THE RACE BETWEEN THE VIRUS AND THE VACCINES

B.C. ECONOMIC REVIEW AND OUTLOOK

February 2021

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Business Council *of* British Columbia
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HIGHLIGHTS

- Global GDP is expected to expand by 5.6% in 2021 and 4.6% in 2022, following a -2.8% contraction in 2020, according to the Bank of Canada. Globally, vaccination programs are being rolled out about six months earlier than previously expected. It is assumed this will allow many advanced economies (except perhaps, Canada) and China to achieve broad COVID-19 immunity for their populations by the end of 2021. Other emerging economies would achieve this by mid-2022.
- The U.S. economy is expected to recover faster than most other advanced economies and to return to full capacity by the end of 2021, roughly two years earlier than Canada.
- Canada's fiscal response in 2020 was easily the largest in the world. Nevertheless, Canadian GDP growth is expected to be only 4.0% in 2021 and 4.8% in 2022, after a large contraction of -5.5% in 2020. The tepid recovery (relative to other countries) means the economy will operate with considerable excess capacity, and inflation will not sustainably return to its 2% target, until sometime in 2023.
- The provincial economy will grow by 4.5% in 2021, marginally outpacing Canada. A slightly stronger growth performance is expected in 2022.
- Global trade has recovered; this backdrop is positive for B.C.'s merchandise exports which are trending higher and will help to underpin the recovery.
- Provincial employment has almost returned to its pre-COVID level; the labour market recovery, however, is very uneven across sectors.
- Air transportation and other tourism-dependent industries remain the epicentre of economic displacement. They will be slow to revive and will weigh on the recovery process.
- Retail spending has rebounded and is on a healthy upward trajectory.
- Construction will be a leading growth engine in 2021-22 as several large capital projects resume full-scale activity and governments spend more on infrastructure.

COVID-19 PANDEMIC

The COVID-19 pandemic to date has caused over 100 million infections and more than 2.2 million fatalities worldwide. In terms of fatalities per capita, the worst hit countries are Belgium, Slovenia, United Kingdom, the Czech Republic, and Italy. The U.S. has the 8th highest fatality rate. A new variant (B.1.1.7), a mutation of the SARS-CoV-2 virus, emerged in December in the U.K. and has since been reported in over 30 more countries, including Canada. It remains to be seen whether the arrival of the new variant alters the course of COVID-19 or delays the economic recovery currently expected in 2021-2022.

Canada is in the top third of affected countries. Out of 152 jurisdictions, Canada has the 47th highest fatality rate per capita, at 532 deaths per million persons. This is similar to Greece, Ukraine, Israel, Costa Rica, Eswatini, and Russia. Canada has recorded over 800,000 COVID-19 infections and 20,300 fatalities, the majority of which have been concentrated in a few provinces (**Figure 1**). B.C. accounts for around 9% of cases and 7% of deaths nationally.

IMPROVED GLOBAL OUTLOOK, ESPECIALLY FOR THE UNITED STATES

Global GDP growth is expected to reach 5.6% in 2021 and 4.6% in 2022, following a 2.8% contraction in 2020, according to the Bank of Canada (**Table 1**). Many countries are in the grip of a second pandemic wave, compounded by the spread of the new B1.1.7 strain, that is proving considerably worse than the first wave in respect of cases and fatalities.

Despite the reintroduction of social lockdowns, the economic impact appears to be less disruptive than during the first wave because of extraordinary fiscal and monetary support already in place and because people have adapted to new ways of living and working. Global public debt as a percent of GDP is at levels last seen in the aftermath of World War II (**Figure 2**).

The good news is that effective vaccines are being rolled out globally about six months earlier than previously forecast. This has pulled forward the timing of the economic recovery in the advanced economies (except perhaps, Canada). Commodity prices have improved in anticipation of stronger global demand (**Figure 3**). The Bank of Canada assumes that vaccination programs will achieve broad population immunity in the advanced economies and China by the end of 2021, and in other emerging economies by mid-2022, enabling a gradual resumption of normal activities. Risks to the global growth outlook are evenly balanced.

United States GDP growth is expected to be 5.0% in 2021 and 3.9% in 2022, following a relatively mild (in comparison to Canada, Japan, and the Euro area) contraction of 3.5% in 2020. The U.S. unemployment rate is currently 6.7%. Additional fiscal support of USD 900 billion will be rolled out during 2021 whilst extraordinary monetary policy stimulus remains in place. The U.S. recovery is expected to be broad-based across consumption, investment, and trade as the rollout of vaccines gradually allows rollback of virus containment measures.

Canada increased its indebtedness by a further 41% of GDP during the pandemic – the largest increase in the world. Canada thus became the 6th most indebted country globally as at 2020-Q2. This will leave us more vulnerable to future financial and economic shocks.

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

	2019	2020f	2021f	2022f	2023f
World	2.8	-2.9	5.6	4.6	3.9
U.S.	2.2	-3.5	5.0	3.9	2.0
Euro area	1.3	-7.1	4.4	4.5	2.7
Japan	0.3	-5.2	2.8	1.9	1.0
China	6.0	1.7	8.4	5.4	5.9
Canada					
Potential GDP	1.5-2.1	0.1-1.3	0.2-1.6	0.3-1.9	0.2-2.2
Actual GDP	1.9	-5.5	4.0	4.8	2.5

f - forecast

Source: Bank of Canada.

The U.S. output gap – the difference between the level of potential and actual GDP – is expected to close towards the end of 2021 and inflation will reach 2% by late 2022. This is much earlier than in other countries, including Canada – where the output gap will not close for another two years. In other words, even though the U.S. was the 8th most affected country from the coronavirus (as noted earlier), its economy will be operating at full capacity by the end of 2021. U.S. GDP growth will cool to around 2.0% in 2023 as the effects of policy stimuli ebb.

