BUDGET ANALYSIS

British Columbia: Budget 2024

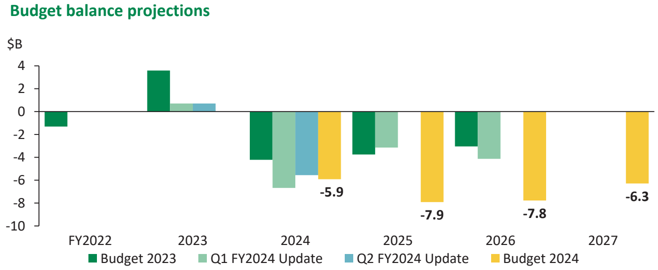
Spending Increased Again, but Fiscal Advantages Largely Intact

By Marc Desormeaux, Principal Economist, and Kari Norman, Economist

HIGHLIGHTS

- British Columbia's (BC) fiscal year 2024–25 (FY2025) budget increased spending and deficit projections again, with shortfalls expected through FY2027 (graph 1). Table 1 on page 2 summarizes the province's updated fiscal forecasts.
- Still, BC's fiscal advantages remain largely intact. Its net debt burden and debt service-to-revenue ratios, although rising, are expected to be among the smallest of the provinces while its fiscal buffers remain significant.
- Spending increases were concentrated in the healthcare sector. The province will also offer incremental new affordability relief via targeted transfers to lower- and middle-income households, tax reductions for small businesses, and expanded property transfer tax exemptions for first-time homeowners.

Graph 1
BC's Bottom Line



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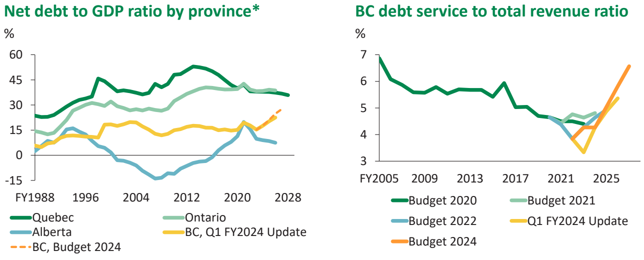
- Gross borrowing requirements are now expected to total $24.2B in FY2025, $29.5B in FY2026, and $28.4B in FY2027, reflecting increases to capital spending plans following project delays and larger deficits. Relative to the last outer-year borrowing projections, FY2025 and FY2026 figures represent boosts of $2.7B and $8B, respectively.

Our Takeaways

While higher spending plans have meaningfully increased deficit projections, BC's longstanding advantages are largely intact. Its net debt-to-GDP ratio—a key focus of rating agencies and organizations like the Parliamentary Budget Office that assess fiscal sustainability—will rise sharply but for now remains one of the lowest of any province (graph 2). The outlook for its debt service-to-revenue ratio is similar: this indicator is expected to rise to its highest point since FY2005 but remains low relative to that of several other provinces.

Graph 2
BC's Debt Indicators Are Set to Rise, But Remain Low



* Quebec, Ontario and Alberta figures based on mid-year FY2024 projections
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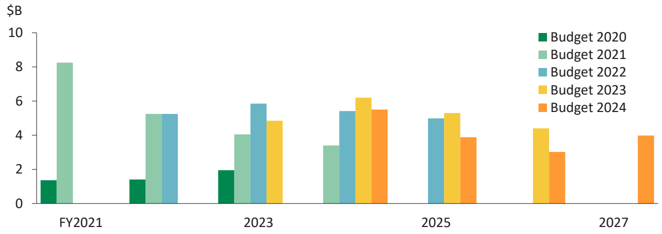
The province's plans continue to contain some upside potential. [Just like in last year's budget] and subsequent updates, contingencies are large (graph 3 on page 2), though they were

Graph 3
Big Fiscal Buffers Remain in BC

Budget balances and contingencies



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reduced relative to Budget 2023 and no longer exceed the forecast deficits. These contingencies can be used to cover revenue shortfalls, absorb unexpected cost pressures, or improve the bottom line going forward. The $5.5B figure allotted to FY2024 includes $2.2B for public sector wage increases beyond the budgeted baseline. This comes as multiple governments contend with the impacts of persistent inflation and labour negotiations on their spending.

Ultimately, BC is facing multiple challenges similar to those of other provinces in the federation, and today, the government chose to increase the size of its footprint as part of efforts to address them. Challenges ahead include the costs of an aging population, and the difficulty of delivering affordable housing and sufficient public services amid surging headcount gains. Moreover, the province must manage the effects of climate change, and the economic outlook is fraught with risks, as discussed in our updated projections released this morning. The good news from today's budget is that BC enters this potentially challenging period with a relatively low public debt burden and some room to manoeuvre.

