Provincial Budget Briefs

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NOVA SCOTIA BUDGET 2018

Nova Scotia continues to project budget surpluses and a declining debt-to-GDP ratio; reaffirming their goal of reducing that ratio to or below 30% by 2024. While the surplus estimated for the outgoing 2017/18 was boosted by the one-time recognition of federal and municipal contributions to the Halifax Convention Centre, that $110mn has been set aside for future health care facility needs. Additionally, the one-time proceeds from offshore royalties, announced last week and giving the Province an additional $245mn in spending power, has been put to use on one-time key initiatives, most notably the $120mn set aside for improved internet connectivity across rural parts of the Province. Heavier maturities see borrowing requirements increase in 2018/19, despite a lower net financial requirement from operations and capital spending. The net change in financial market debt will, however, drop from $225mn in 2017/18 to $168mn.

Table 1

$Millions	2016/17 Actual	2017/18 Sep '17 Bud	2017/18 18 Budget	Change	2018/19 18 Bud	2019/20 18 Bud	2020/21 18 Bud	2021/22 18 Bud
Revenue	**10,208**	**10,574**	**10,741**	**167**	**10,810**	**10,859**	**11,270**	**11,614**
% change	*2.8*	*3.6*	*5.2*	*1.6*	*0.6*	*0.4*	*3.8*	*3.1*
Own Source	6,457	6,649	6,798	149	6,854			
% change	*3.4*	*3.0*	*5.3*	*2.3*	*0.8*			
Federal Transfers	3,357	3,546	3,555	9	3,574			
Net Income: Govt Business Enterprises	395	379	388	9	381			
Expenditures	**10,086**	**10,512**	**10,676**	**163**	**10,863**	**10,849**	**11,237**	**11,561**
Program Spending	9,245	9,631	9,774	143	9,840	9,935	10,378	10,728
% change	*3.3*	*4.2*	*5.7*	*1.5*	*0.7*	*1.0*	*4.5*	*3.4*
Public Debt Charges	824	850	838	-12	894	864	807	776
Pension Valuation Adjustment	17	31	64	33	129	49	52	57
Consolidation Adjustments	28	70	68	-2	82	29	29	22
Budgetary Balance	**150**	**132**	**134**	**2**	**29**	**39**	**61**	**75**
Contribution to Fiscal Capacity For Provincial Health Complex		110	110					
Budgetary Balance (After Contribution)	**150**	**21**	**23**	**2**	**29**	**39**	**61**	**75**

Economic Growth: Modest But Improved

While Nova Scotia continues to face headwinds from a slow growing and ageing population, GDP growth has picked up slightly and more of that improvement is now expected to flow through into later years. Real GDP growth of 1.4% for 2017 (3.3% nominal) is three-ticks better than forecast at the time of the September budget, and the deceleration to 1.0% in 2018 (nominal 2.9%) is less pronounced by about a half percent.

Unlike prior years where economic growth was largely driven by improvements in labour productivity, the economy was also helped by increases in the labour force and employment during 2017. That improvement in population and employment growth, driven by better immigration trends, is expected to continue this year, but wane somewhat in 2019. As such, real GDP growth is expected to decelerate a little further next year, although the 2.9% projected for nominal GDP matches 2018's pace.

More Budget Surpluses Expected

The current projection for 2017/18's balance is very similar to that estimated at the time of September's post-election budget. The $134mn surplus is $2mn higher than expected at that time (although lower than the $139.2mn in the December fiscal update). The surplus is bolstered by the recognition of federal and municipal contributions to the Halifax Convention Centre as a one-time Tangible Capital Asset (TCA). Because this won't re-occur in 2018/19, the $110.3mn in revenue will be used to create fiscal capacity for the future QEII Health Services Redevelopment. After adjusting for that payment, the budget surplus for 2017/18 is slated at $23mn.

Table 2	Key Assumptions		
Y/Y % Chg	**2017**	**2018**	**2019**
Economic Assumptions			
Real GDP	1.4	1.0	0.8
Private Sector Average	*1.4*	*1.1*	*0.9*
Nominal GDP	3.3	2.9	2.9
Employment (thous)	449.0	449.3	449.6
Unemployment Rate (%)	8.4	8.5	8.3
Compensation of Employees	2.4	2.6	1.6
Retail Sales	5.3	2.5	1.7
Corporate Profits	5.1	3.4	3.7
Exports of Goods & Services	3.9	4.3	3.3
CPI	1.1	1.7	2.0
Financial Assumptions			
Exchange Rate (US¢/C$)		78.9	79.4
Crude Oil (US$/bbl)		53.6	56.8

Both revenue and spending growth look higher in 2017/18 than was budgeted for, but that relates to last week's announcement of extra offshore royalty revenue and related spending on key initiatives, both of which are expected to be non-recurring. Recalculated offshore royalty revenue dating back to 1999 gave the Province an additional windfall of almost $245mn. That will be put to use on key initiatives, most notably $120mn put aside for a to-be-created Nova Scotia Internet Funding Trust to expand rural high-speed internet.

The coming years are expected to see further modest surpluses, rising from $29mn in 2018/19 to $75mn in 2021/22. Program spending is allowed to accelerate a little, particularly in 2020/21. The Province's recent improved fiscal position is expected to be reflected in lower gross debt-service costs over the forecast horizon, which fall from $894mn in 2018/19 to $776mn in 2021/22.

