

April 2009

The Provincial Monitor

- The current recession is milder in Quebec than in Alberta and Ontario.
- Personal bankruptcies rise more rapidly than in previous recessions.
- Quebec's economy is expected to rebound gradually towards its cruising speed in 2010.
- Ontario: Sub-par performance during and after the recession.
- Alberta: Another oil shock, another recession.
- British Columbia: Beware of the effects of a negative savings rate coupled with a slump in housing prices.

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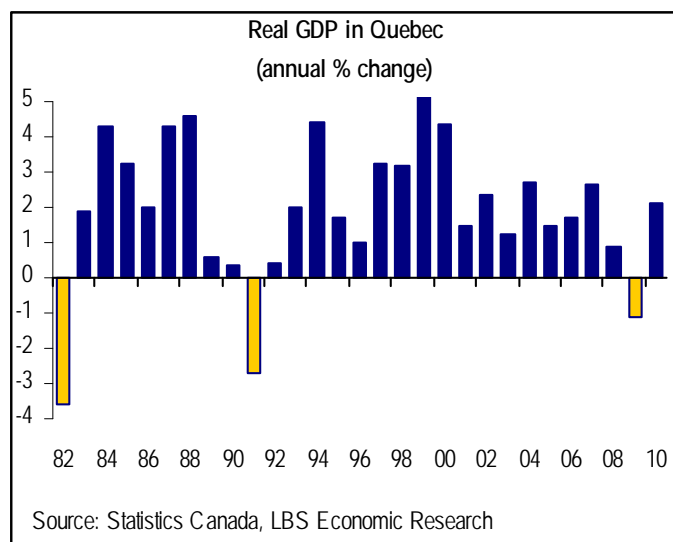
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**VALEURS MOBILIÈRES
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Milder recession in Quebec than in Ontario and Alberta

The Canadian economy looks like a hockey team whose key players are going through slumps. Quebec is one of these players. Since financial stresses began to intensify last fall, businesses and households are increasingly cautious. *LBS Economic Research* projects that the recession in Quebec will continue through 2009, leading to a 1.1% pullback in real GDP (see chart).



Although the pullback in real GDP during 2009 is expected to be less severe than during the 1980s and 1990s recessions, most sectors of economic activity will slow. This contraction will be led by weakness in domestic demand. Sparked by a deteriorating job market and falling asset prices, Quebec will see its first drop in consumer spending since the start of the 1990s. In addition, cooling in residential construction activity could drag on for as much as two years as real estate promoters adjust to the drop in housing demand. Economic uncertainty and weaker profit growth are also pushing businesses to lower inventories and to postpone many investment projects until 2010. On the trade front, Quebec's aerospace industry feels the pain later and less than Ontario's auto industry. Overall, net exports will act as a much weaker drag on real GDP growth in Ontario. The only real positive contributor to economic growth this year will come from government spending, thanks to already-announced increased investments in infrastructure.

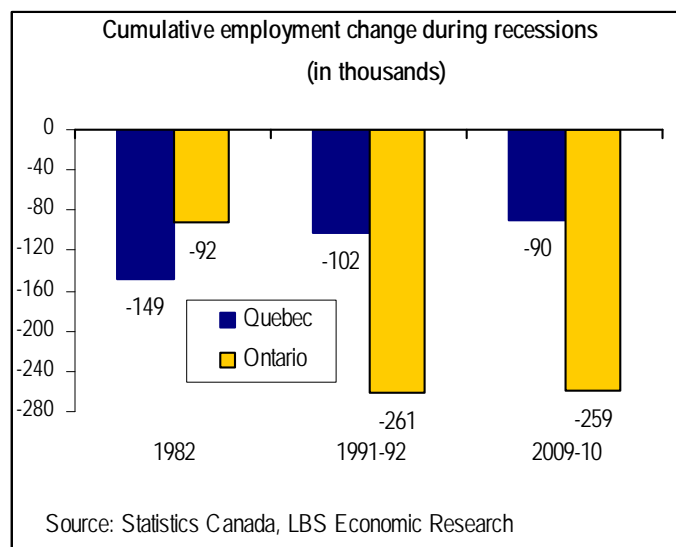
In all, 2009 will be a lethargic year for Quebec's economy. The recovery during 2010 will depend in large part on its main partner: the United States. We believe that Obama, Geithner and Bernanke's efforts will end that country's recession at some point before the end of 2009. We only expect a modest US economic recovery in 2010 amid the long reversal of excesses, namely a rebuilding in savings, a narrowing in current account imbalances, and a restructuring in key auto and financial sectors. At home, it means the province's real GDP will go back gradually to its cruising speed of 2% growth.

