B.C. ECONOMIC REVIEW AND OUTLOOK

Business Council of British Columbia
Est. 1966

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REAL INCOMES CONTINUE TO FALL IN CANADA AND B.C.

HIGHLIGHTS

- Global GDP growth is expected to cool from 7.1% and 3.6% in 2021 and 2022, respectively, to just 1.9% in 2023 and 2.4% in 2024. Runaway inflation over the past 18 months across most advanced countries, including Canada, indicates significant excess demand for goods, services and labour. Central banks are belatedly trying to bring demand into balance with supply, with only partial support from fiscal policymakers.
- Amid higher interest rates, Canada's GDP growth is projected to slow to 1.0% in 2023 and 1.8% in 2024. Looking through the veneer of population growth, Canada is one of the few advanced countries not to have recovered its pre-pandemic level of GDP per capita, the primary measure of prosperity.
- Whilst Canada may dodge a recession in GDP due to booming population growth, GDP per capita could fall by around 1-3% in 2023. In other words, the real per person incomes of households and businesses, which have declined since 2019, will likely fall further in 2023.
- B.C. will also likely dodge an outright recession, but GDP growth will slow to just 0.9% in 2023 and 1.5% in 2024.
- Hiring challenges will persist in some sectors, but labour demand overall will downshift as the economy slows.
- Population growth underpins most of the province's economic expansion as the global economic slowdown weighs on B.C. exports and domestic economic activity slows under the weight of higher interest rates. A notable exception is non-residential construction, boosted by record investment in non-residential buildings in the public sector and sustained by ongoing construction of large capital projects in B.C.'s energy sector.
- Structural challenges, including chronically weak investment in machinery and equipment, mean B.C. is heading into the slowdown on a weak footing. Many of B.C.'s high-productivity, high-paying sectors have shed jobs over the past five years. The global slowdown will reinforce this trend. Job growth in the private sector has been weak for the past few years and is underpinned by a handful of industries, while public sector hiring has been exuberant.

CENTRAL BANKS (FINALLY) TAKE UP ARMS AGAINST THE INFLATION DRAGON

As GDP growth and inflation gathered steam in 2021, policymakers in advanced countries dismissed above-target inflation as "transitory" and due to supply chain pressures that would soon abate. Extraordinary levels of fiscal and monetary policy stimuli, which were apt in 2020 but not 2021, were sustained until well into 2022. It was a costly mistake (**Figure 1**). The inflationary impact of Russia's February 2022 invasion of Ukraine compounded the error.

The good news is that global supply chain disruptions have mostly been resolved. Shipping costs have retreated to pre-pandemic norms. Energy prices have also eased from their mid-2022 peaks, albeit high energy prices are a boon for Canada. As a result, goods price inflation – making up 30% or more of CPI baskets across advanced economies – is dissipating, and *headline* inflation rates appear to have peaked. However, services price inflation, which tends to be more domestically-driven, is still elevated and broad-based. Labour markets remain overheated. Thus, in advanced countries, including the U.S. and Canada, headline and core inflation could stay above central banks' targets for some time.

Global GDP growth is expected to drop from 7.1% and 3.6% in 2021 and 2022, respectively, to just 1.9% in 2023 and 2.4% in 2024. **This is an extraordinarily weak backdrop: by comparison, global growth averaged 3.8% over 2000-19.** Central banks, with grudging, partial assistance from their spendthrift fiscal counterparts, rapidly tightened policy settings over the second half of 2022 to cool demand and bring it into balance with supply. Monetary policy affects the real economy with a lag of about 12-18 months, meaning that the full effects of higher interest rates are still some way off.

The **United States economy** is projected to come to almost a dead stop in 2023 and inch ahead by 1.1% in 2024. Several quarters of nil growth, or a broad-based contraction in GDP, are possible, with the latter scenario qualifying as a recession. A mild winter has helped the **Euro zone economy** avoid the worst consequences of high energy prices. Nonetheless, the Euro zone could still dip into recession sometime during 2023 -- and even if it does not, no growth expected for the year.

The bright spot globally is the **Chinese economy**. Following widespread protests and sustained economic disruption, the Chinese government relented on its "zero-COVID" strategy. The unexpected reopening of China's economy in November and December 2022 adds much-needed extra production capacity to the world's economy. This will improve global GDP growth, contribute to disinflation in tradeable goods prices, and buttress demand for commodities. Ominous clouds still linger over China's overextended real estate sector, however. Overall, risks to the global economy are weighted to the downside.

TABLE 1: **GLOBAL AND CANADA ECONOMIC FORECASTS**

Region	2021	2022f	2023f	2024f
Real GDP growth (%)				
World	7.1	3.6	1.9	2.4
United States	5.9	2.0	0.5	1.1
Euro area	5.3	3.4	0.2	0.9
Japan	2.1	1.2	1.2	1.2
China	8.4	3.0	5.4	5.0
Canada				
Potential GDP (range)	2.1-2.5	0.5-2.0	1.4-3.3	1.4-3.5
Actual GDP (forecast)	5.0	3.6	1.0	1.8

f - forecast

Source: Bank of Canada.

CANADA MIGHT DODGE A RECESSION IN GDP, BUT GDP PER PERSON IS SET TO FALL

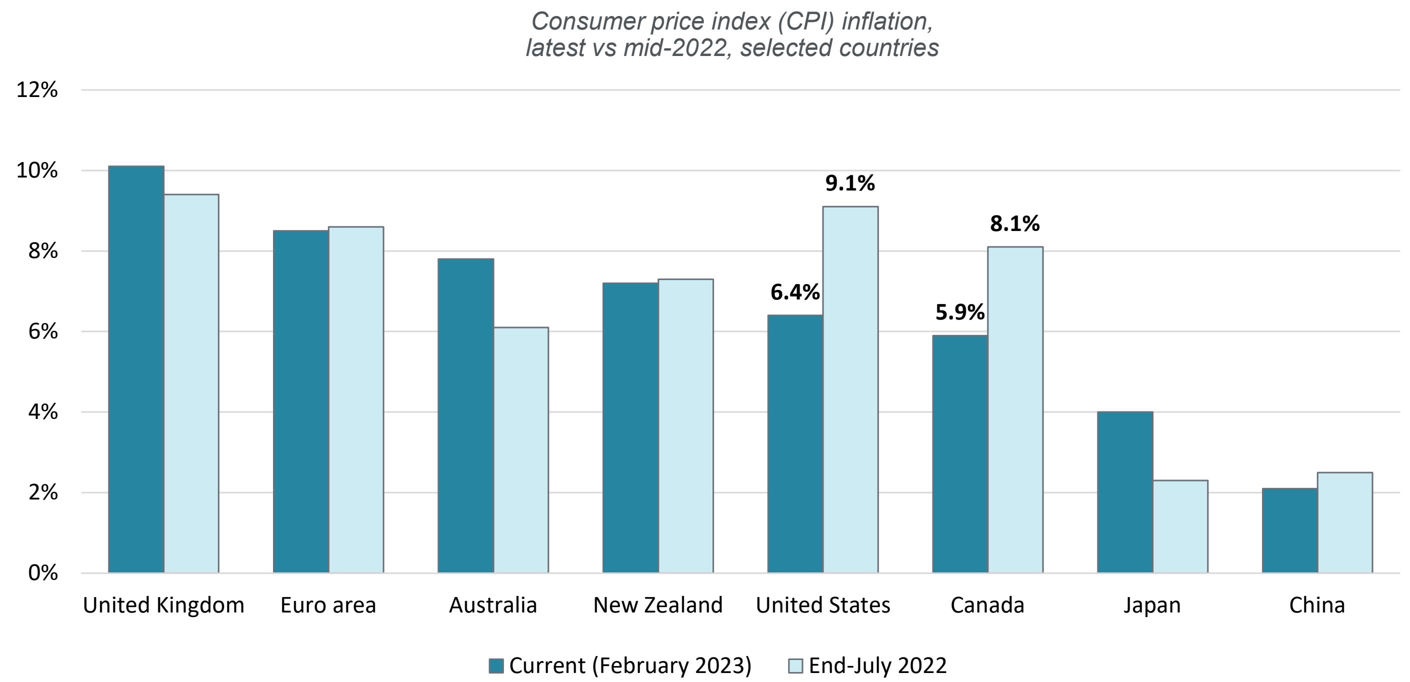
Canadian GDP growth is expected to slow to 1.0% in 2023 and 1.8% in 2024. The economy is clearly overheated with excess demand for services, goods and labour. Consumer inflation is thrice the Bank of Canada's 2% target. There are currently 1 million job vacancies nationally. The vast majority are in entry-level positions requiring little or no experience or qualifications, and paying low wages (see analysis in Williams 2023).

