Environmental Scan

Newfoundland and Labrador

2017

KEY HIGHLIGHTS

The global economy strengthened in the second half of 2016, and the rate of growth is expected to increase through 2018. However, economic gains are expected to be uneven and modest in advanced economies.

In the United States, the labour market continues to strengthen and wage growth is rising. Economic growth is expected to improve in 2017 and 2018. Proposed tax cuts and trade reforms have raised optimism for investors and business. However, much of the uncertainty in global growth is from unknown policy actions of the new U.S. administration and how they may impact on global trade and international relations.

The Bank of Canada anticipates real GDP growth in Canada will strengthen from 1.3% last year, to 2.1% in both 2017 and 2018. Household expenditures are expected to be the main source of growth in 2017. Government stimulus spending, low interest rates and slowly rising commodity prices should also support economic growth through 2018. Although exporters have been successful in diversifying into global markets outside of the U.S., increased protectionist measures south of the border nonetheless pose a downside risk to the outlook.

In Newfoundland and Labrador, employment is expected to decline over the next few years. Capital investment is expected to weaken considerably with the winding down of major construction projects. As the provincial government faces budget deficits exceeding $1 billion, the provincial government is excerising greater fiscal discipline and generating more revenue through higher taxes. The impact of these measure will be felt across all sectors of the economy. While the start of production at the Hebron Oil Project will raise royalties for the government, key industries such as the fishery face very challenging circumstances, with significant declines in the shellfish stock. The province also faces demographic challenges, with an aging population, low birth rates and relatively low immigration levels.

GENERAL OVERVIEW / ECONOMIC CONTEXT

The Global Economy: *Global economic activity remains subdued, and recovery is expected to be uneven and modest in advanced economies*

Global economic conditions appear to have strengthened in the second half of 2016, following a slow start to the year where economic activity fell short of expectations. Growth in real GDP is now anticipated to come in just shy of 3% for 2016, which would be slightly weaker than what it was in 2015. The mid-year turnaround is partly due to a recovery in manufacturing output and a more general pickup in growth in advanced economies. The euro area, meanwhile, seems to have avoided any dramatic economic consequences following the United Kingdom's vote to exit the European Union. Nonetheless, growth prospects across much of Europe lie below historic rates and remain tempered by lingering concerns over further instability associated with rising protectionism and high debt levels.

The United States economy rebounded after a weak first half in 2016. The recent surge in consumer and business confidence is encouraging moving forward. Meanwhile, investors are showing increased optimism, particularly since the conclusion of the U.S. election and a promise of additional fiscal measures (including tax cuts) and trade policy reforms on the part of the new U.S. administration. The labour market continues its steady rebound, with the unemployment rate now sitting below 5% and wage growth beginning to accelerate. More money in the hands of consumers has helped boost retail sales and demand for new housing. Despite a rise in mortgage rates since the last U.S. elections, housing starts in the last quarter of 2016 reached their highest level since the onset of the 2008 global economic recession. Mounting inflationary pressures suggest further U.S. interest rate increases in 2017, which could exert further downward pressure on the Canadian dollar. This should be partly offset by a higher price for oil, however, which is expected to remain fairly stable around $55 per barrel – well off from the $100 per barrel seen in 2014.

Projection for global economic growth

	Projected growth (%)		
	2016	**2017**	**2018**
United States	1.6 (1.5)	2.2 (2.1)	2.3 (2.0)
Rest of the World	1.6 (1.6)	1.3 (1.3)	1.5 (1.5)
China	6.6 (6.5)	6.3 (6.4)	6.4 (6.3)
Oil-importing (Emerging Markets Economies)	3.3 (3.4)	3.6 (3.8)	4.4 (4.3)
Euro Area	1.0 (0.9)	2.1 (1.9)	3.0 (3.0)
World	2.9 (2.8)	3.2 (3.2)	3.6 (3.5)

Sources: Bank of Canada, *Monetary Policy Report, January 2017*
Numbers in parenthesis are projections used in the Bank of Canada's previous Monetary Policy Report (October 2016)

According to the Bank of Canada's January 2017 Monetary Policy Report, growth in real GDP in the U.S. is expected to be better in 2017 (+2.2%) and 2018 (+2.3%), after a disappointing year in 2016 (+1.6%). The global economy is also expected to see stronger economic growth over the next two years. Some caution is required however, as most major forecasters express considerable uncertainty in their outlook, largely related to the unknown policy actions of the new U.S. administration and how it could impact international relations and trade flows.

