Budget Address

2006 - 2007

NORTHWEST TERRITORIES

BUDGET PAPERS

A ♦ Economic Review

February 2, 2006

NORTHWEST TERRITORIES ECONOMIC OUTLOOK

The economic expansion in the Northwest Territories (NWT) continued in 2005: growth for the year was an estimated 11.2 per cent, compared to 5.2 per cent in 2004 and 16.8 per cent in 2003. Since division of the former NWT in 1999, the territory's economy has grown by a cumulative 88 per cent in real terms, easily the best showing in the country. Much of this growth can be traced to the impact of the NWT's vibrant and growing diamond sector.

Driven by solid economic growth, employment and average weekly earnings rose by 4.7 per cent and an estimated 4.1 per cent, respectively. Consumer price inflation, as measured by the year-over-year change in the average Consumer Price Index for Yellowknife, was 2.3 per cent in 2005, up from 1.4 per cent in 2004. Growth in average weekly earnings was higher than consumer price inflation, implying that, by this rough measure, real earnings in the territory advanced.

The NWT's economy is expected to perform well in 2006, driven by continued strength in commodity prices, with growth in real GDP forecast to be 7.6 per cent. The resident employment level is forecast to rise by 1.0 per cent, and average weekly earnings by 4.8 per cent. Consumer price inflation this year is expected to be 2.3 per cent, the same as in 2005.

Over the medium-term, the outlook continues to be favourable. The strength in the world economy and the consequent upward pressure on commodity prices means continued interest in the NWT's non-renewable resource sector. This interest is clearly evident in the diamond sector, where the two diamond mines already in production have made Canada the world's third largest producer of diamonds by value. Construction of the NWT's third mine, at Snap Lake, has already begun, with operations scheduled to start in 2007. The applications for permits to construct and operate a fourth diamond mine at Gahcho Kué (Kennady Lake) were filed in late November 2005.

The proposed Mackenzie Valley natural gas pipeline is another source of considerable economic optimism. The economic benefits that would result from the pipeline would be significant for both the NWT and Canada as a whole. Should the pipeline project go ahead, the economy in the NWT would receive a further boost, propelled initially by the construction phase of the project and longer term through further exploration and development of the territory's substantial oil and gas resources.

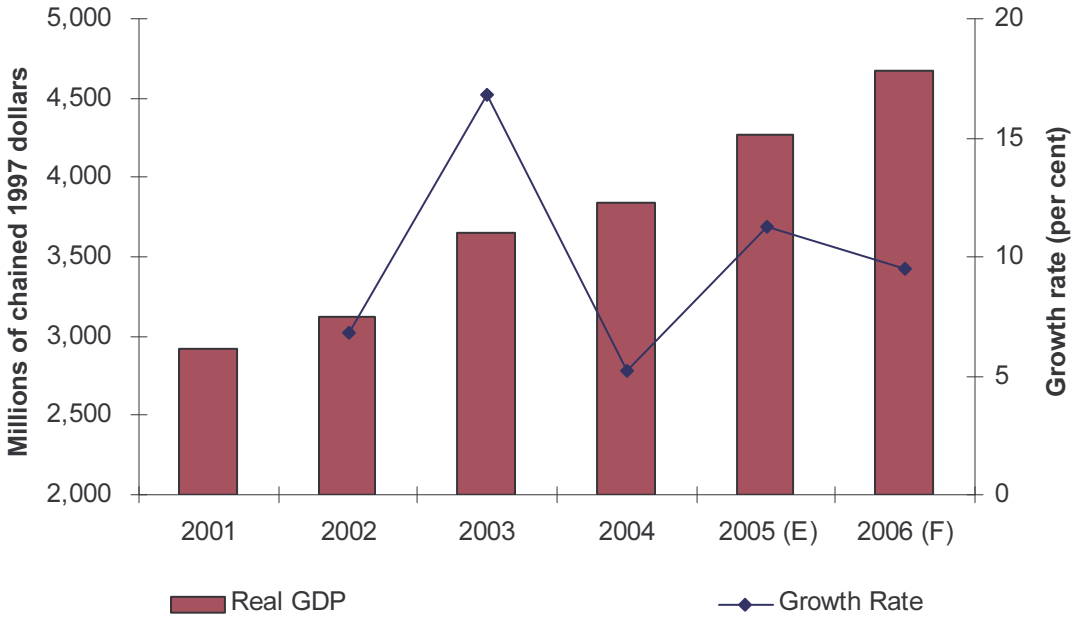
Northwest Territories Economic Indicators

INDICATOR	2003	2004	2005E	2006F
Gross Domestic Product, chained 1997 $ millions	3,649	3,838	4,270	4,595
% change	16.8	5.2	11.2	7.6
Total Investment, chained 1997 $ millions	764	1,046	1,445	1,292
% change	(39.8)	36.9	38.1	(10.6)
Consumer Expenditures, chained 1997 $ millions	1,010	1,047	1,114	1,153
% change	4.6	3.7	6.4	3.4
Government Expenditures, chained 1997 $ millions	1,027	1,046	1,066	1,082
% change	4.6	1.9	1.9	1.5
Exports, chained 1997 $ millions	2,866	3,062	3,266	3,785
% change	44.0	6.8	6.7	15.9
Imports, chained 1997 $ millions	1,923	2,196	2,475	2,561
% change	(5.9)	14.2	12.7	3.5
Employment, number of persons	20,850	21,617	22,625	22,853
% change	(0.4)	3.7	4.7	1.0
Average Weekly Earnings, dollars	895	924	962	1,008
% change	0.8	3.2	4.1	4.8
CPI All-Items (Yellowknife, 1992 = 100)	119.1	120.8	123.6	126.4
% change	2.4	1.4	2.3	2.3

Sources: Statistics Canada
NWT Department of Finance

(E) Estimate
(F) Forecast

NWT Real Gross Domestic Product



Sources: Statistics Canada (2001-2004) and NWT Finance [2005 (E) - estimate; and 2006 (F) - forecast]

