The Provinces

- **Alberta and British Columbia are expected to retain growth leadership through 2019. All provinces are forecast to post gains this year and next, though only two avoid the slower trend anticipated after the 2017 surge.**

- **For a second year, the Provinces project an aggregate deficit for fiscal 2017–18 (FY18) less than CAD 10 bn (0.4% of GDP). Spring *Budgets* forecast a combined deficit of up to CAD 17 bn for FY19, pending election outcomes this year in Ontario, New Brunswick and Quebec.**

SUSTAINING EXPANSION

For Canada's three major oil-producing provinces, a significant assist is anticipated from the steep gains forecast for WTI and Brent oil prices this year and the more moderate advance for Western Canadian Select prices for bitumen. This assumes, however, that at least two of the three major oil pipeline projects—the Line 3 refurbishment and either the Trans Mountain Expansion or Keystone XL—proceed as planned. Combined, the other seven provinces enter 2018 expanding faster than their underlying trend rates, with capacity constraints emerging. In these provinces, the share of longer-term unemployed has slid to levels not seen since 2012 (chart 1), and the fraction of part-time workers seeking full-time jobs in 2017 fell to a post-recession low.

Job creation across the seven oil-consuming provinces is expected to ease over the next two years from the robust 2017 pace. As growth moderates, it will take time to absorb the jump in full-time positions that approached or exceeded 2.0% in six provinces last year. Wage increases, as measured in several surveys, appear to be picking up in higher-growth areas reflecting skills shortages in some instances. In Central Canada, unemployment rates are at historic lows. The 2015–16 setback in Alberta's and Saskatchewan's wages that dampened national averages into early 2017 is reversing. The upward trend in minimum wages has steepened, reflecting double-digit increases in the four largest provinces since the end of 2016, and annual indexation in a number of other provinces providing gradual steady increases. Also boosting household incomes are job gains in high-wage industries such as professional, scientific & technical services, where weekly wages were 38% above the all-industry average in 2017, and employment rose in nine provinces (chart 2).

Core consumer price inflation in recent months has picked up in PEI, Nova Scotia, Manitoba and BC, and with the exception of Manitoba, services are a frequent source of higher prices. In coming quarters in regions witnessing above-trend growth, rising inflation is expected to diminish the real purchasing power of higher wages. On a sector-specific basis, unexpectedly strong housing starts last year plus elevated infrastructure investment are bolstering apartment construction costs apart from land prices (chart 3).

A gentle cooling characterizes our consumption and housing outlooks for most provinces given new mortgage restrictions, moderating job creation, debt burdens and rising interest rates. For the first time on record, six of the net oil-consuming

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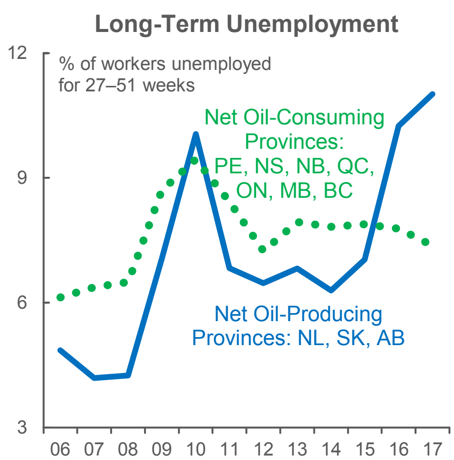
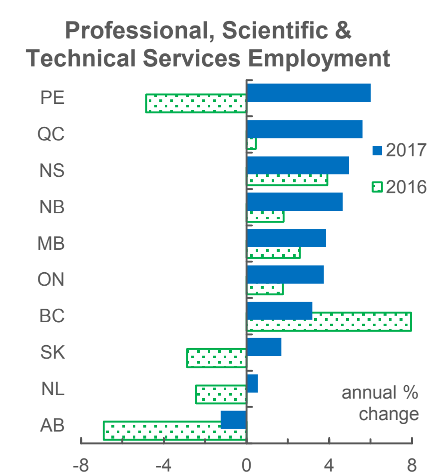
Chart 1



Sources: Scotiabank Economics, Statistics Canada.

