IMF warns Canada on housing, trade; urges caution on rate hikes

By Andrea Hopkins
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The International Monetary Fund said on Thursday that while Canada's economy has regained momentum, housing imbalances have increased and uncertainty surrounding trade negotiations with the United States could hurt the recovery.

The report, written before the central bank raised interest rates by a quarter of a percentage point on Wednesday to 0.75 per cent, also said the Bank of Canada's current monetary policy stance is appropriate, and it cautioned against tightening.

"While the output gap has started to close, monetary policy should stay accommodative until signs of durable growth and higher inflation emerge," it said, adding that rate hikes should be "approached cautiously."

Cheng Hoon Lim, IMF mission chief for Canada, later clarified that even with Wednesday's rate hike, monetary policy remains "appropriately accommodative."

"The Bank of Canada's increase of the policy rate reflects encouraging economic data over the past few months. We welcome the good news on the economy," Lim said in an emailed statement.

"Given the considerable uncertainty around the growth and inflation outlook, the Bank should continue to take a cautious approach in further adjusting the monetary policy stance," she added.

In a statement following its annual policy review with Canada, the IMF cautioned that risks to Canada's outlook are significant – particularly the danger of a sharp correction in the housing market, a further decline in oil prices, or U.S. protectionism.

It said financial stability risks could emerge if the housing correction is accompanied by a recession, but said stress tests have shown Canadian banks could withstand a "significant loss" on their uninsured residential mortgage portfolio, in part because of high capital position.

House prices in Toronto and Vancouver have more than doubled since 2009 and the boom has fueled record household debt, a vulnerability that has also been noted by the Bank of Canada.

"The main risk on the domestic side is a sharp correction in the housing market that impairs bank balance sheets, triggers negative feedback loops in the economy, and increases contingent claims on the government," the Fund said.

The Fund also warned U.S. protectionism could hurt Canada, laying out a scenario for higher tariffs that could come with the renegotiation of the North American Free Trade Agreement.

If the United States raises the average tariff on imports from Canada by 2.1 percentage points and there is no retaliation from Canada, there would be a short-term impact on real GDP of about 0.4 per cent.