

# BC ECONOMIC REVIEW AND OUTLOOK



JULY 2016

## BC'S ECONOMY REMAINS ON SOLID GROWTH PATH DESPITE MUTED GLOBAL BACKDROP

### HIGHLIGHTS

- The global economic backdrop remains unsettled. Over the past year forecasts have been scaled back. Global growth is now projected to be around 3% this year and in 2017 as well.
- Growth projections for many of BC's key trading partners have also been cut, which, along with mixed commodity prices, is weighing on BC's merchandise exports.
- The weak dollar and the ongoing expansion in the US are a source of export strength for the province. Tourism and other service exports are benefitting from the lower currency.
- The domestic side of the BC economy is healthy, led by robust housing activity, large gains in the retail sector and solid job growth.
- Although job growth in BC is strong, it is concentrated in the southwest part of the province. Other regions have seen employment levels slip over the past year.
- Net in-migration from other provinces, particularly Alberta, is helping underpin domestic economic activity.
- In light of the weaker external setting, we have trimmed the outlook for BC's real GDP growth slightly for 2016 to 2.7%. For 2017, we now expect growth to be 2.6% (a reduction of 0.4 percentage points from our previous projection).

Against the backdrop of a subdued global economy, British Columbia looks poised for healthy growth over 2016-17, continuing the pattern of last year. While parts of our economy will be held back by depressed prices for some key commodities, exports of non-resource goods together with many services – including tourism – are enjoying a lift from the low Canadian dollar. The province's housing market also remains buoyant, supported by rock-bottom interest rates, better job growth and steady inflows of immigrants and foreign money.

The ongoing painful economic downturn in Alberta means that BC is also experiencing an uptick in interprovincial migration, which will further support housing demand and retail sales.

### EXTERNAL SETTING

The IMF's spring 2016 World Economic Outlook publication, titled "Too Slow for Too Long," depicts a global economy that continues to struggle. Back in the spring the IMF

expected global output to increase by a modest 3.2% in 2016.<sup>1</sup> Following Brexit, the IMF has trimmed its global outlook, which it now projects at 3.1% in 2016 and 3.4% in 2017.<sup>2</sup>

Several of BC's trading partners have seen their growth prospects scaled back, which is dampening activity in the province's export sector. In the US, gains related to a recovering housing market and continued employment growth are being tempered by softness in exports, declines in capital spending in the energy sector, and weaker

<sup>1</sup> IMF, World Economic Outlook, "Too Slow for Too Long," April 2016 (pg. xv).

<sup>2</sup> IMF, World Economic Outlook, "Uncertainty in the Aftermath of the U.K. Referendum," July 2016.

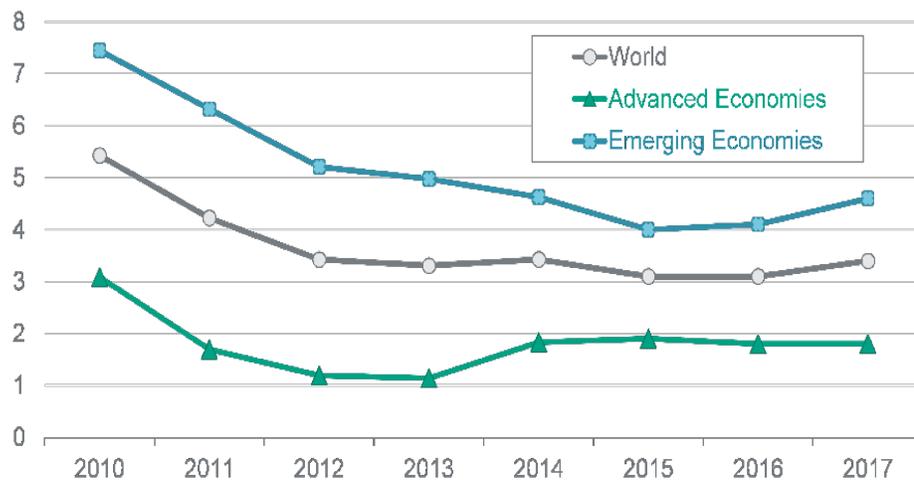
TABLE 1: **GLOBAL ECONOMIC FORECAST (ANNUAL % CHANGE IN REAL GDP)**

	2015	2016f	2017f
World	3.1	3.1	3.4
US	2.4	2.2	2.5
Euro area	1.7	1.6	1.4
Japan	0.5	0.3	0.1
China	6.9	6.6	6.2
Emerging market economies (all)	4.0	4.1	4.6

\* 19 EU member states collectively f - forecast

Source: IMF, July 19, 2016.

