



# Ontario Economic Overview

February 2010 Update



## HIGHLIGHTS

- After falling for four consecutive quarters, Ontario's economy grew by 0.5% in Q3 2009.
- The manufacturing sector finally posted increased output in Q3, largely based on improvement in the auto sector. Other manufacturing sub-sectors continued to falter.
- As banks focused on controlling costs to cope with falling earnings resulting from the recent financial crisis, employment in the traditionally strong finance and insurance sector fell for the fourth consecutive quarter in Q3.
- The construction industry's struggles continued into Q3 with falling output and employment. However, large amounts of infrastructure spending and favourable credit market conditions should result in a strong performance in 2010.
- Trips from international travellers to Ontario hit another all-time low in Q3, but there is some indication that the domestic market has, at least partially, cushioned the negative impacts on the tourism industry.
- The public administration sector defied the trend and added jobs in Q3 2009. This growth may be temporary, however, as it was largely driven by stimulus spending.
- Ontario's economy is expected to return to growth in 2010 after experiencing two years of falling GDP. Output is forecast to grow by 2.7% and employment by 1.1%. The unemployment rate is expected to hit 9.5% in 2010, remaining well above the national rate of 8.4%.



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## KEY ECONOMIC INDICATORS

(% change unless otherwise indicated)	Real GDP			Employment			Unemployment Rate		
	2009f	2010f	2011f	2009	2010f	2011f	2009	2010f	2011f
<b>Ontario</b>	-3.4	2.7	3.4	-2.4	1.1	2.1	9.0	9.5	8.6
<b>Canada</b>	-2.5	2.8	3.2	-1.6	1.1	1.8	8.3	8.4	7.9
<b>United States</b>	-2.4	2.9	3.3	-3.8	-0.1	2.3	9.3	9.9	9.2

Source: Statistics Canada, U.S. 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 and CIBC World Markets. Forecasts collected on February 15, 2009.

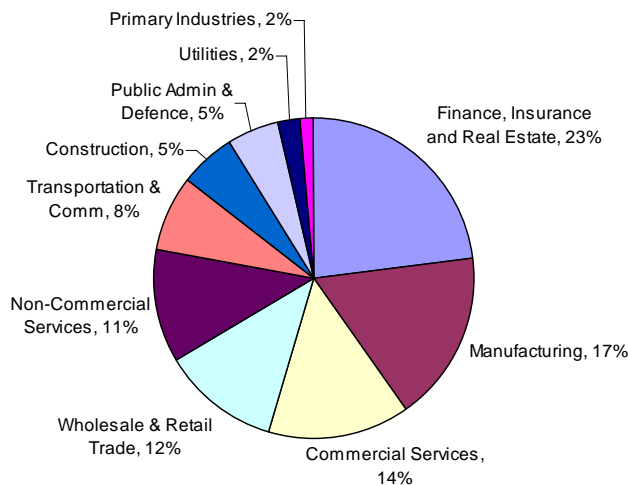
*The Ontario Economic Overview is a quarterly report prepared by the Policy, Analysis & Intelligence Directorate of the Ontario Region of Industry Canada that contains analysis of the current economic and financial performance of industries in Ontario. The analysis is of select economic/industrial issues, and does not contain internal forecasts or policy analysis, assessments, or conclusions. If you have any comments, please email Emily Powadiuk, Policy Analyst, Industry Canada, Ontario Region, at Emily.Powadiuk@ic.gc.ca.*

## GDP and Employment Growth of Selected Ontario Industries

	GDP Growth (%)				Employment Growth (%)			
	2005	2006	2007	2008	2005	2006	2007	2008
Manufacturing	0.4	-2.4	-2.7	-8.0	-2.4	-2.1	-4.5	-5.7
Automotive	3.1	-3.1	-4.6	-23.9	x	x	x	-9.1
Pharmaceutical and Medicine	-7.1	27.9	8.9	4.3	-2.0	0.7	-0.3	0.9
Information and Communication Technology	3.0	5.4	3.8	2.2	0.4	2.3	1.1	2.5
Aerospace	25.1	28.1	-2.2	7.0	2.2	-0.7	-9.0	-0.4
Finance and Insurance	2.4	5.6	4.4	3.6	3.4	3.5	5.0	2.9
Construction	2.0	1.8	5.8	-2.5	2.5	4.9	5.4	5.0
Accommodation and Food Services	0.1	0.0	0.5	2.2	-0.7	3.0	4.6	4.4
Wholesale Trade	6.8	4.7	4.6	-0.9	-0.7	1.2	3.0	0.6
Retail Trade	2.0	4.8	3.6	2.8	1.6	0.8	2.7	3.9
Primary Industries*	4.6	-3.6	-4.9	3.8	13.2	8.8	-5.9	-6.3

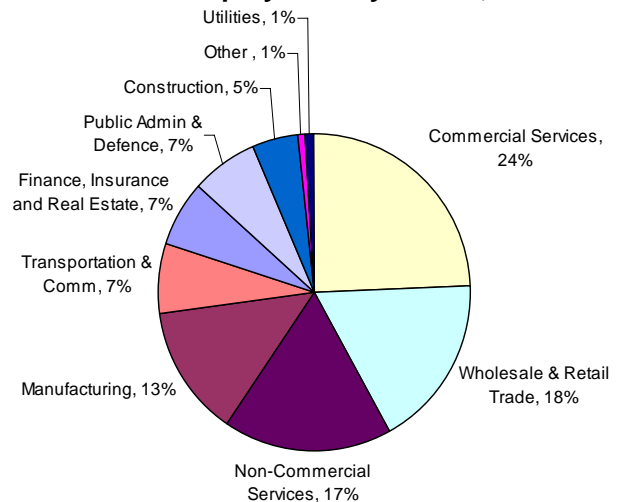
\* Employment data from LFS and is not strictly comparable to SEPH data used elsewhere

### Ontario GDP by Sector, 2008



Source: Ontario Ministry of Finance

### Ontario Employment by Sector, 2008



Source: Statistics Canada, Survey of Employment, Payrolls and Hours (SEPH)

## ECONOMIC FUNDAMENTALS

- Ontario's nominal GDP reached \$566B in Q3 2009<sup>1</sup>, accounting for 37.1%<sup>2</sup> of the national total.
- Provincial real GDP grew by 0.5% in Q3 2009 from the previous quarter following four consecutive quarterly declines. This compares to a 0.1% increase in Canada and growth of 0.6% in the U.S. for the same period.<sup>3</sup>
- Contributing factors to the return to growth in Q3 included gains in all major expenditure categories including consumer spending (+1.0%), business investment (+7.6%) and government spending (+0.9%).<sup>4</sup>
- Imports grew faster than exports in Q3, lowering the trade surplus to \$700M (\$2002).<sup>5</sup>
- Real industrial output increased by 0.6% in Q3 led by solid gains in manufacturing (+2.3%) and wholesale trade (+4.0%). Other sectors continued to struggle, including primary industries (-7.6%).<sup>6</sup>
- Ontario's unemployment rate averaged 9.2% in Q3 2009 before falling slightly to 9.1% in Q4. For 2009, the unemployment rate was 9.0%, above the national rate of 8.3%.<sup>7</sup>
- The Census Metropolitan Area (CMA) of Windsor experienced an unemployment rate of 12.7% in Q4, the highest in the country. St. Catharines-Niagara and Greater Sudbury had unemployment rates above 10% for the same period.<sup>8</sup>
- Consumer insolvencies were up by 41.7% in Q3 over the same period last year, above the national average of 40.2%.<sup>9</sup> Ontario's consumers accounted for 44.1% of Canada's insolvencies. All Ontario CMAs experienced increases in consumer insolvencies, with Greater Sudbury and Oshawa facing rises of over 80%.<sup>10</sup>
- Business insolvencies in the province increased by 5.6% during Q3 year-over-year, in contrast to a national decline of 8.3%. A total of 643 business bankruptcies during the period accounted for 40.9% of the Canadian total.<sup>11</sup>

