NATIONAL BANK OF CANADA
FINANCIAL MARKETS

February 22, 2024

Debt-financed action in pre-election budget

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Highlights

In a pre-election budget, BC's government takes decisive action on several fronts, not least of which is housing scarcity/affordability and the overall cost of living. But new measures come with a fiscal price tag, as the provincial deficit is set to expand to $7.9 billion in 2024-25. There's more budgetary red ink behind that, the combined three-year fiscal shortfall notably larger than the equivalent plan set down a year ago. To be clear, a slowing economy has impacted own-source revenue prospects, while high interest rates add to the debt service burden. Still, program spending looks to increase appreciably, with incremental expenses of $13.0 billion across the three-year fiscal plan for new priority investments and growing demand for government programs and services. There's no timeline for deficit elimination and the budget is likewise quiet on fiscal guardrails. The combination of budgetary red ink and meaningful capital requirements will see ample debt taken on. Although ending 2023-24 at a better-than-expected level, the slope for the taxpayer-supported debt-to-GDP ratio is steeper than a year ago, this preferred debt metric rising from 17.6% to 21.0% in 2024-25 and pointed at 27.5% by 2026-27. Having started with a relatively lower debt burden (at least by provincial standards), BC's interest bite—while slated to increase—should nonetheless remain fairly manageable. There's a bit more borrowing to do in the outgoing fiscal year, with $2 billion of gross bond supply yet to be sourced before March 31st. There could be even more supply if the province opts to pre-fund. Setting aside potential pre-borrowing, the gross borrowing requirement (from all sources/markets) has increased to $24.2 billion for 2024-25. For the full three-year fiscal plan, over $82 billion in new government borrowing has been outlined, standing some 40% higher than the corresponding tally in last year's budget. Look for BC to leverage its diverse investor base, utilizing both domestic and international markets to advance the larger bond program. Note: The provincial general election is scheduled for October 19, 2024.

- Economic outlook – With high inflation and restrictive interest rates from the Bank of Canada, British Columbia's economy grew at a moderate pace in 2023, as real GDP is estimated to have grown by 1.0%, which is roughly in line with the national average. The labour market has also seen moderate expansion, with the number of jobs rising by an average of 1.6% in 2023, mainly in the last five months of the year. This job creation was supported by the strong demographic growth of 3% in 2023, the highest the province has seen since 1994. However, the labour market was unable to absorb the large influx of newcomers to the province, with the unemployment rate rising from 4.5% in January 2023 to 5.4% in January 2024, despite the increase in the number of jobs. Despite high interest rates, B.C.'s new construction sector has held up well, with housing starts reaching a record 50.6K units in 2023, good news in the context of strong demographic growth and persistent affordability challenges. Looking ahead, restrictive monetary policy should continue to slow the province's economy. For 2024, the budget is based on real GDP growth of 0.8%, which seems slightly optimistic compared to the 0.5% expected by the average private sector forecast. Economic growth is expected to regain strength in the following years, against a backdrop of more favourable interest rates. Real GDP should increase by 2.3% in 2025 and by 2.4% in 2026, which is slightly higher than the 2.1% and 2.3% predicted by the average private sector forecast respectively. More importantly for public finances, nominal GDP is expected to grow by 3.3% in 2024, 4.4% in 2025 and 4.5% in 2026, all slightly more optimistic than the average forecaster (2.9%, 4.1% and 4.4% respectively). The labour market is set to continue easing in the current year, with the unemployment rate reaching an average level of 6.1% in 2024 before falling back to 5.9% in 2025 and 5.6% in 2026.

