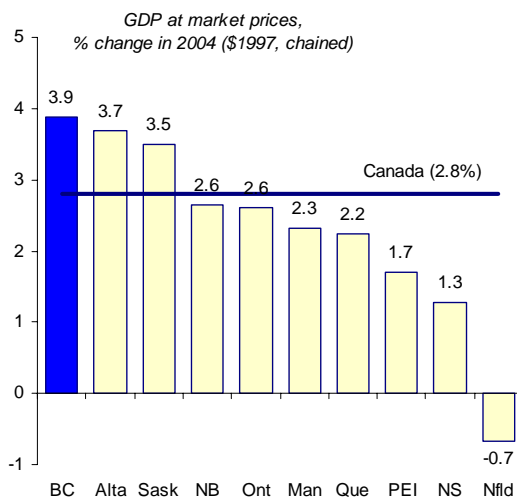


## Business Indicators ♦ June 2005

### BC's economy picks up speed in 2004

**BC outperformed the other provinces for the first time in nearly two decades**

**BC led the provinces for the first time since 1987**



Data Source: Statistics Canada

British Columbia's economy picked up speed in 2004, outperforming every other province<sup>1</sup> during the year. Real gross domestic product (GDP) expanded 3.9%<sup>2</sup>, considerably more than the national average (+2.8%). Alberta (+3.7%) and Saskatchewan (+3.5%) also posted solid growth in 2004, but last year's strong performance catapulted British Columbia to the front of the pack for the first time since 1987.

<sup>1</sup> Northwest Territories actually recorded the strongest growth in the country (+4.2%) last year, but its small size means that year-to-year changes are very volatile (ranging from +4.1% to +21.2% during the last five years). Comparisons among regions have been limited to the provinces.

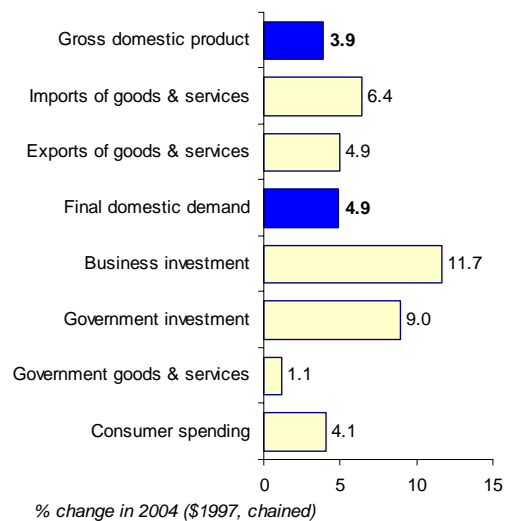
<sup>2</sup> Unless otherwise noted, all of the figures quoted in this paper are in constant (\$1997, chained), or "real" dollars. The data comes from Statistics Canada, primarily from Catalogue 13-213.

**Domestic demand for goods and services still the main engine of growth**

Many factors contributed to the improvement in the province's economic fortunes during 2004. Robust domestic demand was a key element in the overall strength of the economy, as was a rebound in BC's export markets.

Final domestic demand (consumer, business and government spending on goods and services, plus investment in fixed capital) increased 4.9% during the year. BC's hot housing market, which affected both the level of consumer spending and business investment, was a key driving factor.

**Rising imports tempered the effect of strong domestic and external demand for BC products**



Data Source: Statistics Canada

GDP is equal to final domestic demand (consumer, business and government spending and investment) plus inventories, and exports minus imports

Despite strong export growth, trade with other provinces and countries continued to act as a brake on the economy, since exports did not increase fast enough to offset a growing appetite for imported goods and services.

Because many of the goods consumed in the province are not produced in British Columbia, only a portion of the economic activity associated with increased spending on these commodities benefits domestic industries—those that handle or transport the goods in question. This means that the positive effect of robust domestic demand is diluted when the demand is largely satisfied using imported goods or services.

