2015 BRITISH COLUMBIA BUDGET

TD Economics

February 17, 2015

THE LAST ONE STANDING

Highlights

- British Columbia expects to record a surplus of $879 million in fiscal 2014-15, almost double the estimate published in the November 2014 update. The healthier starting point reflects stronger-than-expected corporate and personal income tax revenues as well as income from the Insurance Corporation of British Columbia. With the surplus, B.C. appears poised to be only Canadian province to record black ink in the current fiscal year.
- The government plans to sustain a modest surplus of around 0.1% of GDP through fiscal 2017-18. In order to mitigate risks to the fiscal plan, the budget incorporates four elements of prudence. Annual forecast allowances and contingencies have been included. Lower economic assumptions than the private sector consensus have also been adopted. The natural gas revenue forecast also undershoots the private sector forecast.
- Taxpayer supported debt as a share of GDP is projected to track downwards over the fiscal plan – reaching a six-year low of 16.6% in fiscal 2017-18.
- The budget was short on major new initiatives. Parents receiving income or disability assistance no longer will need to include child-support payments in the income calculation. Also, effective January 2016, the temporary two per cent personal income tax hike on individuals earning over $150,000 that was introduced two years ago will be removed.

With an estimated surplus of $879 million for fiscal 2014-15, British Columbia is expected to be the only province in the black this fiscal year. A combination of sound fiscal management and a moderate acceleration in economic growth has provided strong support to the province's fiscal coffers over the past few years. Looking ahead, the fiscal plan projects continued surpluses over the medium term. All told, annual expenditures are expected to grow at a still-lean 2.5% per year over the plan. Revenue gains are forecast to average 2.7% over the same period.

As expected, the province scaled back focus on the growth potential for Liquefied Natural Gas (LNG). The LNG plan had been championed in Budget 2014. It was acknowledged that deteriorating global economic conditions in the oil and gas sector may impact the timing of final investment decisions. That said, the government remains steadfast in its view that three facilities will be operational by 2020. The budget highlighted the province's economic diversity and planned investments in other areas of the economy such as the mining and forestry sectors. In a document light on initiatives, the government announced that child support payments will be exempted from the calculation of income for parents receiving income or disability assistance as well as the removal of the temporary two per cent personal income tax hike on individuals earning over $150,000 introduced two years ago, effective January 2016.

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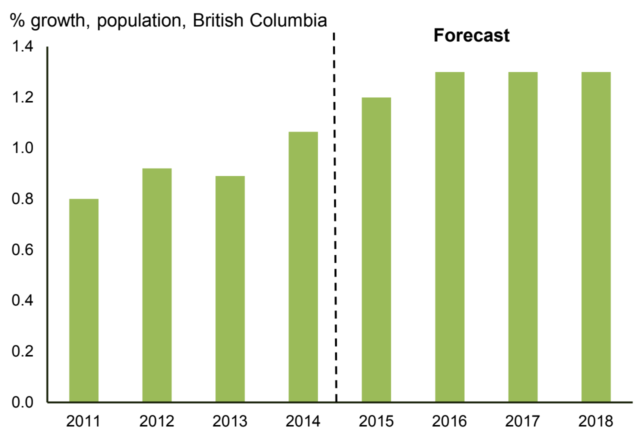
Solid economic outlook underpins fiscal plan

Despite the soft global economic backdrop and concerns surrounding emerging markets, B.C.'s economy is forecast to expand at a healthy clip over the next few years. The government forecasts real GDP growth of 2.3% in 2015, 2.4% in 2016 and 2.3% in 2017. These projections are more conservative than our own over the next two years and below the private sector consensus forecast. Consistent with the economic discussion outlined in today's budget, the provincial economy is expected to benefit from a weaker Canadian dollar and strong U.S. demand. This macroeconomic backdrop bodes well for manufacturing and tourism activity, as well as forestry-related exports.

The government's projects healthy nominal GDP growth of around 4% per year over the next few years. While we believe these expectations are reasonable, TD Economics' forecast for 2015 (+3.1%) is somewhat more conservative reflecting weaker price expectations. But, while this implies that there is some downside risk to the government's revenue forecast in fiscal 2015-16, we are somewhat more optimistic regarding nominal GDP growth in 2016 (+4.6%). As such, the top line risks surrounding the forecast appear to be a wash over the fiscal plan.

