

# Budget ADDRESS

*NORTHWEST TERRITORIES 2005 - 2006*

**BUDGET PAPER**

**A ♦ Economic Review**



## **NORTHWEST TERRITORIES ECONOMIC OUTLOOK**

Growth in the Northwest Territories (NWT) economy in 2004 was once again noteworthy: real GDP grew by an estimated 10.6 per cent. That growth comes on top of the robust growth that has taken place in recent years, including growth of over 20 per cent in 2003. From 1999 to 2004, the NWT economy has grown 79 per cent in real terms. That the economy has been able to sustain these gains even in the face of a rapidly expanding base of activity is remarkable. In fact, no other province or territory has matched the growth that has taken place in the NWT over the past five years.

Half of the growth in the NWT economy in 2004 was due to an increase in diamond exports and one-third was due to higher investment. However, all components of GDP – investment, consumer expenditures, government expenditures and net exports – increased. Employment and average weekly earnings rose 3.7 per cent and 3.0 per cent, respectively. Yet, despite the economic strength, pricing pressure at the consumer level was very modest, with the 2004 Yellowknife Consumer Price Index (CPI) up only 0.6 per cent from 2003. The low growth in the consumer price level, combined with the gain in average weekly earnings, meant that the typical consumer in the NWT witnessed solid growth in purchasing power during the year.

The outlook for 2005 is bright. Driven by continued strength in commodity prices, the NWT economy is expected to continue to perform well, with real GDP growth forecast to be 10.1 per cent. The employment level should continue to rise and should be accompanied by continued growth in average weekly earnings. Consumer price inflation is expected to accelerate from the exceptionally low pace of 2004.

Over the medium-term, the future is also bright. Given the strength in the world economy and the consequent upward pressure on commodity prices, there continues to be significant interest in the NWT's non-renewable resource sector. This interest is clearly evident in the diamond sector, where the two diamond mines in production have made Canada the world's third largest producer of diamonds by value. Construction of the NWT's third mine will start soon at Snap Lake and pre-feasibility studies continue to take place at the Gahcho Kue (Kennady Lake) diamond project northeast of Yellowknife, which may result in a fourth diamond mine in the NWT by 2011.

Another source for considerable optimism is the proposed Mackenzie Valley natural gas pipeline. The economic benefits that would result from the pipeline are significant for both the NWT and Canada.

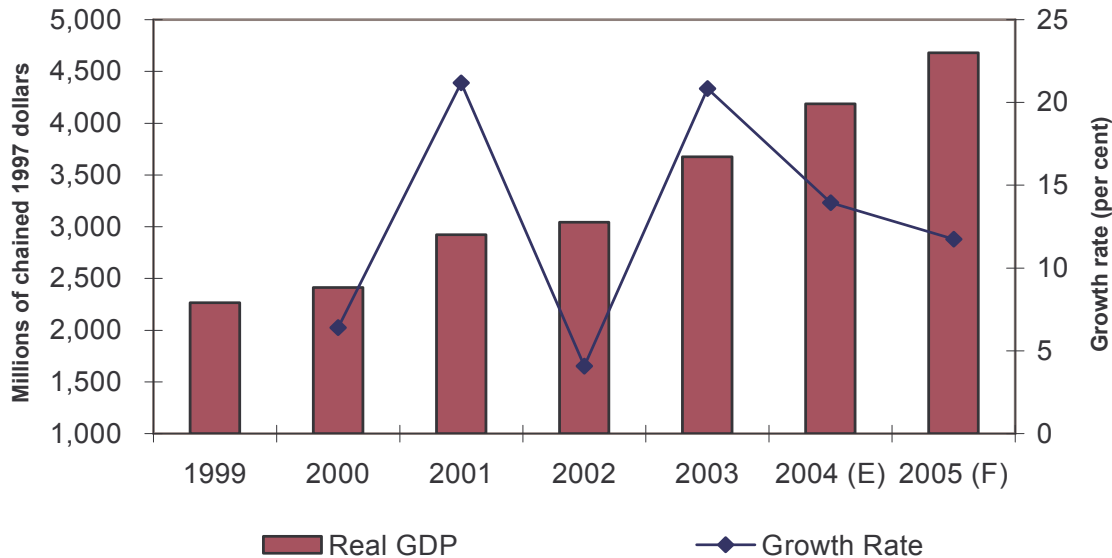
### Northwest Territories Economic Indicators

INDICATOR	2002	2003	2004 (E)	2005 (F)
Gross Domestic Product, chained 1997 dollars	3,042	3,676	4,065	4,474
% change	4.1	20.8	10.6	10.1
Total Investment, chained 1997 dollars	1,256	855	1,007	1,553
% change	(5.8)	(31.9)	17.8	54.2
Consumer Expenditures, chained 1997 dollars	981	1,017	1,032	1,036
% change	4.5	3.7	1.4	0.5
Government Expenditures, chained 1997 dollars	973	1,002	1,028	1,039
% change	3.0	3.0	2.6	1.1
Exports, chained 1997 dollars	1,898	2,979	3,341	3,590
% change	9.0	57.0	12.1	7.5
Imports, chained 1997 dollars	2,051	2,036	2,186	2,573
% change	1.7	(0.7)	7.4	17.7
Employment, number of persons	20,925	20,850	21,617	21,900
% change	0.7	(0.4)	3.7	1.3
Average Weekly Earnings, dollars	888	895	925	943
% change	3.1	0.8	3.3	2.0
CPI (Yellowknife, 1992 = 100)	116.3	118.4	119.1	120.6
% change	2.9	1.8	0.6	1.5

