



TD Economics

Provincial Economic Outlook

January 10, 2008

CENTRAL AND EASTERN MARKETS TO RECORD SUB-2% GROWTH IN 2008

In light of a deteriorating export environment and an elevated Canadian dollar, we have slashed projected provincial growth rates for 2008 by nearly 0.5 percentage points on average compared to TD Economics' October 2007 edition of the *Provincial Economic Outlook*. Real GDP growth is now expected to amble along at a rate of about 1.5% in Newfoundland & Labrador, Ontario, Quebec and P.E.I. while job creation in those provinces ratchets down to a mere 0.4-0.8% this year. Not falling far behind are the provinces of Nova Scotia and New Brunswick, where economic growth is forecast at a lacklustre 2%. Elsewhere, the impressive resilience of crude oil and other commodity prices as 2008 begins is consistent with another year of western outperformance. Still, with the sole exception of Saskatchewan – where burgeoning resource activities are set to pull the province to the head of the pack – the west is unlikely to sidestep the trend towards weaker expansion. On the brighter side, for 2009, we've stuck with our view that prospects in most parts of the country will gradually brighten in tandem with the export picture.

Weaker external conditions to pull down growth

As noted, the chief culprit behind the considerably softer outlook compared to the autumn is the souring prospects for the external environment:

- Faced with worsening credit conditions and a severe correction in residential real estate markets, the United States economy is likely to record little or no expansion in the first half of 2008 followed by a relatively muted recovery in the second half. For the year as whole, the U.S. economy is set to grow by only 1.8%, a downgrading of 0.6 percentage points from the time of our last Provincial Outlook in October. In 2009, the U.S. is

HIGHLIGHTS

- **Deteriorating export picture setting the stage for slow growth across the provinces in 2008**
- **Real GDP growth this year to limp along at about 1.5% in N&L, Ontario, Quebec and P.E.I.**
- **Nova Scotia and New Brunswick poised to expand at a slightly faster 2% rate**
- **While the west will continue to outperform, the region will not be immune to U.S. softness**
- **Saskatchewan only province to record 3%+ growth in 2008**
- **Provincial prospects somewhat brighter in 2009**

likely to begin to shake off its housing-market doldrums and to record improved growth of 2.8%.

- While the U.S. economy is confronting the highest probability of recession on the worldwide landscape, downside risks to growth have been rising in virtually every nook and cranny of the global economy. Accordingly, since the October *Outlook*, we have cut our 2008-09 global growth forecast from about 4.6% on average to about 4.2%. Even China's rate of expansion appears set to ratchet down, to roughly 9.5% per year from its recent trend rate of more than 11%.
- Even though China's appetite for commodities should remain strong over the next two years, the moderation in global growth will not only lead to weaker overall

resource demand, but to some downward pressure on prices as 2008 unfolds, notably in the crude oil and base metal markets. In particular, WTI prices are expected to retreat back to a more sustainable level of just over US\$80 per barrel on average both this year and next. At the same time, however, ongoing supply adjustments in the natural gas, lumber and livestock areas should set the stage for higher prices in those areas, limiting the drop in the overall U.S.-dollar TD Commodity Price Index to a relatively mild 2% in 2008 and 5% in 2009 (on a December-to-December basis).

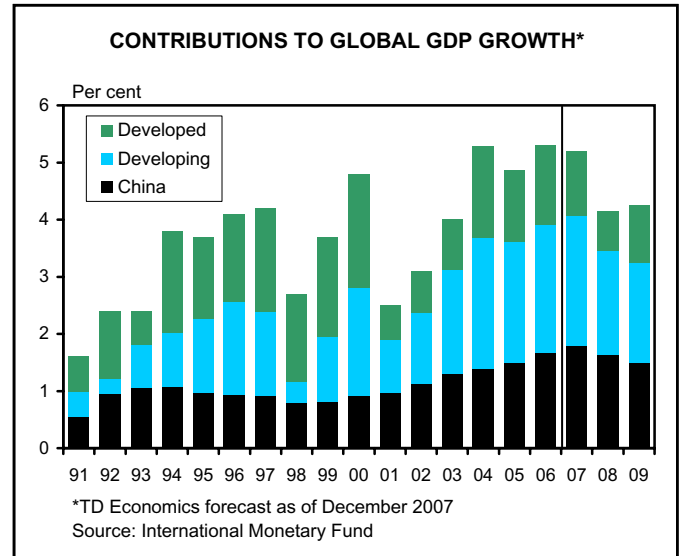
- Exacerbating the challenges on provincial export sectors will be the continued high level of the Canadian dollar, even if the decline in crude oil prices acts to pull the loonie back to about 94 US cents by year-end and 92 US cents by the end of 2009.