Lower oil prices and improved growth prospects will provide a boost to consumer spending and help to prop up B.C.'s labour market, which has underperformed in recent years. After recording net losses in interprovincial migration in 2012 and 2013, B.C. is poised to become a net beneficiary through interprovincial migration flows in 2014. This positive trend is expected to continue over the next few years. Indeed, in recent years migrants were drawn to neighbouring Alberta on account of its strong economic outperformance. The recent drop in oil prices is expected to weigh on Alberta's economy, reducing the lure of migration, and should translate into continued net gains through interprovincial migration flows for the province – boosting population growth.

POPULATION GROWTH EXPECTED TO ACCELERATE OVER FISCAL PLAN



Source: Haver Analytics and British Columbia Ministry of Finance.

BRITISH COLUMBIA ECONOMIC PLANNING ASSUMPTIONS
[Annual Per Cent Change, unless stated]

	2014E	2015	2016	2017	2018
Real GDP	2.2	2.3	2.4	2.3	2.3
Nominal GDP	3.9	3.8	4.3	4.3	4.3
Employment	0.6	1.0	1.2	1.2	1.2
Household Income	3.0	3.5	3.8	4.0	4.0
Retail Sales	5.4	3.3	3.7	3.6	3.6

Source: British Columbia Ministry of Finance.

Prudent revenue forecast

Revenues are forecast to increase at an annual average rate of 2.7% over the next four years, but follow a choppy profile over the plan. A one-time boost to corporate and personal income taxes based on higher 2013 tax assessments as well as higher investment income from the Insurance Corporation of British Columbia is expected to translate into a 4.7% increase in revenues in fiscal 2014-15. With these one-time benefits falling out of the equation next year and lower natural gas prices weighing on the royalty take, revenues are projected to inch forward by 1.3% in fiscal 2015-16.

In the outer years of the plan, revenue intake is expected to stabilize and average 2.4% per year. The steady gains reflect improving economic conditions, rising energy prices and forestry resource royalties and increasing federal government transfers and commercial Crown corporation net income.

Expenditure restraint remains the bedrock of the fiscal plan

Spending will continue to be kept in check over the forecast period. Total expenditures are forecast to average a lean 2.5% over the fiscal term, consistent with the 2.2% annual average increase recorded over the prior four-year period. Program spending growth will be kept at 2% or lower from fiscal 2015-16 onwards.

Spending increases have been targeted at key priorities, such as managing growing pressures in health care, funding the 2014 Economic Stability Mandate compensation increases, and supporting economic development.

BRITISH COLUMBIA GOVERNMENT FISCAL POSITION (C$ millions)	Actual					Est.	2015 Budget		
Fiscal Year	09-10	10-11	11-12	12-13	13-14	14-15	15-16	16-17	17-18
Revenues	**37,978**	**40,688**	**41,809**	**42,049**	**43,728**	**45,772**	**46,365**	**47,646**	**48,617**
% change	(1.9)	7.1	2.8	0.6	4.0	4.7	1.3	2.8	2.0
Own-Source	31,063	32,688	34,125	35,013	36,226	38,393	38,719	39,697	40,407
Federal Transfers	6,927	8,009	7,719	7,044	7,502	7,379	7,646	7,949	8,210
Expenditures	**39,790**	**40,926**	**42,047**	**43,201**	**43,375**	**44,793**	**45,831**	**46,920**	**47,868**
% change	2.9	2.9	2.7	2.7	0.4	3.3	2.3	2.4	2.0
Contingencies	-	-	-	-	-	300	350	400	400
Program Spending*	37,593	38,674	41,263	40,811	40,893	41,981	42,833	43,667	44,451
% change	3.0	2.9	6.7	-1.1	0.2	2.7	2.0	1.9	1.8
Interest on Debt	2,197	2,252	2,383	2,390	2,482	2,512	2,648	2,853	3,017
Forecast Allowance	-	-	-	-		100	250	350	350
Other unusual items**			(1,599)						
Surplus (+) / Deficit (-)	**-1,812**	**-238**	**-1,837**	**-1,152**	**353**	**879**	**284**	**376**	**399**
% of GDP	-0.9	-0.1	-0.8	-0.5	0.2	0.4	0.1	0.1	0.1
Taxpayer-supported debt	**29,968**	**31,821**	**34,659**	**38,182**	**41,068**	**42,302**	**43,182**	**44,126**	**44,733**
% of GDP	15.3	15.4	15.9	17.2	17.9	17.7	17.4	17.1	16.6

Note: * Program spending includes all expenditures except debt servicing costs. ** Liabiliity for HST transition fund repayment.
Sources: British Columbia Ministry of Finance.

