BUDGET ANALYSIS

British Columbia: Budget 2023

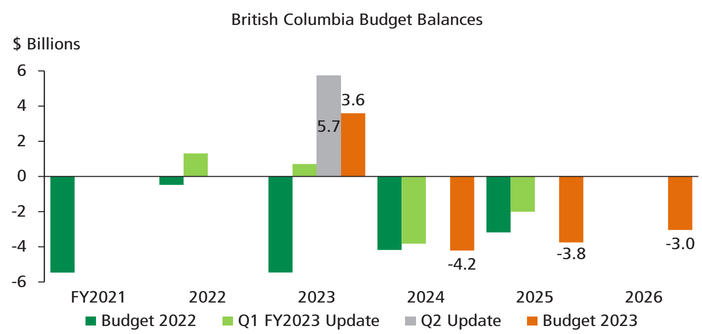
Spending Revenue Windfall Again as Recession Looms

By Marc Desormeaux, Principal Economist

HIGHLIGHTS

- BC's fiscal year 2023–24 (FY2024) budget penciled in a larger-than-previously anticipated deficit of $4.2B (1.1% of nominal GDP) for this coming fiscal year. That follows a large revenue windfall-driven surplus in FY2023. The province expects shortfalls to dwindle beginning in FY2025 but doesn't anticipate a return to black ink over the forecast period (graph 1).
- Borrowing requirement expectations were also revised higher, to $19.0B in FY2024 versus the prior $17.6B forecast in the Q1 FY2023 update. In FY2025 and FY2026, the province expects to borrow $20.5B and $19.4B, respectively, reflecting both higher capital spending projections and a deeper deficit outlook.
- Economic growth forecasts were downgraded for 2023 and 2024 in expectation of much weaker housing activity and a softer global backdrop.

GRAPH 1
BC Plans to Return to Deficit After Surplus this Year



Sources: British Columbia Ministry of Finance and Desjardins Economic Studies

- BC's net debt-to-GDP ratio is forecast to rise steadily from 16.4% in FY2023 to 23.0% in FY2026. That is ultimately larger than anticipated in the Q1 FY2023 update but the second-lowest rate projected by any province so far.
- Program spending was increased by more than $10B over FY2024 and FY2025 combined. This included new health care spending, affordability assistance, and higher costs associated with public sector wage increases.
- Ultimately, BC maintains some of the best deficit and debt metrics of any province, as well as very large contingency allocations that should act as buffers against downside. But new spending and economic vulnerabilities risk undermining those advantages over time.

Our Takeaways

Ultimately, today's budget appears to keep BC's strong fiscal position versus most other jurisdictions intact. We would have preferred that the province keep its fiscal powder dry given its vulnerability to a housing-led recession. But even after spending the FY2023 revenue windfall, it remains on track to maintain some of Canada's best deficit and debt metrics. Large contingency allocations also offer a buffer against adverse events, though, as we noted earlier, this may limit the extent to which BC bond spreads tighten if investors assume fiscal outperformance.

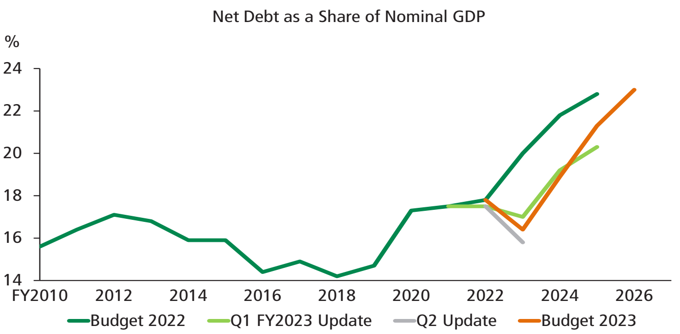
Looking further ahead, however, the province faces risks on multiple fronts. Housing affordability remains long-run challenge even as prices correct. China's economy—an important destination for BC exports—is adjusting and reevaluating its trading relationships. Disruptive climate events, to which the coastal province is particularly exposed, are increasing in frequency and severity. And the population is aging rapidly.

Effectively managing these risks will require a careful balance of longer-run policy needs against fiscal sustainability objectives.

Balances, Debt, and Borrowing Lower than in Budget 2022

Despite the surprise record surplus forecast in its Q2 FY2023 fiscal update, BC now projects a return to deficits of $4.2B, $3.8B, and $3.0B in FY2024, FY2025, and FY2026, respectively. By the same token, net debt forecasts remain on a rising path as a share of provincial output. They are about 1.5ppt lower than in Budget 2022 by FY2025 but 1ppt higher than at Q1 FY2023 (graph 2). Still, among the provinces, those anticipated net debt burdens exceed only those of Alberta.

