ECONOMIC RESEARCH AND STRATEGY

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Provincial Outlook – Winter 2024 Edition

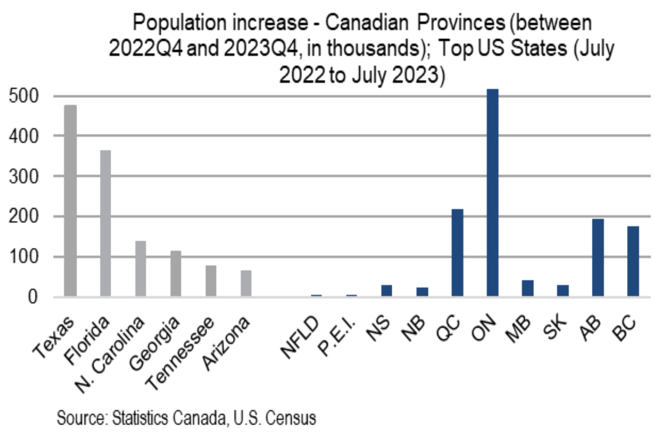
In the upcoming 2024 provincial budget season, governments are poised to use again a soft landing as the base case scenario underlying their fiscal outlook. On track to issue a combined $85B in long term bonds in FY 2023-24, the biggest challenge for subnational entities will be to issue a similar amount of bonds in FY 2024-25 at the same time as the US Treasury and Government of Canada ramp up issuances. Fortunately, provincial budgetary balances are generally manageable. Financial metrics, such as net debt-to-NGDP, are broadly stable too. Compared to the 2023 budget season, the ongoing moderation in CPI inflation will translate into a weaker pace of growth in tax revenues. Also, with policy rates likely at their peak in the U.S. and Canada, the risk of facing ballooning debt servicing ratios has diminished. However, adverse climate shocks could lead to cost overruns again. Additionally, Ottawa’s expansionist immigration policy will continue to exert upward pressure on the delivery of public services and spending of provincial governments. Our revisited Provincial Outlook reviews economic and fiscal developments that merit attention for the investor base exposed to the Canadian provincial credit landscape. Detailed economic forecasts for 2024-25 are available at the end of the report.

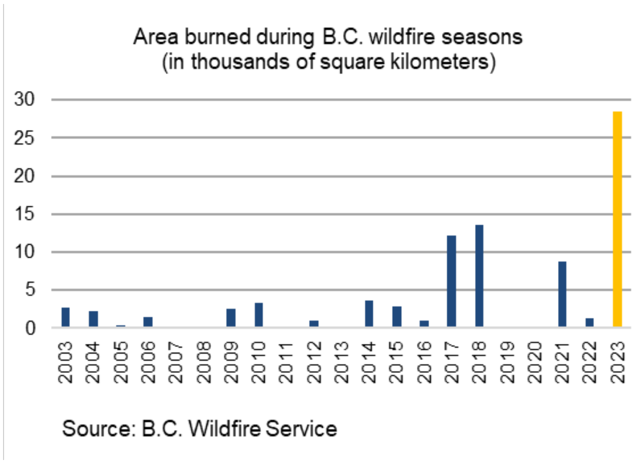
British Columbia – Adverse climate shocks, improving long-term LNG outlook

BC’s economy is structurally challenged due to its greater exposure to Asia. The province is caught in the middle of U.S.-China and Canada-India tensions. Foreign direct investment in China started to fall last year. Chinese consumer confidence is also low amid housing oversupply conditions in the smaller tier 3 cities. Starting in February, Chinese banks will be allowed to hold fewer reserves to reinvigorate real GDP growth to the 5% target. On the domestic front, the adverse impact of higher inflation and interest rates is expected to keep consumer spending and BC’s real GDP growth in the slow lane. About half of firms cite insufficient demand as a limit on sales’ growth according to the Canadian Federation of Independent Business survey, a higher figure than other provinces. The 50K housing starts figure of last year was remarkable. However, the large upcoming increase in development charges in the Metro Vancouver Area is poised to deteriorate housing starts and affordability going forward.

