Nova Scotia 2022 Budget

Economics and Strategy

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Investing for the future, even if it means budgetary red ink

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Highlights

Nova Scotia is wrapping up a 2021-22 fiscal year characterized by hearty economic growth and bountiful revenues. That saw the outgoing fiscal year's budget balance thoroughly transformed, as a planned deficit of $585 million morphed into a budget surplus of $108 million, the corresponding level of net debt landing comfortably below plan. With the economy returning to more "normal" growth, some extraordinary revenue gains unlikely to be repeated, and a host of new investments to be made, Nova Scotia plans for a return to deficit… in 2022-23 and each year of the fresh four-year fiscal plan. A deficit of $506 million has been forecast for 2022-23 (equivalent to just under 1% of GDP). All told, the budgetary red ink sums to ~$1.6 billion over the four fiscal years ending 2025-26. In general, the governing PC Party—which secured a majority in an August 2021 general election—aims to eliminate the deficit over six years. Despite ending 2021-22 on a firmer fiscal footing, the combination of budget deficits and capital investments would see some $6 billion of net debt tacked on over four years, the relative debt burden (vs. nominal GDP) moving higher each year. That key ratio looks to be ending 2021-22 at a leaner-than-planned 33.5% but is projected to hit 40% by 2025-26. The outgoing fiscal year's revenue bonanza—the majority of which was steered to the bottom line—meant Nova Scotia was far less active in debt capital markets, issuing $1.1 billion of purely domestic bonds in 2021-22. Underlying cash requirements step up in the coming fiscal year, but some $600 million of cumulative pre-funding (deemed to have been completed over a number of years) ultimately results in a relatively manageable $1.65 billion gross bond program for 2022-23. It's believed that gross bond issuance could surpass $2 billion in 2023-24, before receding to a low of $1.25 billion by 2025-26 (when the deficit is due to be more than halved vs. 2022-23). All in all, there's a considerably stronger fiscal starting point from which to commit to incremental spending, marginal red ink and additional debt, a return to balance appearing to be some years off.

- **Economic outlook** — Nova Scotia has come through the pandemic relatively well, being the province with the second-smallest decline in real GDP in 2020 at 2.5%. The province's economy has also rebounded nicely in 2021, with an estimated growth of 3.1% sufficient to erase the loss of output recorded the previous year. The labour market has also recovered all its losses, as employment exceeded its pre-pandemic level as early as September 2021 and is now 2.1% above. The unemployment rate in February also reached its second-lowest level in history at only 6.6%. It is also worth noting the population growth of 1.04% between July 2020 and July 2021, an increase achieved despite a drop in international immigration that was offset by the highest interprovincial migration ever recorded since 1961 in the province. Looking ahead, the budget assumes real GDP growth of 2.1% in 2022 and 1.6% in 2023, which is conservative compared to our own projections and to the average private sector forecast. Nominal GDP growth should also be favourable to the public treasury as it is expected to grow by 5.1% in 2022 and 3.5% in 2023. On another positive note, the resumption of international immigration and the increase in federal targets should also benefit Nova Scotia as the population is expected to grow by 1.23% in 2022 and 1.06% in 2023.

- **Outgoing year budget balance (2021-22)** — As we have seen in other provinces, Nova Scotia's budget improved remarkably in 2021-22. The province now expects to run a surplus of $107.7 million compared with an original plan for a $585 million deficit. It is the fifth surplus in the past six fiscal years, with the only deficit registered during the peak pandemic year of 2020-21. The latest estimate is largely in line with the December forecast update. Revenue was up across the board to $12.8 billion – a sizeable $1.1 billion increase vs. planned or 9.3% above last year's guidance. A variety of provincial sources were higher than estimated to the tune of $800 million that included significant prior year adjustments. Federal transfers were also stronger than originally planned. Relative to the $1.1 billion revenue beat, total expenses came in $456 million higher than expected. Overall, nearly 60% of the revenue surprise was steered to the budget balance.

- **Medium-term fiscal outlook (2022-23 & beyond)** — The budget shows Nova Scotia returning to deficit in 2022-23, with deficits extending the length of the four-year fiscal plan. This is to accommodate investments in priority areas such as healthcare, education, and other critical infrastructure. For the coming fiscal year, some of the extraordinary revenue gains from the outgoing year do not repeat. In contrast, total expenses continue to grow modestly resulting in a $506 million deficit (1.0% of GDP) in 2022-23. Further out, the province has penciled in deficits of $419 million (0.8% of GDP), $377 million (0.7% of GDP), and $294 million (0.5% of GDP) for 2023-24, 2024-25, and 2025-26 fiscal years, respectively. Over the medium-term deficits are projected to gradually decline as spending is growing at a slower pace than revenue. In general, the average annual growth rate in revenue is projected to be 1.5% over the four-year fiscal period. The government aims to balance the budget over six years. And while the last two fiscal years surely bettered expectations by a large margin, the deficits pledged for 2022-23 and beyond mark a net erosion in the budgetary position relative to last year's budgetary blueprint (which arrived before a August 2021 election).

