ECONOMIC VIEWPOINT

Tariff Turmoil Foreshadows an Eventful Budget Season

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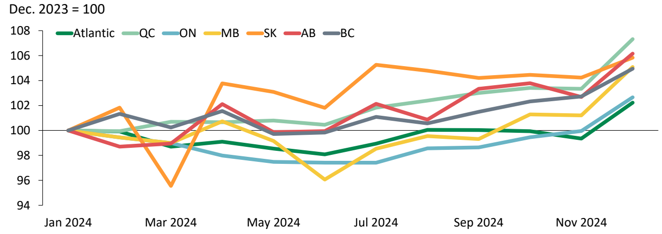
HIGHLIGHTS

- Canadian provinces look to have begun 2025 on a strong note, but impending US tariffs could cause significant slowdowns and alter the growth rankings among provinces. Non-energy sectors, particularly manufacturing, are expected to be the most affected. This would hinder economic activity in Ontario, Quebec, Manitoba and PEI, in particular, resulting in lower growth compared to the national average. In contrast, oil-exporting provinces like Alberta and Saskatchewan might fare better due to anticipated tariff exemptions. Meanwhile, British Columbia and Nova Scotia, being less reliant on US trade, should outperform other provinces.
- While most provinces anticipate robust revenue growth and restrained spending to narrow budget balances in FY2025–26 (FY26), tariff uncertainty introduces significant risks to this plan. Provinces will update their plans in the upcoming 2025 budgets to reflect these risks, likely resulting in weaker bottom lines than anticipated.
- The federal government and several provincial premiers have backed providing tariff relief, if needed. Provincial governments have the fiscal capacity to subsidize industries and individuals affected by the tariffs within a spending envelope in the order of $100B while keeping the net debt-to-GDP ratio below the pandemic level of 35%.
- Provinces with higher exposure to US trade, like Ontario, Quebec and Manitoba, may need more substantial support. However, provinces should maintain a manageable debt burden in the event that they provide targeted relief in regions and sectors most affected by US tariffs.

The pre-budget season is always a hectic time for Canadian premiers, but this year is especially busy due to the ongoing US–Canada trade tensions. Between trips to Washington, DC, and Ottawa, they are advocating for their provinces' interests amid the looming tariffs that have introduced significant uncertainty. Tariffs have the potential to affect provincial economies differently based on their exposure to US trade, complicating fiscal planning for 2025 budgets as previous assumptions are now being challenged. In this pre-budget provincial economic outlook, we delve into these critical trends, examining how the provinces could navigate the challenges and the potential impact of tariffs on their economies.

Graph 1
Retail Sales on Track for Sustained Gains



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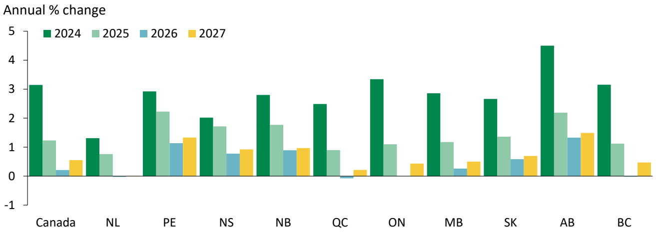
The Calm Before the Storm

As the country awaits the possible implementation of US tariffs, real growth is on track for robust gains, driven by consumer spending. Indeed, retail sales recorded broad-based gains in the second half of 2024 (graph 1). This strong underlying momentum is supported by the Bank of Canada's 200-basis-point reduction in its policy rate, after having brought inflation back to the 2% target. The outlook for consumer spending at the close of 2024 is further bolstered by a resilient labour market that continued to post substantial job gains, thereby increasing disposable income. Consumption is expected to receive an additional boost from

Ontario's $200 taxpayer rebate in the first half of 2025, coupled with the federal government's GST holiday.

However, some headwinds should offset these strengths, particularly as we move through 2025. While the federal government might not fully achieve its aggressive target to slow population growth by slashing the share of temporary residents and immigration, population growth is projected to slow sharply this year and next (graph 2). The reduction in non-permanent resident and immigration numbers limits the expansion of the consumer base, likely weighing on headline growth. Additionally, the upcoming surge in mortgage renewals at higher interest rates—anticipated to escalate starting in April 2025—could curb household spending. These headwinds are expected to be particularly pronounced in Ontario and British Columbia.