The 2024 BC budget will be released on February 22nd. Investors will focus on the 3-year outlook, which may show structural deficits. Among good news, BC’s very solid starting point stands out from the pack: the government has an extremely low public taxpayer debt-to-GDP ratio notably reducing the bite of higher interest rates on debt servicing costs. Unfortunately, climate shocks continue to make headlines. The wildfires of 2023 cost the government approximately $0.8B in FY 2023-24, according to the second-quarter fiscal update. In addition, the crown corporation BC Hydro recorded lower revenues due to drought conditions lowering water levels at dams. Several atmospheric rivers also battered various regions and BC’s lumber capacity continues to decline.

Among positive projects, work on the extension of the Skytrain toward Surrey and Langley will start this year. Furthermore, last December, the Biden Administration released funding for the planning of a high-speed rail connecting Portland, Seattle, and Vancouver. The brightest note of all for BC relates to the Liquified Natural Gas (LNG) sector. Three projects—LNG Canada, Cedar, and Woodfibre—are confirmed and poised to start their production phase between 2025 and 2028. A fourth project, KSI Lisims, is currently at the environmental approval stage. BC has the potential to export a large volume of LNG by 2030, equivalent to Malaysia's current LNG exports but shy of the biggest players (Australia, Qatar, and the United States). U.S. President Biden recently announced a pause on LNG in the U.S., which may eventually favor capital inflows to BC.





Alberta – Challenging Population Boom, Oil Subject to Global and Domestic Developments

Alberta is experiencing the fastest population growth out of all provinces, above 4%, due to solid inflows from Ontario, BC and outside of Canada. The U-Haul growth index showed Calgary as the top Canadian city in terms of net trucks arriving during 2023. The housing market is unable to absorb household formation, leading to a double-digit year-over-year jump in rent in Edmonton and Calgary, according to Rentals.ca and the annual rental survey of CMHC. Housing starts are poised to stay near 36,000 units this year, like in 2022 and 2023. Job postings are also higher than elsewhere. Unemployment rose at a significantly lower pace than in other jurisdictions since last Spring, thanks to above-par full-time job creation.

Providing access to public services, including health and education for this surging population growth should influence the fiscal outlook of the upcoming 2024 budget. To eventually accommodate future energy needs, positive steps are also being taken in the private sector to assess the development of small modular nuclear reactors.

The second-quarter fiscal update released last November revealed a very large surplus of $5.5B for FY 2023-24, even though oil production briefly declined during the year due to wildfires. Oil production rebounded swiftly afterward, reaching an all-time high of 4.16M barrels per day last November. Geopolitical tensions are escalating further with the recent attack in Jordan and U.S. President Biden's upcoming response, contributing to keeping WTI oil prices near the assumption of US$79 used in the second-quarter fiscal update for FY 2023-24. The Trans Mountain pipeline expansion is facing late technical construction issues that are expected to delay its activation by only one quarter, from 2024Q1 to Q2. The Trans Mountain project will approximately triple oil export capacity to the West Coast, supportive of further narrowing of the heavy-light WCS-WTI spread (US$20 per barrel as of late January).

Crucial developments to Alberta's economic future and public finances are likely to unfold throughout the year. First, the federal government unveiled a draft regulation last December proposing a cap on GHG emissions in the oil & gas sector (35%-38% reduction by 2030 compared to 2019 levels). Stakeholders must submit comments on this proposed framework by early February before Ottawa finalizes a GHG cap that could become effective in 2025. Second, current public sector collective agreements, including those for several thousands of workers, will expire at the end of March. The outcome of bargaining with the government may result in upward pressures on fiscal expenses.

Saskatchewan – Uranium Rally, Potash Normalization

Investors should not overlook the second largest uranium producer in the world. Global uranium prices began the year 2024 at a 15-year high, thanks to the global push for zero-emission nuclear energy. The Saskatchewan government could revise up uranium price assumptions in the 2024 budget. In late 2023, the government granted key environmental approval for a very large new uranium project in the province. In the United States, uranium production commenced at three different sites last year.

According to the second-quarter fiscal update released last November, the severe drought of last summer unfortunately contributed to unexpected expenses. The FY 2023-24 budgetary balance swiftly flipped from a large surplus estimate in the 2023 budget to a modest deficit. If normal weather conditions prevail in 2024, crop yields will bounce back, and the province could return to a surplus position in FY 2024-25. Besides the drought, the other adverse factor to public finances has been the normalization of potash market conditions after the surge in prices triggered by the Russian invasion of Ukraine in 2022. Global potash prices declined below the 2023 Saskatchewan budget assumption as exports from Belarus and Russia resumed. In addition, potash production in the province plunged by almost 40% in 2023 relative to 2022, contrasting with stable oil production. Going forward, consensus calls for an exceeding demand potash market worldwide, supporting the Province's non-renewable resource revenues. Otherwise, large canola crushing projects and labour market resiliency support our outperforming Saskatchewan 2024-25 outlook.

