

Forecast Update

September 21, 2015

The Honourable Randy Delorey,
Minister of Finance and Treasury Board



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Introduction

The Forecast Update provides revised information about Nova Scotia's fiscal outlook, including updated information about the major components of revenue and expenses as set out in Budget 2015–2016.

There is much uncertainty in provincial, national and global economies. Weaker economic conditions have led to a softening in the outlook for provincial tax revenues, and a small increase in Departmental Expenses have increased the forecasted deficit for 2015–2016. Revenues are growing but not as much as previously estimated.

There is no change to Government's balanced budget fiscal plan, with an expected budget surplus in 2016–2017.

- There continues to be economic uncertainty that could impact budget targets with revenues below expectations.
- Government will continue to be vigilant on spending and take action where possible to meet the budget and fiscal plan targets. To eliminate the deficit, government must control its single largest expense – labour costs. Wage increases must fit within the fiscal plan.
- Getting to sustainable finances is important as it allows Government to invest in priority areas such as health care and education.

Overview

The Province of Nova Scotia is forecasting a deficit of \$122.5 million for 2015–2016, an increase of \$25.0 million from the budget of \$97.6 million. The difference is essentially the result of Revenue being lower than expected, increased Departmental Expenses and a reduction in Consolidation and Accounting Adjustments.

- While provincial tax revenues are forecasted to decline by \$36.6 million from the estimate, they were mostly offset by revenue increases

from other sources. Total Provincial Revenue, including Net Income from Government Business Enterprises, are forecast to be \$9.9 billion, a decrease of \$10.0 million.

- Total Expenses are forecast to be \$10.0 billion; \$11.6 million higher than budget.
- Changes in Consolidation and Accounting Adjustments result in a \$3.4 million negative impact to the bottom line.

Fiscal Summary 2015–2016

(\$ thousands)

General Revenue Fund	Budget	Forecast	<i>Increase (Decrease) from Budget</i>
Revenue			
Ordinary Revenue	9,036,661	9,004,229	(32,432)
Ordinary Recoveries	531,238	537,354	6,116
Net Income from Government Business Enterprises	352,109	368,415	16,306
Total Revenue	<u>9,920,008</u>	<u>9,909,998</u>	<u>(10,010)</u>
Expenses			
Departmental Expenses	8,910,013	8,924,581	14,568
Refundable Tax Credits	150,968	151,011	43
Pension Valuation Adjustment	90,654	90,654	---
Debt Servicing Costs	872,612	869,571	(3,041)
Total Expenses	<u>10,024,247</u>	<u>10,035,817</u>	<u>11,570</u>
Consolidation and Accounting Adjustments for Government Units	6,664	3,286	(3,378)
Provincial Surplus (Deficit)	<u>(97,575)</u>	<u>(122,533)</u>	<u>(24,958)</u>

Revenue

Total Revenue, including Ordinary Recoveries of \$537.4 million, and Net Income from Government Business Enterprises of \$368.4 million, is forecast to be \$9.9 billion, \$10.0 million less than the 2015–2016 Budget Estimates.

This represents a decrease in provincial tax revenue of \$36.6 million from Budget Estimates, partially offset by gains in Other Provincial Revenue of \$0.9 million, Investment Income of \$0.5 million, Federal Sources of \$2.7 million, Ordinary Recoveries of \$6.1 million, and an increase in Net Income from Government Business Enterprises of \$16.3 million.

Provincial Tax Revenue

Personal Income Tax revenue is forecast to decline by \$14.1 million or 0.6 per cent from the 2015–2016 Budget Estimates as a result of slight decreases in the projected levels of personal taxable income in both 2015 and 2016, primarily due to slower growth in compensation of employees.

Corporate Income Tax revenue is forecast to decline by \$7.1 million or 1.4 per cent from the 2015–2016 Budget Estimates. This is due to decreases in both 2015 and 2016 for the level of national corporate taxable income, based upon federal estimates. The province's projected share of taxable income is marginally higher based upon the use of a three-year average methodology.