Chart 2



Sources: Scotiabank Economics, Statistics Canada.

provinces reported 2017 retail sales growth over 6%, a surge that is likely unsustainable. Motor vehicle unit sales are forecast to drop in seven provinces both this year and next (table 1) while less buoyant housing market activity is expected to constrain spending on other durables. Upbeat statistics for 2017, such as increased international visitors in seven provinces, affirm the rising trend in tourism receipts. Further gains should be supported by the Canadian dollar averaging roughly 80¢(US) and multiple regional tourism investments, either completed or under way.

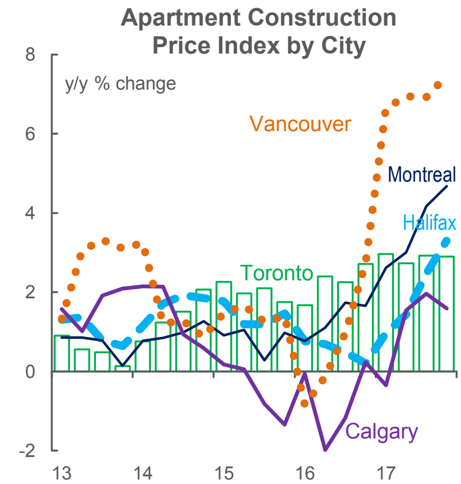
Housing affordability issues are expected to persist in and around British Columbia's largest cities and in Ontario's Greater Golden Horseshoe. More balanced housing markets, however, are anticipated for most other regions, with affordable ownership options and rental vacancy rates typically at or above the 3.0% threshold indicating supply matching demand. In Nova Scotia, an upswing in multi-units has accounted for 55% of housing starts over the last three years, transforming the Halifax skyline and leaving sufficient inventory to drop provincial starts back below 4,000 units annually through 2019. In Quebec City, average residential transaction prices have been virtually flat since 2013, but Montreal witnessed a 5.5% jump in house prices in 2017, mirroring the CMA's strong job creation and the Province's significant personal tax relief. Inventories of completed and unsold housing units, built up since the 2014 commodity price correction, remain elevated in Calgary, Edmonton and Saskatoon, and to a lesser extent in Regina. This inventory is expected to forestall new residential construction and limit price gains, even as housing demand firms.

The projected recovery in business investment this year will be concentrated among the oil-consuming provinces and in machinery & equipment (M&E). Statistics Canada's capital investment intentions survey indicated a 4.2% rebound in nominal M&E purchases for the net oil-consuming provinces (chart 4). This may well understate the eventual increase given reported capacity constraints, particularly in Central Canada and British Columbia, and the anticipated market opportunities. The expected upswing in M&E investment in the oil-consuming provinces is corroborated by the late 2017 spike in industrial machinery imports, and the surge last year in domestic machinery orders and shipments.

Business investment activity across the three oil-producing provinces, after three years of substantial declines, is unlikely to begin regaining lost ground until 2019–20. While their M&E purchases are expected to stabilize over the next year and western Canada's conventional oil & gas exploration remains buoyant, new oil sands construction is more limited after recent major capacity additions and the completion of Hebron, Newfoundland and Labrador's fourth offshore oil field. Apart from the oil & gas sector, non-residential construction is expected to advance this year in areas such as commercial development, pipelines, and utilities.

