain the debt/GDP ratio on a steady downward trajectory. Given the limited budgetary resources that appear to be available in the coming two years, the room for new initiatives will need to be found largely through a reprioritization of existing programs.

59. ***Reforms of the health care system will need to be consistent with longer-term fiscal constraints.*** The system has come under increasing financial strain in recent years, and pressures are likely to intensify with population aging and technological advances. Therefore, it will be important that reforms pay due attention to the cost effectiveness—as well as the equity and quality—of the system, in order to ensure that it is sustainable and consistent with federal and provincial fiscal constraints over the long run. Meeting these competing challenges will be difficult and—especially in light of pressures to extend coverage to a broader range of services—increased emphasis may need to be given to incentive-based systems that encourage efficiencies and cost containment by both providers and patients.

60. ***In many other areas, the fiscal authorities have laid a solid foundation for the future, but opportunities remain to build on past reforms to promote employment and***

productivity. Although tax burdens remain high, there does not appear room presently for further broad-based tax rate reduction. Therefore, it will be important to ensure that any more narrowly targeted tax measures that may be considered are geared toward improving incentives to work and save. Further reforms of the Employment Insurance system—such as scaling back regional-extended benefits, moving to a system of experience rating, and funding those EI programs that appear directed at broader social objectives through other revenue sources—could provide further room to lower premiums and enhance labor market flexibility. Further programmatic improvements to the CPP could also be considered in order to encourage the elderly to remain in the productive work force.

61. ***A more explicit long-term fiscal anchor could be helpful in supporting the current prudent framework for fiscal policy making.*** Thus far, the commitment to balanced budgets has been highly successful in disciplining policies on a year-to-year basis and achieving a significant pay-down of government debt. At the same time, however, substantial further reductions in the debt/GDP ratio—going beyond that projected in the November Fiscal Update—and reforms of the health care system would help ensure that the fiscal burden of demographic trends does not fall unduly on future generations. Against this background, a clearer commitment to the amount of debt reduction being sought over the next decade could provide a useful supplement to the existing framework, and help to guide decisions on tax, expenditure, and health care reform proposals that have important longer-term implications.

62. ***The provinces and territories have made substantial strides in strengthening their finances, but they too face longer-term pressures.*** Looking forward, the provinces will need to work closely with the federal authorities to implement the necessary reforms of health care systems and age-related spending programs, which could be facilitated by fiscal frameworks that take into account the longer-term pressures from population aging.

63. ***Canada's strong supervisory and prudential framework has contributed to the banking sector remaining sound in the face of the economic downturn.*** Although strains have emerged, systemic capital and risk management remain strong. Nonetheless, supervisors will need to remain vigilant to the risk of further pressure on asset quality. From a structural perspective, the authorities have shown a welcome commitment to implementing and further strengthening the anti-money laundering and counter-terrorism financing framework. A framework for bank mergers has also been established, but the criteria that would govern such decisions still need to be clarified.

64. ***The authorities have been commendably pro-active in strengthening corporate governance and preserving investor confidence.*** As in other countries, it will be important to ensure the effective application of these new standards and institutions. In Canada's case, the key challenge will be to ensure that pressures to harmonize with recent U.S. efforts in this area do not unduly erode Canada's more principles- and disclosure-based system, or impose an excessive regulatory burden, especially on smaller firms. The goals of improved corporate governance and easing regulatory costs would also be well served by moving from a system of multiple securities market regulators to a more national system.

65. ***Canada remains at the forefront in the area of trade liberalization.*** The recent announcement of an extension of duty/quota-free access to imports from the least-developed countries provides a welcome demonstration of Canada's commitment to the goal of increasing access to the poorest countries. Further liberalization, including in the areas of textile and clothing products, and "supply-managed" agricultural products, would help improve domestic efficiency and lend an important impetus to multilateral efforts, including in the context of the Doha Round, to boost development through trade.

66. ***The authorities' recent commitment to boost official development assistance (ODA) is commendable.*** However, even doubling Canada's ODA by 2010 would still leave it well short of the authorities' long-standing commitment to achieving the U.N. target of 0.7 percent of GNP and more ambitious efforts are encouraged.

67. It is recommended that the next Article IV consultation take place within the standard 12-month cycle.

Table 1. Canada: Selected Economic Indicators

(Unless otherwise indicated in percent change at annual rates)

						2001				2002		
	1997	1998	1999	2000	2001	Q1	Q2	Q3	Q4	Q1	Q2	Q3
NIPA in constant prices												
Real GDP	4.2	4.1	5.4	4.5	1.5	0.6	0.3	-0.5	2.9	5.7	4.4	3.1
Net exports 1/	-1.7	1.7	1.1	0.2	0.6	-0.2	-2.7	-0.4	6.5	0.3	-5.8	1.5
Total domestic demand	5.7	2.4	4.4	5.0	1.3	0.9	3.2	0.2	-3.6	5.2	10.2	1.2
Final domestic demand	5.4	2.8	4.3	4.0	2.5	2.7	2.3	2.1	0.3	3.7	4.4	2.0
Private consumption	4.6	2.8	3.9	3.7	2.6	3.6	1.6	-0.3	4.1	2.9	4.2	0.5
Personal saving ratio (as a percent of DI)	4.9	4.9	4.1	4.8	4.9	5.5	3.7	4.3	4.8	5.3	4.7	4.7
Public consumption	-1.0	3.2	1.9	2.3	3.3	0.1	5.7	1.9	0.9	1.7	3.3	2.8
Private fixed domestic investment	18.1	2.8	7.2	6.9	0.4	0.0	0.0	8.7	-13.9	8.1	5.8	6.2
Private investment rate (as a percent of GDP)	17.5	17.7	17.6	17.5	17.4	17.2	17.3	17.8	17.3	17.5	17.3	17.4
Public investment	-3.2	-0.7	12.7	3.0	11.5	23.9	11.4	14.1	18.5	7.1	8.3	0.7
Change in inventories 1/	0.7	-0.3	0.1	0.5	-1.5	-1.3	0.6	-2.3	-3.3	1.9	5.8	-0.3
GDP (current prices)	5.5	3.7	7.2	8.6	2.6	5.5	0.1	-5.4	-1.6	9.4	12.0	4.9
Employment and inflation												
Unemployment rate	9.1	8.3	7.6	6.8	7.2	6.9	7.0	7.2	7.7	7.8	7.6	7.6
Employment	2.3	2.7	2.8	2.6	1.1	0.6	0.8	-0.2	0.5	2.8	3.7	3.4
Labor productivity (business sector)	2.5	1.7	2.8	2.1	0.8	0.4	3.4	0.7	3.0	3.7	3.0	0.7
Unit labor costs (business sector)	2.1	2.9	-2.3	3.8	3.1	5.0	2.6	0.4	-1.1	0.4	-0.7	0.7
Consumer price index	1.6	1.0	1.8	2.7	2.5	1.6	4.7	0.2	-1.9	3.3	3.0	3.9
Core consumer price index 2/	1.9	1.3	1.4	1.2	1.4	1.8	2.3	2.4	1.8	2.1	2.2	2.4
GDP deflator	1.2	-0.4	1.7	3.9	1.0	5.0	0.0	-5.1	-4.5	3.5	7.4	1.9
Output gap (as a percent of potential output)	-0.9	-0.8	0.5	1.2	-0.8	0.3	-0.5	-1.4	-1.5	-1.0	-0.7	-0.6
Exchange rate 3/												
U.S. Cents/Canadian dollar	0.72	0.67	0.68	0.67	0.64	0.65	0.65	0.64	0.63	0.63	0.65	0.63
Percent change	-1.8	-6.8	0.6	-0.3	-4.2	-1.1	0.5	-1.6	-1.9	-0.6	3.7	-2.5
Nominal effective exchange rate	0.2	-6.0	-0.6	1.2	-3.0	-0.2	-0.1	-0.6	-2.2	-0.3	1.8	-1.7
Real effective exchange rate	2.6	-6.3	-1.1	0.0	-4.0	-0.3	-0.1	0.0	-1.4	-0.1	2.0	-1.3
Indicators of financial policies (NIA basis, as a percent of GDP)												
Federal fiscal balance	0.7	0.8	0.8	1.7	1.0	1.4	1.7	1.0	0.1	0.3	0.8	0.8
Provincial fiscal balance 4/	-0.2	-0.6	0.8	1.0	0.2	0.9	0.4	-0.2	-0.5	-0.4	-0.5	-0.4
General government	0.2	0.1	1.7	3.1	1.8	2.8	2.7	1.4	0.3	0.7	1.0	1.1
Three-month treasury bill	3.2	4.7	4.7	5.5	3.9	5.0	4.4	3.8	2.3	2.1	2.5	2.8
Ten-year government bond yield	6.1	5.3	5.6	5.9	5.5	5.4	5.8	5.5	5.2	5.5	5.5	5.1
Balance of payments												
Current account balance (as a percent of GDP)	-1.3	-1.2	0.2	2.6	2.8	4.7	3.0	1.6	1.6	1.9	1.7	1.8
Merchandise trade balance (as a percent of GDP)	2.9	2.6	4.1	5.8	5.9	7.8	6.1	4.7	4.8	4.9	4.7	4.8
Export volume	8.5	8.5	11.1	8.6	-4.1	-10.8	-7.3	-6.7	-1.2	6.5	1.6	10.3
Import volume	16.5	6.1	8.5	8.9	-5.9	-13.7	1.4	-6.2	-17.3	7.0	18.3	7.8
Invisibles balance (as a percent of GDP)	-4.2	-3.8	-3.9	-3.2	-3.1	-3.1	-3.1	-3.1	-3.2	-3.0	-3.0	-3.1
Saving and investment (as a percent of GDP)												
Gross national saving	19.6	19.1	21.0	24.0	22.4	24.3	23.2	21.7	20.4	21.1	22.3	22.4
Gross domestic investment	20.7	20.5	20.6	20.6	19.5	19.5	19.9	19.9	18.7	19.4	20.5	20.5
General government	2.2	2.1	3.7	5.2	3.9	4.7	4.7	3.6	2.5	2.9	3.2	3.4
Private	17.4	17.0	17.3	18.8	18.5	19.5	18.5	18.1	17.8	18.3	19.1	18.9
Personal	6.0	6.1	5.4	5.7	5.7	6.1	5.1	5.6	6.0	6.2	5.7	5.7
Business	11.4	10.9	11.9	13.2	12.8	13.4	13.5	12.5	11.9	12.0	13.3	13.2

