RBC Financial Group

Current Analysis

Current Analysis reports address current economic issues of importance to RBC Financial Group and its clients.

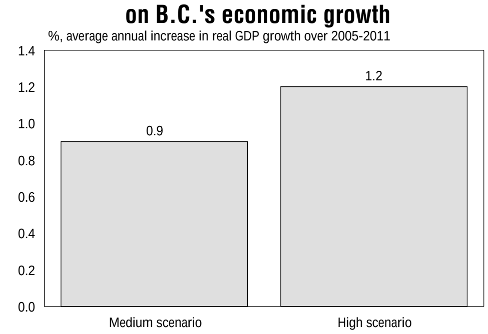
Reassessing the economic impact of the Vancouver Olympic and Paralympic Games

Booming B.C. economy facing 2010 Winter Games pressures

In July 2003 we conducted an initial assessment of the economic impact of the 2010 Olympic and Paralympic Winter Games on the B.C. economy. We estimated that provincial growth would receive a direct and indirect boost of between 0.9 and 1.2 percentage points per year over the 2005 to 2011 period. However, these estimates were performed during a time of economic weakness and uncertainty in British Columbia. Since then the B.C. economy has strengthened considerably and has become much less dependent on the Winter Games to drive what should be healthy, more diversified growth for the remainder of the decade.

Chart 1

Impact of 2010 Vancouver Winter Games on B.C.'s economic growth



Source: RBC Economics, InterVistas Consulting Inc.

At the same time, British Columbia's stronger economy raises new risks such as skilled labour shortages, higher inflation, rising house prices, strained housing affordability, population pressures and risks to government finances. Given the turnaround in the overall economy, the Vancouver Winter 2010 Games are now added to an economy already at or very near full capacity. With five years to go before the flame is ignited, the key will be to ensure that long-range planning is rooted in fiscal prudence and productive investments that sow the seeds of sustainable long-run growth well into the next decade instead of allowing imbalances to propagate, run out of control and feed a boom-bust cycle.

Positive long-term lift to growth

A 2002 B.C. government study estimated that a medium-high scenario amounted to C$2.1 billion in additional GDP in constant 2002 dollars through direct effects such as construction expenditures, operating costs and tourism. Expanding this to include multiplier effects of related business and consumer spending yields an estimate of $3.3 billion. If the impact of expanding the Vancouver Convention and Exhibition Centre is also included, then the estimate rises to as high as $8.4 billion. The report also estimated a high scenario of $10.7 billion, including all direct and indirect impacts.

[1] *The Economic Impact of the 2010 Winter Olympic and Paralympic Games*, November 2002, InterVISTAS Consulting Inc. Prepared for the Minister of State for Community Charter and 2010 Olympic Bid.

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The study estimated that construction costs would peak during the 2005-2009 years and range between $500-$750 million per year. During this period, British Columbia may very well be a leading province for growth in non-residential construction expenditures rivalled perhaps only by Alberta's oil patch. The study assumes that visitor spending will be the dominant economic effect, that it will be spread over the entire 2007-2016 period but concentrated in the 2007-2011 period during which it should amount to $1-2.5 billion per year under the medium-high scenario. With the bulk of new spending concentrated in the seven year period of 2005-2011, the lift to growth at an annual compound rate is estimated to be 0.9% in the medium-high scenario and about 1.2% a year in the high scenario. The actual year of the Winter Games in 2010 would be as much as twice this period average. This is a significant positive lift to long-term growth prospects in B.C. (chart 1).