Not all provinces to face the same export struggles

Not all provincial export sectors will face the same uphill battle in the coming months. For one, as we show in the attached table, reliance on international exports varies widely from coast to coast, from a high of more than 40% in Ontario and New Brunswick to a low of 25-30% in Nova Scotia and British Columbia. In the same table, we've estimated the comparable shares of total provincial GDP exported to the U.S. market. Even though Canada's provinces are less reliant on the United States for export business than at the start of the decade, U.S. shipments still account for roughly three quarters of the total. As such, at least one in every five dollars of provincial real GDP can be attributed to sales in the U.S. market, with the share as

PROVINCIAL RELIANCE ON U.S. EXPORTS						
	Real exports to all countries:		Share of exports destined for U.S.:		Real exports to U.S.:	
	% of GDP	Rank*	%	Rank*	% of GDP^	Rank*
N.&L.	39.0	4	55.9	10	21.8	5
P.E.I.	30.9	7	75.2	7	23.2	6
N.S.	25.1	10	75.6	6	19.0	9
N.B.	43.4	2	90.0	1	39.1	2
Que.	36.8	5	77.6	4	28.6	4
Ont.	46.5	1	86.4	3	40.2	1
Man.	30.8	8	77.3	5	23.8	7
Sask.	40.2	3	65.5	8	26.3	8
Alta.	36.6	6	88.5	2	32.4	3
B.C.	29.8	9	61.2	9	18.2	10

Figures are for 2006. *Provincial rank, 1=highest, 10=lowest. ^Estimate. Source: Statistics Canada, TD Economics.



high as two in five in Ontario and New Brunswick.

The degree of export reliance tells only part of the story. Compounding the difficulties within Ontario and New Brunswick's export sectors are the heavy ties to areas of the U.S. economy that are likely to flounder the most in the coming quarters, notably autos and forest products, respectively. Quebec enjoys a more diverse export orientation, but its all-important forestry and primary metals industries still face a bumpy road. Elsewhere, the export outlook is more mixed. In British Columbia, Manitoba and Nova Scotia, a soft outlook for manufacturing exports will be mitigated to some extent by their lower trade exposure to the United States, not to mention their relative strength in energy and/or power exports, which tend to be less vulnerable to a U.S. downturn. The same case can be made for energy-producing Alberta and Newfoundland & Labrador, especially in view of the recent run-up in crude oil prices to US\$100 per barrel. However, exports in Alberta are likely to be held back in 2008 by a further decline in natural gas shipments while a tapering off in offshore crude oil output on the heels of last year's explosion is likely to put a severe damper on Newfoundland & Labrador's economic showing in both 2008 and 2009. Among the provinces, only Saskatchewan is likely to enjoy a good year for exports, underpinned by ongoing growth in crop, crude oil, potash and uranium activity.

