CANADA

Economic growth is projected to increase in 2017, driven by expansionary fiscal policy, household wealth gains and a resumption in business investment, in particular in the resource sector following the rebound in commodity prices. In 2018, growth is likely to ease but remain robust, as government spending increases taper off. Consumer price inflation is expected to rise to above 2% in late 2018 as excess capacity is gradually eliminated and wage growth picks up.

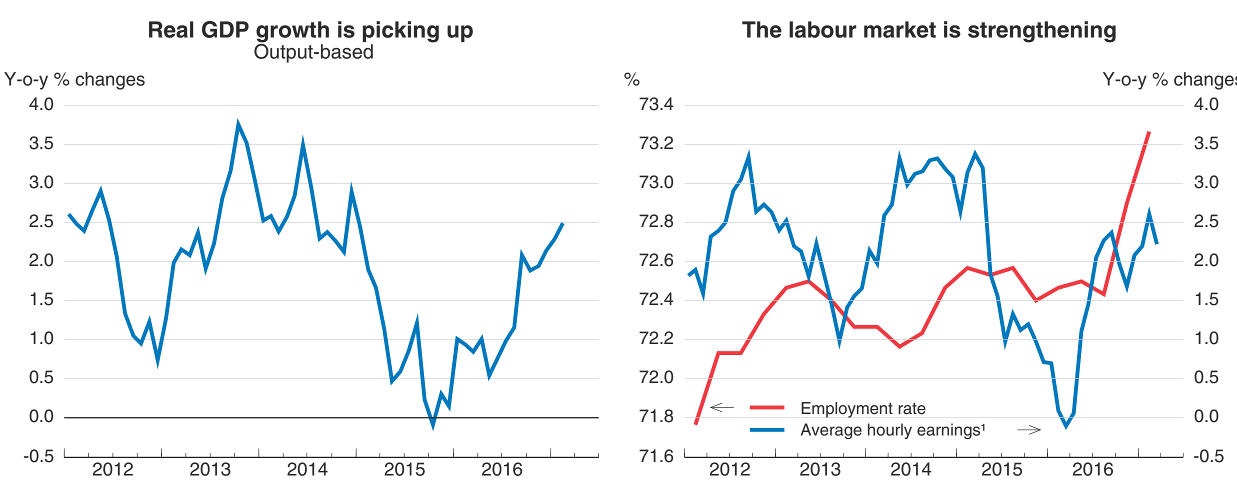
The federal government's mildly expansionary fiscal stance will hasten the economy's return to full employment. Gradual removal of monetary stimulus from late 2017 is projected, in order to stabilise inflation at around the 2% mid-point of the official target range. Higher interest rates will take some of the wind out of booming housing markets and rapidly rising house prices. Nevertheless, macro-prudential measures, which were strengthened during 2016, should be tightened further to address economic and financial risks related to the housing market.

Recent increases in federal investment in physical infrastructure, social housing, education and innovation will improve Canada's capacity to adjust to globalisation in an inclusive and efficient way. Adjustment pressures would be exacerbated in affected industries if the shift toward more protectionist trade policy in the United States continues. Adjustment capability would be enhanced by widening eligibility for active labour market measures and implementing systematic early needs assessment for all displaced workers. Initiatives to address the social problems of Canada's Indigenous Peoples are also critical if growth is to be inclusive going forward.

Expansionary monetary and fiscal policy is boosting growth

The economy has grown steadily in recent quarters. Private consumption is robust and residential investment has picked up, particularly in booming housing markets in British Columbia and Ontario. Consumption has been supported by wealth gains from house price

Canada



1. Earnings including overtime for salaried employees, three-month moving average.

Source: Statistics Canada, Tables 379-0031 and 281-0049; and OECD, Short-Term Labour Market Statistics database.

StatLink http://dx.doi.org/10.1787/888933502845

Canada: **Employment, income and inflation**

Percentage changes

	2014	2015	2016	2017	2018
Employment	0.6	0.9	0.7	1.7	1.1
Unemployment rate[1]	6.9	6.9	7.0	6.5	6.1
Compensation per employee[2]	3.0	2.0	1.7	2.1	3.3
Unit labour cost	1.2	1.8	1.1	1.0	1.9
Household disposable income	3.4	4.4	3.5	4.0	4.0
GDP deflator	1.9	-0.8	0.6	2.6	1.9
Consumer price index	1.9	1.1	1.4	1.9	2.0
Core consumer price index[3]	1.8	2.2	1.9	1.5	2.0
Private consumption deflator	1.9	1.1	1.0	1.8	1.9