Harmonized Sales Tax (HST) revenue is forecast to decline by \$6.6 million or 0.4 per cent from the 2015–2016 Budget Estimates, primarily as a result of higher rebates to public sector bodies (municipalities, universities,

schools and hospitals, etc.) because of higher spending, and lower forecasts for consumer expenditure growth in both 2015 and 2016 due to lower personal incomes.

Motive Fuel Tax revenue is forecast to be down \$3.5 million or 1.3 per cent from the 2015–2016 Budget Estimates based upon lower projected consumption of both gasoline and diesel oil, primarily as the result of lower levels of labour income forecasted for both 2015 and 2016.

Tobacco Tax revenue is forecast to decline by \$4.3 million or 2.0 per cent from the 2015–2016 Budget Estimates as a result of the province's ban on flavoured tobacco and declines in consumption. This is partially offset by the Consumer Price Index for tobacco products growing slower than previously estimated.

Revenue 2015–2016

(\$ thousands)

Provincial Revenue Sources	Budget	Forecast	<i>Increase (Decrease) from Budget</i>
Tax Revenue:			
Personal Income Tax	2,524,962	2,510,833	(14,129)
Corporate Income Tax	493,193	486,135	(7,058)
Harmonized Sales Tax	1,761,253	1,754,646	(6,607)
Motive Fuel Taxes	262,276	258,767	(3,509)
Tobacco Tax	217,792	213,462	(4,330)
Other Tax Revenue	158,855	157,899	(956)
	<u>5,418,331</u>	<u>5,381,742</u>	<u>(36,589)</u>
Other Provincial Revenue:			
Registry of Motor Vehicles	126,949	126,830	(119)
Royalties - Petroleum	19,405	17,986	(1,419)
Other Provincial Sources	142,609	144,535	1,926
TCA Cost Shared Revenue	1,750	1,750	---
Other Fees and Charges	63,176	63,684	508
	<u>353,889</u>	<u>354,785</u>	<u>896</u>
Investment Income:			
Interest Revenues	79,031	79,629	598
Sinking Fund Earnings	99,549	99,477	(72)
	<u>178,580</u>	<u>179,106</u>	<u>526</u>
Total - Provincial Revenue Sources	5,950,800	5,915,633	(35,167)
Federal Revenue Sources			
Equalization Payments	1,768,921	1,768,921	---
Canada Health Transfer	896,863	896,863	---
Canada Social Transfer	341,579	341,579	---
Offshore Accord Offset Payments	36,779	36,779	---
Crown Share	7,437	7,470	33
Other Federal Sources	2,319	5,021	2,702
TCA Cost Shared Revenue	31,963	31,963	---
Total - Federal Revenue Sources	3,085,861	3,088,596	2,735
Total - Ordinary Revenue	9,036,661	9,004,229	(32,432)
Total - Ordinary Recoveries	531,238	537,354	6,116
Net Income from Government Business Enterprises (GBE)			
Nova Scotia Liquor Corporation	228,229	229,690	1,461
Nova Scotia Provincial Lotteries and Casino Corporation	111,300	125,300	14,000
Halifax-Dartmouth Bridge Commission	11,607	12,452	845
Highway 104 Western Alignment Corporation	973	973	---
Total - Net Income from GBE	352,109	368,415	16,306
Total - Revenue	9,920,008	9,909,998	(10,010)

Other Provincial Sources

Other Provincial Revenues are forecast to be up by \$0.9 million or 0.3 per cent. The increase results primarily from more filing fees at the Securities Commission, Pharmacare premiums and other fees and charges, partially offset by reductions in Petroleum Royalty revenue, which is forecasted to decline by \$1.4 million or 7.3 per cent from the 2015–2016 Budget Estimates based upon lower natural gas prices.

Investment income is forecast to be \$0.5 million or 0.3 per cent higher than budget, primarily as a result of higher Interest Revenues from short-term investments.

Federal Revenue Sources

Crown Share Adjustment Payments are up by \$0.03 million or 0.4 per cent from the 2015–2016 Budget Estimates.

