Lillian Hallin
(250) 387-0366
Lillian.Hallin@gov.bc.ca

BC Stats
April 2008
Issue: 08-04

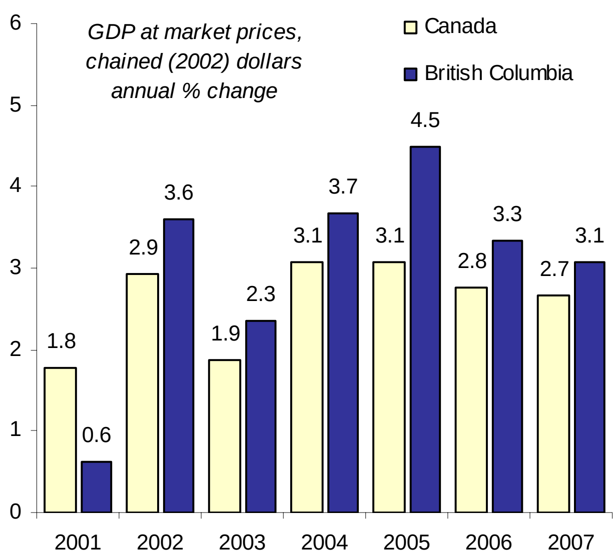
Business Indicators ◆ April 2008

Steady growth in 2007 despite slowdown in goods sector

BC's economy expands 3.1% in 2007

British Columbia's economy expanded 3.1%[1] in 2007, as the province outpaced the national economy for a sixth straight year. However, the increase in gross domestic product (GDP) fell short of the gains made in recent years. After posting the second-highest growth rate[2] in the country (+3.3%) in 2006, British Columbia's ranking relative to other provinces slipped to fourth place in 2007.

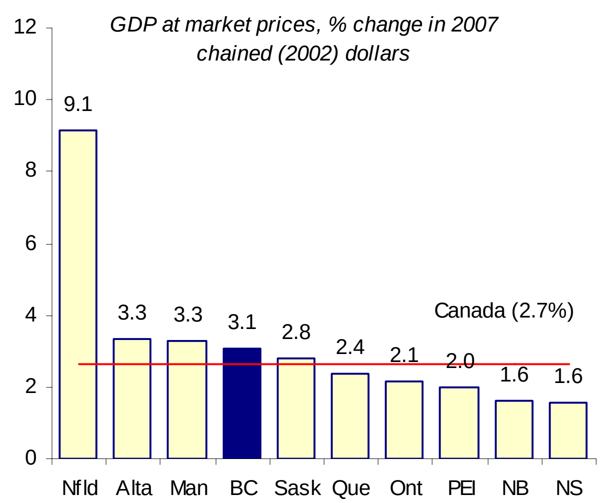
British Columbia's economy grew faster than Canada's for a sixth straight year…



[1] Unless otherwise noted, the figures quoted in this article are expressed in chained (2002) dollars. The data comes from Statistics Canada Catalogue 13-213-PPB, released April 28, 2008.

[2] GDP growth in the North tends to be somewhat volatile so most inter-regional comparisons only include the provinces.

… but Newfoundland, Alberta and Manitoba recorded stronger growth in 2007



Data Source: Statistics Canada

Newfoundland & Labrador's economy shot ahead 9.1%, fuelled by its offshore oil industry. The increase in GDP was more than triple the national average (+2.7%) and well in excess of the growth seen in other provinces. Economic conditions were also robust in the North, with NWT (+13.1%) and Nunavut (+13.0%) making big gains during 2007, while Yukon's economy posted a solid 3.8% gain.

While much of the recent economic news about the Canadian economy has been focused on a slowdown in Central Canada sparked by flagging conditions south of the border, the situation in Western Canada is quite different. Alberta and Manitoba (both at +3.3%), BC (+3.1%) and Saskatchewan (+2.8%) all outperformed the national economy in 2007.

