



Budget Highlights

Victoria's Got No Fiscal Secrets

Fiscal Year 11/12

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The first provincial budget of 2011 was a relatively quiet affair, as British Columbia essentially served up a fiscal update in the face of a still-swirling political backdrop. To capture the essence of this year's budget, here are a few quotes from the document: it *"stays the course"*, *"sets no new directions"* and is *"status quo"*. **The Province is forecasting a \$925 million deficit for FY11/12 (which begins on April 1), a \$340 mln improvement from the \$1.27 bln shortfall now estimated for FY10/11.** The latter marks a \$430 mln improvement over what was projected in the November update, thanks in part to a reduction in the "forecast allowance" stemming from a more certain (and favourable) economic outlook, as well as a bump in revenues. The commitment to eliminate the deficit by FY13/14 remains firmly in place, with allowances of \$350 million embedded in each of the next three years, which could see the budget balanced earlier than expected. Note that this budget was tabled to satisfy legislative requirements,

and a new Liberal leader will be elected on February 26th, leaving the door open for an updated budget and new policy measures later this year.

Total revenue is forecast to grow 3.6% to \$41.3 bln in FY11/12, fuelled by the economic upturn. Tax revenue is slated to rise 4.7%, led by a bounce in personal income receipts, and a full year of HST revenues. Total sales tax revenue is projected to rise 6.6% in the coming year. Note that in the year just ending, estimated HST revenues look to come in \$387 million above last year's budget plan, accounting for a large portion of the improved fiscal projections for FY2010/11.

Total expenses are projected to grow by a modest 2.2% to \$41.9 bln, with cooling off in capital spending plans a notable source of restraint. In a theme that could be echoed across the country, taxpayer-supported capital spending is slated to drop 16% in the coming fiscal year and 23% the next year as the stimulus projects of the past two years roll off. Not surprisingly, the biggest growth area will be in the health services ministry, which is expected to see spending climb 6.2% in FY2011/12.

Turning to the out-years, the Province has put in place a credible plan to return to near balance in FY12/13 (a \$90 million shortfall

Fiscal Outlook

(C\$ millions)

	estimate		— forecast —	
	10/11	11/12	12/13	13/14
Revenues	39,893	41,337	42,446	44,091
Expenditures	41,008	41,912	42,536	43,566
Forecast Allowance	(150)	(350)	(350)	(350)
Budget Balance	(1,265)	(925)	(440)	175
% of GDP	-0.6%	-0.4%	-0.2%	0.1%
Debt-to-GDP ratio*	16.5%	17.5%	17.8%	17.5%

() = deficit

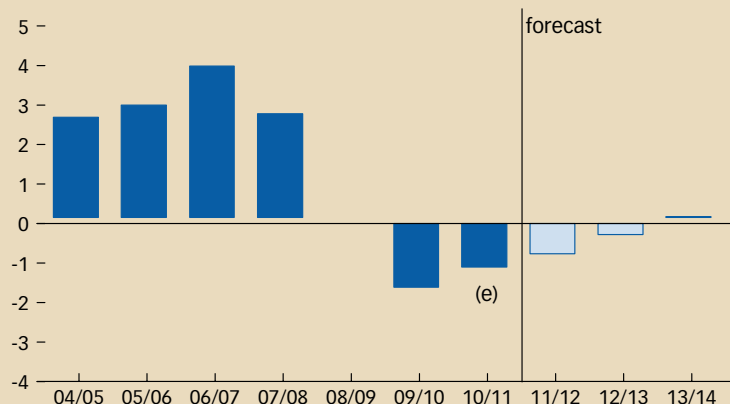
Note: Totals may not add due to rounding.

*Taxpayer-supported debt

Source: Provincial forecasts

Budgetary Balance

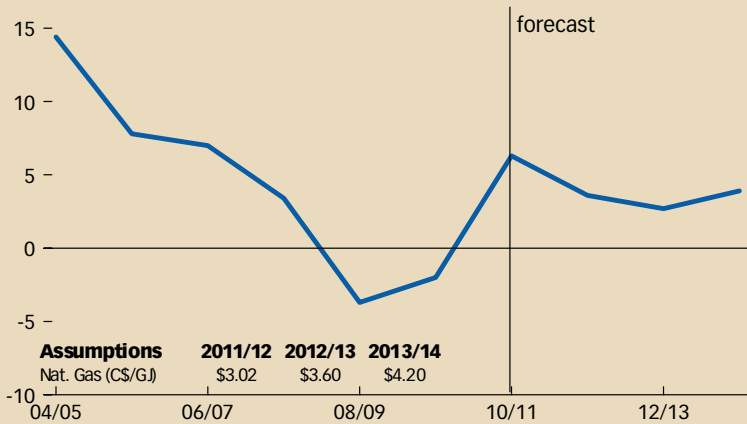
(\$ billions)



Source: Provincial forecasts e = estimate

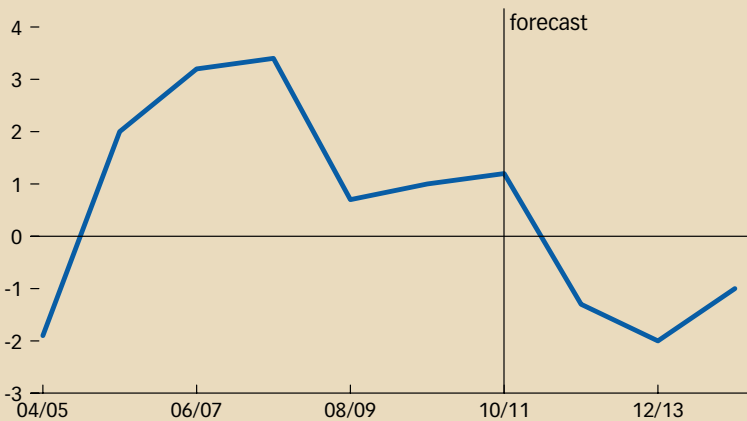


Total Revenue
(annual % chng)



