British Columbia: 2018–19 Q2 Update

SUMMARY

- **The Province of British Columbia published its Second Quarterly Report (*Report*) for fiscal year 2018–19 (FY19) on Monday.**
- **The *Report* outlined a budgetary surplus of $1.35 bn[1] for this fiscal year, $681 mn higher than forecast as of Q1-2018.**
- **A stronger revenue profile is expected to dominate modest upward revisions to expenditures and additional contingencies to mitigate potential downside risks.**
- **BC's taxpayer-supported debt is projected to come in $2.3 bn lower than forecast in Q1. This would eliminate the Province's operating debt.**

ECONOMIC CONDITIONS

BC continues to base its fiscal planning on economic growth of 2.2% in 2018 and 1.8% in 2019 despite modest shifts in private sector forecasts. In keeping with longstanding practice, it incorporated growth lower than the private sector average into its fiscal plan (chart 1, p.2). It also noted improvements since the Q1 forecast for employment, manufacturing shipments, nominal exports, building permits and interprovincial migration.

The housing market outlook was little changed. New home construction remains buoyant so far this year, and the resulting upswing in new listings continues to exert downward pressure on purchase prices. Home sales remain soft relative to the elevated levels of the last two years but look to be adjusting to new housing regulations plus rising interest rates in H2-2018.

With respect to trade, the *Report* identified a number of downside risks. The global rise of protectionism and the prospect of slowing growth in Asia is consequential for BC in particular given its strong trade ties to the continent. Weaker economic growth related to the UK's exit from the European Union poses similar challenges. The softwood lumber dispute and recent declines in Western spruce-pine-fir prices from more than USD 600 mbfm in June to less than USD 400 mbfm in October (chart 2, p.2) represent further concerns for one of BC's key exports.

FISCAL PROJECTIONS

Total revenue is forecast to register gains $1.4 bn higher than planned in the Q1 update. Key to the revision are one-time prior-year adjustments to personal and corporate income tax receipts, which are expected to contribute to a $1.6 bn windfall. These gains are forecast to be eroded by: lower property transfer tax receipts (reflecting the housing market soft patch); weaker federal government contributions; and softer Crown corporation net incomes. This last revision is dominated by a fall relative to Q1 of more than $200 mn for the Insurance Corporation of BC (ICBC).

[1] Figures reported in Canadian dollars unless otherwise stated.

CONTACT

Marc Desormeaux, Provincial Economist
416.866.4733
Scotiabank Economics
marc.desormeaux@scotiabank.com

Updated Fiscal Forecast
$ millions except where noted

	FY18	FY19	
	Final	Q1	Q2
Tax Revenue	28,321	31,383	32,829
Natural Resource Revenue	2,695	2,908	2,959
Commercial Crown Corp. Net Inc.	1,056	2,627	2,412
Other Own-Source Revenue	10,893	9,776	9,901
Total Own-Source Revenue	**42,965**	**46,694**	**48,101**
Federal Transfers	9,055	9,121	9,097
Total Revenue	**52,020**	**55,815**	**57,198**
Health	20,927	21,684	21,731
Education, K-12 & Post-Secondary	13,091	14,094	14,069
Social Services	4,737	5,319	5,310
Other Program Spending	10,341	11,045	11,148
Program Spending	**49,096**	**52,142**	**52,258**
Debt Service*	2,623	2,654	2,640
Total Expenditure	**51,719**	**54,796**	**54,898**
Forecast Allowance	0	350	950
Surplus	**301**	**669**	**1,350**
Capital Outlays: Taxpayer-Supp.	3,908	5,579	5,177
Self-Supported	2,729	4,078	4,061
Taxpayer-Supported Debt	**43,607**	**44,717**	**42,431**
Annual Change, %			
Tax Revenue	*4.5*	*10.8*	*15.9*
Natural Resource Revenue	*-0.6*	*7.9*	*9.8*
Total Own-Source Revenue	*-0.7*	*8.7*	*12.0*
Federal Transfers	*10.9*	*0.7*	*0.5*
Total Revenue	***1.1***	***7.3***	***10.0***
Health	*6.3*	*3.6*	*3.8*
Education	*5.0*	*7.7*	*7.5*
Social Services	*11.6*	*12.3*	*12.1*
Other Program Spending	*6.2*	*6.8*	*7.8*
Program Spending	*6.4*	*6.2*	*6.4*
Total Expenditure	***6.2***	***5.9***	***6.1***
Memo Items, %			
Own-Source Revenue / GDP	*15.2*	*15.8*	*16.2*
Program Spending / GDP	*17.4*	*17.6*	*17.6*
Total Expenditure / GDP	*18.3*	*18.5*	*18.5*
Budget Balance/ GDP	*0.1*	*0.2*	*0.5*
Taxpayer-Supported Debt / GDP	*15.5*	*15.1*	*14.3*
Taxpayer-Supp. Debt / Revenue	*83.8*	*80.1*	*74.2*
Debt Service* / Revenue	*5.0*	*4.8*	*4.6*

* Taxpayer-supported basis. Sources: BC Finance, Statistics Canada; nominal GDP forecasts: Scotiabank Economics.

