



## BC Poised for Small Bounce in Economic Growth in 2013

Economic growth in the province should gain a bit of momentum over the course of 2013. However, overall economic conditions won't feel much different than last year. The province's economy slowed in the latter part of 2012. Consumer spending flattened out, employment growth stalled, and residential real estate activity turned down. So 2012 ended on a subdued note, setting up a weak handoff for the new year. The good news is that we anticipate some positive economic developments over the next 12 months, with BC's projected real GDP growth of 2.3% exceeding last year's estimated 1.9% expansion.

Robust non-residential construction investment and continued strength in the transportation and logistics sector will underpin BC's economic advance in the next two years. In contrast, the residential real estate sector is a source of downside risk and an area where conditions are unlikely to get better in the near term. Our baseline assumption is that residential real estate sales soften only modestly, and that housing prices do not drop sharply. In this environment, new home construction will be trimmed, but renovation spending should remain solid.

BC's exports also ran into a soft patch at the end of last year. But here too there are reasons to look for some gains in 2013. In spite of the uncertain international backdrop, global economic growth is expected to accelerate and should be sufficient to support rising foreign demand for a number of key BC commodity exports. The economic outlook for China has improved in recent months, and the ongoing rebound in US home construction promises to boost BC's forestry sector.

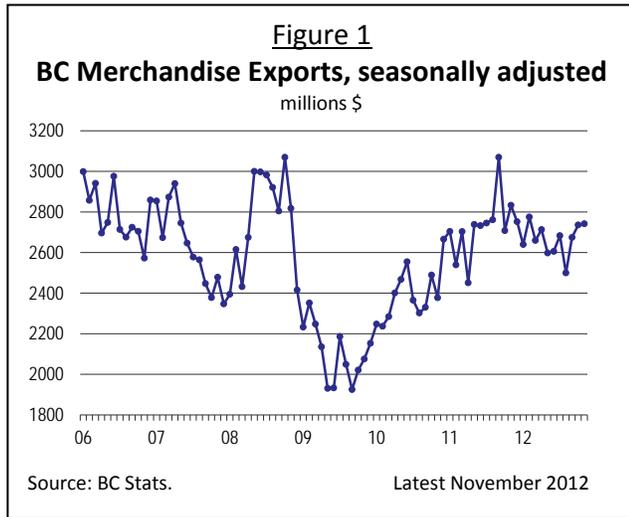
	2011	2012	2013f	2014f
US	1.8	2.3	2.0	3.0
Euro area	1.4	-0.4	-0.2	1.0
Germany	3.1	0.9	0.6	1.4
France	1.7	0.2	0.3	0.9
Italy	0.4	-2.1	-1.0	0.5
Spain	0.4	-1.4	-1.5	0.8
UK	0.9	-0.2	1.0	1.9
Japan	-0.6	2.0	1.2	0.7
China	9.3	7.8	8.2	8.5
World	3.9	3.2	3.5	4.1

Source: IMF, World Economic Update (January 2013)  
f = forecast

### **External Conditions Support Export Growth**

Still, the global economy will stay weak this year, albeit some improvement relative to 2012 is in store. Importantly for BC, most forecasters now see firmer economic growth in China, with earlier fears of a "hard landing" scenario having largely dissipated.

In the United States, the recent mini-deal to fend off the "fiscal cliff" alleviated the immediate threat to the economy, but fears of excessive fiscal drag undermining US growth are likely to re-emerge soon. While uncertainty about fiscal policy continues to hurt both business and consumer confidence, the recovery in housing markets, healthy corporate balance sheets, and perkier job creation numbers are all positive factors for 2013 and beyond. The slow but steady rebound in US housing starts is translating into stronger lumber prices and should help to lift BC's exports over 2013-14.



In Europe, the baseline assumption is for more financial upheaval while policy-makers continue to work on resolving the debt crisis in the Euro zone.<sup>1</sup> The situation has improved since mid-2012, with the European Central Bank's commitment to purchase unlimited amounts of sovereign debt serving to calm financial markets. Italian and Spanish sovereign bond yields have fallen to more manageable levels compared to mid-2012. But there are still widespread concerns about the region's debt crisis and undercapitalized banking system, as well as the huge gaps in national economic performance and competitiveness that exist within the 17-member Eurozone.