Since the turn of the century, Canada's economic momentum has been shifting away from the traditional industrial heartlands in Ontario and Quebec and towards the West, which has been experiencing a sustained economic boom. BC and Alberta have posted stronger-than-average growth in every year since 2002, and while economic conditions in Saskatchewan[3] and Manitoba have not been quite as robust, these provinces have also benefited from generally strong growth during the last five years. Over the same period, the economies of both Ontario and Quebec have consistently lagged behind the national average. This is the first time that Ontario has seen its economy grow at a slower-than-average rate for an extended period.

Energy fueled Newfoundland's economic growth but in BC and Alberta, the service sector accounted for most of the gains in 2007

Newfoundland's newfound status as one of the growth leaders in the country is largely due to its offshore oil industry. The province's energy sector expanded 22.0% in 2007, helping to boost Newfoundland's growth to near-record levels in that year. Alberta's very strong economic growth in recent years also owes a good deal to its oil and gas sector. However, the energy sector was not a big factor in 2007. In real terms Alberta's energy sector contracted slightly (-0.8%), indicating that even though prices continued to rise, the actual value added by the industry declined slightly during the year.

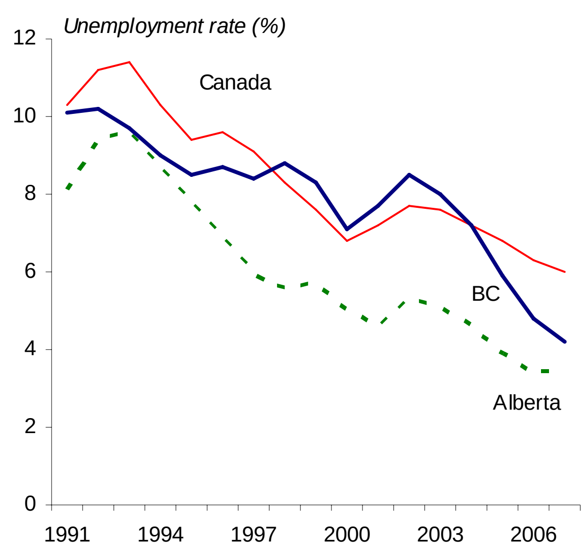
BC's economic growth during 2007 occurred despite systemic weakness in the resource sector. GDP in the province's goods industries shrank (-0.8%) as economic output slowed in most of the big resource industries. Forestry, wood, paper, food & primary metal manufacturing and mining, oil & gas extraction all lost ground during 2007. Despite this, the economy's overall performance remained solid, partly due to continued growth in the residential construction industry, together with ongoing strength in the province's service sector, which generates about three-quarters of British Columbia's GDP.

Interestingly, the situation in Alberta was not all that different. GDP growth in the goods sector was modest at best (just over half a percent) in 2007. It was a surge in service sector industries that boosted Alberta's economy, keeping the province among the top performers in the country during the year.

Most economic indicators strong in 2007

Employment in BC increased 3.2%, well above the national average (+2.3%) and more than in any other province except Alberta (+4.7%). British Columbia's unemployment rate fell to its lowest point (4.2%) in more than thirty years. Alberta was the only province where the unemployment rate was lower than in BC.

BC's unemployment rate was at its lowest level in 30 years



Data Source: Statistics Canada

[3] Saskatchewan's economy shrank slightly in 2006 (-0.4%) but has outpaced the Canadian economy in every other year since 2003.

Retail sales rose 7.2%, the strongest increase since the mid-1990s. This was only partly due to higher costs for oil and gas, as the overall price of consumer goods increased relatively modestly (prices for non-durable goods, including fuels, were up about two percent, but consumers paid about one percent less for semi-durable and durable goods purchased in the province).

Housing starts advanced 7.6%, posting the strongest growth since 2004. Although this was well below the double-digit increases seen in the early part of the decade, it represents a more sustainable level of growth.

Domestic demand continues to drive economic growth

Domestic demand (consumer, business and government spending on goods and services, plus investment in fixed capital) was again the main source of growth in BC's economy, increasing 4.9% during 2007.

