ECONOMIC VIEWPOINT

#1 MEILLEUR PRÉVISIONNISTE GLOBAL – CANADA
FOCUS ECONOMICS
ANALYST FORECAST AWARDS
2022
#1 BEST OVERALL FORECASTER – CANADA

Desjardins Provincial Outlook: Housing versus Commodities

by Marc Desormeaux, Principal Economist, and Hélène Bégin, Principal Economist

- We still expect that few provinces will avoid the growth-dampening effects of rising interest rates, elevated inflation, rapidly correcting housing markets and a deteriorating global backdrop this year.
- The provinces most exposed to the housing market will likely fare the worst during the coming Canadian recession. In contrast, jurisdictions reliant on commodity production—Alberta, Saskatchewan, and Newfoundland and Labrador—face the best prospects.
- A stronger-than-anticipated handoff from Q3 real GDP for Ontario improves the province's growth arithmetic, even though it remains vulnerable to housing correction spillovers.
- Pandemic-era interprovincial migration flows from Ontario to Atlantic Canada may have peaked, but we're now seeing increased movement to Alberta.
- Budget updates for fiscal year 2022–23 (FY2023) broadly leave many provinces with more room to offer economic support in the event of a downturn. But inflation-related spending pressures, commodity price sensitivity, and labour and input product shortages cloud the outlook.

MAJOR TRENDS AFFECTING THE PROVINCIAL ECONOMIES

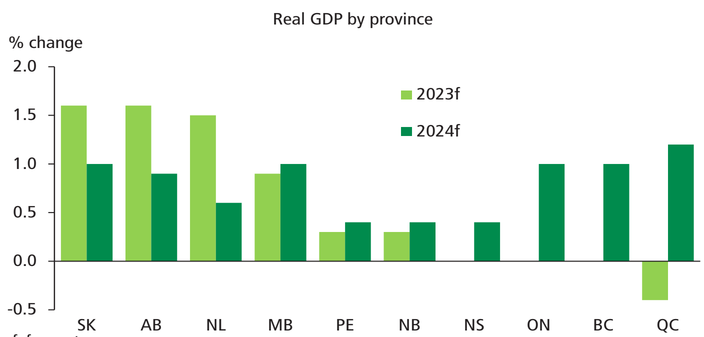
Slower Growth (Nearly) across the Board

We still expect that few provinces will avoid the growth-dampening effects of rising interest rates, elevated inflation, rapidly correcting housing markets and a deteriorating global economy this year (graph 1). The one exception is Newfoundland and Labrador, where returning production in its critical offshore oil industry will propel accelerating growth.

Housing Correction Enters Next Phase

Our base case forecast assumes that we have seen the worst of the decline in home sales and prices in most provinces. We are now awaiting a pullback in residential construction activity, which tends to lag the housing resale market. We expect that adjacent industries, like the financial services sector, will also be affected. British Columbia (BC), Ontario and the Maritime provinces look particularly exposed to these secondary effects (graph 2, on page 2) and therefore remain near the bottom of the growth table.

GRAPH 1
Oil-Producing Provinces Will Fare the Best in This Year's Recession



f: forecasts
Sources: Statistics Canada and Desjardins Economic Studies

Softer Commodity Prices

We still think that Canada's commodity-producing jurisdictions have the best prospects this year. While commodity prices have generally eased against a weakening global economic backdrop, we expect them to stay high enough to support industry profitability and economic activity. Chinese demand is a wildcard because of geopolitical risks and uncertainty about the sustainability of the country's reopening.

Population Flows Shifting

For interprovincial migration, movement from Ontario to Atlantic Canada may have peaked, but we're now seeing increased flows to Alberta (graph 3). We expect this to broadly continue in 2023, posing a drag in the East Coast and Central Canada while offering support to Wild Rose Country.

For international migration, newcomers' economic contributions tend to be a function of their numbers relative to the domestic population and their ability to integrate into the labour market. Given acute labour shortages in Canada's economy, we suspect that immigrants will continue to experience strong labour market outcomes relative to the pre-pandemic period. It's also possible that with the latest national admission target increase, more newcomers will settle in the Prairies, where affordability and economic prospects are better.

