

BC ECONOMIC REVIEW AND OUTLOOK



Q2 2017 (JUNE)

BC'S ECONOMIC MOMENTUM CARRIES ON

HIGHLIGHTS

- The outlook for the BC economy has been revised upwards from our first quarter projection, owing to sustained strength in the job market, robust consumer spending and a slight improvement in the global economic setting.
- That said, economic growth in BC is still expected to ease from the blistering 3.7% pace recorded in 2016 to 2.7% this year and 2.5% in 2018.
- The residential real estate sector remains buoyant in BC. While measures designed to temper demand (the Foreign Buyers' Tax and tighter mortgage lending rules) did have some temporary effect, sales remain at an elevated level and healthy demand is pushing prices up, particularly in the apartment and condo segment.
- Most of BC's export industries are expanding, aided in part by the still-low Loonie.
- Given the strength and momentum the BC economy has enjoyed over the past three years, there is some upside risk to our revised forecast. In particular, additional infrastructure and other large projects could provide an extra economic boost over the next two years.
- There is also downside risk to the outlook. The most significant is the future path of Canadian interest rates. Although we expect the Bank of Canada to move slowly, BC consumers are highly leveraged, and rising interest rates will increase mortgage and debt servicing costs. BC's wildfires also pose a growing risk to the economic outlook.

THE ECONOMY CONTINUES TO HUM ALONG

BC's economy remains healthy, with nearly all sectors contributing to the ongoing expansion. The momentum from last year is carrying forward more so than previously anticipated, prompting us to adjust our 2017 forecast upwards. Early in the year we were calling for real GDP growth of 2.2% in 2017, but strength in the job market, sustained gains in consumer spending, a still-strong housing market, and a more favourable global backdrop all point to another year of above average growth for BC. Accordingly,

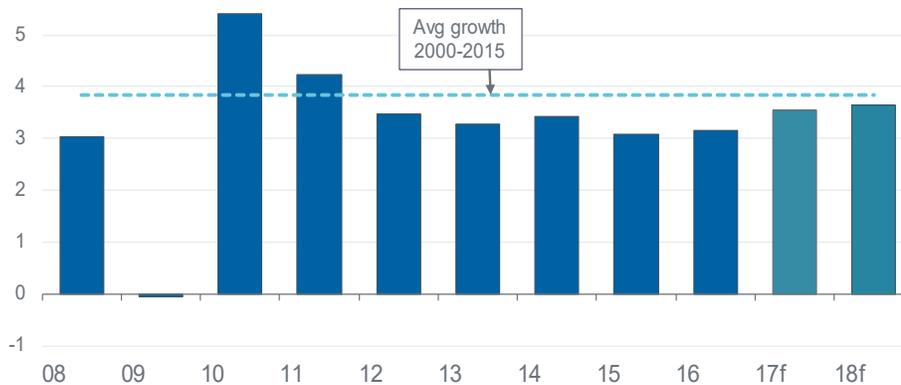
we now project that real GDP will increase by 2.7% in 2017. This still represents a downshift from last year's 3.7% expansion, but some easing is to be expected. If there is a lack of balance in the provincial economy, it is that a disproportionate amount of growth continues to flow from housing-related activity while business investment remains tepid.

GLOBAL ECONOMY PICKS UP

Amid a steady flow of generally positive economic news, the global economy continues to strengthen. According to the IMF's spring World

Economic Outlook, global growth is on track to reach 3.6% in 2017, a notable gain from 3.1% last year. The US economy is set to expand 2.3% this year, rising to 2.5% in 2018. This marks a significant improvement over last year's disappointing 1.6% growth rate. The brighter US economic picture reflects a pick up in the second half of 2016 driven by consumption growth and solid employment gains. Generally looser fiscal policy should also provide an economic lift, although there is uncertainty around the scope and impact of fiscal policy developments in the United States.

FIGURE 1: GLOBAL GDP GROWTH (%)



e = estimate f = forecast

Source: IMF World Economic Outlook, April 2017.