Canada: *Economic activity rebounding slowly*

Following a weak performance in the first half of 2016, which was partly a reflection of the disruption caused by the Alberta wildfires, economic growth rebounded significantly in the second half of the year. The Bank of Canada anticipates real GDP growth in Canada will strengthen from 1.3% in 2016, to 2.1% in both 2017 and 2018.

Activity in the service sector has been relatively healthy and is expected to remain the main source of growth in the medium term. Nevertheless, the goods sector, which has been battered by the slump in commodity prices and competitiveness challenges, has begun to grow again following two years of near-steady declines.

Modest expansion of exports and investment will be supported by increased foreign demand, but uncertainty remains due to the new U.S. administration's position on important trade agreements, including NAFTA. Even though Canada does not seem to be the primary focus of the reopening of the agreement, the country could experience collateral damage from new trade restrictions. While stronger economic growth south of the border is supportive, the dollar's recent appreciation versus the U.S. currency will limit net trade's contribution to overall growth.

Household expenditures, with the support of steady but moderate employment gains and low interest rates are projected to be the primary contributor to growth in 2017. Elevated levels of household debt, however, could eventually begin to weigh on consumption, particularly if borrowing costs rise faster than anticipated. As it stands, however, the Bank of Canada is expected to keep interest rates at current levels until the spring of 2018. Otherwise, government stimulus spending should provide some support to economic growth in 2017 and 2018. As commodity prices rebound gradually, the persistent drag from business investment should diminish significantly in 2017, with positive contributions anticipated in 2018. The possibility of significant corporate and personal income tax cuts in the United States, however, could result in the deterioration in Canadian competitiveness and incite businesses to invest in the United States, rather than in Canada.

Newfoundland and Labrador: *Economic growth will slow in the years ahead*

The province experienced mixed economic performance in 2016. Capital investment was near record levels as major projects such as the Muskrat Falls Hydroelectric Development and Hebron Oil Project continued. In addition, consumer spending was strong with retail trade approaching $9 billion in 2016. With a struggling labour market and increased taxes, the Conference Board of Canada forecasts a decline in real gross domestic product (GDP) of 1.8% in 2017. This is the weakest economic performance in the country. With the anticipated start of production in the Hebron offshore oil field, the Conference Board of Canada forecasts an increase of 4.4% in real GDP in 2018, even though business investment and consumption are expected to be low.

Oil royalties play a significant role in provincial government revenues. Earlier in the decade when oil prices were higher, these royalties have typically represented over thirty percent of every dollar the provincial government has taken in. Falling oil prices and production have resulted in a negative impact on the provincial government's fiscal position. A lower than expected price of oil was the main contributor in raising the provincial government's budgeted deficit for 2015/16 from $1.1 billion in the spring of 2015 to more than $1.9 billion by the end of 2015. However, through reduced expenditures, higher revenues through taxation, and higher than anticipated oil prices, the provincial government reduced its deficit for 2016/17 to $1.1 billion.

