Economics | Forecast / Outlook Reports

Economic Analysis of British Columbia

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Economics

B.C. Economic Outlook 2022-2024

Forget prospects for a “Roaring Twenties”, this looks increasingly like an ongoing period of trying times as the economy navigates a multi-pronged uncertainty from high inflation and rising interest rates, a war in Ukraine amplifying commodity price inflation and the omni-present risks of COVID- variants. Global economic activity is set to slow amidst these factors.

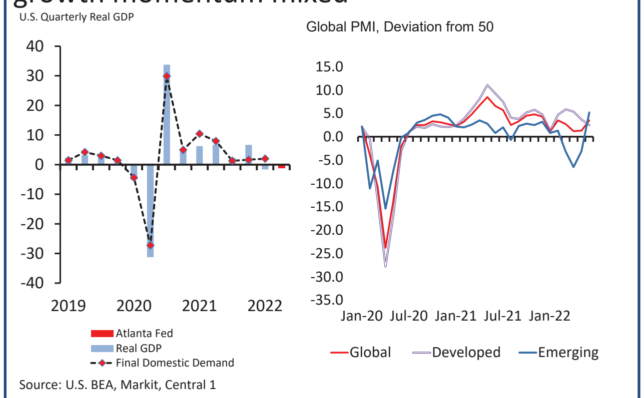
That said, British Columbia is anticipated to navigate the slowdown relatively well despite headwinds of a significant housing market slowdown, inflation and interest rate shocks to consumer spending, and some giveback in commodity price driven growth. An ongoing rotation in the economy towards services-oriented growth, strength in the labour market, population growth and higher investment spending from the private and public sectors contribute to growth of 3.6 per cent this year and above two per cent through 2024. Employment growth comes in at 3.5 per cent this year and 1.8 per cent thereafter as population growth provides a lift to labour supply and eases labour shortages.

Inflation and macro-economy uncertainty clouds outlook

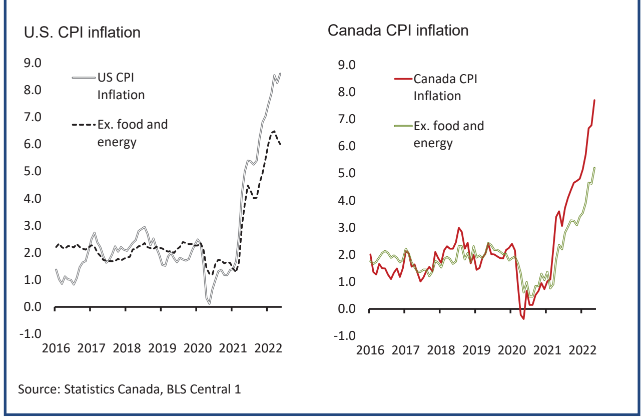
External macro-economic trends are increasingly uncertain with risks of a deep growth slowdown as central banks move quickly to rein in inflationary pressures which have surged across the globe and reached 40 year highs in the U.S. and Canada. Drivers of inflation have been multi-pronged with the combination of pandemic supply chain disruptions, unprecedented pandemic fiscal stimulus and rotation to goods demand. These factors have been amplified by the war in Ukraine which has further shocked global energy prices and food prices. Moreover, China’s COVID-zero strategy and lockdowns continue to delay recoveries in supply chains.

The extreme and unpredictable pandemic-era themes are weighing on global growth prospects as inflation reduces real household income, while energy and food scarcity increasingly become a challenge for emerging market economies and Europe. Knock-on effects of the war are slowing growth, with downside risks if Russian supply of energy is further restricted. Purchasing

U.S. economy flirts with recession, global growth momentum mixed



Multi- decade inflation highs continue

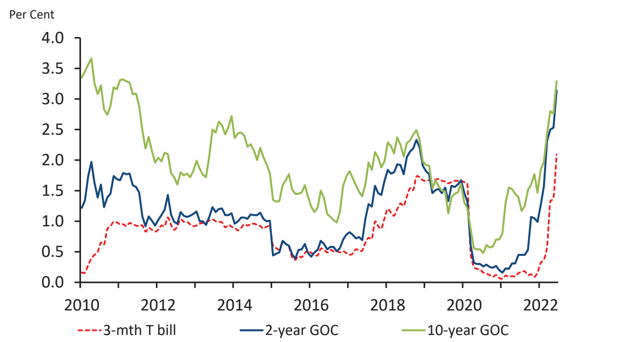


Managers Index (PMI) values are in decline and sat only marginally in expansionary territory into June despite easing of some Chinese COVID-19 restrictions, pointing to deteriorating conditions. The latest OECD global outlook output growth at 3 per cent this year, or 1.5 per cent lower than its December outlook, with a similarly subdued expansion in 2023.

