

BC OUTPACES NATIONAL ECONOMY IN 2003

According to Statistics Canada's preliminary measure of real provincial GDP, the BC economy expanded by 2.2% in 2003. While it would be a stretch to call this robust growth, it is a respectable result, particularly considering all the negative economic shocks that battered the provincial economy in 2003.

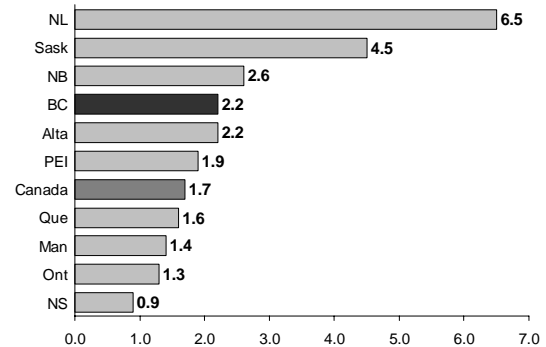
Moreover, for the first time in many years, BC enjoyed stronger economic growth than Canada as a whole in 2003. Among the provinces BC tied Alberta for fourth spot in the growth rankings, and it easily outdistanced the Canadian benchmark of 1.7%. For those who are keeping track, the last time BC's economy outpaced Canada was in 1996.

Also worth noting is that the province's economy turned out to be quite a bit stronger than analysts expected. Even in recent estimates, most forecasters were calling for real GDP to rise by 1.4% to 1.6% in 2003, with some expecting closer to 1%.

It appears that analysts may have underestimated the strength of the domestic economy and consumer confidence. The GDP data show that consumer expenditures increased 3.2% in 2003, keeping pace with the previous four years.

Although analysts were well aware of the booming BC housing market, they may have been surprised by the fact that investment in residential construction surged 15% in 2003, essentially equalling the frothy increase seen in 2002.

Real Gross Domestic Product, 2003 (per cent change, 1997 chained \$)



Source: Statistics Canada

BC's economy also got a lift from higher investment in non-residential structures, which was driven in large part by engineering construction in the oil and gas sector. Higher commodity prices helped drive corporate profits up 12%, following two years of decline.

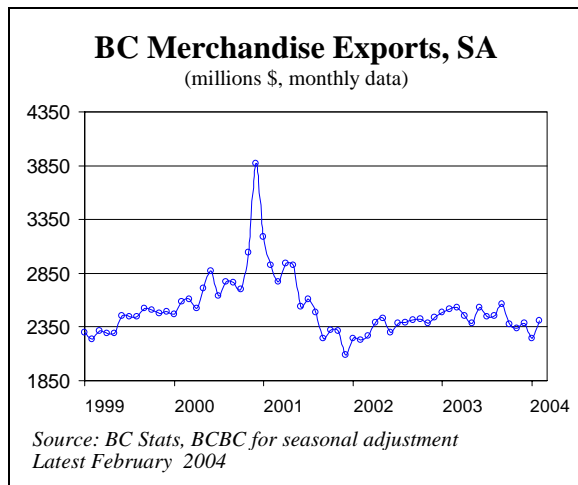
In short, the combination of a surprisingly resilient consumer, higher corporate profits, buoyant housing markets, and an upturn in business investment meant that the provincial economy grew more quickly than anticipated in 2003.

Growth Poised to Accelerate in 2004, Especially if Export Sector Picks Up

Looking to 2004, the outlook for BC's domestic economy remains positive. As the results for 2003 showed, this alone should ensure a decent economic expansion throughout 2004 and into 2005. Achieving somewhat stronger growth (3% plus),

however, continues to hinge on developments in the external environment and, especially, a turnaround in BC's exports.

On this front conditions are still mixed. The lagged effect of the 20% plus run-up in the Canadian dollar in 2003 has kept a lid on BC's **export sector**, while the US-imposed tariffs on Canadian softwood lumber continue to take a bite out of revenues for BC lumber companies. On the other hand, the US economic expansion seems to have staying power, and significantly higher commodity prices are providing a welcome lift to many BC resource exporters.



