

NOVA SCOTIA BUDGET 2014

April 4, 2014

Charting a new (deficits) course...

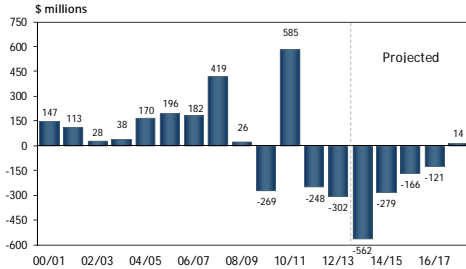
The first budget of the recently elected Nova Scotia government, released yesterday, saw the fiscal trajectory of the province diverge from the plan laid out by the previous government one year ago. A return to surplus is no longer expected in the short term (in fact, it did not occur last year as intended) as the government charted a new course that will see the province weather four more years of budget deficits before edging out a small surplus of \$13.6 million in 2017/18. This marks a sharp turn from last year's budget that projected four years of surpluses, albeit small, including a return to positive fiscal footing in 2013/14. In total, the new plan cumulates \$1.1 billion in deficits through to 2016/17 compared to \$75 million in surpluses in the Budget 2013 plan. This deterioration reflects a significantly lower starting point for the path of budget balances with the 2013/14 bottom line estimated to come in a whopping \$579 million below the initial forecast of a \$16.4 million surplus, now expected to be a deficit of \$562.1 million. The government projects stronger revenues to temper expenditure increases going forward, thereby reducing the budget deficit to \$279 million in 2014/15 and strengthen further through the remainder of the fiscal plan.

The eye-watering shortfall in the 2013/14 fiscal year was revealed in the government's December forecast update. At the time, the government showed a downwardly revised budget estimate of -\$481.7 million for 2013/14, nearly \$500 million below the initial budget projection. A significant portion of the revision was attributable to an accounting change related to the Pension Valuation Adjustment. Last April, the government transferred its interests in the province's Public Service Superannuation Plan to a joint trustee and the previous budget amortized the cost of this change over a period of several years. Under the recommendation of the province's Auditor General in a report released in November, the government adjusted the accounting treatment and instead recorded a one-time charge of \$318.3 million in 2013/14. Other valuation changes provided a partial offset to result in a net Pension Valuation Adjustment of \$280.3 million, which was recorded as an expense. Weaker-than-expected revenues also contributed to the larger shortfall (led by an adjustment to prior years' revenues) while expenditures were revised higher than the initial estimate. As a result, the 2013/14 deficit represents the largest budget shortfall for the province since 1999/2000.

Revenues to rebound in 2014/15

For 2014/15, total revenues (including the net income of government business enterprises, or GBE) are projected to bounce back after remaining relatively flat in 2013/14. A 3.7% rise to \$9.6 billion for total revenues entirely reflects a 4.7% jump in Ordinary Revenues while Ordinary Recoveries and net income from GBE are slated to fall by 7.3% and 1.2%, respectively. The Nova Scotia government expects stronger growth in salaries and wages in the province to lay the foundation for personal income tax revenues to jump 7% (to \$2.3 billion) and in turn, improving consumer expenditures are set to support HST revenues rising by 2.5% (to \$1.7 billion). The latter will also be supported by the government delaying the reduction in the HST rate by 1pp initially expected in July 1, 2014 (as the previous government committed to do under the Financial Measures Act in 2012) and instead will consider reducing the rate when "sustainable fiscal balances are achieved". In the absence of prior years' adjustments, which amounted to \$149 million in 2013/14, other provincial revenues are set to rebound by a solid 66% in 2014/15. Collec-

Nova Scotia budget balance



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tively, total provincial source revenues are projected to rise 6.7% to reach \$5.7 billion. On account of lower levels of offshore royalty revenues being included in the equalization calculations, the federal equalization payment is estimated to increase 2.3% leading overall federal source ordinary revenues to edge up by 1.2% to \$3.0 billion.

New tax initiatives on hold

Despite a fiscal plan that will see the province mark seven consecutive years in the red, the growth profile for revenues is expected to be stronger throughout the projection period. Revenues are slated to rise by 3.3% annually, on average, through to 2016/17 compared to the 1.9% planned in Budget 2013. The extension of the fiscal plan to 2017/18 sees revenues rising by 3.3% that year to reach \$10.5 billion with ordinary revenues expected to compose 92% of total revenues. With the government planning a Comprehensive Tax Review to examine taxes, fees and the regulatory burden on the private sector, no new tax initiatives were presented in Budget 2014 and Finance Minister Diana Whalen highlighted that lower taxes in the short-term are “not realistic”. The government did confirm a previous announcement that it will make the provincial portion of student loans interest-free to support graduates “building a life here in Nova Scotia”. Facing demographic challenges related to a declining working-age population and a net loss of Nova Scotians to other provinces, the government will absorb the \$1.6 million annual cost as well as an additional \$14 million charge to cover the costs back to 2008 (because the change will apply retroactively).