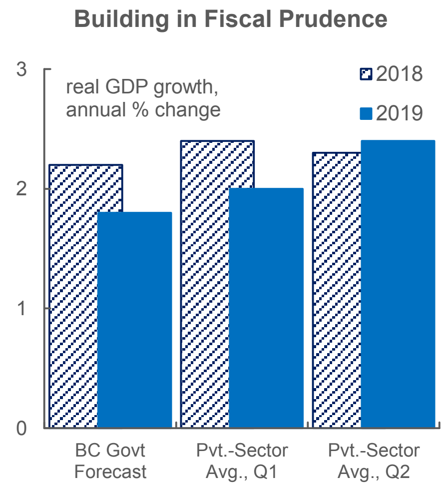
Total expenditure is projected to come in $102 mn higher than anticipated in the prior projection. Spending on fire and flood management services is expected to be $160 mn higher than the Q1 forecast. The Province also foresees higher operating costs related to post-secondary education. Reduced refundable tax credit payments of $118 mn—2017 tax return data revealed lower effective rates will likely apply to film & television production in calendar year 2018—counteract these outlays alongside lower debt servicing costs. Details of the costs associated with wage increases for unionized public sector employees, set to be awarded after BC's real economic growth diverged from the Budget 2018 forecast, will be provided in the 2019 Budget.

To mitigate trade- and housing-related downside, the Province upped its forecast allowance by $600 mn. Contingencies of $950 mn are now earmarked for FY19.

For capital spending, the key development was a $402 mn reduction since Q1 in the forecast for taxpayer-supported outlays. Adjustments to the timing of previously planned expenditures, notably on the Broadway Subway project, are the proximate cause. Ventures now incorporated into fiscal planning include a $79 mn high school in Burnaby, a $54 mn elementary school in Chilliwack, a $63 mn expansion of Highway 1 from Kamloops to Alberta and an $81 mn strategic property purchase in Vancouver. The *Report* also notes modest cost reductions on two dam projects, delays on a mental health and addiction treatment facility in Burnaby and the completion of a post-secondary arts & design campus redevelopment.

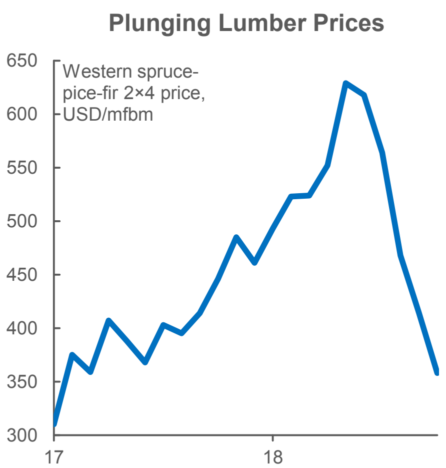
The *Report*'s pièce de résistance was the projected elimination of provincial operating debt for the first time in four decades. The reduction in taxpayer-supported debt since Q1 mirrors a $2.1 bn increase in cash originating from the larger-than-anticipated surplus and lower capital spending profile. To align with the $950 mn forecast contingency, BC is building an equivalent borrowing allowance into its fiscal blueprint.

Chart 1



Sources: Scotiabank Economics, BC Finance.

Chart 2



Sources: Scotiabank Economics, *Random Lengths*.

OUR TAKE

One-time events drove much of the change to the bottom line, but BC maintains one of the most favourable financial positions of any province in Canada. The province's expansion is at an advanced stage and near-term risks are nontrivial. Yet conservative GDP forecasts and a sizeable contingency reserve should serve as a bulwark against adverse economic shocks.

Given the stronger surplus, lighter debt load and the possibility that growth will outpace the Province's forecast in FY19, we view further pocketbook relief as a likely outcome of the next BC Budget scheduled for February 19, 2019. Improving affordability has thus far been a priority for the Government and the better fiscal position leaves room to bolster steps already taken and announced in areas such as child care and prescription drug costs.

An important question going forward is how the $40 bn LNG Canada project will impact fiscal planning in the outer years of the forecast period. Our forecast assumes Canada's largest-ever private-sector project will generate capital expenditures of nearly $14 bn during 2019–20 that will propel BC's economic growth well above that of the other provinces. In line with industry estimates of capital spending profiles for comparable projects, peak construction is expected in 2021 with workforce ramp-up about 18 months after the October 2018 final investment decision. For details on the Government's economic forecast and the anticipated timing of future personal and income tax receipts, we await the 2019 Budget.