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A surprise surplus giving way to years of deficits

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Highlights

Nova Scotia is a month away from registering their seventh budget surplus in the last eight years as long as current estimates hold up. Indeed, the \$264 million deficit that the province had been tracking towards (as recently as the December) was erased, largely due to significant prior year provincial tax adjustments. This one-off revenue windfall should not be expected to repeat and as such, the medium-term fiscal outlook looks similar to what was presented in last year's budget. The province plans to register modest deficits (1% of GDP or less) for at least the next four years, starting with a \$467 million shortfall (0.8% of GDP) in 2024-25. There's no explicit plan to bring the province back to balance outlined in the budget. Not surprisingly, notable new initiatives are centered on health care, housing, and affordability more generally. That's a theme that's likely to be prevalent in all budgets this year. When it comes to debt, Nova Scotia is carrying a lighter load than previously anticipated (\$18.7 billion in 2023-24 or 33% of GDP). However, as we're seeing on the income statement, there will be balance sheet pressures in the years ahead too. The debt burden is expected to steadily rise throughout the forecast horizon, hitting 38.4% of GDP in 2027-28 and surpassing the cyclical peak set at the height of the pandemic in 2020-21 (<37%). Debt servicing costs will grow at a solid clip (7.5%/year) over the coming years but will remain reasonably affordable. The 'interest bite' is forecast to hit 6.2% by 2027-28, which isn't far from the provincial average. Naturally, borrowing needs are moving up too so expect to see Nova Scotia more active in debt capital markets in coming years. The \$2 billion of long-term funding completed in this outgoing year will grow to \$2.6 billion in 2024-25 and \$3.4 billion in 2025-26, before dropping back into the \$2-2.6 billion range further out the horizon. We see this as an entirely manageable bond program.

- **Economic outlook** – After a significant post-pandemic rebound in 2022, it is estimated that Nova Scotia's real GDP has grown at a slower pace of 1.3% in 2023, which is still stronger than the 1.1% growth seen in the country as a whole. The nominal GDP, for its part, has grown by 3.3%, also above what was seen nationally. Nova Scotia's economy has been supported by the strongest demographic growth in its modern history, with the working-age population growing by 3.1% from January 2023 to January 2024. This significant population growth resulted in the creation of 12.9K jobs, or 2.7% growth. Despite this vigour, the labour market has not been able to fully absorb this strong population growth. As a result, the unemployment rate in the province rose from its historic low of 5.4% in January 2023 to 7.0% in January 2024, a much greater deterioration than that seen nationally. For the future, the budget is based on real GDP growth of 1.7% in 2024, which is higher than the 1.0% expected by the average of the private sector economists. For 2025, real GDP growth should be higher at 1.9% (roughly equal to the average private sector forecast of 2.0%), then rise to 2.0% in 2026 before slowing to 1.7% in 2027. Even more important for public finances, Nova Scotia's nominal GDP in 2024 is expected to grow by 3.9%, which seems somewhat optimistic compared with the private sector's forecast of 3.0%. Nominal GDP should then rise by 3.3% in 2025 (below the 3.6% expected by the consensus), 3.2% in 2026 and 3.3% in 2027. As for the labour market, job creation should continue to lag population growth. As a result, the unemployment rate should continue to rise, reaching an average level of 7.4% in 2024 and 7.9% in 2025.
- **Latest (but not yet final) estimate of 2023-24 budget balance** - Prior to today's budget, the latest read on Nova Scotia's finances came as part of a second-quarter update, published in December. In it, the province was guiding towards a \$264 million deficit (0.5% of GDP), which is almost exactly what had been outlined in Budget 2023. Today, we learned that Nova Scotia is instead likely to end the year with a very modest surplus (\$40 million or 0.1% of GDP). Should this black ink hold up, it will be the seventh year in the past eight that the province has ended the year in surplus (the only exception being 2020-21). The improvement relative to the Q2 update is a product of revenues coming in nearly 5% higher than planned. Much of this can be attributed to prior year provincial tax adjustments, which boosted receipts by \$425 million compared to the Q2 update. Expenses were higher-than-expected too but the increase was contained to 2.5%.
- **Medium-term fiscal outlook (2024-25 & beyond)** – The nearly uninterrupted streak of surpluses is expected to end in 2024-25, as the province has pencilled in a \$467 million (0.8% of GDP) budget deficit. The deterioration is expected to be driven by spending growth (+5.6%) outpacing revenue growth (+2.0%). A slower rise in receipts isn't all that surprising considering that a sizeable chunk of last years inflows (\$560 million or 3.6%) were prior year tax adjustments, a line item that can't be expected to repeat itself.