Falling asset prices and job market troubles

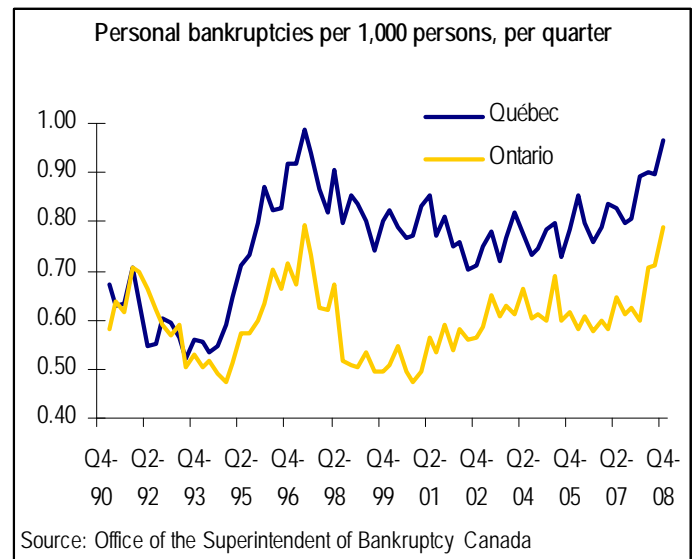
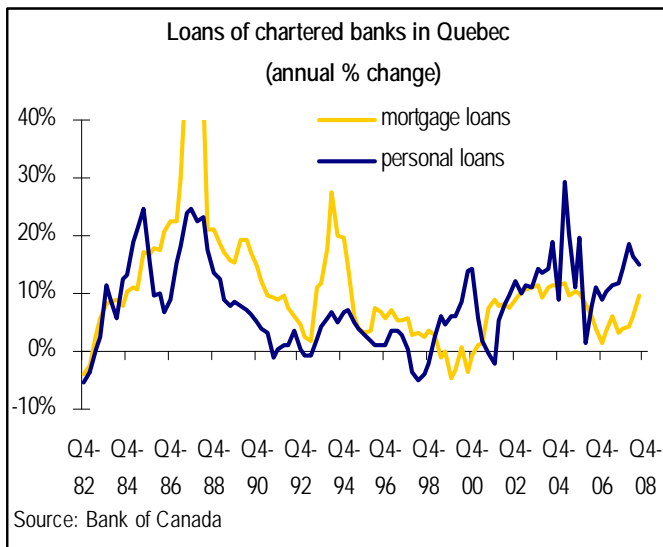
In just a few months, the three main pillars that have supported growth in Quebecers' household incomes and wealth have fallen.

The first two pillars, -- rising asset prices and the positive "wealth effect" they had on consumption, -- have now moved into reverse. Stock prices, the first pillar, have fallen drastically since last year. Secondly, the housing market has cooled substantially. We are forecasting that housing prices will fall by at least 5% during the two coming years, due to a dearth of buyers, coupled with growing inventories that have built up in the resale market. (For more details please consult *The Housing Market Outlook For Quebec and Canada 2009-10* at <http://www.vmbi.ca>).

The third pillar that has been shaken recently is the job market. Fewer Quebecers are working today than a year ago. The province's unemployment rate has risen by about one percentage point during the last year to hit 7.9% in February. The deterioration in the job market is likely to intensify during coming quarters as more businesses announced job cuts. We forecast a cumulative net loss of 90,000 positions in 2009 and 2010 (see chart). This will push the province's unemployment rate past the 9.0% mark by 2010.

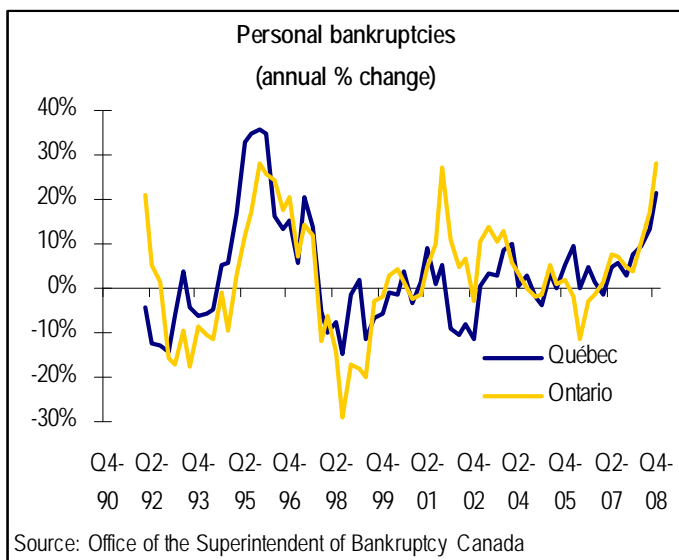
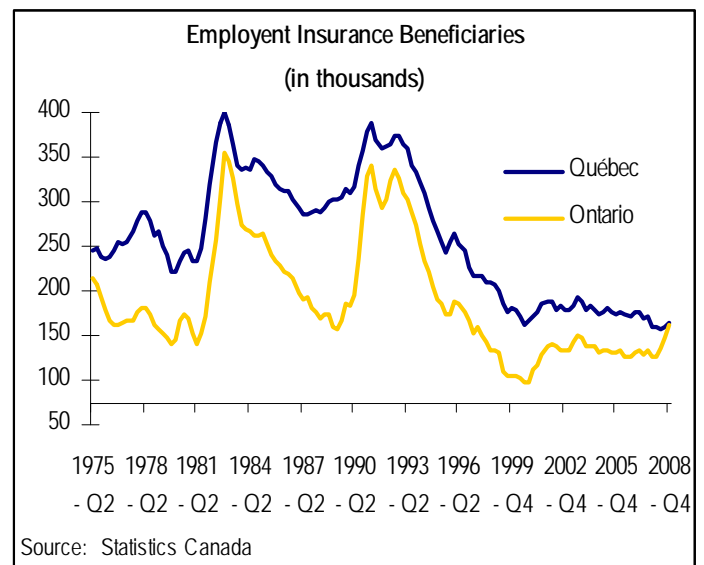


