February 21, 2017

FISCAL SURPLUSES TO CONTINUE IN BRITISH COLUMBIA

Highlights

- The government of British Columbia tabled its FY2017-18 budget today, highlighting its sound fiscal position. Sticking to its previous plan, the government intends to run small surpluses over the next three fiscal years, despite spending growth anticipated to outpace revenue growth.
- The Budget contained some fiscally-stimulative measures, including reducing the MSP premiums and lowering some taxes for businesses. It budget plan also announced increased spending for education and healthcare – areas identified as priorities.
- The taxpayer-supported debt-to-GDP ratio is expected to edge down slightly to 15.9% in the upcoming fiscal year, leaving B.C. with the lowest debt ratio across provinces.

As it readies for the upcoming election in May, the B.C. government's fiscal year (FY) 2017-18 Budget reiterated the province's sound fiscal position, with the government's plan to run surpluses over the next three years intact. The government estimates that the FY2016-17 surplus will come in at nearly $1.5 billion – well above last year's budget projection of $264 million given better-than-expected economic growth. The windfall enabled the provincial government to put some money back in the pockets of businesses and consumers and increase spending, all the while keeping the budget in a slight surplus position. In light of the surplus and a growing economy, the debt-to-GDP ratio is expected to fall from 16.1% in FY2016-17 to 15.9% in FY2017-18.

B.C. economy to decelerate, but remain healthy

After outperforming the rest of the country over the last three years with economic growth above 3%, B.C.'s economy is set to decelerate this year. The provincial government projects growth of a still-healthy 2.1% during 2017, which is roughly in line with our own outlook, and nominal GDP growth of 4.1% which is slightly more optimistic than our forecast. While the economy will slow alongside a cooling housing market, and the outlook is not without risks, this is still a healthy pace of growth for the provincial economy and should be supportive for fiscal coffers. Of note, the B.C. economy is much less dependent than several other provinces on the U.S. as an export destination. In fact, only 54% of B.C. exports are headed stateside, while 35% are destined for Asia. As such, the province would be less exposed to any protectionist measures implemented by the new administration south of the border, thereby limiting the downside risk.

BRITISH COLUMBIA ECONOMIC PLANNING ASSUMPTIONS [Annual Per Cent Change, unless stated]				
		Budget 2017		
	2016	2017F	2018F	2019F
Real GDP	3.0*	2.1	2.1	2.0
Nominal GDP	4.7*	4.1	4.0	3.9
Employment	3.2	1.2	1.2	1.1
Household Income	3.7	3.6	3.8	3.8
Retail Sales	6.3	3.7	3.7	3.6

Source: British Columbia Ministry of Finance. *Estimate.

Larger-than-expected surplus put back into economy

A strong economy, coupled with a larger-than-expected surplus over the 2016-17 fiscal year has allowed the government to announce a number of revenue-reducing measures, and spending initiatives in key priority areas. Perhaps the

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most notable measure in the budget is the cut in Medical Services Plan (MSP) premiums, which reduces them by one-half, or as much as $900 per year, for households with an income under $120,000. This will affect about 40% of B.C. households, with premiums for households making above $120,000 left unchanged, while those where income is below $26,000 will be exempt from paying the premium altogether. The measure will not take effect until the start of 2018 and many employees will not directly see the difference in their paycheques, with premiums typically paid by employers on the employees' behalf. The government also indicated that the announced cut is the first step to eliminating the premiums entirely, although did not specify an exact timeline for abandoning the MSP.

The Budget also attempts to make housing a little more affordable for first time homebuyers by increasing the exemption on property transfer tax to $500,000 from $475,000. This will potentially help to save first time buyers up to $8,000 on the purchase of their first home, but its impact will be diluted by the 7% rise in home prices over the last year.

In an effort to make businesses more competitive, the small business corporate income tax (CIT) rate will be cut to 2% from 2.5%, making the B.C. CIT the second lowest rate amongst provinces. Moreover, the provincial sales tax (PST) on electricity will be eliminated for businesses over the next two years (residential consumers are already PST exempt). The government will also extend and enhance tax credits to encourage growth in the provincial information technology sector.

Despite these measures, revenues are still expected to remain relatively flat in FY2017-18, while increasing over the subsequent two fiscal years. Meanwhile, expenses are expected to rise by a solid 7% in the upcoming fiscal year.

