The 2017 Nova Scotia Budget: Proposing tax relief and new spending in a fiscally sustainable manner

A lot has happened lately in Nova Scotia. The provincial Liberal party proposed a fiscally responsible pre-electoral budget on April 27th. Three days later, Nova Scotians learned that the general election will be held on May 30th.

Let us first review the performance of FY 2016-17 which was, in our view, broadly in line with last year's budget expectations. For the first time since FY 2010-11, the Province registered a balanced budget (a very small $41M surplus, representing exactly 0.1% of GDP). Total revenues were revised down by $94M. About half of this downward revision was due to a change in accounting, rather than a disappointing performance of the economy. Indeed, the delay in the completion of the new Convention Centre in Halifax led to the moving of one-time revenue from FY 2016-17 to FY 2017-18 (part of the funding for this convention center is coming from the federal government and the Halifax Regional Municipality).

The pre-electoral budget basically proposes a second consecutive balanced budget (another very small $26M surplus, representing 0.1% of GDP). It also contains targeted tax cuts and new spending initiatives such as:

- Enhancements of the basic personal amount from $8,481 to $11,481 and some non-refundable tax credits (spousal amount and amount for eligible dependant). Effective January 1, 2018, these will imply $85M in foregone revenues annually for the government.
- Increase in the small business threshold from $350K to $500K to match the threshold in other provinces. Effective January 1, 2017, this measure will cost $14M annually to the government.
- A 3.6% increase in total expenses in FY 2017-18 relative to FY 2016-17; 40% of this additional funding is dedicated to health care and education.

These fiscal initiatives are affordable since the medium-term fiscal outlook proposes balanced budgets for the next four years (see chart on page 2). Both total fiscal revenues and expenditures are projected to increase at an annual pace of 2.1%, on average, during FY 2017-18/FY 2020-21 period.

Part of the sustainable spending trajectory is based on the recent legislative implementation of a contract for teachers imposing a cumulative 3% wage increase over the next four years. Meanwhile, the 2.1% projected rise in fiscal revenues is based on the continuation of respectable economic growth. Real and nominal GDP annual growth is forecast to average 1.1% and 3.0%, respectively, during the next four years. The construction of combat ships for the federal government will likely keep the Halifax shipyard busy for quite some time, most notably when the second construction phase begins in 2020. The low Canadian dollar will likely lead to another profiting year for the tourism industry (non-resident visitation rose by 8% in 2016 versus 2015). Also, the arrival of Syrian refugees and the end of the migration outflow to Alberta are underpinning household expenditures. These two factors allow Nova Scotia's population to rise at its fastest pace since the mid-1990s (+5.1K, or +0.5% in 2016 versus 2015). The other appealing feature is that the Nova Scotia economy is less exposed to the risks of U.S. trade protectionism than most provinces. Indeed, Nova Scotia's merchandise exports to the U.S. represent slightly less than 10% of nominal GDP (compared to 20% or more for New Brunswick, Ontario, N&L, Alberta and Saskatchewan; as we explain in more detail in our *Provincial Monitor* available at www.vmbl.ca).

What also matters for investors is that nominal GDP will likely continue to grow faster than the public debt. Even though the $15.1B net debt is projected to rise by $100M on average each year due to the increase in capital spending, the net debt-to-GDP ratio will likely decline. Estimated at 36.6% in FY 2016-17, the net debt-to-GDP ratio is projected to reach 33.7% in FY 2020-21 (see chart below). If this forecast materialises, it would easily meet the government's commitment to reach its target ratio of 33.7% or less by 2024.

Finally, the budget documents show a modest borrowing program. The Province plans to borrow $640M on the bond market in FY 2017-18, compared to $750M in FY 2016-17. Borrowing requirements are projected to rise in FY 2018-19 ($1.323B) and FY 2019-20 ($1.433B) due to higher debt maturities.

Budget 2017 set the tone for the May 30th election

The Province of Nova Scotia has been a front runner in terms of fiscal sustainability. Since its majority win in the October 2013 general election, the Liberal party was able to eliminate the deficit. This budget proposes to maintain the fiscal house in order for the foreseeable future. Voters will sanction this proposal on May 30th, the date of the next general elections in the Province.

The next step for bond investors is to wait for the election results. According to results of the *Corporate Research Associates* poll conducted earlier in February, the vote intentions among decided voters are the following: the Liberals, 44%; the Progressive Conservatives, 28%; the NDP, 23%; and the Green Party, 5%.

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