Budget Commentary

Province of British Columbia Budget 2024: Deeper Deficits and Rising Debt

Morningstar DBRS
February 23, 2024

Key Highlights

- The Province's prudent fiscal approach, consistent track record of outperformance and strong balance sheet lend stability to its AA (high) credit rating.
- New expenditure initiatives are primarily focused on cost of living reduction, housing affordability, healthcare and climate change.
- Deterioration in Debt outlook compared to prior expectations. Morningstar DBRS - adjusted debt-to-GDP will increase to 22.0% in 2024–25 and is expected to continue to trend upward to 28% of GDP by 2026–27.
- Economic activity is expected to remain muted in the near term. However, notwithstanding the slowdown, growth is forecast to resume an upward trend over the medium term.

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The Province of British Columbia (British Columbia or the Province; rated AA (high) with a Stable trend) released its 2024 budget on February 22 (Budget 2024). With elections approaching in October, the NDP government has prioritized public investments over austerity in response to economic challenges faced by households. The Budget focuses on improving affordability for people and strengthening public services. The budget plans for substantial increases in spending on priority areas, higher deficits, and a larger borrowing program. We expect this to result in reduced flexibility over the years to come. However, the Province's historically prudent fiscal approach, consistent track record of outperformance and strong balance sheet continue to lend stability to its credit profile.

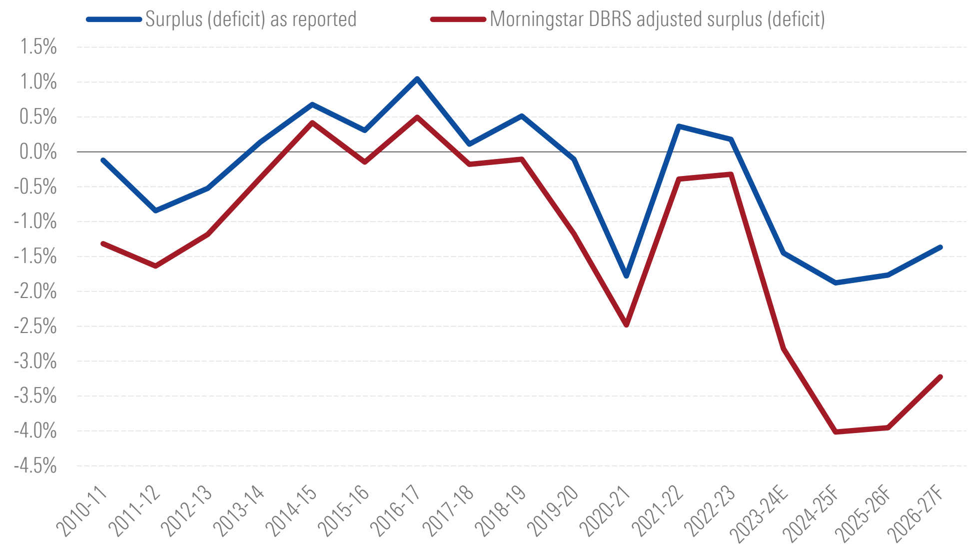
Budget 2024 focuses on four key priorities:

- Helping people with costs;
- Delivering more homes for people;
- Strengthening health care and services; and
- Building a stronger, cleaner economy

Budget Overview

The budget forecasts a deficit of $7.9 billion in 2024–25, compared with a $5.9 billion deficit now anticipated in 2023–24. On a Morningstar DBRS-adjusted basis, this equates to a shortfall of $16.9 billion, or 4.0% of GDP. We make several adjustments to British Columbia’s reported results/budget projections to improve comparability among the provinces. We adjust reported results to recognize capital spending as incurred rather than as amortized, assume a modest amount of capital underspending, and exclude the change in regulatory accounts from British Columbia Hydro and Power Authority's (rated AA (high) with a Stable trend by Morningstar DBRS) net income to arrive at the adjusted deficit.

Exhibit 1 Operating Results as a Share of GDP



Sources: Morningstar DBRS and British Columbia.