Chart 2

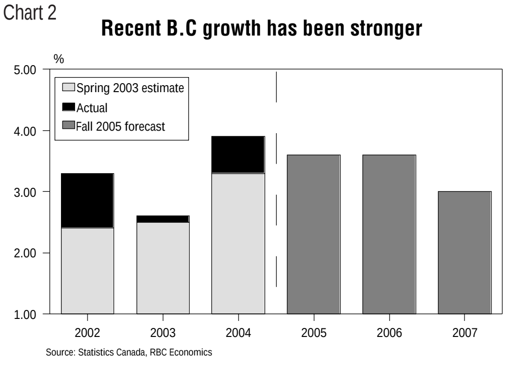


Chart 3

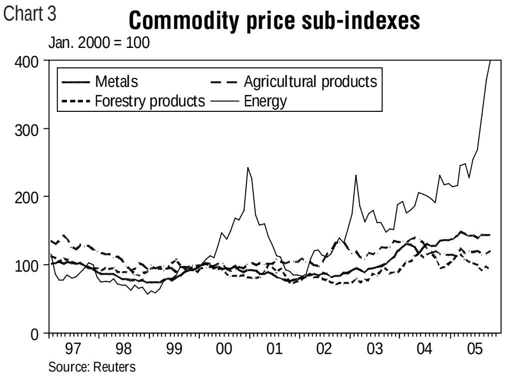
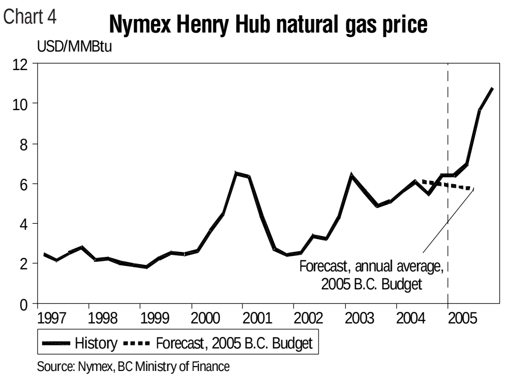


Chart 4



However, these initial cost estimates were marked by many forms of uncertainty, not least of which because they were based on expectations for future wage and materials costs that were formulated in a very different economic environment than that which has since evolved. As a sign of this, although our forecasts for the B.C. economy have enjoyed a strong standing within the B.C. Economic Forecast Council in recent years, it is nonetheless the case that on balance the B.C. economy has grown faster than predicted (chart 2). This, by corollary, means that excess capacity in the B.C. economy has been soaked up faster than would have otherwise been the case. Indeed, it's worth a more in-depth look at the factors that have changed for the better and for the worse since the 2010 Winter Games were first awarded over two years ago. The net effect materially alters our assessment of the risks and opportunities facing B.C.'s economy.

What has changed for the better?

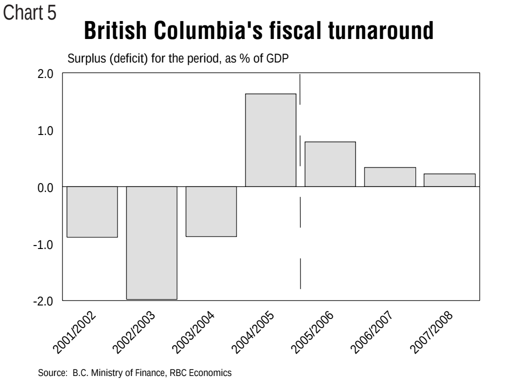
Among the factors that have changed for the better, first and foremost, the commodity price boom that was in its early stages in mid-2003 has continued unabated for two more years (chart 3). The RBC commodity price index is up 97% since July 2003, driven by a 145% gain in the energy sub-index, a 50% increase in the metals and minerals sub-index and a 10% gain in forest products. In terms of particular metals important to B.C., copper prices have more than doubled while lead prices are up 94% and zinc prices are up 80%. The consequence is that B.C.'s mining sector has seen a large increase in production as well as exploration and development activity, while some mines have been re-opened in the B.C. interior.

Higher commodity prices have also changed the landscape for B.C. energy-related output by, for example, spurring higher coal mine output and the re-opening of older mines where production has become economical once again. Moreover, surging natural gas prices (chart 4) have reignited interest in B.C.'s offshore energy deposits, adding to the existing production of onshore gas in the northeast. This renewed activity in mining and natural gas has provided an economic boost to areas of the province outside of Vancouver and Victoria.

