Newfoundland and Labrador: 2018–19 Outlook

IN TRANSITION WITH IMPROVING PROSPECTS

- **Newfoundland and Labrador's real GDP growth is forecast to slow from 2.1% last year to 0.5% in 2018 and 1.2% in 2019. Falling business investment and household spending are key sources of weakness.**
- **Rising mining and oil & gas output are expected to propel strong export gains this year and next, with new projects and stabilizing employment also improving the outlook relative to expectations in early 2018.**
- **The Province has implemented several longer-term diversification measures to reduce reliance on oil & gas, with initial effects expected to be felt in the fishery, forestry, agricultural and technology industries.**

BUSINESS INVESTMENT CONTINUES TO POSE A DRAG

Business investment in Newfoundland and Labrador is forecast to continue falling through 2019, underpinned by waning megaproject activity. The CAD 14 bn Hebron offshore oil platform—construction of which finished in mid-2017—no longer powers capital expenditures this year. Work on the on the Muskrat Falls hydroelectricity generation station—with an estimated budget of CAD 12.7 bn—is expected to wind down during 2018–19 as the project nears completion.

A number of major, albeit smaller mining and oil & gas industry ventures are expected to provide some support for capital outlays this year and next. Increased activity on the CAD 3.2 bn West White Rose Extension offshore drilling project, which began in late 2017, should offset some of the decline. The underground expansion of the Voisey's Bay nickel-cobalt-copper mine—recently restarted with an estimated capital cost approaching USD 2 bn—will gradually ramp up to peak construction levels by 2020. After changing hands last year, the Scully iron ore mine will need CAD 205.5 mn in capital expenditures for reactivation by Q4-2018. Several proposed long-term offshore oil exploration endeavours, if given the go-ahead, would propel additional investment gains.

DEMOGRAPHIC FACTORS WEIGH DOWN HOUSEHOLD SPENDING

Newfoundland and Labrador's demographic composition is expected to limit population and household spending gains. The net population decrease exceeding 2,200 from October 2017 to April 2018 was the largest since 2007, while the natural population contraction in the nine months to April was the largest ever recorded in a three-quarter period (chart 1). This trend will likely persist given the province's aging population. Weak fertility rates should weigh on Canada Child Benefit receipts, which contributed to the province's modest estimated upturn in consumer spending last year. We also do not foresee outflows to other provinces easing substantially as improving labour market conditions increase Alberta's draw.

The extent to which the province mitigates its population decline therefore depends heavily on immigration; on this front, we are more optimistic. After holding steady in 2016 and 2017, newcomers to Newfoundland and Labrador from January to July are up substantially versus year-earlier levels, anchored by a 38%

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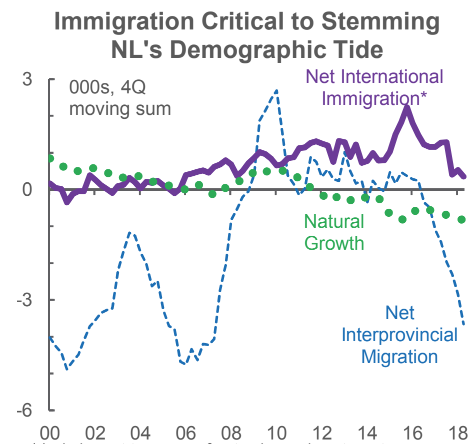
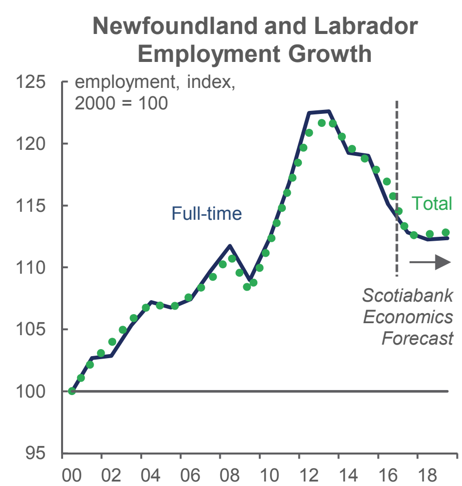
Chart 1



* Includes net temporary & returning emigrants, net non-permanent residents. Sources: Scotiabank Economics, Statistics Canada.

Chart 2



Sources: Scotiabank Economics, Statistics Canada.

y/y ytd jump in economic immigrants. Increases to Ottawa's 2018 and 2019 immigration targets provide a basis for further newcomer attraction, with additional support for retention expected to come via the *Atlantic Immigration Pilot*. The Province's strong record in integrating newcomers into the labour market is reflected in elevated immigrant earnings and employment rates over 2013–17 that trailed only the Prairie Provinces. It will draw on these successes in designing immigration measures to prioritize the technology sector in *Provincial Nominee Program* admissions.