Graph 2
Population Growth to Hit the Brakes Next Year in Ontario, Quebec and BC



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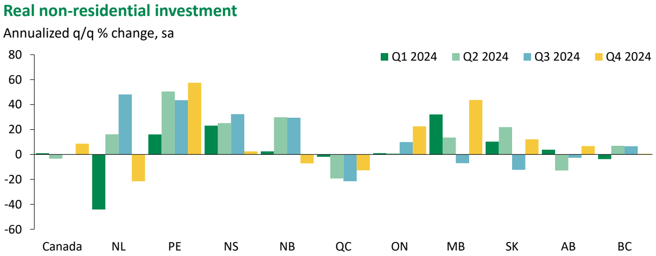
Residential investment is set to rebound robustly in 2025 following a rapid rise in resale activity in the second half of 2024. At the same time, high interest rates have kept non-residential investment growth sluggish. But there are bright spots, particularly in the Maritime provinces, and Ontario has also begun to experience sustained investment gains since late 2024 (graph 3). While uncertainty from the new US administration's policies could dampen business sentiment and deter investment decisions, especially in Quebec and Ontario, some major projects in the pipeline in some provinces may help soften the blow.

Graph 3
Ontario and Maritime Provinces Lead in Non-Residential Investment



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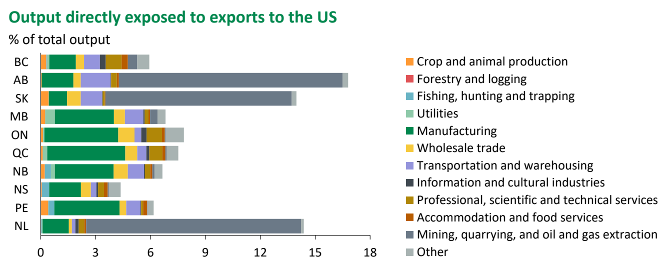
Potential Tariffs Dictate Provincial Rankings

While Canada has received a reprieve from US tariffs till at least March 4, the looming threat of customs duties on virtually all Canadian exports to the US has introduced significant downside risk into the economic outlook. In the short term, exposure to the US market could be advantageous due to surging demand as businesses stock up on inventory composed of Canadian exports. But as tariffs are implemented, reliance on exports to the US can quickly turn into a drag on growth. Meanwhile, businesses may face further setbacks from deferred investments due to heightened uncertainty, leading to an erosion of competitiveness and productivity.

The impact of tariffs on economic activity varies across Canadian provinces due to differences in merchandise exports and sectoral composition of their economies (graph 4). Nova Scotia and BC look to have the least exposure to tariffs, as a result of their lower trade volumes with the US and, in BC's case, a higher proportion of services exports compared to goods. Oil-producing provinces such as Alberta, Saskatchewan, and Newfoundland and Labrador have a significant share of their output exposed to the US, primarily because of their substantial oil exports. For instance, Alberta's export exposure to the US stands at around 17% of total output, with 12% coming from crude exports alone. Excluding the oil and gas sector, these provinces rank among the lowest in terms of US export exposure. Ontario, Quebec, Manitoba and New Brunswick are the most directly exposed, with 6% to 8% of their output directly linked to US exports.

Graph 4
Central Canada's Non-Energy Sectors Face High Tariff Exposure



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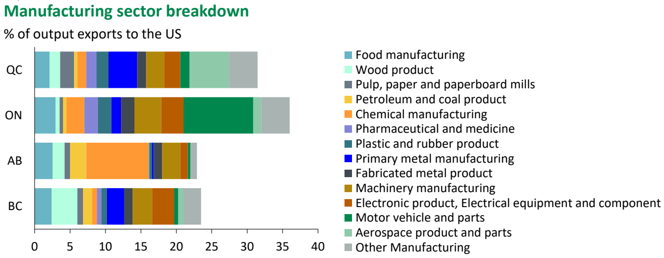
A tariff exemption for crude oil seems highly likely, as imposing such tariffs would counteract President Trump's agenda of increasing oil production and reducing energy prices (discussed in our report). This carve-out is possibly the only silver lining, as approximately 30% of Canadian exports to the US are energy products. This would insulate oil-exporting provinces such as Alberta, Saskatchewan, and Newfoundland and Labrador, and to a lesser extent New Brunswick from the worst impacts of the tariffs.

