

## Meddling in Deficit Reduction

Fiscal Year 10/11

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**The Province of British Columbia is forecasting a \$1.7 bln deficit for FY2010/11, a \$1.1 bln improvement over the \$2.8 bln shortfall estimated for FY2009/10.** The later is identical to what was projected in the September update, allowing for the little wiggle room provided by the “forecast allowance”. The commitment to eliminate the deficit by FY2013/14 continues. With contingencies of \$450 mln embedded in each year and forecast allowances that move up from \$300 mln to \$400 mln, the deficit could easily be eliminated a year or two earlier if these amounts are not needed and deployed to the bottom line.

**Total revenue is forecast to grow 5.8% to \$39.2 bln** in FY2010/11, fuelled by natural resources (rising natural gas and lumber prices and improving forest harvest volumes) and followed by contributions by the federal government (mostly transition payments for the Harmonized Sales Tax). Both of these revenue sources are growing in double digits. Elsewhere, taxation revenue is expected to rise only 2.3%, despite the introduction of the HST

(on July 1<sup>st</sup>), as previously announced cuts in personal taxes and other rebates come into effect to mitigate the impact of the HST. The previously announced cuts in the general corporate tax rate, to 10.5% this January and further to 10.0% next January, along with the legacy of recession-ravaged profits, are causing overall corporate taxes to decrease in FY2010/11 (recall the corporate tax cuts were designed to mitigate the impact of higher carbon taxes). **Total expense is projected to grow 2.3% to \$40.6 bln**, with health care garnering more than 80% of the modest gain.

**Turning to the out-years, the Province has put in place a credible plan to return to near balance in FY2012/13, and then to a \$410 mln surplus by FY2013/14.** This outlook hinges on a sturdy rebound in revenue combined with a moderate slowdown in spending growth. Revenue is projected to grow 4.6% annually in the four years through FY2013/14, a shade stronger than the 3.3% growth seen during the past decade. This is based on the assumption that economic recovery is taking hold in the province, which will drive income tax receipts. Natural gas prices are also expected to move higher, averaging C\$5.38/GJ by FY2012/13, up from C\$4.29/GJ this coming fiscal year (that will

### Fiscal Outlook

(C\$ millions)

	estimate		— forecast —	
	09/10	10/11	11/12	12/13
Revenues	37,050	39,190	40,957	42,800
Expenditures	39,700	40,605	41,602	42,545
Forecast Allowance	(125)	(300)	(300)	(400)
Budget Balance	(2,775)	(1,715)	(945)	(145)
% of GDP	-1.5%	-0.9%	-0.5%	-0.1%
Debt-to-GDP ratio*	15.5%	17.2%	17.9%	17.8%

( ) = deficit

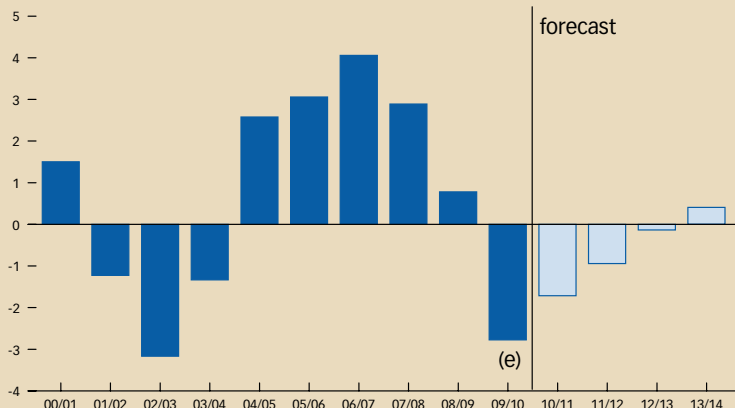
Note: Totals may not add due to rounding.

\*Taxpayer-supported debt

Source: Provincial forecasts

### Budgetary Balance

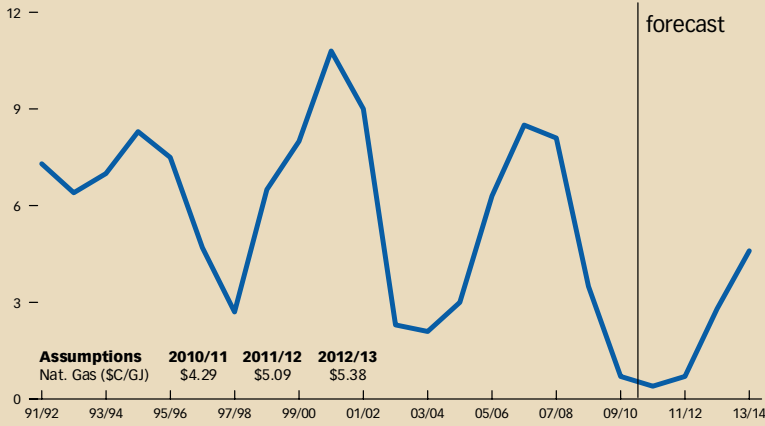
(\$ billions)



