



# Publication

## B.C. OUTLOOK

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Editor: Jock A. Finlayson

### BC 2009 ECONOMIC OUTLOOK: GLOBAL RECESSION SPELLS THE END OF THE BOOM

Amid rapidly deteriorating global economic conditions, BC's economic prospects have dimmed. Most industrialized countries are already in or about to fall into recessions and global commodity prices have fallen precipitously since the spring - creating a difficult situation for the province's export-oriented economy. Fuelled by robust job growth, rising incomes, and an investment boom, the domestic side of the provincial economy was critical in propelling BC's strong growth over the past few years. Unfortunately, domestic demand is now flagging. Both new home construction and non-residential construction are weakening and consumer spending is rapidly downshifting.

We now expect the province to post virtually no economic growth on a year-over-year basis in 2009, on the heels of a modest 1.2% advance in real GDP in 2008 (see table). But we are the first to admit that in today's unsettled financial and economic environment, all forecasts are accompanied by a high degree of uncertainty. It is conceivable that BC could suffer a recession in 2009 with the economy contracting by as much as 1-2%.

| <b>BC Near-Term Economic Outlook</b><br>(annual per cent change unless otherwise indicated) |      |      |      |
|---------------------------------------------------------------------------------------------|------|------|------|
|                                                                                             | 2008 | 2009 | 2010 |
| Real GDP                                                                                    | 1.2  | 0.4  | 2.8  |
| Employment                                                                                  | 2.2  | -0.7 | 1.3  |
| Unemployment rate (%)                                                                       | 4.5  | 6.1  | 6.0  |
| Housing starts (000 units)                                                                  | 35.8 | 24.0 | 26.0 |
| Retail sales                                                                                | 2.1  | 0.7  | 5.0  |
| BC CPI                                                                                      | 2.1  | 0.6  | 1.5  |
| Sources: Statistics Canada, BC Stats and Business Council for estimates and forecasts.      |      |      |      |

While we still view a slightly positive growth number as the most likely outcome for next year, there is a chance (more than 30%) that a negative growth scenario could unfold. Based on our positive scenario, BC should continue to outperform most other provinces in 2009, against the backdrop of a national recession. If the negative scenario materializes, the performance gap between BC and other provinces could disappear. Under either scenario, the economy will be much weaker than in previous years, with the province suffering a net loss of jobs for the year as a whole.

#### **Dismal External Setting**

The US, Japan, the United Kingdom and much of the EU are currently in recession. As bellwether trade-dependent economies, it is telling that both Singapore and Hong Kong have

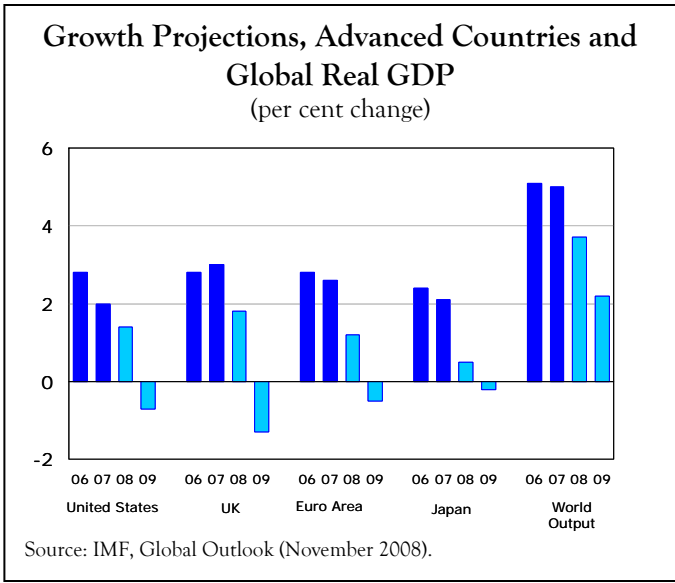


experienced steep declines in economic activity in recent quarters. The International Monetary Fund expects the US economy to contract by 0.7% in 2009, while the advanced industrialized nations collectively will shrink by 0.3%. A downturn in aggregate output for the advanced economies has never occurred since 1970 (when consistent data began to be assembled). This means that emerging economies will be the only source of global growth in 2009. But because emerging markets depend heavily on exports sold to wealthy countries, the IMF believes their collective growth rate will slip to 4-5% next year.

With the global economy sinking, the short-term outlook for commodities is bleak. Lumber prices have retreated to near-record lows, prices for copper and other minerals produced in BC have tumbled, and pulp prices are set to drop as the global economy loses momentum. Natural gas prices are also well off year-ago levels and are likely to face additional downward pressure as North American gas reserves build up in the coming quarters.

