ECONOMIC VIEWPOINT

Desjardins Provincial Outlook:

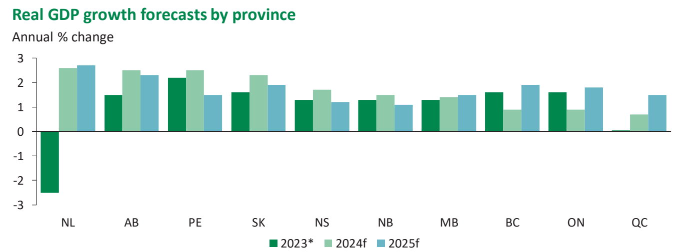
Canada's Provinces Are Facing a "Productivity Emergency" Too

By Marc Desormeaux, Principal Economist, and Hélène Bégin, Principal Economist

Highlights

- We still anticipate that Canada's oil-producing provinces will fare the best in the coming quarters (graph 1). By contrast, more interest rate-sensitive provinces will feel more pain, as the full effects of already completed monetary tightening result in slower economic growth.
- Higher levels of operating and infrastructure spending forecast in this year's provincial and federal budgets should offer a modest incremental boost to economic growth rates this year.
- We expect Ottawa's planned reductions in the non-permanent resident (NPR) population to weigh down national and provincial growth in 2025 and 2026. Our analysis suggests Ontario and BC are the most vulnerable to the policy change.
- But perhaps the biggest takeaway from the latest GDP data is that the "productivity emergency" recently raised by the Bank of Canada is a nationwide crisis. Output per capita fell in every province last year, which was the broadest-based standard of living decline in recorded Canadian history other than during the pandemic. So while the weak economic growth rates we're projecting may not be persistent or severe enough to qualify as a "recession," for many Canadians the next few quarters may feel like one.

Graph 1
Oil-Producing Provinces Face the Best Economic Prospects



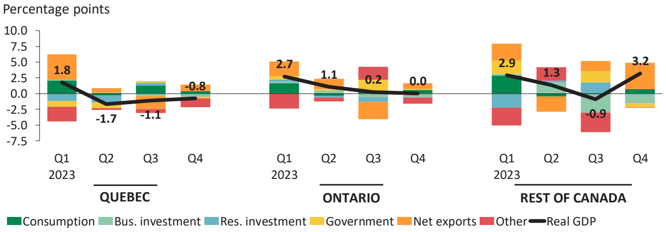
* Based on preliminary estimates of GDP by industry at basic prices. f: forecast
Statistics Canada and Desjardins Economic Studies

A Rising Tide Lifts All Boats, but Does Little to Change Provincial Growth Rankings

The strength of the Canadian economy in Q4 2023 and signs of more momentum to begin 2024 mean that upward revisions to provincial growth rates are in order. But this doesn't materially change our provincial forecast rankings. For one thing, quarterly GDP data show that the economy continued to weaken late last year in Quebec and Ontario, while other provinces underpinned the rebound (graph 2 on page 2). In line with our expectations in our last outlook, this rebound appears to have been propped up by the recovery in Alberta crude production following a summer maintenance period. The post-strike reopening of the Port of Vancouver likely also contributed. Meanwhile employment growth continued to lag population gains by significant margins in Ontario and BC in the first quarter of 2024. And while these two provinces are experiencing near-record-high rates of population growth, they've witnessed the weakest per-person retail spending in Canada since the Bank of Canada's latest tightening cycle began (graph 3 on page 2).

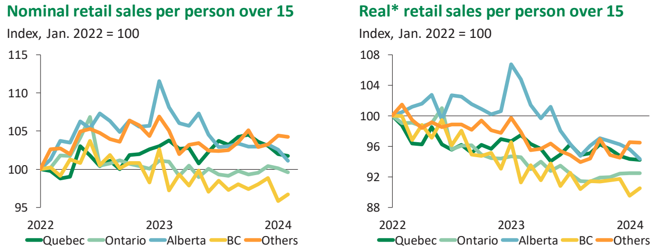
Graph 2
Ontario and Quebec's Economies Were Weak to End 2023, but Growth Rebounded Elsewhere

Contributions to real GDP



Statistics Canada, Institut de la Statistique du Québec, Ontario Ministry of Finance and Desjardins Economic Studies

Graph 3
Population Growth Is Papering over Consumer Weakness (Especially in Ontario and BC)



