B.C.'s Economy Has Shown Its Mettle During the Recent Housing Slowdown

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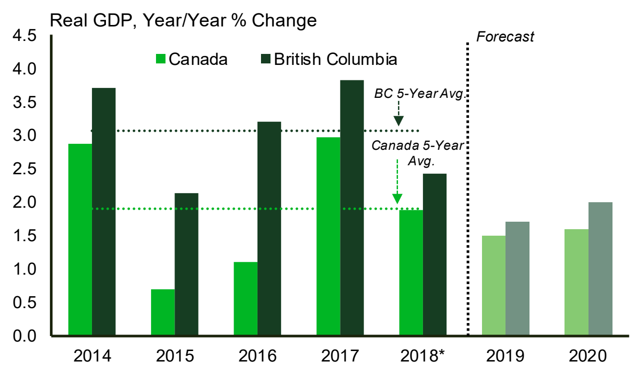
Highlights

- The dramatic slowdown in housing activity since 2018 only delivered a few minor body blows to B.C.'s economic performance. Economic growth has slowed but remained relatively robust, and the pace of hiring has outpaced that of most other provinces.
- There are several factors behind the province's economic resilience story. For one, the housing market downturn was largely manifested in weaker sales – while homebuilding activity has remained relatively strong.
- More importantly, B.C.'s diverse economy has been benefitting from other, well-timed offsets, including a burst of non-residential construction work on LNG and other major projects, buoyant high-tech service industries, and government capital spending.
- Recent evidence that B.C.'s home sales have hit firmer ground bodes well for continued healthy economic expansion in the region in the months ahead. However, we still expect growth to continue to trend around the 2% mark.

You would be forgiven if you had expected the recent dramatic downswing in housing markets to leave an indelible imprint on B.C.'s economy. Yet, through the gut-wrenching slide in its home resale activity over the past few years, there has been one constant – a steady and respectable economic performance in the province. This is not to say that the housing adjustment left no visible impacts at all. Real GDP growth has moderated closer to the 2% mark from the sizzling 3%+ advance chalked up during much of the post-2013 period (Chart 1). However, this more moderate expansion is still decent when benchmarked against the province's estimated longer-term cruising speed. More impressively, even with the slower expansion, the pace of hiring in the province has remained outsized, running at a nation-leading 3.4% y/y so far this year, while the unemployment rate continues to hover at or below 5% (Chart 2).

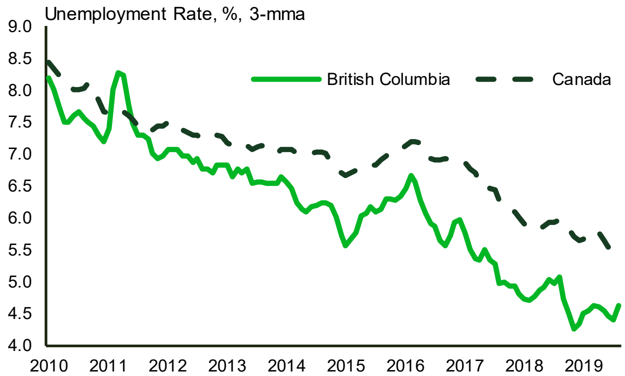
The resilience of B.C.'s economy raises some key questions. Through its relentless run in the four years ending in 2016, housing market activity[1] directly contributed around one-third to the province's overall growth rate. If one takes into account the indirect effects, notably the boost to spending from higher housing wealth, the impact on the economy was even larger. Why then

Chart 1: B.C.'s Economic Growth Has Outpaced the National Average, but Activity is Moderating



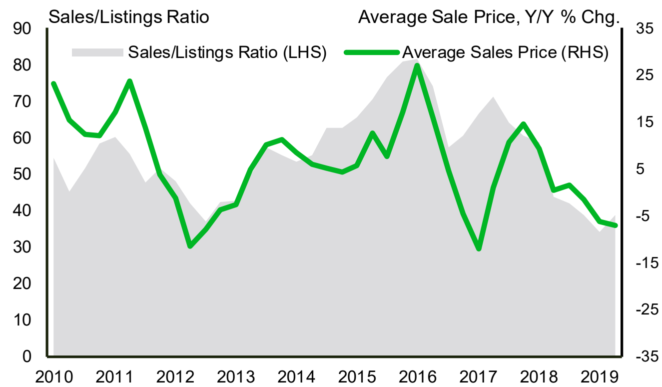
*2018 is a GDP by Industry Estimate for B.C.
Source: Statistics Canada, Forecast by TD Economics as of September 2019