Major Project Activity

As always, we expect that in some provinces, large projects that generate significant capital expenditures will help offset otherwise more downcast economic conditions. Examples include the massive LNG export terminal in BC and Saskatchewan's Jansen potash mine. Production timelines are a related topic, as in some cases these do not mirror the broader economic backdrop.

Fiscal Starting Point Better, Outlook Less Clear

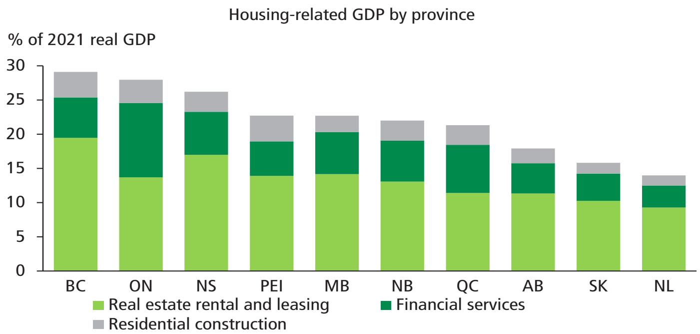
Fiscal updates released since our last outlook almost unequivocally projected better-than-anticipated bottom lines on the back of a stronger-than-anticipated economic recovery and inflation-driven revenue gains. This leaves many provinces with more room to offer support in the event of an economic downturn while also staying true to long-run fiscal sustainability objectives. See Five Takeaways from Mid-Year Updates in Canada's Provinces for more detailed analysis.

But uncertainties remain. We still have not seen the effects of inflation on the expenditure side of the ledger, notably in higher public sector wages. Some governments' finances are likely to be very sensitive to commodity price movements. And after some delays and reprofiling, there are questions as to whether shovel-ready infrastructure projects could be ramped up quickly enough. Acute labour shortages and input product scarcity remain.

Climate Events

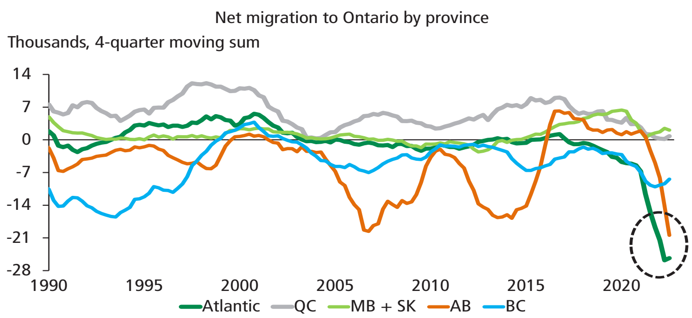
Hurricane Fiona looks to have hit industrial capacity and government finances in Atlantic Canada, while the full impacts of last year's drought in the Prairies are coming into view. This follows the severe flooding on Canada's West Coast in late 2021. We have not made explicit assumptions in this respect in our forecast, but the risk of acute and more frequent climate events is clear.

GRAPH 2
Exposure to the Housing Downturn Varies across Canada



Sources: Statistics Canada and Desjardins Economic Studies

GRAPH 3
Migration to the Atlantic Region May Have Peaked, but More Ontarians Are Moving to Alberta



Sources: Statistics Canada and Desjardins Economic Studies

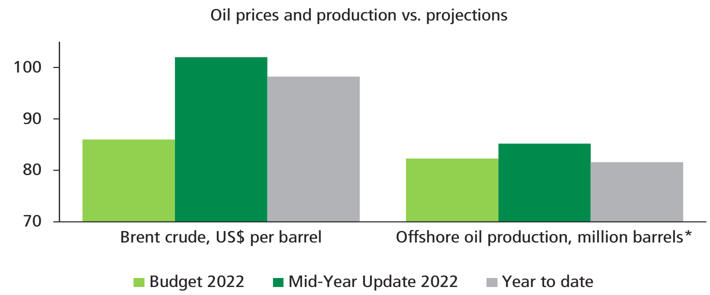
NEWFOUNDLAND AND LABRADOR

We continue to assume stronger growth in Newfoundland and Labrador (NL) over 2023–24 because of major project activity. The Muskrat Falls dam, competed late in 2021, no longer poses a drag this year. Both the West White Rose offshore venture and Terra Nova offshore oil field are set to restart later this year. Longer term, there are opportunities for the deep-water offshore oil industry, and for the province's industrial metals as the climate transition accelerates.

