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B.C. Economic Briefing

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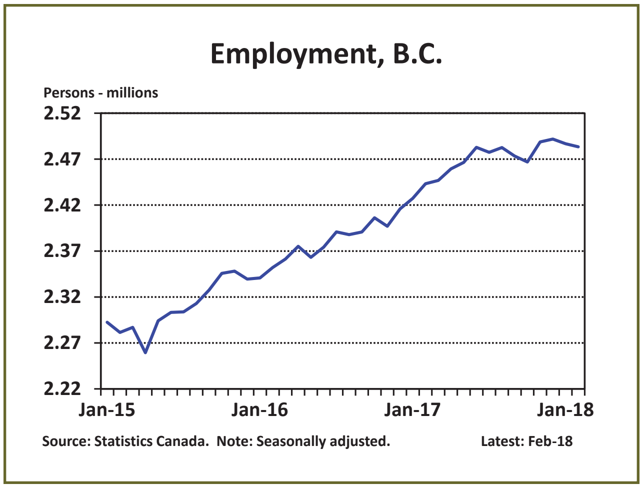
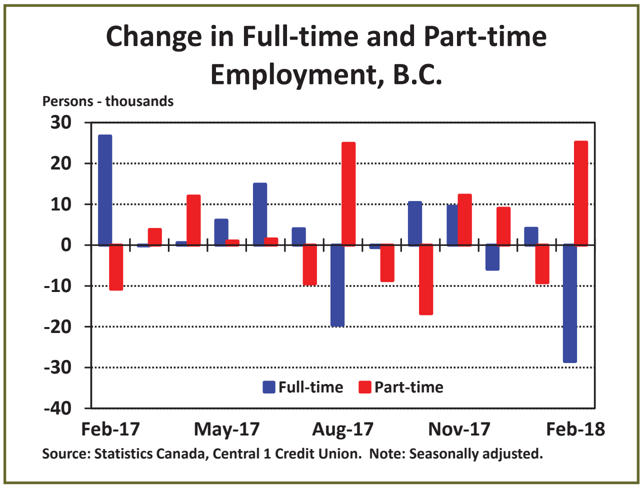
HIGHLIGHTS:

- Labour market holds steady
- February home sales plunge
- Housing starts drop
- Record high building permits
- International goods trade tame





Employment stall continues

Total employment and the unemployment rate saw little change in B.C.'s labour market during February. A significant change played out in the full-time and part-time employment mix with a decline in the former and an increase in the latter. Across industries, employment was mostly unchanged from January with few exceptions. B.C.'s employment growth has stalled during the past several months and February's result offered no improvement.

Seasonally adjusted total employment slipped 3,400 persons in February from January, a statistically insignificant change in the Labour Force Survey (LFS) sample. However, full-time employment fell 28,500 persons while part-time rose 25,200 persons. Both changes were significant.

Full-time employment in February fell to its lowest level in more than one year, while part-time employment reached a new high, though not as a share of total employment. It is not clear whether February's result is due to sample variability or to a fundamental change. At this point, sample variability is the probable cause and a bounce back in the next month or two is expected.

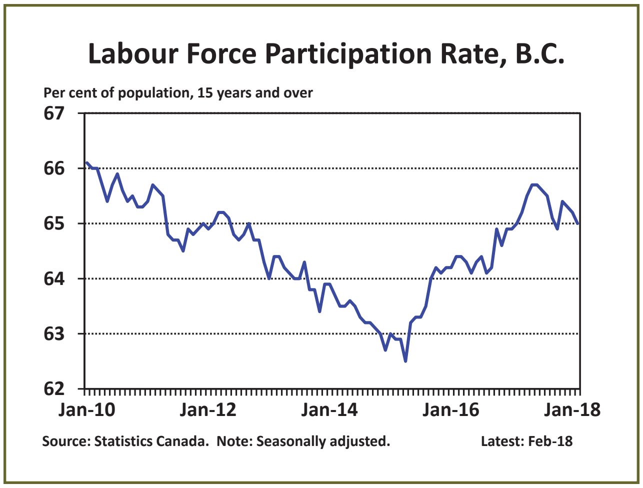
The unemployment rate edged lower to 4.7 per cent from 4.8 per cent in January and represented no material change based on the sample. The unemployment rate nears its low for this cycle and is approaching the 4 per cent low seen in July 2007 during the last cycle.