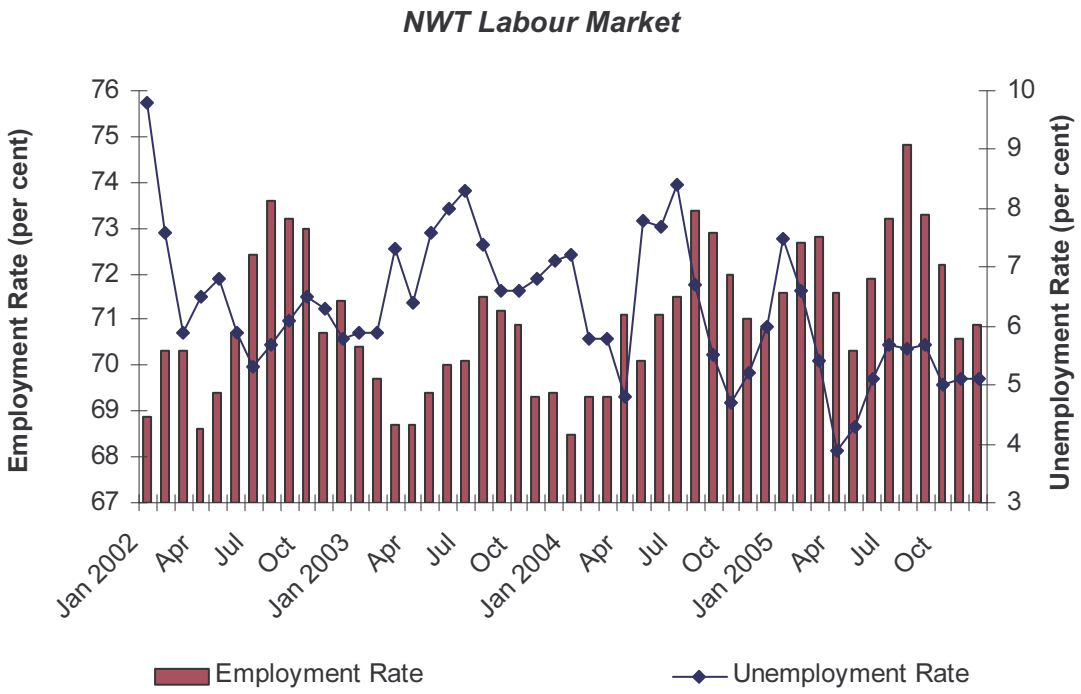
EMPLOYMENT

Following a 3.7 per cent increase in employment in 2004, employment growth in 2005 was a healthy 4.7 per cent. These increases follow a small decline of 0.4 per cent in employment during 2003. Overall, employment in the NWT has grown from 20,925 in 2002 to 22,625 in 2005.

Other major employment indicators also showed improvement in 2005 and continued to compare favourably with the rest of Canada. The NWT unemployment rate dropped from 6.3 per cent in 2004 to 5.4 per cent. Canada's unemployment rate was 6.8 per cent. The NWT participation rate (the percentage of people 15 years of age or older who are in the labour force) improved from 75.6 per cent in 2004 to 76.3 per cent in 2005; and the employment rate (the percentage of people 15 years of age or older who are employed) also increased, from 70.9 per cent to 72.2 per cent. The Canadian participation rate was 67.2 per cent and the employment rate was 62.7 per cent in 2005.

Within the territory, however, differences continue to exist between the larger centres (Fort Simpson, Fort Smith, Hay River, Inuvik, Norman Wells and Yellowknife) and the smaller communities. According to the *Winter 2004 Community Survey* undertaken by the NWT Bureau of Statistics, 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.

Supported by continuing interest in the NWT's resource-based economy, the NWT employment market in 2006 is expected to remain firm and outperform Canada's.



Source: Statistics Canada

INVESTMENT

Capital and Repair Expenditures in the Public and Private Sectors

Capital expenditures in 2004 totalled $1,190 million, made up of $168 million in public capital expenditure and $1,022 million in private capital expenditure. The total capital expenditure figure was up from the 2003 level of $817 million, but down from the high levels witnessed in 2001 and 2002, when expenditure levels reflected the construction of the Diavik diamond mine.

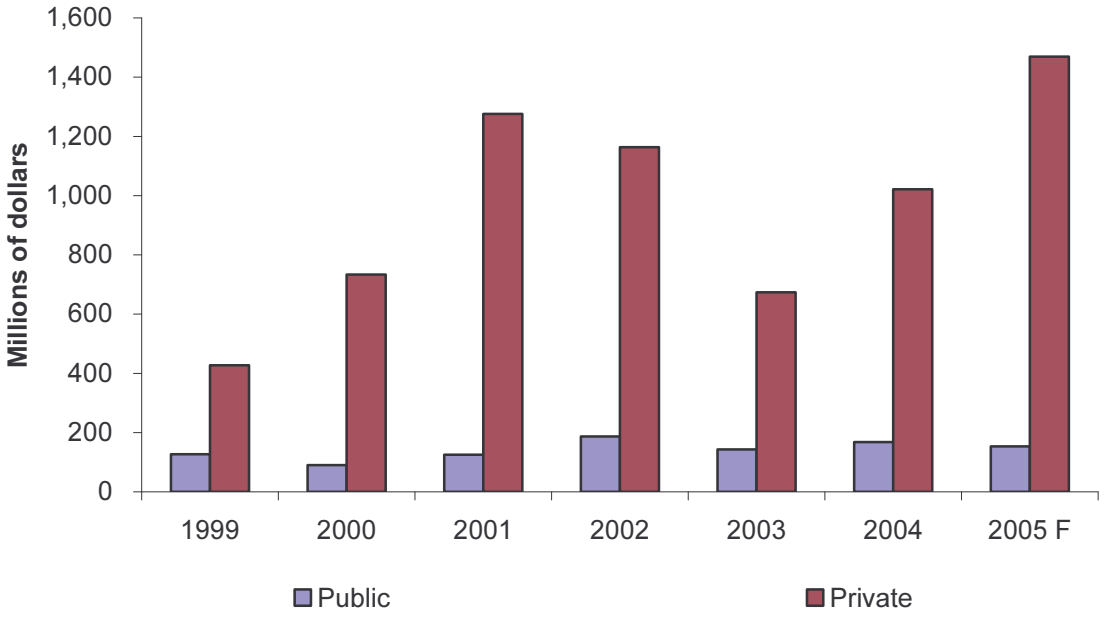
Statistics Canada's survey of the 2005 investment intentions of public and private sector organizations indicated that total capital expenditures were expected to increase 36 per cent from 2004, with public and private expenditures of $153 million (down 9 per cent) and $1,469 million (up 44 per cent), respectively. The large jump in private expenditures results primarily from construction activity in the diamond sector.

Investment in the diamond-mining sector means that private sector expenditures have dominated total NWT capital expenditures, comprising between a 77 and 91 per cent share of total capital expenditures from 1999 to 2005. Private sector investment should remain robust in 2006 as construction at the Snap Lake mine continues.

Public sector investment since 1999 has ranged from $90 million in 2000 to a peak of $187 million in 2002. From 1999 to 2005, public sector investment has averaged $142 million, with the last four years above the average.

Rapid, large-scale, non-renewable resource activity is putting increased pressure on public infrastructure. Public sector capital investment is expected to increase to accommodate these pressures.

NWT Public and Private Investment: Capital and Repair Expenditures



Source: Statistics Canada (Note: F = Forecast; Statistics Canada forecasts 2005 investment using its survey of investment intentions among public and private sector organizations.)

