

Executive summary

Economic growth remains buoyant

- *Well-being in Canada is high.*
- *Economic growth has eased back to potential rates since mid-2017 following problems in pipeline capacity.*
- *Macroeconomic policies are becoming less expansionary.*
- *GDP growth is projected to remain fairly robust.*
- *The greatest uncertainty in the outlook relates to increased global trade restrictions.*

High house prices create risks

- *In recent years, house prices have soared.*
- *Household debt has expanded alongside house prices, exceeding 170% of disposable income.*
- *A series of macro-prudential measures since 2008 have mitigated housing market risks.*
- *Unaffordability and affordable housing shortages raise inclusiveness issues.*

Workforce inclusion can be improved

- *The federal government is working hard to improve female labour market outcomes.*
- *Initiatives underway to improve labour market information offer benefits especially for youth*
- *Later retirement can be supported through flexibility in working hours and skills development.*

Immigrant labour market integration lags

- *Immigrants earn less than the comparable native-born.*
- *Immigration policy has been changed to select immigrants with better earnings prospects.*
- *Canada has an extensive array of programmes that facilitate integration.*

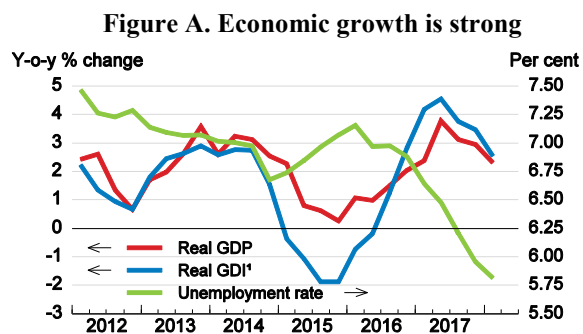
More should be done to raise productivity

- *Hourly labour productivity continues to lag behind the upper half of OECD countries.*
- *Implementing past OECD recommendations would increase productivity.*

Economic growth remains buoyant

Well-being in Canada is high, underpinned by good health, strong education and skills and high environmental quality. Income inequality is close to the OECD mean, but the working-age poverty rate is well above the OECD average. And meeting Canada's climate-change commitments will be challenging.

Economic growth has eased back to potential rates since mid-2017 following problems in pipeline capacity. Strong economic growth in 2017 supported employment, with unemployment reaching record lows (Figure A). Labour market strength is beginning to feed into wage growth.



1. Real Gross Domestic Income (GDI) equals real GDP adjusted for changes in the terms of trade.

Source: Statistics Canada, Table 380-0065; OECD, *Economic Outlook database*.

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Macroeconomic policies are becoming less expansionary. Some monetary policy stimulus has already been withdrawn, but with the economy operating close to potential and core inflation near the mid-point of the official target band, further interest rate increases will be needed. Similarly, the overall fiscal stance is set to become less stimulatory.

GDP growth is projected to remain fairly robust (Figure B). Private consumption gains are set to slow as interest rates rise further, house price appreciation eases and job growth moderates. Rising interest rates and the US corporate tax cut will hold back investment. Export growth has been held back by exchange

rate strength but is underpinned by improving global demand.

Figure B. Growth is projected to remain solid

	2017	2018	2019
Gross domestic product (GDP)	3.0	2.1	2.2
Private consumption	3.4	2.4	1.8
Government consumption	2.2	2.1	1.8
Gross fixed capital formation	2.8	4.2	3.2
Exports	1.0	1.7	4.4
Imports	3.6	3.7	3.9
Unemployment rate	6.3	5.7	5.5
Consumer price index	1.6	2.3	2.2
Government deficit (% of GDP)	-1.0	-1.0	-1.0
Current account deficit (% of GDP)	-3.0	-2.7	-2.5

Source: OECD *Economic Outlook 103 database*.

The greatest uncertainty in the outlook relates to increased global trade restrictions.