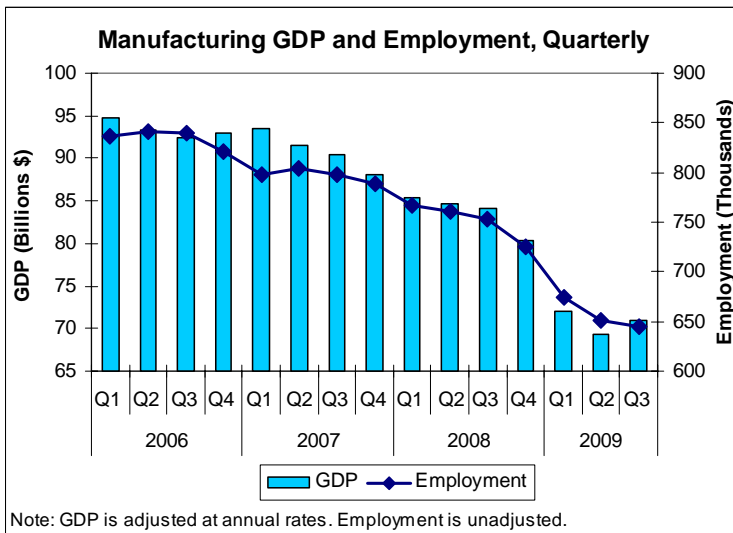


## ECONOMIC OUTLOOK

- According to forecasts done by Canada's five biggest banks and the Conference Board of Canada, Ontario's GDP is expected to grow at a median rate of 2.7% in 2010. This growth would follow a forecast decline of 3.4% in 2009.<sup>12</sup>
- The forecasts for 2010 range from a low of 2.3% (BMO) to a high of 3.2% (Conference Board).
- Growth in the province should be supported by slowly returning demand in the U.S., along with growth in the construction and auto sectors.<sup>13</sup>
- Recovery of the goods-producing sectors will translate into improvements for the service sectors.<sup>14</sup>
- Ontario's Ministry of Finance forecasts average annual GDP growth of 3.1% between 2010 and 2014 which would be an improvement over the average annual rate of 2.6% experienced between 1982 and 2009.<sup>15</sup>
- The Conference Board of Canada expects that Ontario will have the third highest rate of growth in 2010 behind BC and Saskatchewan.
- Canada's GDP is expected to grow at about the same rate as Ontario's. Forecasts range from 2.3% (CIBC) to 3.0% (Scotiabank) and the median is 2.8%.
- In the U.S., GDP growth is forecast to improve by 2.9% in 2010 following a contraction of 2.4% in 2009.
- Consensus is that Ontario's unemployment rate will remain above the national average in 2010. Forecasts range from 9.0% to 9.8% for Ontario and from 8.2% to 8.6% for Canada.
- A strong dollar may weigh on Ontario's exports to the U.S. On average, the big five Canadian banks forecast the U.S. and Canadian dollars to trade near parity in 2010.

## SECTORAL ANALYSIS AND OUTLOOK

### MANUFACTURING



Ontario is the heartland of Canada's manufacturing sector, accounting for nearly half of national output. Despite suffering GDP and employment losses in recent years, the sector continues to be a key contributor to the province's economy. During the recession, Ontario has had to cope with significant restructuring in the U.S. manufacturing sector, in addition to border restrictions and the implications of the Buy America legislation.<sup>16</sup> However, there is indication that the industry is slowly moving towards recovery.

Going forward, the performance of Ontario's manufacturing sector will continue to be largely tied to the manufacturing sector south of the border given their high degree of integration. In January, the ISM index indicated that the U.S. manufacturing sector

expanded for the sixth consecutive month, registering the highest reading for the Index since August 2004.<sup>17</sup> Ontario's recovery will also be contingent upon the impact of a rising Canadian dollar, which threatens to damage the competitiveness of Ontario-made products in the U.S. market.<sup>18</sup>

Ontario's manufacturing GDP turned around in Q3, increasing 2.3% after nine consecutive quarterly declines. This can largely be attributed to transportation equipment output, which grew by 11.5%.<sup>19</sup> Excluding transportation equipment, manufacturing output actually fell slightly (0.1%) as six of the eleven subsectors reported output declines, including textiles (6.3%), machinery (2.9%) and paper products (2.7%).<sup>20</sup> Manufacturing employment has continued to slide, and in Q3 employment was down 14.4% compared to Q3 2008, as almost 109,000 jobs were lost. The non-durable goods and durable goods sectors saw job losses of 28,350 and 80,500, respectively.<sup>21</sup>

The steel industry had a difficult year in 2009; however, it is slowly emerging from the recession as the economy strengthens and demand from automotive and other sectors improves. U.S. Steel, owner of the former Stelco mills in Hamilton and Nanticoke, reported losses greater than US\$1.4B for 2009, a tremendous contrast from its 2008 net profit of more than US\$2.1B.<sup>22</sup> In 2009, U.S. Steel reduced expenses, halted hiring, cut capital spending and idled facilities as a result of sluggish orders and low prices. As of January, all of U.S. Steel's steelmaking facilities, with the exception of Indiana, were producing at about 64% capacity, in contrast to the average of 86% over the past 20 years.<sup>23</sup> Losses were less severe by the end of the year due to higher prices and increased demand from automakers and steel service centres.<sup>24</sup> Orders from automotive and other customers are approaching

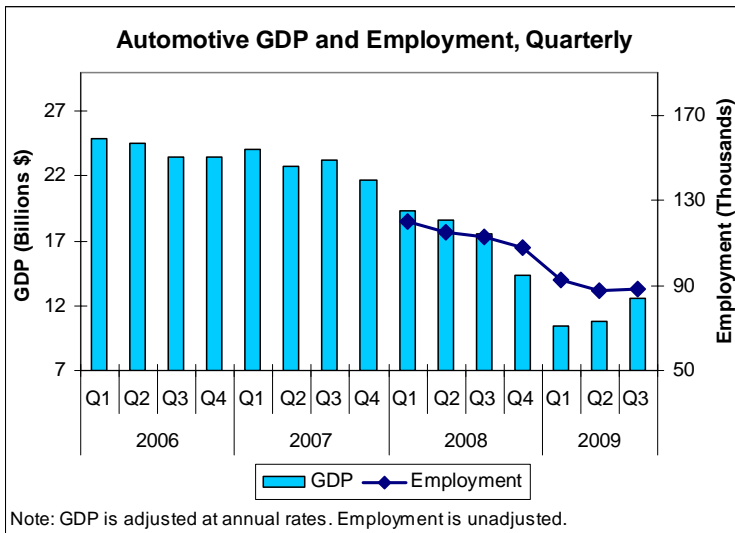


their highest levels in the last 12 months.<sup>25</sup> Slight improvements in consumer confidence and credit availability in the U.S. may also translate into rising auto sales, thereby increasing demand for steel.

In January, Lakeside Steel Inc. increased production at its Stretch Reduction Mill in Welland by adding additional production shifts to meet stronger demand. As a result, the company has returned all of its temporarily laid-off workers to full employment for the first time since November 2008.<sup>26</sup> Increased demand has been driven by the enhanced end finishing capabilities of Lakeside Steel Inc.'s operations and an increase in prices for oil and natural gas. In similar news, ArcelorMittal Dofasco announced that it will be hiring approximately 400 employees this year, with a quarter of these jobs related to a \$100M plan to fire up a third blast furnace.<sup>27</sup>

In January, the Ontario government announced that a consortium led by Samsung C&T Corporation and the Korea Electric Power Corporation will invest \$7B to generate 2,500 megawatts of wind and solar power in Ontario.<sup>28</sup> As a result, the Samsung Group will buy up to 250,000 tonnes from Ontario's steelmakers to construct wind turbine towers across the province. Committed to meeting domestic content requirements under the Ontario Power Authority's feed-in tariff program, the consortium will also build four plants to manufacture components for green energy projects.<sup>29</sup> While the majority of the 16,000 jobs created in this process will be temporary, 1,440 manufacturing and related jobs are expected to be permanent.<sup>30</sup>

#### AUTOMOTIVE



2009 will certainly be remembered as an unprecedented year for the automotive industry - one which saw vehicle sales and production levels

plummet to record lows as consumer spending evaporated due to a deep recession. While the year started in the midst of this turmoil, the final months of 2009 signalled that a modest recovery was underway, renewing optimism for the return to profitability in 2010.<sup>31</sup>

For the second quarter in a row, Ontario's automotive GDP grew in Q3 by posting a much stronger 16.8% growth over the previous quarter.<sup>32</sup> While it appears the industry is finally turning the corner, output is still well below levels seen earlier in the decade. Automotive GDP was down 28.1% compared to a year ago and down 45.7% compared to two years ago.<sup>33</sup> In Q3, auto employment in Ontario was 88,400. Compared to the same time last year, 24,150 jobs (-21.4%) have been lost.<sup>34</sup> The majority of Q3 losses were experienced in the parts sector (-25.0%), but auto assembly also had significant job losses (-14.3%).<sup>35</sup> Ontario's auto exports fell 34.4% for November 2009 YTD, as exports to the U.S., the main market, fell 34.2%.<sup>36</sup>

The decline in the U.S. light vehicle market, where most of Ontario's auto production is headed, appears to have bottomed out. Retail and fleet volumes strengthened during the last three months of 2009, partly due to improving credit availability for both consumers and businesses.<sup>37</sup> U.S. light vehicle sales for 2009 totalled 10.4M units, down 21.2% compared to 2008.<sup>38</sup> A gradual improvement in vehicle purchases is anticipated for 2010, with forecasts ranging between 11.5M to 12.5M units, still well below pre-recession levels.<sup>39</sup> In Canada, vehicle sales for the year totalled 1.46M units, down 10.7% compared to 2008. Total sales reached their lowest levels since 1998.<sup>40</sup> Vehicle sales in Canada are projected to rise to 1.53M in 2010.<sup>41</sup>

North American light vehicle production for 2009 totalled 8.78M units, down 32.3% compared to a year ago. The U.S. faced a decline of 34.2% while both Canada and Mexico fell by roughly 28% each.<sup>42</sup> Low inventories and improving sales are expected to boost North American vehicle production significantly in Q1 2010, with total output for the year estimated at approximately 11M units.<sup>43</sup> Production at Ontario's ten assembly plants totalled about 1.49M units in 2009.<sup>44</sup> Despite declines, the province retained its title as North America's top-producing region for vehicle assembly for the sixth consecutive year.<sup>45</sup> A number of automakers have already announced increases in scheduled output which will further boost Canada's vehicle production.<sup>46</sup>