Sources: Statistics Canada  
NWT Department of Finance

(E) Estimate  
(F) Forecast

**NWT Real Gross Domestic Product**



Sources: Statistics Canada (1999-2003) and NWT Finance (2004 - E, estimate; and 2005 - F, forecast)

**EMPLOYMENT**

The employment market in the NWT remained strong in 2004. The employment level averaged 21,600 people in 2004, up from 20,900 in 2003, for a gain of 3.7 per cent. This gain in employment outpaced the growth in the working age population, which rose 2.3 per cent from 29,800 in 2003 to 30,500 in 2004.

Compared to 2003, the employment and participation rates were up, while the unemployment rate was down. The employment rate in 2004 was, on average, 70.9 per cent, compared to an average 69.9 per cent in 2003. Participation rates (the percentage of people 15 years of age or older who are in the labour force) averaged 75.2 and 75.7 per cent in 2003 and 2004, respectively; and the unemployment rate averaged 7.0 and 6.3 per cent in 2003 and 2004, respectively.

Within the territory, however, differences continue to exist between the larger communities (Fort Simpson, Fort Smith, Hay River, Inuvik, Norman Wells and Yellowknife) and the smaller centres. According to the NWT Bureau of Statistics *Community Survey* (Winter 2004), the unemployment rate in the larger centres was 6.2 per cent, versus 26.0 per cent in the smaller communities. Participation and employment rates in the larger centres were 81.2 per cent and 76.2 per cent, respectively, compared to 59.9 per cent and 44.3 per cent in the smaller communities.

The NWT continues to perform well compared to the rest of Canada, with below average unemployment rates but above average employment and participation rates. In 2004, Canada's participation rate was 67.5 per cent compared to 75.7 per cent in the NWT. The national unemployment rate was 7.3 per cent, which was higher than the NWT unemployment rate of 6.3 per cent.

### NWT Labour Market



Source: Statistics Canada

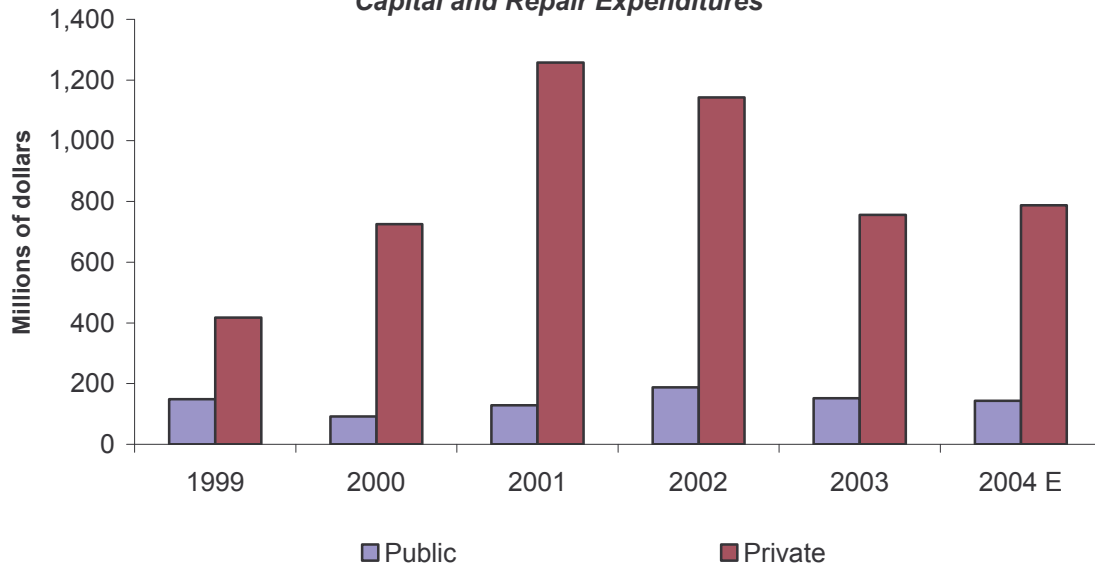
## INVESTMENT

### *Capital and Repair Expenditures in the Public and Private Sectors*

Total investment expenditures in 2004 are estimated at \$931 million, comprised of public sector investment of \$144 million (or 15 per cent) and private sector investment of \$787 million (or 85 per cent). Fiscal restraint measures in the GNWT capital budget have reduced public sector investment from its recent peak of \$188 million in 2002. Private sector investment is also down from its 2001 high of \$1,257 million due primarily to the completion of the construction phase at Diavik, the NWT's second diamond mine.