Second, in comparison to mid-2003, B.C.'s high-tech sector has rebounded and hiring has picked up. In particular, B.C. has become a hotbed for gaming development and programming mostly due to a global hi-tech recovery.

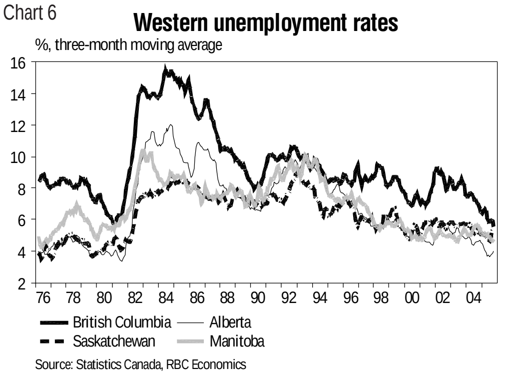
Third, in mid-2003 the provincial government's fiscal position represented a drag on the economy. As recently as FY 2003/04 the province had a $1.3 billion deficit. Since then the fiscal position has completely turned around (chart 5). The B.C. government reported a $2.6 billion surplus for FY 2004/05 and is forecasting a smaller surplus of $1.3 billion in 2005/06. With a small increase in program spending the government is again a contributor to growth after cutting back in 2003 and 2004.

Chart 5



Fourth, B.C.'s labour market is much stronger than in mid-2003. Since July 2003, B.C. has created 140,000 net new jobs and its unemployment rate has declined from 8.5% to 5.1% (chart 6). At the same time its labour force has grown by over 66,000. Average weekly earnings have grown 5.8% over the same period.

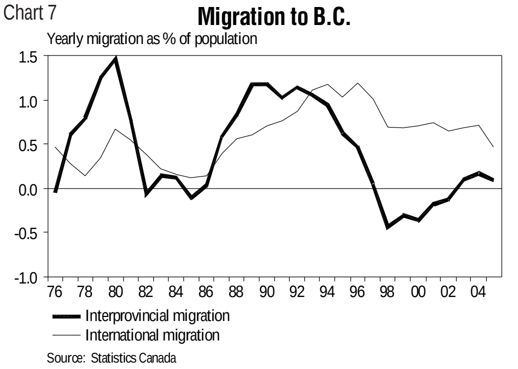
Chart 6



Fifth, since 2003 China has become an even greater force in the world economy. Chinese real GDP growth has averaged between 9 and 10% over the last 8 quarters. As Canada's gateway to the Pacific Rim, B.C.'s trading relationship with China has deepened. China is importing Canada's raw materials and exporting manufactured consumer and industrial goods and much of this activity takes place through the port of Vancouver and other parts of B.C.'s transportation infrastructure.

Sixth, in 2003 SARS was still an issue. SARS is no longer an issue and tourism flows have recovered. Moreover, a spring 2005 MOU between China and Canada has seen Canada added to the approved list for Chinese tour groups. B.C. is a natural first stop for what is estimated to be a potential 1 million visitors per year, adding further long-term support for B.C.'s tourism industry.

Chart 7



Seventh, since 2003, B.C.'s economy has become more diversified. While this was in part forced due to the softwood lumber dispute, the net effect has made B.C. less reliant on forest products. Meanwhile, the U.S. economy has recovered from its mid-2003 soft spot and is growing at a healthy pace, to the benefit of B.C.'s industrial sector.

Eighth, since 2003 North America's housing sector has put in another two years of very strong growth, setting new records for housing starts. As a result, B.C.'s forestry sector has enjoyed consistently strong demand for its products along with higher prices notwithstanding the softwood lumber dispute.