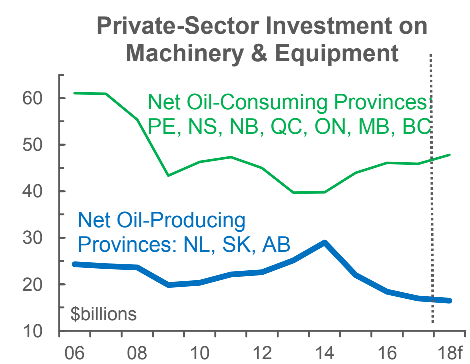
As in 2017, net exports in 2018 are expected to support the three oil-producing provinces' expansion. Their imports will be constrained by their subdued business investment plans as their oil production continues to climb, albeit with some easing from last year's gains. For non-energy exports, BC should continue to benefit from its strong Asian ties (chart 5) and the Comprehensive Economic and Trade Agreement with the EU offers opportunity for all regions. In Ontario, net exports are posing a drag on growth. As the province's domestic spending strength pushes Ontario's imports higher, the forecast 7½% decline in motor vehicles assembled will detract from the anticipated gains in areas such as machinery.

Chart 3



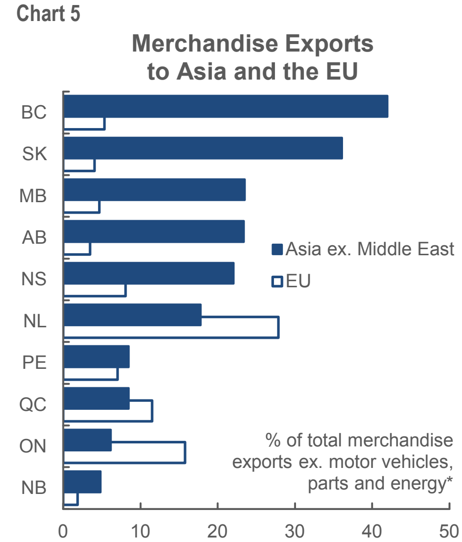
Sources: Statistics Canada.

Chart 4



Sources: Statistics Canada, *Capital & Repair Expenditures Survey*.

Chart 5

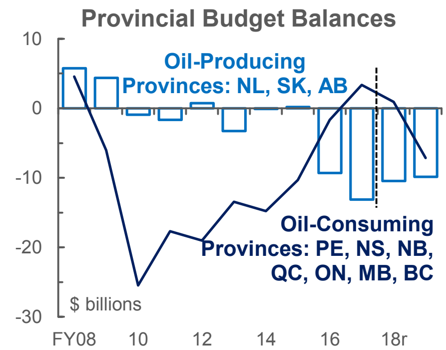


* Oil & gas, power and motor vehicles & parts exports largely destined for the US market.
Sources: Scotiabank Economics, Industry Canada.

POTENTIAL DIVERGENCE IN PROVINCIAL FISCAL PATHS

The Provinces' wider FY19 aggregate deficit is primarily due to BC's and Quebec's more modest surpluses and Ontario's CAD 6.7 bn deficit, though upcoming Central Canada elections could alter the forecast (chart 6). Deficit reduction by the three oil-producing Provinces continues, with a forecast CAD 3 bn (-25%) improvement since FY17. New *Budget* priorities this year include: raising child care availability and affordability; expanding lower-price rental housing supply; reinforcing immigrant attraction and retention efforts; and broadening innovation, in addition to each region's participation in Ottawa's selected superclusters on oceans, AI, advanced manufacturing, protein industries and digital technology. Challenges include the rising amortization and interest charges resulting from several consecutive years of stepped-up infrastructure investment and employee remuneration demands after lengthy restraint.

Chart 6



Source: *Budget* documents.