An improved fiscal situation will permit the GNWT to increase its investments in infrastructure over the coming years. Private sector investment should continue to be robust in 2005, as construction activity begins on the NWT's third diamond mine, located near Snap Lake. As a result, total investment in 2005 is forecast to increase from the 2004 level.

**NWT Public and Private Investment**  
*Capital and Repair Expenditures*



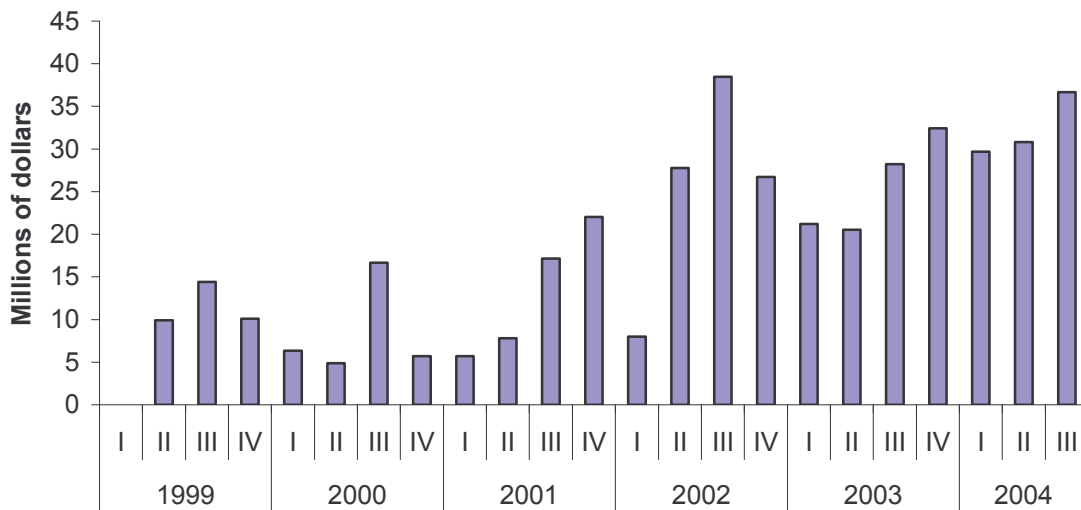
Source: Statistics Canada (2004 data estimated by Statistics Canada, using survey of investment intentions among public- and private-sector organizations)

**Housing Investment**

Total housing sector investment in the NWT continues to grow, driven by continued economic strength in the territory and attendant personal income gains. Through to the third quarter of 2004, the most recent quarter for which data are available, housing investment totalled \$97.2 million, up from \$70.0 million in the same nine-month period a year ago; a growth rate of 39 per cent. Housing investment in 2004 is expected to exceed the high level posted last year, which itself followed on the heels of strong gains in 2001 and 2002.

As in recent years, most of the housing investment growth in 2004 has occurred in Yellowknife. The housing market is expected to show continued vigour in 2005 due to low interest rates and economic activity such as the start of construction of the Snap Lake diamond mine.

### ***NWT Housing Investment***



Source: Statistics Canada

## **MINING AND OIL AND GAS EXPLORATION**

The non-renewable resource sector is the powerhouse of the NWT economy. Within this sector, the diamond industry is now the most significant by far, although the proposed Mackenzie Valley natural gas pipeline would provide an impetus to the energy sector and would allow for new exploration for oil and gas in the territory, especially in those regions that straddle or lie near the pipeline route.

Driven by pre-production trial mining at Snap Lake, exploration spending in the NWT continued to grow briskly in 2004, coming in at \$110.4 million, more than double the 2003 level of \$49.8 million. Exploration spending in the NWT in 2004 was the third highest in Canada, behind only Ontario and Quebec. Because of the strong commodity prices that have been in place since 2002, interest in mineral exploration continues, and exploration expenditures are expected to remain robust in 2005.

### ***The Diamond Sector***

The value of diamond production in 2003 was over \$1.7 billion, more than twice the 2002 level, due to the effect of production starting at Diavik, the NWT's second producing diamond mine. The value of diamond production in 2004 is estimated to be in excess of \$2 billion. With the Snap Lake mine set to begin production in 2007, the value of diamonds mined in the NWT should continue to grow. Pre-feasibility studies are underway for a possible fourth mine at the Gahcho Kue (Kennady Lake) property.



Although the value of the rough diamonds produced in the NWT’s mines should top \$2 billion in 2004, the value of these diamonds increases as they move through the supply chain to the point at which they are sold as jewellery at the retail level. The tasks of sorting, polishing, manufacturing and marketing diamonds add much value beyond that assigned to the rough stones produced at the mine site. Various diamond polishing enterprises operating in the NWT help to ensure that some of these downstream benefits remain in Canada’s North. However, currently less than one per cent by volume of the NWT’s diamond production remains in Canada to be cut and polished.