We expect population growth to moderate through 2024 as diminished remote and hybrid work reduces interprovincial migration. That should weigh on housing and consumption activity alongside high interest rates and inflation. Still, these sectors account for a small share of provincial output. They should also benefit from rising immigration and affordability measures implemented by the provincial government, particularly amid tight household savings and rapid population aging.

We see some downside risk to NL's near-term budget balances. This fiscal year, Brent crude has averaged about US$4/barrel less than projected in the October budget update, while 2022 oil production is tracking almost 2 million barrels lower (graph 4). Even so, a strong starting point improvement should push revenues much higher than anticipated in Budget 2022, which means the province could relax its previously planned spending restraint.

GRAPH 4
Downside Risk to NL's FY2023 Fiscal Balances



* Based on Jan. to Oct. data
Sources: Newfoundland and Labrador Ministry of Finance, Canada–Newfoundland and Labrador Offshore Petroleum Board and Desjardins Economic Studies

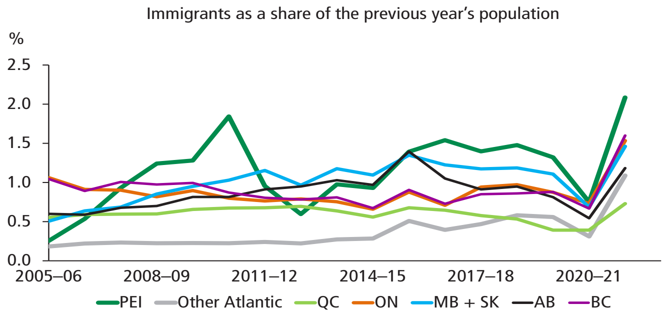
PRINCE EDWARD ISLAND

Prince Edward Island (PEI) enters 2023 with strong economic momentum. Its 6.3% rate of total job creation was the best of any province last year, while the 1.4% advance in Q4 2022 was second-best. It is also likely to be among the provinces most positively impacted by rising immigration. PEI's labour market integration is improving, and newcomer admissions tend to make up a high share of the domestic population (graph 5). By contrast, we remain more bearish on interprovincial migration to the Island, which we suspect will cool as remote work becomes less common.

As predicted in our last outlook, government capital expenditures will be more supportive of the expansion. With much stronger revenues, PEI aims to increase infrastructure outlays by 24% in FY2024, in stark contrast to the prior plan's 6% decline.

The trade outlook is less sanguine. Aerospace, pharmaceutical and food processing export values softened over 2022 against the difficult global economic backdrop. Moreover, damage to fishery and processing infrastructure from Hurricane Fiona could hold back production and exports in those key industries. However, this year, early autumn tourism could bounce back from storm impacts, while a weak Canadian dollar may attract US visitors looking for bargains during the recession.

GRAPH 5
PEI Normally Welcomes the Most Newcomers per Capita



Sources: Statistics Canada and Desjardins Economic Studies

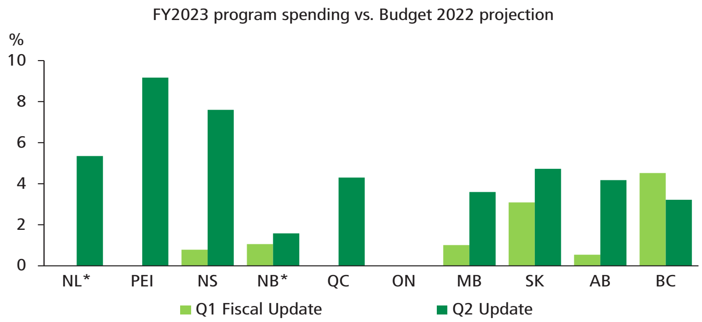
NOVA SCOTIA

We still think Nova Scotia has some of the strongest long-run prospects on Canada's East Coast. It is the Atlantic Region's high-wage services hub and its most diversified economy. The strength of international and interprovincial migration before the pandemic speaks to its draw. Strong trade linkages to Asia, Europe and other Canadian provinces limit exposure to economic slowdown in any one jurisdiction.

