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Quebec's comeback

Long seen as an economic laggard, the province is in the midst of a mini-boom. Unemployment is falling, companies are investing and the government's fiscal house is in order. But does its status as an economic star have staying power? **Nicolas Van Praet** reports

A clutch of Quebec Inc. executives and politicians in high spirits streamed into the greystone headquarters of Montreal media firm Stingray Digital one recent morning to sip Champagne cocktails and toast the firm's fresh-faced founder, Eric Boyko.

The dot-com millionaire and social butterfly held court as officials with major investors such as the Caisse de dépôt et placement du Québec and FTQ Solidarity Fund mingled with local and federal lawmakers over fancy pastries and mimosas.

"This is big growth for us," Mr. Boyko said of his plans to double Stingray's staff to 750 people over the next five years and expand the work space to a newly built tower next door. "My dream is that the grandchildren of my employees work here one day."

Just hours before, Mr. Boyko confessed privately that he felt as if this was his birthday party and fretted that no one would show up. He needn't have worried. This was never going to be your run-of-the-mill ribbon cutting or rubber-chicken lunch.

Rather, it felt more like the latest testament to an economy that's roared back to life, another confirmation that after so many years of listlessness, the future was bright. And no one invited was going to miss that fête, early morning or not.

There's been plenty to cheer for lately.

Long seen as Canada's economic straggler, Quebec is now experiencing a mini-boom driven by unprecedented job gains. Public finances in Quebec are under control for the first time anyone can remember, ushering in a new era of fiscal predictability for companies. The province's long-term borrowing costs are now below Ontario's. The unemployment rate is at 5.8 per cent – the lowest rate since comparable data became available in 1976 – and falling faster than anywhere else in the country.

Behind the cyclical factors firing up the economy, other things are at play. Entrepreneurs such as Mr. Boyko are leading a new generation of risk takers. Labour participation is higher than expected, pushing back the demographic reckoning as the number of people between the ages of 15 and 64 – the biggest pool of potential workers – continues to shrink.

All of that is fuelling an economy that continues to defy projections. And it's turned Quebec from a chronic underperformer into one of Canada's unexpected bright spots, raising the previously unthinkable prospect that one of the country's historically poorest provinces could one day become a net contributor to equalization, instead of a perennial beneficiary.

To what degree has Quebec shaken off its uninspired economic performance of recent past? The first quarter of the year was so strong that even if the economy were to slow to an annual expansion rate of 1 per cent for the rest of the year, gross domestic product for 2017 would still be up 2.4 per cent from 2016, a rate of growth not seen in a decade.

"We've always kind of been the underdog in terms of economic performance since I've been old enough to look at how things are going," said Sonny Scarfone, an economist with the Institut du Québec. "Improvement has been very fast over the last 24 months. And that's been surprising."

"Somehow, the cake rose very quickly in the oven," said Sébastien Lavoie, chief economist at Laurentian Bank. "Growth just accelerated very substantially."

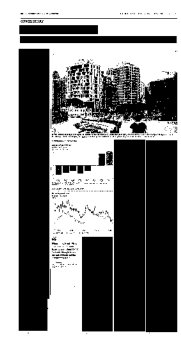
The pace of the upturn was both swift and startling.

In 2015, Quebec was in the throes of a funk. For three years, the economy had barely expanded. Consumer confidence was low and Quebeckers were generally in a foul mood, their frame of mind reflected nightly on TV newscasts relating the latest developments in the Charbonneau Commission examining corruption in the province's construction industry.

Then the mood began to change.

Mr. Lavoie said he believes the trigger was a mix of factors: A rally in Quebec exports for materials such as aluminum and plastics that began in 2013 hitched onto better domestic demand as oil prices declined. The decision by both the federal and Quebec governments to lighten the tax load for the middle class stoked it further, he said. That in turn left Quebeckers with more money in their pockets and companies with higher profits. The disposable income of Quebec households has been growing at a faster pace than spending since late 2014, something not seen in Ontario, Mr. Lavoie said.

Companies opened the hiring taps in 2015, and by 2016, it had turned into a full blown gusher. Quebec added no fewer than 85,400 full-time jobs last year, most of them private-sector service jobs. That was more than all other provinces combined. And although the quality of new jobs



appears to have decayed somewhat since, with more part-time work in the mix, the quantity keeps coming. Over the past 12 months to July, employment in Quebec was up 124,000, Statistics Canada's latest figures show. And wage growth is up more than 3 per cent year over year, much stronger than the national average of 1.3 per cent.

