NOVA SCOTIA BUDGET 2017

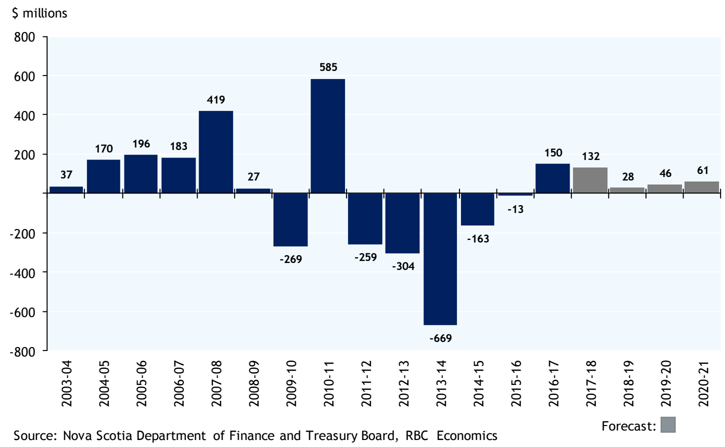
September 27, 2017

A second surplus and a sustainable fiscal future

Overview

Nova Scotia's election last May returned the Liberal Party to power and in the first budget of their new mandate the government is signalling they intend to stay the course set in previous years. Budget 2017 builds on the budget announced in April by introducing a number of new spending measures and tax cuts. However these new measures are relatively modest and the budget maintains Nova Scotia's hard-won budget surplus for a second year and through their forecast horizon. While the forecasted surpluses are slim and risks to the outlook remain, our view is that the risks are tilted to the upside given the prudent assessment of the economy built into the government's estimates.

Nova Scotia Budget Balance



Source: Nova Scotia Department of Finance and Treasury Board, RBC Economics

Fiscal balance

After a large $150 million surplus last year, Budget 2017 anticipates a net surplus of $132 million this year and a fiscal balance narrowly in the black through 2021. This year's surplus is inflated by a one-time $110-million bump from federal and municipal contributions for the new convention center in Halifax. Looking ahead, the Province expects to maintain their surplus position as they match modest increases in spending and tax cuts with rising revenues from a growing economy.

Revenues to grow despite tax cuts

Budget 2017 includes a number of measures to ease the burden of taxation on Nova Scotians and businesses. In terms of budgetary impact, the largest measure is an increase in the basic personal amount by up to $3,000 for individuals with incomes below $75,000. The proposal will absolve 63,000 Nova Scotians from having to pay provincial income taxes and constitutes a significant tax cut at the bottom end of the income distribution. Small businesses will also get some relief as the threshold for the small business tax rate is raised from $350,000 to $500,000. In all, the budget's tax measures will deprive the government of $100 million in annual revenue. Despite these measures, economic growth, an increase in recoveries, and one-time transfers are expected to deliver 3.6% revenue growth this year giving the Province the wherewithal to introduce a number of targeted spending measures.

Table 1: Economic Assumptions

Year-over-year % change	Forecast	
	2017	2018
2017 Budget		
Real GDP growth	1.1	0.5
CPI	1.5	2.0
Nominal GDP growth	3.2	2.4
Unemployment Rate*	8.0	8.4
Employment growth	0.5	-0.3
RBC Economics		
Real GDP growth	1.3	1.1
CPI	0.9	1.8
Nominal GDP growth	3.3	3.2
Unemployment Rate*	8.2	7.8
Employment growth	0.7	0.3

*Average level

Source: RBC Economics, Nova Scotia Department of Finance and Treasury Board

New expenditures focus on health, jobs and education

In her budget speech, Finance Minister Karen Casey named health care, jobs, and support for young people and communities as key priorities for the government. Budget 2017 reflects those priorities by increasing spending on health care (+3%), business (+49%), and education and early childhood development (+10%). Compared with 2016-17, new health-related measures total $47 million in new spending and include improved Pharmacare access, hiring additional health care workers, and funds for more orthopaedic surgeries and mental health services. For the economy and young people, the government plans to expand programs to retain university graduates, bolster pre-primary education and ensure high-speed internet access to rural areas. In all, Budget 2017 anticipates departmental expenses to rise by 4.3% this year.