Offsetting tailwinds to keep all provinces growing

With provincial export sectors facing headwinds to varying degrees over the near term, the pressure will be on other sides of the economy to continue to do the heavy

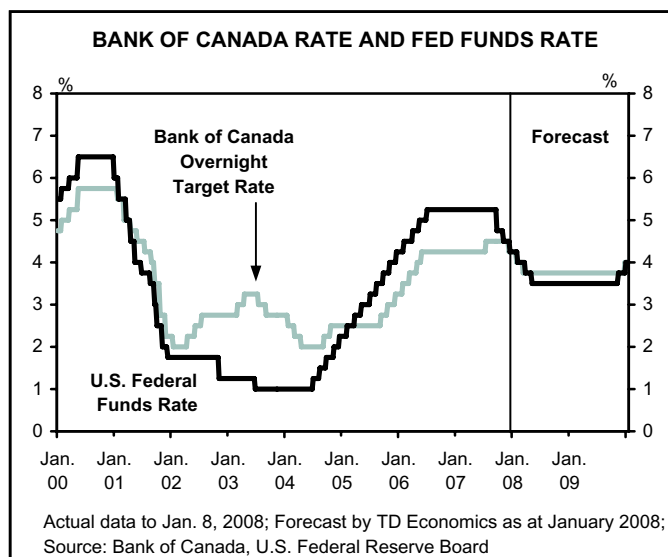
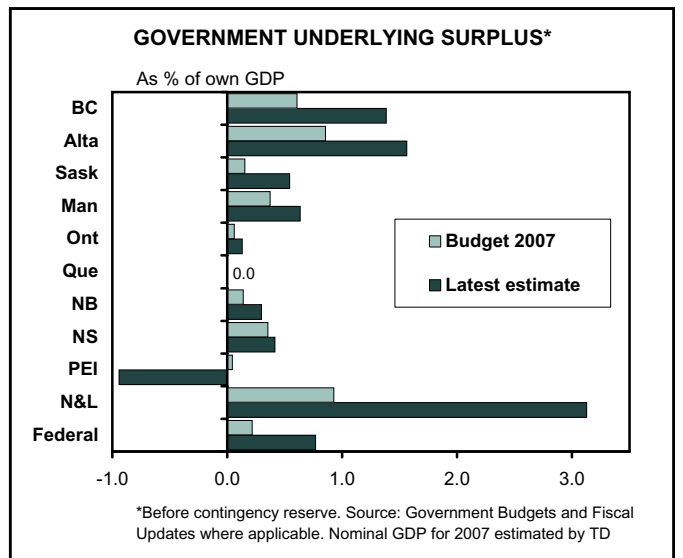
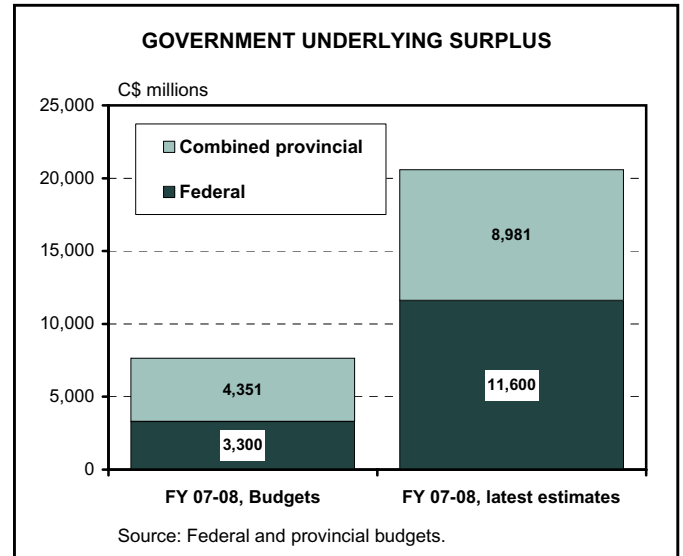
lifting. Heading into 2008, a healthy domestic mix of interest-rate relief, healthy government fiscal positions and federal tax cuts, solid gains in business investment, buoyant real estate markets and low unemployment rates are all helping to fortify provincial economies against the emerging external body blows. Although some of these domestic tailwinds are likely to moderate in 2008, they will continue to be supportive of ongoing expansion in provincial economies.