Enhancements of tax credits such as the Basic Personal Amount, effective January 1, 2018, are expected to cost $85mn in the 2018/19 fiscal year, while the cannabis tax is expected to bring in $10.4mn. With the sale of recreational cannabis also subject to HST, another $10.4mn in revenue is expected to be generated through that channel.

Nova Scotia's Borrowing Requirements Increase on Larger Maturities

Nova Scotia's borrowing requirements will increase significantly in 2018/19 due to larger debt maturities, whereas its net financial requirements from operations and capital spending are falling. The 2018/19 Capital Plan totals $605mn across a wide-range of projects for education, health care, roads and other infrastructure, as well as technology.

Planned borrowings will grow from $813mn in 2017/18 to $1.363bn in 2018/19 (no change in short-term paper and cash). However, the net change in financial market debt will actually drop from $225mn in 2017/18 to $168mn in 2018/19. Nova Scotia's Budget indicates that the Province does not anticipate drawing down from its discretionary sinking funds in 2018/19. These funds total $893mn. However, there will be mandatory sinking fund withdrawals of $198.0mn 2018/19 and $855.4mn in 2019/20 for USD debt issues. These mandatory withdrawals are the first time since March 2016.

Looking ahead, heavier debt maturities will prompt a bigger return to the debt markets with borrowing requirements increasing to $1.7bn in 2019-20 and staying above $1bn over the forecast horizon.

Although the domestic market is the primary source of funding for Nova Scotia, the Province maintains access to foreign markets and is registered with the United States Securities and Exchange Commission (SEC) to gain access to the US, as well as global bond markets. We highlight that the Province has flexibility around borrowing plans to navigate choppy and volatile markets. The Province periodically does not access the domestic public markets for funding for extended periods, instead choosing to borrow via the private placement market.

Table 3					
$Millions	2017/18A	2018/19E	2019/20E	2020/21E	2021/22E
Borrowing Requirements					
Budget (Surplus)/Deficit	-134	-29	-39	-61	-75
Net Capital Advances	19	47	30	30	30
Tangible Capital Assets: Net Cash	230	150	140	280	110
Other Operating Requirements	110	0	261	-205	-227
Sinking/Debt Retirement Funds	111	-88	-763	69	-464
Discretionary Fund Requirements	17	22	24	26	27
Net Financial Requirement	**353**	**102**	**-347**	**139**	**-598**
Maturities and Calls	460	1,261	2,073	1,081	1,714
Total	**813**	**1,363**	**1,725**	**1,220**	**1,116**
Sources of Funding					
Short-term Paper/Cash	0	0	0	0	0
Bonds & MTNs	813	1,363	1,725	1,220	1,115
Total	**813**	**1,363**	**1,725**	**1,220**	**1,116**
Change in Net Financial Market Debt	225	168	391	44	-162

Nova Scotia has tabled another straight-forward budget with projected surpluses, a declining debt-to-GDP profile, and a reaffirmation of their goal to reduce the debt ratio to or below 30% by 2024. The Province projects that net debt / GDP will be 34.9% at March 31, 2018, declining to 34.2% by March 31, 2019.

We view today's budget as supportive of the ratings and bond credit spreads. We highlight that Nova Scotia is Canada's largest Maritime province by population and GDP. The economy is well diversified and benefits from being Atlantic Canada's regional hub. Its capital, the City of Halifax, is an important port for the region. The Province has one of the lowest unemployment rates in Atlantic Canada and its economy is expected to grow at a slow, but steady pace. Its service sector share of GDP is 80%, the largest in the country because it benefits from the presence of financial and other services entities, as well as Canada's East Coast Navy operations. These are important sources of strength when manufacturing, mining, or oil and gas extraction activity are down.

Nova Scotia's economy is projected to continue to expand at a moderate pace. Supporting the economy are some very large projects including a major federal shipbuilding procurement contract, the development of energy infrastructure assets in conjunction with the Muskrat Falls hydro-electric project, and offshore drilling activity. Although mining activity has been slowing with the Sable Offshore Energy Project being decommissioned and Deep Panuke being scaled back, offshore exploration activity continues and could be a source of growth in the future. Major projects listed above are off their peaks, but non-residential investment is expected to get a boost from the Provincial Health Complex (also referred to the Queen Elizabeth II Health Sciences Re-Development) as well as green and public transit infrastructure investments under the federal government's infrastructure plan. A recent positive development on the softwood lumber file was a decision taken by the U.S. Department of Commerce's last November to reverse the punitive duties on imports from Nova Scotia.

We highlight that recent third-party assessments have validated the conservative fiscal path of the Province. S&P upgraded Nova Scotia's outlook to 'positive' from 'stable' last fall on its improving fiscal trajectory. In the Parliamentary Budget Office's Annual Fiscal Sustainability Report (October 6, 2017), Nova Scotia was listed as one of the few provinces with sustainable fiscal policies. Moody's recently listed Nova Scotia as one of the least exposed provinces to the termination of NAFTA.

On the political front, the Liberal's back-to-back win of a majority in last May's election provides greater assurance of continuity along the current fiscal path before the next general provincial election in 2021.

Credit Ratings:
DBRS A(high) stable [short term R-1(middle)]
Moody's Aa2 stable
S&P A+ positive* [short term A-1+]

*revised to 'positive' from 'stable' in September 2017

S&P Rating Report: "The positive outlook reflects our expectations that, in the next two years, the Province's medium-term borrowing plans will continue to indicate a declining debt burden approaching 120% of operating revenues, the Province will maintain a balanced budget position, and that liquidity will remain sufficient to cover more than 40% of debt service requirements."