- Latest (but not yet final) estimate of 2023-24 budget balance – Not unlike other provinces, British Columbia's budget balance has been under pressure this year as is evident in updated guidance for the outgoing 2023-24 fiscal year. Indeed, the $4.2 billion deficit projected in last year's budget was revised to $5.6 billion in the Q2 update and has now been downgraded further to a $5.9 billion shortfall (1.4% of GDP). This latest revision can be attributed to both softer revenues (0.4% lower than the Q2 update) and marginal expense pressures (+0.9% vs. Q2 update). We'd note that, despite just over a month remaining in the fiscal year, there are still significant contingencies built in, totalling $5.5 billion.
- Medium-term fiscal outlook (2024-25 & beyond) – 2023-24's weaker-than-projected budget balance is set to deteriorate further in 2024-25 as the province is guiding towards a $7.9 billion shortfall (1.9% of GDP). That's being driven by a sizeable jump (+8.8%) in expense pressures across all major envelopes. Health care accounts for most of the net new spending but larger outlays on education and higher debt servicing costs were also major contributors. While not enough to offset marginal expenses, revenue growth is expected to be healthy, up 5.4% compared to 2023-24. A large and temporary jump in corporate income tax receipts is the main driver here. Further out the horizon, deficits will be reined in a touch but not by much. A $7.8 billion deficit (1.8% of GDP) has been pencilled in for 2025-26 and a $6.3 billion shortfall is expected in 2026-27 (1.4% of GDP). The modest consolidation in those outer years is expected to be a function of revenue growth (3.0%) outpacing better-contained spending growth (+1.8%). Unlike past budgets, there's no explicit forecast allowance in this fiscal plan. There province has, however, built in significant contingencies throughout the fiscal plan (totalling $10.6 billion over the next three years). Slightly below consensus economic assumptions add

another layer of prudence. Overall, the fiscal plan represents a non-trivial budgetary deterioration compared to the plan laid out a year ago. The combined deficit over the three overlapping years (i.e., 2023-24 to 2025-26) moves from $11.0 billion to $21.6 billion and the deficit expected in the newest year added to the forecast horizon (i.e., 2026-27) is larger than would have been implied by the old trajectory.

- New measures – Dubbed 'Taking Action For You', Budget 2024 includes four major lines of action, namely 'helping with people's everyday costs', 'delivering more homes for people faster', strengthening health care and services', and building a stronger, cleaner economy'. On the cost of living front, the budget includes $248 million to increase the BC Family Benefit by 25% between July 2024 and June 2025. Overall, 340,000 families, including 66,000 new ones, should benefit from an average increase of $445 over this period. The government is also announcing the introduction of the BC Electricity Affordability Credit at a cost of $370 million, which will save households an average of $100 on their electricity bills between April 2024 and March 2025. In addition, the budget also raises the exemption threshold for the Employer Health Tax from $500K to $1 million, representing a shortfall of around $100 million per year. On the housing front, the government is announcing a new tax targeting home flipping activity starting January 1, 2025. This will be a tax on the profit made from selling a residential property within two years of buying it. Revenue from the tax will go directly to building homes in B.C., like the existing Speculation and Vacancy Tax. In addition, the Budget provides additional funding of $198 million over 3 years for operating and capital funding for BC Builds to deliver more rental homes, and $102 million per year for lowering cost for first-time home buyers and people buying newly built home through increased property tax transfer exemption measures. On the health care and services front, the Budget includes $8 billion in new initiatives over 3 years, including $ 968 million for K-12 enrolment growth, $398 million for justice and public safety services, $300 million to support more people receiving income and disability assistance, $270 million for cancer care supports, $354 million for home and community care services for seniors, $215 million for mental health, addictions and treatment, and $68 million to reduce costs for in-vitro fertilization starting in 2025. Finally, on the stronger and cleaner economy front, the government plans to invest an additional $1.3 billion over 4 years, including $405 million to respond to climate emergencies, $435 million for the province climate plan, CleanBC, and advancing the clean economy, and $474 million to support critical transportation networks and community infrastructure.

