LAURENTIAN BANK

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BC Second Quarterly Report – From a Deep Budgeted Deficit to an Unsustainable Strong Surplus

Like other provinces, BC is taking advantage of a better-than-expected economy to generate solid near-term fiscal results. The budgeted deficit of $5.5B has turned into a solid surplus of $5.7B for FY 2022-23 (1.5% of NGDP). However, there was no update for future years. The taxpayer-supported debt is expected to stand at $62B at the end of the current fiscal year (16% of NGDP, 78% of total revenues), down $5.5B relative to the First Quarterly Report. The decline in debt more than offset the increase in interest rates. Accordingly, the downtrend in the debt servicing-to-revenue ratio should continue (2.3 cents out of every dollar in FY 2022-23 instead of 3 cents or more in previous years, also below most peers).

Total revenue is expected to reach $81.1B, up $3.2B relative to the First Quarterly Report and $12.5B higher than initially budgeted last February. Personal and corporate taxes, natural gas & resources royalties, and sales tax revenues are behind this improvement. Another noticeable change relates to the crown corporation ICBC in charge of motor vehicle insurance. ICBC will return in a net loss situation this year, the main contributor of a $0.6B deterioration in net income generated by all crown corporations for FY 2022-23 relative to the First Quarterly Report. ICBC, who registered $1.9B in net income during FY 2021-22, has been subject to a volatile financial situation in recent years. Part of this year’s deterioration is tied to the one-time relief rebate announced last Spring in response to the war in Ukraine. The adverse impact of high interest rates on housing activity also led to a $0.3B downward revision to property tax revenue.

Compared to the First Quarterly Report, expenses decrease $1.1B to $75.1B (including a $2B allocated for pandemic contingencies). Part of this improvement is unsustainable: new public sector wage increases totaling 11% over 3 years will boost spending in outer years, but not in FY 2022-23 versus expectations as salary costs were revised down $1.1B relative to the First Quarterly Report.

Despite the high degree of economic uncertainty, one surprise in our view came from the forecast allowance $0.7B reduction to $0.3B. Even if half of the current fiscal year is behind us, this is an unusual move relative to other provinces. Also, the update on borrowing requirements puts remaining issuance for FY 2022-23 at $1.1B out of the projected $7.5B financing program. There is no indication of pre-financing activity.

With new Premier David Eby in place since mid-November, it will be interesting to see if his public policy choices and 100-day plan alter the fiscal path in the future. Our understanding is that very few of the Premier's recent announcements are included in the Second Quarterly Report, such as the new BC Affordability Credit to help low- and middle-income earners starting in January. The report does not mention other announcements made by Premier Eby such as the one-time $100 cost-of-living credit for BC Hydro customers and the Housing Supply Act to speed up housing development. We are of the view that the Province is highly sensitive to rising interest rates, and the recent decline in home sales and prices could alter the economic outlook. Adding to that the slowdown in China and in the United States, the province's largest two trading partners, and BC won't be able to sustain such a stunning improvement in its fiscal situation. Both the path of revenues and spending could be modified and thus compress the surplus in upcoming years. However, a very large buffer in terms of job postings and more natural resources investments projects relative to other provinces will alleviate some of the broader, adverse macroeconomic events for BC.

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