Global Economic Storm: Quebec Doing Rather Well, But Long-Term Challenges Remain

Montreal, September 1, 2009 – According to a report prepared by TD Economics at TD Bank Financial Group, the Quebec economy has withstood the shocks in the global economy relatively well over the last two years. This report is an update of a 2007 study entitled *Converting Quebec's Strengths Into Prosperity*. Over the last two years, Quebec has been able to make up some lost ground in terms of per capita income. Despite its enviable position, Quebec must face some significant challenges before economic prosperity is assured.

Even if the province did not grow as fast as the rest of Canada (ROC) in 2007, the Quebec economy performed moderately well in the second quarter of 2008, growing at an annual rate of 2.0%, while the ROC posted no growth. The Quebec economy also suffered its first significant drop in GDP in Q1-09, one quarter after the ROC (Q4-08). The job market has held up relatively well in this recession, with employment retreating by 1.8% since October 2008, as compared to a 2.6% retreat in the ROC.

Quebec's superior performance is explained in part by a better balance in the housing market: the value of existing houses stood firm, which supported consumer confidence and household consumption. Furthermore, the launch of a public infrastructure investment program (initially set at $30 billion and increased to $42 billion) created a situation where many public works projects were underway or about to break ground when the recession hit.

"A return to growth later this year will mark the end of a relatively short and weak recession in Quebec compared to the recessions of the 1980s and 1990s," said Don Drummond, Senior Vice President and Chief Economist at TD Bank Financial Group. "The current recession should run its course in four quarters. The last two recessions spanned six and eight quarters, respectively. Although the recession has been brutal in some parts of the country – particularly in Ontario, Alberta and British Columbia – so far Quebec has been able to avoid the worst."

TD's economists predict that the peak-to-trough change in Quebec's output will be -2.3%, as compared to -3.6% for the ROC. Total job losses are likely to reach 110,000 in Quebec, or 2.8%. The last two recessions produced job losses of 3.3% (1990-1992) and 7.3% (1981-1982).

Challenges ahead

Even if Quebec took a softer blow from this recession, the province still faces many challenges in the medium and long term, such as competition from the United States and emerging economies. The threat of a wider prosperity gap against other provinces still looms, and the same barriers keep it from catching up, in particular demographics and the labour force, and productivity.

The scale of some challenges, such as demography, has abated to some degree since our 2007 report. But others, such as international competition and the lower participation rate of older cohorts, have grown, not to mention new challenges such as the budget deficit. In addition, the old foundations of manufacturing and export sector competitiveness, such as a low Canadian dollar and cheap energy, will continue to erode.

"Health costs, below-market electricity rates, the cost of higher education, and $7-a-day childcare services are areas where the cost-benefit analysis will have be re-evaluated in the context of ever-increasing budgetary challenges" said Mr. Drummond. "Particularly since the new budget challenge will limit Quebec's margin of manoeuvre in the medium term, and measures are required to get back to balanced budgets."

Encouraging factors

Paradoxically, some of the very things holding Quebec back from increased prosperity can create favourable conditions for the province. The imminent demographic crisis and a shrinking active population create an obligation to see results in terms of immigration, labour mobility and participation as well as education. Pressure from foreign competitors holds the promise of greater productivity for exporters looking to succeed and expand.

Pressures to reduce greenhouse gas emissions and have businesses adopt environmental measures will drive up the costs of production and utilization of fossil fuels. As a result, demand will flow to sources of clean energy, an area where Quebec is particularly well positioned. In addition, Quebec can capitalize on the massive public infrastructure investment program and the progressive elimination of capital taxes by 2011 to foster economic growth.

"Quebec certainly has the tools it needs to enhance economic prosperity," concludes Mr. Drummond. "Before the current recession, it was difficult to imagine the province could withstand this storm so aptly. And the coming recovery may very well create opportunities for repositioning Quebec for the younger generations and those still to come."

The complete report, entitled *The Road Travelled and Road Ahead: An Update on the Quebec Economy* is available at: http://www.td.com/economics/special/pg0909_que.pdf. The original 2007 study, entitled *Converting Quebec's Strengths Into Prosperity*, is available at http://www.td.com/economics/special/db0407_que.pdf .

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