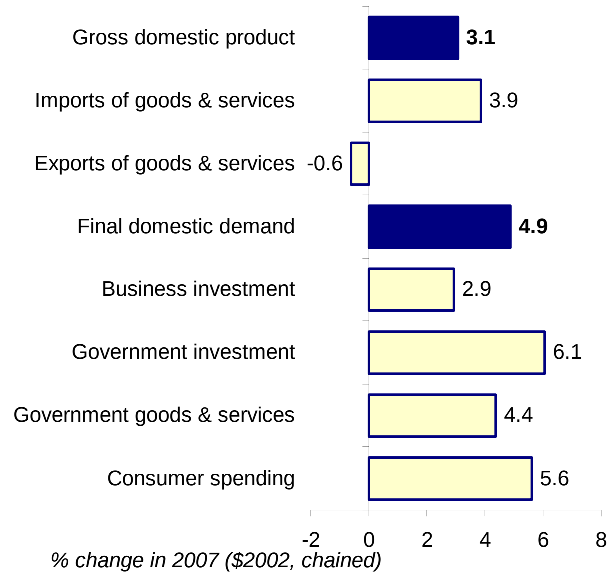
Consumer spending continued to rise (+5.6%) as consumers invested heavily in durable (+8.9%) and non-durable (+8.2%) goods such as new appliances, furniture, clothing and household furnishings. Spending on services increased 5.6%, but purchases of non-durable goods (such as food and fuels) rose a more modest 2.8%.

Current expenditures (wages, salaries and purchases of goods and services) of the federal, provincial and local government sector (which includes hospitals, schools and other institutions) grew 4.4%, only marginally more than in the previous year.

Governments invested in new machinery, equipment and structures (+6.1%), but spending rose at a slower pace than in recent years. Infrastructure projects related to the Olympics have boosted government investment levels in recent years but as 2010 approaches and work on some of the projects is completed, this is likely to become a less important source of economic growth in the province.

A downturn in spending on non-residential structures (-2.2%) put the brakes on business investment, which rose just 2.9% during the year after posting a double-digit increase in 2006. Investment in machinery & equipment (+7.2%) and residential structures (+3.5%) also slowed down considerably from the rapid pace set during the early part of the decade.

Consumer spending and government investment key sources of growth in 2007



Data Source: Statistics Canada

Trade deficit continues to grow

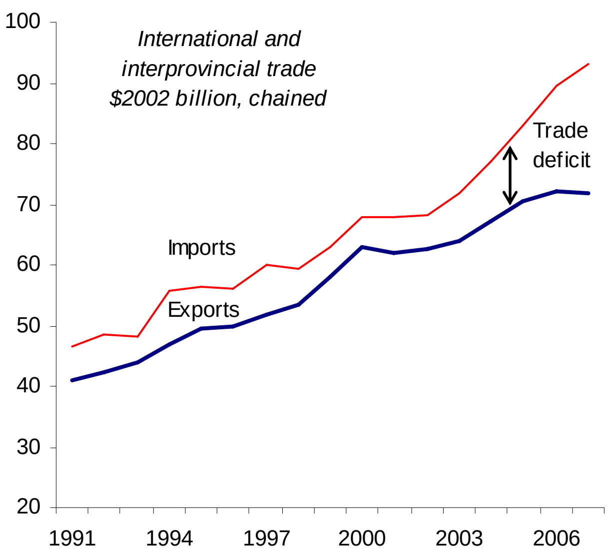
The province's trade deficit continued to worsen as the value of exports, both international and interprovincial, fell (-0.6%) for the first time since 2001. Exports of goods and services bound for other countries were down 1.0%, largely due to a decline (-1.2%), also the first since 2001, in the value of goods shipped to other countries.

At the same time, total imports of goods and services increased 3.9% in 2007. This was almost entirely due to a 6.4% increase in the value of international imports. Interprovincial imports rose only marginally (+0.7%) during the year.

A strong Canadian dollar, together with continued growth in domestic demand for goods and services, almost certainly contributed to the increase in international imports, while keeping a lid on the province's exports to other countries. Many of the goods exported from BC are valued in US dollars or other currencies, so an appreciation of the Canadian dollar means that exporters receive less for their products when the exchange rate is factored in. At the same time, goods that are valued in Canadian dollars become more expensive to foreign buyers, which may reduce the demand for these products.

