BUSINESS ALERT

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BUCKLE UP: TURBULENCE AT HOME AND ABROAD PROMPTS A DOWNGRADE TO ECONOMIC OUTLOOK

HIGHLIGHTS

- Over the past month, blockades of transport infrastructure across Canada and the global COVID-19 outbreak have emerged as significant negative shocks. These developments have prompted us to downgrade our economic growth forecasts for Canada and B.C.
- BCBC now expects Canadian GDP growth to be 1.1% in 2020, down half a percentage point from our February update. The domestic blockades will subtract 0.2 percentage points (pp) and the impact of the COVID-19 outbreak will subtract a further 0.3pp.
- BCBC has also downgraded its 2020 provincial GDP growth forecast by 0.6pp. We now expect the B.C. economy to grow in the 1.3-1.5% range this year, with the domestic blockades trimming 0.1pp and the COVID-19 impact subtracting a further 0.5pp.
- The air transportation industry and tourism and hospitality will be especially hard hit and will take longer to recover. Shipping and goods flow have also fallen sharply, impacting supply chains and activity in B.C.'s ports. Exports will also slip as the global economy slows.
- B.C.'s outlook is downgraded more than Canada's because our province is more interconnected with China and Asia. The tourism, transport and logistics sectors are also larger proportions of the B.C. economy.
- Our base case assumptions are that the COVID-19 outbreak subsides by 2020Q2 and that intermittent transport blockades do not become a regular part of economic life in Canada. However, the risks to our outlook are weighted to the downside.

Since the Business Council's last economic update, new information has emerged regarding the COVID-19 outbreak (**Table 1**) and its economic impact. In addition, Canada has faced disruptions in key segments of the nation's transportation infrastructure that are weighing on the economy. Both developments have caused us to recalibrate our economic forecast for 2020-21.

There are currently over 100,000 COVID-19 cases globally, mostly in China but with the virus spreading

TABLE 1: **TIMELINE OF THE COVID-19 OUTBREAK**

Data	Event
31 Dec 2019	A pneumonia-like virus of unknown origin detected in Wuhan, China, is reported to the World Health Organization (WHO) country office in China
30 Jan 2020	WHO declares a "Public Health Emergency of International Concern"
11 Feb 2020	WHO names the new coronavirus disease 2019-nCoV ("COVID-19")

Source: World Health Organization (WHO)

to many other countries. Of these, to date around 55,000 patients have recovered while over 3,400 have died (**Table 2**). In addition to the human toll, the outbreak is causing significant disruption to global supply chains, tourism and retail activity, financial markets and business and consumer confidence. Countries for whom China is a major market or supplier appear to be particularly affected (e.g. Japan, Korea and Australia).

TABLE 2: **COVID-19 STATISTICS AS OF MARCH 6, 2020**

Rank (# of cases)	Country	Confirmed cases	Deaths	Recovered
1	China	80,573	3,042	53,888
2	South Korea	6,593	42	135
3	Iran	4,747	124	913
4	Italy	4,636	197	523
5	Others	696	6	40
6	Germany	670	Unknown	17
7	France	577	9	12
…	…	…	…	…
24	Canada	48	0	6 *(of which 3 in B.C.)*
	TOTAL	**101,583**	**3,460**	**55,863**

Source: John Hopkins CSSE

TABLE 3: **GLOBAL ECONOMIC FORECAST**

Region	**Table 3: Global Economic Forecast** annual % change in real GDP		
	2019	**2020f**	**2021f**
World	2.9	2.4	3.3
U.S.	2.3	1.9	2.1
Euro area	1.2	0.8	1.2
Japan	0.7	0.2	0.7
China	6.1	4.9	6.4
Canada	1.6	1.1	2.2

Source: OECD Interim Economic Outlook; BCBC (for Canada)

GLOBAL ECONOMY TAKES A HIT

COVID-19 appears to be the most serious threat to the world economy since the global financial crisis of 2008-09. On March 2, the OECD took the unusual step of issuing an interim economic outlook. Their base case assumption is that the epidemic peaks in China in the first quarter of 2020 and that outbreaks in other countries are mild and contained by mid-year. As shown in **Table 3**, this scenario would see world GDP growth drop to 2.4% in 2020, or 0.5 percentage points (pp) lower than their previous forecast (November), before rebounding to 3.3% in 2021 (0.3pp higher than previously forecast). However, if the epidemic spreads more widely, they estimate global growth could drop as low as 1½% in 2020.