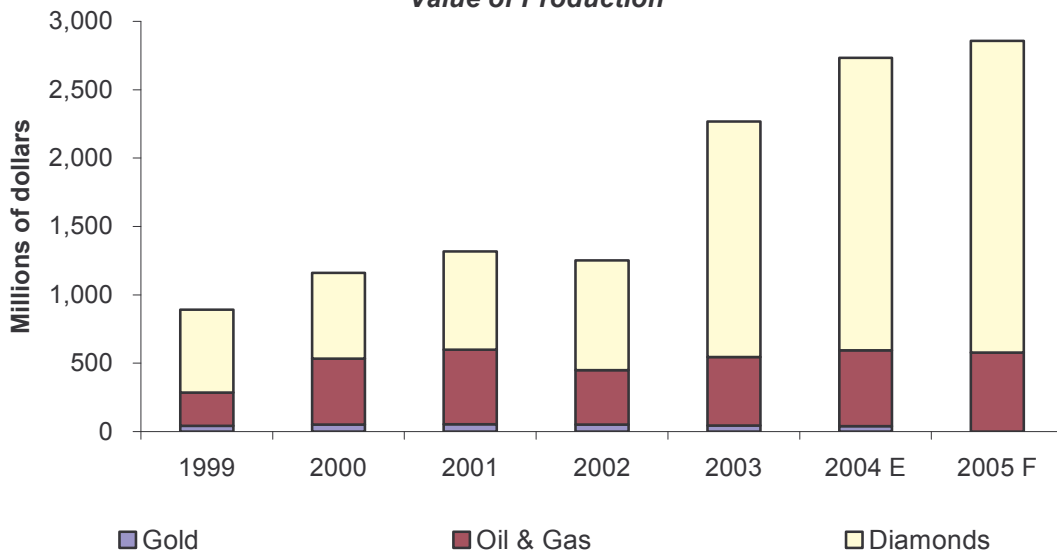
**The Oil and Gas Sector**

2004 was a strong year for the oil and gas sector and production values should top the \$501 million mark posted in 2003. Oil and gas activity in the NWT remains centred in the Fort Liard, Cameron Hills and Norman Wells areas. However, should the Mackenzie Valley pipeline project go ahead, substantial oil and gas production and exploration is likely to take place in the Mackenzie Delta and Beaufort Sea areas.

**Gold Mining**

Mining operations at the last gold mine operating in the NWT ceased in July 2004 and the mine is slated to close in 2005. Gold production was valued at \$45 million in 2003 and is forecast to fall to less than \$10 million in 2004 and to zero in 2005.

**NWT Gold, Oil & Gas and Diamonds**  
Value of Production



Sources: Statistics Canada (1999-2003) and NWT Finance (2004 estimate and 2005 forecast)

## COMMODITY PRICES AND EXCHANGE RATES

2004 was another year of strong commodity prices, especially in base metals and energy. The price of oil, in nominal terms, hit a new record, but, in real terms, the price of oil still remains below its peak of 25 years ago, when the world was still dealing with the supply disruptions that followed the second oil crisis of the 1970s. Further, because of lower energy dependency in the world's major industrial economies, the run-up in the price of oil does not seem to have had the detrimental impact that might have been expected. Nevertheless, base metal and oil and gas producers had a good year in 2004. The strength is expected to carry over into 2005, but much hinges on what happens in China, where demand for energy is a major cause of the upsurge in global commodity demand.

### Oil Prices

The average price of West Texas Intermediate (WTI) oil in 2004 was US\$41.41 a barrel, compared to US\$31.14 a barrel in 2003, a gain of 33 per cent. Prices peaked in October, when they averaged US\$53.19/bbl, and then fell slightly in November and December. Prices continued to fall in early January 2005, to lows of US\$40-41/bbl, but have since rebounded to the upper US\$40s/bbl.