Interest rates to rise, but how fast and how high?

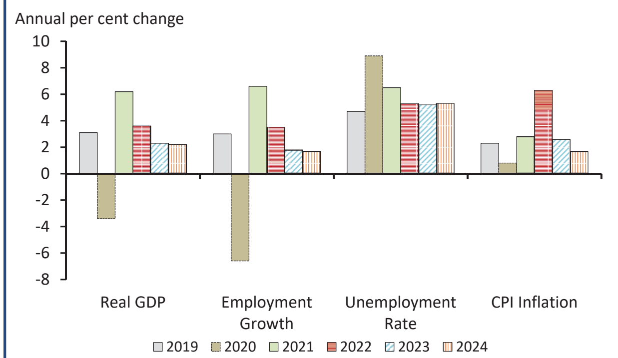
Intertwined with these shocks are central banks looking to move quickly to rein in inflation and risks of higher inflationary expectations which triggered a sharp upswing in bond yields.The U.S. Fed signaled a series of aggressive rate hikes this year which could lift the federal funds rate to 3.4 per cent or up nearly 200 basis points by year-end. That said, this combination of high inflation, energy prices and rising rates are already curbing U.S. growth. Purchasing

Interest rates rise sharply



Source: Statistics Canada, Central 1 (monthly average of weekly rates)

B.C. growth momentum slows through 2024, inflation moderates



Source: Statistics Canada, Central 1

Manager Indices (PMI_ are in decline, real consumer spending has turned over, sentiment is weak and housing volumes are in decline. While risk of a U.S. recession has increased with flagging GDP growth in the first half the U.S. labour market remains supportive and continues to churn out jobs at a solid pace and the unemployment rate remains excessively low at 3.6 per cent. Nevertheless, broad deterioration in momentum will, in our view, be enough to meaningfully curtail inflation into 2023 and put the brakes on excessive rate tightening both in magnitude and duration. Commodity prices have recently retrenched rather sharply, perhaps preceding a turn in inflation pressure. Long bond yields have also recently declined suggesting markets are expecting less upward rate pressure as economic activity slows.

The Canadian economy is expected to decelerate but remain in relatively solid shape despite the downdraft of slowing global and U.S. growth, reflecting a lift from strong, but waning commodity prices, higher investment, a tight labour market and robust population growth. Following the 100 basis point Bank of Canada rate hike in July, we expect the policy rate to reach 3.25 per cent in late 2022 which will curtail interest-rate-sensitive sectors like housing and durable goods spending. A slower economy and dampening inflation next year introduces the spectre of rate cuts later in 2023.

B.C. resilience tested by housing market downturn but growth to remain steady

B.C.'s economy has remained a picture of resilience through the pandemic. After recording one of the shallowest contractions among provinces in 2020, growth in provincial gross domestic product (GDP) was near the top of the pack in 2021 at 6.2 per cent. Average annual employment rose 6.6 per cent on an annual basis with year-end employment up two per cent above pre-pandemic levels, topping most provinces and driving the unemployment rate down to a pandemic low of 5.1 per cent.

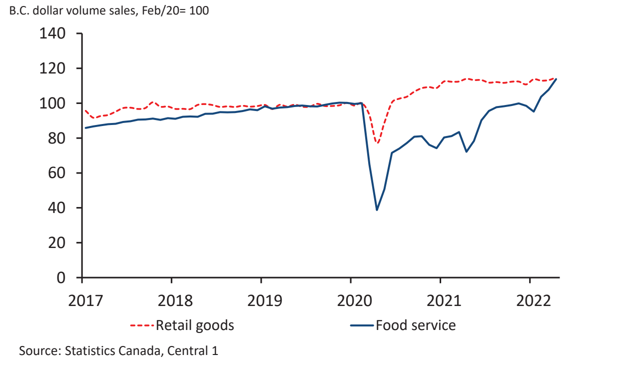
Economic outperformance reflected a broad range of factors including relatively lighter pandemic health restrictions that contributed to consumer spending and rebounding tourist activity, record housing sales driven by low interest rates, in-migration and remote work options, strong commodity markets and capital investment in major project construction. Pandemic demand for health services also increased at a strong pace, as did public administration. Public-sector hiring has far outpaced private-sector hiring.

B.C. remains in a solid position to weather current economic headwinds although GDP growth will fall far off last year's performance, reflecting less runway for further recovery and drag from higher inflation and interest rates. Real GDP growth is forecast to reach 3.6 per cent this year, 2.3 per cent in 2023 and 2.2 per cent in 2024. Inflationary pressures lift nominal GDP growth to 9.2 per cent this year, albeit down from our estimate of 16 per cent in 2021, before shifting down toward 4.5-5.0 per cent in the following two years.