Spending Increased Again

Spending plans were increased again in BC, though there's somewhat more nuance to the story than the headlines suggest. Relative to the Q1 FY2024 update (the last available set of projections for FY2025 and beyond) program spending plans were lifted by nearly $11B combined during the FY2025 to FY2026 period. Projections for all major spending categories were lifted versus last year's budget, but health outlays are set to see the biggest such increases. That means that BC remains poised to continue to lead the provinces in post-pandemic program spending growth. However, similar to last year, the government expects a flatter spending profile beyond FY2025. And given that strong rates of population growth are expected to continue, that translates into roughly flat per-person operating expenditure levels from FY2025 and FY2027 (graph 4 on page 3). After adjusting for inflation, per-capita operating expenditures are projected to decline beginning in FY2026.

TABLE 1
Updated BC Fiscal Forecasts

	2023–2024		2024–2025		2025-2026		2026-2027
IN $B (UNLESS OTHERWISE INDICATED)	Q2 FY2024	Budget 2024	Q1 FY2024	Budget 2024	Q1 FY2024	Budget 2024	Budget 2024
Total revenues	77.7	77.3	80.7	81.5	81.5	82.8	86.4
% change	*-4.7*	*-5.2*	*3.9*	*5.4*	*1.0*	*2.6*	*4.3*
Own-Source Revenues	64.1	63.3	67.1	67.1	67.8	67.9	71.7
% change	*-7.1*	*-8.3*	*4.7*	*6.0*	*1.1*	*1.3*	*5.6*
Federal Transfers	13.6	14.0	13.7	14.4	13.7	14.9	14.7
Total expense	81.2	83.2	83.4	89.4	85.2	90.6	92.7
% change	*0.5*	*3.0*	*2.7*	*7.4*	*2.1*	*8.7*	*2.3*
Program spending	78.0	79.9	79.5	85.3	80.8	85.8	87.0
% change	*0.1*	*2.6*	*1.9*	*6.7*	*1.7*	*8.0*	*1.4*
Debt charges	3.2	3.3	3.9	4.1	4.4	4.8	5.7
% of total revenues	*4.2*	*4.3*	*4.9*	*5.0*	*5.4*	*5.8*	*6.6*
Forecast allowance	0.7		0.5		0.5		
Budget balance	**-4.2**	**-5.9**	**-3.1**	**-7.9**	**-4.1**	**-7.8**	**-6.3**
% of GDP	*-1.1*	*-1.5*	*-0.8*	*-1.9*	*-1.0*	*-1.8*	*-1.4*
Net Debt, % of GDP	*18.9*	*17.6*	*20.3*	*21.0*	*22.6*	*24.8*	*27.5*
Gross Borrowing Requirements	**19.0**	**20.2**	**21.4**	**24.2**	**21.5**	**29.5**	**28.4**
Capital Requirements	15.8	14.9	16.8	18.8	15.9	19.0	18.7
Refinancing Requirements	3.6	4.4	3.9	3.7	6.1	6.3	6.3
Other Financing Sources	(4.6)	(5.0)	(2.4)	(5.9)	(4.7)	(3.3)	(2.6)

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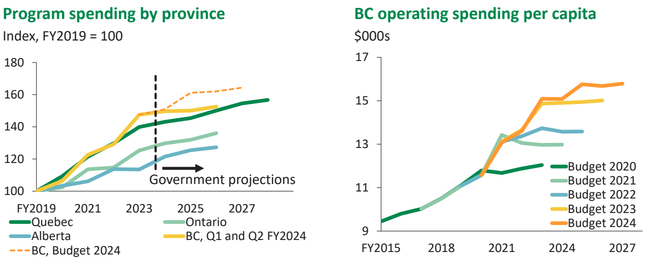
Graph 4
BC's Spending Plans Have Continued to Climb Since the Pandemic



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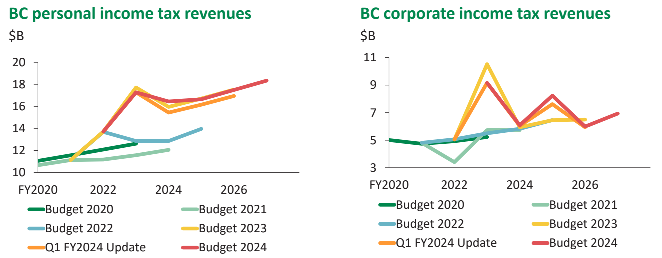
Statistics Canada, provincial budget documents and Desjardins Economic Studies

Graph 5
Personal and Corporate Income Taxes Back on Track



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While limiting the rate of spending growth below that of the population is challenging for any government, the targets imply a greater degree of restraint in BC's expenditure projections than is obvious looking at levels alone. Keep in mind as well that spending projections include more than $16B in contingencies earmarked for FY2024 to FY2027, which may not prove necessary.