Although the general outlook for BC exporters is poor, certain factors should help to mitigate the impact of the global downturn. One is that much of the downward adjustment in BC's forest products sector (responsible for 40% of the province's goods exports) has already occurred. US housing starts have fallen off a cliff since 2006, and while they will probably slide further in 2009, much of the adjustment in the industry has taken place as sawmills have closed or taken downtime. While this is of little solace to companies bleeding red ink or workers on layoff, arguably it is better for the industry to be near a bottom than at the top facing a sudden collapse in demand.

Another plus for exporters is the depreciation of the Canadian dollar against the US greenback. The 20% reduction in the US dollar cost of BC produced goods and services

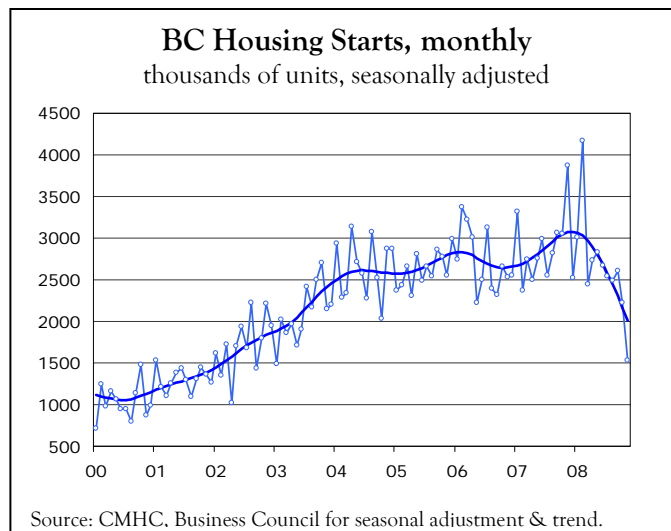




since the spring has improved the province's competitive position. Thus, while 2009 will be a tough year for many BC exporters, at least they will not have the additional challenge of a currency trading at par with the American dollar. So far in 2008 BC's exports have been propped up by strong coal prices and high natural gas prices earlier in the year. Prices for these energy commodities will be lower in 2009, setting the stage for an overall decline in the province's exports.

### Domestic Economic Engines Stalling

BC's economic expansion over the past four years was mainly attributable to buoyant domestic activity rather than a supercharged export sector. Growth in the key segments of domestic demand (investment spending on housing, investment in non-residential structures, and personal consumption) exceeded the long-term average in four of the past five years. However, these domestic economic engines are now faltering. With housing prices out of line with any measure of affordability, a downturn in BC's housing market was inevitable. But the drop in prices and sales since early 2008 owes much to the global financial crisis and the associated deterioration in consumer sentiment. Province-wide housing sales have been shaved in half. At the same time, the number of new listings has climbed sharply. With these changes in the market, the average price of a house sold in BC has declined 7% from year ago levels and is down 13% from the spring 2008 peak. More price falls are in store for 2009.



Given the rising supply of new and existing homes for sale, new home construction is poised to slump in 2009. The latest monthly figures show housing starts dropping to a seasonally adjusted annual rate of 18,300, roughly half of the year-ago pace. While the monthly figures can be volatile, recent building permits data and anecdotal reports from developers confirm that homebuilding will be curtailed in the coming quarters. This realignment will have a significant impact on economic growth, both directly through reduced construction activity and indirectly via dwindling demand for real estate services and related retail activity.

Non-residential construction has been a vital economic driver in BC since 2004. Here too conditions are weakening, notwithstanding high levels of public sector investment in infrastructure and other capital assets. Over the first three quarters of 2008 investment in non-residential structures was off 4% versus the same period in 2007. In inflation-adjusted terms (which more closely reflects real economic growth), investment in non-residential



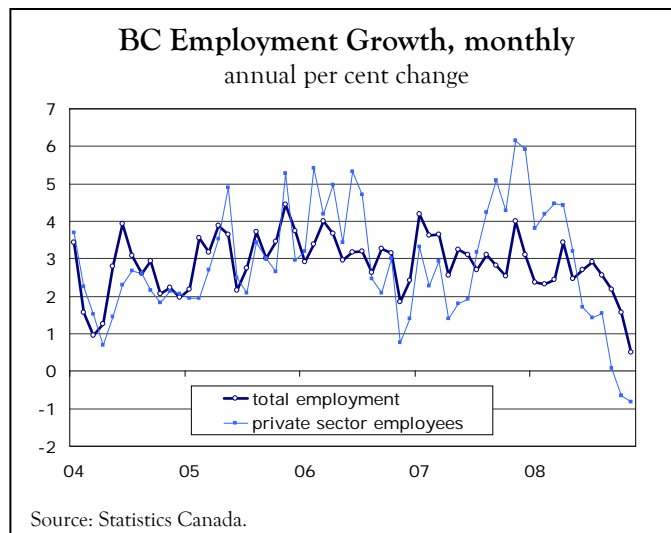
structures is down 11% year-to-date. Building permits - a more forward looking indicator - suggest the slowing trend in non-residential construction will continue in 2009.