The Bank of Canada estimates the "output gap" – the difference between the level of output the economy is currently producing and the level it can sustainably produce without generating above-target inflation – is around +0.5% to +1.5% of GDP. Canada's CPI inflation is currently 5.9% y/y while the unemployment rate is 5.0%. The last time the national inflation rate exceeded the unemployment rate was in the late 1970s/early 1980s (**Figure 2**).

From a supply-side perspective, Canada's GDP recovery in 2021-22 was due to growth in labour inputs (i.e., total hours worked), not labour productivity (GDP per hour worked, **Figure 3**). In other words, the economy expanded because there were more people in the workforce and the unemployment rate fell, not because the workforce or the average firm became more productive. Whereas growth in labour productivity translates to higher GDP per capita and real incomes, growth in total hours worked only raises topline or total GDP.

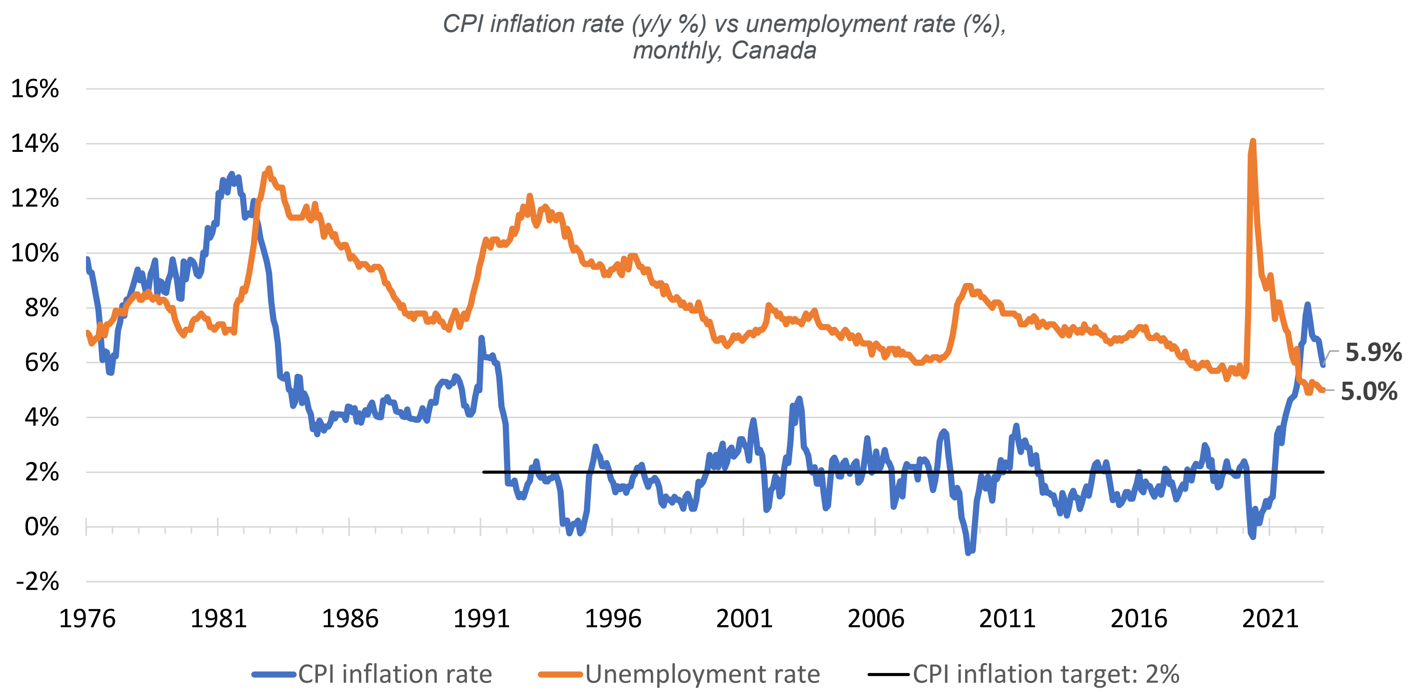
Immigration, not productivity, remains at the centre of the federal government's thinking about how to expand the economy's supply-side capacity. Canada's population increased by an unprecedented 703,000 persons in the year to July 1, 2022, of which around 658,000 was due to net international migration (temporary and permanent) and 46,000 was natural increase (births less deaths) (**Figure 4** and **5**). Further increases to immigration are planned. However, while immigration expands the absolute size of the labour force

