The Provinces

- **Alberta and BC are forecast to top provincial economic growth in 2018, with BC reclaiming the outright lead thereafter due to new major project activity; all provinces are expected to continue expanding through 2020.**
- **Pressure to restrain public spending is intensifying as revenue growth slows, with the federal government offering some near-term assistance.**

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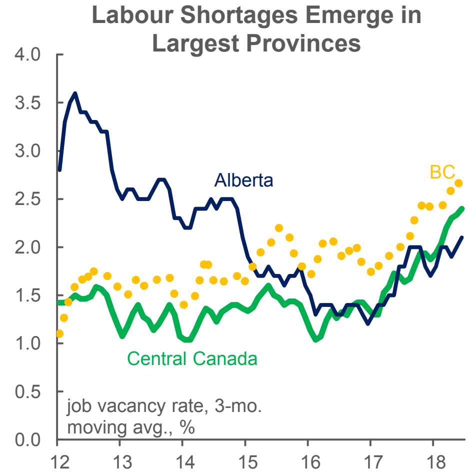
NEW PROJECTS, TRADE PACT BUOY PROVINCIAL PROSPECTS

Expectations of moderating consumer spending across the provinces still underlie our forecast. Slower job creation is the proximate cause in net oil-consuming regions. Waning Fort McMurray rebuild-related outlays are negating Alberta's year-to-date hiring pick-up. Newfoundland and Labrador's falling population should offset modest projected job gains, and weak wage growth plus rising inflation are weighing on Saskatchewan consumer spending. As job creation eases further, Canada Child Benefit stimulus continues to dissipate, interest rates rise and housing activity slows through 2020, we foresee a gentle cooling of real consumer expenditure growth in most regions.

Labour shortages, arising across Central and Western Canada after above-trend job creation last year, present new challenges. Though tight labour markets have the potential to push wages higher, they also limit businesses' ability to hire and expand. In June, job vacancy rates reached record highs in Quebec, Ontario and BC and a post-2014 high in Alberta (chart 1), with elevated numbers of unfilled positions reported in a range of industries.

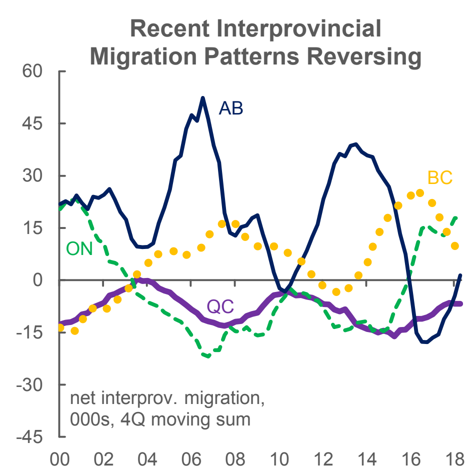
Chart 1



Sources: Scotiabank Economics, Statistics Canada.

Skills shortages come as interprovincial migration is shifting. A cooling economy and housing affordability pressures appear to be weakening BC's attraction, with Ontario benefiting to date. Alberta's improving employment prospects and competitive wages are increasing its draw following the 2015–16 recession (chart 2). Quebec's net population outflow to other regions—in progress since Q2-2003—receded amid a robust 2017 expansion but is rising again.

Chart 2



Sources: Scotiabank Economics, Statistics Canada.

These changes highlight the importance of immigration in Central Canada and BC. The integration of skilled immigrants is crucial to maintaining BC's attraction and addressing labour market shortages. Ontario's labour productivity lags that in BC, Saskatchewan, and Alberta, and this year's rise in economic immigrants—newcomers admitted for their ability to contribute to the economy—bodes well for its longer-term productive capacity. Newcomers to Quebec have historically not fared as well in the labour market as in other regions, but the province needs immigration to sustain population growth given its older populace.

Immigration is expected to assist population growth in other provinces. Increases to Ottawa's 2018 and 2019 immigration targets provide a basis for newcomer attraction, especially in the Prairies, where immigrants have historically best integrated into the labour market. The *Atlantic Immigration Pilot* will support retention in Atlantic Canada, helping to mitigate the effects of aging populations.

We still expect accelerating machinery & equipment (M&E) outlays in most provinces this year as firms bump up against capacity constraints. Ontario's torrid 22.7% (q/q ann.) Q1-2018 real M&E investment jump drove national-level gains, while Quebec M&E spending accelerated in Q2 after a first-quarter pause.

As firms address capacity limitations this year, we expect rising non-residential construction investment already underway (chart 3) **to supplant M&E as a key driver of growth in many provinces.** Alberta's steady forecast gains in capital outlays on non-residential buildings reflect construction of petrochemicals and conventional oil & gas facilities. Volatility in the light-heavy oil price differential due to insufficient pipeline capacity continues to pose significant downside risk for investment in both Alberta and Saskatchewan. Industrial and commercial activity—concentrated in Toronto but also present in other major cities—should propel Ontario's continued expansion. The industrial and commercial sector is also expected to support Quebec's economic growth, with mining investment and a port expansion providing an additional lift.