For a while it appeared as though the fallout from the rising Canadian dollar was going to be the dominant factor. BC's international merchandise exports dropped in the final quarter of 2003, and then fell a further 6% in January. But February saw exports rebound with a hefty 7.4% jump. Commodity prices were a key factor, as much of the recent growth in forestry exports was price-induced, a reflection of sustained US housing demand, elevated prices for plywood and oriented strand board, and modestly higher pulp prices. As well, lumber prices moved up, averaging US\$386 per thousand board feet in February, compared to US\$300 at the end of 2003.

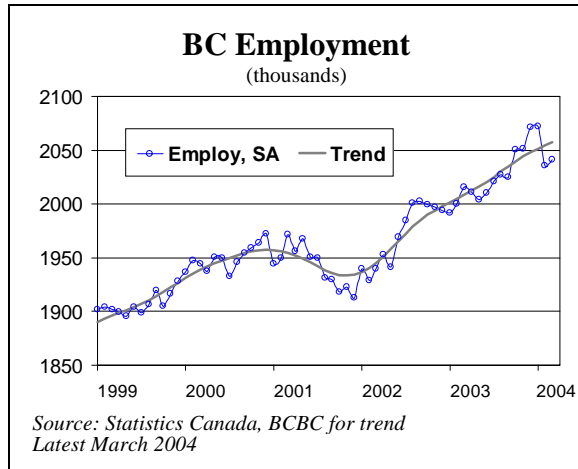
The increase in exports only covers a single month and likely foreshadows additional volatility as much as it does a more durable upswing. Nevertheless, it does lend support to the view that firmer commodity prices and the ongoing US recovery will boost BC's beleaguered export sector this year. The fact that the dollar has retreated to the US 74-75 cent range (after hitting 78 cents in January) will also provide some reprieve for exporters.

In a recent Bank of Canada survey of exporting companies, the manufacturing and natural resource sectors (which dominate BC's exports) reported being most adversely affected by last year's rapid increase in the dollar. The main effect was reduced profit margins, although some companies reported lower export volumes as well. It is interesting to note that despite the exchange rate appreciation, adversely affected companies were still as optimistic as other firms about future growth in sales, suggesting that they may be anticipating a lift from the expanding economy south of the border as well as continued solid growth in China.

The other "export" that needs to improve to get BC's economy firing on all cylinders again is **tourism**. Here, unfortunately, the near term outlook is cloudier, with little or no growth coming from any of the province's major markets. Although the number of visitors coming from Asia has recovered from the last year's SARS-induced drop, Asian tourism has basically flat-lined for three years. The number of Europeans vacationing in BC has trended lower since 2000, returning to levels last seen in 1995.

For the local tourism industry the biggest concern is the US market, which accounts for about 70% of all tourists to BC. After regaining much of the lost ground related to

SARS, the recovery in this market has stalled. In fact, in recent months tourist traffic out of the US has actually slipped, perhaps in a lagged response to the stronger Canadian dollar.



In spite of the unevenness across the various export-oriented sectors, BC's healthy domestic economy is fuelling job growth. **Employment** attracted some attention when the estimated number of jobs plunged in February. But this single month of poor job numbers is not indicative of underlying conditions in the labour market. Provincial job numbers are often volatile, so it is necessary to examine longer-term trends. In this case, February's drop followed several months of above average increases in the latter part of 2003, and is probably best seen as a reversion to the trend (see graph) rather than a sign that the job market is derailing. The small increase in employment reported in March is consistent with this viewpoint.

The bottom line is that the upward trend in employment evident since early 2002 basically remains intact, despite month-to-month volatility. Given that other domestic economic indicators are positive, we do not expect employment to turn down anytime soon.

One indicator that is consistent with an expanding workforce is **retail sales**. In February, retail spending recorded an impressive 2.4% monthly advance. Prior to this, total retail sales had been quite soft, but most of the weakness in the headline figure was due to a marked slowing in automobile sales. Stripping out autos, annual growth in retail spending hovered in the 3% to 4% range throughout 2003, a pace that speaks to reasonably high consumer confidence.

Finally, the **housing market** remains a key pillar of the provincial economy. The first quarter of 2004 saw a 44% jump in starts versus the same period in 2003; this pushed housing construction to its highest level since 1994.

In summary, most indicators suggest the domestic economy will be relatively strong through 2004 and into 2005, but a more robust economic expansion awaits a pick-up in export growth. There is hope that BC's merchandise exports will climb in the coming months, but a fuller recovery in the tourism sector may not materialize until 2005.

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