



Inflation stays subdued

B.C.'s inflation rate in the year ending October 2003 was 1.6%, according to the latest Consumer Price Index (CPI) from Statistics Canada. The latest month-over-month change came in at -0.5%, down sharply from September's 0.2% increase. Lower prices for gasoline, fuel oil and natural gas in October lowered the overall index.

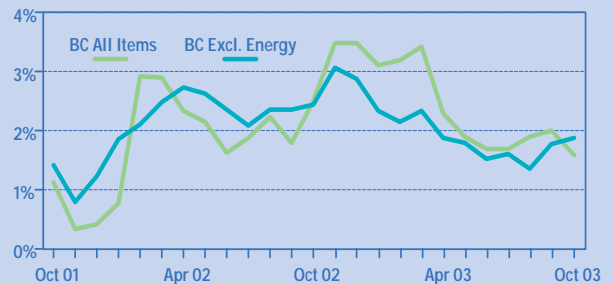
Excluding energy, B.C.'s inflation rate in the year ending October 2003 was 1.9%, up slightly from 1.8% in September. Property taxes, personal care goods and services, fruits, cereals and liquor all experience above average price increases in October. Non-alcoholic beverages, seafood and recreational goods and services had above average price decreases in October.

Based on performance so far and projecting a trend to the end of the year, the 2003 rate of consumer price inflation will be about 2%. Last year, the inflation rate was 2.3%.

Next year's CPI inflation rate will probably stay below 2%, and we are forecasting a rate of 1.6%. Energy prices are always a wild card and any supply disruptions will drive up prices and boost total CPI. Underlying inflation forces, however, are expected to remain tame, since the economy as a whole will operate at below capacity. Wage increases will be close to or below the inflation rate, since the unemployment rate is over 8% and demand will not be strong enough to lower it significantly.

Consumer price inflation remains subdued

B.C. Consumer Price Index (CPI)
Year-over-Year Per Cent Change



Source: Statistics Canada.

A similar forecast prevails for Canada as a whole. Next year's CPI inflation rate is seen dropping to 1.6% by the forecast consensus, with all analysts expecting lower inflation in 2004. Even the Bank of Canada is forecasting a lower inflation rate for next year, also at 1.6%, according to its October 2003 monetary policy report. This sets the stage for further interest rate cuts by the Bank.

One benefit of a higher Canadian dollar is that imported goods from the U.S., such as fresh vegetables in the winter, will be cheaper and this will help keep the inflation rate down. However, a falling U.S. dollar will slow the growth in Canada's money supply, thereby delaying further rate cuts by the Bank of Canada.

U.S. housing starts soar

New housing construction in the U.S. continues to soar, with October housing starts rising by almost 3% from September to 1.96 million dwelling units at a seasonally adjusted annualized rate (SAAR). Low mortgage rates combined with a recently rising GDP growth rate led housing starts to their fifth month-over-month gain in the past six months.

Single-family house construction is particularly strong and at all-time record levels, while the volatile multi-family-unit market continues to plod along at a reasonably balanced pace. October's rise in housing starts was particularly strong in the western states, higher in the south and lower in the midwest and northeast.

October's strong rise in U.S. housing starts was somewhat surprising, beating most analysts' expectations. The preliminary estimate of new housing starts in September was also revised upward by 4%. The near-term outlook for continued gains in housing starts remains very solid, based on a 5% increase in residential building permits issued in October.

Strong residential investment in the U.S. and Canada is inducing growth in demand for lumber, panels and other forest products. The composite price measure for framing lumber in the U.S. was \$325 in October, down from a one-month spike of \$375 in September brought about by temporary supply interruptions due to this summer's forest fires. So far this year, composite framing lumber prices are about level with the same period last year. Rising demand coupled with level prices indicate lumber supply is highly elastic. Put another way, there is plenty of timber and milling capacity in North America.

The composite price measure for structural panels in the U.S. was \$555 in October, up sharply from \$537 in September and \$440 in August. Year-to-date average composite prices for structural panels are well ahead of last year's. Rising demand and rising prices indicate that structural panel supply is constrained. The market for oriented strand-board, plywood and other structural panels has shifted in favour of producers over the past six months, as housing construction in North America has soared.

The strong rise in the U.S.-Canada exchange rate over the past six months has hurt B.C. lumber producers who sell into the U.S. market. With level U.S.-dollar prices, the Canadian dollar price is falling. Softwood lumber duties are already decimating softwood lumber revenues, margins and employment in B.C. this year. The structural panel side of the B.C.'s forest product sector is doing better, with U.S.-dollar price gains exceeding the changes in the exchange rate over the past several months.

The outlook for housing starts in the U.S. over the next year is favourable, although few forecasters expect the very strong growth rates of the past six months to continue unchecked. Mortgage rates and publicly traded equity market prices are generally expected to rise somewhat, dampening growth in investment demand for housing assets. On the other hand, employment and personal income are generally anticipated to grow over the next year, accelerating growth in demand for housing. On balance, the value of U.S. housing construction is expected to grow next year at a moderate overall rate.

