British Columbia
2017 Budget Update
Economics and Strategy

September 11, 2017

"First steps" for a government in an enviable position

Highlights

- BC's economy all but blew the doors off last year, as real GDP surged 3.6%. Importantly, expectations for the current year have been lifted. The government expects 2.9% growth in 2017, up smartly from the 2.1% eyed back in February. Nominal growth is slated to surpass 5% once more in 2017, a full percentage point stronger than in February.
- Few (if any) governments in Canada have inherited such a favourable economic and fiscal position, with this stronger economic backdrop providing ample room to maneuver. The budget update allocated funding for related initiatives, funded from a notably stronger-than-expected revenue base and also via some previously telegraphed tax changes.
- The net result is a three-year budget balance trajectory not that far removed from what investors last saw in February. The 2017-18 surplus is now projected at $246 million vs $295 million in February. Over the full three-year fiscal plan, the updated aggregate surplus, at $731 million, is just $31 million shy of that previously outlined. That net difference doesn't really register when compared to BC's $276 billion provincial economy.
- The stated priorities for the new NDP minority government are improving affordability, enhancing critical services and building a strong/sustainable/inclusive economy. Specific initiatives, some of which had already been announced, include: a 50% cut in MSP premiums, eliminated bridge tolls, increased social assistance/disability supports, investment in rental units/modular housing for the homeless, funding for new teachers and to combat addiction. The small business tax rate is heading down 0.5%-pts and the PST on electricity will be phased out for business. But there's a new tax bracket for high income earners and a 1%-pt increase in the corporate income tax rate (to 12%). The carbon levy will also rise $5 tonne each year through 2021.
- The budget update continues to include significant prudence. Budget planning assumptions for real GDP growth have been set one to two ticks below the consensus each and every year through 2021. Natural gas price assumptions are likewise conservative. And there's a significant buffer provided through the contingencies vote and a separate forecast allowance, amounting to a hefty $900 million for 2017-18—providing protection should wildfire costs continue to accumulate.
- BC sees its taxpayer-supported debt burden at 16.2% of GDP in 2017-18, up from 15.9% in February due to a reclassification of some debt following the removal of bridge tolls. The province expects its direct operating debt to be eliminated by 2019-20, although capital investments would see the taxpayer-supported debt ratio edge a bit higher next fiscal year (to 16.4%), before starting to turn lower in 2019-20 (16.3%). The debt ratio compares favourably to most other provincial jurisdictions.
- Gross funding requirements amount to less than $3.5 billion for 2017-18, down from $5.37 billion in February. Taking into consideration internal financing sources and/or short-term borrowing, there's officially $2.938 billion of term funding to do before the fiscal year is out (a figure that includes fiscal prudence). That's exceptionally manageable for a province with a sterling credit rating and strong domestic/international investor following. Requirements for the coming two fiscal years may be higher than 2017-18, but are nonetheless lower than what had been last telegraphed. At this point, the cumulative decrease in BC's planned gross bond issuance over three years to 2019-20 is ~$4.8 billion.
- Finance Minister James made clear that the government sees itself as having taken only the "first steps" when it comes to investing in the province. So one can expect more policy action in the NDP's first full budget due in February.

New government, new priorities

Whether in the form of an earlier election campaign platform, a days old Speech from the Throne or today's budget update, the priorities for British Columbia's new NDP minority government are clear enough. At a high level, the new government is focused on three core commitments: improving affordability, enhancing critical services and building a strong/sustainable/inclusive economy.

The government used today's budget update to outline funding for many related priorities. New investments are being funded from a notably stronger-than-expected revenue base and also via some previously telegraphed tax changes. So notwithstanding notable differences in a host of revenue and expenditure lines items, the net result is a three-year budget balance trajectory that's not too far removed from what investors last saw in February.

There may well be something of a "placeholder" feel to this update, with Finance Minister James making clear that the government sees itself as having taken only the "first steps" when it comes to investing in the province. So one can expect more policy action in the NDP's first full budget due in February. In the meantime, there's ample prudence built into the fiscal plan and less than $3 billion of funding to do before March 2018—ultra manageable for a 'triple-A' rated credit.

Strong economy = room to maneuver

Armed with a buoyant economy, BC's minority NDP government clearly has fiscal room to maneuver. Indeed, few (if any) governments in Canada have inherited such a favourable economic and fiscal position.

The economy all but blew the doors off last year, as real GDP surged 3.6%. That was much better than originally projected. Importantly, expectations for the current year have also been lifted. The government expects 2.9% growth in 2017, up smartly from the 2.1% eyed back in February. Nominal growth is slated to surpass 5% once more in 2017, a full percentage point stronger than in February.

