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Ontario Economic Overview

July 2007

Highlights

- Economic growth in Ontario is trailing the national average. It was one of the slowest growing provinces in the country in 2006. Continued slowed growth in 2007 will keep the province behind the national average.
- Higher energy costs, a higher Canadian dollar, and competitive pressures from lower-cost centres are squeezing the province's manufacturing industries. The result has been slower growth in manufacturing output and a loss of 93,000 jobs between 2004 and 2006.
- Strong growth in services has helped compensate for lost production jobs. The unemployment rate was on par with the national average in 2006. Rising real estate values and relatively low interest rates have supported healthy consumer spending.
- The magnitude of a U.S. economic slowdown, as well as future commodity prices, will be key determinants of growth through 2007. Other economic risks include the nature and timing of U.S. plans to increase border security, which could affect trade and tourism flows.

Key economic indicators

(% change unless otherwise indicated)	Real GDP			Employment			Unemployment rate		
	2006	2007f	2008f	2006	2007f	2008f	2006	2007f	2008f
Ontario	1.9	1.9	3.0	1.5	1.1	1.2	6.3	6.6	6.6
Canada	2.7	2.4	2.9	2.0	1.8	1.2	6.3	6.3	6.4
United States	3.3	2.2	2.9	1.9	1.3	1.2	4.6	4.7	4.8

Source: Statistics Canada, Bureau of Economic Analysis; f indicates forecasted data, using median forecasts, where available, from Conference Board of Canada, Scotiabank, RBC Financial, TD Economics, BMO Financial, CIBC World Markets and BMO Nesbitt Burns.

The Ontario Economic Overview is a quarterly report prepared by the Policy, Analysis & Intelligence Directorate of the Ontario Region of Industry Canada that contains analysis of the current economic and financial performance of industries in Ontario. The analysis is of select economic/industrial issues, and does not contain internal forecasts nor policy analysis, assessments, and conclusions. If you have any comments, please email Steve Grunau, Senior Economist, Industry Canada, Ontario Region, at grunau.steve@ic.gc.ca. Last updated July 30, 2007.

Economic fundamentals

- Ontario nominal GDP was $556.2 billion in 2006, 39% of the national total.[1]
- Ontario's real GDP increased by 1.9% in 2006. Declining manufacturing output slowed GDP growth from 2.6% in 2005 and 2.9% in 2004.
- Services are an increasingly important part of the Ontario economy, contributing 72% to the provincial GDP in 2006 and responsible for 96% of net employment growth since 2000. Growth in services has cushioned Ontarians from the impact of the recent slow-down in manufacturing, which is expected to shed more jobs in 2007.
- Ontario's 6% growth in business investment intentions for 2007 was second only to Quebec, reflecting a strong growth in utilities and a positive turn in manufacturing. Most services plan to expand, especially transportation, retail and finance.[2]
- The high Canadian dollar continues to attract investment in machinery and equipment (M&E). Ontario M&E expenditures increased by 6.1% in 2006, up from 5% in 2005 led by growth in the mining, oil & gas, arts, entertainment & recreation, and utilities sectors.
- Investment intentions in these same sectors have slowed for 2007, leading to overall intended investment growth of 4% for the year.[3]
- Ontario ended 2006 with a trade surplus of $19.5 billion, less than half that in 2004 ($41.8B). Total exports of goods and services declined by 0.3% in 2006, with a 1% fall in international exports cushioned by growth interprovincial exports.[4] Ontario is responsible for 45% of Canada's exports and 59% of imports.[5]

Sectoral analysis and outlook

Manufacturing

Manufacturing is a significant contributor to the Ontario economy, making up the second largest proportion (19%) of Ontario's GDP in 2006.[6] The province accounted for 48% of Canadian manufacturing GDP for the year.[7] The sector's annual GDP fell 4.6% in 2006 led by declines in auto production, pulp and paper, metal products, and rubber and plastics.[8]

Ontario's manufacturing sector is in a recession after having fallen for eight consecutive quarters as of Q1 2007.[9] Real GDP fell by 0.8% in the first quarter, faster than the 0.2% drop seen in the last quarter of 2006. Food, beverage and tobacco production led the way, falling $400 million, or 4.2%. Menu Foods, based near Toronto, was forced to recall 60 million units of pet food in March containing contaminated wheat gluten that had been imported from China. If the U.S. Congress passes legislation requiring user fees for firms exporting food to the U.S. to fund stepped up inspections, Ontario firms will pay the price. Paper and printing and plastic and rubber products also lost more than $100 million in the first quarter.