A little more interest-rate relief in early 2008

Although most of the attention on the surging Canadian dollar has been directed at its costs in terms of lost export competitiveness, a higher currency has also set the stage for lower import prices, lower inflation and cuts in short-term interest rates. While recent energy price increases may exert an upward influence on inflation over the near term, we project CPI increases to moderate across the provinces for the year as a whole, to 1.5-2%. Notably, inflation in Alberta is expected to be cut in half from last year's 5% clip. Supported by easing risks on the price front, the Bank of Canada was afforded the room to cut interest rates by 25 basis points at its fixed announcement date (FAD) on December 4th in order to ensure against the emerging downside risks. We project follow-up interest rate cuts at the Bank's next two FAD on January 22nd and March 4th.

Governments racking up big surpluses

As revealed in recent mid-year government updates, fiscal positions remain a strong suit for provincial economies as economies enter a period of heightened uncer-



tainty. Underpinned by an unexpectedly strong revenue take, the aggregate federal-provincial underlying surplus (i.e., before deducting contingency reserves) for fiscal 2007-08 was marked up to a hefty \$21 billion – down only moderately from last year's \$29 billion result and almost three times the projected \$7.7 billion tally at the time of the 2007 spring budgets. This overshoot was split roughly 65/35 between the federal and provincial levels. Eight of ten provinces – all but P.E.I. and Quebec – upgraded their surplus projections, with resource-heavy Alberta, B.C. and Newfoundland & Labrador accounting for the largest upward adjustments (see chart). In Quebec, the negative impact of accounting adjustments was partly responsible for a steady zero-deficit target. Only P.E.I., with its newly-elected government, has lowered its year-end outlook to a budget

deficit.

In addition to new spending measures, some governments have used some of the excess fiscal room to announce new tax cuts. October's Federal Fiscal Update delivered a further percentage point reduction in the GST and deepened an existing plan to lower corporate income-tax rates. In Ontario, the government accelerated a cut to corporate capital taxes and announced an accelerated write-off to machinery and equipment (M&E) purchases by manufacturers. These reductions, complemented by previously-announced income-tax cuts in Newfoundland & Labrador, Quebec and B.C., will provide near-term stimulus to household and business spending.

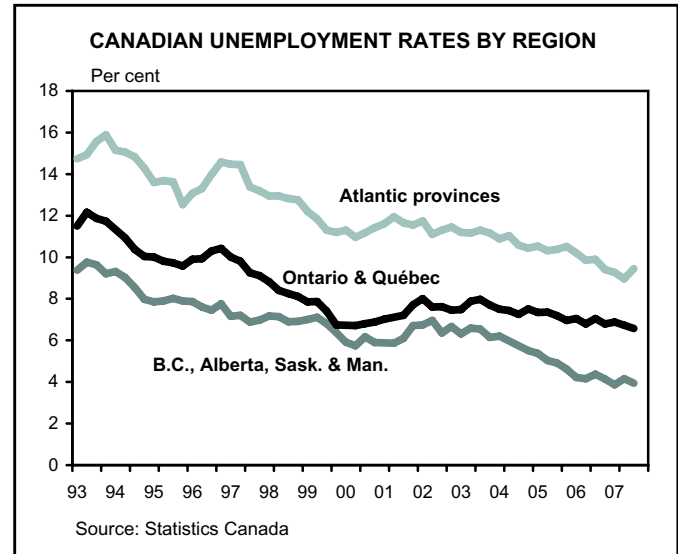
That said, the prospects for slowing provincial economies will put somewhat of a damper on fiscal positions in the lead-up to the 2008 federal and provincial budgets. As such, this year's budget season is likely to be on the cautious side as governments look to keep their finances in the black. The focus of new initiatives is likely to remain on health care, education, the environment and some further targeted measures aimed at the ailing manufacturing sector.