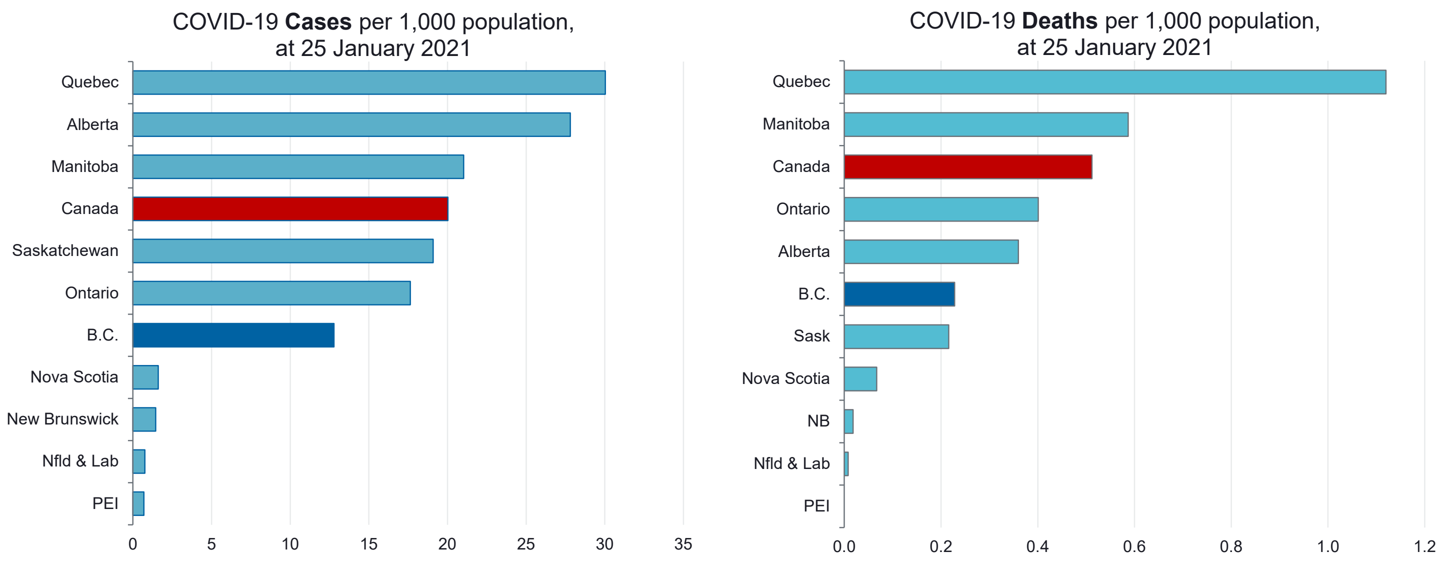
CANADIAN OUTLOOK

Canadian GDP growth is expected to be 4.0% in 2021 and 4.8% in 2022, following a large contraction of 5.5% in 2020. The Bank of Canada assumes that vaccinations help achieve herd immunity by the end of 2021 in line with other advanced countries. This timing is looking increasingly shaky, however. Canada's vaccination rate appears to lag other advanced countries by about six months. Therefore, a more realistic assumption may be that Canada will achieve herd immunity by mid-2022, in line with the emerging market economies. Canada's economy will likely operate below its potential until demand fully recovers sometime in 2023, and in the interim, this will cause persistent disinflationary pressures. Inflation is not expected to sustainably return to the central bank's 2% target until 2023.

The shock to aggregate demand from the pandemic has been uneven. High-contact services industries saw

FIGURE 1: **PROVINCES HAVE FARED DIFFERENTLY**

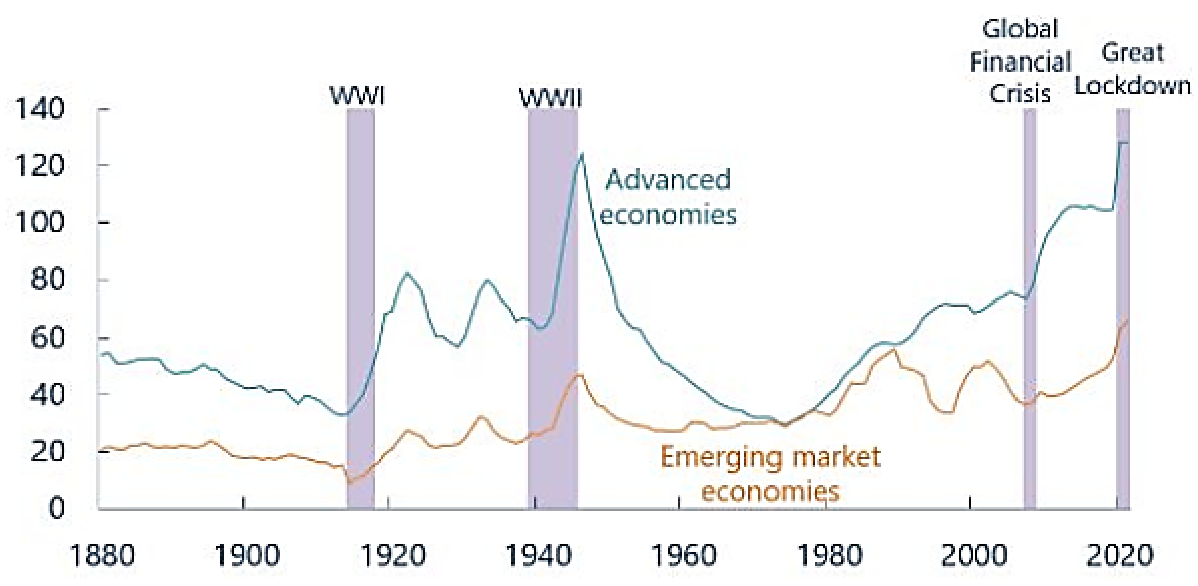
COVID-19 cases and fatalities by province, per capita, as at 25 January 2021



Source: Government of Canada, COVID-19 Situational Awareness Dashboard.

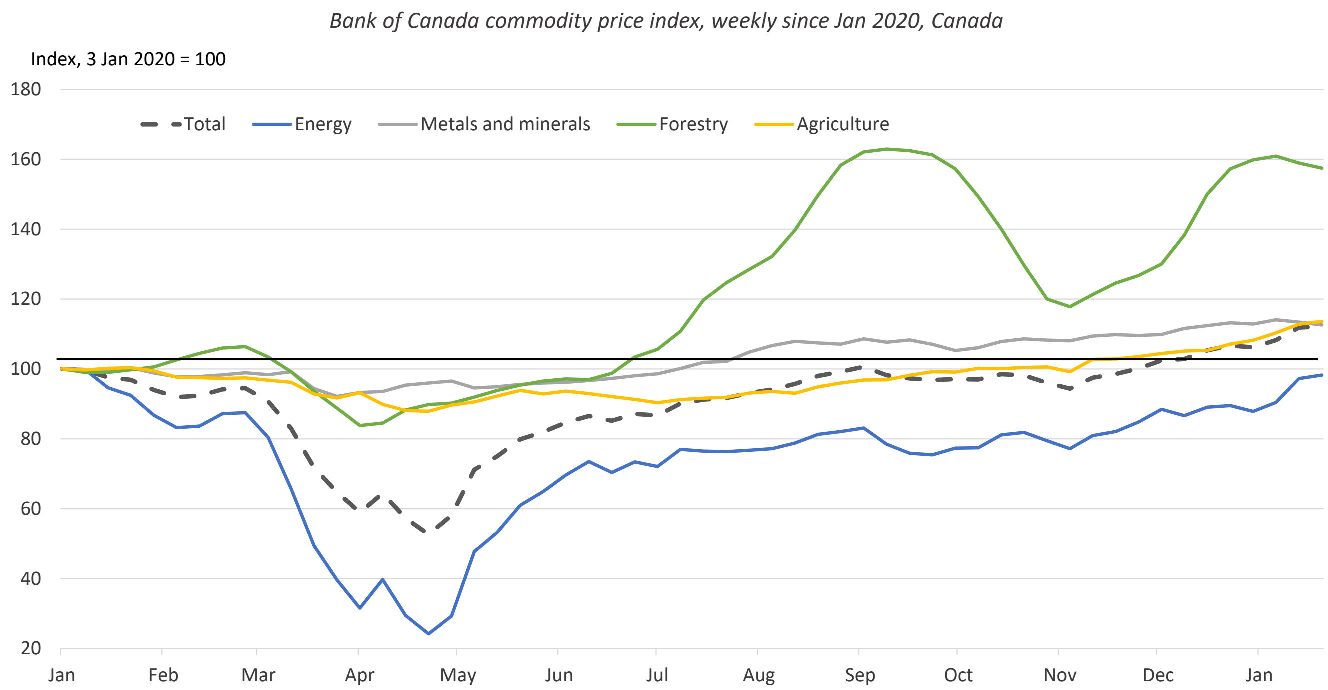
FIGURE 2: **GLOBAL PUBLIC INDEBTEDNESS IS AT LEVELS LAST SEEN AFTER WORLD WAR II**