Manufacturing employment has been declining in Ontario, with 57,000 job losses in 2006 alone. The decline in manufacturing jobs appears to be accelerating, with an additional 40,000 jobs lost in the first four months of 2007.[10] Declines were most significant in automotive, primary and fabricated metal, and machinery, each of which lost more than 10,000 jobs.

The Conference Board of Canada is predicting a modest rebound in manufacturing in 2007 based on the mining, electrical equipment, and machinery and equipment industries.[11]

Automotive

The auto sector is the largest contributor (21%) to Ontario's manufacturing industry. The sector GDP fell by 5.9% in 2006 due largely to ongoing restructuring and lower U.S. demand. Employment in the sector has experienced significant declines, with 18,000 job losses between 2003 and 2006.

Auto shipments increased in Q1 2007 by $208 million, in contrast to an annual decline of $9.6 billion in 2006.[12] Higher shipments were fuelled by the introduction of the Ford Edge and Lincoln MKX to replace the discontinued Freestar at Ford's Oakville plant, leading Ford Canada production to increase by 59% in the first five months of 2007. Canadian vehicle production grew by 1.6% in the face of declines of over 7% in both the U.S. and Mexico.[13] Ford recently increased its target for 2007 production of the Edge by 20% in recognition of rising sales.[14]

Detroit-based automakers are confronting both declining market share, due in part to falling demand for vehicles with lower fuel efficiency, and steep costs for health and retirement benefits that reflect a workforce dominated by aging baby-boomers. By comparison, Japanese automakers, having established North American plants more recently, are running at or over capacity thanks to growing sales and a lower cost structure.[15] While Canadian manufacturers are coping with the effects of a rising dollar, Ontario's public health care system serves to attract and retain investment, providing American firms with means of avoiding prohibitive costs for medical benefits in the U.S. This advantage could be threatened by a potential reduction in the automakers' health-care costs in the U.S. during labour negotiations this summer.

Communities such as Windsor that are more reliant on the Detroit-based automakers are suffering ongoing job cuts by GM, Ford, and Chrysler, which announced it will cut 2,000 production jobs in Canada by 2009. Ford closed its Windsor casting plant, which employed 450, at the end of May, and plans to close an engine plant in neighbouring Essex later in 2007.[16] The future of GM's transmission plant in Windsor is also uncertain, as new transmission work was awarded to St. Catharines, sparking threats by the CAW to launch a national strike of GM if new product is not found for the Windsor facility.[17] Windsor's unemployment rate, at 9.4% in April 2007, is the highest among Ontario cities, and second highest nationally.[18]

The Conference Board and Scotiabank both expect the auto industry to continue to struggle until 2008, when new production from Toyota's Woodstock factory comes on line.[19] However, than expected May sales in both Canada and the U.S. have led Ford and GM to increase production forecasts for Q3 2007 by 1%, the first year over year increase since early 2006.[20]

Auto parts firms have been particularly challenged by the falling market share of the Detroit 3, responsible for the lion's share of parts contracts. Canadian parts firms also have had difficulty accessing the supply chains of foreign-based automakers in North America, as these tend to produce more parts in-house or import from established suppliers overseas. After falling $2.5 billion (8.4%) in 2006, auto parts shipments fell another 7.0% in Q1 2007.[21] Auto parts employment has declined significantly, and continue to fall in the first quarter, now 21% lower than in Q1 2006.

While the stress has been felt by some auto parts firms such as Dura and Affinia which have announced plant closures in Sudbury and Bracebridge,[22] other firms are growing.[23] Recent reports indicate that Southwestern Ontario will get as many as 10 new Toyota automotive parts plants over a five or six year time period. These plants, which would employ more than 3,000 workers, are a direct spinoff of Toyota's new Woodstock assembly plant.[24] Detroit 3 companies have also committed to re-investing in plants in Brampton (Chrysler) and Oshawa (GM) to bring new production.

