April 27, 2017

From now on, bottom lines are written with black ink

Highlights

- Fiscal year 2016-17 is confirmed to close out five years of red ink. The surplus is now pegged at $40.8 million (0.1% of GDP), an improvement compared to $17.1 million surplus budgeted last year.
- Excluding a one-time $110 million one-time revenue set aside as a Contribution to Fiscal Capacity for Provincial Health Complex, the surplus for 2017-18 is projected at $25.9 million (0.1% of GDP). 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.
- Effective January 1, 2018, the basic personal amount 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. Implemented on a full fiscal year, this measure is assumed to cost $85 million.
- 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 1.1% in 2017 and 0.8% in 2018. Nominal GDP is assumed to have grown 2.2% in 2016, and to increase 2.8% in 2017 and 2.6% in 2018.
- Projected term debt borrowing requirements for FY 2017–18 are expected to be $620 million. 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 36.6%. 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 35.9% for 2017–2018 and to 33.7% at the end of FY 2020-21.

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First surplus confirmed for 2016-17

For 2016-17, the surplus is now pegged at $40.8 million (0.1% of GDP), an improvement compared to the $17.1 million surplus budgeted last year. From the table on page 4, it may seem that revenue is forecasted to be down $94.3 million from budget. But that's only because budgeted revenues were incorporating 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, this revenue was no longer recognized in fiscal year 2016-17, and this is reflected in the forecast for 2016-17 published today. Excluding the $110.3 million, forecasted revenue is $16 million above budget. Ordinary Recoveries are forecast to be $53.5 million higher than Budget because of Federal Infrastructure programs flowing through the province to municipal and other projects. On the other hand, tax revenue is forecasted to be lower by $42.4 million.

The increase in Ordinary Recoveries is offset by corresponding increases to departmental expenses. These were revised up by $51.6 million. But this was offset by a $36.8 million decrease in the Pension Valuation Adjustment because of revised actuarial assumption, an $11.3 million decline in debt servicing costs as interest rates have not risen as anticipated. The $4.1 million decline in Refundable tax credits mostly came from prior-year adjustments. Taking into account the consolidation and accounting adjustments, total expenses were in fact revised down $7.8 million.

We arrive at a surplus that improved $23 million over budget. This is a first surplus after a string of five fiscal years with the bottom line written in red ink.

Surpluses projected through 2020-21

Budget 2017-18 is showing a hefty $416.8 million (+4.1%) increase in revenue, but this includes the one-time $110.3 million revenue discussed above, deferred to 2017-18. Note that this revenue does not find its way into the fiscal net position, as it is affected to a Contribution to Fiscal capacity for a Provincial health Complex. Despite this, the Government projects a surplus of $25.9 million in 2017-18.

If we exclude the afore-mentioned one-time revenue of $110.3 million, revenue is projected to grow 3.0% (or $306 .5 million to $10.476 billion) compared to the 2016-17 forecast. Tax revenue is projected to increase $141.1 million (+3.6%), of which $94.7 million (+3.6%) coming from personal income tax and $46.8 million (+2.7%) from sales tax.

Two new measures impact taxation revenue. Effective January 1, 2018, the tax-free basic personal amount 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, as telegraphed a month before the budget, 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 $103.4 million. Federal sources recoveries, estimated to increase $93.6 million, represent the major portion of that amount. It 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 $52.2 million.

Total expenses, including consolidation and accounting adjustments, are projected to increase $321.6 million (+3.2%). Departmental expenses are expected to be $9,486.5 million in 2017-18, $334.8 million (+3.7%) above the 2016-17 forecast. It must be said that a portion of this increase is offset by the afore-mentioned increase in federal sources recoveries. The increase in departmental expenses is split as follows: $134.7 million for the Department of Municipal Affairs (+68.1%), $102.5 million (+2.5%) is for the Department of Health and Wellness, $53.8 million (+39.1%) for the Department of Business and $42.4 million (+2.5%) for Education and Early Childhood Development. For the rest, the decreases in some departments' expenses offset increases in others.

Over the next three fiscal years, revenue is assumed to grow at an annual rate of 1.8% (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 0.8% in 2018. This is below the results of a survey of private forecasters where the average real GDP growth forecast is 1.2% for both 2017 and 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 2.2% in 2016, and to increase 2.8% in 2017 and 2.6% in 2018. Again, this is below the average of private sector forecasters who projected nominal GDP growth at 3.0% in 2017 and 3.1% 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 $620 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.