<b>Change in Vehicle Production and Sales 2009 vs. 2008* (% Change)</b>			
	<b>Canadian Production</b>	<b>North American Production</b>	<b>U.S. Light Vehicle Sales</b>
<b>General Motors</b>	-47.9%	-45.6%	-29.9%
<b>Ford</b>	-23.2%	-16.3%	-16.2%
<b>Chrysler</b>	-34.8%	-50.4%	-35.9%
<b>Honda</b>	-32.9%	-27.9%	-19.5%
<b>Toyota</b>	10.9%	-17.0%	-20.2%
<b>Canada</b>		-28.3%	
<b>United States</b>		-34.2%	-21.2%

\*includes production up to December 26, 2009 and December 27, 2008

Source: Automotive News Data Center

General Motors experienced a dramatic year in 2009 which included filing for bankruptcy in June and the elimination of four brands. GM's restructuring progress continues. In December, it began to repay its Canadian and U.S. government loans that were part of the overall bankruptcy assistance.<sup>47</sup> However, GM is still struggling with reducing its dealer network and faces legal challenges from dealers in the U.S. and Canada that are appealing the decisions.<sup>48</sup> GM faced some of the most significant sales and output drops in the sector in 2009 and saw its U.S. market share decline to 19.9%.<sup>49</sup> Canadian GM production fell by 47.9%, mostly due the closure of the Oshawa truck plant in May.<sup>50</sup> However, with the success of some of its Canadian-built vehicles, GM has announced plans to increase Canadian production levels<sup>51</sup> and add new models such as the Buick Regal, which will be built in the Oshawa facility starting in early 2011.<sup>52</sup>

Chrysler Group LLC continues to struggle since emerging from bankruptcy last spring and partnering with Fiat SpA. Like GM, the company received financing from the Canadian and U.S. governments, but has been slower in meeting its restructuring goals. Chrysler is also still trying to rationalize its dealer network and is facing legal challenges from terminated dealers in the U.S.<sup>53</sup> For the first time in 47 years, Chrysler sold fewer than a million cars and trucks in the U.S. market<sup>54</sup> and witnessed its share of the market erode to 8.9% in 2009.<sup>55</sup> Largely due to the strength of the minivan, Canadian output fared better than Chrysler's overall North American production, falling 34.8% compared to a year ago.<sup>56</sup> The company remains committed to its five year plan to overhaul its vehicles, including smaller cars built on Fiat platforms, by the end of the year. Chrysler recently confirmed that if it decides to build its new Alfa Romeo, it will be built at the Brampton plant.<sup>57</sup>

Ford Motor Corporation is reaping the benefits of its turn-around efforts and strong product portfolio, as the company's sales and market share continue to improve. Ford experienced the smallest sales decline of the top five major automakers in 2009.<sup>58</sup> Its U.S. market share rose by one percentage point to 16.1%, the first increase since 1995.<sup>59</sup> Ford's Canadian production was down 23.2% in 2009, falling further than the company's total North American output.<sup>60</sup> The company plans to launch eight new vehicles in 2010<sup>61</sup> and recently announced plans for several new engines and transmissions. Production of a new fuel-efficient V-8 engine at the Windsor Essex Engine plant will start in early 2010<sup>62</sup>, but any related employment gains are expected to be offset by a loss of 250 jobs in September at Ford's Windsor Engine plant, which produces large engines for the F-150 truck.<sup>63</sup> Ford has also been making strides to adopt green technology, and recently revealed that it will use straw-reinforced plastic storage bins in the 2010 Ford Flex models assembled in Oakville.<sup>64</sup> The process was created by a University of Waterloo professor.

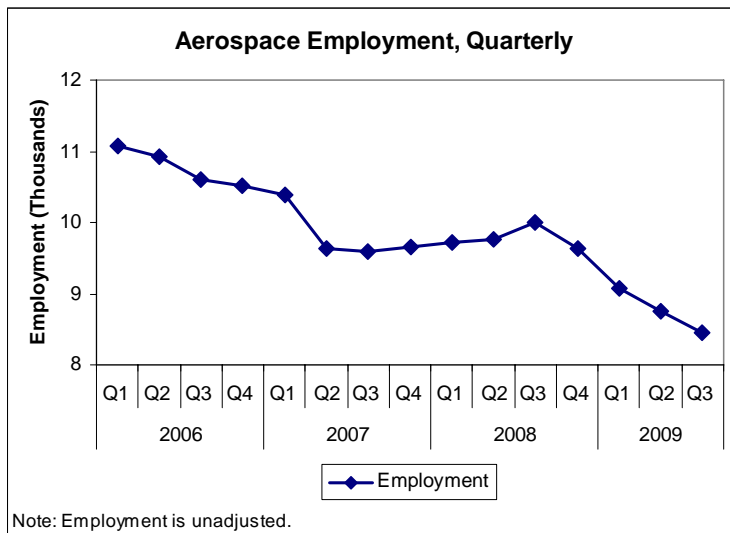
Despite posting a 20% decline in its total U.S. sales, Toyota Motor Corp.'s North American market improved in the second half of 2009 compared to a year earlier.<sup>65</sup> The company's U.S. market share rose slightly to 17%.<sup>66</sup> In Canada, Toyota posted record sales in the final months of 2009, and increased production and employment to the highest levels ever for its Canadian operations.<sup>67</sup> Although Toyota's North American production level was down, Canadian output climbed by 10.9% in 2009.<sup>68</sup> Toyota Canada recently announced that a second shift would be added to its Woodstock facility in March to meet strong demand for the RAV4, adding 800 workers.<sup>69</sup> However, any positive news for Toyota has been overshadowed by a string of massive recalls that began in the fall of 2009. Over 8M vehicles worldwide, including about 270,000 in Canada, have been recalled due to problems concerning unintended acceleration.<sup>70</sup> The company faces several lawsuits and U.S. Congressional hearings. Toyota temporarily suspended sales of eight recalled models and halted production at five North American assembly plants, including its Canadian operations, for one week to undertake accelerator pedal repairs.<sup>71</sup> Toyota and its supplier have since developed a pedal fix for cars already on the road and have redesigned the accelerator system for new vehicles.<sup>72</sup> The overall cost of the recalls is expected to reach US\$2B.<sup>73</sup>

After months of turmoil, many automotive parts suppliers have started to ramp up production as the industry begins to recover. However, with volumes in North America expected to remain below historical



levels for some time, the industry anticipates greater consolidation of the supply base, including more bankruptcies.<sup>74</sup> Financially stronger manufacturers which have successfully restructured their operations are gradually returning to profitability and gaining new ground with their OEM customers.<sup>75</sup> Many smaller suppliers, however, still face challenges in securing adequate financing from commercial lenders, making it difficult to purchase new equipment and meet increasing customer demands.<sup>76</sup>

## AEROSPACE



Ontario's aerospace industry, which produces aircraft parts and systems, accounts for 25.9% of Canadian aerospace GDP, second in Canada behind Quebec at 64.8%.<sup>77</sup> Approximately 350 aerospace companies are located in Ontario and over 70% of their products are designated for export.<sup>78</sup>

The province's aerospace GDP reached \$2.0B in 2008, up 7.0% from 2007. Revised GDP data shows that Ontario's aerospace output saw very strong growth between 2004 and 2008, notwithstanding a 2.2% decline in 2007.<sup>79</sup> There is indication that output may have started slowing in 2009. Nationally, aerospace output was down by an annual rate of 0.9% in November and down by 12.0% compared to the same time last year.<sup>80</sup> Ontario's October 2009 YTD aerospace shipments were also down 6.7% compared to the same period a year earlier.<sup>81</sup>

Aerospace employment began falling in 2006 and continued sliding through the first three quarters of 2009. In Q3, the sector had over 1,500 fewer employees than a year earlier, a 15.4% drop. Total employment is nearly 40% lower than it was 10 years earlier.<sup>82</sup> Additional layoffs are expected in 2010 as

manufacturers continue to reduce production due to decreased demand.<sup>83</sup>

The Canadian aerospace industry had a backlog of orders equivalent to two years of production going into the recession, allowing it to fare better than many other manufacturing industries.<sup>84</sup> However, with backlogs disappearing, customers cancelling orders and new orders declining, the industry is falling on harder times. The consensus seems to be that Canada's aerospace industry will experience a difficult year in 2010. Claude Lajeunesse, head of the Aerospace Industries Association of Canada, believes that full recovery could be as much as two years away.<sup>85</sup> Richard Aboulafia, aerospace analyst at Teal Group, expects it could take years for the industry to return to its peak period of late 2007 and early 2008. He believes the overall outlook for Canada's aerospace industry is fairly bright despite uncertainties about both Bombardier's CSeries and the future popularity of regional jets, in addition to the potential for weakness in the small business jet market to expand to larger plane sales.<sup>86</sup> Marc Parent, president and CEO of simulator and training giant CAE, believes that the civil industry will double over the next 20 years in support of globalization and industrial transportation needs.<sup>87</sup> The Conference Board of Canada forecasts that Canadian aerospace GDP will decline by 2.3% in 2010 and employment will fall by 6.2% before recovery starts in 2011.<sup>88</sup>