Outcomes will depend on political decisions, notably in the United States, but the associated uncertainty may be dampening Canadian investment. Termination of the North American Free Trade Agreement (NAFTA) would have a small but material effect (around -0.5%, but with considerable uncertainty) on GDP. The other major risk is a disorderly housing market correction, which would reduce residential investment, household wealth and consumption.

High house prices create risks

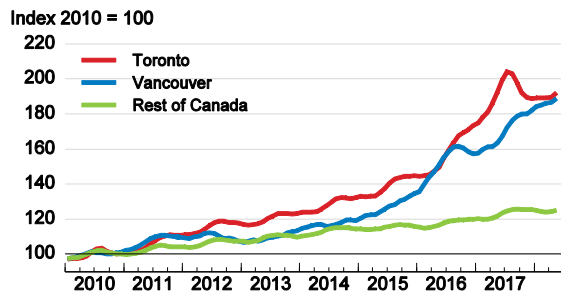
In recent years, house prices have soared in the major fast-growing centres of Toronto and Vancouver, which face supply constraints (Figure C). They have outpaced incomes and rents, driven by low interest rates, population growth, foreign buying and speculation. However, national house price appreciation has eased since mid-2017 following federal and provincial policy measures.

Household debt has expanded alongside house prices, exceeding 170% of disposable income.


Debt-servicing costs have been held down by low interest rates but could reach levels not seen since at least 1990 with projected policy rate normalisation. Highly indebted new borrowers are particularly vulnerable and are disproportionately likely to be young, living in

Toronto or Vancouver and to have lower incomes than other recent mortgage borrowers.

Figure C. House prices have increased most in Toronto and Vancouver



Source: Teranet and National Bank of Canada, *House Price Index*.

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A series of macro-prudential measures since 2008 have mitigated housing market risks. Federally and provincially regulated institutions operate side by side in mortgage markets, which makes close coordination important in monitoring the effects of recent tightening and in preparing to act further as circumstances change.

Unaffordability and affordable housing shortages raise inclusiveness issues. Homelessness is high, and the stock of social housing is low relative to other high-income OECD countries. Waiting times for social housing are as long as 14 years for recent applicants in urban, high demand regions of Ontario, for example. The CAD 40 billion National Housing Strategy seeks to address these problems through construction of new social and affordable housing units, repair or renewal of existing units and provision of housing allowances directly to households.

Workforce inclusion can be improved

The federal government is working hard to improve female labour market outcomes. Greater-than-planned improvements in access to high-quality, affordable early childhood education and care would support women's participation and child development, particularly for those from disadvantaged backgrounds. It

would also help to address the sizeable gender earnings gap, which is particularly large for Canadian mothers. The introduction of non-transferable parental benefits and leave for the second parent (usually fathers) announced in the 2018 federal budget should also help reduce that gap.

Initiatives underway to improve labour market information offer benefits especially for youth and could increase productivity by reducing the high rate of qualification mismatches. The Labour Market Information Council should build on the national Job Bank website to provide school leavers and existing workers with detailed, nationally consistent information.

Later retirement can be supported through flexibility in working hours and skills development. The age of eligibility for public and basic contributory pensions has remained fixed despite steadily rising life expectancy, holding back seniors' labour force participation. It should be indexed to such increases.

Immigrant labour market integration lags

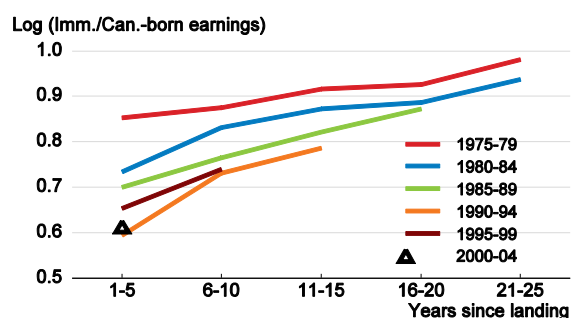
Immigrants earn less than the comparable native-born, but the gap shrinks as they spend more time in Canada. Controlling for relevant characteristics, the initial earnings of male immigrants fell sharply in relation to those of the native-born until the early 1990s and then probably remained too low for catch-up to occur during most immigrants' working lives (Figure D); similar trends are observed for female immigrants. Major causes of the fall include a deterioration in official language skills and in returns to foreign work experience.

