Budget Commentary

British Columbia's Budget 2025: Mounting Debt, With Election Promises Overshadowed by Tariffs

Morningstar DBRS
March 6, 2025

Key Highlights

- The Province has incorporated ample prudence in Budget 2025 through conservative economic assumptions and large contingencies.
- Nonetheless, Budget 2025 points to a deterioration in debt-to-GDP beyond our previous expectations that will erode flexibility within the current credit ratings. On a Morningstar DBRS-adjusted basis, debt-to-GDP will increase to 25.2% in 2025–26 and is expected to continue to trend upward to 32.8% of GDP by 2027–28.
- However, the Province's strong balance sheet, historically prudent fiscal approach and past track record of outperformance continue to lend support to its credit profile.

Apurva Khandeparker
Assistant Vice President, Public Finance
Global Sovereign Ratings
+1 416 597-7467
apurva.khandeparker@morningstar.com

Thomas Torgerson
Managing Director
Global Fundamental Ratings
+1 212 806-3218
thomas.torgerson@morningstar.com

On March 4, 2025, the Province of British Columbia (BC or the Province; rated AA (high) with a Stable trend) released its 2025–26 budget (Budget 2025). Trade uncertainties loom over the budget as the re-elected NDP government seeks to balance spending on priority areas of healthcare and education while postponing some of its key campaign promises like the one-time rebate and ongoing middle-income tax credit. The budget anticipates ongoing deficits and a significantly larger borrowing program while prioritizing targeted public investments. We note that BC entered this period of uncertainty with somewhat reduced flexibility given its consistent deficits and rising debt in recent years. Although the Province has incorporated ample prudence in Budget 2025 through conservative economic assumptions and large contingencies, we believe the flexibility needed to withstand the anticipated deterioration in debt metrics is constrained within the current credit ratings. Nevertheless, BC's strong balance sheet, prudent fiscal approach and past track record of outperformance continue to lend support to its credit profile.

At our last review in May 2024, we noted that a negative credit rating action could result from a sustained deterioration in operating results and marked increased in the debt-to-GDP ratio beyond our expectations. At that time, we had contemplated a debt-to-GDP ratio approaching 27.0%. The latest budget points to a deterioration in debt-to-GDP ratio beyond our previous expectations that will erode flexibility within the current credit ratings.

The key priorities of Budget 2025 include:

- Strengthening public services with a focus on healthcare, education, and affordability;
- Building economic resilience amid trade uncertainties by diversifying trade, accelerating critical resource projects, and supporting jobs creation; and
- Increasing housing supply and affordability.

Budget Overview

Budget 2025 forecasts a deficit of $10.9 billion in 2025–26 compared with the $9.1 billion deficit now anticipated in 2024–25. On a Morningstar DBRS-adjusted basis, this equates to a shortfall of $20.8 billion, or 4.7% of GDP. We made several adjustments to BC's reported results/budget projections to improve comparability among the provinces. We adjusted reported results to recognize capital spending as incurred rather than as amortized, assumed a modest amount of capital underspending, and excluded the change in regulatory accounts from British Columbia Hydro and Power Authority's (rated AA (high) with a Stable trend) net income to arrive at the adjusted deficit.

Consistent with past prudent budget practice, the budget includes contingencies totalling $4.0 billion in each of the three years through 2027–28 to offset unexpected financial pressures resulting from the current tariff-related economic headwinds, collective bargaining, and other emerging priorities, which, if unused, would contribute to improvements in the bottom line and debt outlook. Program spending is modest at +3.2% year over year (YOY) compared with last year's significant growth of 8.7% YOY, with expenditure management targets through administrative and operational efficiencies set at $1.5 billion over the plan period. While base-case revenue projections assume a limited impact of tariffs, the budget presents a scenario analysis that estimates potential annual revenue losses between $1.7 billion and $3.4 billion over the next three years that are reasonably offset by contingencies.

The Province will focus a targeted capital spending program on the critical priorities of healthcare, transportation, and education—sectors that will help support economic activity. The three-year, taxpayer-supported capital plan is projected to be $45.9 billion, up $2.6 billion from the previous plan. For 2025–26, a total capital investment of $20.2 billion is planned. However, we note that actual capital investment tends to be below budget projections, and we have assumed a modest amount of capital underspending in our debt projections.