Looking at the BC export data, the impact of last year's slowdown in China and softer global growth is apparent. When the data for December are tallied, the value of BC's international merchandise exports will end up being a bit lower than in 2011. Consistent with the modest US recovery, BC's exports to the US edged higher in 2012, led by a 30% jump in the value of wood products shipments. Sizable decreases in export sales to several offshore

<sup>1</sup> The Eurozone consists of 17 of the 27 European Union member states that operate with a common currency and central bank.

markets, including South Korea, Taiwan, and Western Europe, led to an overall drop in the province's international exports. For 2013, we expect the uptrend in exports to the US to continue, while sales to China and most other Asian markets should also see some turnaround.

In its January 2013 Monetary Policy Report, the Bank of Canada retained language suggesting that interest rates will eventually rise. But with economic growth in Canada sluggish and inflation low, most forecasters believe the Bank won't be adjusting its overnight policy rate until late 2013 or early 2014. The US Federal Reserve has clearly stated that it intends to keep rates exceptionally low for a protracted period, which somewhat limits the Bank of Canada's policy choices. The bottom line is that while interest rates in Canada may edge higher by the last quarter of 2013, they aren't expected to move by much.

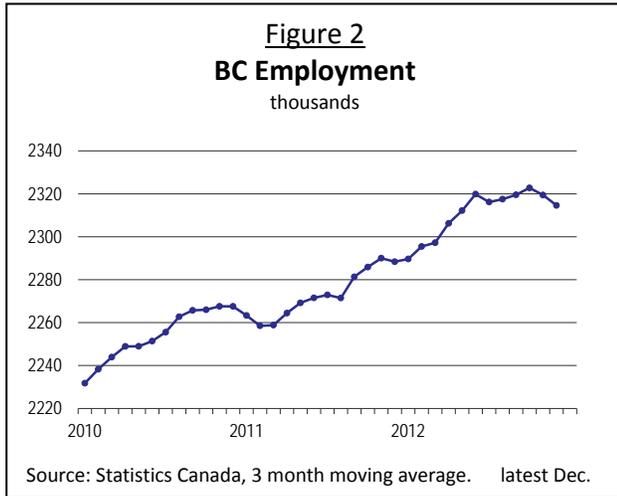
### **Domestic Economic Soft Patch to Pass**

Within BC's borders, many measures of economic activity slowed in the second half of last year, and this affected the pattern of job growth. For 2012 as a whole, average employment increased by a respectable 1.7%, but momentum flagged as the year progressed.

A drop in the number of people on private sector payrolls was a key driver of softer job growth in the second half of 2012. The fall-off was significant enough that private sector employment in December was essentially the same as at the beginning of the year. This pattern of weakness is unlikely to persist, however. By the second quarter of 2013, we expect hiring to pick up and employment levels to climb.

Job growth across BC industries has been uneven. While gains were recorded in manufacturing and primary resource industries, the number of people working in construction

declined (reflecting weaker residential investment). Employment was flat in the retail and wholesale trade segments, and it fell in the broad professional services category.



Stagnant retail employment is not surprising in light of the weak retail sales picture in BC. Year-over-year growth in retail spending declined as the year unfolded, and by October it had slipped into negative territory. Note that a similar slowing trend was evident in the beginning of 2011, but this was when year-over-year comparisons were being made relative to the period when spending was boosted by the 2010 Winter Olympics. Adjusted for inflation, constant dollar retail sales actually dropped last year. It's not entirely clear why retail spending has been so weak in BC, but high levels of consumer debt, a slowdown in home sales, and increased cross-border shopping are likely all contributing factors. Looking to 2013, a stronger labour market should support some gains in retail spending.