With over 30% of its output destined for export to the US, the manufacturing sector is the most exposed non-energy sector to US tariffs (key vulnerable sectors have been identified in our research). Ontario, with its substantial auto exports to the US, faces significant exposure. So does Quebec with its diverse exports, including mineral products, aircraft and forestry products (graph 5). Manitoba and Prince Edward Island are also highly exposed due to their manufacturing sectors' reliance on US demand. In contrast, Western provinces such as Alberta and BC are less affected in these sectors due to the anticipated exemption of energy products, as well as BC's more diversified export destinations. Alberta's non-energy exports are predominantly chemical products, while BC exports wood products, food and electronic products.

Graph 5
Manufacturing Exposure: Auto in Ontario, Aerospace and Metal in Quebec



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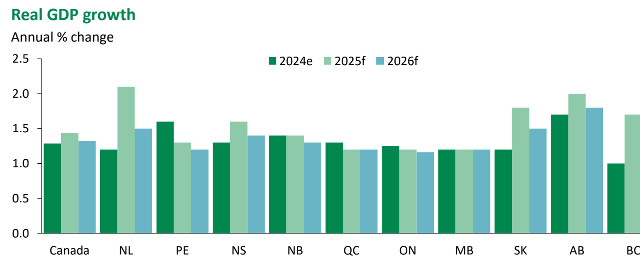
Implications of Tariffs for the Provincial Outlook

Given the lack of clarity on tariff implementation, our current baseline scenario assumes a partial imposition of the threatened tariffs: 10% on all goods except energy, with higher tariffs of 35% on steel and 25% on aluminum. Our baseline assumptions indicate that most provinces will experience rapid slowdowns starting in the second quarter of this year. While growth is on track to strengthen nationwide before these tariffs take effect, overall economic growth in 2025 is expected to remain weak in half of the provinces despite the initial rebound. A few provinces may experience slightly brighter prospects, depending on the specific exemptions applied to these tariffs.

The growth ranking of Canadian provinces is poised for a reshuffle as growth drivers shift from domestic to external factors. Central Canada—namely Quebec, Ontario and Manitoba—is expected to bear the brunt of the tariffs. PEI also faces considerable risk, with its economy heavily dependent on manufacturing consumer goods and exporting agricultural products to the US. These provinces are likely to underperform the national economy and experience lower growth in 2025 compared to the previous year if blanket tariffs on non-energy products are imposed (graph 6).

Graph 6
Growth Will Weaken Sooner in Central Canada



e: estimate; f: forecast
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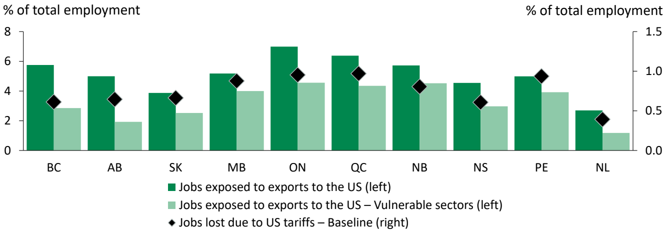
Since energy products are anticipated to be largely exempt from these tariffs, Alberta, Saskatchewan, and Newfoundland and Labrador will likely outperform. New Brunswick may also avoid the worst impacts of the tariffs, given that refined petroleum and coal products constitute the majority of its exports to the US. But its manufacturing and agricultural exports still make it vulnerable. BC is among the least affected provinces due to its diverse export destinations and lower dependency on US demand. As a result, these provinces may experience some economic rebound this year.

Under our middle-of-the road baseline assumptions of a 10% blanket tariff (with some exemptions) on Canadian exports, job losses are estimated to be around 1% of total employment for Central Canadian provinces—namely Ontario, Quebec and Manitoba—as well as PEI, compared to a no-tariff scenario. Other provinces would experience a lesser impact, with anticipated job losses around 0.5% for BC, Alberta, Saskatchewan, Nova Scotia, and Newfoundland and Labrador. New Brunswick falls in the middle, expecting a 0.8% loss in jobs.

