BC ECONOMIC REVIEW AND OUTLOOK

Business Council of British Columbia
Est. 1966

Q3 2018 (OCTOBER)

THE END OF MONEY FOR NOTHING

HIGHLIGHTS

- The global economy is expanding at its fastest pace since 2010, led by an ebullient U.S. economy. Global growth is projected to level off at 3.7% per annum in 2018 and 2019, reflecting some softness in recent trade and investment data and financial stresses impacting several emerging economies. Risks to the global outlook appear balanced.

- The U.S., Mexico and Canada agreed to a revised trade pact on October 1. The agreement (the USMCA) sees Canada and Mexico allowing freer access to their markets in certain areas, in return for maintaining overall access to U.S. markets under somewhat less favourable terms than was the case with NAFTA. The new agreement should reduce uncertainty around trade and investment decisions in the short and medium term. However, unlike NAFTA, the pact is subject to review and renewal. Companies considering major, irreversible investments in long-lived assets may not have the same certainty about future trading rules that they had under NAFTA.

- The Canadian economy shows strong momentum and is running close to its potential. The composition of growth is expected to shift away from sectors that have feasted on unusually cheap and readily accessible credit since the late-2000s (i.e. consumption, new residential construction, renovations and real estate transfer costs). Export growth will be supported by strong U.S. demand, the resolution of trade access to U.S. markets, and the weak Canadian dollar. Business investment is also expected to play a larger role in the ongoing economic expansion as firms, especially in Central Canada and B.C., strive to meet demand amid widespread capacity constraints and labour shortages.

- The B.C. economy has solid momentum. B.C.'s job market is one of the strongest in the country. The province has accounted for one-quarter of all new jobs in Canada over the past few years. B.C. also has the highest job vacancy rate of any province and the unemployment rate is around 4%.

- B.C. is projected to grow in the range of 2.3% to 2.5% over 2018 and 2019, near the top of the provincial growth rankings. The changing composition of growth - toward investment and exports and away from credit-driven sectors – will likely be more pronounced in B.C. The province's role as a trade gateway and the contributions of the large transportation and logistics industry will continue to underpin its success. The recent announcement that LNG Canada is proceeding with its $40 billion LNG investment in Kitimat has prompted us to revise our provincial forecast up to 2.5% for 2019.

- The Canadian and B.C. economies are vulnerable to tightening financial conditions, however. The current leverage cycle that began in the second half of the 2000s is easily the largest of the post-war era. Canada's increase in private sector indebtedness has not been checked by any effective domestic policy response. Monetary and credit supply policies have remained mostly accommodative since the 2008-09 recession to support economic expansion.

- Global financial conditions are now clearly tightening. In September, the U.S. Federal Reserve raised its policy interest rate for the eighth time since 2015 and signalled that further rises are ahead. Similarly, the Bank of Canada raised its policy rate to 1.75% in late October. Despite being the fifth increase since June 2017, Canada's policy rate is still negative in inflation-adjusted terms – highly unusual at this point in the business cycle. Going forward, the Bank indicated it will need to raise rates to a neutral stance – which it estimates could be about 75 to 175 basis points higher – to keep inflation close to its target of 2% per annum.

- The long era of cheap and easy credit appears to be over. As interest rates rise, Canada and B.C. could find that carrying current debt loads becomes much more challenging.

GLOBAL GROWTH REMAINS SOLID DESPITE TRADE TENSIONS AND POLICY RISKS

The world economy is expanding at its fastest pace since 2010, led by an ebullient U.S. economy. Global growth is projected to level off at 3.7% per annum in 2018 and 2019, a slight trimming for 2019 relative to our previous update (**Table 1**). This reflects some softness in recent trade and investment data and financial stresses impacting several emerging economies. Risks to the outlook appear balanced.

The **United States** economy is near or perhaps beyond full capacity. The unemployment rate stands at 3.9%, a level last seen in the 1960s and briefly in 2000. Yields on ten-year Treasuries are at a seven-year high of 3.2%. On September 26, citing strong growth, robust job gains and overall inflation near 2%, the Federal Reserve raised its policy rate by 25 basis points (bps). It is the Fed's eighth hike in rates since 2015. The mid-point of the Fed funds rate is now at 2.125% and inflation is around 2% – marking the first time since 2008 that the *real* (inflation-adjusted) Fed funds rate has been in positive territory. Accordingly, in its press statement, the Fed removed its long-standing reference to monetary conditions being "accommodative." The Fed also signaled that further rate rises are very likely. The members of the Fed's Open Market Committee indicated they expect another rate increase in 2018, three in 2019 and one in 2020.

The USMCA sees Canada and Mexico allowing freer access to their markets in certain areas, in return for maintaining overall access to U.S. markets under somewhat less favourable terms than was the case under NAFTA.

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

	2017	2018f	2019f
World	3.6	3.7	3.7
Canada	3.0	2.1	2.0
U.S.	2.2	2.9	2.7
Euro area	2.5	2.0	1.9
Japan	1.7	1.2	1.2
China	6.9	6.7	6.4

f - forecast

Source: OECD, September 2018.