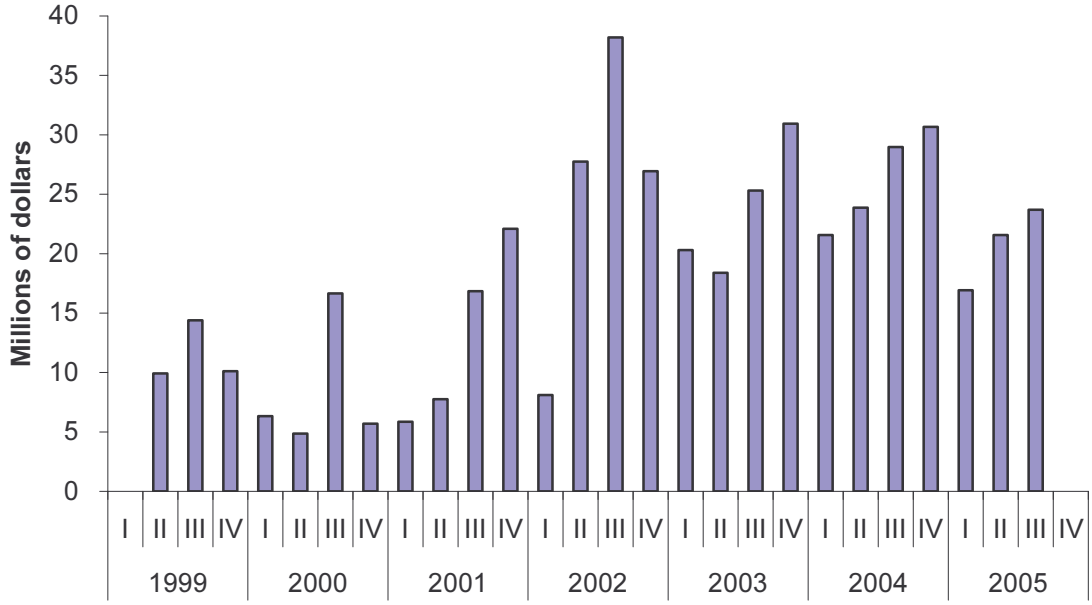
Housing Investment

As a result of a strong economy, low interest rates and rising personal incomes, housing investment in the NWT has generally increased in recent years. After very substantial gains of 57 and 92 per cent in 2001 and 2002, respectively, housing investment declined by 6 per cent in 2003, but increased 11 per cent in 2004. As a result of this growth, housing investment of $34 million in 2000 had risen to $105 million by 2004.

Through to the third quarter of 2005, housing investment totalled $62 million; a 16 per cent decline from $74 million in the same nine-month period a year ago. Barring a turnaround in the fourth quarter, housing investment for 2005 is expected to be below the level of 2004.

As in recent years, most of the housing activity in 2005 has occurred in Yellowknife and the larger communities.

NWT Housing Investment



Source: Statistics Canada

MINERAL, OIL AND GAS EXPLORATION AND PRODUCTION

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 by allowing for new exploration for oil and gas in the territory.

Driven by pre-production trial mining at Snap Lake, exploration spending in the NWT has more than doubled from 2003 to 2004, from $49.8 million to $110.4 million. Exploration spending in the NWT in 2004 was the third highest in Canada, behind Ontario and Quebec. Strong commodity prices should continue to spur interest in mineral exploration and exploration expenditures should remain strong.

The Diamond Sector

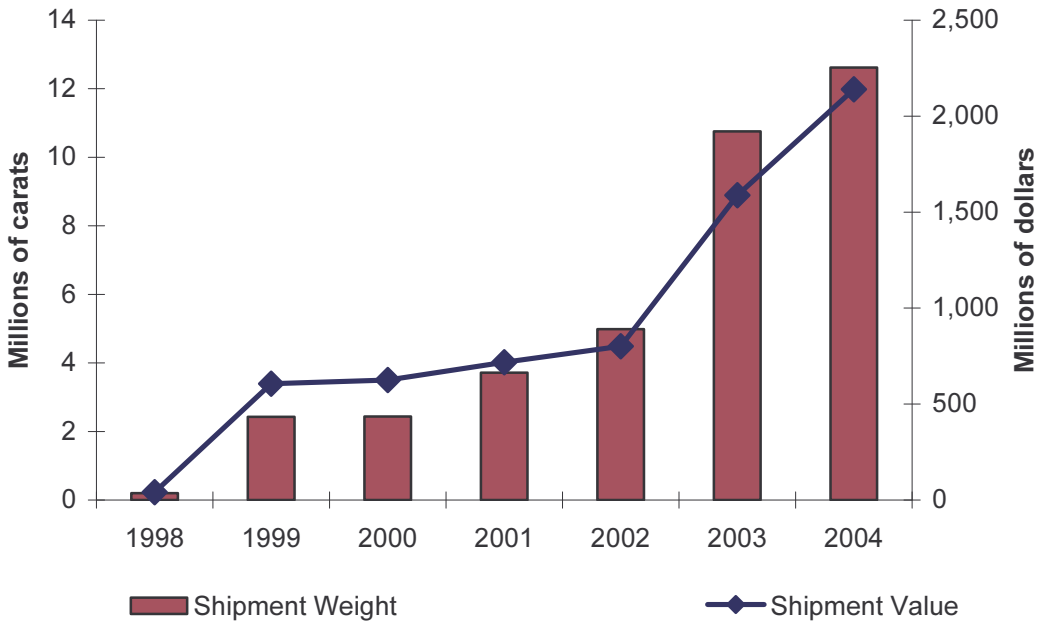
Diamond shipments in 2004 were approximately 12.6 million carats, with a value over $2.1 billion, for an average per carat value of $170. These figures compare favourably to those of 2003, when shipments of 10.8 million carats – worth $1.6 billion – were made, with an average value of $148 per carat. Therefore, from 2003 to 2004, shipments grew by 17 per cent, per carat values by 15 per cent, and total value by 35 per cent. These increases in shipments and total value were due to increased activity and quality levels

at the NWT's two existing mines, Ekati (opened 1998) and Diavik (opened 2003), since no new mines opened in 2004. Indications are that shipment quality of diamond production improved again in 2005. The following graph shows diamond shipments and the value of those shipments since the start of NWT diamond production in 1998. The 2003 increase is due to the start of operations at Diavik.

The next several years will see continued development of diamond mining in the NWT. Snap Lake, De Beers' first Canadian diamond mine, is currently under construction, with production scheduled to begin in 2007. De Beers announced in late November that it has filed an application with the Mackenzie Valley Land and Water Board for permits to construct and operate a second NWT mine at Gahcho Kué (Kennady Lake). If approved, the Gahcho Kué mine will be the NWT's fourth diamond mine, and potential exists for more mines in the future.

The value of diamonds increase 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 the value of the rough stones. Various diamond polishing enterprises operating in the NWT help to ensure that some of these downstream benefits remain in Canada's North. However, currently only a small portion of the NWT's diamond production remains in Canada to be cut and polished.

NWT Diamond Shipment Data, Weight and Values: 1998-2004



Source: Natural Resources Canada

The Oil and Gas Sector

The energy sector performed strongly in 2004 with NWT shipments increasing 11 per cent from $501 million in 2003 to $555 million in 2004. The most recent 2005 data indicate that oil and gas producers in the NWT are benefiting immensely from rising energy prices.

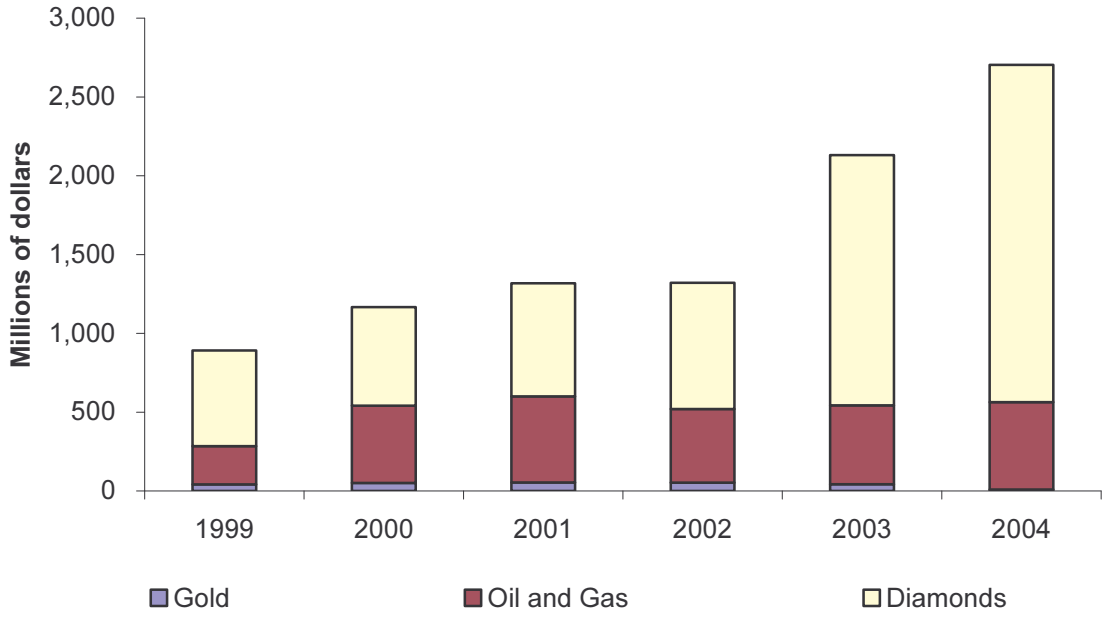
Oil and gas activity in the NWT remains centred in the Fort Liard, Cameron Hills and Norman Wells areas. However, should the Mackenzie Valley pipeline project go ahead, substantial oil and gas exploration and production is likely to take place in the Mackenzie Delta and Beaufort Sea areas, allowing the NWT to emerge as a major exporter of energy.

