



Commercial Leading Indicator

BC Commercial Leading Indicator Points to a Strong 2012

The BCREA Commercial Leading Indicator (CLI) rose for the second consecutive quarter, advancing 1.1 points to an index level of 111. On a fourth-quarter over fourth-quarter basis, the CLI moved 1.6 per cent higher in 2011. While this is a marked slowing from the 5.2 per cent surge in 2010, the index picked up considerable momentum in the third and fourth quarter of the year, more than making up for a weak first half of 2011.

The trend in the CLI, turned up slightly as early softness in economic activity was smoothed out by a stronger second half of the year. This change in trend indicates a positive economic environment for the BC commercial real estate sector in 2012.

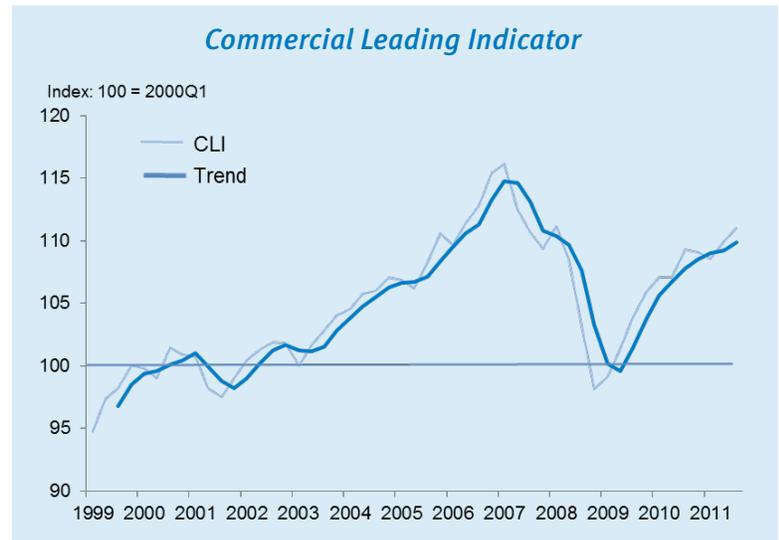
The increase in the CLI in the fourth quarter of last year was driven by fairly broad based gains as 5 of the 7 index components posted quarterly increases. The index laggards – credit spreads and manufacturing employment – likely fell behind due to rising financial uncertainty and growing anxiety over a slowing global economy.

Economic Environment

2011 proved to be a challenging year for the BC economy. While there were some highlights, overall the economy muddled through most of the year, growing in real terms at an estimated rate of 2 per cent.

About the CLI

The BCREA Commercial Leading Indicator was designed to forecast changes in broad commercial real estate activity. Our research shows that the variables that compose the CLI reliably forecast BC commercial real estate activity at a lag of two to four quarters. The index is revised each quarter due to revisions in the underlying data.



Highly indebted households and tepid job growth created a significant drag on consumer spending over the past year. While retail sales in the province picked up slightly in the holiday shopping season, overall retail trade grew just 2.3 per cent over 2010. We anticipate that households will continue to pare back spending in 2012, creating a slight drag on economic growth.

BC export growth was a bright spot in 2011. Total exports rose close to 15 per cent, propelled by a 33 per cent increase in exports to emerging Asian markets. However, global economic growth is forecast to slow in 2012 which may negatively impact commodity prices and slow growth in demand for BC goods.

We are currently forecasting real GDP growth of 2.3 per cent this year followed by 2.5 per cent in 2013. The outlook for 2012 remains murkier than usual owing to the ongoing uncertainty in the Eurozone. While the province has limited direct exposure to Europe, a small open economy like BC remains vulnerable to global economic and financial shocks. Our baseline forecast assumes that the Euro-crisis will resolve in an orderly fashion, but the uncertainty stemming from that resolution remains the key downside risk to growth.

Employment

2011 was a difficult year in the BC labour market. Total BC employment grew just 0.8 per cent and the provincial unemployment rate remained stubbornly above 7 per cent. This fundamental weakness in the job market was a real constraint on the economy last year, leading to a considerable softening of consumer spending. A modest level of economic growth and increased uncertainty in 2012 will likely constrain employment gains further in 2012, however we anticipate job growth to increase to a rate of around 1.5 per cent. Although we expect better job growth this year, the BC unemployment rate is very likely to stay above 7 per cent for much of 2012.

Employment in key sectors related to the BC commercial real estate market also had a mixed year in 2011. Office employment rose close to 2 per cent as a result of strong growth in the professional, scientific and technical services sector. However, manufacturing employment struggled, falling 1 per cent from 2010 and close to 8 per cent when comparing the fourth quarter of 2011 to the fourth quarter of 2010.