Beyond 2024-25, modest deficits (1% of GDP or less) are expected to persist for at least the following three years (through 2027-28). Per the budget, these reflect "the government's commitment to making investments in priority areas for Nova Scotians such as healthcare, housing and affordability." To be clear, an outlook written in red ink isn't a new development as last year's budget painted a similar fiscal picture. Indeed, the three years spanning 2024-25 to 2026-27, the combined deficit is very little changed from Budget 2023 (\$1.65 billion in Budget 2024 vs. \$1.57 billion in Budget 2023). Per this fresh update, the shortfall is expected to

peak in 2025-26 at \$609 million (1.0% of GDP) before improving over the final two years of the forecast horizon, hitting \$360 million (0.6% of GDP) in 2027-28. There is no explicit commitment to returning the budget to balance.

- **New initiatives – Dubbed ‘Building Nova Scotia, Faster’, Budget 2024 focuses on three key elements: supporting Nova Scotians and building communities, action for healthcare, and building a skilled workforce for more housing and healthy economy.** In the first axis, the most noteworthy measure is undoubtedly the indexing of personal income tax brackets, basic personal amount and certain non-refundable tax credits to Nova Scotia’s inflation rate starting on January 1, 2025. By 2028, this change will represent about \$150-\$160 million per year in taxes saved by taxpayers. In this section, the budget also includes the launch of a new lunch program for students in the public school system at a cost of \$18.8 million for the first year. The program is scheduled to be rolled out over a four-year period, with investment rising to \$100 million a year by 2027-28. On the affordable housing front, the budget also includes an additional \$2.4 million to create 500 new rent supplements, for a total of \$69.2 million to help 8,500 households. Regarding the second area, health care, the Budget points out that expenditure in this area now stands at \$7.3 billion, or 44% of total expenditure, and has risen by \$1.9 billion or 36% in the last 3 years. The new sums announced in the 2024 Budget include an additional \$360.7 million for the operation of Nova Scotia Health and IWK Health, \$184.3 million more to continue progress on the Action for Health plan (which included amounts for primary healthcare initiatives, moving patients through the healthcare system more quickly and for cancer care and precision medicine improvements), and an additional \$36.2 million to move toward universal mental health and addictions care in the province. Finally, the third axis of the Budget announces \$80-\$100 million annually to rebate the 10% provincial HST on the new construction of purpose-built, multi-unit apartments (just like the Federal government did in the previous months), \$46.4 million in 2024 to grow the skilled trades workforce (\$100 million plan over three years), and \$36.7 million this year for various actions to advance Nova Scotia’s Climate Change Plan for Clean Growth.
- **Debt burden & interest bite – Nova Scotia’s net debt looks to end 2023-24 at \$18.7 billion, equivalent to 33.3% of GDP. That’s a lighter absolute and relative debt load than originally planned for in Budget 2023, providing a firmer balance sheet starting point for Budget 2024.** Beginning with the coming fiscal year (2024-25), budgetary deficits and capital investment plans place net debt on a steady upward track. At \$20.2 billion, the coming fiscal year’s net debt level would be more than \$1.5 billion higher year-on-year, equating to 34.6% of GDP. But thanks to that positive base effect, the projected debt burden for 2024-25 appears no worse than what was flagged a year ago. Taking a medium-term perspective, the debt-to-GDP ratio is seen rising each year of four-year fiscal plan, reaching a projected 38.4% by 2027-28—surpassing the cyclical peak set at the height of the pandemic in 2020-21 (<37%). Debt servicing costs are anticipated to grow at an average annual rate of 7½% over the coming four fiscal years, consuming a gradually larger share of provincial revenue. Still, Nova Scotia’s ‘interest bite’—forecast at 5.2% of revenue for 2024-25 and 6.2% by 2027-28—would still indicate a reasonably affordable debt load, all else being equal. Note that the province has no net FX exposure on its outstanding debt, with official sensitivity analysis suggesting a 1% increase/(decrease) in T-bill yields adds/(subtracts) ~\$10 million in annual interest. (For reference, debt servicing costs are projected at \$823 million for the coming fiscal year.)
- **Borrowing requirement – Nova Scotia tapped debt capital markets for an even \$2 billion in 2023-24, all but matching the level of gross long-term funding outlined in Budget 2023.** Completed issuance was placed exclusively in the domestic market, the province steering fixed-rate deals to each of the three main benchmark tenors (i.e., 5s, 10s, 30s) alongside a fresh 5-year CORRA FRN. In light of the deficits, capital spending plans and Crown Corp. advances outlined in the budget, investors can expect Nova Scotia to be somewhat more active in the coming two fiscal years. For 2024-25, the budget details a total funding requirement (all sources) of \$3.3 billion. With \$750 million to be sourced from short-term markets or via a drawdown of short-term assets, 2024-25’s gross long-term borrowing requirement amounts to just under \$2.6 billion. We consider this a manageable bond program for a provincial credit currently rated A(high) to AA(mid). The coming’s year bond crop looks once again to be steered primarily to the domestic (i.e., CAD) bond market, although documentation remains in place to access international markets. Indicatively, Nova Scotia’s long-term requirement is set to increase further in 2025-26, hitting \$3.4 billion before dropping back into the \$2-2.6 billion range in the final two years of the financial plan.
- **Current long-term credit ratings – S&P: AA-, Stable | Moody’s: Aa2, Stable | DBRS: A(High), Stable**
[Refer to our Provincial Ratings Snapshot for additional colour on specific credit rating drivers/considerations]



