British Columbia’s (BC or the Province) minority New Democratic Party (NDP) government released its 2020 provincial budget yesterday. This is the government’s fourth budget since taking office in 2017 but it does not have the look or feel of a typical pre-election budget, despite increasing speculation that the government could call an early election. The plan is largely status quo – the government cites the same core policy objectives, reiterates past initiatives, and announces few new measures. Much of the growth in planned operating spending stems from steady growth in caseloads and the impact of recently negotiated collective agreements. The outlook for capital spending remains largely unchanged, albeit rising quickly.

While DBRS Limited (DBRS Morningstar) sees the budget as largely status quo, we believe there are several noteworthy elements.

- **Balanced budgets remain a priority.** Revenue growth is slowing sharply, which has compelled the government to raise taxes and slow spending growth to maintain a thin track of budget surpluses. Including capital spending, however, adjusted (post-capex) operating results are set to deteriorate.

- **The Province remains cautious in its budgeting.** The Province forecast a $227 million surplus for 2020–21, which incorporates about $1.0 billion in conservatism through the use of a weaker-than-consensus economic forecast, a $300 million forecast allowance, $600 million in explicit expense contingencies, and a relatively low natural gas price for resource revenue projections.

- **ICBC operating results are stabilizing.** The outlook for the Insurance Corporation of British Columbia’s governance, operations, and earnings has improved following government intervention.

- **Economic growth slowing, but the economic base remains diverse and resilient.** Global economic conditions are weighing on growth, but the Province’s economic activity remains resilient and growth is relatively broad based.

- **Capex to drive debt growth.** Having previously announced many large capital projects, capex is now rising and will lead to considerable debt growth through the medium term. We estimate that adjusted debt will rise to $54.3 billion (+21.7%) over the next three years, resulting in the adjusted debt-to-GDP ratio rising to about 16.0% from the current 14.5%.
As noted at the time of our last review, we do not anticipate any rating actions through the medium term. A positive rating action appears increasingly unlikely and would require the Province to maintain a sustainable budget position and for its adjusted debt-to-GDP ratio to fall well below 15.0% on a sustainable basis. Conversely, a negative rating action could arise from a sustained deterioration in operating results and a marked increase in the debt-to-GDP ratio.

**Election 2020?**
The NDP formed a minority government in July 2017 and has governed with the support of the Green Party.

The next general election is legislated for October 2021. However, there has been speculation in recent months that an early election may be possible. The NDP government has implemented, in full or in part, many of its 2017 campaign commitments and opinion polls show support for the government. While the budget does not have the look and feel of a typical pre-election budget, the government can demonstrate considerable progress on many of its major policy initiatives and a reasonably strong record on economic and fiscal policy albeit made possible, in part, by a robust economy.

The Liberal Party continues to rebuild following its loss of power in 2017 and is now choosing candidates ahead of the next election, while the Green Party has scheduled a leadership convention for the summer 2020 to replace Andrew Weaver following his resignation as leader and his decision to sit as independent member of the legislature.

**Budget 2020**
Budget 2020 is the NDP government’s fourth budget and the policy direction remains largely consistent with the vision and priorities set out early in the government’s mandate. The government continues to emphasize its policy objectives of (1) making life more affordable, (2) enhancing public services, and (3) building a strong and sustainable economy.

The Province has projected a modest surplus of $227 million for 2020–21. However, BC uses conservative budgeting practices, which provide it with considerable flexibility to address unforeseen spending pressures, revenue volatility, and statutory spending requirements (e.g., response to disasters, litigation, etc.). In the past, the use of these prudent budgetary measures enabled the Province to outperform its budget projections in most years (see Appendix). We expect the Province will outperform its budget targets again in 2020–21 provided no major downside risks materialize.

The projected surplus equates to an adjusted operating deficit of $2.2 billion (-0.7% of GDP). We make several adjustments to BC’s reported results/budget projections to improve comparability between provinces. These adjustments include: (1) the addition of capital investment and the removal of amortization, (2) the exclusion of the change in regulatory accounts from BC Hydro’s net income, and (3) the exclusion of the forecast allowance and nonrecurring items.

The Province projects revenue to grow to $60.6 billion, which is modest when compared to the recent past. Revenue growth is relatively broad based with growth in taxation, federal transfers, net income from government business enterprises, and most other own-source revenues. These increases will be offset by noticeable declines in corporate income tax revenue and natural resource revenue, and the elimination of Medical Service Plan premiums.
British Columbia has similarly projected modest expense growth for 2020–21. Total expense is projected to rise by $1.2 billion to $60.1 billion (+2.1%). The Province announced only modest new spending initiatives to build on the major policy initiatives announced in previous years (e.g., housing, child care, homelessness, etc.). Much of the spending growth is attributable to steady volume pressures in core program areas and compensation increases associated with the Sustainable Services Negotiating Mandate. The new wage mandate provides for annual wage and salary increases of about 2.0%.

