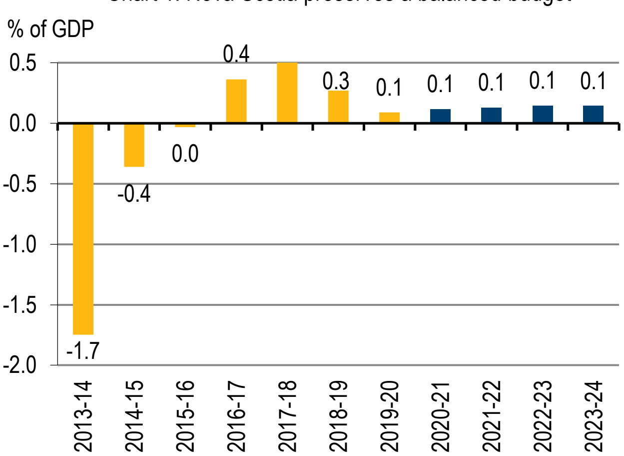
The 2020 Nova Scotia Budget: Infrastructure Spending and Steady Balanced Budget

Corporate tax rate reduction and a softer pace of growth for program spending

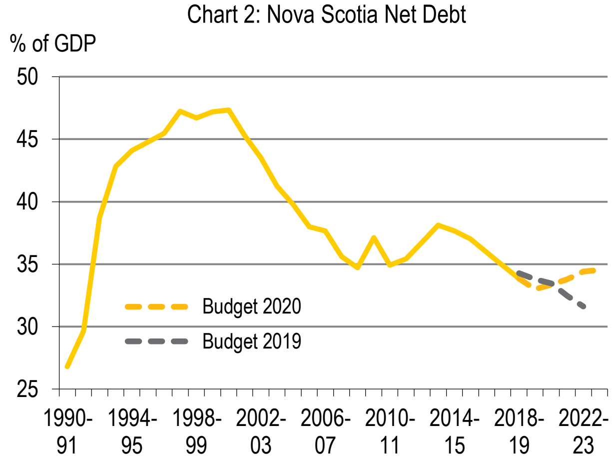
Nova Scotia Finance Minister Karen Casey presented yesterday the province's fifth consecutive balanced budget. Following a surge in revenues (+8.7%) and program expenditures (+6.3%) in FY 2019-20, the government looks for a moderate pace of growth in those going forward. First, total revenues are expected to increase at a below-average rate of 1.6% in FY 2020-21 due to a 2 percentage point corporate tax rate reduction costing $71M in FY 2020-21. Effective April 1st 2020, the general corporate tax will be reduced from 16% to 14%. Similarly, the small business tax rate will go down from 3.0% to 2.5% and cost $11M in foregone revenues. The government will balance these tax reductions by restraining the pace of growth in program spending. Program expenditures are forecast to grow by 2.1% in FY 2020-21, lower than the 2.9% annual average registered during the last decade. However, important investments are being made in health care services, including a $75M injection to improve the recruitment and retention of medical professionals. Altogether, a $55M surplus is projected in FY 2020-21. As a percent of GDP, a constant 0.1% surplus is expected over the 4-year forecast horizon (chart 1).

Chart 1: Nova Scotia preserves a balanced budget



Source: Nova Scotia gvt., Stat. Can., LBS Econ. Res. and Strategy.

Chart 2: Nova Scotia Net Debt



Source : Nova Scotia Government, Government of Canada Fiscal Reference Tables, LBS Econ. Res. and Strategy.

Surge in capital spending and small increase in the borrowing program

Health care remains a core issue in the Province's FY 2020-21 capital plan. For instance, $154M will be dedicated to the Queen Elizabeth II Health Care Center in Halifax and the Cape Breton Regional Hospital. $266M is also committed to school building and repairs. Overall, the FY 2020-21 capital plan is estimated at $1.0B, an increase of more than 50% relative to FY 2019-20. Thus, the capital plan will increase the province's debt in the coming years. Relative to GDP, net debt is forecast to rise to 34.5% in FY 2023-24 from a multi-decade low of 33.0% in FY 2019-20 (chart 2). This increase in the net debt ratio is manageable because 1) it is fairly mild; 2) long-term benchmark interest rates remain low 3) Nova Scotia's strong commitment to budget balance is intact.

The borrowing program is slightly revised up relative to last year. Financing needs are projected at $1.5B, $1.4B and $1.1B in FY 2020-21, 2021-22 and 2022-23 respectively (see table). On an annual average basis, it represents a $166M increase relative to Budget 2019 forecasts and is mainly attributable to the updated capital plan.