The defence segment has been a bright spot for the aerospace industry, helping companies soften the impact of the downturn in civil programs. The Canadian federal government plans to spend upwards of \$20B over the next 15 years to modernize its military infrastructure and while many of the contracts are with foreign-based manufacturers, Canadian companies will benefit from spinoffs and after-service contracts.<sup>89</sup>

## BIOTECHNOLOGY AND PHARMACEUTICAL

Ontario is a leading region in the pharmaceutical and biotechnology industry. It is home to more than half of the brand-name pharmaceutical companies in Canada and has the largest regional concentration of biotechnology firms in North America. Ontario has 33% of Canadian biotechnology companies<sup>90</sup> and ranks 6<sup>th</sup> in North America in terms of revenue.<sup>91</sup> In 2009, FierceBiotech named Ontario one of the top five places in North America for biotech.<sup>92</sup> Demand for pharmaceutical products continues to rise as total spending on pharmaceutical drugs in Canada is estimated at \$30B for 2009, an increase of 5.1% compared to 2008.<sup>93</sup>





Ontario's pharmaceutical and medicine manufacturing GDP rose 4.3% in 2008 adding to two years of strong growth.<sup>94</sup> As of October, YTD national GDP for the pharmaceutical and medicine manufacturing industry, of which Ontario accounts for 63%, was up 11.4%.<sup>95</sup> Shipments have also been growing for most of 2009, and Q3 2009 shipments in Ontario improved 15.3% compared to Q3 2008. This was the fifth consecutive year-over-year quarterly increase in shipments. Total shipments were up 11.3% YTD for the period ending October 2009.<sup>96</sup> The sector accounted for 3.2% of Ontario's total manufacturing shipments for October YTD, up slightly from the 2.5% share in 2008. Export Development Canada predicts that growth in Ontario's pharmaceutical exports will outpace the national average for 2009.<sup>97</sup>

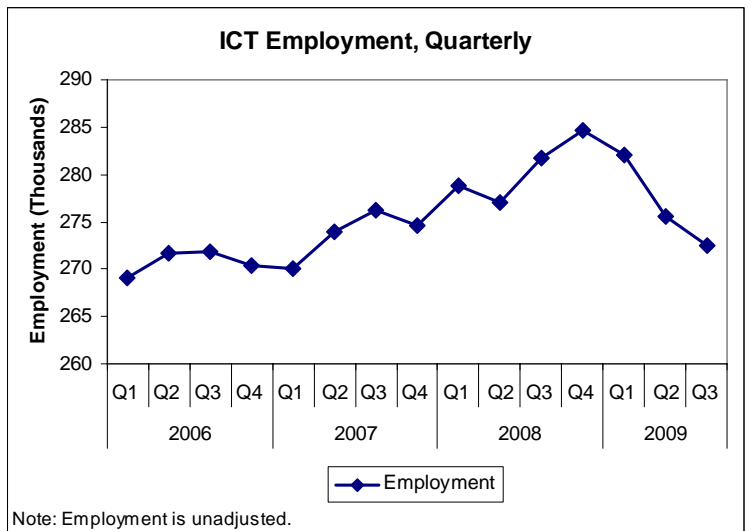
Despite sustained improvements in shipments, employment in the pharmaceutical and medicine manufacturing sector dropped 3.6% in Q3 2009 compared to same period in 2008. This was the largest quarterly drop since Q2 2005.<sup>98</sup> There is some indication that biotechnology sector employment has also declined. A 2009 study by BIOTECANADA found that 2,500 scientists lost their jobs in Canada during the first six months of 2009, with as many as 7,000 more in jeopardy.<sup>99</sup>

Details on national R&D spending for the pharmaceutical and biotechnology sectors in 2008 have recently been released. The Patented Medicine Prices Review Board found that R&D expenditures totalled \$1.3B in 2008, a decline of 1.1% compared to 2007.<sup>100</sup> One-third of the top 100 Canadian corporate R&D spenders in 2008 were pharmaceutical or biotechnology companies, nine of which were based in Ontario.<sup>101</sup> However, only one Ontario-based company, Biovail, landed in the top 1000 non-EU

R&D spending companies in the 2009 EU Industrial R&D Investment Scoreboard.<sup>102</sup>

The biotech sector faces considerable challenges ahead. Numerous studies have found that limited access to financial capital is the greatest challenge facing the industry. According to the 2009 Biotech Industry Forecast, 80% of the 167 companies surveyed listed access to capital as their main concern.<sup>103</sup>

## INFORMATION AND COMMUNICATIONS TECHNOLOGY



The ICT industry is strongly concentrated in Ontario; about 50% of Canadian ICT GDP, revenue and employment are in the province. Ontario is home to more than 16,000 ICT firms and many of the country's largest industry leaders are headquartered in Ontario, including IBM, Alcatel-Lucent, AMD, Cognos, Rogers, OpenText, RIM, Celestica and Aastra.

With more than 4.4% of Ontario's total employment in the ICT sector, Ontario has the largest share of ICT employment of any region in Canada. Ontario's ICT industry had 272,500 employees in Q3, approximately<sup>i</sup> a 3.3% drop compared to a year earlier.<sup>104</sup> Employment in both ICT manufacturing and ICT services has declined recently.

In 2008, the ICT sector contributed \$27.9B, or 5.7%, to Ontario's GDP.<sup>105</sup> ICT manufacturing generated almost 20% of Ontario's ICT GDP, while ICT services contributed over 80%. ICT GDP has improved every

<sup>i</sup> 2008 employment for telecommunications, a sub-sector of ICT, was estimated using a share of national telecommunications employment in order to calculate total ICT employment.



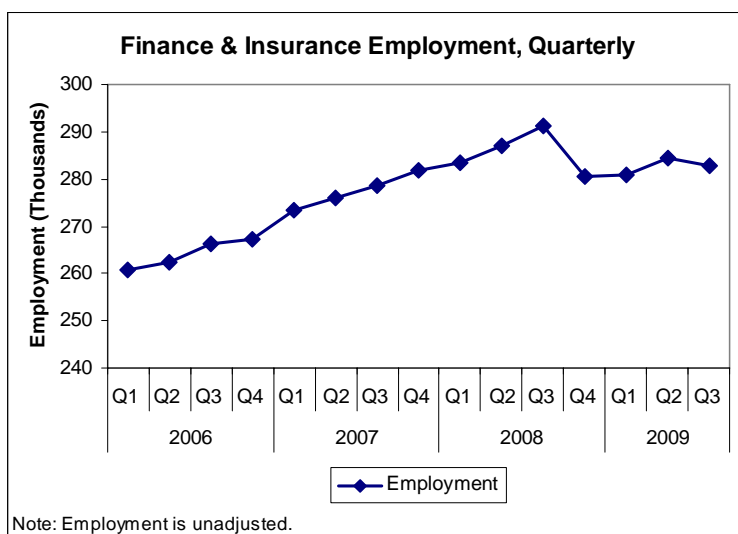
year since records began in 1997, and posted a 2.2% gain in 2008. However, ICT manufacturing shipments began declining in 2009. In Q3 2009, shipments fell 4.1%, bringing September YTD declines to 0.6%.<sup>106</sup>

The ICT sector in Ontario is both very innovative and research intensive. It is also very export oriented, with 90% of ICT manufacturing revenues being derived from exports in 2006. Nearly 63.5% of Canadian ICT manufacturing exports originated from Ontario in 2009.<sup>107</sup> The U.S. is the largest market for Ontario's exports, accounting for roughly 70% of ICT exports. Exports to the U.S. fell by 11.2% for November 2009 YTD, contributing to the total export decline of 7.5% for the period.<sup>108</sup> These declines added to the 4.1% drop experienced in 2008. While Mexico accounts for only 4% of Ontario's total ICT exports, it is the second largest export market and has posted impressive growth. In 2008, exports to Mexico were up by 43.8% and for November YTD they grew by 74.5%.