Global public debt, % of GDP



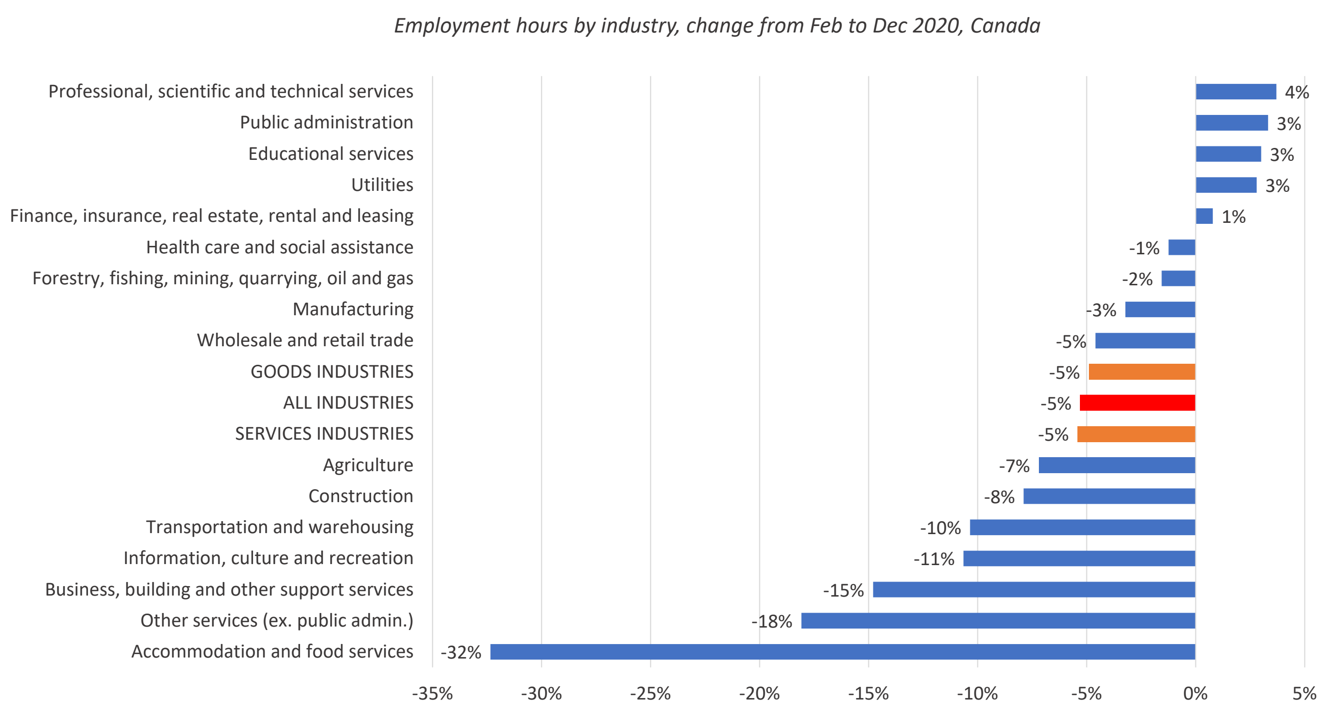
Sources: Historical Public Debt Database; IMF, World Economic Outlook; Maddison Database Project; and IMF staff calculations.

FIGURE 3: **COMMODITY PRICES HAVE STRENGTHENED**



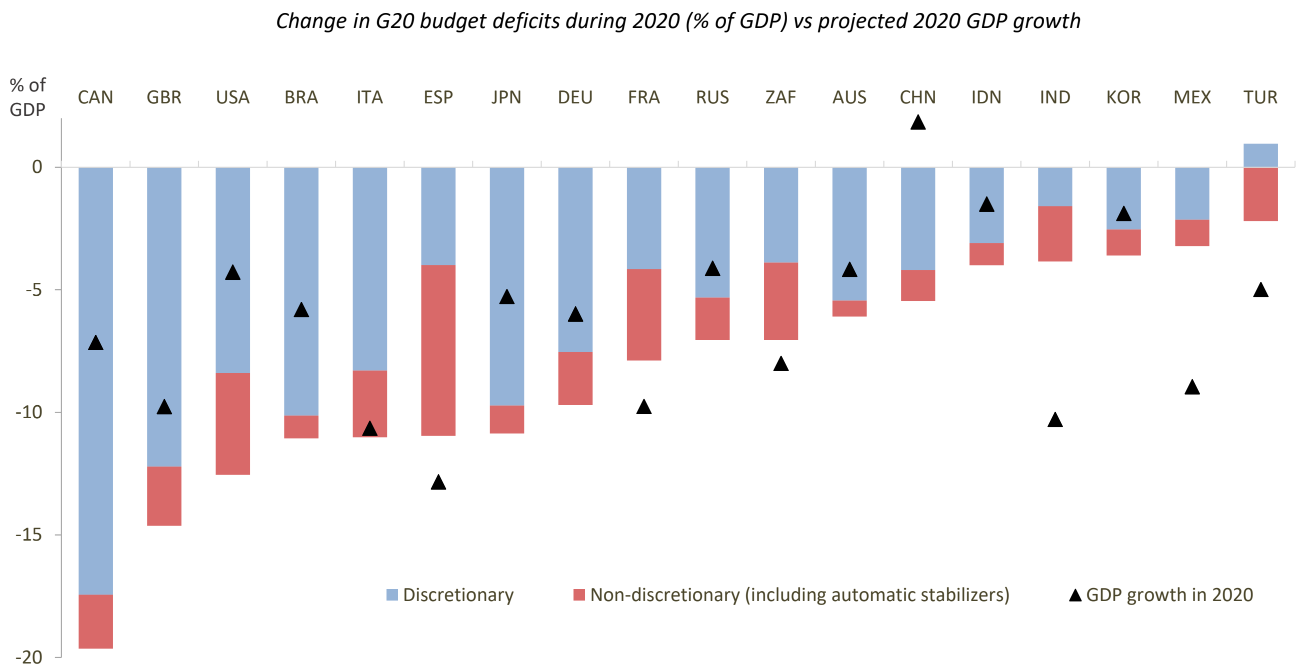
Sources: Bank of Canada.

FIGURE 4: **COVID CAUSED AN EXTRAORDINARY DECREASE IN LABOUR DEMAND**



Sources: Statistics Canada.

