LAURENTIAN BANK

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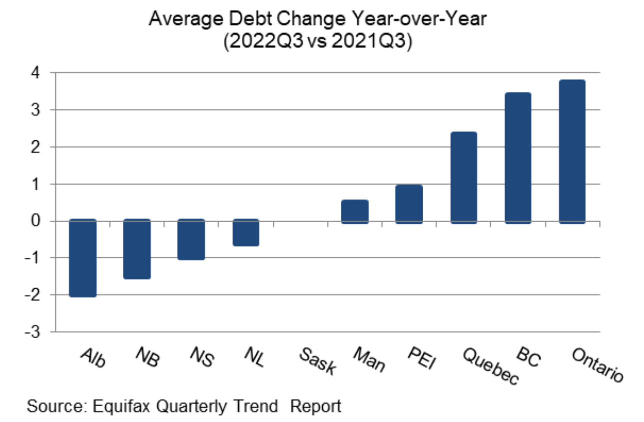
Provincial Economic Forecasts – Winter 2023

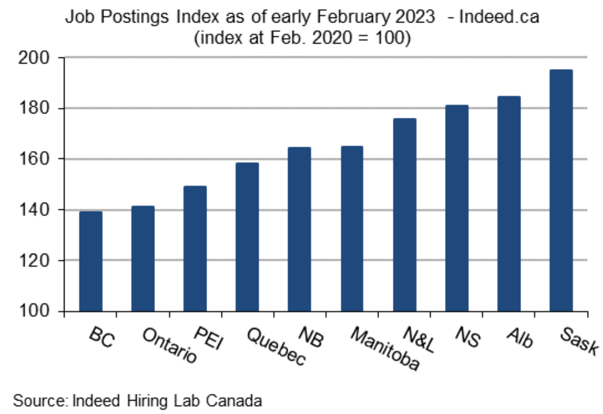
In between fiscal updates released by provincial issuers last Fall and the impending provincial budget season, the near-term economic outlook generally improved coast to coast. CPI inflation has turned the corner without pain so far. Resilient job market conditions contribute to the maintaining of mild positive economic momentum. However, prudence is in order when it comes to reassessing on the upside real GDP and other economic forecasts for the 2023-24 horizon. The inflation cooling process is bumpy and the long period of adjustment for households and businesses will require an elevated plateau in North American policy interest rates. The full adverse impact of high interest rates is expected to weigh down on economic momentum to the point of generating a mild recession that suddenly appears to be delayed by a quarter or two. Overall, provinces releasing their 2023 budgets should be able to show improvements in a variety of financial metrics such as debt-to-GDP ratios under their respective base case scenarios.

One development for provincial issuers that recently made the headlines relates to the bonified health-care funding deal proposed by the federal government. $46B in additional transfers over 10 years, an amount accepted by Canadian provinces earlier this month, will go on top of the existing health transfers. This agreement has been appropriately interpreted as a step in the right direction. In our view, it represents a small step. $46B does not materially improve the long-term financial situation of Canadian provinces, considering the Parliament Budget Officer projects that health care spending will increase by a large 1.5%-2% of nominal GDP over the long run in most jurisdictions. This revisited report reviews our selection of economic and fiscal developments that merit attention for the investor base exposed to the Canadian provincial credit landscape. Detailed forecasts for 2023-24 are available at the end of the report.

British Columbia: BC reported a large $5.7B surplus in its 2nd quarter update released last Fall. Since then, China's reopening, possibly the single most important factor for global economic growth in 2023, has become a positive game changer for BC due to its larger trade exposure to Asia. The relaxation of COVID restrictions recently led the IMF and the BoC to sharply revise up China's real GDP 2023 growth forecast above 5%, significantly up from one of the worst historical performances in 2022. The improving BC economic outlook will facilitate the financing of spending initiatives announced by new Premier David Eby since he was sworn last November. His initiatives notably include funding for infrastructure grants at the municipal level. Also, climate shocks have become a recurrent theme as floods and wildfires of recent years have bumped up provincial spending. Time will tell if unexpected costs occur this year. Otherwise, the ESG Report released last September by the Ministry of Finance revealed BC's solid foundations toward the climate transition. There are notably two additional LNG projects proposals beyond the existing LNG Canada export terminal. In addition, the thriving mining sector offers ESG benefits. Overall, the value of natural resources projects over the next 10 years is significantly higher than in other provinces according to an annual compilation done by Natural Resources Canada.

