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A balanced fiscal plan with debt consolidation well in-train

Highlights

- The outgoing fiscal year's surplus is pegged at \$133.5 million (0.3% of GDP). Strip out a \$110 million "fiscal capacity" contribution deferred from 2016-17 and the net balance remains positive at \$23 million.
- As announced in the days leading up to the budget, Nova Scotia benefited from a favourable recalculation of offshore royalties, which made possible a series of fiscal year-end investments (e.g., high-speed internet, research/innovation, primary health care, energy efficiency programming and various other growth initiatives). To some extent, significant year-end investments could lessen spending pressures down the road.
- The Province plans for a third straight budget surplus in 2018-19 (\$29 million), making Nova Scotia one of just four provinces currently planning to balance the books in the fiscal year ahead. The budgetary black ink is seen extending all the way through 2021-22.
- The provincial Auditor General reviewed the coming year's revenue estimates, finding them "reasonable and presented fairly".
- The government will continue to prioritize the two big funding envelopes of health care and education. There's likewise a focus on disability supports, public housing, connectedness, innovation and inclusive economic growth. In terms of revenue measures, 2018-19 is the first full year of previously announced tax relief via the basic personal amount. A new cannabis tax is expected to generate \$10.4 million in duties in 2018-19 and an equivalent amount of incremental sales tax revenue.
- The budget is based on a prudent economic forecast, one that is subjected to a challenge and review process with private sector economists. For 2018, real GDP growth is estimated at 1.0%, slowing to 0.8% in 2019. The corresponding nominal growth rate is forecast at 2.9% for each of 2018 and 2019.
- Net debt is projected to end fiscal 2017-18 at \$15.05 billion, amounting to less than 35% of GDP. The budget sees net debt rising \$120 million to \$15.17 billion in 2018-19, easing the corresponding debt burden to 34.2% of GDP. That key ratio could be down to 32.1% by 2021-22, with the Province on track to hit a longer-term goal of 30% by 2024. The interest bite is quite manageable.
- While a bit of a step-up from recent years, 2018-19's gross funding requirement of \$1.36 billion is largely in-line with the longer-term average and remarkably little changed relative to preliminary guidance offered up a year ago. Further out, the Province anticipates gross borrowings of \$1.75 billion in 2019-20, \$1.22 billion in 2020-21 and \$1.12 billion in 2021-22. These borrowing figures largely reflect refinancings.
- Nova Scotia has demonstrated a preference for FRNs, have previously found a receptive domestic investor audience. The Province also retains the right to opportunistically tap international markets should conditions prove favourable. The current maturity schedule reveals ample flexibility to issue into key benchmark tenors (5s, 10s or 30s).
- All told, balanced budgets, improved ratings and relatively modest funding needs should continue to lend important support to Nova Scotia credit spreads.

One-time revenue windfall in 2017-18

As announced in the days leading up to the budget, Nova Scotia benefited from a favourable recalculation of offshore royalties, which made possible a series of fiscal year-end investments. So while total revenue and spending both came in above-plan, the resulting budget surplus was little changed vs the original plan or subsequent guidance.

The outgoing fiscal year's surplus is pegged at \$133.5 million (0.3% of GDP). Strip out a \$110 million "fiscal capacity" contribution deferred from 2016-17 and the net balance remains positive at \$23 million. Any way you slice it then, Nova Scotia was in the black last fiscal year.

The Province likewise would have balanced the books in the absence of the unexpected offshore royalty revenue. Really, the extra royalties (awarded via arbitration and linked to Sable natural gas) more than offset negative prior-year adjustments on personal income taxes and made a series of new spending announcements possible, leaving the net fiscal result essentially unchanged. Where did this year-end spending go? Towards the one-time spending items of high-speed internet, research/innovation, primary health care, energy efficiency programming and various other growth initiatives. To some extent, these significant year-end investments could lessen spending pressures down the road.

It's also worth noting the savings generated via restructuring in 2017-18, equivalent to some \$75 million, which alongside the one-time royalty boost paved the way for some one-off strategic investments.

In balance and planning to stay there

While other governments at various levels (here in Canada and abroad) have shown a willingness to run budget deficits at what might be considered the top of the economic cycle, Nova Scotia is opting for a balanced fiscal path.

The Province plans for a third straight budget surplus in 2018-19 (\$29 million). You could call that a modest surplus relative to GDP (<0.1%), but at this point, Nova Scotia is one of just four provinces planning to balance the books in the fiscal year ahead. Moreover, the budgetary black ink is seen extending all the way through 2021-22. Those future year surpluses stack up like this: \$39 million in 2019-20, \$61 million in 2020-21 and \$75 million in 2021-22. (Refer to the table on page 4 for greater detail.)