FIGURE 5: **CANADA'S FISCAL RESPONSE WAS EASILY THE LARGEST AMONGST THE G20 COUNTRIES**



Note: Discretionary fiscal support is measured as the change in the cyclically adjusted primary balance (CAPB); nondiscretionary fiscal support is the residual. The allocation between discretionary and non-discretionary measures should be considered indicative because output gap estimates, which are used to derive the CAPB, are subject to a high degree of uncertainty.

Sources: IMF, WEO database; and IMF staff estimates.

the largest drop in GDP, resulting in a severe decrease in labour demand as measured by employment hours by industry (**Figure 4**). The distribution of the shock has particularly affected lower-income and young workers who work in high-contact service industries. The national unemployment rate was 8.8% in December 2020, having peaked at 13.8% in May.

Extraordinary policy stimulus has helped to offset the shock. Canada's fiscal response – both federal and provincial combined – was easily the largest in the world as a share of GDP (**Figure 5**). Households were more than compensated for the loss of private sector wages through federal programs such as the Canada Emergency Response Benefit (CERB). The household saving rate, which is usually around 5% or less of disposable income, soared to a record 27.5% in 2020Q2 before slipping to (a still high) 14.6% in 2020Q3. In our view, it will require a careful balancing act to wean Canadian households off fiscal and monetary stimuli as private sector demand improves over the next three years.

Overall, the near-term risks to the Canadian outlook are weighted to the downside as Canada's vaccination rates falter and appear set to push back to mid-2022 the timing for a full return to normal activities. Canada's long-term prosperity appears more precarious. Labour productivity growth has been chronically low for the past two decades, and based on current policy settings we see little reason to expect it will be sustainably higher in the long term. Canada was the 9th most indebted country globally in 2019, with the combined debt of corporations, households, and governments hitting 302% of GDP in 2019. Canada increased its indebtedness by a further 41% of GDP during the pandemic – the largest increase in the world. Canada thus became the 6th most indebted country globally as at 2020-Q2. This puts us in a vulnerable position once the COVID crisis has passed.

Canada's borrowing spree was partly a necessary response to the crisis and partly a rational response to ultra-low global interest rates. Arguably, it is also a bet that either borrowing costs will stay ultra-low for a long time or that decades of higher productivity growth lie ahead. In our view, this seems an ambitious and improbable bet. More likely, the combination of very high indebtedness and chronically low productivity growth (in stark contrast to the post-war era) indicates that Canada's economy will be more susceptible to future financial and economic shocks.

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

	2019	2020	2021f	2022f
Real GDP	1.7	-6.0	4.5	4.8
Employment	2.6	-6.2	5.2	3.2
Unemployment rate (%)	4.7	8.8	6.4	5.2
Housing Starts (000 units)	45.2	38.0	42.0	45.0
Retail sales	0.7	1.8	4.5	4.0
B.C. CPI	2.3	0.8	1.8	2.2

f - forecast

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

B.C. OUTLOOK: EXPORTS AND CONSTRUCTION SUPPORT GROWTH WHILE CONSUMER FACING SERVICES RECOVER LATER

The near-term economic outlook for B.C. is broadly similar to that for Canada. Following the massive COVID-induced demand shock in 2020, the provincial economy will rebound and expand by 4.5% this year, just ahead of the Canada-wide pace. In 2022 the B.C. economy should pick up a little more steam and grow by 4.8%, in line with Bank of Canada's expectation for Canada.

These two-years of robust growth, however, come after the steepest decline in GDP in a century. We estimate the B.C. economy contracted by about 6% in 2020 on an average annual basis. We estimate the downturn was larger than for Canada as a whole, owing in part to B.C.'s oversized tourism and air transportation industries, a much larger film and television industry (which was shuttered for part of the year), and the pull-back in our oversized construction activity.

The economy will struggle in the first quarter of 2021 amid rising and elevated COVID cases and temporary weakness in Canada and the U.S. But growth should resume and accelerate as vaccines are administered in North America and around the world. According to B.C.'s COVID-19 Immunization Plan, vaccinations will be completed by the end of September. (As noted above, it is starting to look like disruptions in vaccine supply will push back the target date.) As of January 27, more than 124,000 doses had been administered. This first phase covered long-term care homes, health care workers and other high-risk populations. Phase 2 begins in February and covers seniors aged 80 and over and other high-risk and vulnerable populations not immunized in Phase 1. In April, the third phase shifts to the general population starting with persons aged 75 to 79. Distribution continues in 5-year increments down to 60 years at the end of June, with the youngest adults (18-24) completing the vaccination process by the end of September.

In the second and third quarters of 2021 we expect economic growth to pick up as restrictions are gradually eased. B.C.'s tailored approach to closing consumer-facing businesses should also help limit the downside. Many consumers and businesses have adjusted to operating under limited and restricted physical distancing conditions. The final quarter of 2021 will see a more fulsome re-opening of consumer-facing businesses and, perhaps, a return to travel. Economic growth over the course of 2021 will also be lifted by the return to full capacity in the construction sector. All of this assumes B.C.'s vaccination program goes to plan.

EXPORTS HELPING THE RECOVERY

B.C.'s diverse export sector is adding to the recovery. A projected 5.6% expansion in global output in 2021 anchors a generally positive outlook for most of the province's export industries. Global trade has regained its pre-pandemic level and continues to rise. The fact that the U.S. suffered a comparatively mild COVID-induced recession and is growing at a respectable clip is also positive. B.C.'s forest product exports are buoyant. An 8.4% GDP growth rate in China in 2021 – China is B.C.'s second largest export market – is also good news for the province.

Activity in the film and television sector was hit when productions were closed for a period in 2020. Filming has resumed and again is an important factor driving B.C.'s overall exports higher.

The weak spot in in B.C.'s export base, of course, is international tourism. Even with vaccines and the expectation that the U.S. and much of Europe will vaccinate their populations much faster than Canada, we believe international travel will be slow to recover. The industry suffered a devastating blow in 2020. And the future is uncertain. There will be pent up demand to resume travelling later this year if feasible, or perhaps by mid-2022 (again, depending on the actual vaccination rate). But the recovery will probably take multiple years. And it's unclear when the Canada-U.S. border will reopen, and under what conditions. Meanwhile, the number of international visitors coming to the province plummeted a staggering 97% in 2020. In downtown Vancouver hotel occupancy was just 28% last summer (it is lower today). Countries are on different re-opening timelines and the airline industry has been severely disrupted – with Canada hit harder than most due to punitive travel restrictions. Business travel – including for conventions and large meetings – will eventually rebound, but it is unlikely to get back to its pre-pandemic level for many years, particularly since people have seen how digital communications saves both time and money.

EMPLOYMENT REVIVES

Following massive job losses in March and April last year, provincial job numbers had mostly recovered by the end of the year. As with Canada, the COVID shock dealt unequal blows across the economy.

Employment in tourism-related sectors, food and accommodation, transportation, entertainment, and personal services recovered to some extent in the second half of 2020, but the recovery lost momentum in the latter part the year. Sluggish activity in these industries is expected to persist well into 2021 (and perhaps beyond).

