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Addressing health care takes priority over balancing the budget

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Highlights

Nova Scotia is wrapping up a 2022–23 fiscal year which once again saw revenues and the budget balance finish stronger than originally envisioned. That said, the province did swing back into deficit for just the second time in seven years (the other being the exceptional ‘peak-COVID’ 2020–21 fiscal year). As the province and, country/globe more generally, contend with a monetary policy-induced growth slowdown, it’s expected that there will be some budgetary deterioration over the medium-term. That’s also a function of large-scale investments into the province’s health care system, which is very clearly the overriding priority of this budget as its title “More Healthcare, Faster” implies. The province has guided us to a \$279 million deficit next year, with the shortfall set to grow thereafter. All told, the budgetary red ink sums to ~\$1.85 billion over the four fiscal years ending 2026–27. That may be higher than earlier anticipated, but we’d highlight that these are still relatively modest shortfalls, never surpassing 1% of GDP and improving a tad by the outer year of the forecast horizon. It follows that debt burdens are set to rise too in order to finance aforementioned budget shortfalls and capital investments. It’s expected that \$5.07 billion in net debt will be tacked on over the next four years, pushing the net debt burden from 32.5% in 2022–23 to 36.2% by 2026–27. Importantly, that is still comfortably below the trajectory outlined in Budget 2022. Underlying cash requirements step up in the coming fiscal year, but nearly \$700 million of cumulative pre-funding (deemed to have been completed over a number of years) ultimately results in a relatively manageable \$2.0 billion gross bond program for 2023–24 (up from \$1.5 billion in 2022–23). Further out, we can expect \$2.2–2.3 billion of annual issuance in the following two years before it recedes to \$1.15 billion in 2026–27. All in all, this is a budget that clearly reflects an ongoing/expected slowdown in global economic activity and a prioritization of investments in the healthcare system. That of course comes at a cost, as evidenced by continued deficits (admittedly relatively modest at <1% of GDP) and a gradual increase in indebtedness.

- **Economic outlook** – Nova Scotia’s real GDP was estimated to have grow at 2.2% in 2022, the fastest pace of the Maritime provinces. That’s technically slower than the national average, but this comes after two years of notable outperformance in 2020 and 2021. Going forward, real GDP growth of 0.6% in 2023 and 1.1% in 2024 is expected. 2023’s projection is in line with our own, but we see a slightly slower rate of growth in 2024 (0.3%). Meanwhile, the province is planning for nominal GDP growth of 4.0% in 2023 and 3.4% in 2024. That’s stronger than our own forecasts and the average of private sector forecasters. The province expects solid population growth to continue, as the number of Nova Scotians is expected to grow by 2.0% in 2023 and 1.6% in 2024. This will keep the labour force and employment levels growing over the coming years. To date, the labour market has been strong, with employment reaching an all-time high at the end of 2022, up 6% from pre-pandemic levels. That said, the province does expect the unemployment rate to rise in the years ahead, averaging 7.4% in 2023 and 7.7% in 2024. Notably, that is well above our own projection for the province of 6.2% and 7.3% in 2023 and 2024, respectively.
- **Outgoing year budget balance (2022–23)** – Just as we saw in 2021–22 (and as we’ve seen from other provinces this year), Nova Scotia’s fiscal position improved over the course of the fiscal year. The province now expects to run a deficit of \$259 million compared with an original plan for a \$506 million deficit. Note that in the province’s December forecast update, it had telegraphed a deficit of \$143 million so this is a modest deterioration from recent guidance. In any event, the deficit is still quite modest at just 0.5% of GDP and comes after five surpluses in the last six years (the peak pandemic year of 2020–21 being the exception). Relative to last year’s budget, revenue came in an impressive \$1.7 billion (+13%) higher than anticipated. That was thanks largely to higher levels of personal, corporate and sales tax receipts and significant prior year adjustments. Expenses came in higher too at +\$14 billion (or +11%). Higher spending was broad-based, but the largest contributors were (unsurprisingly) health care and seniors/long-term care. All told, higher expenses consumed about 85% of unplanned revenue.
- **Medium-term fiscal outlook (2023–24 & beyond)** – The budget shows Nova Scotia remaining in deficit in 2023–24, the shortfall slightly worsening to \$279 million (still 0.5% of GDP). That’s driven both by modestly lower revenues (-1.0%) and modestly higher spending (+0.7%). On the income side, provincially-sourced revenue is set to fall nearly 8% as the \$900 million positive adjustment to prior years’ provincial taxes that was booked in 2022–23 isn’t expected to repeat. Meanwhile, federal transfers are set to jump more than 12%. Spending pressures are (unsurprisingly) most evident in health care where expenditures are set to rise almost 7%. You’ll also find sizeable increases in education spending and debt servicing costs, though the latter remains quite small as a share of revenue/expenses (more on that below).

