B.C. Economic Briefing

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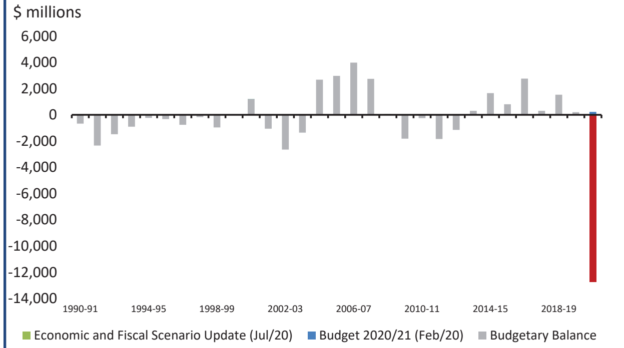
central 1

Highlights:

- A record setting provincial government deficit expected as revenue drops and pandemic measures lift expenses
- B.C. home sales surge 70 per cent in June, prices firm
- Manufacturing sales rebound 7.2 per cent in May, downturn less severe than other provinces

Potential $12.5 billion deficit under baseline scenario



Source: BC Ministry of Finance, Central 1

A record deficit of $12.5 billion in sight for B.C. as pandemic ravages economy

The B.C. government presented its Economic and Fiscal Scenario- Update 2020/21 this week which unsurprisingly points to the largest deficit on record for fiscal year 2020-21 as COVID-19 and required efforts to stem the health crisis ravages the economy and government finances.[1]

B.C.'s potential deficit hits a record $12.524 billion for fiscal year 2020/21 under the government's baseline scenario. Pre-COVID19, Budget 2020 had the surplus pegged at $227 million highlighting the unprecedented effects of the pandemic. This would be the largest deficit, both in nominal terms and as share of gross domestic product (~4.2 per cent) going back to at least fiscal year 1981/82.

While this potential deficit is larger and deeper than we expect, it is not entirely a surprise given the state of the economy due to COVID-19 and pandemic response measures. It is largely unavoidable. Federally, the projected deficit is a massive $343 billion deficit.

Provincially, pandemic response measures totaled $5 billion, with funds allocated to programs including the B.C. Emergency Wage Benefit for Workers ($1 billion), health and mental health services ($1 billion), temporary rental supplement, and other spending. This amount also includes $1.5 billion for the recovery phase. Other measures included reduced school taxes for the year, and one-time Climate Action Tax Credit enhancement. This does not include tax deferrals which should roll back into revenue in the future.

There is greater uncertainty on the revenue front. Under the government's scenario, revenues decline $6.3 billion due to COVID-19, with personal income tax (-$999 million), corporate income tax (-$973 million) and provincial sales tax (-$1.3 billion), property transfer tax (-$465 million) accounting for the bulk of the hit. Employment losses, weaker employment demand, and housing downturn are factors.

The scenario is driven by an economic future that will remain highly uncertain given the unknown trajectory of the virus both domestically and internationally and impacts on both the depth and duration of the downturn and recovery phase. Underpinning the fiscal scenario are the economic planning assumptions that are relatively conservative, but prudent. This includes a near record GDP contraction of 6.8 per cent for 2020 which is consistent with Central 1's outlook, albeit with higher average unemployment (11.3 per cent) and weaker expectations for consumer spending and housing. Growth for 2021 is also assumed to be 3.1 per cent which would mark a soft rebound.

The fiscal scenario is plausible, but given the current economic environment, it has both upside and downside risks. In the former, the economy could firm more quickly as consumers are more resilient than expected, or quicker progress may be made on a

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1 https://www2.gov.bc.ca/assets/gov/british-columbians-our-governments/government-finances/quarterly-reports/2020-21-economic-fiscal-update-backgrounder.pdf

vaccine or effective therapeutics. On the other hand, a second wave of the virus could knock the recovery back and temper the already shallow outlook.

It is prudent to expect multiple years of deficits, although the magnitude will decline as the economy recovers and governments control costs. That said, the economy is unlikely to fully recover until 2022 as physical distancing measures will likely persist constraining operational capacity, and sectors like tourism remain weak, and global growth remains soft. Tax revenues will follow suit.

B.C. remains fortunate that it entered the pandemic on solid fiscal footing and is in a good position to weather the recovery. The province was running surpluses for eight consecutive years, compared to deficits among many of its peers. Debt will continue to rise due to the operational deficit alongside previously announced capital investments. This could lift the debt-to-GDP ratio to 22 per cent in the current fiscal year from 15.5 per cent previously projected. Pre-COVID19 estimates ranged from 30 – 40 per cent for most other provinces aside from Alberta and Saskatchewan.

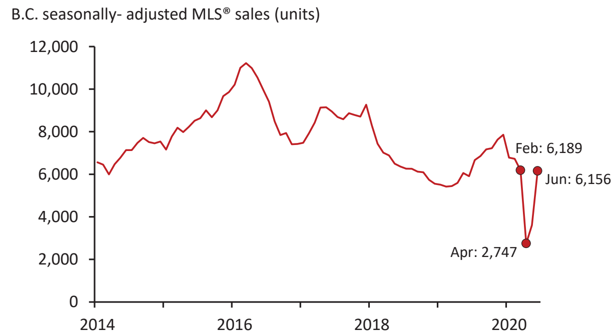
Housing market surges following pandemic driven hiatus

B.C. home sales rebounded sharply in June alongside markets across the country as buyers returned to the market following a pandemic driven hiatus. MLS® sales surged 70.6 per cent in June, following a 31 per cent increase in May. From February to April, sales declined 60 per cent. At about 6,160 units, seasonally-adjusted sales have recovered to about 92 per cent of February levels when the economy was still functioning normally pre-pandemic.