A slowdown in the provincial housing sector is clearly underway. The number of homes sold through the MLS system is down 25% from year-ago levels, while the average price of a home sold is off by 9%. Tighter mortgage rules, still high home prices, and related affordability

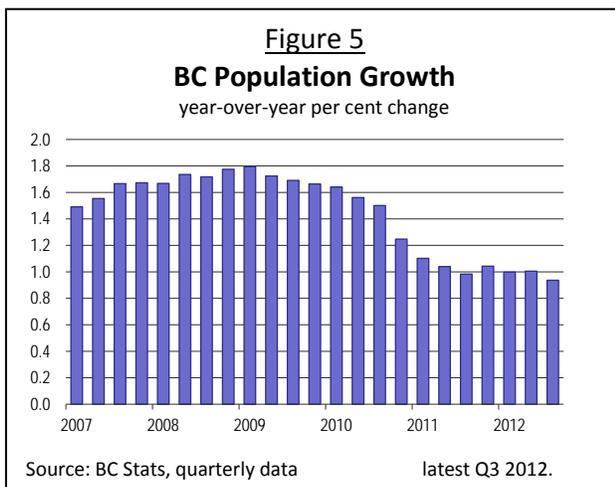
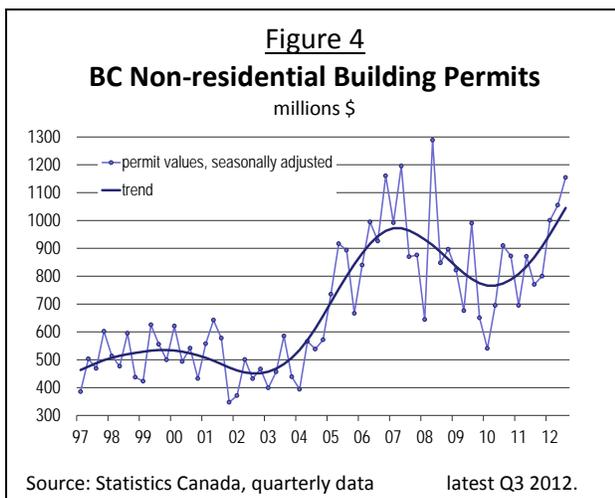
issues are keeping some prospective buyers on the sidelines. Anecdotal reports suggest a dwindling influx of foreign investors is also tempering home sales, although this is difficult to quantify. One concern is that the housing slowdown has occurred even with near record low interest rates. This suggests that any improvement in affordability will have to come through the price adjustment channel. As noted above, the housing sector presents a downside risk to our BC outlook (although we don't expect a significant housing slump). While a sharper-than-expected drop in prices would bolster affordability, it would also prompt first-time buyers to be cautious about getting into the market and reduce the net worth of many current homeowners.

**Table 2**  
**BC Economic Outlook**  
(annual per cent change unless otherwise indicated)

	2012e	2013f	2014f
Real GDP	1.9	2.3	2.6
Employment	1.7	1.1	1.9
Unemployment rate (%)	6.7	6.5	6.2
Housing starts – all areas (000 units)	27.0	24.5	25.0
Retail sales	2.8	4.5	4.5
BC CPI	1.3	1.6	1.8

a – actual f – forecast e – estimate  
Sources: Statistics Canada and BC Stats; Business Council for forecasts.

Non-residential construction is the main area of economic strength in BC, and this should continue through 2013-14. The value of non-residential building permits is now back to the peak levels seen during the 2006-07 building boom, notwithstanding the fact that overall economic conditions are on the softer side. Resource industry projects, new infrastructure development, expansions of some existing infrastructure assets, and a stepped up pace of commercial development in some urban areas



are all supporting high levels of non-residential construction activity. Transportation and energy are key areas of strength for capital spending and project activity. A number of liquefied natural gas projects and pipelines have been proposed that – if they proceed – will bring big economic benefits to the province, but commencement of these is beyond the current forecast horizon.

One factor that is weighing on the economy is fiscal policy. Both the federal and provincial governments are working to eliminate deficits and thus are restraining spending. To be clear, government spending will still rise, but at a slower pace. The BC government is committed to balancing the budget in 2013-14, which signals spending restraint and possibly some revenue measures in the upcoming budget. The provincial election in May introduces a degree of uncertainty around the future path of fiscal policy, but this becomes more relevant for 2014 and beyond.

Another variable that is working to temper top line economic growth is slower population growth. Due largely to a net outflow of people moving to other provinces, BC’s annual population growth rate has slipped below 1%. Net interprovincial migration is now negative, as more British Columbians move to Alberta (as well as Saskatchewan). Alberta in particular may continue to attract more working-age British Columbians over the next few years. Weaker population growth is apt to have a dampening effect on key areas of domestic demand, notably consumer spending and residential investment, although not all regions of the province will be affected to the same extent.

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