Taking a look at high level elements of the fiscal framework, the budget assumes ~2.3% average annual growth in ordinary revenue over the coming four fiscal years, an assumption that jives with the underlying economic outlook once you control for one-time adjustments and tax measures (more on that in

a moment). It should also be noted that the provincial Auditor General reviewed the coming year's revenue estimates, finding them "reasonable and presented fairly". Slicing the revenue pie, some 30% of 2018-19 revenue is slated to arrive via federal transfers, with more than half of that amount (\$1.8 billion) taking the form of equalization payments.

Departmental expenses are scheduled to grow at a 2.3% average annual rate over the life of the fiscal plan. Matching spending growth to revenue gains: that's how you keep a structurally balanced budget on track.

In the fiscal year ahead, the government will continue to prioritize the two big funding envelopes of health care (e.g., more doctors, expanded collaborative care, mental health funding, upgraded facilities) and education (e.g., new pre-primary classes, more accessible child care). There's likewise a focus on disability supports, public housing, connectedness, innovation and inclusive economic growth. To aid implementation, the total complement of departmental FTEs is estimated to grow 0.9% in 2018-19.

In terms of revenue measures, note that 2018-19 will be the first full year of previously announced tax relief via the basic personal amount, where the full-year cost works out to \$85 million. As per a framework agreement between Ottawa and the provinces, a new cannabis tax is expected to generate \$10.4 million in duties in 2018-19, with an additional and equivalent amount of incremental HST revenue tied to recreational cannabis. Separately, the budget outlined a more narrowly focused innovation equity tax credit (to commence January 2019) that's better aligned with competing jurisdictions.

Economic outlook

Provincial growth ended up being stronger than expected in 2017, as real GDP advanced by 1.4% and nominal output grew by 3.3%. The budget is based on a prudent economic forecast, one that is subjected to a fairly rigorous challenge and review process with private sector economists.

For 2018, real GDP growth is estimated at 1.0%, slowing to 0.8% in 2019. For both of those years, the budget planning assumption has been set 0.1%-pt below consensus. The corresponding nominal growth rate is forecast at 2.9% for each of 2018 and 2019.

Noted economic risks (to the upside or downside) include: tighter monetary policies being pursued by various central banks, faster-than-expected US growth (due to Trump's tax plan), long-term demographic pressures/uncertainties, new housing measures and ever-present geopolitical uncertainty (most notably the NAFTA renegotiation). Meanwhile, as is often the case, there's a degree of uncertainty attached to

the longer-term economic outlook, reflecting the timing of some major projects (including, for example, work on maritime combat vessels at the large Halifax Shipyard).

Progress on debt burden & refi-driven funding

Net debt is projected to end fiscal 2017-18 at \$15.05 billion, coming in a bit below the original budget plan and amounting to less than 35% of GDP. With balanced budgets dotting the landscape and a responsible capital plan spelled out, the debt burden is slated to ease each and every year through 2021-22 (despite somewhat modest nominal GDP growth).

Specifically, the budget sees net debt rising \$120 million to \$15.17 billion in 2018-19, easing the corresponding debt burden to 34.2% of GDP. That key ratio could be down to 32.1% by 2021-22. This trajectory is fully consistent with the One NS goal of getting the net debt burden down to 30% by 2024. Meanwhile, the so-called “interest bite” (i.e., debt servicing costs as a share of total revenue) looks quite manageable at 8.3% for 2018-19, becoming even more so over time (slipping below 7% by the end of the current fiscal planning horizon).

When it comes to borrowing, budget surpluses and the lack of large Crown requirements (a feature in many provinces) result in modest net requirements. Indeed, for fiscal 2018-19, the overwhelming majority of a planned \$1.36 billion gross borrowing program can be traced to refinancings. Of note, there are two large FRNs coming due in fiscal 2018-19 (C\$500 million apiece, one in Aug-2018 and the other in Feb-2019).

It should be noted that Nova Scotia has demonstrated a preference for issuing floating-rate notes, finding a receptive domestic investor audience. In what is really a statement of the obvious, the Province also retains the right to opportunistically tap international markets should conditions prove favourable. Overall, a look at Nova Scotia’s maturity schedule shows an issuer with ample flexibility/room to issue into key benchmark tenors, be it 5s, 10s or 30s.