Manitoba – First NDP Budget Coming Up

The provincial NDP won a majority in the October 4th elections last year. The new Premier, Wab Kinew, temporarily lifted the gasoline tax in January until at least the end of June, sufficient to forecast lower CPI inflation than other provinces during 2024. New Finance Minister Adrien Sala will eventually unveil the first NDP budget this Spring. During the election campaign, the NDP promised to balance the books within the first 4-year term, a challenging task considering the structural deficits registered under the previous Progressive Conservative government. Additionally, investors will eventually find out about time-specific objectives when the government releases details about its critical mining strategy later this year. A foreign company is exploring the possibility of a major $1.5B lithium-ion battery facility, although lithium prices have collapsed due to oversupplied global conditions.

In terms of vulnerability to climate shocks, 2021 and 2023 droughts reducing water levels stood out from the pack. These droughts deteriorated Manitoba Hydro's financial position relative to budget expectations. As a result, the second-quarter update released last December indicated a $1.6B shortfall in FY 2023-24 for the new NDP government, the largest deficit on record excluding the pandemic period. One way to mitigate higher sensitivity to climate shocks is to increase electricity production in the long run. Manitoba Hydro plans to boost wind power capacity over the next two decades. Lastly, on the economic front, Manitoba registered above-average full-time job gains for the second time in the last three years, including in 2023, keeping resale housing conditions in sellers' territory.

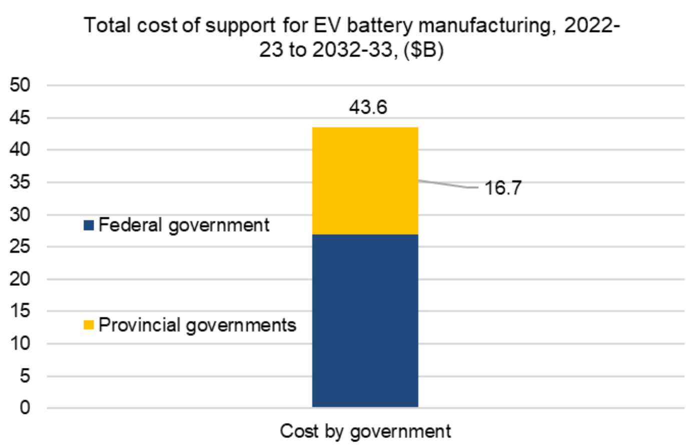
Ontario – EV Transition to Boost Non-Residential Construction, Housing Rebound Activity in Sight

In a report released last December, the Parliamentary Budget Officer (PBO) indicated that the federal government will fund about two-thirds of the subsidies for the Stellantis and Volkswagen EV projects, a very good deal for Ontario. The PBO estimates the break-even timeline – when fiscal revenues generated by the economic impact of these projects equals production subsidies – at 23 years for the Stellantis plant and at 15 years for the Volkswagen plant. The PBO sees a shorter break-even threshold for the Northvolt project in Quebec (11 years). Thanks in part to the construction phase of Stellantis, industrial-type construction activity in Ontario improved in 2023, moving closer to the all-time high level reached in 2018. Construction of the larger Volkswagen EV plant is poised to begin this year, fueling non-residential investment further. The production phase is expected to begin in 2025 for the Stellantis project, and in 2027 at the Volkswagen plant. Honda is also considering a multi-billion EV plant in the province and a final decision will be taken this year.