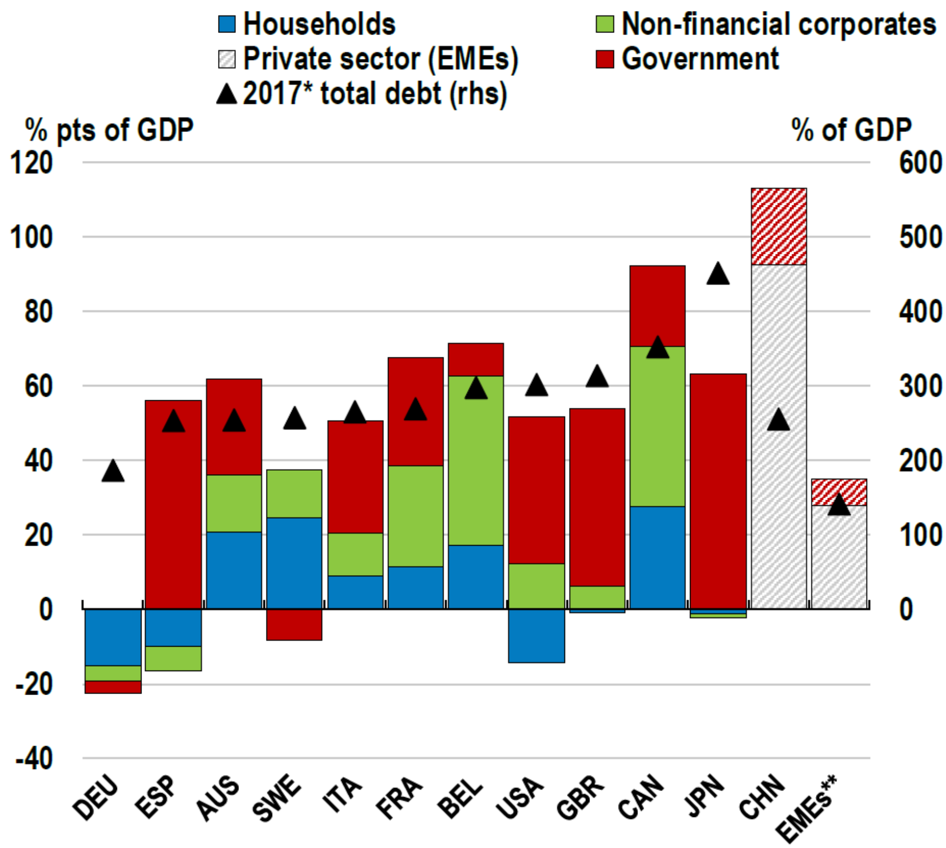
The outlook for the **Euro area** has moderated given softer external demand. While the European Central Bank expects to keep policy rates unchanged until mid-2019, it will wind down asset purchases by the end of 2018. Growth in the **United Kingdom** remains tepid by historical standards. However, there is little unabsorbed capacity, and the Bank of England expects a small margin of excess demand to emerge in 2019. The Bank duly raised its policy rate by 25bps in August – the first increase since rates were dropped to emergency levels in March 2009. Meanwhile, the outlook for **Japan** is positive, modest and unchanged. The Bank of Japan continues to suppress short and long-term interest rates at around zero percent.

Risks to the global outlook appear roughly balanced. On the upside, the pending ratification of NAFTA 2.0, now the "U.S.-Mexico-Canada Agreement" (USMCA), should help lift the fog of uncertainty bearing on medium-term, cross-border investment decisions (see below). The three North American economies represent about 28% of world GDP.

On the downside, tariffs on steel and aluminum imports into the U.S. from several countries (including Canada) remain in place, as do retaliatory measures from affected countries. Effective September 24, the U.S. will impose tariffs on USD 200 billion worth of Chinese imports. The tariffs are initially set at 10% and will rise to 25% by the end of 2018. They come on top of the July measures that added 25% tariffs to USD 50 billion worth of Chinese imports. Taken together, there are now tariffs on roughly half of all Chinese exports to the U.S. In retaliation, China has imposed tariffs on USD 60 billion worth of U.S. imports. U.S.-China discordance could weigh on global trade and business confidence in the medium term.

The tightening of global financial conditions presents another downside risk. Already, some emerging economies are feeling the pressure (e.g. Turkey, Argentina and Brazil). But there is also the risk of a broader, disorderly unwinding of global financial imbalances. Several advanced economies, especially Canada, and China have significantly increased their indebtedness since the mid-2000s (**Figure 1**).[1] For many, the increase reflects higher borrowing across governments, corporates and households. The increase in *private sector indebtedness* – households and non-financial corporates – has been particularly large in China and Canada (**Figure 2**). Carrying these debt loads is likely to become more challenging as some key central banks continue to withdraw monetary support and global financial conditions tighten.

FIGURE 1: **CHINA AND CANADA HAVE LED THE RISE IN GLOBAL BORROWING**
CHANGE IN TOTAL DEBT, 2005-2017



Source: OECD Economic Outlook, September 2018.

INTRODUCING THE USCMA

The U.S., Mexico and Canada agreed to a revised trade pact on October 1, the USMCA. The agreement is "in-principle" – meaning that it is between executive branches of government and now awaits ratification by the three countries' national legislatures. That will likely happen sometime in 2019. The agreement does not affect U.S. tariffs on Canadian steel and aluminum (or softwood lumber). It is possible that the tariffs on steel and aluminum will be eliminated as part of a "side agreement" reached with the U.S. in the coming weeks.[2]

The USMCA sees Canada and Mexico allowing freer access to their markets in certain areas, in return for maintaining overall access to U.S. markets under somewhat less favourable terms than was the case under NAFTA. Covering USD 1.1 trillion in trilateral trade, the agreement should remove or at least substantially reduce uncertainty around trade and investment decisions in the short and medium term.