Biotechnology and pharmaceutical

Ontario's biotechnology sector ranks sixth in North America in terms of revenue and is the third largest in North America in terms of workforce and R&D expenditures. Ontario accounts for roughly 40% of total biotechnology revenue in Canada, leading all provinces.[25] Ontario biotechnology firms were identified as top investment prospects by international venture capitalists, with nine of the top ten Canadian firms from Ontario.[26]

Pharmaceutical GDP has steadily declined since 2003, falling 9.2% in 2006 alone.[27] Pharmaceutical shipments also declined for the second straight year in 2006, falling 4.2% after steady growth between 2000 and 2004. However, first quarter 2007 results have been encouraging as shipments increased by 5.7% compared to the first of quarter 2006.[28]

While GDP has been declining, pharmaceutical exports have been a bright spot for Ontario, having grown steadily since 1997. In 2006, exports were up by 15.6% and Ontario accounted for approximately 72% of Canada's pharmaceutical exports. Exports in Q1 2007 were almost double that of Q1 2006.[29]

In 2005, R&D expenditures in Ontario's biotechnology sector amounted to $649 million, higher than other provinces and approximately 38% of the Canadian total.[30] Three of the top five R&D spenders in the Canadian Biotech/Pharma sector were based in Ontario and each spent over $100 million in research and development in 2005.[31] These included Apotex which spent approximately $183 million in 2005 or close to 20% of its sales, and Biovail, which spent $107 million. In May 2007, California and Ontario signed an agreement to form a Cancer Stem Cell Consortium based at the MaRS Convergence Centre in Toronto, towards which Premier Dalton McGuinty has committed $30 million.[32]

Information and communications technology

Ontario has the third-largest ICT services sector in North America based on employment,[33] accounting for most of the province's 297,000 ICT jobs in 2006.[34] After an increase in ICT employment during the first

quarter of 2006, the sector has experienced a gradual decline in employment, losing 13,000 jobs over the 12 months ending in May, with 9,000 of the lost jobs in ICT services.[35] Following a rapid decline from 2001 to 2004, employment in the ICT manufacturing sector is recovering slowly with moderate increases in 2005 and 2006, and steady employment steady in Q1 2007.
ICT manufacturing GDP remained stable at approximately $6.4 billion in 2006.[36] Shipments grew by $275 million (11.6%) during the first four months of 2007.[37] ICT manufacturing exports increased gradually from 2004 to 2006, after suffering a decline between 2001 and 2003 following the IT crash. Exports were down 4.7% during the first quarter of 2007, primarily due to poor performance in February.[38] Ontario's proportion of national exports rose to 62% in 2006, up from 57% in 2004.[39]

Leading high-tech clusters have evolved in the Greater Toronto Area (GTA), Ottawa, and the Kitchener-Waterloo region. The GTA is home to over 40 of Canada's top 100 IT companies, generating 55% of the revenue growth among the top 250 firms.[40] Ottawa IT firms grew revenue by 9.7% to hit $2.95 billion in 2006. ICT revenue in Waterloo region increased by $879.9 million in 2006, up 37% on the strength of growth at RIM.[41] Waterloo was also named the 2007 Intelligent Community of the Year at the Intelligent Community Forum Awards in New York on May 18, 2007.[42]

While Nortel maintained its position as Ontario's largest overall research and development spender, its R&D expenditures continued their steady decline, dropping to $409 million in Q1 2007, down 15% from Q1 2006.[43] Nortel R&D in 2006 was $1.9 billion, 45% lower than the $3.5 billion it spent in 2000. Bell Canada's annual investment in R&D was approximately $1.7 billion in 2006, making it the second largest private sector R&D investor.[44]