FIGURE 1: **RUNAWAY GLOBAL INFLATION**



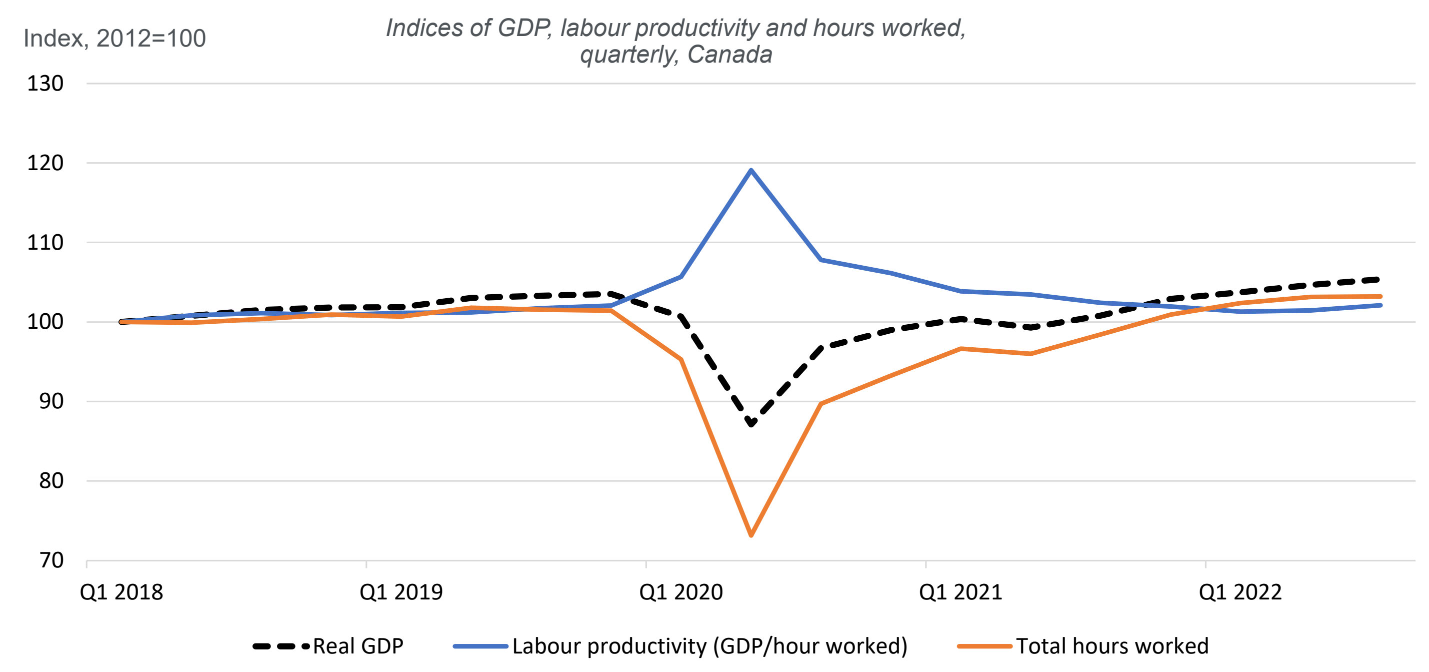
Source: The Economist, BCBC.

FIGURE 2: **INFLATION HAS NOT EXCEEDED UNEMPLOYMENT RATE SINCE 1970s/1980s**



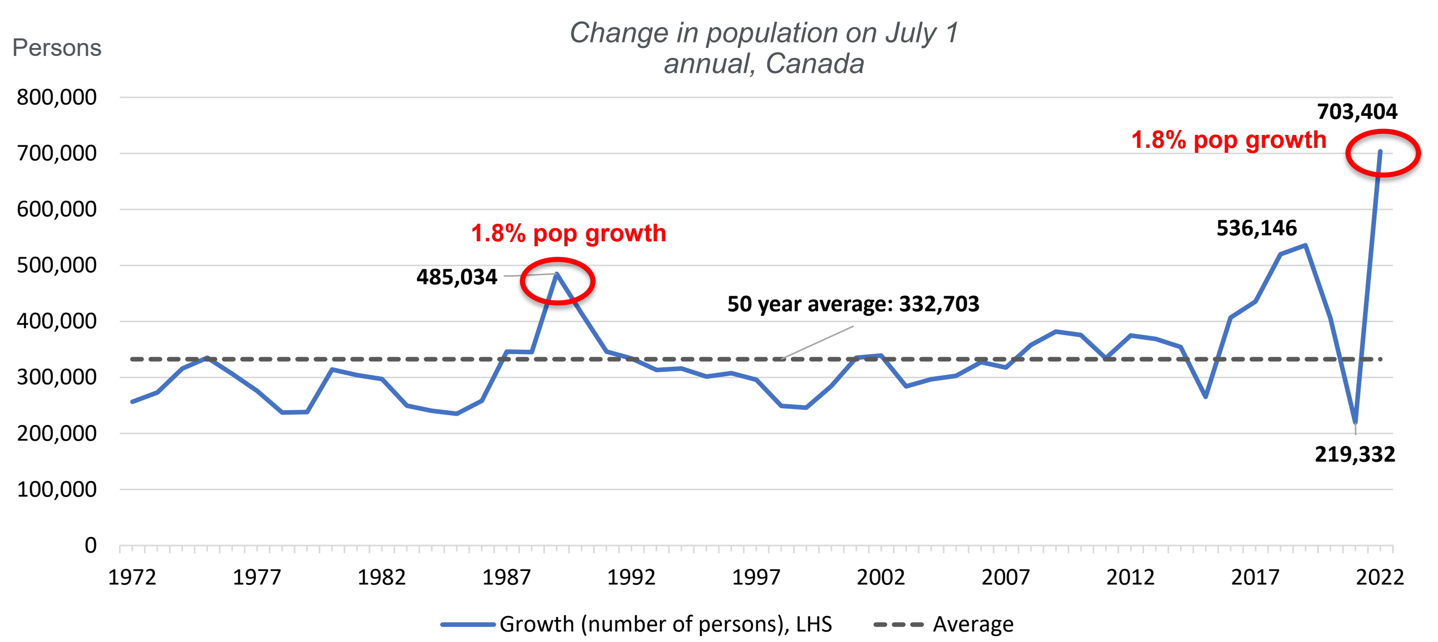
Source: Statistics Canada, BCBC.

FIGURE 3: **CANADA'S GDP RECOVERY IS DUE TO GROWTH IN LABOUR INPUTS, *NOT* LABOUR PRODUCTIVITY**



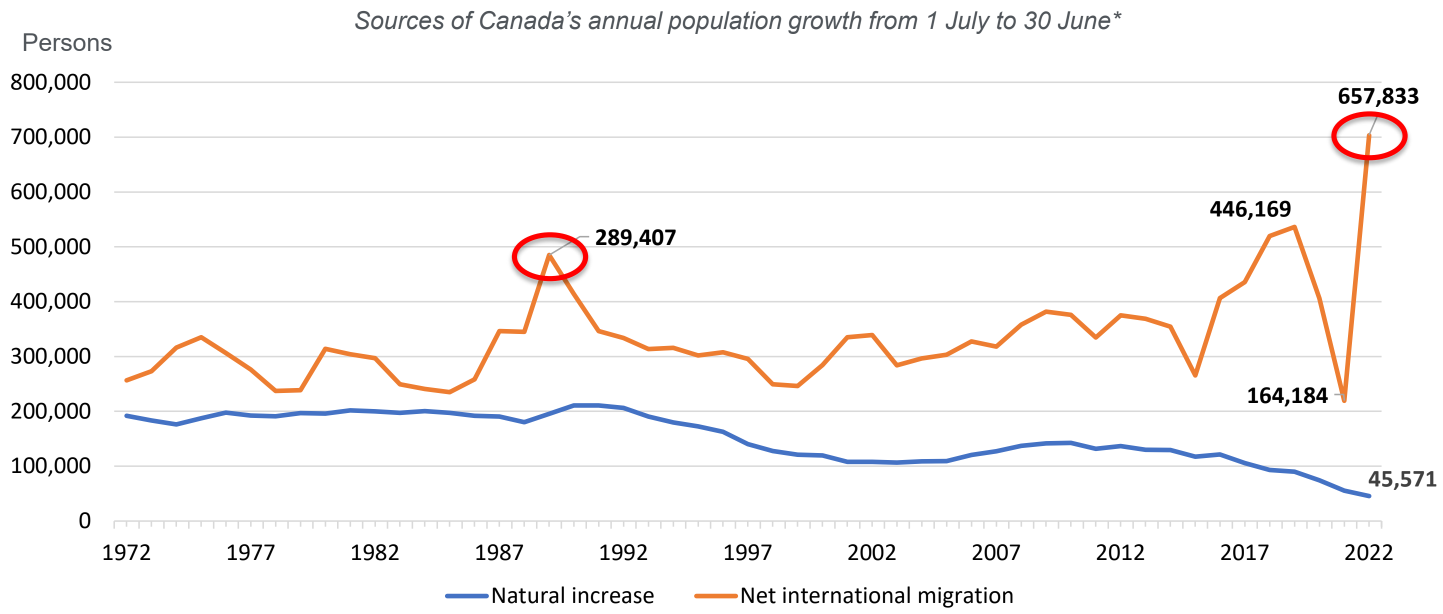
Source: Statistics Canada, BCBC.