Sources: Statistics Canada; and Fund staff estimates.

1/ Contribution to growth.

2/ For quarterly data, year-on-year percent change.

3/ For quarterly data, quarter-on-quarter percent change.

4/ Includes local governments and hospitals.

Table 2. Canada: Indicators of Economic Performance

	Average 1986-96	1997	1998	1999	2000	2001	Projections 2002	2003
		(Annual percent change)						
Real GDP								
Canada	2.5	4.2	4.1	5.4	4.5	1.5	3.3	3.0
United States	3.2	4.4	4.3	4.1	3.8	0.3	2.2	2.6
Japan	3.5	1.8	-1.2	0.8	2.4	-0.3	-0.5	1.1
Germany	5.2	1.4	2.0	2.0	2.9	0.6	0.5	2.0
G-7 countries	3.0	3.2	2.8	3.0	3.4	0.6	1.4	2.3
Real fixed private investment								
Canada	2.4	18.1	2.8	7.2	6.9	0.4	2.3	5.2
United States	3.7	9.6	11.4	7.8	6.1	-3.8	-3.3	3.8
Japan	3.9	5.8	-4.9	-2.6	8.7	-1.2	-5.8	3.0
Germany	...	1.5	3.1	3.9	3.0	-5.4	-5.4	1.5
G-7 countries	2.9	7.4	6.7	5.0	6.3	-2.5	-3.3	3.1
Consumer prices								
Canada	3.8	1.6	1.0	1.8	2.7	2.5	2.1	3.1
United States	1.4	2.3	1.5	2.2	3.4	2.8	1.5	2.3
Japan	2.6	1.7	0.6	-0.3	-0.8	-0.7	-1.0	-0.6
Germany	4.9	1.5	0.6	0.7	2.1	2.4	1.4	1.1
G-7 countries	3.4	2.0	1.3	1.4	2.3	2.1	1.2	1.6
Unit labor cost in manufacturing								
Canada	2.2	-1.2	1.1	-0.9	-0.7	5.5	0.7	0.5
United States	0.6	-2.2	0.4	-1.1	3.2	0.6	-0.3	0.9
Japan	1.2	-1.6	5.3	-4.0	-6.3	5.6	-0.5	-1.6
Germany	0.9	-5.5	-2.6	-0.3	-3.5	-0.7	-0.2	0.0
G-7 countries	1.3	-2.0	0.8	-1.3	-0.3	1.7	0.4	0.5
		(As a percent of labor force)						
Unemployment rate								
Canada	9.6	9.1	8.3	7.6	6.8	7.2	7.7	7.4
United States	6.4	4.9	4.5	4.2	4.0	4.8	5.9	6.3
Japan	2.5	3.4	4.1	4.7	4.7	5.0	5.5	5.6
Germany	6.6	9.6	9.1	8.4	7.8	7.8	8.3	8.3
G-7 countries	6.7	6.6	6.3	6.1	5.7	6.0	6.6	6.7
		(As a percent of GDP)						
General government revenues								
Canada	43.7	46.3	46.3	45.6	45.8	45.2	43.4	43.4
United States	27.8	29.3	29.8	30.0	30.8	29.4	27.8	27.8
Japan	31.3	30.0	29.3	29.0	29.4	29.4	29.3	29.0
Germany	45.7	46.6	46.6	47.3	47.0	45.5	45.7	45.8
G-7 countries	34.6	35.5	35.4	35.6	36.1	35.1	34.3	34.3
General government expenditures								
Canada	50.4	46.1	46.2	43.9	42.7	43.4	42.6	42.2
United States	32.3	30.6	29.8	29.4	29.3	29.6	30.4	30.6
Japan	31.8	33.8	34.9	36.0	36.7	36.5	36.5	35.1
Germany	47.7	49.3	48.8	48.8	45.9	48.3	48.6	48.0
G-7 countries	38.5	37.5	37.0	36.7	36.2	36.8	37.3	37.1
General government financial balance								
Canada	-6.7	0.2	0.1	1.7	3.1	1.8	0.8	1.2
United States	-4.6	-1.3	-0.1	0.6	1.5	-0.2	-2.6	-2.8
Japan	-0.5	-3.7	-5.5	-7.0	-7.3	-7.1	-7.2	-6.1
Germany	-2.1	-2.7	-2.2	-1.5	1.1	-2.8	-2.9	-2.2
G-7 countries	-3.9	-2.1	-1.6	-1.1	-0.1	-1.7	-3.0	-2.8
General government net debt								
Canada	68.5	85.6	81.8	75.6	65.4	61.2	57.8	53.6
United States	52.2	57.0	53.4	48.9	43.9	43.0	44.1	45.0
Japan	14.9	27.9	38.1	45.2	57.5	65.5	74.0	80.2
Germany	27.6	52.3	52.2	52.5	51.5	50.8	52.5	53.1
G-7 countries	42.6	55.2	54.8	53.2	51.6	52.0	53.8	54.7
Current account balance								
Canada	-2.9	-1.3	-1.2	0.2	2.6	2.8	1.8	2.3
United States	-1.8	-1.5	-2.3	-3.2	-4.2	-3.9	-4.6	-4.7
Japan	2.8	2.2	3.0	2.5	2.5	2.1	3.0	2.9
Germany	1.8	-0.1	-0.3	-0.9	-1.1	0.1	1.9	2.1
G-7 countries	-0.5	0.0	-0.4	-1.1	-1.7	-1.4	-1.4	-1.6

Source: Fund staff estimates. Projections for G-7 countries except Canada are from the World Economic Outlook (September 2002).

