Economic Analysis of British Columbia

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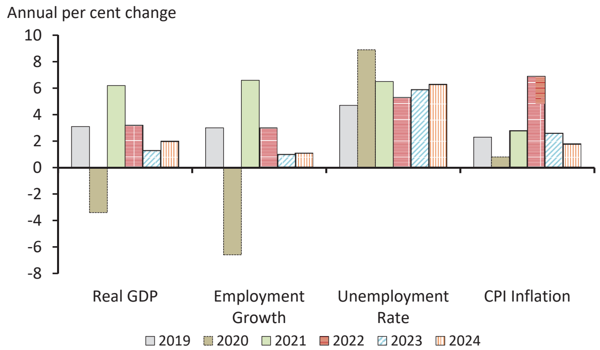
central 1 Economics

B.C. Economic Outlook Update 2022- 2025

This has certainly been a year of intense uncertainty for the economy as the world moved from shock to shock. Punctuated by the invasion of Ukraine and ongoing war, already elevated inflation pressures earlier this year were further amplified by commodity price shocks. Central banks have found themselves behind the inflationary curve and have moved rapidly and with force to stem further pressures and dampen domestic economies through monetary policy tightening. Global economic conditions are decelerating, and quickly the risk of recession in Canada has increased.

B.C.'s economy is expected to move with broader economic trends. Economic growth is forecast at 3.2 per cent this year, before slowing to 1.3 per cent in 2023. Growth recovers to 2.0 per cent in 2024 and 2.2 per cent in 2025. The province faces a deeper housing cycle downturn and pullback in housing starts, while consumption slows. A tight labour market remains supportive of activity as does strong population growth, but B.C.'s unemployment rate is forecast to ease with the latter. Inflation declines with the national pattern.

B.C. growth slows through 2023 with broader economy



Source: Statistics Canada, Central 1

B.C. economy remained on strong footing heading into H2 2022

The province has remained among Canada's stronger economic performers during the pandemic. The economy has been buoyed by the combination of relatively moderate COVID-19 economic restrictions, strong interprovincial in-migration and domestic tourism, and capital expenditures which quickly re-invigorated the labour market. B.C. experienced both the shallowest downturns in 2020 and among the strongest growth performances in 2021.

While the economy remained solid through mid-2022, growth momentum has slowed, and economic progress is moving more in line with its provincial peers after outperforming early in the pandemic recovery.

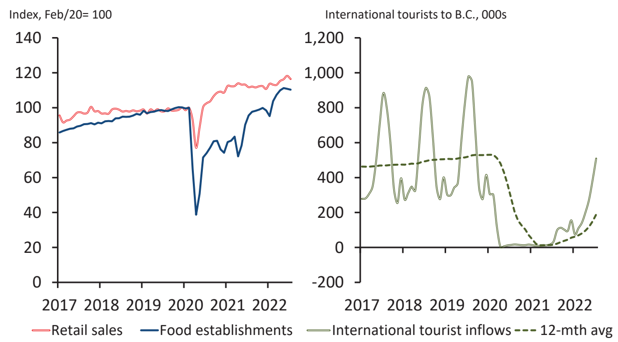
August's sharp slide in employment of 1.0 per cent after a flat July was not a major concern given the concentration in the retail and wholesale trade sector. September data proved this to be a blip as employment rebounded. Employment still exceeded pre-pandemic February 2020 by nearly 3.0 per cent, comparing favourably over other provinces. Moreover, the unemployment rate trends near 4.5 per cent and high job vacancy rates point to a lack of labour availability being the biggest problem rather than demand. Total compensation for workers, which equates to about half of total gross domestic income, was up 12.0 per cent through the first half of the year and led all provinces.

Consumer spending has held steady in nominal terms despite increased pressures from inflation and higher interest rates. Retail spending is trending towards a 3.0 per cent annual increase driven by the tight labour market, although the housing market downturn has curbed building materials sales while vehicle sales are also lower due to a combination of vehicle shortages and increasingly higher interest rates. Inflation pressures point to weaker real goods spending but high savings rates during the pandemic have cushioned the blow. Moreover, dollars have rotated away from stores and screens as people shuffled their feet towards restaurants, bars and in-person events, which has been further amplified by rising tourism trends. B.C.'s tourism sector, although hammered by COVID-19, found some relief in a high number of Canadian tourists visiting during strict global restrictions and is now seeing a surge in international tourism as conditions normalize.