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 $878.2 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 is forecast to be 36.6%. 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 35.9% for 2017–2018 and to 33.7% at the end of FY 2020-21.

Marc Pinsonneault

Nova Scotia – 2017 Budget

NATIONAL BANK OF CANADA FINANCIAL MARKETS

Nova Scotia

$ Million	Budget 2016-17	Forecast 2016-17	Budget 2017-18	Estimate 2018-19	Estimate 2019-20	Estimate 2020-21
Revenues	**10,264.3**	**10,169.9**	**10,586.7**	**10,578.8**	**10,731.5**	**11,053.5**
Provincial Taxation, Fees and Charges	6,005.5	5,916.3	6,112.4			
Royalties - Petroleum	10.5	10.3	12.4			
Other Revenues Provincial Sources	169.6	170.3	178.1			
Prior Years' Adjustments - Provincial Sources	-	(10.9)	-			
Federal sources	3,143.9	3,092.0	3,195.7			
Ordinary Recoveries	552.5	606.0	709.4	571.6	555.9	556.1
Sub-total	**9,882.0**	**9,784.0**	**10,208.0**	**10,204.2**	**10,355.0**	**10,670.8**
Net Icome from Government Business Enterprises	382.2	386.0	378.8	374.6	376.5	382.7
Net Expenses	**10,136.8**	**10,129.0**	**10,450.6**	**10,543.1**	**10,684.9**	**10,992.6**
Departmental expenses	9,100.0	9,151.6	9,486.5	9,529.6	9,669.9	10,014.1
Tax Credits and Rebates	137.6	133.5	125.5	126.7	132.4	133.0
Pension Valuation Adjustment	66.3	29.4	54.1	57.4	72.4	74.7
Debt Servicing Costs	841.7	830.4	850.2	872.6	845.1	786.2
Consolidation and Accounting Adjustments	8.8	15.9	65.7	43.2	34.9	15.4
Provincial Surplus (Deficit)	**127.4**	**40.8**	**136.2**	**35.6**	**46.6**	**60.8**
Contrib. to Fiscal Capacity for provincial Health Complex	(110.3)	-	(110.3)	-	-	-
Net position	**17.1**	**40.8**	**25.9**	**35.6**	**46.6**	**60.8**
Term debt borrowing						
Provincial Deficit (Surplus)	(127.4)	(40.8)	(136.2)	(35.6)	(46.6)	(60.8)
Tangible capital assets: Net cash	202.9	6.6	236.6	146.4	136.2	277.3
Other Cash Operating Requirements	(178.6)	(212.6)	(65.1)	23.2	13.9	(240.7)
Net Allocation to Various Funds	118.0	119.9	125.1	(70.4)	(741.2)	98.0
Cash Debt Retirement	994.8	997.2	459.7	1,259.1	2,070.8	1,078.8
Sub-total: Total borroweing requirements	**1,009.6**	**870.4**	**620.1**	**1,322.7**	**1,433.1**	**1,152.6**
Change in Short-Term Borrowing (inc)/dec	(200.0)	(120.4)	-	-	-	-
Total	**809.6**	**750.0**	**620.1**	**1,322.7**	**1,433.1**	**1,152.6**
Net Direct Debt						
Opening Balance	15,113.7	15,094.9	15,060.7	15,161.1	15,271.9	15,361.4
Provincial Balance	(127.4)	(40.8)	(136.2)	(35.6)	(46.6)	(60.8)
Increase in net book value of tangible capital assets	203.0	6.6	236.6	146.4	136.2	277.3
Closing Balance	**15,189.3**	**15,060.7**	**15,161.1**	**15,271.9**	**15,361.4**	**15,577.9**
Nominal GDP	40,902	41,098	42,249	43,363	44,600	46,212
Net position: Surplus (Deficit) / GDP	**0.0%**	**0.1%**	**0.1%**	**0.1%**	**0.1%**	**0.1%**
Net Direct Debt / GDP	**37.1%**	**36.6%**	**35.9%**	**35.2%**	**34.4%**	**33.7%**
Gross Debt Servicing / Total revenues	**8.2%**			**8.2%**	**7.9%**	**7.1%**

Source: Budget Documents, Nova Scotia Department of Finance.

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