Consolidations in the sector are expected to continue following the acquisition of one of Ontario's strongest R&D performers, ATI technologies by US-based AMD, the second largest chipmaker in the world. In 2006 the Ottawa region high tech companies report adding 3,340 employees while the number of firms dropped slightly from 1,811 in 2005 to 1,803 in 2006.[45] According to OCRI, the level of merger and acquisition activity in 2006 had not been witnessed since the tech boom. According to the Branham Group, Ontario's ICT sector faces tough challenges ahead due to the rise of offshore suppliers especially in China and India.[46] The growing trend of outsourcing in the US along with the strong Canadian dollar is also expected to affect the attractiveness of the sector's exports.[47]

Finance and insurance

According to the Institute for Competitiveness and Prosperity, financial services is Ontario's second largest traded cluster, behind business services.[48] Workers earn 26% more than the all-industry Ontario average.[49] In 2006, employment grew by 4%, or 13,300 jobs.[50] Following strong increases in the second and third quarters of 2006, employment in the sector has remained fairly stable.

Insurance companies experienced slower GDP growth (2.2%) than the banks (5.7%) in 2006. These figures corroborate the long term trend in this sector, as banks have increased output by 27% from 2000 to 2006, while the insurance companies fell by 5% during this period.[51] Banking GDP growth in Q4 2006 was also fairly steady, registering a 1.5% increase over the previous quarter.[52] Record lows in unemployment, a strong Canadian dollar and low levels of corporate defaults helped big banks post record profits last year.[53] The insurance industry, on the other hand, has faced an environment of increasing global competition and rising frequency and size of claims due to recent natural disasters in the U.S.[54] Canadian insurers depend heavily on foreign business and in sectors such as health and life insurance, foreign income can account for up to 60% of total revenue.[55]

Toronto has the third-largest financial services sector in North America after New York City and Chicago, based on employment. Over the last decade Toronto has led all North American cities in job creation in the sector, with average annual growth of over 5%.[56] All but one of Canada's national banks are based in Toronto as well as 50 foreign banks, 115 securities firms and the country's pre-eminent stock exchange. The headquarters of Canada's top six insurance companies, managing 90% of the industry's assets, are also located in Toronto.[57]

Manulife Financial has been touted by experts as one of the most attractive investment prospects in the financial services sector. Having already acquired U.S-based insurance and financial services firm John Hancock, Manulife is seeking to make further acquisitions in the U.S to extend its lead over other Canadian firms in the sector.[58] Manulife reported net earnings of $1.1 billion in Q4 2006, a 21% per cent increase over Q4 2005.[59]

In the banking industry, RBC continued its strong performance in 2006, posting revenue of $36 billion, allowing it to rise from fourth to first place on the FP500. Its stock price rose by 22.2% in 2006 surpassing TSX's gain of 14.5%. UBS, a global wealth management and investment banking firm named TD Bank amongst the industry's top three performers, highlighting its strong domestic platform as well as the growth in its TD Ameritrade division.[60]

The finance and insurance sectors face significant challenges in demographics and labour market trends. Approximately 25,000 workers in these sectors are over 55 years of age, and the exodus of baby boomers may create an annual shortfall of about 2,000 workers.[61] The insurance industry faces the stiffest challenge, with the highest percentage of workers over 55, as well as the most significant leadership gaps with over half the industry reporting shortages at the middle and senior management levels. The finance and insurance sectors also face significant skilled labour shortages over the next five years, especially in the IT field.

Construction

Construction GDP declined by 1.6% year-over-year in Q1 2007.[62] The sector contributed $23.4 billion, or 5% of Ontario's GDP in 2006, while Ontario generated 35% of Canada's construction GDP.[63]

Residential construction investment, which includes new housing, renovations, and acquisition costs, dropped 0.5% year-over-year in Q1 2007.[64] Non-residential construction investment was also down (-3.9%) in the first quarter of 2007 from last year. The decline took place largely in institutional (-13.1%) and industrial (-7.2%) buildings, while commercial construction investment grew by 1.9%.[65]

The value of building permits declined in April 2007 by $221.6M (-10.4%). An 8.2% drop in non-residential permits led the monthly decline, namely for plants and medical buildings.[66] This decline may be temporary as overall non-residential construction is expected to increase in 2007 by 3.9%,[67] driven by continued activity in the utility sector, government spending on infrastructure and strong investment in mining.[68]

Permits for multi-unit residential projects dropped sharply by 21%, due to Toronto permits falling by one-third. Ontario and PEI were the only two provinces to see a decline in overall building permits last year.[69]

Despite lower permits, the Ontario Home Builders Association reports that sales of high-rise condos in Toronto in 2006 remained close to the record levels set in 2005.

