B.C. Economic Briefing

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Highlights:

- August annualized housing starts above 40,000 units for a second straight month
- B.C. government forecasts $12.8 billion deficit for 2020/21
- Despite rising debt, fiscal position remains steady, particularly when compared to its peers

Ground-oriented units lift housing starts in August

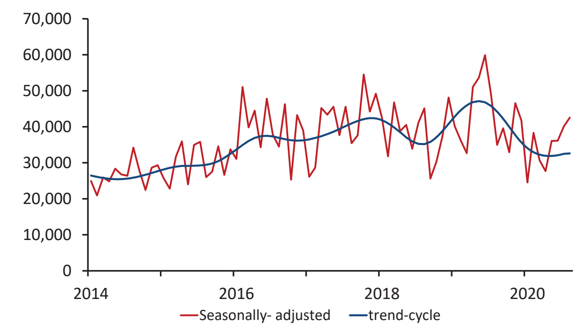
B.C. housing starts picked up traction in August with annualized construction above 40,000 units for a second straight month and for the first time since late 2019. Total urban-area B.C. starts reached a seasonally adjusted annualized rate of 42,564 units marking the strongest performance since November. This was up 6.3 per cent (2,508 units) from July and 21.7 per cent year-over-year. While monthly starts are often volatile given the impact of apartment structures on unit counts, these gains were observed in the construction of detached homes and a doubling of townhome starts from July. Apartments starts held steady after a sharp gain in July. Rising construction of ground-oriented units could reflect a modest rebound in the housing demand cycle. Insufficient resale inventory and increased demand for space (both indoor and outdoor) may be inducing demand for new builds and expediting townhome projects.

Among B.C.'s four metro markets, August's increase was concentrated in the Vancouver CMA which posted a gain in annualized starts of 5,350 units to 29,754 units. Abbotsford-Mission starts nearly tripled to 1,431 units. These were offset by declines in Kelowna, Victoria and other markets from July.

Despite recent gains, housing starts remain sharply below last year's record pace. Year-to-date starts reached 22,894 units (actual units) through August

Housing starts track higher on ground-oriented units

B.C. urban area housing starts, annualized



Source: CMHC, Central 1, latest: Aug 2020

which was 23 per cent below same period 2019. Detached starts declined 12 per cent, while multi-family activity fell 25 per cent. Vancouver Metro starts declined 29 per cent, with Abbotsford-Mission down 16 per cent. Victoria and Kelowna starts rose by five and eight per cent.

Total housing starts are forecast to come in at 34,700 units this year compared to 44,900 units in 2019. While housing demand has been lifted by lower interest rates, lower construction trends largely reflect a pull-back in pre-sale condominium activity in recent years, which has led to fewer projects in the pipeline. Stronger current demand could provide lift going forward, but this will be offset by a period of slower population growth and weaker rental market demand. Starts are forecast to rise to 36,300 units in 2021.

B.C. government forecasts $12.8 billion deficit for 2020/21

The B.C. government released its updated fiscal forecast, *First Quarterly Report, September 2020*, this week and unsurprisingly the underlying economic outlook and pandemic related outlays point to a massive deficit for fiscal 2020/21 following a relatively modest deficit for fiscal 2019/20. This is consistent with the government's economic and fiscal scenario report published in July.

The pandemic has blown a hole through fiscal plans and budgets for all governments and B.C. is no exception. While the pandemic did not fully hit the economy until March, it was enough to shift government finances into deficit for fiscal year 2019/20. Public accounts show a $321 million deficit for the year compared to a forecast for a $203 million surplus published in Budget 2020.

