Economics | Forecast / Outlook Reports

Economic Analysis of British Columbia

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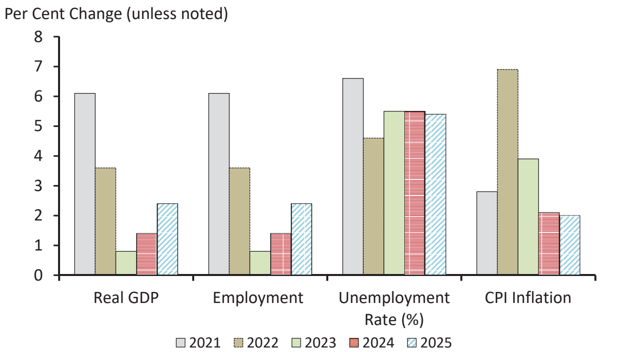
central 1 Economics

B.C. Economic Outlook 2023-2025

British Columbia's economy is forecast to slow this year in line with broader trends as the cumulative impacts of higher interest rates on consumer spending and business investment, and deterioration in the global economic environment weight. Provincial gross domestic product (GDP) growth is forecast to slow to 0.8 per cent which will lag national growth for the first time in a decade. That said, the initial conditions of a tight labour market, elevated savings, and support from major project construction activity will support growth for the year.

B.C. economy slows in 2023, lags national picture



Source: Statistics Canada, Central 1

Key macro themes

Economic themes have been volatile in 2023. Financial market turbulence has rate expectations flip from strong early year with higher than anticipated inflation and helped by China's re-opening. This was followed by banking sector woes with failure of several large regional banks and fears of contagion and an economic downturn which prematurely triggered rate cut expectations. The rapid response from the Fed and Treasury, and evidence that poor risk management, concentration risk, and portfolio duration were key drivers of the Silicon Valley Bank failure, eased market fears to shift focus back economic data and inflation.

While risks of a downturn from higher interest rates weighs and have triggered many calls for a recession, the economy has generally proven resilient and firmer inflation both in North America and markets like the United Kingdom is leading upward revisions to rate expectations. Rates are in our view more likely to stay elevated into 2024.

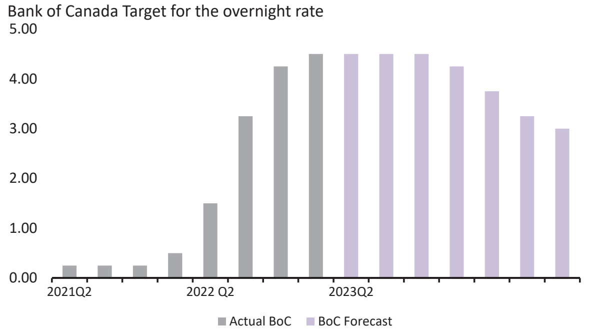
Indeed, the U.S. economy expanded by 2.6 per cent in Q4 and 1.3 per cent in Q1 due largely to weaker investment and inventory drawdown. While housing remains heavily constrained by higher interest rates, and the technology sector has stumbled badly, labour markets remain tight including another solid increase in non-farm payrolls in April of more than 250k jobs and an unemployment rate that dipped to 3.4 per cent. Inflation has accelerated and still sat at 4.9 per cent year-over-year in April. While the economy is still expected to slow in the back half this year, we expect the Fed to hold the Fed Funds rate target at the current range of 5.00 to 5.25 per cent through the duration of the year, with risk to the upside given inflation.

The Canadian economy has similarly been resilient. The economy expanded 3.6 per cent in 2022, an unexpectedly strong pace given the news flow surrounding recession risks, rapid interest rate gains and a housing market correction. Growth is anticipated to slow after a strong January performance and through most of 2023 as debt-sensitive Canadian absorb higher interest rates. Impacts of higher interest rates on variable rate mortgage have thus far been tempered in part by shifting of share of payments from principal repayment, but mortgage renewals are likely to boost payments for more borrowers going forward, while business investment slows. Housing construction will also decline in response to low resale transactions. We do not expect a significant recession in Canada, although GDP growth could turn mildly negative for a couple quarters. The labour market is expected to cool with slowing employment growth and a mild pick up in the unemployment rate.

The Bank of Canada's conditional policy rate pause at 4.5 per cent is forecast to continue through 2023 despite market pricing for a cut late in the year. Recent data suggest inflation will be harder to arrest than anticipated and at 4.4 per cent in April, it remained far too high. We expect the Bank to wait until a retreat to near the 2 per cent target to cut. Having been late hiking rates in the recent inflationary episode, it will be more cautious in its decision to cut rates particularly given the strength in labour markets. We forecast a cut in early 2024, and a 3.0 per cent policy rate by year end, before stabilizing at 2.5 per cent in 2025.

