Weekly economic Briefing
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B.C. Budget 2005

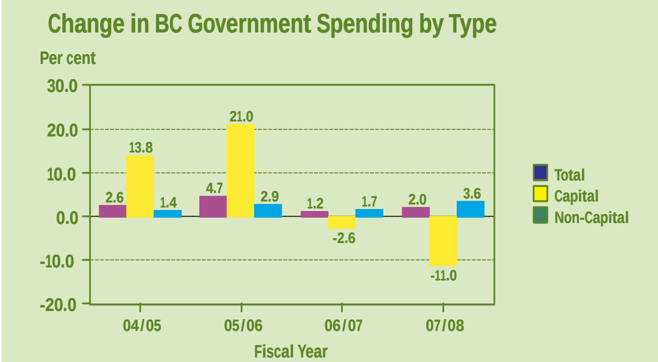
The provincial government's latest budget contained measures aimed at several targets -– debt reduction, tax reduction, and spending increases.

Debt reduction is the result of last year's budget and its likely surplus of $1.7 billion, which will be used to pay down debt. Budget 2005 contains targeted tax reduction measures of just under $500 million in the coming fiscal year (2005/06). Total spending is budgeted to rise by 4.7% in 2005/06 and slow to 1.2% in 2006/07 and to 2% in 2007/08. Capital spending — the main driver of overall spending — is slated to jump by 21% in 2005/06 and then decline in the following two years. For 2004/05, capital spending will be up 13.8%.

Excluding capital spending, other spending will rises 2.9% in 2005/06, 1.7% in 2006/07, and 3.6% in 2007/08. Spending on health and education will outpace growth in total spending, except in 2007/08 when the budget foresees transportation, debt servicing, and contingency spending rising the most. Transportation, in this instance, means the general function, and includes spending outside the Transportation Ministry.

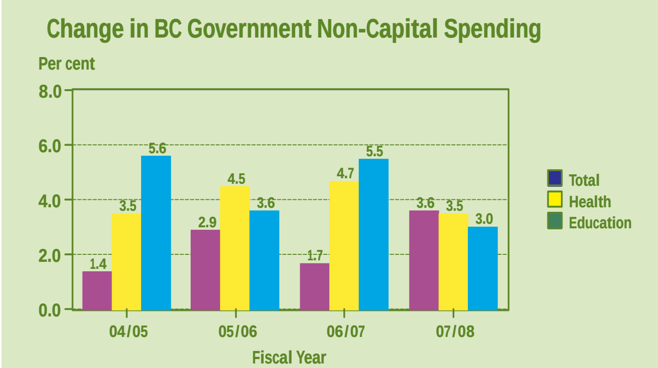
Budget 2005 provides stimulus to the economy with real (inflation-adjusted) spending increases. The actual impact of the capital spending in this budget will be felt over a number of years, and will show up in the economic

Budget for capital spending up sharply



Source: BC Budget 2005. Note: Includes crown corporations, agencies, SUCH, and regional authorities.

Larger increases in health and education non-capital spending to continue



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statistics with a time lag, as construction proceeds. For the same reason, the decline in budgeted capital spending in 2006/07 and 2007/08 will not translate directly into an immediate decline in actual construction activity in those years.

Prudent economic and revenue projections, the forecast allowance, and the contingencies spending line form three buffers that will almost certainly result in higher-than-projected surpluses, barring a major unexpected negative event(s) in the economy. It is also quite likely that the 2004/05 surplus will be higher than the $1.44 billion projected and, combined with the unneeded $300 million forecast allowance, the surplus and debt pay-down will be higher than $1.7 billion. A final figure closer to $2 billion is possible.

Projected debt levels will be lower as a result of these higher-than-expected surpluses. Provincial debt is projected to rise due to capital project financing, though not as fast as the rise in current dollar GDP, leading to a decline in the key debt-to-GDP measure. Should debt rise by less than projected and current dollar GDP rise by more than forecast in the budget, taxpayer-supported debt-to-GDP could fall to under 16% by the end of this fiscal plan. Budget 2005 projects this measure to drop to 17.3% in 2007/08.