Table 3. Canada: Vulnerability Indicators

(In percent of GDP, unless otherwise indicated)

	1997	1998	1999	2000	2001	2002 1/
External indicators						
Exports (annual percentage change)	8.5	8.7	11.3	14.9	-2.4	-1.2
Imports (annual percentage change)	15.2	9.0	7.6	10.6	-2.9	0.7
Terms of trade (annual percentage change)	-0.7	-3.8	1.3	4.1	-1.5	-4.3
Current account balance	-1.3	-1.2	0.2	2.6	2.8	1.8
Capital and financial account balance	1.8	0.5	-1.3	-2.0	-1.9	-6.3
Of which: Inward portfolio investment (debt securities, etc.)	1.8	2.7	0.3	1.3	2.8	0.6
Inward foreign direct investment	1.8	3.7	3.7	9.3	3.9	3.1
Other investment liabilities (net)	4.4	0.9	-1.7	0.3	1.0	1.2
Official reserves (in billions of U.S. dollars)	18.0	23.4	28.6	32.4	34.2	37.2
Broad money (M3) to foreign exchange reserves (percent)	23.0	17.1	14.5	13.8	13.2	12.9
Central bank foreign liabilities (in billions of dollars)	0.2	0.2	0.5	0.6	0.2	0.2
Official reserves in months of imports	0.9	1.2	1.3	1.4	1.5	1.6
Net international investment position (current cost, billions of dollars)	-290.2	-299.7	-247.0	-202.5	-203.4	...
Of which: General government debt (in billions of dollars) 2/	108.8	99.6	96.3	85.4	73.2	70.9
External debt to exports ratio (in percent)	83.6	79.4	58.8	41.9	43.2	...
External interest payments to exports (in percent) 3/	17.9	16.4	15.5	14.1	13.3	12.4
Nominal effective exchange rate (percent change)	2.4	-3.7	-1.0	1.8	-1.1	-0.8
Financial markets indicators						
General government gross debt	97.5	94.3	92.5	83.3	83.2	...
Three-month Treasury bill yield (percent)	3.2	4.7	4.7	5.5	3.9	2.6
Three-month Treasury bill yield (percent; real deflated by CPI)	1.6	3.7	2.9	2.7	1.3	0.6
Change in stock market index (TSE 300, annual percentage change)	22.6	4.6	4.5	36.1	-19.5	-8.5
Banking sector risk indicators 4/						
Total loans to assets (percent)	62.1	58.4	58.7	57.7	55.8	56.0
Total loans to deposits (percent)	92.5	90.2	86.8	84.2	84.5	83.6
Share of nonperforming loans in total loans (percent)	1.4	1.3	1.2	1.3	1.5	...
Loans to the rest of the world as percent of total loans (percent) 5/	20.0	21.7	21.7	20.2	19.8	18.9
Return on total shareholders' equity (percent)	16.4	13.4	15.8	15.3	13.9	7.8
Personal sector 6/						
Net worth as a percent of disposable income	509.6	511.2	514.3	506.9	503.2	483.8
Debt as a percent of disposable income	108.7	110.4	111.8	110.8	111.7	111.9
Debt interest payments as a percent of disposable income 7/	8.3	8.5	9.4	10.5	9.2	9.4
Corporate sector						
Debt of private nonfinancial corporations as a percent of GDP 8/	49.2	51.7	50.9	49.3	51.7	51.2
Debt service as a percent of net worth 9/	10.4	15.0	15.8	19.7	17.0	11.1
Debt-to-equity ratio of nonfinancial private corporations 8/	78.8	79.0	77.6	72.4	71.3	70.3
Price-earnings ratio of TSE 300, year-to-date percent change	16.0	26.9	9.0	-2.9	-21.5	9.3

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

1/ Unless otherwise indicated data are as of third quarter of 2002. Balance of payments data have been seasonally adjusted at annual rates. Personal sector indicators are staff estimates based on quarterly flows.

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

3/ Income payments on foreign-owned assets (other private payments plus Canada government payments).

4/ Unless otherwise indicated, based on data reported by the six largest chartered Canadian banks.

5/ Data are for all chartered Canadian banks as of second quarter of 2002.

6/ Persons and unincorporated business.

7/ Comprises interest payments on mortgage and other types of consumer credit/bank loans. The five-year average residential mortgage rate and bank rate on consumer loans were used to calculate interest payments on mortgage and other consumer credit/bank loans, respectively.

8/ Based on total debt less trade payables, corporate claims, and other liabilities.

9/ The prime business loan rate is used to compute business credit interest payments.

Table 4. Canada: Balance of Payments

(In billions of Canadian dollars)

	1997	1998	1999	2000	2001	2002 1/
Current account balance	-11.4	-11.4	2.0	27.8	30.1	20.2
In percent of GDP	-1.3	-1.2	0.2	2.6	2.8	1.8
Merchandise trade balance	25.7	23.8	40.2	62.2	64.0	55.2
Exports, goods	303.4	327.2	367.2	425.6	414.6	408.8
Imports, goods	277.7	303.4	327.0	363.4	350.6	353.7
Services balance	-8.9	-6.3	-7.2	-7.4	-8.4	-8.2
Investment income balance	-28.9	-29.6	-32.1	-28.4	-27.5	-28.3
Transfer balance	0.7	0.8	1.0	1.5	1.9	1.6
Capital and financial accounts balance	15.8	4.5	-13.2	-21.5	-20.9	-6.3
Direct investment, net	-16.0	-17.1	13.1	28.4	-12.4	-3.2
In Canada	16.0	33.8	36.3	98.9	42.5	34.7
Abroad	-31.9	-51.0	-23.2	-70.5	-54.9	-38.0
Portfolio investment, net	4.3	2.3	-19.8	-48.3	-6.8	-19.2
Canadian securities	16.2	24.8	3.3	14.0	30.9	7.1
Bonds	6.2	10.3	2.3	-22.7	33.6	12.4
Stocks	7.6	14.3	14.1	35.0	4.6	-5.0
Money market	2.4	0.1	-13.1	1.7	-7.3	-0.2
Foreign securities	-11.8	-22.5	-23.1	-62.3	-37.7	-26.4
Bonds	-6.6	-7.1	-2.5	-4.0	-1.9	-8.3
Stocks	-5.2	-15.4	-20.6	-58.3	-35.8	-18.0
Other investment 2/	16.5	21.9	-2.7	-1.5	-4.0	11.1
Assets	-22.1	13.7	14.4	-4.1	-14.4	-2.9
Liabilities	38.7	8.2	-17.1	2.7	10.4	14.0
Other flows, net	7.5	4.9	5.1	5.3	5.7	5.5
Transactions in official international reserves	3.4	-7.5	-8.8	-5.5	-3.4	-0.3
Statistical discrepancy	-4.4	6.8	11.2	-6.3	-9.1	-13.9
Memorandum item:						
Net external investment position	-290.2	-299.7	-247.0	-202.5	-203.4	...
In percent of GDP	-32.9	-32.8	-25.2	-19.0	-18.6	...

Source: Statistics Canada.

1/ First three quarters of the year at annual rates, current account flows have been seasonally adjusted.
2/ Includes bank, nonbank, and official transactions other than reserve transactions.

