



## Slow But Gradually Improving Growth In Store For BC

BC's economic growth in 2011 was modest and uneven. The first half of the year was particularly weak, as global equity markets underwent a steep sell-off, the American economy stumbled, the earthquake and tsunami sent Japan into a temporary recession, and financial stresses in the Eurozone<sup>1</sup> escalated. Towards the end of the year, economic conditions in the US improved and, judging by job growth and a handful of other indicators, BC's economy also appeared to pick up. This helped the province's real gross domestic product (GDP) to expand by an estimated 2.0% in 2011. BC's performance was reasonable compared to many other advanced economies, and was in the middle of the provincial growth rankings within Canada.

The late-in-the-year strengthening provides a decent hand-off to 2012. However, the external environment remains unsettled, making it uncertain whether this positive momentum can be sustained. We expect BC's economic growth to moderate slightly from the pace set toward the end of 2011, resulting in another ho-hum year in 2012 – not terrible, but below average. While our forecast is for the province's economy to advance by 2.0% again this year, there are clear downside risks. The financial turbulence in Europe, and the risk of "contagion" flowing from a possible disorderly sovereign debt default in some Eurozone member states, is a big cloud hanging over the global economy.

As always, BC's economic prospects are closely linked to the outlook for the export sector. Fortunately, while growth in the advanced

economies is tepid, China and other emerging markets are doing better. BC will continue to become more oriented towards the Asia Pacific region in terms of our commercial ties, even as the US economy gathers strength in the next few years.

### External Picture

Global growth prospects have dimmed and downside risks have intensified over the past six months. As shown in Table 1, world output is now projected to increase by 3.3% in 2012, a downward revision of  $\frac{3}{4}$  of a percentage point from the IMF's September forecast.

Table 1 World Economic Forecast (per cent change in real GDP)				
	2010	2011	2012f	2013f
US	3.0	1.8	1.8	2.2
Euro area	1.9	1.6	-0.5	0.8
Germany	3.6	3.0	0.3	1.5
France	1.4	1.6	0.2	1.0
Italy	1.5	0.4	-2.2	-0.6
Spain	-0.1	0.7	-1.7	-0.3
UK	2.1	0.9	0.6	2.0
Japan	4.4	-0.9	1.7	1.6
China	10.4	9.2	8.2	8.8
World	5.2	3.8	3.3	3.9

Source: IMF, World Economic Update (January 24, 2012).  
f = forecast

In the US, domestic risks have eased and growth momentum has picked up, buoyed by better job market numbers. The household de-leveraging process is happening faster than anticipated, which is good news; but in the short term, it means that ongoing efforts to pay down debt will dampen consumer spending. Stronger job growth suggests US businesses are finally becoming more disposed to hire, which should lift incomes and provide some support for

<sup>1</sup> The Eurozone is comprised of 17 out of 27 European Union nations that have adopted a common currency, the euro, and operate a single central bank, the European Central Bank.

consumer spending. Corporate profits are very high (the highest in 60 years relative to GDP), laying a positive foundation for business investment going forward. So far the US economy has displayed a fair amount of resilience in the face of financial uncertainty, a potential crisis in Europe, and persistent weakness in the domestic housing market. The US should easily avoid recession this year, but growth over 2012-13 will be stunted by the global slowdown and a shift towards public sector fiscal restraint.

The Eurozone, unlike the US, is headed for (or already in) recession. Fiscal austerity is in full swing, bank credit is tightening, and confidence is plummeting. The IMF forecasts a mild recession (-0.5%), followed by a muted recovery in 2013. Some other forecasters expect a deeper downturn. TD Economics, for example, expects Eurozone GDP to shrink by 1.2% in 2012.<sup>2</sup> The Bank of Canada also projects a similar decline of 1% this year. With few exceptions, the Eurozone economies will see negative growth in 2012, while the large German and French economies are likely to stall. It is possible (though still unlikely) that a more serious slump in the region could be triggered by messy sovereign defaults and/or certain countries choosing, or being forced, to exit the Eurozone.