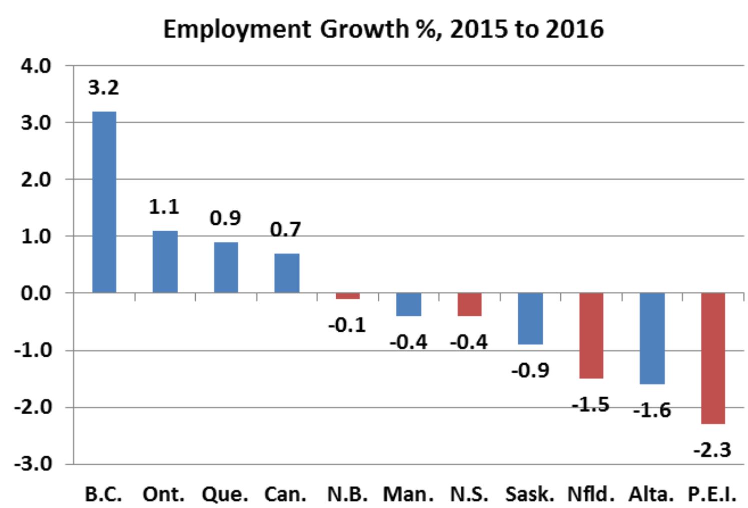
Despite some improvement in oil prices, investment in projects related to the Alberta Oil Sands is expected to remain relatively low. This has a direct impact on workers from Newfoundland and Labrador who would typically commute to Alberta to work. Beyond the direct income reduction, businesses that rely on income from Alberta work will also experience negative effects.

One of the biggest challenges facing the Newfoundland and Labrador economy is the changing demographics of the region. A relatively low birth rate, as well as relatively low levels of immigration into the province and net outflows of youth to other provinces have resulted in an aging population that is among the oldest in Canada. In addition, rural parts of the province are older and aging faster than urban areas. The aging population is seen as a challenge to providing necessary labour input for development projects in the province, and may restrain economic activity in general. Immigration is seen as a very important piece in the financial future of the province, not only from the point of sustaining the province's population size, but also filling high-skilled positions. As part of the Atlantic Growth Strategy, the provincial government plans to increase its immigration quota from 1,500 to 2,200 by 2022.

LABOUR MARKET CONDITIONS

Canada: *The labour market has been resilient despite weakness in the economy*

Labour market conditions deteriorated somewhat in 2016, thanks in part to slumping commodity prices. Although the economy added around 130,000 jobs last year, more than 80,000 were in part-time employment. The increasing shift towards part-time gains intensified during the final months of the year. More generally, the average pace of job gains over the past two years is down sharply from the typical gains seen prior to the recession. In 2016, job losses were concentrated in provinces that faced the greatest exposure to the slump in commodity prices earlier in the year, such as Alberta, Newfoundland and Saskatchewan. Otherwise, with the exception of British Columbia, job gains were relatively weak across the board in the other provinces. The unemployment rate, which has been stuck at around 7% for the past four years, was broadly unchanged in 2016 thanks to a bigger rise in the labour force. The participation rate, however, edged down in 2016 and has been on a well-established downward trend since the onset of the recession. Indeed, since 2008, the latter has fallen from 67.5% to 65.7% and is expected to fall further over the outlook period.



Source: Statistics Canada, Labour Force Survey

The majority of job gains in 2016 were concentrated among older workers (aged 55 plus), a trend which has been firmly in place since the recovery began in 2009. The increasing share of jobs going to those in the older age cohort, which might have a higher propensity to work fewer hours, could explain the shift towards part-time work. In comparison, employment among the core working-age (25-54 years) group was up only slightly by 0.2% or 26,700 jobs, while younger workers (15-24 years) experienced a slight decline (-0.2% or - 5,100 jobs). Compared to the previous year, the Services-producing sector generated more than 295,000 jobs in 2015, while the Goods-producing sector experienced job losses largely due to a 5.7% (or 17,700 jobs) decline in the Mining, quarrying, and oil and gas extraction industry.