Weakness in the key three pillars makes consumers increasingly prudent. As of January 2009, retail sales in Quebec were a sizeable 3.6% lower than a year ago. *LBS Economic Research* forecasts that consumers will continue to cut expenses during coming quarters. Consequently, growth in personal loans will moderate quickly, just as it had during previous recession cycles. The growth in personal non-mortgage loans in Quebec (including personal loans, credit card loans and lines of credit, excluding mortgage loans) already showed its first signs of weakness last year (see chart).



Personal bankruptcies are rising earlier than during previous recession cycles

Fallout from the decline in the three pillars is not limited to a pullback in consumption. The deterioration in asset prices and in the job market is also pushing many financially vulnerable households over the edge. Increases in personal bankruptcies in Quebec have accelerated to 21% year-over-year in the fourth quarter of 2008 (see chart). During that quarter, almost one out of every 1,000 Quebecers slipped into bankruptcy, the highest share in more than a decade (see chart). This trend marks a stark change from previous recession cycles. During the 1990s episode, personal bankruptcies occurred later, at the end of or after the recession. This is likely due in part to record household debt/income ratios this time around (136% in Canada at the end of 2008), and weaker support to unemployed workers from the EI program (see chart). The pace of increase in personal bankruptcies is expected to be much higher for 2009 than in 2008 (13%).



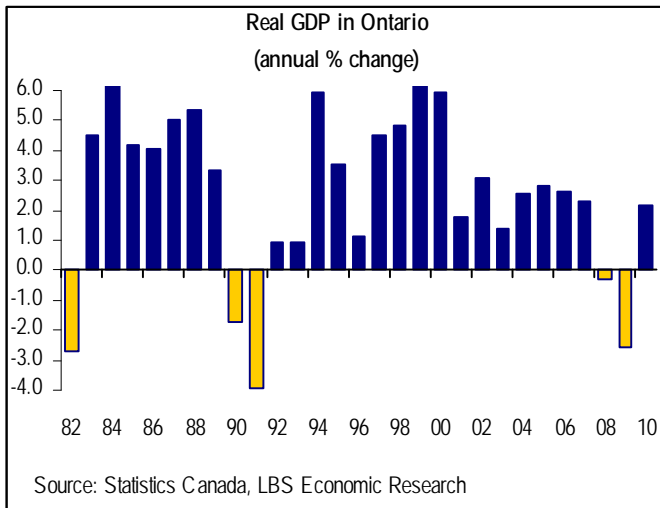
Quebec Economy	2007	2008	2009	2010
Real GDP growth	2.6	0.9	-1.1	2.1
Consumer spending	4.3	3.6	-0.3	1.6
Business Investment	7.6	2.3	-4.3	3.8
Residential Construction	5.7	-0.5	-8.6	-2.1
Government spending	4.4	4.2	4.0	3.6
Exports	0.6	-3.8	-5.4	2.8
Imports	4.6	0.2	-3.8	3.2
Employment growth	2.3	0.8	-2.0	-0.3
Unemployment rate	7.2	7.3	8.7	9.2
Housing starts (units)	48533	47825	38000	35000
Retail sales growth	4.6	4.8	-0.8	1.9
CPI Inflation	1.6	2.1	0.3	2.3