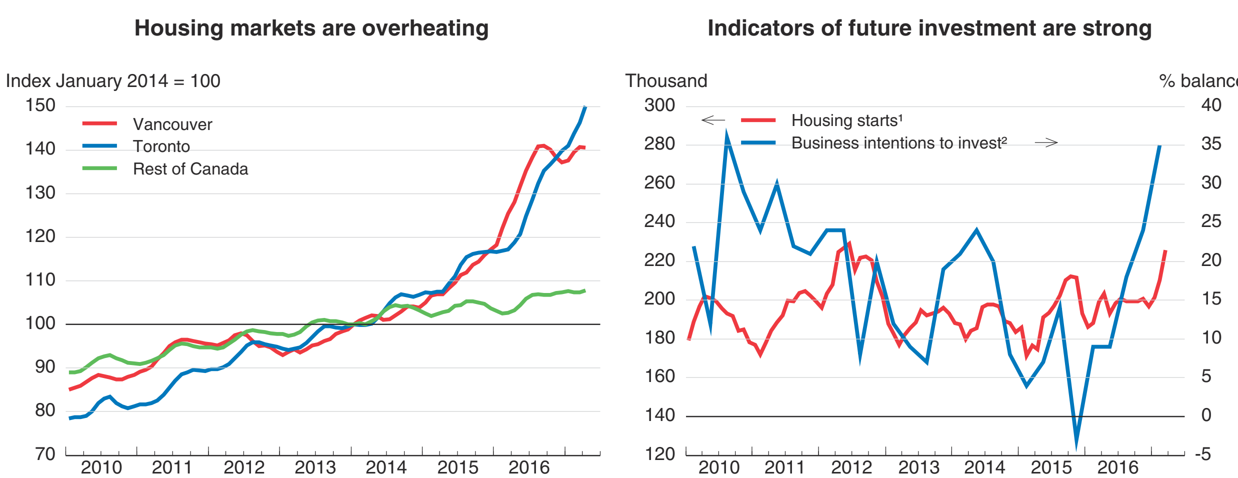
1. As a percentage of labour force.
2. In the total economy.
3. Bank of Canada definition: consumer price index excluding eight of the most volatile components and the effects of changes in indirect taxes on the remaining components.

Source: OECD Economic Outlook 101 database.

StatLink http://dx.doi.org/10.1787/888933505543

appreciation, which are linked in part to sustained low interest rates, and increased government transfer payments, notably the introduction of the Canada Child Benefit in July 2016. Business investment fell during 2015 and 2016 due to a severe contraction in the oil and gas sector in the wake of the collapse in global energy prices, but is now showing signs of picking up. The number of active drilling rigs is higher than in 2016, and plans to invest in machinery and equipment have spread. However, in many cases the increase is expected to be modest, if oil prices remain around USD 50 per barrel, given the relatively high cost of oil production in Canada. Merchandise trade growth was weak during 2016, and exports have continued to grow only slowly thus far this year.

Canada



1. Three-month moving average.
2. Percentage balance of business expectations to increase/decrease investment in machinery and equipment over the next 12 months.

Source: Teranet and National Bank of Canada, House Price Index; Statistics Canada, Table 027-0054; Bank of Canada (2017), *Business Outlook Survey*, Spring.

StatLink http://dx.doi.org/10.1787/888933502864

Canada: **Financial indicators**

	2014	2015	2016	2017	2018
Household saving ratio, net[1]	3.5	4.8	5.1	4.2	4.4
General government financial balance[2]	0.0	-1.1	-1.9	-1.7	-1.3
General government gross debt[2,3]	92.3	98.4	99.4	99.5	99.5
General government net debt[2,3]	30.8	30.0	31.3	31.4	31.4
Current account balance[2]	-2.4	-3.4	-3.3	-2.2	-1.9
Short-term interest rate[4]	1.2	0.8	0.8	0.8	1.4
Long-term interest rate[5]	2.2	1.5	1.3	2.0	2.7

1. As a percentage of disposable income.
2. As a percentage of GDP.
3. Debt is overstated relative to most other countries as no account is taken of assets in government-employee pension funds.
4. 3-month interbank rate.
5. 10-year government bonds.

Source: OECD Economic Outlook 101 database.

StatLink http://dx.doi.org/10.1787/888933505562

The labour market is strengthening. The unemployment rate is down about half a percentage point from a year earlier, and more people are coming into the labour force. Persistent excess capacity has prevented labour market strength from flowing through into wage increases, and slow growth in real hourly wages has allowed corporate profitability to recover from its 2015 decline. Consumer price inflation remains below the mid-point of the Bank of Canada's 1-3% target range, with the Bank's preferred measures of core inflation all close to 1.5%.