Alberta: The International Energy Agency estimates China's reopening will contribute to half of the increase in global oil demand this year. Most analysts project a mild increase in global oil demand in 2023 relative to 2022. On the supply side, Russia plans to further redirect oil exports to new markets, away from traditional ones. The long, uneasy global search for energy security is poised to support Alberta's economy and fiscal revenues again in 2023, following the 20%+ annual surge in nominal GDP during 2021 and 2022. Tight global oil conditions matter more than before for Alberta, as the December mid-year update cites increasing royalties due to several oilsands projects moving into the viable post-payout status where revenues surpass expenses. Solid corporate balance sheets in the energy sector should allow Alberta to outperform in terms of labour and housing market conditions. The business investment outlook is bright. New project announcements include a large renewable diesel facility that will be operational in 2025 and what will become the largest hydrogen plant on the planet in 2024. As for the February 28th budget, Finance Minister Travis Toews recently said it will focus on additional health care and education spending, measures that should be financed with unallocated funds highlighted in the mid-year update rather than debt issuance. The next general elections will be held on May 29.

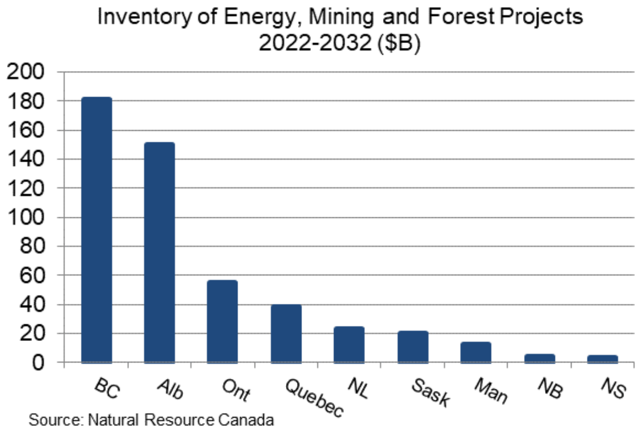




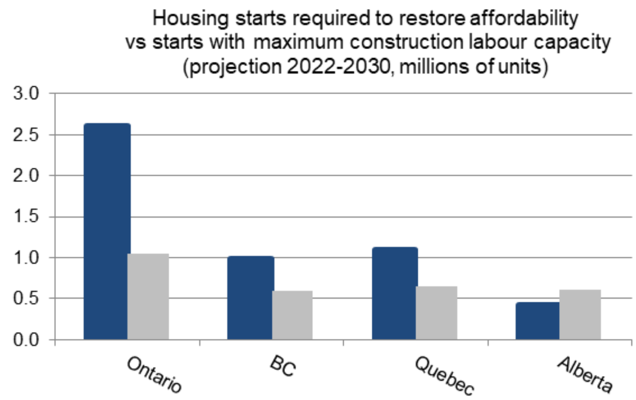
Saskatchewan: Saskatchewan was home of a larger rebound in crop production during 2022 relative to its neighbors Alberta and Manitoba. Also, the province has been able to ramp up potash production in response to geopolitical tensions unfortunately worsening food insecurity globally. Global agriculture prices have been broadly stable at high levels in recent months according to the World Bank's monitoring, supportive for Saskatchewan's tax base. Potash prices have fallen sharply from sky-high levels observed last Spring but remain historically elevated. This recent decline was triggered by lower demand from farmers and the plunge in natural gas prices. Several companies are expanding canola crushing capacity in the province, creating positive spillover effects on economic activity. Canadian canola oil has been approved last December by U.S. environmental authority regulating the biofuel industry. Finally, the advantageous fiscal position taking the form of a $1.1B surplus in FY 2022-23, according to the mid-year update, allows the province to remove $1B in marketable debt. Beyond our 2023-24 forecast horizon, the Jansen potash mine, the world's largest, is now projected to begin production in 2026 rather than 2027.