Over the medium term, the Province projects deficits of $10.2 billion and $9.8 billion for 2026–27 and 2027–28, respectively. On a Morningstar DBRS-adjusted basis, these equate to deficits of 4.4% and 3.9% of GDP, respectively. Budget 2025 emphasizes that achieving a balanced budget will be a multi-year effort, continuing on the path of modest YOY declining deficits with no plan for a return to balance over the plan period.

Exhibit 1 Fiscal Outlook

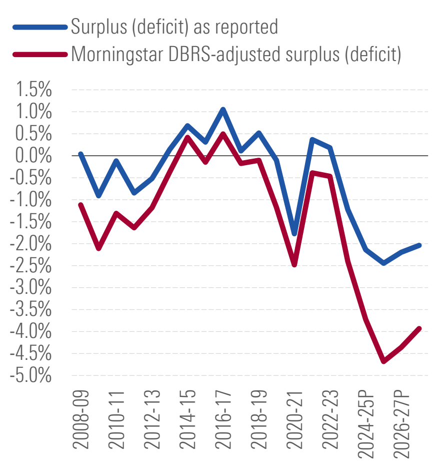


Exhibit 2 Debt Outlook

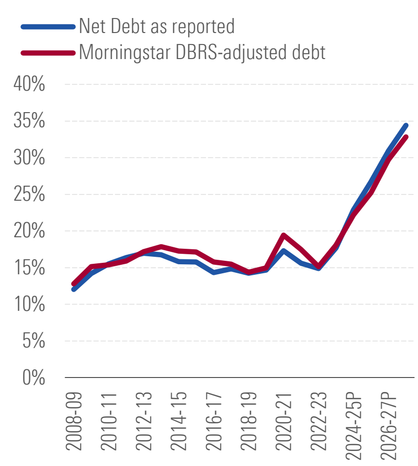
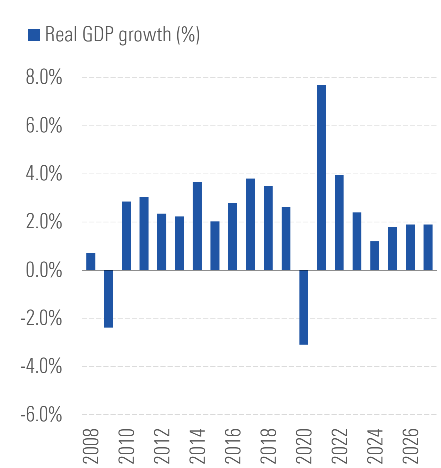


Exhibit 3 Real GDP Growth (%)



Sources: British Columbia and Morningstar DBRS.

The debt burden is expected to continue increasing as spending on priority capital investments ramps up. The Province projects net debt-to-GDP to reach 26.7% in 2025–26 and anticipates that this will increase to 34.4% by 2027–28. On a Morningstar DBRS-adjusted basis, debt-to-GDP will increase to

25.2% in 2025–26 and is expected to continue to trend upward to 32.8% of GDP by 2027–28. Gross borrowing requirements are estimated to be $31.1 billion in 2025–26 and to increase to $34.7 billion in 2027–28. Given the substantial deficit projections with no plan to return to balance, we expect debt to remain high over the medium term.

BC's economy is estimated to have grown by 1.2% in 2024, amid ongoing global economic uncertainty, high interest rates, and inflationary pressures. Budget 2025 assumes real GDP growth of 1.8% in 2025 and 1.9% in 2026, reflecting the effects of slower population growth as a result of federal immigration policies and trade uncertainty. In an alternative scenario that incorporates the impact of U.S. tariffs, including a 10% tariff on Canadian energy and a 25% tariff on all other goods along with retaliatory measures from Canada, GDP is projected to slow significantly to a 0.3% increase in 2025 and 0.8% in 2026. The downside scenario assumptions are considered reasonable and comparable with private-sector consensus. However, the overall impact remains uncertain, depending on the extent of additional U.S. tariffs on softwood lumber and how long the tariffs remain in place. While key industries like forestry and energy remain susceptible to tariffs and export restrictions, we note that the Province has some resilience to U.S. trade shocks because of its diversified economy, strong technology and clean energy sectors, and relatively diversified trading relationships. Ongoing capital investments, moderate housing activity driven by rate cuts, and contingency funds will lend some support to the economy, which has the potential for outperformance if trade relations improve.

Note:
All figures are in Canadian dollars unless otherwise noted.