Manufacturing and Trade

The BC manufacturing sector turned in a solid year in 2011, growing sales by 7 per cent on fairly broad-based strength in both durable and non-durable products. However, the recovery in manufacturing is far from complete. Both the value of manufacturing shipments and manufacturing employment have yet to regain pre-recession peaks. Indeed, manufacturing employment further weakened in 2011.

The measured recovery in manufacturing has a lot to do with the sluggish recoveries of BC's main trading partners – the United States and Japan – and in particular the 4 years and counting slump in the US housing market which has depressed demand for BC wood products.

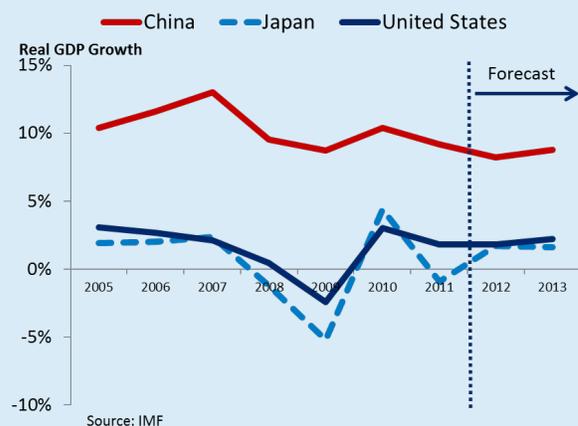
In fact, omitting sales to the United States and Japan, BC exports expanded at a pace close to 25 per cent due to remarkable growth in exports to emerging Asian markets. Moreover, the export story extends beyond the familiar tale of insatiable Chinese demand. In fact, while exports to China grew an impressive 27 per cent in 2011, exports

Slowing Global Economy Could Constrain BC Exports in 2012

While exports were a major contributor to economic growth in 2011, there exist significant headwinds in the global economy that could materially impact the economic growth of BC's main trading partners.

Economic growth in China – a major driver of BC exports in 2011 - is forecast by the IMF to slow by a full point in 2012. Moreover, growth in the United States is expected to remain weak while the recovery in Japan from last year's devastating earthquake and tsunami is unfolding at a slow pace.

Slower Growth Ahead for BC Trade Partners



to South Korea and Taiwan were nearly 50 per cent and 27 per cent higher respectively last year and trade with India grew almost 20 per cent. As BC continues to shift its trade portfolio to high-growth emerging markets, the manufacturing sector should expand and stimulate demand for industrial commercial real estate.

New Construction

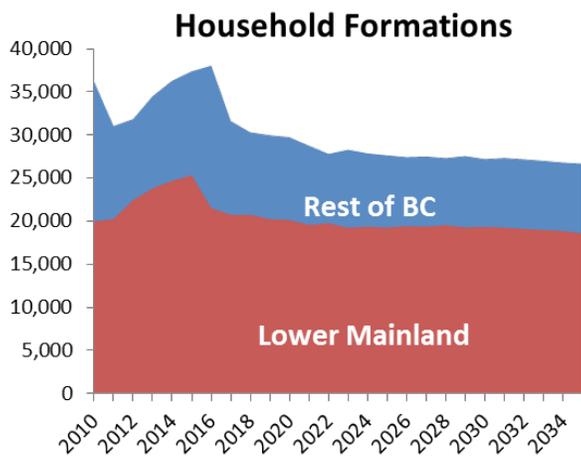
Construction activity in 2011 was driven by a 40 per cent increase in industrial construction while commercial construction finished the year roughly flat. Permitting activity in 2011, a leading indicator for future investment spending, shows that the strong trend in industrial construction should continue in 2012. Industrial permits ended last year 46 per cent higher over 2010 while commercial permits were just 7 per cent higher.

Retail Trade and Consumer Spending

There is no way to gloss-over what was a truly awful year for retail sales in BC that saw sales growth of just 2.3 per cent. Adjusting for inflation, retail sales were completely flat from 2010. We anticipate a slightly better year for retail in 2012, though sales growth is expected to remain below trend.

Fortunately, the weakness in BC’s retail trade sector remains short-term while the long-term prospects for the BC retail sector are very favourable. Recently released 2011 Census numbers show that BC had the second fastest growing population in Canada. Furthermore, demographic projections indicate that strong household formation growth, particularly in the Lower Mainland of BC, will continue over the next decade.