TABLE 1: GLOBAL ECONOMIC FORECAST (ANNUAL % CHANGE IN REAL GDP)

	2015	2016	2017f	2018f
World	3.2	3.1	3.5	3.6
US	2.6	1.6	2.3	2.5
Euro area*	2.0	1.7	1.7	1.6
Japan	1.2	1.0	1.2	0.6
China	6.9	6.7	6.6	6.2
Emerging market economies (all)	4.1	4.1	4.5	4.8

* 19 EU member states collectively f - forecast

Source: IMF, April 2017.

Even though the US recovery from the Great Recession has been underwhelming, a few points are worth noting. America's giant economy is now in its ninth year of expansion, making the current upswing the third longest since 1850. The level of output, or real GDP, is now 12% above the pre-recession peak. A pattern of persistently strong job growth suggests the US is now at or fast approaching full employment. Even though the expansion is getting long in the tooth, the broad array of positive indicators

suggests the US economy still has room to run.

Economic growth in China will likely continue to decelerate gently, reflecting the transition towards more domestic consumption and an increased orientation towards services. Chinese authorities have lowered the 2017 real GDP growth target to 6.5%, from the previous 6.5-7.0% range. The IMF expects the Chinese economy to grow 6.6% this year, before gearing down to 6.2% in 2018.

Meanwhile, stronger global demand has led to a firming of many commodity prices since early 2016, a shift that is benefitting Western Canada. Global oil markets remain choppy and subdued, however. And while North American lumber prices have ticked higher, for the BC industry this is tempered by the renewed softwood lumber trade dispute with the United States and the recent levying of penalty tariffs by the US government.

SURPRISE: CANADA COULD LEAD THE G7 ECONOMIES

The brighter global backdrop is good news for Canada and supports the improved near-term economic outlook. Canada's economy surged ahead in the first quarter of the year, growing at an annualized 3.7% pace. Much of this momentum has continued into the second quarter, leading forecasters to revise their outlook upwards. The current consensus view is that Canadian output will grow by 2.6% this year, followed by 1.9% in 2018. It now looks conceivable that Canada could top the G7 growth rankings this year. For the Bank of Canada, this implies that the economy is moving closer to operating at capacity. Although inflation is hovering below the Bank of Canada's 2% target, upbeat economic indicators signal that interest rate hikes are now within sight. Indeed, the Governor of the Bank of Canada and his deputies have hinted that the Bank will be looking to raise its trend-setting policy rate soon. Markets are now pricing in a greater than 50% chance of a rate increase in July. Just a few months back, most pundits expected the Bank to remain on hold until mid-2018.

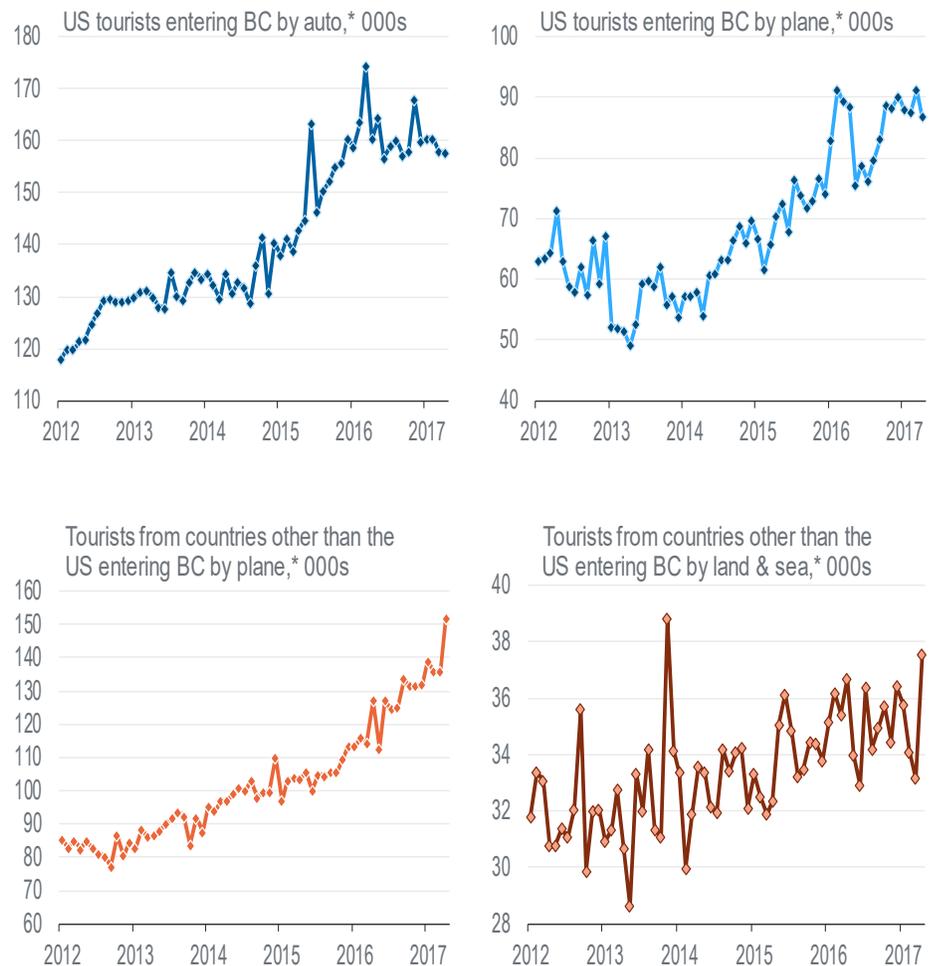
Even though oil prices are below US\$50, stronger Canadian growth and the increased likelihood that interest rates are heading higher have pushed the Loonie up relative to the US dollar. There is scope for the Loonie to climb further, but we see it staying below 78 US cents, which is still positive for BC's exports.