Economic momentum tested by housing downturn, consumer spending to decelerate

Consumer spending is forecast to slow but align with headline growth at 3.8 per cent this year on strength in the labour market, population growth and as rotation of spending from goods towards services lifts growth. Retail sales soared in 2021 as consumers splurged on goods, reflecting shifting lifestyles as many individuals worked and stayed home, robust housing markets and cheap credit. However, the trend has stabilized in recent quarters amidst satiation of demand for big ticket items, inflation, gasoline-price-induced erosion in purchasing power, and rotation in demand toward experiences and services. The latter reflects households returning to in-person events and experiences, while population growth drives demand for shelter. Rising interest rates and the bite of high inflation, (forecast to average 6.3 per cent in B.C. this year before slowing to about 2.5 per cent in 2023), is already curbing

Rotation to services supporting consumer spending, inflation erodes real activity

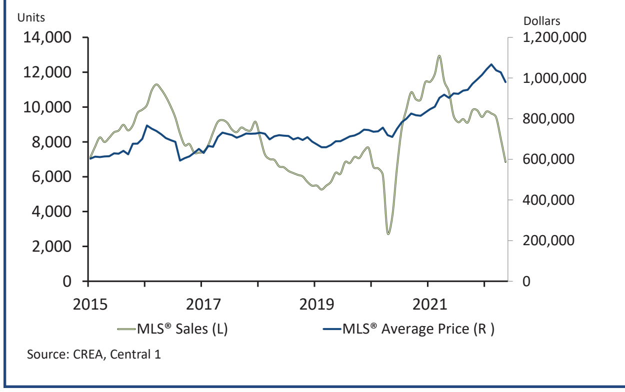


consumer spending momentum on goods this year, although retail sales have recovered to near 4 per cent growth in 2023 and 2024. A strong labour market and excess consumers will provide some cushion against higher prices.

Although consumer spending continues to rise, the reversal of the housing boom will drag on growth. Real residential investment is forecast to decline 5.5 per cent this year and 2.4 per cent in 2023 before increasing thereafter. This year's decline is the largest since 2009 but comes off a robust expansion in 2021. The key driver is higher interest rates. While likely near peak, fixed 5-year mortgage rates have ratcheted up to a decade high amidst tighter financial conditions while variable rates are tracking higher due to Bank of Canada rate hikes. Despite labour market strength, prospective homebuyers are increasingly being side-lined as higher rates and 40 per cent pandemic price gains crush any semblance of affordability as carrying costs and mortgage stress test thresholds increase. Sellers face prospects of an ice-cold summer market that persists until price expectations are cut. MLS® sales fell 30 per cent over the course of two months in May, and while still above pre-pandemic levels, the trend is likely to remain negative through Q3 as lower rate holds expire. Market conditions shift into buyers' market territory as inventory rebuilds, cutting the average home value by 15 per cent from peak. Pass through of the slowdown is predominantly through transaction flow and land sales which will depend on the magnitude that sellers reduce prices. Weakening conditions also dampen renovation spending.

Housing starts are forecast to decline 20 per cent this year after a record 2021. This pullback is not being driven by current market headwinds since multi-family projects are often planned and pre-sold well in advance of construction. Instead, higher interest rates

Housing market downturn pinches economic activity

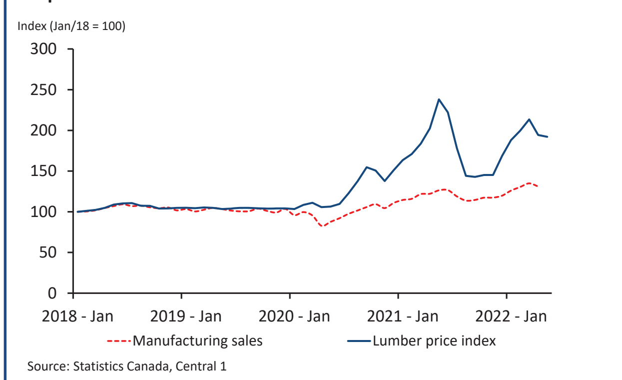


and a period of higher input prices for both material costs and labour have likely constrained development as demand declined. Starts for 2023 and 2024 come in just shy of 40,000 units before popping higher in 2025. Population growth continues to underpin demand for shelter.