Chart 2: B.C.'s Labour Markets Have also Been Notably Healthy



Source: Statistics Canada, TD Economics

Chart 3: GVA Price Growth and Market Balances Pointed to Some Froth in 2015-16



Source: CREA, TD Economics

did a subsequent reversal in housing activity over the past few years not leave more visible negative impacts on the economy and job market? And with the housing market now appearing to gain some renewed traction, how does that change the calculus for B.C.'s near-term economic outlook – if any?

The run-up in housing

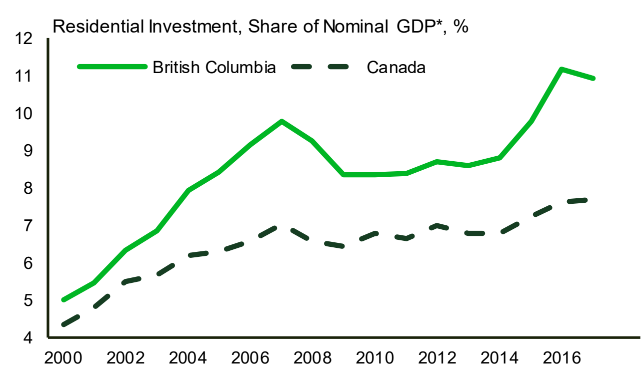
The last two decades have provided countless examples both domestically and internationally on the importance of housing cycles to movements in the overall economy. A general rule has been reinforced: what goes up, must come down – with the global sub-prime mortgage boom and bust being the most extreme example.

With the benefit of hindsight we can now appreciate how big a factor the run-away housing market was in driving B.C. to above-trend growth in the past half decade. Overall, the run-up during the 2013-16 period saw average home prices skyrocket by around 50% in the GVA (Greater Vancouver Area) and the broader B.C. market. Price acceleration and evidence of frothiness became particularly pronounced in 2015 and early 2016 (Chart 3), during which price growth consistently hit the double-digit mark and ouptaced that in Canada and other major metropolitan areas. Likewise, existing home sale volumes also ballooned[2]. The result was a market that surged well into sellers' territory (Chart 3).

The rising contribution of housing activity to GDP was best captured by the share of residential investment in GDP. This share continued to trend upward until it peaked in 2016 (Chart 4) – providing a solid boost to the province's economic outperformance. Housing activity was punching above its weight.

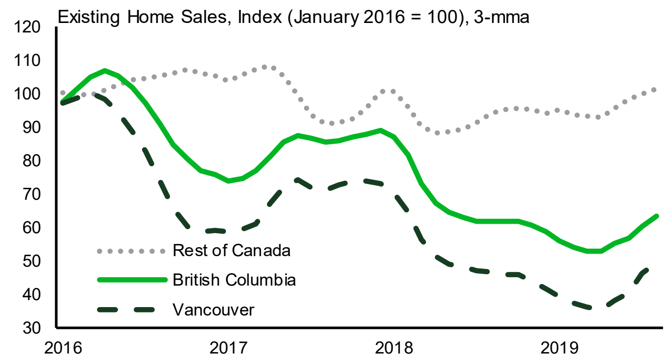
But there was likely more to the run-up than the direct contribution from homebuilding and real estate services. The indirect impacts, while difficult to measure, can perhaps best be seen in the province's gangbuster household final consumption and retail sales outperformance during the period. Indeed, B.C.'s retail sales[3] were the strongest in the country between 2015 and 2017, growing at a robust 9.3% in 2017. Previous research (see report), including Bank of Canada Staff research, estimated a housing wealth effect on consumption of around 5 cents for every dollar increase in housing wealth, whereby consumer spending responds to increased housing wealth (through higher home prices) with some lag[4]. This dynamic may have been at play

Chart 4: The Share of Residential Investment in B.C.'s GDP Peaked in 2016



Source: Statistics Canada, TD Economics
* Residential Investment doesn't account for all housing activity.

