

September 26, 2017

## From now on, bottom lines are written with black ink

Main changes to the budget that was tabled last April but not approved by the Legislature:

The budget papers tabled today take account of the issuance, at the end of last July, of Nova Scotia's 2016-17 public accounts. This document showed a \$150 million surplus, equivalent to 0.4% of GDP, compared to a \$40.1 million surplus estimated back in April. Projected revenue, departmental expenses and pension valuation adjustments are revised down, the end results being smaller surpluses (but still surpluses) forecasted for this year and next, with surpluses projected for 2019-20 and 2020-21 little changed. The economic assumptions underlying today's budget of course take account of information available after last April. As per public accounts, the opening balance of the current FY has been revised down \$105.8 million, and this accounts for most of the change in projected net debt.

### Highlights

- Public accounts confirmed that FY 2016-17 closed out five years of red ink. The surplus is now pegged at \$149.6 million (0.4% of GDP), compared to \$40.1 million as estimated last April.
- Excluding a one-time \$110 million revenue set aside as a Contribution to Fiscal Capacity for Provincial Health Complex, the surplus for 2017-18 is projected at \$21.3 million (0.1% of GDP), \$4.6 million lower than estimated back in April. The previous back-to-back balanced budgets occurred nine years ago. Other surpluses representing 0.1% of GDP are forecasted for each of the three next fiscal years.
- As announced last April, effective January 1, 2018, the basic personal amount, the spousal amount and the amount for eligible dependent is increased by up to \$3,000 for taxable incomes of up to \$75,000. People with a taxable income under \$25,000 get the full benefit. The benefit decreases as income increases. The cost of this measure in 2017-18 is estimated at \$21.7 million. Implemented on a full fiscal year, this measure is assumed to cost \$85 million.
- As announced last April, effective January 1, 2017, the small business tax threshold is increased from \$350,000 to \$500,000 (yearly cost: \$13.9 million).
- After a 1.0% estimated gain in 2016, real GDP is forecast to grow 1.2% in 2017 (revised up from 1.1% last April) and 0.5% in 2018. Nominal GDP is assumed to have grown 2.3% in 2016, and to increase 3.2% in 2017 (revised up from 2.8%) and 2.4% in 2018.
- Projected term debt borrowing requirements for FY 2017-18 are expected to be \$683.5 million (up from April due to purchase of MFC spring issue and change in non-cash expense). This is the lowest annual borrowing requirement over the last decade, as maturing debt will only amount to \$459.7 million. However, borrowing requirements will largely exceed \$1 billion over each of the next three fiscal years, but this is due to the large amount of maturing debt (\$1,259 million in 2018-19, \$2,071 million in 2019-20 and \$1,079 million in 2020-21). Offsetting these debt maturities are mandatory sinking funds of \$198 million in 2018-19 and \$855 million in 2019-20.
- The debt-to-GDP ratio at the end of FY 2016-17 is forecast to be 36.3%. This ratio is much lower than for the most indebted Canadian provinces, where it used to exceed 40%. Even if it is not the lowest, investors will take comfort in the fact that it is expected to decrease along the forecast horizon, to 35.5% for 2017-2018 and to 33.4% at the end of FY 2020-21.

## Surpluses projected through 2020-21

As per the public accounts, the surplus for FY 2016-17 is now pegged at \$149.6 million (0.4% of GDP), against \$40.8 million estimated back in April. This is a first surplus after a five-year string of deficits.

The budget tabled today shows a hefty \$378.7 million increase in revenue (+3.7%) for 2017-18 but this includes a one-time revenue of \$110.3 million for capital contributions from federal and municipal governments towards the new Halifax Convention Centre. In the Third Quarter Update of FY 2016-17, this revenue was no longer recognized in that fiscal year. It is recognized in the current fiscal year. But the province is not using that one-time revenue in order to fund program spending this year. It is rather saved to provide increased fiscal capacity in future years for the continuation of the QEII Health Sciences Complex redevelopment.

If we exclude the afore-mentioned one-time revenue of \$110.3 million, revenue is projected to grow 3.6% (or \$255.8 million to \$10.463 billion) compared to the 2016-17 forecast. Tax revenue is projected to increase \$181 million (+3.1%), of which \$74.0 million (+2.8%) coming from personal income tax and \$50.9 million (+2.9%) from sales tax.

Two new measures, already included in last April's budget, impact taxation revenue. Effective January 1, 2018, the tax-free basic personal amount, the spousal amount and the amount for eligible dependent is increased by up to \$3,000 (from \$8,481 to \$11,481) for taxable incomes of up to \$75,000. People with a taxable income under \$25,000 get the full benefit. The benefit decreases as income increases. It is believed that 500,000 people will have a lower tax burden as a result, including 60,000 additional Nova Scotians who will no longer pay provincial income tax. The full cost of this measure will be felt in 2018-19, and is then estimated at \$85 million. Also announced last April, effective January 1, 2017, the small business income threshold is increased from \$350,000 to \$500,000 (yearly cost: \$13.9 million). This matches the threshold in effect at the federal level as well as all provinces except Manitoba (\$450,000). The small business corporate income tax rate is 3% in Nova Scotia, compared to 16% for the general corporate income tax rate.

