



Publication

HALF-WAY THERE: BC ECONOMIC UPDATE July 2009

As the world continues to grapple with the most severe economic downturn since the 1930s, the near-term outlook for British Columbia remains poor. This year will see the first outright decline in global economic activity in six decades. All of the major developed countries – the US, Japan, the UK, the EU and Canada – are mired in recessions. And while China, India and a few other emerging markets are still growing, collectively the developing countries are expected to eke out a meagre gain in output of barely 1% in 2009, compared to 6% last year.

British Columbia today finds itself battling stiff economic headwinds, notably a significant diminution in foreign demand for our exports. Led by plummeting lumber sales and a sharp drop in natural gas prices, BC’s exports are in a virtual free-fall – according to Export Development Canada, in 2009 they will be down 23% compared to last year.¹ Moreover, the previously purring engines of domestic demand are now sputtering. Housing starts are running at less than half of 2008’s pace, non-residential building permits are down, and retail sales are in negative territory. Add it all up, and we now expect the province’s economy to shrink by 2.5% (after-inflation) this year, before posting a moderate rebound in 2010.

External Outlook

Rarely have global conditions been less favourable for the Canadian economy. The latest World Bank forecast has the world economy contracting by 1.7% in 2009, the worst showing since the Depression of the 1930s.² Industrial production in the advanced industrial countries fell 15% between August 2008 and

May 2009. Many export-oriented economies in Europe and Asia have been hit by unprecedented declines in export demand. In the first quarter of 2009, nominal global trade dropped by 30% relative to the same period last year.³

World Economic Forecast				
(% change in real GDP)				
	2008	2009	2010	2011
US	+1.1	-3.0	+1.8	+2.5
Euro area	+0.6	-4.5	+0.5	+1.9
Japan	-0.7	-6.8	+1.0	+2.0
China	+9.0	+6.5	+7.5	+8.5
World*	+1.9	-1.7	+2.8	+4.0
*PPP basis Source: World Bank, Global Development Finance 2009, June 22, 2009.				

¹ EDC, Restoring Balance: Global Export Forecast, Spring 2009.

² World Bank, Prospects for the Global Economy, June 22, 2009. The 1.7% figure is based on weighting the size of individual national economies within the global market using purchasing-power-parity exchange rates, not market exchange rates.

³ Caroline Freund, “Demystifying the Collapse in Trade,” voxeu.org, July 3, 2009.



Of interest, Japan and the EU are expected to post bigger declines in economic output than the United States – the epicentre of the Great Recession of 2008-09. This reflects the increasingly complex ways in which cross-border commercial linkages – including supply chains and financial flows – have served as vectors for transmitting the impact of slumping demand and malfunctioning credit markets around the world. The volume of global trade is projected to shrink by 9-10% in 2009 – marking the first actual decrease in international trade since World War II.⁴

However, the collapse in trade seems to have bottomed out. And the risks to the global financial system have eased from the extreme levels of late 2008 and early 2009, thanks in part to strong policy action by central banks and governments to provide liquidity and shore up over-leveraged banking systems. That said, financial conditions remain difficult in many countries, with little or no growth in bank-credit and ongoing impairment of securitization markets (beyond those directly supported by governments).

As always, the outlook for the US weighs heavily on Canada's prospects. Here there is lots of bad news, partially offset by a few glimmers of light. The US is experiencing an unusually severe recession that began in December 2007 and may last until the end of this year. In the past 18 months more than 6 million jobs have disappeared, pushing the absolute level of employment almost back to where it stood a decade ago.

Canadian Outlook			
(annual per cent change unless otherwise indicated)			
	2008	2009	2010
Real GDP	0.4%	-2.4%	2.5%
Unemployment rate (%)	6.1%	8.5%	9.0%
Inflation (CPI)	2.4%	0.4%	1.7%
Interest rates:*			
3-mnth T-bill	0.83%	0.35%	1.85%
10-yr Gov't bond	2.69%	2.75%	3.40%
US/Can exchange rate*	1.23	1.14	1.09
*end of year Source: RBC Economic Research, June 2009 Economic and Financial Market Outlook.			

Meanwhile, the price of a typical American home has been slashed by one-third since peaking in 2006, and millions of homeowners are learning what the term “negative equity” means as the value of their largest asset slips below their outstanding mortgage principal.

But there are also a few positive signs stateside.⁵ Forward-looking indicators, such as equity markets and consumer confidence, have moved up from the depressed levels of February and March. A survey of 50 leading American forecasters finds 96% confident that the recession will end by the fourth quarter of 2009.⁶ The recently completed “stress tests” conducted on 19 large American commercial banks suggest that most of these institutions have enough capital to survive through the downturn. Housing starts appear to have reached bottom, albeit after more than two years of unprecedented declines. Aggressive

⁴ Ibid., and World Trade Organization [News Release](#), March 23, 2009.

⁵ Martin Neil Baily and Douglas J. Elliott, [The US Financial and Economic Crisis: Where Does it Stand and Where Do We Go From Here?](#), Brookings Institution, June 2009.