Strong Population Growth Projected to Continue



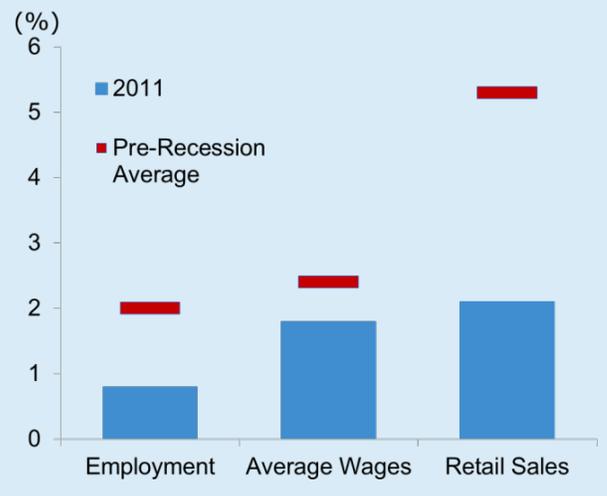
Moreover, the BC economy has for many years, with the exception of the recent recession, produced above-average disposable income growth and robust job creation. The combined effect of a growing population and a solid track record of income growth should continue to attract new retailers to BC as well as encourage an expansion of existing BC retail locations.

Retail Sales Disappoint in 2011

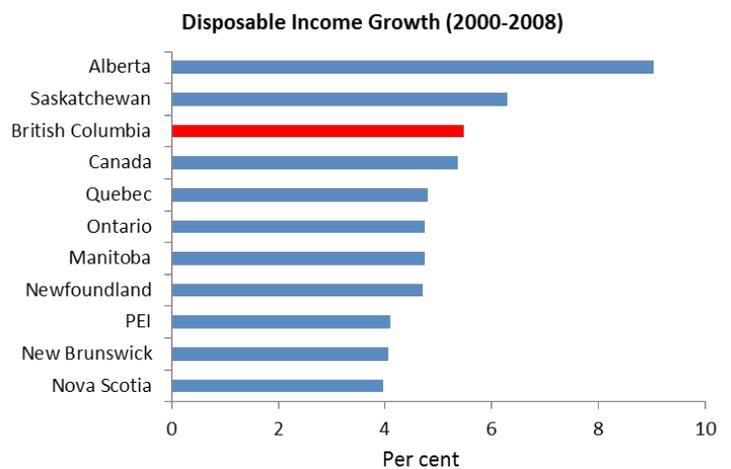
2011 was a challenging year for the retail sector. One needs to look no further than the fundamentals of retail sales growth to see why.

The general arithmetic of retail is fairly straightforward. Without strong employment and wage growth, retail sales will struggle. In 2011, weak employment and average wage growth added up to the worst non-recession year of retail sales growth in over a decade.

Weak Fundamentals Lead to Poor Retail Sales



Record of Above Average Disposable Income Growth



Interest Rates and Commercial Investment

Long-term interest rates in Canada have been forced to previously unfathomable lows as global investors have eschewed all things Euro and have piled into dollar (both US and Canadian) denominated assets.

We anticipate that yields will remain depressed for most of 2012, creating a stable environment for commercial market borrowers, but also a continuation of very low cap-rates. Nevertheless, low cap-rates have not deterred investors from seeking the relatively safe confines of BC commercial real estate since even the modest yields offered are still much more attractive than volatile equity markets and thin bond yields.

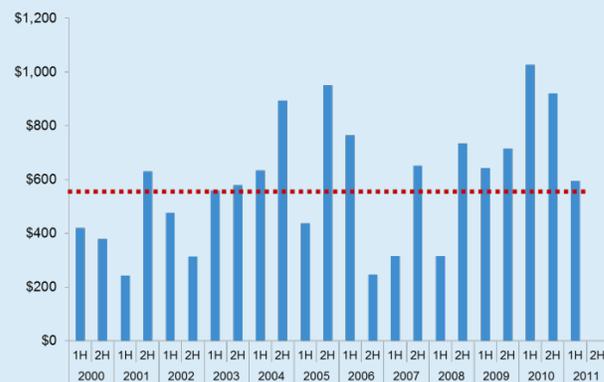
Total commercial market investment through the first half of 2011 was down from the robust activity of 2010, but was still relatively strong. The primary governor on commercial market investment in the past year was not so much price, capital costs or capitalization rates but rather supply which remains short of demand.

Investment Stable in 2011

Demand for commercial real estate assets in BC continues to be strong due to rock-bottom interest rates and elevated risk aversion. Investors view Canadian commercial real estate as a safe and relatively high-yielding asset compared to alternative investments.

Although investment volume was down from a record setting year in 2010, activity remained fairly strong last year. In fact, the main constraint on investment in 2011 was a lack of supply across most sectors rather than a diminished appetite of investors.

An Average Year for Investment



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