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B.C. Budget

“Seismic shift” in economy draws red ink

The groundwork had been laid in recent weeks and months: the B.C. government warned on several occasions that the rapid souring of the economy – a “seismic shift” in the words of Premier Gordon Campbell – was significantly damaging the fiscal picture of British Columbia. With revenues evaporating quickly, balancing the books in this economic storm increasingly appeared improbable even to a government as staunchly averse to red ink as the current provincial government. Last week, the balanced budget legislation was suspended for a period of two years (starting April 1), clearing the way for the return of deficits in the province after five consecutive years of surpluses. Therefore, it came as no surprise in yesterday’s budget that the books will be marked in red during the next two fiscal years with projected deficits of \$495 million in 2009-10 and \$245 million in 2010-11. With the legislation exemption expiring thereafter, the government is projecting a balanced budget in 2011-12.

The sharp deterioration in the fiscal situation is squarely blamed on the poor economy which has caused an “unprecedented drop in provincial revenues”. Relative to Budget 2008, revenues are now projected to come in more than \$2 billion lower in the coming fiscal year, a downward revision of 5%. The vast majority of revenue sources will be impacted with royalties (natural gas, other energy, metals and minerals, forest) shouldering most of the decline, followed by tax revenues (personal, corporate, social service and others).

Intense pressure on revenues is already evident in the current fiscal year (2008-09), now projected to fall 3.5% from 2007-08. With expenses still on the rise (up 2.3%), the government is running down the forecast allowance of \$750 million it had earlier set aside to maintain the small surplus of \$50 million it projected for 2008-09 last budget – although that surplus had been revised significantly higher (up to \$1 billion at one point) in subsequent quarterly updates.

In order to “protect vital health care, education and social services” and minding the risk it would pose for the economy in such troubled times, the government will refrain from cutting program spending over the next three years. Total expenses are projected to increase by 2.3%, 1.9% and 2.9% in 2009-10, 2010-11 and 2011-12, respectively, which would nonetheless represent a substantial slowing from the average rate of nearly 6% over the previous four years. The government is pledging to squeeze out meaningful savings in “administrative and other discretionary spending” as well as from the streamlining of some government programs (\$1.9 billion over three years), which it will reallocate to health, education and social services.

Main budget items

Infrastructure investment. Taxpayer-supported capital spending will ramp up from \$4.1 billion in 2008-09 to \$4.7 billion in both 2009-10 and 2010-11 before moderating to \$3.4 billion in 2011-12. This will represent \$2.9 billion in additional spending over the next two fiscal years compared to what was planned in the 2008 budget. Including capital outlays by crown corporations and joint ventures, the total will amount to \$20 billion over the three-year fiscal plan. This will include \$2 billion in new capital investments cost-shared with the federal

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government under the fiscal stimulus plan announced in its January 27 budget. The province estimates its share of the federal plan at \$1 billion (although the details have yet to be finalized).

Program spending. The current fiscal year sees \$622 million (funded from ministry savings and the reduction in the forecast allowance) for “priority spending initiatives”, defined as “strategic investments to support communities, provide additional health care funding and to acquire social housing”. Healthcare will receive \$945 million in additional spending in the fiscal plan although nearly all will take place in its final year. Social services will get an extra \$350 million and post-secondary education \$244 million over the next three years.