One of the major issues facing Ontario's ICT sector is the attraction and retention of talent. Ontario is facing challenges in meeting its need for highly specialized, leading edge and niche skills. It is expected that Ontario employers will need to fill up to 89,400 ICT professional jobs by 2015.<sup>109</sup> Shortages are expected in computer and information systems managers, software engineers and computer systems analysts. Currently, there are up to 2,000 jobs available every day at roughly 550 high-tech companies in the Technology Triangle (located in the Kitchener/Waterloo region).<sup>110</sup> Declining enrolment in computer science at Ontario universities is also a pressing issue which needs to be addressed in order to improve the global competitiveness of Ontario's ICT industry.<sup>111</sup>

#### FINANCE AND INSURANCE

The financial services sector employs roughly 285,000 people in Ontario and accounts for 7.7% of Ontario's total GDP.<sup>112</sup> About 230,000 in the sector are employed in Toronto, making the city the third largest financial sector in North America after New York and Chicago. Another 290,000 jobs are indirectly supported by the sector.<sup>113</sup> Toronto is home to the headquarters of Canada's five largest banks, six of the country's top insurance companies, over 100 securities firms, and the Toronto Stock Exchange—Canada's senior equities market and the third largest equity exchange group in North America.<sup>114</sup> Although Toronto dropped from 11<sup>th</sup> to 13<sup>th</sup> in the most recent Global Financial Centres Index, its absolute score improved and the city remained third in North America behind New York and Chicago.<sup>115</sup>



Output for Ontario's banks and insurance firms was \$30.8B in 2008, an increase of 22.5% since 2000, higher than the 16.1% growth seen for Ontario's economy overall. Output in 2008 was 3.6% higher than in 2007. Banks accounted for a significant portion of the growth over both periods, increasing 32.4% since 2000 and 4.4% since 2008, while insurance companies showed modest growth of 1.4% over the previous year, and have only added 1.7% to output since 2000.<sup>116</sup>

As of Q3 2009, employment in the financial services sector had fallen 2.9% over the last four quarters, as banks and other lenders shed 15,000 jobs (a 9.5% drop). Banks have focused on controlling costs to cope with falling earnings resulting from the recent financial crisis, ending a string of seven consecutive years of employment growth. The fall in bank employment was cushioned by hiring in the insurance sector, which added 4,900 jobs over the last year (ending in Q3). Employment in securities and investment firms was stable.<sup>117</sup>

	2009 Q4 earnings (millions)	Change in Earnings from Q4 2008 (%)	2009 Q4 ROE (%)	Tier 1 capital ratio (%)
<b>BMO</b>	\$647	15.5%	14.0%	12.2%
<b>CIBC</b>	\$644	47.7%	22.2%	12.1%
<b>RBC</b>	\$1,237	10.4%	14.7%	13.0%
<b>TD</b>	\$1,010	-0.4%	11.0%	11.3%
<b>Scotia</b>	\$902	186.3%	16.4%	10.7%



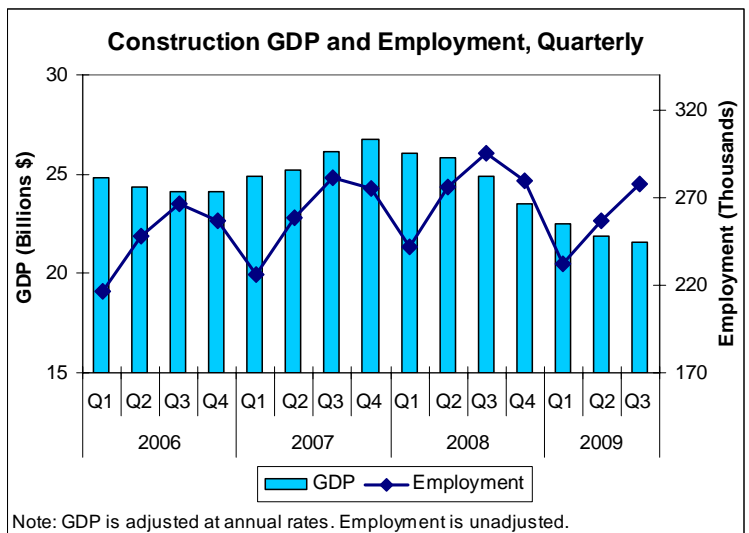


Despite the recent financial turbulence, Canadian banks continue to post relatively strong earnings. The five largest Canadian banks earned \$4.4B in Q4 (ending October 31), up 29% from Q4 2008, with TD being the only bank that did not increase earnings. For the fiscal year ending October 31, earnings totalled \$13.5B, reflecting a return to profitability for CIBC while three of the remaining four banks saw earnings fall compared with 2008. Despite significantly higher provisions for loan losses, Canadian banks have emerged from the recent recession with higher Tier I capital ratios, now in excess of 10%, which will provide security against future economic uncertainty and position them to acquire assets as opportunities arise.<sup>118</sup>

Some have noted that the banks' strong performance, together with strengths in insurance and securities trading, could increase Toronto's stature as a leading global financial services centre and launch a "Golden Era" of Canadian banking.<sup>119</sup> Scotiabank has used its relative strength to expand into emerging markets, including investing \$270M to take a 49% stake in Thailand's Thanachart bank and \$162M to take an 18% stake in China's Xi'an City Commercial Bank.<sup>120</sup> However, the deployment of substantial capital reserves to make more significant acquisitions will await the outcome of international negotiations on new financial services regulations, which will likely bring higher capital ratios.<sup>121</sup> The Obama administration has recently proposed new policies, including a tax on large financial institutions, a limit on the size of banks, and a prohibition on proprietary trading. If these proposals are passed by the U.S. Congress, Canadian banks with significant holdings in the U.S.—in particular TD and BMO—could be affected.<sup>122</sup> However, if these new regulations are not matched in Canada, there could be an incentive for U.S. banks to expand their operations north of the border.<sup>123</sup>

Changes in assumptions about future values of interest rates and equity markets cost the two leading insurance firms over \$500M each in Q3 (ending September 30), as Manulife reported a loss of \$172M and Sun Life lost \$140M. Both firms have focussed on significantly adding to capital reserves, with Manulife cutting dividends by 50% and raising \$5B in equity, while Sun Life has raised \$1.25B in new capital over the last year in addition to the \$2.2B realized from the sale of its stake in CI Financial.<sup>124</sup> The recent recovery in stock markets drove a return to profitability in Q4, with Manulife earning \$868M while Sun Life posted \$296M in profits, both slightly below expectations.<sup>125</sup> Rising demand for insurance stemming from the aging of the baby-boomer generation bodes well for the industry in the future.<sup>126</sup>

## CONSTRUCTION



The struggles faced by Ontario's construction industry in the first half of 2009 carried over into Q3. Although the decline in GDP for the sector was the smallest since Q2 2008, the 1.2% drop in Q3 output represents the seventh straight quarter with negative performance. Both residential construction (-2.2%) and non-residential construction (-0.6%) output were down since the previous quarter while engineering activity picked up by 0.7%. Since the same time last year, overall GDP for the construction sector was down by more than 13%.<sup>127</sup>

The recent trends in housing start declines were curbed in Q3 as total provincial starts ticked upwards by 6.7% in Q3 compared to Q2. Growth continued into Q4 as housing starts climbed 23.5%. The strong second-half growth did not compensate for the massive losses earlier in the year, bringing total 2009 losses to 33.3%.<sup>128</sup> This followed the national trend that saw housing starts throughout the country improve by a more robust 15.1% in Q3 and a steady 13.7% in Q4.<sup>129</sup> Declines were not evenly distributed throughout the province, however. Communities such as Barrie, Hamilton and Oshawa all saw their housing starts decline by more than 50% in Q3.<sup>130</sup>

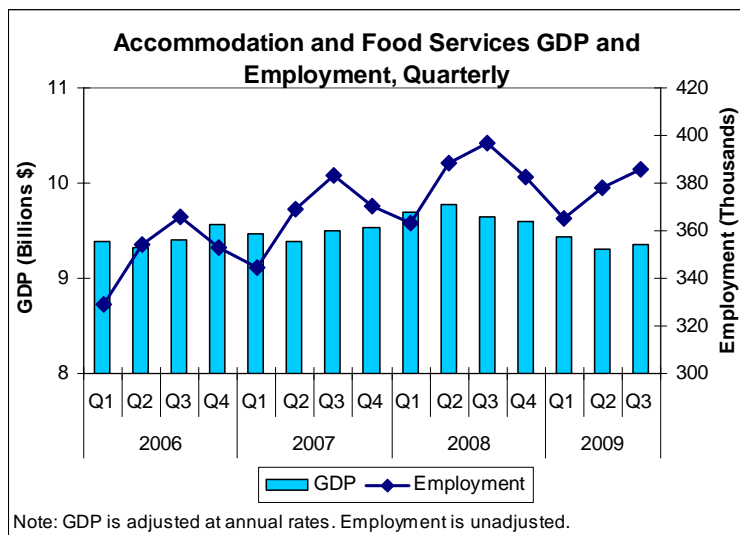
Employment in the construction industry dropped for the third consecutive quarter in Q3 2009, down by 6.1% compared to the same quarter last year. Prior to 2009, quarterly employment had not suffered from a year-over-year loss since 1995. Again, job losses in the specialty trade contractors sub-sector were the most severe, down 7.0% or more than 13,100 jobs. Compared to the first three quarters of 2008, total industry employment was down 5.8% with a net job loss of close to 15,800.<sup>131</sup>



The total value of building permits was down by 27% in Q3 compared to the same period in 2008. This decrease was the result of a 36% slide in the value of non-residential permits and a lesser, but still substantial, 19% decrease in the value of residential permits. Compared to Q2 2009, however, the value of permits was down 6.8% following positive growth in the previous quarter. Comparatively, Canada's overall value for total permits rose by 1.2%. The decrease in Ontario was mostly attributed to the non-residential sector which saw the value of permits decline by 16.6% over Q2 2009. Toronto, which accounts for slightly more than 40% of all permits in the province, had the third largest percentage decrease (-23%) of all census metropolitan areas (CMAs) in Ontario, trailing only Windsor and Greater Sudbury.<sup>132</sup>