Manitoba: In addition to the crop rebound, the strengthening in hydro exports and pricing has generated an above-par bump in nominal GDP during 2022 and largely benefited public finances. The province was shy of a balanced budget according to the mid-year December update, projecting a tiny $193M deficit for FY 2022-23. Housing conditions have been cooling to a lesser degree relative to peers. In contrast to most provinces, job postings reported by Statistics Canada and Indeed have not declined during the second half of 2022. Manitoba is home of the second lowest unemployment rate in the country. It reached 4.2% last January. However, job gains during the last year have been mostly driven by part-time occupations, a soft spot contrasting with other provinces. Progress has been made about the possible construction phase of a green hydrogen plant in the small city of Selkirk. The North End Sewage Treatment Plant upgrades in Winnipeg at a cost of approximately $2B continues and should be completed by 2025.

Ontario: Solid economic performance in recent months and a higher corporate income tax base led to a substantial improvement in Ontario's near-term financial situation in a very short period. The FY 2022-23 deficit was cut by half to $6.5B between the mid-year update of last November and the 3rd Quarter Update released mid-February. FY 2022-23 borrowing requirements were left unchanged at $43B but include a sizeable $10B in pre-financing, allowing Ontario to modestly reduce issuance in FY 2023-24. On the economic front, the most noticeable development relates to the 2.4%, or 360K, y-o-y jump in population in 2022Q4 led by record high non-permanent residents generally renting. Job search of Ontario's residents looking for positions outside the province reported by Indeed, and larger interprovincial outflows reported by Statistics Canada, indicate an accelerating trend in homebuyers looking outside of Ontario for less expensive alternatives. The main recipients are Alberta and Nova Scotia. The principal culprit behind this behaviour is simply high interest rates: CMHC's latest rental survey reported a record-high gap between the monthly cost of owning a condo versus a monthly rent in the GTA. The full impact of higher interest rates is expected to unfold in upcoming quarters, requiring a larger adjustment for households located in Ontario due to their higher leverage. Growth in nominal household spending is notably poised to slow and converge towards disposable income during the year. Otherwise, solid public and private investments to retool the auto sector will increase EV assembly, parts production and EV battery production in 2023, 2024 and 2025. Over this horizon, the utility crown corporation Ontario Power Generation recently recommended the province to expand hydroelectric capacity.



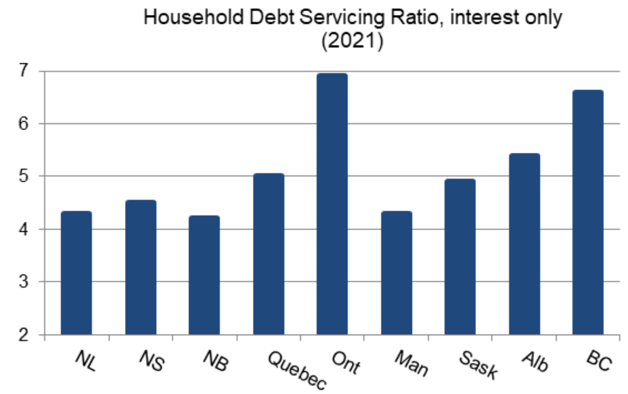
Source: Natural Resource Canada



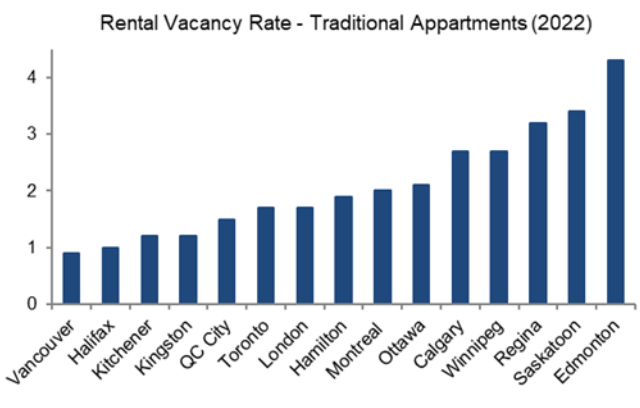
Source: CMHC October and June 2022 Reports