Sizzling growth, ample hiring and robust spending have generated fiscal traction. As per the previously released public accounts, BC ran a $2.737 billion surplus in fiscal 2016-17, equivalent to a bit more than 1% of GDP. That continued a string of sturdy fiscal results, leaving the provincial debt burden and interest bite at *very* manageable levels heading into 2017-18.

Indeed, the budget update details a much improved underlying fiscal position relative to February (prior to new measures). Case in point, the 2017-18 revenue base is fully $1.5 billion stronger. So even after accounting for almost $670 million in unplanned spending (mainly fire management/emergency spending linked to a record forest fire season), the underlying surplus for the current year was tracking towards $700 million—well north of the $295 million projected in February. It was a similar story for the two final years of the fiscal plan, as the underlying budget surplus was more than double that previously predicted.

Budget balance: Then vs now

Suffice it to say, BC's new government has found itself with scope to fund new initiatives without jeopardizing the province's long-term fiscal sustainability.

The update set out almost $2.5 billion over three years for "new priority investments". After some tweaking in the contingencies vote/prudence (more on that later), the budget update puts the resulting 2017-18 surplus at $246 million, about $50 million lower than in February. Over the three year period to 2019-20, the aggregate surplus is now estimated at $731 million—not far from the $762 million aggregate surplus previously set down. The net difference of $31 million over three years doesn't really register when stacked up against a provincial economy worth $275 billion a year.

First steps… there are more than a few

If you thought this release was solely an exercise in updating the economic forecast, you'd be mistaken. To wit, today's budget update included/confirmed the following:

- A 50% cut in Medical Services Plan (MSP) premiums, starting January 2018, with the remaining 50% to be eliminated over four years. This will save couples $900/year, while costing the province over $1.2 billion on a full fiscal year basis. It should be noted that the prior government's February budget had included MSP premium relief (i.e., a 50% cut for households with a net family income of <$120K);
- The elimination of tolls on two bridges effective September 1st, saving the average commuter $1500/year and more like $4500 in annual savings for commercial truck drivers;
- A reduction in the small business corporate income tax rate to 2% (from 2.5%), the phasing out of PST on electricity for business (fully exempt come April 2019), the extension of the main scientific research tax credit for five more years and restoration of the credit union tax benefit;
- A $100 per month boost to income and disability assistance rates, taking effect in October of this year;
- Significant new investments in affordable rental units (over $200 million), alongside capital (>$290 million) and operating commitments ($170 million over three years) for new modular housing units for the homeless;
- Some $680 million over three years to allow for the hiring of 3500 new teachers, with investment in new schools a priority element of the capital plan;

- Over $320 million to combat addictions, focused on the fentanyl overdose crisis that has taken root in a growing number of North America jurisdictions;
- Free tuition for adult basic education/English language learning;
- Funding via a federal-provincial agreement for home/residential care for seniors;
- $140 million for wildfire risk reduction and related restoration/awareness programming.

While BC's strong economy is spinning off extra revenue, the government made some tax changes to help finance its affordability measures/new commitments. Of note, the general corporate income tax rate will increase 1%-pt to 12% starting January 2018, raising over $300 million on a full-year basis. Also for the 2018 tax year, a new personal income tax bracket of 16.8% will be introduced for those earning over $150K (vs the current 14.7%), worth ~$275 million/year. Meanwhile, the province's carbon levy will increase by $5 per tonne for the 2018-19 fiscal year (equivalent to $212 million). Further annual increases of $5 per tonne are planned until the carbon levy reaches $50/tonne in April 2021. On balance, today's budget update outlined a non-trivial $881 million in net tax relief on a full-year basis… again, some of which had already been pledged back in February.

The budget update foresees a significant increase in natural gas royalties (up >50% on higher volumes/prices). The budget update assumes nat. gas averages C$1.60/GJ in 2017-18. Despite this contribution, resource revenue is slated to slip more than 10% this fiscal year, accounting less than 5% of BC's total revenue. Property transfer tax revenue is also seen declining each year of the fiscal plan, consistent with a projected decline in housing activity from extremely elevated levels. Official sensitivities suggest a 5% change in starts is worth $40-60 million in property transfer revenue, all else equal.

Significant prudence remains

In what you might consider a very welcome continuation, today's budget update contains some very significant prudence. As in years past, it comes in a few different flavours.