FIGURE 1: **GLOBAL ECONOMIC GROWTH (%)**



Source: IMF *World Economic Outlook*, July 2016 & Historical Database.

manufacturing activity. The IMF now projects that the US economy will expand by 2.2% in 2016 (some private sector forecasters are looking for sub-2% growth). Next year should see something closer to 2.5% growth for the massive \$18 trillion American economy.

In Japan, which is still BC's third largest trading partner (accounting

for 12% of merchandise exports), growth is expected to remain anemic, around 0.3% in 2016. The Bank of Japan's easing measures—including the extraordinary step of implementing negative interest rates on reserve deposits adopted in February—will provide some support to the economy. On balance, however, Japan's medium- to long-

term prospects are poor, primarily because the labour force and the population are both shrinking.

A sizable downshifting in China's growth path has sent reverberations through many emerging markets and was a major factor behind the sharp drop in global commodity prices over 2014-15. Output in China is on track to increase by 6.6% this year, before dipping to 6.2% in 2017, according to IMF projections. China's multi-decade string of 10% plus annual GDP growth rates has come to an end.

The UK's vote to leave the European Union creates more uncertainty that will weigh on the troubled global economy in the near term. In its most recent Monetary Policy Report, the Bank of Canada updated its international outlook in the wake of the Brexit vote. The Bank now sees global growth reaching 2.9% this year, slightly lower than the IMF's expectations, and down 0.1% from its forecast in April.

## CANADA: STRUCTURAL ADJUSTMENT CONTINUES

Despite a decent start to the year, Canada is set to post sub-par economic growth for 2016 as a whole. The national economy is in the midst of a protracted and painful adjustment brought on by plunging oil and gas prices and related declines in energy-related investment. As the adjustment process continues, by 2017 Canada should be transitioning back to a sturdier economic footing, with real GDP likely to increase by at least 2%, up from 1.1% in 2015 and just 1.2-1.3% this year.<sup>3</sup>

<sup>3</sup> 2016 forecasts from BMO Capital Markets and TD Economics.

TABLE 2: **CANADIAN ECONOMIC FORECAST  
(ANNUAL % CHANGE UNLESS OTHERWISE NOTED)**

	2015	2016	2017
Real GDP	1.1	1.2	2.1
Consumer spending*	1.9	2.0	1.5
Business investment <sup>+</sup>	-10.6	-8.4	1.5
Employment	0.9	0.6	0.8
Housing starts (000 units)	194	195	190
CPI inflation	1.1	1.6	2.0

\* real dollars    <sup>+</sup> real dollars, non-residential capital spending

Source: BMO Capital Markets Economics July 15, 2016.

Although direct linkages with the UK are limited, Canada is not immune to the Brexit fallout. Slower global growth and an expected fall in US business investment will be headwinds for Canada over the next year or so.

In its recent policy announcement, the Bank of Canada took the opportunity to adjust its outlook for the Canadian economy. The Bank now expects real GDP to rise by just 1.3% this year. It foresees a rebound next year, with growth climbing to 2.2% as activity in the oil industry picks up, monetary policy remains accommodative, and federal government stimulus spending kicks into gear (these forecasts are essentially in line with private sector projections). Rebuilding in the aftermath of the recent devastating Alberta fires will also contribute to stronger growth in 2017.

Consumer spending, which has been a primary source of strength for the

Canadian economy, will still add to overall economic growth — but to a lesser extent than in recent years. In this regard, record levels of household debt are a risk for Canada and will likely limit future gains in consumer outlays.

The fallout from Brexit and the related increase in global uncertainty will work to further delay any interest rate increases by the Bank of Canada. The Bank will keep its target overnight lending rate at 0.5% all through 2017 — if not longer.