June sales growth was observed across all real estate boards in the province. Sales nearly doubled in the Fraser Valley Real Estate Board area (which includes Abbotsford Mission and Metro Vancouver municipalities south of the Fraser River) and Chilliwack. Vancouver Island sales rose close to 80 per cent, while gains were relatively modest in the Thompson-Okanagan and northern B.C.

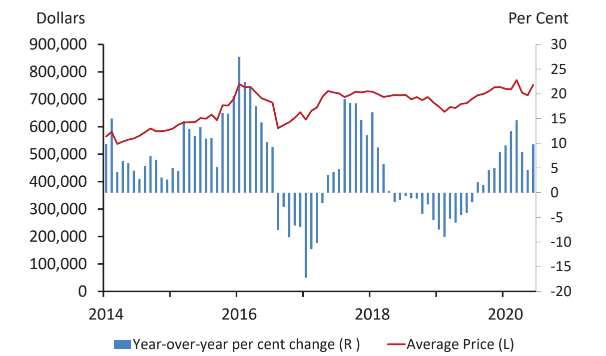
Various factors have contributed to a firmer footing for sales, at least temporarily. A delayed Spring market due to health fears and restrictions, physical distancing recommendations and sharp job loss likely triggered a release of pent up demand amidst the economic re-opening phase, and health and safety adjustments by the industry to bolster consumer confidence. This has been supported by declining mortgage rates. On the policy front, the announcement of tighter mortgage insurance requirement by CMHC effective July 1 likely pulled forward sales. An additional factor may be behavioural changes amidst the pandemic as more buyers search for space in the suburbs in anticipation of work-from-home situations.

MLS® sales snap back in June



Source: CREA, Central 1

Price levels climb with firming sales



Source: CREA, Central 1

Higher demand and low inventory lifted the average price by 5.3 per cent month-to month, and 9.8 per cent year-over-year to a seasonally- adjusted $752,779. There were strong increases across markets, but likely owed to composition effects both at the provincial level and regional level. New listings rose 46 per cent but lagged the sales gain, which kept inventory steady. The sales-to-active listings ratio jumped to 21 per cent which is in line with a sellers' market and consistent with anecdotal evidence of multiple offers and rising prices. Ratios on Vancouver Island are close to 30 per cent, with levels near 20 per cent in the Lower Mainland. Benchmark home prices rose 0.1 per cent in the Lower Mainland and Victoria, and 0.7 per cent on Vancouver Island (exc. Victoria), and 0.9 per cent in the Okanagan.

Strength in the housing market remains surprising given a weak economy. We remain of the view that home sales will soften in coming months as temporary drivers retreat. Economic activity is unlikely to return to pre-pandemic levels prior to 2022 and the recovery is likely to slow following an initial re-opening burst. Lower business revenues will crystallize a portion of the job loss and could lead to business closures impacting employment and housing demand. More stringent CMHC mortgage requirements will also impact ability of some prospective buyers to obtain financing. Home prices are also expected to ease modestly but be supported by moderately low inventory and low interest rates.

Manufacturing sales partially rebound in May, B.C. downturn milder than provincial peers

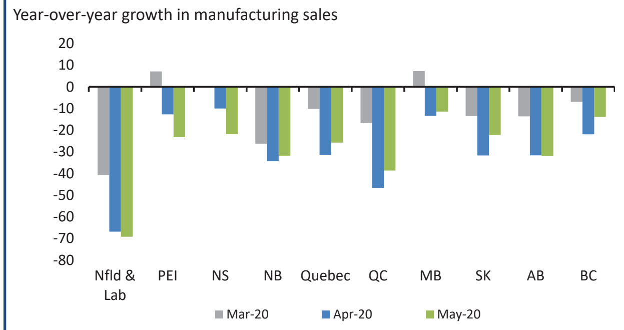
Manufacturing sales in B.C. rose 7.2 per cent in May to $3.86 billion following April's near 15 per cent decline which coincided with the most severe month of economic contraction during the current pandemic. While the figures point to the start of the recovery phase, the increase retraced less than half of May's decline. In comparison, national sales rose 10.7 per cent in May, but plunged 28 per cent in April. B.C.'s manufacturing pullback has been comparatively mild due to less exposure to vehicle manufacturing and energy production.

Year-over-year, B.C. manufacturing sales fell 13.8 per cent, owing to a combination of pandemic related declines but also deterioration in wood product manufacturing over the past year. Declines in B.C. have been modest compared to other provinces. Nationally, sales fell 31.6 per cent, and only Manitoba posted less of decline at 11.4 per cent.

Among sectors, the monthly rebound was driven by a 9.8 per cent increase in durable goods as non-durable goods sales rose 4.1 per cent. In the former, rebounds in fabricated metals, machinery, and transportation production of more than 20 per cent drove much of the increase.

Like much of the economy at the current time, the manufacturing outlook remains uncertain given the state of the viral pandemic both domestically and internationally, which effects export demand. Through the first five months of the year, sales fell 11.8 per cent on a same period basis. Expectation is that the economy continues to recover but at a modest pace, which should support the manufacturing up trend but constrained by an economy that remains below pandemic levels. Real manufacturing production is forecast to contract about eight per cent in 2020, before partially rebounding by six per cent in 2021.

B.C. manufacturing decline shallow compared to peers



Source: Statistics Canada, Central 1

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