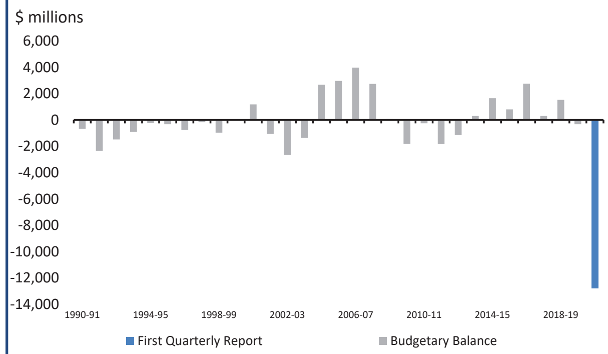
The impact of the ongoing pandemic hammered the economy from March onwards, with health concerns, shuttered tourism, and severe government policies to bend the COVID-19 curve crushing the economy, while governments turned on the taps to provide substantial fiscal support for households. The government's latest forecast, based on the latest available forecasts and program spending, is for a 2020/21 deficit of $12.792 billion in the current fiscal year which compares to a pre-pandemic plan of a $227 million surplus in Budget 2020. The latest value includes a $1 billion forecast allowance for prudence.

The pandemic has led to both a sharp decline in revenue and ballooning of expenses. Revenue is forecast at $56 billion, marking a difference of 7.5 per cent ($4.57 billion) from the Budget 2020 forecast and a drop of 4.5 per cent from fiscal year 2019/20. The main driver of the revenue hole is lower tax revenues which declines $4.7 billion from Budget 2020. This reflects the effects of lower employment, profits, and consumer spending has cut into income taxes and sales taxes. The government also expects lower property and property transfer taxes due to commercial tax relief and fewer home sales, while delay of carbon tax hikes also bite. Other revenue drivers are generally lower, although federal COVID-19 funding provides an offset of $2.37 billion.

Provincial expenses are forecast to rise $7.75 billion relative to the Budget 2020 baseline to $67.8 billion. The largest additional outlay was the Pandemic Response and Economic Recovery Plan pegged at $5 billion. This included the Emergency Benefit for Workers program, other income supplements, and other services. Cost sharing agreements with the federal government under the Safe Restart Agreement was also a large expenditure.

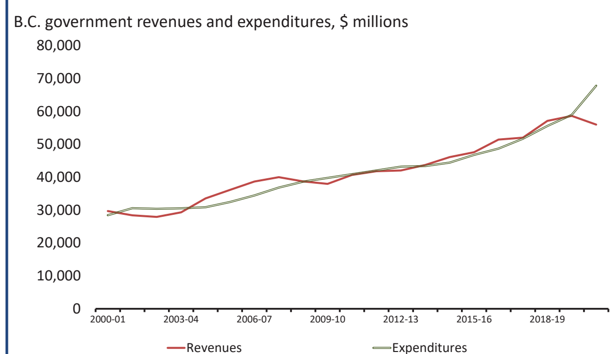
Fiscal forecasts contain substantial uncertainty, particularly given the current environment, given unknowns about the economic recovery, vaccine development, and potential for a harmful second wave of the virus on the economy. That said, the government is generally conservative in its economic assumptions, which include a contraction in provincial gross domestic product of 6.7 per cent this year and a mild rebound of 3.0 per cent in 2021. Employment growth is assumed to contract 7.8 per cent this year and increase 3.6 per cent in 2021. Both measures are weaker than private sector consensus and Central 1 forecasts.

Pandemic leads to forecasted $12.8 billion deficit forecast for fiscal 2020/21



Source: BC Ministry of Finance, Canada Fiscal Reference Tables, Central 1

Expenditures spike as revenues decline



Source: BC Ministry of Finance, Canada Fiscal Reference Tables, Central 1

Fiscal year 2020/21 will mark the worst of the deficit as economic recovery lifts revenues and pandemic related spending recedes. That said, with the economy and employment expected to remain below pre-pandemic levels into 2022, it is reasonable to expect deficits will likely continue into 2022/23. The province still remains in a strong position, particularly when compared to its peers.

Operating deficits will mean higher levels of provincial debt than expected. Total debt is expected to come in close to $87.9 billion, compared to $76.4 billion in Budget 2020. Taxpayer supported debt of $59.8 billion comes in at 20.8 per cent of GDP, compared to 15.5 per cent in Budget 2020. That said, with lower interest rates and a strong credit rating, debt servicing costs remain low. The ratio of interest costs to revenue (interest rate bite) remains steady near 3.5 cents per dollar and affordable. There is of course a risk that credit ratings are lowered.

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