Nova Scotia

\$ Million	Budget 2023-24	Budget 2023-24	Budget 2024-25	Estimate 2025-26	Estimate 2026-27	Estimate 2027-28
Revenues	14,168.9	15,531.0	15,843.8	16,240.4	16,668.5	16,999.0
Provincial Taxation, Fees and Charges	7,396.1	8,369.0	8,021.4			
Interest Revenues and Sinking Funds Earnings	137.3	172.6	162.8			
Federal sources	5,363.8	5,410.4	6,041.6			
Ordinary Recoveries	986.2	1,109.4	1,144.0	1,091.0	1,019.0	901.4
Sub-total	13,883.5	15,061.4	15,369.9	15,767.9	16,183.6	16,514.6
Net Income from Government Business Enterprises	285.4	469.7	473.9	472.5	484.9	484.4
Expenses	14,820.3	15,643.5	16,518.7	17,054.1	17,444.2	17,551.5
Departmental expenses	13,850.7	14,659.5	15,536.4	15,984.3	16,268.3	16,307.7
Refundable tax credits	136.1	133.9	126.3	128.1	128.2	128.4
Pension Valuation Adjustment	66.6	57.7	33.1	42.2	46.7	58.9
Debt Servicing Costs	766.9	792.3	822.9	899.5	1,001.0	1,056.5
Consolidation and Accounting Adjustments	372.5	152.8	207.5	205.1	200.0	192.4
Provincial Surplus (Deficit)	(278.9)	40.3	(467.4)	(608.6)	(575.7)	(360.1)
Term debt borrowing						
Provincial Deficit (Surplus)	278.9	(40.3)	467.4	608.6	575.7	360.1
Tangible capital assets: Net cash	1,078.9	971.0	1,048.1	988.1	983.5	980.3
Other Non-Budgetary transactions	220.6	(156.8)	(77.2)	(91.7)	(106.3)	(121.2)
Other Net Allocations to Various Funds	(400.2)	392.8	300.7	1,076.1	500.7	162.5
Cash Debt Retirement	851.4	851.4	859.2	841.2	3.5	1,203.4
Sub-total: Total borrowing requirements	2,029.6	2,018.1	2,598.2	3,422.3	1,957.1	2,585.1
Change in Short-Term Borrowing (inc)/dec	(680.0)	67.7	(750.0)	-	-	-
Total	2,709.6	1,950.4	3,348.2	3,422.3	1,957.1	2,585.1
Net Direct Debt						
Opening Balance	18,186.0	17,771.0	18,701.7	20,217.2	21,813.9	23,373.2
Provincial Balance	278.9	(40.3)	467.4	608.6	575.7	360.1
Increase in net book value of tangible capital assets, other	1,078.9	971.0	1,048.1	988.1	983.5	980.3
Closing Balance	19,543.8	18,701.7	20,217.2	21,813.9	23,373.1	24,713.6
Nominal GDP	58,143	56,182	58,375	60,325	62,276	64,356
Net position: Surplus (Deficit) / GDP	-0.5%	0.1%	-0.8%	-1.0%	-0.9%	-0.6%
Net Direct Debt / GDP	33.6%	33.3%	34.6%	36.2%	37.5%	38.4%
Gross Debt Servicing / Total revenues	5.4%	5.1%	5.2%	5.5%	6.0%	6.2%

Source: Budget Documents, Nova Scotia Department of Finance.

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