Quebec: 2018–19 Outlook

ON A HIGHER GROWTH TRAJECTORY

- **With yesterday's release of Quebec real GDP by industry for May 2018 (here), our analysis of Quebec's current economic situation and the outlook through 2019 reflects existing provincial policy.**
- **After the breadth of its robust 2017 economic expansion, Quebec's growth is poised to pace the national average this year and next with gains in the 2% range. This contrasts starkly with 2012–16, when Quebec's 1.3% average annual real GDP advances significantly lagged Canada's 1.9% increases.**
- **Quebec's job creation in 2018–19 is expected to average a solid 1.1% annually, lowering its unemployment rate to 5.4% in 2019—the lowest in over four decades of published data.**

Quebec's 3.1% real GDP growth in 2017—the strongest since 2002—was broad-based, with 18 of its 20 major industries witnessing advances over 0.5% and 13 expanding by more than 1.0%. For Quebec's goods producers, last year's 3.5% climb was the steepest since 2000. For its services, the 2.9% rise in 2017 propelled the tenth consecutive annual rise in real services exports.

This year through May Quebec reports a 3.2% y/y rise in real GDP by industry. The goods-producers' recent pace over 4.0% is likely unsustainable given easing anticipated in construction and manufacturing gains. The increase in services output is expected to moderate from close to 3.0% y/y earlier this year to a still-solid advance of about 2.0% over the next year and a half, further assisting the province's external sector.

Technology remains key for many of Quebec's goods-producers and services. Entering 2018 on a tear, jobs in industries with a significant technology component, such as specialized manufacturing and business services, have jumped almost 7% y/y through May (chart 2, p.2). Real GDP in professional, scientific & technical services (PSTS), after climbing 5.1% in 2017, leads the services sector from January to May 2018 with a 6.1% rise y/y (chart 1). Quebec's information & communications technology output surged 5.8% last year, second only to Ontario.

Investments are positioning the tech sector to remain a key driver of economic growth in 2018–19**.** Public- and private-sector funding are earmarked for Artificial Intelligence ventures via the federal AI supercluster spanning the Quebec-Windsor corridor. Recent announcements include a $780 million investment over ten years, across the province, in video game design.

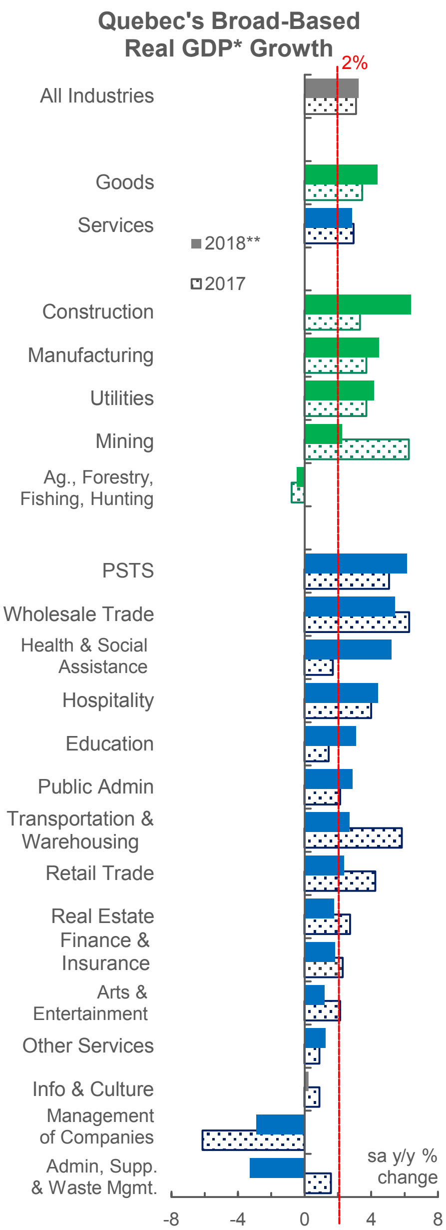
Momentum in hospitality services' is extending into 2018. Their activity through May rose 4.4% y/y, building on a 4.0% gain in 2017 that was aided by the national sesquicentennial and Montreal's 375th anniversary celebrations. During the first five months of 2018, international overnight visits are up 4.5% y/y after a record 3.1 million visits in 2017, encouraged by a Canadian dollar expected to remain below 80¢(US) this year.