Asia continues to outpace the rest of the world on most metrics of economic performance. While the region is not immune to a Eurozone recession, growth in Asia will again set the pace globally in 2012 (around 5.5%, according to the IMF). Japan's post-earthquake rebound will help underpin intra-Asian exports, offsetting some of the weakness in sales to Europe. China's real GDP growth is expected to hold up at near 8%, sufficient to further bolster economic prospects

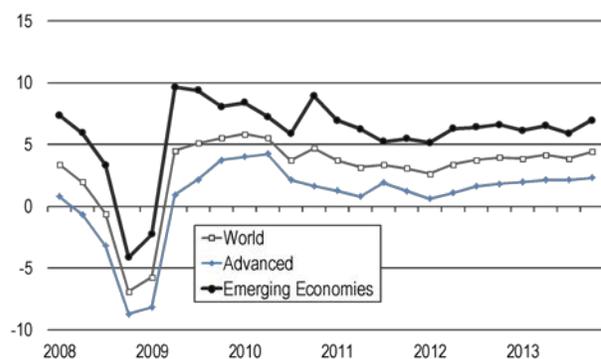
<sup>2</sup> TD Economics, Quarterly Economic Forecast (December 14, 2011).

across Asia as a whole. There is some concern that China's housing sector could experience a sharp downturn, but recent evidence of lower inflation should give Chinese and other Asian policy-makers more leeway to stimulate their economies if this is judged to be necessary.

Figure 1

### Global Growth

Real GDP, quarter-to-quarter annualized % change



Source: IMF, World Economic Outlook, January 24, 2012.

The Canadian economy strengthened over the second half of 2011, thanks to a jump in export shipments. Slower global growth and the onset of recession in Europe will negatively affect Canada through commodity price and trade channels, and may also pinch business and consumer confidence in 2012. Domestically, there are also some headwinds at play. High and rising debt loads for Canadians are likely to temper household spending for the next couple of years at least. Federal and provincial governments are moving to restrain spending growth. And we believe housing sales and residential construction activity in Canada are set to ease.

The strong Canadian dollar is another factor that is hindering growth. The Loonie is trading at parity with the US dollar and is likely to remain near there for some time. But we note that BC's growing commercial orientation to Asia and

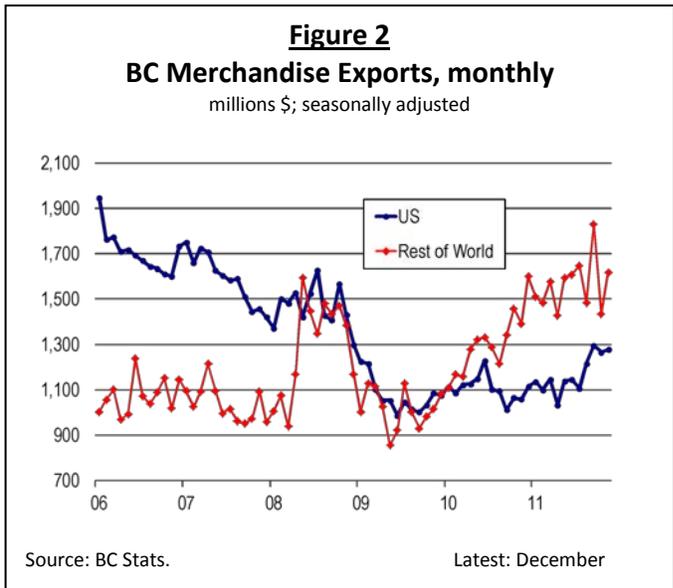
decreasing reliance on the American market mean that the higher dollar is less of a concern for the province than it was five or 10 years ago.

Over the course of the forecast horizon, interest rates are expected to remain very low. The US Federal Reserve has committed to keeping its overnight lending rate near zero well into 2014. The Bank of Canada likely won't deviate too far from the Fed's policy; and, given the modest growth outlook for Canada, there should be little reason for the Bank to embark on a tightening agenda (raise its interest rate) in 2012. Most analysts see the Canadian economy growing by around 2% (after inflation) in 2012 and then strengthening somewhat in 2013 (2.4%).

**British Columbia Exports**

China's appetite for resources is the dominant story for BC's large export sector. In 2011 the value of the province's exports to China surged 27%, representing an increase of some \$1 billion in sales. All of BC's major markets, however, registered increases in 2011. Exports to South Korea were up \$800 million (47%), and another \$500 million (13%) of BC-produced goods were shipped to Japan. The US, which is still BC's largest foreign market, bought an additional \$800 million of our exports in 2011, which is a 6% gain.

In total, BC's international merchandise exports advanced by a solid 15% in 2011, on the heels of a previous double-digit jump the year before. With the global economic backdrop softening, a repeat performance isn't expected this year. But most of the global slowdown is concentrated in Europe, to which BC ships only 7-8% of its exports. Continued economic expansion across most emerging markets should benefit a number of BC export industries. Another year of rising exports to the US means that all of BC's key foreign markets will grow this year, which should allow the province's overall merchandise exports to climb by around 10% in 2012.