Table 5. Canada: Federal Government Budget, Public Accounts 1/

	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02
	(In billions of Canadian dollars; unless otherwise indicated)						
Total revenues	130.3	140.9	153.5	155.9	166.1	179.6	173.3
In percent of GDP	16.1	16.8	17.4	17.0	16.9	16.9	15.9
Total spending	158.9	149.8	149.7	152.8	153.4	161.4	164.4
In percent of GDP	19.6	17.9	17.0	16.7	15.6	15.2	15.1
Program spending	112.0	104.8	108.8	111.4	111.8	119.3	126.7
In percent of GDP	13.8	12.5	12.3	12.2	11.4	11.2	11.6
Interest payments	46.9	45.0	40.9	41.4	41.6	42.1	37.7
In percent of GDP	5.8	5.4	4.6	4.5	4.2	4.0	3.5
Budget balance	-28.5	-8.9	3.8	3.1	12.7	18.1	8.9
In percent of GDP	-3.5	-1.1	0.4	0.3	1.3	1.7	0.8
Net public debt 2/	574.3	583.2	579.4	576.3	563.5	545.4	536.5
In percent of GDP	70.9	69.7	65.6	63.0	57.5	51.2	49.1
Memorandum items:							
Balances							
Structural budget balance	-27.9	-5.5	6.2	5.0	12.2	12.8	11.4
In percent of GDP	-3.4	-0.7	0.7	0.5	1.2	1.2	1.0
Primary balance	18.4	36.1	44.7	44.5	54.4	60.2	46.6
In percent of GDP	2.3	4.3	5.1	4.9	5.5	5.7	4.3
Structural primary balance	19.0	39.5	47.1	46.4	53.9	54.9	49.1
In percent of GDP	2.3	4.7	5.3	5.1	5.5	5.2	4.5
General government debt (NIA basis)							
Gross debt 3/	99.9	99.2	97.5	94.3	92.5	83.3	83.2
Net debt	88.8	88.1	85.6	81.8	75.6	65.4	61.2
Federal	69.5	68.5	64.3	60.6	56.4	49.7	46.8
Provincial 4/	26.1	25.9	27.2	26.7	24.7	21.4	20.6
CPP and QPP 5/	-6.7	-6.4	-5.9	-5.5	-5.5	-5.7	-6.3
Government of Canada marketable securities held by nonresidents 6/	26.5	26.1	25.4	23.6	21.7	20.8	17.0

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/ Unless otherwise indicated on a fiscal year basis, which starts on April 1.

2/ The public accounts measure of net debt includes government debt held by the public service pension plans, the CPP and QPP.

3/ Excluding the unfunded liabilities of the public employee pension plan.

4/ Also includes local government and hospital sectors.

5/ Canada Pension Plan and Quebec Pension Plan.

6/ As a percent of unmatured debt.

Table 6. Canada: Staff Projections

(In percent change from previous period; unless otherwise indicated)

	2001	2002	2003	2004	2005	2006	2007
NIPA in real terms							
Real GDP	1.5	3.3	3.0	3.2	2.8	2.7	2.7
Net exports 1/	0.6	0.3	0.1	0.5	0.4	0.2	0.3
Total domestic demand	1.3	2.9	2.9	2.8	2.5	2.6	2.6
Private consumption	2.6	2.5	2.4	2.9	2.4	2.5	2.5
Private domestic investment	0.4	2.3	5.2	4.9	4.0	4.0	4.0
Change in business inventories 1/	-1.5	1.1	0.2	-0.2	-0.1	0.0	0.0
Final domestic demand	2.5	2.6	2.8	3.0	2.6	2.7	2.6
GDP (current prices)	2.6	4.4	5.4	5.2	4.7	4.7	4.7
Employment and inflation							
Unemployment rate (percent)	7.2	7.7	7.4	6.6	6.5	6.5	6.5
Consumer price index	2.5	2.1	3.1	2.0	2.0	2.0	2.0
GDP deflator	1.0	1.1	2.3	1.9	1.9	1.9	1.9
Indicators of financial policies 2/							
Federal fiscal balance							
(public accounts) 3/ 4/	8.9	3.0	3.0	3.0	3.0	3.0	3.0
(in percent of GDP)	0.8	0.3	0.2	0.2	0.2	0.2	0.2
Federal fiscal balance (NIA) 3/	11.2	5.3	5.3	5.3	5.3	5.3	5.3
(in percent of GDP)	1.0	0.5	0.4	0.4	0.4	0.4	0.4
Provincial fiscal balance (NIA) 3/ 5/	1.8	-3.6	0.0	0.0	0.0	0.0	0.0
(in percent of GDP)	0.2	-0.3	0.0	0.0	0.0	0.0	0.0
General goverment fiscal							
balance (NIA) 3/	19.4	9.1	14.8	15.6	15.5	14.8	14.3
(in percent of GDP)	1.8	0.8	1.2	1.2	1.2	1.1	1.0
General goverment net debt (NIA)							
(in percent of GDP)	61.2	57.8	53.6	49.7	46.3	43.2	40.2
Three-month treasury bill rates (percent)	3.9	2.6	3.7	4.8	5.2	5.2	5.2
Ten-year government bond rates (percent)	5.5	5.2	4.8	6.0	6.5	6.5	6.5
Balance of payments							
Current account balance 3/	30.0	21.1	28.1	37.1	41.1	42.9	43.6
(in percent of GDP)	2.8	1.8	2.3	2.9	3.1	3.1	3.0
Merchandise trade balance 3/	64.0	55.9	63.5	73.3	81.9	88.1	93.9
(in percent of GDP)	5.9	4.9	5.3	5.8	6.2	6.4	6.5
Invisibles, net 3/	-34.0	-34.8	-35.4	-36.2	-40.8	-45.1	-50.3
(in percent of GDP)	-3.1	-3.1	-2.9	-2.9	-3.1	-3.3	-3.5

Source: Fund staff estimates.

1/ Contribution to growth.
2/ Projections are based on the WEO assumption of unchanged fiscal policy. After FY 2001/02, it is assumed that new measures, aimed at reducing taxes and introducing new spending initiatives, are implemented such that the federal government would maintain budget surpluses equivalent to the contingency reserve in the budget. 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/ For fiscal years, which start on April 1.
5/ Includes local governments and hospitals.

Table 7. Canada: Medium-Term Federal Government Budget

	2000/01	2001/02	Staff Projections 2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
			(In billions of dollars)					
Revenue	179.6	173.3	174.1	184.5	193.6	202.1	210.9	219.7
Program spending	119.3	126.7	133.7	140.1	146.7	153.8	161.3	167.7
Interest payments	42.1	37.7	35.5	36.2	36.2	36.0	36.2	36.4
Prudence	...	...	3.0	4.0	5.0	6.0	6.5	7.0
Contingency reserve	...	...	3.0	3.0	3.0	3.0	3.0	3.0
Economic prudence	...	...	0.0	1.0	2.0	3.0	3.5	4.0
Remaining balance	18.1	8.9	1.8	4.2	5.8	6.3	6.9	8.5
			(In percent of GDP)					
Revenue	16.9	15.9	15.3	15.3	15.3	15.3	15.2	15.1
Program spending	11.2	11.6	11.7	11.7	11.6	11.6	11.6	11.6
Interest payments	4.0	3.5	3.1	3.0	2.9	2.7	2.6	2.5
Prudence	...	...	0.3	0.3	0.4	0.5	0.5	0.5
Contingency reserve	...	...	0.3	0.2	0.2	0.2	0.2	0.2
Economic prudence	...	...	0.0	0.1	0.2	0.2	0.3	0.3
Remaining balance	1.7	0.8	0.2	0.4	0.5	0.5	0.5	0.6
Memorandum items								
Net public debt 1/	51.2	49.1	46.8	44.1	41.7	39.6	37.6	35.7
Available balance (in percent of GDP) 2/								
Actual	1.7	0.8	0.4	0.7	0.9	0.9	1.0	1.1
Structural 3/	1.2	1.0	0.7	0.9	0.9	0.9	1.0	1.1
Real GDP growth 4/	4.5	1.5	3.3	3.0	3.2	2.8	2.7	2.7
Nominal GDP growth rate 4/	8.6	2.6	4.4	5.4	5.2	4.7	4.7	4.7
Three-month Treasury bill rate 4/	5.5	3.9	2.6	3.7	4.8	5.2	5.2	5.2
Ten-year government bond rate 4/	5.9	5.5	5.2	4.8	6.0	6.5	6.5	6.5

Source: Department of Finance Canada The Budget Plan 2002; and Fund staff estimates.

1/ Based on the staff's assumption that the contingency reserve is applied to debt reduction.
2/ This consists of the contingency reserve and economic prudence factor plus the remaining balance.
3/ In percent of potential GDP.
4/ For calendar years, in percent.