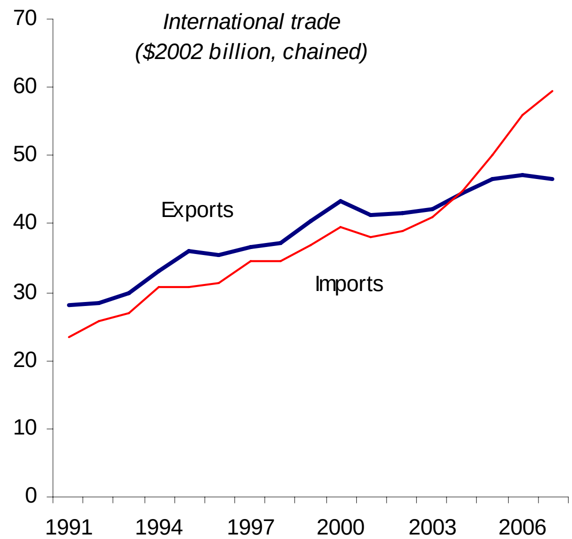
On the other hand, imports become more affordable when the dollar is strong, and this tends to boost the demand for these goods. However, a stronger dollar doesn't seem to have boosted BC's imports too much; last year's increase was significantly lower than in the previous three years.

BC's overall trade deficit deepened as export growth stalled while the demand for imported goods and services increased



Data Source: Statistics Canada

International demand for BC goods and services continued to slump



Data Source: Statistics Canada

Canadian demand for BC products softened, and interprovincial exports of goods fell (-4.6%), offsetting a similar (+4.7%) increase in service exports. Total exports to the rest of Canada were virtually unchanged from the previous year.

Many of the goods and services used in BC are not produced here, so the only way to supply domestic demand is by bringing them into the province. Because BC producers are not able to satisfy domestic demand, this means that growth in consumer, business and government spending is a bit of a mixed blessing, since producers in other regions may be the biggest beneficiaries of an increase in final domestic demand in this province.

BC has always been a net importer of goods and services from other provinces, but has traditionally had a significant surplus in international trade. This is no longer the case. The province has become a net importer at both the international and interprovincial levels. In fact, 2007 marked the fourth straight year in which BC's international imports of goods and services were higher than the value of its exports–and the size of the gap is growing.

BC's expanding international trade deficit is cause for concern. Goods account for nearly 80% of the total value of exports, and the province's international export base remains largely grounded in the traditional resource commodities. While the province is less reliant on trade with the US than are other parts of Canada, our dependence on US markets has increased over time. With the US economy slowing, the demand for BC lumber and other resource products shipped south of the border is likely to decline.

Whether or not the province will be successful in diverting some of these commodities toward other markets overseas remains to be seen. The outlook may not be all that promising. BC's commodity exports to a number of key markets (other than the US) fell[4] in 2007. China was a notable exception, but while international shipments to that country have increased significantly, they still account for only 6% of total international commodity shipments. The US, at 60%, remains by far the most important international market for BC products, followed by Japan (13%).

In terms of commodities, BC continues to rely significantly on resource based goods, but there are indications that the export mix is diversifying. In 1988, nearly 60% of the province's total commodity exports were forest products. That share has been falling and was less than 40% in 2007. Not surprisingly, energy products have become a more significant part of the export mix (up to 20% from 12%[5]). There are some signs of diversification: international shipments of more highly processed products (such as machinery and equipment and other manufactured goods) have increased their share of total commodity exports from 10% to 20%.

How does BC stack up?

BC's economy has performed quite well in recent years. Its GDP has grown faster than the national average since the early part of this decade, and by many measures, the province has done quite well. With the province's unemployment rate at a thirty-year low, and solid growth in most economic indicators, overall economic conditions in the province are quite robust.