Gold Mining

For many decades gold mining has been an important part of the NWT economy. However, the NWT's two remaining mines, the Con and Giant mines located in Yellowknife, have shut down because of resource depletion: the Con mine in November 2003 and the Giant mine in July 2004. With these closures, over six decades of gold mining history in Yellowknife came to a close. There was no gold production in 2005.

Strong gold prices have brought several new companies to the NWT in 2005 to explore for gold and other minerals.

NWT Gold, Oil & Gas and Diamonds Shipments, by Value



Source: Statistics Canada

COMMODITY PRICES AND EXCHANGE RATES

Similar to 2004, 2005 experienced rising commodity prices, especially in base metals and energy.

However, the high oil prices are not causing the detrimental economic effects of previous oil price shocks, particularly the two major shocks of the 1970s. Lower relative energy dependency in the world's major industrial economies and the fact that the run-up in oil prices has been both demand-driven (as opposed to restrictions in supply) and spread fairly smoothly over three or four years, are the main mitigating factors. Higher oil prices are a reflection of the strength of the global economy.

In a similar fashion, increased demand for base metals, in particular from China, has lifted prices for those commodities to their highest levels in many years. Because metals prices were so low for so long, investment has been neglected, which is allowing prices to increase further because the new investment currently undertaken will not lead to additional supply for several years.

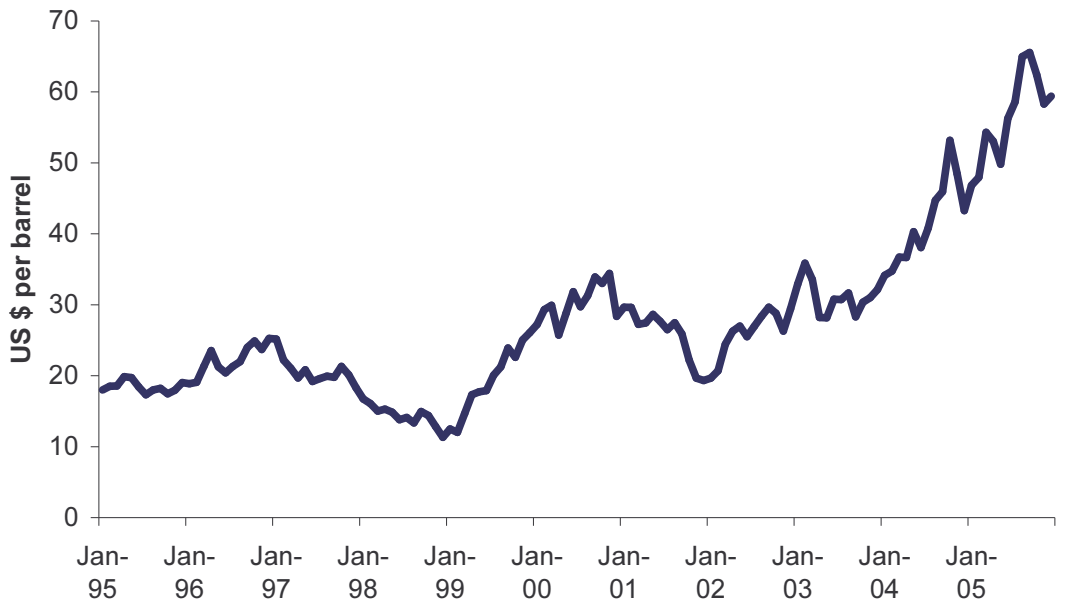
Canada, as a major exporter of commodities, has benefited from a terms-of-trade improvement (an improvement in the ratio of export to import prices). This has led to an increase in Canadians' real incomes and a big jump in the value of the Canadian dollar vis-à-vis not just the US dollar but also many other major international currencies.

The 2006 outlook for commodity prices, and therefore the Canadian dollar, depends on whether demand for energy and metals holds up under the increased prices. Since the current commodities cycle is driven mainly by a Chinese investment boom in tandem with a US consumption boom, a slowdown in either country would likely cause commodity prices to decrease from their current levels. However, continued strong growth in those economies may allow commodity prices to maintain, or even increase, their gains. From an historical point of view, however, commodity cycles, although of varying intensity and duration, have never extended indefinitely. This is because at some point higher prices cause demand growth to lessen and supply growth to quicken, reducing the market tightness that led initially to higher prices.

Oil Prices

For the fourth year running, oil prices rose in 2005: a barrel of West Texas Intermediate (WTI) had an average price of US$56.45 a barrel, up from an average of US$41.42 a barrel in 2004 and US$31.14 a barrel in 2003. Oil prices shot briefly above US$70.00 a barrel when Hurricanes Katrina and Rita damaged the oil and gas production and transportation infrastructure in the Gulf of Mexico, but then backed off as supply concerns waned and traders focused on signs that higher prices were beginning to reduce demand. However, prices have begun to rise again. As of mid-January, the price of WTI oil was US$66 a barrel, the highest since October 2005. Even adjusted for inflation, oil prices are now approaching their all-time highs of 1980, resulting in economic booms in oil producing jurisdictions around the world, including Canada. As the following graph shows, oil prices have risen from their lows after the Asian Crisis in 1998, which resulted in a plunge in oil demand.

Price of Oil: West Texas Intermediate



Source: Sproule Associates Limited

Natural Gas Prices

Natural gas prices rose again in 2005, extending their gains from 2003 and 2004. For the year, natural gas averaged US$8.62 per million British thermal units (MMBtu) at Henry Hub, Louisiana – the benchmark for North American gas. That price compares to an average of US$6.14/MMBtu in 2004 and US$5.39/MMBtu in 2003. Natural gas prices remain far higher than they were in the 1990s, when prices of US$2-3/MMBtu were the norm. Many analysts believe that prices will never again fall to those low levels.

