

**September 25, 2012**

## Overview

The Province of Nova Scotia is forecasting a deficit of \$249.3 million for 2012–2013, an increase of \$38.1 million from the estimate at budget time. This is primarily the result of a change in revenue recognition for the federal contribution to the new convention centre, which reduces current year revenue by \$36.6 million.

Total revenues, including net income from Government Business Enterprises, are forecast to be \$9.2 billion, a decrease of \$43.3 million from budget. Total expenses are forecast to be \$9.6 billion, \$6 thousand lower than budget. Changes in consolidation and accounting adjustments result in a \$5.2 million positive impact to the bottom line.

## Fiscal Summary Fiscal 2012–2013

(\$ thousands)

	Budget	Forecast	Increase (Decrease) from Budget
<b>GENERAL REVENUE FUND</b>			
<b>Revenue</b>			
Ordinary Revenue	8,350,830	8,301,342	(49,488)
Ordinary Recoveries	568,490	578,857	10,367
Net Income from Government Business Enterprises	350,993	346,793	(4,200)
<b>Total — Revenue</b>	<b>9,270,313</b>	<b>9,226,992</b>	<b>(43,321)</b>
<b>Expenses</b>			
Departmental Expenses	8,534,646	8,534,640	(6)
Tax Credits and Rebates	73,500	73,500	---
Pension Valuation Adjustment	71,485	71,485	---
Debt Servicing Costs	881,701	881,701	---
<b>Total Expenses</b>	<b>9,561,332</b>	<b>9,561,326</b>	<b>(6)</b>
	<b>(291,019)</b>	<b>(334,334)</b>	<b>(43,315)</b>
<b>Consolidation and Accounting Adjustments for Governmental Units</b>	<b>79,819</b>	<b>85,051</b>	<b>5,232</b>
<b>Provincial Surplus (Deficit)</b>	<b>(211,200)</b>	<b>(249,283)</b>	<b>(38,083)</b>

## Ordinary Revenue Fiscal 2012–2013

(\$ thousands)

	Budget	Forecast	Increase (Decrease) from Budget
<b>Provincial Revenue Sources</b>			
Tax Revenue:			
Personal Income Tax	2,195,300	2,200,800	5,500
Corporate Income Tax	398,450	387,600	(10,850)
Harmonized Sales Tax	1,642,900	1,645,000	2,100
Motive Fuel Taxes	254,100	252,900	(1,200)
Tobacco Tax	211,000	209,600	(1,400)
Other Tax Revenue	157,640	157,769	129
Other Provincial Revenue:			
Registry of Motor Vehicles	110,279	110,279	---
Royalties—Petroleum	27,672	27,672	---
Other Provincial Sources	124,576	127,276	2,700
TCA Cost Shared Revenue—Provincial Sources	3,625	3,383	(242)
Other Fees and Charges	67,598	67,355	(243)
Prior Year's Adjustments	---	(5,986)	(5,986)
Investment Income:			
Interest Revenues	74,070	72,719	(1,351)
Sinking Fund Earnings	108,348	108,567	219
<b>Total — Provincial Revenue Sources</b>	<b>5,375,558</b>	<b>5,364,934</b>	<b>(10,624)</b>
<b>Federal Revenue Sources</b>			
Equalization Payments	1,593,820	1,593,820	---
Canada Health Transfer	796,959	796,959	---
Canada Social Transfer	321,943	321,943	---
Offshore Oil and Gas Payments	146,059	146,059	---
Crown Share	19,628	19,628	---
Other Federal Sources	23,712	23,401	(311)
TCA Cost Shared Revenue	73,151	34,598	(38,553)
Prior Years' Adjustments	---	---	---
<b>Total — Federal Revenue Sources</b>	<b>2,975,272</b>	<b>2,936,408</b>	<b>(38,864)</b>
<b>Total Ordinary Revenue</b>	<b>8,350,830</b>	<b>8,301,342</b>	<b>(49,488)</b>
<b>Net Income from Government Business Enterprises</b>			
Nova Scotia Liquor Corporation	224,451	224,451	---
Nova Scotia Gaming Corporation	112,600	108,400	(4,200)
Halifax-Dartmouth Bridge Commission	11,536	11,536	---
Highway 104 Western Alignment Corporation	2,406	2,406	---
<b>Total — Net Income from Government Business Enterprises</b>	<b>350,993</b>	<b>346,793</b>	<b>(4,200)</b>