Quebec: The Quebec economy registered a brief setback in 2022Q3 due to weaker export activity and further retrenchment in housing activity. Within the province, one fostering trend relates to the large interregional outflow of residents from the Montreal area to other regions. In turn, housing activity has been more resilient outside of Montreal. Following the 2022Q3 setback, momentum improved according to several high-frequency economic indicators. Unemployment notably returned to its all-time low of 3.9% in January, the lowest figure in the country. Altogether, Quebec has been improving its near-term fiscal situation according to the Monthly Financial Transactions Report released on January 20th. For the first 7 months of FY 2022-23, the $2.7B surplus before use of the $0.5B stabilization reserve contrasts with the mid-year update predicting a $5.2B deficit for the entire year. Own-source revenue year-to-date growth run hot at almost 10%, surpassing the mid-year update's solid expectation of a 5.1% increase. Looking ahead, the 2023 budget will be a big one for the bond market community. Last December, Finance Minister Eric Girard said he will announce a new, long-term debt target. Since FY 2014-15, the Quebec government has considerably narrowed its net debt-to-GDP gap with other provinces. Minister Girard said the new debt target will have to consider business cycle volatility. The budget will also include the promised 1% personal income tax rate reduction for the first two tax brackets, effective in 2023 and costing close to $7B over 5 years. This tax cut will be financed by reducing payments to the Generations Fund. Otherwise, the Quebec government is pressing forward since it laid out its 2030 Green Economy Plan to boost electrification and initiate climate change policies. In a report released in May 2022, the Canadian Climate Institute ranked Quebec very high in terms of climate transition-opportunity companies, capital raising and competitiveness.

New Brunswick: The 3rd quarter update released mid-February solidifies the near-term fiscal outlook. The large $0.9B surplus estimate for FY 2022-23 is unchanged from the previous update. The widening personal and corporate income tax bases reflects cyclical strengthening and a booming population rising north of 3% year-over-year. FY 2022-23 spending does not surpass initial budget expectations, a rarity among provinces. Modest rate reductions to several personal income tax brackets effective this year also stands out from other jurisdictions. Furthermore, NB households had from the lowest average debt service ratio in Canada, below 5% of disposable income in 2021 before the 2022 surge in financing costs. The province's deadline for financial assistance applications following Hurricane Fiona has recently passed.



Source: Statistics Canada



Source: CMHC Rental Survey

Nova Scotia: After the $342M pandemic-related deficit of FY 2020-21 and economic rebound-led $351M surplus of FY 2021-22, the Province is close to returning to the pattern observed in the four years prior to the COVID-19 shock. The FY 2022-23 $506M budgeted deficit has been scaled down to $143M in the December mid-year update, a mere 0.3% of nominal GDP. Due to its relative affordable cost of living, Nova Scotia has recently drawn a record number of interprovincial migrants, contributing to a robust 3.2% y-o-y increase in labour supply as of January 2023. In 2022, the population grew at its quickest pace ever, 2.6%, surpassing one million. Last December, the Province formed two new entities to promote economic growth. "Build Nova Scotia" leads significant initiatives such as the high-speed internet effort, environmental remediation and healthcare projects. "Invest Nova Scotia" will make it easier for entrepreneurs and businesses to gain access to tools and counsel in order to expand and export. Nova Scotia will invest $1B over the next seven years to modernise its roads, bridges, and ferries. It represents one of the largest initiatives in the province's history. In 2023 and 2024, the government will invest $450M, or 0.8% of NGDP, on roadway projects. With a household debt-to-disposable-income and thus debt-servicing ratio significantly lower than the Canadian average, the transition to high interest rates should be relatively less abrupt.