However, we see less-than-optimistic prospects in some key industries this year following weakness in recent months. With sharply higher interest rates and softer prices, housing starts and residential construction investment slowed to end 2022. Nova Scotia trailed only BC in terms of housing-related industries' share of provincial GDP in 2021—the last year of available data. Net migration from other provinces, particularly Ontario, also now may have peaked, having arguably benefited Nova Scotia more than any other jurisdiction during the pandemic.

Although Nova Scotia's fiscal position has improved versus budget projections, details under the hood were less auspicious. Ambitious capital spending plans were cut successively this year, presumably because of labour shortages and high input costs. By contrast, program expense forecasts have been raised significantly (graph 6), largely because of health care and Hurricane Fiona-related costs.

GRAPH 6
Hurricane Fiona Has Driven Cost Overages in the Maritimes



* Total spending. (Program spending was not available.)
Sources: Statistics Canada and Desjardins Economic Studies

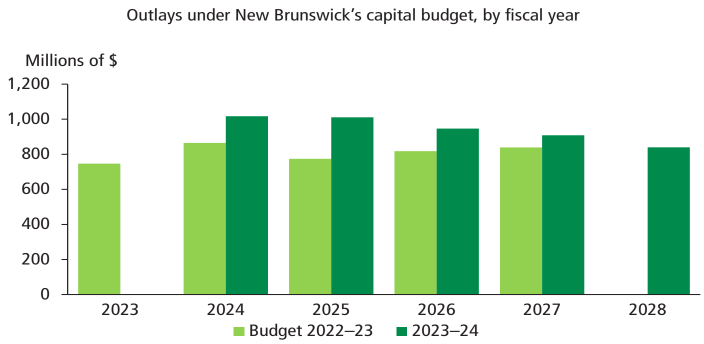
NEW BRUNSWICK

New Brunswick enters the coming downturn with some advantages. One is its fiscal position. It was the only province to run black ink throughout the pandemic. More recently, it projected a record surplus, which enabled a $587 million (18%) boost in infrastructure spending plans for FY2024 to FY2027 to support a growing population and stimulate growth (graph 7). Another is its low level of household indebtedness. Alongside a relatively affordable housing market and little economic reliance on residential real estate, that leaves it better protected than most provinces against the adverse effects of rising borrowing costs.

Less optimistically, the recent record rate of population growth is likely to ease. As in the other Maritime provinces, net interprovincial migration to New Brunswick looks to have peaked. We expect it to continue to ease this year and next, which in turn should increasingly weigh on housing activity. Higher national immigration targets may partly offset this drag.

A softer US expansion and cooling prices for refined petroleum and pulp and paper—two staple products in New Brunswick—should also mean less support for producer incomes. A U.S. Department of Commerce ruling of a combined 15% duty on softwood lumber is raising costs for the province's largest producer.

GRAPH 7
New Brunswick Has Increased Its Infrastructure Spending Plans



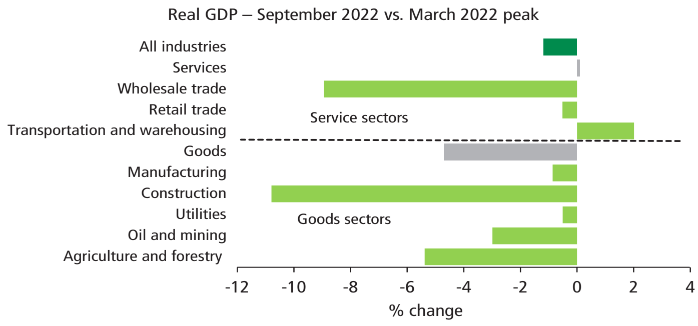
Sources: New Brunswick Ministry of Finance and Desjardins Economic Studies

QUEBEC

In Quebec, the recession appears to have already begun, with annualized real GDP falling 1.9% in the third quarter of 2022. Household spending and business investment have slowed but are holding up well so far. However, exports are starting to feel the global economic headwinds. The housing sector continues to decline on rising interest rates. Home prices fell 6.9% from their April peak to December of 2022, and that figure could approach 15% by year's end.