**Oil Prices**  
West Texas Intermediate



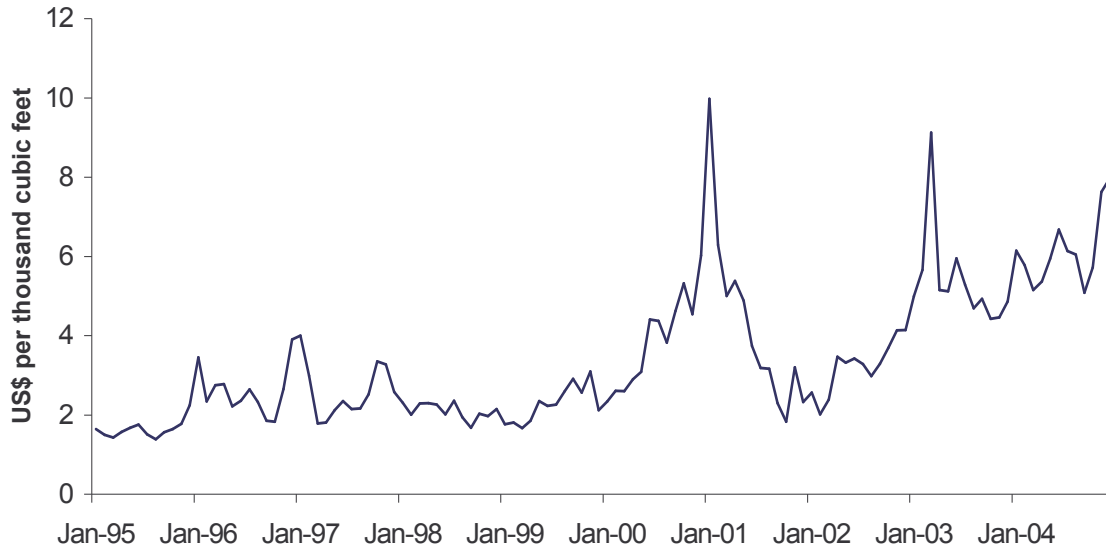
Source: Sproule Associates Limited

### Natural Gas Prices

As with oil, natural gas prices also rose in 2004, when they averaged US\$6.14 per thousand cubic feet (at Henry Hub, Louisiana), up 13.9 per cent from the year earlier average price of US\$5.39/mcf. Unlike oil prices, natural gas prices peaked in December when the price averaged US\$7.98/mcf. Natural gas prices are far higher than they were in the 1990s, when prices of US\$2-3/mcf were the norm.

### Natural Gas Price

Henry Hub NYMEX

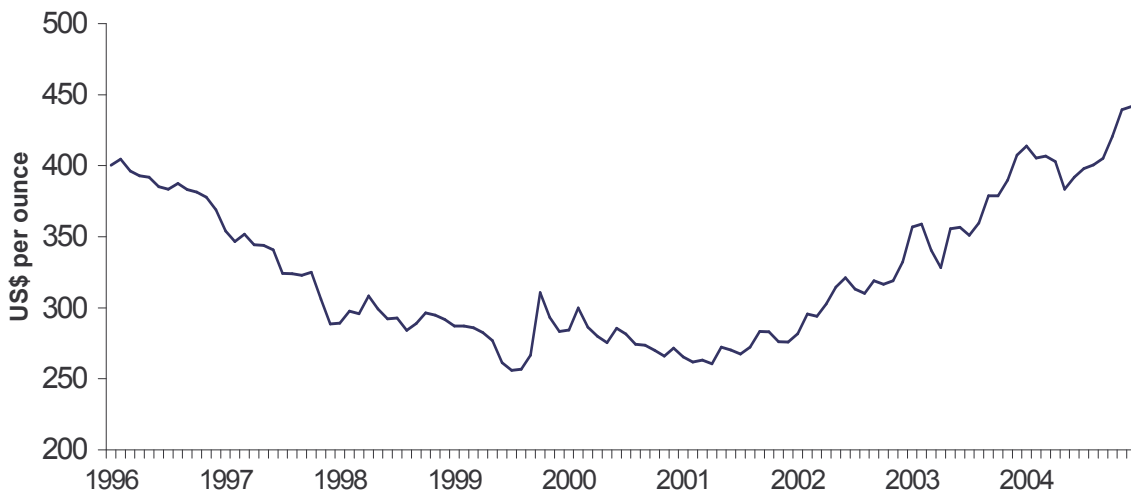


Source: Sproule Associates Limited

### Gold Prices

Gold prices in 2004 built on their gains of 2003, averaging US\$409.72 per ounce in 2004 versus US\$363.38/oz in 2003, a rise of 12.8 per cent. That follows a gain of 17.3 per cent in 2003. The rise in the price of gold has been mainly due to the weakness in the US dollar, with which gold has a strong inverse correlation. In fact, gold's rise in price is more a matter of US dollar weakness rather than any particular strength in the price of gold itself. Expressed in terms of other currencies, the price increase looks far less dramatic. In US dollar terms, the price of gold hit multi-year highs in 2004 and was at its highest in December, when it averaged US\$441.76/oz. Gold has since retreated to about US\$425/oz as of mid-January 2005.

### Price of Gold



Source: Kitco Precious Metals

### **US-Canada Exchange Rate** *US dollars per Canadian dollar*



Source: Bank of Canada

### ***The Canadian Dollar***

In 2004, the Canadian dollar, rising in tandem with commodity prices, posted another year of solid gains versus its US counterpart, increasing from average US71.59 cents in 2003 to average US76.98 cents in 2004, for a gain of 7.5 per cent. This gain builds on that of the previous year, when the Canadian dollar climbed 12.4 per cent. For the year, the Canadian dollar peaked at US85.04 cents on November 26. It had closed as low as US71.65 cents on May 17.

The Canadian dollar has benefited from the leap in commodity prices over the last several years, reflecting the high proportion of commodities in the composition of Canada's exports. Also giving a lift to the Canadian dollar has been a plunge in the value of the US dollar against major world currencies in general. Measured against those other currencies, the Canadian dollar has been fairly flat over the past couple of years, in marked contrast to its performance relative to the US currency.