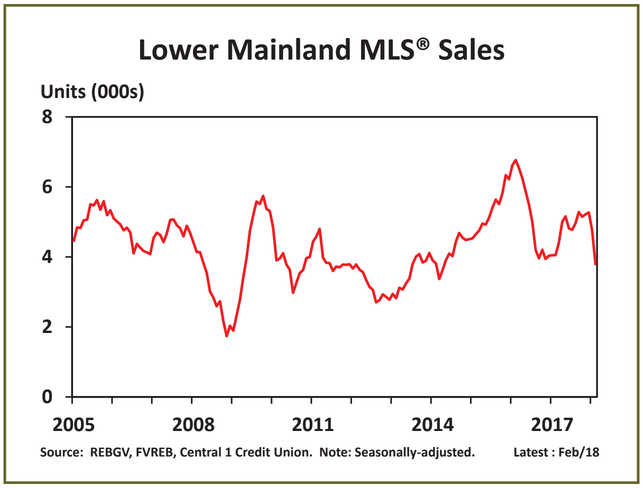
Notable industry employment changes this month were a 9,500 person decline in wholesale and retail trade, a 7,200 person increase in other services (mostly repair and maintenance, personal services), 4,400 person decrease in construction, and a 2,400 person increase in primary resources. All other industries had no statistically significant change based on the LFS sample.

The employment stall of the past eight months could be due to labour supply issues rather than to labour demand. The labour force participation rate hit a high at 65.7 per cent of the population 15 years and over in June 2017 and has since declined to 65 per cent. Accordingly, labour force growth has stalled, and with it, employment. Demographics could be overriding cyclical forces attracting workers into the labour market, unlike in the prior two years. A lack of demand is not likely the cause of no employment growth since June 2017, because other economic indicators for B.C. and external economies are mostly positive.

During this employment stall period, employment outside Metro Vancouver declined, while it rose in Vancouver. Across industries, employment gains occurred in construction, health and social services, and in wholesale and retail trade, but in all other industries, employment was flat or down.

The high job growth rate, 3.7 per cent seen in 2017, will not be repeated this year. Employment in the first two months of this year was 2 per cent above the level in the same period last year. Our forecast calls for a 2 per cent gain for the whole year, which means that employment needs to increase and breakout from this stall phase. Our unemployment rate forecast for 2018 is 4.5 per cent.





February home sales plunge with latest federal mortgage rules and provincial policy uncertainty

With the full effects of the federal mortgage rule tightening making its way into the data, and policy uncertainty in advance of the provincial budget undoubtedly weighing on household purchasing decisions, February MLS® sales sank like a stone. Activity in the combined Abbotsford-Mission and Vancouver region reached 3,530 units during the month, marking a 6 per cent drop from same-month 2017, compared to a 22 per cent gain in January. Seasonally-adjusted (s.a.), sales fell 15 per cent from January.

Prospective buyers have been hit with a barrage of policy measures to dissuade purchasing and further debt accumulation, shutting out buyers from homeownership opportunities, as well as offsetting strong demand conditions emanating from low interest rates, population growth, and strong economic fundamentals. Tightening of mortgage insurance rules in late 2016, B-20 mortgage regulations and stress tests on conventional mortgages in effect since January 1, 2018 have severely constrained financing capacity for first-time and low equity buyers, with the latter being a key driver of the sharp sales pullback. Buyers previously able to afford higher prices have been forced to scale back their expectations, maintaining high demand for relatively affordable condominiums and townhomes, at the expense of the detached market.

A further headwind to the market was uncertainty about prospective housing policies in the provincial budget that could further impact the market and home values. Budget 2018 included a swath of housing policies that included new tax measures, tackled sales transparency, and supply expansion of the housing stock over the medium-to-long term.