The Loonie has been trading around 77 cents per US dollar. This is a level that makes Canadian goods and services significantly more competitive in the North American marketplace, and the cheaper currency is benefitting Canadian exporters across many industries, including tourism, business services, forest products, and various segments of manufacturing.

## BC ECONOMY ON A FIRM FOOTING

Supported by impressive job gains and a booming housing market, BC should remain a growth leader among the provinces in 2016-17. However, it is worth noting that BC's ascent to the top of the pack is partly explained by the fact that the previous Canadian growth stars — Alberta, Saskatchewan and Newfoundland — have all been hit hard by plummeting oil prices. [British Columbia produces little crude oil.] So even though BC looks set to lead the country, the overall pace of economic growth will be in line with or slightly below the historic average.

A notable feature of the BC growth dynamic is its heavy tilt towards domestic activity. Although the lower Canadian dollar is helping several of the province's major export industries, the hot housing sector and high levels of retail spending are playing bigger roles in driving economic growth. Judging from the

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retail spending figures and the state of the housing market, consumer confidence remains elevated. Strong job creation is also feeding into the domestic growth story and prompting more people to migrate to BC.

Over the past six months there have been positive developments and negative developments affecting the provincial economy. On balance, the deterioration in the global backdrop has led us to slightly trim our BC growth forecast for 2016 and 2017. The Business Council now expects BC's economy to expand by 2.7% (after inflation) this year, a reduction of one-tenth of a percentage point from our earlier forecast.

For 2017, we see slightly weaker growth of 2.6%, which represents a 0.4 percentage point reduction from our prediction at the start of this year. The larger downward revision for 2017 reflects a softer global economy as well as the removal of any LNG projects from our near-term forecast.

## SLUGGISH GLOBAL ECONOMY WEIGHS ON BC'S MERCHANDISE EXPORTS

The impact of Brexit and the disappointing global economic backdrop continue to pinch BC's exports. Even though only a small share of the province's exports are shipped to Europe, the knock-on effects of Brexit via slightly weaker growth in North America and greater uncertainty about the future of Europe will affect the export side of the provincial economy.

Fortunately, the lower Canadian dollar is helping some of BC industries make further inroads

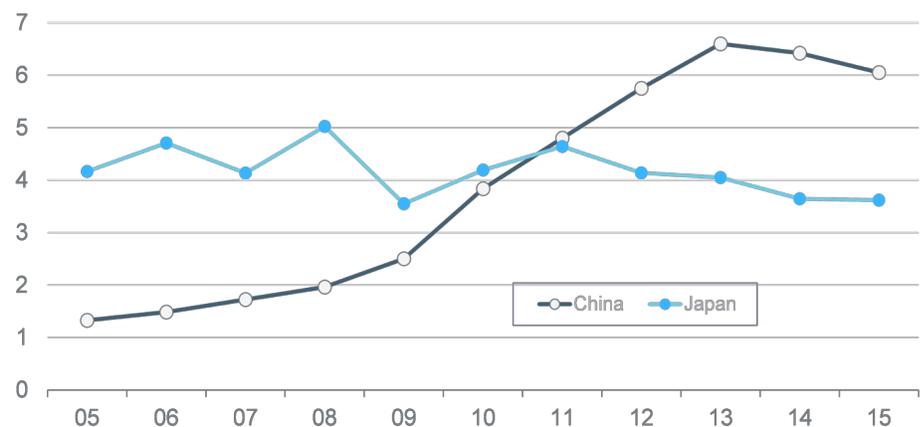
FIGURE 2: **BC MERCHANDISE EXPORTS (US AND REST OF WORLD, BILLIONS \$)**



Source: BC Stats. 3-month moving average.

Latest: April.

FIGURE 3: **BC MERCHANDISE EXPORTS TO CHINA & JAPAN (BILLIONS \$)**



Source: BC Stats. Annual.

into the US market. The province's merchandise exports have edged higher over the past couple of years, due almost entirely to rising shipments to the US. Strikingly, exports to almost all other markets are down this year. The total value of BC's merchandise exports inched ahead by less than 1% in 2015 and so far this year they are tracking for a meagre 0.6% gain.