Most sectors of the economy are already slowing (graph 8). If the downturn continues for a few more quarters, Quebec will officially be in a recession. And while the economy should improve late this year, real GDP is expected to contract 0.4% in 2023 before expanding 1.2% in 2024. After hitting an all-time low of 3.8% in November, the unemployment rate should continue to creep up, nearing 6% by the end of the year. Unlike in previous recessions, Quebec currently has a high number of job vacancies, so the labour market should weather the storm pretty well. Wage growth is expected to moderate, especially with inflation poised to ease throughout the year.

GRAPH 8
Quebec's Real GDP Decline Is Relatively Broad-Based



Sources: Institut de la statistique du Québec and Desjardins Economic Studies

ONTARIO

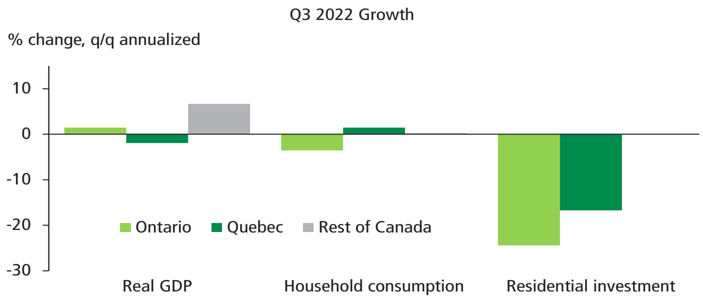
We still expect Canada's largest province to be one of the most affected in the coming recession. Surging borrowing costs, particularly stretched affordability, high household debt levels, and plunging housing market activity are clearly biting. Household spending and residential investment dropped even more sharply than in Quebec and across Canada in Q3 (graph 9). Retail employment and sales have also weakened. And there remains risk of spillover housing impacts next year given financial services' outsized role in Ontario's economy.

Still, Ontario carries momentum into 2023. Unlike in Quebec, early provincial estimates suggest real GDP continued to advance in the third quarter, supported by non-residential business investment and exports (plus volatile and oft-revised inventories). Hiring in less interest-sensitive sectors picked up after a weak Autumn. Homebuilding remains remarkably resilient to the housing market correction, although this isn't expected to last past the middle of the year.

Demographics are mostly favourable. Higher immigration targets should offer a boost to growth given Ontario's high admissions rate and improving newcomer labour market integration. Out-migration to Atlantic Canada may have peaked, though Alberta's draw is increasing.

Automotive sector output is also still on track to advance significantly this year, providing a boost to Ontario's key export industry. However, those gains will bump up against domestic weakness in the United States.

GRAPH 9
Interest-Sensitive Sectors Are Weakening in Ontario



Sources: Statistics Canada, Ontario Ministry of Finance, Institut de la Statistique du Québec and Desjardins Economic Studies

MANITOBA

We still think Manitoba's diversified provincial economy will avoid the worst of the 2023 recession.

For housing, balanced and relatively affordable local markets saw some of the smallest price spikes during COVID-19 and some of the least severe drops since monetary tightening began. Housing-adjacent financial services make up only a small share of provincial GDP.

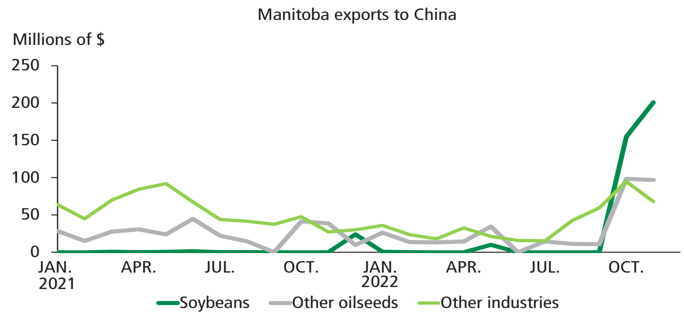
Mining sector investments should help offset the drag from cooling (but still-high) commodity prices.