Investment prospects remain bright

Also backstopping provincial economies this year and into 2009 is a continued solid outlook for non-residential investment across the country. Despite a growing squeeze on profit performances, many businesses – including those in manufacturing – are likely to take advantage of the high Canadian dollar and any new or existing government tax incentives to invest in M&E and boost productivity this year and next. Although commercial construction activity appears set to moderate in Calgary following several years of booming expansion, relatively low vacancy rates in the major urban centres suggest little downside risk to office construction spending this year and next. Lastly, a number of developments in the resource sector are expected to support growth in western and Atlantic Canada. These include Olympics-related building in B.C., oil projects in Alberta's Athabasca basin, construction of mines in Saskatchewan's uranium and potash industry, an expansion of the White Rose development in Newfoundland & Labrador and an LNG terminal in New Brunswick.

Housing activity to remain brisk

Among the big surprises of 2007 was the relentless



strength of provincial housing markets. About half the provinces defied the odds by recording a further gain in housing starts from the elevated levels posted in the prior year – Saskatchewan, Manitoba, Newfoundland & Labrador, B.C. and Quebec. Even more striking, unit sales are estimated to have risen in all provinces with the sole exception of Alberta. In sharp contrast to developments in the United States, average resale prices increased by 11% on average across the country last year. Although all provinces fared well, the spotlight turned on Saskatchewan, which supplanted Alberta as the provincial leader in terms of growth in housing activity, fuelled in part by a sharp acceleration in population growth. Indeed, in the third quarter of 2007, Saskatchewan recorded the strongest population growth among the provinces, supported by a marked uptick in inter-provincial migration flows.

The cooling in Alberta's housing market in recent months largely reflects developments in Calgary, where the impressive increases in prices strained affordability and resulted in increased supply on the market. While no other housing market has experienced the same degree of growth over the past 3-4 years, housing sales, starts and price growth all appear set to moderate broadly across the country in line with overall economic growth. Major culprits for the slackening will be the past erosion in housing affordability and a lack of pent-up demand. In terms of price growth, Saskatchewan (+15%), British Columbia (+7%), Alberta and Manitoba (+6%), are expected to record gains topping the national average of about 5.5% in the 2008-09 period.

Unemployment rates to stay low

In 2007, the rate of job creation is estimated to have accelerated in all provinces, with the majority of jurisdictions recording further declines in jobless rates to multi-decade lows. This development raised the most eyebrows in manufacturing-heavy central Canada. Even though manufacturers in Ontario and Quebec continue to cut jobs in the face of a soaring loonie, the losses were more than offset by strength in construction and service industries. And in light of tightening job markets, wage growth accelerated in most regions in 2007, with gains in median hourly wage rates ranging from 3% in Ontario, Quebec and P.E.I. to 6-7% in Saskatchewan, Alberta, Manitoba, Nova Scotia and N&L.

Perhaps most striking about last year's glowing provincial job-market performances is that job creation appeared to fall just short of – or even surpass – output growth in most regions of Canada. This outcome implies little or no growth in labour productivity, which is not sustainable, especially in view of the recent hit on economic competitiveness from the high Canadian dollar. Add on the fact that domestic spending appears poised to simmer down in most provinces and a significant slowdown in new hiring is in store. Still, with labour force growth likely to slow in tandem, unemployment rates are likely to remain ultra-low

from coast to coast. In fact, we see scope for even further declines in Newfoundland & Labrador, Nova Scotia and British Columbia.

Accordingly, look for consumer spending to remain respectable in most parts of the country, especially in the low-unemployment western provinces. We present retail spending forecasts by province in the summary tables on pages 6-7. Note that while the volume of retail spending is expected to hold up well from coast to coast this year, the value of sales will come under some pressure from a more difficult pricing environment, especially in the wake of the Canadian's dollar move to parity in late 2007.

The bottom line

2008 is likely to be marked by a meaningful downshifting in growth in virtually all parts of the country. Put simply, no region – including the long-outperforming west – will be fully immune to downside risks emerging outside of Canada's borders. At the same time, continued healthy prospects for domestic spending will help to keep provincial economies in expansion mode in 2008 and into 2009.

