The Provinces

SUMMARY

- **As a result of weaker-than-previously anticipated growth in Q4-2018 and Q1-2019, we have edged down our forecast expansions for a number of provinces this year, and modestly raised projected advances for 2020.**
- **Nevertheless, most provincial economies are still on firm footing, and we continue to look for BC to lead provincial economic growth through 2020. Labour shortages and protectionist sentiment remain key risks.**
- **Several Provinces have progressed on fiscal consolidation plans, and newly released and upcoming financial blueprints underline a range of policy priorities.**

LOOK PAST LATE-2018 SOFT PATCH, FUNDAMENTALS REMAIN SOLID

The slowdown in economic growth witnessed across Canada was felt in several regions. Real non-residential business investment, which was a key factor behind national-level weakness, fell 3.9% (q/q ann.) in Quebec in Q4-2018. The dip continued the retreat in that province after gains in 2017 and early last year that were largely attributable to capacity pressures; capital outlays thus far have followed a similar pattern in Ontario (chart 1). Alberta drilling activity, likely influenced by softer oil prices, slowed substantially in November and then fell by more than 20% y/y in December to reach the second-lowest ever recorded level for the latter month.

While a slower expansion in late 2018 provides a weak hand-off for 2019, we foresee a return to healthy growth in H2. To complement federal accelerated depreciation measures, BC, Ontario, and Nova Scotia have allocated funds for further capital expenditure write-offs, and Quebec added generous provincial-level incentives in December. Work will likely begin in earnest on the Kitimat LNG export terminal this year; this should boost capital outlays by nearly $14 bn in BC over 2019–20, and lift the province to the top of the growth table in both years. Firm full-time job creation in most regions thus far in 2019 should also support consumer outlays as monetary stimulus is withdrawn (chart 2).

Heavy oil production limits, implemented to alleviate the light-heavy oil price discount, continue to underlie our Alberta forecast. The cuts are expected to dampen key oil and gas sector output this year. Construction delays for the Line 3 pipeline will also likely weigh on price differentials throughout the forecast period and prolong the province's investment recovery. Outside the oil patch, there is more cause for optimism; work is expected to progress this year on petrochemicals facilities and a potato processing plant.

Stable, albeit more moderate export gains are also key to our forecast of a return to healthy economic growth. We expect resolution of ongoing Sino-US trade tensions to result in US demand for imports from most provinces that largely mirrors a more moderate, but still healthy expansion south of the border. We also anticipate exemptions to US import tariffs on steel and aluminum

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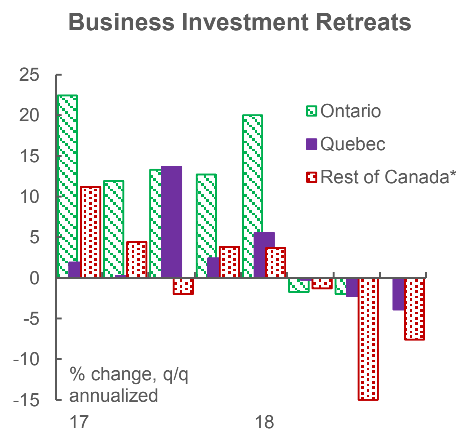
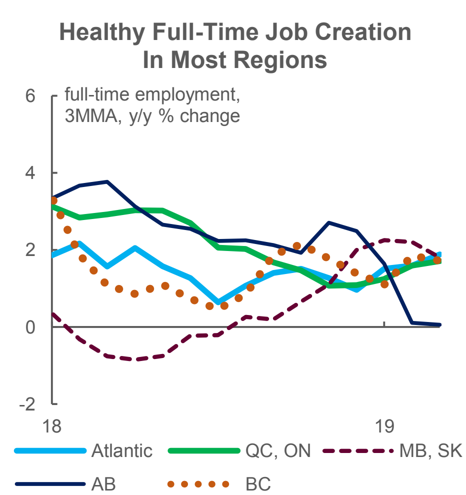
Chart 1



* Q4-2018 figure is for Canada less Quebec. Sources: Scotiabank Economics, Statistics Canada, Ontario Finance, Insitut de la Statistique du Québec.

Chart 2



Sources: Scotiabank Economics, Statistics Canada.

products. The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) will provide new market access in the Pacific Rim. Exports to China are also forecast to assist economic growth in multiple jurisdictions, from BC where trade linkages to the country are strong (chart 3), to Newfoundland and Labrador as oil production rises, to Manitoba as soybean sales stabilize.