Source: Statistics Canada, CMHC, LBS Economic Research

A severe contraction in Ontario's economy

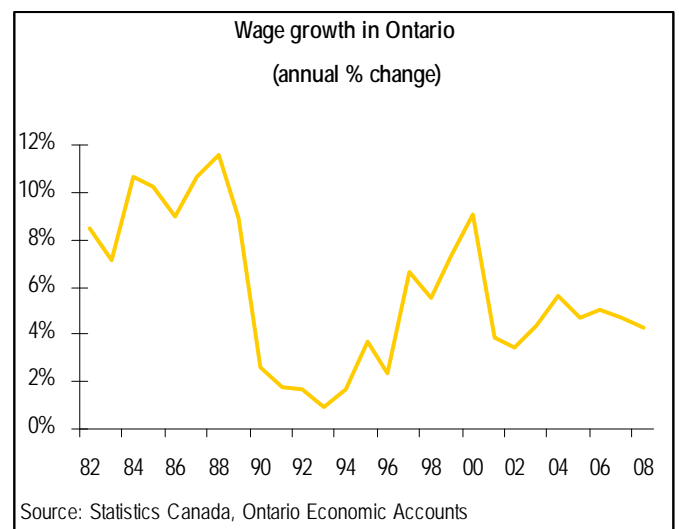
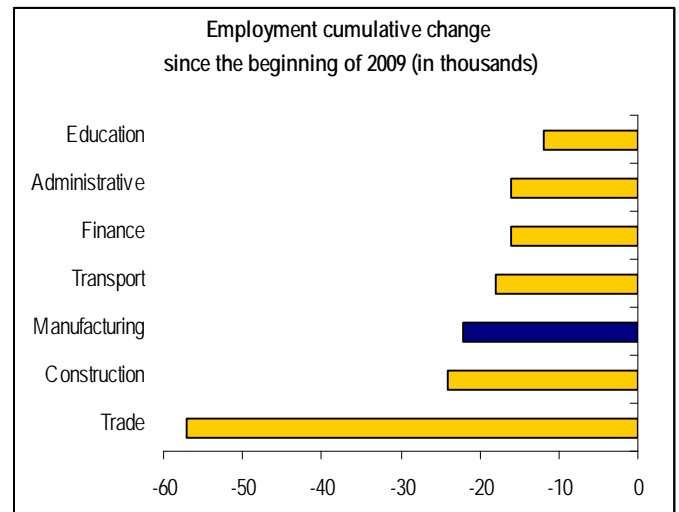
In this new edition of *The Provincial Monitor*, we will also look at Ontario, Alberta and British Columbia's economic and budgetary positions. Detailed forecasts for these provinces are available in the table at the end of this report. Other provinces fiscal and economic situation are detailed in budget notes released recently (see www.vmb.ca).

As we mentioned earlier, the Canadian economy resembles a hockey team whose key players are slumping. Ontario is certainly going through the worst stretch of its career. We are forecasting a 2.6% contraction in Ontario's real GDP during 2009 on the heels of a 0.3% pullback last year (see chart).

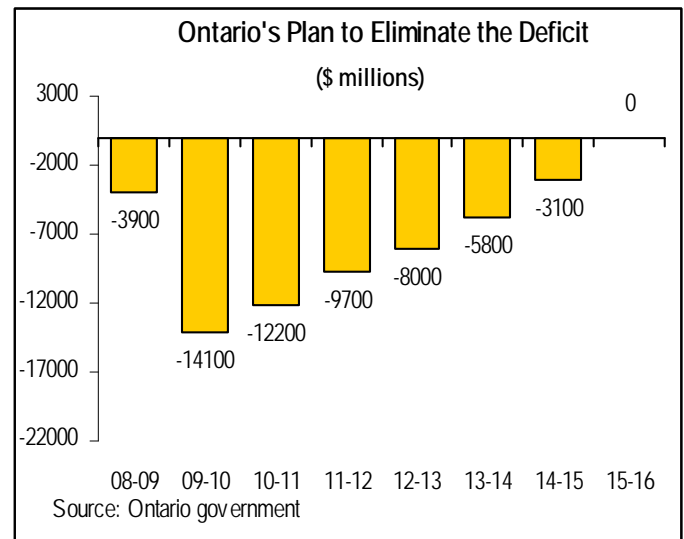
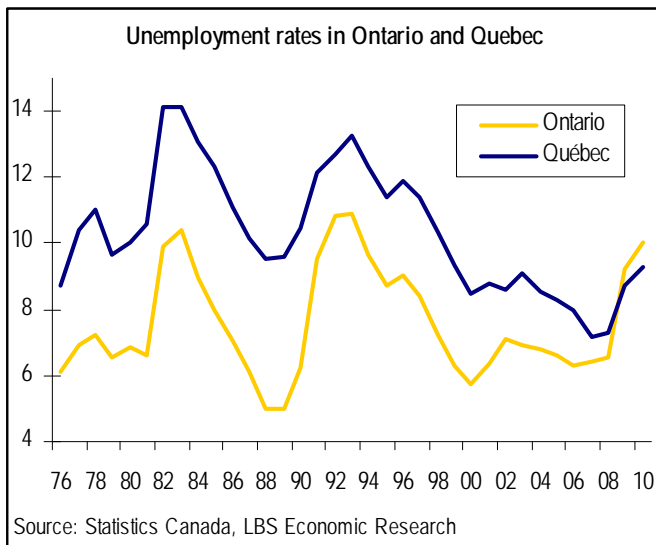


First, Ontario is more than hit by the cyclical downturn in the automotive sector. The fallout from anemic US automotive sales continues, with job losses rising and working hours decreasing. That said, the automotive sector alone does not account for the fact that Ontario's unemployment rate is higher than in the United States, (8.7% versus 8.1% in February). Full time job losses have occurred in several of the province's key economic sectors, including steel, financial services, retail & wholesale trade and construction.