BC EXPANSION HELPED BY EXPORT SECTOR

Boosted by a weak Loonie and generally higher commodity prices, BC's merchandise exports reached nearly \$40 billion last year, putting them into record territory. We expect further gains in 2017. However, the pace of export growth is likely to cool. One reason is that even though US housing starts continue to grind higher and lumber prices are at healthy levels, the outlook for BC wood product exports is clouded by the imposition of US countervailing and anti-dumping duties on softwood lumber products imported from Canada. With lumber accounting for 17-18% of BC's merchandise exports, troubles in the lumber business will act as a drag on BC's growth over the next 12 months. Gains in other sectors such as agricultural products will also be more modest, as much of the realignment to a more competitively priced Canadian dollar has already occurred.

Other BC export segments are also benefitting from a low dollar. Tourism is an area of particular strength, with the total number of foreign tourists rising by 12% last year. BC saw big jumps in the number of tourists flying in from the US as well as in visitors from Asia and Europe.

FIGURE 2: TOURISM ACTIVITY HIGHER



Source: Statistics Canada. *seasonally adjusted.

But the number of US visitors, particularly those coming by auto, has already levelled off, suggesting that overall growth in tourism activity is likely to moderate somewhat in 2017-18.

BC's film and television production sector is also booming. In addition to a long and growing list of productions and the fact that studios are running at capacity, the sector has seen a steep rise in employment.

In 2012, there were an estimated 8,300 people working directly in the Motion Picture and Sound Recording Industry. By 2016 the figure had risen to 22,300. The competitive exchange rate has also bolstered BC's exports of tradable business services such as engineering, finance, and architectural and environmental services.

FIGURE 3: **HEALTHY JOB MARKET IN BC**



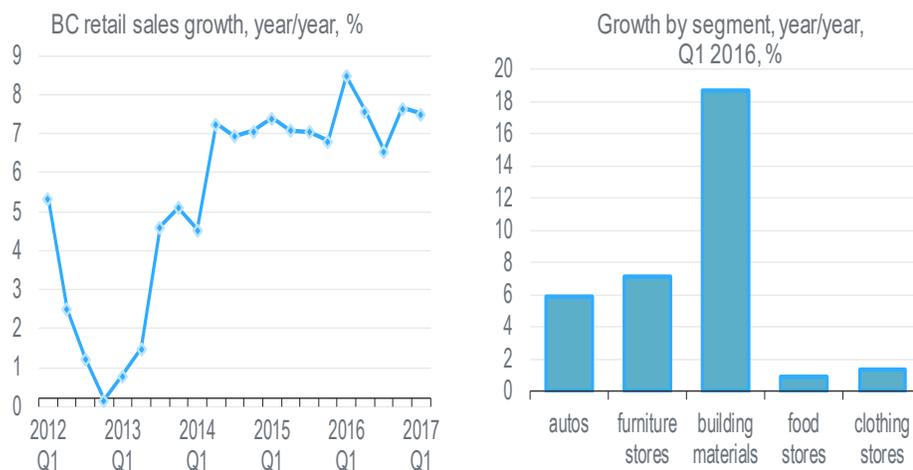
Source: Statistics Canada, LFS.