Looking ahead, the construction sector is expected to return to growth. Infrastructure program spending should peak in early 2010 and at the same time consumer and business confidence are expected to improve, stimulating both the housing market and renovation activity.<sup>133</sup> The relatively better economic conditions in 2010, coupled with low interest rates, are anticipated to create a significant rebound in housing starts in many of the larger urban centres throughout the province.<sup>134</sup> Additionally, major construction projects are anticipated to help general employment in the sector. According to a new report, 41 of Canada's 100 most expensive infrastructure projects currently underway or expected to begin in 2010 are in Ontario.<sup>135</sup>

## TOURISM



The performance of the tourism industry is closely linked to overall economic health, both in domestic and foreign markets. Much of tourism involves discretionary expenditures; thus, during economic

downturns, individuals and businesses tend to cut down on tourism-related spending. However, travel and tourism do not stop, people just travel differently. For example, there is some indication that Ontarians are continuing to travel, but closer to home. National tourism spending grew in Q3 2009 based on increased expenditures by Canadians, outweighing declines in international spending.<sup>136</sup> Ontarians' out-of-country travel fell sharply for October YTD, down 12.1% over the same period the prior year.<sup>137</sup> Taking into account that over 80% of visitors in Ontario are residents of the province, the domestic market plays an important role in sustaining the industry. Ontario's Ministry of Tourism forecasts modest growth in visits to Ontario in 2010 as increases in domestic travel outweigh continued weakness in international markets.<sup>138</sup>

Trips by international travellers to Ontario have been falling for years. There are many factors behind this trend, including the terrorism attacks in 2001, the Toronto SARS crisis in 2003, fluctuations in the Canadian dollar and gas prices, increased border security, and the recent global recession. International traveller trips to Ontario fell to yet another all-time quarterly low in Q3 2009 of 3.1M.<sup>139</sup> This represents a decline of 5.1% compared to the previous quarter, a 16.7% drop from Q3 2008, and a massive 62.0% drop from Q2 2001, the quarter prior to the September 11, 2001 attacks. Visitors from the U.S., which make up nearly 90% of Ontario's international visitors, accounted for most of the declines, but overseas visitors also fell sharply.<sup>140</sup> Entries from Mexicans have been falling particularly fast following the introduction of new visa requirements in July 2009. In October 2009, entries were down by over 60% compared to 2008.<sup>141</sup> In response to falling demand, AeroMexico plans to suspend its flights to Toronto beginning in March 2010, after pulling out of Montreal in January.<sup>142</sup>

The overseas market may get a boost from two new international travel agreements. In December, Canada signed a reciprocal air transport agreement with the European Union, which includes Ontario's top three overseas markets: the U.K., Germany and France. The agreement removes all restrictions on routes, prices, and number of weekly flights and is expected to result in cheaper fares and more choices for consumers.<sup>143</sup> Canada was also granted Approved Destination Status (ADS) from China in December, which will make it easier for Chinese tourists to come to Canada. China is forecast to be one of the top outbound tourism markets in the world by 2020<sup>144</sup>, and it was the only country to increase overseas arrivals to Ontario for October 2009 YTD.<sup>145</sup> A Conference Board of Canada survey



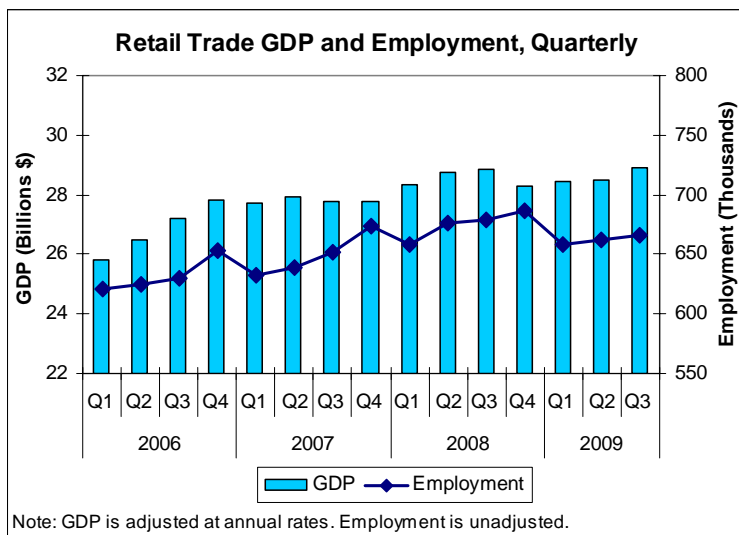
indicated that ADS could boost the yearly rate of travel to Canada from China by up to 50% by 2015.<sup>146</sup>

Employment in Ontario's accommodation and food services industry, the largest segment of the tourism industry, fell by 2.8% in Q3 2009 over the same period in 2008.<sup>147</sup> After falling for four consecutive quarters, the sector posted a small 0.6% GDP gain in Q3.<sup>148</sup> Occupancy rates at Ontario hotels fell 4.8 percentage points to 58.6% for the first ten months of 2009.<sup>149</sup> Some of the lowest occupancy rates were recorded in southern Ontario, including a rate of only 42.0% in Windsor. Average daily room rates in Ontario fell 6.1% for the period and revenue per available room declined by 13.2%.<sup>150</sup> Ontario hoteliers cited regional economic conditions as the top business impediment during Q3.<sup>151</sup>

Globally, tourism is expected to pick up in 2010. The United Nations World Tourism Organization (UNWTO) forecasts growth in international tourist arrivals of between 3% and 4% in 2010.<sup>152</sup> Upside opportunities identified by UNWTO include growing business and consumer confidence, historically low interest rates and inflation, and pent-up demand. Downside risks include high unemployment rates, fragile economic growth in major source markets like the U.S. and Europe, phasing out of stimulus spending, and volatile oil prices.<sup>153</sup>

#### RETAIL AND WHOLESALE TRADE

Ontario's retail and wholesale trade sector accounted for 12.4% of the province's total output and 17.6% of employment in Q3 2009.<sup>154</sup>



As Ontario's labour market begins to stabilize and consumer confidence rebounds, there has been some positive news for the retail sector. Sector output grew

by 1.4% in Q3 and in addition to smaller gains in the previous two quarters, output surpassed levels seen before the recession.<sup>155</sup>

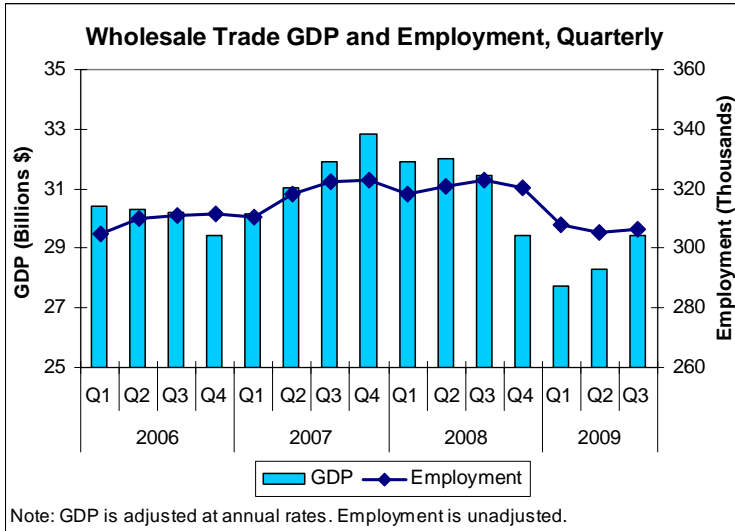
However, other indicators point to continued struggles in the traditionally strong sector. Retail employment fell for the second consecutive quarter in Q3, down 1.8% over the same period last year, a slightly slower pace than the 2.1% decline in Q2.<sup>156</sup> Retail sales also declined in Q3, falling 3.2% over the same time last year.<sup>157</sup> Most of the decline was caused by lower sales at gasoline stations (-25.1%), driven by lower gas prices. If gasoline station sales are excluded, retail sales actually posted a small increase of 0.1%. Pharmacy and supermarket sales grew in Q3, up 6.0% (+\$171M) and 2.9% (+\$169M) respectively. Home centres and hardware stores also experienced increases (2.9% or +\$58M). Many of the country's biggest home improvement retailers have reported gains over the past year, in part benefitting from the home renovation tax credit.<sup>158</sup> However, business could slow after expiry of the tax credit on January 31.<sup>159</sup>

After faltering in the first three quarters of 2009, monthly retail sales increased year-over-year for the first time in 12 months in October (the first month following Q3).<sup>160</sup> Growth continued in November, with sales increasing 1.3% from a year ago. The Conference Board of Canada forecasts that retail sales will post a solid 4.3% growth in 2010, followed by an even stronger performance in 2011.<sup>161</sup>