### **Consumer spending was robust**

Consumer expenditures, accounting for about 60% of total domestic demand, rose 4.1%, as purchases of most types of goods and services increased significantly. Investment in consumer durables, often seen as a bellwether of confidence in the economy, was up 4.7%. Sales of furniture, appliances and similar consumer durables increased significantly. This was almost certainly a by-product of an active real estate market, as individuals who move house often invest in new furnishings and accessories. Spending on semi-durable (+5.4%) and non-durable (+3.3%) goods continued to increase. Consumer purchases of services advanced 4.1% during the year. Both paid and imputed<sup>3</sup> rent costs rose, reflecting the effect of a strong housing market. Paid and imputed rent accounts for nearly a quarter of total consumer spending in the province.

<sup>3</sup> Imputed rent is an estimate of the rental income foregone by homeowners who reside in their homes. It is an important component of consumer expenditures, unincorporated business income, and the GDP of the finance, insurance and real estate industry.

### **High fuel prices didn't keep people off the roads, but they're buying smaller vehicles**

High fuel prices had an effect on consumer spending patterns, but it was not as profound as might be thought. In real terms, spending on natural gas and heating fuels declined, suggesting that consumers may have reacted to higher prices by conserving energy. However, other factors such as weather conditions may also have influenced the demand for heating fuels.

High prices didn't keep people from gassing up their vehicles. Even with the effects of price increases factored out, sales of gasoline and motor fuels<sup>4</sup> were up for the second year in a row.

Retailers of new and used vehicles did not fare well in 2004 as the value of sales declined for the second year in a row. The extent to which gas prices may have contributed to the slump is unknown. Whatever the cause, consumer preferences for vehicles are shifting away from trucks and vans and back to cars. Trucks and vans dominated the new vehicle market during the late 1990s, but since 2003, sales of these vehicles have slipped back behind new car sales, possibly because fuel efficiency is becoming more of an issue for purchasers of new vehicles.

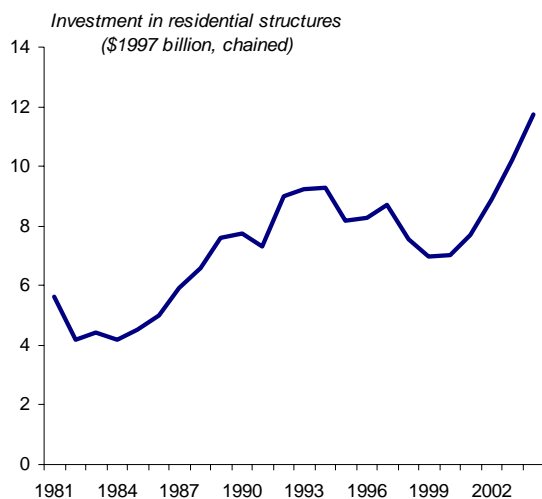
### **Business investment soared as the housing boom continued unabated**

Business investment in fixed capital was a major factor in the province's strong economic performance last year. Overall, investment by the business sector increased 11.7% during 2004.

The housing boom continued unchecked as new starts climbed to record levels. Work began on nearly 33,000 new housing units last year, more than double the number in 2000.

<sup>4</sup> This includes purchases by residents as well as visitors to BC who filled up their gas tanks while they were in the province.

## Residential investment climbed to new highs



Data Source: Statistics Canada

The frenetic pace of new housing construction continued as spending on residential structures advanced 14.8%, reaching record-high levels after four straight years of similarly strong growth. The value of new housing construction rose more than twenty percent. Spending on alterations and improvements was somewhat more restrained, but still grew at double-digit rates. Real estate commissions from the transfer of ownership of existing dwellings were also up.

Businesses invested heavily in new machinery and equipment, with spending increasing by a fifth (+20.0%) during 2004. A stronger Canadian dollar may have been a factor in these investment decisions, since much of the equipment is imported. However, other factors such as generally favourable economic conditions and strong demand for BC products would also have played a role in decisions to replace or upgrade existing equipment. Business investment in commercial and industrial buildings and other types of infrastructure slipped 4.2%, reversing the gain made in 2003.

The value of inventories continued to rise, as the volume of production continued to outpace growth in demand for BC goods.

### Governments held the line on current spending, but invested in infrastructure

Governments held the line on purchases of goods and services, which advanced 1.1% in 2004. Federal government spending increased, but the provincial and local government sectors (including hospitals, schools and post-secondary institutions) were more restrained.