Kootenay region is up more than 11% year-over-year, and the number of people working on Vancouver Island is up 7%. The province's job market is healthy overall, with rising employment lending support to consumption and helping to sustain the multi-year upswing in the housing market.

CONSUMER SPENDING ALSO DEFIES EXPECTATIONS

A big part of BC's economic growth story lies with the consumer. British Columbians have been out spending in stores, purchasing services in greater volumes and buying cars. Last year, retail sales advanced by 7.4%. And so far this year, the consumer's appetite to spend has held up, with retail sales rising by more than 7%. Most segments of the retail landscape have enjoyed gains, but sectors linked to residential housing have benefitted from especially brisk growth. Sales at building supply and gardening material stores posted an annualized gain of 19% in the first quarter of 2017. Furniture and appliance stores have also enjoyed robust sales growth (up 7%).

FIGURE 4: **RETAIL SPENDING GROWTH REMAINS ELEVATED**



Source: Statistics Canada.

JOB MARKET DEFIES EXPECTATIONS

The principal reason we have upgraded our outlook for 2017 lies in the domestic side of the BC economy, which is stronger than anticipated back in February. Within this context, the labour market is especially important.

BC's job market has defied expectations, with employment

growth picking up in the first part of 2017 after a red hot 2016. Total employment was up 3.6% in the first quarter, an acceleration from the already robust 3.1% increase seen in 2016. Moreover, job growth hit a twenty-three year high of 4.1% in the second quarter. Encouragingly, job creation is now spread across most of the province, instead of being overwhelmingly concentrated in the lower mainland. Employment in the

Prolific spending in dining and drinking establishments is another sign that BC consumers are feeling optimistic (of course, more than a few may be drinking away their sorrows). Sales in food service and drinking places rose by more than 10% in 2016, the biggest increase on record. Here, tourism is playing a role. However, BC consumers account for the majority of sales in the food service industry. Against the backdrop of above average job creation, modest population growth

Efforts to curb activity in the housing market, including the Foreign Buyers' Tax in Metro Vancouver and a tightening of federal mortgage insurance rules, did dampen sales, but it now appears that these policies have had only a mild impact on demand.

and a healthy tourism sector, we expect food service sales to stay on an upward trajectory through 2017.

The fact that homeowners in much of the province have seen steep increases in the price of their homes (leading to higher net worth) is also supporting consumer spending. Many homeowners are accessing the equity in their homes to finance renovations, remodelling, and the purchase of new automobiles. Others are just feeling wealthier and may be adjusting their spending habits accordingly.

HOUSING MARKET STILL GOING STRONG

Efforts to curb activity in the housing market, including the Foreign Buyers' Tax in Metro Vancouver and a tightening of federal mortgage insurance rules, did dampen sales, but it now appears that these policies have had only a mild impact on demand. While down considerably from 2016's record levels, home sales are still running well above their long-term average. The BC Home Partnership Plan introduced by the outgoing Liberal government likely provided a boost

to the entry-level market, notably for condos/apartments. However, the fact that prices for single family homes are increasingly out of reach for most people looking to get into the market is likely a bigger factor behind greater demand for attached housing. Although sales volumes have slowed from last year's record pace, the Greater Vancouver Real Estate Board reports that sales in June were still 15% above the 10-year average for that month. The picture is similar in the Fraser Valley, where sales activity is down 7% from year ago levels but with sales in May 2017 still the second highest on record.

The shift in demand to more affordable condos and apartments is evident in upward pressure on prices: prices for townhomes and apartments in Greater Vancouver are up 11% and 18%, respectively, from one year ago. Prices for single family homes in the Fraser Valley are up 7.4%, while townhomes and apartments are up 16% and 23% respectively.