Chart 5: B.C.'s and the GVA's Resale Markets Absorbed the Greatest Policy Impacts



Source: CREA, TD Economics

in British Columbia. Indeed, retail sales and overall consumer spending remained strong even into 2017, a year after resale housing activity had already peaked.

Of course, the exact overall impact of housing on the province's period of heady growth in 2013-16 is difficult to disentangle given complicating factors such as the prominence of foreign ownership in the province's housing markets relative to other provinces[5]. Moreover, other factors may have also acted as a tailwind to retail spending, including high population growth and a marked acceleration in tourist numbers. Nonetheless, it is clear that housing activity and its indirect impacts were responsible for more than a third of the overall expansion.

Housing's fall from grace

In light of that eye-popping contribution to growth, most forecasters would have clearly entertained grim scenarios on B.C.'s growth if presented with what actually transpired: a 50% peak to trough drop in sales activity between the first quarter of 2016 and the first quarter of 2019, with the GVA's falling more than 60% in the same period (Chart 5). This drop was a response to a combination of federal and provincial macro-prudential regulations implemented in 2016 and 2018, and to the impact of rising borrowing rates since 2017. The extended decline in home resales, which was driven in no small part by a drying up in foreign purchases, resulted in a 31% slump in real GDP for the "Offices of Real Estate Agents" sub-category[6].

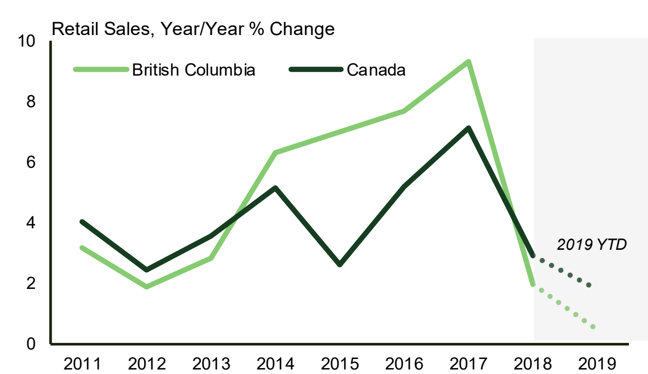
Evidence of housing-related softness was also observed in retail spending data. Indeed, retail sales in B.C. slipped below the national average in 2018, and have continued to soften further in 2019 (Chart 6). Only the the oil-producing provinces have been turning in more tepid gains this year. Within retail sub-categories, housing-related expenditure categories – namely furniture and homebuilding equipment – have recorded virtually no year-to-date growth. Also important is the noteworthy drop in sales at motor vehicle and parts dealers, which have pulled back by roughly 5% in total over the past two years. This weakness in consumer spending was to be expected and is likely due to a combination of a negative housing wealth effects and elevated debt levels. On the latter, B.C records the second highest average household debt-to-income ratio in the country.

Factors mitigating the downside in housing

Still, while the negative impacts of the pull-back in housing have been evident, they did not produce the heavy body blows that one might have feared. Perhaps most surprisingly, the province's job market has barely lost a beat over the past few years.

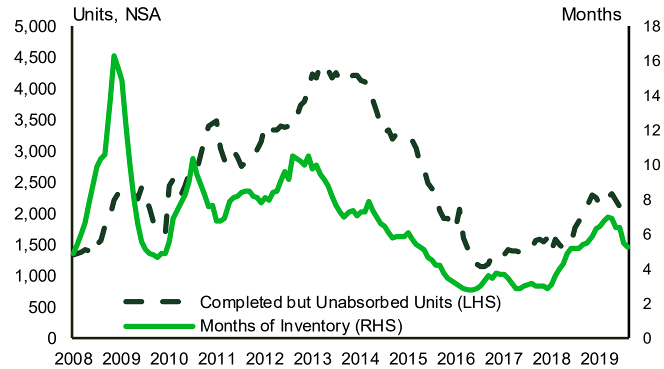
What explains this resilience? While not inconsequential, average home prices have fallen by a comparatively moderate 10%-15% over a period of three years. Even then, with the top end of the market hit hardest by the policy changes, this average price metric has overstated the price adjustment to some extent. In addition, to put the pull-back into context, consider that a B.C. homeowner that purchased a house at the average price in the beginning of 2013 and sold at this year's trough would have still seen a notable appreciation in home value of around 25%.