However, the pact entrenches an element of uncertainty about long-term, cross-border investments. NAFTA, which came into force in 1994, had no sunset clause and set out "permanent" trading rules. The USMCA is reviewable after six years and automatically expires after 16 years (unless all parties agree at the interim review to renew it for a further 16 years). Therefore, companies considering major, irreversible investments in

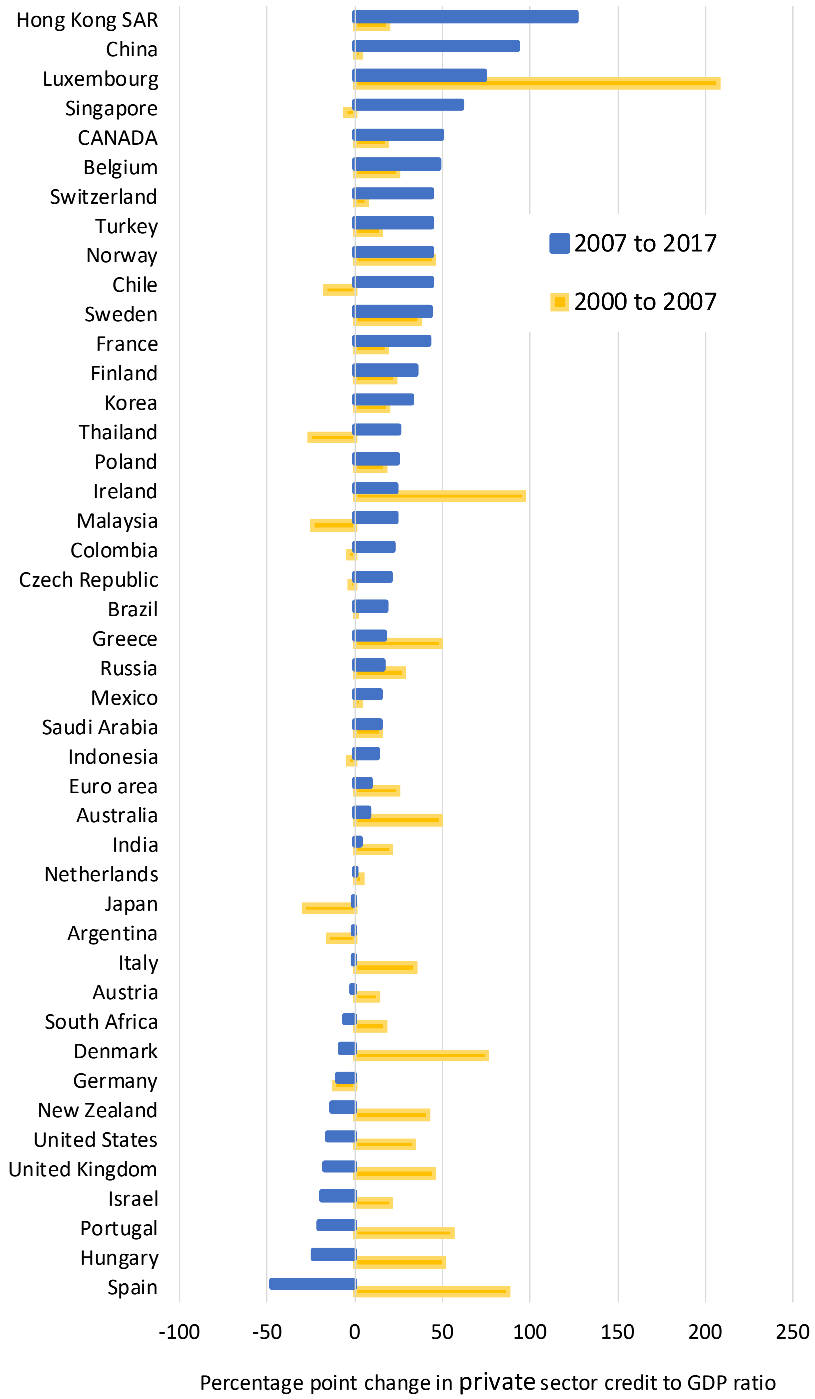
[1] Germany is an exception.
[2] In exchange, it is likely that Canada (and Mexico) would agree to some kind of upper limit on the volumes of steel and aluminum exports to the United States.

long-lived assets will not have the same certainty about future trading rules that they had under NAFTA.[3] However, at least the USMCA, if ratified, eliminates the threat that the Trump Administration will choose to destroy the North American trade arrangement.

Key features of the USMCA include the following:

- **Auto tariffs**: The limit for tariff exemptions for Canadian auto exports to the U.S. is capped at 2.6 million units. This is well above Canada's current export rate of 1.8 million units (the limit mostly impacts Mexico). Content for manufactured motor vehicles must be 75% sourced from USMCA countries, up from 62.5% previously. Also, 40-45% of the content must be produced by workers paid at least US$16 per hour.
- **Agricultural tariffs**: Canada will allow U.S. producers tariff-free access to a larger sliver (3.6%) of its heavily-protected dairy market and abolish "Class 7" pricing on certain milk ingredients. U.S. producers will also have modest but increased access to Canadian markets for turkey, eggs, chicken, broiler hatching eggs and chicks.
- ***De minimis* thresholds**: Canada's limit for duty-free purchases through e-commerce will increase to CAD 150, up from the current CAD 20. Purchases under CAD 40 will also be exempt from sales taxes. Conversely, U.S. consumers will see their duty-free limit for purchases from Canada and Mexico drop to USD 100 from USD 800. The changes will benefit Canadian consumers and U.S. retailers, but disadvantage U.S. consumers and Canadian retailers.

FIGURE 2: **CANADA'S POST-2007 INCREASE IN PRIVATE SECTOR INDEBTEDNESS IS THE 5TH LARGEST GOBALLY**
PRIVATE NON-FINANCIAL SECTOR CREDIT TO GDP RATIO, PERCENTAGE POINT CHANGE



Source: BIS Statistics; BCBC.

[3] The parties might, at the sixth-year review, make an early decision to extend the USMCA for a further 16 years or remove the sunset clause entirely. President Trump will have left office by then, so the U.S. may be more open to these options.