Government investment in fixed capital rose a substantial 9.0%, primarily due to spending on new buildings, roads, and other infrastructure (+13.8%). However, purchases of machinery and equipment fell 3.0%.

### Trade deficit grows as exports recover, but imports soar

Both international and interprovincial exports increased in 2004, as external demand for BC goods and services was robust. However, the value of imported goods purchased in 2004 rose even more, and the external sector once again acted as a drag on the economy. The increase in international imports alone was more than enough to offset the boost provided by both international and interprovincial exports last year.

Exports to other countries advanced 5.8% during 2004. The growth in international exports was primarily concentrated in the goods sector, which expanded 6.1% to \$33.8 billion. Exports of wood and paper products were particularly strong. Service exports rose 1.7% during 2004, largely because of strong growth in exports of transportation services.

A high Canadian dollar made international imports less costly for BC consumers and businesses, and purchases of goods and services produced outside the country rose sharply (+10.4%) during 2004.

## International trade deficit looming?



Data Source: Statistics Canada

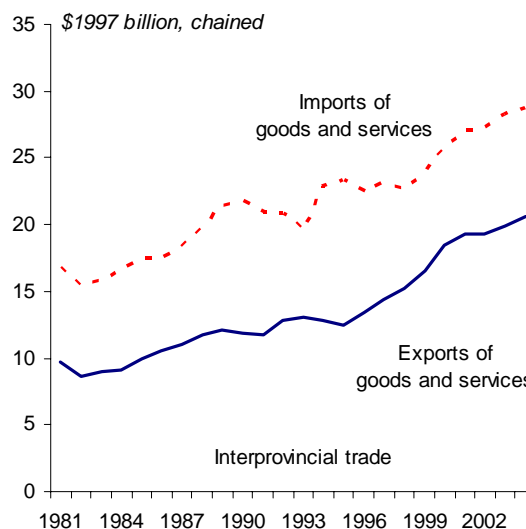
Spending on imported goods jumped 10.6%, as purchases of electrical equipment, fuel, machinery and other products increased at rates that were well into the double-digits. The value of service imports rose 8.1%.

The province's international exports continue to outweigh the value of its imports, but the size of the surplus has been dwindling. It became even smaller in 2004. On the other hand, the interprovincial trade deficit shrank slightly.

BC's exports to other provinces expanded 3.3% in 2004, largely due to solid growth in service exports (+3.9%). Services dominate our trade with other provinces, accounting for just over \$11 billion of the total value of interprovincial exports (\$20.6 billion) in 2004. Exports of financial and wholesaling services were particularly robust.

Imports from other provinces rose only modestly (+1.8%) in 2004. Service imports (+4.1%) grew faster than imports of goods (+0.7%) produced in other provinces.

## Interprovincial trade deficit remains large



Data Source: Statistics Canada

### **Goods industries ramp up production; services post slower, but steady, growth**

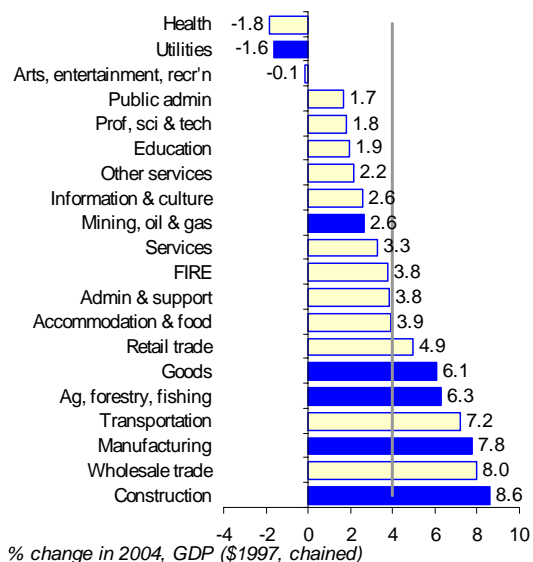
For the second year in a row, goods industries (+6.1%) outperformed the service sector (+3.3%), growing nearly twice as fast as the service industries. Three of the five fastest-growing industries in the province were the in goods sector.

