ECONOMIC RESEARCH AND STRATEGY

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BC First Quarterly Report – Temporary Surplus, Uncertain Outlook

BC's fiscal bottom line improves significantly for FY 2022-23 according to the First Quarterly Report. The deep $5.5B deficit projected in budget 2022 has been turned into a moderate surplus position of $0.7B. Long-term borrowing requirements fall from $19B to $12.3B.

The upward revision to revenue of $9.3B is 3 times the size of the revision to expense ($3.1B). Very dynamic labour market conditions and supportive commodity prices contribute to higher personal and corporate income taxes and resource revenue. Natural gas royalties stand out in the resource revenue category due to higher prices. Also, the BC government anticipates the Canada LNG project to enter production phase around 2025-26, beyond the 3-year outlook proposed in the First Quarterly Update. The construction phase of the Canada LNG project in Kitimat continues, while Qatar, the U.S. and Australia are boosting LNG exports to support Europe struggling with energy access.

On the spending side, a tentative agreement announced last week between the government and public sector unions include large cumulative wage increases slightly north of 10% over three years. This outcome of public sector negotiations will add $1.9B in additional expenses during FY 2022-23 alone. In addition, fire management costs have been revised up modestly to more than $0.4B, a figure that could change based on the September wildfires leading to evacuations in several regions of the Province. As we mentioned in the past, BC households are more vulnerable financially and to climate shocks than in other provinces according to a Bank of Canada 2021 staff note, which could notably lead to an uptrend in climate resiliency infrastructure spending over time. Also, $1B in inflation-fighting measures for individuals was included in the First Quarterly Update. For instance, the BC government announced last week temporary increases to several benefit programs and cap the rent increase to 2% for 2023.

The FY 2023-23 surplus estimate of $0.7B is not structural. Deficits of $3.8B and $2B are projected for FY 2023-24 and FY 2024-25, better figures relative to budget 2022. The return in deficit territory is driven notably by the addition of $2B in expenses that will be eventually used for new fiscal initiatives and "caseload pressures". The expectation of a major decline in revenues in FY 2023-24 also contributes to the return in deficit territory. BC's annual real GDP growth forecast is cut by half in 2023 (1.5%) relative to 2022 (3.2%). In our view, higher interest rates bite more BC households than other provinces since a larger share of disposable income goes to housing costs. Accordingly, there is less discretionary dollars to spend. BC retail sales in real terms have unsurprisingly declined so far in 2022 relative to 2021. Of course, one major economic risk to BC's outlook relates to loss of momentum in China: the zero-COVID policy led to a new wave of shutdowns in several regions lately; one of the worse droughts in history have led to power shortages

and a new kind of supply chain problems; manufacturing activity is poised to stay in contraction territory; real estate markets weaken; and consumer spending is sluggish.

Given the uncertain path of various elements on the revenue and spending side, BC's 3-year fiscal outlook includes an annual forecast allowance buffer of $1B, the equivalent of 1.2% of revenue. There is also at least $4B per year set aside to manage unexpected costs pressures coming from the pandemic and flooding related costs, the equivalent of about 5% of total expense.

In summary, BC's financial situation improves significantly in FY 2022-23 according to various metrics including the debt-to-GDP ratio (17%), debt-to-revenue ratio (88%) and interest costs-to-revenue ratio (2.6%). However, most metrics are poised to deteriorate in the medium-term.

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