- **Intellectual property protections**: Copyright will expire 70 years after the creator's death, up from 50 years previously. Canada will also lengthen patent protections on "biologic" pharmaceutics to ten years, up from eight years. This will potentially delay the introduction of some cheaper, generic drugs in Canada.
- **Cultural protections**: Existing Canadian content protections under NAFTA are preserved. However, the rules prohibit Canadian content protections in the fast-growing fields of digital audio and video.
- **Dispute resolution mechanisms**: A dispute resolution process remains in place – essentially Chapter 19 of NAFTA – whereby governments can appeal anti-dumping and countervailing duty decisions before a bilateral expert panel. However, the USMCA abolishes NAFTA's Chapter 11 investor-state dispute mechanism, whereby U.S. and Canadian firms could sue governments for damages from what they perceive as "unfair" government decisions.
- **Trade agreements with "non-market" countries**: The USMCA countries must consult with each other in advance of any trade negotiations with "non-market" countries (e.g. possibly China). The USMCA may be reviewed and amended in light of any such agreements being reached with non-market countries.
- **No progress on cross-border procurement rules**: The USMCA makes no changes to the rules governing public sector procurement as between Canada and the U.S. NAFTA was largely silent on this subject, meaning that WTO standards and disciplines apply.

CANADIAN ECONOMY IS RUNNING NEAR POTENTIAL

After a stellar 2017, the Canadian economy shows strong momentum and is running close to its potential. There are few signs of labour market slack except in the Prairies. Canada's unemployment rate is trending at or below 6% (i.e. around 40-year lows). Headline inflation grew by 2.2% (y/y) in September, with core measures of inflation around the Bank of Canada's 2% target.

The Bank of Canada's autumn *Business Outlook Survey* (BOS) indicates that Canadian firms have a robust outlook for growth over the next 12 months.[4] Domestic and foreign sales growth is strong. Investment intentions are positive and focused on expanding production or improving efficiency. Outside of the Prairies, capacity pressures are pervasive. More than half of the surveyed firms said they would face "some" or "significant" difficulty meeting an unanticipated increase in demand. Capacity pressures are expected to further intensify over the next 12 months. A survey record number of firms said labour shortages were more intense than a year ago. And for more than one third of firms, labour shortages are binding and restricting their ability to meet demand. Overall, the BOS presents a very positive near-term outlook for business activity, notwithstanding the broader structural concerns about Canada's eroding competitiveness in the business community.

Looking ahead, the composition of Canadian growth is expected to shift away from sectors of GDP that have feasted on unusually cheap and readily accessible credit since the late-2000s. These sectors include household consumption, new residential construction, renovations and real estate transfer costs. Export growth should continue, supported by the ebullient U.S. economy, the weak Canadian dollar and USMCA's resolution of access to U.S. markets. Business investment is also expected to play a larger economic role as firms, especially in Central Canada and B.C., strive to meet demand amid widespread physical capacity constraints and labour shortages.

In October, the Bank of Canada raised its policy interest rates to 1.75%. This is the fifth 25 bps increase since July 2017. However, in inflation-adjusted terms, the policy rate is still negative — highly unusual for this point in the business cycle. With the economy steaming along and NAFTA uncertainty dissipating, the Bank is keen to reduce the accommodativeness of monetary policy. Another two or three rate increases may follow in 2019 to bring rates back to levels more "neutral" and consistent with an economy growing at full potential. The Bank's estimate of the neutral policy rate is 2.5-3.5% (i.e. 75-175 bps from where we are now).

Risks to the Canadian outlook are roughly balanced. On the upside, brisk U.S. growth could provide a larger than expected boost to Canada's economy, assisted by the ratification of the USMCA. On the downside, there are risks to the global outlook discussed earlier (trade tensions, emerging economies' distress, and tightening global financial conditions).

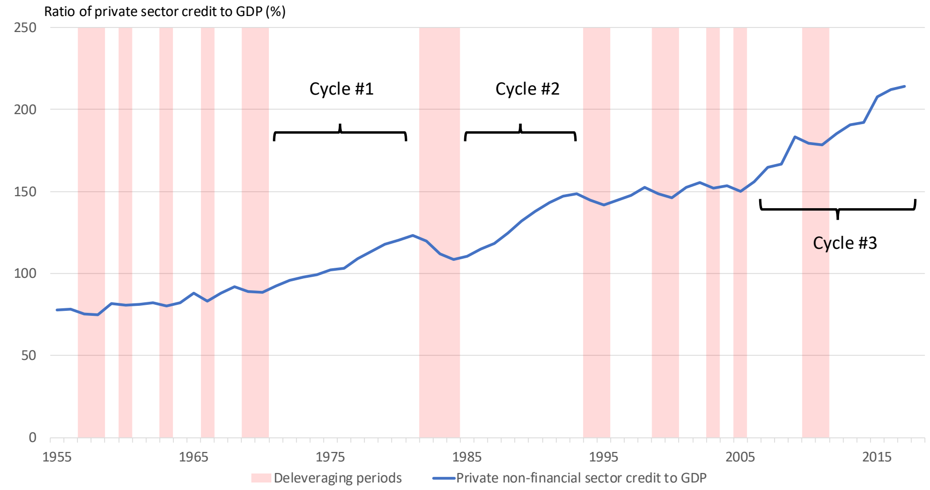
[4] The *Business Outlook Survey* summarizes interviews conducted by the Bank's regional offices with the senior management of about 100 firms selected in accordance with the composition of the gross domestic product of Canada's business sector. The autumn survey was conducted from August 23 to September 17, 2018.

Canada is particularly vulnerable to tighter global financial conditions. **Figure 3 and 4** plot Canada's three major leverage cycles in the post-war era. The ratio of private non-financial sector credit to GDP (i.e. household and non-financial corporate indebtedness) climbed significantly from 1970 to 1981, 1984 to 1993, and 2005 to 2017. Outside of these periods, the historical pattern shows mostly short periods of leverage expansion and contraction.

