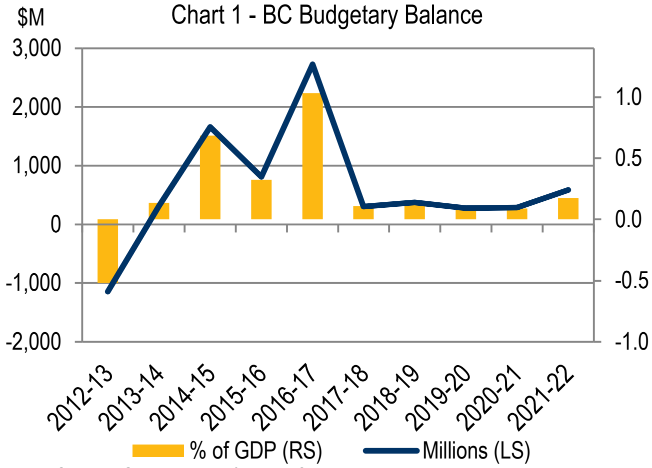
Laurentian Bank Securities
ECONOMIC RESEARCH AND STRATEGY

The 2019 British Columbia Budget – Solid financial situation expected to persist

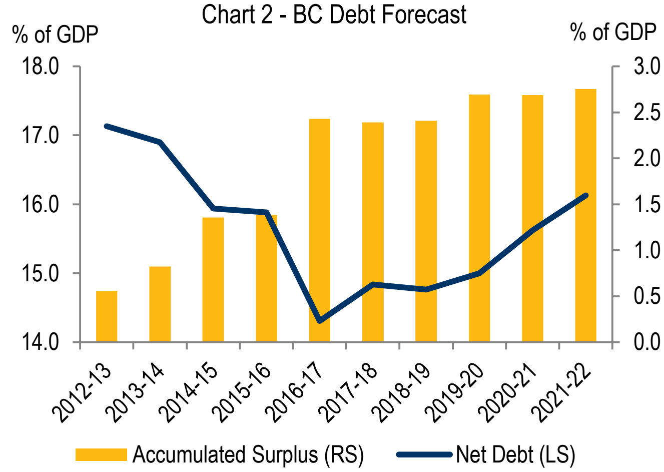
BC Finance Minister Carole James delivered the second budget from the NDP minority government yesterday. For the sixth year in a row, the province should register a modest budgetary surplus in FY 2018-19 ($374M, 0.1% of GDP).

On the policy front, the government is taking advantage of its favourable fiscal position by introducing an array of tax initiatives and spending measures in the areas of child care, education (through elimination of interests on student loans) and the elimination of Medical Services Plans (MSP) premiums (starting in January 2020). After accounting for those new fiscal measures, according to the new three year fiscal plan, the government continues to forecast steady and modest surpluses averaging 0.1% of nominal GDP between 2019-20 and 2021-22 (chart 1). Finally, BC follows along with the federal government as well as other provinces in accelerating business capital cost allowance on capital investments; a measure costing $443M in foregone revenues in 2019-20.

Since the province expects surpluses, the *accumulated surplus* is also projected to grow further, reaching 2.8% of GDP in 2021-22.[1] This being said, the Province's public debt will increase due to the sizeable infrastructure plan ($20.1B over 3 years). The net debt-to-GDP is expected to stay in the same historical range even though it is projected to increase modestly from 14.8% of GDP in FY 2018-19 to 16.1% at the end of FY 2021-22 (chart 2). With strong fundamentals, forecast allowances, and the upcoming economic boost tied to the LNG Canada project, the Province is in a good position to preserve its triple-A rating while delivering new fiscal measures.



Source: Government of British Columbia.



Source: Government of British Columbia.

A Small Surplus in FY 2018-19 despite ICBC woes

The $374M (0.1% of GDP) 2018-19 surplus estimated in the third quarter fiscal update (published at the same time as the 2019 budget) is slightly larger than the $219M surplus tabled in Budget 2018 but significantly lower than the

[1] BC's financial framework, as well as its fiscal sensitivities is presented on page 4.

$1.4B surplus projected in the 2nd Quarterly Report. This sudden downward revision reflects a higher net loss for the ICBC crown corporation ($290M), the elimination of interest on student loans ($217M), higher non-recurrent expenditures on specific projects ($375M) and the reassessment of corporate income tax revenues ($259M).

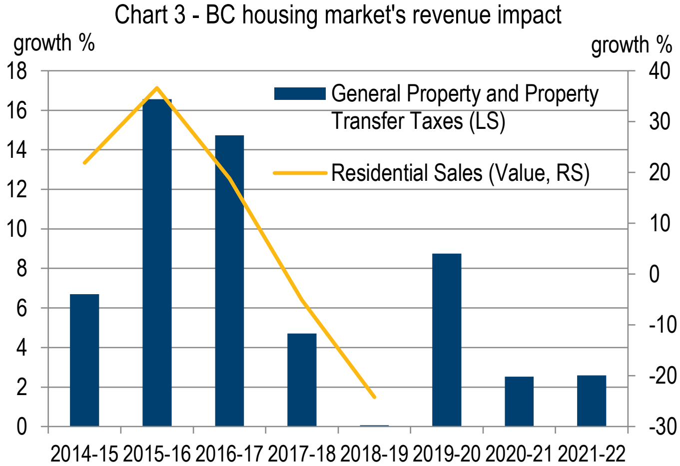
For the entire FY 2018-19, relative to the 2018 Budget, unexpected claims costs at ICBC reduces the Province's bottom line by a whopping $1.2B (equivalent to 2% of total revenues), after having registered a $1.3B net income loss in FY 2017-18. ICBC's financial restructuring is expected to eliminate almost the entire net loss in 2019-20 (a minor $50M loss) before showing a positive net income position in 2020-21.Such a quick turnaround would be positive. This being said, ICBC's financial results continue to be flagged by the government as one key fiscal risk to the outlook.

