ECONOMIC VIEWPOINT

Are the Provinces Catching Up?

Contrasting economic results have come out of the provinces in recent years. The oil-producing provinces were affected by the energy sector’s problems. But the other provinces actually benefited from the wealth effect of lower fuel prices and have been growing nicely. Growth has even sped up in some provinces that are usually weaker, such as Quebec. With such differences, are the less prosperous provinces catching up to those that have traditionally been wealthier? The fundamental trends that influence growth potential in each province have not really changed, however. We believe that a major catch-up is not very likely. That said, the widespread economic growth expected in the provinces for 2017 and 2018 is very satisfying and reassuring.

Economic growth among the Canadian provinces has been uneven in recent years (graph 1). The energy-producing provinces, led by Alberta, had difficulties in 2015 and 2016 due to the drop in gas prices and the resulting major decline in investments in the energy sector. Conversely, other provinces recorded fairly good economic growth during that time period, as the harmful effects caused by the energy sector difficulties were low and reduced gas prices generated a wealth effect for households and many businesses.

That said, other provinces have also been recording growth worthy of mention for some time. That is especially true of Quebec, whose real GDP has grown much faster in recent quarters. The labour market also improved significantly in that province, with the unemployment rate reaching an all-time low (that is, since data from labour force surveys was first released in 1976). Several other provinces also saw improved labour markets and notable drops in the unemployment rate (graph 2). There has been similar regional disparity among several economic indicators, such as manufacturing, wholesale and retail sales.

Ontario and British Columbia did particularly well, with growth rates well above the Canadian average. The strength of the housing markets in Toronto and Vancouver was a determining factor in those regions.

Do these contrasting results mean that some less prosperous provinces are catching up to those that have traditionally been wealthier? Have regional disparities really faded away in recent years, especially in terms of wealth?
Some Heavy Trends Difficult to Reverse
Measuring real GDP per capita is a way of comparing wealth between provinces. As graph 3 shows, real GDP per capita has quickly made up for losses during the 2008-2009 Great Recession; by 2011, most provinces posted higher real GDP per capita than before the crisis. Wealth continued to grow in most provinces, reaching an all-time high in 2016. However, that did not happen in either Alberta or Newfoundland and Labrador, which have been particularly hard hit by the recent energy sector difficulties and whose real GDP per capita has retreated in recent years.

Despite these differences, comparative wealth among the provinces has not changed much. Alberta, Saskatchewan and Newfoundland and Labrador still had the highest real GDP per capita in Canada in 2016. The gap in relation to other provinces has changed very little in recent years. That makes it hard to argue that some provinces are catching up and that there is less regional disparity across Canada.

Bottom line: the provinces’ fundamental trends have not really changed. The population is still growing much faster out west, particularly in Alberta (graph 4). Conversely, population growth has slowed significantly in the Atlantic provinces and Quebec and is much weaker than elsewhere in Canada.

Weak population growth can theoretically be offset by greater labour productivity. If every worker becomes more productive, that will make up for the negative impact of fewer workers. As graph 5 shows, that is what happened in Prince Edward Island, where productivity growth is higher than the Canadian average.

Combining population growth with productivity growth gives us an estimate of each province’s potential for economic growth (graph 6). It shows us that Canada seems to be split in two. In the east (Quebec and the Atlantic provinces), the potential for economic growth is generally weaker since productivity growth cannot make up for the lack of population. The potential for economic growth is much higher out west (Ontario, the Prairie provinces and British Columbia).

It would be very hard for a province with lower economic growth potential to have a spurt that is long enough and robust enough to catch up with the wealthier provinces. We are therefore forced to conclude that significant gaps in economic growth potential...
will continue to underpin regional differences for some time to come.

**Economic Growth Should Be more Widespread as of 2017**

2017 saw a strong comeback by major trends in terms of growth distribution across the country. As gas prices stabilized, the energy-producing provinces were able to bounce back. So our most recent 2017 forecasts show a significant increase in real GDP out west, particularly for Alberta, Saskatchewan and British Columbia, where real GDP growth could outstrip the Canadian average.

Growth should also remain fairly good in most other provinces, including Quebec, where a 2.5% gain is expected for 2017. That would be excellent in light of the province’s relatively low potential for growth. But the increase would not be enough to push the province’s growth rate over the Canadian average.

**A Federal Program to Reduce Regional Disparities**

Some programs have already been set up to minimize the negative effects of regional disparities on economic growth. For example, the federal equalization program is designed to reduce the effects of such disparities on the different provinces’ revenues and budget expenditures. According to the federal Department of Finance: “Equalization is the Government of Canada’s transfer program for addressing fiscal disparities among provinces. Equalization payments enable less prosperous provincial governments to provide their residents with public services that are reasonably comparable to those in other provinces, at reasonably comparable levels of taxation.”

That means that the less wealthy provinces, i.e. those with lower real GDP per capita, are generally the ones to receive federal equalization payments. Graph 7 shows that Quebec receives the largest amount of equalization, but the statistic is misleading, because Quebec is also one of the most heavily populated provinces. If we divide the amount of the equalization payments by the number of inhabitants per province, we get a comparative geographic portrait (graph 8).

That gives the Maritime provinces the highest relative equalization amount in Canada. Not surprisingly, those provinces also have the lowest real GDP per capita.

**Reassuring Widespread Growth**

Despite certain measures to minimize their negative effects, regional disparities will still mark the Canadian economy for years to come. That said, with the anticipated recovery of real GDP in the energy-producing provinces in 2017, economic growth will be more widespread across the country. That will greatly ease uncertainties, although there will still be substantial differences in the forecast growth of real GDP per province (graph 9).

The Bank of Canada, which has to deal with all these regional disparities of course, appears to be reassured by the evening out of economic growth across Canada. That partly explains its decision to start hiking key interest rates last July and September. Other increases are likely to come in 2018 and 2019.

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