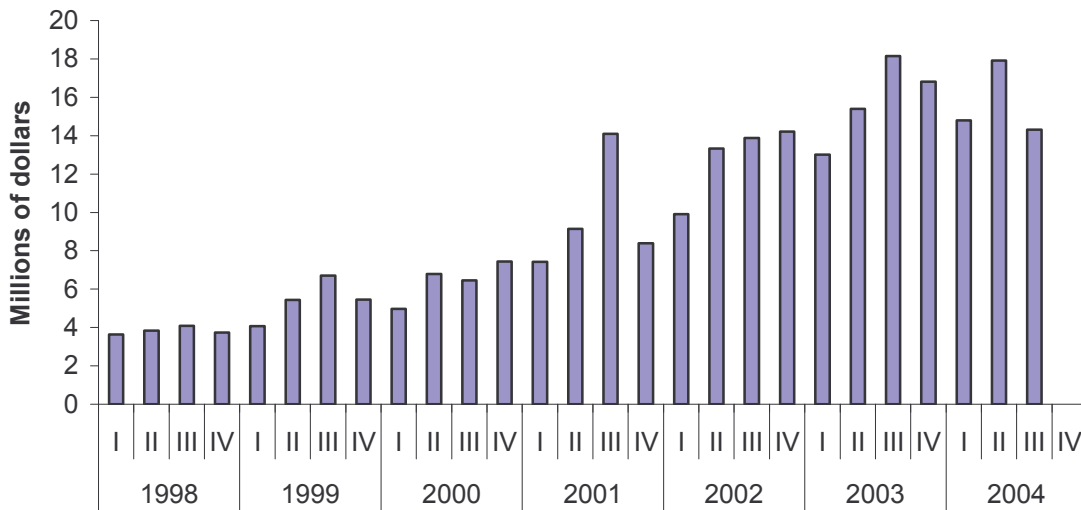
## **MANUFACTURING SHIPMENTS AND TRADE**

Both manufacturing and trade have benefited from the strong economic growth of the past several years, much of which has been fuelled by the increasing influence of the diamond industry in the NWT's economic landscape. Indeed, in the case of trade, the link is direct: much of the NWT's manufacturing shipments consist of cut and polished diamonds. As the number of raw diamonds available for processing in the NWT has expanded, so too have the territory's manufacturing shipments.

**Manufacturing Shipments**

Manufacturing shipments, which totalled only \$15 million in 1998, had grown to \$63 million as of 2003. Figures for the fourth quarter of 2004 are not yet available, but, over the first three quarters of the year, shipments came to \$47.0 million, versus \$46.6 million during the same period the previous year. Total manufacturing shipments in 2004 are expected to be slightly higher than in 2003. Shipments are forecast to grow in 2005.

**NWT Manufacturing Shipments, All Industries**



Source: Statistics Canada

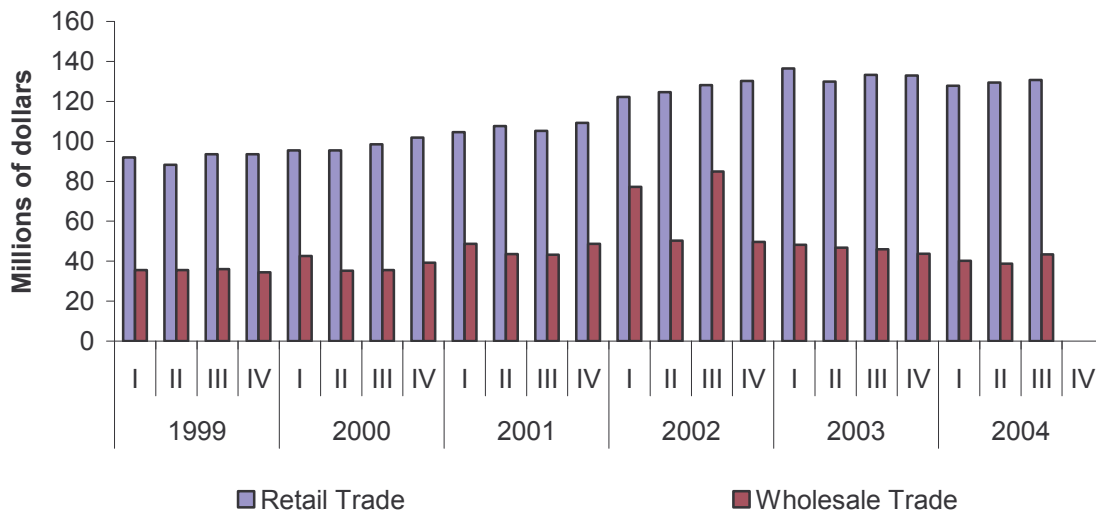
**Wholesale Trade**

Wholesale trade has exhibited a close correlation with resource development and has been positively affected by the growth in the diamond mining sector in recent years. The value of trade fell by 30 per cent in 2003 due to the end of the construction phase at the second diamond mine in late 2002. For full year 2003, wholesale trade totalled \$184.6 million. Figures for the fourth quarter of 2004 are not yet available, but, through the first three quarters of the year, wholesale trade equalled \$122.4 million, down from the level of the same period in 2003, when trade amounted to \$140.9 million.

**Retail Trade**

In recent years, retail trade has grown at rates in excess of those in the rest of Canada, driven by strong economic conditions in the NWT. The value of retail trade grew from \$367.3 million in 1999 to \$532.3 million in 2003 for cumulative growth over that period of 45 per cent. Through the first three quarters of 2004, retail trade, at \$388.1 million, has been somewhat weaker than in the same period of 2003, when trade amounted to \$399.5 million. Retail trade is expected to grow in 2005, as personal incomes and population are expected to continue to grow.