Various tax measures that will especially impact the Lower Mainland, include but are not limited to:

1. Speculation tax on targeting non-B.C. residents, vacant homes, and wealthy satellite families

2. Hike in the foreign buyer tax from 15 to 20 per cent

3. Hike in the property transfer tax for homes above $3 million from three to five per cent for the incremental amount

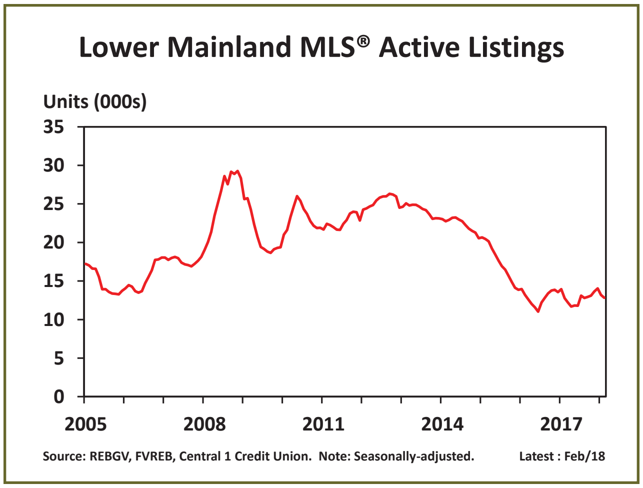
4. Increase in school taxes for homes above $3 million in 2019 onwards

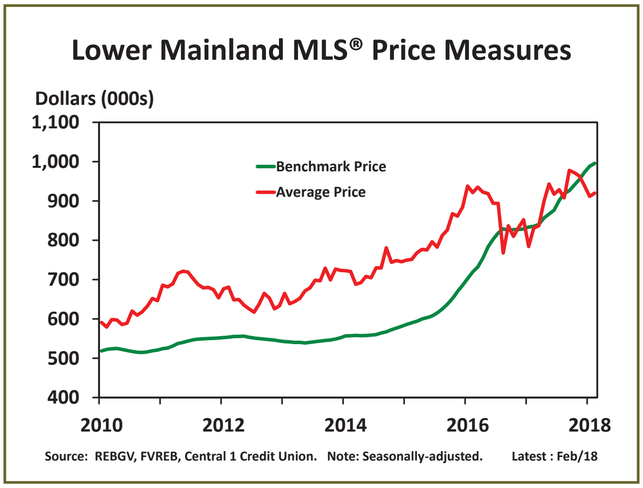
None of these provincial measures are game changers for the market, but they will further curtail sales going forward, particularly in the higher priced luxury segment and single-family market and suggest a relatively subdued sales pace for overall sales in the coming months.

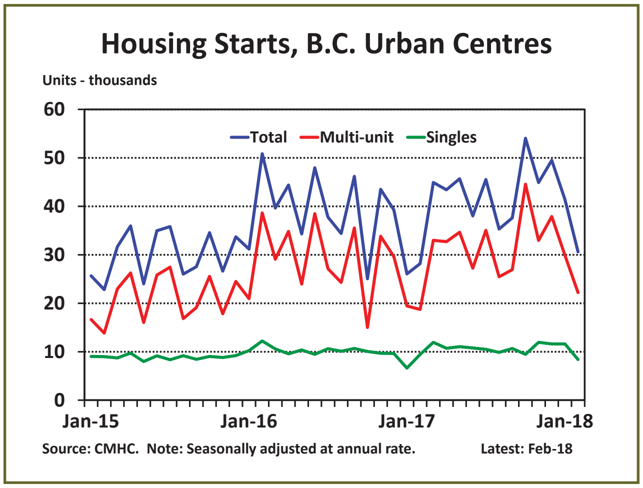
Fewer sales had little impact on resale market supply during the month, which remained exceptionally low. New listings bounced higher, but remained below historical norms for February, while active listings or month-end inventory continued to hover near historical lows. Lower sales will not lead to a flood of supply hitting the market, due largely to strength in the economy and labour market, and tight rental market, although some owners impacted by the provincial measures may decide to divest.

The result is further price appreciation. The constant-quality benchmark home value rose 0.7 per cent from January to a seasonally-adjusted $995,700, and 19 per cent from same-month 2017. However, detached home price growth slowed sharply, as townhomes rose 1.2 per cent from January and apartment prices surged 2.2 per cent. Compared to same-month 2017, benchmark values for detached homes were 11 per cent higher, compared to 21 per cent for townhomes, and 31 per cent for apartments.

A weaker trend in sales is expected to extend into the second quarter, and this moderation will dampen pressure on prices going. However, supply constraints will continue, pointing to more modest price growth through 2018. We do not anticipate a significant correction in prices.