The current leverage cycle is the *largest* of the post-war era. The private sector credit to GDP ratio has increased by a remarkable 69 percentage points (interrupted only briefly in 2010-11). The current cycle is about *twice* as large as the two previous major cycles. Both of these were followed by economic recessions and periods of deleveraging.

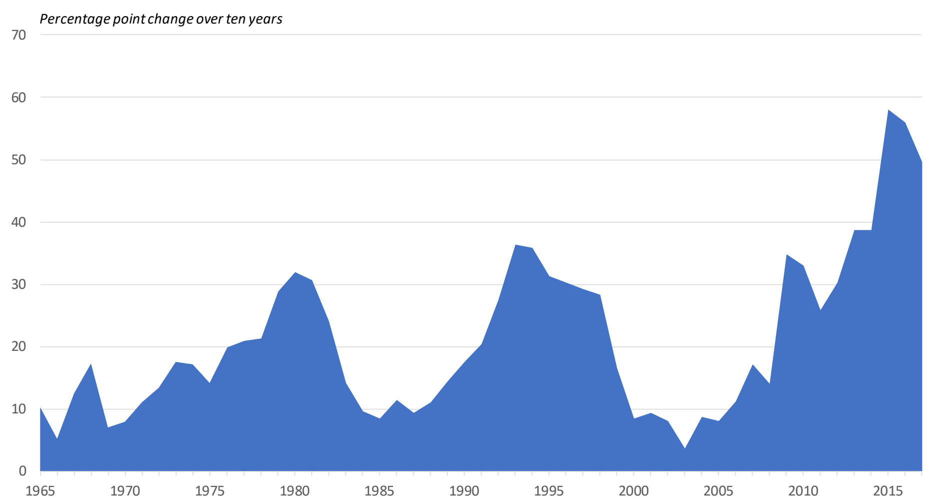
Canada's increase in private sector indebtedness has not been checked by any effective domestic policy response. Monetary and credit supply policies have remained mostly accommodative since the 2008-09 recession to support the economic recovery and expansion. Interest rates were cut again in 2015 to counter the effects of falling oil prices. Global financial conditions over the past decade have also been exceptionally supportive of credit-sensitive spending. As global and domestic financial conditions continue to tighten, Canada could find that carrying current debt loads becomes much more challenging.

FIGURE 3: **CANADA HAS HAD THREE SIGNIFICANT LEVERAGE CYCLES IN THE POST-WAR ERA: THIS IS THE LARGEST**
PRIVATE NON-FINANCIAL SECTOR CREDIT TO GDP



Source: BIS Statistics; BCBC calculations.

FIGURE 4: **TO SUPPORT THE POST-CRISIS RECOVERY, CANADIAN POLICY HAS ACCOMMODATED THE GREATEST LEVERAGE CYCLE OF THE POSTWAR ERA**
TEN-YEAR CHANGE IN THE RATIO OF PRIVATE NON-FINANCIAL SECTOR CREDIT TO GDP



Source: BIS Statistics; BCBC calculations.

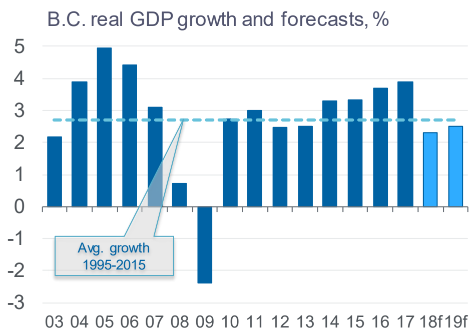
B.C. ECONOMY OPERATING AT FULL TILT

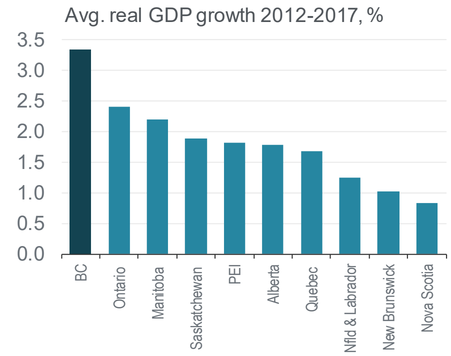
Having grown at more than 3% for a number of years, and by a stellar 3.9% last year, the B.C. economy is operating near or beyond full potential. B.C. is a growth leader in Canada. Over the past five years, real GDP growth has averaged 3.3%, well ahead of other provinces. Ontario, the next strongest province, posted a much more modest growth of 2.4% over the past five years. B.C.'s multi-year economic upswing has translated into the best job growth and the lowest jobless rate of any province.

We expect B.C. will remain a solid performer in 2019-20. The pace of growth will downshift, however. The anticipated rotation in Canada away from sectors fueled by ultra low interest rates and easy credit supply will be even more pronounced in British Columbia. The real estate boom has stoked economic growth more than in other parts of the country. As a result, the slowing in this sector is likely to be a bigger drag than in other provinces. Similarly, B.C. consumers (until recently) have been outspending their counterparts in most other provinces. However, recent retail sales data show a sharp slowing in spending growth.

Fortunately, the export sector remains on a sturdy growth path, supported by the strongest global economic backdrop in nearly a decade. Consistent with the outlook at the national level, the provincial economy will also rotate towards business investment. Non-residential construction activity is on the upswing. We expect companies to invest more in capital equipment, in part because of greater hiring challenges. In B.C.'s case, however, as we move further into the forecast horizon, these trends will be supercharged by the construction of the LNG facility in Kitimat and the related infrastructure required to deliver natural gas to the coastal facility.