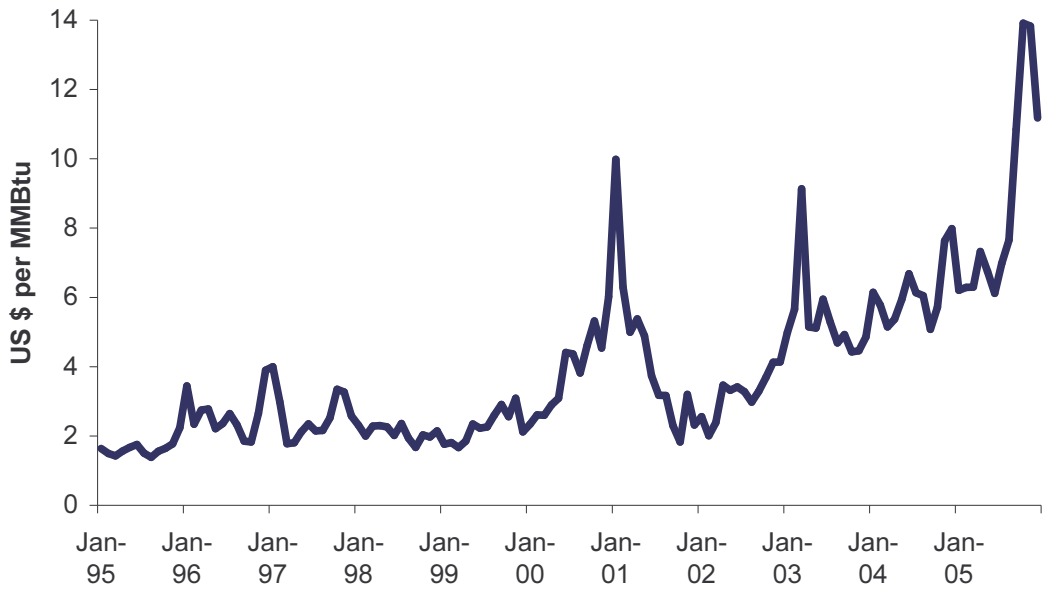
Diamond Prices

Because each diamond is unique, it is difficult to track the prices of diamonds. A diamond's value hinges critically on its characteristics, known in the trade as the "four Cs": colour, clarity, carat (weight) and cut. By controlling for these factors, it is possible, in theory, to derive indices that approximate prices for diamonds of a certain quality, and by aggregating such indices, it is possible to derive an overall index that tracks movements in the prices of polished diamonds overall. PolishedPrices.com publishes a price index on its website using this approach.

The PolishedPrices.com website explains its methodology for the calculation of its polished price index as follows: "The PolishedPrices Indices are created by weighting each of the individual prices of transactions reported to PolishedPrices.com by an estimate of the total world production of polished prices over the ranges covered."

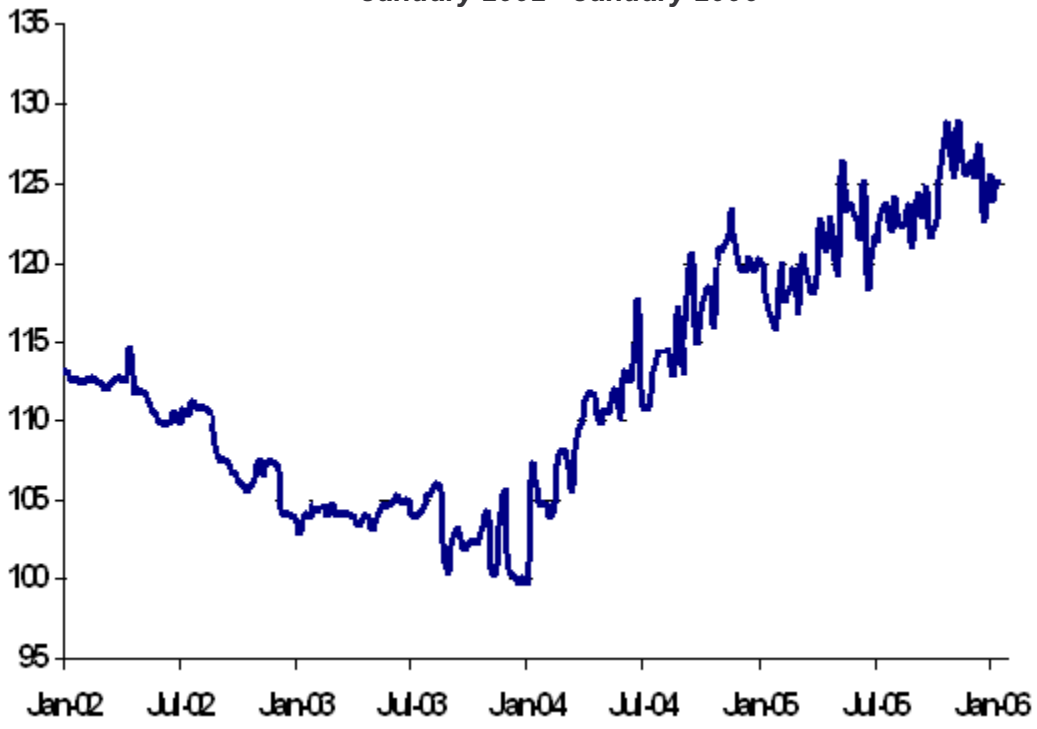
As the graph on the following page shows, in the two years to January 2004, the index fell, but, since that time, the index has been rising and now is about 26 per cent higher than its low in January 2004.

Price of Natural Gas: Henry Hub NYMEX



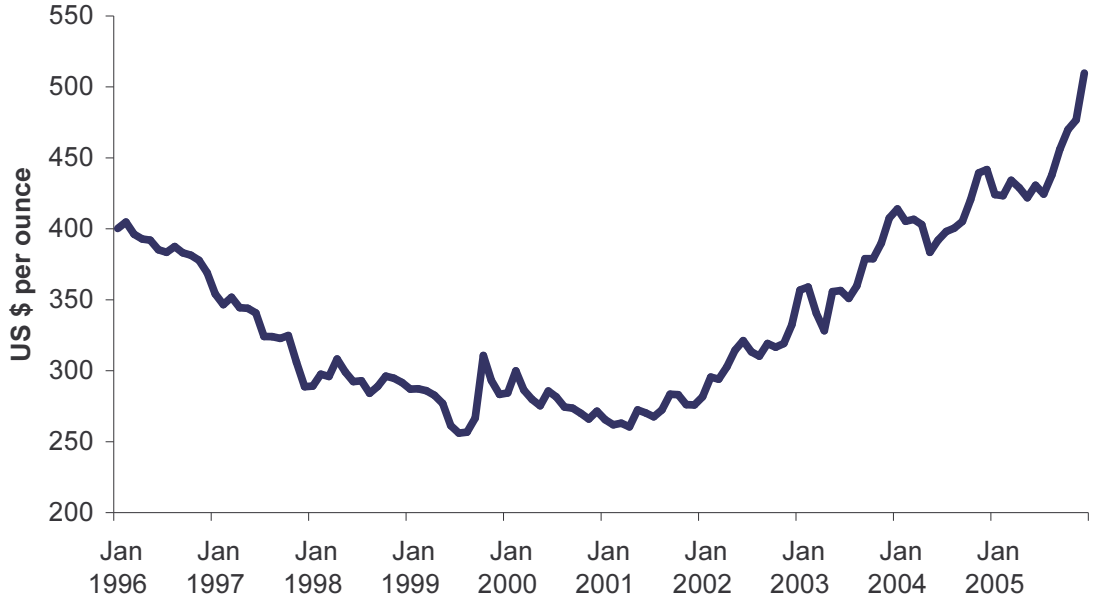
Source: Sproule Associates Limited

Polished Diamond Price Index: Overall Index, January 2002 - January 2006



Source: PolishedPrices.com (reprinted with permission)