More people with better-paying jobs and more tax relief means more people buying things, and experts say that is at the heart of Quebec's strength at the moment. Consumer spending rose 5.75 per cent year over year in the province in the second quarter, the biggest increase in the country.

Infrastructure spending is also firing up growth. Montrealers complain regularly these days that their city is little more than a maddening stream of orange safety cones. But multibillion dollar projects such as the Champlain Bridge and Turcot Interchange rebuilds are creating jobs and keeping the construction industry running at high capacity.

You don't have to search far to see who's hiring.

In Quebec City, which has been at full employment for several years now, senior business leaders organize regular trips overseas to hunt for specialized talent. More recently, "Help Wanted" signs have started popping up in local McDonald's restaurants targeting seniors who might want to make their days more "fun" by serving cheeseburgers.

The provincial capital's tech industry is going strong, anchored by new investments from companies such as Medicago. The vaccine maker is spending $245-million on a new production complex in the city and is in the midst of hiring 200 new workers at the site for 2019.

Building on the business community's confidence, developers have hatched major plans for the Quebec City area. The grandest of all is being spearheaded by Michel Dallaire, a real estate magnate who wants to build the tallest skyscraper outside of Toronto. His plans for a 65-storey, multiuse steel-and-glass tower called Le Phare are awaiting final regulatory approval.

"This will be an iconic building in Quebec, certainly," Mr. Dallaire said, adding he believes he'll have no trouble finding commercial tenants in an expanding economy. "I've already got offices leased out in the building so I've got to deliver the space."

Back in Montreal, the buzz is palpable at the headquarters of Moment Factory. The multimedia company, which produces big-scale, blow-you-away light shows and other innovative entertainment experiences, was started in 2007 by two pals who financed the business on their credit cards. A decade later, with Madonna's Superbowl show under its belt in addition to a slew of other contracts for clients including Disney and Sony, it is capturing the attention of clients around the world.

The loft work space is relaxed and fun. Think dogs, sofas, beers, skateboards, a bubble-gum machine. A smiling Buddha on the cafeteria counter sports sunglasses and a lei. The privately held company's ambition, however, is dead serious. It has 250 employees, half of them multiskilled workers from various corners of the globe. The founders plan to double that by 2020.

"When all the head offices decamped for Toronto [starting in the late 1970s], everyone thought it was the end of Montreal," said Éric Fournier, one of Moment's partners and senior executives. "But it reinvented itself."

The combination of four major universities churning out talent and government tax relief has spawned a new media and technology ecosystem in Montreal. The city has already cemented its status as a major video-game production hub. But it's now also home to growing investment in fields such as artificial intelligence, with leading experts working here, and companies such as Alphabet's Google Inc. sinking money into local AI research.

Companies such as Lightspeed, GSoft, RodeoFX, Frank & Oak and Airbnb's Luxury Retreats have all set up shop in Montreal. And it's no coincidence why.

"It's clear that we're seeing a change of paradigm in Montreal," said Christian Bernard, an economist for economic development agency Montreal International. "When I came here 20 years ago, unemployment was [in the] double digits. The main economic development issue was trying to get the jobless rate down, to try to find ways to integrate people into employment. Twenty years later, Montreal has succeeded in making the transition from a traditional manufacturing economy to one centred on knowledge."

Lightspeed has ballooned from 50 employees at its inception to 600, and plans to hire "hundreds" more over the next two years, founder and chief executive Dax Dasilva said. Mr. Dasilva, who's originally from Vancouver, said the e-commerce software provider is able to do a lot of things in Montreal it couldn't do elsewhere.

For example, the low cost of business allowed the company to buy real estate in its early years instead of paying a landlord. Labour is also cheaper, he said. "Our California investors encourage us to hire more in Montreal," he said. "We can get many more people here for the same price as we can get an engineer from [Silicon] Valley, where it's really competitive and a lot harder to stand out."

In turn, employees are able to build a life that's inaccessible to them in other major cities, he said. Although home prices are rising, Montreal does not have a runaway property market such as those in Vancouver or Toronto. And consumer electricity prices are among the cheapest in the world.

Quebec's strong labour market and a surge in consumer confidence are feeding optimism among home buyers in the province, the Quebec Federation of Real Estate Boards says. Luxury homes are among the hottest spots in the market, with sales of Montreal properties priced above $1-million up 17 per cent so far this year, according to Sotheby's.