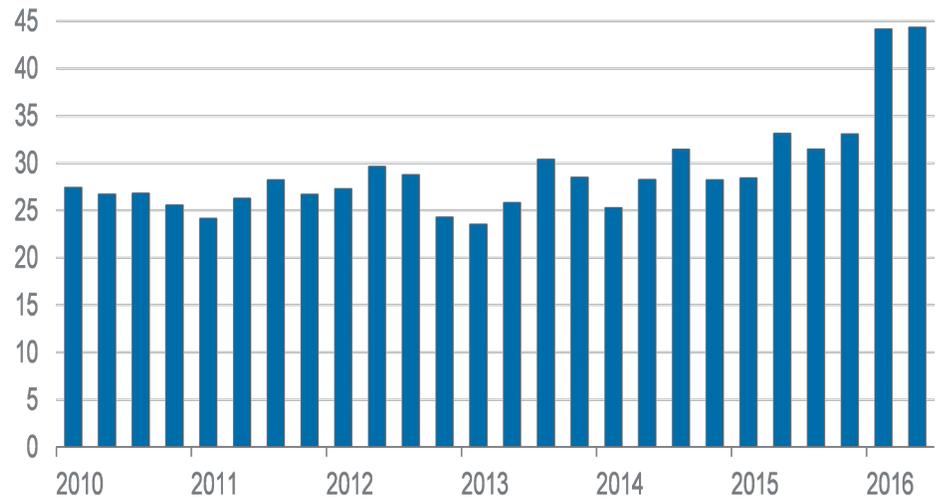
The US expansion coupled with the lower dollar is a plus for BC's exporters. So far this year exports to the US are up a healthy 8%, with much of this fuelled by wood products (up 33% year-to-date) and agricultural products (up 9%). On the other hand, the value of natural gas exports is off by 11%, extending the downtrend that has been in place for several years.

Slower growth in China and the country's shift away from an investment- and export-led growth model towards more domestic consumption is impacting BC's exports. Our merchandise exports to China are down about 3% so far this year, following a 6% decrease last year. Although China will remain an important market for BC in the years ahead, the days of large double digit annual increases in the value of sales to China may be firmly in the past.

Tourism has become a notable bright spot in the provincial economy, led by sizable gains in the number of American visitors. By April of this year, the number of US visitors arriving by transportation modes other than automobiles had jumped 24% compared to the same month in 2015. Travellers from all other countries were also up 20%. The number of US travellers coming by automobile also climbed 12% over the past year, on the heels of a similar

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FIGURE 4: **BC HOUSING STARTS (000'S OF UNITS, SEASONALLY ADJUSTED ANNUAL RATE)**



Source: Statistics Canada.

Latest Q2 2016.

gain the previous year. An increase in foreign visitors is welcome news for the accommodation industry. In the first quarter of 2016, room revenue in BC was up 17% from the previous year. Hotel and motel operators are benefiting from higher occupancy rates as well as increases in average room rates. The market in Whistler is especially robust, with room revenue in that community surging 29%.

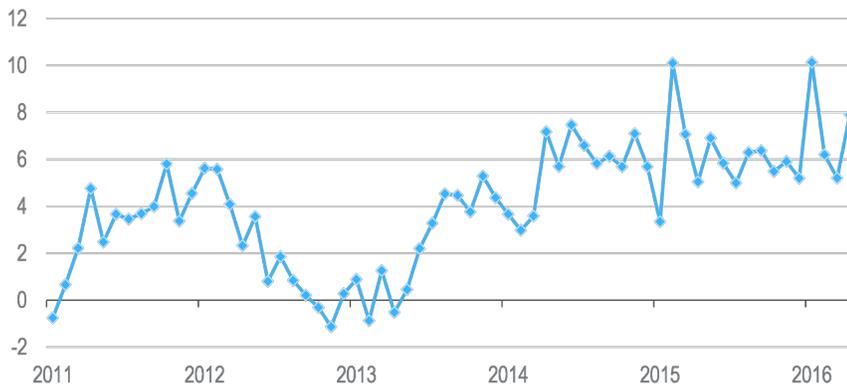
The lower Canadian dollar, a growing local talent pool, and the arrival of new production companies brought the province's film and television industry to new heights in 2015-16. A total of 287 film and television productions were shot in BC in fiscal 2014-15, up from 248 the year before. The result was a record \$2 billion plus spent in the province on production.<sup>4</sup>