Price of Gold: 1996-2005



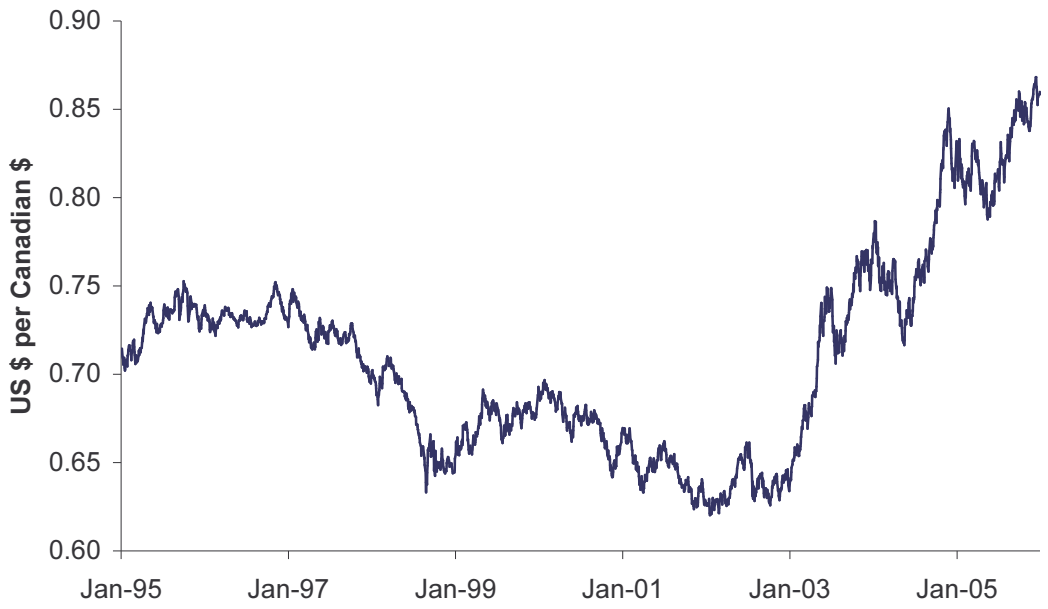
Source: Kitco Precious Metals

Gold Prices

The price of gold rose in 2005 for the fourth year in a row. For the year, it averaged US$444.74 an ounce, an increase of 9 per cent over the average price for 2004 of US$409.72 an ounce. By early 2006, the gold price reached US$560 an ounce, a new 25-year high in nominal terms. In real terms, gold prices are about one-quarter of what they were at the market's peak of US$850 an ounce in 1980.

For the first several years of the recent rally until 2004, the rise in the price of gold was due mainly to weakness in the US dollar, with which gold has typically had a strong inverse correlation. However, in 2005 the gold price rose despite widespread gains for the US dollar, a sign that some observers interpret as a broadening of the bull market in gold.

US-Canada Exchange Rate (US$/C$) Since 1995



Source: Bank of Canada

The Canadian Dollar

The Canadian dollar once more advanced against its US counterpart in 2005, averaging US82.54 cents, up 7 per cent from 2004, when it averaged US76.98 cents. In 2003, the Canadian dollar averaged US71.59 cents, and, as recently as January 18, 2002, it closed at only US62.02 cents. For 2005, the Canadian dollar peaked at US86.82 cents on December 14, 2005 and dropped to its lowest closing point of US78.76 cents on May 16, 2005.

The Canadian dollar has benefited from increasing commodity prices over the last several years, reflecting the high proportion of commodities in the composition of Canada's exports. From 2002 through 2004, the Canadian dollar rose in large part due to general US dollar weakness against most major currencies. Thus, measured against those other currencies, the Canadian dollar had been fairly flat until 2004, in marked contrast to its performance relative to the US currency. In 2005, however, the US dollar rallied, lodging sizeable gains against many currencies, and so the Canadian dollar's strength against the US dollar over that same period implies that the Canadian dollar rose by even more in 2005 against many other currencies than it did against the US dollar. Other commodity currencies – such as the Australian and New Zealand dollars – also performed well last year.

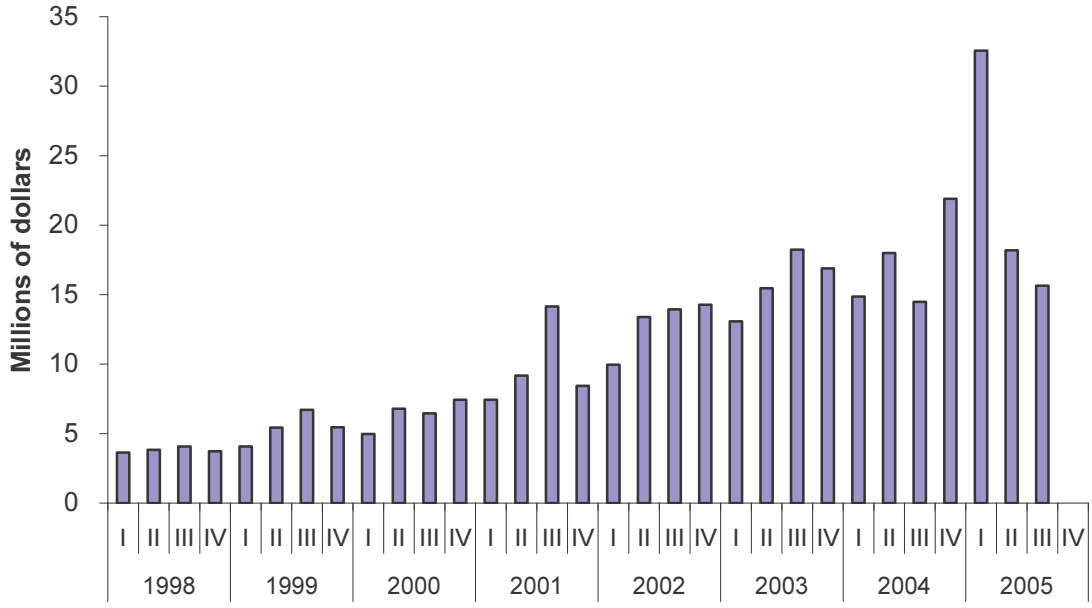
MANUFACTURING SHIPMENTS AND TRADE

Both NWT manufacturing and trade have benefited from the strong economic growth of the past several years, primarily because of the NWT diamond industry. 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 increased, the NWT's manufacturing shipments have also increased.

Manufacturing Shipments

Since 1998, manufacturing shipments have posted yearly growth rates of between 9 and 53 per cent; growing from $15 million in 1998 to $69 million by 2004. Over the first three quarters of 2005, shipments came to $66 million, compared to $47 million in the first three quarters of 2004, for a growth rate of 40 per cent. Driven by continued robust activity in the diamond sector, shipments are forecast to grow again in 2006.