Other Federal Sources are forecast to be up by \$2.7 million due to recoverable funding from Canada Health Infoway for the Personal Health Record project.

Ordinary Recoveries

Ordinary Recoveries are forecast to be \$6.1 million, or 1.2 per cent higher than budget. The main increase is the result of a \$2.2 million repayment of a lien holder bond related to the Nova Star Ferry. Recovery revenue at Labour and Advanced Education is up \$1.2 million as a result of increased recoverable spending for the Canadian Jobs Fund. Internal Services is projecting increased recoveries of \$1.0 million related to third party work and IT contracts. Education and Early Childhood Development is projecting \$0.8 million in increased recoveries for French Language services.

Net Income from Government Business Enterprises (GBE)

The total Net Income from GBE is forecast to be \$16.3 million or 4.5 per cent higher than the Budget Estimate. The Nova Scotia Provincial Lotteries and Casinos Corporation is forecasting an increase in net income of \$14.0 million or 12.6 per cent as a result of changes in the video lottery business line. The Liquor Corporation is projecting a net income increase of \$1.5 million or 0.6 per cent due to lower costs, and the Halifax-Dartmouth Bridge Commission is forecasting net income to be \$0.8 million or 7.3 per cent above budget primarily because of lower than expected amortization charges.

Expenses

Total Expenses for 2015–2016 are forecast to be \$10.0 billion, \$11.6 million higher than budget. An increase in Departmental Expenses of \$14.6

million is partially offset by a reduction in Debt Servicing Costs of \$3.0 million.

Departmental Expenses 2015–2016

(\$ thousands)

	Budget	Forecast	Increase (Decrease) from Budget
Agriculture	61,536	61,534	(2)
Business	114,143	116,980	2,837
Communities, Culture and Heritage	61,837	61,837	---
Community Services	915,410	915,410	---
Education and Early Childhood Development	1,244,607	1,245,453	846
Energy	30,160	30,160	---
Environment	25,343	25,343	---
Finance and Treasury Board	14,415	14,415	---
Fisheries and Aquaculture	9,883	9,880	(3)
Health and Wellness	4,137,741	4,143,441	5,700
Internal Services	180,300	180,718	418
Justice	327,593	327,593	---
Labour and Advanced Education	362,931	364,104	1,173
Assistance to Universities	376,084	375,734	(350)
Municipal Affairs	167,474	167,474	---
Natural Resources	82,983	82,983	---
Public Service	200,947	201,435	488
Seniors	1,496	1,426	(70)
Transportation and Infrastructure Renewal	419,277	422,808	3,531
Restructuring Costs	175,853	175,853	---
Total - Departmental Expenses	8,910,013	8,924,581	14,568

Departmental Expenses

Total Departmental Expenses for 2015–2016 are forecast to be \$8.9 billion or \$14.6 million higher than the budget. Of the \$14.6 million, \$5.5 million is offset by revenues and recoveries, resulting in a net change in Departmental Expenses of \$9.1 million.

The Department of Business is forecasting to be \$2.8 million over budget due to the divestiture of Keltic Lodge.

The Department of Education and Early Childhood Development is forecasting to be \$846 thousand over budget due to French Language programming, which is recoverable from the Federal Government.

The Department of Health and Wellness is forecasting to be \$5.7 million over budget. The department is forecasting pressures of \$5.0 million in the Home Care program due to increased utilization, and \$2.7 million for the Personal Health Record project, which is recoverable from Canada Health Infoway, and \$2.0 million for Canadian Blood Services due to the increased exchange rate for products purchased from the United States. The pressures are partially offset by a net underspend in capital grants of \$4.0 million due to project delays and changes in cash flow requirements.

The Department of Internal Services is forecasting to be \$418 thousand over budget primarily due to recoverable third party work.

The Department of Labour and Advanced Education is forecasting to be \$1.2 million over budget due to federal employment programs, which are recoverable from the Federal Government.

The Public Service Offices are forecasting to be \$488 thousand over budget primarily due to Elections Nova Scotia costs related to the July 2015 by-elections held in Cape Breton Centre, Dartmouth South, and Sydney-Whitney Pier; offset by Legislative Services projected to be under budget.