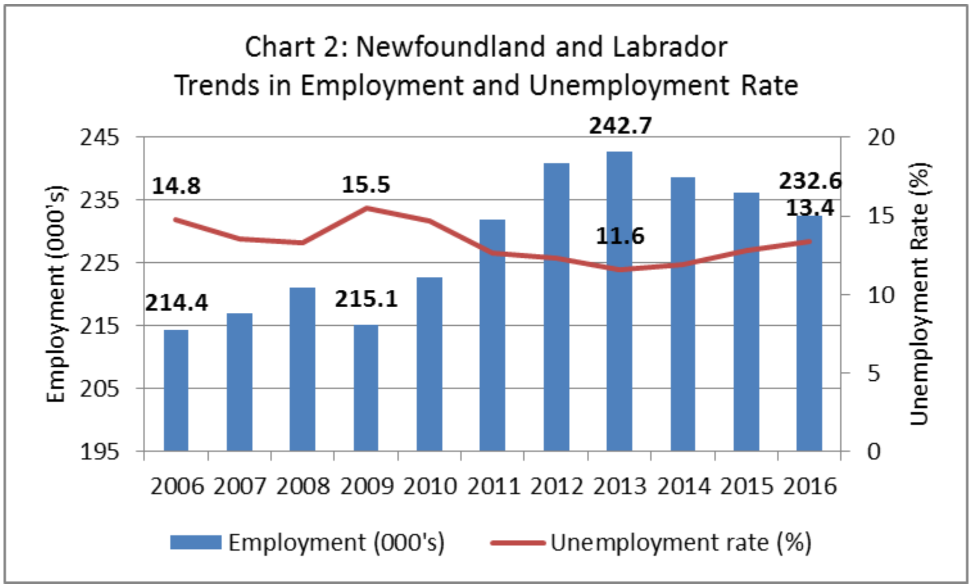
Newfoundland and Labrador: *Employment levels will decline for the next few years as major construction projects are completed and government fiscal measures are felt through the economy*

Labour market conditions in Newfoundland and Labrador have been showing signs of weakness over the last three years. In 2016, the unemployment rate increased for the third year in a row after reaching a record low of 11.6% in 2013. This has been mainly due to a drop in employment levels which declined twice as fast as the labour force. The unemployment rate was the highest the province has experienced since 2010, when it reached 14.7%. The province's participation rate reached a record high in 2012 of 62.0%, but has declined to 60.5% in 2016 as optimism in the labour market has decreased. The size of the labour force has declined by 5,800 people since reaching record highs in 2012 and 2013.

Between 2013 and 2016, the size of the labour force for those aged 25 to 54 years declined by 6,800 or 3.7%. The youth (aged 15-24 years) labour force decreased by 800 or 2.2%, while there were gains for those aged 55 years or older (1,700 or 3.1%). Nearly all of the employment decline over this time was from the core working age group (25 to 54 years). Youth employment decreased slightly by 700 jobs, while the number of jobs among those 55 years and older increased by 600 jobs or 1.3%. The province's population has been aging, with more people approaching the latter stages of their work careers, fewer youth to fill the losses due to retirement, and a shrinking number of people who represent the core work-age population.

Since reaching a record high in 2013, the employment decline has been evenly split between the goods-producing and service-producing sectors, though the smaller goods-producing sector has decreased at a faster rate (-9.3% for goods compared to -2.6% for services). In the services-producing industries, most of the decline has been in Public administration (-4,000), and Educational services (-3,800). Employment in Public administration is the lowest it has been since 2006, while Educational services reached its lowest point since 1977. However, Wholesale and Retail trade increased by 5,300 jobs, reaching a new high in 2016.

In the goods-producing sector, the employment decline since 2013 has been mainly in Mining, quarrying, and oil and gas extraction (down 2,800 jobs). In addition, Manufacturing lost 1,900 jobs to reach its lowest point on record in the province.



Source: Statistics Canada, Labour Force Survey Estimates

Labour market conditions in the province are expected to further weaken over the next two years. The provincial economy has been negatively affected by relatively low prices for commodities such as oil and iron ore, and construction activity on major projects will decline further as they reach completion.

The mining industry has been hit hard over recent years, particularly in Labrador West. Wabush Mines ceased operations in February of 2014, resulting in approximately 500 job losses. The Iron Ore Company of Canada's (IOC) operations in Labrador City has also experienced challenges. While iron ore prices have improved over the past year, they remain around half the record price reached in February 2011. However, there has been a recent development that is expected to boost the long-term prospects of the mining industry. A decision concerning the development of the Wabush 3 expansion project had been delayed since May of 2016, but the company recently announced that it will be going ahead with production in the second half of 2018. This will increase output by five million tonnes per year and extend the life of IOC's operations in the region by twelve years. This is very good news for an area that is heavily reliant on the mining industry.