## Revenues

Total revenues, including Ordinary Recoveries of \$578.9 million, and net income from Government Business Enterprises of \$346.8 million, are forecast to be \$9.2 billion, \$43.3 million less than the 2012–2013 Budget Estimates. This represents a decrease in Ordinary Revenues of \$49.5 million, an increase in Ordinary Recoveries of \$10.4 million, and a decrease in Net Income from Government Business Enterprises of \$4.2 million.

Personal Income Taxes are up by \$5.5 million or 0.3 per cent from the 2012–2013 Budget Estimates. Nova Scotia personal taxable income is expected to decline by 0.7 per cent in 2012 and 2013 relative to the Budget Estimates. Offsetting these declines is a reduction in the expected cost of non-refundable personal income tax credits.

Corporate Income Taxes are down by \$10.9 million or 2.7 per cent from the 2012–2013 Budget Estimates. Projected growth in Nova Scotia corporate profits has been reduced. This reflects the paper mill closure in Liverpool as well as a change in timing for the start-up of the NewPage plant.

Harmonized Sales Tax is forecast to increase by \$2.1 million or 0.1 per cent from the 2012–2013 Budget Estimates primarily as the result of upward revisions to the consumer expenditure and residential housing investment tax bases. Consumer expenditures on goods and services accounts for over 70 per cent of the province's tax base.

Motive Fuel Taxes are forecast to be down \$1.2 million or 0.5 per cent from the 2012–2013 Budget Estimates largely as result of a decline in the forecasted level of diesel oil consumption. A slower growth rate in labour income and slightly higher gasoline prices has also contributed to the decline, offset by lower-than-anticipated prices for diesel oil.

Tobacco Tax revenues are forecast to decrease by \$1.4 million or 0.7 per cent from the 2012–2013 Budget Estimates. Consumption of both cigarettes (-2.1 per cent) and fine cut tobacco (-8.7 per cent) are declining at a greater rate than anticipated in the Budget Estimates. The impact is partially offset by slower-than-projected growth in the price of tobacco products. Consumption is on the decline as a result of tobacco price increases and long-term cessation trends.

Other Provincial Sources are forecast to be up by \$2.7 million, primarily as a result of increased revenue from the sale of lumber arising from the forestry plan at Natural Resources.

Other fees and charges are forecast to be \$243 thousand lower than budget primarily as a result of lower-than-expected fees collected in the areas of Casino investigation, Air Quality regulation, sale of trees from the Department of Natural Resources nursery, and accommodation licenses and tourism advertising.

Prior Year Adjustments from provincial sources are forecast to be negative \$6.0 million: a reduction of \$0.6 million for Personal Income Tax, and \$5.4 million for Corporate Income Tax.

Interest revenue is forecast to be down by \$1.4 million primarily as a result of lower than expected income stream from the Nova Scotia Housing Development Corp. for long-term care facilities.

Sinking fund earnings are expected to be up by \$219 thousand due to changes within the portfolio.

Equalization and the Offshore Accord Payments are based upon the province's election to receive payments calculated according to the Expert Panel approach. This is a one-estimate, one-payment approach and as a result the forecast is equal to the Budget Estimates. The province expects to receive a cumulative best-of-guarantee payment of \$312.3 million in 2012–2013 pursuant to the clarification reached with the federal government in October 2007. An update to this forecast will be provided by the federal government in December.

Other Federal Sources are reduced by \$311 thousand as a result of the Personal Health Records project timeline being extended from one to two years.