* Deflated using Consumer Price Index for goods
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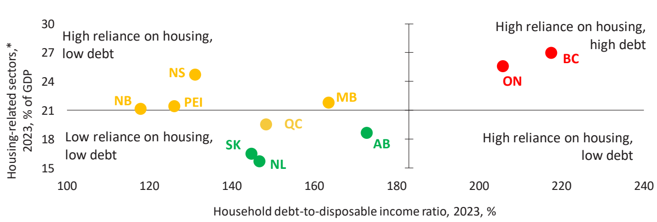
Taking those results together, we still expect past rate hikes to increasingly weigh on growth as the year progresses. Canada's oil-producing provinces should fare the best when that happens. In Alberta, Saskatchewan, and Newfoundland and Labrador, crude oil production continues to trend higher and should support export growth in 2024 despite a slowing US economy weighing on provincial trade prospects more broadly. The oil producers also remain less sensitive to high interest rates, the full effects of which are increasingly being felt across Canada. By contrast, more indebted and housing-oriented Ontario and BC should continue to feel the pinch more in the quarters ahead (graph 4).

Graph 4
Oil-Producing Provinces Remain the Least Exposed to Higher Interest Rates

Household indebtedness and housing exposure by province



* Residential construction, real estate rental and leasing, and financial services
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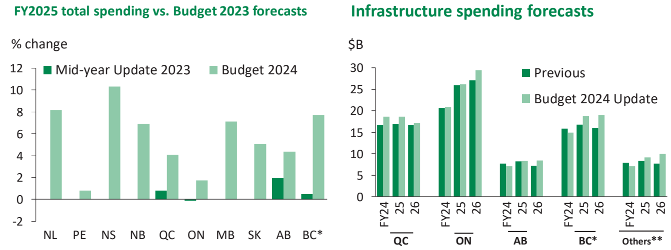
Governments Are Playing a Somewhat Bigger Role in the Economy, but So Are High-Wage Services

From an economic growth perspective, the higher levels of operating and infrastructure spending forecast in this year's provincial budgets (graph 5) suggest that governments will play a slightly larger role in the expansion this year than previously suggested. However, provincial spending levels aren't expected to reach record highs in per capita terms or as a share of GDP, and many governments are penciling in per-person expenditure cuts in the years ahead after adjusting for inflation.

Graph 5
Operating and Infrastructure Spending Plans Increased

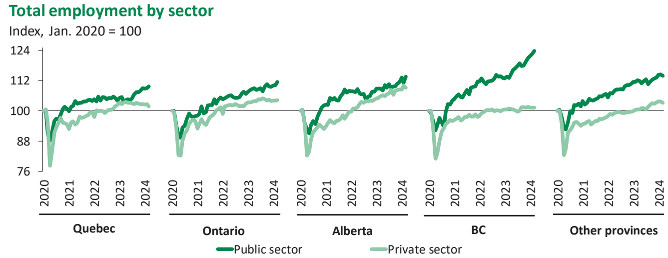


* Used Q1 in place of Mid-year Update, as Q1 provided the last available forecast for FY2025
** NL and NS not included because they did not provide outer-year forecasts
Provincial budget documents and Desjardins Economic Studies

Plans for bigger government footprints come at a time when the public sector has been getting attention for having driven an outsized share of Canadian job creation during the recovery from COVID-19. Indeed, we can see this trend clearly in most provinces (graph 6). It's often argued that this is a consequence of Canada's poor business investment and productivity results, since better performance could reasonably be expected to correspond with more balanced hiring. Quebec and BC will likely continue to see some of the strongest economic contributions from the public sector given that those provinces are expecting to continue to lead the pack in spending growth. More moderate spending growth forecasts in Ontario and Alberta suggest less of a public sector footprint going forward in those provinces.

Graph 6
Public Sector Job Creation Has Outperformed during the Recovery from COVID-19 …

Total employment by sector



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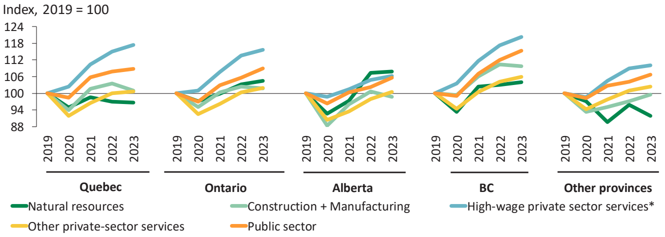
However, comparing the entire private sector to the public sector misses some important nuances, both at the national level and at the provincial level. Our work has shown that labour productivity growth in public services has slowed, so it's possible that government hiring has influenced Canada's poor productivity performance. But we've also seen high-wage private-sector industries like financial, professional, scientific and technical services support growth meaningfully, especially in Quebec, Ontario and BC (graph 7). And Canada's tech sector has continued to expand—albeit at a much slower pace in 2023—despite its sensitivity to financial market fluctuations. Meanwhile the slower recovery from pandemic lockdowns in sectors like accommodation and entertainment also held back a more robust overall private sector recovery. In all, while governments undoubtedly bolstered Canada's strong bounceback from COVID-19, sector-specific factors explain a lot of private industry's muted performance relative to the public sector.