Source: Provincial forecasts e = estimate

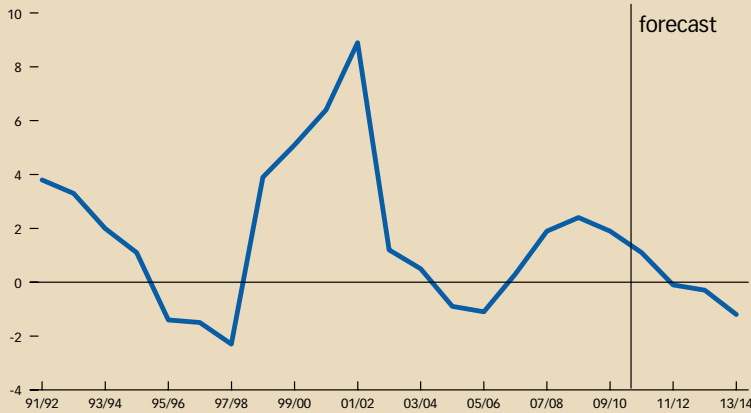


**Total Revenue**  
(4-yr annualized % chng)



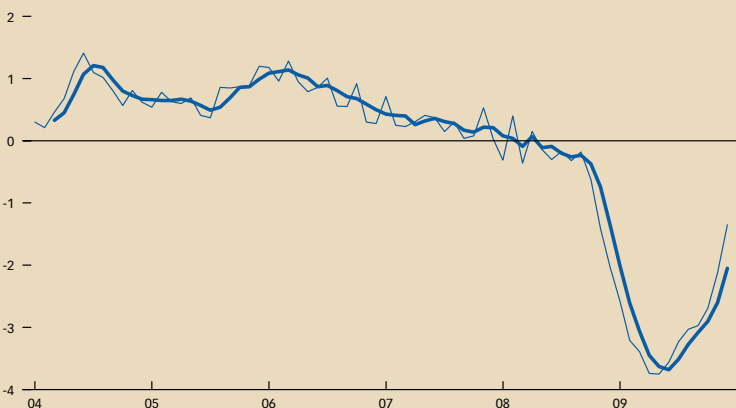
Source: Provincial forecasts

**Real Total Spending per Capita**  
(4-yr annualized % chng)



Source: Provincial forecasts

**Provincial Economic Momentum Index: B.C.**  
(Dark line = 3-mo. average)



\*The PEI measures the number of standard deviations economic activity is above or below trend.

provide a \$550 mln boost over the forecast horizon). Note that the Province’s sensitivity to natural gas prices is about \$275 mln per \$1 change in price, and resource revenues are projected to be 8.2% of total revenue this fiscal year (lower than the other Western provinces). All told, the Province is expecting an economic recovery to drive revenue growth—we share the recovery view, and deem the revenue forecast to be realistic.

**Meantime, the rate of spending growth is projected to moderate starting this fiscal year**, rising 2.3% annually over the next four years versus growth of 4.0% over the past decade. On a real per-capita basis, total spending will contract 1.2% annually over the next four years, similar to the episodes of restraint seen in the mid-1990s and mid-2000s. Given that the Province (including the incumbent party) has a precedent of such spending restraint, these targets seem achievable.

**British Columbia was hit hard during the recession, but sights are now set squarely on recovery.** After contracting an estimated 2.2% in 2009, real GDP growth should rebound a solid 3.1% this year (the Province is forecasting 2.2% growth). While the short-term boost from the Olympics will eventually fade, and U.S. export growth is expected to remain sluggish, domestic demand should drive growth—namely in the housing and commodity sectors. Existing home sales in the province have staged a furious comeback from their recession lows (partly stoked by the coming HST), and housing starts have begun to follow. While building activity should remain well below peak levels, this improving trend will help growth in the coming years. Meantime, previous moves by the Province to reduce royalties have stimulated drilling and exploration activity, which should continue as commodity prices trend higher. However, note that a (possible) move by Alberta to reduce royalties in the coming months would eat into British Columbia’s cost advantage.

**The Province’s total gross borrowing requirements are projected to be \$9.4 bln in**



**FY2010/11.** After accounting for maturities and sinking funds, the net increase in debt is projected to be \$6.4 bln. This will cause the total debt-to-GDP ratio to rise from 22.0% in FY2009/10 to 25.9% by FY2012/13. The taxpayer-supported debt-to-GDP ratio will rise from 15.5% in FY2009/10 to 17.8% by FY2012/13, though that's still below the recent high of 21.3% seen in FY2002/03.

**Provincial Financing**  
(\$ mlns)

	Outstanding Mar. 31/10	New Borrowing	Retirement Provision	Outstanding Mar. 31/11
Taxpayer-supported debt	29,093	7,468	(2,813)	33,748
Self-supported debt	12,100	1,769	(160)	13,709
Forecast allowance	125	175	—	300
<b>Total debt</b>	<b>41,318</b>	<b>9,412</b>	<b>(2,973)</b>	<b>47,757</b>

**The Bottom Line:** British Columbia's FY2010/11 budget lays out a plan to return to balance by FY2012/13 (before forecast allowance), and maintain a small surplus thereafter. Given the prospects for solid economic growth in the province, and realistic revenue and spending assumptions, this plan deserves a spot on the deficit-reduction podium.

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