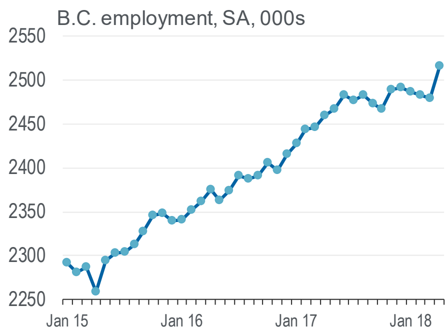
FIGURE 5: **DOWNSHIFT EXPECTED IN B.C. FOLLOWING A PERIOD OF STRONG ECONOMIC GROWTH**

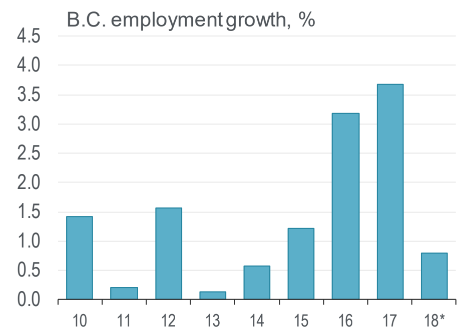




Source: Statistics Canada, Table 36-10-0401-01.

FIGURE 6: **STRONG JOB GROWTH IN 2016 AND 2017**





Monthly data are seasonally adjusted, latest Sept. 2018.

Source: Statistics Canada, Labour Force Survey.

JOB GROWTH IN B.C. SLOWS AMID TIGHT LABOUR MARKET CONDITIONS

The province's job market is buoyant, although job growth has slowed from the breakneck pace seen in recent years. In 2017, total employment surged 3.7%, on the back of a 3.2% gain the previous year. The province's labour market has been so strong that since 2015 B.C. has accounted for approximately one-quarter of all new jobs in Canada. Meanwhile, the jobless rate has marched steadily downwards to a record low of just 4.2%.

The job creation engine is no longer firing on all cylinders. So far this year (through September) employment in B.C. is up a by only 0.8%. This reflects some moderation in economic activity, particularly in segments related to residential real estate and parts of retail. Given B.C.'s record low unemployment rate, hiring challenges are curtailing job growth. Employers are finding it difficult to hire new workers.

B.C. has the highest job vacancy rate of any province. B.C.'s job vacancy rate — the share of all jobs that are unfilled — sits at 4.7%. Mirroring the fall in unemployment, the job vacancy rate has climbed steadily higher over the past couple of years. Many industries are feeling the pinch, but hiring challenges are acute in the construction sector, the trucking industry and parts of the hospitality sector. Data tracking conditions in different regions of the province show high job vacancy rates right across the board. The highest share of unfilled positions is in Thompson Okanagan where over 5% of all jobs are vacant.

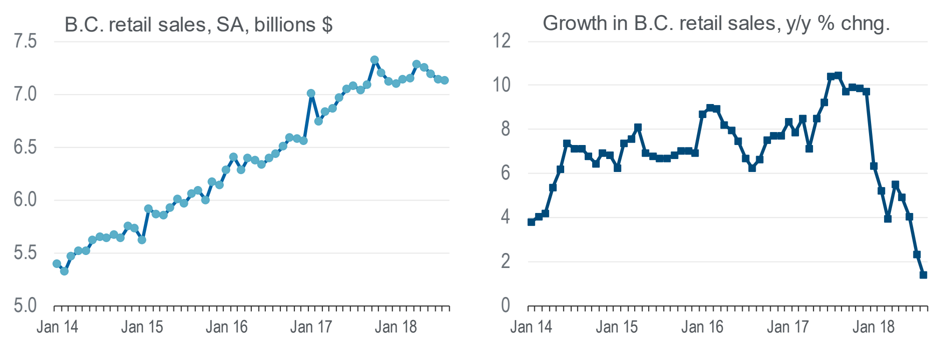
Tight labour market conditions are translating into higher wage pressures in some industries. In contrast to usual historic patterns, average wage growth in the province is outpacing the Canadian benchmark. According to Statistics Canada's Labour Force Survey, average hourly wage growth recently hit 6% in B.C. Other measures of average wages produced by Statistics Canada point to weekly wage increases in the 2% to 3% range. While tighter labour markets are clearly pushing wages higher, the 11% increase in the province's minimum wage is also a factor contributing to the strong annual wage increase.

Job markets are healthy in most parts of the country. But in B.C., skill shortages and hiring challenges are more intense and are to some extent restraining job growth. We expect tight labour market conditions to continue over the forecast horizon.

FIGURE 7: **RISING JOB VACANCY RATE IN B.C.**

Source: Statistics Canada, Job Vacancy and Wage Survey.

FIGURE 8: **GROWTH IN CONSUMER SPENDING SLOWS**



Growth rates calculated from 3-month moving averages.

Source: Source: Statistics Canada.

CONSUMERS PULLING BACK

Consumers in B.C. are now curbing their spending enthusiasm, reflected in the sharp slowdown in retail sales growth. Retail sales have posted big gains in recent years, culminating in annual sales growth of ~10% throughout much of 2017. This year, spending in the province's retail outlets has moderated. Year-over-year growth has nose-dived to a tepid pace of just over 1%.

The slowing is evident across most segments of the retail landscape, with the pullback in motor vehicles, stores selling building materials, and gas stations being the most significant. Over the first eight months of the year, spending at automobile dealers and parts stores was up just 1.7% year-over-year. Over the comparable period in 2017, auto sales were up by more than 10%. The automobile and parts sector accounts for one quarter of all retail sales. The flattening in this segment is therefore a drag on overall spending.