Pulp mill closure and coronavirus impact in early 2020, but medium-term outlook remains strong

The vibrant Halifax economy contributed to lift real GDP growth to a decade-high of 1.9% last year. However, economic growth is poised to cool down in 2020 due to the recent closure of the Northern Pulp mill in Pictou County. The province expects real GDP growth to slow considerably to 0.4% in 2020, below the 1.2% private sector consensus. The impact of large employers in smaller communities should not be overlooked. For instance, the Bowater Mersey paper mill closure of mid-2012 was a key factor that led to a sub-par real GDP performance in 2012 and 2013 (chart 3). Accordingly, Budget 2020 incorporates a contraction in exports to other countries this year. In our view, Nova Scotia's higher trade dependence on China could weigh down further on economic growth in 2020. China's share of Nova Scotia exports has risen exponentially in the last decade as the province was able to benefit from strong Asian demand for seafood products (chart 4). The 2020 budget is based on a 6.0% expansion of the Chinese economy this year. The coronavirus outbreak is too recent to be incorporated into the budget's economic assumptions. For instance, *The Economist Intelligence Unit* released a report today with possible economic outcomes related to the coronavirus. The base case scenario calls for 5.4% real GDP growth in China and there is a 25% chance that growth ends up at 4.5% or below. In Nova Scotia, media recently reported a decline in lobster exports to China.

While the world deals with coronavirus uncertainty at the moment, investors can take comfort in the strong fundamentals of the Nova Scotia economy that will keep the province on a sustainable fiscal path. The province notably benefits from a stronger potential GDP, thanks to record high immigration in recent years and the return to positive net interprovincial migration flow. Thus, trend growth is projected to remain above 1% for a long period, contrasting with the mid-2010s period (chart 3).

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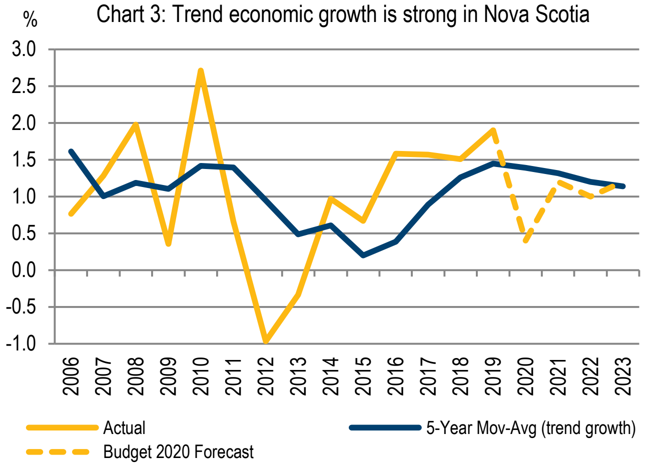
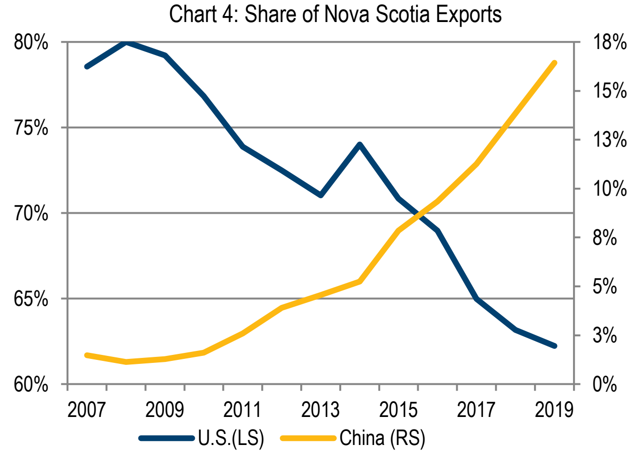
Chart 3: Trend economic growth is strong in Nova Scotia



Source: Statistics Canada, Nova Scotia gvt and LBS Econ. Res. and Strategy calculations.

Chart 4: Share of Nova Scotia Exports



Source: Statistics Canada.

Nova Scotia Fiscal Projections						
		Forecast		Estimate		
($millions)	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Total Revenue	**10,501**	**11,412**	**11,597**	**11,856**	**11,996**	**12,181**
% change	-0.8	8.7	1.6	2.2	1.2	1.5
Program Spending	10,003	10,637	10,858	11,094	11,282	11,466
Debt Servicing Costs	856	843	758	725	664	664
Total Expenditure	**10,860**	**11,480**	**11,616**	**11,819**	**11,946**	**12,129**
% change	0.6	5.7	1.2	1.7	1.1	1.5
Consolidation and Adjustments	478	110	74	26	23	23
Surplus/Deficit (-)	**120**	**41**	**55**	**63**	**73**	**74**
As a % of Nominal GDP	0.3	0.1	0.1	0.1	0.1	0.1
Net Debt	**15,011**	**15,181**	**15,716**	**16,443**	**17,253**	**17,866**
As a % of Nominal GDP	33.8	33.0	33.3	33.8	34.4	34.5
Total Borrowing Requirements		**1,600***	**1,521**	**1,420**	**1,079**	**368**

Source: Nova Scotia Budget 2020 and *LBS Economic Research and Strategy calculations.