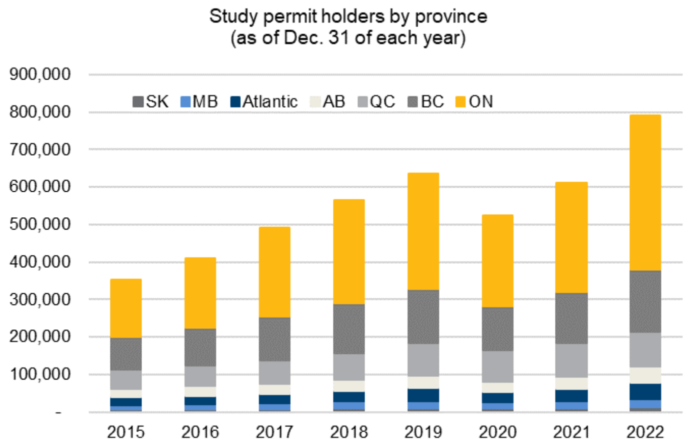
If the recent federal government announcement to cap student visas for the next two years becomes reality, it could shave approximately 0.1pp-0.2pp from Ontario's real GDP annual growth, and 0.1pp from Ontario's CPI inflation through relief in shelter CPI. The relief's impact on home prices and rents should be contained to areas close to universities. The province has welcomed the vast majority of the 500K increase in international students, more than its national population share, between 2015 and last year.

Otherwise, we expect a modest rebound in resale housing transactions and prices this year, in line with additional evidence of a complete pivot by the Bank of Canada and U.S. Federal Reserve. Home prices dropped by a modest 5% across unit types and within both the 416 and 905 areas during 2023 relative to 2022. Toronto is one of the rare cities in Ontario, with Kitchener and Kingston among others, that met the housing supply objective set by the provincial government in 2023, with slightly more than 30,000 housing starts. Unsurprisingly, average monthly rents rose more in cities that did not meet their objectives, such as Mississauga, London, Ajax, Vaughan, Oakville, and Hamilton.

Since the release of the mid-year fiscal update last November, the province has been very active in completing its remaining long-term bond issuance for FY 2023-24. Interest rates sit lower today relative to the mid-year government's expectations, facilitating the reach of the medium-term financial objective of keeping the debt-to-servicing ratio below 7.5%. The government announced in late January the refurbishment of the Pickering nuclear plant that will last two years and begin in 2028, which may add upward pressure on the capital spending plan and thus borrowing requirements. The manageable deficits unveiled at the mid-year fiscal update stood at $5.6B in FY 2023-24 and $5.3B in FY 2024-25.



Source: Office of the Parliamentary Budget Officer



Source: Immigration, Refugees and Citizenship Canada

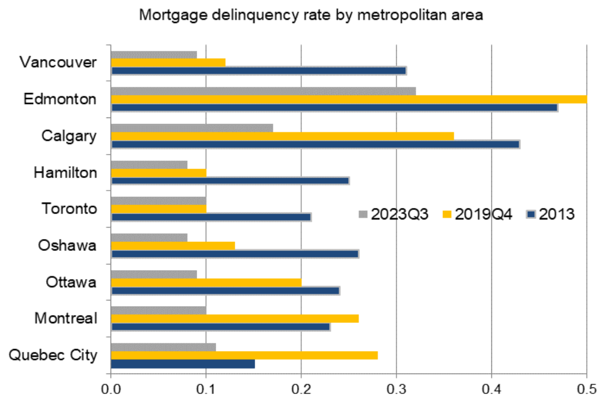
Quebec – Mixed Short-Term Economic Picture, Fiscal Outlook Subject to Larger Deficits

The breakdown of Quebec real GDP by industry reveals a moderate contraction of activity in all goods sectors and a mild expansion in most services-oriented industries. Economic activity in about half of the 20 industries is down year-over-year, far from broad-based weakness aligning with the traditional definition of a recession. Consumer spending growth has slowed to a modest pace. Households in Quebec faced higher CPI inflation last year than other Canadians but should benefit from above-average disposable income growth.