BC's international tourism industry is operating in a difficult climate. The number of foreign tourists coming to the province continues to trend lower. The Olympics provided a one-time boost in 2010, so it's not surprising that the visitor count was down in 2011. The decline, however, was enough to push the number of visitors below 2009 levels. Some of the weakness in international tourism has been offset by growth in domestic tourism activity.

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

	2011a	2012f	2013f
Real GDP	2.0e	2.0	2.6
Employment	0.8	1.4	1.6
Unemployment rate (%)	7.5	7.4	6.6
Housing starts (000 units)	25.5	25.0	25.0
Retail sales	2.1	3.5	4.5
BC CPI	2.3	2.0	2.1

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

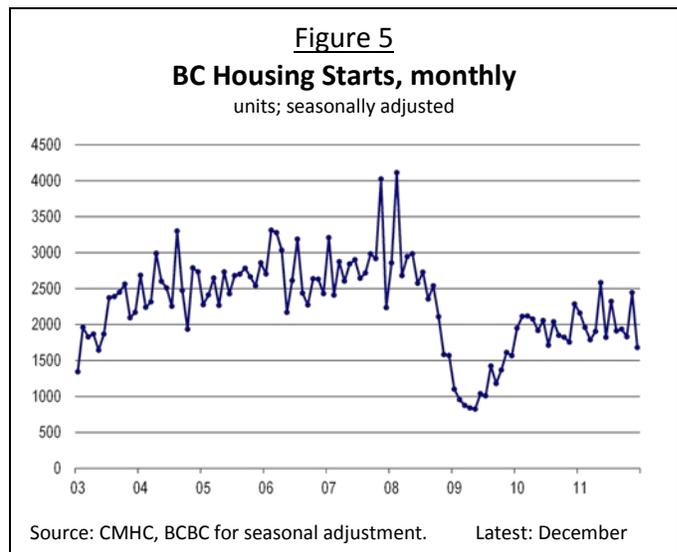
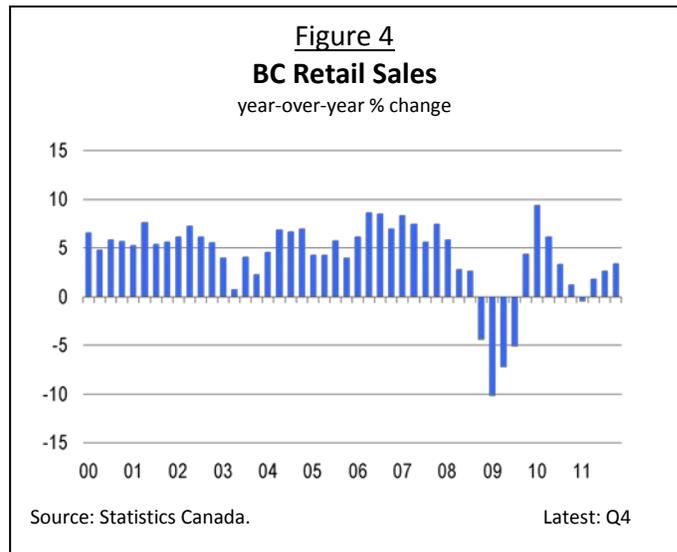
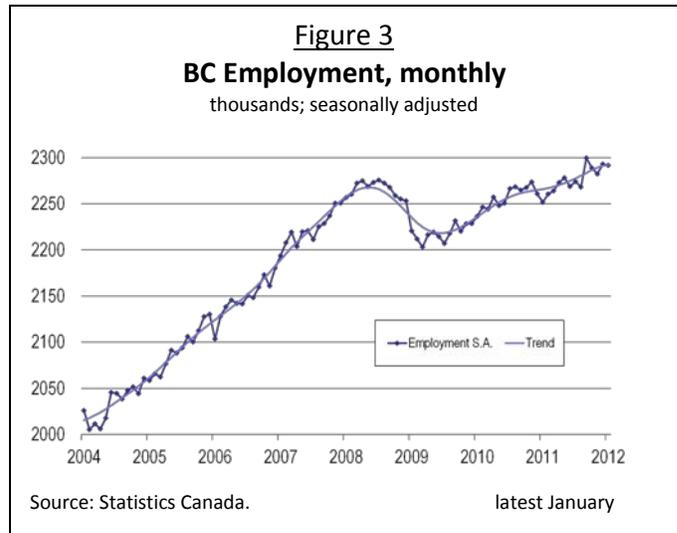
**Domestic Economy**

BC's rate of job growth in the post-recession environment has been running at about half the pace recorded during the six years preceding the recession. Admittedly, the hiring boom in the mid 2000s distorts the comparison, but it is still worth noting that job creation was an anaemic 0.8% in 2011. Employment did strengthen in the latter part of the year. Yet Statistics Canada's latest employment report showed no additional jobs in January and raises questions about the health of the job market, at least in the near-term.