That said, the external economy has rapidly shifted with sharp increases in interest rates to combat inflation pressure, elevated recession risks, and declines in already pinched commodity prices in recent quarters, and the trend is likely to worsen.

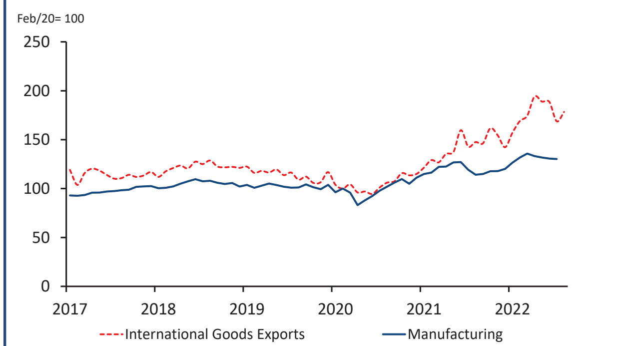
Housing is a notable casualty as the surge in fixed and variable mortgage rates have priced a swath of potential buyers out of the market with the largest melt occurring in markets that flew too close to the sun, including areas in the Fraser Valley. MLS® sales have declined more than half from pandemic highs

Services still improving as pandemic wanes



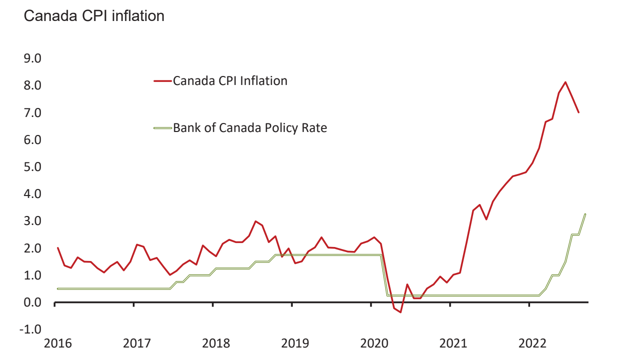
Source: Statistics Canada, Central 1

Commodity price retracement tapering manufacturing and export sales



Source: Statistics Canada, Central 1

Consumers and economy shocked by high inflation and sharp rate hikes



Source: Statistics Canada, Bank of Canada, Central 1

and are well below pre-pandemic norms. Average home values have declined 10.0 per cent, albeit with varying patterns among markets. Consumer spending, while holding firm, is likely to be curbed due to the same factors. B.C. household debt-to-income ratios are highest among provinces, and while a surge in loan delinquencies and defaults is not expected, consumers will pare back unnecessary spending.

Strong gains from trade during the pandemic are also abating. B.C. benefitted from rapid gains in commodity prices, including lumber, natural gas and mining, contributing to sharp increases in corporate profits and rising capital investment into 2022. However., the U.S. housing downturn, abatement of higher prices following the invasion of Ukraine, and weaker expectations for global growth which has intensified has since led to a rollback. That said, prices remain elevated compared to pre- pandemic levels, particularly for natural gas where Henry Hub is at $6.80 US per mmbtu compared to less than $2.00 pre-pandemic. Goods exports were up 30 per cent in nominal terms at mid-year with manufacturing sales up 8.0 per cent. Real production and exports have been mixed. Natural gas production rose 15.0 per cent through mid-year. In contrast real exports of softwood lumber fell 12.0 per cent.

Lower commodity prices and high borrowing costs will curb capital spending as companies de-risk over the short term, while the forestry sector also faces long-term constraints from the mountain pine beetle epidemic. On the positive side, a more polarized geo-political environment and demand for inputs from friendly sources is likely to support longer-term investment and provide some cushion as major projects such as Site C and LNG Canada complete buildout.

Service-oriented exports including tourism and work on TV and film remain strong. Despite the broader economic downturn, travel continues to recover on rising leisure and business travel. Demand for content is still propelling TV and film, and the sector will likely receive a boost from a weak Canadian dollar. Government spending remains a source of growth for the economy particularly as budgetary revenues exceed expectations due to strength in the economy.

B.C. to bend, not break, with broader economic slowdown

There is little doubt that economic conditions will continue to soften given the macro-economic backdrop. Inflation, while showing signs of abating, remains much too high and the U.S. Fed and Bank of Canada will continue to hike their respective policy rates to rein in price pressures and clamp down on inflation expectations. The U.S. Federal Open Market Committee projections signaled expectations for a 4.5 per cent terminal rate, while we forecast a 3.75 per cent Bank of Canada terminal rate with upside risk to 4.0 per cent. While the level of rates is not excessive, the speed of U.S. adjustments has triggered volatility in fixed income, currency and equity markets.