Secondly, the long-term restructuring of automotive sector, which employs close to 400,000 workers, will have a crucial influence on Ontario's economic future. During the 1990s, collective agreements negotiated by the automakers gave workers generous salary and benefits increases, as well as indexation clauses. Since these agreements often served as a basis for those negotiated in many other industries, most Ontarians benefited from the healthy auto industry. As a result, wage growth in the hole province was particularly strong when Ontario's economy bloomed in second half of the 1990s (see chart). The well-paying jobs in the auto industry helped to create a strong prosperity and a relatively rich middle-class.



Ten years later, this auto-related prosperity is under threat. The time has come to trim down labor costs, so that the Big 3 American automakers can be more competitive. No matter the outcome of on-going negotiations between the companies, governments, and unions, growth in total remuneration in the medium-term is likely to be the weakest since the start of the 1990s (see chart). The province's unemployment rate is also expected to hit 10% in 2010. Negative repercussions on retail sales and the housing market should be quite considerable, notably in regions with closed ties to the auto industry. Lastly, since the recession is hitting Ontario harder than it is in Quebec, the rise in personal bankruptcies there has also been more pronounced. These have increased by 15% during 2008 and are likely to rise at an even faster pace this year. As in Quebec, personal bankruptcies in Ontario arrive earlier in the recession cycle than they have in the past, an indication that many households are financially at the end of their ropes.



The Seven-Year Hitch

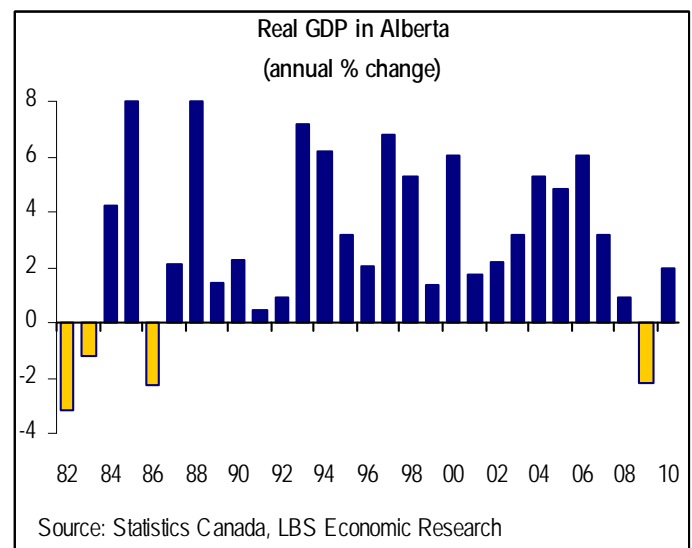
Finance Minister Dwight Duncan showed considerable effort to mitigate the severity of the recession. Ontario has the biggest infrastructure spending plan of all provinces for the next two years. The McGuinty government also introduced a major tax reform package. The goal is to help traditional industries and attract investment in new industries in order to create "green collar" jobs for example. The harmonization of the outdated provincial retail sales tax with the federal GST, for a 13% single value-added sales tax, and the cut in the general income tax rate from 14% to 12% in 2010, are good ideas. For consumers, the harmonization will translate into a higher tax burden. To compensate, the budget proposes direct payments (i.e. mailing cheques) totalling \$1,000 by June 2011 for families earning less than \$160,000, a reduction in the rate of the first income tax bracket from 6.05% to 5.05% and a permanent refundable sales tax credit for low-income individuals. For the province, special Federal assistance to the tune of \$4.3 billion over two years definitely "facilitates" the transition!

Of course, the severe recession has put a strain on the province's finances. To begin with, a \$3.9 billion deficit is estimated for the current fiscal year 2008-09. This is just the beginning of a seven-year period of consecutive deficits, including sizeable ones in 2009-10 (\$14 billion) and 2010-11 (\$12 billion). Overall, it is a combined \$57 billion deficit that is projected between 2008-09 and 2014-15. This streak of planned deficits resembles the one seen in the 1990s. The real problem, however, is that aiming at balancing the books by 2015-16 is more like a roadmap than a plan. And, when we look down the road on that map, we realize it is rather bumpy and foggy, in terms of its economic assumptions, the uncertain future of the auto industry, and therefore the ability to hold program spending increases below revenue growth.

Fortunately, Ontario's net debt to GDP ratio peaked at 33% in 1999-00 and fell to 25% in 2008-09, providing a much-needed cushion for the coming years. In the aftermath of the 1991-92 recession, the net debt to GDP ratio doubled within four years. This time, the increase will be less steep, going from 25% in 2008-09 to a still-manageable 32.6% in 2011-12.

