PROVINCIAL ECONOMIC FORECAST

TD Economics

July 6, 2016

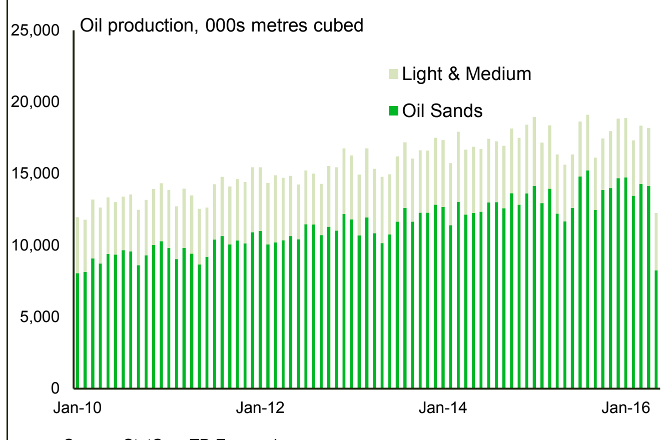
PROVINCIAL ECONOMIES INCREASINGLY DIVERGENT IN 2016

Highlights

- The devestating destruction caused by wildfires in Northern Alberta reduce economic activity in that province for 2016, though reconstruction efforts will result in a steeper recovery in 2017.
- Economic adjustment among the Canadian provinces is expected to be the single largest theme over the near term, as changing commodity prices, lower interest rates, and softer Canadian dollar manifest on provinces differently. Three-speeds of provincial growth have resulted, with British Columbia and Ontario emerging at the top of the pack.
- We've recently downgraded slightly our national forecast in response to the result of the Brexit referendum. Canada's direct export exposure to the United Kingdom is relatively low, with most of the negative economic impact related to slower global trade volumes as well as depressed business investment stemming from lower business confidence.

The multiyear adjustment of provincial economies as they adapt to low commodity prices, interest rates, and value of the Canadian dollar remains the overriding theme in this Provincial Economic Forecast (PEF) update. The adjustment is most apparent across the oil-producing provinces, with contractions proving significantly deeper than we had expected in our previous forecast in March. This is especially the case for Alberta, where devastating wildfires resulted in weeks-long evacuation of Fort McMurray and a sharp decline in oil production. This delivered a final blow to Alberta, which will post deep back-to-back years in recession that have not occurred before on record. Rebounding oil production and rebuilding efforts will help economic activity recover in the province next year, with Saskatchewan's economy also expected to see some green-shoots of growth this year. However, with economic activity subdued in the commodity-oriented regions, overall conditions are still likely to feel sluggish. In contrast, growth expectations in other regions have taken root, where the tailwinds of low energy prices, a soft Canadian dollar and low interest rates have provided a positive thrust to growth. Overall, B.C. and Ontario are likely to remain at the top of the leaderboard this year, partly reflecting red-hot conditions in housing, with only a moderate cooling on tap for 2017.

ONE THIRD OF CANADIAN OIL PRODUCTION OFFLINE IN MAY DUE TO WILDFIRES



Source: StatCan. TD Economics

Provinces not immune to Brexit

The recent vote by the UK electorate to leave the European Union is likely to restrain global growth and adds some uncertainty to the provincial forecast. Canada's trade exposure to the UK is relatively small with most of the Brexit impacts likely to be indirect

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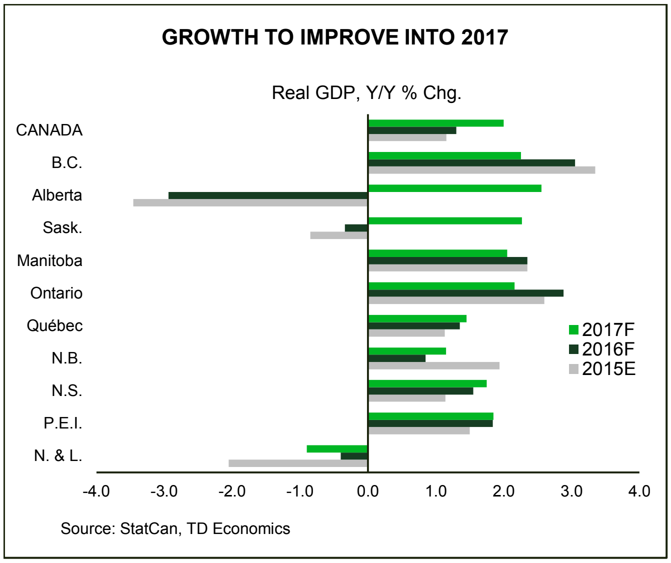