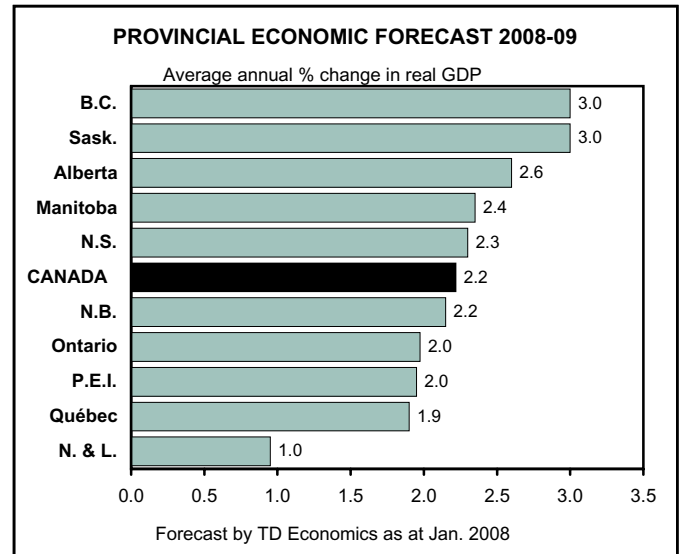
Derek Burleton
AVP & Director of Economic Studies
416-982-2514

Pascal Gauthier, Economist
416-944-5730

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REAL GROSS DOMESTIC PRODUCT (GDP)						
Annual average per cent change						
	97-06	2005	2006	2007E	2008F	2009F
CANADA	3.5	2.9	2.8	2.5	1.9	2.5
N. & L.	4.3	0.4	3.3	8.0	1.0	0.9
P.E.I.	2.3	2.1	2.6	1.7	1.6	2.3
N.S.	2.8	1.6	0.9	2.0	2.0	2.6
N.B.	2.7	0.3	3.0	2.3	1.9	2.4
Québec	2.9	2.2	1.7	2.0	1.7	2.1
Ontario	3.7	2.8	2.1	1.8	1.5	2.5
Manitoba	2.6	2.7	3.2	2.8	2.2	2.5
Sask.	2.0	3.1	-0.4	3.9	3.4	2.6
Alberta	4.3	4.6	6.6	4.3	2.5	2.7
B.C.	3.1	4.5	3.4	3.2	2.8	3.2

E: Estimate; F: Forecast by TD Economics as at Jan. 2008
Source: Statistics Canada



TOTAL CONSUMER PRICE INDEX						
Annual average per cent change						
	97-06	2005	2006	2007E	2008F	2009F
CANADA	2.1	2.2	2.0	2.1	1.4	2.0
N. & L.	1.9	2.6	1.8	1.4	1.1	1.4
P.E.I.	2.2	3.2	2.2	1.8	1.3	1.7
N.S.	2.3	2.8	2.1	1.8	1.7	2.2
N.B.	2.1	2.4	1.7	1.8	1.7	1.8
Québec	2.0	2.3	1.7	1.5	1.3	1.7
Ontario	2.1	2.2	1.8	1.8	1.5	1.8
Manitoba	2.0	2.7	1.9	2.1	2.1	2.3
Sask.	2.2	2.3	2.0	2.8	2.7	2.9
Alberta	2.7	2.1	3.9	5.0	2.6	3.0
B.C.	1.6	2.0	1.7	1.8	1.7	2.3

E: Estimate; F: Forecast by TD Economics as at Jan. 2008.
Source: Statistics Canada.

RETAIL TRADE						
Annual average per cent change						
	97-06	2005	2006	2007E	2008F	2009F
CANADA	5.5	6.1	6.4	5.5	3.4	4.7
N. & L.	5.2	2.2	3.0	8.5	3.7	3.0
P.E.I.	4.5	3.0	4.1	7.8	4.1	4.4
N.S.	4.2	2.9	6.4	3.9	3.8	4.6
N.B.	4.6	5.4	5.8	5.7	3.6	4.0
Quebec	5.2	5.8	4.8	4.3	2.4	4.4
Ontario	5.3	4.7	4.1	3.5	2.2	3.9
Manitoba	5.4	6.4	6.0	8.0	4.0	4.9
Sask.	5.0	7.5	6.0	11.3	7.2	5.6
Alberta	9.1	12.1	16.1	9.2	5.2	5.8
B.C.	4.4	5.7	6.4	6.6	5.0	6.0