⁶ Blue Chip Economic Consensus, May 2009.



monetary and fiscal stimulus is providing needed support to aggregate demand. Still, the consensus view among forecasters is that the US will experience a sizable fall in output and a further rise in unemployment this year, followed by a relatively muted recovery in 2010.

Finally, like its principal trading partner to the south, Canada is also in the midst of recession. Real GDP is set to decline by around 2.5% this year before reviving in 2010. Job losses, which have accelerated since last summer, will persist into next year. The country's once mighty trade surplus has (temporarily) evaporated in the face of weakening global demand and lower commodity prices. Conditions in the financial system have improved but have yet to fully "normalize." Meanwhile, the Canadian dollar has rallied against the US greenback since the winter and is poised for further appreciation once the global economy picks up steam and energy prices move higher - a challenging prospect for many trade-exposed industries on this side of the Canada-US border.

BC Economy

British Columbia's impressive economic expansion from 2003 to 2007 was largely underpinned by robust domestic activity rather than a buoyant export sector. But domestic demand has been downshifting since the middle of last year, and it remains notably sluggish mid-way through 2009. The Business Council's latest provincial forecast points to a substantial fall-off in housing starts and business investment in 2009, dwindling employment, and significantly lower retail sales. Together with sinking exports, the weakness in these key components of domestic demand will pave the way for an overall economic contraction (real GDP) in the vicinity of 2.5% for 2009.

It should be noted that this year's poor economic performance comes on the heels of a disappointing 2008: last year the province's real GDP dipped by 0.3%, the first year of negative growth since 1982.⁷ On a sectoral basis, output in the goods-producing industries as a whole fell 4.3%, manufacturing output slipped 10.5%, and wood products manufacturing fell 21.4%. All of these areas remain weak spots in 2009.

A worrisome aspect of the recession is the impact on the labour market. Here, there has been a rapid-fire shift from near-record low unemployment and widespread skill shortages 12 months ago to mounting job losses and a steeply rising unemployment rate. Over the first half of 2009, total employment is down 2.5% from the same period in 2008,

BC Economic Outlook			
(annual per cent change unless otherwise indicated)			
	2008a	2009f	2010f
Real GDP	-0.3	-2.5	2.4
Employment	2.1	-2.5	1.8
Unemployment rate (%)	4.6	7.8	7.7
Housing starts (000 units)	34.3	13.8	18.0
Retail sales	0.3	-7.0	3.0
Merchandise exports	5.0	-2.3	3.0
BC CPI	2.1	0.3	1.5
a=actual f=forecast Sources: Statistics Canada, Business Council for forecasts, Export Development Canada for export forecast.			

⁷ BC Stats, Business Indicators, Issue 09-04. Canadian real GDP increased by 0.5% in 2008.



representing a net loss of 56,000 jobs. The unemployment rate averaged 7% during January-June, compared to 4.3% last year (unemployment is now above 8%). A closer look at the data reveals that underlying conditions in the labour market are even worse than the top-line figures suggest. For example, the number of employees working in the private sector has decreased by 4.5% year-to-date, while self-employment has been climbing.

An unusual feature of this recession is the outright decline in nominal or current dollar GDP. Normally an economic downturn leads to a lower level of real economic activity (real GDP), but nominal GDP continues to grow. Not this time. Near zero inflation, sagging commodity prices, dwindling consumer outlays, and sharply lower residential and non-residential investment are translating into shrinking current dollar GDP, as well as a reduction in real output. Among other things, the pronounced weakness in nominal GDP is putting significant downward pressure on government revenues, since taxes are based on nominal rather than inflation-adjusted economic activities. This helps to explain recent reports of larger government budget deficits at the federal and provincial levels.

Another peculiar feature of this recession is the fall-off in consumer spending. Retail sales in BC are off a full 9.4% year-to-date compared to 2008. Much of the weakness in retail is concentrated in automobiles and segments linked to homebuilding and home renovation. So far in 2009 housing starts are running 60% below last year's level, while the cumulative value of non-residential building permits has contracted by almost one-quarter. The significant drop in construction activity is an important factor dragging down the overall BC economy.

Looking to 2010, conditions should improve as the American and Canadian recessions end, financial markets continue to stabilize, and the global economy starts to grow again. Because of lags, federal government stimulus spending and higher capital outlays by all levels of government in Canada will produce greater economic dividends next year than in 2009. In addition, BC can look forward to a timely economic boost courtesy of the 2010 Winter Olympic Games. The incremental spending injected into BC from hosting the Games in the first quarter of 2010 should help to put the province back on a positive growth footing after the 2008-09 slump. Our revised economic forecast projects a 2.4% rebound in real GDP next year, with modest gains in retail sales, employment, housing starts, and exports.

Even with the Olympics, we anticipate a subdued recovery in 2010 – there will be no quick return to the economic boom the province enjoyed over 2004-07. It is going to take time for the global economy to re-gain traction after the traumatic events of the past 18 months. Economic downturns which are preceded by periods of severe financial distress tend to be more protracted than a “normal” recession, and are then followed by below-average recoveries. So from a BC vantage point, it would be imprudent to bank on the resumption of anything resembling strong economic growth in the near-term.