First off, budget planning assumptions for real GDP growth have been set one to two ticks below the consensus each and every year through 2021. Natural gas price assumptions are likewise conservative (relative to private sector expectations).

Then there's the significant buffer provided through the contingencies vote and a separate forecast allowance. This one-two punch amounts to a hefty $900 million for 2017-18—a fiscal year that's now well under way. That's noted protection should wildfire costs continue to accumulate. Fiscal prudence is currently set at $600 million for 2018-19 and $700 million in the final year of the fiscal plan (i.e., 2019-20). All in all, BC is well protected against potential risks. And if it's smooth sailing, well then there's likely some additional fiscal wiggle room to advance more of the new government's policy priorities.

Some debt reclassified, but burden low

BC is a low debt jurisdiction by provincial standards, a relative advantage that helps explain why it's the top-ranked provincial credit in Canada (with the tightest relative spreads to boot). Still, there are a couple of points worth covering here. Of particular note is a partial reclassification of debt, brought about by the removal of bridge tolls cited above. Specifically, the removal of tolls on the Port Mann bridge has triggered a one-time shift of $3.5 billion in Transportation Investment Corporation debt from self-supporting to taxpayer-supported. It's that change, and not any fundamental erosion in budgetary metrics, that explains a somewhat higher taxpayer-supported debt burden relative to February.

Specifically, BC now puts its taxpayer-supported debt burden at $44.85 billion for 2017-18, equivalent to 16.2% of GDP. That ratio had been set at 15.9% in February. The province sees its direct operating debt eliminated by 2019-20, although capital investments would see the taxpayer-supported debt ratio edge a bit higher next fiscal year (to 16.4%), before starting to turn lower in 2019-20 (16.3%). Again, that's a debt ratio that stacks up pretty favourably by historical standards and relative to most other provincial jurisdictions. Meanwhile, the debt burden looks to remain very manageable, even assuming interest rates continue on a normalization path. Taxpayer-supported interest cost are set to consume less than 4 cents of BC's annual revenue dollar through 2019-20.

A significant drop in self-supporting debt vs February not only captures the aforementioned reclassification, but also reflects the cancellation of the George Massey Tunnel Replacement project. Meanwhile, BC Hydro's Site C project, which heavily influences the utility's capital spending plans, has been sent for review. Stay tuned.

<$3 billion of funding for 2017-18

What of the province's borrowing requirements? Well, the current year budget balance may not be that different from February, but with extra cash from the prior fiscal year, funding needs for 2017-18 have stepped down nicely.

Gross requirements now amount to less than $3.5 billion, down from $5.37 billion in February. Moreover, with roughly $500 million slated to come from internal financing sources and/or short-term borrowing, the bond program is pegged at just $3 billion—a figure that includes some significant prudence/padding. Strip out the tiny bit of CPP borrowing completed in the fiscal year-to-date, and there's officially $2.938 billion of term funding to do before the fiscal year is out. That's exceptionally manageable for a province with a sterling credit rating and strong domestic/international investor following.

Looking further out, the budget update points to $6.87 billion of term funding in 2018-19, followed by $5.25 billion in 2019-20. Those figures might be up from this year's modest requirement, but are lower than what had been last telegraphed. So here's a number for all you bond investors out there: $4.755 billion. That's the cumulative *decrease* in BC's planned bond issuance over full three-year fiscal plan. Granted, the NDP have flagged further action ahead, including in the upcoming February budget. But whether it's sizzling economic growth, a string of budget surpluses, multiple layers of fiscal prudence, or fairly modest borrowing requirements, BC's enviable story so far remains intact.

[As a final aside, you'd be forgiven for wondering just how stable today's minority government is. By way of recap, British Columbia's May 2017 general election ultimately snapped 16 straight years of Liberal majority rule. In its place, an NDP minority government rose to power, supported by the third party Greens (via a formal confidence/supply agreement). Initially, the NDP (which were sworn in on July 18th) were operating with the very slimmest of legislative margins, but they've since gained a bit of breathing room, owing to loss of two Liberal MLAs… one via retirement (former Premier Christy Clark) and one via expulsion (Speaker Darryl Plecas). As it stands, the NDP hold 41 of 87 seats in the provincial legislature, the same number as the Liberals, with the balance comprised of 3 Green Party MLAs, 1 independent (the Speaker) and 1 vacancy. That's still fairly tight yes, but it's a distribution of seats that should nonetheless allow the NDP to pass this budget update and move forward on its legislative agenda.]

