

NOVA SCOTIA BUDGET 2013

April 4, 2013

Back in the black

The Nova Scotia government maintained its commitment to return to fiscal balance in its 2013 budget yesterday, with a small projected surplus of \$16.4 million for 2013/14. A stronger revenue profile coupled with modest expenditure growth – thanks to an outright pullback in the upcoming year – is projected to yield a series of small consecutive budget surpluses through to 2016/17. This would come after a challenging year for the province during which it registered (as least according to the latest estimates released yesterday) its largest estimated budget deficit (\$356 million) in 13 years in fiscal year 2012/13 as a weaker than expected economy pulled revenues and expenditures in the wrong directions. None the less, the government is confident that a rebound in household spending and incomes will generate stronger revenues in 2013/14 and beyond. With a provincial election expected later this year, the impetus to deliver on the current government’s long-held plan to achieve a return to surplus within its mandate was quite clear.

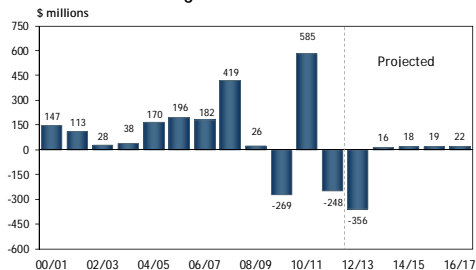
Largest budget deficit in 2012/13 since 1999/2000

Fiscal 2012/13 marked a year of growing uncertainty in the province’s fiscal outlook. From an initial \$211 million projected in Budget 2012, the 2012/13 budget deficit estimate increased with each quarterly fiscal update – climbing to \$249 million in September and to \$277 million in December – and was revised higher once again yesterday to \$356 million, a near 70% increase (or \$145 million) from the original projection a year ago. \$89 million of this deterioration can be attributed to revenues coming in 1% lower than expected, falling to \$8.8 billion. A 3.7% downward revision to Federal source revenues to \$3.1 billion more than offset a modest upward revision (0.6% to \$5.7 billion) to the province’s own-source revenues. Federal source cost-shared revenues from Tangible Capital Assets are now estimated at \$26.2 million compared to an initial estimate of \$73.2 million due to a deferral of \$36.6 million contribution for the Nova Centre to 2015/16. Offshore resource royalty revenues plunged 18% to \$22.7 million on account of low natural gas prices and production declines at Sable Offshore Energy Project. On the expenditure side, an upward revision of \$44.2 million (or 0.5%) in total expenses further contributed to the province’s budget balance deterioration in 2012/13. Despite a 0.6% decline in Departmental Expenses (accounting for 88% of total expenses), sizeable increases in Refundable Tax Credits (68% to \$123.5 million) and Pension Valuation Adjustment (46% to \$104.1 million) boosted total expenditures.

Stronger revenues to support a return to surplus in 2013/14

For the coming year, the Nova Scotia government expects renewed strength in personal incomes to lay the foundation for total revenues to rise 3.4% in 2013/14 to \$9.1 billion, as tax revenues are slated to rise 5.5% to \$5.1 billion. The government is counting on a rebound in salaries and wages from a slowdown in 2012 and continued growth in pension income to contribute to a 6.8% increase in Personal Income Tax revenues to \$2.3 billion. This improvement is forecasted to support a 3.8% rise in consumer expenditure in the province and, in turn, boost Harmonized Sales Tax revenues by 3.8% to \$1.7 billion. Corporate income taxes are slated to rise 8.4% to \$474 million despite another 0.5 percentage point reduction in the small business tax rate to 3%, effective January 1, 2014. A reduction in the threshold for eligible taxable small business income to \$350k from \$400k provides a revenue offset to the tax initiative. Tax revenues are expected to get an additional boost from an 8.3% rise in tobacco tax revenues to \$228 million as a \$0.02 per cigarette charge comes into effect April 5, 2013. Strictly on account of these gains in tax revenues, provincial own-source revenues are slated to rise 3.8% to \$5.9 bil-

Nova Scotia budget balance



Source: Nova Scotia Ministry of Finance, RBC Economics Research

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lion. On account of lower offshore royalty revenues (which are included in the equalization calculations), the federal equalization payment is estimated to rise 7.9% leading overall federal source revenues to increase 2.7% to \$3.2 billion.

Few revenue boosting surprises

As announced previously in Budget 2012, the government confirmed its commitment to reverse the two-percentage point increase in its portion of the Harmonized Sales Tax that was introduced in 2010. Under the condition of returning to a balance surplus in 2013/14, the current 15% combined rate will be reduced by one percentage point in 2014 and a further one percentage point by July 1, 2015. The foregone \$390 million in estimated HST revenues as a result are projected to be partially offset by growth in the HST tax base. A tax initiative that remains, however, is the fifth income tax bracket for high income earners (those earning more than \$150k per year). Introduced in 2010 as a temporary revenue initiative, this tax bracket is projected to contribute \$80.3 million to tax revenues in 2013/14.