## **JOBS, RESIDENTIAL HOUSING AND RETAIL SPENDING ARE ALL SUPPORTING GROWTH**

Our review of trends in domestic economic activity starts with housing because, by any measure, it has been one of the major economic engines in BC over the past few years. The housing market in urban regions of BC is being fuelled by a combination of supportive fundamentals as well as an element of speculative froth. On the fundamentals side, record low mortgage rates are a primary consideration, for both first-time and move-up buyers. While rapidly escalating prices are pushing home ownership in Metro Vancouver beyond the reach of

<sup>4</sup> Creative BC, BC tax Credit Certifications for Film and Television.

FIGURE 5: **BC RETAIL SALES GROWTH (ANNUAL % CHANGE)**



Source: Statistics Canada.

Latest: April 2016.

many people, rock-bottom interest rates are helping to make purchases manageable, at least for some buyers. Strong job growth and a rising population are also contributing to the demand for homes, notably in Greater Vancouver, the Fraser Valley and the Squamish area. On the supply side, limited land availability is pushing prices higher in Metro Vancouver. Land supply constraints have long resulted in more rapid price escalation for single family homes, but more recently the upward price pressures have spilled over to the multi-unit segment.

Looking at GDP industry data, the residential “real estate complex” (which includes residential construction industry, offices of real estate agents and brokers and owner occupied imputed rent) in BC grew by 6% last year. This pace of expansion was enough to lift overall growth in the province to 3%. If the real estate complex is excluded, BC’s economy would have grown by a more muted 2.4% in 2015.

However, when one also considers the **indirect contributions** of housing, its economic impact is considerably greater. In the retail industry, segments linked to housing have recorded exceptionally strong sales growth. Stores in the building materials and garden equipment and supplies segment saw sales soar nearly 20% last year – and they are up a further 17% in the first four months of this year. Sales at furniture and home furnishing stores jumped 11% last year.

The outsized gains in residential property prices are also having a

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significant wealth effect that has implications for the wider economy. Although this part of the housing story is difficult to quantify, rising home values and household net worth are undoubtedly boosting consumer sentiment and fostering greater spending by some BC homeowners. Many homeowners are realizing these gains by selling their houses in Metro Vancouver and downsizing or moving to smaller communities. In other cases, homeowners are tapping into their equity to finance other purchases or are simply feeling better about their financial circumstances and spending more freely.

Consumer spending is a bright spot in BC’s economic landscape, with growth in retail spending running at 5-6%. Although a few retail sub-sectors most directly linked to housing have been especially strong, the housing wealth effect is supporting spending across much of the retail spectrum. Sales at new and used motor vehicle dealers are up 12% so far this year. Looking ahead, positive consumer sentiment, low interest rates, more visitors, an inflow of foreign wealth and continued job growth all point to further gains in the retail space over the next couple of years.

Job growth in BC is another area of strength. At the beginning of 2015 total employment in the province turned up – and it has been on a clear upward trajectory since. Job gains have come in both the private and public sectors. Over the first half of 2016, the number of employees in the private sector rose 3.8%. Public sector employment is up almost 3% year-over-year. Job growth has