Logging and forestry services expanded 15.9%, as the industry was kept busy supplying fibre to BC mills. High metal and fuel prices continued to revive interest in mineral exploration activity, and support services for mining (mineral exploration, drilling for oil and gas, and similar activities) increased 13.1% after more than doubling in 2003. The construction industry grew 8.6%, largely because the residential construction industry expanded 19.6% to reach a record high of \$2.9 billion in 2004. Non-residential construction activity increased only modestly.

Overall, the manufacturing sector expanded 7.8% last year, posting the strongest gain since 2000. The strength in manufacturing was largely concentrated in the wood industry, which benefitted from strong housing starts in BC as well as other regions of North America. Wood prices rebounded

in 2004, following four years of decline. Even with the price effect factored out, and despite the crippling duties imposed by the US on softwood lumber imports, real GDP in the wood industry increased 16.0% in 2004. Producers of paper products posted a more modest gain of 2.1%.

### Goods industries surged ahead



Data Source: Statistics Canada

Other industries within the manufacturing sector also made notable gains. The chemicals, machinery, primary & fabricated metals and furniture industries expanded at double-digit rates, while the computer & electronic products industry continued to recover from a slump that began in 2001. However, producers of food, beverages, clothing and textiles experienced a downturn in 2004.

Despite the avian flu situation, and continued pressure on the cattle industry as a result of the closure of some international markets for Canadian cattle, BC's agriculture industry posted solid growth in 2004. Producers of field, tree, greenhouse crops and aquaculture products made substantial gains.

The news was not entirely good, however. Some industries struggled through the year.

Commercial fishing, utilities and arts, recreation & entertainment contracted, as did the health care sector. High prices boosted the value of mineral, especially metal, production in the province, but the increase in value was largely price, rather than volume, driven.

The building boom in the province extended its reach to other industries in the province, and contributed to strong gains in the wholesale sector, where GDP expanded 8.0%. Wholesalers of lumber and millwork, metal products and computers and electronics had a particularly good year.

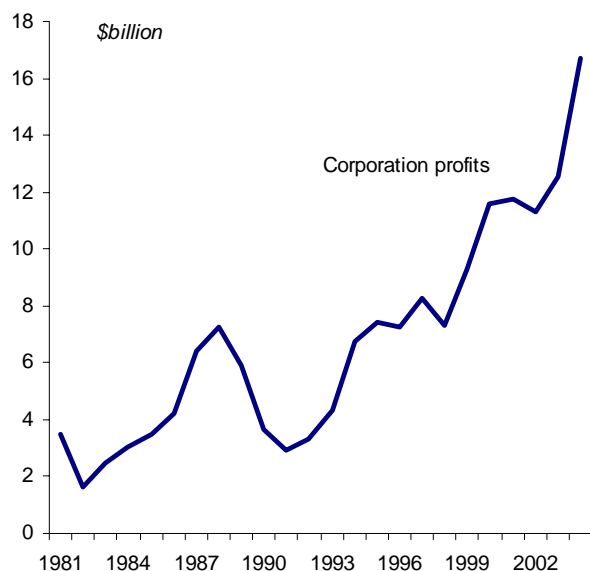
Activity in the retail industry was more muted, but here too the effect of the construction boom was evident. Cash registers were busy at furniture, appliance and household furnishings stores. However, business was slow for retailers of new and used cars, shoes, sporting goods and computers & electronics.

### Tourism back on track?

The slowdown in tourism activity that began early in the decade and was exacerbated by the terrorist attacks of 9/11 (and other subsequent events) showed signs of abating. The transportation industry recovered from a slump in 2003, expanding 7.2%. Some of the increase was related to the movement of goods (both water and truck transport, and related services, made notable gains in 2004), but passenger transportation also experienced an upturn as tourism-related transportation services rebounded from a slow year in 2003. The accommodation and food services industry grew for the second year in a row.

## ***Individuals, businesses and governments all benefited from a robust economy***

### **Record-high corporation profits**



Data Source: Statistics Canada

### **Corporation profits reach new highs**

Corporation profits soared to new highs, rising to \$16.7 billion<sup>5</sup> in 2004, a 32.9% increase. Corporation profits have more than doubled since the mid-1990s. Interest and other investment earnings of individuals, businesses and governments were 8.3% higher than in 2003.

