ECONOMIC RESEARCH AND STARTEGY

LAURENTIAN BANK SECURITIES

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Nova Scotia September Update – Large FY 2022-23 Deficit, Risks Titled to the Downside

Before discussing the FY 2022-23 September update, let us begin with a few words on the public accounts released on September 8th. Nova Scotia registered a record fiscal surplus of $351M in FY 2021-22. The adverse impact of the pandemic on economic activity was less severe than expected, creating large upside surprises on the revenue side. At the same time, the NS government increased health, education and housing funding. Both net debt-to-GDP (32%) and net debt-to-revenue (118%) metrics improved markedly, sitting below provincial averages.

The September Update shows a large $554M deficit in FY 2022-23, a significant deterioration in public finances relative to FY 2021-22. The addition of $48M to the deficit relative to the 2022 budget released last March is unambiguously small. FY 2022-23 revenues are poised to fall back to normal levels ($12.7B) after the unusual surge above the $14B mark in FY 2021-22. Both tax revenues and federal transfers are on track to decline versus last year. Non-recurrent COVID expenses contribute to lower expenses in FY 2022-23 ($13.4B) versus FY 2021-22. Departmental expenses, mostly for health care services, were nonetheless revised up $97M relative to the 2022 budget.

Pegged at $554M, NS is clearly on track to register a shortfall significantly larger than the pandemic period of FY 2020-21 ($348M). In fact, the deficit could end up being larger than $554M. In the risks section of the September Update, the government stipulates that associated expenses to Hurricane Fiona will be added in future updates. The NS government just announced a $40M Disaster Financial Assistance Program. The most recent news indicates economic disruptions and capital destruction.

In addition to potentially higher spending, revenues could end up slightly lower. NS real GDP growth will likely end up below the government's assumptions (2% in 2022, 1.7% in 2023) made before last week's very restrictive interest rates path proposed by the FOMC. Even if the sensitivity of the NS economy to higher rates is lower than most provinces - based on lower shelter costs and a lower % of households holding a mortgage -, we are in the process of cutting down our US and Canadian real GDP forecasts going forward. Combined with the UK policy mistake bringing spillovers effects to the North American bond market in the form of higher interest rates, the tide has suddenly shifted in favour of at least a mild North American economic contraction in early 2023. We will notably bring down our NS real GDP growth estimate for 2023 below 1%. Thus, we see elevated CPI inflation providing only a short-lived boost to NS sales tax revenues. Indeed, CPI inflation in NS during the Jan.-Aug. period reached 7.7%, implying it will likely end up above the 5.5% 2022 annual assumption used by the government.

In summary, even if the FY 2022-23 deficit ends up being more important than $554M, borrowing requirements are not necessarily going to increase as the capital spending plan of $1.5B was revised down by $109M relative to the 2022 budget. The September Update does not include new borrowing requirements figures for FY 2022-23. Our latest tracking points to funding needs of $1.646B. 34% of this issuance is completed, occurring completely on the Canadian market.

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