In contrast, the number of people working in B.C.'s natural resource sector, manufacturing and in professional and technical services is up sharply since February. Employment in the broad public sector has also increased over the past six months with education reopening and health care hiring for COVID testing and tracing.

The provincial unemployment rate currently sits as at 7.2%, well down from the 13.4% rate last spring. The job market will be slower to heal for younger age cohorts with the unemployment rate for persons below age 25 likely to stay above 10% for much of 2022.

HOURS WORKED FELL SHARPLY

In 2020 the total number of hours worked in B.C. plunged by 10%. This exceeded the 6% drop in employment because hours worked also captures people who retained their jobs but worked fewer hours. The province also saw a significant rotation to part-time employment during the shutdown.

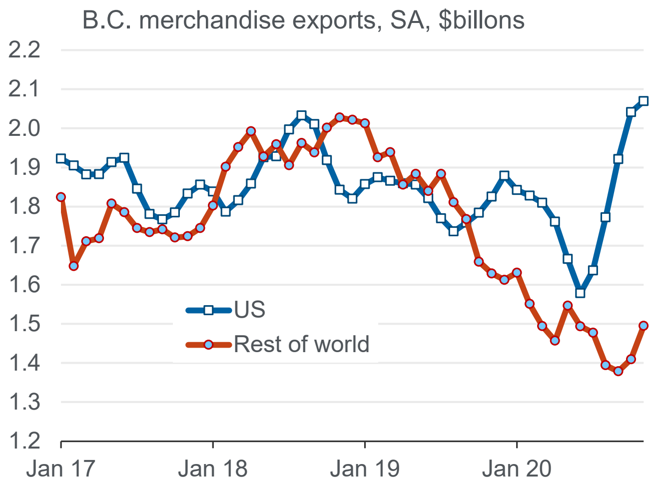
Following massive job losses in March and April last year, provincial job numbers (but not hours worked) had mostly recovered by the end of the year.

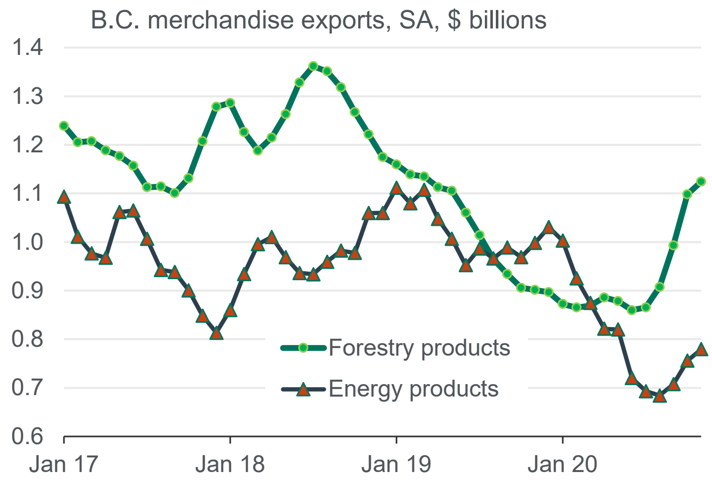
The hit to hours worked was larger in B.C. than in Canada. Nationally, hours worked fell 8.7% for the full year. The B.C. food and accommodation industry took the biggest hit, with hours falling by nearly one quarter. Even though construction has stayed open throughout the pandemic, hours worked in the sector fell 16% because of the need to physical distance on sites. The impact of scaled-back workforces and fewer hours worked was especially significant at large capital projects. Many smaller projects were postponed in 2020.

RETAIL ACTIVITY MOVES HIGHER

Consumers have adjusted to distancing measures, reduced hours, and other impediments and are out spending again in retail outlets around the province. Sales in stores have rebounded. By November retail spending was up around 10% year-over-year. With the exception of gas stations and clothing stores, even the hardest hit segments had recovered. Retail activity is expected to remain solid in 2021, supported by extraordinary government financial transfers to households and also because curtailed spending in areas such as entertainment, travel, and dining means consumers will realign some spending to other parts of the broad retail sector.

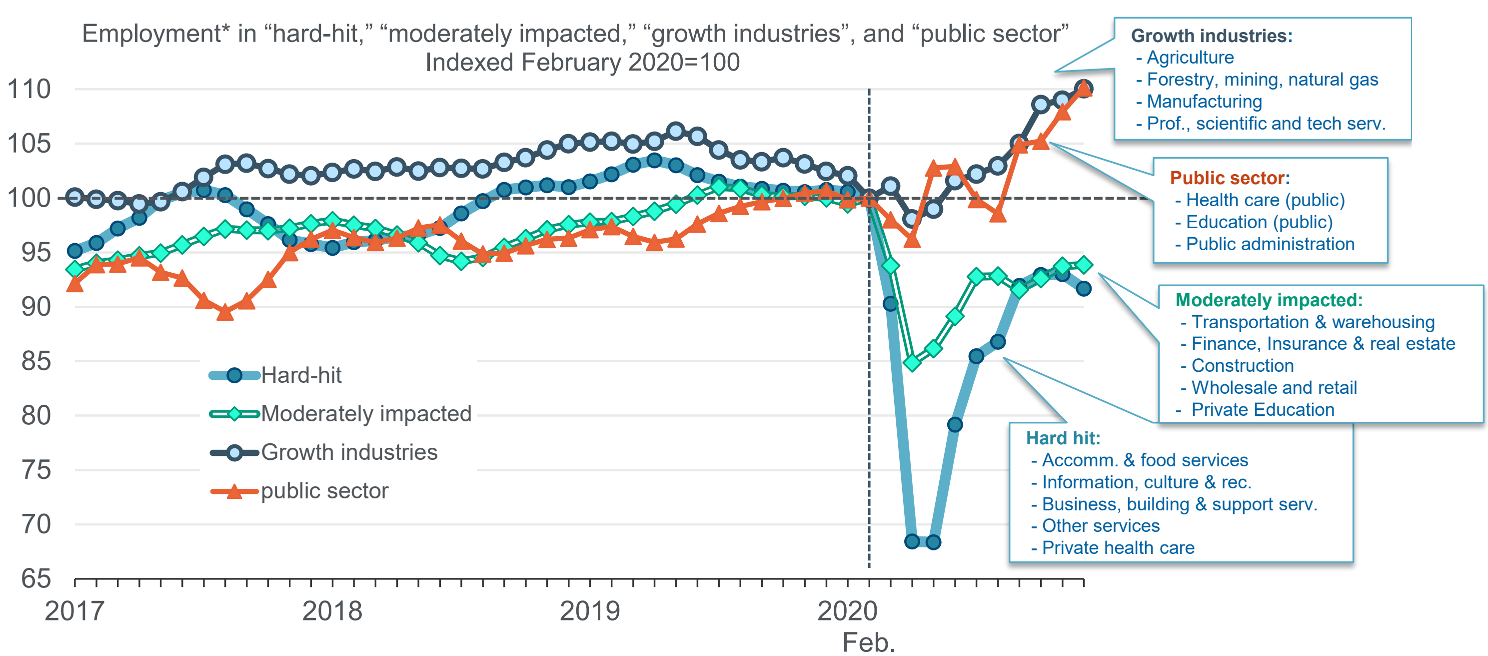
FIGURE 6: **EXPORTS TO U.S. HIGHER, BOOSTED BY FORESTRY EXPORTS**





Source: B.C. Stats. Latest data November 2020, seasonally adjusted, 3-month moving averages.