E: Estimate; F: Forecast by TD Economics as at Jan. 2008
Source: Statistics Canada

EMPLOYMENT						
Annual average per cent change						
	97-06	2005	2006	2007E	2008F	2009F
CANADA	2.1	1.4	2.0	2.3	1.2	0.9
N. & L.	1.4	-0.1	0.7	0.8	0.6	0.4
P.E.I.	1.5	2.0	0.5	1.3	0.4	0.6
N.S.	1.6	0.2	-0.3	1.3	1.0	0.9
N.B.	1.5	0.1	1.4	1.9	0.5	0.8
Québec	1.9	1.0	1.3	2.2	0.5	0.6
Ontario	2.3	1.3	1.5	1.6	0.8	0.8
Manitoba	1.3	0.6	1.2	1.5	1.0	0.8
Sask.	0.7	0.8	1.7	2.4	2.3	1.1
Alberta	2.9	1.5	4.8	4.8	2.4	1.5
B.C.	1.9	3.3	3.1	3.2	2.0	1.8

E: Estimate; F: Forecast by TD Economics as at Jan. 2008.
Source: Statistics Canada.

UNEMPLOYMENT RATE						
Per cent						
	97-06	2005	2006	2007E	2008F	2009F
CANADA	7.4	6.8	6.3	6.0	6.0	6.1
N. & L.	16.5	15.2	14.8	13.7	13.2	12.8
P.E.I.	12.4	10.9	11.1	10.2	9.9	9.9
N.S.	9.5	8.4	8.0	8.0	7.7	7.5
N.B.	10.5	9.7	8.8	7.5	7.6	7.3
Québec	9.1	8.3	8.0	7.2	7.3	7.4
Ontario	6.8	6.6	6.3	6.4	6.4	6.5
Manitoba	5.2	4.8	4.3	4.4	4.3	4.5
Sask.	5.5	5.1	4.7	4.2	3.8	3.9
Alberta	4.9	3.9	3.4	3.5	3.8	3.9
B.C.	7.5	5.9	4.8	4.2	4.3	4.2

E: Estimate; F: Forecast by TD Economics as at Jan. 2008.
Source: Statistics Canada.

HOUSING STARTS					
Thousands of units					
	2005	2006	2007E	2008F	2009F
CANADA	224.0	228.4	230.0	210.5	205.2
N. & L.	2.6	2.3	2.4	2.2	2.3
P.E.I.	0.9	0.8	0.7	0.6	0.6
N.S.	4.7	5.2	4.7	4.4	4.7
N.B.	3.9	4.1	4.0	3.6	3.8
Quebec	50.9	47.7	50.3	44.6	42.5
Ontario	77.8	74.2	68.7	64.4	64.4
Manitoba	4.7	5.0	5.7	5.4	5.1
Sask.	3.3	3.7	5.9	6.2	5.8
Alberta	40.6	48.9	48.7	42.5	38.5
B.C.	34.5	36.5	38.9	36.4	37.5

E: Estimate; F: Forecast by TD Economics as at Jan. 2008
Source: Canada Mortgage and Housing Corporation

HOUSING STARTS					
Per cent change					
	2005	2006	2007E	2008F	2009F
CANADA	-3.7	2.0	0.7	-8.5	-2.5
N. & L.	-11.7	-11.0	7.0	-8.1	3.5
P.E.I.	3.7	-9.9	-20.5	-8.0	3.0
N.S.	-2.1	10.3	-10.0	-6.3	7.0
N.B.	2.6	4.5	-1.0	-9.4	3.8
Quebec	-13.0	-6.3	5.5	-11.5	-4.7
Ontario	-7.9	-4.7	-7.4	-6.2	0.0
Manitoba	6.2	6.4	13.0	-4.2	-6.3
Sask.	-11.6	11.6	60.5	5.0	-7.5
Alberta	12.1	20.4	-0.5	-12.6	-9.4
B.C.	5.1	5.8	6.5	-6.4	3.0