JOB CREATION IS IMPROVING

We look for total employment to edge higher this year and next, albeit at a weaker pace than before the recession or during the run-up in energy project construction (chart 2, p.1). Modest projected job gains represent a marked improvement from early-year forecasts of 0.5%–1% decreases in 2018 and 2019 and from last year's decline approaching 4%, and should offer some support for consumer spending. Though year-to-date hiring is concentrated in part-time jobs, full-time positions appear to have stabilized since the job losses that followed energy project completion. Sectors likely to assist hiring include construction, manufacturing and engineering—via West White Rose and Voisey's Bay—wholesale & retail trade as a shopping centre opens in Paradise in 2019, and business services by way of a call centre in St. John's. Under its *Education Action Plan*, the Province will hire over 350 teaching assistants and specialists during 2018–20.

Yet other factors will dampen consumer expenditures. Nominal average weekly earnings for payroll employees are not expected to rise significantly without stronger job creation to absorb labour market slack. Rising interest rates should instill more caution among consumers, with the Province's *Temporary Deficit Reduction Levy*, in place until the end of the 2019 taxation year, eroding household disposable income gains.

HOUSING MARKET ACTIVITY TO REMAIN MUTED

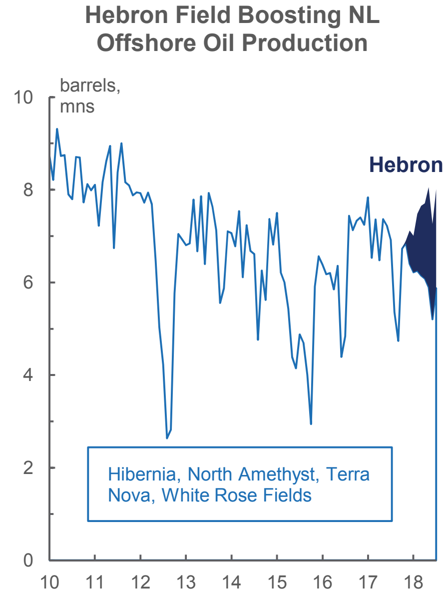
As in Canada's other net oil-producing provinces, Newfoundland and Labrador's housing market is characterized by an inventory overhang built up since the commodity price correction. In July 2018, completed and unabsorbed units in St. John's sat 220% above their 2010–16 average. Our forecast rise in housing starts to 1,500 this year largely reflects construction on a large multi-unit building that broke ground early this year. In 2019, we expect just 1,300 starts as the cumulative excess supply continues to discourage new building.

Home sales activity and price gains are also expected to remain soft this year and next. Oversupply conditions, modest employment growth, higher borrowing costs and stricter mortgage qualifying rules implemented January 1st, 2018 dominate the outlook. The Province's new *Home Purchase Program*—which began April 1st, 2018 and offers $3,000 grants for down payments on newly constructed homes valued under $400,000 (including sales taxes)—may provide a partial offset.

PRIOR INVESTMENTS SPUR MINING AND OIL & GAS EXPORTS

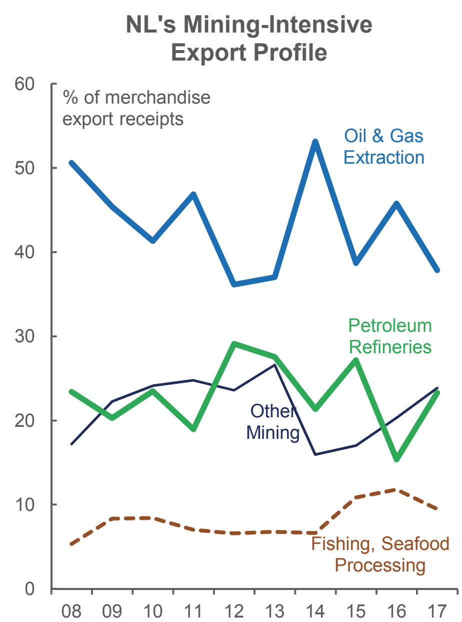
With the Hebron oil field entering its first full year of operation, rising oil production volumes will support export growth this year and next. While output at other wells is trending generally downward (chart 3), we expect Hebron to power oil production in the province 5–10% above 2017. Even stronger output growth of over 10% is anticipated in 2019 as production continues ramping up, lending greater support for oil exports. Provincial oil exports also have advantages via tidewater access and a premium for Brent oil prices over the WCS price benchmark.

Chart 3



Sources: Scotiabank Economics, Canada-Newfoundland and Labrador Offshore Petroleum Board.

Chart 4



Sources: Scotiabank Economics, Industry Canada.