- Debt outlook & interest bite – British Columbia's preferred debt measure—taxpayer-supported debt—is poised to end the outgoing 2023-24 fiscal year at $71.9 billion. That's coming in $3.8 billion lower than the original 2023 budget target. However, with no shortage of red ink/deficits and strategic capital projects to finance, the absolute level of debt and key related ratios are tilted distinctly higher. Nearly $55 billion of net new taxpayer-supported debt is to be taken on over the coming three fiscal years, including $16.7 billion in new debt in 2024-25. It's expected that the taxpayer-supported debt burden will step up notably in the coming three fiscal years. Relative to nominal GDP, the taxpayer-supported debt load is slated to rise from 17.6% in 2023-24 to 21.0% in 2024-25, ultimately reaching 27.5% by 2026-27. (For context, the debt-to-GDP ratio hovered around 15% prior to the pandemic and had more or less returned to that level in 2022-23, before starting its more recent and forecasted move up.) Scaling debt to total revenue, the corresponding ratios evolve (i.e., increase) in broadly similar fashion, rising from 95% in 2023-24 to 112% in 2024-25 and then onwards to 151% by 2026-27. This can be seen as relatively brisk debt accumulation, even if the latest forecasts for 2024-25's debt burden (vs. GDP or revenue) are no higher than what was telegraphed a year ago (i.e., in Budget 2023). At present, we've no other 2024 provincial budgets to compare to. Still, we suspect that BC's after-capital deficit could be larger than the provincial average, hinting at relatively faster debt accumulation vs. some key peers.

  BC has historically been at the lower end of the provincial debt spectrum and has a relatively modest/limited 'interest bite' to show for it. For the outgoing fiscal year, taxpayer-supported debt charges are set to consume just 3.2% of the revenue dollar. (Although there's less taxpayer-supported debt in 2023-24 than was planned for, higher average borrowing rates result in a somewhat larger-than-expected interest bite.) The combination of extra debt and higher interest rates will impact debt affordability (and add to spending pressure). Nonetheless, BC's 'interest bite' should still be no higher than 5½% of revenue by 2026-27.

  For reference, the yield on 10-year Canada bonds is seen averaging 3.25% in 2024, with implied policy rate easing pulling the average yield down to 3.07% in 2025. Fiscal sensitivity analysis suggests that a 1%-pt increase in interest rates equates to a $174 million annual fiscal impact.

- Long-term borrowing requirement – Long-term borrowing requirement – 2023-24's larger-than-expected deficit has meant incremental borrowing needs. So the outgoing fiscal year's gross funding requirement (all sources) is now pegged at just over $20 billion vs. $18.9 billion in budget. Excluding internal financing sources, the adjusted gross bond program is $16.6 billion. At this point, $14.6 billion of long-term debt has been issued, the majority steered to international markets. All else being equal, that technically leaves $2 billion of gross bond supply to complete in the final month and change of the fiscal year (which ends March 31st). The province could, however, opt to pre-fund a portion of next fiscal year's relatively sizeable requirement should market conditions generally prove favourable.

  Setting aside any prospective (and optional) pre-funding, the combination of larger deficits, enhanced capital requirements and (in later years) extra maturities will result in more significant borrowing needs for the coming three-year period. Starting with 2024-25, BC is now telegraphing $24.2 billion in new borrowing. (That had been $20.6 billion in Budget 2023.) Again, the coming year's gross borrowing requirement excludes potential pre-funding, while the underlying budget balance includes non-trivial prudence, including the spending contingencies outlined earlier. As it stands, government borrowing is set to approach $30 billion in 2025-26, receding somewhat to a still sizeable $28.4 billion come 2026-27. Putting the three years together, Budget 2024's financial framework entails $82.1 billion in government borrowing, which stands some 40% above than the corresponding three-year tally set out in last year's budget. (As per the previous section on net debt, adjusting for maturities and sinking funds still sees net debt growing quickly under this latest fiscal plan.)