through lower business investment and modestly weaker exports to other trading partners. No provincial economy is likely to be completely immune to Brexit, but the fallout will likely to be felt most in Central Canada's manufacturing heartland which accounts for most of Canada's capital goods exports. However, some of these negative impacts could be slightly offset by a boost to residential investment related to lower interest rates globally.

Direct export exposure to the UK varies substantially across provinces but consists largely of commodities. More than one tenth of Newfoundland & Labrador's goods are destined for Great Britain (mostly oil, iron, and seafood) with about 7% of Ontario's merchandise exports are headed there (gold accounts for most). On the other end of the spectrum is Alberta, which sends a mere 0.2% of its goods exports to the UK.

Alberta stands out as largest forecast change

Alberta captured the hearts and minds of Canadians in recent months, and marks the province with the most notable forecast change. The fires halted oil sands production in excess of 1 million barrels per day for several weeks. And while production levels have started to recover in June, ongoing fires and caustic ash have delayed the restart of operations as well as the resettlement of its population. We project that this economic disruption alone pulled down Alberta's real GDP by an additional 1.5%, resulting in a forecast of nearly -3% for 2016 as a whole. However, oil production is already starting to come back on line and rebuilding efforts of the devastated region will underpin a stronger rebound in 2017, with the Alberta economy likely to grow by about 2.6% – double that anticipated in the March forecast.

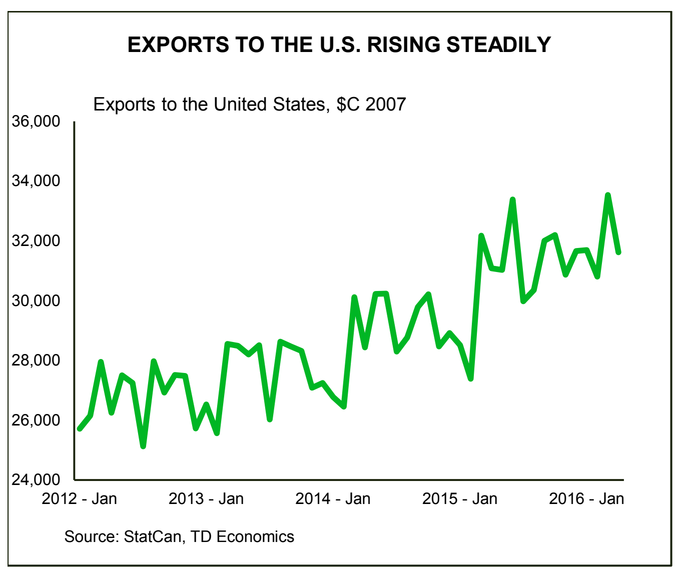
Economic adjustment to extend over the medium term

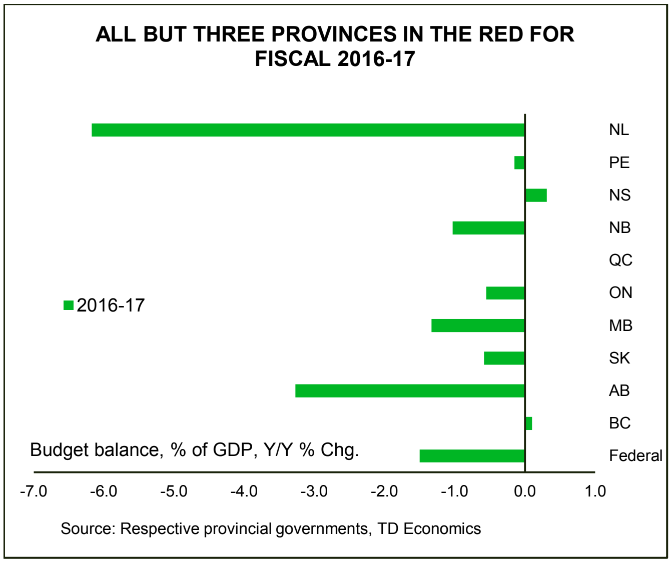
Looking beyond the near-term effects of the wildfires, Alberta's adjustment to low oil prices is proving to be both deeper and more persistent than we had expected. Last year's real GDP estimate turned in a far more pessimistic tracking than we were expecting, at roughly -4% (versus prior estimate of -1.6%). If 2016 tracks as we foresee, it will bring the cumulative contraction to nearly 7% over the two years.