The economic implications of COVID-19 have the attention of central bankers. On March 2, the U.S. Federal Reserve implemented an "emergency" interest rate cut of 50 basis points. The Bank of Canada followed the next day, also cutting its policy rate by 50 basis points. Market interest rates also headed lower. Earlier this week, the U.S. 10-year bond yield fell below 1% for the first time ever, reflecting growing fears and uncertainty about future economic growth. The U.S. 10-year bond yield is now 0.9%, compared to 3.2% in late 2018.

CANADIAN OUTLOOK ALSO DIMS

Going into 2020, the Canadian economy was already struggling under the weight of its structural problems. GDP was barely growing at all in per capita terms. Productivity

[1] Statistics Canada, Table 36-10-0222-01 (measured in current dollars).

growth was making its smallest contribution to overall GDP growth since the 1980s. Capital intensity across the business sector was falling. Canada continues to lose global market share across many of the traded industries that make up the export economy. And Canada has become the 7th most indebted country in the world, with the combined debt of corporations, households and governments sitting at 302% of GDP. Unfortunately, the picture has deteriorated even more in recent weeks.

BCBC now expects the Canadian economy to grow by a meagre 1.1% in 2020, down 0.5pp from our last update. The Canadian economy has been hit by two major shocks in as many months: one internal, in the form of widespread blockades of transport infrastructure in parts of the country; and one external, in the form of COVID-19. We expect the domestic blockades – assuming they end soon - will subtract 0.2pp from Canadian GDP growth in 2020 (including confidence effects). The impact of the COVID-19 virus on the global economy will subtract a further 0.3pp from Canadian growth in 2020, which is in line with the OECD's base case.

Assuming the COVID-19 outbreak subsides sometime in the second quarter of 2020, and that intermittent transport blockades do not become a regular part of economic life in Canada, BCBC expects Canadian GDP growth to recover to 2.2% in 2021. This rebound is partly arithmetic as production returns to, or close to, previous levels.

The risks to the Canadian outlook are firmly weighted to the downside, however. The COVID-19 outbreak could become more widespread, disruptive and persistent globally and in North America. Due to very high levels of debt relative to GDP across all sectors (i.e. corporations, households and governments), Canada is also exposed to global financial shocks caused by COVID-19. Finally, on the domestic front, the service outages, layoffs and uncertainty caused by intermittent blockades of major infrastructure, as well as the ongoing political uncertainty about whether major natural resource and infrastructure projects can proceed, could have long-lasting negative effects on Canada's potential GDP growth rate and discourage inward investment and capital formation in several major industries for years to come.

TABLE 4: **B.C. ECONOMIC FORECAST UPDATE**

	Table 4: B.C. Economic Forecast update annual % change in real GDP		
	2019e	**2020f**	**2021f**
First quarter outlook (January)	1.8	2.0	2.3
Updated forecast (March)	1.8	1.3 – 1.5	2.5 – 2.7