E: Estimate; F: Forecast by TD Economics as at Jan. 2008
Source: Canada Mortgage and Housing Corporation

RESALE UNITS					
Thousands of units					
	2005	2006	2007E	2008F	2009F
CANADA	483.8	483.8	523.9	505.6	500.5
N. & L.	3.2	3.5	4.5	4.2	4.3
P.E.I.	1.4	1.5	1.8	1.6	1.7
N.S.	10.9	10.6	11.9	11.5	11.7
N.B.	6.8	7.1	8.2	7.9	7.7
Quebec	70.6	72.5	81.0	77.9	76.5
Ontario	197.0	194.8	215.5	208.7	204.9
Manitoba	12.8	13.0	14.1	13.6	13.8
Sask.	8.3	9.1	12.0	12.3	12.0
Alberta	65.9	74.4	72.3	68.0	66.3
B.C.	106.3	96.7	102.7	99.8	101.7

E: Estimate; F: Forecast by TD Economics as at Jan. 2008
Source: Canadian Real Estate Association

RESALE UNITS					
Per cent change					
	2005	2006	2007E	2008F	2009F
CANADA	5.0	0.0	8.3	-3.5	-1.0
N. & L.	-1.7	10.2	26.4	-6.0	1.5
P.E.I.	-3.4	3.0	18.5	-8.4	2.3
N.S.	23.1	-3.3	12.5	-3.0	1.6
N.B.	14.3	4.2	15.4	-4.5	-2.0
Quebec	2.0	2.6	11.7	-3.9	-1.8
Ontario	-0.2	-1.1	10.6	-3.1	-1.8
Manitoba	5.5	2.0	7.9	-3.0	1.4
Sask.	1.7	10.0	31.7	2.5	-3.1
Alberta	14.6	12.9	-2.8	-5.9	-2.5
B.C.	10.3	-9.1	6.2	-2.8	1.9

E: Estimate; F: Forecast by TD Economics as at Jan. 2008
Source: Canadian Real Estate Association

AVERAGE RESALE HOME PRICE					
Thousand \$					
	2005	2006	2007E	2008F	2009F
CANADA	249.2	277.0	306.3	325.6	341.9
N. & L.	141.2	139.5	145.7	154.5	163.0
P.E.I.	117.2	125.4	134.7	137.7	142.5
N.S.	159.2	169.2	181.1	191.7	204.0
N.B.	120.6	126.9	137.0	142.4	148.4
Quebec	184.6	194.0	207.8	215.3	224.5
Ontario	263.0	278.5	298.3	309.6	327.0
Manitoba	133.9	150.2	168.3	181.4	190.9
Sask.	122.8	132.1	171.9	209.7	227.1
Alberta	218.3	285.4	356.9	376.6	402.9
B.C.	332.2	391.0	438.0	473.0	501.4

E: Estimate; F: Forecast by TD Economics as at Jan. 2008
Source: Canadian Real Estate Association

AVERAGE RESALE HOME PRICE					
Per cent change					
	2005	2006	2007E	2008F	2009F
CANADA	10.1	11.1	10.6	6.3	5.0
N. & L.	7.4	-1.2	4.4	6.0	5.5
P.E.I.	5.8	7.0	7.4	2.2	3.5
N.S.	9.0	6.3	7.0	5.9	6.4
N.B.	6.8	5.2	8.0	4.0	4.2
Quebec	7.9	5.1	7.1	3.6	4.3
Ontario	7.3	5.9	7.1	3.8	5.6
Manitoba	12.3	12.2	12.0	7.8	5.2
Sask.	10.8	7.6	30.2	22.0	8.3
Alberta	12.1	30.8	25.1	5.5	7.0
B.C.	14.9	17.7	12.0	8.0	6.0

E: Estimate; F: Forecast by TD Economics as at Jan. 2008
Source: Canadian Real Estate Association