The Department of Transportation and Infrastructure Renewal is forecasting to be \$3.5 million over budget primarily due to costs related to the 2014–2015 winter season. Expenditures related to the harsh winter conditions, extending into 2015–16, include snow and ice removal as well as costs related to equipment repairs.

Gross Debt Servicing Costs

Total Debt Servicing Costs are forecast to be \$3.0 million less than budget because of reduced interest rates.

Consolidation and Accounting Adjustments

Consolidation and Accounting Adjustments for government units are forecasting to be \$3.4 million below budget primarily due to a \$4.0 million reduction in the Department of Health and Wellness capital grants.

Capital

Capital Spending 2015–2016

(\$ thousands)

	Budget	Forecast	Increase (Decrease) from Budget
Highways and Structures	222,470	225,992	3,522
Buildings	112,812	102,503	(10,309)
Information Technology	47,370	44,990	(2,380)
Land Purchases	2,000	1,550	(450)
Vehicles and Equipment	15,266	15,461	195
Contingency	26,236	23,000	(3,236)
Total - Departmental	426,154	413,496	(12,658)
Capital Grants	63,846	59,846	(4,000)
Total - Capital Spending	490,000	473,342	(16,658)

Tangible Capital Assets (TCA)

The Province is forecasting capital purchase requirements to be under budget due to reduced projected spending on buildings, IT projects and land as well as a reduction in the contingency. This is partially offset by increased spending on highways and structures as well as vehicles and equipment spending.

Capital Grants

The Province is forecasting capital grant requirements to be under budget by \$4.0 million, net, primarily due to project delays and changes in cash flow requirements.

Economic Performance and Outlook: 2015 and 2016

Prior to receiving results of actual tax revenues collected, the Province relies on economic forecasts and statistical relationships with historical administrative data to estimate tax revenues. Nominal Gross Domestic Product (GDP) is the broadest measure of the potential tax base, and components of Nominal GDP provide indications of growth in specific tax bases, including household income, consumer expenditures, residential construction, and corporate profits.

External Conditions

The world economy is expected to grow at 3.3 per cent in 2015, marginally lower than 2014 (International Monetary Fund). In 2016, global growth is expected to strengthen to 3.8 per cent. Recent volatility in Chinese equity markets and foreign exchange rates has shaken global confidence, but does not pose a direct risk to Nova Scotia's economic growth. Japan's economy has recovered moderately in 2015.

Europe has managed to keep its recovery on track in 2015 while working through further support to maintain the currency union and the Greek economy. Europe's economic recovery will continue but with difficulties around internal adjustment, high unemployment, and balance sheet unwinding. Issues around a Greek exit, the Ukraine border, and the refugee crisis continue to be risks for Europe. The United Kingdom economy continues to have solid growth, in the second quarter, growing 2.7 per cent (seasonally adjusted annualized rate).

Nova Scotia is more exposed to the performance of the American and Canadian economies. United States (US) economic

growth slowed in the first quarter (+0.6 per cent) because of poor weather and temporary shutdowns, but recovered with 3.7 per cent growth in the second quarter of 2015. The US economy is fundamentally on track, with employment, incomes, consumer spending and housing activity growing. The US Federal Reserve may keep the target range for interest rates lower for longer as a cushion against any instability associated with China.

For 2015, Canadian economic growth was negative over the first half of the year. Falling oil prices and softer prices for other commodities have weighed on investment in the resource sectors and therefore on overall Canadian economic growth. A lower Canadian dollar and stronger US growth have lifted non-energy exports over the past year while energy exports have fallen. However, the current account deficit has widened to \$17.4 billion as the non-commodity sector of the economy has been slow to pick up pace.