Table 1

The Provinces					(annual % change except where noted)						
Real GDP	**CA**	**NL**	**PE**	**NS**	**NB**	**QC**	**ON**	**MB**	**SK**	**AB**	**BC**
2000–16	2.1	2.5	1.7	1.3	1.2	1.7	2.0	2.3	2.0	2.7	2.8
2016	1.4	1.9	2.3	0.8	1.2	1.4	2.6	2.2	-0.5	-3.7	3.5
2017e	3.0	-1.5	2.2	1.6	1.4	2.8	2.9	2.3	1.9	4.3	3.5
2018f	2.2	0.5	1.8	1.4	1.0	2.1	2.1	2.0	1.8	2.5	2.6
2019f	2.1	1.2	1.6	1.0	0.7	1.9	2.0	1.8	2.0	2.3	2.4
Nominal GDP											
2000–16	4.2	5.6	4.2	3.4	3.3	3.6	3.8	4.4	5.3	5.9	4.5
2016	2.0	2.6	4.0	2.8	3.6	2.7	4.3	2.3	-4.0	-4.9	4.8
2017e	5.3	3.1	4.0	3.2	3.0	4.2	5.1	4.0	4.8	7.6	5.6
2018f	4.5	3.6	3.6	3.1	2.7	4.0	4.5	3.9	3.8	5.3	4.8
2019f	4.5	4.5	3.6	2.9	2.4	4.1	4.4	3.6	4.3	5.3	4.8
Employment											
2000–16	1.3	0.8	1.0	0.6	0.4	1.3	1.3	0.9	1.1	2.3	1.4
2016	0.7	-1.5	-2.3	-0.4	-0.1	0.9	1.1	-0.4	-0.9	-1.6	3.2
2017	1.9	-3.7	3.1	0.6	0.4	2.2	1.8	1.7	-0.2	1.0	3.7
2018f	1.3	-0.8	1.5	0.5	0.3	1.5	1.5	0.6	0.4	1.5	1.6
2019f	1.0	-0.5	0.8	0.2	0.1	0.8	1.0	0.6	0.6	1.1	1.2
Unemployment Rate (%)											
2000–16	7.1	14.3	11.2	8.8	9.6	8.0	7.1	5.1	5.0	5.1	6.6
2016	7.0	13.4	10.7	8.3	9.5	7.1	6.5	6.1	6.3	8.1	6.0
2017	6.3	14.8	9.8	8.4	8.1	6.1	6.0	5.4	6.3	7.8	5.1
2018f	5.8	14.9	9.9	8.2	8.0	5.5	5.5	5.3	5.8	7.0	4.8
2019f	5.7	15.0	10.0	8.0	8.0	5.4	5.4	5.2	5.7	6.9	4.8
Housing Starts (units, 000s)											
2000–16	199	2.6	0.7	4.3	3.5	44	71	5.1	5.2	34	28
2016	198	1.4	0.6	3.8	1.8	39	75	5.3	4.8	25	42
2017	220	1.4	0.9	4.0	2.3	46	79	7.5	4.9	29	44
2018f	208	1.3	0.9	3.8	2.1	42	77	6.3	5.0	28	42
2019f	196	1.3	0.8	3.8	2.1	38	71	6.3	5.0	30	38
Motor Vehicle Sales (units, 000s)											
2000–16	1,657	29	6	48	38	413	635	47	45	216	180
2016	1,949	33	9	54	44	458	807	55	51	220	218
2017	2,041	33	9	59	42	453	847	62	56	245	235
2018f	2,000	32	8	58	40	445	821	61	56	248	231
2019f	1,950	30	8	56	39	434	791	60	56	250	226
Budget Balances, Fiscal Year Ending March 31 (CAD mn)											
2000–16*	-2,803	-93	-38	-30	-153	-768	-5,115	-142	307	1,064	319
2016	-987	-2,206	-13	-13	-261	2,191	-3,515	-839	-1,520	-6,442	811
2017	-17,770	-1,148	-1	150	-119	2,361	-991	-764	-1,218	-10,784	2,737
2018f**	-19,400	-812	1	134	-115	850	642	-726	-595	-9,066	151
2019f	-15,100	-683	1	29	-189	0	-6,704	-521	-365	-8,802	219

Sources: Scotiabank Economics, Statistics Canada, CMHC, Budget documents. * MB:FY04–FY16; AB:FY05–FY16. ** Federal & Provinces' FY18 & FY19: Budget documents. Federal FY19: ex risk adjustment of $3.0bn.