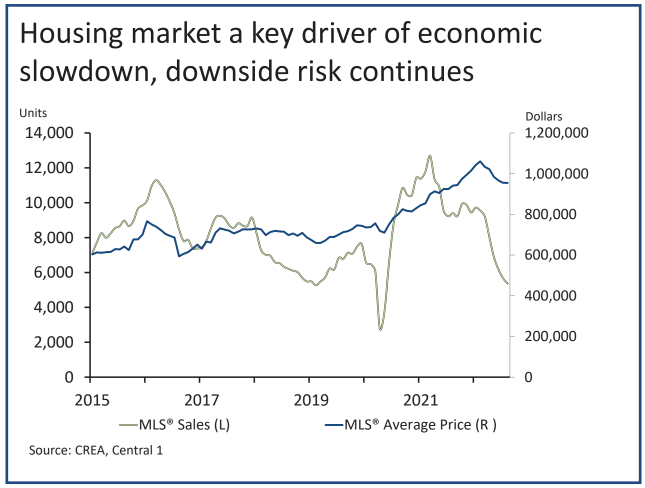
Tighter monetary is expected to solidify a modest recession in the U.S. after mixed but negative GDP growth during the first half of 2022. Higher rates and lagged transmission of monetary policy is forecast to slam the brakes on the Canadian economy during the second half of 2022 and extend through 2023. That said, we still expect the economy to trundle along and avert a recession, albeit with downside risk. Housing markets and interest rate sensitive sectors have been the first to adjust, although monetary pass through can take 18 months to fully flow through broader consumption and business investment. The economy is forecast to grow below potential into 2024.

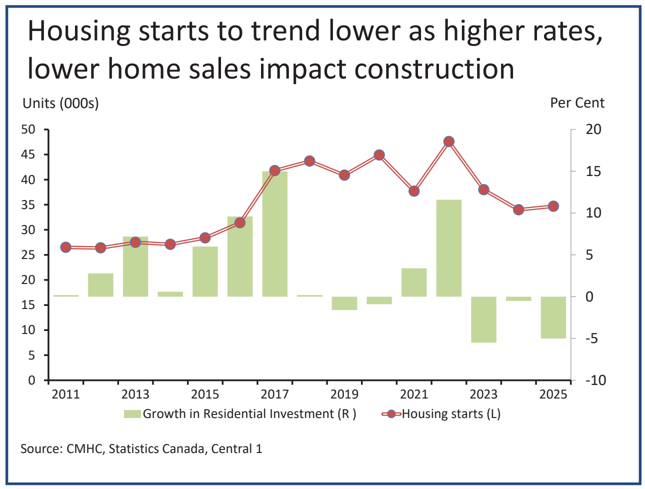
B.C.'s economy is expected to follow a similar trajectory. High debt loads and steeper housing market correction is anticipated to curb residential investment and consumption, but the tight labour market, robust population growth and still robust capital investment in public and private sector projects support growth. GDP growth is forecast to reach 3.2 per cent this year before slipping to 1.3 per cent in 2023. Growth climbs to 2.0 per cent in 2024 before accelerating further in 2025.

Decelerating growth is driven by the housing market slowdown. Fewer transactions and renovations slow short-term growth, while housing starts to decline into 2024. As many construction projects, specifically multi-family starts, are planned years in advance and have a long buildout period, a slowdown in new construction is a multi-year process. Household consumption is set to hold steady with positive demographic drivers tempered by the weak housing market and associated purchases. The rotation towards services- sector consumption is expected to continue due to pent up demand. Government contribution to growth, which picked up during the pandemic and fueled job creation, is expected to ease.

The capital investment cycle remains mixed. Firms are grappling with labour shortages and will look to productivity-enhancing investments while major project investments for both private and public projects remain supportive. That said, the construction cycle will slow as projects such as the Site C Dam and LNG Canada's liquefied natural gas terminal and pipeline should be completed by mid-decade. It remains to be seen if other projects can take up the baton.