Digging into the employment figures, one positive sign is that private sector hiring has accelerated, while the overall job numbers have been tempered by declines in self employment and public sector employment. The timing of the improvement in private sector hiring is fortunate (if it is sustained), because fiscal austerity is likely to dampen job creation in the broad government sector for some time.

Consumer spending has been an obvious soft spot in the provincial economy. Retail sales inched ahead by just 2.1% in 2011 (Alberta and Saskatchewan both saw gains in the vicinity of 7%). Allowing for inflation, in real terms BC's retail sales were basically flat last year. While it is difficult to pinpoint all the reasons why consumers are reluctant to spend, sluggish job growth and high debt loads (Table 3) are no doubt important contributing factors. We do expect consumer spending to pick up modestly in 2012.

Also related to soft retail environment is the cooling of home sales. The slowdown in the housing market has kept new home construction flat. The upcoming reversion to the PST is purportedly discouraging home-building, because buyers believe they can avoid paying the provincial portion of the HST on a new home if they wait until mid-2013, when the



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HST is scheduled to disappear. However, the HST only affects properties priced over \$525,000, so it should not impact all new home construction. Sluggish home sales probably owe more to muted job and income growth.

	Debt/Income ratio (%)	Avg. home price/income ratio
BC	160.2	8.4
Alberta	144.8	4.8
Ontario	137.8	5.3
Quebec	98.3	4.6
Atlantic provinces	99.1	1.0
Canada	128.3	4.6

Source: TD Economics.

### Positive Outlook for Investment

The value of permits for new commercial buildings rose 6% last year, and the underlying trend points to additional growth in 2012. We expect non-residential construction in general to contribute to BC's economic growth in 2012-13. But the development of major projects will be a more significant factor and deliver a sizable economic boost -- for the northern parts of the province in particular -- over the next several years.

A number of major projects, mainly tied to resources, power, manufacturing and transportation, are already underway. Rio Tinto Alcan's \$3.3 billion investment to modernize its aluminium smelter in Kitimat is proceeding, with construction already commencing and slated to ramp up this spring. The \$200 million expansion of the Ridley coal terminal in Prince Rupert that began in August 2011 will double the terminal's capacity. Clearing for the Northwest Transmission line has started, and construction of the \$400- \$500 million power

line is supposed to begin in the spring/summer. Mount Milligan, a copper-gold project northwest of Prince George, is under construction, and several additional mine sites are in the final permitting phase. Construction of the Forrest Kerr 195 megawatt run-of-river hydroelectric project is also underway. With an estimated cost of \$700 million, it too will provide a substantial lift to the economy of northwest BC.

In addition to projects already underway or imminent, there are many others -- collectively worth tens of billions of dollars -- that are expected to move ahead in the next few years. The \$650 million phase 2 expansion of the Fairview Container Terminal is now in the design, consultation and assessment phase. When completed, it will increase the Port of Prince Rupert's capacity from 500,000 TEUs to 2,000,000 annually. Port Metro Vancouver (PMV) also has expansion plans. We are optimistic that the province's recently announced natural gas and LNG<sup>3</sup> strategy will enable the development of a globally competitive LNG industry and lead to new construction projects towards the end of 2012. The proposed Kitimat LNG facility and the Pacific Trails Pipeline carrying gas to the coast represent a multi-billion dollar investment and promise several years of construction activity. Proponents have already invested \$250 million in permitting and site preparation and are awaiting final approval from participating partners. The BC government is targeting at least two other LNG operations by 2020. BC Hydro's Site C hydroelectric project is in the environmental and regulatory review stage. The updated cost estimate for Site C is \$7.9 billion and, if it proceeds, the project will create an estimated 7,000 person years of construction employment over seven years.

<sup>3</sup> Liquefied natural gas.

### Fiscal Policy Set to Weigh on Growth

Both the federal and provincial governments are restraining spending as they aim to move back to balanced budgets. This will temper overall economic growth, as both levels of government transition from providing fiscal stimulus to a period of lean increases in budgetary outlays. While plans may change in the upcoming March budget, the federal government's fall 2011 fiscal update shows program spending climbing by 1.8% and 2.1% in 2012-13 and 2013-14, respectively. In this context, it is useful to recall that federal program spending grew on average by roughly 6% annually in the years prior to the recent recession, before soaring by almost 18% in 2009-10 in response to the downturn. Similarly, last year's provincial budget projected spending increases of 1.5% and 2.4%, respectively, in 2012-13 and 2013-14. While the BC government's fiscal plans could be altered when the budget is brought down later this month, we would be surprised to see program spending increases in excess of these amounts.