PEI: The P.E.I. government submitted the highest capital budget ever last November: $1.2B in infrastructure projects over 5 years, including $300M, or 3.4% of NGDP, on roads, schools, and government-owned housing units in the upcoming fiscal year 2023-24. Very tight rental conditions are contributing to fuel the province's inflation rate, the highest in the country. Tourism activity significantly exceeded pre-pandemic levels due to the return of cruise liner trips. Port Charlottetown expects a record 2023 year in terms of cruise ship arrivals. The positive impact of a growing population on employment and household spending should offset the negative impact of high interest rates.

Newfoundland and Labrador: 2022 offshore oil production dropped 10% to 85 million barrels. Production at the Terra Nova oilfield was halted in 2022 for an overhaul but the restart of operations should occur this spring or early summer. Production at the West White Rose offshore oilfield should also resume this year. For the first time in over three years, all four mature offshore fields, including Hibernia and Hebron, will produce oil in 2023. Higher prices countered lower production in 2022, increasing value by 34%. Accordingly, the province expects to shift from a $272M deficit position in FY 2021-22 to a $479M surplus in FY 2022-23. NL is on track to register its second surplus during the last decade. Besides the short-term improvement in public finances, the long-term outlook brightens. Following Ottawa's approval of the Bay du Nord oil project last year, the province negotiates with Norwegian-based Equinor about construction and engineering inputs that will come from local trade workers and contractors. Also, the 2021 Feasibility Study of Hydrogen Production, Storage, Distribution, and Use in Newfoundland and Labrador demonstrates that the province has vast offshore areas, abundant wind resources regulatory regimes for offshore petroleum development that are being expanded to regulate offshore wind and hydrogen development. NL has the potential to become a major producer of green hydrogen with renewable wind to serve local, Maritimes, and European markets. Canada and Germany inked an agreement last August to increase German energy security with clean Canadian hydrogen, committing themselves to create a transatlantic Canada–Germany supply corridor and exporting hydrogen by 2025.

As for hydro developments, the N&L government recently received a panel report exploring the long-term maximisation of Churchill Falls hydropower. The report was not made public. Future developments will be key both for N&L and Quebec. Quebec purchases power from Churchill Falls at the ultra-low price of 0.2 cents per kWh. The agreement signed in 1969 expires in 2041. Churchill Falls generates enough electricity to power the province three times over. Therefore, it requires a large external customer. One option would be to build infrastructures and sell hydropower elsewhere in North America or use it to generate green hydrogen. Without a new deal, Hydro Quebec could lose access to 15% of its actual power. Time is of the essence as Quebec would need to construct new dams. The other option would be to use existing infrastructure in place and sign a new deal with Quebec at a higher price, which would provide NL with additional recurrent revenues over the long term.

Real GDP Growth (%)	2020	2021	2022	2023	2024
Canada	-5.1	5.0	3.6	0.6	1.3
N&L	-4.6	0.6	0.8	1.0	1.4
PEI	-1.6	7.9	1.8	0.9	1.0
NS	-3.5	6.2	2.4	0.8	1.2
NB	-2.7	5.9	2.0	0.6	0.9
Quebec	-5.0	6.0	2.7	0.2	1.2
Ontario	-4.7	5.2	3.7	0.4	1.4
Manitoba	-4.4	1.8	3.3	0.9	1.2
Sask	-4.8	-0.9	5.2	1.7	1.8
Alberta	-8.0	4.8	4.9	2.4	1.9
BC	-3.0	6.1	2.9	0.7	1.2

Source: Stat. Can.; forecast: LBS Econ. Research and Strategy.