The Canada Mortgage and Housing Corporation (CMHC) forecasts that Ontario housing starts will drop by 7% in 2007 as housing adjusts slower economic growth, higher new home prices, increased choice in the resale market and land constraints. CMHC believes the drop will be concentrated in lower single starts.[70]

The construction sector employed 405,200 workers in 2006, growing by 2.6%,slower than the 7.4% growth seen in 2005. Ontario lost 7,000 construction workers in the second quarter of 2007, nearly eliminating the 8,100 it gained in the first quarter. New public investment of $1.2 billion in transportation infrastructure along with several office complex developments under way in downtown Toronto will help counter cooling housing starts in the province.[71]

Tourism

Total visits were estimated at 113.2 million in 2005, still well short of pre-SARS levels. Visitors from Ontario account for over three-quarters of visits, followed by Americans (15%), visitors from other provinces (4%) and overseas visitors (2%). Ongoing growth in intraprovincial visits should drive overall increases through 2011, despite significant expected annual declines of 1.7% in U.S. visits, and marginal declines in interprovincial visits as the lower American dollar attracts Canadians to U.S. destinations.[72]

Employment growth in the first half of 2007 has been strong in certain tourism-related industries such as accommodation and food services, which increased employment by 8.2%, and arts, entertainment and recreation, where employment rose by 11.1% and GDP increased a healthy 2.8%.[73]

Accommodation and food services in Ontario were hit hard by SARS, dropping 8.4% to $8.3 billion in 2003, and by 2006 GDP had only partly recovered to $8.8 billion.[74] After seven consecutive quarters of rising occupancy rates beginning in 2005, Ontario hoteliers reported lower occupancy rates in Q1 2007. Excess capacity, along with the lack of attractions and exchange rate volatility, were the top three concerns cited.[75] The industry has suffered most in border communities like Windsor, which saw double-digit declines in both occupancy and room prices, while the

GTA and Ottawa enjoyed growth in both of these.[76]

The tourism industry has had to grapple with the fallout of the terrorism attacks in 2001 and the SARS crisis in Toronto in 2003, both of which brought declines in visits and tourism spending. The sharp appreciation of the Canadian dollar over the past three years, concerns over border delays and security, and high gas prices have also contributed to reduced foreign travel by U.S. citizens in recent years.[77] The industry is also grappling with new passport requirements for air travellers entering the United States, and the extension of this to land and sea crossings planned by 2009.

Since 2000, the annual number of American visitors to Ontario has been cut in half, with the decline concentrated among same day visits. While other provinces have also suffered from fewer American tourists, Ontario has been hit harder, as its share of U.S. visitors to Canada has fallen from 66% in 2000 to 60% in 2006. Amid growing confusion over required documentation to cross the border, the fall in American visitors accelerated in the first quarter, with over 940,000 fewer visitors than in Q1 2006. The 21% drop exceeds the 15% decline seen in Q1 2002, just after the attacks of 9/11. The requirement for passports to enter the U.S. by air, which came into effect in January, may have triggered an 8% decline U.S. air travel to Ontario in the first quarter, the biggest decline since 9/11.