There is substantial downside risk to this outlook, as a sizable portion of jobs are directly tied to US exports, with over two-thirds in vulnerable sectors (graph 7 on page 4). The implementation of additional tariffs of up to 25% on Canadian exports could lead to a significant decline in US demand, potentially pushing the Canadian economy into a recession in 2025. Direct job losses could reach 2% to 3% of total employment in central Canada and PEI, pushing the unemployment rate to recessionary levels, and 1% in other provinces. Other industries could eventually suffer from ripple effects if tariffs lead to a broader economic slowdown. This scenario could see the unemployment rate rise to roughly 8% nationally, 10% in Ontario and 7.5% in Quebec.

Graph 7
Outsized Job Exposure to US Exports in Central Canada, Manitoba and PEI
Direct jobs due to US exports



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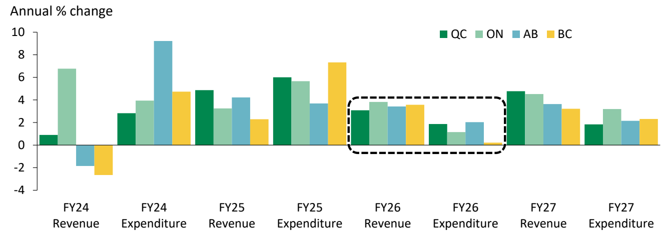
Graph 9
… While Downside Risks Threaten Plans for Strong Revenue Growth and Restrained Spending
Revenue and expenditure growth



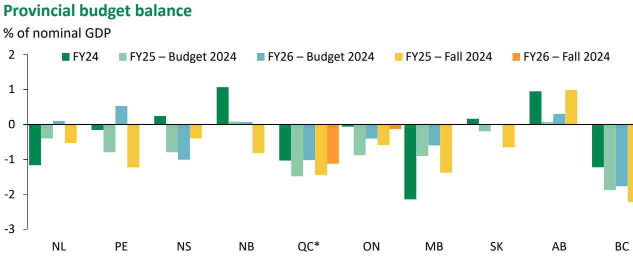
Note: FY26 and FY27 growth rates for Alberta come from Budget 2024.
Budget Documents and Desjardins Economic Studies

Adapting Fiscal Planning for Trade Tensions

As the macroeconomic backdrop softens due to trade uncertainty and slowing population growth, provinces could face downside risks to their bottom lines in the upcoming 2025 budgets. This was evident in Nova Scotia's budget released on February 18, which projected wider deficits over the next two years than previously anticipated. Collectively, provinces anticipated budget balances to widen from -0.3% of nominal GDP in the 2023–24 fiscal year (FY24) to -0.8% in FY25 in their mid-year updates, as spending growth outpaces revenue gains. This deterioration is expected to be widespread, with the exceptions of Alberta, Manitoba, and Newfoundland and Labrador (graph 8).

Graph 8
Provinces Expect FY26 Improvement Following FY25 Deterioration…

Provincial budget balance

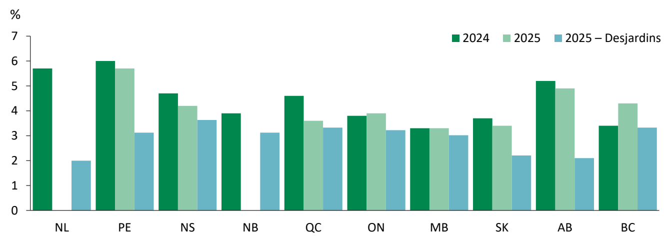


* Before deposits into the Generations Fund.
Budget Documents and Desjardins Economic Studies

Despite larger deficits expected in the near term, most provinces anticipated robust revenue growth and restrained spending growth to narrow budget deficits in the upcoming fiscal year (graph 9). However, this outlook is challenged by renewed uncertainty, introducing significant downside risks. For non-energy producing provinces, official nominal growth projections for 2025 are a touch higher than our baseline forecasts, which accounts for a fraction of the tariff impact (graph 10). Additionally, the delayed federal implementation of the increased capital gains inclusion rate presents further revenue downside for provinces that had accounted for this change, removing $3.3B over FY25–FY27 for Ontario and $1.8B for Quebec over the same period.