Chart 6: B.C.'s Retail Sales Were Likely Impacted by Housing Markets



Source: Statistics Canada, TD Economics

Chart 7: No Elevated Supply Gluts in New Home and Resale Markets by 2016



Source: CMHC, CREA, TD Economics

Well-behaved trends on the supply side have helped to put a floor underneath home prices amid slumping demand. In particular, listings have remained quite stable for the most part, thus precluding a more pronounced softening in supply-demand conditions.

Support to prices (particularly condos) has also been received from ongoing tightness in the market. For instance, stock of completed but unabsorbed units and resale market inventory (represented in months of inventory) were already on a downward trend prior to the recent adjustment – suggesting a lack of a major supply glut in both the new homes and resale markets (Chart 7). As a result, homebuilding activity – which tends to have outsized multiplier effects on an economy – has continued to expand for the most part since 2016, preventing a further amplification of the slowdown[7].

Well-timed offsets: other sectors have been stepping on the gas pedal

A bigger reason for continued healthy expansion in the province's economy, however, is its diverse economic base. Within the last two years, as the contribution in housing activity has declined from 35% to around 15%, other areas of the economy have stepped in to take up the slack (Chart 8). These include manufacturing, transportation/warehousing, natural resource extraction, public sector activity, professional/scientific/technical services, and non-residential construction.

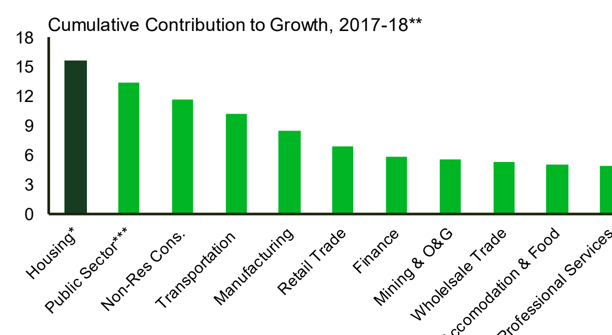
Manufacturing has cooled significantly this year. But up until 2018, this sector had been enjoying the tailwinds of a low Canadian dollar and strong growth south of the border. The transportation and warehousing sector has continued to fare well, supported by B.C.'s position as a gateway to Asia and through solid tourism activity and related demand for air transportation. Elsewhere, a healthy balance sheet and ample fiscal room has allowed the provincial government to maintain steady growth in public spending, particularly on healthcare, education, and infrastructure. A surge in natural gas extraction has also lent a helping hand to growth over the past few years.

Above all, the province is seeing a well-timed offset coming from two key sectors: non-residential construction and high-tech services. This year, non-residential construction investment and permits have taken a further leap up (Chart 9), notably in commercial space and institutional buildings (schools, hospitals). The positive contribution from non-residential construction is expected to continue in 2020 and 2021 as work on the LNG Canada project ramps up. Furthermore, within the labour market, professional/scientific/technical services sector has remained a leading contributor to hiring gains (Chart 10). Indeed, the province is well known for being a high tech. hub, with several global players located in Vancouver, and one identifying plans to significantly expand their office space in last year.

Recent signs of a housing recovery and implications for 2020 outlook

More recently, housing data have conveyed some encouraging news that the housing market adjustment is now in the rear-view mirror. Resale activity has increased in five

Chart 8: B.C. Has Been Experiencing Broad-Based Growth in the Past Two Years



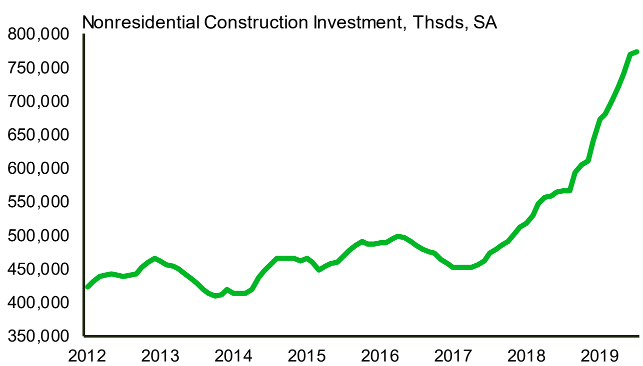
Source: Statistics Canada TD Economics
* Includes Real Estate and Residential Construction ** These are only approximate calculations given that Real GDP by Industry is not additive
*** Includes Education, Healthcare, and Public Adminstration

of the past six months. Average home prices have followed suit, moving into positive territory in year/year terms last month. We expect this recovery to be sustained in the coming months, further fanned by the pull-back in borrowing rates so far this year.