The Bank of Canada cut the overnight target rate in half to 0.5 percent in 2015 as the Canadian economy fell further below capacity with the ongoing adjustment to lower oil prices. Canadian employment growth has slowed in 2014 and 2015 and the unemployment rate has moved up from a recent low of 6.6 per cent in January 2015 to 7.0 per cent as of August. Overall inflation has slowed with falling energy prices, but core inflation has moved above 2.0 per cent as import prices have risen with a depreciating currency. Forecasts of the exchange rate expect it to remain between 75 and 80 US cents over the next two years.

Current Economic Outlook for Nova Scotia

Consistent with previous practice, this September update uses the Economic Outlook from the Public Accounts released in July. The 2015–2016 Budget used the Province’s Economic Outlook, as published in the 2015–2016 Budget Assumptions, with data and information up to February 12, 2015. A revised economic forecast was published in the 2014–2015 Public Accounts in July 2015 (data and information up to June 3, 2015) and is reflected in the provincial tax revenue forecast presented in this update.

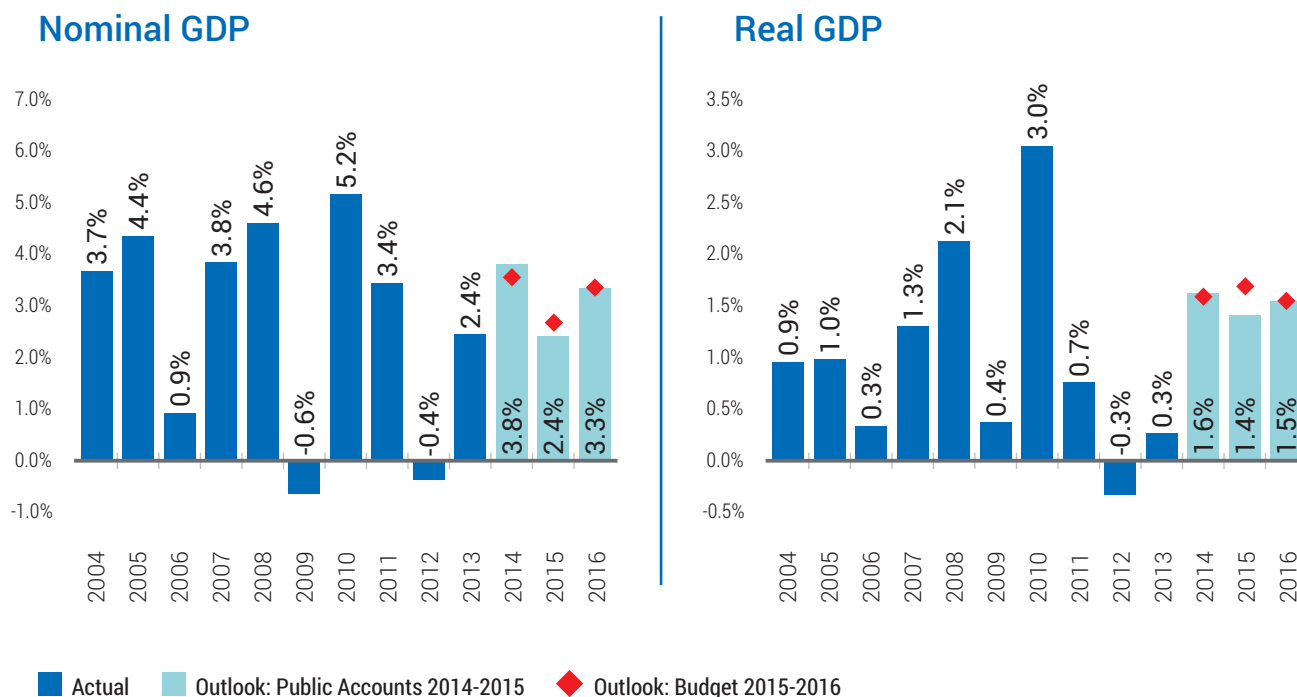
Some of the data released after the latest forecast date is discussed in Economic

Performance and will be incorporated into future economic outlooks.