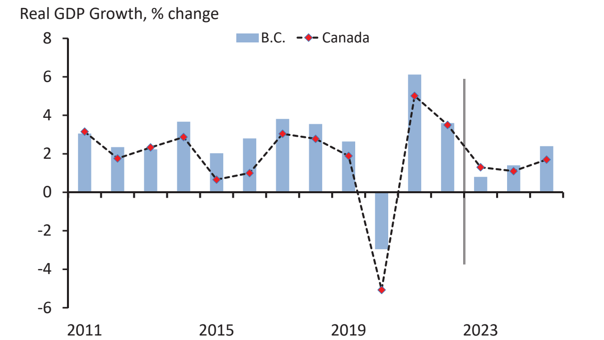
subway line) propelled engineering construction. In contrast, activity related to the existing home market soured and forestry retrenched.

Elevated policy interest rates to continues through 2023



Source: Bank of Canada, Central 1

Economic slowdown follows a decade of outperformance



Source Statistics Canada, Central 1

Consumer retrenchment to curb B.C. economic growth

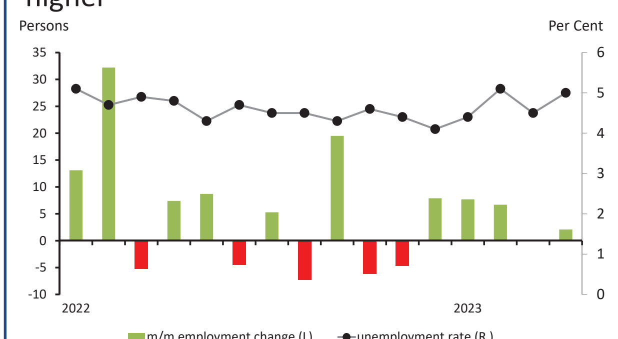
B.C. economic performance has been mixed since the latter stages of 2022 and into early 2023, pointing to a slowdown in activity as higher interest rates weigh on household finances and housing demand, while business uncertainty has increased with recession risk. Consumers are pushing on the brakes, the province's once high-flying technology sector have seen fortunes fade with substantial layoffs amidst broader industry weakness, and forestry has recessed with the U.S. housing downturn. At the same time, a tight labour market, high levels of accumulated consumer savings, continuation of major project construction, and strong population expansion have kept the economy steady.

These trends are expected to continue and contribute to a slowdown in annual GDP growth this year to 0.8 per cent. Notwithstanding the pandemic shock of 2020, this will mark the slowest pace of growth since 2001 and 2008 and lag the national growth for the first time in a decade. GDP growth rebounds to 1.4 per cent in 2024 as lower interest rates and population growth support growth, while exports gain traction thereafter with completion of liquefied natural gas projects and shipments to Asian markets commence.

That said, this slowdown follows a strong growth in recent years including 3.6 per cent in 2022 which matched the national average and 6.2 per cent in 2021 which led all large provinces. Employment growth in 2022 hit 3.1 per cent. Key industry drivers included ongoing recovery of hard-hit pandemic hospitality sectors, culture, and travel. Technology sectors, while contracting in the latter half posted robust growth, alongside other professional services, and the massive pipeline of major project activity (including liquefied gas terminals and pipelines, and the Broadway

Economic patterns have slowed. Hiring tracked an annualized pace of less than one per cent in the first quarter and driven by an increase in part-time work. Hiring demand from the public-sector continues to climb, but hiring of knowledge workers and construction and general private-sector has eased. While elevated job vacancies remain a constraint, a rise in unemployment rate to about 5.0 per cent suggests labour market conditions are loosening although wage growth remains elevated. Slower macro-economic conditions, consumer spending and business investment are expected to restrain hiring to 1 per cent, with a rebound to 1.5 and 1.7 per cent over the next two years. The unemployment rate is forecast to average around 5.5 per cent on stronger population.