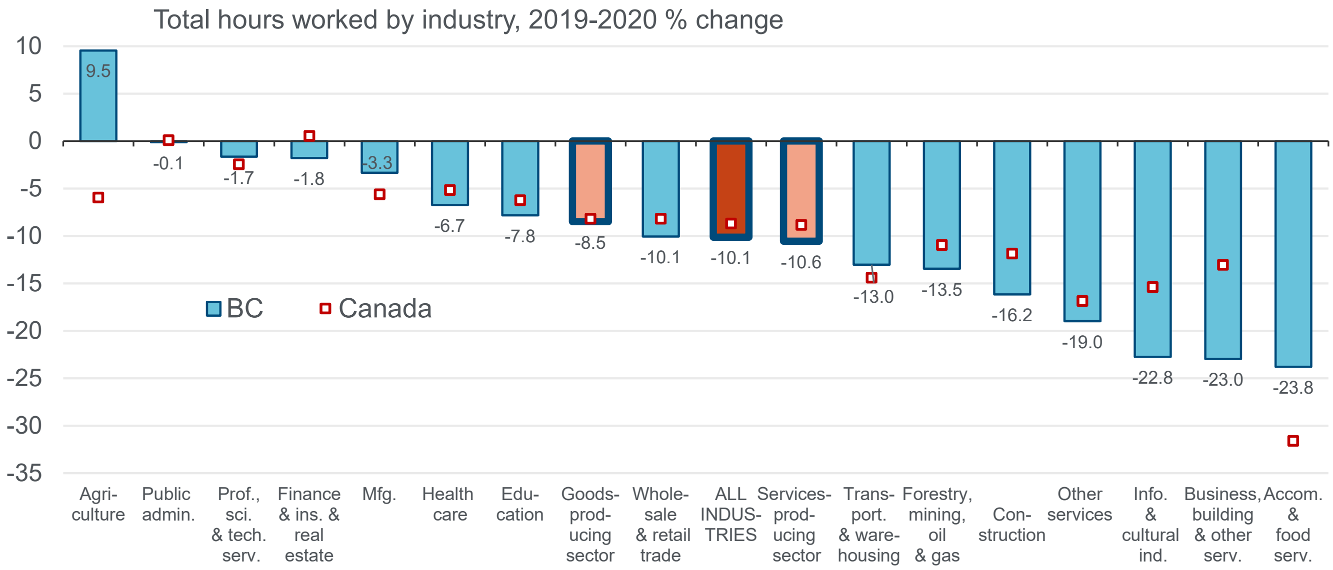
FIGURE 7: **EMPLOYMENT RECOVERY HAS PLATEAUED IN HARDER-HIT AND MODERATELY-HIT INDUSTRIES**



Latest: December 2020. *aged 15 and over, seasonally adjusted, 3-month moving averages up to 2020.

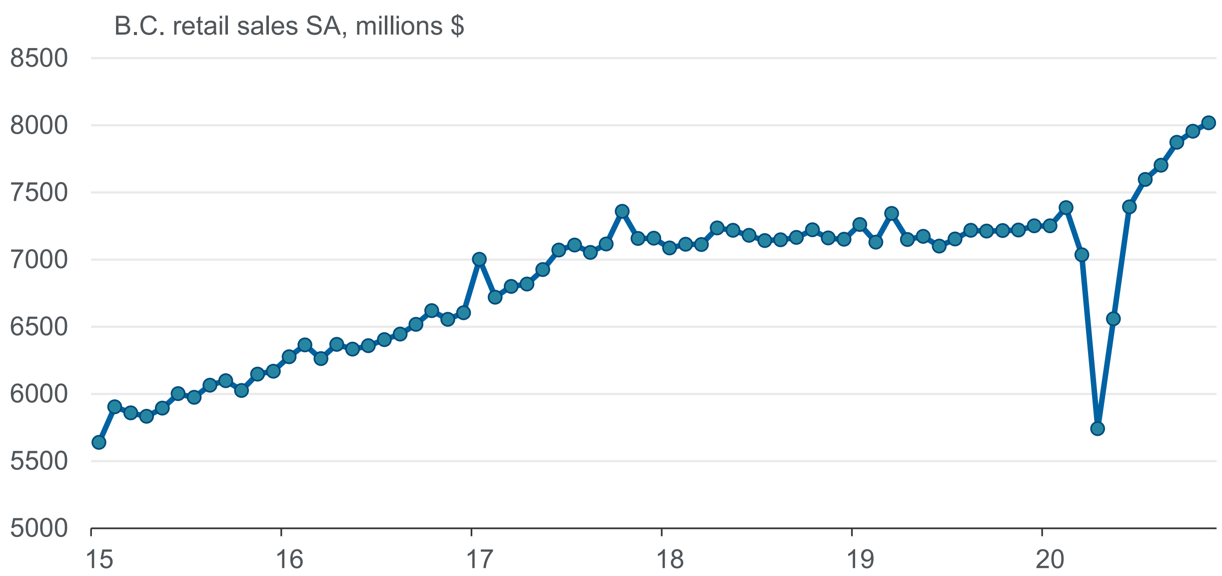
Source: Statistics Canada, Labour Force Survey. Table 14-10-0294-01.