We also look for climbing production to propel growth in mining exports during 2018–19. Mining (excluding oil & gas) accounted for nearly 21% of 2013–17 provincial merchandise shipments abroad (chart 4, p.2). First ore is anticipated late this year at the Wabush 3 iron ore pit after a temporary delay owing to a labour strike. A further boost to key iron ore exports is expected as we enter 2019 when the Scully mine reopens. A St. Lawrence fluorspar mine also began producing this year. Rising capacity at the Long Harbour nickel processing plant—construction of which ended in 2016—should spur fabricated metals output and export gains.

DIVERSIFICATION MEASURES ASSIST DOMESTIC OUTPUT AND EXPORTS

The outlook is modestly positive for the primary sector, which the Province has targeted in efforts to broaden Newfoundland and Labrador's economic base. Rising groundfish harvests—alongside funding for projects that aid transition to the species—should offset the drag from quota reductions on fishing and processed seafood output. Chinese tariff cuts as of late 2017, the Comprehensive Economic and Trade Agreement (CETA) with the European Union, and the *Atlantic Fisheries Fund*—with seven-year CAD 400 mn funding in partnership with the federal government—offer new export opportunities for value-added seafood products. For aquaculture, a CAD 250 mn salmon farm near Placentia Bay would advance the Province's goal of doubling commercial salmon production over 2016 levels. Opening of Crown land for agricultural development augurs well for dairy, poultry, hay and vegetable production. Lumber output should benefit from policies aiming to boost timber allocations and harvest levels that take effect next year.

The tentative US-Mexico-Canada Agreement (USMCA) free-trade pact reached last night represents another positive trade development. About 70% of Newfoundland and Labrador's 2013–17 non-energy merchandise export receipts were bound for the US market—the fourth-highest share of any province.

Sources of services sector export growth include tourism and the tech sector. The CAD 200 mn St. John's International Airport expansion continues and should advance the Province's objective of increasing tourism spending 42% over 2016 levels by 2020. The project's first phase finished early this year, adding capacity of 145,000 sq. ft. With targeted immigration, educational and procurement supports, the Province aims to scale up 40 so-called "high growth technology firms" over the next two years. Tech sector growth in Newfoundland and Labrador has generally lagged that of other provinces, and we believe a focus on integrating productive new technologies into existing areas of strength—like offshore oil exploration and mining—is a wise approach to developing the industry. The Oceans Supercluster earmarking public- and private-sector funding to develop Atlantic Canada's ocean industry should further support the sector plus offshore oil & gas and related segments.

Infrastructure spending should also aid diversification efforts. Outlays are expected to total CAD 2.5 bn during FY19–23, with CAD 555.8 mn from the federal government over the next decade for green and cultural and community infrastructure, public transit, and support for rural and northern communities. However, the Province's plan to balance the books by FY23 relies on substantial expenditure restraint that will likely pose a drag on growth.

CONCLUSION

Newfoundland and Labrador's economy is in a transition period. Mining and energy sector investments made prior to the commodity price downturn are beginning to bear fruit, but demographics will continue to pose challenges for the province's economic growth in the coming years. Diversification efforts attempting to leverage existing strengths are laudable and should provide a modest boost to some sectors during 2018–19, but the full benefits will likely only be felt over the longer-term.

Newfoundland & Labrador Profile, 2017

Population, July 1	529,000 (1.5% of Cda)
annual % change	*-0.3*
St. John's CMA	219,000 (41.5% of NL)
annual % change	*0.7*
Rest of Province	310,000 (58.5% of NL)
annual % change	*-1.0*
Real GDP, Chn. 2007$	28.4 bn (1.5% of Cda)
Per Capita Nom. GDP, $000	62.2 (106% of Cdn avg.)

Economic Outlook

	2010–16	16	17e	18f	19f
	annual % change except where noted				
Newfoundland and Labrador					
Real GDP	1.1	1.9	2.1	0.5	1.2
Nominal GDP	3.2	2.6	5.6	4.1	4.0
Employment	1.1	-1.5	-3.7	0.1	0.1
Unemployment Rate, %	10.2	13.4	14.8	14.6	14.2
Housing Starts, 000s	2.9	1.6	1.4	1.5	1.4
Canada					
Real GDP	2.2	1.4	3.0	2.1	2.1
Employment	1.1	0.7	1.9	1.2	1.0

Governance

Premier	Dwight Ball, Liberal (as of 2015)
Legislature	28 of 40 seats
Next Election	October 2019
Credit ratings:	
Moody's	Aa3(N)
S&P	A
DBRS	A(low)

* NL real GDP growth, 2017, by industry at basic prices.
Sources: Scotiabank Economics, Statistics Canada, CMHC, NL Legislature, Ratings Agencies.