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PROVINCIAL ECONOMIC OUTLOOK FOR 2007-08 BY SÉBASTIEN LAVOIE,
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Montréal, February 7, 2007 – Sébastien Lavoie, Economist of Laurentian Bank Securities, has disclosed this morning the Provincial Economic Outlook for 2007-08.

It is hardly new that the run-up in commodity prices provided an economic boost for the resource-based provinces of Saskatchewan, British Columbia, Alberta, and Newfoundland & Labrador during the last four years. At the same time, the manufacturing-based economies of Ontario and Quebec lost their mojo, hit by the unprecedented 40% run-up in the Canadian dollar and most recently, the US mid-cycle slowdown.

**Dichotomy in regional economic performances reached its peak in 2006**

Central Canada bears most of the brunt of the weakening in U.S. demand. We estimate Ontario and Quebec’s real GDP advanced at a pace lower than 2% in 2006, amid a contraction in the key manufacturing sector. The continued ascent in commodity prices added fuel to the fire in Alberta and British Columbia, where the economy rolled at a pace two to three times faster than other provinces last year. The diversified economies of Manitoba and Saskatchewan performed better than Central Canada, but not as well as Alberta and British Columbia. Lastly, the performance of Atlantic provinces was in the middle of the pack, with real GDP growth surrounding 2%.

**The disparity in provincial economic growth will narrow in 2007 and 2008, and remain in favour of the West**

Provincial economic performances should be more homogenous in 2007. The U.S. economic slowdown currently underway will continue to put a dent on economic activity from coast to coast. Real output growth in 7 out of 10 provinces is expected to be the same or a tad weaker than last year. The only exceptions to the rule will be Nova Scotia, Saskatchewan and Newfoundland & Labrador. Saskatchewan will benefit from a rebound in mining activity whereas a surge in oil production will fuel growth in Newfoundland & Labrador. Look for economic growth to stay moderate in the rest of Atlantic Canada. In Central Canada, Quebec and Ontario’s economies are forecast to advance below the 2% mark for a second consecutive year as the restructuring in export-oriented forestry and automotive sectors continues. Solid construction activity will keep Manitoba’s economic expansion above the national average of 2.3%. Alberta’s economy should come off the broil in 2007 in tandem with the on-going retreat in some commodity prices. The weakening external demand for wood products will moderate growth in British Columbia. Nonetheless, Alberta and British Columbia’s economies should continue to be the growth leaders for a fourth consecutive year in 2007, by advancing at a still-solid pace of 4.5% and 3.3%, respectively. In 2008, economic growth from coast to coast should be even less heterogeneous than in 2007. In a nutshell, we believe Alberta and British Columbia will stay on top for the following reasons:
• Despite the recent pull back, energy prices are expected to stay at elevated levels, providing positive spinoffs to the development of oil sands in Alberta and natural gas in British Columbia. Also, British Columbia and Alberta’s governments have more fiscal flexibility than other jurisdictions to introduce tax relief for households and businesses.

• Risks to the Quebec and Ontario’s economic outlook are tilted on the downside. The export-oriented manufacturing sector represents about one-fifth of real GDP. And, unfortunately, both employment and output in that sector contracted in both provinces since late 2006. This persistent weakness could lead to a deterioration in household’s confidence and spread to the rest of the economy. Further, exporters in Central Canada do not have the same price competitiveness as back in the late 1990s. In addition to the elevated loonie, the China-Canada competition in the U.S. market for manufacturing goods is intensifying, and could cause more pain to factories in Central Canada.

• Potential massive investments projects in the energy sector could fuel Atlantic Canada’s economy. But, given the uncertainty surrounding the final approval to some of these projects, the benefits reap in the Maritimes would be captured beyond 2008.

Uncertainties and challenges surrounding the 2007 Spring budget season
On the fiscal side, provinces are on track to meet objectives set during the previous 2006 Budget season for the current fiscal year 2006-07. The federal and provincial governments are currently preparing the ground for the 2007 Budget season, knowing that challenges are coming along the way. The moderate slowdown in the North American economy could translate into softer-than-expected revenues in coffers. Also, a potential agreement towards fixing the fiscal imbalance – i.e. changes to federal transfers and the equalization formula – could change to various extent the fiscal position of government’s finances. Upcoming elections in some provinces could also mix the cards.

Regional economic growth and stock market performances tie together
From an investment perspective, it is interesting to notice how strong the link is between regional economic growth and stock market performances. Between 2002 and 2006, the top 3 fastest-growing regions on a GDP basis – Alberta, British Columbia, Prairies – were also the regions where the return on investment on the stock market was the highest. Inversely, stock returns of firms located in Quebec, Ontario and Atlantic Canada were lower than in the West. Similarly, these 3 regions registered relatively softer economic growth than in Western Canada.

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