International tourist visits up in 2004

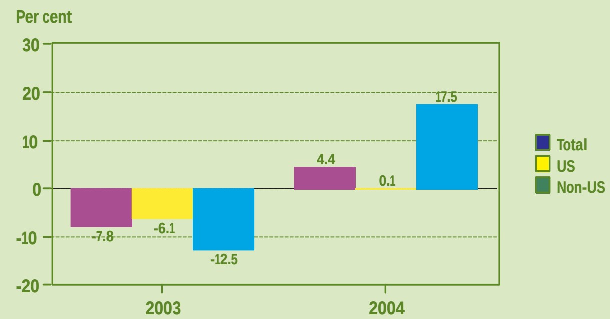
Tourist visits to B.C. from other countries rebounded in 2004, after a substantial drop in 2003 due to SARS and other negative one-time factors at play at that time. Total international entries to B.C. rose 4.4% in 2004, due entirely to a 17.5% increase in non-U.S. entries, as U.S. entry counts were unchanged. For the tourism industry, this was reflected in higher hotel occupancy rates, room revenue, and employment. The industry's real GDP no doubt rose as well.

Currency movements and income growth in source countries are the main factors affecting tourist visits to B.C. The U.S.-Canada exchange rate moved against U.S. tourists in 2004 and that had a negative impact, although U.S. economic growth probably provided some offset. Otherwise, an outright decline could have emerged in the face of the 10% depreciation of the U.S. dollar in 2004.

Overseas tourists benefited from currency appreciation in the Japanese yen and the Euro during 2004 and contributed to the large rebound in visits to B.C. Income or economic growth improved in Japan during 2004, although Europe's growth remained slow. Looking ahead, tourist visits from China will shift markedly upwards following the recent granting of Approved Destination Status to Canada by China.

Overseas tourists behind 2004 gain

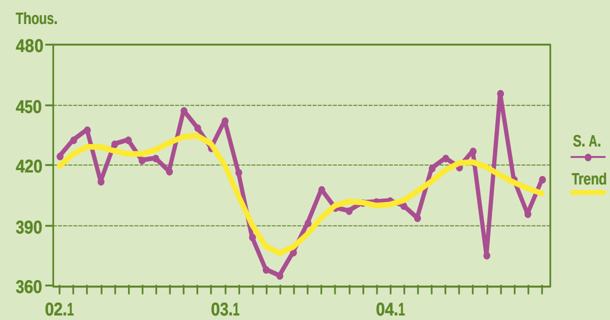
Change in International Tourist Entries to BC by Source



Source: Statistics Canada, CUCBC.

December tourist traffic up, short term trend still down

International Tourist Entries to B.C., Monthly



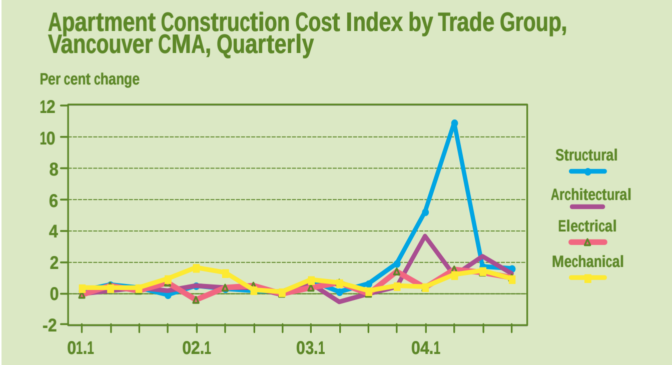
Source: Statistics Canada, CUCBC. Latest: December 2004

Turning to the monthly figures, December saw a pick-up in U.S. and non-U.S. visitors, but not enough to significantly alter the short-term trend. It appears that 2005 will start on a weak note. Our forecast calls for a modest 2% to 4% gain in tourist visits to B.C. during 2005.

Construction cost increases subside

The sharp run-up in apartment construction costs in the first half of 2004 continues to subside, as the main culprit –- structural costs (mainly steel and concrete) -– settles down. Structural costs rose 5.2% in the first quarter of 2004 from the previous quarter, followed by a 10.9% jump in the second quarter. In the final half of 2004, structural costs increased by less than 2% per quarter, as more steel (rebar) became available. These data are based on the Apartment Construction Cost Index produced by Statistics Canada for the Vancouver Census Metropolitan Area (CMA).

Structural building cost increases come down



Source: Statistics Canada, CUCBC. Latest: Q4 2004

For the year, total apartment construction costs rose by 9.0%, the largest increase since 1989 (8.1%). This is even more significant considering the 4.5% overall inflation rate that prevailed in 1989 compared to today's 2%. Structural costs jumped 17.4% from 2003. The next largest increase was in the architectural trade group, at 6.4%.

Buoyant construction activity in 2005, reflected in both residential and non-residential construction, will be the main impetus for future cost increases. The demand for construction labour, as evidenced by last year's 20% increase, will continue to rise and put upward pressure on costs. Materials cost increases are not likely to show the same gains as in 2004, with lower lumber prices in the forecast and the steel shortage subsiding. An overall increase in the 5% range is expected for 2005.

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