FIGURE 8: **TOTAL NUMBER OF HOURS WORKED IN B.C. FELL 10% IN 2020**



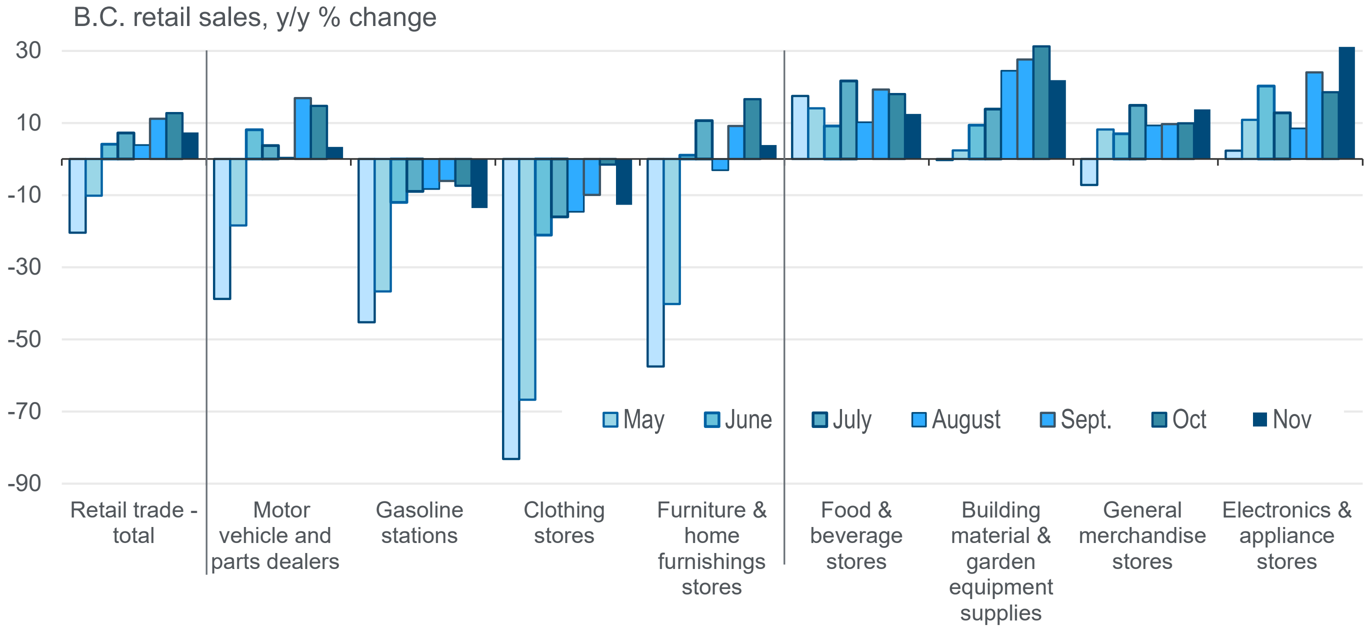
Source: Statistics Canada, Table 14-10-0036-01.

FIGURE 9: **CONSUMERS RETURN TO B.C. STORES**



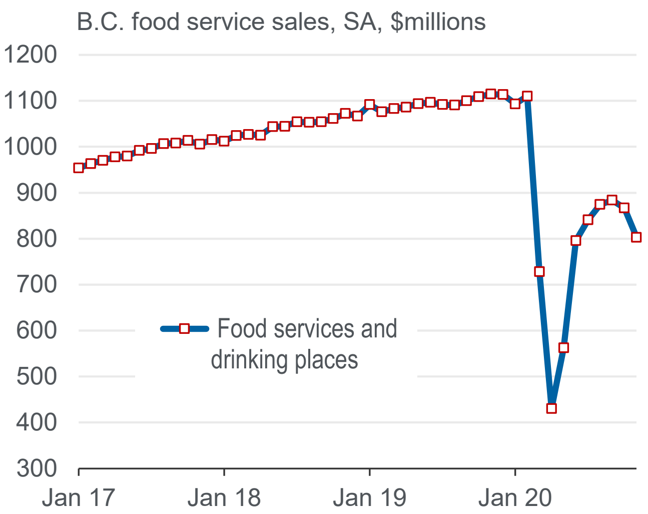
Source: Statistics Canada, Table 20-10-0008-01. Latest: November 2020. SA = seasonally adjusted.

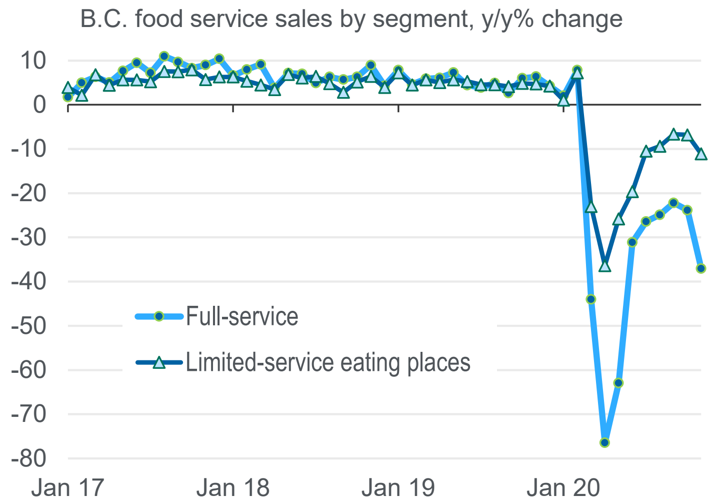
FIGURE 10: **MOST SEGMENTS OF RETAIL HAVE RECOVERED...**



Source: Statistics Canada, Table 20-10-0008-01.

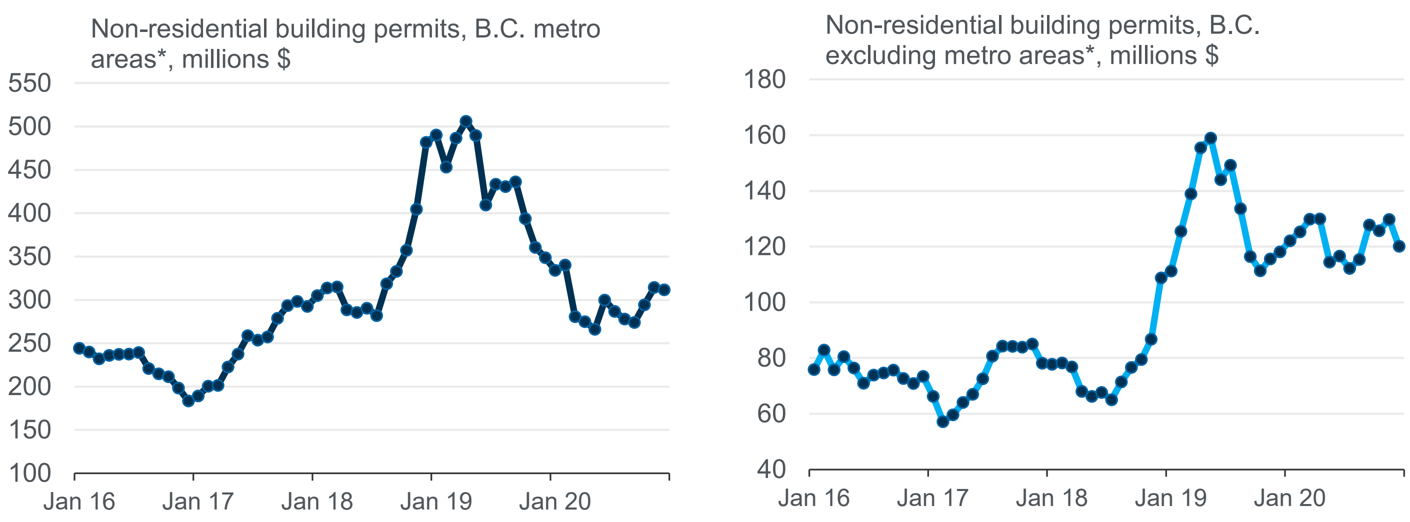
FIGURE 11: **...BUT FOOD SERVICE SALES STILL WELL BELOW PRE-PANDEMIC LEVELS**





Source: Statistics Canada, Table: 21-10-0019-01. Latest: November 2020. SA = seasonally adjusted.