FIGURE 4: **POPULATION GROWTH IS THE MAINSTAY OF OTTAWA'S ECONOMIC GROWTH STRATEGY**



Source: Statistics Canada, BCBC.

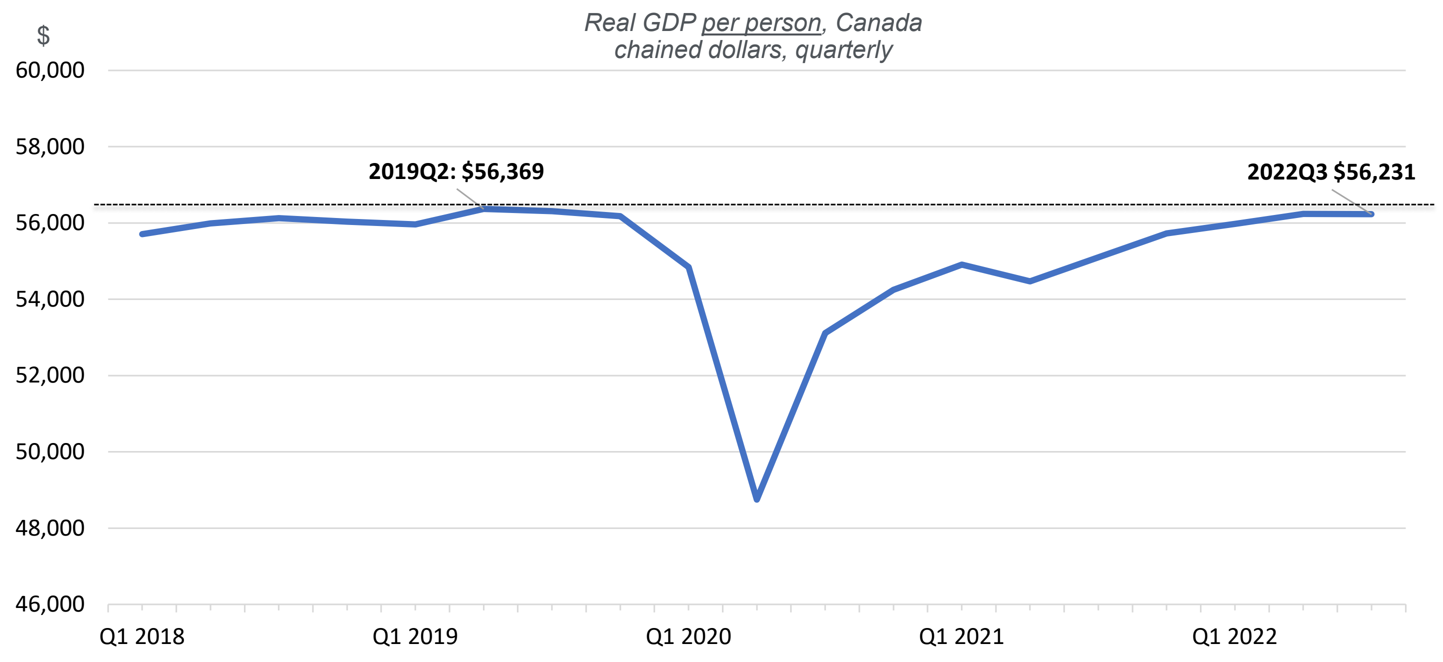
FIGURE 5: **IMMIGRATION ACCOUNTS FOR ALL OF CANADA'S POPULATION BOOM, CONCENTRATED IN MAJOR CITIES**



Source: Statistics Canada, BCBC.

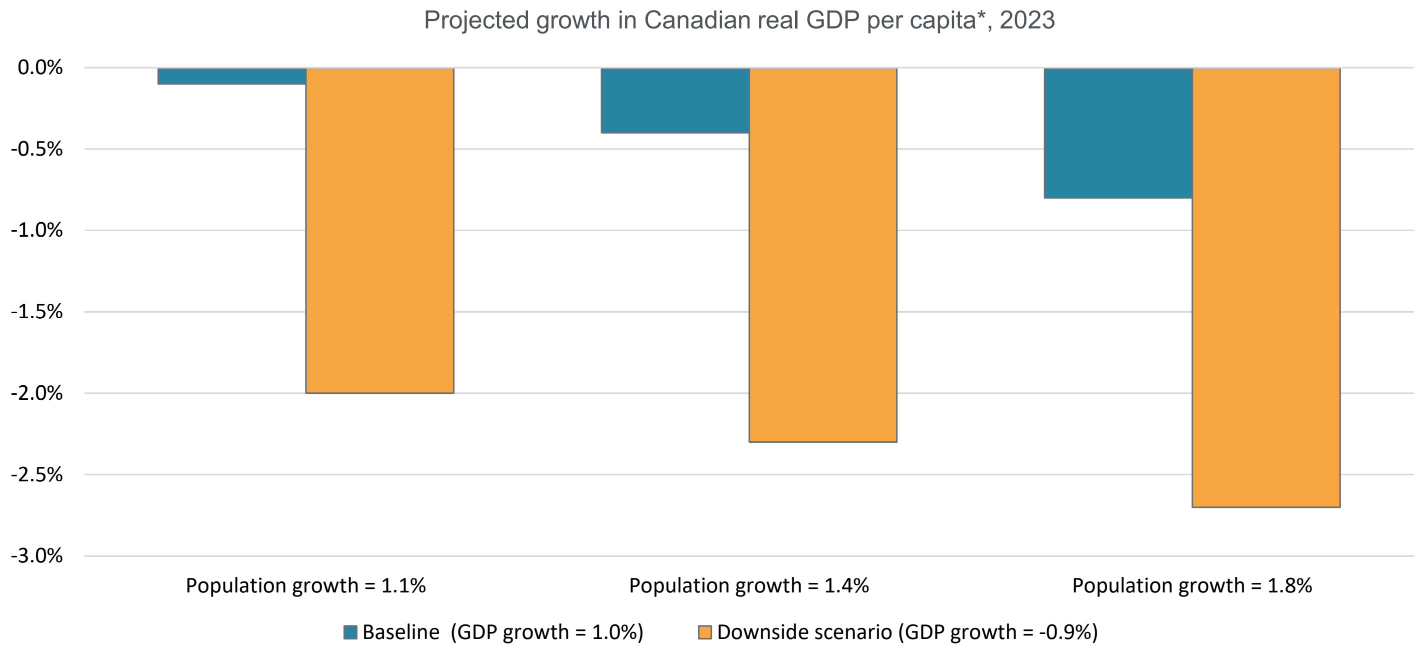
*Natural increase is births minus deaths. Net international migration is calculated as the residual of population growth less natural increase.