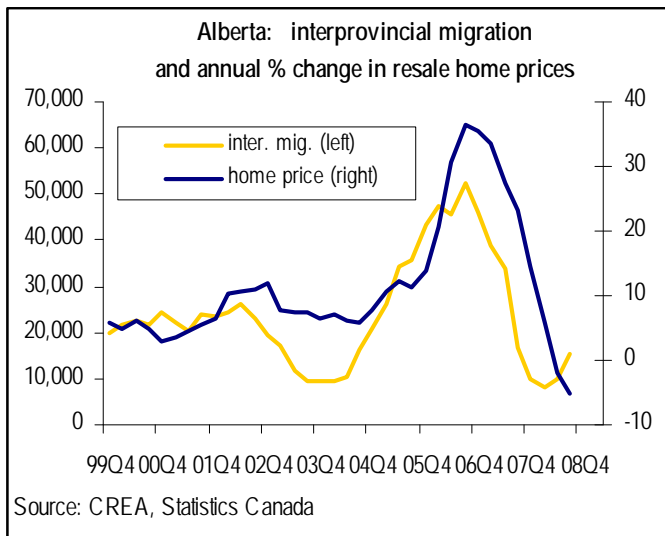
Alberta: a first recession in 23 years, a first deficit in 15 years

While Ontario is suffering from imploding automobile sector sales, Alberta is reeling due to the effects of lower energy prices. The \$100 fall in oil prices (per barrel) and \$8 drop in natural gas prices (per MMBtu) from their peak have sparked a dramatic plunge in the province's terms of trade (the ratio of the prices it gets for its exports, compared to the prices it pays for its imports) the bread and butter of Alberta's businesses and households since 2002.

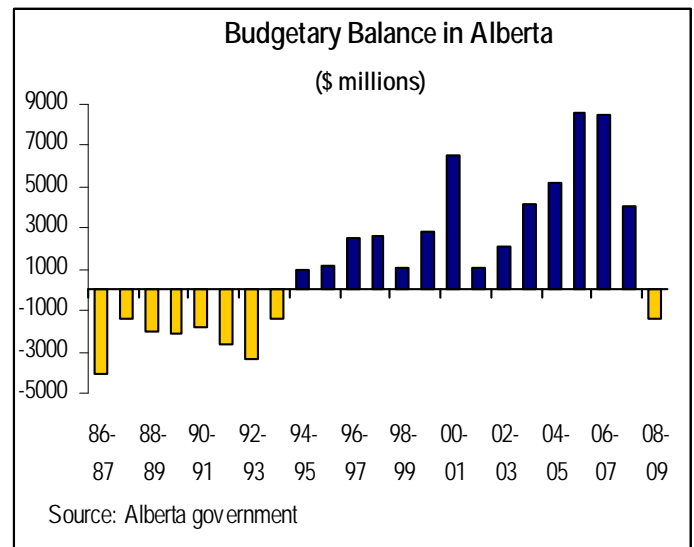


2009 will mark the first contraction in Alberta's economy since the oil bust of the 1980s (see chart). This pullback in economic activity stems foremost from the behavior of businesses, many of which have pared back investment projects. A new program put forward to increase exploration activities is unlikely to bear much fruit during the coming two years. Households too are showing signs of exhaustion, though high savings rates there (above 10%) will cushion in part the decline in consumption.

The pullback in both residential construction and housing prices is likely to continue over the next two years, stemming in part from fewer net inter-provincial migration gains (see chart). Houses are no longer difficult to buy as they once were after all the build-up of previous years. Housing starts should reach about 20,000 units annually during the next two years – about half the pace of 2006 and 2007.



Falling energy prices have also hit hurt Alberta's public finances (close to one third of the government's revenues come from resource-sector levies). For the fiscal year ended March 31, 2009, the Alberta government is projecting a \$1 billion deficit - a far cry from the \$1.5 billion surplus projected in its 2008 budget. This is the first deficit since 1993 (see chart). Alberta's Finance Minister Iris Evans could have used the "Ralph Bucks" wasted several years ago in his next provincial budget to be tabled on April 7th. Instead, the province may have to issue bonds and restrain the rapid spending increases. The mistake that the Alberta government made after energy prices tanked dramatically during the mid-1980 was to wait for prices to bounce back up. The result? By the end of the 1980s, the province slipped into years of structural deficits (see chart). Finally, the *Heritage Savings Trust Fund*, lost considerable ground during 2008-09 as a result of falling stock prices. This investment fund, which was valued at \$17 billion in 2007-08 – a fairly modest amount, considering the large surpluses the government recorded in recent years, -- is now estimated to be worth less than \$15 billion.