Expenditure growth to slow in 2014/15

Budget 2014 sets a slower course for expenditure growth over the forecast horizon relative to the previous path laid out in last year’s budget. Total expenditures are slated to rise by 1.1% to \$9.9 billion in 2014/15 following a 3.3% jump in 2013/14. A 4.6% jump in Departmental Expenses (to \$8.9 billion) coupled with a 2.5% rise in Debt Servicing Costs (to \$878 million) are the main factors contributing to the overall increase. The Pension Valuation Adjustment (PVA) will decline significantly in 2014/15 as a result of the one-time charge in 2013/14 (falling 77% to \$90.5 million) and provide a partial offset to the other rising expenses. Excluding Pension Valuation Adjustment, total expenditures would rise by a stronger 4.1% this year. Going forward, the new PVA accounting framework will result in lower annual expenses for the Nova Scotia government. Health and Wellness is slated to cross the \$4 billion mark for the first time in 2014/15 with a 4.9% spending hike bringing the total to \$4.1 billion. A number of initiatives are also expected to propel spending in Education and Early Childhood Development by 9.8% to reach \$1.2 billion. Together, these two components account for 60% of departmental expenses.

Through to 2016/17, expenditures are expected to grow 1.7% annually compared to 1.9% in the previous budget; however, spending is set to reach close to \$10.5 billion in 2016/17 compared to the previous estimate of \$10.1 billion laid out in Budget 2013. Beyond 2014/15, department expenses are set to rise 2% annually on average contributing to total expenditures climbing 1.9%, 2.2% and 2% in each of the outer years of the plan, respectively, to reach \$10.6 billion by 2017/18.

Deficits planned for the medium-term

The higher starting point for expenses and lower starting point for revenues in 2013/14 will cause the budgetary gap to take longer to close despite revenue gains projected to outpace growth in spending throughout the fiscal plan. Beyond the \$279 shortfall in 2014/15, the fiscal plan shows projected deficits of \$166 million in 2015/16 and \$121.4 million in 2016/17 before returning to a surplus, albeit small, of \$13.6 million in 2017/18.

Capital spending

In the December 2013 release of its Capital Plan, the province outlined its capital spending intentions for the upcoming fiscal year. Capital spending is projected to rise to \$535 million in 2014/15 after spending fell sharply in 2013/14 to \$511.6 (following the purchase of Bowater paper mill that saw spending jump in 2012/13). Spending on highways and structures is expected to come in at \$240.8 million (47% of capital spending) with \$235 million allocated for the 5-year Highway Improvement Plan. At 25% of capital spending, building and land investments are estimated to decline to \$135 million in 2014/15 from \$170 million in 2013/14. The province plans to allocate \$81.5 million for the construction of ten new schools as well as support upgrades to eighteen others throughout the province.

Net debt

For the fiscal year ending March 31, 2014, the provincial net debt is estimated to rise to \$14.6 billion from \$14.0 billion one year earlier, reflecting the \$562 million deficit for 2013/14. At the same date in 2015, net debt is projected to increase to \$15.0 billion and climb further through the fiscal plan to reach \$15.7 billion by 2017/18. Nominal GDP growth is forecasted to outpace the rise in net debt through the projection period resulting in the ratio declining from a peak of 37.5% in 2014/15 to 34.2% by 2017/18.

Borrowing requirements

The borrowing requirements of the province in 2014/15 are expected to total \$770.3 million with the budgetary deficit largely contributing to \$359 million required for cash operations. The requirements are set to rise in 2015/16 and 2016/17 to \$1.0 billion and \$1.1 billion, respectively, with nearly all of the funds allocated for debt retirement. In the final year of the plan, borrowing is set to fall to \$415 million.

Major projects supporting the economic outlook

The persistence of challenging economic conditions in Nova Scotia resulted in the government downwardly revising its real GDP growth forecast to 1.4% for 2014 (was 2.0% in December). The budget assumes a modest acceleration in 2015 to 2.1% growth on account of export-oriented sectors strengthening and helping to offset weak performance on the domestic side of the economy. The real GDP growth estimate in 2015 compares closely to RBC's forecast of 2.2% as major projects, including the cutting of steel for the multi-billion dollar federal shipbuilding contract, are expected to spur an overall improvement in growth. The government's projection for 2014 is modestly weaker than our forecast of 2.0%, however. The government noted that domestic forecasts risks have "proven to be the greater source of downward revision" to the economic outlook and the improving outlook largely reflects the ramping up of major projects in the province. While downside risks exist, specifically related to the timing and scale of major projects in the province, the government's economic outlook is conservative and does not take into account the potential lift to growth from projects that are currently at the development stage.

Nova Scotia's fiscal plan

\$ millions	Actual	Estimate	Forecast	Projection	Projection	Projection	Projection
	2012-13	2013-14	2013-14	2014-15	2015-16	2016-17	2017-18
General Revenue Fund	9,232	9,481	9,222	9,566	9,889	10,153	10,493
Revenue	8,880	9,131	8,878	9,226	9,550	9,816	10,160
Government Business Enterprises	352	350	344	340	339	337	333
Expense	9,583	9,524	9,825	9,936	10,129	10,349	10,553
Program spending	8,686	8,635	8,969	9,058	9,239	9,437	9,635
Interest on public debt	897	889	856	878	891	912	919
Consolidation adjustments	48	59	41	91	74	74	74
Surplus/ (deficit)	-302	16	-562	-279	-166	-121	14

Source: Nova Scotia Ministry of Finance, RBC Economics Research

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