New Affordability Measures

Affordability relief had been teased in BC and Budget 2024 did indeed announce new measures. These included the creation of a one-year BC Family Benefit for low- and middle-income families. The province also introduced a one-year electricity rebate and increased the exemption threshold for the Employer Health Tax for small businesses. Given that there's still a risk of re-invigorating inflation, we like the time-limited nature of these measures as well as the focus on lower- and medium-income households and businesses most impacted by sharp rises in prices.

For housing affordability, new measures were incremental. BC introduced a new tax targeting home-flipping activity—intended to discourage short-term speculation—and will expand property transfer tax exemptions for first-time homeowners and newly-built homes.

Tax Revenues Bolstered by Base Adjustments

As implied in BC's mid-year fiscal update, tax revenues are back on track with Budget 2023 projections. This partly reflects prior year adjustments to the tax base from the Canada Revenue Agency, which carried into the outer years of the forecast horizon (graph 5). This is undoubtedly positive for the province's finances, though in all provinces, there remains a risk of downward revisions going forward, as seen in the FY2024 mid-year plans and in Ontario's third quarter update.

Economic and demographic forecasts were largely unchanged versus the prior fiscal update (table 2). The province still expects growth to slow meaningfully this year before picking up quickly

TABLE 2
Updated BC Economic Projections

IN $ MILLIONS (UNLESS INDICATED)	2023	2024	2025	2026
Real GDP Growth (%)				
Q1 FY2024 Update	1.2	0.8	2.4	2.3
Budget 2024	**1.0**	**0.8**	**2.3**	**2.4**
Nominal GDP Growth (%)				
Q1 FY2024 Update	2.9	3.3	4.3	4.2
Budget 2024	**3.2**	**3.3**	**4.4**	**4.5**
Population Growth (%)				
Q1 FY2024 Update	3.2	2.9	1.7	1.7
Budget 2024	**3.0**	**2.8**	**1.9**	**1.6**

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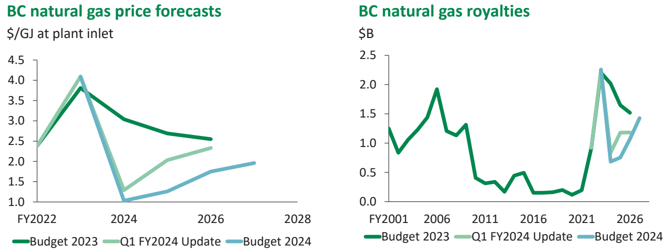
in 2025. Desjardins Economic Studies has a below-consensus outlook when it comes to Canadian economic growth this year, so there's some risk to output and tax revenues to the extent that our forecasts come to fruition.

Population growth forecasts were also largely unchanged, but outer-year average expansion near 2% is still stronger than the average seen over the last 20 years. The slowdown assumes a reduction in international migration, presumably because of much fewer non-permanent resident (NPR) admissions. As we recently showed, higher-than-expected NPR arrivals could stimulate economic growth, but they could also put upward pressure on spending.

Natural Gas Royalties Lowered Again

Natural gas royalty forecasts were further reduced following the Q1 FY2024 update amid a deterioration in the outlook for the commodity. Fortunately, the province had already incorporated very conservative natural gas prices into its fiscal blueprint following the first quarter revenue deterioration (graph 6 on page 4), so the hit to revenues might otherwise have been worse. The province also characteristically based its plan on prices below the private sector average forecast. While the outlook remains

Graph 6
Conservative Natural Gas Price Forecasts Late Last Year Likely Protected Against A Bigger Fiscal Hit



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challenging for the US natural gas sector, the beginning of operations at the LNG Canada terminal in Kitimat should increase access to markets in Asia and provide some respite for Canadian gas pricing over time.

Bigger Deficits, Boost to Capital Spending Increase Borrowing Plans

With larger planned deficits and higher infrastructure spending expected in the next two fiscal years, BC borrowing requirement projections were lifted meaningfully. Labour shortages and other challenges in the construction sector have naturally delayed major project work, but Budget 2024 boosted outer year total capital requirements by more than the amount of the downward revision in FY2024. Infrastructure investments remain focused on public transit and the education and the healthcare sector. Consequently, gross borrowing requirements are now expected to total $24.2B in FY2025, $29.5B in FY2026, and $28.4B in FY2027. Relative to the last outer-year borrowing projections, FY2025 and FY2026 figures represent boosts of $2.7B and $8B, respectively.

Though bigger near-term deficits had been signalled beforehand, BC long bond spreads widened in the immediate aftermath of the budget. Over time, investors should look favourably on BC's low debt load and the significant fiscal buffers that reduce downside risk, though relative performance will also depend on other provinces' forthcoming budgets. That said, contingencies could limit bond market movement if BC outperforms its targets. In the past, we've seen investors shrug off better-than-projected results following past plans with large buffers, as fiscal outperformance had been baked in. In the next few months, all provinces' spreads will continue to be influenced by market risk sentiment.