New home construction, which has

made an outsized contribution to BC's economic expansion in recent years, remains at an elevated level. The number of housing starts dipped in the first quarter, but is on track to reach 47,000 units (annualized) in Q2, one of the busiest quarters on record. For 2017 as a whole, we now expect housing starts province-wide to come in at 39,000 units.

INFRASTRUCTURE PROJECTS

There are a number of large infrastructure projects underway or slated to begin that will have a material impact on BC's growth prospects over the next few years. For this quarterly outlook, we are assuming that construction of BC Hydro's Site C dam will continue and the Massey bridge project will also advance. We are also assuming the TransMountain pipeline will proceed, with the economic impact from the project materializing in 2018 and beyond. With respect to LNG, construction of the Woodfibre plant near Squamish is assumed

TABLE 2: **BC ECONOMIC OUTLOOK (ANNUAL % CHANGE UNLESS OTHERWISE INDICATED)**

	2015	2016	2017f	2018f
Real GDP	3.3	3.7	2.7	2.5
Employment	1.2	3.1	3.2	2.0
Unemployment rate (%)	6.2	6.0	5.7	5.6
Housing Starts (000 units)	31.4	41.8	39.0	38.0
Retail sales	6.4	7.4	7.0	6.5
BC CPI	1.1	1.8	1.9	2.0

f - forecast

Source: Statistics Canada and BC Stats; BCBC for forecasts.

to commence within the current forecast horizon, but we have no other large LNG projects built into the revised forecast.

CONCLUDING THOUGHTS

The BC economy is on a solid footing and will continue to expand at an above average pace in both 2017 and 2018. The province is benefitting from better external economic circumstances, which include higher commodity prices. But the domestic side of the economy is especially strong. Given impressive job growth and potential for additional large projects (LNG and additional infrastructure), there is some upside risk to our current projection. The main downside risk is the pace at which interest rates and borrowing costs will be increasing, with higher rates likely to take some of the froth out of the residential real estate sector.

The current wildfires are also a risk to the outlook. Fires burning in BC have already caused extensive damage, displaced thousands of people from their homes, and led to the closing of a number of wood production facilities. If the fire season continues to escalate in the province, it could have a material impact on the provincial economy beyond the local devastation and tragedy.

There is also some difficult-to-quantify political risk to the BC forecast. Anytime a new government arrives in office, some policy changes can be expected. British Columbia's incoming NDP government will have a razor thin majority in the Legislature, which may limit its ability to implement new legislation. However, spending commitments

A CLOSER LOOK AT BC'S HOT JOB MARKET

A primary reason for the underlying strength in BC's job market is that employment growth is diverse, with most industries adding to payrolls. At the same time, many of the fastest growing sectors have been adding jobs at a record pace.

At a high level, the signs of this diversity are evident in the fact that employment has increased in both the goods producing sector and the services sector. The number of people working in goods producing industries grew 2.4% last year, with the number of services sector jobs advancing by 3.4%. Note, however, because the services sector is much larger and grew more quickly, the majority of new jobs created in BC last year were in service industries: in absolute terms, employment in all of the goods industries rose 11,000, while 62,000 jobs were created in the services sector.

The benefits of the lower Loonie are apparent in the job numbers.

- The film and television sector recorded the strongest job growth of any industry in BC last year. The number of people working directly in the industry jumped by an astonishing 55% in 2016.
- Food manufacturing employment increased by 11%, with the industry now employing almost 30,000 British Columbians.
- The Machinery manufacturing sector posted a 29% gain in employment, with most of the new jobs linked to an expansion of exports.
- Computer and electronic product manufacturing added 12.5% more jobs last year.
- Miscellaneous manufacturing (manufacturing jobs not classified in other industries) grew by 9% last year.
- Employment in electrical equipment and appliance component manufacturing grew by 11% in 2016, driven by exports as well as rising domestic consumption.

BC's ongoing residential housing boom has also helped to fuel strong job growth.

- The number of people working in the real estate industry grew by 8% in 2016. Although this covers all parts of the real estate industry, the residential segment is a key driver of this gain.
- Strong growth in construction jobs is reflected in the 7% increase in employment in the Trade Contracting industry. With this category, it is not possible to distinguish between residential and non-residential construction, but given the record number of housing starts it is clear that the residential segment was clearly the main contributor to new construction jobs.