Table 8. Canada: Banking Sector

	1995	1996	1997	1998	1999	2000	2001	2002 1/
(In percent unless otherwise indicated)								
Six largest chartered banks 2/								
Return on total shareholders' equity	13.3	15.0	16.4	13.4	15.8	15.3	13.9	7.8
Return on average assets	0.7	0.7	0.7	0.6	0.7	0.7	0.7	0.4
Average intermediation spread	3.1	2.9	2.9	2.6	2.7	2.9	3.0	3.1
Net interest income (in percent of average earning assets)	2.5	2.4	2.1	1.8	1.8	1.8	1.9	2.0
Nonperforming loans as a percent of total loans	2.4	2.0	1.4	1.3	1.2	1.3	1.5	...
Loan loss provision (consolidated, in percent of total problem loans)	65.1	70.0	106.9	104.8	114.3	109.0	96.1	...
Total capital ratio	9.8	9.1	10.0	10.7	11.6	11.8	12.2	12.2
Tier 1 capital ratio	7.0	6.8	6.9	7.4	8.3	8.4	8.8	9.0
(In percent of total assets unless otherwise indicated)								
All chartered banks 3/ 4/								
Total assets 5/	912	1,105	1,321	1,432	1,398	1,550	1,710	1,750
Total Canadian dollar assets	67.0	61.8	58.5	53.6	59.8	59.5	57.3	58.0
Canadian dollar liquid assets	10.1	7.9	5.9	5.4	5.7	6.0	6.3	5.9
Total foreign currency assets	33.0	38.2	41.5	46.4	40.2	40.5	42.7	42.0
Banks' exposure to commercial real estate sector 6/	1.4	1.1	1.0	0.9	1.0	1.0	0.9	1.0
Banks' exposure to resource sector 7/	1.4	1.2	1.2	1.2	1.3	1.2	1.1	1.1
Total liabilities and shareholders' equity 5/	912	1,105	1,321	1,432	1,398	1,550	1,710	1,750
Of which: Total Canadian dollar liabilities	65.7	60.4	56.5	52.3	57.6	57.8	55.3	55.7
Total foreign currency liabilities	34.3	39.6	43.5	47.7	42.4	42.2	44.7	44.3
Total deposits	47.6	40.7	37.1	34.2	37.3	38.3	36.6	37.2
Total foreign currency deposits	27.8	28.0	30.7	32.2	31.3	29.5	30.4	29.6
Total international position 5/								
Claims on nonresidents	898	1,088	1,381	1,756	1,695	1,771	2,062	2,091
Liabilities to nonresidents	935	1,043	1,339	1,615	1,571	1,609	1,763	1,141

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

1/ Data for all chartered are as of 2002-Q3. Data for six largest Canadian banks are as of October 31, 2002.
2/ For financial years, which start on November 1.
3/ For calendar years.
4/ Based on consolidated data.
5/ In billions of Canadian dollars.
6/ Proxied by nonresidential mortgages.
7/ The resource sector consists of agriculture, fishing, forestry, mining, and oil and gas.

Table 9. Canada: Official Development Assistance 1/

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
	(In billions of U.S. dollars)									
Total	**2.5**	**2.4**	**2.3**	**2.1**	**1.8**	**2.0**	**1.7**	**1.7**	**1.7**	**1.5**
Bilateral	1.7	1.6	1.5	1.4	1.4	1.2	1.2	1.2	1.2	1.2
Multilateral	0.8	0.8	0.8	0.7	0.4	0.8	0.5	0.5	0.6	0.3
	(In percent of GNP)									
Total	**0.46**	**0.45**	**0.43**	**0.38**	**0.32**	**0.34**	**0.29**	**0.28**	**0.25**	**0.22**
Bilateral	0.31	0.3	0.28	0.25	0.24	0.2	0.21	0.19	0.17	0.18
Multilateral	0.15	0.15	0.15	0.13	0.08	0.14	0.08	0.09	0.09	0.04
	(In percent of total ODA)									
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Bilateral	68	67	65	67	76	59	71	70	67	78
Multilateral	32	33	35	33	24	41	29	30	33	22

Source: OECD, Development Assistance Committee, provisional data.

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

Canada—Fund Relations
(As of November 30, 2002)

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	3,903.98	61.29
Reserve position in Fund	2,465.24	38.71

III. **SDR Department:**	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	779.29	100.00
Holdings	528.84	67.86

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

V. **Financial Arrangements:** None.

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

VII. **Implementation of HIPC Initiative:** Not applicable.

VIII. **Safeguards Assessments**:

The safeguards assessment procedures are not applicable to the Bank of Canada at this time.

IX. **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 January 8, 2003 the exchange rate of the Canadian dollar was 0.64 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).

X. Last Article IV Consultation

The staff report for the 2002 consultation with Canada was considered by the Executive Board on February 4, 2002 (EBM/02/12). Canada is on a 12-month consultation cycle.

XI. FSAP Participation and ROSC Assessments

Standard Assessed	Date of Issuance	Document Number
Canada - Financial System Stability Assessment - Volume II: Report on Observance of Standards in the Financial System	4/1/00	FO/Dis/00/2, Sup. 1
Report on the Observance of Standards and Codes—Fiscal Transparency Module: Canada	10/31/01	SM/01/330
Canada: Report on the Observance of Standards and Codes—Fiscal Transparency Module	03/12/02	IMF Country Report No. 02/51

Summary of Findings

Financial System Stability Assessment

The FSSA report concluded that Canada has a stable and highly advanced financial system, which is among the soundest in the world. Moreover, it is supported by a well-developed regulatory system that shows a high degree of compliance with major international standards. Nevertheless, the FSSA report made a few recommendations to further strengthening the regulatory framework and financial system's resilience, most of which have already been addressed, including:

- Introducing capital requirements for the guarantees in life insurance segregated fund (completed by end-2001);
- Tabling legislation granting OSFI powers to remove a financial institution's director or senior officer if the person is deemed not suitable to hold that office based on a number of criteria. The latter legislation brought Canada into broad compliance with the Basel Core Principles;
- Making significant progress in harmonizing securities regulation and improving coordination among provincial securities regulators, including through

a newly created association of securities regulators, the Canadian Securities Administrators. Although there remain multiple regulators at the provincial level, a Senate commission was created to develop specific recommendations on further harmonization and streamlining of securities regulation.

Report on the Observance of Standards and Codes— Fiscal Transparency

The report found that fiscal management in Canada meets the requirements of the fiscal transparency code, and in a number of instances represents best practice. In particular, it highlighted the use of private sector economic forecasts, prudence factors, and a contingency reserve for fiscal forecasting in Canada. Fiscal management was also commended for its statistical integrity, impartial tax administration, open procurement, and a transparent regulatory process.

The report found several areas where further improvements would be desirable, including: (i) the preparation of timely, current year estimates of federal and provincial budgets on a comparable basis, (ii) a comprehensive account of the procedures for the budget cycle and expenditure management system, (iii) systematic reporting of the use of reserves for non-economic contingencies, (iv) resume publication of reconciled national and public accounts forecasts of major aggregates over the forecast horizon, and (v) publication by all governments of quasi-fiscal activities.

Many of these issues have been addressed, including: (i) the release by Statistics Canada of consolidated data for federal and provincial budgets for 2001-02 (on a Financial Management System basis), and (ii) the publication of comprehensive descriptions of budget and expenditure management procedures, including: a joint document entitled "Budgeting in Canada" by the Government and the OECD; detailed accounts of policies and procedures on expenditure management at the website of the Treasury Board Secretariat; and the explanation of the budget cycle and process in Budget and Update documents.

XII Review of Past Surveillance

Surveillance guidelines now require that Fund reports contain an assessment of the "impact" of Fund policy advice, including the authorities' response to the key policy challenges addressed in previous Article IV consultations (see "Operational Guidance Note for Staff Following the 2002 Biennial Surveillance Review," September 2002).

Over the past five years, the Fund in its Article IV consultations with Canada has emphasized the importance of: fiscal policies aimed at ensuring longer-term fiscal sustainability; a strong commitment to price stability; and structural reforms that promote economic efficiency and boost productivity growth. Specific policy advice has included calls for fiscal surpluses and debt reduction, in order to prepare for the longer-term pressures expected to arise from population aging, as well as cautions against the use of significant discretionary countercyclical policies in the face of the recent slowdown. Structural policy advice has centered on the need for further tax reforms to further promote incentives to work and save; reforms of the Employment Insurance system to promote labor market flexibility; greater trade liberalization, especially in the area of supply-managed agricultural products and garments and textiles; and reducing barriers to entry in the financial sector.