Warren Lovely

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British Columbia

	Actual	Budget	Update	Plan	Plan	Percentage change		
$000,000	2016/17	2017/18	2017/18	2018/19	2019/20	2017/18	2018/19	2019/20
Taxation revenue	27,093	26,804	28,180	29,292	30,277	-1.1%	9.3%	3.4%
Resource revenue	2,711	2,320	2,413	2,250	2,210	-14.4%	-3.0%	-1.8%
Other revenue	10,963	10,482	10,483	9,502	9,574	-4.4%	-9.3%	0.8%
Other federal transfers	8,167	8,317	8,372	8,565	8,738	1.8%	3.0%	2.0%
Commercial Crown corporation net income	2,525	2,915	2,959	2,948	2,878	15.4%	1.1%	-2.4%
Total revenue	**51,459**	**50,838**	**52,407**	**52,557**	**53,677**	**-1.2%**	**3.4%**	**2.1%**
Program spending	46,135	47,127	48,586	48,897	49,803	2.2%	3.8%	1.9%
Contingencies	-	400	600	300	350			
Debt servicing costs	2,587	2,666	2,675	2,832	2,917	3.1%	6.2%	3.0%
Total spending	**48,722**	**50,193**	**51,861**	**52,029**	**53,070**	**3.0%**	**3.7%**	**2.0%**
Forecast allowance	-	(350)	(300)	(300)	(350)			
Surplus	**2,737**	**295**	**246**	**228**	**257**			
Provincial Debt Changes								
Deficit (surplus) before forecast allowance	(2,737)	(645)	(546)	(528)	(607)			
Taxpayer-supported capital spending	3,659	4,804	4,956	4,855	4,814			
Self-supported capital investments	2,725	3,278	2,701	2,635	3,154			
Commercial Crown corp. retained earnings	(20)	489	827	594	357			
Amortization, taxpayer-supported capital investments	(2,638)	(2,239)	664	(2,333)	(2,379)			
Other items	(398)	(2,531)	(7,708)	(2,345)	(2,608)			
Increase in total provincial debt	**591**	**3,121**	**894**	**3,063**	**2,916**			
Total provincial debt	**65,883**	**69,787**	**66,777**	**69,840**	**72,756**	**5.9%**	**0.1%**	**4.2%**
Provincial government direct operating	**4,644**	**3,609**	**1,573**	**249**	**-**	**-22.3%**	**-93.1%**	**-100.0%**
Other taxpayer-supported (mainly capital)	**36,862**	**39,693**	**43,280**	**46,782**	**48,642**	**7.7%**	**17.9%**	**4.0%**
Self-supported	**24,377**	**26,135**	**21,624**	**22,509**	**23,764**	**7.2%**	**-13.9%**	**5.6%**
Forecast Allowance	**-**	**350**	**300**	**300**	**350**			
Total provincial debt / GDP	25.1%	25.6%	24.2%	24.3%	24.3%			
Taxpayer-supported	15.8%	15.9%	16.2%	16.4%	16.3%			
Capital Spending	**6,384**	**8,082**	**7,657**	**7,490**	**7,968**	**26.6%**	**-7.3%**	**6.4%**
Taxpayer-supported capital spending	3,659	4,804	4,956	4,855	4,814	31.3%	1.1%	-0.8%
Self-supported	2,725	3,278	2,701	2,635	3,154	20.3%	-19.6%	19.7%
Gross Borrowing Requirements	**1,995**	**5,368**	**3,484**	**6,874**	**5,248**			
Operatins deficit (surplus)	(2,737)	(295)	(246)	(228)	(257)			
Capital spending	6,384	8,083	7,657	7,490	7,968			
Refinancing requirements	2,133	2,756	2,707	3,823	1,973			
Other financing sources	(3,785)	(5,176)	(6,634)	(4,211)	(4,436)			
Large program expenses								
Education	12,468	13,124	13,376	13,661	13,870	5.3%	4.1%	1.5%
Health services	19,689	20,629	20,747	21,466	22,150	4.8%	4.1%	3.2%
Subtotal	32,157	33,753	34,123	35,127	36,020	5.0%	4.1%	2.5%
Other program expenses	13,978	13,374	14,463	13,770	13,783	-4.3%	3.0%	0.1%
Total education / total expenses	25.6%	26.1%	25.8%	26.3%	26.1%			
Health services / total expenses	40.4%	41.1%	40.0%	41.3%	41.7%			
Debt servicing costs / total expenses	5.3%	5.3%	5.2%	5.4%	5.5%			

Source: Budget documents, British Columbia Ministry of Finance

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