Tangible Capital Assets (TCA) Cost Shared Revenue for combined federal and provincial sources is expected to be down by \$38.8 million. Federal TCA Cost Shared Revenue is forecast to be down by \$38.6 million, primarily (\$36.6 million) as a result of the deferred recognition of Provincial/Territorial Base Funding received from the federal government, to align with the terms of the contract for the new convention centre (Nova Centre). Provincial source TCA Cost Shared Revenue is expected to be down by \$242 thousand as a result of lower-than-budgeted spending on municipal projects.

Total Ordinary Recoveries are \$10.4 million higher than budget, primarily as a result of increased recoveries for out-of-province insured services and joint data storage agreements at the Department of Health and Wellness, recovery of RCMP costs at Justice, a higher recovery for highway and building work at Transportation and Infrastructure Renewal, and increased recoveries associated with the Nova Scotia Teachers Union benefit plans, Mi'Kmaq Kina Matnewey Education Agreement, and French language grants at the Department of Education.

Net income from Government Business Enterprises is forecast to be \$4.2 million lower as a result of a steeper-than-expected decline in Video Lottery Terminal revenues at the Nova Scotia Gaming Corporation after the introduction of the MyPlay system in this fiscal year.

### Expenses

Total expenses for 2012–2013 are forecast to be \$9.6 billion, \$6 thousand lower than budget. Departmental expenses account for the entire variance as no change is forecasted in debt servicing costs, Pension Valuation Adjustment, or tax credits and rebates.

## Departmental Expenses Fiscal 2012–2013

(\$ thousands)

	Budget	Forecast	Increase (Decrease) from Budget
Agriculture	63,949	63,939	(10)
Communities, Culture and Heritage	58,665	58,665	---
Community Services	977,924	976,940	(984)
Economic and Rural Development and Tourism	187,353	185,903	(1,450)
Education	1,112,830	1,113,553	723
Energy	29,568	29,568	---
Environment	26,385	26,161	(224)
Finance	38,990	38,890	(100)
Fisheries and Aquaculture	8,799	8,789	(10)
Health and Wellness	3,861,513	3,861,513	---
Justice	306,723	307,579	856
Labour and Advanced Education	346,208	345,761	(447)
Assistance to Universities	347,619	347,619	---
Natural Resources	95,685	95,685	---
Public Service	174,314	175,166	852
Seniors	1,871	1,871	---
Service Nova Scotia and Municipal Relations	275,909	275,909	---
Transportation and Infrastructure Renewal	421,617	422,405	788
Restructuring Costs	198,724	198,724	---
<b>Total Departmental Expenses</b>	<b>8,534,646</b>	<b>8,534,640</b>	<b>(6)</b>

## Departmental Expenses

Total departmental expenses for 2012–2013 are forecast to be \$8.5 billion, \$6 thousand below budget.

The Department of Community Services is forecasting to be under budget by \$1.0 million primarily due to lower-than-expected spending in the Family Services division due to declining caseloads.

Economic and Rural Development and Tourism is forecasting \$1.5 million less than budget due to new jobsHere programs being implemented partway through the year.

The Department of Education is expecting to be over budget by \$723 thousand primarily due to an increase in funding for both the Mi'kmaw Kina'matnewey education agreement and French language grants, both of which are fully recoverable.

The Department of Justice is forecasting to be over budget by \$856 thousand as a result of the recent conversion of RCMP services of three towns to the Provincial Police Service Agreement. This is fully recoverable.

Transportation and Infrastructure Renewal is projecting to be over budget by \$788 thousand primarily due to increased maintenance costs for highways and bridges, which is offset by increased recoveries.

### Public Service

The Public Prosecution Service is forecasting to be over budget by \$852 thousand, primarily related to salary and operational pressures.

## Consolidation and Accounting Adjustments

Consolidation and accounting adjustments for government units are forecast to be \$85.1 million, which is an increase of \$5.2 million, primarily due to an increase in capital grants to the District Health Authorities to address funding needs for infrastructure.