Wholesale and retail trade

In 2006, GDP from Ontario's wholesale and retail trade totalled $60.4 billion, accounting for 43% of the national total. GDP growth slowed to 5.6% in 2006 from 5.8% in 2005.[78]

Retail sales rose by 4% in 2006 to top $140.9 billion, with new car dealers, general merchandise, supermarkets, and gas retailers contributing to the gains.[79] Retail sales in Ontario edged down by 0.3% in April after registering two strong increases in February (+1.0%) and March (+1.7%). Retail sales are forecast to slow to 3.6% growth in 2007 and regain momentum in 2008 at 5.6%.[80]

Ontario's wholesale trade posted its best performance since 2002 in 2006, growing by 6.4% to $250.9 billion. Double digit growth in the machinery & equipment and personal & household goods sectors led the increase.[81] Rising motor vehicle sales were also an important part of the gains, as some assemblers began shipping new models to retailers in the United States and Canada.[82]

Over the first quarter of 2007, wholesale and retail trade rose by 3% and 4% respectively, over the same period in 2006. Wholesale trade posted the strongest quarterly gain since the fourth quarter of 2005.[83]

Wholesale and retail trade are important sources of jobs, employing one quarter of Ontario's 4 million workers in 2006. Three-quarters of these work in retail trade, with heavy concentrations in food and beverage, general merchandise and clothing stores. Ontario added over 30,000 employees to its retail work force in the second quarter of 2007 over the same period last year with larger gains within the furniture, clothing, and food and beverage stores. Wholesale trade, on the other hand, lost 21,000 workers during the second quarter from the second quarter in 2007, with losses in motor vehicle and parts wholesaler-distributors (-9,400) as well as tobacco, food and beverage wholesaler-distributors (-4,500). Both of these sectors lost 1,500 and 1,200 workers respectively from the first quarter in 2007 alone.

Primary industries

Ontario has the greatest proportion (25%) of the country's farms, totalling 57,211 and a quarter of the all farm revenues at $8.9B in 2006. The farming community, largely concentrated in the Simcoe, Huron and Grey counties, has seen consolidation of farming enterprises, with fewer farms than in 2001 and the number of million dollar farms on the rise.[84]

Ontario's cattle exports are recuperating from a 2003 U.S. export ban due to Bovine Spongiform Encephalopathy (BSE). Cattle ranching and farming exports grew to $45 million in 2006, spurred by the re-opening of the U.S. border to Canadian beef in July 2005. Although far below annual exports of $368 million in 2001, it shows considerable improvement from the $2 million posted in 2004.[85] January to April year to date cattle ranching and farming exports in 2007 showed continued growth, reaching $31 million, up from $22 million in the same period a year prior.[86]

Ontario is Canada's largest miner, producing $2.5 billion or almost 26% of Canada's total minerals GDP in 2006.[87] Exports of industrial goods climbed by 16% ($420 million) in 2006, driven by higher metal prices which have triggered increased exploration in Ontario. Annual investment in mine construction and equipment almost doubled from $732 million in 2002 to $1.25 billion in 2005. The mining sector employs over 19,000 workers directly and an additional 5,000 through its mine service companies. Current growth is straining the supply of skilled labour. Other challenges facing the mining sector include high energy prices and environmental obligations.

INCO and Falconbridge, two prominent mining companies headquartered in Toronto, were bought last year by Switzerland's Xstrata and Brazil's CVRD, respectively. Alcan, Canada's largest aluminum company, is also on the verge of completing a merger deal with multinational mining giant Rio Tinto.[88] Mining GDP rebounded with 4.4% growth in the 4th quarter of 2006 following second and third quarter declines of 1.3%.[89] Export Development Canada (EDC) forecasts zero export growth for 2007. A slowed US economy, and growing production of steel and aluminum in China, which threaten to outpace domestic demand, will lower prices through 2008.[90]

Ontario generated roughly $811 million, or 12% of Canada's forest and logging GDP in 2006.[91] Forest exports fell by 20% ($1.3 billion) in 2006, worse than declines in Quebec and B.C. of 4.5% and 3.3%, respectively. Ontario's drop was higher than expected by EDC, which is calling for a decline of 6% in 2007.[92]

Ontario's forestry industry has had to contend with numerous challenges including falling international prices for pulp and paper, lower demand for newsprint, a rising Canadian dollar and increased production costs due to uncertain timber supply and increased electricity costs. Quebec has been able to benefit from lower electricity costs than Ontario and B.C. producers have lower harvesting costs due to the need to clear areas threatened by Mountain Pine Beetle infestation..[93] The spread of the beetle to Ontario could be disastrous for the forest products and pulp and paper industries, which rely on jack pine as a preferred species.[94]