Total revenues are projected to rise by 5.4% year over year (YOY) in 2024–25 relative to the prior year, reflecting strong increase in tax revenues on the back of population growth and improved forecast for corporate taxable income partly offset by lower carbon tax revenues and the absence of one-time revenue experienced in 2023–24. Own-source revenues are projected to rise by 6.0% YOY, mainly as a result of higher taxation revenue and modest growth in other revenue categories. Federal transfers are budgeted to increase by 3.0% YOY driven primarily by an increase health and social transfers. The budget includes a new home flipping tax on profits of homes sold within two years of purchase, increases the employer health tax exemption threshold and also introduces a few tax breaks including an increased family benefit and increased climate action tax credits among others. Spending is expected to increase by a substantial 7.4% YOY as the government increases funding for priority areas of cost of living, housing affordability and healthcare. Debt-servicing costs are projected to rise by 2.4%, reflecting an increase in debt and rising interest rates; however, these costs remain relatively low at around 5.0% of total revenues.

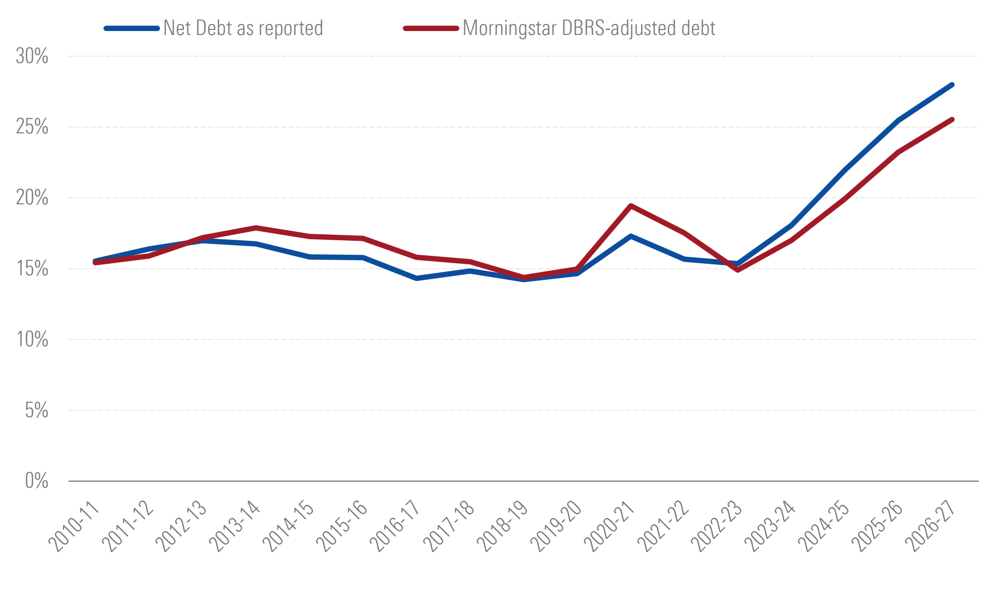
Consistent with past prudent budget practice, the budget includes contingencies totaling $3.9 billion in 2024-25, $3.0 billion in 2025-26 and $3.7 billion in 2026-27 towards General Contingencies, Clean BC and other priority spending initiatives, which, if unused, would contribute to improvement in the bottom line and debt outlook. The budget does not include a forecast allowance compared to prior years; while the forecast is in line with other projections, this could at the margin add to downside risks to fiscal performance.

The Province is continuing with a robust capital spending program towards health, transportation, housing and education sectors that will help support an economic recovery. The three-year taxpayer-supported capital plan is projected to be $43.3 billion, up $5.8 billion from the previous plan. For 2024–25, a total capital investment of $18.8 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 $7.8 billion and $6.3 billion for 2025–26 and 2026–27, respectively. On a Morningstar DBRS-adjusted basis, these equate to deficits of 4.0% to 3.2% of GDP. In line with the past two budgets, budget 2024 does not present any plan for a return to balance; however, continues to advocate for modest YOY declining deficits.