**NWT Retail and Wholesale Trade**  
Total Sales (Seasonally Adjusted)



Source: Statistics Canada

## RENEWABLE RESOURCE SECTOR

The renewable resource sector of the NWT economy is an important part of the territory's economy and provides valuable employment opportunities to many residents. Under the umbrella of the renewable resource sector, three specific areas – tourism, the commercial fishery and the fur harvest – are highlighted below.

### *Tourism*

Tourism is an important part of the NWT's renewable resource sector. There are a number of opportunities yet to be fully explored including cultural tourism, diamond-based tourism and catering to the international tourist market.

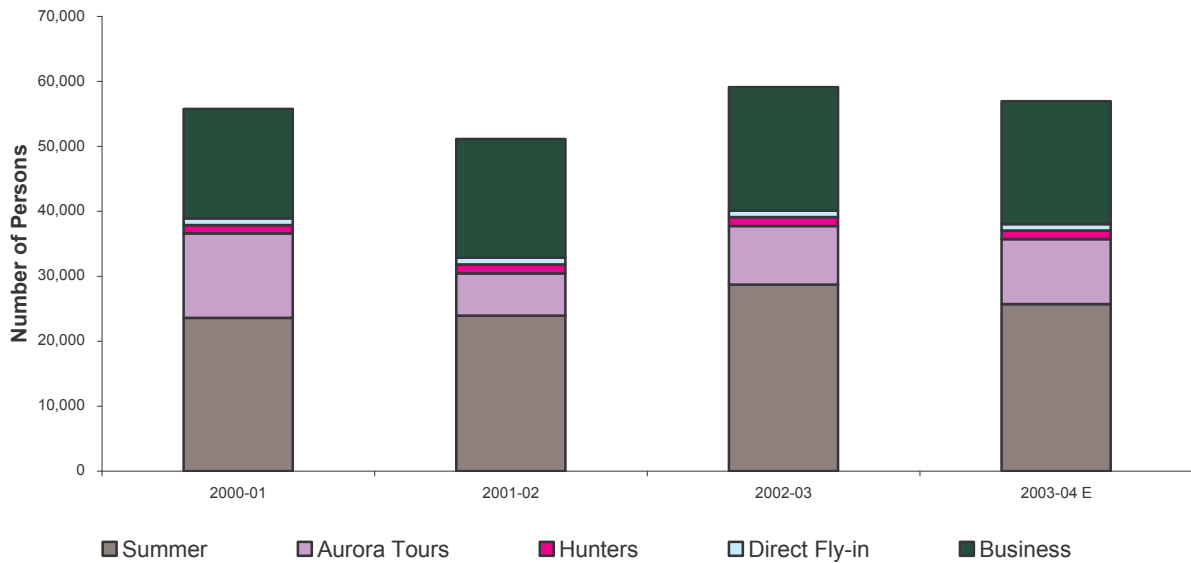
Over half of leisure visitors to the NWT come from other parts of Canada, primarily Alberta, British Columbia and Ontario. However, a lack of road infrastructure in the NWT remains an impediment to expansion, especially with regard to the growing recreational vehicle market.

The tourism industry endured a somewhat disappointing year in 2003-04, with data indicating that the number of visitors dropped by 5 per cent compared to 2002-03, from 40,100 visitors to 38,044 visitors. Spending by tourists in the NWT declined 3 per cent, from \$50.8 million in 2002-03 to \$49.5 million in 2003-04. However, if spending by the 19,000 business visitors are included, the NWT tourism industry contributes \$90 million in direct spending annually to the NWT economy. Nevertheless, these numbers are much improved over 2001-02, when terrorist concerns and SARS caused a significant decline in visitors to the NWT.

Summer travellers and hunters continue to be the most important sources of tourism revenue for the NWT, capturing about 37 per cent each of the revenue generated. Aurora viewers bring in approximately 24 per cent of total revenues from tourism. However, in 2003-04, the summer travel visitors were 68 per cent, Aurora viewers were 26 per cent, and hunters were only 4 per cent of the total number of leisure visitors.

The Aurora market is the only tourism sector that showed an increase in both the number of visitors and the amount of money spent in 2003-04. The Aurora tour market brought almost 10,000 visitors to the NWT in 2003-04, an increase from their 2002-03 level of 9,000 persons. The other three categories of travellers – summer visitors, hunters and direct fly-in visitors – were either unchanged or declined from the 2002-03 levels, both in terms of the numbers of visitors and the amounts of money spent.

**Visitors to the Northwest Territories**



Source: Department of Resources, Wildlife and Economic Development  
 Note: The number of hunters who visited the NWT in 2003-04 is estimated

**Commercial Fishery**

The NWT’s commercial fishery is a small but valued part of the territory’s economic mosaic. According to the federal Department of Fisheries and Oceans, the fish harvest in 2002 amounted to 1,164 live weight tonnes and carried a value of \$1.43 million. This volume of harvest is very similar to that obtained in 2000 and 2001, when catches totalled 1,173 and 1,152 live weight tonnes, respectively. The values of the harvests were also similar, at \$1.39 million in 2000 and \$1.58 million in 2001. Figures for 2003 and 2004 are not yet available.