Immigration policy has been changed to select immigrants with better earnings prospects. More are selected for their human capital, and greater weight has been given to official language competence, age (inversely related to foreign work experience) and Canadian work experience. Further changes that give extra weight to factors that affect the likelihood of immigrants finding good job matches would help to narrow the earnings gap.

Canada has an extensive array of programmes that facilitate integration. The Targeted Employment Strategy for Newcomers facilitates foreign-credentials recognition and helps immigrants gain Canadian work experience in their profession. Bridge programmes, which help with post-secondary credentials recognition in regulated occupations, and mentoring programmes, which help immigrants overcome underrepresentation in high-quality jobs by developing professional networks, have proved effective and should be expanded. The federal government's settlement programmes are extensively used, especially by immigrants with the greatest barriers to integration, but it is not clear whether utilisation patterns reflect differences in needs or availability. There are large differences in efficiency of government language programmes, pointing to possibilities for reorganisation to improve outcomes. Private management of government-assisted refugees is being trialled to see if it yields better results.

Figure D. Predicted male immigrant earnings relative to those of comparable Canadian-born

Full-time, full-year male workers, by years since landing, 1975-2004



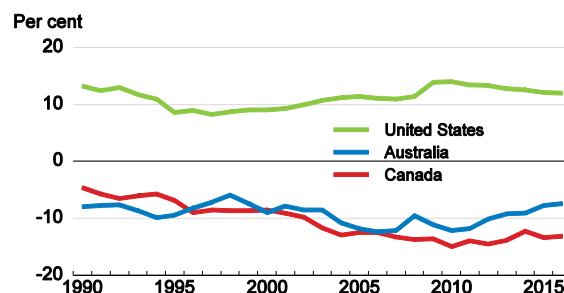
Source: G. Picot and A. Sweetman (2012), "Making It in Canada - Immigration Outcomes and Policies", *IRPP Study*, No. 29, April, Figure B1.

StatLink <http://dx.doi.org/10.1787/888933779447>

More should be done to raise productivity

Hourly labour productivity continues to lag behind the upper half of OECD countries (Figure E). Disappointing productivity performance reflects low growth in both capital intensity and multifactor productivity.

Figure E. Gaps in labour productivity relative to the upper half of OECD countries



Source: OECD (2018), *Economic Policy Reforms: Going for Growth 2018*.

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Implementing past OECD recommendations would increase productivity. Barriers to entry in network and services sectors should be reduced as should non-tariff barriers to internal trade. The innovation framework would benefit from focusing measures on correcting market failures. And the tax system should be reformed by reducing the reliance on taxes with high efficiency costs and phasing out tax expenditures not warranted by clear market failures or equity objectives, such as the preferential small business corporate tax rate.

The authorities are rightly putting more resources into infrastructure investment, but good project selection will be critical. The Canada Infrastructure Bank offers potential gains from access to private technology and innovation, enhanced incentives for project delivery and increased efficiency through user charging. However, rigorous cost-benefit analysis has been lacking from recent large public infrastructure projects in some jurisdictions. It will be important for the Bank to develop robust selection processes.