Construction of a $400–$500 million solar glass manufacturing plant beginning early this year should supplement new capacity in the key pea and meat processing sectors.

Yet recent export tailwinds should recede. Normalization of electricity production—held back by the same 2021 drought that hammered agricultural shipments—drove a surge in related exports last year, an effect that should fade in 2023. The pace of China's reopening from its latest round of COVID-19 lockdowns could also affect soybean imports, which exploded late last year (graph 10). And interprovincial exports will likely suffer during this year's Canadian recession.

Manitoba is likely to benefit considerably from higher immigration. It has historically been one of the most successful provinces with respect to newcomer labour market outcomes. We're hopeful that near-record interprovincial outflows will ease after stabilizing late last year.

GRAPH 10
Agricultural Trade with China Surged in Late 2022



Sources: Industry Canada and Desjardins Economic Studies

SASKATCHEWAN

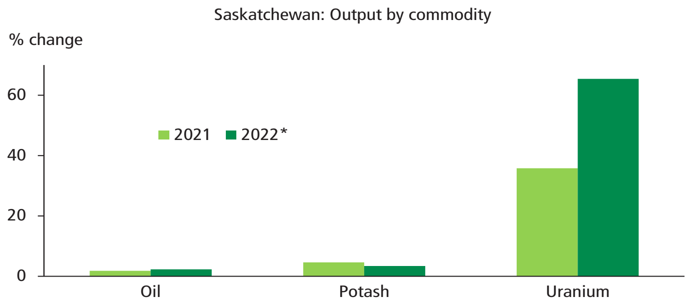
Major project activity still anchors our view that Saskatchewan will be a provincial growth leader this year. The first stage of the $7.5 billion Jansen potash mine continues, and on an accelerated timeline. Other projects include a $350 million Cargill-based canola crushing plant and a Regina area canola-to-diesel processing facility set to enter production in 2027.

For commodities, we expect rising output and more moderate prices. Though crude values have fallen from sky-high early-2022 levels amid a softening global backdrop, we think they'll remain strong enough to continue to support Saskatchewan's production recovery. Potash and uranium output also rose last year (graph 11). The latter should benefit from Cigar Lake mine ramp-up and reopening at McArthur River. However, China's latest pandemic reopening may affect demand for canola and soybeans, which drove a late-2022 surge in Saskatchewan's exports as in Manitoba.

Higher interest rates should have mixed impacts in Saskatchewan. While the province's housing market is small as a share of GDP, households in Saskatchewan were more indebted in 2022 than those in most other provinces.

Rising immigration is particularly positive for Saskatchewan, as newcomers tend to enjoy strong labour market outcomes in the province. And more people may land there in the coming years because of good economic prospects.

GRAPH 11
Production of Saskatchewan's Key Commodities Rose in 2022



* Based on Jan. to Nov. data for potash and uranium, Jan. to Oct. for oil.
Sources: Statistics Canada and Desjardins Economic Studies

ALBERTA

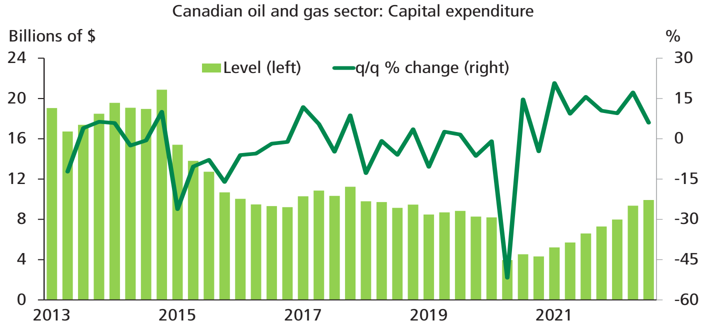
Robust oil and gas sector activity provides a strong handoff into 2023 for Alberta. Oil production is hovering around record levels, and drilling and national-level sectoral investment (graph 12) were trending higher in late 2022. Yet we still do not anticipate a return to the heights of 2014. This reflects rising interest rates, investor appetite for renewable energy sources, and ongoing efforts to repair balance sheets among major industry players.

