



Economic Clouds Sweep Across Canada

The credit crisis has economic storm clouds forming around the world, and Canada is no exception. As such, our provincial growth forecasts have been revised down across the board since the July Provincial Monitor, with even the strongest Canadian provinces not completely sheltered.

Central Canada... The challenges facing Central Canada are well documented—a manufacturing sector that is losing competitiveness and a U.S. recession crimping export demand. While Ontario managed to skirt a technical recession in Q2, real GDP was up just 0.2% y/y, the slowest pace in four years. Indeed, it was the export sector that weighed heavily on growth—final domestic demand was up a solid 4.2% y/y—with real net exports negative for the first time on record dating back to 1981. As the credit crunch continues to take its toll on the U.S. economy, Ontario will struggle to post any growth through 2009. Quebec, with its more favourable manufacturing sector mix (no auto production) will fare only slightly better.

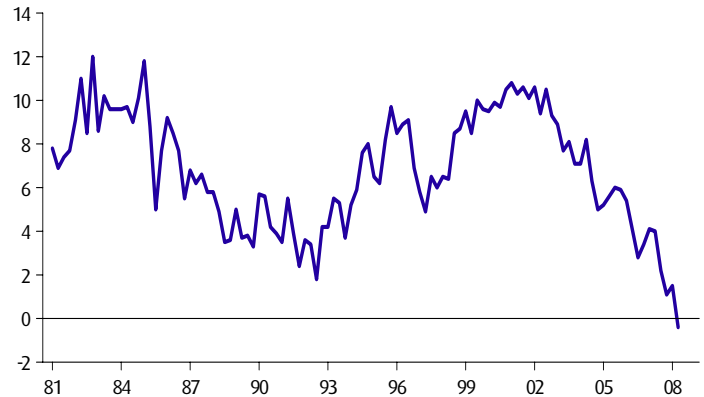
Ontario fiscal update... The province of Ontario today revised its budget estimate for FY08/09 to reflect a \$500 mln deficit (versus a balanced budget), as revenue estimates were cut to reflect slower-than-expected economic growth, and the government looks to manage spending. Revenues are now pegged at \$96 bln, down 0.9% from the first quarter update, as lower corporate income tax receipts take a bite. Interestingly, program spending is 0.2% higher than in the prior update at \$87.4 bln (total spending is \$96.3 bln), trimming the bottom line to a \$500 mln deficit after accounting for a \$200 mln reserve allowance (previously \$750 mln). If these estimates prove correct, it will mark the end of a three-year run of black ink in Ontario. The new estimates are based on the assumption of 0.1% real GDP growth in 2008, down from the 1.1% prior estimate and still a shade above our forecast. In 2009, the province expects a pickup to 0.7%, also more aggressive than our forecast.

Borrowing requirements in FY08/09 are pegged at \$24.8 bln, of which 55% has been completed.

Western Canada... The outlook in the once-resilient Western provinces is also deteriorating. The growing likelihood of a global economic downturn has dragged oil prices down more than \$70 in the space of just three months, to levels

Ontario: Trade Winds Blowing Strong

(Real Net Exports as a share of GDP)



Ontario - Fall Fiscal Update

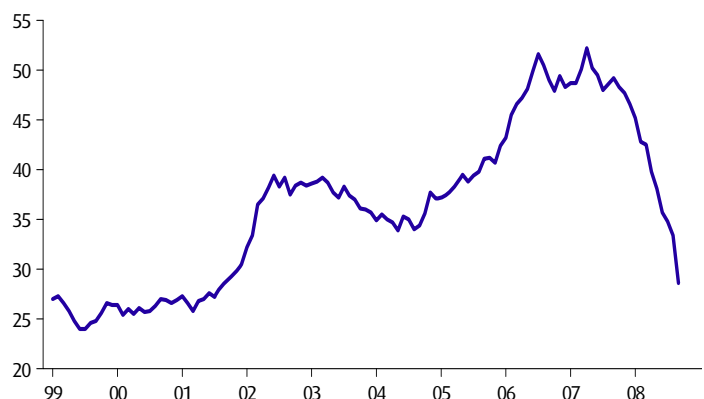
(FY2008/09, \$ millions)