Policies pursued by the Canadian authorities have been broadly consistent with Fund advice. Fiscal surpluses have been preserved, even in the face of the recent economic slowdown, and tax reforms that involved significant reductions in marginal rates. Earlier reforms placed the Canada Pension Plan on a sound financial footing, and efforts are underway to introduce reforms of the health care system in advance of impending demographic pressures. Monetary policies—underpinned by an inflation-targeting framework—have succeeded in maintaining low inflation, while at the same time demonstrating a strong commitment to policy transparency and accountability. Considerable progress has also been made toward addressing the structural policy issues identified in past surveillance reports, although there remains scope for further improvements, including with regard to easing barriers to imports of agricultural goods, further reforms of the Employment Insurance system, and continued strengthening of the regulatory framework for the financial sector.

XIII. **Technical Assistance:** Not applicable.

XIV. **Resident Representative:** Not applicable.

Canada— Core Statistical Indicators

(as of December 20, 2002)

	Exchange Rates	International Reserves 1/	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance 2/	GDP/ GNP	External Debt 3/	Debt Service
Date of latest Observation	12/16/02	November 2002	12/20/01	November 2002	November 2002	12/20/02	November 2002	October 2002	2002 Q3	2002 Q3	2002 Q3	end-2001	2002 Q3
Date received	12/20/02	12/20/01	12/20/01	12/20/01	12/20/01	12/20/01	12/20/02	12/18/2002	11/29/2002	11/29/2002	11/29/2002	May 2002	11/29/2002
Frequency of data	Daily	Monthly	Weekly	Monthly	Monthly	Daily	Monthly	Monthly	Quarterly	Quarterly	Quarterly	Annual	Quarterly
Frequency of reporting	Daily	Monthly	Weekly	Weekly	Weekly	Daily	Monthly	Monthly	Quarterly	Quarterly	Quarterly	Annual	Quarterly
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	Statistics Canada
Mode of Reporting	Electronic	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	Unrestricted
Frequency of Publication	Daily	Monthly	Weekly	Weekly	Weekly	Daily	Monthly	Monthly	Quarterly	Quarterly	Quarterly	Annually	Quarterly

1/Gross and net official reserve assets are available.
2/ National accounts.
3/ Net international investment position.

Canada—Statistical Issues

The quality, coverage, periodicity, and timeliness of Canada's economic data are considered to be excellent both in the context of the Article IV consultation and for purposes of ongoing surveillance. Canada has subscribed to the Fund's Special Data Dissemination Standard (SDDS), and its metadata are posted on the Fund's Dissemination Standard Bulletin Board (DSBB).

Real Sector. Statistics Canada provides timely and comprehensive data at monthly, quarterly, and annual frequencies. In May 2001, Statistics Canada adopted the Fisher index methodology for computing national account statistics.

Fiscal Sector. The Department of Finance provides monthly and annual data on the federal government's budget. The January 2002 Report on Observance of Standards and Codes (ROSC) found that fiscal management in Canada meets the requirements for fiscal transparency and, in a number of instances, represents best practices (see Appendix I). The report also found several areas where further improvements were desirable, including the preparation of timely, current year estimates of federal and provincial budgets on a comparable basis, and a comprehensive account of procedures for the budget cycle and expenditure management system, which the authorities have already addressed.

Financial Sector. The Office of the Superintendent of Financial Institutions (OSFI), provides comprehensive data at quarterly and annual frequencies on the financial sector, including data on individual institutions.

Monetary Sector. The Bank of Canada provides timely and comprehensive monetary data at daily, weekly, monthly, quarterly, and annual frequencies. Monetary data for the monetary authorities and the deposit money banks sent to STA for publication are also provided on a timely basis. However, the latest monthly data for the other banking institutions provided to STA for publication refer to June 2002.

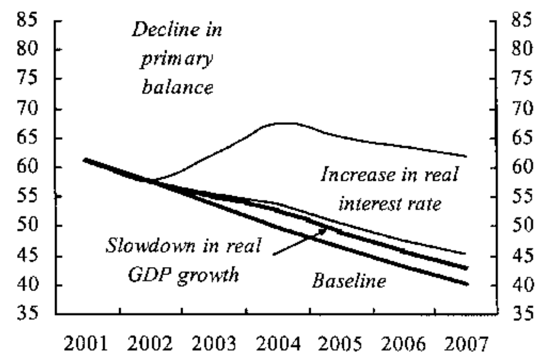
External Sector. Statistics Canada provides timely information on the Balance of Payments and international investment position at monthly, quarterly, and annual frequencies. Finance Canada provides monthly data on Official International Reserves in a format comparable to the IMF reserve data template. Data are published at http://www.fin.gc.ca/news02/02-089e.html.

Canada—Public and External Debt Sustainability

1. ***The Executive Board recently called for greater discipline and cross-country consistency in staff estimates of public and external debt sustainability—a key element in Fund surveillance.***[1] Based on the approach detailed in a recent Executive Board paper, this annex presents the staff's medium-term baseline fiscal and external balance scenarios and the results of the standard stress tests.[2]

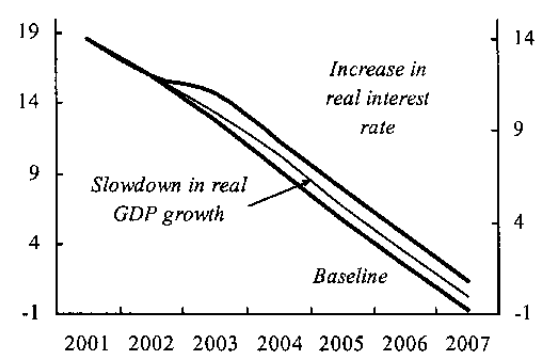
2. ***The staff's baseline fiscal scenario is predicated on the assumption that the Federal Government remains committed to its objective of reducing debt over the medium term, and achieves a surplus of $3 billion each year.*** The economy is projected to grow at around its potential rate of 2¾ percent in 2004-2007; inflation would average about 2 percent, the mid-point of the Bank of Canada's target range; provincial budgets are projected to be balanced; and real interest rates on the public debt average around 4.9 percent.

Figure 1. Sensitivity of Net Public Debt
(As a percent of GDP)



3. ***Under these baseline assumptions, the overall public debt-to-GDP ratio would fall to 40 percent by 2007 from 57 percent in 2002 (Figure 1).*** The drop in the debt ratio would be largely driven by fiscal surpluses and growth in the economy at potential.

Figure 2. Sensitivity of Net External Debt
(As a percent of GDP)



4. ***Stress tests illustrate the robustness of this result.***[3] The baseline scenario was subjected to real interest rate, real growth, and primary balance shocks during 2003–2004 (Figure 2). The shocks were based on two-standard deviations from the ten year average of each of these variables. In all cases, the debt-to-GDP ratio still declined over the medium term. The simulations illustrated, however, that the greatest vulnerability was with regard to unforeseen budgetary demands—the primary balance shock

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[1] Public Information Notice No. 02/69, July 11, 2002.

[2] Stress tests for public and external debt sustainability are based on the methodology described in SM/02/166.

[3] The stress tests assume unchanged fiscal policies in response to shocks.

temporarily increased the debt ratio in 2003 and 2004 and left the ratio in 2007 at nearly 20 percentage points above the baseline.

5. ***A myriad of factors not included in these stress tests are expected to affect Canada's fiscal position over the longer-term.*** These would include pressures associated with the aging of the baby boom generation. A more comprehensive discussion of Canada's fiscal outlook and public debt dynamics over a 75-year horizon is included in a *Selected Issues Paper*.

6. ***The stress tests illustrate the strength of Canada's external position.*** The baseline projection assumes that the current account surplus, excluding interest payments, declines from about 4 percent in 2002 to about 3 percent in 2007, with net external liabilities turning to net external assets of about 1 percent of GDP (Figure 2). Even assuming two standard deviation shocks to macroeconomic variables, the net position continues to decline.