In July, the median price for single-family home in Montreal was $323,000, according to the Greater Montreal Real Estate Board, up 8 per cent year over year.

"Is it crazy? No," Montreal real estate agent Amy Assaad said. "Still, we're seeing things fly off the shelves in 2017" as demand outstrips supply. Montreal homes sales jumped 16 per cent in July over the same month last year, outpacing activity in both Toronto and Vancouver as those markets cooled.

Ms. Assaad said though foreign buyers represent a tiny portion of total sales volumes, their interest in Montreal is growing and that roughly 40 per cent of the deals she's working on currently involve Chinese buyers. "I feel like a lot of them are moving here," she said.

And Quebec needs all the immigrants it can get.

The province, which has some control over immigration, currently admits about 50,000 to 60,000 newcomers annually. That level helps it replenish a work force that is aging faster than almost everywhere else in Canada. As many of those people as possible, as well as those already here, need to participate in the labour market in order to support economic growth and improve Quebeckers' living standards, the government says.

That's happening. And to a much greater extent than most people expected. The employment rate for those between the ages of 15 and 54 was nearly 78 per cent last year, after having risen sharply over the past few years. That's higher than the Canadian average of about 75.4 per cent.

Women are the main reason Quebec has made such acute gains. The employment rate for females between the ages of 15 and 54 has climbed more than 10 percentage points over the past 16 years, to 76.8 per cent, compared with 73 per cent in the rest of Canada. At last count, the trend line was continuing upward. Quebec-specific programs, such as subsidized daycare and generous parental leave, have certainly contributed to more women pursuing careers. Canada also fares well, but Quebec ranks third-highest in the world for the participation rate by women in the work force, according to National Bank.

Quebec's labour participation gains represent a major structural factor lifting the economy, said Louis Vachon, National's CEO. He notes that the bank's loan losses, which were already very low, have continued to decline over the past six to 12 months.

"One thing that suggests is that a lot of people are working and companies are active," Mr. Vachon said. "We're having a good run right now."

The return of entrepreneurship is another structural element with a potential to lift the economy, Mr. Vachon said. Quebec has lagged the rest of Canada badly in recent years, both in terms of the percentage of adults who own a business and those with intentions of owning a business in the future.

The latest figures show a tripling of intentions in Quebec and a dramatic rise in the percentage of Quebeckers taking steps to start a company. That change still hasn't shown up in terms of formal ownership. But experts are confident that it's coming as a serious push by government and the private sector to demystify entrepreneurship to young Quebeckers in recent years takes hold.

"Communication is a big part of that shift we're seeing" in intentions, said Elizabeth Stefanka, 30, a Montrealer who launched an apparel-fitting company and is active helping new entrepreneurs. "It's empowered people."

"We literally saved Quebec," Premier Philippe Couillard said this past January to reporters quizzing him about his Liberal party's poor performance in four by-elections. "We were on the brink of disaster."

When the Liberals took office in 2014, Quebec was headed straight for a debt cliff. The province's net debt had ballooned to more than 50 per cent of GDP after years of running deficits. Economic output was positive, but sputtering. Taxes were the highest on the continent. Virtually no options remained for lawmakers except to slash spending.

And slash they did. The government's two years of spending cuts took a hatchet to many of Quebec's most lauded social programs. Its budget compression ended the universal fee structure for Quebec's $7-a-day daycare program, cancelled free IVF for infertile couples, squeezed support services in schools and limited the number of baths for elderly patients in public nursing homes.

The media called it "austerity" and for some, it felt like it, even if that term wasn't quite appropriate. Spending growth slowed, but still grew in absolute terms. The results of that effort are now clear as daylight, even if Quebec did receive a helping hand from equalization payments.

The province posted a surplus of $2.5-billion for the fiscal year ended March 31, according to preliminary data released in June. And that's after a $2-billion contribution to its Generations Fund, an investment fund set up in 2006 to reduce net debt. It is managed by pension-fund manager Caisse de dépôt et placement du Québec.

Quebec now expects to balance its budgets for the next five years. It is forecasting that net debt will fall from 47.2 per cent of GDP at the end of March, 2017, to 46 per cent by next March and 42 per cent by 2021. After Standard & Poor's upgraded Quebec's debt to AA- in June because of its fiscal prudence, the province's credit rating topped that of Ontario for the first time.