Labour shortages remain in place across multiple jurisdictions and continue to present barriers for firms that intend to hire and expand. Job vacancy rates averaged more than 3% in half of the provinces in 2018. Increases to Ottawa's newcomer admission targets through 2021 are constructive given the present tightness and expectations of population aging, especially in regions with a low immigrant population share (chart 4). In light of persistent labour shortages and a more moderate growth environment, we remain skeptical of the merits of Quebec's planned immigration cut. However, new programs that aim to lift immigrant integration are auspicious, and may help to improve newcomer labour market outcomes alongside further success with respect to attraction of net non-permanent residents.

We foresee relatively stable home sales and price growth in Ontario and BC after 2018's stress-test-led soft patch. Sales-to-new listings ratios still point to more muted home price rises in the Greater Golden Horseshoe over the next year than at the early 2017 market peak, though there is evidence that tightness and affordability pains have spread elsewhere in Ontario. BC sales continue to adjust to taxes enacted last year plus measures that target the high end market as of January 1, 2019. Elevated immigration and steady job creation should keep prices and rents elevated relative to incomes in both regions, even as still-high builder margins combined with government policy to incite near-record construction.

Cities in Canada's net oil-producing regions continue to grapple with an overhang of units accrued since the commodity price correction. Substantial building and home value increases are not expected until that glut is absorbed.

Elsewhere, housing construction and price gains are set to move with job creation and underlying demographics. Ownership and rental market tightness in Montreal and Ottawa reflect strong economic conditions rather than fundamental supply-demand imbalances, and should abate as growth cools in Central Canada.

BUDGET SEASON 2019 HIGHLIGHTS DISPARATE FISCAL PATHS

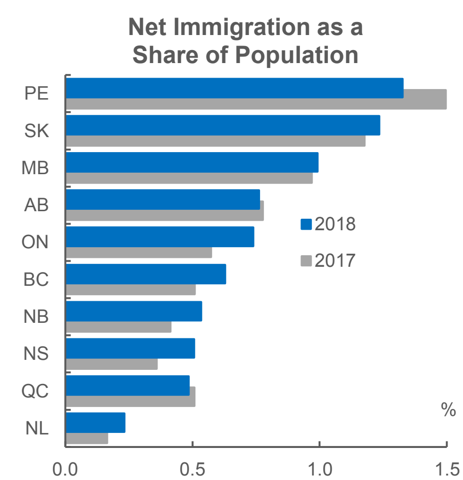
A number of Provinces will deploy surpluses to fortify policy plans already underway. As efforts to lift the supply of affordable housing progress, BC will direct stronger-than-anticipated revenue gains to enhanced child care benefits that build on fee reductions and investments in child care spaces announced in 2018. Nova Scotia, buoyed by a sizeable consolidation adjustment, will raise FY20 spending beyond prior plans, with a focus on health care and education. Quebec will allot an FY19 windfall to lower childcare costs and school tax rates paid by homeowners. It will maintain the accelerated borrowing retirement schedule unveiled in December to ramp up debt reduction completed since FY15 (chart 5).

Other jurisdictions will likely wait to loosen the purse strings. New Brunswick aims to balance the books and curtail net debt in FY20 via funding reductions across several government departments, but will review the competitiveness of its tax system. Amid uncertain energy sector conditions, Saskatchewan will contain spending and limit new measures to boutique personal income tax credits on its path to balance by FY20.

Chart 3

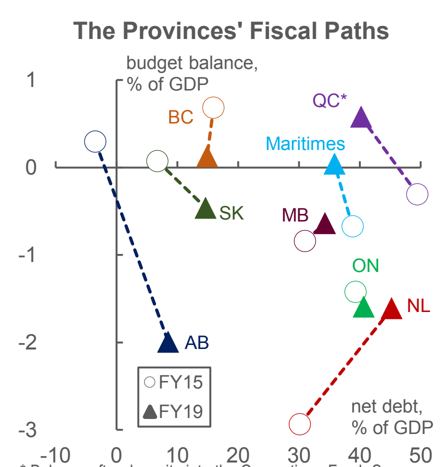
Sources: Scotiabank Economics, Industry Canada.

Chart 4



Sources: Scotiabank Economics, IRCC.

Chart 5



* Balance after deposits into the Generations Fund. Sources: Scotiabank Economics, Budget Documents.

Blueprints in Alberta and Newfoundland and Labrador should stay anchored to expenditure restraint. The latter's FY23 surplus target currently rests on a 1.4% average annual total spending contraction beyond FY19. Alberta's recent financial update—released in the shadow of an election—revised FY20–21 spending plans $8 bn higher than expected last year, in respect of outlays on crude-by-rail transportation to provide additional takeaway capacity until pipelines are built. A return to black ink relies on flat total spending during FY23–24. Regardless of the incoming government, Alberta's medium fiscal planning will require a balance between expenditure management and attention to the viability of large energy projects.