The return of close to $4.5 billion in duties under the softwood lumber agreement, negotiated by the governments of Canada and the United States, is helping lumber producers. However, it will have less impact on the pulp and paper industry, which is suffering from increased energy costs and offshore competition. Seven sawmills and one planing mill have closed in less than two years in Ontario and in the six months between October 2006 and April 2007, an additional seven mills closed with two others cutting production in half. The provincial government has agreed to provide approximately $1 billion in supports such as loan guarantees, help with road costs, an enhanced Forest Resource Inventory, stumpage fee refunds, and electricity rebates to help pulp and paper mills cope with these challenges.[95] In the fall of 2005 the Government of Canada announced an assistance package for its forest products industry worth $1.5 billion over a five -year period. This is a partnered strategy by Natural Resources Canada, Industry Canada, Service Canada and FedNor in Ontario to address a wide range of issues such as diversifying the economies of forest-dependent communities, enhancing skills of forestry workers, investigating new markets for wood products, developing innovative technologies.[96]

Issues facing provincial economy

Costs of production

After declining late in 2006, the Canadian dollar resumed its climb in 2007, hitting a 30-year high of 94.8 cents (US) in early June. While the higher dollar lowered revenues for Canadian exporters, rising commodity prices continued to drive up the costs of inputs for manufacturers. Prices for metals and minerals grew by 77% between February and May alone, on top of previous gains, and oil prices returned to the high US$60 range in June.[97] Some relief may be in sight for Ontario manufacturers, as the EDC is calling for both commodity prices and the dollar to fall later this year.[98] In the near term, the dollar could rise if concerns about inflation in Western Canada lead to interest rate hikes.

Responding to calls from industry groups for lower taxes on investment and capital, the federal government announced in the 2007 budget that it would allow manufacturers to write off investments in plants, machinery and equipment. The move is being matched by Ontario, and will help manufactures take advantage of the high dollar to import capital equipment more cheaply. The province also announced it would renew its incentive program for investment attraction, accelerate elimination of the capital tax and suspend the Retail Sales Tax on inputs to production. A recent CD Howe study identified Ontario's taxes on manufacturing investment as the highest in Canada.[99]

Supply of electricity remains an issue for Ontario, with demand projected to rise by 1.2% per year between 2005 and 2025.[100] Costs of electricity in Ontario equal or surpass those of the eastern U.S. states. The province is addressing rising demand by gradually phasing out coal burning plants through 2014, increasing conservation and renewable energy use, and building new transmission lines to Quebec. It also plans to invest in refurbishing existing nuclear plants and building some replacement facilities.[101]

U.S. economy

While U.S. economic growth has been strong in recent years, a housing market slump has precipitated a modest slowdown, and falling house values combined with rising interest rates are contributing to rising defaults among highly leveraged homeowners in the "sub-prime" market. These loans represent a small proportion of U.S. mortgages, but there is a possibility that concerns about defaults could lead to tightening credit terms overall. If access to credit becomes more costly, this would certainly hurt consumer spending, the primary driver of U.S. economic growth. Falling house values have already lowered withdrawal of home equity by 40% since Q1 2006, which will in turn impact consumer spending.[102]

Analysts are encouraged by strong consumer spending growth of 4% in the last two quarters, with some calling for growth of 3% in the second quarter before the impact of lower housing wealth is felt later in the year.[103] The ongoing decline of the U.S. dollar continues to fuel export growth, which combined with increases in employment and wages should help keep the economy out of recession. However, most analysts believe that GDP growth will be significantly slower in 2007 than in recent years.

Since over half of Ontario's manufactured goods are shipped to the United States, a slowdown there would restrain growth in Ontario as well.[104] The effects of slower U.S. growth could be limited to manufacturing-driven central Canada, while the West continues to enjoy a commodity-driven expansion. However, if a sharper U.S. decline does materialize, it would likely undercut commodity prices and economic growth across Canada. The consequences would be more serious for Ontario, where cross-border supply chains link many industries (including the auto sector) with developments in the United States.