The moderation in sales at the building supply stores from a 33% surge last year to an 8% gain so far this year is also weighing on the top line retail sales figure. We expect conditions in the retail industry to be mixed in the next two years. Higher interest rates will be a headwind for interest-sensitive segments such as automobiles and household furniture and furnishings. Slower economic and job growth also point to more modest increases in retail sales.

Spending in restaurants and other eating establishments continues to grow at a healthy pace, although here too there is some evidence of a pullback.

CAPITAL SPENDING AND CONSTRUCTION TO DO MORE OF THE HEAVY LIFTING

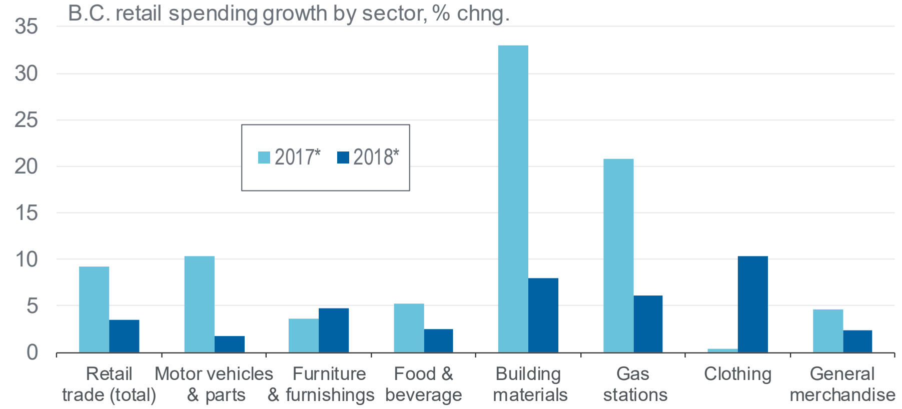
Construction activity in B.C. is running at elevated levels. Over the first eight months of the year, the value of non-residential building permits was 20% higher than last year. The growth is tilted somewhat to the south-west: permits are up 25% y/y in Metro Vancouver, while in the rest of the province non-residential construction permits are up almost 10% y/y.

Public sector capital spending is also rising. Construction spending on public infrastructure will rise from $4.2 billion to $5.2 billion this year. Much of the increase is due to transportation projects and transit infrastructure. Some preliminary spending on the Pattullo Bridge replacement begins in fiscal 2018-19 and then ramps up further the following year. The provincial government's plan to expand the stock of publicly-funded housing adds another $300 million to capital spending next year. Public sector capital spending that is self-supporting (essentially construction undertaken by certain Crown corporations) rises from $2.6 billion to $4.1 billion. Most of this reflects the Site C project.

Housing starts have eased from recent peaks, but remain elevated. Over the past two quarters, starts have been running at an annualized pace of around 40,000 units. The jump in the value of residential building permits also points to sustained strength in residential construction. The Federal government's plans to ramp up immigration levels by 2020 and the province's plan to construct more social housing units should keep home building at strong levels over the next few years.

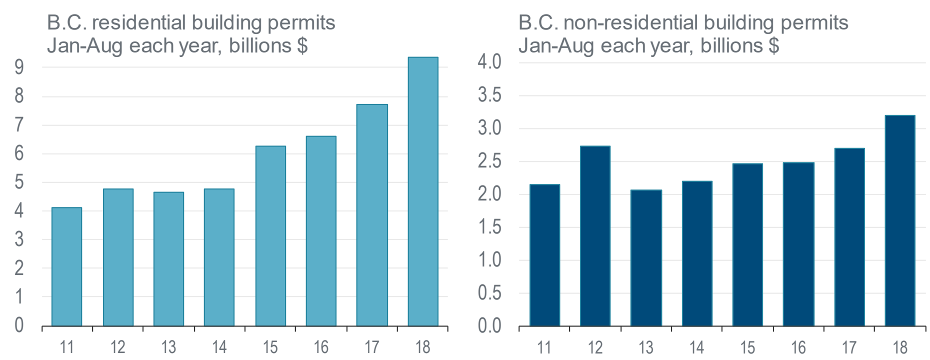
The real estate transaction sector (i.e. resales of existing properties) are on a more precarious footing. Tighter mortgage lending requirements introduced by the federal government, coupled with higher interest rates, will weigh on turnover in residential real estate in B.C. At the same time, numerous housing tax and other demand-dampening measures introduced in the 2018 B.C. budget and a renewed focus on anti-money laundering and real-estate related tax evasion will diminish the interest of foreign buyers. Also, given the oversized role foreign buyers have played in the B.C. real estate market, the aggressive steps by the Chinese government to rein in credit and stem capital outflows could also reduce demand in the B.C. real estate market. Taken together, these developments point to a notably slower pace of resale activity. Home resales in B.C. are down 33%

FIGURE 9: **SLOWER GROWTH IN MOST RETAIL SEGMENTS**



Source: Source: Statistics Canada. *year-to-date to August

FIGURE 10: **HIGHER PERMIT VALUES POINT TO MORE CONSTRUCTION ACTIVITY**



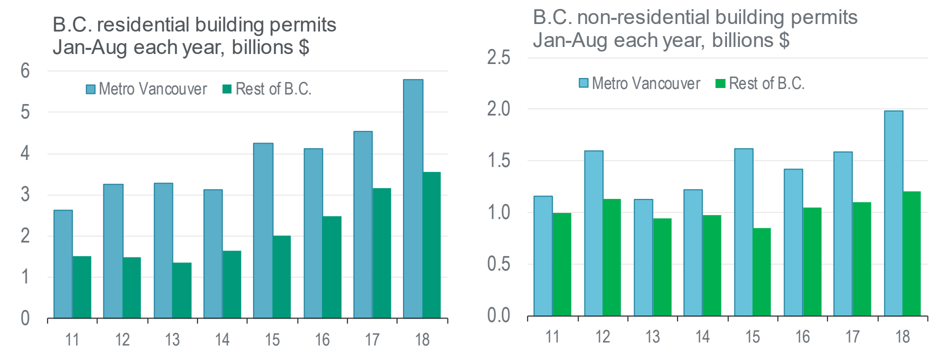
Source: Statistics Canada.

this year compared to 2017. Real estate prices in Metro Vancouver (and some other parts of the province) will be sensitive to rising rates as the stock of outstanding mortgages comes due for renewal over the next five years.