FIGURE 6: **CANADA HAS NOT YET RECOVERED ITS PRE-PANDEMIC LEVEL OF GDP PER CAPITA (STILL 0.2% BELOW 2019 LEVELS)**



Source: Statistics Canada, BCBC.

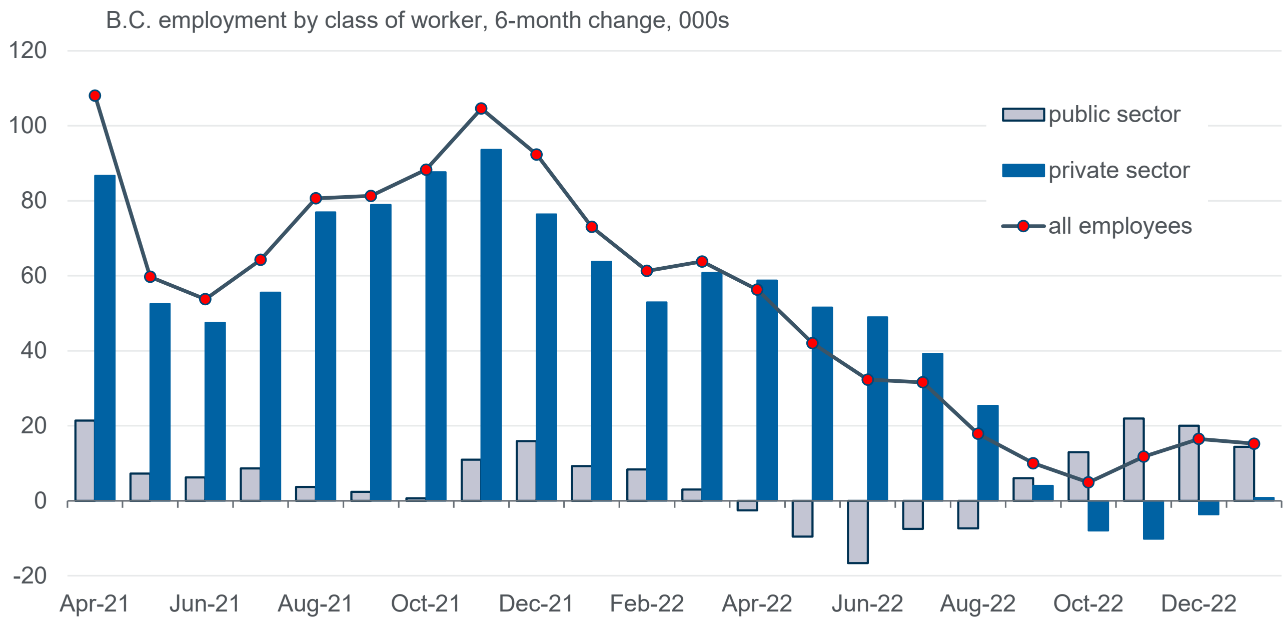
FIGURE 7: **GDP PER CAPITA LIKELY TO FALL BY 1-3% IN 2023**



Source: Bank of Canada, Fall Economic Statement (FES) 2022; BCBC.

*Calculated using 2023 GDP growth forecasts from Bank of Canada (baseline) and *Fall Economic Statement* (downside scenario) under three assumptions about population growth

FIGURE 8: **EMPLOYMENT SLOWING**



Source: Statistics Canada, Table 14-10-0288-01.

Seasonally adjusted.

and economy (i.e., total GDP), the academic literature overwhelmingly finds that it has negligible impact on indicators that determine a country's living standards: labour productivity, real wages, the employment rate, the age structure of the population and, importantly, GDP per person.

The government's recent claim that higher immigration levels is the right policy lever to address broad-based labour shortages in an overheated economy is dubious. **Immigration adds to both labour supply and labour demand, for the obvious reason that a newcomer is at the same time a worker and a consumer.** The government's strategy is like thinking Christmas dinner will be made easier if you invite more people because they can help with the washing up.

In our view, the appropriate strategy to address an overheated economy is modest monetary and fiscal restraint, supported by supply-side policies focused on lifting growth in productivity and per capita GDP. This will cool demand and enhance supply, bringing them into balance. Critically, this would also lift rather than reduce or stagnate real average incomes, as is happening under the federal government's current approach.

Looking through the veneer of booming population growth, the national economy is in rough shape. Canada's economy enters 2023 shouldering serious structural weaknesses: the world's 4th most indebted advanced economy; the highest private sector debt-servicing burden among G7 countries; the worst prospects in the OECD for growth in GDP per capita and labour productivity over the next 40 years; business investment that is barely keeping up with depreciation, resulting in a flat or declining capital stock per worker; and a two-decade retreat from international trade with exports shrinking as a share of GDP. Young Canadians entering the workforce today face the unhappy prospect of the lowest projected growth in average real incomes among the 38 OECD countries over 2020-2060.

Canada is one of the few advanced countries not to have recovered its pre-pandemic level of GDP per capita. Canada's GDP per capita remains 0.2% below its 2019 level (**Figure 6**). Further falls lie ahead. Assuming 2023 GDP growth of either 1.0% (baseline forecast from the Bank of Canada) or -0.9% ("downside scenario" in the federal government's *Fall Economic Statement*), and assuming population growth continues at a blistering pace of 1.8% y/y, this implies GDP per capita growth of -0.8% to -2.7% in 2023. **In other words, the average real income per person of households and businesses in the Canadian economy could fall by another 1-3% in 2023.**

Overall, Canada may superficially dodge a recession in GDP in 2023 due to surging population growth, concentrated in its major cities. **However, Canada will likely not dodge a recession in GDP per capita.** With high indebtedness, low productivity growth and weak prospects for real income growth, Canada could face some difficult adjustments if tight financial conditions are sustained. There is the potential for a disorderly unwinding of the country's significant economic and financial imbalances. Risks to the outlook are therefore weighted to the downside.

B.C. ECONOMIC OUTLOOK

B.C.'s economic outlook aligns closely with Canada's. The provincial economy should grow by 0.9% (after inflation) in 2023 and 1.5% in 2024. B.C.'s exports will slow amid the weaker global backdrop, while higher interest rates continue to dampen the housing sector, consumer purchases of big-ticket durables, and capital investment. But as in Canada as a whole, strong population growth will offset these other headwinds and generate modest topline GDP growth this year.

The GDP growth slowdown will help pull the economy back from operating at overcapacity. Demand for labour will ease and the unemployment rate will edge higher. Even as job vacancy rates fall from record levels, the underlying demographic picture means hiring challenges could persist in some sectors.