	1st Quarter Forecast	Fall Forecast	Change from 1st Quarter
Revenue	96,920	96,002	-918
Expenditures	96,170	96,302	132
Operations	87,279	87,411	132
Debt Service	8,891	8,891	0
Balance Before Reserve	750	-300	-1,050
Reserve Fund	750	200	-550
Budget Balance	0	-500	-500

Source: Province of Ontario

Alberta: Building Boom Takes a Breather

(Housing Starts: 6-month m.a., 000s a.r.)





below those that represent break-even prices for marginal oil sands projects—most reports peg this in the \$80-\$90 range. At the same time, tighter credit conditions threaten to impact the resource and agriculture sectors. While large oil companies have built up plenty of cash during the commodity boom, the junior energy and farm sectors tend to be more financing-dependent. Indeed, Alberta Premier Stelmach said this week that, “*the glacial pace of bank financing is hindering big and small projects in oil and gas and infrastructure*”. Meantime, tighter lending standards and declining confidence threaten to weigh further on Western housing markets that have led the country for the past four years—average prices are down in B.C. for the first time since 2001, and residential construction in Alberta is running at half the pace of last year. More recently, anecdotes suggest that tougher access to financing has stalled condo projects in B.C., posing a further downside risk to construction activity. Importantly, this does not mean Western Canada’s economy is dead, as historically lofty oil prices will keep cash from existing projects flowing. Rather, a period of slow economic growth is in the cards after a four-year boom.

Commodity provinces’ fiscal situation... While Central Canada is paddling choppy fiscal waters, the commodity provinces remain in a much more favourable budget position, even as prices have come down sharply from their summer highs. Original budget estimates in these provinces had pegged commodity prices conservatively below prevailing market prices, but the latest round of fiscal updates likely overshoot to the upside. Saskatchewan, for example has now built \$120 oil and \$9.35 natural gas into its FY 2008/09 estimates (originally \$82 and \$6.55, respectively), above the fiscal year-to-date average and well above current levels. Alberta also looks to be high with its oil price assumption but in line on natural gas. On the bright side, both provinces are working with massive projected surpluses to the tune of \$8.5 bln in Alberta and \$1.5 bln in Saskatchewan, so the fiscal disparity between commodity and non-commodity provinces should remain intact in FY2008/09.

Commodity Price Sensitivity

From latest FY2008/09 provincial update

	Oil			Natural Gas			Potash		
	Budget	Latest	Sensitivity	Budget	Latest	Sensitivity	Budget	Latest	Sensitivity
	Est.	Est.	(\$/mns per \$1)	Est.	Est.	(\$/mns per \$1)	Est.	Est.	(\$/mns per \$1)
British Columbia	n/a	n/a	n/a	\$5.65	\$7.58	\$275	—	—	—
Alberta	\$78	\$119	\$130	\$6.75	\$8.50	\$1,140	—	—	—
Saskatchewan	\$82	\$120	\$19	\$6.55	\$9.35	\$28	\$335	\$718	\$4
Newfoundland & Labrador	\$87	\$87	—	—	—	—	—	—	—
<i>Actual (Apr-Oct)</i>		\$117			\$8.75				<i>Range: \$400-\$1000</i>

Fiscal action in Saskatchewan... The province put some of its fiscal muscle to work on Tuesday, announcing \$1 bln in additional debt reduction (to \$4.2 bln by March-09), a 50% increase in commitments to rebuild infrastructure (to \$1.5 bln) and income tax cuts (\$4,000 increase in the basic personal exemption and \$2,000 increase in child tax credit). The tax is expected to cost \$334 mln this year and \$300 mln in FY09/10. For reference, the Province’s latest projection was for a \$1.5 bln surplus in FY08/09, after a like-sized transfer to the financial security fund.