Debt Outlook

Exhibit 2 Debt Outlook (as a Share of GDP)



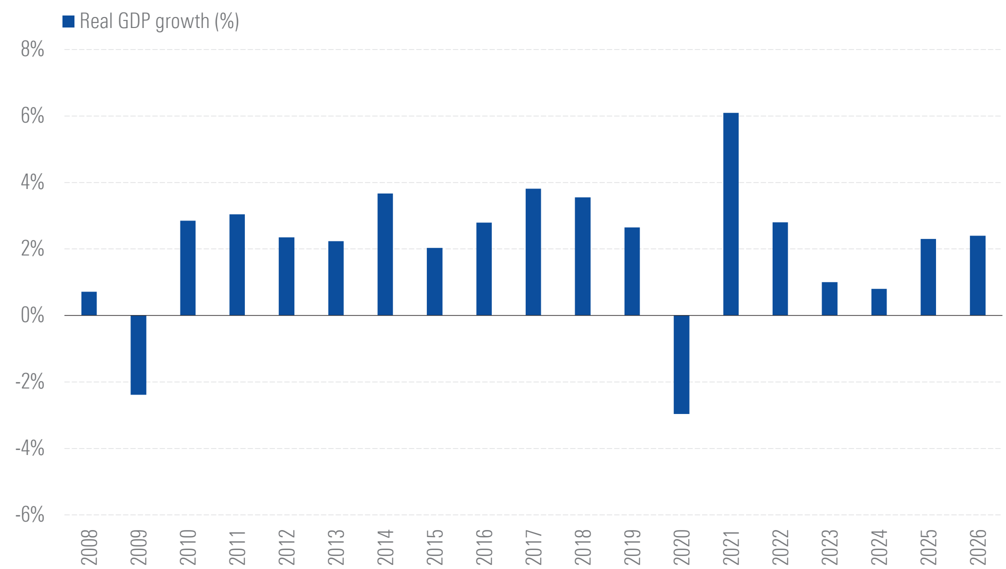
Sources: Morningstar DBRS and British Columbia.

Contrary to prior expectations at the time of our last review in June 2023, British Columbia's debt outlook has deteriorated. The debt burden is expected to rise substantially as spending ramps up for budget-related investments. The Province projects net liabilities (net debt)-to-GDP to reach 21.0% in 2024–25 and anticipates that this will increase to 27.5% by 2026–27. On a Morningstar DBRS -adjusted basis, debt-to-GDP will increase to 22.0% in 2024–25 and is expected to continue to trend upward to 28% of GDP by 2026–27. We previously expected debt-to-GDP to hover around 22% over the medium term. Given the higher deficit projections and no plan to balance debt is expected to gradually rise over the medium term, although this is still likely to be the lowest level among provinces.

Gross borrowing requirements are estimated to be $24.0 billion in 2024–25 and are estimated to increase to $29.5 billion in 2025–26 and decline slightly thereafter as the deficit moderates.

Economic Outlook

Exhibit 3 Real GDP Growth (%)



Sources: Morningstar DBRS and British Columbia.

British Columbia's economy is estimated to have expanded by 1.0% in 2023, amid an economic slowdown in Asia, high interest rates, and inflationary pressures. Growth is expected to remain muted for the better part of 2024 only to recover later in the year with continued moderation in inflation and the potential for rate cuts in the second half of 2024. Notwithstanding the subdued outlook for 2024, growth is forecast to resume an upward momentum over the medium term as economic activity rebounds, inflation eases into the target range and interest rates trend lower. Economic growth is also expected to be supported by strength in labour markets and export growth driven by increased LNG production and recovery for key trading partners. For 2024–25, the Province anticipates real GDP growth of 0.8%, followed by 2.3% in 2025–26 and 2.4% in 2026–27. Unlike previous budgets, the forecast seems to be slightly more optimistic relative to the private-sector average. We view the forecasts as reasonable assumptions, albeit susceptible to downside risks from persistently high interest rates and commodity price volatility.

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

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