Statement by the IMF Staff Representative on Canada
January 31, 2003

1. The following information has become available since the staff report was issued and does not change the thrust of the staff appraisal.

Recent data

2. In December, **headline CPI inflation** fell to 3.9 percent (y/y) from 4.3 percent in November, and core inflation went down to 2.7 percent from 3.1 percent. To a large extent, the decline in inflation reflected rebates provided by the Ontario government for past electricity price hikes. The effects of heavy price discounting following the terrorist attacks in September 2001 and hikes in insurance premiums continued to boost the year-over-year inflation rate, but most measures of inflation expectations continue to be consistent with a return to the mid-point of the 1-3 percent target range.

3. December's **unemployment rate** was unchanged at 7.5 percent. Employment grew by 58,000 jobs—80 percent of which were full time positions—and the participation rate rose to 67.5 percent, matching the January 1990 all-time high. Meanwhile wage growth continued to decline as average hourly wages of permanent employees increased in December by only 1.9 percent from a year earlier.

4. The **merchandise trade surplus** narrowed in November, driven by a 2.2 percent fall in exports and flat import values. The drop in exports was broad-based and reflected a 2 percent decline in volumes.

5. The **Canadian dollar** has appreciated so far in January against the U.S. dollar by around 3 percent, and the broad TSX composite index has remained broadly unchanged. **Interest rates** have remained broadly stable at around 2¾ percent for 3-month treasury bills and 5 percent for ten-year government bonds.

Monetary policy

6. On January 21st the Bank of Canada announced that it was maintaining its target for the overnight rate at 2¾ percent. In its *Monetary Policy Report Update,* the Bank explained that core and total CPI inflation have risen somewhat more than expected since the previous policy announcement in December, reflecting some broadening of price pressures and that the economy may be operating closer to capacity than previously thought. Nevertheless, the Bank noted that domestic growth had moderated in the second half of 2002 and that, while conditions in financial markets were improving, significant geopolitical and economic uncertainties remained.

7. In the *Update*, the Bank indicated that it expected economic activity to accelerate in the second half of the year and that average annual growth would reach 3 percent, which would be in line with the Fund staff's estimates. The Bank cautioned that, with the economy

possibly operating closer to potential than previously believed, and the current stance of monetary policy still very stimulative, "a reduction of stimulus will be required to return inflation to the 2 percent target over the medium term."

Health care reform

8. The Prime Minister is expected to meet with his provincial counterparts in early February to discuss health care reform, following the meeting of provincial premiers held last week. The Minister of Health recently indicated that the federal government would support amendments to the existing health care system that would provide for universal home care and catastrophic drug coverage, as well as increased funding for high-tech diagnostic machinery. The federal authorities would also support reforms to encourage greater efficiencies in the area of primary care that would involve the establishment of multidisciplinary professional units. The Minister also proposed to heighten accountability and set up targeted funds—for home care, pharmacare, and high-tech diagnostic equipment—to ensure provinces meet national goals. The fiscal costs of these proposal have not been specified.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 03/18
FOR IMMEDIATE RELEASE
February 25, 2003

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

IMF Concludes 2003 Article IV Consultation with Canada

On January 31, 2003, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Canada.[1]

Background

Canada's strong policy framework has brought impressive economic results, and the Canadian economy has proven exceptionally resilient in the face of the recent global downturn. Economic activity slowed relatively modestly in 2001, with only one quarter of output decline recorded, and growth recovered strongly thereafter, averaging 4 percent over the subsequent four quarters.

As in many other countries, business investment and inventory adjustments led the slowdown and subsequent recovery, while household consumption and residential investment have remained robust. Household and business demand was supported by sustained productivity growth, rapid growth of employment and labor incomes and gains in real estate prices, which helped mitigate the impact of stock market declines on household net worth. The strength of the recovery and structural reforms contributed to rapid employment growth. However, the sharp increase in the participation rate meant that the unemployment rate—which had risen to 8 percent in December 2001 from a three-decade low of 6¾ percent in mid-2000—remained at 7½ percent by end 2002.

[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.

Net external demand also remained supportive of economic activity in 2001 and, to a lesser extent, in 2002. The current account surplus, although remaining substantial, fell to near 2 percent in the first three quarters of 2002, from 2¾ percent of GDP in 2001. Continued surpluses brought Canada's net foreign liability position to just under 19 percent of GDP by end–2001, half the level of the mid-1990s.

Despite a favorable macroeconomic performance, capital outflows, lower non-energy commodity prices, and the strength of the U.S. currency contributed to continued weakness of the Canadian dollar. The dollar reached historical lows against the U.S. currency in January 2002, and despite some recent strengthening has stayed close to these levels despite the widening of interest rate differentials. In real effective terms, the Canadian dollar remains roughly 5 percent below its average of the mid-1990s.

The rebound in activity is bringing the economy back toward potential, and inflation has picked up over the past year. After breaching the Bank of Canada's 1–3 percent target range in November, headline CPI inflation fell to 3.9 percent (y/y) in December from 4.3 percent in the previous month, and core inflation also fell to 2.7 percent from 3.1 percent. A number of special factors appear to have contributed to the recent pick-up in inflation, including the base effect of discounting in the wake of the September 11th attacks, the effect of warmer-than-usual weather in the summer on recently-deregulated electricity prices, automobile insurance price hikes, and tobacco price increases, while the recent decline in inflation largely reflected the rebates provided by the Ontario government for past electricity price hikes. Most measures of inflation expectations continue to be consistent with a return to the mid-point of the 1-3 percent target range by year-end.

The Bank of Canada began to withdraw monetary stimulus in early 2002, raising its target overnight rate during April–July by a cumulative 75 basis points, to 2¾ percent, in recognition of the need to act preemptively given the narrowing of the output gap. However, since July, the Bank has left the target rate unchanged, noting that, while further reductions in monetary stimulus would eventually be required, weaker near-term prospects for the U.S. and global economy and the unsettled circumstances in global financial markets argued for a pause.

A significant improvement in the fiscal position had been achieved during the past decade—the general government fiscal balance moved from a deficit of 9 percent of GDP in the early 1990s to a surplus of 3 percent of GDP in 2000, and the ratio of net public debt fell sharply. This has provided room for fiscal policy to help cushion the effects of the slowdown in recent years while demonstrating a continued commitment to debt reduction. The federal fiscal surplus (public accounts basis) fell from 1¾ percent of GDP in FY 2000/01 to about ¾ percent of GDP in FY 2001/02, reflecting cyclical effects, cuts in personal and corporate income tax rates announced in October 2000, and spending increases introduced in the December 2001 budget. With a drop in provincial surpluses totaling ¾ percent of GDP, the general government surplus declined to 1¾ percent of GDP (national accounts basis) in 2001, from over 3 percent in 2000, and has fallen further in 2002.

Executive Board Assessment

Executive Directors broadly endorsed the staff appraisal. In reviewing developments over the past year, they highlighted the remarkable resilience of the Canadian economy in the face of the global downturn, which underscores Canada's sound policy framework and the authorities' skillful policy implementation. They noted that the inflation-targeting framework has helped to anchor expectations and permitted a timely monetary policy response, and that fiscal consolidation and debt reduction undertaken since the mid-1990s have provided room to further ease tax burdens and introduce modest discretionary spending stimulus.

Directors agreed that prospects for the Canadian economy remain sound, and that domestic vulnerabilities are relatively modest. Nevertheless, they cautioned that uncertainties about the strength of the U.S. recovery and financial market developments represented important risks to the outlook, especially against the backdrop of potential geopolitical risks. They suggested, therefore, that the key challenge facing the authorities will be to balance the shorter-term risks to the outlook against the need for policies to remain firmly geared toward preparing for the fiscal consequences of population aging and boosting Canada's long-term productive potential.