Fiscal action in B.C... The province announced a 10-point economic plan that includes tax cuts and increased infrastructure spending. The tax cuts (personal income, small business income and school property taxes) are expected to total \$485 million over the next three years. B.C. did not issue updated projections, but said they will remain in “deficit-free zone”. Exploration land sales and natural gas revenues have boosted the province’s coffers—a \$1 bln surplus at last check, with a \$750 mln allowance.

Atlantic Canada... The outlook in Atlantic Canada remains mixed. Capital projects like the Point Lepreau nuclear plant and New Brunswick potash mine have spilled over into solid domestic demand—retail sales growth is outpacing the national average in all Atlantic provinces through August. However, the region cannot escape the force of materially weaker U.S. demand, which should keep growth rates below 1.5% through 2009. The long term skilled labour challenge in the region persists, especially as capital projects come online, but an improvement in migration flows in recent quarters is an encouraging development.



Provincial Economic Summary

	Cda	BC	Alta	Sask	Man	Ont	Que	NB	NS	PEI	Nfld
Real GDP Growth (% change, chain-weighted)											
2005	2.9	4.5	5.3	3.5	2.7	2.9	2.0	0.5	1.8	1.3	0.2
2006	3.1	3.3	6.6	-0.4	3.2	2.1	1.7	3.0	0.9	2.6	3.3
2007	2.7	3.1	3.3	2.8	3.3	2.1	2.4	1.6	1.6	2.0	9.1
2008 f	0.7	1.6	2.0	3.0	1.8	-0.1	0.3	1.4	1.3	1.0	0.7
2009 f	0.0	0.5	0.3	1.3	0.6	-0.5	0.0	1.0	0.5	0.9	1.3

Employment Growth (% change)

2005	1.4	3.3	1.5	0.8	0.6	1.3	1.0	0.1	0.2	2.0	-0.1
2006	1.9	3.0	4.8	1.7	1.2	1.5	1.3	1.4	-0.3	0.5	0.7
2007	2.3	3.2	4.7	2.1	1.6	1.5	2.3	2.1	1.3	1.2	0.7
2008 f	1.6	2.4	2.7	1.7	1.8	1.5	0.7	0.9	1.2	1.5	1.7
2009 f	0.1	1.3	1.5	1.4	0.8	-0.5	-0.6	0.8	0.7	0.6	1.0

Unemployment Rate (percent)

2005	6.8	5.9	3.9	5.1	4.8	6.6	8.3	9.7	8.5	10.9	15.2
2006	6.3	4.8	3.4	4.6	4.3	6.3	8.0	8.7	7.9	11.1	14.8
2007	6.0	4.2	3.5	4.2	4.4	6.4	7.2	7.6	8.1	10.3	13.6
2008 f	6.1	4.3	3.6	4.2	4.1	6.4	7.4	8.5	7.7	10.7	13.0
2009 f	6.9	4.7	4.1	4.1	4.3	7.5	8.4	8.9	8.1	11.0	12.6

Housing Starts (thousands)

2005	224.0	34.5	40.6	3.3	4.7	77.8	50.9	3.9	4.7	0.9	2.6
2006	229.1	36.6	49.1	3.7	5.0	74.4	48.0	4.0	5.2	0.8	2.3
2007	227.6	39.2	48.1	5.9	5.8	68.0	48.5	4.1	4.7	0.7	2.6
2008 f	213.6	36.4	33.3	7.0	5.7	73.4	45.6	4.2	4.6	0.6	2.9
2009 f	185.0	31.0	35.0	5.5	4.6	60.0	38.5	3.4	3.3	0.6	3.2

Consumer Price Index (% change)

2005	2.2	2.0	2.1	2.2	2.7	2.2	2.3	2.4	2.8	3.2	2.6
2006	2.0	1.7	3.9	2.0	1.9	1.8	1.7	1.7	2.1	2.2	1.8
2007	2.1	1.8	4.9	2.9	2.1	1.8	1.7	1.9	1.9	1.8	1.6
2008 f	2.6	2.2	3.6	3.4	2.3	2.3	2.4	2.2	3.5	3.6	3.1
2009 f	1.8	1.7	2.8	2.9	1.8	1.6	1.7	2.0	2.3	2.2	2.5

Source: BMO Capital Markets

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