- **New initiatives** — Emerging from the pandemic, Nova Scotia has a renewed focus on investing in health care, its economy and population. Budget 2022-23 invests a total of $5.7 billion in healthcare, an increase of $413.3 million from last year. This includes $1.2 billion in spending for continuing care, $286.6 million for mental health/addictions, and recruitment of health care professionals. In addition, there is a focus on skilled trades, (including personal income tax relief), alongside initiatives to attract people to the province and support the tourism sector. On housing, the budget allocates more money for affordable housing, while non-residents will be subject to new property/deed transfer taxes. Together, these two non-resident taxes are worth ~$80 million starting 2022-23. Elsewhere, disability supports were boosted while child care is expanded in conjunction with incremental federal government assistance.

- **Debt burden & interest bite** – Provincial net debt is projected to end 2021-22 at $16.8 billion, the latest (although not-yet-final) estimate tracking an impressive $1.2 billion below the original March 2021 budget plan (when pandemic-related uncertainty argued for a cautious budgeting). The outgoing fiscal year's net debt burden is equivalent to 33.5% of GDP, falling on a year-over-year basis and coming in considerably better than the 37.9% ratio planned for in last year's budget. The material beat on the net debt-to-GDP ratio reflects a stronger handoff from 2020-21 (previously confirmed via public accounts), the big-time fiscal improvement for 2021-22 (a planned deficit transformed into a surplus), plus a more muscular tally for nominal GDP (as output measured in current dollars surged 7% last year). Taking into account planned budget deficits and capital investment priorities, net debt is scheduled to grow in absolute and relative terms from here. Net debt is forecast to increase by ~$1.6 billion in 2022-23 (reaching $18.4 billion), with a further $4.5 billion due to be tacked on the final three years of the fiscal plan (i.e., up about $1.5 billion/year from 2023-24 to 2025-26). Despite a much-improved starting point, the level of net debt is expected to surpass that forecast in last year's budget by 2024-25—a result consistent with the larger and more prolonged deficits now being flagged starting in 2022-23. Relative to the better-than-planned reading for the outgoing fiscal year, Nova Scotia's debt-to-GDP ratio is scheduled to rise in each of the coming four fiscal years: +1.4%-pts to 34.9% in 2022-23 en route to an even 40% by 2025-26. Despite the expected increase in financial leverage, debt servicing costs look to remain manageable. Gross debt service totaled $682 million in 2021-22, once again coming in below plan. After controlling for sinking fund earnings, the net interest bill was even lighter at $642 million. Interest charges took a relatively modest bite out of revenue in 2021-22 and while rate hikes hint at rising borrowing costs ahead, sinking fund provisions and effective debt management should mitigate/delay pressure from the recent back-up in underlying interest rates. The province sees debt charges consuming no more than 5.5% of total revenue over the planning horizon. Note that all foreign currency exposure has been hedged. And Nova Scotia, like many provinces, has moved to lock-in its debt for a relatively long term, the weighted average term to maturity lengthening in 2021-22 to 14.5 years (2020-21: 13.7 years). Official sensitivity analysis suggests a 1%-pt increase in short-term yields would add $15 million to debt servicing costs in year one.
- **Long-term borrowing requirement** – Nova Scotia issued $1.1 billion (par value) of exclusively domestic bonds in 2021-22, the actual volume of debt capital markets activity turning out to be only half that projected in Budget 2021. Issuance took the following form: 2X $300 million for $600 million in the 10-year sector (one re-open plus a new 2031 bond); 2X $250 million for $500 million of additional longs (re-openings of the existing 2051 benchmark). For the coming fiscal year, a gross long-term borrowing requirement of $1.65 billion has been indicated. Note that underlying cash requirements are north of $2.2 billion, but Nova Scotia will move to absorb some $600 million of pre-borrowing it reckons was accumulated over the past number of years. Notwithstanding evident market volatility and an anticipated tightening of financial conditions as monetary stimulus is removed, we foresee little difficulty completing this relatively modest bond program. The domestic debt market is once again the primary focus for future issuance. Building/maintaining liquid domestic benchmark bonds is a noted priority, although a domestic MTN program affords potential flexibility. Documentation likewise remains in place, affording Nova Scotia prospective access to international markets. There are no plans to draw on discretionary sinking funds in the coming fiscal year, which currently total $957 million. Looking at the full four-year financing plan, long-term gross bond supply is set to average roughly $1.6 billion/year, with a high of $2.09 billion (in 2023-24) and a low of $1.25 billion (in 2025-26, when it is expected that the deficit will have been worked down some).
- **Current long-term credit ratings** – S&P: AA-, Stable | Moody's: Aa2, Stable | DBRS: A(High), Stable