- Health care spending is targeted to increase by a modest 2.9% over the next three years (or nearly $3 billion) – faster than what was projected in Budget 2014 and outstripping program spending in other areas. That said, the increase in spending is still well below the recent high of near-8% recorded in the mid-2000s.
- Recall that the 2014 Economic Stability Mandate provides for modest compensation increases to public sector employees. It also offers public sector employees an opportunity to participate in the Economic Stability Dividend. This dividend means that if the province's real GDP growth exceeds the annual forecasts, half of the increases in growth will be shared with the public sector employee. To date, over two-thirds of the 313,000 unionized employees are covered by tentative or ratified agreements under the Economic Stability Mandate. Funding has been reallocated to ministry budgets to provide for the modest wage increases outlined in the Mandate. The government explains that that there is adequate funding to accommodate the settlement of the remaining groups that are not covered under new agreements.
- $27 million has been dedicated towards the mining sector to improve turnaround times for notice of work permits, creating a Major Mines Permitting Office to improve the major mines permitting process and provide additional staff to increase compliance and enforcement activities.

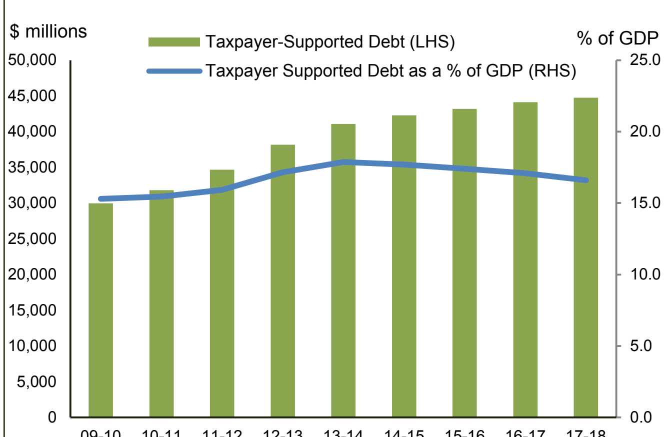
Today's lean budget allowed for little room for other new initiatives. Some other noteworthy announcements include:

- Child support payments will be exempt from the calculation of income for parents receiving income or disability assistance at a cost of $13 million. This will be partially offset by savings of $4 million tied to administering the Family Maintenance Program.
- The temporary two per cent income tax hike on individuals earning over $150,000 will be eliminated effective January 2016. Recall that two years ago, the government increased personal income taxes on people earning over $150,000 in an effort to bring the province out of deficit.

Debt burden to track lower

Over the next three years, the British Columbia government plans to borrow $14.0 billion and retire $7.6 billion in maturing debt. Taxpayer-supported debt is forecast to rise to $44.7 billion by fiscal 2017-18, a $2.4 billion increase relative to fiscal 2014-15.The increase is chalked up to significant investments in capital assets planned over the next three years. This includes a $3.8 billion increase on capital spending tied to education and health care facilities, $2.7 billion dedicated towards transportation projects and $0.6 billion tied to other initiatives. These increases are partially

DEBT BURDEN TO TREND LOWER



Note: * Taxpayer-supported debt levels are presented.
Source: British Columbia Ministry of Finance.

offset by a $4.7 billion reduction in government direct operating debt. Indeed, by fiscal 2017-18 direct operating debt will be at its lowest level since the early 90s.

Taxpayer-supported debt as a share of GDP is poised to trek downwards over the fiscal plan. Consistent with this profile and expectations of only a gradual increase in interest rates, debt servicing costs will remain contained at a modest four cents out of every revenue dollar.

Bottom line

With a surplus of close to $1 billion in fiscal 2014-15 and plans to sustain a modest surplus throughout its medium term plan, B.C. remains the envy of all other regions in Canada. Sound expenditure management and a conservative budget planning framework remain the bedrocks of its favourable fiscal position. What's more, the debt burden is expected to trend lower – ensuring that debt servicing costs do not crowd out other services. And, given the province's Triple-A rating, it is able to access debt markets affordability.

Despite B.C.'s solid fiscal fortunes, we see two notable risks surrounding the fiscal forecast. The first is related to its spending targets. While the province's economy is poised to benefit from rising net-migration gains over the next several years, a rising population base tends to place upward pressure on government spending in order to accommodate that growth. Yet the government plans to reduce spending in real per capital terms over the forecast horizon, which may be a challenge. Second, the government has previously acknowledged that the current court case with the B.C. Teachers Federation regarding the right to bargain for class size and composition, could cost up to $1 billion, which would more than exhaust the $600 million in amounts set aside for contingency and the forecast allowance this fiscal year.