Job growth slows, unemployment rate moves higher

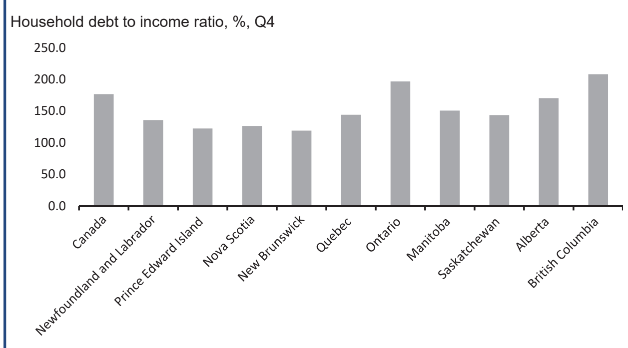


Source: Statistics Canada, Central 1

Inflation, interest rates a hex on consumer finances and construction trend

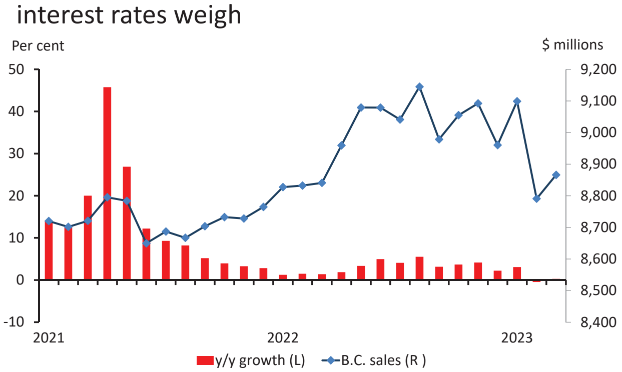
Consumers are expected to pull back, a pattern already reflected in sluggish nominal retail sales through much of 2022 and into 2023, with the latter tracking less than one per cent year-over-year. Households are feeling the pinch of inflation and last year's spike in interest rates. For the latter, the impact on B.C. households is greater than in other provinces due to higher debt loads from high home prices in the region and larger mortgage balances. B.C.'s debt-to- disposable income ratio at 207.1 per cent exceeds the national ratio of 176.1 per cent. Only Ontario is within spitting distance at 196.7 per cent. Revolving credit lines and variable mortgages are an increasing burden on households, which will only push debt-service-ratios higher over coming years as more fixed term mortgages renew. This stress is likely to intensify with Bank of Canada projections to increasing share of Canadian mortgage interest as a share of disposable income climbs through 2023 and to the highest level since the 1990s. High interest rates curb consumer demand but easing interest rates in 2024 and persistence of strong population growth accelerates spending in 2024 and 2025.

B.C. households acutely sensitive to higher rates due to elevated debt



Source: Statistics Canada, Central 1

Consumers curb spending as inflation and interest rates weigh



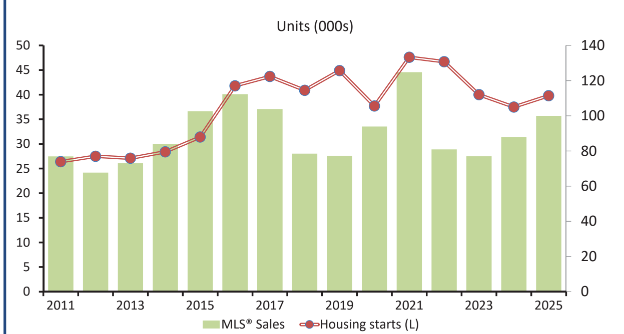
Source: Statistics Canada, Central 1

On the housing front, the existing home market was the first to adjust to higher interest rates, driving MLS® sales down 35 per cent in 2022 and prices down from their highs. However, there has been resilience this year with sales rebounding and prices firming during the spring market. Impatient buyers, adaptability to higher rates, and lack of listing has triggered more sales and willingness to meet seller price demands.

Nevertheless, affordability and high rates are a key impediment to a market turnaround, and we anticipate that home sales will remain at low levels until interest rates retreat and affordability is partly restored.

New housing construction is forecast to decline from 46.7k units in 2022 to 40k units this year, although the brisk start to the year has been surprising. Starts are forecast to fall to 36.7k units in 2024 before rebounding to 40k in 2025. Housing starts lag existing housing market conditions due to long lead times for multi-family projects. Low pre-sale activity in 2022 is a headwind to construction financing and more challenging economics for rental products contribute to the slide. However, this will only amplify the housing supply deficit, which according to CMHC could be close to 500k units at the end of the decade. This risks more upside for rent and home prices in coming years as demand outstrips construction and the sector struggles to play catch up in building more units.

Resilient housing construction to decline, lag resale market as interest rates bite



Source: CMHC, CREA, Central 1

Capital investment supportive through 2023, trade to soften

Outside consumer driven sectors, we anticipate a mixed performance with diverse drivers supporting the economy. Major project construction continues to support non-residential capital and building expenditures this year including work on the Site C dam, liquefied natural gas terminals and pipelines, alongside public projects including the subway line and hospitals. However, these drivers fall off in 2024 and into 2025 as construction peaks without any apparent projects of similar scale to take the baton. Businesses, like households feel the pinch of higher borrowing costs and softer demand, while still elevated wage costs will curb expansion.

