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More action = larger deficit, as BC eyes partial recovery in 2021

By Warren Lovely

- **Economic outlook:** For planning purposes, British Columbia assumes a 6.2% contraction in real GDP for 2020, giving way to 3.0% real growth in 2021. For both years, growth rates have been set notably and intentionally below the private sector consensus, which is -5.2% for this year and +4.5% for next year. Think of this as one level of prudence incorporated into BC's fiscal framework. Nominal GDP—historically the better proxy for own-source revenues—is due to advance by 3.9% in 2021, partially recovering the 6.0% hit sustained this year. The provincial unemployment rate, which had been holding at less than 5% pre-virus, is expected to average 9.3% in 2020. Job creation, already in evidence, should see the jobless rate ease to 8.1% in 2021 (full-year average). Notwithstanding a generalized improvement in the outlook vs. a Q1 update, the economic environment remains highly uncertain, particularly in light of resurgent virus case counts.
- **Updated 2020-21 fiscal picture:** BC now puts the 2020-21 deficit at $13.6 billion, inclusive of a $1 billion forecast allowance and contingencies in excess of $1 billion. The latest deficit figure represents an $851 million deterioration relative to Q1 and for obvious reasons remains in a different league relative to original Budget 2020 guidance, where a modest surplus had been projected before the full-extent of COVID-19 pandemic was understood. For additional context, note that the NDP re-election platform had signaled a $15 billion deficit for 2020-21, after factoring in new spending promises. In a sense then, today's deficit tally is an improvement vs. the budget balance flagged on the campaign trail. As it stands, British Columbia's deficit is equivalent to 4.7% of GDP, not far from the weighted provincial average for 2020-21 (with Alberta at the high end of the spectrum and New Brunswick currently telegraphing the smallest relative shortfall). Today's mid-year update does not provide guidance on future fiscal years.
- **Revenue outlook:** Total revenue is up $1.4 billion from Q1 estimates, with the improvement traced to a variety of sources. A significant increase in real estate transactions has resulted in extra property transfer tax revenue. Meantime, an improved household income picture has contributed positively to income tax revenue. Net results at provincial Crowns look more buoyant. Importantly, that includes a material improvement at ICBC (the provincial auto insurer), where $410 million in net income in turn reflects lower claims/fewer accidents (presumably the upshot of reduced traffic as more people work from home) and a recovery in investment losses. Additionally, there are extra federal transfers relative to Q1, the latest boost capturing support to safely return students to classrooms (which is fully offset on the spending side). For Canada's provinces, the stabilizing impact of extraordinary federal support shouldn't be overstated. In BC's case, federal transfers are slated to jump >$3.1 billion or fully one-third in 2020-21 compared to the prior fiscal year. The resulting federal transfer share of total revenue goes from 16% in 2019-20 to 22% in 2020-21. As an aside, resource revenue isn't nearly the driver here as it is in some other provincial jurisdictions, comprising just 3.6% of total revenue in 2020-21. All told, while the revenue picture is brighter than in Q1, total revenue still looks to be off 2.1% year-on-year.
- **Expenditure outlook:** Total provincial spending has been set $2.3 billion higher relative to Q1, surging almost 20% year-on-year. The extra outlays vs. Q1 are primarily tied to supplementary enhancements to BC's COVID-19 action plan. There, an extra $2 billion allocation brings the total appropriation for the pandemic response and economic recovery to $7.04 billion (about 2½% of GDP). As noted in the deficit comment, updated expenditure figures include $1.066 billion in untapped contingencies, more than half of which is set aside to cover unforeseen spending pressures and the balance notionally earmarked to support new collective bargaining agreements.
- **Debt burden:** Consistent with the larger deficit tally, British Columbia's preferred debt measure—taxpayer-supported debt—will grow at a faster rate than projected in the Q1 update. Having added $744 million vs. Q1, this debt measure is projected to end 2020-21 at $60.5 billion. The corresponding debt-to-GDP burden is pegged at 20.8%, unchanged from Q1, owing to an economic upgrade (i.e., a larger denominator). Expressed differently, taxpayer-supported debt works out to just under 110% of total revenue, a slight improvement from Q1. As we've heard repeatedly from governments across Canada and abroad, the large deficits left in the virus' wake mean debt burdens have moved up fast, but low interest rates are keeping debt very affordable. In BC's case, the taxpayer-supported interest bite (net of sinking fund interest) works out to just 3.3% of total revenue—an historically low reading and down somewhat from Q1 despite the extra debt.
- **Borrowing requirement:** Accompanying the revised fiscal picture is fresh guidance on long-term funding requirements. BC now estimates its gross borrowing requirement for 2020-21 at $19.4 billion—more than double what Budget 2020 predicted due to the large-scale fiscal re-write. A portion of that gross requirement, $3.7 billion, has been met via internal financing sources and/or increases in short-term borrowing. Meanwhile, the province has been active in debt capital markets, securing $10.6 billion in long-term debt—the vast majority of which (97%) taking the form of Canadian dollar public bond offerings. All this leaves BC with just over $5 billion to fund over the balance of the fiscal year, inclusive of $1 billion forecast allowance that may not be needed. The province has guided that a portion of the remaining financing could be satisfied via the short-term market. At this point, the "strategic target" for remaining long-term issuance is ~$3 billion, an amount that we believe British Columbia could readily secure from either domestic or international markets before the fiscal year is out (i.e., 31-March-2021).
- **Long-term credit ratings (latest rating report/action date in parentheses):**