Decelerated economic growth and elevated population growth is expected to contribute to a cooling of the labour market. Employment growth is forecast to climb at a rate near 1.0 per cent for both 2022 and 2023. Robust population growth, which spiked to 2.2 per cent on a July-over-July basis this year due to a surge in non-permanent residents, is expected to fall back but remain high at 1.5 per cent. Population supports demand in the economy but will also provide a much-





needed source of labour supply. B.C.'s unemployment rate is forecast to climb above 6.0 per cent in 2024 before easing in 2025. Wage growth is expected to decelerate to under 3.0 per cent in 2023 and 2024 from 4.0 per cent this year.

Inflation is forecast to decelerate to 2.6 per cent in 2023 from nearly 7.0 per cent in 2022, in line with broader trend and moves to 2.0 per cent in 2024. A slowdown in gross domestic income will largely flow through deceleration in corporate profits as labour markets and lagged impact of consumer inflation lift wages. Nominal GDP reaches 10.0 per cent this year and before ranging from 3.0-4.0 per cent in 2023 and 2024.

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B.C. Forecast Table

	2017	2018	2019	2020	2021	2022	2023	2024	2025
GDP at market prices	7	5.4	4.6	-0.5	16	10.7	3.8	4.2	3.7
Real GDP, expenditure-based	3.8	3.6	3.1	-3.4	6.2	3.2	1.3	2	2.2
Household consumption	4.8	3.3	1.5	-3.5	6	2.7	0.4	1.9	2.9
Government expenditure	2.2	3.2	2.4	1.1	4.3	1.1	1.5	1.6	1.6
Government capital formation	8.4	12.4	0.1	9.9	7.2	5.8	2.5	17.9	-13.7
Business capital formation	4.3	1.6	12.2	1.3	5.6	0.9	-2	-2.2	-1.6
Residential structures	0.2	-1.6	-0.9	3.4	11.6	-4.9	-5.6	-0.5	-5.4
Machinery and equipment	3.8	7.4	9.9	-21.4	10.4	6.5	2.1	4.5	3.9
Non-residential structures	12.9	0.1	40.6	10.6	-2.7	4.9	-1	-8.7	-0.1
Final domestic demand	4.2	3.2	3.6	-1.2	5.7	2	0.1	1.6	0.9
Exports	2.8	3.8	1.6	-9.7	7.1	2.7	1.7	2.8	5.2
Imports	5.2	3.6	3.4	-8	7.6	2.4	-0.4	1.5	1.8
Employment	4.1	1.4	3.0	-6.6	6.6	3.0	1.0	1.1	1.6
Unemployment rate (%)	5.2	4.7	4.7	8.9	6.5	5.3	5.9	6.3	6.1
Personal income	5.8	3.4	6.5	7.9	5.0	7.8	4.2	4.0	4.5
Disposable income	6.8	2.1	7.1	11.3	3.1	7.7	4.3	4.2	4.7
Net operating surplus: Corporations	18.6	1.5	-6.2	19.1	32.5	17.9	-5.5	0.2	1.4
CPI	2.1	2.7	2.3	0.8	2.8	6.9	2.6	1.8	1.8
Retail sales	9.3	1.9	0.6	1.3	14.6	3.0	1.6	2.6	3.7
Housing starts, 000s	43.7	40.9	44.9	37.7	47.6	37.6	37.9	34.0	34.7
Population Growth (%)	1.4	1.6	1.7	1.3	1.1	2.2	1.5	1.5	1.3
Key External Forecasts									
U.S. Real GDP	2.3	2.9	2.3	-3.4	5.2	1.5	0.7	1.8	2
Canada Real GDP	3.1	2.7	1.6	-5.6	4.9	3.2	0.9	1.9	2
European Union Real GDP	2.8	1.8	1.6	-6.5	5.3	1.5	1.1	2	1.8
China Real GDP	6.9	6.7	5.9	2.3	8.1	3	5.1	4.8	4.5
Japan Real GDP	1.7	0.6	-0.2	-4.5	1.6	2.4	2.3	1.5	1.2
Canada 3-month t-bill, %	0.71	1.4	1.66	0.42	0.13	2	3.6	3.3	2.7
Canada GoC long-term Bond, %	2.18	2.33	1.73	1.08	1.8	3	2.9	2.7	2.6
U.S.-Canada Exchange Rate, cents/dollar	77.05	77.16	75.37	74.56	79.88	76.92	75.19	78.12	80.00
Crude Oil WTI USD$ per barrel	50.88	64.94	56.98	39.23	68.00	90.00	80.00	85.00	85.00
Henry Hub Natural Gas Price, US$ per mmbtu	2.99	3.17	2.57	2.03	4.06	7.00	5.00	4.00	3.50