Source: Business Council of British Columbia

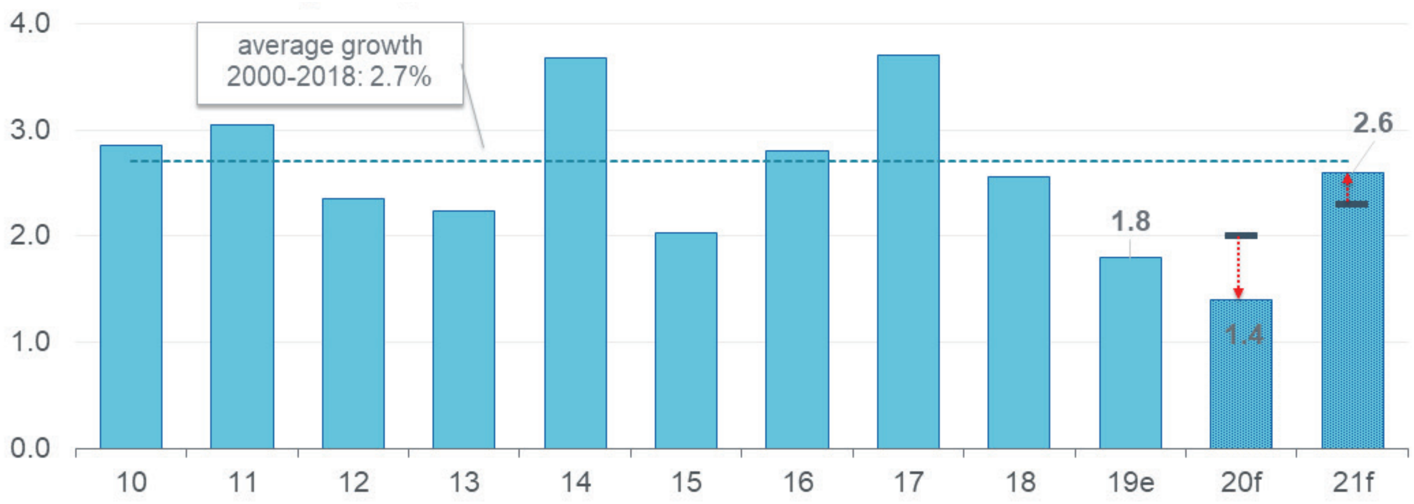
THE ECONOMIC PICTURE IN B.C.

In our first Q1 *B.C. Economic Review and Outlook* publication, we forecast that the B.C. economy would grow by 2% in 2020. While this marked a downgrade from our earlier outlook amid a general softening in economic conditions, we went on to say that several positive factors suggested that economic growth in B.C. was unlikely to fall below 2%.

> "Population growth, the stabilization of the residential real estate market after two years of turbulence and price drops, buoyant non-residential construction, a list of sizable engineering projects, the fall in mortgage interest rates – given these factors, it is hard to imagine real GDP growth falling much below 2%, short of a major slump."

The equivalent of a "major slump," or at least a "slump" large enough to dampen B.C.'s growth outlook significantly, has arrived. The combined impact of COVID-19 and the blockades is prompting us to scale back our forecast for B.C. economic growth to 1.3-1.5% for 2020. This marks roughly a 0.6pp reduction from what we foresaw in January. In line with the OECD's base case scenario outlined above, as the virus recovery process unfolds later this year some sectors of the province's economy will rebound. And as the recovery broadens in 2021, we would expect overall

FIGURE 1: **B.C. REAL GDP GROWTH PERCENTAGE**



Source: Statistics Canada, BCBC Forecasts. Forecasts shown are the midpoints of ranges from the forecast table.

FIGURE 2: **INTERNATIONAL TRAVELLERS ENTERING B.C. BY PLANE, SEASONALLY ADJUSTED, 000s**

Source: Statistics Canada, Table 24-10-0005-01 economic growth to be between two- and four-tenths of a point stronger next year.

THE IMPACT OF RECENT SHOCKS ON THE B.C. ECONOMY: SOME CONTEXT

The transport infrastructure blockades linked to opposition by some groups to the Coastal Gas Link Pipeline have caused significant economic disruptions, including a blockade near Hazelton, stopping CN rail traffic between Prince George and Prince Rupert, and blocked CN rail lines in East Vancouver, crippling the movement of container traffic for several days. The impact of these disruptions has been most keenly felt in B.C.'s large transportation and logistics sector, but supply chains, production activity and exporters' ability to ship products to markets have also been affected. Other provinces have also been impacted. For B.C., the blockades are assumed to have reduced annual GDP growth by 0.1-0.2pp in 2020.

COVID-19 has much broader implications. The drop in consumer demand, the fall-off in air travel and the closure of factories in China are all being felt in Canada and B.C. Global shipping activity has dropped sharply – a very bearish development for near-term economic growth.