NWT Manufacturing Shipments, All Industries



Source: Statistics Canada

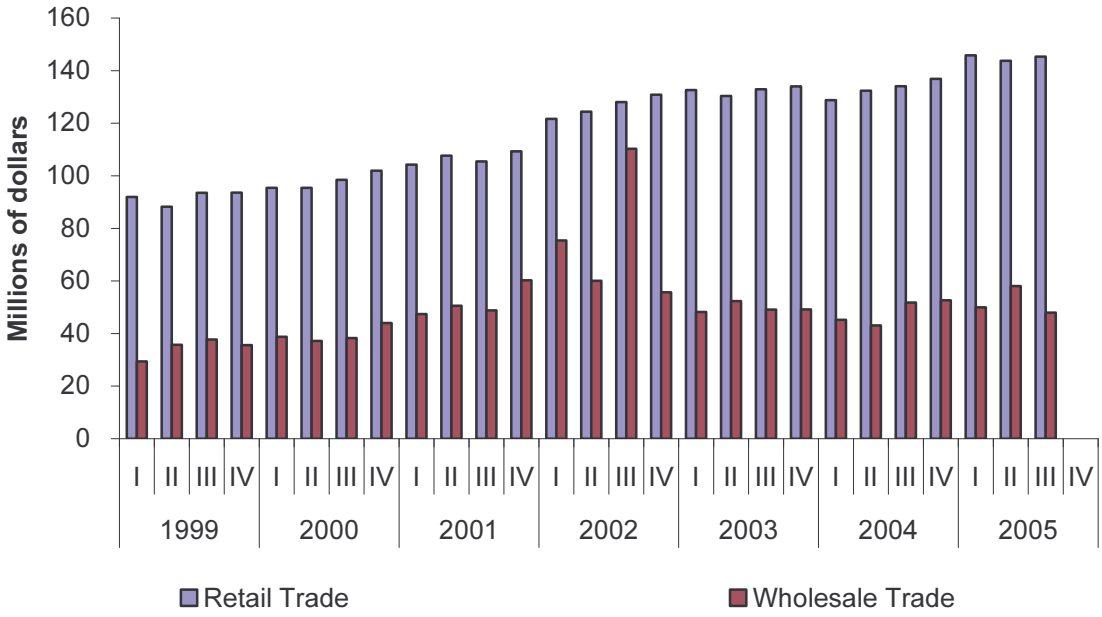
Wholesale Trade

Wholesale trade shows a close correlation with resource development and has been positively affected by the growth in the diamond mining sector. Owing primarily to the end of the construction phase at the Diavik diamond mine in late 2002, the value of trade fell by 34 per cent in 2003 and an additional 3 per cent in 2004. For 2004, wholesale trade totalled $193 million. Wholesale trade in the first three quarters of 2005 totalled $156 million, an 11 per cent increase from the first three quarters of 2004.

Retail Trade

In recent years, driven by strong economic conditions and buoyant growth in the NWT, retail trade has grown at higher rates than in the rest of Canada. The high performance came to an end however in 2004, when NWT retail sales grew by a slim 0.4 per cent, compared to the corresponding Canadian growth of 4.7 per cent. However, retail trade in 2004 still amounted to $532 million. NWT retail sales in the first three quarters of 2005 were 10 per cent higher than in the first three quarters of 2004. Propelled higher by an expanding population and increased personal incomes, retail trade is expected to regain its footing along its well-established growth path in 2006.

NWT Retail and Wholesale Trade, Seasonally Adjusted



Source: Statistics Canada

RENEWABLE RESOURCE SECTOR

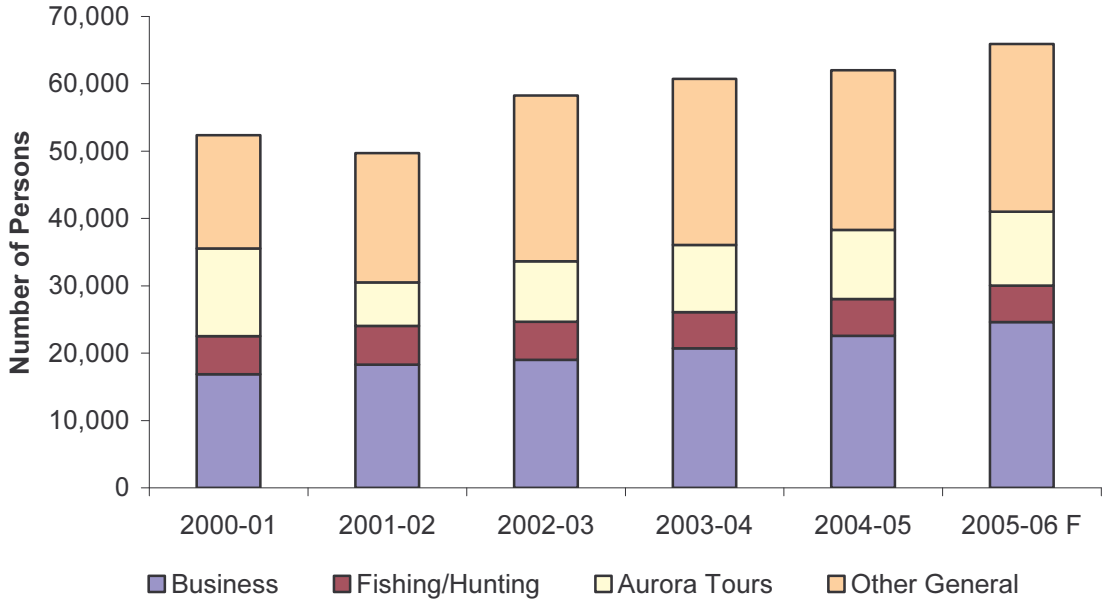
The renewable resource sector is an important part of the NWT economy and provides valuable employment opportunities to many residents.

Tourism

Tourism is an important part of the NWT economy, with many opportunities yet to be fully developed, including such possibilities as cultural tourism, diamond-based tourism and a sharpened focus on catering to the international tourist market.

Over half of the 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 regarding the growing recreational vehicle market.

Visitors to the Northwest Territories



Source: Department of Industry, Tourism and Investment
Notes: F = Forecast
Other General category includes European visitors, visitors seeing friends/relatives, outdoor adventure travellers, and general touring visitors

Tourism spending, comprising both leisure and business travel, continued a three year positive run in 2004-05, with increases in both the number of visitors and total spending. The NWT welcomed over 62,000 visitors in 2004-05, including 39,412 leisure and 22,591 business travellers. Tourists' visits increased 2.1 per cent in 2004-05, and are forecast to increase 6.3 per cent in 2005-06. Spending by tourists was up 6.2 per cent in 2004-05, and is forecast to increase 6.1 per cent in 2005-06.

In dollar terms, total tourism spending has grown from $88 million in 2000-01 to over $100 million in 2004-05, and is forecast to grow to almost $107 million in 2005-06. Tourism spending is split roughly equally between leisure and business travel. Since 2000-01, growth in total spending has been driven by the business segment of the market; spending by leisure travellers having been more or less flat since that time. In 2004-05, business travellers were 36 per cent of all visitors to the NWT but made 50 per cent of all tourist expenditures. This is consistent with previous years' results.

The three most important sectors for leisure visitors continue to be general touring visits, aurora borealis tourists and people visiting friends or relatives. In 2004-05, these three sectors accounted for about half of all leisure visitors. However, in terms of money spent by tourists, only aurora borealis tourists, in second place, made the top three. The first and third spots go to hunters and fishers, respectively. Hunters provide a disproportionate amount of spending relative to their numbers: in 2004-05, hunters were only 3 per cent of leisure visitors, yet were responsible for 34 per cent of spending.

Both the number of tourists and tourism spending is forecast to increase in 2005-06, with the exceptions of hunters and fishers, compared to 2004-05. Hunting and fishing activity

has been under pressure over the past several years, and both numbers of visitors and their spending in 2004-05 were slightly below their 2000-01 levels.