Graph 10
Provinces' Growth Projections Face Downside Amid Trade Uncertainty

Nominal GDP Forecast



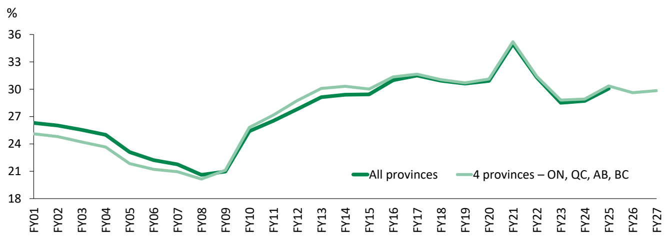
Budget Documents and Desjardins Economic Studies

Although energy products are expected to be largely exempt from the impending US tariffs—providing a layer of protection for energy-producing provinces—these regions will still likely face some headwinds as lower-than-anticipated commodity prices weigh on revenue growth. Alberta projected the WTI price to average US$74/bbl for FY25 and remain steady over FY26–FY27, as outlined in last year's budget and unchanged in the fall economic update. This projection is US$3 to US$4 above our current forecast for the next two fiscal years, with considerable downside risks due to concerns over global demand and political volatility under the new US administration, which could cap commodity prices.

Given Alberta's high sensitivity to resource revenues—accounting for 26% of total revenue in FY25—and the fiscal impact of a US$1/bbl change in WTI price linked to $630M in oil revenue, minimal or even negative growth in total revenues is possible over the next two years, resulting in shrinking surpluses. The light–heavy spread is also crucial; while the province forecasts it to narrow by US$2/bbl over the next two years, potential US tariffs on Canadian heavy oil could widen it, with a US$1/bbl increase leading to a $600M revenue loss. Saskatchewan faces similar revenue pressures, compounded by continued weakness in potash prices. On the other hand, the Canadian dollar is likely to weaken relative to Alberta's current projections (73.3 US¢/C$ in FY25, 78.1 US¢/C$ in FY26, and 79.7 US¢/C$ in FY27), benefiting producer profits and offsetting some of the price weaknesses.

This budget season is poised to be eventful, with major developments to watch. The federal government, along with several provincial premiers, has announced their backing for tariff relief. The provincial governments have collectively improved their net debt burden, thanks to revenue windfalls during the recovery from the COVID-19 pandemic. Net debt is projected to reach 30% of GDP in FY25 and remain flat over the next two years, well below the 35% registered during the height of the pandemic (graph 11).

Graph 11
Provinces Maintain Fiscal Buffer as Net Debt Projected to Stabilize at 30% of GDP Amid Trade Risks
Combined provincial net debt-to-GDP*



* Calculated as the sum of all provinces' net debt as a share of the sum of their nominal GDP.
Budget Documents and Desjardins Economic Studies

This recent improvement in debt burden provides the provinces with additional spending power. Accounting for revenue losses from the tariff impact, the provinces have the capacity to collectively deploy around $100B to temporarily support industries and individuals affected by the tariffs while maintaining a net debt-to-GDP ratio below the pandemic level of 35% and implement economic transition initiatives, mitigating the economic fallout. That is in addition to a similar level of stimulus the federal government could deploy while also keeping its debt-to-GDP ratio below its pandemic peak.

The availability of this fiscal buffer is crucial, given the significant downside risks posed by tariffs. Provinces with higher exposure to US trade, such as Ontario, Quebec and Manitoba, may require more substantial support to cushion the impact on their economies. Similar to our recent analysis on potential policy interventions for Quebec, we recommend that all provinces commit to maintaining a manageable debt burden while providing targeted relief, thereby preventing deeper recessions in the most affected regions and sectors.