Graph 7
... but High-Wage Private Sector Services Have Also Supported the Post-Pandemic Rebound
Real GDP by industry
Index, 2019 = 100



* Financial, professional, scientific and technical services
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Temporary Resident Cuts Should Hit Ontario and BC Hardest

Another major development since our last Provincial Outlook was Ottawa's announcement that it would take steps to reduce the national non-permanent resident (NPR) population by 20% over the next three years. We already estimated that the national-level impacts will be significant, and have incorporated the associated drag on Canadian growth projections into 2025 and 2026.

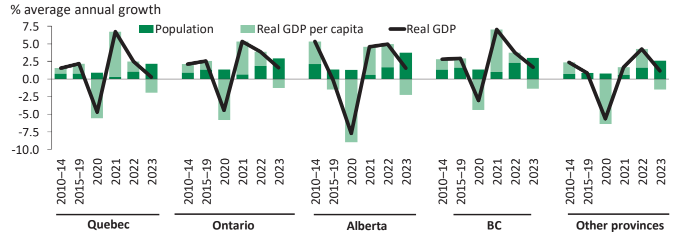
Analysis we published last October suggests Ontario and BC are the most vulnerable to a potential reduction in net NPRs. That's because their recent population growth has been highly dependent on NPRs. As well, their Budget 2024 projections—completed before the announcement—still rely heavily on international migration flows. By contrast, Alberta's more balanced recent and projected population growth suggests its economy is less exposed in this respect.

Productivity Growth Is a Major Challenge for All Provinces

Longer term, it's becoming clear that the "productivity emergency" recently raised by the Bank of Canada is a nationwide crisis (regardless of which industries may be causing it). Amid decades-high population growth, preliminary GDP data show that output per capita fell in every province last year (graph 8). That jarring result represents one of the broadest-based standard of living declines in recorded Canadian history: only at the peak of the pandemic did we see all 10 provinces report a decrease. We don't see much scope for improvement in the near term, even if slowing population growth puts some upward pressure on per capita output. With broad-based weakness in investment, capital stock per worker is declining, which does not bode well for future productivity gains. It also isn't good news that neither the Alberta Energy Regulator nor the Alberta government expects investment in oil and gas—the traditional anchor of Canadian productivity gains—to return to its 2014 peak.

Graph 8
GDP per Capita Fell across Canada in 2023

Growth in real GDP* and its components
% average annual growth



* 2014–22 data based on GDP by expenditure, 2023 GDP based on growth rate for preliminary GDP by industry numbers
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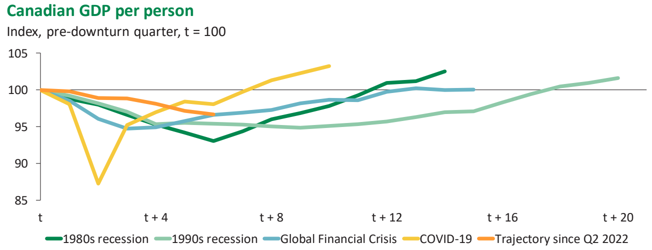
Productivity challenges speak to Canada's long-run competitiveness and prosperity, but are also relevant to the debate about whether our economy will enter a recession. So far, Canada still hasn't experienced the requisite two consecutive quarters of negative GDP growth, and the labour market has proved resilient to the drag from interest rate hikes already completed. Our baseline forecast now calls for continued—albeit slower—net job creation and weak but still positive economic growth. But GDP per capita is the broadest measure of our standard of living and it's now fallen in six consecutive quarters (with persistent declines in Quebec, Ontario and the rest of the country). A streak of decreases like that hasn't previously been experienced outside of economic downturns (graph 9 on page 4). So while the weak growth rates we're projecting may not be persistent or severe enough to qualify as a "recession," for many Canadians the next few quarters may still feel like one.