Tightened border security restricting trade, tourism

Cross-border trade is key to the provincial and national economies. Ontario's goods exports to the United States alone was equal to almost 36% of provincial GDP in 2006. Four of Ontario's 14 fixed border crossings (Windsor, Fort Erie, Sarnia and Lansdowne) handle 66% of Canada-U.S. road trade.[105]

Infrastructure at these crossings has not kept pace with the growth of trade. Border delays have resulted in annual costs of over $5 billion to the Ontario economy, with the trade-dependent automotive industry particularly vulnerable.[106] Transport Minister Cannon has confirmed $400 million in federal funding for an access road for a new Windsor-Detroit crossing as part of a Quebec-Ontario Gateway strategy the federal government is developing,[107] and the provincial government has also called the Windsor crossing a top priority. Border delays were identified as a concern by Honda in locating a new facility, though the company still decided to invest in Ontario.[108]

There is some evidence that delays may be easing, as road trade stagnates, tourism crossings fall and pre-clearance programs such as FAST and NEXUS gain membership. However, ongoing uncertainty about U.S. security requirements and the potential for delays may be leading businesses to sacrifice the benefits of just-in-time cross-border delivery by stockpiling inventory or choosing sub-optimal border crossings to ensure shipments arrive on time.[109] Persistent difficulties could lead U.S. firms to prefer American sites for new investments.

As of January, air travellers to the United States have been required under the U.S. Western Hemisphere Travel Initiative (WHTI) to have a passport. As demand for passports overloaded capacity approaching the summer tourism season, this requirement has been temporarily reduced for U.S. citizens, who must now provide proof of having applied for a passport. Implementation of the full WHTI, which includes requirements for land and sea travel, has been postponed at least until June 2008. Congressional representatives from northern border states are pushing the Department of Homeland Security to delay it further.[110]

In a conciliatory move, DHS Secretary Chertoff recently confirmed his willingness to work with state authorities in New York to develop enhanced driver's licenses that would meet security requirements, eliminating the need to purchase costly passports.[111] This builds on a request by Michigan for a similar program, and on Ontario's intention to increase security on its licences in hopes that DHS would validate their use at the border.[112] However, there is evidence that the confusion around border requirements is already hurting tourism, with travellers avoiding the border even though passports are not yet required.[113] Same-day visits by Americans have fallen sharply in recent years, hurting businesses that depend on tourism for a significant proportion of revenues. The steeper decline in U.S. visits seen in Q1 2007 may be an indication of what is to come if passport requirements are extended from air to land crossings, which is expected to have a much greater impact on tourism given that two-thirds of U.S. visitors to Ontario are from the border states of Michigan and New York.[114] Easy and cheap access to approved border documents for Americans and Canadians will be necessary to avoid negative impacts on trade flows and cross-border tourism.

Internal trade

Interprovincial trade moved forward with the signing of the *British Columbia-Alberta Trade, Investment, and Labour Mobility Agreement (TILMA),* which came into effect in April, 2007. TILMA applies to all government measures that affect trade, investment and labour mobility and will be expanded to other areas such as municipalities by 2009. Among other things, the new agreement will eliminate duplicate registration and reporting requirements for business and reconcile occupational standards.[115]

Ontario Premier Dalton McGuinty has expressed interest in joining the B.C. - Alberta agreement, calling it a "step in the right direction". However, provincial bureaucrats are still studying the deal, which would prohibit business subsidy programs such as Ontario's Automotive Investment Strategy, a cornerstone of provincial economic development policy.[116] Ontario is also examining proposals by Quebec to expand existing bilateral trade agreements, though progress on either deal will likely await the outcome of Ontario elections on October 10, 2007.

Ontario Minister of Economic Development and Trade Sandra Pupatello is leading an effort to link Ontario's manufacturing strength with demand for capital projects in Alberta's oilsands. Pupatello has led three delegations of Ontario companies to Alberta since being appointed Minister last year, focussing on opportunities for metal fabricators and pre-fabricated housing. Increased access to business in high-growth Alberta could help alleviate some of the challenges Ontario manufacturers are currently facing, and increase the incentives for Ontario to eliminate trade restrictions with Alberta.

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