### **Workers took home more cash...**

With more people employed in a strong economy, workers were able to cash in on the demand for labour. Total compensation (wages, salaries and benefits) increased 4.5% last year, the strongest gain since 2000, when labour income advanced 6.8%. Self-employed and other unincorporated business (non-farm) income was up 5.0%. Here too, construction and manufacturing industries contributed much of the increase, together with net (paid and imputed) rental income.

### **...and government coffers swelled**

<sup>5</sup> Data on incomes, as well as government revenue and expenditure are reported in current dollars.

The government got in on the action as well, receiving 4.5% more in indirect taxes (net of subsidies) on factors of production, and 6.9% more from taxes on products—including GST, PST, and various excise taxes.

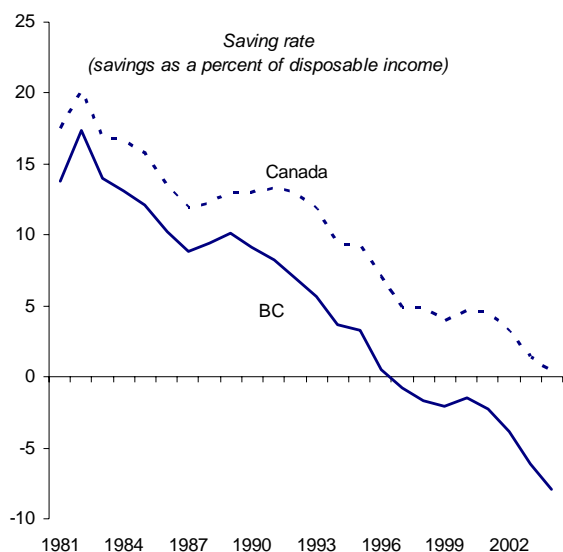
Higher profits and earnings mean higher tax revenues, and government coffers swelled as money poured in from businesses and individuals. Total revenues of federal, provincial and local governments increased an estimated 6.9% last year, well in excess of the demand on the public purse for transfer and similar payments. Public debt interest payments continued to decline as government surpluses, together with relatively low interest rates, put less stress on the public purse. As a result, the overall savings of the government sector increased significantly during the year.

### **Personal income rises, but saving rate continues to plunge**

Personal income rose 4.1% in 2004, reflecting strong gains in earned and investment income, together with more modest increases in transfers from government during the year. After-tax income increased slightly less (+4.0%) largely because taxes took a bigger bite out of the consumer purse. Although tax rates were stable, consumers who earned more income also paid more into government coffers.

Consumers don't seem to be focussing a great deal on expanding the size of their nest eggs. Personal spending on goods and services rose substantially more (+5.7%) than after-tax income, and for the eighth year in a row, the personal sector posted an overall net deficit. The total amount of dis-saving in 2004 was \$7.4 billion, and the province's saving rate reached a new low of -7.9% (down from -6.1% in 2003). BC is the only province where spending exceeds income to such a great extent.

### **BC's saving rate continued to plummet**



Data Source: Statistics Canada

Saskatchewan is the only other province that has had a similarly long run of dissaving. However, the extent of dissaving in BC has been growing steadily since 2000. In Saskatchewan, the tide appears to be turning. Last year the saving rate in Saskatchewan was -2.3%, a significant improvement over 2003, when it bottomed at -5.2%.

BC is not the only spendthrift province. Canada's saving rate dropped to 0.4%, and six provinces posted negative saving rates last year. Alberta is the only province where the saving rate remains relatively solid, at 4.4% in 2004, up from 4.2% in the previous year.

Of course, the saving rate does not portray a completely accurate picture of consumer behaviour, since a negative rate does not necessarily mean that consumers are living on borrowed funds. With a large senior population—and an influx of immigrants, particularly those in the entrepreneurial category—some of the dissaving could be due to these people supplementing their income by divesting themselves of some of their stored wealth: savings, mutual funds, privately held RRSPs, or property. Only the income that is earned in the current year is counted in personal income (and it does not

include the value of assets that change hands).