CONTACTS

Marc Desormeaux
416.866.4733
Scotiabank Economics
marc.desormeaux@scotiabank.com

Mary Webb
416.866.4202
Scotiabank Economics
mary.webb@scotiabank.com

Chart 1



* Real GDP by industry at basic prices. ** Jan.–May. Sources: Scotiabank Economics, Institut de la statistique du Québec.

Metals mining has a positive outlook. The Westwood gold mine is planning further production increases after restarting its level 104 mining block, and output is up 13% y/y through June. Next year, the Whabouchi lithium mine is scheduled to begin ramping up production.

Manufacturing faces mixed prospects, with machinery a bright spot. After rising 8% last year, Quebec's machinery production should continue to climb given demand spurred by Central Canada's capacity constraints and the projected 3.6% rise in US industrial production this year. For the broader Quebec economy, the 2017 surge of 9.2% in machinery & equipment (M&E) investment volumes and a healthy Q1–2018 increase will assist future growth. From 2010 to 2016, M&E purchases failed to keep up with estimated depreciation. Quebec's aerospace outlook is upbeat with the dismissal of a key US trade action this past January, escalating C Series jet sales and the competitiveness of its parts producers.

Several of Quebec's other manufacturing industries, however, face hurdles that are largely related to US trade actions. August's final countervailing and anti-dumping duties on uncoated groundwood paper (which includes newsprint) are lower than the preliminary levies but still material. For softwood lumber producers, buoyant prices are helping to compensate for current US duties. The heavy US reliance on foreign aluminum suppliers to meet its domestic needs has mitigated the impact of the US tariffs implemented in June on Quebec's aluminum export volumes, though investment plans may be dampened. US resistance to Canada's supply management framework is a current concern for Quebec's dairy industry.

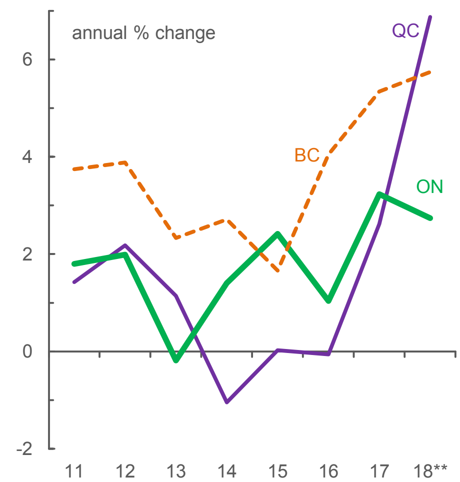
The *Québec Economic Plan*, since its introduction in March 2015 by the current provincial administration, has phased in personal and corporate tax relief, additional program spending, new infrastructure investment, and economic development initiatives as its fiscal position has allowed. The result, leveraged by additional federal funding, has been a pick-up starting in 2016 in real GDP in health & social assistance, education and core government services.

Real residential construction—rising 7.9% in 2017 and up 10.9% y/y through May 2018—should continue to benefit from a buoyant housing market this year before moderating in 2019. Lifted by strong H1–2018 activity, Quebec is the only province where housing starts are forecast to rise in 2018. A post-recession high in 2017 for job creation plus a 2.8% y/y rise in full-time positions as of July—the strongest of any province—are thus far dominating the potential slowing impact of rising interest rates and tighter mortgage lending standards.

The affordability of Montreal's housing relative to Southern BC's largest cities and Ontario's Greater Golden Horseshoe bestows a significant competitive advantage. Balanced 2017–18 homeownership conditions in Montreal are reflected in a sales-to-new listings ratio only slightly breaching the 60% (sa) threshold consistent with a seller's market despite surging job creation. Moderate monthly HPI growth generally between 4% and 9% (nsa y/y) across dwelling types over the same period further imply a balanced market. Montreal's rental vacancy rate near 3% in October 2017 indicates a balanced rental market and contrasts with tight rates around 1% in Vancouver and Toronto, and its rents averaged less than 60% of those for the latter cities in 2014–17. Balanced home ownership and rental markets point to relatively modest near-term home price appreciation and rent increases for Montreal, reinforcing its housing affordability edge (see our *Montreal Housing Outlook*, here).

Chart 2

Tech Sector* Employment



* Includes employment in industries such as aerospace, chemicals, pharmaceuticals, specialized machinery, engineering & design, ICT and scientific R&D. ** Jan.– May. Sources: Scotiabank Economics, Statistics Canada.