Export growth buoyed by commodities and rising tourism

Trade and business investment are expected to remain a positive contributor to economic growth although the tailwinds of rapid gains in commodity prices over the past year are likely to wane. Year-to-date B.C. goods exports to international markets are up 34 per cent following a 36 per cent full-year increase in 2021. Similarly, manufacturing sales rose 21 per cent in 2021 with upward momentum in early 2022. However, most of this upswing has reflected higher commodity prices, specifically in the forestry sector last year and natural gas sector this year which has seen prices buoyed by the war in Ukraine and global supply uncertainty. Improved terms of trade via high commodity prices were a key contributor to higher nominal GDP and incomes. Export-oriented growth will remain a solid contributor to B.C. growth, although trends moderate.

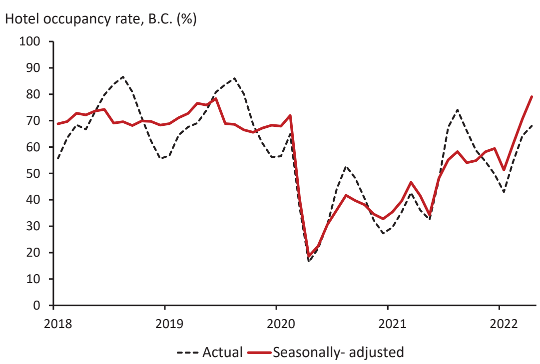
Commodity prices buoy manufacturing and export sales



The housing downturn in the U.S. and Canada is already cutting both prices and lumber export volumes into negative territory after last year's blockbuster performance, and lower housing starts and renovations will be a drag. At the same time, the natural gas sector should outperform, particularly as LNG Canada buildout intensifies (although export lift does not come until 2025), while the province is likely to benefit from a shift towards "friendly" trade partners for key commodities and manufactured goods.

More important for near-term export momentum is the ongoing recovery in tourism services. The sector managed relatively well during the pandemic owing to relatively modest public health measures and a funneling of Canada-constrained domestic tourists to coastal provinces. Tourism inflows are now rotating back to international inflows due to less restrictive border entry rules and increased flows from leisure and business travelers. Hotel occupancy rates in B.C. have already returned to pre-pandemic levels and demand will amplify pressures on restaurants and food services and arts/entertainment sectors. That said, the sector as a whole will likely be constrained by acute labour shortages as many workers left the industry during the pandemic. Other key service-oriented export sectors including software development and TV and film are expected to expand further, but recent downturns in the technology sector and higher interest rates are likely to temper gains.

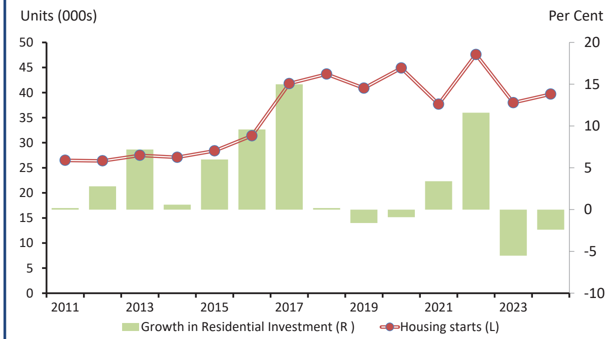
Hotels return to normal occupancy rates



Source: CBRE latest: Apr.-22

B.C. capital spending and investment are forecast to rise through 2023 but pull back in 2024 as major projects such as Site C dam and the LNG Canada project pass peak construction. Near-term momentum

Housing starts dampened by higher rates, but employment and population growth positive



Source: CMHC, Statistics Canada, Central 1

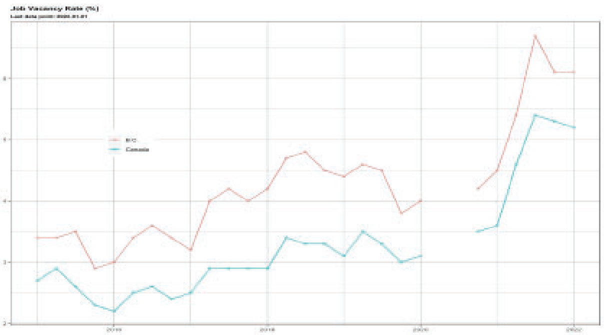
will be lifted by businesses in harder-hit sectors looking to invest in building and machinery coming out of the pandemic, commodity-price-induced investment, and on work on major projects such as the Broadway Subway construction and government funded hospital construction around the province. Capital expenditure survey expectations for 2022 pointed to a 7.2 per cent increase this year. Government capital is forecast to remain robust with funds allocated to repairing and redesigning infrastructure following last year's floods, while an election cycle could also fuel additional spending promises.