The structural weaknesses afflicting Canada extend to B.C. Labour productivity and per capita GDP growth closely tracked Canada over the past couple of decades. With the notable exception of the large capital projects (LNG Canada, related pipelines, Trans Mountain and Site C) that collectively have provided a huge lift to provincial growth in recent years, business capital investment per worker is weak in B.C. Of particular concern, the amount of capital equipment, machinery and advanced process technology per worker badly lags other advanced economies. Households are also under more strain in B.C. as they carry higher debt burdens and face dramatically higher credit-fuelled established home prices, and thus rents, compared to other Canadian cities and regions.

TABLE 2: **B.C. ECONOMIC OUTLOOK (BCBC INTERIM FORECAST) (ANNUAL % CHANGE UNLESS OTHERWISE INDICATED)**

	2021	2022	2023f	2024f
Real GDP	**6.1**	**2.9e**	**0.9**	**1.5**
Real GDP per capita	5.2	0.7	-1.1	-0.4
Employment	6.6	3.2	0.6	1.2
Unemployment rate (%)	6.5	4.7	5.7	6.0
Housing Starts (000 units)	47.5	42.8e	40.5	39.0
Retail sales	13.5	2.4e	2.9	3.7
B.C. CPI	2.8	6.8e	4.4	3.0

f - forecast e - estimate

Source: Statistics Canada and BC Stats; Business Council of B.C. for forecasts.

JOB GROWTH SLOWS THROUGHOUT 2022

Job creation slowed in the second half of 2022, as demand for workers moderated and hiring challenges intensified (**Figure 8**). The provincial unemployment rate continues to hover near record lows and job vacancies remain elevated. Having job vacancies (155,000) exceed the number of unemployed persons (125,000) in the latter months of last year undoubtedly slowed hiring activity. The private sector experienced the most pronounced slowing. Outsized public sector job growth looks set to continue. Job creation in the private sector will continue to be concentrated in scientific and technical services (mostly computer and related services), construction, and information and culture (which captures film and TV, and data services). Unfortunately, jobs in some high productivity B.C. industries (forestry, manufacturing) are shrinking as businesses in these sectors grapple with escalating costs and a complex operating environment. (**Figure 9**)

INTERNATIONAL EXPORT VALUES RETREAT FROM 2022 RECORD HIGHS

High commodity prices helped propel B.C.'s merchandise export values to new highs in 2022 (**Figure 10**). Export revenues, however, peaked in the second quarter and turned sharply lower in the second half of the year. By the fourth quarter, merchandise exports were down almost $4 billion from their peak, with energy exports off by more than $2.5 billion and lumber by $1 billion. China's reopening is positive, but B.C. ships only 15% of all merchandise exports to this market. Weaker commodity prices and the slowdown in the U.S. demand for lumber and other goods are already weighing on export sales and will continue to do so in the coming year.

International tourism is a bright spot for B.C. It will provide a lift to the economy in 2023, as international travel makes a more complete recovery. The weak Canadian dollar and an anticipated surge in the number of Chinese visitors are clear positives for the tourism industry.

HOUSING RESALES TUMBLE AMID SHARPLY HIGHER BORROWING COSTS

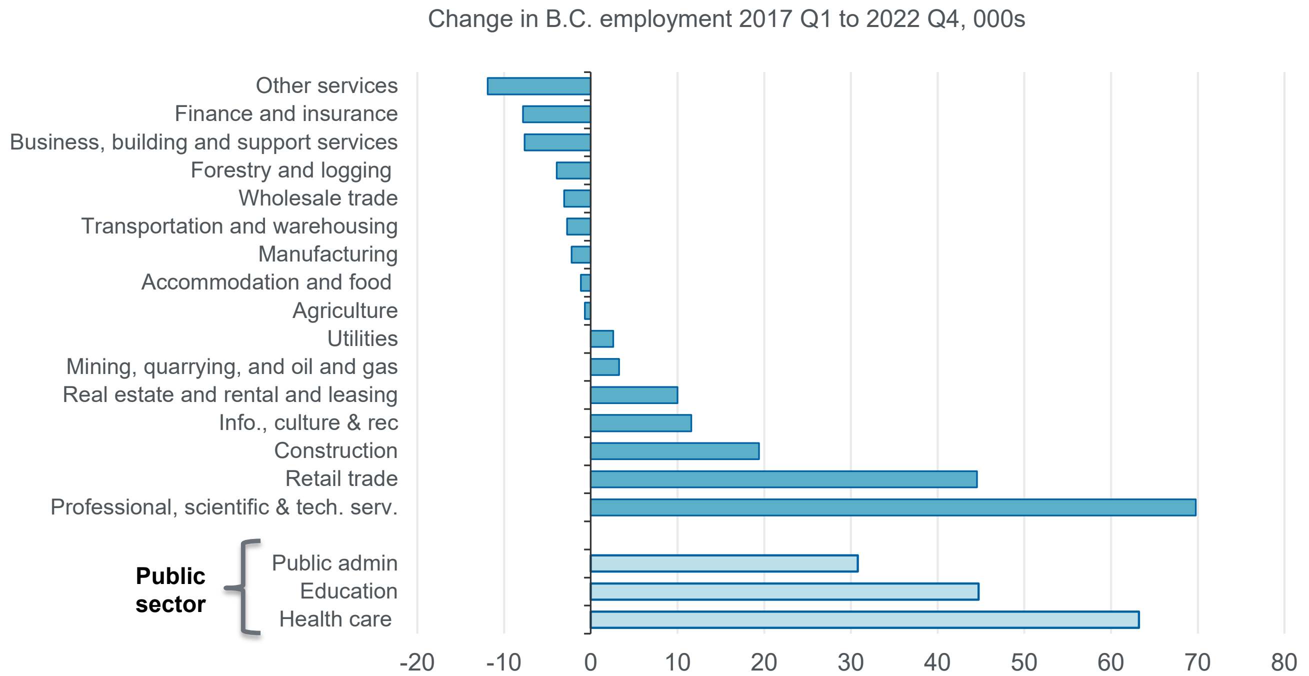
Sales of established homes ("resales") in B.C. have fallen sharply in the face of much higher borrowing costs. In January, home resales in Greater Vancouver were down more than 55% compared to the same month in 2022. Benchmark resale prices are down nearly 7% — and down twice that in real terms — over the same period. In the hard-hit Fraser Valley, January resales were down 52% Y/Y and the average benchmark resale price was 25% lower. Patterns were similar in other markets, even if the declines are smaller (Victoria resales down 41% and Vancouver Island Real Estate Board resales down 25%).

Residential construction has accounted for a record share of GDP in B.C. in recent years. Housing starts are at very high levels (**Figure 11**).Due to higher interest rates, new home construction is set to slow in 2023 and will serve as a drag on overall economic growth. The provincial government's intention to support the development of more purpose-built rental housing is something of a wild card. It will take time to implement plans and secure permits. Escalating building costs are also a consideration. Construction has one of the highest job vacancy rates in the province and has seen one of the largest increase in job vacancies in recent years, which suggests it may be difficult to quickly ramp up home-building.