In view of the uncertain global economic outlook and risks associated with developments in financial markets, Directors broadly endorsed the Bank of Canada's cautious approach to withdrawing monetary stimulus. While there was the view that it could be difficult to draw a clear-cut line between one-time and more lasting effects, there was general agreement that the recent pickup in core inflation appears to have largely reflected temporary factors and that inflation expectations seem to be well anchored. Therefore, a gradual approach to withdrawing stimulus seems to be consistent with the forward-looking, inflation-targeting framework. Looking forward, Directors agreed that a further tightening of monetary conditions would likely be needed, as the economy is now operating close to its potential. They welcomed the authorities' commitment to act decisively, if needed, to ensure that price pressures do not become embedded into inflation expectations.

Directors agreed that Canada's flexible exchange rate regime continued to serve the country well, as it has been effective in cushioning the economy from external shocks. The depreciation of the currency over the last decade has helped to offset the effects of changes in world commodity prices and mitigate the impact of the global downturn. Directors also observed that Canada's strong economic fundamentals favor a continued appreciation of the Canadian dollar over the medium term.

Directors commended the authorities' prudent fiscal management, and welcomed the re-affirmation of their commitment to budget surpluses and debt reduction, especially given looming demographic pressures. They noted that this strategy has paid important dividends in recent years, as debt reduction has provided room for tax cuts and a measured fiscal response to the recent downturn. With the retirement of the baby-boom generation starting later this decade, rising health-care costs, and the debt-to-GDP ratio still high, Directors considered it important to maintain the debt ratio on a steady downward trajectory, though many would not see the need to recommend a specific long-term target for debt reduction at this time. In this context, and given limited budgetary resources in the coming two years, Directors encouraged a close adherence to the existing budgetary framework and efforts to ensure that new initiatives are accommodated, to the extent possible, through the reprioritization of existing programs. A few Directors observed that tax burdens remained high vis-à-vis the United States, and they saw some room for further tax reductions over the medium-term as a means of boosting employment and the economy's productive capacity.

Financial pressures on the public health care system are likely to increase given demographic trends. Directors therefore stressed that reform of the system would need to be consistent with meeting longer-term federal and provincial fiscal constraints, while boosting the quality and breadth of service. Meeting these competing challenges would be difficult in light of pressures to extend coverage, and Directors suggested that further emphasis could be given to incentives that encourage efficiencies on the part of both providers and patients.

Directors commended the authorities for the substantial reforms that had been introduced over the past decade, which had contributed to the strong performance of the labor market. However, they noted that further reductions in the level of structural unemployment would be desirable, and suggested that there remain opportunities in a number of areas to further promote employment and productivity. In particular, they stressed that further reform of the Employment Insurance system—including the scaling back of regional-extended benefits, moving to a system of experience rating, and funding those Employment Insurance programs directed at broader social objectives through other revenue sources—would provide additional room to lower premiums and enhance labor market flexibility.

Directors commended Canada's strong supervisory and prudential framework, which has contributed to the banking sector remaining sound in the face of the economic downturn. They stressed that supervisors would need to remain vigilant to the risk of further pressure on asset quality.

Directors welcomed the authorities' continued commitment to implementing a strong anti-money laundering and counter-terrorism financing framework. They also welcomed steps being taken to establish a framework for approving bank mergers.

Directors commended the authorities on their pro-active response in strengthening corporate governance and preserving investor confidence, and emphasized the importance of effectively applying these new standards and institutions. In this regard, a key challenge would be to make sure that efforts to harmonize with other countries' policies in this area preserve the benefits of Canada's more principles- and disclosure-based system, and do not impose an excessive regulatory burden, especially on smaller firms. Some Directors also suggested that moving from a system of multiple securities market regulators to a more national system would serve well the goals of improved corporate governance and easing regulatory costs.

Directors welcomed Canada's long-standing commitment to trade liberalization and, in particular, the authorities' recent announcement of an extension of duty/quota-free access to imports from the least-developed countries. Directors stressed that further liberalization, including in the areas of textile and clothing products and "supply-managed" agricultural products, would help improve domestic efficiency and provide an important impetus to multilateral efforts, including in the context of the Doha Round, to boost development through trade.

Directors welcomed the authorities' recent commitment to substantially increase the level of official development assistance (ODA) by doubling Canada's ODA commitment by 2010. However, they noted that more ambitious efforts would be needed to achieve the authorities' long-standing commitment to achieving the U.N. target of 0.7 percent of GNP.

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. The Staff Report for the 2003 Article IV Consultation with Canada is also available.

Table 1. Canada: Selected Economic Indicators 1/

(Annual change in percent, unless otherwise noted)

	1996	1997	1998	1999	2000	2001	2002
Real GDP	1.6	4.2	4.1	5.4	4.5	1.5	3.3
Net exports 2/	0.3	-1.7	1.7	1.1	0.2	0.6	0.3
Total domestic demand	0.9	5.7	2.4	4.4	5.0	1.3	2.9
Final domestic demand	2.1	5.4	2.8	4.3	4.0	2.5	2.6
Private consumption	2.6	4.6	2.8	3.9	3.7	2.6	2.5
Public consumption	-1.2	-1.0	3.2	1.9	2.3	3.3	2.4
Private fixed domestic investment	5.9	18.1	2.8	7.2	6.9	0.4	2.3
Private investment rate (as a percent of GDP)	15.5	17.5	17.7	17.6	17.5	17.4	17.4
Public investment	-4.3	-3.2	-0.7	12.7	3.0	11.5	9.4
Change in business inventories 2/	-0.7	0.7	-0.3	0.1	0.5	-1.5	1.1
GDP (current prices) 1/	3.3	5.5	3.7	7.2	8.6	2.6	4.4
Employment and inflation							
Unemployment rate	9.6	9.1	8.3	7.6	6.8	7.2	7.6
Consumer price index	1.6	1.6	1.0	1.8	2.7	2.5	2.0
GDP deflator	1.6	1.2	-0.4	1.7	3.9	1.0	1.1
Exchange rate (period average)							
U.S. cents/Canadian dollar	0.73	0.72	0.67	0.68	0.67	0.64	0.63
Percent change	0.3	-1.8	-6.8	0.6	-0.3	-4.2	-1.6
Nominal effective exchange rate	1.7	0.2	-6.0	-0.6	1.2	-3.0	-1.8
Real effective exchange rate	0.8	2.6	-6.3	-1.1	0.0	-4.0	-0.4
Indicators of financial policies (national accounts basis, as a percent of GDP)							
Federal fiscal balance	-2.0	0.7	0.8	0.8	1.7	1.0	0.5
Provincial fiscal balance 3/	-0.5	-0.2	-0.6	0.8	1.0	0.2	-0.3
General government	-2.8	0.2	0.1	1.7	3.1	1.8	0.8
Three-month treasury bill	4.3	3.2	4.7	4.7	5.5	3.9	2.6
Ten-year government bond yield	7.2	6.1	5.3	5.6	5.9	5.5	5.2
Balance of payments							
Current account balance (as a percent of GDP)	0.5	-1.3	-1.2	0.2	2.6	2.8	1.8
Merchandise trade balance (as a percent of GDP)	5.1	2.9	2.6	4.1	5.8	5.9	4.9
Export volume	5.2	8.5	8.5	11.1	8.6	-4.1	1.8
Import volume	5.1	16.5	6.1	8.5	8.9	-5.9	1.8
Invisibles balance (as a percent of GDP)	-4.5	-4.2	-3.8	-3.9	-3.2	-3.1	-3.1
Saving and investment (as a percent of GDP)							
Gross national saving	18.8	19.6	19.1	21.0	24.0	22.4	22.0
General government	-0.4	2.2	2.1	3.7	5.2	3.9	3.2
Private	19.1	17.4	17.0	17.3	18.8	18.5	18.9
Personal	7.5	6.0	6.1	5.4	5.7	5.7	6.7
Business	11.6	11.4	10.9	11.9	13.2	12.8	12.8
Gross domestic investment	18.2	20.7	20.5	20.6	20.6	19.5	20.2

Sources: Statistics Canada; and IMF staff estimates.

1/ Data as available at the time of the Executive Board Discussion on January 31, 2003.

2/ Contribution to growth.

3/ Includes local governments and hospitals.