However, the province is part of a larger economy, and while it has done better than many other parts of Canada, it has fallen behind in other respects. BC's relatively solid growth is not that impressive when compared to other provinces, particularly those in the West, which have also been traditionally viewed as resource-based.

BC's economy falling further behind Alberta's

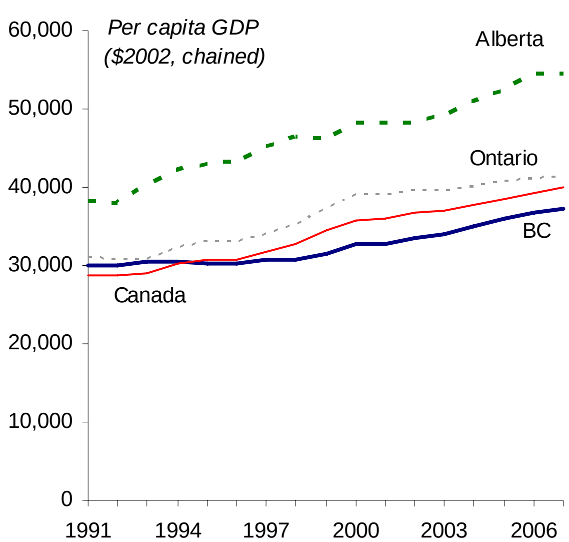
With 13% of the nation's population, it would not be unreasonable to expect that BC's economy should represent a similarly large share of total GDP. However, when compared to its population, the province's economic base has been deteriorating. Per capita GDP in BC fell below the national average in the mid-1990s, and has remained there since then. Despite the recent slower growth in Ontario's economy, on a per capita basis, the increase in BC's GDP has failed to keep pace with per capita economic growth in Ontario. Alberta is now firmly ensconced as the third largest economy in the country, a position traditionally held by British Columbia. Alberta's total gross domestic product was 16% higher than BC's in 2007.

[4] Export data by country and commodity are in current dollars, and based on customs data, so are not completely consistent with the information in the economic accounts. However, it is unlikely that adjusting for inflation would significantly affect the trends discussed in this section.

[5] At least some of this increase is price-related. However, the increase in the cost of energy products is partly offset by the effect of a stronger Canadian dollar.

By almost every measure of either income or expenditure, Alberta's economy is now larger than BC's not only a per capita basis, but also in actual dollar terms. On the income side[6], total labour income, profits, investment income and capital consumption allowances in Alberta exceed those in BC. Although Alberta does not have a provincial sales tax, both GDP at market prices (including sales taxes) and at basic prices (excluding them) is higher in Alberta than in BC. On the expenditure side, total final domestic demand, business and government investment, exports and imports in Alberta are all higher, in absolute terms, than in BC–and the gap is growing bigger.

Per capita GDP in the province remains below the national average, and is falling further behind both Ontario and Alberta



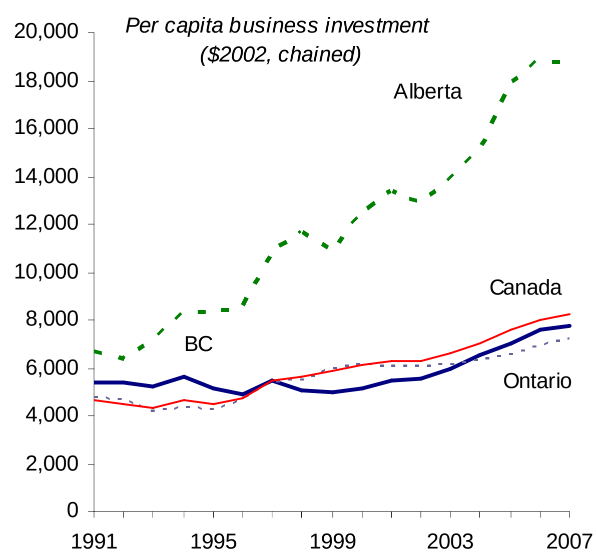
Data Source: Statistics Canada

Investment in new plant and equipment has not kept pace with other regions

More troubling is the fact that during this period of relatively strong growth, the necessary foundation for future economic growth in the province has not been laid. BC businesses have not invested as much (per capita) in new plant and equipment as those in most other parts of the country.