The Forecast Outlook for Nova Scotia’s Nominal and Real GDP growth has been downwardly revised, reflecting challenging economic conditions. Since the 2015-2016 Budget, the forecast for Nominal GDP growth has been reduced from 2.7 per cent to 2.4 per cent for 2015. Real GDP growth is forecast to reduce from 1.7 per cent to 1.4 per cent. The Province’s forecast for Real GDP growth continues to be in line with private sector projections in the range of 1.3 to 1.9 per cent. The Nominal GDP forecast remains below the private sector average.

Nova Scotia GDP Growth

(Per Cent Change)



Nova Scotia Economic Performance

GDP Growth: Nova Scotia's GDP growth in 2013 just offset the decline reported in 2012. Preliminary data for 2014 suggests that Real GDP (at basic prices) grew at a pace of 1.6 per cent, led by peak production at the Deep Panuke natural gas field and broad-based non-energy exports. Year-to-date indicators for 2015 suggest that non-energy exports and residential construction are the leading sources of growth, while natural gas output has declined significantly and wage growth remains slow.

Labour Market: For the first eight months of 2015, employment and the labour force have shown a smaller decline than observed in the previous two years. Employment grew by 0.2 per cent, while the labour force declined by 0.2 per cent. The unemployment rate has declined to an average of 8.7 per cent, with notable declines occurring in regions outside Halifax. Employment was down in manufacturing and construction, but up for resources. Service-producing sectors have gained 2,800 jobs. Through the first six months of the year, average weekly earnings growth at 2.0 per cent has been below the Canadian growth of 2.3 per cent, while employee compensation (total wages, salaries and employers' social contribution) has grown by 1.6 per cent.

Inflation: Overall, the Consumer Price Index (CPI) inflation is up by an average of 0.4 per cent in the first eight months of 2015, relative to the same period in 2014. Lower world oil prices have dropped the Nova Scotia energy index by 13.5 per cent between the first eight months of 2015 and 2014. Food prices are up 4.5 per cent.

Retail Sales: Retail sales have been soft in 2015 – lower gasoline prices have driven a sharp decline in the value of sales at gasoline stations, while a downturn over the winter months has lowered the year-to-date numbers in other categories. Excluding gasoline sales, retail sales are up 2.7 per cent over the first six months of the year.

Construction: Housing activity rebounded in the first half of 2015 with growth of 8.5 per cent in residential investments. Residential building permits and housing starts have had several very positive months, though home prices in Halifax continue to stagnate as they have for the past few years. For the first half of 2015, non-residential building declined 9.2 per cent compared to last year as institutional/governmental construction fell while commercial building in Halifax picked up.

International Exports: In 2014, Nova Scotia led Canada's international goods exports with growth of 25.1 per cent. Exports received a significant lift from higher natural gas output, but there were also substantial gains in non-energy exports. For the first seven months of 2015, non-energy exports have increased 6.3 per cent. However, overall exports declined by 8.7 per cent, as energy exports have declined 68.8 per cent. Production of natural gas is down 8.9 per cent from the Sable platform and 62.1 per cent at Deep Panuke.

Key Risks

Economic

The Current Economic Outlook was prepared for the 2014–2015 Public Accounts and reflects information and events up to June 3, 2015. Since then, a number of economic events and recent indicators have been published that are not incorporated in this outlook, and will be considered in future economic forecasts.

Within the Province, the risks to Nova Scotia's economic forecast are on the downside, given the latest year-to-date data. The key downside risk at this time is to the employee compensation forecast for 2015, with follow-on effects for household consumption. Employee compensation grew only 1.6 per cent over the first half of the year, tracking below recent historical averages and the 3.1 per cent gain forecast for this year. Year-to-date employment growth has underperformed expectations and average weekly earnings are below their recent trends. These factors could significantly erode the economic outlook for 2015 and reduce the level of GDP in 2016. There are two factors that may mitigate this risk: major project activities are expected to ramp up later in the year while the number of regular Employment Insurance beneficiaries is up 5.3 per cent. The rise in Employment Insurance (EI) usage may signal the possibility that inter-provincial workers are facing job losses from cancelled projects in oil-producing provinces, jeopardizing income remittance to Nova Scotian households as well as associated consumption and residential investment.