### Industry Outlook

Mining will be one of BC's leading growth sectors over the next few years, helped along by a generally favourable commodity price environment and the opening of new mines. The forestry and wood products industry should post solid growth as China buys more wood and US home-building slowly recovers after an epic slump in housing starts over 2007-2011. On the other hand, the province's natural gas industry is apt to struggle in the face of an exceptionally poor pricing environment. A major upturn in the sector is not anticipated until the proposed LNG facilities become operational.

Boosted by a growing number of major projects and moderate increases in investment in non-residential structures, BC's construction industry

should see decent growth over the next few years. A challenge for the sector, however, is finding enough qualified workers, particularly in the north. As reflected in our outlook for housing starts, new home construction won't contribute much to economic growth in the near-term. British Columbians now spend almost as much on renovations as on new homes, with this segment of the residential construction sector expected to make a modest contribution to growth.

Tourism is another industry where the picture is mixed, but overall conditions are soft. As noted above, international tourism activity remains muted. But we are hopeful that robust economic and job growth in Alberta and Saskatchewan will result in more prairie visitors (and dollars) flowing into the province. There are also opportunities to attract more tourists from China, Brazil, Mexico, and other rapidly developing emerging markets.

Activity in the province's diverse and economically important advanced technology sector – accounting for about 5% of GDP -- should continue to accelerate in 2012 and beyond. The clean technology industry is expected to be a leading growth area. The film and television industry faces competitive challenges from the stronger Loonie, the pending elimination of the Harmonized Sales Tax, and escalating tax credits in some other jurisdictions.

Transportation and logistics is poised to be a leading growth engine for the province, due to a rebound in global trade and the benefits stemming from BC's position as Canada's gateway to the Asia-Pacific. Port Metro Vancouver and the Port of Prince Rupert both had record years in 2011. PMV handled 122 million tonnes of cargo in 2011, a 3.4% increase over the previous year (which itself was up by 16% from 2009). In terms of containers, the number of loaded TEUs (twenty-foot equivalent

units) processed by PMV rose 3%. The gain in the number of laden outbound containers outpaced growth in inbound containers, with forest products driving the increase. The volume of lumber, pulp and panels exported in containers rose 25%, 15% and 56%, respectively. In Prince Rupert, total container traffic surged 30% in 2011 (lifting the number of TEUs to 410,000). The volume of bulk commodities also increased by 18% in 2011. Strategic investments in transportation infrastructure are allowing BC to capitalize on growth in Asia and leverage the province's important Gateway role.

#### **From HST to PST**

Our forecast incorporates the fact that the province will be returning to the Provincial Sales Tax (PST) in the spring of 2013. Having the HST in place for the next year or so may temporarily boost capital investment, as some businesses accelerate capital expenditure plans to take advantage of the lower sales tax burden on investment-related purchases under the HST. This is one of the factors likely to support business investment in 2012. Note, however, that manufacturers and resource companies received exemptions on machinery and equipment under the old PST system, so they may not have much incentive to advance spending on these types of investments in 2012. Another area affected by the HST is new home construction. We expect the development of some higher-priced homes to be delayed as a result of the planned return to the PST in 2013. On balance, however, the shift from the HST to the PST will have little macro-economic impact in the next two years. Unfortunately, over the medium-term the restoration of the PST in its original form will undermine BC's competitive position, discourage

capital investment and put downward pressure on private sector productivity growth.

#### **Concluding Thoughts**

Our baseline projection for 2012 is for the BC economy to perform much as it did in 2011, followed by some improvement in 2013. Thanks to China and Asia more generally, BC's export sector will continue to expand, albeit at a somewhat slower clip than last year. Although exports to the US should gradually rise, Asia has sustained much of the province's export recovery to date and is looming ever larger in the province's economic future.

Activity on the domestic side of the economy is more mixed. The job market and consumer spending have been soft spots. Retail sales should accelerate after a very poor 2011. Fiscal restraint will offset some of the gains coming from additional consumer spending and business investment and is apt to weigh on the province's (and Canada's) top-line economic results over 2012-13.

Risks to the outlook described in this report are tilted to the downside because of the potential for Europe's fiscal and financial woes to escalate into a full blown "crisis." We also see some upside risk, however, mainly linked to the possibility that the United States will exceed current expectations. Most forecasters predict the US will grow by around 2% (after inflation) in 2012. If the world's largest economy does significantly better than this, Canada as a whole would benefit via stronger exports and an improvement in business and consumer confidence.

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