When it comes to the borrowing strategy, note that a portion of the total requirement could be sourced internally and/or from short-term markets. Additionally, don't lose sight of potential revisions to the start-of-year cash position when the final results for 2023-24 are confirmed via the forthcoming public accounts. BC has aptly demonstrated its strong access to domestic and international debt capital markets and one suspects the province will keep its funding options open in 2024-25. Indeed, there's a stated interest in expanding the investor base. And as we saw in the outgoing fiscal year, leaning into deep pools of liquidity in key international markets can quickly and meaningfully advance the provincial borrowing program. As a final note: In addition to the traditional funding blackout periods that generally accompany financial and credit rating reporting, BC's borrowing program will also need to work around a provincial general election, which is scheduled for October 19, 2024.

- Long-term credit ratings: S&P: AA, Negative | Moody's: Aaa, Stable | DBRS: AA(high), Stable | Fitch: AA+, Stable

British Columbia

$000,000	Budget 2023/24	Forecast 2023/24	Budget 2024/25	Plan 2025/26	Plan 2026/27
Taxation revenue	45,324	46,219	49,214	49,394	52,655
Resource revenue	4,764	3,015	3,150	3,432	3,769
Other revenue	10,520	10,851	11,400	11,382	11,516
Other federal transfers	13,593	14,023	14,446	14,889	14,674
Commercial Crown corporation net income	3,489	3,207	3,313	3,741	3,794
as of Insurance Corporation of British Columbia (ICBC)	-	*140*	-	*400*	*400*
Total revenue	**77,690**	**77,320**	**81,523**	**82,838**	**86,408**
Program spending	72,471	74,434	81,444	83,776	85,290
Debt servicing costs	3,235	3,300	4,105	4,815	5,676
Contingencies	4,500	4,500	3,885	2,020	1,730
Total spending	**80,206**	**82,234**	**89,434**	**90,611**	**92,696**
Pandemic and Recovery Contingencies	(1,000)	(1,000)	-	-	-
Forecast allowance	(700)	-	-	-	-
Surplus/Deficit	**(4,216)**	**(5,914)**	**(7,911)**	**(7,773)**	**(6,288)**
Provincial Debt Changes					
Deficit (surplus) before forecast allowance	3,516	5,914	7,911	7,773	6,288
Taxpayer-supported capital spending	11,813	10,107	14,104	15,082	14,083
Self-supported capital investments	4,027	4,752	4,652	3,955	4,623
Commercial Crown corp. retained earnings	744	487	751	1,150	1,151
Amortization and other capital asset changes	3,016	3,012	3,170	3,455	3,686
Other items	(8,681)	(9,915)	(11,104)	(9,422)	(10,118)
Increase in total provincial debt	**14,435**	**14,357**	**19,484**	**21,993**	**19,713**
Total provincial debt	**107,924**	**103,783**	**123,267**	**145,260**	**164,973**
Taxpayer-supported	**75,617**	**71,863**	**88,639**	**109,182**	**126,499**
Self-supported	**31,607**	**31,920**	**34,628**	**36,078**	**38,474**
Forecast Allowance	**700**	**-**	**-**	**-**	**-**
Total provincial debt / GDP	27.0%	25.4%	29.2%	33.0%	35.8%
Taxpayer-supported	18.9%	17.6%	21.0%	24.8%	27.5%
Capital Spending	**15,840**	**14,859**	**18,756**	**19,037**	**18,706**
Taxpayer-supported capital spending	11,813	10,107	14,104	15,082	14,083
Self-supported	4,027	4,752	4,652	3,955	4,623
Provincial borrowing requirements	**19,046**	**20,193**	**24,406**	**29,812**	**28,628**
Operating deficit (surplus)	4,216	5,914	7,911	7,773	6,288
Capital spending	15,840	14,859	18,756	19,037	18,706
Refinancing requirements	3,632	4,397	3,670	6,295	6,257
Other financing sources	(4,642)	(4,977)	(5,931)	(3,293)	(2,623)

Source: Budget documents, British Columbia Ministry of Finance

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