Lastly, B.C.'s rebound means more people are being attracted to the province. In particular, inter-provincial migration has now turned in B.C.'s favour after several years in which more people left B.C. for other provinces (chart 7). Since the second quarter of 2003 over 15,000 people have come to B.C. from other provinces, compared to a loss of over 57,000 in the 5 years from 1998 to 2003.

What has changed for the worse?

There are also numerous factors that have changed for the worse insofar as B.C. is concerned. First, since its trough in February 2002, the exchange rate has appreciated by about one-third, moving from 62 U.S. cents to a recent range of around 85 U.S. cents. Without the current strong U.S. demand for B.C.'s natural resources, the net impact of the higher exchange rate on B.C. would have been worse. However, our view is that the Canadian economy's adjustment to the higher exchange rate is nearly complete and the negative impact is ebbing. In 2006 net trade is likely to be relatively neutral to growth.

Second, booming trade flows have clogged B.C.'s ports, leading to backlogs and delays. The huge volumes of shipments passing through narrow choke points like the Vancouver port also expose firms to the risk of further labour disputes by key workers.

Third, while higher energy prices can spur exploration and development, for the majority of firms they are an added cost that must either be passed on to customers or absorbed. Consumers are also faced with higher gasoline and home heating costs, modestly diverting funds that could otherwise be spent on goods and services within B.C. although this effect is moderating.

Fourth, a few years ago hopes were running high for an end to the blatant U.S. protectionism behind the softwood lumber dispute. Those hopes have been dashed and resurrected several times since then. At present, the dispute lingers on, creating uncertainty in B.C.'s softwood lumber industry. At the same time, the pine beetle infestation meant increased timber harvesting; adding to lumber stockpiles and creating added inventory management issues.

Net implications

After netting out all of these factors together, there are several key cautionary notes to sound. The key point is that preparation for the Winter Games is now occurring in the context of a booming economy already grappling with capacity constraints in several areas. A broad range of sectors are now participating in B.C.'s recovery and adding the Games may heat up the economy to the point where it runs up against shortages in materials or labour. The effect may be a higher cost of living across the entire province, cost over-runs on Games projects, and intensifying price and wage pressures in coming years.

The construction industry is a case in point. British Columbia is in the midst of a housing boom and although single-family housing starts have flattened out, multiple-unit condo projects continue to power the sector ahead. Meanwhile, renovation activity, which lags home building and sales activity slightly, is also booming. To this can be added an increase in non-residential construction as strong global demand leads to capital investment in mining, forestry and energy. The provincial government's fiscal position has allowed renewed spending on programs and infrastructure. In addition, large capital projects in other parts of western Canada such as in the oil sands and in the Mackenzie Valley will add to regional skilled labour and materials shortages.

The shift in migration, while a potential relief valve for labour shortages, adds to other capacity pressures and raises fresh short-term and long-term challenges. For one thing, people need a place to live and the shift in net migration back in B.C.'s favour has added to upward pressure on house prices. It also adds pressure on southern B.C.'s infrastructure, in particular its congested road network. Over the next few years B.C.'s booming economy will likely find jobs for most takers. But will opportunities still be there after the Olympic and Paralympic games are over?

The best way to address the post-Games challenges is to pursue policies that emphasize fiscal prudence and productive investments as opposed to current spending. This is the best way in which to ensure that in-migration does not lead to excess pressure on regional infrastructure, while avoiding the potential for over-investment and over-spending on infrastructure and housing by government and private citizens that crowds out productive investment.

The issue of investment spending related to the 2010 Olympic and Paralympic Winter Games crowding out other investment that would have occurred is of particular concern to British Columbia. Booming commodity prices have led to a resurgence in investment in the natural resources sector. Private firms and various levels of government are involved in kick-starting natural gas production in northeast British Columbia and in expanding port capacity in the province. These are projects with multi-year payoffs that may be put at risk by inflated construction costs, delays due to labour shortages or a misplaced focus.