Effective April 1, 2017, the province will provide an exemption from motive fuel tax for equipment used in the mining and quarrying sector (annual cost: \$1.6 million).

Apart from taxation revenue, ordinary recoveries are assumed to represent an increase in revenue of \$81.5 million, all accounted by Federal sources recoveries, estimated to increase \$86.2 million. The latter mostly relates to the Clean Water and Waste Water Initiative and to Public Transit Infrastructure Fund, all of which are flowed to municipalities through the provincial government. Excluding \$51.4 million as a one-time federal cost shared funding for the Halifax

Convention Centre, the increase in federal sources revenue that is relevant to our accounting is \$51.9 million.

Total expenses are projected to increase \$426.1 million (+4.2%) from actual 2016-17. Departmental expenses are expected to be \$9,505.5 million in 2017-18, \$405.5 million (+4.5%) above actual 2016-17. It must be said that a portion of this increase is offset by the afore-mentioned increase in federal sources recoveries.

Over the next three fiscal years, revenue is assumed to grow at an annual rate of 1.6% (remember to strip out \$110.3 million to total revenue in 2017-18 for a meaningful calculation) while total expenses are projected to grow 1.7%.

## Economic assumptions

After a 1.0% estimated gain in 2016, real GDP is forecast to grow 1.1% in 2017 and 0.5% in 2018. For 2017 and 2018, this is below the results of a survey of private forecasters where the average real GDP growth forecast is 1.2% in 2017 and 1.0% in 2018. While this might sound like weak numbers, remember that the government and private sector forecasters take account of a decline in potential GDP brought about by the reduction in the pool of prime-aged workers, which has been underway for some years now. Nominal GDP is assumed to have grown 2.3% in 2016, and to increase 3.2% in 2017 and 2.4% in 2018. This is rather similar to private sector forecasters except for 2018 where they pegged nominal GDP growth at 2.7% in 2018.

## Borrowing requirements will increase in future years due to maturing debt

The Debt Management Committee, an advisory committee to the Minister of Finance and Treasury Board, has had a policy guideline over the past number of years to increase the portion of long-term debt in the gross debt portfolio. The ongoing goal is to structure the maturity profile to withstand adverse changes in economic and fiscal circumstances. At present, the province continues to have about 50% of net financial market debt in issues longer than 15 years.

Projected term debt borrowing requirements for FY 2017-18 are expected to be \$683.5 million. This is the lowest annual borrowing requirement over the last decade. It must be said that the \$100.3 million of one-time revenue is a financing source that helps decrease borrowing needs. But the net acquisition of tangible capital assets (excess of capital expenditure over capital amortization) was \$236.6 million. However, the cash requirement arising from the net acquisition of tangible capital assets is expected to be only \$118.7 million as the remainder is the value of capital lease for the Convention Centre. Add to that the fact that maturing debt will represent only \$459.7 million, and you have a good idea of why borrowing needs are expected to be modest in 2017-18.

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The Department of Finance and Treasury Board does not anticipate drawing down discretionary sinking funds in 2017-2018, but draws attention to the fact that these funds total \$876.5 million. These funds are available to smooth the maturity schedule by reducing the necessity to borrow in financial markets in any given year.

Borrowing requirements are projected to largely exceed \$1 billion over each of the next three fiscal years, but this is due to the large amount of maturing debt (\$1,259 million in 2018-19, \$2,071 million in 2019-20 and \$1,079 million in 2020-21). Offsetting these debt maturities are mandatory sinking funds of \$198 million in 2018-19 and \$855 million in 2019-20. In addition to the rollover of term debt, the borrowing program also includes the principal repayments under capital leases.

The Canadian dollar payable debt has represented 100 per cent of the debt portfolio since late 2007. By way of background, the province historically carried large foreign currency exposures, and peaked at over 70 per cent in the mid-1990s. While the province has no foreign currency exposure, Section 44 of the Finance Act continues to limit this exposure, stating: "Unless the foreign currency exposure of the public debt is less than twenty per cent, no further transactions that increase foreign currency exposure may be executed. No borrowing in a foreign currency may be executed that cause the foreign currency exposure of the public debt to exceed twenty per cent."

Net debt is made up of total liabilities less financial assets. Surpluses reduce net debt, while the increase in the net book value of tangible capital assets directly reflects on net debt. Net debt is reported to GDP in order to gauge indebtedness.

The debt-to-GDP ratio at the end of FY 2016-17 was 36.3%. This ratio is much lower than for the most indebted Canadian provinces, where it used to exceed 40%. Even if it is not the lowest, investors will take comfort in the fact that it is expected to decrease along the forecast horizon, to 35.5% for 2017-2018 and to 33.4% at the end of FY 2020-21.

