Province of British Columbia (Canada)

Debt financing of capital plans will weaken debt metrics despite balanced budgets

On 18 February, the Province of British Columbia (Aaa stable) released its 2020/21 budget in which it forecasts continued small surpluses over the next three years. The forecast of balanced fiscal results and economic growth above the national average are in line with our previous expectations and continue to position British Columbia as one of the fiscally strongest Canadian provinces. Nevertheless, the province’s significant capital infrastructure plans require material new debt issuance which will continue to weaken its debt metrics.

Exhibit 1
Debt metrics will weaken over the next three years

The budget forecasts a CAD 203 million surplus (0.3% of revenue) in 2019/20 followed by small surpluses that average CAD 260 million (0.4% of revenues) over the 2020/21 - 2022/23 period. The forecast of balanced budgets with small surpluses is in line with our previous expectations and supports a strong credit profile. The balanced budget forecasts are based on the province’s expectation of a marginally faster acceleration in average revenue growth of 2.7% over the next three years compared to average spending growth of 2.6% over the same period. The forecasts reflect the province’s very cautious approach to budgeting and continue to include sizeable contingencies and forecast allowances for unexpected pressures and revenue fluctuations, which together amount to CAD 900 million in 2020/21 and CAD 700 million in each of 2021/22 and 2022/23. Collectively, they provide a considerable buffer against adverse fiscal changes.

The province projects revenue growth of 2.1%, compared to updated 2019/20 estimates, to CAD 60.6 billion in 2020/21, supported in large part by rising tax revenue including provincial sales taxes, carbon taxes (rising to CAD 50/tonne of CO2 emissions in 2020/21) and employer health taxes; the latter will offset lost revenue from the elimination of medical
premiums starting in 2020/21. These revenue sources will also help offset slower revenue expected from corporate income taxes and natural resources. Although the budget does not introduce new taxes, the province raised the top marginal personal income tax bracket to 20.5% effective 1 January 2020 (from 16.8%), boosting revenue by an estimated total CAD 659 million over the next three years. The improving fiscal position of the Insurance Corporation of British Columbia (ICBC), a provincial crown corporation, including the expected return to positive net income starting in 2020/21, also adds to revenue growth. The 2020/21 budget also reaffirms the province’s earlier commitment to share CAD 3 billion in gaming revenue over 25 years with First Nations in the province.

Expenditure for 2020/21 amounts to CAD 60.1 billion, up 2.1% relative to updated 2019/20 estimates, primarily supporting the government’s social spending initiatives in healthcare, child care, affordable housing and clean energy programs, including pollution reduction and climate change plans under the province’s CleanBC and Climate Action initiatives.

The province will increase capital spending over the next three years to CAD 32.6 billion from CAD 31.1 billion three-year aggregate in the 2019/20 budget and CAD 26.2 billion in the 2018/19 budget. Capital projects will support a range of renewal and new capital infrastructure expenses, including spending on health, education and transportation projects, as well as hydroelectric projects. New borrowing will finance a significant component of the capital spending plans, and we forecast that the province’s net direct and indirect debt will rise by CAD 14 billion between 2019/20 and 2022/23. As a result, net debt will reach nearly 91% of revenue in 2022/23 from 74.5% in 2019/20. Net debt in excess of 95% of revenue on a sustained basis would lead to downward pressure on the province’s credit profile.

The provincial unemployment rate remained low at 4.7% in 2019, although the province expects it will rise modestly to 5.3% by 2021. The province forecasts real GDP growth of 2.0% in 2020 and 1.9% for 2021-2022, reflecting more muted expectations for consumer spending, housing and export activity. Nevertheless, real GDP growth is expected to exceed the national average growth of 1.6% for 2020 and 1.8% for 2021. Macroeconomic risks to these forecasts include global uncertainties, decelerating Asian growth and commodity price volatility. Despite these factors, we expect that British Columbia will remain one of the strongest provincial economies in Canada over the next three years.

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