B.C. Floods: It Couldn't Come at a Worse Time

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The last thing the Canadian economy needs right now is **another supply-side constraint**, and the devastating floods in British Columbia are serving up a major one. Rail transport is halted, road transportation has been effectively reduced to backroads, and pipeline flow has been significantly curtailed. This comes as supply chains are already stretched thin amid torrid consumer demand, and the economy more broadly is pushing up against capacity constraints (e.g., labour supply), stoking inflation concerns. Here is an early assessment, with an understanding that it's next to impossible to judge the precise impacts at this point.

The Situation

In a nutshell, flooding has knocked out key transportation infrastructure in the region, which serves as a critical trade corridor for Western Canada. The Port of Vancouver, for example, enables roughly $240 bln per year worth of goods trade, or 15%-to-20% of the Canadian total. Damaged road and rail infrastructure has **severed the flow of goods** through the region. Rail lines could take a week more to get back up to service, while two key road arteries (Coquihalla and TransCanada) are probably looking at months of repair. In the meantime, it looks like road shipments will be diverted along a much tougher two-lane stretch that will, at best, lengthen transit times. Also, pipeline flow (crude and natural gas) has stalled, with TMX currently shut down and work on the expansion project (to move Alberta crude) now delayed.

The Economic Impact

The immediate impact is on the flow and availability of goods. Inbound trade mostly consists of goods destined for Western Canada. Outbound trade includes forestry, grain and food products. While some of these exports can be diverted, the supply chain is already backed up. An early estimate of **the combined impact of lost trade, delayed/lost spending and output will pull Canadian real GDP growth into negative territory for November**; cut 3 pts from Q4 growth (now +3.0% a.r.); and trim 0.2 ppts from calendar 2021 growth (now 4.8%). Our forecast for B.C. growth was chopped to 3.8% for 2021, down from 5.3% previously. One recent reference point is the Calgary floods in 2013. The cost of that flood was roughly $5 bln; Canadian GDP fell 0.4% in the month; and Alberta spent about $2.5 bln on recovery and capital improvements. This episode is likely bigger and the impact wider because of how it is choking off supply lines.

The flip side is that **rebuilding efforts will add to growth through 2022**—we revised up our 2022Q1 forecast for Canada, and our overall calendar-year forecast for B.C. This is where natural disasters like this become a bit difficult to characterize from an economic perspective. That is, real GDP 'growth' will get boosted by repair and rebuilding efforts, but replacing destroyed capital is not adding new capacity, and it takes up productive resources that could have been used elsewhere.

Fiscal Consequences

Federal support funding will foot some of the B.C. bill, as it has in the past. Ottawa, for example, covered roughly $500 mln of Alberta's expenses in 2013. The Disaster Financial Assistance Arrangement has a set formula to support the provinces based on the per-capita cost of a given disaster. With about 5 mln people in B.C., the province would have to absorb the first $16 mln, before Ottawa would cover a range up to 90% beyond roughly $90 mln. These are eligible disaster-related expenses only, such as restoring public utilities, fixing roads (to pre-flood condition) and basic property repairs. However, it is often the case that the province will go **beyond just repair**, with capital spending on infrastructure improvement and future disaster prevention, dollars that would not be covered by Ottawa. That **could be a source of increased borrowing** over the next few years, but it's far too early to judge the dollar amount.

It's also noteworthy that **B.C. builds in heavy contingencies** for natural disasters, though this has already been a very bad one for wildfires. Budget 2021 had built in $1 bln of general contingencies, and a $1 bln forecast allowance. Plus, there was $3.2 bln in pandemic-related contingencies that may not all be used given the positive outcome in B.C. A mid-year fiscal update is expected very soon but, again, it will be far too early to build in an estimate. All told, it's not necessarily the case that the flood will be a major credit-negative event given budget contingencies, support from Ottawa, and the reality that B.C. finances were running well ahead of expectations coming into this situation.

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