Employment growth remain solid near two per cent in 2023, population growth elevated

B.C. has experienced among the strongest recoveries in hiring compared to other provinces, and conditions remain tight as businesses struggle to find workers. The job vacancy rate in the province has declined to 6.8 per cent in April as a swelling pool of jobs go unfilled amidst a growing economy. While the unemployment rate recently slipped below 5 per cent, we forecast a full-year average of 5.3 per cent with a similar but tight pattern in the following two years. Employment growth averages 3.5 per cent this year, before slipping to 1.8 per cent and 1.7 per cent the following two years. Population growth will be a key factor in preventing further declines in unemployment rates and further wage acceleration.

Supporting consumer and housing demand, and providing a cushion for labour supply, population growth reaches 1.9 per cent in 2022, 1.7 per cent in both 2022 and 2023, and 1.5 per cent in 2024. This will average more than 90,000 persons annually.

Job vacancy rates high, population growth to alleviate some pressure



Source: Statistics Canada, Central 1

Following strong interprovincial migration during the pandemic as Canadians flocked to the province due to remote work options and accelerated retirements, growth rotates back to international drivers. While a recent surge in net international migration reflected transition of non-permanent residents already in the country to permanent status, future gains will reflect incoming bodies given the federal government's plan to attract 1.3 million residents over three years.

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Terms

B.C. Forecast Table - July 2022

Provincial Forecast

	2017	2018	2019	2020	2021	2022	2023	2024
GDP at market prices	7	5.4	4.6	-0.5	16	9.2	4.9	4.5
Real GDP, expenditure-based	3.8	3.6	3.1	-3.4	6.2	3.6	2.3	2.2
Household consumption	4.8	3.3	1.5	-3.5	6	3.8	1.8	2.6
Government expenditure	2.2	3.2	2.4	1.1	4.3	0.9	1.4	1.9
Government capital formation	8.4	12.4	0.1	9.9	7.2	5.7	7.3	13.2
Business capital formation	4.3	1.6	12.2	1.3	5.6	0.4	2.1	-1.4
Residential structures	0.2	-1.6	-0.9	3.4	11.6	-5.5	-2.4	2.4
Machinery and equipment	3.8	7.4	9.9	-21.4	10.4	6.7	7.8	2.9
Non-residential structures	12.9	0.1	40.6	10.6	-2.7	4.1	3.4	-9
Final domestic demand	4.2	3.2	3.6	-1.2	5.7	2.5	1.9	2.1
Exports	2.8	3.8	1.6	-9.7	7.1	3.5	2.7	2.6
Imports	5.2	3.6	3.4	-8	7.6	3.3	1.9	2.2
Employment	4.1	1.4	3	-6.6	6.6	3.5	1.8	1.7
Unemployment rate (%)	5.2	4.7	4.7	8.9	6.5	5.3	5.2	5.3
Personal income	5.8	3.4	6.5	7.9	5	7.2	4.5	4.5
Disposable income	6.8	2.1	7.1	11.3	3.1	7.1	4.5	4.6
Net operating surplus: Corporations	18.6	1.5	-6.2	19.1	32.5	10.7	2	0.3
CPI	2.1	2.7	2.3	0.8	2.8	6.3	2.6	1.7
Retail sales	9.3	1.9	0.6	1.3	14.6	2.4	3.8	3.6
Housing starts, 000s	43.7	40.9	44.9	37.7	47.6	38	39.7	39.8
Population Growth (%)	1.4	1.6	1.7	1.3	1.1	1.9	1.7	1.7
Key External Forecasts								
U.S. Real GDP	2.3	2.9	2.3	-3.4	5.2	2.6	1.8	2.1
Canada Real GDP	3.1	2.7	1.6	-5.6	4.9	3.8	2.4	2
European Union Real GDP	2.8	1.8	1.6	-6.5	5.3	1.2	2.3	2
China Real GDP	6.9	6.7	5.9	2.3	8.1	4	5.1	4.8
Japan Real GDP	1.7	0.6	-0.2	-4.5	1.6	2.4	2.3	1.5
Canada 3-month t-bill, %	0.71	1.4	1.66	0.42	0.13	2.2	3.1	2.8
Canada GoC long-term Bond, %	2.18	2.33	1.73	1.08	1.8	3	2.8	2.6
U.S.-Canada Exchange Rate, cents/dollar	77.05	77.16	75.37	74.56	79.88	78.62	79.55	80.29
Crude Oil WTI USD$ per barrel	51	65	57	39	68	100	90	85
Henry Hub Natural Gas Price, US$ per mmbtu	2.99	3.17	2.57	2.03	4.06	5.43	4.17	3.5