In a historic shift, investors are no longer demanding a higher yield when lending to Quebec rather than Ontario. Quebec yields on both 10-year and 30-year bonds plunged below Ontario's following the S&P credit hike and remained two basis points lower as of Aug. 3, Quebec finance official Dominic Cormier said, citing data from PC-Bond. He said Quebec's 30-year bond yield had never been below Ontario's. So-called spreads, or the difference in yields, now favour Quebec.

"My goal in life is to have our spreads lower than Ontario," Quebec Finance Minister Carlos Leitao told The Globe and Mail. "We've now put in place a virtuous circle of improved confidence, improved economy, strengthening public finances, more confidence. So we're going in the right direction."

Improving its public finances allows Quebec to shave interest costs off its debt. But it also has an effect on the wider economy because it creates more certainty that taxes won't jump unpredictably. "People can invest here and they know the government has more fiscal margin to manoeuvre," Mr. Vachon said.

There was a cynicism among Quebec's business leaders that the government could fix public finances, said Yves-Thomas Dorval, head of Quebec's Conseil du patronat, an association representing major employers. That it was able to do so has led to a change of perception among those employers, he said.

"Hope came back."

Can Quebec keep it up? Or will la boom turn into la doom as a rapidly greying population fails to keep enough people working to support its vast array of social programs? More urgently, how will the renegotiation of trade pacts such as the North American free-trade agreement affect its export-dependent economy?

Almost no one believes Quebec's real GDP annualized growth of 4.3 per cent in the first quarter is sustainable, or even desirable. But for now, Mr. Lavoie noted that almost all industries are growing on a year-over-year basis in Quebec and that broad-based growth raises chances that it will continue. Manufacturing of food, chemicals, metals and machinery has been particularly strong this year, feeding momentum in the economy, according to Toronto-Dominion Bank. Consumer and small-business confidence is also at levels not seen since the before the 2008 recession.

"People are confident; they want to invest. And in the regions, there's more creativity and entrepreneurship than we think," said Guy Cormier, CEO of Desjardins Group, Quebec's biggest lender. "In the last 10 years, this is probably a period of time when people have been the most positive."

As Quebec regains its swagger in a more definitive way, it's perhaps not surprising that there is also renewed optimism among business leaders about the province's ability to confront major structural challenges and face the future.

The fading likelihood of another referendum on independence has certainly played a role in calming the fears of home buyers and investors. And although the prospect of another vote can't be discarded fully, it diminishes with each passing day.

The fact Quebec has so far been able to avoid a major labour-force decline by keeping more people working also bodes well, observers say. But major hurdles remain, particularly in areas such as retraining. Quebec has more one-industry towns than many other provinces and a lower labour-force participation rate for people aged 55 and over than most other jurisdictions. That means it's not easy for someone such as a laid-off lumber mill worker to find another job. And it means Quebeckers retire earlier. Lawmakers are trying to address these problems by introducing policies such as tax credits for people who choose to continue working but more solutions are needed.

If Quebec can solve the issue of underemployment in its immigrant population – Montreal trails other Canadian cities badly when it comes to the integration of immigrants into the labour market, according to a 2016 study by the Institut du Québec – and stop bleeding people to other provinces, that would also help.

"Our greatest challenge going forward is not so much job creation as it is finding people to fill those jobs," Mr. Leitao said, adding worker shortages are even more acute outside big cities. "That's what keeps me awake at night."

In the end, wealth is generated by human beings. And Quebec's success in the future will be measured by its ability to attract people and keep those it has in the work force as much as possible, said Michel Kelly-Gagnon, founder of the Montreal Institute think tank.

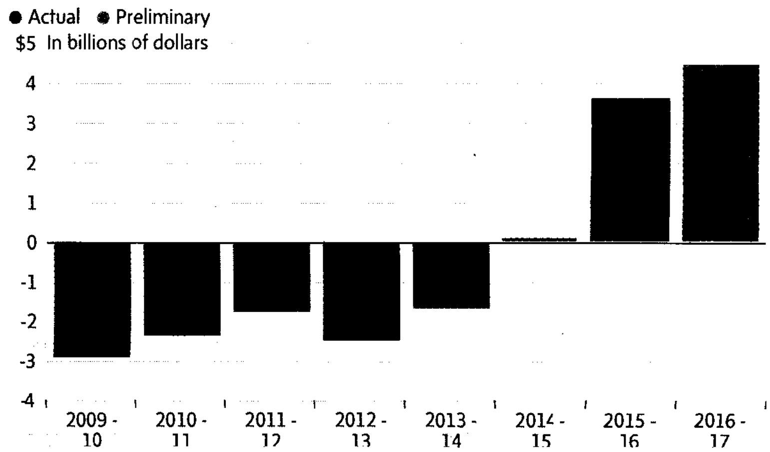
It can't do anything about the cold in February. But it can do things such as avoiding unnecessarily aggravating policy on things such as language law, he said.