In 2007, only the Atlantic provinces invested less in new machinery & equipment, per capita, than BC. In terms of business investment in new structures, BC ranked fourth among the provinces, after Alberta, Saskatchewan and Newfoundland. While investment patterns are partly related to economic structure, lower than average capital expenditures may be one of the factors contributing to the province's comparatively low business sector labour productivity.

Per capita investment in new plant and equipment is below the national average[7]



Data Source: Statistics Canada

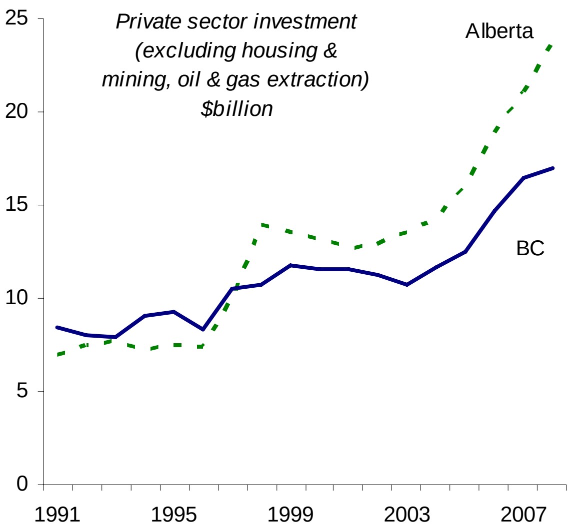
The extent to which private sector businesses (in both the goods and service sectors) are willing or able to invest in new plant and equipment is a key indicator of the future prospects for economic growth. Investment involves an element of risk; businesses are spending money today in order to improve their processes or increase their production in

[6] The income account is measured in current dollars.

[7] The disparity would be even more pronounced if investment in new residential structures was excluded, since per capita spending on housing in BC is the highest in the country.

the future. They will only be willing to do so if they believe they will get a good return on their investment. The fact that businesses in BC continue to invest less than those in other parts of the country is therefore cause for concern, and the reasons for this deserve further investigation.

Private sector investment[8] in Alberta exceeds that in BC even when spending by the oil and gas industry is excluded



Data Source: Statistics Canada

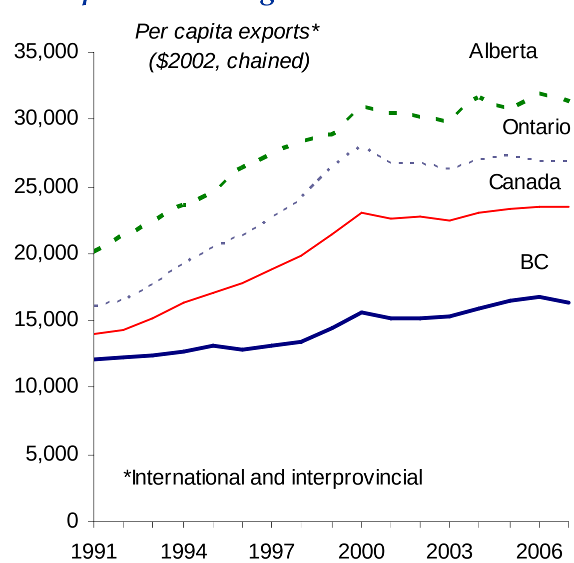
In contrast, Alberta businesses have been investing heavily in new plant and equipment, and have done so since the early 1980s. This higher-than-average per capita investment has persisted even through periods of economic slowdown in Alberta. Past investment decisions in that province have, without a doubt, contributed significantly to the province's current strong economy.

It can be argued that the higher level of investment in Alberta reflects the huge capital requirements of leading edge oil and gas extraction technologies such as the Alberta tar sands, which required massive investment decades before the first barrel of tar sands oil was ever produced. This is, however, only partially true. A comparison of private sector investment in BC and Alberta, excluding the oil and gas industry and, in the case of BC, spending on new housing, suggests that even when these are taken into account (and when industry by industry comparisons are made) the Alberta advantage remains.