BC's economic outlook is dominated by the CAD 40 bn LNG Canada project, which received a final investment decision on October 2nd. The venture will see construction of a natural gas pipeline from northeast BC to a new export terminal in Kitimat, with work likely proceeding until 2025. Our forecast assumes capital outlays of nearly CAD 14 bn during 2019–20, which add about two percentage points to real GDP over the two years and propel BC well ahead of the other provinces. Hydroelectricity projects provide a further assist for non-residential building investment.

For most provinces, the US-Mexico-Canada Agreement (USMCA) free-trade pact forestalls downside associated with NAFTA termination. Ontario, where motor vehicles and parts to the US made up 30% of 2013–17 nominal export receipts, likely averts 25% US tariffs on foreign-made automobiles. Some farmers are aggrieved over greater US access to Canadian dairy markets, but the deal helps Quebec skirt major downside risk. New Brunswick remains subject to softwood lumber duties with Quebec and BC, but will breathe a sigh of relief given its 88% share of non-energy exports bound for the US market over 2013–17 (chart 4). For the net oil-producing regions—less sensitive to US trade disruptions—the pact scrapped a number of archaic regulations that largely did not constrain producers under NAFTA. Potential drawbacks come via terms requiring advance notice of free-trade negotiations with 'non-market' countries, which may hinder several provinces' efforts to expand Asian market access.

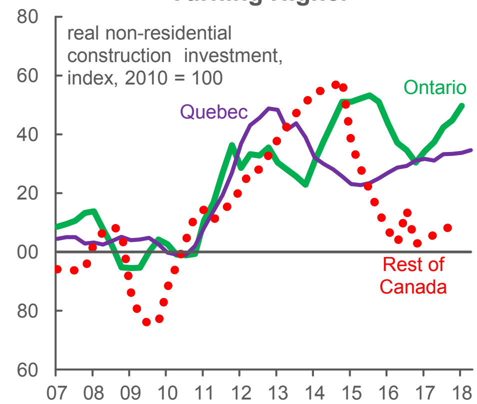
The near-term outlook for agricultural output and exports is mixed. Farmers anticipate principal field crop production declines this year across the prairies—largely due to dry growing conditions—as well as in Ontario. Other trends include a more competitive global market for wheat—a staple crop in many provinces—and greater protein demand in the Indo-Pacific region. The latter could benefit meat and pulse producers, but Indian import tariffs on Canadian pulses present challenges.

Services exports will remain anchored by tourism and the tech sector. Eight provinces reported y/y ytd gains in July and tourism facility expansions are underway in many jurisdictions. Investments in video game design should support tech sector gains in Quebec. A self-driving vehicle company and an e-commerce firm are expanding their footprints in Toronto. Vancouver and Victoria are home to many high-tech satellites of large international corporations and fast-growing local firms.

In 2020, a slowing US economic expansion should induce easing export gains in Central Canada. Our forecast of moderating economic growth in Quebec and Ontario mirrors cooling US import demand. By contrast, rising oil production should continue to power robust export gains and trade surpluses in the net oil-producing regions.

Chart 3

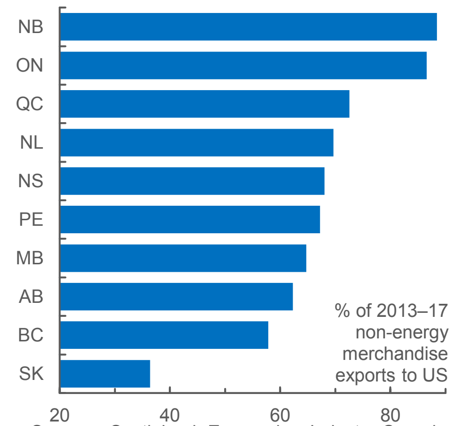
Non-Residential Construction Turning Higher



Sources: Scotiabank Economics, Statistics Canada.

Chart 4

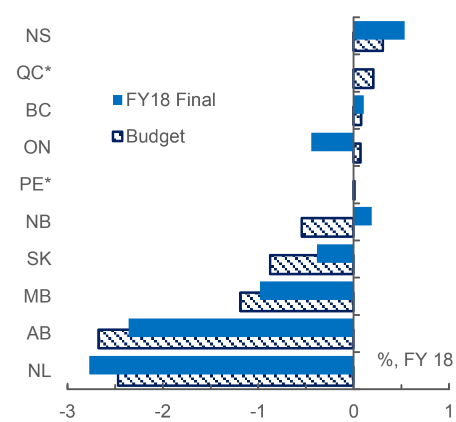
USMCA Averts Significant Downside



Sources: Scotiabank Economics, Industry Canada.

Chart 5

Budget Balance as a Share of GDP



* FY18 results not yet available. Sources: Scotiabank Economics, Budget Documents.