Housing starts drop

February housing starts fell in B.C. urban centers to their slowest pace in one year. Total housing starts came in at a seasonally-adjusted annual rate of 30,600 units in February, down 26 per cent from January and the lowest since last February's 28,200 unit pace. All of February's decline was multi-unit starts in Metro Vancouver. Large monthly swings in multi-unit starts are common, and February's result is taken in that context, and not a sign that housing starts are plunging due to demand or supply factors.

Year-to-date housing starts were 33 per cent above the same period last year, though at that time last year, starts were low for two consecutive months, making for a more favourable base comparison than will play out in the remainder of the year.

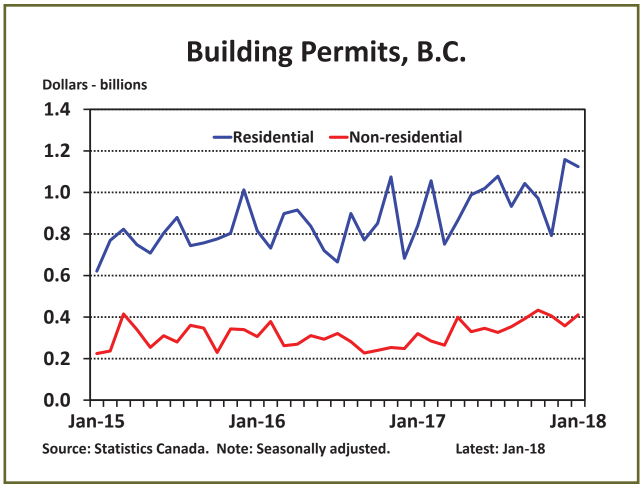
The recent drop in housing sales due to the latest mortgage rate stress test and a recent bump up in mortgage rates does not bode well for housing starts staying at a high level. In addition, the Province's new housing measures on the expanded foreign buyes' tax, a new speculation tax, and other property tax increases will have a dampening impact on future sales. Also, mortgage rates are expected to trend higher.

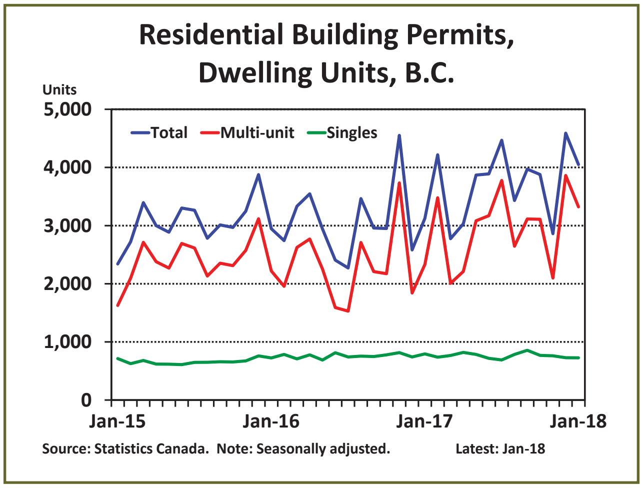
Factors supporting a high level of housing starts are: income, job, and population growth, low mortgage rates, high consumer confidence, investor demand, and pent-up demand for ownership and rental housing. Market conditions with rising prices and low rental vacancy rates will spur investment in new construction. Increased government funding for social housing units is a new factor. Some negative supply factors are rising land and construction costs, labour shortage issues, long development timelines, and rising financing costs. Deteriorating purchase affordability among potential low equity buyers will continue to squeeze out sales at the margin.

Our expectation is for B.C. housing starts to come in around 40,000 units this year, slightly lower than in 2017, but among the highest levels recorded. A significant downturn in housing starts will require an economic recession or a longer period of negative housing factors and demand reduction policies.

Building permits at record high

Building permits issued during January hit a record high total permits at $1.53 billion, seasonally adjusted. Residential permits valued at $1.12 billion, seasonally adjusted, off 3 per cent from its record high set in December 2017. Non-residential permits jumped 15 per cent higher to





come in at $410.8 million, not a record high, but among the highest levels seen and well above historical averages.

The value of residential permits includes renovations, improvements, demolitions, and minor construction as well as construction for new dwelling units. The number of new dwelling units created during January declined 15 per cent from December, on a seasonally-adjusted basis. Most of the decline was in multi-units and in Metro Vancouver. The Victoria metro area saw a near 50 per cent jump in January permits. These moves are consistent with CMHC's February housing starts report.