Canada: **Demand and output**

	2015	2016	2017	2018	Fourth quarter 2016	Fourth quarter 2017	Fourth quarter 2018
	Current prices CAD billion	Percentage changes from previous year, volume (2007 prices)					
GDP at market prices	1 986.2	1.4	2.8	2.3	1.9	2.9	2.3
Private consumption	1 143.7	2.2	3.1	1.9	2.3	3.0	1.7
Government consumption	417.7	2.0	1.5	0.8	2.3	1.4	0.7
Gross fixed investment	470.5	-3.2	1.4	3.3	-2.4	4.2	3.0
Public[1]	75.7	1.0	6.2	5.9	2.9	7.1	5.8
Residential	149.7	2.7	3.8	1.8	2.2	4.8	0.7
Non-residential	245.1	-8.0	-1.9	3.5	-7.1	2.9	3.6
Final domestic demand	2 032.0	0.9	2.4	2.0	1.2	3.0	1.8
Stockbuilding[2]	1.7	-0.3	0.0	0.0			
Total domestic demand	2 033.7	0.6	2.4	2.0	1.2	3.1	1.8
Exports of goods and services	627.2	1.1	2.3	4.4	0.8	3.4	4.7
Imports of goods and services	674.7	-1.0	0.8	3.2	-1.3	4.2	3.1
Net exports[2]	- 47.5	0.7	0.4	0.3			

Note: Detailed quarterly projections are reported for the major seven countries, the euro area and the total OECD in the Statistical Annex.
1. Excluding nationalised industries and public corporations.
2. Contributions to changes in real GDP, actual amount in the first column.

Source: OECD Economic Outlook 101 database.

StatLink http://dx.doi.org/10.1787/888933505581

Canada: **External indicators**

	2014	2015	2016	2017	2018
			USD billion		
Goods and services exports	567.1	491.1	474.3	495	519
Goods and services imports	585.4	528.4	510.7	512	531
Foreign balance	- 18.3	- 37.2	- 36.4	- 17	- 13
Invisibles, net	- 25.3	- 15.7	- 14.8	- 18	- 18
Current account balance	- 43.6	- 52.9	- 51.2	- 35	- 31
			Percentage changes		
Goods and services export volumes	5.8	3.4	1.1	2.3	4.4
Goods and services import volumes	2.2	0.3	- 1.0	0.8	3.2
Export performance[1]	1.4	- 0.5	- 0.3	- 2.2	- 0.2
Terms of trade	- 1.3	- 6.9	- 2.1	2.6	- 0.1

1. Ratio between export volume and export market of total goods and services.

Source: OECD Economic Outlook 101 database.

StatLink http://dx.doi.org/10.1787/888933505600

Policy measures will be needed to address inflation and rising house prices

Monetary policy has been very expansionary for some time. Excess capacity is projected to be used up by early 2018, and accordingly the Bank of Canada is projected to start increasing rates towards the end of 2017. Raising interest rates will reduce overheating in housing markets, which poses economic and financial stability risks and has made housing increasingly unaffordable, especially in Toronto and Vancouver. Greater use should be made of macro-prudential policies, particularly tools such as debt-to-income constraints under which a national rule is more restrictive in regions where house prices are inflated relative to fundamentals. Ontario has recently introduced legislation for a foreign buyers' transaction tax, similar to that introduced in Vancouver in August 2016, in conjunction with a broad expansion of rent control and rebates on development charges for new rental apartment buildings. Some short-term reprieve in house price growth is likely, but speculation-fuelled price increases may resume and the expansion of rent control risks discouraging the supply of new rental housing. Low rental supply would hamper labour mobility – particularly for the poor and the young – which will make adjustment to globalisation more costly and prolonged.

The federal government's fiscal stance continues to be mildly expansionary. The general government deficit increased by 0.8 percentage point to 1.9% of GDP in 2016, which primarily reflected demand-boosting measures in the 2016 federal budget. The deficit is projected to decline gradually as a share of GDP as the fiscal stimulus moderates. Spending is shifting to infrastructure, as the government has committed to deliver a planned CAD 181 billion of investment over 12 years.

Growth is projected to remain robust

Growth is set to shift from private consumption, housing investment and government spending toward business investment and exports. Very recent increases in consumption are unsustainable as they have not been matched by increases in income or output. Housing investment should also slow as further supply comes onto the market and as price growth eases in the overheated Vancouver and Toronto markets. Export growth is projected to increase gradually, reflecting strengthening global demand, a pick up in import-intensive investment in the United States and increased production from the recent rebound in energy investment. Unemployment is projected to fall further and, with excess capacity eliminated, inflation is projected to rise above the midpoint of the Bank of Canada's target range, even as interest rates are normalised during 2018.

The main downside risk to these projections is a disorderly housing market correction, notably in the Vancouver and Toronto markets. Such a correction would reduce residential investment, household wealth and consumption. A sufficiently large shock could even threaten financial stability. Export growth could be lower if trade barriers in key trading partners increase, for example through renegotiation of the North American Free Trade Agreement or further increases in specific barriers such as anti-subsidy duties recently imposed by the United States on Canadian softwood lumber. Alternatively, renegotiation of trade agreements could boost inclusive growth if it led to a phasing-out of Canadian dairy supply management policies. Other upside risks include delayed tightening of monetary policy, a continuation of recent depreciation in the Canadian dollar, further global oil price increases and a stronger-than-expected expansion in the United States, for example if fiscal policy is more expansionary than projected.