FUELLED BY PUBLIC SECTOR INVESTMENT, NON-RESIDENTIAL CONSTRUCTION IS A BRIGHT SPOT

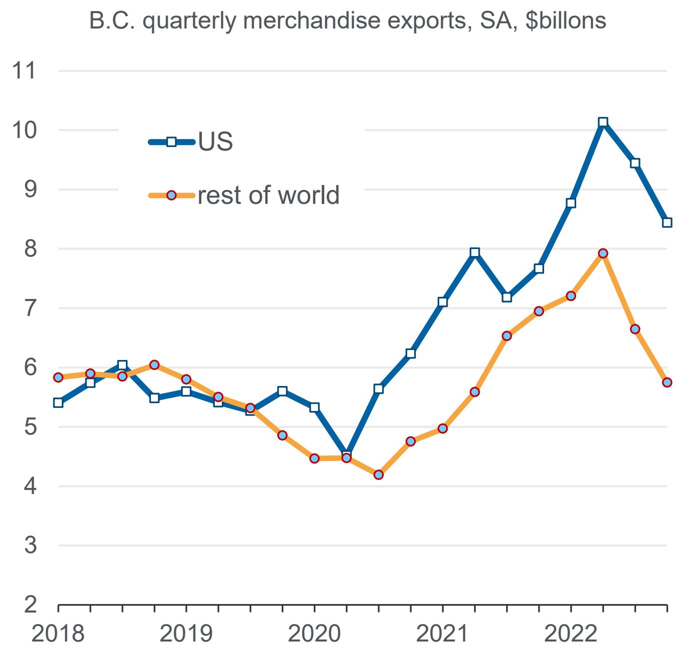
Non-residential permits climbed to record highs in 2022, pointing to further construction activity in this

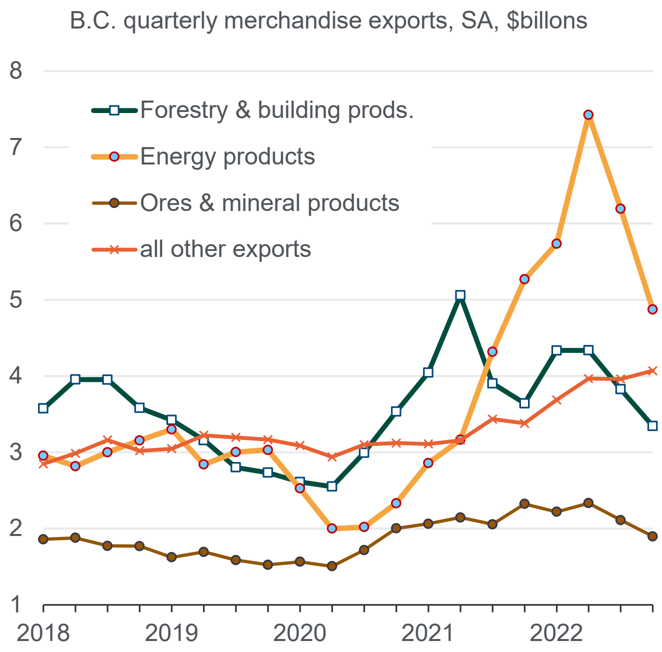
FIGURE 9: **B.C. EMPLOYMENT BY INDUSTRY**



Source: Statistics Canada, Table 14-10-0355-01.

FIGURE 10: **B.C. EXPORTS TURNING LOWER**

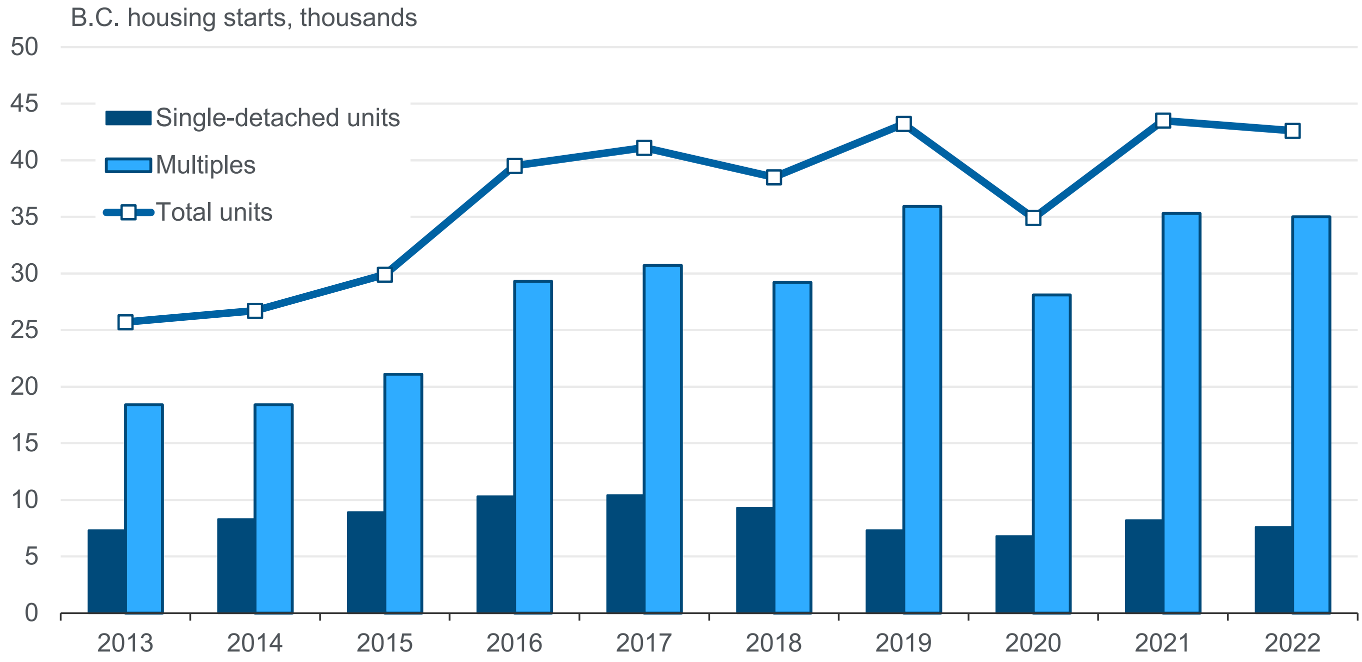




Source: B.C. Stats.

Latest Q4 2022, seasonally adjusted.