GRAPH 2
After a Brief Reprieve, BC's Debt is Expected to Climb



Sources: British Columbia Ministry of Finance and Desjardins Economic Studies

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TABLE 1
Updated BC Projections

$ MILLIONS (UNLESS INDICATED)	2022–23	2023–24	2024–25	2025–26
Gross Borrowing Requirements				
Q1 FY2023 Update*	7,056	17,563	14,509	—
Budget 2023	**8,885**	**19,046**	**20,454**	**19,384**
Taxpayer-supported Capital Spending				
Q1 FY2023 Update*	9,279	9,333	8,815	—
Budget 2023	**8,117**	**11,813**	**12,634**	**13,098**
Real GDP Growth (%)				
Q1 FY2023 Update	3.2	1.5	2.0	2.4
Budget 2023	**2.8**	**0.4**	**1.5**	**2.4**
Nominal GDP Growth (%)				
Q1 FY2023 Update	11.6	3.5	3.7	4.1
Budget 2023	11.0	2.8	3.7	4.2

* Q2 FY2023 forecast for 2022–23
Sources: British Columbia Ministry of Finance and Desjardins Economic Studies

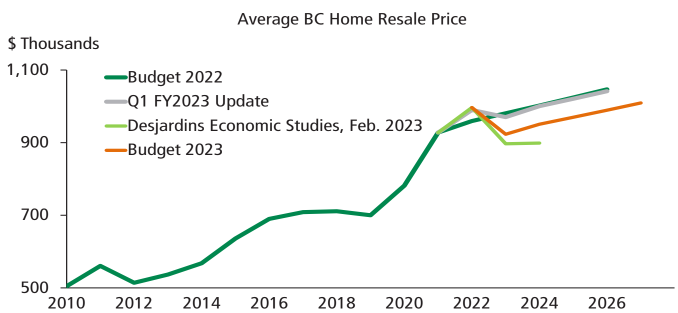
Some rating agencies have cited after-capital deficits as an indicator to watch when it comes to assessing BC's finances. The sum of budget balances and taxpayer-supported infrastructure outlays remains under 10% of nominal GDP in this plan.

Economic Forecasts Trimmed

In its economic outlook section, BC lowered forecasts for economic growth this year and next. The effects of sharply higher interest rates anchored the move, while a deteriorating global expansion was also a factor. Employment and household consumption look to have weakened more than in other provinces towards the end of 2022. Headwinds to China's growth related to slowing foreign demand and ongoing pandemic challenges could be larger-than-expected.

Much softer housing price expectations were of particular interest (graph 3). The province now expects the BC average home resale price to fall by 7.4% in 2023 and only reach the peak attained last year in 2027. More optimistically, the LNG Canada megaproject is still expected to support business investment throughout the forecast period.

GRAPH 3
Housing Price Forecasts Revised Lower



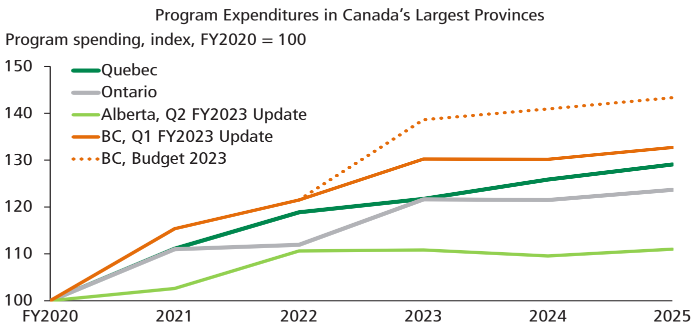
Sources: British Columbia Ministry of Finance and Desjardins Economic Studies

While risks are tilted to the downside at this time, BC maintained its practice of building in significant fiscal contingencies. In FY2024, these included a $700M economic forecast allowance, $1B for pandemic and recovery measures, and $2.3B for unexpected program spending and costs related to the CleanBC emissions reduction plan, among other measures. Total contingencies in FY2025 and FY2026 were penciled in at $5.3B and $5.2B, respectively. And with an estimated revenue sensitivity of $200–300M per 1ppt in nominal GDP growth, the province would lose around $175M this fiscal year if its economy evolves in line with our latest, more bearish forecast.

Extending the Lead on Provincial Spending

On the grounds that support is needed amid slowing economic growth, BC increased its already ambitious program spending targets. It continues to lead Canada's four largest provinces in pandemic-era spending forecasts (graph 4 on page 3).