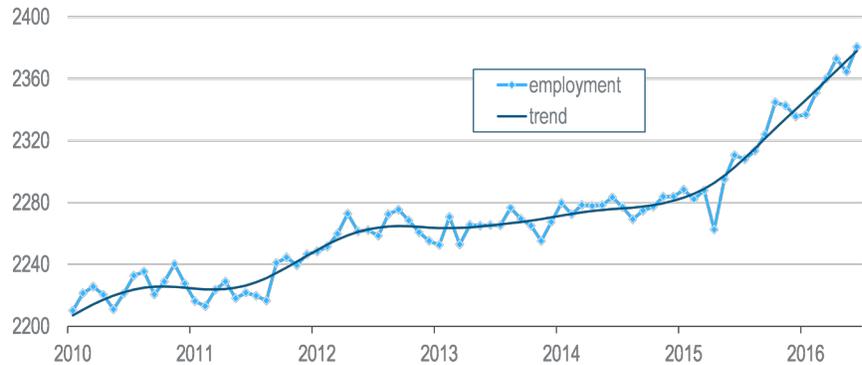
spread across most industry sectors. Not surprisingly, employment in the retail sector is up sharply (7%), with construction jobs also making an impressive advance (4%).

BC's unemployment rate remains just above 6%, roughly where it has been for the past three years. This reflects the fact that the labour force participation rate has edged higher with the improvements in job market conditions. Even as job growth continues, the unemployment rate may stay around 6% as there is room for participation rates to move up further. It is worth noting that prior to the 2008 downturn, the labour force participation rate in BC peaked at 66%; it currently stands at just over 64%.

There is one significant caveat to the employment growth story, however. Job growth has been heavily concentrated in the southwest region of the province. In fact, this has been the case for a number of years. If jobs in the lower mainland are subtracted from the provincial total, employment in the "rest of the province" has been flat or down since 2010. So far this year, the pattern has continued, although employment in the Vancouver Island labour market region has ticked up.

**As with most other mature economies, business investment in BC has been an area of weakness. Over the first five months of the year, non-residential building permits edged up just 1.4% over the same period last year.**

FIGURE 6: **BC EMPLOYMENT (000'S)**



Source: Statistics Canada, Labour Force Survey, seasonally adjusted.

Latest: June 2016.

FIGURE 7: **EMPLOYMENT**



Source: Statistics Canada, Labour Force Survey.

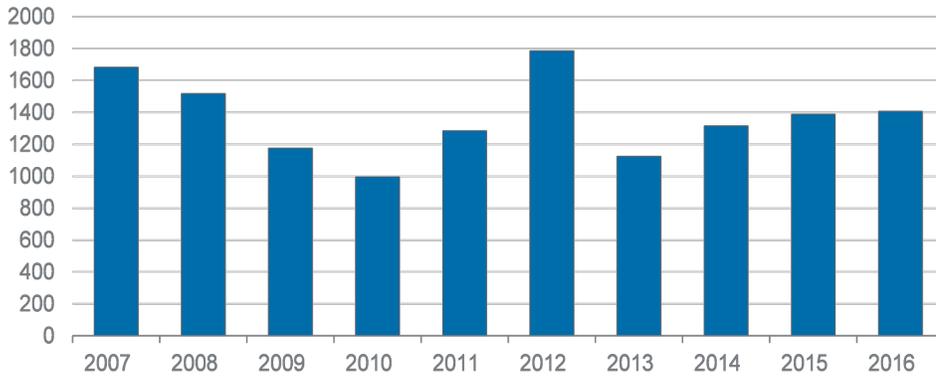
Latest: June 2016.

Continuing with the theme of a healthy domestic setting, sales in BC food and drinking establishments have also been brisk. Consumers are increasingly spending money in dining and drinking establishments. The rise in tourism activity is also providing a lift. This sector has enjoyed some of the largest increases in sales in decades. Over the first four months of 2016 sales in food and drinking establishments rose 8.5% compared to the same four month period last year.