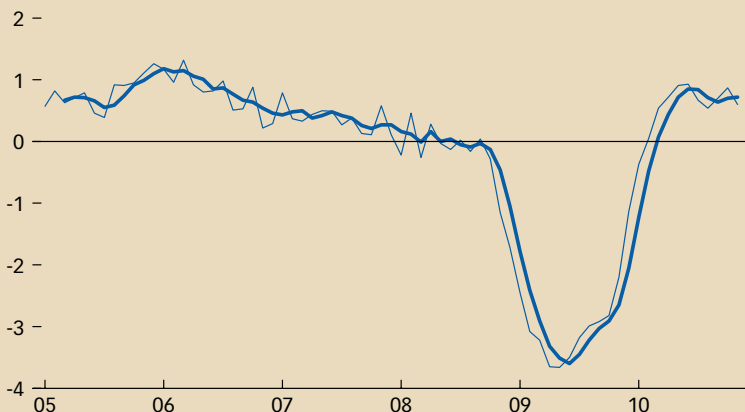
Source: Provincial forecasts

Real Total Spending per Capita
(annual % chng)



Source: Provincial forecasts

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



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

before the forecast allowance), and then to a \$175 mln surplus by FY13/14 (even accounting for the forecast allowance). This outlook hinges on a continued recovery in provincial revenues combined with a slowdown in spending growth. Revenue is projected to grow 3.4% annually in the three years through FY13/14. Natural gas prices are expected to move higher, averaging C\$4.20/GJ by FY13/14, up from C\$3.02/GJ this coming fiscal year (this would provide a \$400 mln boost over the forecast horizon). Note that the Province's sensitivity to natural gas prices is about \$340 mln per \$1 change in price, and resource revenues are projected to be 7.5% of total revenue the coming fiscal year (lower than the other Western provinces). **Meantime, spending growth is projected to clock in at a mere 2.0%** annualized rate over the next three years, keeping it effectively flat in real terms, and declining in real per-capita terms. Given that the Province has a precedent of such spending restraint, these targets seem achievable, if ambitious.

The British Columbia economy is firmly entering expansion mode. We are on the high side of consensus on B.C. growth, and estimate that after advancing 3.8% in 2010, real GDP growth should maintain a solid 3.2% pace this year and grow a further 3.0% in 2012. The budget is based on much more modest economic assumptions. The Province is basing its fiscal plan on GDP growth of just 2.0% in 2011 and 2.6% in 2012, which seems especially cautious. While the housing market is likely to see much more balanced conditions this year, and housing starts have levelled off recently, activity in the commodity space is gathering momentum. Additionally, exports were up 21% y/y in the final quarter of 2010, and should be supported in the coming year by firming U.S. demand and still-strong growth in Asia. If the economy comes closer to our forecast, look for both revenues and spending to grow faster than the fiscal plan over the next three years, and for B.C. to return to balance a year earlier.



Still, there are clearly some risks to our upbeat economic outlook for the province. One concern has been a recent sag in B.C. employment, in stark contrast to solid gains elsewhere. In fact, the B.C. jobless rate vaulted above the national average last month (to 8.2% versus 7.8%) for the first time since 2004. And, this is not due to entrants streaming back into the job market—B.C. has actually recorded the second slowest labour force growth in the country over the past year. We believe that employment will pick back up through the spring, but at the very least, the recent weakness raises a warning flag on our relatively upbeat outlook for the provincial economy. Another cautionary note is sounded by the heated local housing market, where prices have doubled in the past seven years. Vancouver’s average home prices are now more than two times the national average, and look vulnerable to a correction. Finally, there is clearly some uncertainty on the outlook for economic policy in the province, given the recent political upheaval (leaders of both the two major parties resigning within weeks of each other) and the unresolved issue of the fate of the HST.

The Province’s total gross borrowing requirements are projected to be \$9.2 bln in FY11/12. After accounting for maturities and sinking funds, the net increase in debt is projected to be \$6.2 bln. This will cause the total debt-to-GDP ratio to rise from 23.4% in FY10/11 to 25.4% in the coming year and 26.1% by FY13/14. The taxpayer-supported debt-to-GDP ratio will rise from 16.5% in FY10/11 to 17.5% next year and also by FY13/14, though that’s still below the recent high of early last decade.

Provincial Borrowing Requirements (\$ mlns)	2010/11	2011/12
Total Provincial Debt at Beginning of Year	41,885	47,281
New Borrowing	7,940	9,002
Direct Borrowing by Crown Corp. and Agencies	750	255
Retirement Provision	(3,444)	(3,301)
Change in Forecast Allowance	150	200
Net Change in Total Debt	<u>5,396</u>	<u>6,156</u>
Total Provincial Debt at Year End	<u>47,281</u>	<u>53,437</u>

The Bottom Line: As one of Canada’s two provinces with a triple-A credit rating, British Columbia has high standards to meet, and its fiscal plan appears on track. The budget lays out a plan to return to near-balance by FY2012/13 (before forecast allowances), and maintain a small surplus thereafter. Given the prospects for solid economic growth in the province—even if a bit shy of our upbeat projections—and realistic revenue and spending assumptions, this plan appears credible. Of course, we may need to reassess as new policy measures are pending once a Liberal leader is chosen later this month.



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