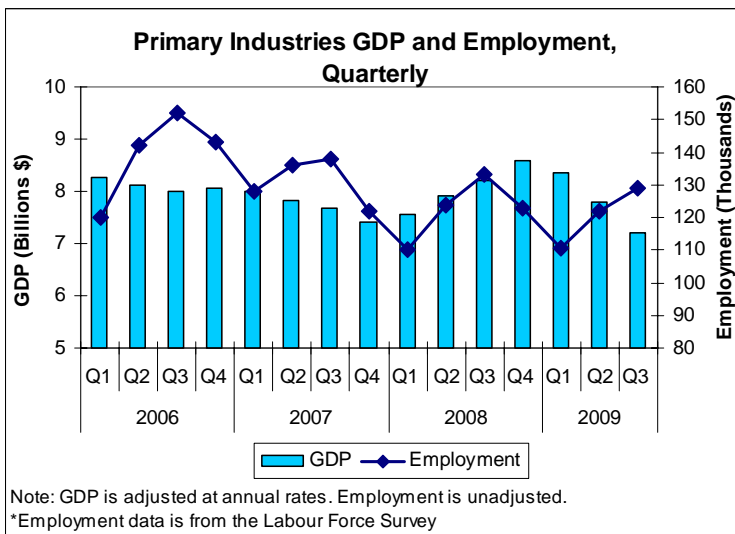
Many retailers have been providing significant discounts, resulting in narrower margins, while others have been faced with layoffs and closures. Some of the most recent announcements in this industry include closures of long standing Toronto businesses. In December, Dack's Shoes went into bankruptcy after 175 years in business and shortly thereafter, Syd Silver Formals declared bankruptcy after 82 years in business, resulting in 95 lost jobs.<sup>162</sup> Mississauga-based Cotton Ginny also filed for bankruptcy in November 2009 after a restructuring earlier in the year that included store closures and layoffs.<sup>163</sup>

Adding to other signs of economic recovery, wholesale sales were up 6.4% year-over-year in November—the first increase recorded in 11 months.<sup>164</sup> On a seasonally adjusted basis, Ontario sales were up 3.5% over the previous month as gains in the automotive products sector boosted sales.<sup>165</sup> Sector GDP grew by 4.0% in Q3, making a strong contribution to Ontario's overall growth.<sup>166</sup> Unfortunately, job losses continued to accumulate in the wholesale trade sector. In Q3 there were over





16,500 fewer jobs than the same time last year, a 5.1% decline.<sup>167</sup>



### AGRICULTURE

Accounting for 1.4% of provincial employment, Ontario's agriculture sector employed<sup>ii</sup> 91,000 workers in Q3 2009.<sup>168</sup> There was a modest 0.6% employment gain in Q3, as the animal production sector added 4,500 jobs over the same period last year, outweighing losses in crop production, mixed farming and support activities.<sup>169</sup> However, those gains were erased in Q4, when agricultural employment fell 6.4% compared to Q4 2008. Ontario's November YTD crop exports generated \$1.5B, a 0.9% decline from a year ago, while animal production exports fell 26.2% to \$5.1M.<sup>170</sup>

<sup>ii</sup> Employment data for this section is from Statistics Canada Labour Force Survey and is not strictly comparable to SEPH data used elsewhere.

Ontario's farm cash receipts totalled \$2.3B in Q3, a 14.8% year-over-year quarterly decline, as receipts from crops, livestock and direct payments all fell.<sup>171</sup> Crop receipts dropped 18.1% in Q3 2009 over Q3 2008, accounting for the majority of overall declines. Crop receipts were down due to falling grain and oilseed prices, as strong demand and production boosted sales.<sup>172</sup>

Total receipts from livestock and its products decreased 9.4% during the one year period, as international cattle exports fell due to a rapidly rising dollar, an increasing flow of beef from the U.S. and a competing pork sector. Ontario cattle farmers have incurred losses of \$350 to \$400 an animal since the summer of 2009.<sup>173</sup> Ontario's November YTD beef cattle exports to the U.S. fell 47.4%, while total international exports declined by 30.7% during the one year period.<sup>174</sup> In some good news for the sector, China lifted its ban on Canadian beef and pork products in December 2009, translating into potential sales of \$110M annually for Canadian farmers.<sup>175</sup> However, a ban on Canadian canola remains in place, blocking exports potentially worth \$150M annually.<sup>176</sup>

In December 2009, the federal and provincial governments jointly invested \$11.27M through the *Growing Forward* initiative in Guelph's Agri-Technology Commercialization Centre.<sup>177</sup> This investment aims to help make Ontario's agriculture industry more innovative, competitive and profitable, as organizations housed in this facility assist in commercializing new agricultural products.

### MINING

Employment in the province's mining sector declined 26.6% between Q3 2009 and Q3 2008.<sup>178</sup> Over that period, there were almost 5,400 fewer jobs in mining and quarrying and almost 2,600 fewer jobs in support activities.<sup>179</sup>

Based on figures from the last twelve years, Ontario's mining industry reported a record low GDP of \$2.18B.<sup>180</sup> Output fell 11.0% from the preceding quarter, as continuing labour disputes in the nickel mining industry hampered production.<sup>181</sup>

According to an Export Development Canada (EDC) report, metals have surpassed the auto sector to become the largest export industry in Ontario, accounting for 33.1% of the province's total exports.<sup>182</sup> Ontario's November YTD mining exports declined 3.6% to \$8.4B compared to the same period in 2008.<sup>183</sup> More specifically, exports from metal ore mining decreased 2.7% to \$7.6B, reflected in the overwhelming declines in iron (46%), nickel-copper





(100%), lead-zinc (97.4%), copper-zinc (100%) and other metal ore mining (73.3%).<sup>184</sup> Exports from gold and silver ore mining have increased marginally by 0.5% to \$7.6B since Q3 2008.<sup>185</sup>

In February, the strike at Vale Inco's nickel mining and processing operations in Sudbury and Port Colborne entered its seventh month. Over 3,100 workers in Ontario have been on strike since July 13, 2009.<sup>186</sup> Despite the strike, Vale began operating its Sudbury Copper Cliff smelter at 50% of capacity in January using non-union workers. In February, it was announced that it would restart its Creighton nickel mine and boost production at the Coleman mine, both in Sudbury, using workers provided by a contractor.<sup>187</sup> It is suspected that the strike has helped push nickel prices from around \$7 (U.S.) per pound before the strike to about \$8.2.<sup>188</sup> Prices rose even higher on the threat of a strike by Xstrata employees in Sudbury, but on February 3 employees voted in favour of a 3-year contract. With the new contract in place, Xstrata plans to reactivate its Fraser Mine in late February, which could result in the recall of 100 of the 500 laid-off workers.<sup>189</sup>

On January 21, Liberty Mines Inc. announced that it would be increasing production at its two nickel mines in Timmins and Gogama, and may restart a third by mid-year.<sup>190</sup> Within the next three months, output will be raised to 1,500 tonnes of ore per day, potentially resulting in the company hiring additional employees. Currently, both the Redstone and McWatters mines are producing at a rate of 300 and 500 tonnes of ore per day, respectively.<sup>191</sup>

EDC experts believe that despite nickel exports being adversely affected by labour disputes, these declines will be offset by much higher prices and output at provincial gold mines in 2010.<sup>192</sup> Similarly, weak demand for steel will be partially offset by very strong iron ore demand, especially from European and Asian markets.<sup>193</sup>

## FORESTRY

With increasing international competition, the relatively strong Canadian dollar, weakening demand for commodity products and the U.S. housing market downturn, Ontario's forest and paper companies continued to face challenging business conditions in Q3. In Eastern Canada (all provinces east of Manitoba), the six largest public forest and paper companies reported an aggregate loss of \$422M in Q3, exceeding losses of \$322M reported during the same period last year.<sup>194</sup>

Forestry sector employment averaged 4,900 workers in Q3; prior to 2007, Q3 employment figures were well above 10,000. When compared to the same quarter last year, forestry sector employment decreased 43.2%, composed of a 23% decline in forestry and logging and 65.2% drop in support activities.<sup>195</sup>

Since its peak of \$79.8M in 2002, Ontario's forestry exports have continued to decline.<sup>196</sup> Totalling \$19.2M in the first nine months of 2009, exports decreased 24.4% from the same period last year.<sup>197</sup> Paper and wood product manufacturing, sectors highly integrated with the forestry industry, saw exports decline 17.9% and 17.4%, respectively.<sup>198</sup>

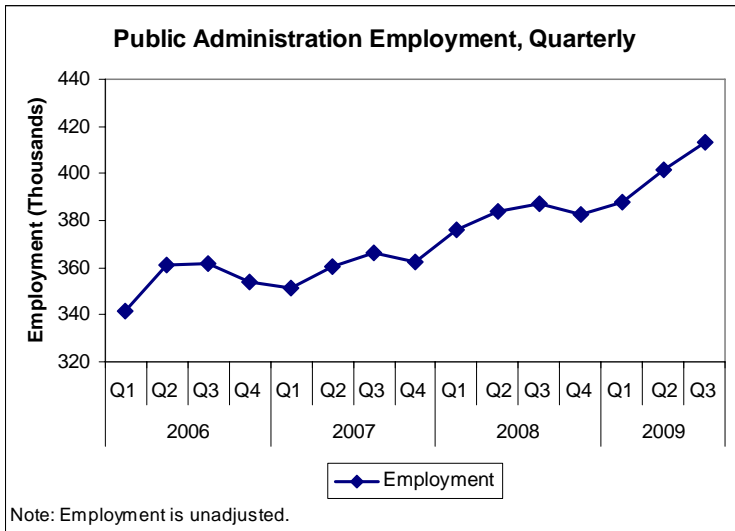
On January 19, AbitibiBowater indefinitely shut down operations at its Fort Frances Ontario mill after the mill's effluent treatment system exceeded its daily biochemical oxygen demand. The mill employs about 565 workers and produces northern bleached softwood kraft pulp. Partially offsetting this news, the Ontario government announced on the same day that it would be investing \$5.3M, through the Forest Sector Prosperity Fund Ontario, in Canadian Bio Pellet's Ingleside facility.<sup>199</sup> Scheduled to open in spring 2011, this facility will turn wood chips, sawdust and shavings into biomass wood pellets for North American and European markets. The company is expected to add about \$60M annually to the local and regional economy and generate about 90 jobs in the community.<sup>200</sup>