Marc Pinsonneault

# Nova Scotia - 2017 Budget

## Nova Scotia

\$ Million	Actual 2016-17	March Budget 2017-18	Sept. Budget 2017-18	Estimate 2018-19	Estimate 2019-20	Estimate 2020-21
<b>Revenues</b>	<b>10,208.0</b>	<b>10,586.7</b>	<b>10,573.7</b>	<b>10,525.4</b>	<b>10,668.6</b>	<b>10,981.7</b>
Provincial Taxation, Fees and Charges	5,916.6	6,112.4	6,097.6			
Royalties - Petroleum	9.9	12.4	12.0			
Interest Revenues and Sinking Funds Earnings	172.3	178.1	180.1			
Prior Years' Adjustments - Provincial Sources	(5.8)	-	-			
Federal sources	3,092.5	3,195.7	3,195.9			
Ordinary Recoveries	627.9	709.4	709.4	571.6	555.9	556.1
<b>Sub-total</b>	<b>9,813.4</b>	<b>10,208.0</b>	<b>10,194.9</b>	<b>10,150.8</b>	<b>10,292.1</b>	<b>10,599.0</b>
Net Income from Government Business Enterprises	394.6	378.8	378.8	374.6	376.5	382.7
<b>Expenses</b>	<b>10,086.3</b>	<b>10,516.3</b>	<b>10,512.4</b>	<b>10,540.5</b>	<b>10,657.6</b>	<b>10,936.4</b>
Departmental expenses	9,111.6	9,486.5	9,505.5	9,506.7	9,637.7	9,972.6
Tax Credits and Rebates	133.7	125.5	125.5	126.7	132.4	133.0
Pension Valuation Adjustment	17.2	54.1	31.2	34.4	42.4	44.7
Debt Servicing Costs	823.8	850.2	850.2	872.6	845.1	786.2
Consolidation and Accounting Adjustments	27.8	65.7	70.4	43.2	34.9	15.4
Provincial Surplus (Deficit)	<b>149.6</b>	<b>136.2</b>	<b>131.6</b>	<b>28.1</b>	<b>46.0</b>	<b>60.7</b>
Contrib. to Fiscal Capacity for provincial Health Complex	-	(110.3)	(110.3)	-	-	-
<b>Net position</b>	<b>149.6</b>	<b>25.9</b>	<b>21.3</b>	<b>28.1</b>	<b>46.0</b>	<b>60.7</b>
<b>Term debt borrowing</b>						
Provincial Deficit (Surplus)	(149.6)	(136.2)	(131.6)	(28.1)	(46.0)	(60.7)
Tangible capital assets: Net cash	30.2	236.6	236.6	146.4	136.2	277.3
Other Non-Budgetary transactions	(124.2)	(65.1)	(8.1)	43.0	40.8	(213.8)
Mandatory Sinking Funds Withdrawals	-	-	-	(198.0)	(855.4)	-
Other Net Allocations to Various Funds	116.8	125.1	126.9	128.7	114.7	92.4
Cash Debt Retirement	997.2	459.7	459.7	1,259.1	2,070.8	1,078.8
<b>Sub-total: Total borrowing requirements</b>	<b>870.4</b>	<b>620.1</b>	<b>683.5</b>	<b>1,351.1</b>	<b>1,461.1</b>	<b>1,174.0</b>
Change in Short-Term Borrowing (inc)/dec	(120.4)	-	-	-	-	-
<b>Total</b>	<b>750.0</b>	<b>620.1</b>	<b>683.5</b>	<b>1,351.1</b>	<b>1,461.1</b>	<b>1,174.0</b>
<b>Net Direct Debt</b>						
Opening Balance	15,076.0	15,060.7	14,954.9	15,059.9	15,178.2	15,268.4
Provincial Balance	(149.6)	(136.2)	(131.6)	(28.1)	(46.0)	(60.7)
Increase in net book value of tangible capital assets, other	28.4	236.6	236.6	146.4	136.2	277.3
<b>Closing Balance</b>	<b>14,954.9</b>	<b>15,161.1</b>	<b>15,059.9</b>	<b>15,178.2</b>	<b>15,268.4</b>	<b>15,485.0</b>
Nominal GDP	41,157	42,249	42,456	43,488	44,829	46,359
<b>Net position: Surplus (Deficit) / GDP</b>	<b>0.4%</b>	<b>0.1%</b>	<b>0.1%</b>	<b>0.1%</b>	<b>0.1%</b>	<b>0.1%</b>
<b>Net Direct Debt / GDP</b>	<b>36.3%</b>	<b>35.9%</b>	<b>35.5%</b>	<b>34.9%</b>	<b>34.1%</b>	<b>33.4%</b>
<b>Gross Debt Servicing / Total revenues</b>	<b>8.1%</b>	<b>8.0%</b>	<b>8.0%</b>	<b>8.3%</b>	<b>7.9%</b>	<b>7.2%</b>

Source: Budget Documents, Nova Scotia Department of Finance.

# Nova Scotia - 2017 Budget

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