  S&P: AAA, Negative (14-May-20) | Moody's: Aaa, Stable (15-May-20) | DBRS: AA(high), Stable (21-Apr-20) | Fitch: AAA, Negative (30-Jul-20)

Conclusion

This is the first fiscal update for new Finance Minister Selina Robinson, who was named to post following a recent provincial general election. BC's public finances still show all the tell-tale signs of what has been a tumultuous year: own-source revenue declines (even if the outlook is somewhat better vs. Q1); extraordinary spending levels as the government rushed out extensive stimulus to help the vulnerable and support the provincial economy; a dramatic recasting of the budget balance, from a modest surplus in an early year budget to a $13.6 billion shortfall equivalent to 4.7% of GDP; a notable increase in the debt burden and extra borrowing. Saying all that, British Columbia arguably entered the pandemic from a position of absolute and relative economic and fiscal strength. In other words, there's greater scope to absorb an economic and fiscal shock here than in some other provincial jurisdictions. While having jumped higher, the provincial debt burden remains more modest by provincial standards (although credit rating agencies consider all provinces to be more heavily indebted than many international peers). Moreover, as should come as no surprise, debt remains highly affordable, with domestic and international bond holders continuing to express confidence in the BC name, as evidenced by relatively tight credit spreads (vs. GoC and credit market peers). The province's residual funding needs look imminently manageable to us, given demonstrated access to debt capital markets and still-elevated levels of liquidity in global financial markets. While the health and economic situation remains highly uncertain, BC has maintained its practice of incorporating meaningful prudence. We look to Budget 2021 for direction in terms of the fiscal recovery path this province aims to walk, including potential guidance on longer-term priorities and preferred fiscal anchors.

($ millions)	*Budget 2020*	*First Quarterly Report*	*Fall 2020 Update*
Revenue	60,585	56,013	57,424
Expense	(60,058)	(67,805)	(70,067)
Forecast allowance	(300)	(1,000)	(1,000)
Surplus (deficit)	**227**	**(12,792)**	**(13,643)**
Capital Spending:			
Taxpayer-supported capital spending	7,126	7,015	6,781
Self-supported capital spending	3,409	3,372	3,365
Total capital spending	**10,535**	**10,387**	**10,146**
Provincial Debt:			
Taxpayer-supported debt	49,202	59,802	60,546
Self-supported debt	26,890	27,068	27,080
Total debt (including forecast allowance)	**76,392**	**87,870**	**88,626**
Taxpayer-supported debt to GDP ratio	**15.5%**	**20.8%**	**20.8%**
Taxpayer-supported debt to revenue ratio	**84.1%**	**110.6%**	**109.7%**

Economics and Strategy

Montreal Office
514-879-2529

Stéfane Marion
Chief Economist and Strategist
stefane.marion@nbc.ca

Matthieu Arseneau
Deputy Chief Economist
matthieu.arseneau@nbc.ca

Paul-André Pinsonnault
Senior Economist
paulandre.pinsonnault@nbc.ca

Marc Pinsonneault
Senior Economist
marc.pinsonneault@nbc.ca

Angelo Katsoras
Geopolitical Analyst
angelo.katsoras@nbc.ca

Kyle Dahms
Economist
kyle.dahms@nbc.ca

Jocelyn Paquet
Economist
jocelyn.paquet@nbc.ca

Alexandra Ducharme
Intern Economist
alexandra.ducharme@bnc.ca

Toronto Office
416-869-8598

Warren Lovely
Chief Rate Strategist, Economics and Strategy
warren.lovely@nbc.ca

Taylor Schleich
Associate, Rates Strategist, Economics and Strategy
taylor.Schleich@nbc.ca

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