MAIN FINDINGS	KEY RECOMMENDATIONS
Making growth stronger, more sustainable and more inclusive	
With the economy operating around potential and growth near its potential rate, the need for macroeconomic stimulus is steadily waning.	Gradually withdraw monetary and fiscal stimulus as capacity constraints tighten and inflation returns to the midpoint of the 1-3% official target band, as foreseen.
Rapid growth in resale prices of houses, elevated household debt and a high housing investment share of GDP pose risks to the economy.	Monitor the effects of recent macro-prudential tightening, and stand ready to act should the balance of risks change.
Housing affordability has worsened, homelessness is high, and there are long waiting lists for social housing in some major urban centres.	Increase the supply of affordable housing and better maintain the existing social housing stock, as planned. Improve targeting of social housing to those with the greatest needs.
Infrastructure investment has the potential to boost productivity if well implemented.	Ensure projects supported by the Canada Infrastructure Bank meet cost-benefit criteria through existing infrastructure planning processes.
Rising health-care costs associated with population ageing contribute to unsustainable provincial/territorial fiscal positions, which are highly heterogeneous across these jurisdictions.	Adjust the Canada Health Transfer (and other social transfers from the federal government) for provinces' and territories' varying age structures.
Although important actions have been taken over the years to improve the competitiveness of the Canadian corporate tax system, a comprehensive review of the overall tax system may be helpful in determining how it can further attract investment.	Review the tax system to ensure that it remains efficient -- raising sufficient revenues to fund public spending without imposing excessive costs on the economy -- equitable and supports the competitiveness of the Canadian economy.
Canada has overlapping and potentially expensive measures to reduce carbon emissions, many of which would be redundant if all emissions were adequately priced.	Progressively increase the carbon price to the extent necessary to meet Canada's GHG abatement objectives, and eliminate redundant abatement measures.
Increasing inclusiveness for women, youth and seniors	
Gender employment gaps within Canada increase with childcare costs, which are high by international comparison. Increasing government spending on early childhood education and care to match leading countries would significantly lift female employment.	Further increase federal and provincial funding of childcare with a goal of making access to affordable high-quality childcare available to all children aged three and under. Extend kindergarten so that all four year-old children have access to affordable pre-school education.
The gender earnings gap is large, especially for women with children, in part due to the large disparity in time spent on childcare.	Support take-up of new parental leave by fathers through information provision and, if necessary, increasing payment rates.
Fragmented labour market information has contributed to a high rate of qualifications mismatch and fails to provide clear signals to young Canadians regarding career prospects.	Consolidate the existing range of career guidance and education information into a single national portal to provide a comprehensive one-stop shop.
Many people retire at 60 or 65 despite increasing life expectancy, holding back incomes.	Index the eligibility age for public pensions to life expectancy, supported by encouraging flexibility in working hours and skill development.
A shortage of formal long-term care puts considerable strain on carers, the majority of whom are women, and hospitals.	Manage growing demand for long-term care by improving targeting of public payments, wider application of user charging and further encouraging home-care services.
Enhancing labour-market integration of immigrants	
Prior Canadian skilled work experience boosts immigrant earnings. Canadian post-secondary education and a relevant job offer are advantageous when combined with such experience.	Increase the weight given to skilled Canadian work experience in selection of economic immigrants. Condition points for post-secondary Canadian education and a relevant job offer on such experience.
Employer demand continues to play a minor role in immigrant selection through Express Entry.	Process Express-Entry applications of immigrant candidates with skilled Canadian experience and a relevant job offer before others, and reduce administrative complexity.
Many Provincial Nominee Program (PNP) immigrants lack human capital levels associated with long-term economic success and flexibility. Immigrants who work in their pre-immigration regulated occupation earn more than those who do not.	Channel more PNP candidates through the federal government's Express Entry system, which selects candidates with high levels of human capital. Enhance norms for provinces' foreign qualifications recognition, and take into account the gap between applicants' credentials and requirements in regulated professions when awarding points. Expand bridge programmes to help bring credentials up to the required level and mentoring programmes to help immigrants into high-quality jobs.
Government settlement services are widely used, but it is not clear whether service patterns reflect needs or availability.	Assess the extent to which utilisation patterns reflect needs and, insofar as they do not, redirect resources.
There are large differences in the efficiency of government language programmes by type of programme and client.	Increase resources for the more effective programmes, such as occupation-specific training, to reduce queueing.



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