And the real estate boom shows up in the retail and wholesale space as well...

- Employment in the Building Materials and Garden Supplies segment of the retail sector advanced 12% in 2016 (it has posted above average annual job growth of 4% over the past three years).
- Employment in Wholesaling and Distribution of Building Materials rose by 9%.
- Employment in Consumer Electronics and Appliance Stores jumped 13% last year.
- Wholesaling of Motor Vehicles and Parts was a top job growth industry last year, reflecting both robust overall consumer spending and the wealth effect of rising home prices.

General services and consumption spending has also contributed to BC's strong job growth.

- Employment in the Building Services industry rose by an impressive 30% last year. The Building Services Industry captures people working in industries involved in the care and maintenance of buildings (janitorial services, window cleaning, landscaping services, carpet cleaning and so on).

as laid out in the NDP platform, if fully implemented, may negatively impact the government's fiscal health over time. This, combined with looming changes in tax policy, and in the regulatory regimes affecting labour markets and natural resource industries, could affect business confidence and investment, and thus have a dampening effect on economic growth. The same may be true if the new government takes steps to halt or slow major project development in the energy and transportation sectors. On the other hand, certain elements in the NDP's policy platform, such as a major increase in the stock of rental housing and an expected jump in total government spending, should provide an economic lift in the next few years. We will wait for the new government's Throne Speech and budget before making any adjustments to our economic forecast.

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- Employment in the Security Services industry increased by 9% in 2016.
- The number of people working in the Repair and Maintenance industry rose by 11% (this captures automotive repairs, repairs of household and personal items and maintenance of machinery and equipment).
- Employment in the Performing Arts, Spectator Sports, etc. jumped 20%.

A number of industries classified broadly as professional services have also experienced strong job growth over the past few years. Most of these industries sell services domestically and so are benefitting from the healthy domestic economy, but some are selling their services in foreign markets as well.

- The number of people working in the Legal Services industry grew by 17% in 2016.
- The Accountants and Preparation Industry grew by 16%.
- Employment in Architectural, Engineering and Design Services grew 10% in 2016. Here, both the domestic and foreign markets have been drivers of demand for additional workers.
- Other Professional Services had the second fastest job growth (up 32% in 2016). This grouping captures specialized design services (interior design and computer graphics) as well as veterinary services, photography services, and marketing services.
- Employment in Other Schools rose 9%. This industry category captures technical training, language schools and computer training.

BC EMPLOYMENT GROWTH: 25 FASTEST GROWING INDUSTRIES*

		2016 growth, %	2016 # people employed, 000s
1	Motion Picture and Sound Recording Industries	54.9	22.3
2	Other Professional Services	32.1	14.4
3	Building Services	29.6	49.0
4	Machinery Manufacturing	29.1	10.2
5	Securities, Commodity Contracts & Other Intermediation	22.2	21.5
6	Performing Arts, Spectator Sports and Related	19.3	19.8
7	Legal Services	17.6	24.7
8	Accounting and Tax Preparation	16.4	26.2
9	Mining (except Oil and Gas)	13.7	16.6
10	Personal & Household Goods Wholesaler-Distributors	12.6	9.8
11	Electronics and Appliance Stores	12.5	13.5
12	Computer and Electronic Product Manufacturing	12.5	8.1
13	Building Material & Garden Equipment & Supplies Dealers	12.3	19.2
14	Motor Vehicle and Parts Wholesaler-Distributors	12.1	6.5
15	Electrical Equipment, Appliance & Component Mfg	11.1	4.0
16	Food Manufacturing	10.9	29.5
17	Repair and Maintenance	10.8	31.9
18	Architectural, Engineering & Design Services	10.3	55.6
19	Building Material and Supplies Wholesaler-Distributors	9.2	15.4
20	Miscellaneous Manufacturing	9.0	10.9
21	Crop Production	8.9	13.5
22	Other Schools and Educational Support	8.8	28.3
23	Security Services	8.7	18.7
24	Real Estate	8.3	39.3
25	Trade Contracting	7.3	121.5

* The jobs noted represent 25% of all jobs in British Columbia.