Campaign priorities look to be key for near-term fiscal policy elsewhere. Ontario's budget is the first for the new administration, and includes steps to reduce the Province's sizeable debt and deficit, as well as pocketbook relief and support for businesses. Manitoba recently reduced its Provincial Sales Tax to 7% from 8%, which fulfills a touchstone pledge from the 2016 election. With balanced books and an election only weeks away, PEI has outlined new pocketbook and small business tax relief and stepped-up infrastructure spending.

Table 1

The Provinces (annual % change except where noted)

Real GDP	CA	NL	PE	NS	NB	QC	ON	MB	SK	AB	BC
2000–17	2.1	2.4	1.8	1.3	1.2	1.8	2.0	2.3	2.0	2.8	2.7
2017	3.0	0.9	3.5	1.5	1.8	2.8	2.8	3.2	2.2	4.4	3.8
2018e	1.8	-0.6	2.0	1.2	1.1	2.1	1.8	1.8	1.4	2.1	2.2
2019f	1.6	1.3	1.5	1.0	0.8	1.7	1.7	1.6	1.6	1.2	2.4
2020f	2.1	0.9	1.1	0.9	0.9	1.7	1.7	1.5	1.7	2.5	3.5
Nominal GDP											
2000–17	4.3	5.6	4.2	3.3	3.4	3.7	3.9	4.4	5.4	5.9	4.7
2017	5.6	4.3	4.8	2.9	4.3	5.0	4.1	5.4	4.8	10.0	6.9
2018e	3.6	2.7	3.8	3.0	2.8	4.1	2.8	3.6	3.6	4.5	4.4
2019f	2.6	3.2	3.4	2.7	2.4	2.2	2.3	3.4	3.5	1.8	4.3
2020f	4.6	4.3	3.1	2.9	2.6	3.8	4.0	3.4	4.4	5.3	6.5
Employment											
2000–17	1.4	0.6	1.1	0.6	0.4	1.3	1.3	1.0	1.1	2.2	1.5
2017	1.9	-3.7	3.1	0.6	0.4	2.2	1.8	1.7	-0.2	1.0	3.7
2018	1.3	0.5	3.0	1.5	0.3	0.9	1.6	0.6	0.4	1.9	1.1
2019f	1.6	1.2	0.9	1.3	0.3	1.2	1.8	1.3	1.2	1.1	2.1
2020f	0.7	0.0	0.7	0.2	0.2	0.6	0.7	0.6	0.6	1.0	1.0
Unemployment Rate (%)											
2000–17	7.1	14.3	11.1	8.8	9.5	7.9	7.0	5.1	5.0	5.3	6.5
2017	6.3	14.8	9.8	8.4	8.1	6.1	6.0	5.4	6.3	7.8	5.1
2018	5.8	13.8	9.4	7.6	8.0	5.5	5.6	6.0	6.1	6.6	4.7
2019f	5.7	12.8	9.3	7.0	8.0	5.3	5.7	5.9	5.9	6.5	4.5
2020f	5.9	12.7	9.5	7.1	8.0	5.5	5.8	5.9	5.9	6.7	4.7
Housing Starts (units, 000s)											
2000–17	200	2.5	0.8	4.3	3.4	44	72	5.2	5.2	34	29
2017	220	1.4	0.9	4.0	2.3	46	79	7.5	4.9	29	44
2018	213	1.1	1.1	4.8	2.3	47	79	7.4	3.6	26	41
2019f	202	1.3	0.8	3.9	1.8	43	73	6.1	4.2	28	39
2020f	200	1.4	0.8	3.8	2.0	41	72	6.1	5.0	31	37
Motor Vehicle Sales (units, 000s)											
2000–17	1,657	29	6	48	38	413	635	47	45	216	180
2017	2,041	33	9	59	42	453	847	62	56	245	235
2018	1,984	28	8	51	38	449	853	67	47	226	217
2019f	1,930	30	8	48	35	430	826	60	48	220	225
2020f	1,900	30	8	47	34	420	810	55	48	215	233
Budget Balances, Fiscal Year Ending March 31 (CAD mn)											
2017	-19,000	-1,148	-1	151	-117	2,361	-991	-764	-1,218	-10,784	2,737
2018	-19,000	-911	75	230	67	2,622	-3,700	-695	-303	-8,023	301
2019e	-14,900	-547	14	28	5	2,500	-13,549	-470	-348	-6,930	374

Sources: Scotiabank Economics, Statistics Canada, CMHC, Budget documents; Quebec budget balance figures are after Generations Fund transfers.