Upward revisions to economic growth despite a slowing housing market

Relative to a year ago, the global economic slowdown led to downward revisions to the economic outlook in most regions. However, BC is an exception to the rule. Principally because of the combined effect of the new CUSMA and the final approval for the massive LNG Canada project, BC's real GDP growth forecasts has been revised up in both 2019 (from 1.8% to 2.4%) and 2020 (from 2.0% to 2.3%) compared to the 1st Quarterly Report published last September. The Ministry of Finance's forecasts are nevertheless more conservative than the private sector average (2.5% and 2.6%) and our own (2.8% and 2.4%); See the February 2019 edition of the Provincial Monitor for our full provincial forecasts. Besides LNG, it is important to flag the key issues affecting BC's economic momentum:

- First, the good old days when the housing boom led to double-digit growth in property transfer taxes (2012 to 2016) is clearly over (chart 3). Provincial and federal macro prudential measures taxes as well as higher interest rates have been cooling down Vancouver's housing market for quite some time. For instance, Vancouver's MLS resale unit transactions fell by 32% in 2018 vs. 2017 and was down 40% on a year-over-year basis in January 2019, leading to a much lower resales-to-new listings ratio (chart 4). Also, resale home prices have been declining since mid-2018. Altogether, cooling housing market conditions led to stagnation in property revenues in FY 2018-19 (chart 3). These are projected to improve slightly over the forecast horizon based on the government's expectations of a moderate improvement in the number of transactions and value of home sales.

Chart 3 - BC housing market's revenue impact



Source: Government of British Columbia, CREA.

Chart 4 - Resales-to-New Listings Ratio

Note: Shown as a 3-month moving average.
Sources: CREA, LBS Economic Research and Strategy.

- **Second, BC's forestry industry** is also under the investors' radar. The Chinese slowdown lowered BC's exports of softwood lumber. Combined with lower lumber prices, the government expects forestry revenues to decline by 17% in FY 2019-20. This being said, forestry revenues represented "only" 2.5% of total fiscal revenues in FY 2018-19.
- Based on higher natural gas prices, **natural gas royalties** are projected to increase over the forecast horizon relative to 2018-19. These natural gas royalty projections (averaging $256M from FY 2019 to 2022) do not include Phase 1 of the LNG Canada export and processing terminal expected to start operation by 2023.

Higher borrowing requirements due to large capital spending program

British Columbia does not borrow to finance operations since it is running a budget surplus. Moreover, the province's direct operating debt has been completely eliminated.[2] However, the 2019 Budget introduces a major $20B infrastructure program over three years targeted towards health care, education and transportation needs. Thus, borrowings for investment in tangible capital assets will increase from $9.0B in FY 2018-19 to $10.6B in FY 2019-20 and stay around this level afterwards (see table 1). Overall, after removing other financing sources and the operating surplus, **total gross borrowing requirements are expected to be $7.5B, $8.1B and $8.6Bin 2019-20, 2020-21, 2021-22, respectively**. However, it is important for investors to note that BC's use of internal financing sources and changes in short-term borrowing could lower the province's long-term borrowing requirements. Indeed, in FY 2018-19, internal financing reduced net borrowings by $3.8B.

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[2] Other taxpayer supported debt includes debt from the education, health and transportation sectors.

Budget and Fiscal Plan ($ billions)				
	2018-19	2019-20	2020-21	2021-22
Total Revenue	**56.6**	**59.0**	**60.0**	**62.5**
% change	8.9	4.3	1.7	4.0
Total Expenditure	**55.8**	**58.3**	**59.5**	**61.6**
% change	7.8	4.5	2.0	3.6
Forecast allowance	0.5	0.5	0.3	0.3
Budgetary Balance	**0.37**	**0.27**	**0.29**	**0.58**
% of GDP	0.1	0.1	0.1	0.2
Net Debt	43.6	46.3	50.3	54.0
% of Nominal GDP	14.8	15.0	15.6	16.1
Accumulated Surplus	7.1	8.3	8.6	9.2
% of Nominal GDP	2.4	2.7	2.7	2.8
Taxpayer-supported Debt	44.0	46.4	50.5	54.0
% of Nominal GDP	14.9	15.0	15.7	16.1
Gross Borrowing Requirements	6.8	7.5	8.1	8.6
Of Which: Capital Requirements*	9.0	10.6	10.2	10.3

Note: Other financing sources and operating surplus reduce gross borrowing requirements.
Source: BC Budget 2019 and LBS Econ.Res. and Strategy.

British Columbia : Key Fiscal Sensitivities for FY 2019-20*		
	Increases of	**Annual Fiscal Impact $M**
Nominal GDP	1%	$150-$250
Lumber prices (US$/000 board feet)	$50	$150 -$175
Natural gas prices (Cdn$/GJ)	25 cents	$10-$40
Exchange rate (US$/CAD)	1 cent	-$25 to -$50
Interest rates	1%	around -$93
Debt	$500 million	-$16 to -$17

* change in the entire fiscal-year average; Source : The 2019 British Columbia budget