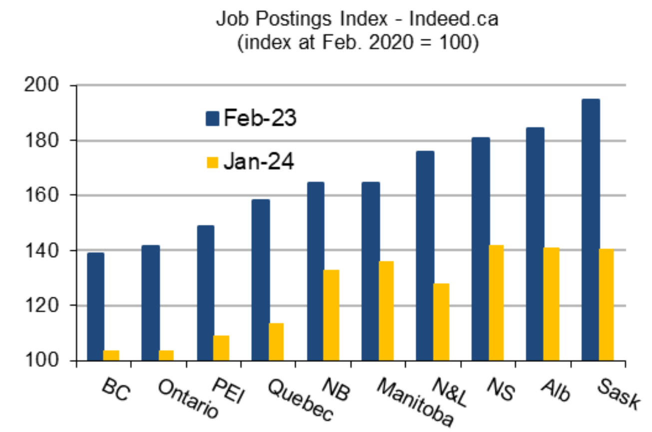
The business investment picture is mixed. Business investment in machinery, equipment, and non-residential building has been falling modestly despite favorable export growth. By market type, investment in the industrial market is thriving, albeit insufficient to offset the drawback in commercial and residential real estate markets. In contrast to higher multiple housing starts (condos, rental apartments, plex, townhouses) registered in Toronto, Vancouver, and Calgary, multiple starts fell for a second consecutive year in the Montreal area, reaching the lowest level since 2013. All in all, we estimate that Quebec's real GDP advanced by 0.2% in 2023, below the mid-year fiscal update assumption of 0.6%. Quebec's real GDP growth is poised to improve modestly in 2024 (+0.4%). We expect resale housing market activity to rebound in 2024 after a 13% pullback in 2023, as lower policy rates and bond yields filter through lower mortgage rates. Promoters may gain confidence to start building more homes in 2025.

This soft economic outlook should logically lead to a modest downward revision in the path of fiscal revenues when the 2024 Quebec Budget is released, usually in March. The most significant factor influencing the 5-year fiscal outlook relates to new public sector agreements. Negotiations between the government and unions resulted in large wage increases over 5 years to public sector employees. Quebec Finance Minister Eric Girard mentioned to media in late January that the impact on the government's financial situation will be "material". For instance, more than 400K employees will receive a massive 17.4% wage increase over 5 years. In comparison, the 2023 budget assumed softer 2%-2.5% annual wage increases over time. Accordingly, annual deficits could widen by at least $0.8B, everything else being equal. The return to a balanced budget by FY 2027-28, as proposed in the 2023 budget, suddenly looks increasingly questionable.

Similar to BC and Manitoba, low water levels put a dent in the province's electricity exports, and Hydro-Quebec registered lower-than-usual net income according to their 2023Q3 financial results. The crown corporation projects the end of electricity surplus by 2027. It plans to boost the power of existing power stations and expand wind production to increase electricity capacity by 2035—a crucial step to attract large-scale investments. Finally, new legislation could be tabled this Spring to allow private-to-private electricity sales between firms.



Source: CMHC



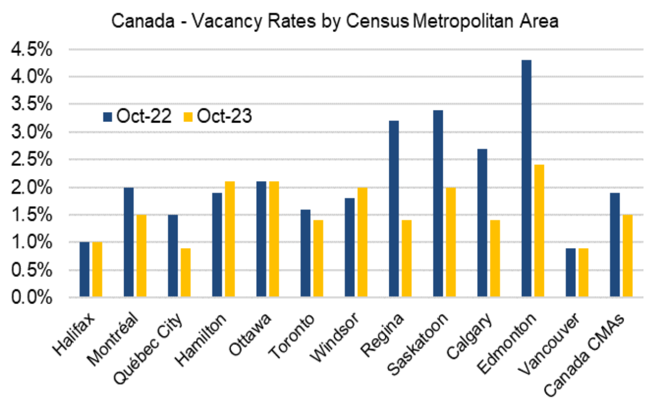
Source: Indeed Hiring Lab Canada

New Brunswick – Population Surge Continues, Solid Public Finances

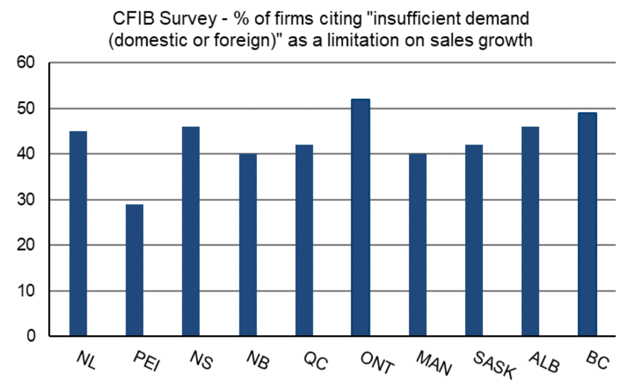
New Brunswick registered the third largest net gain of one-way U-Haul trucks in 2023. During his annual state of the province address in late January, Premier Blaine Higgs notably highlighted the first decline in the average age population in nearly five decades. In this context, it is not surprising to find out NB is also home to the tightest resale housing market conditions with Nova Scotia, with a sales-to-new listings ratio of 0.70. Housing starts should stay above the 4K mark for a third consecutive year in 2024. Like Alberta, NB's unemployment rate has increased at a slower pace than most provinces since the Spring of 2023, although the falling job vacancy rate should translate into an upward trend in unemployment going forward. With wage inflation gains above the national average and personal income tax cuts boosting disposable income further, NB's retail sales growth should continue to outperform peers. NB's nominal exports and manufacturing sales are down from a year ago but remain at dynamic levels. NB's export sector should benefit from its higher exposure to the U.S. market (92% of all exports) in 2024. On the fiscal front, the era of structural balanced budgets continues. The road to a tiny surplus ($35M) in FY 2023-24 has been solidified in the second quarter fiscal update released last November, allowing the Province to maintain a very low net debt-to-GDP ratio (27% projection for FY 2023-24).