The budget's focus on health care reflects the salience of the subject in this year's election. The government was criticized for insufficiently addressing a perceived

Gerard Walsh
Economist | 416-974-6525 | Gerard.walsh@rbc.com

shortage of family doctors and long wait times for procedures. To address these concerns Budget 2017 includes only an incremental $6 million in health funding above that proposed in April. Adequate funding for health care is likely to remain a challenge for the province going forward. Late last year Nova Scotia reached a deal with the federal government on an increase in the Canada Health Transfer of 3% per year, or the average rate of growth in nominal GDP, whichever is higher. This base amount is then adjusted for the province's changing share of Canada's population. This means that Nova Scotia's slipping share of the national population will lower the growth rate of the transfer to 2.4%, less than half the pace in recent years. A slower growing Canada Health Transfer presents a long-term challenge for a province facing a rapidly ageing population and its attendant rise in demand for health care.

The Capital Plan

Despite the government's intention to run surpluses through 2020-21, the province's burden of debt is expected to rise modestly over time largely thanks to infrastructure spending. Budget 2017 includes capital investments throughout the province with many leveraging municipal and federal funding. The 2017-18 capital budget totals $684 million, a 6% increase over last year. Key projects include ongoing spending on the Halifax Convention Centre, the twinning of highways, and building and renovating schools and hospitals.

Borrowing and Net Debt

Because of an increased capital budget, Nova Scotia's net debt will edge higher through the forecast horizon peaking in 2020-21 at $15.5 billion despite balanced operating budgets. However, a growing economy will push debt-to-GDP lower through the forecast horizon from 36.3% today to 33.4% in 2021. Nova Scotia's relatively low and falling debt burden puts the province on track to achieve the 30% debt-to-GDP target set by the *One Nova Scotia Commission* by 2024 and is a far cry from a decade ago when Nova Scotia had among the highest debt burdens in the country as a share of GDP.

Table 2: Projected Borrowing Requirements (millions of dollars)

	Actual	Estimate			
	2016-17	2017-18	2018-19	2019-20	2020-21
Cash Operating Requirements	-244	97	161	131	3
Cash Debt Retirements	997	460	1,259	2,071	1,079
Net Mandatory Sinking Fund Req	107	111	-89	-764	68
Net Discretionary Fund Requirements	10	16	20	23	25
Short-term borrowing (inc)/dec	-120				
Total Term Debt Requirements	**750**	**684**	**1,351**	**1,461**	**1,174**
Net Financial Market Debt	12,461	12,523	12,684	12,815	12,818

Source: Nova Scotia Department of Finance and Treasury Board

To fund borrowing for new capital spending and the maturing of debt, the province intends to borrow $684 million in 2017-18 followed by $1.4 billion in 2018-19.

Commentary

In its second consecutive balanced budget and its first since re-election, the government of Nova Scotia has eschewed major new spending programs in favour of fiscal probity. A spate of modest surpluses along with an increased capital budget to leverage federal spending may increase the burden of debt modestly in the coming years, but it will help spur economic growth and cause the debt burden as a share of the economy to decline. As the finance minister noted in her budget address, fiscal sustainability is a top goal for Nova Scotia's government and in our view fiscal prudence in the near term is crucial. Canada's economy is currently operating near its potential and provincial governments are taking the opportunity to replenish their fiscal capacity while times remain good. Beyond cyclical considerations, Nova Scotia's ageing population will mean steadily fewer taxpayers going forward with negative implications for the province's fiscal balance. Whereas the ratio of working-age to retirement-age Nova Scotians is currently 3.3 to 1 it is projected to decline to 2.1 to 1 by 2030. Given this outlook, we welcome the government's prudent fiscal plans and hope they are continued going forward.

Table 3: Budget Summary (millions of dollars)

	Actual	Estimate			
	2016-17	2017-18	2018-19	2019-20	2020-21
Total Revenue	**10,208**	**10,574**	**10,525**	**10,669**	**10,982**
Departmental and Other Expenses	9,262	9,662	9,668	9,813	10,150
Public Debt Charges	824	850	873	845	786
Total Expenses	**10,086**	**10,512**	**10,540**	**10,658**	**10,937**
Accounting Adjustments	28	70	43	35	15
One-time adjustments		-110			
Net Budgetary Balance (after adjustments)	**150**	**21**	**28**	**46**	**61**
Net Debt - Opening Balance	**15,076**	**14,955**	**15,060**	**15,178**	**15,268**
Add (deduct):					
Deficit (surplus)	(150)	(132)	(28)	(46)	(61)
Δ net book value of capital assets	30	237	146	136	277
Other	(2)				
Change in net debt	**-121**	**105**	**118**	**90**	**217**
Net Debt	14,955	15,060	15,178	15,268	15,485
Nominal GDP	41,157	42,456	43,488	44,829	46,359
Net debt to GDP Ratio	36.3%	35.5%	34.9%	34.1%	33.4%

Source: Nova Scotia Department of Finance and Treasury Board