With the aim of maintaining a balanced budget and funding core priorities, the government reallocated a modest amount of funding within government to higher-priority program areas. On a functional basis, the core spending on health (+5.6%), education (+2.6%), and social services (+7.8%) will rise, while spending on the remaining areas will collectively fall by 5.9%, which is mainly due to one-time spending in 2019–20.

The budget contains few major policy announcements. The government announced a series of tax policy changes, the most significant of which was the introduction of a new tax bracket for higher income earners, which is projected to provide $216 million in incremental revenue in 2020–21. The major spending initiatives contained in the budget included a new grant for postsecondary students, funding for public sector entities to improve energy efficiency, funding for a public inquiry into money laundering, and funding for a variety of new climate change-related initiatives.

The Province continues to increase capital spending, with $22.9 billion in taxpayer-supported capex planned for the next three years. The Province has budgeted for capex of $71 billion in 2020–21, up 35.8% from the prior year and well above the average annual spending of $3.8 billion between 2014–15 and 2018–19. The three-year plan includes $5.8 billion for kindergarten to grade 12 and postsecondary facilities, $6.4 billion for health facilities, $1.5 billion for social housing, and $7.4 billion for transportation infrastructure and transit. In the past, actual capex has tended to be about 15% lower than planned.

The Province’s multiyear outlook contains a thin track of small budget surpluses. While the government’s commitment to maintain balanced budgets appears genuine, the Province may face challenges in the coming years amid slowing revenue growth. The Province has significantly increased core program spending, negotiated annual wage increases of about 2.0%, and is now pursuing a significantly larger capital program. While some capital spending can be reduced or deferred, scaling back spending in health, education, and social services tends to be more difficult.
Debt Outlook

The budget projects considerable growth in net debt and taxpayer-supported debt because of the growing debt-financed capital program. The Province projects taxpayer-supported debt to rise by $14.0 billion over the next three years to $58.6 billion (+31.5%).

We believe the debt forecast is somewhat conservative. BC tends to outperform its budget targets and underspend its capital plan. Consequently, we project that the Province’s adjusted debt burden will rise, but that the adjusted debt-to-GDP ratio will remain largely unchanged in 2020–21 at around 14.5% of GDP and that the ratio may rise to about 16.0% in 2022–23. Despite the increase, British Columbia’s debt-to-GDP ratio will remain the lowest for Canadian provinces and consistent with DBRS Morningstar’s AA (high) rating.

The Province’s 2020–21 borrowing requirement is $8.6 billion, of which $3.0 billion is for refinancing requirements and the remainder represents the net requirements for taxpayer- and self-supported capital spending.

Economic Outlook

The budget is based on a real GDP forecast of 2.0% in 2020 and 1.9% in 2021. The outlook is modestly lower than the private-sector consensus (0.4 ppts), which reflects the Province’s practice of systematically underforecasting economic growth as a matter of budgetary prudence.

Economic growth continues to moderate in British Columbia after a period of relatively strong growth. The Province expects slowing global growth, persistent trade uncertainty, and geopolitical tensions to weigh on domestic growth. BC will, nevertheless, remain a growth leader among Canadian provinces in 2020.

Economic growth is forecast to remain broad based, with modest growth in consumption, residential investment, business investment, and exports. Strong population growth and low interest rates remain supportive of the consumer spending and housing markets, while exports are expected to post a modest recovery following a decline in 2019 due to weakness in forestry and metals exports stemming from weaker global demand and lower prices.

Labour market conditions remain tight in the Province. The BC unemployment rate remained at 4.7% in 2019, while average weekly earnings growth was 2.5% in 2019. The Province added 65,400 net new jobs during the year (+2.6%), which was driven primarily by the private sector with gains in the service sector offsetting modest declines in the goods sector, which experienced losses in the manufacturing and natural resources industries.

The Province cites a number of economic risks to the outlook, including global trade policy uncertainty, geopolitical tensions, lower commodity prices, financial market volatility, housing and consumption uncertainty, and the pace of major capital project spending.
Appendix

Budgeted and actual amounts from 2014–15 to 2017–18 are taken from British Columbia’s public accounts. Figures published in the year that the public accounts were published and do not incorporate any subsequent restatements. Budgeted amounts for 2019–20 and the actual amounts for 2019–20 are taken from British Columbia’s 2020 provincial budget. Capex is investment in tangible capital assets, as defined by the Public Sector Accounting Standards.

The revised 2019–20 forecast shows a modest deterioration in the operating result, though we note that the forecast includes a $300 million forecast allowance and $1.2 billion in contingencies. Taken together, these factors suggest that public accounts is likely to show another year of budget outperformance for 2019–20.

### Budgeted Data

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<td>284</td>
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<td>37,795</td>
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### Variance

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<td>907</td>
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<td>(80)</td>
<td>138</td>
<td>(48)</td>
<td>(52)</td>
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<td>(102)</td>
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<td>1,499</td>
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