With natural gas exports falling, Nova Scotian goods export figures are tracking below forecast and would need to accelerate (driven by a lower Canadian dollar and stronger US

economy) in the second half of the year. Export growth is more concentrated in farm/fish and tires in 2015 relative to more broad based growth seen in 2014, though manufacturing sales are up 3.6 per cent through July 2015. These risks could weigh on prospects for economic growth and corporate net operating surplus.

Residential construction activities have recently shown better performance than anticipated in this outlook with housing starts, residential permits and residential construction investment reporting stronger results for the first half of 2015. This could provide an upside risk to the economic outlook. However, housing prices (as measured in the Halifax market) have changed little since 2012 and there remains an elevated inventory of unsold units. Also on the upside, the foreign exchange rate and interest rate assumptions underlying this outlook are more pessimistic than has unfolded in recent events, mitigating some of the downside risk from weaker energy exports.

Revenue

Provincial own-source revenues are strongly influenced by several key factors in the economic outlook. In addition, the revenue models use administrative data, external factors and historical relationships between factors to arrive at forecasted revenues. All factors are subject to change throughout the fiscal year and can contribute to significant variations in revenues. Final personal and corporate income tax assessments for the 2014 taxation year will not be received until the spring of 2016 and can create prior year adjustments (PYAs).

Slower growth in the level of compensation of employees poses a significant downside risk to personal income tax revenues – the Province's largest source of revenue. Losses due to stock market volatility also affect investment income and the value of RSP/RIF withdrawals, all of which are taxable income. The risks are partially offset by the potential increase in employment insurance benefits and positive signs with respect to the Province's yield rate on taxable income.

Lower levels of personal income usually lead to slower growth in consumer expenditures, which accounts for more than 70 per cent of Harmonized Sales Tax (HST) revenues. Early indications show an improvement in the level of residential housing expenditures but the impact of changes to this tax base are relatively small compared to consumer expenditures.

The forecast of corporate income tax revenues is highly dependent upon national corporate taxable income. A low oil price environment combined with global uncertainty presents substantial risks to corporate income tax revenues.

Deep Panuke production issues, lower prices for natural gas, and the risk of increased decommissioning costs for the Sable Offshore Energy Project (SOEP) are key concerns for offshore royalties.

Tobacco tax revenues continue to be influenced by cessation and reduced consumption.

Expenses

There is a down-side risk related to the Film Industry Tax Credit. The 2015–2016 Budget Estimate was \$24.1 million. Currently, there are \$36.5 million worth of Part B applications being processed (at the end of projects). Since April 1, 2015, \$32.6 million Part A and B applications have been received (58 applications). This represents \$12.9 million Part B applications (37) and \$19.7 million Part A applications (21).

A 1.0 per cent change in short term interest rates would result in a \$15 to \$20 million change in Debt Servicing Costs over the next 12 months.

Current Economic Outlook Assumptions

<i>Per cent change, except where noted</i>	Budget 2015–2016		Revised June 2015	
	2015	2016	2015	2016
Real GDP (\$2007 chained)	1.7%	1.5%	1.4%	1.5%
Nominal GDP	2.7%	3.4%	2.4%	3.3%
Compensation of Employees	3.4%	3.6%	3.1%	3.1%
Household Final Consumption	3.4%	3.5%	2.9%	3.3%
Retail Sales	1.0%	2.7%	-0.5%	4.5%
Consumer Price Index	0.7%	2.3%	0.8%	2.6%
Investment in Residential Structures	3.4%	2.9%	3.4%	2.8%
Net Operating Surplus: Corporations	1.9%	5.6%	2.1%	5.7%
Exports of Goods to Other Countries	0.1%	3.4%	-0.4%	3.5%
Population at July 1 (thousands)	943.7	944.5	943.7	944.5
Employment (thousands)	450.1	452.2	450.1	451.8
Unemployment Rate, Annual Average	8.5%	7.9%	8.5%	8.0%

Note: Budget Estimates economic forecast was made with data and information as of February 12, 2015. The revised June forecast was made with data and information as of June 3, 2015.