Non-residential building permits in January were driven higher by a 21 per cent jump in commercial permits and aided by a 9 per cent increase in institutional and governmental permits with industrial holding steady. Among the Province's four metropolitan areas, only Vancouver did not contribute to the increase in January. The Abbotsford-Mission metro area posted a 128 per cent surge to $36.1 million, seasonally adjusted, over December and the highest in nearly five years. Metro Victoria contributed with a 119 per cent increase to $31.5 million. The Kelowna metro area posted an 83 per cent rise to $18.9 million.

Non-residential building permit activity is seen trending higher in response to declining vacancies and rising rents in commercial and industrial properties located in growing market areas, including beyond Metro Vancouver. Residential permit activity mirrors the housing sales and price cycles, with a time lag.

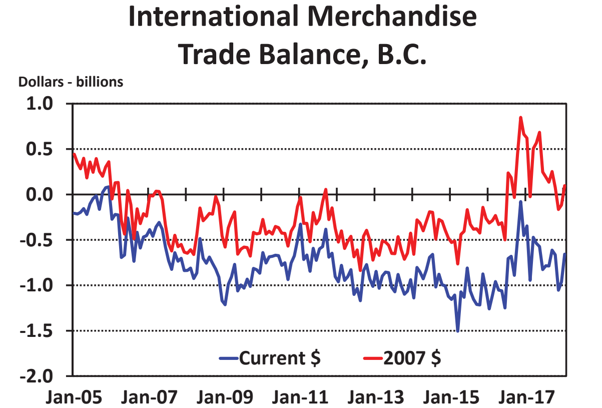
Lacklustre trade performance

B.C.'s international merchandise trade situation changed little in January 2018, with only a modest improvement in the trade balance. The seasonally-adjusted trade balance narrowed to a $657 million deficit from $962 million in December, however, in real terms the trade balance swung to a small surplus of $96 million in January from a $116 million deficit in December.

B.C. has run a real merchandise trade deficit for most of the past decade except for a brief period of surpluses from late 2016 through most of 2017, when energy, metal and non-metallic exports surged. However, in nominal terms, a trade deficit prevailed throughout. Trade deficits pull down overall GDP.

Merchandise exports declined 8 per cent from December, though after seasonally adjustment, exports edged lower 1 per cent. January's decline in exports was led by forest products and building and packaging materials, which were down 11 per cent from December. Energy, B.C.'s next largest commodity export, posted a 14 per cent seasonally adjusted gain. Metal ores and non-metallic minerals exports saw a large gain in the month, which may reflect their inherent volatility rather than a trend change. Consumer goods, metal and non-metallic minerals, and farm, fishing and intermediate food products exports declined.

International merchandise imports, before seasonal adjustment, declined 3 per cent from December and 8 per cent after. Consumer goods, the largest component, dropped 10 per cent on a seasonally adjusted basis from



Source: Statistics Canada, Central 1 Credit Union. Note: Seasonally adjusted.
Latest: Jan-18

December. Electronic and electrical equipment and parts imports dipped slightly, and industrial machinery, equipment and parts imports fell 14 per cent, seasonally adjusted. Most of the remaining components underwent small changes.

The U.S. administration's proposed tariffs on steel (25 per cent) and aluminum (10 per cent) imports will have a minor impact on B.C.'s overall merchandise exports, but a substantial impact on those sectors. In 2017, B.C. exported $585 million in alumina and aluminum production and processing to the U.S., which represented 49 per cent of the total, and was B.C.'s largest customer. Japan (27 per cent) and South Korea (24 per cent) were the next two largest destinations for B.C.'s aluminum exports. As an aside, more than 95 per cent of Ontario and Quebec aluminum exports are sent to the U.S. Basic and semi-finished iron and steel products and unwrought iron, steel and ferro-alloys exports from B.C. are mostly destined to the U.S. at 96 per cent and 89 per cent shares respectively, in 2017. Total aluminum and steel exports from B.C. to the U.S. amounted to $721 million or 1.6 per cent of total 2017 merchandise exports.

The latest twist has Canada and Mexico receiving a temporary exemption from these tariffs, conditional on NAFTA negotiations resulting in a favourable deal for the U.S. – in effect a bargaining tactic. We will have to wait and see.

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