Public-sector investment remains supported by hospital redevelopment across B.C. and general infrastructure. Moreover, provincial and federal government spending continues to grow reflecting population growth and a decision to run substantial deficits through the fiscal planning period.

B.C.'s robust export performance in 2022 was driven by a combination of economic expansion and still elevated commodity and general product prices. International goods exports jumped 20 per cent. However, exports are set to decelerate as the slowing global economy tempers demand for commodities and business investment. Forestry sector prices have collapsed since early 2022 driven by higher interest rates and a subsequent decline in U.S. housing starts and several mills have permanent shuttered or curtailed production which will have long-lived impacts on sector and export performance as capacity and prices are lower. Through the first quarter, forestry exports fell 26 per cent in nominal terms from a year ago. Energy has remained relatively stable, with strong sales among manufactured machinery and equipment. Exports also include services-oriented activities like tourism and associated spending. Travel has largely recovered from the pandemic, specifically from the U.S. while hotel occupancy rates sit at pre-pandemic peaks. Tourism is expected to rise but at a slower pace as the broader economy and consumers show more restraint. However, this could again support more domestic tourism from other province as Canadians curb international travel.

While economic trends slow, provincial population growth is forecast to remain at an elevated pace and support consumer spending and long-term housing demand. After swelling by 150,000 persons and a near 30-year high year high of 2.8 per cent in 2022, population growth is expected to remain above norms. Drivers of last year's increase, including a deluge of students, refugees and foreign workers are unlikely to repeat at the same magnitude but rising federal immigration targets will continue to fuel substantial inflows into B.C. and Vancouver specifically. This will amplify pressure on the housing markets, and rental market specifically pushing rents higher and contribute to sharply higher prices when interest rates decline.

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British Columbia Forecast Table - May 2023

	2021	2022	2023	2024	2025
GDP at market prices	14.2	9.8	3.7	3.8	4.4
Real GDP, expenditure-based	6.1	3.6	0.8	1.4	2.4
Household consumption	7.3	4.5	1.0	2.4	3.6
Government expenditure	7.9	1.7	2.6	2.2	1.7
Government capital formation	15.6	3.0	2.5	3.9	-1.6
Business capital formation	9.4	0.6	-2.0	-3.8	-2.8
Residential structures	14.6	-5.2	-8.1	1.9	2.4
Machinery and equipment	5.6	16.8	3.1	-0.9	-1.6
Non-residential structures	5.1	3.5	3.1	-12.2	-9.7
Final domestic demand	8.1	2.9	0.6	1.1	1.8
Exports	3.2	3.5	1.4	1.9	4
Imports	10.3	5.3	0.5	1.4	2.4
Employment	6.2	3.2	1.0	1.5	1.7
Unemployment rate (%)	6.6	4.6	5.5	5.5	5.4
Personal income	6.0	7.8	4.7	4.9	4.9
Disposable income	4.8	7.5	4.6	5.0	5
Net operating surplus: Corporations	26.3	1.1	-4.8	-3.5	7.8
CPI	2.8	6.9	3.9	2.1	2
Retail sales	12.6	3.7	-0.4	3.8	4.6
Housing starts, 000s	47.6	46.7	40.0	37.5	39.8
Population Growth (%)	0.9	2.2	2.6	1.6	1.6
MLS Sales (000s)	124.8	80.9	77.0	88.0	100.0
% ch	*32.9*	*-35.2*	*-4.7*	*14.3*	*13.6*
MLS Average Price (000s)	927.5	996.6	930.0	945.0	980.0
% ch	*18.7*	*7.5*	*-6.7*	*1.6*	*4.0*
Key External Forecasts					
U.S. Real GDP	5.7	2.1	1.2	1.2	1.8
Canada Real GDP	4.8	3.5	1.3	1.2	1.7
European Union Real GDP	5.3	3.5	1.0	1.5	1.5
China Real GDP	8.1	5.2	4.5	4.0	4.2
Japan Real GDP	2.2	1.0	1.3	1.0	0.9
Canada 3-month t-bill, %	0.13	2.40	4.30	3.20	2.7
Canada GoC long-term Bond, %	1.80	2.90	3.30	2.90	2.8
U.S.-Canada Exchange Rate, cents/dollar	79.8	76.8	75.0	78.0	80
Crude Oil WTI USD$ per barrel	68.0	95.0	75.0	75.0	75