After several years of impressive growth in consumer spending<sup>1</sup>, 2009 is shaping up to be a difficult year for BC retailers and consumer service providers. Retrenchment in spending patterns is already evident, as annual growth in retail sales has tumbled from the 6-7% range in 2006-2007 to 1.3% in the third quarter of 2008. Much of the slowdown is linked to a softer housing sector, as sales of furniture/home furnishings as well as appliances and electronics have slowed to a crawl. Spending at home centres has also fallen rapidly. Automobile sales have plummeted, which speaks to the fragile state of consumer confidence. While lower oil prices and the accompanying retreat in gasoline pump prices are positive for household budgets, negative consumer sentiment and the housing slowdown will trump the impact of any gasoline savings accruing to consumers.

### Focus on the Job Market

A worrisome aspect of any economic downturn is the impact on jobs. To date, BC's job market has held up well, but the spreading economic malaise is starting to show up in the labour market numbers. Total employment is now below its mid-year peak, with year-over-year job growth slipping to 0.5%, compared to the 3% pace of recent years. Looking ahead we expect the level of employment to dip slightly in 2009. The number of paid employees working in the private sector has already slipped 0.8% below year-ago levels. As we move into 2009, layoffs are expected to accelerate in many sectors, including construction, real estate and related services, financial services and retail.

The subdued employment outlook means that the unemployment rate is set to rise to an average of 6% in 2009. While this is far below the 8.5% rate registered in 2002, higher unemployment will create more slack in BC's labour market - a market which has been exceptionally tight for the past two years. Many companies may still have difficulty finding qualified workers, but widespread concerns over labour shortages should ease somewhat in 2009. In addition to a larger pool of unemployed residents, there will continue to be a steady flow of people migrating to BC from other provinces (especially Ontario) and from abroad.



<sup>1</sup> Growth in consumption in BC was higher than in all other provinces except Alberta over the past half decade.



### **Looking to 2010**

As a small open economy, British Columbia cannot avoid being dragged down by the unfolding recession in North America and the downturn occurring in the wider global economy. Most indicators have turned negative, confirming that growth will be very weak (or non-existent) in 2009. Because of the global financial crisis and the synchronized world-wide economic downturn, the balance of near-term risks is clearly on the downside. The emerging slump in the BC housing market also creates uncertainty. On the way up rising property prices nurtured a feeling of prosperity and helped to buoy consumer spending. With home prices sliding, the reverse pattern could weigh on consumer sentiment in 2009 (and perhaps beyond).

The good news is that British Columbia arguably is relatively well-positioned to withstand the looming economic downturn. Thanks to excellent fiscal management and a string of annual budget surpluses, the provincial government is in a strong financial position and has room to accelerate capital spending as part of a broader effort to support the economy. The substantial tax cuts implemented since the start of the decade have enhanced BC's competitiveness and increased after-tax incomes/profits for many businesses and households. Significant public sector spending on infrastructure projects should also bolster economic activity in the months ahead. Finally, British Columbia's economy is more diversified than it was two or three decades ago, as evidenced by the fact that the severe problems affecting the forest products industry over the past 18 months have (yet) to tip the overall economy into a recession.

It is also encouraging to see central banks and governments across the world taking aggressive action to boost national economies, re-capitalize banking systems, and get the credit markets functioning properly. In both the US and Canada, central banks have slashed their target rates to near-record lows. And governments in North America, Europe and Asia will be providing further fiscal stimulus over the course of 2009.

Most forecasters expect at least some recovery in the global and North American economies by 2010. Prognosticators and analysts will be closely monitoring incoming economic and financial data for clues that the foundations for a recovery are being put in place. Key indicators to watch include credit market interest rate spreads, evidence that business lending is picking up, trends in inventory accumulation/de-accumulation, global commodity prices, and stock market performance. All of these indicators are likely to "go positive" before an economic recovery actually gets underway.

At this point, we believe 2010 will bring an upswing for British Columbia as economic conditions improve globally and in North America. In addition, BC will reap significant economic benefits from hosting the Olympics. By 2010, we anticipate a return to economic growth, with the province's real GDP rising by 2.8% and a 1.3% increase in employment.

Jock Finlayson, Executive Vice President  
Ken Peacock, Director of Economic Research