While current oil projects such as Hibernia, Terra Nova and White Rose continue operations and Hebron is expected to start production by the end of 2017, activity in the industry is expected to remain more subdued in comparison to recent years. Suppliers to the industry have experienced additional cost pressures and have been forced to cut costs and innovate to remain competitive. Husky Energy has deferred its investment decision concerning the West White Rose Expansion. First production of oil had been anticipated to occur in 2017. A positive note in the oil industry pertains to the potential that exists offshore in the Flemish Pass Basin. Statoil is looking at its options, but development of the oil field remains years away. In addition, oil companies have pledged more than $750M in work commitments related to offshore exploration. This action points to the long-term potential that exists in the industry.

Construction employment has been slowly declining since reaching a record high in 2013. Construction on the Muskrat Falls Hydroelectric Project is past its peak, while construction activity related to the Hebron Oil Project has dropped considerably, with first oil expected by the end of 2017. Housing starts declined in 2016 and are expected to trend lower over the next few years as well.

The fishery faces challenging circumstances. Shrimp and crab have been the industry's main source of revenue over the past decade, but there have been notable quota cuts for these species in the last two years in particular. For example, the stock for shrimp in Zone 6, an important area for this species along the Northeast Coast to Southern Labrador, is being designated as "critical". The stock is down 25% from 2015, and 87% lower than what it was in 2006. This will have a negative effect on the harvesting sector since shrimp have been such an important source of income. While groundfish is slowly making a comeback, it is far away from developing to the point of being able to replace shellfish losses.

The tourism industry has benefitted from a low Canadian dollar, making it relatively cheaper than past years to visit the province. The provincial government has placed significant investment in the promotion of the province as a tourist destination. As of September 30, 2016, there were 88,544 non-resident visitations by automobile (up 6.2% over 2015). Other tourism indicators also point to a positive year. Examples include the number of visits to provincial historical sites, airport activity, and occupancy rates. In addition, a more expensive U.S. dollar has translated into more tourism activity from Canadian residents. Tourism is seen as a key sector in diversifying rural economies that have been heavily dependent on the fishery.

An aging population is expected to keep the demand for Health care services high in the province. Employment in Health care has trended upwards over the past decade and is very close to its peak in 2013. This industry is expected to be a major source of employment over the next few years. However, employment growth in Health care will continue to be challenged by restraints on fiscal spending, as governments deal with a tightening of budgets in response to falling revenue.

Employment in Education is affected by two key factors - demographic change and fiscal restraint. A large component of employment in Education is in the primary and secondary school system. This industry has been challenged due to declining enrolments in the face of an aging and slowly growing population, and fiscal restraint.

The number of jobs in Public administration has declined considerably since 2013, when it reached a high of 19,300. Employment in 2016 was 15,300, down 21% in three years. Growth prospects over the next few years will be limited due to budgetary challenges.

The Regional Occupational Outlooks in Canada (ROOC) forecast, produced by Service Canada, anticipates a decline in employment over the 2016-2018 forecast period. Most of the job losses over this period are expected to be in Construction, Retail trade, and Professional, scientific and technical services.

Economic Regions

The labour market performance of the economic regions in Newfoundland and Labrador varies widely. Labour market conditions in the Avalon Peninsula have been generally positive, while the labour markets of the other regions have struggled in comparison. The Avalon Peninsula's better labour market performance is mainly because it is home to the St. John's Census Metropolitan Area (CMA), which represents over 80% of the economic region's labour force and had an unemployment rate of 7.8% in 2016. The working age population of the Avalon Peninsula has continued to expand while the other economic regions have experienced varying degrees of decline. The South Coast-Burin Peninsula and Notre Dame-Central Bonavista Bay economic region had the largest decrease between 2006 and 2016, with a decline of 4.2% in the working age population. The decrease was less notable (-1.0%) in the West Coast-Northern Peninsula-Labrador region.