The longer the WCS–WTI discount stays high, the worse it is for industry profitability and Alberta's finances. We're hopeful that this will improve over time. Fewer US Strategic Petroleum Reserve releases plus Trans Mountain pipeline expansion completion this year should boost Alberta crude's market share in the US Gulf Coast region and WCS pricing.

Alberta's non-oil and gas sectors continue to enjoy solid prospects. Various projects are underway in the petrochemicals, hydrogen and renewable energy sectors.

There is also a relatively strong backdrop for the housing market. With economic opportunity and affordable housing, net interprovincial migration to Alberta reached its highest level since the early 1980s late last year. A rising international immigration share offers further support. However, some of Alberta's highly indebted households will increasingly feel the pinch of higher rates this year.

GRAPH 12
Energy Investment Is Growing Strongly but Is Well below Its 2014 Peak



Sources: Statistics Canada and Desjardins Economic Studies

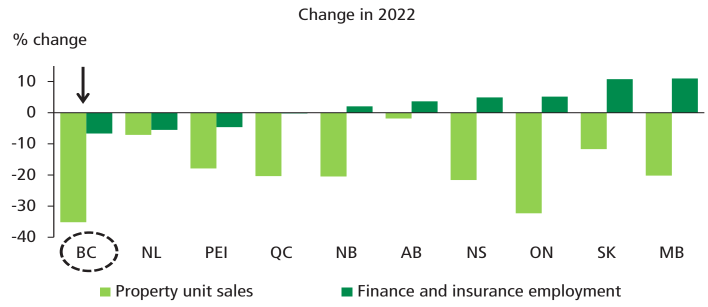
BRITISH COLUMBIA

The effects of sharply higher rates are already evident in British Columbia. The province is Canada's most housing-exposed, and its households are Canada's most indebted. Home sales fell by more in BC than in any other province in 2022. Interest-sensitive retail sales have weakened more than at the national level, and financial services employment fell more than anywhere else in Canada (graph 13). Residential construction activity has thus far held up well to higher rates and softer housing activity. But weakness should increasingly emerge as we progress through 2023.

Because China is a key export market and supplier of import products, it continues to present risk to the expansion and inflation in BC. We've revised our growth forecasts for China progressively lower since October 2022, though recent reopening is auspicious.

It's not all bad news. Work on the multi-billion-dollar LNG Canada natural gas export terminal is ongoing. Though metal and forest product prices are off Ukraine conflict peaks, we expect them to stay high enough to bolster mining sector profitability. And a massive revenue windfall reported in the mid-year fiscal update leaves BC with some of the strongest public finances of any province, as well as considerable room to support an economic recovery.

GRAPH 13
BC's Housing and Housing-Adjacent Sectors Took a Hit in 2022



Sources: Statistics Canada, Canadian Real Estate Association and Desjardins Economic Studies