The province's tourism and air transportation sectors will be hard hit by the fast spreading coronavirus. Flight bans and cancelled flights have already hurt the air transportation industry. Global Affairs is urging Canadians to avoid all non-essential travel to China and to avoid all travel to Iran. Air Canada's daily services to Shanghai and Beijing from Vancouver, Montreal and Toronto were suspended through February, according to the airline. Additional cancelations of flights to Asian destinations are likely. And demand will be further dampened as more people cancel or postpone travel plans, including those intending to come to B.C. from Asia.

While there are important differences between the two viruses, looking back on the SARS (Severe Acute Respiratory Syndrome) experience may provide some insight into how the coronavirus will affect air travel and tourism in B.C. Back in 2003, the SARS outbreak led to a precipitous drop in tourism activity and business travel to the province. As the figure below shows, the number of visitors from the U.S. held up, but the number coming from all other countries dropped from more than 90,000 to below 60,000 over a month or two. The decline was driven by dramatic fall in travellers from Asia. It took about six months for travel activity into B.C. to recover. With COVID-19, the number of travellers from Asia will also slump, but travel from Europe and the U.S. may also be affected given the world-wide scope of the outbreak.

In the year of the SARS outbreak, economic output in the air transportation industry tumbled by 11%. But the sector experienced a sharp rebound the following year. Largely as a result of the drop in tourism activity related to SARS, the economic output on the accommodation industry in B.C. decreased by 2% in 2003. This industry also enjoyed a rebound in 2004 with growth surging by more than 9%.

In thinking about the economic impact of COVID-19, it is necessary to recognize that China – the epicentre of the virus – is today a much bigger economy, accounting for more than 15% of global GDP. China is also a far more significant tourism market for B.C. than it was in 2003. China now accounts for 12% of total tourism expenditures in B.C.[1] Add in South Korea and Japan, and these three countries together represent upwards of 17% of all B.C. tourism revenue.

Apart from tourism, B.C.'s exporters of goods are also being hurt by sagging consumer demand in foreign markets as well as reduced demand for commodities and raw materials as manufacturing in Asia contracts. In the early days of the outbreak, exports of fresh agriculture and seafood products to China dropped sharply. Other resource sectors are also seeing reduced demand stemming from factory closures and lower production activity in China, South Korea and now Japan. China is B.C.'s second largest export market, purchasing about 15% of the province's international merchandise exports. The associated drop in bulk and container shipping activity will be felt across the province's ports and the related transportation logistics sector.

[1] Statistics Canada, Table 24-10-0005-01

SUMMARY THOUGHTS

The potential impact of the COVID-19 virus is difficult to gauge because the situation is evolving rapidly. Our operating or base case scenario sees the outbreak in China being contained and its economy returning to near normal operating capacity by the end of the second quarter. In other regions of the world where the virus has taken hold, community transmission will likely continue, but as with China we assume that the spread of the virus will be contained well before year-end. Even with this relatively optimistic scenario, we believe economic activity in key global markets will be weaker than previously expected into the third quarter. Global supply chains should begin to gradually rebalance in the second half of the year. But the recovery in the tourism, hospitality and air travel sectors will be slower.

The emergence of a less favourable economic backdrop, because of the coronavirus and Canada's home-grown infrastructure disruptions, has implications for governments, including the federal government as it works to finalize its 2020 budget. Now more than ever, policymakers need to be focused on bolstering business confidence, encouraging investment in Canada, reducing uncertainty, and improving the country's faltering global competitiveness. For the federal government, this argues strongly against any new measures that lead to higher tax and regulatory costs for Canadian businesses. Instead, Ottawa should be taking action to reduce costs for business and lighten what in many Canadian industries has become a crippling regulatory burden. The federal government must also do what it can to address the erosion of confidence in Canada that is evident among investors, global corporations and customers all over the world.

In the coming weeks, BCBC staff will be closely monitoring the spread of COVID-19 and the effectiveness of containment efforts. We will also track new data relating to travel, shipping and other transportation activity along with B.C.'s international exports. We intend to update our forecast for the province in the next edition of our quarterly *B.C. Economic Review and Outlook* publication.

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