According to PricewaterhouseCoopers' 2010 *CEO Perspectives* report, the Canadian paper and forestry industry is standing on the brink of major changes and the need for transformation is imminent.<sup>201</sup> This is attributed to the fact that demand for paper and forestry goods is unlikely to return to pre-recession levels due to the prominence of digital media, among other factors. In response, reducing production costs and producing bio-fuels and other chemicals derived from forest products could fundamentally alter the structure of the entire industry.<sup>202</sup>

## PUBLIC ADMINISTRATION

The public administration sector is a significant part of Ontario's large service economy. This sector is broadly defined to include activities that are purely government in nature, such as taxation, legislation, and public safety.<sup>203</sup> As a subcomponent of the broader public sector, the public administration sector does not include all establishments under government control (i.e. it excludes port operations for the federal government, public hospitals and educational





institutions for provincial or territorial governments, and school boards for local governments).

The sector is divided into four parts: federal, provincial/territorial, municipal/local/regional, and aboriginal. In Q3 2009, Ontario recorded more than 413,000 workers in the public administration sector. Municipal governments employed 44.8% of the overall sector, followed by federal (31.9%), provincial (20.9%), and aboriginal (2.4%) governments.<sup>204</sup> Employment increased by 6.7% in Q3 over the same period in 2008, with the provincial government accounting for the majority of gains. Employment in the other three levels of government also grew, but at a more moderate pace. The following section focuses solely on the provincial public administration subsector.

In the provincial subsector, annual employment climbed by 7.1% in 2008 compared to 2007, or by 4,450 additional workers. Employment growth in this subsector outpaced both the overall service industry average (2.8%) and total all-industry employment growth (1.5%) for the same period.<sup>205</sup> Employment continued trending upwards in 2009, with a Q3 2009 year-over-year employment increase of 24.8% compared to Q3 2008, the largest increase on record. Q3 represented the third consecutive quarter of more than 20% employment growth and the seventh consecutive quarter of job growth in the provincial public administration sector.<sup>206</sup>

Much of the growth in this sector has been driven by higher public sector spending to combat the global recession. The provincial government, however, has stated that spending growth will be addressed in its expenditure review in the budget (expected in March 2010). Also, Ontario's Ministry of Revenue

announced that it will lose 1,250 employees when the harmonized sales tax (HST) comes into effect on July 1. A memorandum of agreement between Ontario and the federal government stresses that many of these jobs will be absorbed by the federal government.<sup>207</sup>

## ISSUES FACING THE PROVINCIAL ECONOMY

### BUSINESS CONDITIONS

Recent economic data has been generally encouraging, resulting in positive adjustments to forecasts. In January, the International Monetary Fund's prediction of Canadian economic growth in 2010, for example, was revised from 2.1% to 2.6% as commodity producing countries all benefitted from strong demand for commodities in emerging Asian markets.<sup>208</sup> In advanced countries, however, the IMF saw little indication of a rise in demand that was not based on government policy.<sup>209</sup>

Although demand for commodities tends to support Canada's economy, increased energy prices would be a drag on the economy in Ontario. Oil prices are difficult to project, however, with forecasts spanning a very wide range.<sup>210</sup> According to the Bank of Canada's Commodity Price Index, energy prices rose throughout 2009 but remained below the highs of mid-2008.<sup>211</sup>

Persistently high unemployment could weigh on consumer demand. The U.S. unemployment rate remained at 10% in December 2009 with no expectation of much improvement this year. The slight increase in jobs in November was wiped out by 85,000 job losses in December 2009. Consumer demand could also drop due to a shrinking labour force as 600,000 people left the U.S. labour force in December.<sup>212</sup> Ontario's unemployment rate remained at 9.3% for the final three months of 2009<sup>213</sup> and is projected to average 9.5% in 2010.<sup>214</sup>

Confidence in economic recovery among Canadian businesses continues to grow, according to the Bank of Canada's Business Outlook Survey. Although most firms still have excess capacity, on balance they expect to increase investments in machinery and equipment, expect sales growth to increase at a higher rate, and expect to increase employment over the next twelve months. Firms also expected input prices and output prices to grow at a faster rate over the next twelve months.<sup>215</sup>

Credit conditions continued to stabilize in Q4 2009, according to both the Business Outlook Survey and the Bank's Senior Loan Officer Survey. The price component of business lending improved slightly, tipping the balance of opinion onto the side of easing



credit for the first time since Q2 2007. Notably, some small business owners reported that they still faced tightening credit conditions.<sup>216</sup>

Consumer confidence in both Canada and the U.S. continues to rise. According to the Nielsen index, Canada's consumer confidence in December 2009 was 98, compared to 82 in the U.S. and a global score of 87. Canadians were rated as more likely than global consumers to use cash to pay down debts and less likely to save, spend, or invest their money.<sup>217</sup>

Consumer insolvencies in Canada were up 14.4% year-over-year in November 2009 and 17.3% in Ontario. Ontario's business insolvencies, however, had improved at a higher rate than the national one for the same period; Ontario had 18.9% fewer insolvencies compared to 14.7% fewer in Canada.<sup>218</sup>

### U.S. ECONOMY

Although Ontario's reliance on the U.S. as an export market has been declining over the past decade, over 80% of the province's exports still go to the U.S.<sup>219</sup> Sectors including automotive, tourism, and forestry are particularly reliant on the U.S. economy. As such, economic conditions in the U.S. will play a large role in Ontario's economic recovery.<sup>220</sup>

After contracting in the first two quarters of 2009, U.S. GDP increased in Q3 by 2.2% and in Q4 by an initial estimate of 5.7% annualized. On an annual level, GDP was down 2.4% in 2009 compared to 2008.<sup>221</sup> While 5.7% growth would seem to indicate a strong exit from the recession, the details are important. This initial estimate of Q4 GDP is likely to be revised downward; Q3 GDP had initially been estimated at 3.5%, for example, before eventually being revised down to 2.2%. If the short-lived impact of inventory re-stocking were removed from the data, Q4 growth would have been 2.2%. Perhaps more alarmingly, growth in domestic demand declined from 2.3% in Q3 to 1.7% in Q4.<sup>222</sup>

The U.S. unemployment rate remained at 10% in December as employers cut 85,000 jobs. The work force, however, declined by 661,000 people as discouraged job seekers abandoned their searches. Overall in 2009, 4.2M jobs were lost and the unemployment rate averaged 9.3% compared to the 2008 figure of 5.8%. The consensus among forecasters is that unemployment will remain high in 2010 and decline gradually.<sup>223</sup>

Corporate profits were up 12.7% in Q3, the largest increase since Q1 2004.<sup>224</sup> The Institute for Supply Management's (ISM) manufacturing index was also

up, reaching 58.4% in January, its highest level since August 2004. January marked the ninth consecutive month that the index suggested growth in the overall economy. ISM's new orders index rose to 65.9% in January, the seventh consecutive month of growth. Production and prices were also up according to ISM's data, suggesting that manufacturing continues to recover from the economic downturn.<sup>225</sup>

There remain challenges to economic recovery in the U.S., however. Although the housing market is improving, difficulties at the Federal Housing Administration (FHA) illustrate the persistent problems created by drops in real estate prices. In December, 9.1% of borrowers backed by the FHA had missed at least three payments, compared to 6.5% in December 2008. Claims filed with the FHA by lenders who had lost money on loans were up 47% year-over-year in October and November 2009. The default rate is expected to continue rising and potentially drain the FHA's reserves, requiring the U.S. government to cover excess losses.<sup>226</sup> The withdrawal of government support for mortgage-backed securities, planned for March, could also drive up interest rates, making refinancing more difficult and reducing sales.<sup>227</sup>

Government stimulus likely played a significant role in GDP growth during Q4.<sup>228</sup> Homebuyers were offered continued support when the Obama administration extended the first-time buyer credit to deals signed by April 30 and closed by June 30, and offered it to existing homeowners.<sup>229</sup> President Obama also announced plans for a \$30B program to fund community banks offering loans to small businesses.<sup>230</sup>

After months of criticism by Canadian exporters, a solution was apparently found to "Buy American" restrictions in U.S. procurement. Canadians are now free to compete on U.S. projects at the state level in 37 states. In return, American companies have been granted the right to bid on most Canadian provincial projects.<sup>231</sup> The deal has been criticized by some, however, for exchanging too much for the right to compete on projects for a very small percentage of remaining U.S. stimulus funding.<sup>232</sup>



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