The depth of the downturn has also surprised in Newfoundland & Labrador and Saskatchewan. While the former will get a boost from a temporary rebound in oil production, austere budget measures will likely weigh on growth over the medium term. Saskatchewan, on the other hand, enjoys more diversity in its resource basket relative to the other oil producers, and should see some stability in its economy this year – with GDP declining 0.4% – before once again outpacing the nation next year.

Forecast changes in oil-consuming regions relative to March have been more modest by comparison. A better-than-expected performance in 2015, alongside positive recent data, have corroborated the view that Ontario, British Columbia, and Manitoba have increasingly benefitted from a number of tailwinds including the relatively low Canadian dollar, accommodative monetary policy, low energy prices and increased migration to regions where labour conditions are favourable.

However this is not the case for all provinces. Weaker than anticipated data as of late suggests that these tailwinds are not manifesting to the same extent in the case of Quebec and the Maritimes. Part of this is related to their own unique commodity narratives, with lower prices often weighing on





some of these economies through mine closures or reduced production. Moreover, growth is also being stymied by the comparatively limited share of exports destined for the U.S. consumer in these provinces, with the recent forecast downgrades reflecting the combination of these factors.

Low interest rates lift growth

Still, while the degree may differ, the theme of an export-led recovery remains present across the non-resource intensive provinces. Volumes of U.S. bound Canadian goods shipments rose 7.7% in the last six-months, with exports led by consumer products, autos, food, and forestry products, while tourism activity helped as well. Ontario has emerged as the particular outperformer, with the value of exports surging 14% through the last two quarters, owing largely to automotive manufacturing.

At the same time, low interest rates, which could stay even lower for longer in light of the Brexit vote outcome, are helping domestic consumption and continue to fuel housing activity across Canada – with remarkable strength evident in the Vancouver and Toronto markets. In the first quarter of 2016, residential investment surged more than 17% y/y in British Columbia and 25% y/y in Ontario, with nascent signs of slowing. Adding fuel to these already heated markets are shifting interprovincial migration flows and foreign investment. These dynamics, in addition to strong domestic fundamentals, should maintain support under housing demand within these urban markets this year. However, affordability has become incredibly stretched and price increases at these levels are simply unsustainable. This sets up a backdrop for cooler markets in Toronto and Vancouver next year.

Shifting trends in interprovincial migration are directly related to the disparity in provincial economic fortunes, with more Canadians now leaving the formerly booming resource-rich provinces for others – notably British Columbia and Ontario. Elsewhere, the weakness in the oil patch is causing more Canadians to stay put, with outbound migration decreasing markedly in regions such as Quebec, Manitoba and the Maritimes. These dynamics should support housing demand in these regions and help shore government coffers, with several of these facing declining populations previously.

Provincial budgets highlight cost control while investment expands

The provincial budget season concluded in June, with seven of ten provinces expecting deficits this year. However, five provinces have managed to narrow their fiscal deficit positions, and net debt-to-GDP is also decreasing for half of all provinces. Quebec's balanced budget position is leading to meaningful debt retirement amid stronger economic growth, resulting in net debt-to-GDP falling 1.2 percentage points to 48.4%, the lowest level since 2008-09. As well, Ontario's debt-to-GDP is expected to level off this year, and begin a downward trend with consistent and steadier economic growth. The result of these improved fiscal standings is likely to be felt over the longer term, as more manageable debt levels free up resources. Importantly, all governments also stated the importance of infrastructure investment over the near term though.