Looking further out, the deficit will grow over the following two years (\$464 million in 2024–25 and \$611 million in 2025–26) before an improvement is pencilled in for 2026–27 (\$499 million). While the past three fiscal years have come out stronger than originally planned, the 2024–25 and beyond outlook has deteriorated over recent budgets. The province highlights that these budgetary shortfalls “reflect the government’s commitment to making investments in priority areas for Nova Scotians such as healthcare”. It’s

worth pointing out that, despite the fiscal erosion out the forecast horizon, these are all still relatively modest deficits as a share of the economy. In each fiscal year of the medium-term plan, the deficit should represent no more than 1% of Nova Scotia's GDP. Nonetheless, you won't find an explicit commitment to returning the budget to balance.

- **New initiatives** – Continuing the pandemic-emerging trend, Nova Scotia remains focused on health care investment – as made clear by the budget's title, "More Healthcare, Faster". Budget 2023-24 invests a total of \$6.5 billion into healthcare, 21.8% more than two years ago. The province will focus over \$130 million on spending to incentivize those in nursing professions through tax relief programs, service agreement bonuses, and other mentoring/placement improvements. In addition to worker incentives, the budget outlines plans for accelerating access to healthcare (including ~\$50 million dedicated to address backlogged surgeries) and improving long-term care. \$538 million under the Capital Plan is set to modernize and expand healthcare facilities in key communities. Nova Scotia is committed to improving the health of its economy and communities, the budget outlining investments in infrastructure, as well as targeted supports for affordability, education, and the vulnerable population. Just under \$500 million will be put towards roads, highways, and bridges, and ~\$70 million will be directed towards housing, homelessness, and affordability. On supporting vulnerable citizens, the province plans to spend \$14 million more on youth-support programs and improvements to the foster care system, while directing an additional ~\$23 million to both disability support and public housing programs. Lastly, Budget 2023-24 earmarks over \$240 million for spending related to the building and renovation of schools, with over \$100 million supporting the affordability of education and early childhood development services. As per the province, the 2023-24 Capital Plan is "the largest single-year capital funding program in the province's history".
- **Debt burden & interest bite** – Provincial net debt is projected to end 2022-23 at \$18.2 billion, which is roughly \$200 million below what had been estimated in Budget 2022. Further, much stronger-than-expected nominal GDP in 2022 (output measured in current dollars surged over 8% last year) meant an even greater improvement in indebtedness when scaled to the size of the economy. The 32.5% net debt-to-GDP ratio is nearly 2.5%-pts below what was estimated a year ago, creating a strong hand-off to future years. While indebtedness will climb to 33.6% of GDP (\$19.5 billion) in 2023-24 and steadily rise thereafter to 36.2% (\$23.3 billion) by 2026-27, this is improved versus debt ratios envisioned a year ago. (For context, 2025-26 net debt-to-GDP was estimated at 40.0% of GDP). Even in dollar terms, the level of net debt remains below earlier projections despite larger deficits out the forecast horizon. Nonetheless, the province will of course still take on debt to finance budget deficits and investments in roads, schools and healthcare. Meanwhile, higher debt loads combined with higher interest rates means that debt servicing costs will be on the rise. The \$680 million interest bill for 2022-23 is set to grow to \$767 million in 2023-24 and to just a hair over \$900 million by 2026-27. Interest charges consumed 4.8% of total revenue in the outgoing fiscal year, and while this "interest bite" will rise going forward, it will remain no higher than 6% over the forecast horizon. Sinking fund earnings of roughly \$20-30 million/year will offset some of the impact of higher interest charges. Moreover, lower interest rates and rate expectations that have taken hold over recent weeks create some scope for debt charges to come in lower, should central banks ease as quickly and aggressively as markets anticipate. More specifically, official sensitivity analysis suggests that a 1%-pt increase/decrease in short-term yields would add/subtract \$15 million to debt servicing costs in year one.