This firming in housing activity at a time when other drivers are still expected to forge ahead clearly bodes well for the province's near-term economic outlook. While we remain constructive on B.C.'s outlook (see our September Outlook), we are equally careful not to get too far ahead of ourselves in expecting a return back to the heady 3% expansion rates that had become commonplace over the past half a decade. While not an exhaustive list, three forces will likely hold growth closer to the 2% mark.

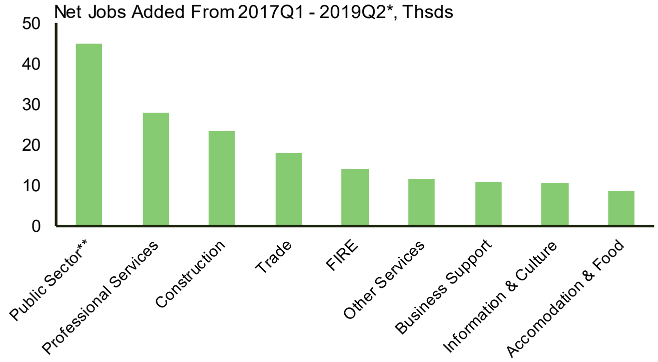
- Limited upside for housing: a combination of still-soft foreign demand and ongoing housing affordability constraints are expected to limit the upside in home sales and prices going forward. We expect resale activity and prices to trend up only modestly from current levels. At the same time, we are forecasting a moderate drop in housing starts for the province on the heels of this year's outsized gains, which will lean against any positive swing in growth contribution from the resale housing market.
- Growing external headwinds: a slowing global economy and world trade activity is expected to increasingly weigh on the external side of B.C.'s economy. Recent data show a growing weakness in manufacturing (mostly in wood, paper, and primary metal products). Manufacturing is a sector that has been a growth driver since 2014.

Chart 9: Non-Res. Construction Has Surged, Led by Commercial and Institutional Buildings



Source: Statistics Canada, TD Economics

Chart 10: B.C. Has Seen a Surge in Employment Within the Services Sector



Source: Statistics Canada, TD Economics
* Based on LFS Data ** Includes Education, Health care, and Public Adminstration

- Labour market capacity constraints: job creation is likely to take a step back next year partly reflecting growing labour shortages. Job vacancy rates remain elevated, the unemployment rate continues to plumb the depths and labour-market participation rates are showing little additional upside. Employment growth is set to slow to a more sustainable 0.7% rate in 2020 following this year's surge, but the unemployment rate is still expected to trend around a decent 5%.

Bottom line

B.C.'s economy has shown its mettle through the 3-year long adjustment in housing activity with special help from some well-timed offsets, including non-residential building, high-tech, and government stimulus. More recently, signs of an earlier-than-expected pickup in housing demand augur well for the economic outlook in 2020, though a return back to an above-trend 3% expansion appears unlikely.

Endnotes and References

1. We measure housing activity as the sum of the real estate and residential building construction sectors.
2. Measures controlling for population and income (sales/employment, price/income, and affordability metrics) were also hinting at frothiness at the time.
3. B.C.'s real household final consumption growth (in the GDP by Expenditure data) also outpaced that for all other provinces during that time period.
4. See: Pichette, Lise. 2014. "Are Wealth Effects Important for Canada?" Bank of Canada Review (Spring 2014).
5. Which, as described in previous research, could imply that some of the housing wealth gains and losses are absorbed by non-residents outside of Canada.
6. This drop was between 2016-2018. Other sub-categories, such as "Owner-Occupied Dwellings," kept growth in the overall real estate sector positive.
7. They only dipped slightly in 2018, before rebounding again in 2019.