At the same time, the provinces experiencing significant reductions in fiscal health owe their difficulties in large part to natural resource revenues, notably oil royalties in Alberta, Saskatchewan, and Newfoundland & Labrador. All three provinces have absorbed sizeable deficits, but each is taking differing approaches on how to return to surplus. Saskatchewan will be the first to return back into the black next year on account of a more diversified economy and a stronger fiscal position moving into the crisis. Newfoundland & Labrador, on the other hand, has instituted sweeping tax increases and expenditure restraint in an attempt to get their deficit under control. This will weigh on growth and has contributed to a near-term forecast downgrade. While there is a clear intention to reduce deficits each year, their path back to balance remains opaque for the time being. Alberta intends to run the largest deficit of the provinces – larger than all other provinces combined – with only a limited focus on expenditure restraint, while maintaining a stable hand on taxes. This will help short-term growth at the expense of future consumption.

Bottom line

The divergence in economic growth across Canada's oil-producing and oil-consuming provinces has widened even further since our previous forecast in March. The latter are experiencing the cross-benefits stemming from robust manufacturing, housing, and consumption. At the other end of the spectrum, oil producing provinces are digging out of fiscal deficits, experiencing slumping commodity-related investment and pressures on population outflows as their labor markets weaken. As such, after stripping away temporary influences related to natural disasters, the underlying dynamics support only a moderate recovery in domestic conditions among the major resource producing provinces. At the same time, exports and housing wealth should continue to pivot national growth towards Ontario and B.C. well into next year.

SUMMARY TABLES

REAL GROSS DOMESTIC PRODUCT (GDP) Annual average per cent change					
	2013	2014	2015E	2016F	2017F
CANADA	1.9	2.6	1.2	1.2	1.9
N. & L.	5.8	-2.0	-2.1	-0.6	-1.2
P.E.I.	2.0	1.5	1.5	1.8	1.8
N.S.	0.0	0.6	1.1	1.5	1.7
N.B.	0.4	-0.3	1.9	0.8	1.1
Québec	1.2	1.5	1.1	1.3	1.7
Ontario	1.3	2.7	2.6	2.7	2.0
Manitoba	2.4	2.3	2.3	2.3	1.9
Sask.	5.8	1.9	-0.9	-0.4	2.3
Alberta	5.1	4.8	-3.5	-3.0	2.5
B.C.	2.1	3.2	3.3	3.0	2.2

E\|F: Forecast by TD Economics as at July 2016.
Source: Statistics Canada / Haver Analytics

NOMINAL GROSS DOMESTIC PRODUCT (GDP) Annual average per cent change					
	2013	2014	2015E	2016F	2017F
CANADA	3.8	4.3	0.6	2.6	4.3
N. & L.	9.2	-4.2	-6.0	-0.8	-0.5
P.E.I.	3.8	3.8	2.6	3.3	3.4
N.S.	2.0	1.3	2.8	3.4	3.1
N.B.	0.4	0.6	2.6	2.4	3.0
Québec	2.0	2.5	1.6	3.0	3.5
Ontario	1.9	4.1	3.6	4.5	4.1
Manitoba	3.5	3.5	3.5	4.3	3.9
Sask.	7.1	-0.9	-1.5	-1.2	4.7
Alberta	10.2	9.1	-9.4	-6.7	6.5
B.C.	2.3	4.7	4.9	5.1	4.4

E\|F: Forecast by TD Economics as at July 2016.
Source: Statistics Canada / Haver Analytics

EMPLOYMENT Annual average per cent change					
	2013	2014	2015	2016F	2017F
CANADA	1.5	0.6	0.9	0.5	0.6
N. & L.	0.8	-1.7	-1.0	-0.2	0.5
P.E.I.	1.5	-0.1	-1.1	-2.1	0.4
N.S.	-1.1	-1.1	0.1	-0.3	0.2
N.B.	0.4	-0.2	-0.4	-1.2	0.2
Québec	1.4	0.0	1.0	0.5	0.6
Ontario	1.8	0.8	0.7	1.2	1.1
Manitoba	0.7	0.1	1.5	-0.2	0.8
Sask.	3.1	1.0	0.6	-0.9	0.6
Alberta	2.5	2.2	1.2	-2.0	-0.4
B.C.	0.1	0.6	1.3	2.7	0.6