British Columbia: beware of a negative savings rate and falling housing prices

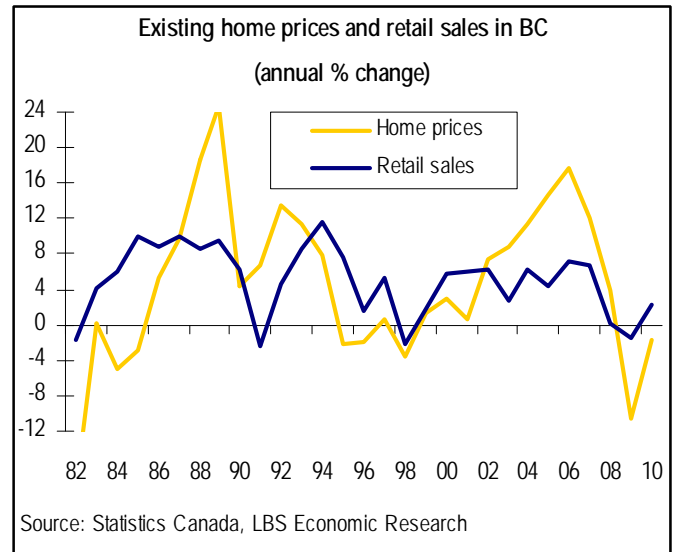
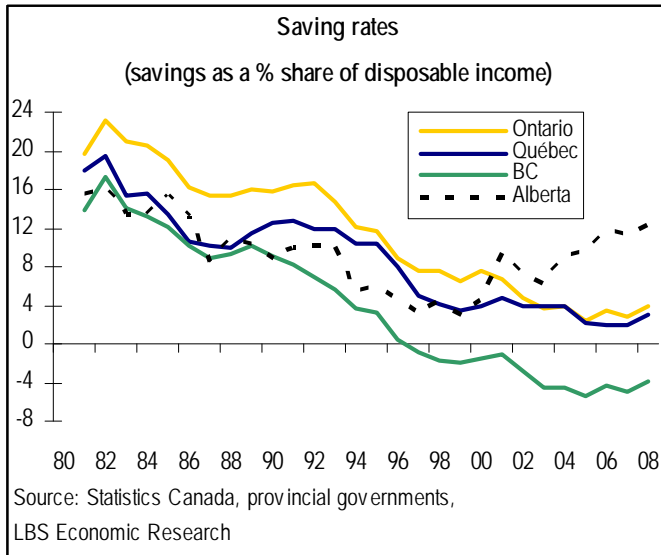
The budget that British Columbia's government tabled last February was quite conservative compared to other jurisdictions. Instead of riding the interventionism wave currently hitting the shores of many countries, the province's finance minister Colin Hansen decided to restrain program spending by cutting non-essential services. As a result, British Columbia is on track to register smaller deficits during 2009-10 and 2010-11 than other provinces. In addition, the return to balanced budgets is expected to be much quicker (in 2011-12) than other jurisdictions. The province's debt/GDP burden (currently less than 16%) is projected to remain so low that it will continue to make other provincial finance ministers jealous.

British Columbia's forecasted deficits are a direct result of the recession. The province's economic downturn, sparked in recent years by shrinking demand for forest products, has intensified because of falling residential real estate activity. Declines in existing home sales, selling prices and housing starts will be sharp this year. The resale housing market will remain highly favorable for buyers for at least two years, particularly in Vancouver.

One worrying aspect about British Columbia is its low savings rate (the remaining of disposable income after expenses and taxes are deducted). BC's saving rate has been in negative territory for several years (see chart). We estimate the savings rate of British Columbians was -5% in 2008 (that is they spent roughly 5% more than they earned). The fact that British Columbians overspent was not a problem in previous years, since the underlying value of their assets was so much higher than elsewhere in the country. The rapid appreciation in homes prices, coupled with the generous tax cuts of the Campbell government, were financing consumption expenditures.

Today, the tide has turned. The meltdown in housing and condo prices will leave households with no other choice to British Columbians but to cut spending in 2009. It should be noted that when British Columbia's housing prices shrank during 1982 and 1998, retail sales fell too (see chart).

We believe that the same thing will happen this time, especially since British Columbians face weaker personal income growth at the same time they face falling real estate values. Job losses during the current recession are larger than they were during the 1980s recession. In fact, British Columbia is second only to Ontario among provinces that have seen the largest deterioration in their labour market. For example, British Columbia's unemployment rate is rising quite rapidly.



On the external front, the fall in international merchandise trade among industrialized nations will weigh heavily on British Columbia's crucial transport and forestry industries. Furthermore, the province cannot count on the 2010 Olympics to spark a sustainable recovery. New money from visiting tourists may spark increased activity and heat up inflation temporarily for a few weeks. The province will have to wait for stabilization in the U.S. real estate market and a rebound in key Asian economies before its own economy can get back on its feet. Until then, real GDP growth in British Columbia will remain below 3%, a rate that the province was accustomed to since the start of the decade.