Working Age Population 15+ (000's) by Economic Region
2006-2016

	2006	2016	Change	% Change
Newfoundland and Labrador	**425.6**	**444.3**	**18.7**	**4.4%**
Avalon Peninsula	210.2	235.1	24.9	11.8%
South Coast-Burin Peninsula and Notre Dame-Central Bonavista Bay	127.4	122.1	-5.3	-4.2%
West Coast-Northern Peninsula-Labrador	88.0	87.1	-0.9	-1.0%

Source: Statistics Canada, Labour Force Survey

Changes in labour force size mirror the change in the working age population for the economic regions within the province. The Avalon Peninsula's labour force has increased by 22,300 people (+16.9%) between 2006 and 2016, with this growth being attributed to the St. John's Census Metropolitan Area (CMA). The South Coast-Burin Peninsula and Notre Dame-Central Bonavista Bay region dropped by 3,500, or 5.2%, while the West Coast-Northern Peninsula-Labrador region showed a smaller reduction in labour force size (-1,700 or -3.3%) over the past decade.

Employment has followed a similar pattern, with the Avalon Peninsula accounting for most of the province's employment growth over the past ten years, increasing by 20,700 jobs (a 17.6% gain). Employment levels in the South Coast-Burin Peninsula and Notre Dame-Central Bonavista Bay region declined by 2,000 jobs or 3.7% over the ten-year period. The West Coast-Northern Peninsula-Labrador region had a small decline of 500 jobs between 2006 and 2016 (down 1.2%). However, employment losses have been deeper (-1,800) when compared to 2014, when the number of jobs in this economic region was relatively strong.

Employment (000's) by Economic Region
2006-2016

	2006	2016	Change	% Change
Newfoundland and Labrador	**214.4**	**232.6**	**18.2**	**8.5%**
Avalon Peninsula	117.5	138.2	20.7	17.6%
South Coast-Burin Peninsula and Notre Dame-Central Bonavista Bay	53.8	51.8	-2.0	-3.7%
West Coast-Northern Peninsula-Labrador	43.1	42.6	-0.5	-1.2%

Source: Statistics Canada, Labour Force Survey

Of note, the growth experienced in the Avalon Peninsula has cooled off over the past four years, after growing significantly between 2010 and 2012. While the size of the labour force remains high, employment has declined by 3,300 jobs since 2012 (down 2.3%), with full-time losses outweighing gains in part-time work.

Despite an increasing unemployment rate in recent years, the Avalon Peninsula is the only economic region in the province with a lower unemployment rate than the province overall (10.5% vs 13.4% in 2016). It was also lower than the region's unemployment rate in 2006 (11.1%). While the unemployment rate in the South Coast-Burin Peninsula and Notre Dame-Central Bonavista Bay region improved by 1.2 percentage points between 2006 and 2016, it remained high at 18.6% in 2016. Employment in the region decreased by 2,000 jobs over the past decade, and the size of the labour force declined at a faster rate, with a loss of 3,500 people. In the West Coast-Northern Peninsula-Labrador region, the unemployment rate in 2016 was 1.6 percentage points lower than ten years earlier, at 16.0%. Employment levels showed little change while the size of the labour force declined by 1,700 people.

KEY CHALLENGES AFFECTING THE ATLANTIC REGION'S LABOUR MARKET

Demographic Challenge

The Atlantic Region is aging more rapidly than the rest of Canada. Coupled with out-migration, population aging is expected to negatively impact the labour market and public finances. As all members of the baby-boom cohort reach age 65, the aging phenomenon will accelerate in Atlantic Canada in the coming decades. Managing pensions and overall public finances will become more challenging with fewer workers and more retirees. In the Atlantic Region, the percentage of seniors living with low-incomes was 6% in 1996. Since then, the proportion has more than tripled to 21% in 2014. If this trend continues, as a higher percentage of the population move into the 65 years + age group, it could lead to higher spending commitments on the Old Age Security (OAS) and the Guaranteed Income Supplement (GIS).