E\|F: Forecast by TD Economics as at July 2016.
Source: Statistics Canada / Haver Analytics

UNEMPLOYMENT RATE Annual, per cent					
	2013	2014	2015	2016F	2017F
CANADA	7.1	6.9	6.9	7.1	7.1
N. & L.	11.6	11.9	12.8	12.8	12.6
P.E.I.	11.6	10.6	10.4	10.7	10.8
N.S.	9.1	9.0	8.6	8.5	8.3
N.B.	10.3	9.9	9.7	9.8	9.8
Québec	7.6	7.7	7.6	7.4	7.3
Ontario	7.6	7.3	6.8	6.9	7.0
Manitoba	5.4	5.4	5.6	5.9	5.8
Sask.	4.1	3.8	5.0	6.0	5.8
Alberta	4.6	4.7	6.0	7.7	7.3
B.C.	6.6	6.1	6.1	6.2	6.0

E\|F: Forecast by TD Economics as at July 2016.
Source: Statistics Canada / Haver Analytics

CONSUMER PRICE INDEX (CPI) Annual average per cent change					
	2013	2014	2015	2016F	2017F
CANADA	0.9	1.9	1.1	1.8	2.2
N. & L.	1.7	1.9	0.4	2.1	2.2
P.E.I.	2.0	1.6	-0.6	1.7	2.3
N.S.	1.2	1.7	0.4	1.7	2.2
N.B.	0.8	1.5	0.5	2.1	2.1
Québec	0.8	1.4	1.1	1.3	2.0
Ontario	1.1	2.3	1.2	2.0	2.2
Manitoba	2.3	1.8	1.2	1.5	2.3
Sask.	1.4	2.4	1.6	1.8	2.3
Alberta	1.4	2.6	1.2	1.6	2.2
B.C.	-0.1	1.0	1.1	1.7	1.9

E\|F: Forecast by TD Economics as at July 2016.
Source: Statistics Canada / Haver Analytics

RETAIL TRADE Annual average per cent change					
	2013	2014	2015	2016F	2017F
CANADA	3.2	4.6	2.2	3.3	2.9
N. & L.	5.0	3.4	0.2	2.6	2.3
P.E.I.	0.8	3.3	2.3	4.5	1.9
N.S.	2.9	2.3	-0.6	3.9	2.8
N.B.	0.7	3.8	2.4	3.9	2.7
Québec	2.5	1.7	0.5	3.8	2.0
Ontario	2.3	5.0	4.2	4.9	2.4
Manitoba	3.9	4.3	1.5	6.1	2.8
Sask.	5.1	4.6	-3.5	1.9	2.5
Alberta	6.9	7.5	-4.6	-3.4	3.0
B.C.	2.4	5.6	6.0	5.2	2.9

E\|F: Forecast by TD Economics as at July 2016.
Source: Statistics Canada / Haver Analytics

HOUSING STARTS Thousands of units					
	2013	2014	2015	2016F	2017F
CANADA	187.9	189.2	193.6	194.2	188.5
N. & L.	2.9	2.2	1.8	1.6	1.4
P.E.I.	0.6	0.5	0.5	0.6	0.6
N.S.	3.9	3.0	3.9	3.0	3.3
N.B.	2.8	2.3	1.9	1.8	2.3
Québec	37.6	39.3	36.8	39.0	44.1
Ontario	60.9	58.6	68.8	71.6	64.9
Manitoba	7.5	6.2	5.6	4.8	4.9
Sask.	8.3	8.3	5.2	4.4	4.4
Alberta	36.1	40.5	37.5	22.5	23.7
B.C.	27.1	28.3	31.5	45.0	38.9

F: Forecast by TD Economics as at July 2016.
Source: CMHC / Haver Analytics

HOUSING STARTS Per cent change					
	2013	2014	2015	2016F	2017F
CANADA	-12.5	0.7	2.3	0.3	-3.0
N. & L.	-26.3	-23.6	-19.0	-9.7	-12.5
P.E.I.	-33.2	-19.3	5.1	7.4	3.4
N.S.	-14.4	-22.0	27.2	-22.6	10.0
N.B.	-13.4	-18.9	-15.2	-9.9	29.7
Québec	-20.3	4.5	-6.3	5.8	13.1
Ontario	-21.4	-3.8	17.5	4.0	-9.4
Manitoba	2.6	-17.6	-9.3	-14.4	2.1
Sask.	-17.1	0.2	-37.2	-15.3	0.0
Alberta	8.2	12.4	-7.4	-40.1	5.3
B.C.	-1.5	4.5	11.4	42.8	-13.6