  [Refer to our Provincial Ratings Snapshot for additional colour on specific credit rating drivers/considerations]

Nova Scotia

$ Million	Budget 2021-22	Estimate 2021-22	Budget 2022-23	Estimate 2023-24	Estimate 2024-25	Estimate 2025-26
Revenues	**11,781.8**	**12,878.0**	**12,661.9**	**12,910.5**	**13,263.8**	**13,662.0**
Provincial Taxation, Fees and Charges	6,131.2	6,831.5	6,633.8			
Interest Revenues and Sinking Funds Earnings	105.9	116.7	112.1			
Federal sources	4,459.8	4,765.7	4,694.6			
Ordinary Recoveries	685.0	764.3	801.6	818.0	763.7	764.9
Sub-total	**11,381.9**	**12,478.2**	**12,242.1**	**12,474.5**	**12,814.7**	**13,205.0**
Net Income from Government Business Enterprises	399.9	399.8	419.8	436.0	449.1	457.0
Expenses	**12,472.8**	**12,929.0**	**13,292.5**	**13,330.8**	**13,642.2**	**13,956.4**
Departmental expenses	11,509.4	12,079.8	12,422.7	12,434.1	12,704.5	13,019.9
Refundable tax credits	144.7	105.0	121.8	123.1	124.1	124.9
Pension Valuation Adjustment	107.8	62.1	71.5	69.6	79.5	71.7
Debt Servicing Costs	710.9	682.2	676.4	704.0	734.1	739.9
Consolidation and Accounting Adjustments	106.1	158.6	124.4	1.4	1.1	0.7
Provincial Surplus (Deficit)	**(584.9)**	**107.7**	**(506.2)**	**(418.9)**	**(377.3)**	**(293.7)**
Term debt borrowing						
Provincial Deficit (Surplus)	584.9	(107.7)	506.2	418.9	377.3	293.7
Tangible capital assets: Net cash	476.5	275.5	711.5	982.8	510.1	226.5
Other Non-Budgetary transactions	(105.5)	(286.5)	(40.7)	(176.5)	(186.7)	(121.0)
Net Mandatory Sinking Funds Withdrawals	(475.5)	(475.7)	(680.5)	-	-	-
Other Net Allocations to Various Funds	8.5	13.6	15.2	16.3	17.2	19.6
Cash Debt Retirement	1,715.8	1,715.8	1,734.2	851.4	859.1	835.0
Sub-total: Total borrowing requirements	**2,204.7**	**1,135.0**	**2,245.9**	**2,092.9**	**1,577.0**	**1,253.8**
Change in Short-Term Borrowing (inc)/dec	-	-	600.0	-	-	-
Total	**2,204.7**	**1,135.0**	**1,645.9**	**2,092.9**	**1,577.0**	**1,253.8**
Net Direct Debt						
Opening Balance	16,680.3	16,400.7	16,805.6	18,397.2	20,130.0	21,779.1
Provincial Balance	584.9	(107.7)	506.2	418.9	377.3	293.7
Increase in net book value of tangible capital assets, other	710.4	512.6	1,085.4	1,313.9	1,271.9	802.3
Closing Balance	**17,975.7**	**16,805.6**	**18,397.2**	**20,130.0**	**21,779.1**	**22,875.1**
Nominal GDP	47,387	50,124	52,667	54,522	55,491	57,118
Net position: Surplus (Deficit) / GDP	**-1.2%**	**0.2%**	**-1.0%**	**-0.8%**	**-0.7%**	**-0.5%**
Net Direct Debt / GDP	**37.9%**	**33.5%**	**34.9%**	**36.9%**	**39.2%**	**40.0%**
Gross Debt Servicing / Total revenues	**6.0%**	**5.3%**	**5.3%**	**5.5%**	**5.5%**	**5.4%**

Source: Budget Documents, Nova Scotia Department of Finance.

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