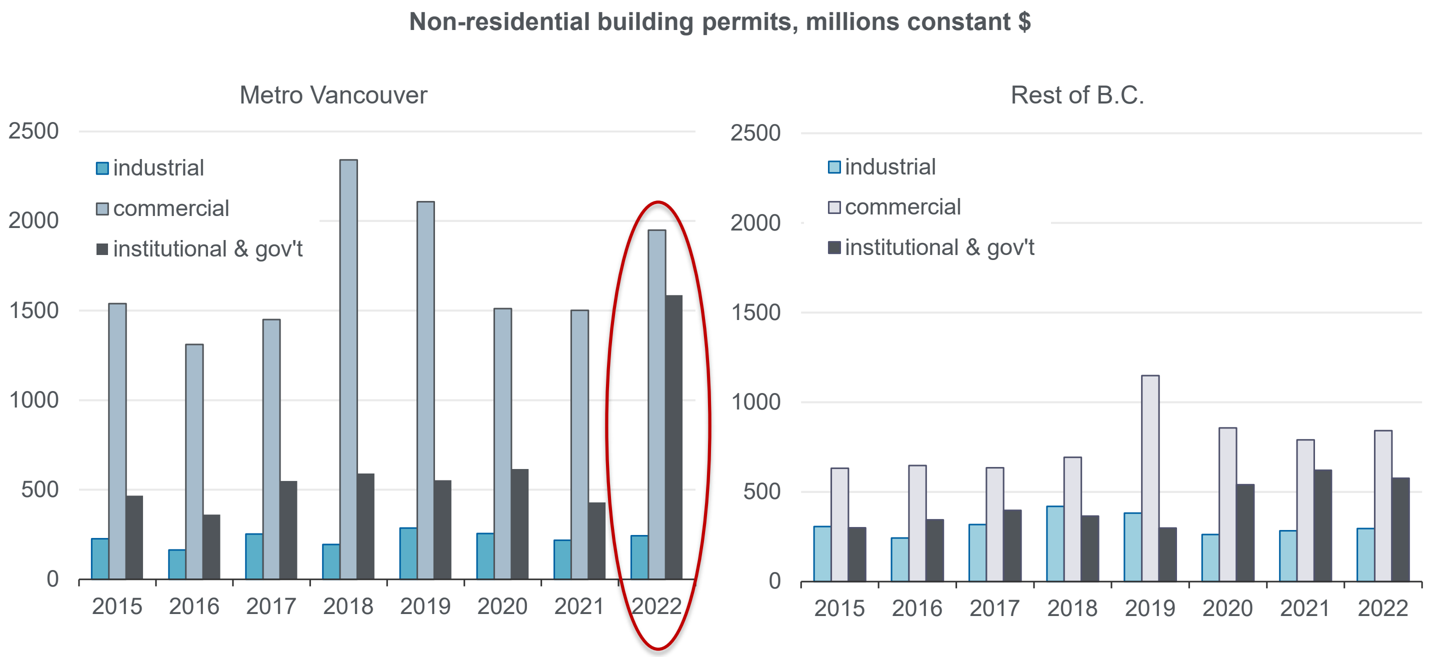
FIGURE 11: **B.C. HOUSING STARTS**



Source: BC Stats.

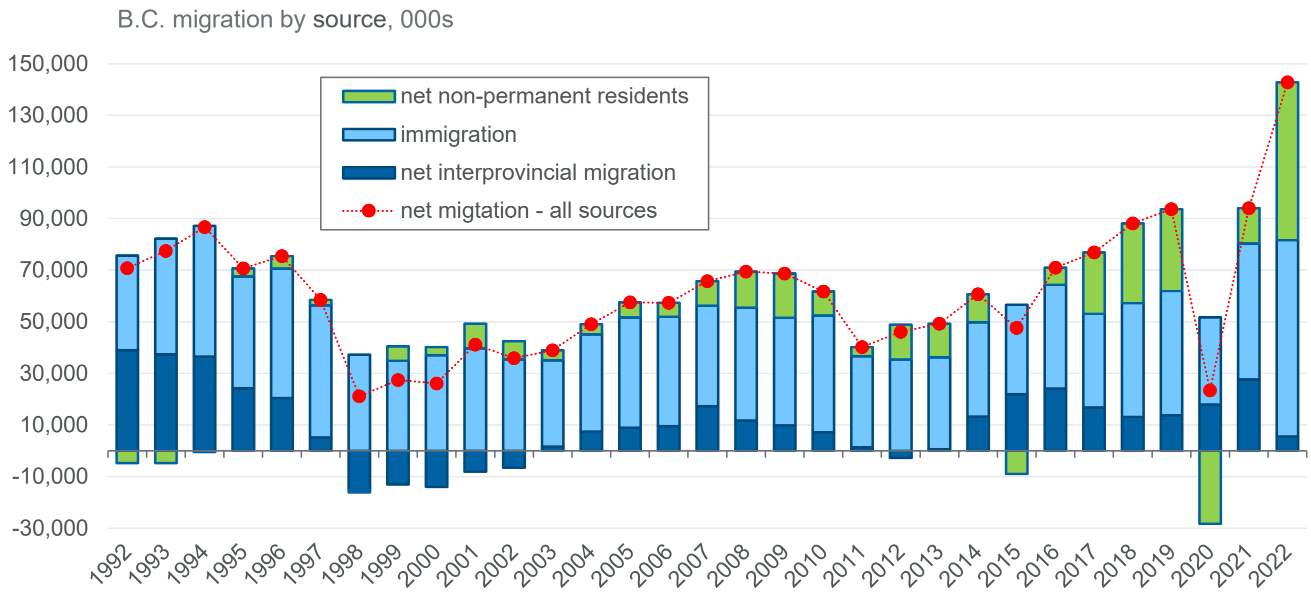
Latest Q4 2022, seasonally adjusted.

FIGURE 12: **B.C. NON RESIDENTIAL BUILDING PERMITS**



Source: Statistics Canada, Table 34-10-0066-01.

FIGURE 13: **B.C. IN-MIGRATION SURGES TO NEW HIGHS**



Source: Statistics Canada, Tables 17-10-0040-01, 17-10-0009-01 and 17-10-0020-01.

sector in 2023 and 2024. Increased provincial government spending on schools and hospitals has pushed institutional and governmental permits to a record high (**Figure 12**), with the new Saint Paul's Hospital redevelopment project playing an outsized role in the 2022 spike. Institutional and governmental permits have also moved steadily higher outside of the Metro Vancouver region.

POPULATION GROWTH DELIVERING TOPLINE ECONOMIC GROWTH

Record in-migration will keep B.C.'s economy growing over the next two years. More than 75,000 permanent immigrants settled in B.C. in 2022 (**Figure 13**). In addition, more than 60,000 non-permanent residents (mostly students and temporary foreign workers) also arrived in the province. Net inflows from other provinces were also adding to the population, but this source has fallen off recently. Overall population growth is expected to remain close to 2%. Nonetheless, looking through the veneer of population growth, GDP per person in B.C. is set to fall.

SUMMARY THOUGHTS

The lift that B.C. enjoyed from strong global commodity markets in 2021 and the first half of last year will wane in 2023. Households will trim discretionary spending in the face of rampant inflation and higher interest rates. However, total domestic consumption and spending on services will increase owing to a fast-growing B.C. population.

The expansion of the broad B.C. public sector is also stimulative in the near term. However, significant jumps in public sector spending and employment come at a time when the Bank of Canada is aggressively working to tame inflation and slow the economy. An expanding public sector makes the job of the central bank harder. It also aggravates labour pressures in the private sector through "crowding out".

Even if B.C. avoids outright recession, with GDP growth in the vicinity of 1% and population growth around 2%, **GDP per capita is set to fall significantly this year**. If the economy expands as expected in 2024, per capita GDP may gradually claw its way back to 2017 levels – meaning no gains in per person prosperity over a period of 6-7 years. This is not a picture that B.C. policymakers should be satisfied with.

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