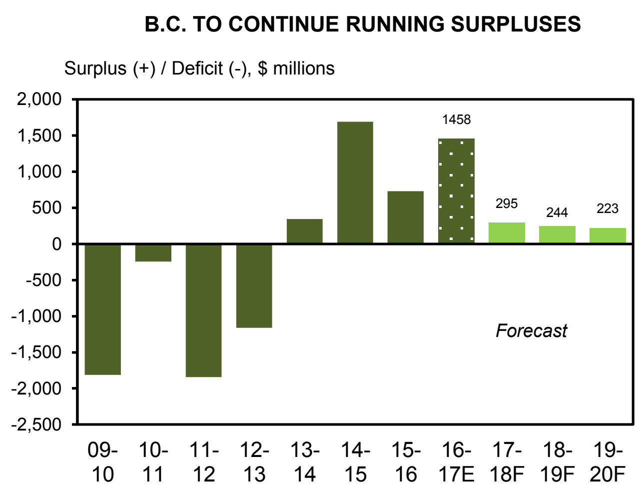
In particular, the government will boost funding for education, with an additional $740 million over three years allocated to enrolment growth, rural education enhancement, transportation, and salary costs. This includes $320 million to address the recent Supreme Court ruling related to class size and composition. The Budget also includes $2 billion over three years ($1.7 billion in Budget 2016) to fund school capital projects, and $2.6 billion ($2.5 billion in Budget 2016) for post-secondary infrastructure, although a significant portion of this will be funded by other sources (including donations, foundations, federal funding).

The healthcare sector will also get some further support, with an additional $4.2 billion in funding over three years above what was allocated in the previous budget. This includes $100 million earmarked to help address mental health and substance abuse. The B.C. government recently signed a deal with the federal government on health-care funding, which included some support to help fight the opioid and other substance abuse crisis in the province. On the capital front, the Budget includes $2.7 billion in funding for health projects, which will also receive funding from other sources including regional hospital districts and foundations. This is slightly lower than the $2.9 billion included in the previous budget.

BRITISH COLUMBIA GOVERNMENT FISCAL POSITION (C$ millions)

		2017 Budget		
Fiscal Year	**16-17***	**17-18**	**18-19**	**19-20**
Revenues	50,890	50,838	51,196	52,045
% change	6.9	-0.1	0.7	1.7
Own-Source	42,810	42,521	42,789	43,395
Federal Transfers	8,080	8,317	8,407	8,650
Expenditures	49,082	50,193	50,702	51,572
% change	4.7	7.1	3.3	2.7
Contingencies	450	400	300	300
Forecast Allowance	350	350	250	250
Surplus (+) / Deficit (-)	1,458	295	244	223
% of GDP	0.6	0.1	0.1	0.1
Total Debt (includign forecast allowance)	66,666	69,787	73,457	77,688
Self-supported debt	24,289	26,135	28,023	30,237
Taxpayer-supported debt	42,027	43,302	45,184	47,201
% of GDP	16.1	15.9	15.9	16.0

Sources: British Columbia Ministry of Finance. *Updated forecast.



Source: B.C. Ministry of Finance, Haver Analytics. *E: expected, F: forecast.

Moreover, an additional $796 million in funding over three years will be allocated to support children, individuals and families in need, and $920 million to support nearly 5,300 affordable housing units for those in need. The Province will also invest $4.7 billion in transportation infrastructure, bringing total infrastructure spending to $13.7 billion over three years. This compares to $12 billion in infrastructure spending in the previous budget, with the increase due in part to cost-shared projects with the federal government as part of the Strategic Investment Fund and Public Transit Infrastructure Fund.

Debt-to-GDP ratio to edge down slightly

Despite spending growth outpacing revenue growth over the next three years, the B.C. government still plans to remain in the black, with surpluses in the $200-300 million range in each fiscal year. Meanwhile, alongside a growing economy, the debt-to-GDP ratio is expected to remain largely unchanged, edging down slightly to 15.9% in the upcoming fiscal year, from 16.1% currently, before creeping back up to 16% by the end of the decade. This is by far the lowest debt ratio among Canadian provinces and is largely made up of infrastructure debt. In fact, by FY2019-20, infrastructure will account for 98% of total debt. That said, this measure consists of taxpayer-supported debt only, while most other provinces consolidate it with self-supported debt (ie. Crown Corporations that have their own source of revenue such as B.C. Hydro). Consolidating both types of debt would push the debt-to-GDP ratio up to nearly 26%, which is still among the lowest across provinces.

Bottom Line

All in all, there were no big surprises, with this pre-election budget containing several targeted measures aimed at putting some money back into the economy, which the provincial government hopes will go down well with voters come election time. Following four years of the provincial finances being in the black, the government hopes to keep it that way going forward, despite some mildly stimulative measures laid out in the Budget. As such, the Province is expected to remain in surplus territory throughout its forecast horizon barring any unforeseen circumstances. That said, should downside risks materialize, B.C.'s fiscal position and diverse economy positions it quite well to manage any unexpected outcomes.