

**PROVINCIAL ECONOMY IN A 'SOFT SPOT',
BUT STRONGER GROWTH EXPECTED IN 2003**

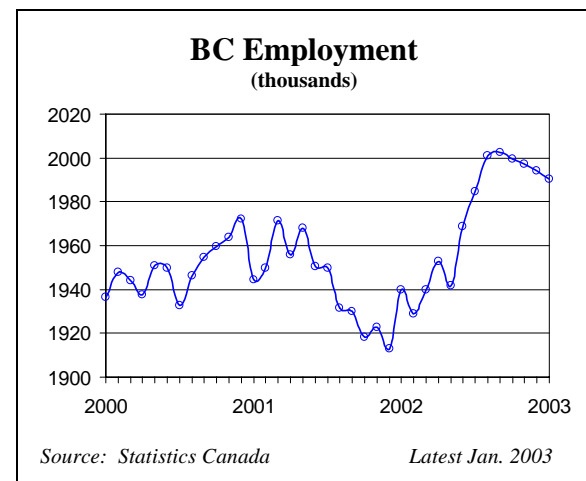
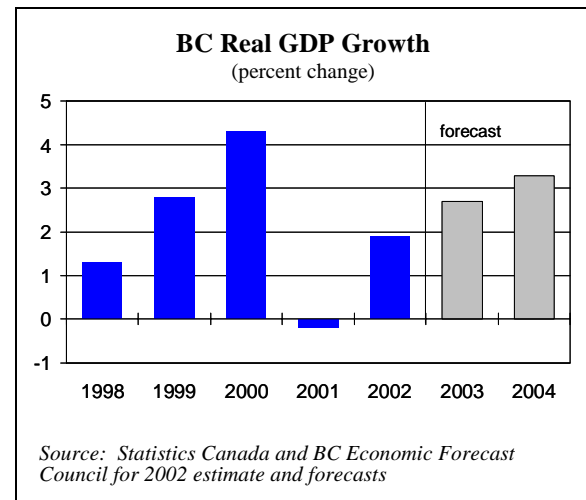
A year ago BC was emerging from a mild recession. A strong upturn in employment was widely seen as early evidence that the province's economy had turned the corner and was poised to slowly gain momentum as the year progressed. As it turned out, the recovery was stronger and took hold sooner than expected, but then faded. The last quarter of 2002 ended on a soft note.

This subdued economic picture has extended into the first months of 2003 and is reflected in the fact that employment has been edging lower (full time employment has been particularly weak), growth in consumer spending has moderated somewhat, and BC's international exports have yet to register an upturn.

In spite of this, the consensus outlook is for British Columbia's real GDP to increase by a respectable 2.7% in 2003¹. Given current geo-political uncertainties and the still sputtering American economy (the US currently accounts for 70% of BC's international merchandise exports), growth is likely to be sub-par in the first part of the year and then accelerate in the second half.

Consumer spending should remain relatively healthy while other sectors improve

Consumer spending is expected to remain a key source of growth in 2003. Rising incomes, comparatively low interest rates, and the positive wealth effect stemming from higher residential housing prices will



all work to keep British Columbians spending. A number of other factors, however, suggest that although retail sales should remain healthy, they may fall short of last year's 5.7% increase. As interest rates edge up, consumer spending will be affected – even slightly higher borrowing costs will impact housing sales, which have generated spending on furniture, appliances, and other household items. Rising energy costs also promise to take a bigger bite out of household budgets, leaving fewer dollars to

¹ The consensus forecast is the average forecast of the Ministry of Finance's Economic Forecast Council. In its February budget the BC government adopted a slightly more conservative forecast of 2.4% for 2003.

spend on other items. High levels of personal debt in BC could also constrain consumer spending going forward.

Add it all up and one thing becomes clear: if economic growth in the province is going to exceed last year's 1.9% pace, other sectors of the economy, namely exports and business investment, will have to contribute.

A modest recovery in BC's export sector is anticipated by the second half of 2003, mostly due to a delayed upturn in the United States economy. The fact that BC's exports have fallen for two consecutive years has left the value of international exports at a sufficiently low level that some sort of improvement is almost inevitable, especially since commodity prices have been rising. Having said that, BC's exports will continue to be dampened somewhat by recession in Japan and very weak economies in Germany and France.

Developments in the US will have a major influence on the economic outlook for BC. Here there is some upside potential if the conflict with Iraq reaches a quick resolution and there is a partial solution to the softwood lumber dispute. It is still possible that an interim border export tax on softwood lumber will be implemented at a lower rate than the current combined US tariffs of approximately 27%. This would provide some financial relief and greater certainty for BC lumber companies, while also creating a welcome source of additional revenue for the provincial government.

Business investment also needs to improve before BC can get on a solid growth footing. One positive sign is that private sector non-residential building permits seem to have bottomed and began to show some improvement during 2002.

Perhaps more encouraging is a new Statistics Canada survey indicating that private sector investment in BC is slated to rise by 5.6% this year. Construction capital

spending will be higher, spurred by a buoyant housing market. But even excluding housing, planned non-residential construction investment is predicted to rise by 4.2% in 2003. The forecast 3.7% increase in spending on machinery and equipment in the private sector is also good news. The latter finding points to a positive shift in business sentiment: last year, intentions were to reduce spending on M&E by nearly 5%.

<u>Business Investment Intentions</u>	
(percent change from 2002 to 2003)	
Private sector investment	+5.6%
Construction	+6.9%
Housing	+8.6%
Excluding housing	+4.2%
Machinery & equipment	+3.7%

Source: Statistics Canada, Public and Private Investment in Canada, Intentions 2003. Note: 2002 are preliminary actual and 2003 are intentions; all housing investment is assumed to be in the private sector.

Ottawa's fiscal stimulus will contribute

A final consideration in BC's growth outlook is the sizable fiscal injection the province will receive owing to the measures announced in the February 18th federal budget. The biggest gain will come from expanded federal transfers for health care in 2003 and later years. The budget also promises more federal money for research in academic institutions and teaching hospitals; increased financial support for families with children, those with disabilities, the homeless, and aboriginal communities; more venture capital to support the growth of knowledge-based BC companies; increased federal outlays on environmental initiatives; and small-scale federal tax cuts. All of these measures will contribute to economic activity in 2003-04.

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