With the announcement that LNG Canada plans to proceed with its $40 billion investment in an LNG facility and related upstream infrastructure, this huge project has turned from an "upside risk" into a reality. This is the largest capital investment in Canadian history. The construction activity will provide a significant boost to the provincial economy. We estimate construction will add 0.2 percentage points to real GDP growth in 2019, which has prompted us to bump up our outlook for 2019 to 2.5%.

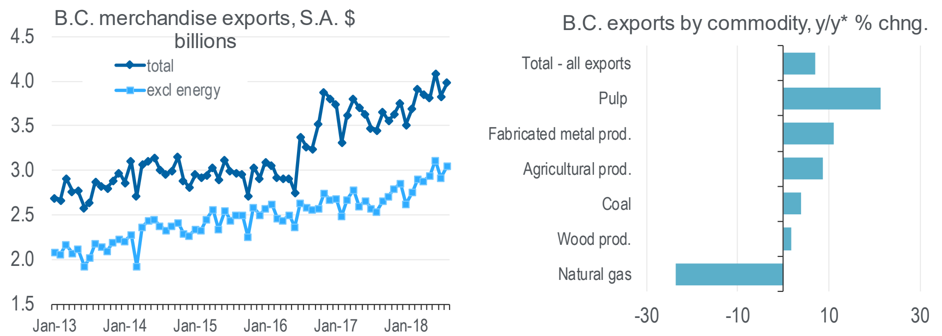
We expect the Trans Mountain pipeline project will also proceed, but the timing is more uncertain. At this stage it remains an upside risk to the provincial growth outlook.

FIGURE 11: **BUILDING PERMITS REMAIN ELEVATED IN METRO VANCOUVER AND OTHER PARTS OF B.C.**



Source: Statistics Canada.

FIGURE 12: **B.C. EXPORTS: STEADY GROWTH**



Source: BC Stats.

*year-to-date to August

EXPORT SECTOR ON A FIRM FOOTING

The outlook for B.C.'s export sector is upbeat. Most significantly, the strong U.S. economy and a solid global economy will help keep B.C.'s export sector on a healthy growth path. A Canadian dollar trading in the mid 70 cent range vis-à-vis the U.S. Greenback also supports the province's export sector. And finally, the replacement of NAFTA with the USMCA ensures favourable access to the vital U.S. market.

Currently (through August of this year) B.C.'s international merchandise exports are up 7% over the same period in 2017. Last year exports to India surpassed $1 billion. India is now B.C.'s fifth biggest international export market and with sales to India up 48% so far this year, due largely to a rise in the value of coal shipments as well as copper. Exports to China are up 11%; shipments of coal are down, but this is more than offset by gains in copper exports, pulp and agricultural products.

Tourism continues to be a bright spot for the province. Boosted by U.S. demand and an attractive exchange rate for American visitors, between January and July the number of Americans coming to B.C. rose 3%. The number of visitors from Asia was up 7%. The European market saw the strongest increase (8%) but it is less than half the size (based on the number of visitors) of the Asia-Pacific market.

TABLE 2: **B.C. ECONOMIC FORECASTS (ANNUAL % CHANGE UNLESS OTHERWISE INDICATED)**

	2016	2017	2018f	2019f
Real GDP	3.7	3.9	2.3	2.5
Employment	3.2	3.7	1.0	1.2
Unemployment rate (%)	6.0	5.1	4.6	4.4
Housing Starts (000 units)	41.8	40.1	40.0	38.0
Retail sales	7.4	9.0	4.5	5.0
B.C. CPI	1.8	1.7	2.7	2.3

f - forecast

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

SUMMARY AND RISKS

The B.C. economy has solid momentum. Real GDP growth is expected to moderate to the 2.3% to 2.5% range after four years of unusual strength due to the real estate boom. This momentum will be enough to keep B.C. near the top of the provincial growth rankings. Exports will be supportive of growth in B.C. and the other Western provinces. B.C.'s role as a gateway and the related contributions of the large transportation and logistics industry also continue to underpin growth.

Rising global and domestic interest rates is a key factor shaping B.C.'s outlook. The province's real estate economy and related consumer spending are already feeling the effects of higher borrowing costs. We expect that capital investment and to some extent exports will contribute more to growth in the next two years.

Policy changes and government-created policy risks have also emerged as factors weighing on the broader business investment outlook. The tax burden for business and highly-skilled earners in B.C. (and Canada) has increased at a time when the United States has reduced taxes (especially for businesses) and taken steps to lighten and streamline regulatory burdens. As the economy shifts away from real estate-driven growth, there is a risk that business investment will fall short of the upswing typically expected at this stage in the economic cycle – not only in B.C., but in Canada as a whole. There is increasing pressure on policy-makers to pay more attention to competitiveness and to take steps to bolster the province's (and Canada's) ability to attract productivity-enhancing investment and talent.

On the downside, external risks for B.C. and Canada include further escalation of the United States' global trade war – particularly with China, the world's second largest economy. The key domestic risk is that the sizable imbalances in Canada's real estate and credit markets could unwind in a disorderly manner, as lessons from financial history and from the experiences of other countries suggest could happen. This risk could become more acute if global financial conditions tighten faster than anticipated.

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