Nominal GDP Growth (%)	2020	2021	2022	2023	2024
Canada	-4.5	13.6	10.5	3.0	3.7
N&L	-10.0	17.7	13.8	2.4	3.7
PEI	1.4	14.3	6.3	3.8	3.1
NS	0.0	10.9	7.2	4.0	3.4
NB	-1.6	13.8	5.8	3.6	3.0
Quebec	-1.9	11.8	8.6	3.4	3.4
Ontario	-2.9	10.3	9.7	3.8	3.6
Manitoba	-1.3	8.4	10.8	1.5	3.4
Sask	-7.6	13.1	19.2	1.0	4.0
Alberta	-15.7	26.2	19.9	2.0	4.2
BC	-0.7	14.2	7.4	3.3	3.4

Source: Stat. Canada; forecast: LBS Econ. Research and Strategy.

Unemployment Rate (%)	2020	2021	2022	2023	2024
Canada	9.7	7.5	5.3	5.7	6.0
N&L	14.5	13.1	11.2	11.9	12.1
PEI	10.7	9.9	7.5	8.0	8.2
NS	9.9	8.6	6.6	7.1	7.5
NB	10.4	9.1	7.2	7.7	8.1
Quebec	9.0	6.1	4.3	4.6	5.1
Ontario	9.8	8.2	5.6	6.1	6.3
Manitoba	8.2	6.4	4.5	5.0	5.4
Sask	8.3	6.5	4.7	5.2	5.5
Alberta	11.5	8.5	5.8	6.2	6.3
BC	9.2	6.5	4.6	4.9	5.1

Source: Stat. Can.; forecast: LBS Econ. Research and Strategy.

Employment (annual change in %)	2020	2021	2022	2023	2024
Canada	-5.6	5.0	4.0	0.6	0.8
N&L	-6.4	3.6	4.3	0.3	0.8
PEI	-3.5	4.1	5.3	0.9	0.7
NS	-4.6	5.6	3.6	1.4	0.7
NB	-3.0	3.2	2.7	0.4	0.5
Quebec	-5.4	4.4	3.1	0.6	0.6
Ontario	-5.4	5.2	4.6	0.7	0.9
Manitoba	-4.3	3.7	3.2	0.5	0.6
Sask	-5.0	2.6	3.5	0.8	1.0
Alberta	-7.0	5.5	5.2	1.7	1.3
BC	-6.2	6.2	3.1	0.9	1.0

Source: Statistics Canada, LBS Econ. Research and Strategy.

CPI Inflation (%)	2020	2021	2022	2023	2024
Canada	0.7	3.4	6.8	3.4	2.1
N&L	0.2	3.7	6.4	3.0	2.1
PEI	0.0	5.1	8.9	4.0	2.1
NS	0.3	4.1	7.5	3.8	2.1
NB	0.2	3.8	7.3	3.6	2.1
Quebec	0.8	3.8	6.7	3.4	2.1
Ontario	0.6	3.5	6.8	3.3	2.2
Manitoba	0.5	3.2	7.9	3.9	2.2
Sask	0.6	2.6	6.6	3.1	2.1
Alberta	1.1	3.2	6.5	3.2	2.2
BC	0.8	2.8	6.9	3.4	2.2

Source: Stat. Canada; forecast: LBS Econ. Research and Strategy.

Housing Starts (000s of units)	2020	2021	2022	2023	2024
Canada	**218**	**271**	**262**	**220**	**222**
N&L	0.8	1.0	1.4	1.1	0.9
PEI	1.2	1.3	1.3	1.0	1.0
NS	4.9	6.0	5.7	5.4	5.2
NB	3.5	3.8	4.7	3.8	3.6
Quebec	54.1	67.8	57.1	48.0	48.0
Ontario	81.3	99.6	96.1	74.0	77.0
Manitoba	7.3	8.0	8.1	6.8	6.5
Sask	3.1	4.2	4.2	4.3	4.1
Alberta	24.0	31.9	36.5	37.0	36.0
BC	37.7	47.6	46.7	39.0	40.0

Source: Stat. Canada; forecast: LBS Econ. Research and Strategy.

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