Nova Scotia – Tight Labour and Housing Market Conditions

The mid-year fiscal update from last December did not fundamentally change the short-term financial picture. A moderate $264M deficit is expected for FY 2023-24. Expenses rose in a few departments due to the May wildfires and July floods. The government has recently proposed a plan to limit the increase in electricity rates this year to 1.1%, rather than 7%. This 7% hike was planned by NS Power, looking to pass on additional fuel costs to customers. If the NS Utility and Review Board supports the government's plan, CPI inflation will be lower relative to our current forecast. It would also imply a $117M charge for the Province, planning to spread out the financial impact over 10 years. Labour market conditions are more resilient than in most provinces. Full-time job gains more than offset volatile movements in part-time jobs. The Red Sea crisis is disrupting global shipping traffic worldwide, including at the Port of Halifax. Finally, Halifax is one of the rare Canadian cities where the rental vacancy did not decrease in 2023. The vacancy rate remained intact and very low at 1% due to the record high completion of rental units, according to the annual rental survey released by CMHC at the end of January. Nova Scotia is one of three provinces, with Saskatchewan and BC, registering higher housing starts in 2023 relative to 2022.



Source: CMHC; Vacancy rate for privately initiated purpose-built rental apartments (3+ units)



Source: CFIB January 2024 Business Barometer

PEI – Economic outperformance to Continue, Large Fiscal Deficit

Only PEI is close to matching Alberta in terms of population growth (4% year-over-year as of 2023Q4). The PEI government moved in the same direction as the federal government by removing the 10% harmonized sales tax on new rental builds last Fall. Fewer firms cite limitations on sales or production growth in PEI relative to other provinces according to the CFIB Business Barometer. This is a big reason to keep real GDP growth surpassing peers again in 2024. The 2023 tourism and cruise season was very busy, and the PEI government pushes forward with the introduction of a winter tourism strategy. Despite above-average economic and employment growth, expense pressures bring the budgetary balance deeply in negative territory. The latest December fiscal update projects a large $99M deficit in FY 2023-24 contrasting with surpluses registered in recent years.

N&L – Improvement in Sight for Both Real GDP and the Budgetary Balance

Maintenance delays and mechanical and weather-related events at the Hebron and White Rose projects led to a plunge in oil production during 2023 (-13% year-to-date January-November). This situation contributed to a modest drop in real GDP and a temporary return to a fiscal deficit position. Production at the Terra Nova site has resumed in late 2023 and is expected to ramp up further. Thus, a rebound in oil production should bring back real GDP momentum into positive territory during 2024, as well as eliminating the deficit. In our view, the $154M shortfall expected in FY 2023-24 should be interpreted as a short-lived dip into negative territory.

Construction activity on the West White Rose drilling platform continues, expected to bring new oil production in 2025. The SeaRose FPSO floating production vessel will be taken out of operation for several months in 2024 to extend its life by 10 years. Considering the mix of market concerns relative to global oil demand and heightening geopolitical tensions, Brent oil prices currently stand only a few $ below the US$85/bbl assumption used in the mid-year fiscal update of last November.

In respect to the long-term outlook and energy transition, the onshore wind power potential of N&L to produce emissions-free hydrogen has been often cited and private sector interests are growing. Furthermore, a new agreement ratified last December with the federal government will allow the province to regulate wind projects more efficiently.