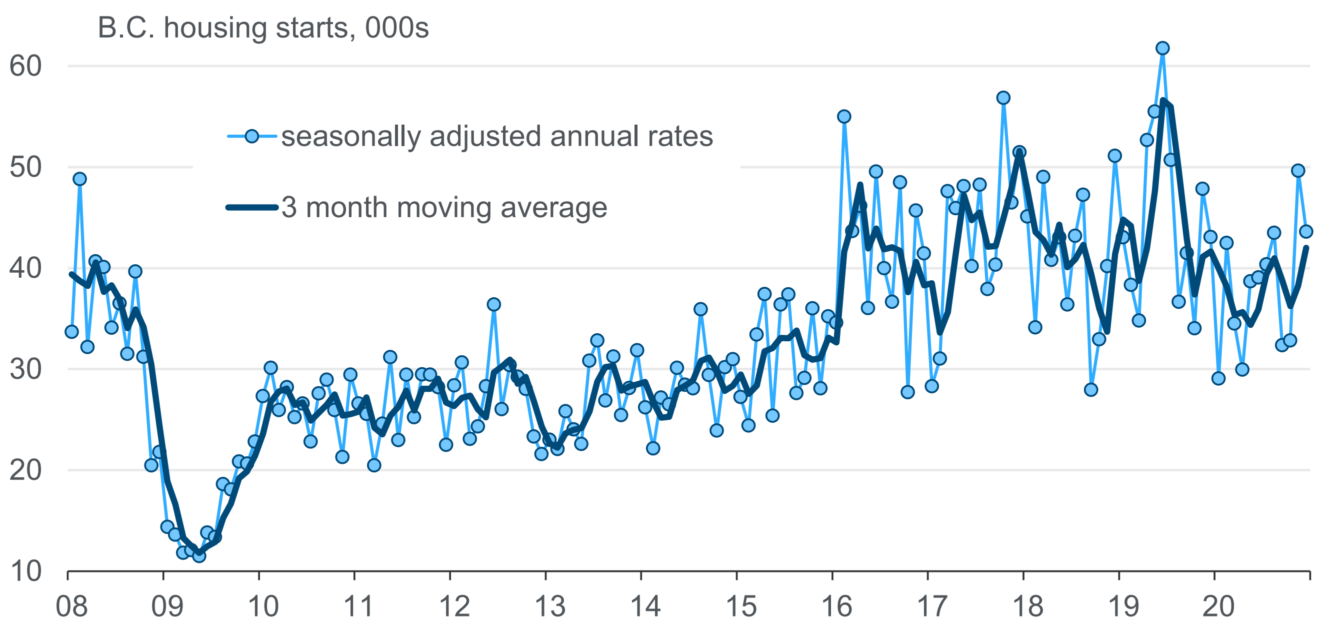
FIGURE 12: **NON-RESIDENTIAL PERMITS HAVE HELD UP IN NON-METRO AREAS**



*Vancouver, Victoria, Abbotsford and Kelowna.

Source: Statistics Canada . Table: 34-10-0066-01. Latest: December 2020. 6-month moving averages.

FIGURE 13: **PROVINCIAL HOUSING STARTS RELATIVELY STABLE IN THE WAKE OF THE PANDEMIC**



Source: Statistics Canada, Table: 34-10-0158-01. Latest: December 2020.

Despite a solid growth outlook, it will still take time for the provincial economy to fully heal. Much depends on the path of the virus

HOUSEHOLD SPENDING ON SERVICES SLOWER TO RECOVER

Retail spending has posted an impressive revival but some parts of household consumption will not regain pre-crisis levels until large gatherings are allowed (e.g., sporting events, concerts, conventions, casinos, and some other services are reopened). In-house dining is still operating at around 50% capacity and recently (November) restaurant sales fell again.

CAPITAL INVESTMENT AND CONSTRUCTION PROVIDE A BOOST IN 2021

Construction has long been a key B.C. economic engine and that is set to continue. In the five years to 2019, construction registered the strongest average growth performance of any major industry group. In 2019, construction of large capital projects accounted for more than half of all economic growth. Construction will continue to make an outsized contribution to growth in B.C. Non-residential building permits reached record highs in 2019 and have generally held up well during the pandemic. Fiscal stimulus will boost non-residential construction over the next two years as governments look to advance various capital projects to boost the recovery and "green" the economy.

B.C.'s large residential construction sector will also support growth in 2021. The reduction in mortgage rates to near-record lows is good for affordability (although the benefit has largely been offset by rising prices for single family homes). Although residential home sales were initially curtailed because of COVID, later in the year sales activity climbed to record highs. While sales may stabilize in 2021, the level of activity will remain elevated and housing starts should pick up from 2020. The provincial government is expected to continue with its affordable housing programs which will further add to new home construction over the forecast horizon.

IMPACT OF FISCAL AND MONETARY POLICY STIMULI

In response to the pandemic's economic disruption, the federal government delivered hundreds of billions of dollars in financial support to households and businesses while the Bank of Canada slashed its policy interest rate and engaged in unprecedented "quantitative easing" by directly purchasing government-issued debt. Overall, Ottawa has done the lion's share of the fiscal heavy lifting in the past year. However, provincial governments, including in B.C., also stepped forward with significant measures aimed at shoring up stressed health care systems and assisting households and firms. With the bumpy economic recovery now underway, we anticipate that governments will continue to invest in infrastructure and move only gradually to unwind the extraordinary spending programs adopted in 2020.

CONCLUDING THOUGHTS

Considering the damage reaped in 2020, the B.C. economy could post a solid growth performance over the next two years. However, as for Canada, the timing of the economic recovery hinges on the timing for vaccine delivery, which is racing against the spread of the virus and the B.1.1.7 variant. B.C. has enjoyed a comparatively strong rebound in employment. The province's export and construction sectors are leading the recovery as spending on high-contact services remains restricted. The drop in interest rates has spurred activity in the residential real estate sector, which should translate into more home building in the coming years.

Despite a solid growth outlook, it will still take time for the provincial economy to fully heal. Much depends on the path of the virus, the impact of new strains, the pace of vaccinations, and how businesses and consumers respond to what remains a complex and uncertain economic environment. There are significant risks to our baseline forecasts. It is starting to look likely that Canada, and therefore B.C., could lag other advanced countries' vaccination rates by about 6 months. That would mean herd immunity and a return to normal activities is not possible by the end of 2021 as curently expected. Rather, this would take place by mid-2022, in line with the timing for emerging market economies. For B.C., another key unknown is how quickly the battered tourism sector springs back to life after a truly disastrous 2020.

Looking further ahead, government policy risks have also emerged as factors that could weigh on the broader business environment and affect the outlook for investment. The tax burden for business and high-skilled earners in B.C. (and Canada) has increased and is now higher than in most competing jurisdictions. The increasing array of new, complex and costly regulations is making it harder for many firms to justify deploying fresh capital to the province. Canada's recent decision to sharply boost carbon taxes over the next decade could speed the decline of some natural resource and manufacturing industries that are sensitive to the cost of energy. More generally, both Canada and B.C. have entered an era of activist and expanding government. In this setting, policymakers need to be alert to waning competitiveness and pay attention to the province's ability to attract private sector capital investment dollars and qualified talent.

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