GRAPH 4
BC Spending Boosted Again

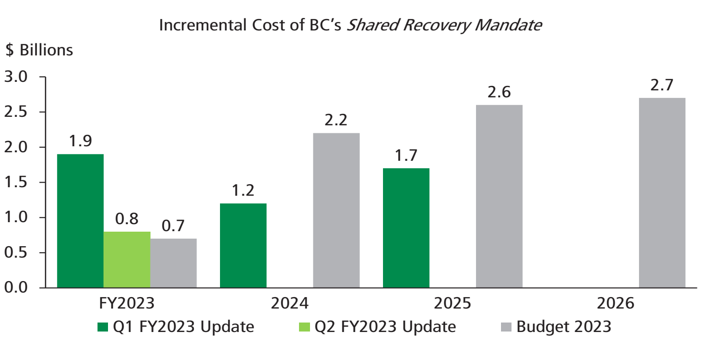


Sources: Provincial budget documents, Statistics Canada, and Desjardins Economic Studies

Measures underpinning the spending increases were wide-ranging. First and foremost, health expenditure projections were raised to address capacity issues in the healthcare system. The effects to budget balances will presumably be partly offset by higher transfer payments from the federal government. Various transfers and fee reductions that aim to improve affordability will shave a collective $0.6B off the bottom line in FY2023. An array of funding increases and incentives for affordable housing construction should add to both capital and operating expenditure.

Total public sector wage costs under the Shared Recovery Mandate are now expected to reach $5.5B from FY2023 to FY2025. That represents a $0.7B increase versus multi-year projections laid out in the Q1 FY2023 fiscal update (graph 5). The province cited rising inflation as the principal driver of the bump. BC has its own unique practices for wage negotiations. Still, at this early stage of budget season, this cost base expansion highlights the potential expenditure-side risks for other provinces so long as inflation remains elevated.

GRAPH 5
Public Sector Wage Pressures Add to Costs



Sources: British Columbia Ministry of Finance and Desjardins Economic Studies

Spread Movement Could be Impacted by Contingencies

Yields for BC long bonds have traded through those of Ontario for the last decade, and we don't see that changing given the western province's relatively strong debt metrics. Though BC deficits were well telegraphed before this budget, sustained fiscal shortfalls may drive some widening versus Ontario over time.

Large contingencies built into this plan could, however, limit bond market movement if BC outperforms its targets. We have noted many times that investors appeared to assume a reserve fund-led boost after BC's budget last year, and then accordingly shrugged off a strong surplus in the FY2022 Public Accounts.

The author thanks Farjad Khan and Marc-Antoine Dumont of Desjardins Economic Studies for their contributions to this note.

TABLE 2
Summary of Fiscal Forecasts

	2021–2022	2022–2023		2023–2024		2024–2025	2025-2026
IN $B (EXCEPT IF INDICATED)	**Actual**	**Q2 FY2023**	**Budget 2023**	**Q1 FY2023***	**Budget 2023**	**Budget 2023**	**Budget 2023**
Total revenues	72.4	81.1	82.7	73.8	77.7	79.7	82.2
% change	*16.5*	*12.0*	*14.2*	*-5.2*	*-6.1*	*2.6*	*3.1*
Own-Source Revenues	60.4	68.5	70.2	61.7	64.1	66.5	68.7
% change	*22.6*	*13.5*	*16.2*	*-5.4*	*-8.7*	*3.8*	*3.3*
Federal Transfers	12.0	12.6	12.5	12.1	13.6	13.2	13.5
Total expense	71.1	75.1	79.1	76.6	81.2	83.0	84.8
% change	*5.1*	*5.6*	*11.3*	*3.4*	*2.7*	*2.2*	*2.2*
Program spending	68.3	72.3	76.2	73.2	78.0	79.3	80.6
% change	*5.3*	*5.8*	*11.6*	*2.8*	*2.3*	*1.7*	*1.7*
Debt charges	2.7	2.7	2.9	3.4	3.2	3.7	4.1
% of total revenues	*3.8*	*3.4*	*3.5*	*4.6*	*4.2*	*4.7*	*5.0*
Forecast allowance	—	0.3	0.0	1.0	0.7	0.5	0.5
Budget balance	**1.3**	**5.7**	**3.6**	**-3.8**	**-4.2**	**-3.8**	**-3.0**
% of GDP	*0.4*	*1.5*	*0.9*	*-0.9*	*-1.1*	*-0.9*	*-0.7*
Net Debt, % of GDP	*17.8*	*15.8*	*16.4*	*19.2*	*18.9*	*21.3*	*23.0*

* Last available forecast for FY2024.

Sources: British Columbia Ministry of Finance and Desjardins Economic Studies