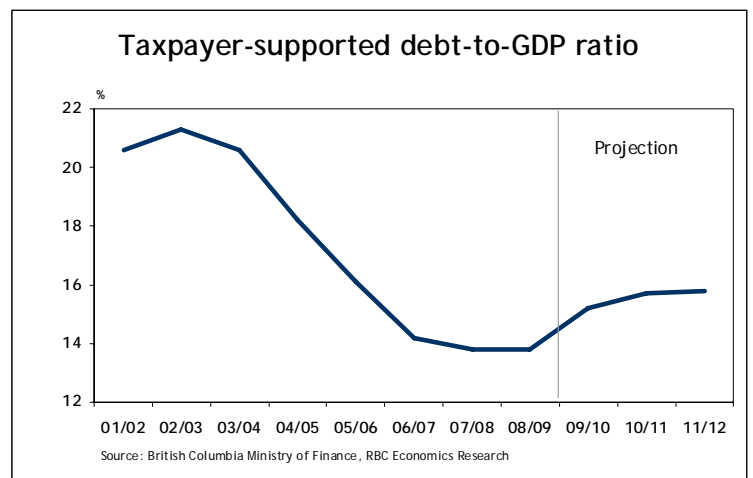
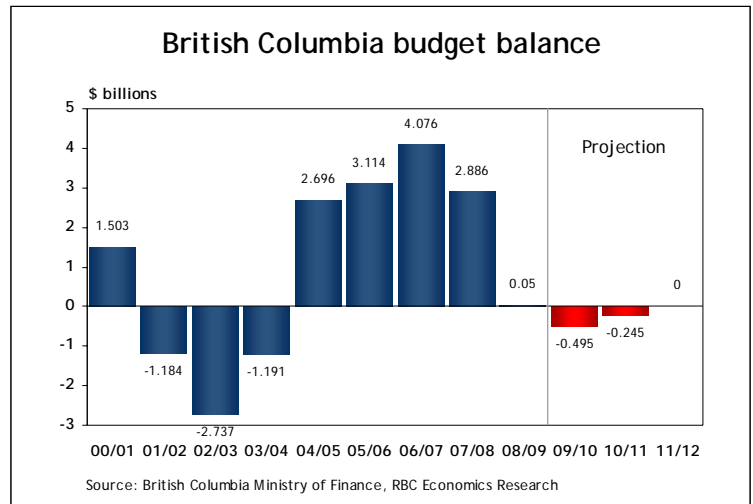
Tax measures. New tax measures are relatively minor in this budget (e.g. one-year extension to the mining flow-through share tax credit). The bigger announcements had been made at the economic statement in October when the government accelerated the previously-scheduled personal income tax cuts and small business tax relief.

Debt

As the B.C. government runs deficits and ramps up capital spending, taxpayer-supported debt will climb to \$34.1 billion by 2011-12, up from \$27.7 billion in 2008-09. As a percentage of provincial GDP, taxpayer-supported debt is projected to rise to 15.8% in three years from a low of 13.8% this year. Even after the increase, the debt/GDP ratio will remain well below the recent peak of more than 21% registered earlier this decade and still rank as one of the lowest among provinces.

Discussion

Overall, the B.C. government has adopted a sensible approach to deal with the very difficult circumstances. Rather than cutting its way out of an inevitable deficit – which would have likely exacerbated economic woes – it has chosen a less disruptive path, even if this had to result in deficits in the next two fiscal years. These deficits, as currently projected, are relatively modest and should not jeopardize the longer-term health of the province. Nonetheless, as is always the case when budgets come under downward pressure, the risk of underestimating the size of the shortfall is present, especially since B.C.’s three-year fiscal plan omits explicit forecast allowances, leaving less room to maneuver if conditions deteriorate further. That being said, conservative economic assumptions used in the budget should minimize the likelihood of sizable negative surprises. The budget uses a below-consensus economic growth profile for the province, including a decline of 0.9% in 2009 (versus a private forecasters average of 0%).



British Columbia's fiscal plan

\$ billions	Updated			Budget	Plan	Plan
	<u>06/07</u>	<u>07/08</u>	<u>08/09</u>	<u>09/10</u>	<u>10/11</u>	<u>11/12</u>
Revenue	38.5	39.8	38.5	38.8	39.8	41.2
Expense	34.2	36.5	38.4	39.3	40.0	41.2
Negotiating framework incentive	-0.3	-0.004				
Climate action dividend		-0.4				
Surplus (before fcst allowance)	4.1	2.9	0.05	-0.495	-0.245	0
Forecast allowance			0	0	0	0
Surplus	4.08	2.89	0.05	-0.495	-0.245	0
Total capital spending	4.4	5.0	6.0	6.9	7.2	5.9

Source: British Columbia Ministry of Finance, RBC Economics Research