Table 1

Canada: Major Economic Indicators by Province

% change	2021	2022	2023	2024	2025f	2026f
Real GDP growth – Canada	**6.0**	**4.2**	**1.5**	**1.3**	**1.4**	**1.3**
Newfoundland and Labrador	1.0	-1.9	-2.6	1.2	2.1	1.5
Prince Edward Island	7.8	4.4	2.2	1.6	1.3	1.2
Nova Scotia	6.4	3.5	2.0	1.3	1.6	1.4
New Brunswick	5.3	2.0	1.6	1.4	1.4	1.3
Quebec	7.3	3.4	0.6	1.3	1.2	1.2
Ontario	6.1	4.1	1.7	1.3	1.2	1.2
Manitoba	1.4	4.2	1.7	1.2	1.2	1.2
Saskatchewan	-2.6	7.2	2.3	1.2	1.8	1.5
Alberta	5.2	6.0	2.3	1.7	2.0	1.8
British Columbia	7.7	4.0	2.4	1.0	1.7	1.4
Nominal GDP growth – Canada	**14.2**	**12.4**	**2.9**	**4.3**	**3.0**	**2.3**
Newfoundland and Labrador	20.2	6.5	-5.5	2.2	2.0	0.9
Prince Edward Island	14.8	10.4	4.9	4.5	3.1	2.7
Nova Scotia	11.3	7.4	8.0	5.0	3.7	2.8
New Brunswick	10.5	10.4	3.2	4.2	3.1	2.4
Quebec	12.4	8.7	5.0	5.0	3.3	2.7
Ontario	11.0	9.4	5.4	5.0	3.2	2.7
Manitoba	8.7	10.8	4.5	4.4	3.0	2.3
Saskatchewan	13.6	30.4	-4.8	2.3	2.3	1.0
Alberta	26.1	24.4	-4.3	3.1	2.1	0.7
British Columbia	16.1	10.8	3.6	3.0	3.3	2.5
Total inflation rate – Canada	**3.4**	**6.8**	**3.9**	**2.4**	**2.4**	**2.1**
Newfoundland and Labrador	3.7	6.4	3.3	1.8	1.9	2.0
Prince Edward Island	5.1	8.9	2.9	1.9	1.8	1.9
Nova Scotia	4.1	7.5	4.0	2.3	2.3	2.2
New Brunswick	3.8	7.3	3.5	2.2	2.2	2.1
Quebec	3.8	6.7	4.5	2.3	2.5	2.2
Ontario	3.5	6.8	3.8	2.4	2.3	2.1
Manitoba	3.2	7.9	3.6	1.0	1.2	1.4
Saskatchewan	2.6	6.6	3.9	1.4	1.8	1.7
Alberta	3.2	6.5	3.3	2.9	3.0	2.4
British Columbia	2.8	6.9	4.0	2.6	2.6	2.0
Employment growth – Canada	**5.0**	**4.1**	**3.0**	**1.9**	**0.7**	**0.2**
Newfoundland and Labrador	3.9	4.0	1.7	2.7	0.7	0.2
Prince Edward Island	5.0	5.0	6.2	3.6	0.9	0.4
Nova Scotia	6.4	3.5	2.7	3.1	1.0	0.4
New Brunswick	3.8	2.9	3.4	2.8	0.9	0.3
Quebec	4.3	3.1	2.9	0.9	0.3	0.0
Ontario	5.1	4.8	3.1	1.7	0.4	0.0
Manitoba	4.4	3.6	2.7	2.6	0.8	0.4
Saskatchewan	2.4	3.5	1.6	2.6	1.0	0.5
Alberta	5.1	4.9	3.7	2.9	1.7	1.0
British Columbia	6.2	3.4	2.6	2.4	0.8	0.1
Unemployment rate – Canada	**7.5**	**5.3**	**5.4**	**6.4**	**6.9**	**7.0**
Newfoundland and Labrador	13.0	11.1	9.8	10.0	10.3	10.3
Prince Edward Island	10.0	7.7	7.3	7.8	8.4	8.4
Nova Scotia	8.6	6.6	6.4	6.5	6.7	6.8
New Brunswick	9.2	7.2	6.6	7.1	7.5	7.6
Quebec	6.1	4.3	4.4	5.4	5.9	5.9
Ontario	8.1	5.6	5.6	7.0	7.7	7.8
Manitoba	6.4	4.5	4.9	5.5	6.1	6.3
Saskatchewan	6.5	4.6	4.7	5.5	5.8	5.9
Alberta	8.5	5.8	5.9	7.1	7.3	7.3
British Columbia	6.5	4.6	5.2	5.6	5.8	5.8

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