SUMMARY FORECAST TABLES

ANNUAL AVERAGE IN % (UNLESS OTHERWISE INDICATED)	2019	2020	2021	2022f	2023f	2024f
Real GDP growth – Canada	**1.9**	**-5.1**	**5.0**	**3.6**	**0.4**	**0.9**
Newfoundland and Labrador	4.0	-4.6	0.6	0.7	1.5	0.6
Prince Edward Island	4.5	-1.6	7.9	2.8	0.3	0.4
Nova Scotia	3.4	-3.5	6.2	2.7	0.1	0.4
New Brunswick	1.3	-2.7	5.9	2.4	0.3	0.4
Quebec	2.8	-5.0	6.0	2.7	-0.4	1.2
Ontario	2.1	-4.7	5.2	3.7	0.0	1.0
Manitoba	1.2	-4.4	1.8	2.4	0.9	1.0
Saskatchewan	-0.4	-4.8	-0.9	5.0	1.6	1.0
Alberta	0.1	-8.0	4.8	4.9	1.6	0.9
British Columbia	2.6	-3.0	6.1	3.5	0.0	1.0
Nominal GDP growth – Canada	**3.5**	**-4.5**	**13.6**	**11.6**	**1.8**	**2.8**
Newfoundland and Labrador	3.6	-10.0	17.7	15.8	0.0	2.5
Prince Edward Island	6.5	1.4	14.3	8.7	2.3	1.7
Nova Scotia	4.4	0.0	10.9	7.1	2.1	1.7
New Brunswick	2.4	-1.6	13.8	9.5	2.3	1.7
Quebec	4.6	-1.9	11.8	9.7	2.3	3.4
Ontario	3.9	-2.9	10.3	9.3	1.8	2.8
Manitoba	1.7	-1.3	8.4	8.7	3.0	2.2
Saskatchewan	1.0	-7.6	13.1	16.6	0.9	3.1
Alberta	1.7	-15.7	26.2	20.7	0.5	3.4
British Columbia	3.9	-0.7	14.2	11.0	2.1	2.3
Total inflation rate – Canada	**1.9**	**0.7**	**3.4**	**6.8**	**3.4**	**1.9**
Newfoundland and Labrador	1.0	0.2	3.7	6.4	3.1	1.9
Prince Edward Island	1.2	0.0	5.1	8.9	4.0	2.4
Nova Scotia	1.6	0.3	4.1	7.5	3.7	2.2
New Brunswick	1.7	0.2	3.8	7.3	3.2	2.0
Quebec	2.1	0.8	3.8	6.7	3.2	1.9
Ontario	1.9	0.6	3.5	6.8	3.3	1.9
Manitoba	2.3	0.5	3.2	7.9	3.7	2.1
Saskatchewan	1.7	0.6	2.6	6.6	3.7	2.1
Alberta	1.7	1.1	3.2	6.5	3.5	2.0
British Columbia	2.3	0.8	2.8	6.9	3.5	1.9
Employment growth – Canada	**2.2**	**-5.1**	**4.8**	**3.7**	**0.5**	**1.0**
Newfoundland and Labrador	1.2	-5.9	3.0	3.9	0.4	0.1
Prince Edward Island	3.4	-3.2	3.7	6.3	0.3	0.6
Nova Scotia	2.3	-4.7	5.4	3.4	0.2	0.5
New Brunswick	0.7	-2.6	2.6	2.2	0.1	0.4
Quebec	2.0	-4.8	4.1	2.6	1.2	1.2
Ontario	2.8	-4.7	4.9	4.3	0.2	1.0
Manitoba	1.1	-3.7	3.5	2.5	0.2	1.0
Saskatchewan	1.7	-4.6	2.6	3.4	0.4	1.2
Alberta	0.6	-6.5	5.2	5.1	0.4	1.2
British Columbia	2.9	-6.5	6.6	3.2	0.4	1.2
Unemployment rate – Canada	**5.7**	**9.5**	**7.4**	**5.3**	**6.2**	**6.5**
Newfoundland and Labrador	12.3	14.1	12.9	10.8	11.2	11.4
Prince Edward Island	8.6	10.6	9.4	7.2	8.3	9.2
Nova Scotia	7.3	9.7	8.4	6.6	7.2	7.5
New Brunswick	8.2	10.0	9.0	7.3	8.0	8.2
Quebec	5.1	8.9	6.1	4.3	4.7	4.9
Ontario	5.6	9.5	8.0	5.6	7.0	7.2
Manitoba	5.4	8.0	6.4	4.6	5.6	5.8
Saskatchewan	5.6	8.3	6.5	4.6	5.5	6.0
Alberta	7.0	11.5	8.6	5.8	6.7	7.1
British Columbia	4.7	9.0	6.5	4.7	5.6	5.9

f: forecasts
Sources: Statistics Canada, Institut de la statistique du Québec, Ontario Ministry of Finance and Desjardins Economic Studies