Still, a persistently negative saving rate is cause for concern because transferring the value of assets into income that is used to support current expenditures is not sustainable in the long run. How long the situation can last is anybody's guess.

### ***2004 was a good year, but the province still faces some challenges***

2004 was a good year for British Columbia, and most of the economic indicators bear out the fundamental strength that characterized the economy last year. While that is good news, there are still a number of troubling signs.

### **A growing trade deficit and the decline in the saving rate are cause for concern**

The trade deficit is growing, and domestic spending, particularly on housing, remains a major source of economic growth. The building boom cannot continue indefinitely, and when the market for new housing begins to soften, one of the underpinnings of the current strong economy will be weakened. The long-run decline in saving rates—with BC leading the country in a downward spiral—is also not sustainable for an indefinite period. Finally, many of the goods industries that boosted economic growth in 2004 are in the resource sector and are, by nature, volatile. Further diversification of the economy, and development of industries that can support steady long-term growth is vital to the future growth of the province's economy.

### **Real per capita GDP is still below average...**

Real per capita GDP slipped below the national average in 1997 and has remained there since. The province continued to lose ground until 2003, when the size of the gap began to shrink. Last year, real per capita GDP in BC increased 2.8%, to \$33,072. This

was \$2,194 less than the national average (\$35,266).

### ...and labour productivity remains an issue

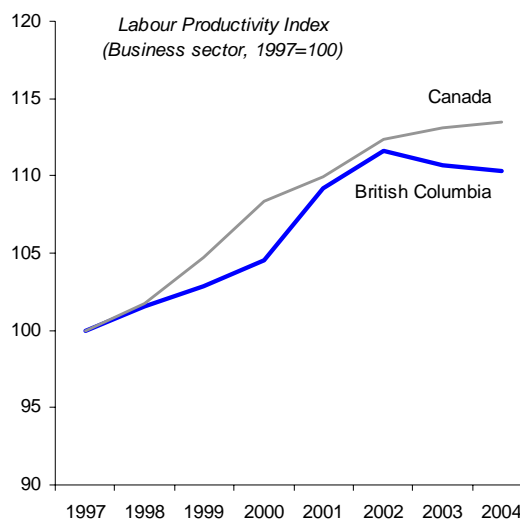
Labour productivity also remains an issue in British Columbia. Productivity gains are a key factor in long-term economic growth, since the ability to make more effective use of labour and capital means that output can be increased without using more raw materials, labour or capital inputs.

Productivity growth in this province has consistently lagged behind the national average. Last year, real output per hour worked in the business sector<sup>6</sup> slipped (-0.4%), with the average worker contributing \$31.45 to the province's GDP for every hour spent on the job<sup>7</sup>. This suggests that the strong economic growth experienced during the last two years was largely due to increased use of labour and capital inputs, rather than improved efficiency of production. Furthermore, as is the case for real per capita GDP, labour productivity in BC remains well below the national average. Canada-wide, labour productivity averaged \$33.75 in 2004, with output per worker hour ranging from a low of \$20.40 in PEI to a high of \$36.25 in Alberta.

<sup>6</sup> The business sector includes all industries except education, hospitals, public administration and the implicit rental income on owner occupied dwellings. Public sector services are usually excluded from productivity measures because output measures for these industries are based on the cost of labour inputs. In the case of imputed rent, there is no associated labour input.

<sup>7</sup> This contribution is not entirely due to the worker's efforts, since labour productivity includes the effect of both labour and capital (machinery, equipment, buildings and other infrastructure) used in production.

### Lagging productivity growth remains a cause for concern



Data Source: BC Stats

Although 2004 was a stellar year, the late 1990s and the early part of this decade were a period of slow growth in BC, and as a result the province lost some ground relative to the rest of Canada. Between 1994 and 2002, British Columbia's economy expanded 23%, a full ten percentage points less than the national increase (33%). Manitoba and Saskatchewan were the only provinces that experienced slower growth during this period. Ontario (+38%) and Newfoundland (+36%) posted the strongest gains.

BC's strong performance during the last two years has improved the province's position, but long-run growth remains weak compared to other key players in the national economy. British Columbia will have to chalk up a few more stellar performances to make up all the lost ground, but last year's solid growth is cause for some optimism.