## CONSTRUCTION AND BUSINESS INVESTMENT

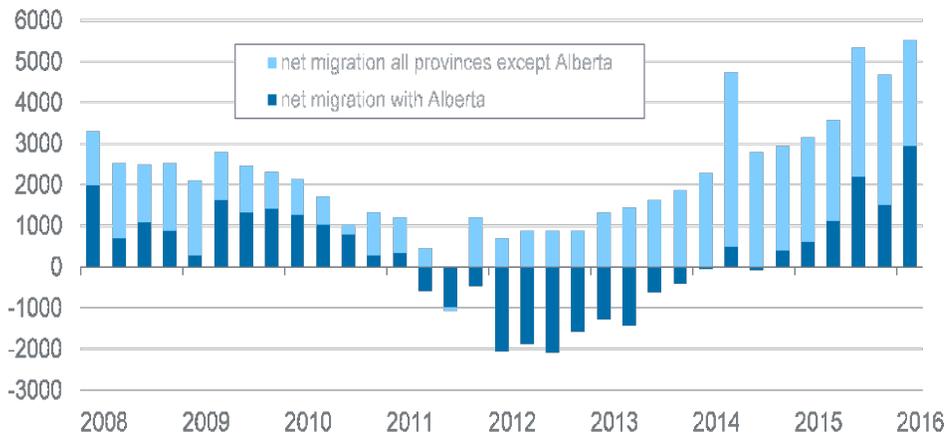
In response to the strong housing market, new home construction has jumped significantly. Over the first half of the year, the number of housing starts climbed to an annual (seasonally adjusted pace) 44,000 units, up sharply from 33,000 at the end of 2015. Because of the increasing orientation towards multi-unit housing, much of the gain

**FIGURE 8: BC NON-RESIDENTIAL BUILDING PERMITS (JANUARY TO MAY EACH YEAR, BILLIONS \$)**



Source: Statistics Canada.

**FIGURE 9: BC NET INTERPROVINCIAL MIGRATION (PERSONS, SEASONALLY ADJUSTED)**



Source: BC Stats, BCBC for seasonal adjustment.

Latest: Q1 2016.

reflects building plans put in place a year or more ago. The strength of the housing market suggests that home construction will remain at elevated levels well into 2017.

As with most other mature economies, business investment in BC has been an area of weakness. In the first five months of the year, non-residential building permits edged up just 1.4% over the same period

last year. In the longer-term context, non-residential permits are running at a moderate pace.

There are some large engineering projects that are not captured in the permits data but that are generating economic activity. Most notably, the multi-billion multi-year construction of BC Hydro's Site C in northern BC is now underway.

For this revised forecast, we have assumed that no large-scale LNG projects proceed in 2016-17. This is consistent with the approach taken by the BC Ministry of Finance in developing Budget 2016. If one or two LNG projects do commence construction some time in 2017, this would cause us to adjust our BC growth forecast.

Federal government fiscal policy has shifted from a preoccupation with balanced budgets toward a focus on providing stimulus for a sluggish Canadian economy. This will have a small positive impact on economic growth in BC over the forecast horizon.

## INTERPROVINCIAL MIGRATION CONTINUES TO SUPPORT POPULATION AND ECONOMIC GROWTH

Population growth is helping to fuel stronger domestic demand. Overall population growth, however, is running at just over 1%. Increased interprovincial migration is being tempered by a slower natural increase in population (births minus deaths) and some decline in the international migration numbers (largely attributable to fewer temporary workers).

British Columbia is seeing an upturn in net interprovincial migration as fewer BC residents are now moving to Alberta and more people from other parts of Canada are coming to BC, especially from Alberta. We expect the recent inflow of interprovincial migrants to continue over the next two years.

TABLE 3: **BC ECONOMIC OUTLOOK**  
(ANNUAL % CHANGE UNLESS OTHERWISE INDICATED)

	2014	2015e	2016f	2017f
Real GDP	3.2	3.0	2.7	2.6
Employment	0.6	1.2	3.0	1.5
Unemployment rate (%)	6.1	6.2	6.1	5.9
Housing Starts (000 units)	28.4	31.4	39.0	38.0
Retail sales	5.5	6.5	6.5	5.5
BC CPI	1.2	1.1	1.6	1.6

f - forecast e - estimate

Source: Statistics Canada and BC Stats; BCBC for forecasts.

## CONCLUDING THOUGHTS

In summary, our mid-year evaluation of the provincial economic outlook points to slightly slower but still decent growth over the next 18 months. BC will continue to be a growth leader within Canada, with real GDP expanding by around 2.6% in both 2016 and 2017. The province is benefitting from the lower Canadian dollar and the US economic expansion, but the domestic side of the economy is especially healthy, supported by in-migration, high levels of housing-related activity, and strong consumer spending. At a time when the global economy is choppy and facing considerable uncertainty, BC is doing quite well.

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