Commercial Fishery

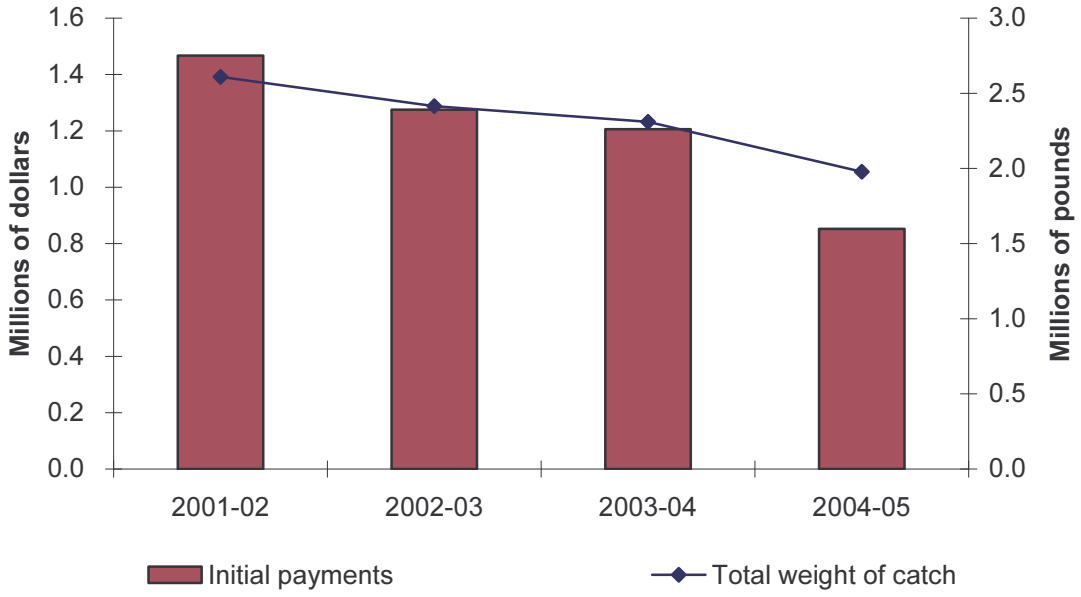
The NWT's commercial fishery is a small but valued part of the territory's economic mosaic. According to the Freshwater Fish Marketing Corporation – a self-sustaining federal Crown corporation which functions as the buyer, processor and marketer of freshwater fish from Alberta, Saskatchewan, Manitoba, the NWT and part of Northwestern Ontario – the commercial fishery in the NWT has declined in recent years.

The Corporation reports that initial payments to NWT fishers – on a delivery-point, net-of-freight basis – have declined annually from $1,467,000 in 2001-02 to $852,000 in 2004-05. Similarly, the fish harvest has declined each year over that same period, from 2.61 million pounds in 2001-02 to 1.98 million pounds in 2004-05. The most important species by volume is whitefish, at about three quarters of the total catch.

The increase in the value of the Canadian dollar relative to the US dollar since 2002 has hurt the freshwater fishery in Canada, and reduced fish volumes in the NWT indicate a lower participation in the NWT commercial fishery.

However, the 2005-06 first quarter catch was 29 per cent higher than the 2004-05 first quarter, with a corresponding increase in value of 33 per cent. The increase is driven mainly by a stronger whitefish catch, including increases in size grading of whitefish, with some large and even jumbo fish showing up in the catch.

NWT Commercial Fishery Activity, Fiscal Years ending April 30th



Source: Freshwater Fish Marketing Corporation

Fur Harvest

For many people in the NWT, trapping remains an important source of cash income, especially in the smaller communities, and allows for a connection with the land that is not possible in many other occupations. In the fiscal year ending June 30, 2005, 704 trappers plied their trade throughout the NWT, although not necessarily on a full-time basis throughout the entire year.

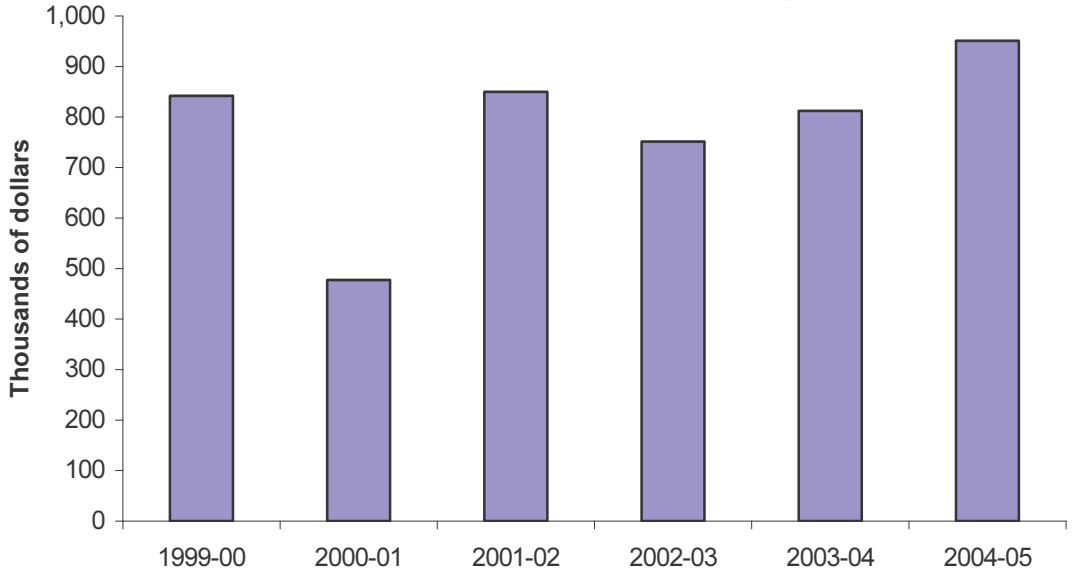
Across all species, the total number of pelts harvested increased 81 per cent from 23,536 in 2003-04 to 42,491 in 2004-05. The value realized from the pelt sales, however, increased only 17 per cent from $812,311 in 2003-04 to $950,739 in 2004-05 because of a significant change in the mix of the pelt harvest. In fact, 95 per cent of the growth in the total pelt harvest was due to higher trappings of muskrats, which fetched an average $2.67 a pelt in 2004-05. Revenues from pelt sales in 2004-05 were the highest on record for post-division NWT.

Pricing across species was mixed in 2004-05, with per pelt price increases of 41 per cent for ringed seals, 16 per cent for tundra wolves and 12 per cent for marten; but decreases of 20 per cent for red foxes, 28 per cent for black bears and 25 per cent for cross foxes. The most valuable pelts in per-unit terms in 2004-05 were grizzly bears ($1,181), polar bears ($1,083) and tundra wolves ($211).

Marten and lynx continue to be the largest contributors to total revenue from pelt sales, providing trappers with 64 per cent and 12 per cent, respectively, of their revenue in 2004-05. The third-most-important species changed from wolverine in 2003-04 to muskrat in 2004-05 because of the large increase in the size of the muskrat harvest.

The demand for NWT pelts hinges critically, as always, on trends in the unpredictable world of fashion. On the supply side, the health of the northern ecosystem and sustainable harvesting practices are imperative.

Total Value of NWT Pelts, Fiscal Years Ending June 30th



Source: NWT Department of Industry, Tourism and Investment