Sébastien Lavoie, economist

Real GDP growth in Canada and the provinces										
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Canada	1.8	2.9	1.9	3.1	3.1	2.8	2.7	0.5	-1.6	2.2
N&L	1.6	15.6	5.8	-1.7	0.2	3.3	9.1	0.5	-2.1	2.8
PEI	-1.1	4.8	2.1	3.0	1.3	2.6	2.0	0.6	-0.5	1.7
NS	3.2	4.0	1.4	1.4	1.8	0.9	1.6	1.1	-0.4	2.0
NB	1.7	4.5	2.8	1.4	0.5	3.0	1.6	1.0	-0.2	2.2
Quebec	1.5	2.4	1.2	2.6	2.0	1.7	2.4	0.9	-1.1	2.1
Ontario	1.8	3.1	1.4	2.5	2.9	2.1	2.1	-0.3	-2.6	2.2
Manitoba	0.8	1.6	1.4	2.6	2.7	3.2	3.3	2.0	0.5	2.0
Sask.	-1.0	-0.4	4.6	3.8	3.5	-0.4	2.8	2.5	1.0	1.9
Alberta	1.7	2.2	3.2	5.2	5.3	6.6	3.3	0.9	-2.2	2.0
BC	0.6	3.6	2.3	3.7	4.5	3.3	3.1	0.8	-0.7	2.0

Source: Statistics Canada, LBS Economic Research

Unemployment rate in Canada and the provinces										
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Canada	7.2	7.6	7.6	7.2	6.8	6.3	6.0	6.1	8.2	9.0
N&L	16.1	16.6	16.5	15.7	15.2	14.8	13.6	13.2	14.2	14.8
PEI	12.0	11.9	10.9	11.2	10.9	11.1	10.3	10.7	11.6	12.4
NS	9.8	9.6	9.1	8.8	8.5	7.9	8.0	7.7	8.6	9.5
NB	11.1	10.2	10.3	9.8	9.7	8.7	7.6	8.6	9.5	9.8
Quebec	8.8	8.6	9.1	8.6	8.3	8.0	7.2	7.3	8.7	9.2
Ontario	6.3	7.1	6.9	6.8	6.6	6.3	6.4	6.5	9.3	10.0
Manitoba	5.1	5.1	5.0	5.3	4.8	4.3	4.4	4.1	5.4	6.5
Sask.	5.8	5.7	5.6	5.3	5.1	4.7	4.2	4.1	5.5	6.6
Alberta	4.7	5.3	5.1	4.6	3.9	3.4	3.5	3.5	5.7	6.7
BC	7.8	8.5	8.1	7.2	5.9	4.8	4.2	4.5	6.4	6.6

Source: Statistics Canada, LBS Economic Research

Employment growth in Canada and the provinces										
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Canada	1.2	2.4	2.4	1.8	1.4	1.9	2.3	1.5	-1.9	-0.3
N&L	2.9	1.8	2.2	1.0	-0.1	0.7	0.7	1.4	-0.8	0.0
PEI	1.4	1.8	2.0	1.3	2.0	0.5	1.2	1.2	-0.9	-0.1
NS	0.9	1.8	2.0	2.6	0.2	-0.3	1.3	1.2	-1.2	-0.2
NB	-0.3	3.9	0.0	2.1	0.1	1.4	2.1	0.9	-1.5	-0.2
Quebec	1.1	3.8	1.6	1.5	1.0	1.3	2.3	0.8	-2.0	-0.3
Ontario	1.9	1.8	3.0	1.7	1.3	1.5	1.5	1.4	-2.9	-1.0
Manitoba	0.3	2.3	0.6	1.1	0.6	1.2	1.6	1.7	-0.8	0.1
Sask.	-2.8	1.7	1.7	0.8	0.8	1.7	2.1	2.2	-0.7	-0.2
Alberta	2.9	2.5	2.7	2.4	1.5	4.8	4.7	2.7	-1.2	-0.1
BC	-0.5	2.3	2.5	2.4	3.3	3.0	3.2	2.1	-1.7	0.1

Source: Statistics Canada, LBS Economic Research

Retail sales growth in Canada and the provinces										
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Canada	4.4	6.3	3.6	4.7	5.6	6.4	5.8	3.2	-0.9	2.0
N&L	9.3	4.0	6.1	0.3	1.2	3.4	8.9	7.7	1.0	2.8
PEI	4.0	3.4	1.0	0.1	2.8	6.2	7.7	4.8	-0.9	2.0
NS	3.6	6.1	1.8	2.8	2.2	6.0	4.2	4.5	-0.9	2.2
NB	3.0	3.9	0.5	1.7	4.6	5.9	5.7	4.8	-0.5	1.8
Quebec	4.2	6.1	4.5	4.2	5.1	5.1	4.6	4.8	-0.8	1.9
Ontario	2.5	5.9	3.4	3.2	4.8	4.1	3.9	3.4	-1.3	1.6
Manitoba	5.8	7.0	3.6	6.7	5.9	3.9	8.8	7.1	0.5	2.2
Sask.	4.4	7.6	5.0	4.1	5.2	6.5	13.0	10.3	1.2	2.4
Alberta	8.9	9.0	4.4	10.3	11.8	15.4	9.3	-0.2	-1.0	1.8
BC	5.9	6.3	2.7	6.3	4.4	7.2	6.7	0.3	-1.4	2.3

Source: Statistics Canada, LBS Economic Research