Export markets in decline

Relative to its population, BC exports less goods and services to other provinces and countries than either Alberta or Ontario. In fact, on a per capita basis, the province's exports are among the lowest in the country. Nova Scotia is the only province that exports less, per capita, than BC. This represents a significant deterioration since the 1980s, when BC was ranked fourth among the provinces. BC's relative position has worsened steadily since the mid 1990s.

On a per capita basis, the value of BC's total exports is among the lowest in the country



Data Source: Statistics Canada

Twenty years ago, BC was one of the most internationally export-oriented economies in the country, but this is no longer the case. Per

[8] This data comes from the private and public investment intentions survey, and is expressed in current dollars.

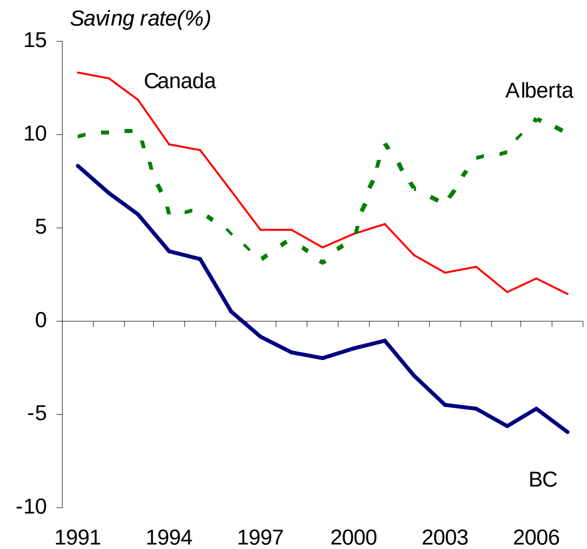
capita international exports are nearly 50% lower than the national average. Both Ontario and Alberta export significantly more, per capita, than the national average. The disparity is even more pronounced when only goods exports are considered. This suggests that BC exporters have been unable to expand their markets to the same extent as those in other parts of the country.

Saving rate continues to fall

The saving rate resumed its downward path in 2007, falling to -5.9% as British Columbians spent an average of $1,454[9] more than their after-tax income. BC was one of only four provinces where personal expenditures exceeded personal disposable income[10] in 2007.

The province's negative saving rate reflects the fact that personal disposable income in BC is slightly lower[11] than the national average, while per capita spending is significantly higher than in the country as a whole. Housing costs in the province contribute to this higher-than-average spending. Personal expenditures on goods and services include an estimate of the rental value of owner occupied housing. In a market where real estate costs considerably more than in other parts of Canada, consumers have to spend a bigger chunk of their income on housing. In fact, when paid and imputed rent are excluded from per capita personal expenditures, spending in BC is more in line with the Canadian average. Even when these expenditures are excluded, however, BC residents still save less of their after-tax income than the average Canadian does.

BC's saving rate is the lowest in the country



Data Source: Statistics Canada

A number of factors contribute to lower than average personal after tax income in the province. Most notably, the labour income of British Columbians is not as high, on a per capita basis, as in the other have provinces. This is not because wages are lower in BC (average hourly earnings in this province have increased faster than the Canadian average), but because relatively fewer British Columbians are in the workforce. BC's labour force participation rate is slightly below Canada's and about 8 percentage points lower than in Alberta, which has the highest rate in the country.

What lies ahead?

BC's economy faces some serious challenges. The province's relatively strong economic growth and labour market conditions mask some fundamental weaknesses in the economy. If the province is to continue to enjoy strong growth in the future, the underlying causes of some of the weaknesses will need to be addressed. Otherwise, British Columbia could see itself falling even further behind the rest of Canada.

[9] 2002 dollars.

[10] Personal income minus taxes and other payments to government.

[11] Per capita income in the province is well below the national average, but the effect of this is partly offset by lower-than-average transfers (taxes, other payments to government and contributions to social insurance plans) to government.