- **Long-term borrowing requirement** – Nova Scotia issued \$1.5 billion (par value) of exclusively domestic bonds in 2022-23, coming to market with five \$300 million deals: 2X Jun-2028, 1X Jun-2029 and 2X Dec-2031. The resulting weighted average term was relatively shorter than in some other provinces. For the coming fiscal year, the province is flagging a more-than-\$1.8 billion increase in operating cash requirements, despite the roughly unchanged deficit. That's due largely to a sizeable (+\$1.3 billion) swing in non-budgetary transactions, driven by retention incentives for healthcare workers booked in 2022-23 but paid in 2023-24 and non-cash interest charges on unfunded pension liabilities and post-employment benefits. Add in \$851 million in maturing debt and the province's total borrowing requirement amounts to \$2.7 billion. Importantly, that tally will be moderated by the absorption of nearly \$700 million of pre-borrowing that was accumulated over the past number of years. The punchline is the province is set to issue \$2.03 billion in the coming fiscal year which we would consider manageable. The domestic market will be the primary focus for the province in 2023-24, but documentation remains in place to borrow from foreign markets if needed/desired. In future years, there will only be limited growth in gross borrowing requirements: \$2.3 billion is pencilled in for 2024-25, with \$2.2 billion and \$1.1 billion in expected issuance for 2025-26 and 2026-27, respectively.
- **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 2022-23	Estimate 2022-23	Budget 2023-24	Estimate 2024-25	Estimate 2025-26	Estimate 2026-27
Revenues	12,661.9	14,318.4	14,168.9	14,347.5	14,763.7	15,026.4
Provincial Taxation, Fees and Charges	6,633.8	8,161.1	7,396.1			
Interest Revenues and Sinking Funds Earnings	112.1	140.6	137.3			
Federal sources	4,694.6	4,776.7	5,363.8			
Ordinary Recoveries	801.6	844.5	986.2	868.1	866.0	660.0
Sub-total	12,242.1	13,922.9	13,883.5	14,068.3	14,487.5	14,746.8
Net Income from Government Business Enterprises	419.8	395.5	285.4	279.2	276.2	279.6
Expenses	13,292.5	14,712.9	14,820.3	14,972.1	15,533.0	15,680.7
Departmental expenses	12,422.7	13,833.3	13,850.7	13,982.9	14,504.7	14,576.6
Refundable tax credits	121.8	136.2	136.1	136.7	137.4	138.1
Pension Valuation Adjustment	71.5	62.9	66.6	55.2	51.2	63.4
Debt Servicing Costs	676.4	680.5	766.9	797.3	839.7	902.6
Consolidation and Accounting Adjustments	124.4	135.1	372.5	160.4	158.4	155.2
Provincial Surplus (Deficit)	(506.2)	(259.4)	(278.9)	(464.2)	(610.9)	(499.1)
Term debt borrowing						
Provincial Deficit (Surplus)	506.2	259.4	278.9	464.2	610.9	499.1
Tangible capital assets: Net cash	711.5	732.3	1,078.9	935.6	649.5	554.1
Other Non-Budgetary transactions	(63.9)	(1,087.0)	220.6	(133.7)	(129.6)	(147.3)
Net Mandatory Sinking Funds Withdrawals	(708.8)	(708.8)	-	-	-	-
Other Net Allocations to Various Funds	(533.3)	423.8	(400.2)	170.9	145.4	126.2
Cash Debt Retirement	1,734.2	1,734.2	851.4	859.2	932.9	113.1
Sub-total: Total borrowing requirements	1,645.9	1,353.9	2,029.6	2,296.2	2,209.1	1,145.2
Change in Short-Term Borrowing (inc)/dec	(600.0)	289.2	(680.0)	-	-	-
Total	2,245.9	1,064.7	2,709.6	2,296.2	2,209.1	1,145.2
Net Direct Debt						
Opening Balance	16,805.6	16,568.2	18,186.0	19,543.8	20,943.6	22,203.9
Provincial Balance	506.2	259.4	278.9	464.2	610.9	499.1
Increase in net book value of tangible capital assets, other	1,085.4	1,358.3	1,078.9	935.6	649.5	554.1
Closing Balance	18,397.2	18,185.9	19,543.8	20,943.6	22,204.0	23,257.1
Nominal GDP	52,667	55,903	58,143	60,132	62,071	64,178
Net position: Surplus (Deficit) / GDP	-1.0%	-0.5%	-0.5%	-0.8%	-1.0%	-0.8%
Net Direct Debt / GDP	34.9%	32.5%	33.6%	34.8%	35.8%	36.2%
Gross Debt Servicing / Total revenues	5.3%	4.8%	5.4%	5.6%	5.7%	6.0%

Source: Budget Documents, Nova Scotia Department of Finance.



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