"I think if we could tweak a few problems that are under our control" we can keep driving growth, Mr. Kelly-Gagnon said. "That's why I have this sort of cautiously, almost semi-bullish outlook."

Quebec's economic climb back, driven by Montreal, is one of Canada's most astonishing business developments of the past 12 months. "We're walking on snow," said Hubert Bolduc of Montreal International. Exactly how long it can stay there remains to be seen.

UNPRECEDENTED GAINS

Quebec's fiscal balance

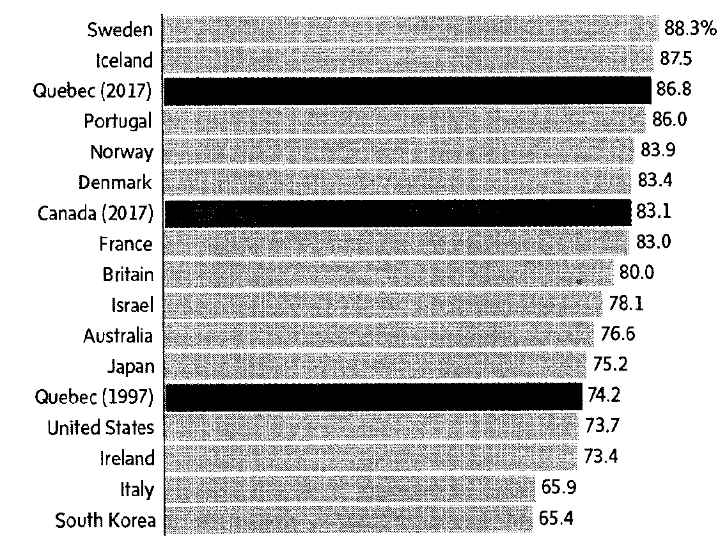


THE GLOBE AND MAIL, SOURCE: QUEBEC FINANCE / NOTE: BALANCE FOR PUBLIC ACCOUNTS; FIGURES BEFORE CONTRIBUTIONS TO GENERATIONS FUND

RISING PARTICIPATION

Women's labour participation rate

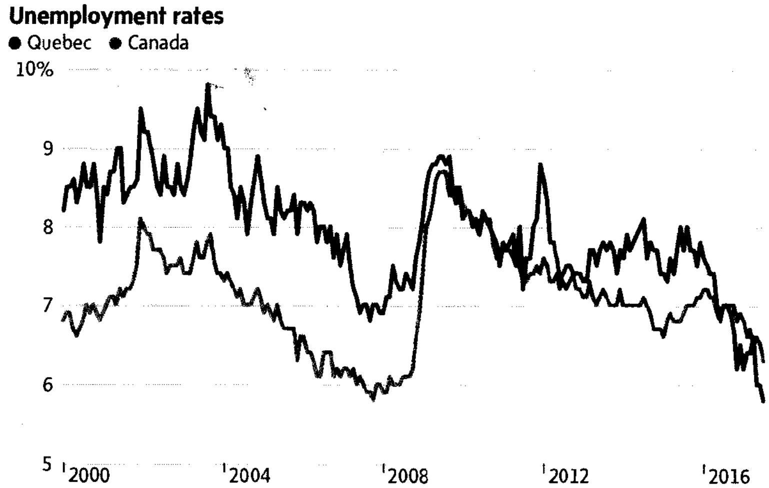
For women aged 25 to 54 (figures for 2015 unless specified)



THE GLOBE AND MAIL, SOURCE: NBF ECONOMICS AND STRATEGY (VIA STATSCAN AND OECD); 2017 DATA AS OF JULY

PLUMMETING UNEMPLOYMENT

Unemployment rates



THE GLOBE AND MAIL. SOURCE: STATSCAN / SEASONALLY ADJUSTED