F: Forecast by TD Economics as at July 2016.
Source: CMHC / Haver Analytics

EXISTING HOME SALES Thousands of units					
	2013	2014	2015	2016F	2017F
CANADA	456.5	480.3	506.4	540.9	515.2
N. & L.	4.3	4.1	4.3	4.3	4.4
P.E.I.	1.4	1.4	1.7	2.0	2.1
N.S.	9.1	8.9	9.2	9.4	9.2
N.B.	6.3	6.3	6.7	6.8	6.9
Québec	71.2	70.6	74.2	78.7	80.9
Ontario	197.4	205.0	224.6	239.2	228.4
Manitoba	13.7	13.8	14.0	14.8	14.9
Sask.	13.5	13.9	12.4	11.6	11.7
Alberta	66.1	71.8	56.5	51.3	52.4
B.C.	72.9	84.0	102.5	122.4	104.3

F: Forecast by TD Economics as at July 2016.
Source: Canadian Real Estate Association

EXISTING HOME SALES Per cent change					
	2013	2014	2015	2016F	2017F
CANADA	0.7	5.2	5.4	6.8	-4.8
N. & L.	-7.5	-4.7	3.7	0.8	2.4
P.E.I.	-11.8	-3.2	20.8	22.7	4.9
N.S.	-12.3	-2.3	2.8	2.6	-2.1
N.B.	-1.9	-0.1	6.5	1.6	1.6
Québec	-8.0	-0.8	5.0	6.2	2.7
Ontario	0.5	3.9	9.5	6.5	-4.5
Manitoba	-1.2	0.3	1.7	5.7	0.4
Sask.	-2.4	2.4	-10.8	-6.1	0.5
Alberta	9.5	8.6	-21.3	-9.1	2.1
B.C.	7.8	15.2	22.0	19.4	-14.8

F: Forecast by TD Economics as at July 2016.
Source: Canadian Real Estate Association

AVERAGE EXISTING HOME PRICE Thousands of C$					
	2013	2014	2015	2016F	2017F
CANADA	381.7	407.1	440.0	487.9	472.8
N. & L.	283.7	284.3	276.3	253.3	250.3
P.E.I.	155.1	165.1	164.1	171.2	171.3
N.S.	214.8	213.2	217.8	214.9	215.9
N.B.	161.4	161.1	159.5	165.8	172.6
Québec	267.7	271.4	275.4	281.9	286.9
Ontario	401.5	429.5	461.5	513.3	512.4
Manitoba	260.7	264.7	268.1	273.7	276.3
Sask.	287.5	298.0	296.1	291.0	290.8
Alberta	380.2	399.8	391.4	377.8	375.1
B.C.	537.6	570.2	637.0	723.0	696.0

F: Forecast by TD Economics as at July 2016.
Source: Canadian Real Estate Association

AVERAGE EXISTING HOME PRICE Per cent change					
	2013	2014	2015	2016F	2017F
CANADA	5.6	6.6	8.1	10.9	-3.1
N. & L.	5.4	0.2	-2.8	-8.3	-1.2
P.E.I.	1.6	6.4	-0.6	4.3	0.1
N.S.	-1.6	-0.7	2.1	-1.3	0.5
N.B.	1.3	-0.2	-0.9	3.9	4.1
Québec	1.2	1.4	1.5	2.4	1.8
Ontario	5.2	7.0	7.5	11.2	-0.2
Manitoba	5.7	1.5	1.3	2.1	1.0
Sask.	4.5	3.6	-0.6	-1.7	-0.1
Alberta	5.0	5.2	-2.1	-3.5	-0.7
B.C.	4.8	6.1	11.7	13.5	-3.7

F: Forecast by TD Economics as at July 2016.
Source: Canadian Real Estate Association