Nominal GDP Growth (%)	2021	2022	2023	2024	2025
Canada	13.4	11.8	2.5	3.7	4.7
N&L	18.5	6.8	-3.4	3.5	3.4
PEI	14.9	9.3	5.0	3.1	3.5
NS	10.0	7.1	4.4	2.9	3.3
NB	10.9	7.4	4.4	3.5	3.5
Quebec	11.6	8.4	3.7	3.7	3.6
Ontario	9.8	9.2	4.1	3.4	4.1
Manitoba	9.2	8.6	2.2	2.8	3.4
Sask	13.9	29.2	-1.6	2.9	3.7
Alberta	24.9	22.0	-1.8	3.4	4.2
BC	15.8	11.0	1.9	2.7	3.6

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

Real GDP Growth (%)	2021	2022	2023	2024	2025
Canada	5.3	3.8	1.1	0.4	1.7
N&L	1.0	-1.7	-0.4	1.4	1.1
PEI	8.4	2.9	2.4	0.9	1.4
NS	5.9	2.9	1.2	0.4	1.3
NB	5.3	1.1	1.3	0.8	1.4
Quebec	6.7	2.5	0.2	0.4	1.5
Ontario	5.4	3.9	1.2	0.4	2.0
Manitoba	1.3	3.3	1.0	0.5	1.4
Sask	-0.7	6.0	1.4	0.9	1.5
Alberta	4.6	5.0	2.2	1.5	2.0
BC	7.1	3.8	0.9	0.4	1.6

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

Unemployment Rate (%)	2021	2022	2023	2024	2025
Canada	7.5	5.3	5.4	6.4	6.3
N&L	13.1	11.2	9.9	9.8	8.9
PEI	9.9	7.5	7.4	8.2	8.0
NS	8.6	6.6	6.3	7.2	7.0
NB	9.1	7.2	6.6	8.1	8.0
Quebec	6.1	4.3	4.4	5.2	5.1
Ontario	8.2	5.6	5.6	6.5	6.3
Manitoba	6.4	4.5	4.8	6.2	6.3
Sask	6.5	4.7	4.8	6.4	6.2
Alberta	8.5	5.8	5.9	7.4	8.0
BC	6.5	4.6	5.2	6.4	6.3

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

Employment (annual change in %)	2021	2022	2023	2024	2025
Canada	5.0	4.0	2.4	1.0	1.5
N&L	3.6	4.3	1.8	0.8	1.4
PEI	4.1	5.3	5.6	1.8	1.6
NS	5.6	3.6	2.7	0.9	1.4
NB	3.2	2.7	3.3	0.7	1.6
Quebec	4.4	3.1	2.3	0.7	1.2
Ontario	5.2	4.6	2.4	0.9	1.6
Manitoba	3.7	3.2	2.5	0.9	1.4
Sask	2.6	3.5	1.8	1.0	1.7
Alberta	5.5	5.2	3.6	1.5	2.2
BC	6.2	3.1	1.6	0.6	1.3

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

CPI Inflation (%)	2021	2022	2023	2024	2025
Canada	3.4	6.8	3.9	2.7	2.1
N&L	3.7	6.4	3.3	2.5	2.0
PEI	5.1	8.9	2.9	2.5	2.1
NS	4.1	7.5	4.0	2.7	2.0
NB	3.8	7.3	3.5	2.6	2.1
Quebec	3.8	6.7	4.5	2.8	2.1
Ontario	3.5	6.8	3.8	2.7	2.1
Manitoba	3.2	7.9	3.6	2.3	2.1
Sask	2.6	6.6	3.9	2.6	2.1
Alberta	3.2	6.5	3.3	2.7	2.2
BC	2.8	6.9	4.0	2.6	2.1

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

Housing Starts (000s of units)	2021	2022	2023	2024	2025
Canada	**271**	**262**	**240**	**228**	**256**
N&L	1.0	1.4	1.0	0.9	0.9
PEI	1.3	1.3	1.1	1.0	1.0
NS	6.0	5.7	7.2	5.7	6.1
NB	3.8	4.7	4.5	4.2	4.4
Quebec	67.8	57.1	38.9	39.0	46.0
Ontario	99.6	96.1	89.3	86.0	97.0
Manitoba	8.0	8.1	7.1	6.9	7.6
Sask	4.2	4.2	4.6	4.1	4.5
Alberta	31.9	36.5	36.0	36.0	39.0
BC	47.6	46.7	50.5	44.0	49.0

Source: CMHC; forecast: LBS Econ. Research and Strategy.

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