The coming year’s borrowing program, while a bit of a step-up from recent years, is largely in-line with the longer-term average and remarkably little changed relative to preliminary guidance offered up a year ago. Further out, the Province anticipates gross borrowings of \$1.75 billion in 2019-20, \$1.22 billion in 2020-21 and \$1.12 billion in 2021-22. As in 2018-19, those future year funding needs are largely a refi story, as cash operating requirements look to average barely \$90 million/year (-0.2% of GDP) in the final three years of the fiscal plan.

All in all, it’s fair to say that Nova Scotia has made a bit of a name for itself when it comes to responsible fiscal management and debt consolidation. Few provinces have demonstrated as much sustained progress on indebtedness, and this absolute/relative fiscal consolidation is paying important dividends. Witness an improving credit rating profile, highlighted by a “positive” outlook that was earned from closely-watched S&P back in September. Balanced budgets, improved ratings and relatively modest funding needs should continue to lend important support to Nova Scotia credit spreads, which have shown a greater tendency to separate (read outperform) certain provincial peers.

Warren Lovely

Nova Scotia • 2018 Budget

Nova Scotia

\$ Million	Sept. Budget	Estimate	Budget	Estimate	Estimate	Estimate
	2017-18	2017-18	2018-19	2019-20	2020-21	2021-22
Revenues	10,573.7	10,740.6	10,810.2	10,858.8	11,269.5	11,614.4
Provincial Taxation, Fees and Charges	6,097.6	6,135.2	6,293.7			
Royalties - Petroleum	12.0	11.1	6.0			
Interest Revenues and Sinking Funds Earnings	180.1	178.1	193.1			
Prior Years' Adjustments - Provincial Sources	-	107.1	-			
Federal sources	3,195.9	3,224.7	3,280.7			
Ordinary Recoveries	709.4	696.9	655.5	614.2	618.6	624.0
Sub-total	10,194.9	10,353.1	10,428.9	10,458.2	10,859.3	11,191.3
Net Income from Government Business Enterprises	378.8	387.5	381.3	400.6	410.2	423.1
Expenses	10,512.4	10,675.6	10,862.7	10,848.7	11,237.2	11,561.1
Departmental expenses	9,505.5	9,658.9	9,693.4	9,790.7	10,233.2	10,582.4
Refundable tax credits	125.5	115.2	146.9	144.4	145.1	145.8
Pension Valuation Adjustment	31.2	63.8	128.8	49.3	52.3	56.9
Debt Servicing Costs	850.2	837.7	893.6	864.3	806.6	776.1
Consolidation and Accounting Adjustments	70.4	68.5	81.9	28.9	28.6	21.7
Provincial Surplus (Deficit)	131.6	133.5	29.4	39.1	60.9	75.0
Contrib. to Fiscal Capacity for provincial Health Complex	(110.3)	(110.3)	-	-	-	-
Net position	21.3	23.2	29.4	39.1	60.9	75.0
Term debt borrowing						
Provincial Deficit (Surplus)	(131.6)	(133.5)	(29.4)	(39.1)	(60.9)	(75.0)
Tangible capital assets: Net cash	236.6	229.5	150.0	139.5	280.4	110.1
Other Non-Budgetary transactions	(8.1)	129.3	47.3	290.6	(175.4)	(196.8)
Mandatory Sinking Funds Withdrawals	-	-	(198.0)	(855.4)	-	(512.0)
Other Net Allocations to Various Funds	126.9	127.4	131.7	117.1	94.6	75.2
Cash Debt Retirement	459.7	459.7	1,261.0	2,072.8	1,080.9	1,713.9
Sub-total: Total borrowing requirements	683.5	812.5	1,362.6	1,725.5	1,219.6	1,115.4
Change in Short-Term Borrowing (inc)/dec	-	-	-	-	-	-
Total	683.5	812.5	1,362.6	1,725.5	1,219.6	1,115.4
Net Direct Debt						
Opening Balance	14,954.9	14,954.9	15,050.9	15,171.5	15,271.9	15,491.5
Provincial Balance	(131.6)	(133.5)	(29.4)	(39.1)	(60.9)	(75.0)
Increase in net book value of tangible capital assets, other	236.6	229.5	150.0	139.5	280.4	110.1
Closing Balance	15,059.9	15,050.9	15,171.5	15,271.9	15,491.5	15,526.6
Nominal GDP	42,456	43,099	44,329	45,604	47,224	48,406
Net position: Surplus (Deficit) / GDP	0.1%	0.1%	0.1%	0.1%	0.1%	0.2%
Net Direct Debt / GDP	35.5%	34.9%	34.2%	33.5%	32.8%	32.1%
Gross Debt Servicing / Total revenues	8.0%	7.8%	8.3%	8.0%	7.2%	6.7%

Source: Budget Documents, Nova Scotia Department of Finance.

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