Graph 9
Canada's Already in a "Per Capita Recession"



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Provincial Forecast Summaries

We still expect **Newfoundland and Labrador** (NL) to place near the top of the provincial growth rankings in 2024, primarily because of recovering oil production. The industry is responsible for a larger share of GDP in NL than in any other province, and the Terra Nova offshore oilfield is up and running as of late 2023 following a multi-year shutdown. Outlays related to new wind-hydrogen projects are also poised to stimulate growth significantly beginning next year.

Prince Edward Island (PEI) should be a relatively strong performer as well, helped by hefty population growth—which isn't highly reliant on NPRs—and another boost to infrastructure spending plans. Initial capital investment intentions data also imply the Island will see strong gains in construction- and real estate-related outlays this year, and indeed, housing starts are trending higher to begin 2024. One question at this time is how the accumulated effects of higher interest rates will impact the key tourism industry during the pivotal summer months.

Nova Scotia (NS) also appears poised to benefit from skyrocketing population growth—again not reliant on temporary migration—and from infrastructure spending. We've highlighted that NS headcount gains are exceeding the pre-pandemic trend by more than anywhere else in Canada. The province's 2024 investment intentions also lead the country, with hefty advances expected because of public sector capital projects. Having gotten off to a good start this year, NS is one of only a few provinces where job creation is largely tracking the rate suggested by population growth alone.

New Brunswick's (NB) economy continues to hold two key advantages. One is relatively low exposure to high interest rates: its households are the least indebted in the country. Another is its fiscal position, which leaves room to offer economic support if needed. NB expects to keep its books balanced for the foreseeable future and have the third-lowest net debt burden of any province by mid-decade. US monetary policy is a question mark. If rates stay higher for longer, that could weigh on American homebuilding and ultimately demand for NB lumber.

Quebec real GDP rebounded 1.9% in January thanks in large part to employees returning to work in the education and healthcare sectors following the strike at the end of last year. Even though the Quebec economy no longer seems to be contracting, it will continue to struggle until the real recovery begins—probably sometime in the second half of 2024. Until then, the labour market will continue to deteriorate. The unemployment rate, which was 5.0% in March, will rise to roughly 6.0% in the coming months. This is significantly higher than the record low of 3.9% from November 2022.

After outperforming the broader Canadian economy for much of 2023, **Ontario** began to lag the national average as expected towards the end of last year. Household spending has been weak of late despite decades-high population growth, a trend we expect to persist as the drag from rate hikes is increasingly felt this year. Declining auto production expected in 2024 adds to weak trade prospects created by a slowing US economy. Eventual interest rate cuts and a rebound in car output should support stronger growth next year, though reduced NPR admissions could pose a drag.

Manitoba's growth should outperform the national average this year. Its economy is not as vulnerable to the effects of higher interest rates than those in many other provinces. Its broad industrial base—which includes mining, financial services and various kinds of manufacturing—means it's not as exposed to the ups and downs of any one sector. Budget 2024 also increased infrastructure spending plans by at least 10% versus 2023 forecasts in every year of the fiscal plan, providing consistent support for economic growth going forward.

Like other commodity producers, **Saskatchewan** has a better near-term economic outlook than most other parts of Canada. Though Budget 2024 reduced oil production projections, the province should still benefit from rising uranium production, higher agricultural output and construction work on the Jansen potash mine. Its highest-in-the-country job vacancy rate suggests only a relatively modest hiring slowdown in the months ahead.

Alberta continues to have some of the best near-term growth prospects of any province. Oil production is up strongly to begin 2024 and should continue to grow in the year ahead. Wild Rose Country's population growth remains the strongest in the country as young Canadians seek out affordable housing, which has kept its real estate market humming despite the effects of sharply higher interest rates. Completed construction of the Trans Mountain pipeline project bodes well for both Western Canadian oil prices and international market access.

British Columbia's (BC) household sector is showing signs of weakness. Both hiring and retail sales are significantly lagging population growth, though the housing market has been holding up fairly well in recent months. That said, business investment should receive solid, albeit easing support from the ongoing LNG Canada project. Despite recent credit rating downgrades, we still see BC's public finances as strong relative to most other provinces', with some potential for bottom line outperformance.