PROVINCES' FISCAL PATHS BUILD ON SLOWER GROWTH

Slowing revenue growth is a key fiscal concern going forward. As last year's economic expansion wanes, many Provinces will need to rely more heavily on expenditure restraint to reduce deficits and address policy priorities. Six Provinces have thus far reported better-than-expected FY18 fiscal positions (chart 5, p.2), but health care systems will be increasingly strained by aging populations and rising interest rates will push debt servicing costs higher as we enter 2020. With a strong fiscal position, the new administration elected in Quebec has promised to target competitiveness and pocketbook relief once it takes office. In Ontario, however, personal and business tax cuts proposed during this year's campaign may be postponed following reports of a much larger-than-expected deficit from the Province's *Independent Financial Commission of Inquiry*.

Federal policy should offer some support for near-term provincial fiscal repair and economic growth. Ottawa has allotted funding of CAD 33 bn over the next 10 years as part of the second phase of its infrastructure plan. Targeted tax changes aiming to boost competitiveness after January's US federal corporate income tax rate cut are expected in the fall fiscal update.

Table 1

The Provinces	(annual % change except where noted)										
Real GDP	**CA**	**NL**	**PE**	**NS**	**NB**	**QC**	**ON**	**MB**	**SK**	**AB**	**BC**
2000–17	2.2	2.4	1.8	1.3	1.3	1.8	2.1	2.4	2.0	2.8	2.8
2017*	3.0	2.1	3.2	1.2	1.9	3.1	2.8	2.9	2.9	4.9	3.9
2018f	2.1	0.5	2.0	1.2	1.1	2.1	2.1	1.9	1.5	2.4	2.4
2019f	2.2	1.2	1.6	1.0	0.9	2.0	2.1	1.9	1.8	2.5	2.7
2020f	1.8	0.8	1.1	0.9	0.9	1.5	1.6	1.5	1.8	2.0	3.6
Nominal GDP											
2000–17	4.3	5.6	4.2	3.3	3.3	3.7	3.9	4.4	5.3	6.0	4.6
2017e	5.4	5.6	4.7	3.1	3.2	4.5	4.8	4.3	5.4	7.9	5.9
2018f	4.3	4.1	3.9	3.2	2.9	3.8	4.1	3.9	4.1	5.5	5.0
2019f	4.6	4.1	3.9	3.1	3.0	4.3	4.6	4.3	4.1	5.5	5.3
2020f	3.7	3.9	2.9	2.8	2.4	3.4	3.7	3.5	4.4	4.8	5.8
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
2018f	1.2	0.3	2.5	1.1	0.4	1.1	1.5	0.5	0.0	1.8	0.8
2019f	1.0	0.1	0.9	0.3	0.2	0.9	1.1	0.7	0.5	1.2	1.1
2020f	0.8	-0.1	0.5	0.2	0.2	0.7	0.9	0.6	0.7	1.2	1.1
Unemployment Rate (%)											
2000–17	7.1	14.3	11.1	8.8	9.5	7.9	7.0	5.1	5.0	5.2	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
2018f	5.9	14.5	9.9	7.9	8.0	5.5	5.6	5.8	6.2	6.6	4.8
2019f	5.8	14.1	10.0	7.8	8.0	5.4	5.5	5.6	6.1	6.5	4.9
2020f	5.8	14.0	10.0	7.7	7.9	5.4	5.5	5.5	6.0	6.4	4.9
Housing Starts (units, 000s)											
2000–17	199	2.6	0.8	4.3	3.5	44	72	5.1	5.2	34	28
2017	220	1.4	1.0	4.0	2.3	46	80	7.6	5.0	29	44
2018f	213	1.5	0.9	4.7	2.1	46	77	6.9	3.7	29	41
2019f	202	1.4	0.8	3.9	2.0	42	72	6.1	4.6	30	39
2020f	201	1.4	0.8	3.8	1.9	41	72	6.1	5.0	31	38
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
2018f	2,000	29	9	53	39	450	855	68	48	230	219
2019f	1,950	31	8	50	37	435	825	60	50	225	229
2020f	1,905	30	8	48	35	420	810	55	49	215	235
Budget Balances, Fiscal Year Ending March 31 (CAD mn)											
2000–17**	-3,635	-93	-38	-30	-153	-768	-5,115	-142	307	1,064	454
2017	-17,770	-1,148	-1	151	-117	2,361	-991	-764	-1,218	-10,784	2,737
2018f***	-20,000	-911 †	1	230 †	67 †	850	-3,700 †	-695 †	-303 †	-8,023 †	301 †
2019f***	-18,000	-683	1	29	-187	0	-15,000	-521	-306	-7,757	669
2020f	-17,000	-507	3	39	-124	0	n/a	-388	6	-7,912	810

Sources: Scotiabank Economics, Statistics Canada, CMHC, Budget documents. * Real GDP by industry, basic prices. ** MB:FY04–FY16; AB:FY05–FY16. *** Provinces' FY18 & FY19: Budget documents. Federal FY19: ex risk adjustment of $3.0bn. † FY18 final result.