With fertility rates remaining low and continued losses with respect to interprovincial migration, projected international migratory increase would be the main driver of population growth in the Region. Immigration to Atlantic Canada has risen in recent times due to the expanded use of Provincial Nominee Programs and this trend is expected to continue in the years ahead. The Atlantic Provinces Economic Council (APEC) estimates that the total number of provincial nominees in Atlantic Canada could reach 10,600 annually, if the provinces fully use their existing federal allotments.

Trade Uncertainty

International exports represent an important source of revenue to the Atlantic Region, valued at nearly $28 billion in 2015. A number of industries in the region have managed to benefit in recent years from favourable export conditions, namely a lower Canadian dollar and the strengthening economies of key trading partners. Despite this, the Region has seen a 25% drop in the value of international exports in the past two years, primarily due to a large, prolonged decline in commodity prices and reduced production in natural resource and energy industries. The impact on the Region has been most severe in Newfoundland and Labrador and New Brunswick. Furthermore, recent geopolitical events and a growing protectionist sentiment have heightened concerns around international relations and trade stability. Important trade agreements for Canada and the Atlantic Region, such as NAFTA, APTA and the Softwood Lumber Agreement, face uncertain futures, and many Canadian industries stand poised for possible trade barriers (tariffs) to enter the U.S. market. These risk factors, along with a weak outlook for commodity prices, are inevitably impacting businesses as they make investment and hiring decisions.

The implications for the labour market are potentially large, considering roughly 1 in 6 jobs across the country are tied to exports, either directly and indirectly. This issue could pose a higher risk to small communities in Atlantic Canada considering a greater portion of workers, at roughly twice the incidence compared to urban centres, are employed in export-oriented industries (e.g., agriculture, manufacturing). Employers adversely affected by dramatic changes to terms of trade could be forced to adjust their workforce and operations.

Rural-Urban Divide

Atlantic Canada has one of the most rural populations in the industrialized world, and the Region's weaker economic and labour market outcomes compared to the rest of Canada, are largely due to the poorer performances seen in the rural areas. Employment in the core population centres in Atlantic Canada expanded by 41,200 jobs between 2011 and 2016. In comparison, employment in the small population centres and rural areas declined by a similar amount (41,300 jobs) over the same period. While there are no significant gaps in performances between Atlantic Canada population centres and the rest of the country, there exists a wider prosperity gap between rural Atlantic Canada and rural areas in the rest of the country. For example, in 2016, the unemployment rate in rural Atlantic Canada was 14.4% compared to 7.6% for rural areas in the rest of the country. These diverging trends reflect the concentration of export-oriented primary and resource-related manufacturing job losses in rural communities. Furthermore, chronic out-migration of the younger segments of the population is changing the composition of the labour force in rural Atlantic Canada and exerting further pressures on the pool of available labour in these areas. Recent suggestions by the Economic Advisory Council points to demographic groups such as indigenous people, lower income earners, women with young children and Canadians aged 55 to 69 years old as untapped resources that could augment the pool of available labour should the government find ways to get more of them into the job market.

Fiscal Challenges

Rising provincial government debt levels continue to pose a range of challenges to the Atlantic Region. In 2015/16, the net debt-to-GDP ratio across the Atlantic Provinces was 39.8%, which was up significantly from 30.7% in 2011/12. This means that rising shares of provincial government revenues are going towards servicing the debt, potentially at the expense of programs and services. With the exception of Newfoundland and Labrador, provincial governments across the region have made some progress towards lowering their respective deficits and returning to balance. The result of these lower deficits, however, is that households and businesses across the region are now carrying a higher tax burden. In addition to having the highest sales tax rate in the country, the Atlantic Provinces also have the highest corporate and personal income taxes. Personal income taxes across the region are most strikingly high in New Brunswick and Nova Scotia. More generally, the labour market implications of higher income taxes are that it is increasingly difficult for employers in the region to attract and retain workers. This makes addressing certain labour shortages challenging, particularly in some higher-skill and better paid occupations. High corporate income taxes relative to the rest of the country also makes it challenging to attract investment and employment in the region.

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