SUMMARY FORECAST TABLE

TABLE 1
Canada: Major economic indicators by province

% CHANGE (UNLESS OTHERWISE INDICATED)	2020	2021	2022	2023*	2024f	2025f
Real GDP growth – Canada	**-5.0**	**5.3**	**3.8**	**1.1**	**1.3**	**1.8**
Newfoundland and Labrador	-4.8	1.0	-1.7	-2.5	2.6	2.7
Prince Edward Island	-3.0	8.4	2.9	2.2	2.5	1.5
Nova Scotia	-4.5	5.9	2.9	1.3	1.7	1.2
New Brunswick	-3.6	5.3	1.1	1.3	1.5	1.1
Quebec	-4.7	6.7	2.5	0.0	0.7	1.5
Ontario	-4.5	5.4	3.9	1.2	0.9	1.8
Manitoba	-4.1	1.3	3.3	1.3	1.4	1.5
Saskatchewan	-4.3	-0.7	6.0	1.6	2.3	1.9
Alberta	-7.8	4.6	5.0	1.5	2.5	2.3
British Columbia	-3.1	7.1	3.8	1.6	0.9	1.9
Nominal GDP growth – Canada	**-4.0**	**13.4**	**11.8**	**2.7**	**4.2**	**3.1**
Newfoundland and Labrador	-10.2	18.5	6.8	-4.9	6.7	2.9
Prince Edward Island	0.3	14.9	9.3	3.2	4.3	3.5
Nova Scotia	-1.4	10.0	7.1	2.1	3.6	3.2
New Brunswick	-1.8	10.9	7.4	1.9	3.4	3.1
Quebec	-1.8	11.6	8.4	3.7	3.6	3.4
Ontario	-2.1	9.8	9.2	4.4	3.6	3.8
Manitoba	-2.2	9.2	8.6	2.1	3.4	2.6
Saskatchewan	-8.0	13.9	29.2	-0.5	5.9	1.4
Alberta	-14.4	24.9	22.0	-0.6	6.8	1.8
British Columbia	-0.5	15.8	11.0	2.6	3.2	3.4
Total inflation rate – Canada	**0.7**	**3.4**	**6.8**	**3.9**	**2.5**	**2.4**
Newfoundland and Labrador	0.2	3.7	6.4	3.3	2.2	2.2
Prince Edward Island	0.0	5.1	8.9	2.9	1.8	1.7
Nova Scotia	0.3	4.1	7.5	4.0	2.7	2.6
New Brunswick	0.2	3.8	7.3	3.5	2.1	2.0
Quebec	0.8	3.8	6.7	4.5	2.7	2.3
Ontario	0.6	3.5	6.8	3.8	2.3	2.2
Manitoba	0.5	3.2	7.9	3.6	0.8	2.1
Saskatchewan	0.6	2.6	6.6	3.9	1.5	2.1
Alberta	1.1	3.2	6.5	3.3	3.3	2.8
British Columbia	0.8	2.8	6.9	4.0	2.5	2.4
Employment growth – Canada	**-5.6**	**5.0**	**4.0**	**2.4**	**1.5**	**1.8**
Newfoundland and Labrador	-6.4	3.6	4.3	1.7	4.0	2.0
Prince Edward Island	-3.5	4.2	5.3	5.7	3.8	1.4
Nova Scotia	-4.6	5.6	3.6	2.7	4.5	1.3
New Brunswick	-3.0	3.2	2.7	3.4	1.8	1.2
Quebec	-5.4	4.3	3.1	2.3	0.6	1.9
Ontario	-5.4	5.2	4.6	2.4	0.8	1.6
Manitoba	-4.3	3.7	3.2	2.5	2.0	1.8
Saskatchewan	-5.0	2.6	3.5	1.8	1.9	2.1
Alberta	-7.0	5.5	5.2	3.6	3.2	2.3
British Columbia	-6.2	6.2	3.1	1.6	2.1	1.6
Unemployment rate – Canada	**9.7**	**7.5**	**5.3**	**5.4**	**6.3**	**6.2**
Newfoundland and Labrador	14.5	13.1	11.2	9.9	10.5	9.1
Prince Edward Island	10.7	9.9	7.5	7.4	7.2	7.6
Nova Scotia	9.9	8.6	6.6	6.4	6.6	6.8
New Brunswick	10.3	9.1	7.2	6.6	7.5	7.8
Quebec	8.9	6.1	4.3	4.4	5.5	5.7
Ontario	9.8	8.1	5.6	5.7	6.9	6.8
Manitoba	8.2	6.4	4.5	4.8	4.6	4.5
Saskatchewan	8.3	6.5	4.7	4.8	5.3	5.1
Alberta	11.4	8.5	5.8	5.9	6.5	6.2
British Columbia	9.1	6.5	4.6	5.2	5.9	5.8

* Based on preliminary estimates of GDP by industry at basic prices (except for QC and ON). f: forecast
Statistics Canada, Institut de la statistique du Québec, Ontario Ministry of Finance
and Desjardins Economic Studies