### ***Fur Harvest***

The value of the 2003-04 fur harvest increased 8.1 per cent, from \$751,000 in 2002-03 to \$812,000, even though the total pelt harvest dropped from 31,848 in 2002-03 to 23,536 in 2003-04. The value of the pelts increased because of pricing changes for individual species and a shift in the amounts of different species that were harvested.

Both the size of the fur harvest and the prices realized at auction from the furs remain volatile. By either measure, the 2000-01 was the worst year over the 1999-00 to 2003-04 period, when the total number of pelts harvested was only 13,092 and the value of the furs was \$477,000.

Marten and lynx are currently the most valuable species to NWT trappers, with the greatest shares of total revenue in both 2002-03 and 2003-04. Marten had almost a two-thirds share of total revenue in both years and lynx had a 10.9 per cent share in 2002-03 and a 13.3 per cent share in 2003-04.

On a per-pelt basis, the most valuable species in 2003-04, were grizzly bear (\$1,221), polar bear (\$1,019) and wolverine (\$226). These results compare to 2002-03, when the three most valuable species, among those that were caught, were grizzly bear (\$1,740), wolverine (\$240) and tundra wolf (\$216). No polar bears were caught in 2002-03.

The prospects for NWT trappers hinge critically, as always, on trends in the unpredictable world of fashion.

### ***Total Value of NWT Pelts, Fiscal Years Ending June 30<sup>th</sup>***



Source: Department of Resources, Wildlife and Economic Development



## **NWT NON-RENEWABLE RESOURCE DEVELOPMENT AND THE NATIONAL ECONOMY**

Non-renewable resource development in the NWT contributes significantly to the economic welfare of the rest of Canada. However, although the NWT bears most of the costs associated with these development activities, the majority of the benefits flow to the rest of Canada.

Measured by value, Canada is already the third-largest producer of diamonds in the world, behind only Botswana and Russia, and Canada's entire diamond production comes from two mines in the NWT. Canada's third diamond mine will also be located in the NWT.

The three NWT mines are expected, over their lifetimes, to contribute \$26 billion to Canada's GDP and \$7.5 billion in total government revenue. Assuming current financial arrangements, the Conference Board of Canada estimates that of this \$7.5 billion in government revenue, the net share to the GNWT will be only \$260 million, or 3.5 percent.

Furthermore, the three mines are expected to create a cumulative 126,000 person-years of direct, indirect (secondary and support industry), and induced (created by the spending of labour income) employment. It is projected that more than half of this employment, or 71,000 person-years, will be created in the rest of Canada. The construction phases alone of the first two diamond mines created 2,500 person-years of direct employment and contributed some \$2.5 billion to the national economy.

In addition to the cutting and polishing facilities established in Yellowknife, facilities for cutting and polishing also exist in British Columbia and Quebec. Moreover, with general jewellery facilities in existence in Vancouver, Calgary, Toronto and Montreal, jewellery industry jobs across a wide spectrum of activity could grow across southern Canada as a result of diamond production in the NWT. The NWT's proposal for a national diamond strategy would have significant positive benefits for the rest of Canada.

The primary beneficiaries of a Mackenzie Valley natural gas pipeline would be Canadians living outside of the NWT.

According to a 2004 report prepared by Wright Mansell Research Ltd., the thirty year pipeline project would, based on a natural gas price of US\$4.00 per thousand cubic feet (mcf), add \$58.8 billion to Canada's GDP; create total revenue for all levels of government in Canada of \$15 billion, of which net federal revenue would be \$13 billion, or 89 per cent of the total revenue to governments; and create 180,000 person-years of direct and indirect employment. Of this direct and indirect employment, it is projected that over 72 per cent would take place in southern Canada.

All Canadians would benefit from the 61 trillion cubic feet (National Energy Board estimate) of Beaufort Sea/Mackenzie Delta natural gas that would flow through the Mackenzie Valley pipeline to southern markets. The additional supply would help to check increases in the price of natural gas, saving Canadian consumers an estimated \$350 million annually in fuel costs for each US10 cent per mcf restraining effect that the presence of the pipeline's gas supply might engender.

In 2003, the GNWT undertook a detailed assessment of the impacts of development on its expenditures in an attempt to understand and quantify the investment needed to prepare for and cope with the non-renewable development. The impacts of resource development are very wide ranging, from the need for improved highways to the need for more police to cope with higher crime rates. The study estimated that, over the next 20 years, the GNWT would experience a demand for \$1.3 billion in increased expenditures. Taking into account the expected fiscal benefits – from the higher tax revenues and population growth – the net cost to the GNWT of current and planned projects is \$400 million, most of which will be incurred in the next 10 years.

Over the coming years, Canadians living outside the NWT will receive the largest share of the benefits from non-renewable resource development activities in the NWT and other governments, particularly the federal government, will receive the majority of the government revenues generated by these activities. This mismatch between the expenditures induced by the projects and the revenues flowing to governments from NWT non-renewable natural resources development is inequitable.