Expenses set to decline in 2013/14

Budget 2013 holds the line on expenditure growth in 2013/14. Total expenditures are slated to fall 0.85% to \$9.5 billion. A 1.0% drop in Departmental Expenses (to \$8.4 billion) coupled with a 0.9% fall in Debt Servicing Costs (to \$889 million) are the main factors contributing to the overall decline. Increases to Refundable Tax Credits and Pension Valuation Adjustments provide a partial offset, collectively rising by 5.5%. A 4.7% increase (to \$129 million) in Refundable Tax Credits builds upon a significant increase in 2012/13 and is the result of these credits being reported going forward as expenditures, whereas previously they were netted against income tax revenues. The Pensions Valuation Adjustment accounts for the net cost of converting the government's benefit plan obligations to the accrual basis of accounting at the departmental level, and is expected to rise 6.5% to \$111 million. Composing 47% of departmental expenses, Health and Wellness is expected to rise 1.3% following annual increases of 7% from 2001-2010. Expenses related to Education and Early Childhood Development are projected to fall 1.2% in 2013/14, accounting for 13% of total departmental expenses.

Medium-term plan projects small surpluses

Including 2013/14, General Revenue Fund revenues (excluding net income from government business entities) are slated to rise on average by 2.3% annually through the forecast horizon. This is a stronger profile compared to Budget 2012 where annual revenues were projected to grow on average by 1.8%. Revenues will grow faster than total expenses, which are forecasted to average 1.2% annually through to 2016/17. Beyond 2013/14, total revenue growth follows a similar growth trajectory to that of total expenses resulting in only small year over year changes in the budget balance. The government projects a budget surplus will be sustained over the next four years with projected balances of \$18.3 million in 2014/15, \$19.4 million in 2015/16 and \$21.9 million in 2016/17.

Budget assumes modest pick-up in economic growth

After a challenging year for the natural gas and forestry industries in 2012, the government downwardly revised its real GDP growth forecast to 1.2% for 2012 (was 1.6% in December). The budget assumes a slight acceleration in 2013 to 1.3% growth (was 1.8%) on account of a modest strengthening in exports and an anticipated mid-year start up of production at Deep Panuke. Last year's real GDP growth estimate compares closely to RBC's estimate of 1.1%; however, the government's projection for 2013 is modestly weaker than our forecast of 1.9%. Over the forecast horizon, the growth assumptions are quite conservative with growth forecasted at 1.5% in 2014, rising to 2.2% in 2015 when construction is expected to begin on the multi billion-dollar federal shipbuilding contract. The provincial government expects shipbuilding work and other major project investments to have little immediate impact on the economy however as they are considered to be "medium-term growth drivers". By 2016, growth is expected to slow considerably to 0.8% rising to 1.7% in 2017, what could be considered to be medium term. That being said, these forecasts do not incorporate offshore energy exploration activities, including those by both Shell and British Petroleum, that have the potential to provide upside risk to the projections.

Capital spending

In the Fall 2012 release of its Jobs and Building plan, the province outlined its capital spending intentions for the upcoming fiscal year. Capital spending is projected to decline in 2013/14 to \$525 million after spending related to the Bowater purchase boosted spending in 2012/13 to above \$700 million (initial estimate was for \$610 million). Spending on highways and structures is expected to come in at \$246 million (47% of capital spending) as the province enters the third year of its 5-year Highway Improvement Plan. This represents a 35% decline from the year prior. At 29% of capital spending, building and land investments are estimated to decline to \$152 million in 2013/14 from \$158 million in 2012/13. The province plans to allocate \$84 million for the construction of six new schools as well as additions and alterations to twenty-six others throughout the province.

Net debt

Despite the return to a series of consecutive budget surpluses, the acquisition of tangible capital assets is projected to drive net debt in the province higher over the medium term. For the fiscal year ending March 31, 2013, the \$377 million deficit for 2012/13 is expected to contribute to a provincial net debt of \$13.9 billion with a net debt-to-GDP ratio of 36.3%. At the same date next year, net debt is projected to come in at \$14.0 billion, rising to \$14.4 billion by 2016/17. The net debt to GDP ratio, however, is projected to decline to 35.8% by March 31, 2014, falling further to 33.4% by 2017, supported by a forecasted strengthening in nominal GDP growth.

Nova Scotia's fiscal plan

\$ millions	Actual	Estimate	Forecast	Projection	Projection	Projection	Projection
	2011-12	2012-13	2012-13	2013-14	2014-15	2015-16	2016-17
Revenue	8,941	8,919	8,830	9,131	9,279	9,460	9,666
Expense	9,182	9,561	9,606	9,524	9,677	9,863	10,072
Program spending	8,342	8,680	8,709	8,635	8,767	8,946	9,156
Interest on public debt	840	882	897	889	910	917	916
Consolidation adjustments		80	69	59	59	59	59
Government Business							
Enterprises	370	351	350	350	357	363	368
Surplus/ (deficit)	-248	-211	-356	16	18	19	22

Source: Nova Scotia Ministry of Finance, RBC Economics Research

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