Quebec Profile, 2017

Quebec Population, July 1	8.4mn (23% of Cda)
annual % change	*0.9*
Montreal CMA	4.1mn (49% of QC)
annual % change	*1.2*
Quebec City CMA	812,200 (10% of QC)
annual % change	*0.7*
Rest of Quebec	3.4mn (41% of QC)
annual % change	*0.5*
Real GDP, C$ 2007 bn	353.7 (19.1% of Cda)
Per Capita Nom. GDP, $000	49.2 (84% of nat'l avg.)

Economic Outlook

	2010-16	16	17*	18f	19f
	annual % change except where noted				
Quebec					
Real GDP	1.7	1.4	3.1	2.1	1.9
Nominal GDP	3.6	2.7	4.5	3.9	4.1
Employment	1.3	0.9	2.2	1.4	0.9
Unemployment Rate	8.0	7.1	6.1	5.5	5.4
Housing Starts, 000s	44	39	46	48	42
Canada					
Real GDP	2.1	1.4	3.0	2.2	2.0
Employment	1.3	0.7	1.9	1.2	1.0

Governance

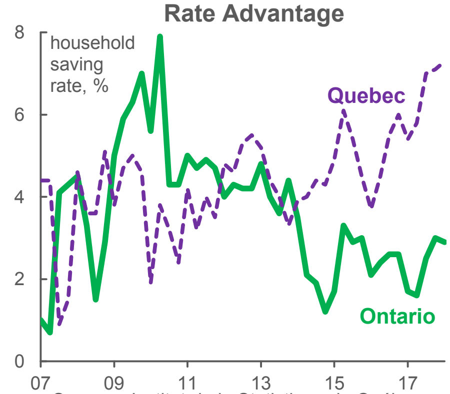
Premier	Phillippe Couillard, Liberal (since 2014)
Seats in legislature	68 of 125
Next Election	October 2018
Credit Ratings:	
Moody's	Aa2
S&P	AA -
Fitch	AA -
DBRS	A(high)

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

Retail trade gains are expected to cool following a second consecutive year of real growth near 4% in 2017. Households' disposable income climbed 5.7% last year—the sharpest advance since 2008—aided by full-time employment gains. As well, in 2017 personal income tax relief, the health contribution elimination and its refund for 2016 for lower- and middle-income residents buoyed consumers. As disposable income growth eased to 3.9% (q/q annualized) in Q1–2018, retail activity slowed to just 2.4% y/y through May, a more moderate trend expected to continue amid cooling job creation. Yet consumer spending will still be supported this year via a rate cut for the lowest personal income tax bracket from 16% to 15% retroactive to 2017. Moreover, further attention to the burden of household taxes and fees is likely next year regardless of the outcome of the upcoming October 1st provincial election. Quebec's elevated household saving rate, averaging 7.1% over the three quarters to Q1–2018, higher than many other provinces (chart 3), also positions consumers well for the future.

Chart 3

A Significant Saving Rate Advantage



Sources: Institut de la Statistique du Québec, Ontario Finance.

Wholesale trade is expected to witness solid, albeit slowing growth over the next eighteen months. Real GDP gains of 6.3% in 2017 and 5.4% y/y this year through May mirror the upswing in domestic and export sales, construction, and M&E outlays. Last year's $1 billion acquisition of a Pointe-Claire-based heavy equipment dealer, and the resulting plans for substantive workforce and facilities expansion to service anticipated mining and infrastructure investment, is a positive near-term development.

Transportation & warehousing's rise of nearly 14% in real terms over the three years to 2017—outstripping all other sectors—also mirrors Quebec's increased economic activity. Alongside capacity expansions at Montreal's port, other investments are proceeding under Quebec's *Maritime Strategy,* and should facilitate further provincial growth.

The Province's March *2018 Budget* rolled out a 4.0% increase in the *Québec Infrastructure Plan* outlays for fiscal 2018–19, and leaves investment at a robust $10 billion for each of the following two fiscal years. The *Plan*'s transit focus includes a new tram network for Quebec City and, in Montreal, the Metropolitan Express Rail Network and a long-awaited Blue Line subway extension. In Montreal, as the $4½ billion reconstruction of the federal Champlain Bridge nears completion, work on the Turcot interchange project will continue.

Acknowledged risks to Quebec's economic outlook include US trade actions and the potential escalation in international retaliation and global protectionism. Monday's announcement of a US-Mexico trade agreement appears constructive (see our note, here) and we continue to monitor NAFTA renegotiations. Quebec is better positioned to weather these challenges because of the 2017 economic expansion, income growth and improved investment.