## Capital Spending Forecast 2012–2013

(\$ thousands)

	Budget	Forecast	Variance
Highways	281,000	278,816	(2,184)
Buildings	158,000	146,287	(11,713)
IT	57,200	44,850	(12,350)
Land Purchases	12,800	33,492	20,692
Vehicles and Equipment	13,100	15,190	2,090
Total Departmental	522,100	518,635	(3,465)
Capital Grants	87,900	91,365	3,465
<b>Total Capital Program</b>	<b>610,000</b>	<b>610,000</b>	<b>...</b>

## Capital Spending

### Tangible Capital Assets (TCA)

The province is forecasting Capital Purchase Requirements to be on budget. A land purchase of \$20 million for NewPage is almost entirely offset by reduced capital spending by the Department of Education for school construction and renovations, and by the Department of Health and Wellness for IT projects.

### Capital Grants

The province is forecasting to be over budget on capital grant spending by \$3.5 million primarily due to additional grant funding for the Department of Health and Wellness to address funding needs for infrastructure. This increase is partially offset by reduced capital grant requirements for the Housing Development Corporation.

## Economic Performance and Outlook: 2012 and 2013

Since the preparation of the 2012–2013 Budget Economic Assumptions, a number of economic indicators and key economic events have deviated from expectations. A revised forecast for 2011 and 2012 was published in the 2011–2012 Public Accounts in August.

Global economic conditions have deteriorated since the preparation of the budget while domestic challenges have also emerged, within the province. However, these conditions are transitory and Nova Scotia's economic prospects are expected to improve over the medium term as governments complete fiscal consolidation and major projects get underway.

### External Conditions

Europe is on the verge of recession, necessitating extraordinary measures from the European Central Bank to stabilize sovereign debt markets. The UK is in a recession. Deceleration in China and other emerging economies has also been steeper than expected. Persistent and high unemployment rates remain a concern in many advanced countries.

Signs continue to point to a strengthening recovery in the US, albeit a slow one. So far, the pick up in demand from the private sector has also been growing at a fast enough pace to offset the fiscal drag from public sector consolidation. US GDP advanced at an annualized rate of 1.7 per cent in the second quarter of 2012 following a 2.0 per cent increase in the first quarter 2012.

Canadian GDP growth advanced 0.5 per cent in the first and second quarters of 2012 (an annualized rate of 1.8 per cent). Business investment continued to fuel GDP growth in the 2nd quarter of 2012 despite slowing residential investment. Contributions to growth from the public sector continued to diminish. Consumer spending has sustained growth at a modest pace. Export growth was again offset by an acceleration in imports. Canada's employment has shown some volatility in the past few months but over the first eight months of 2012 employment is up 1.0 per cent to 17.5 million.

The Bank of Canada has noted Canada's underlying growth is roughly in line with its production potential. The Bank expects total CPI inflation to return to 2 per cent over the next 12 months.

Canada's outlook remains uncertain owing mostly to external risks. Internal risks include household indebtedness and potential housing price correction. Compared with the US, Canada's outlook is slightly more subdued in the medium run.

### Current Economic Indicators for Nova Scotia

In 2010, Nova Scotia's Real GDP grew 1.9 per cent (chained 2002 dollars, market prices). Preliminary Real GDP estimates for Nova Scotia (at basic prices, by Industry) suggest Real GDP for all industries advanced 0.3 per cent in 2011 as construction sector GDP slowed after stimulus projects and energy investments wound down. Both of these figures will be revised and updated in November with Statistics Canada's release of historical revisions to the Provincial Economic Accounts for 2007–2011.

Nova Scotia's residential construction investments continue to grow. Residential structure investment through the first half of 2012 was up 7 per cent compared with the same period in 2011, though this strong pace may not persist through the rest of 2012. Residential investments have grown across new dwellings, renovations and cottages, with particularly strong growth in apartment construction. Although these investments are currently outpacing Budget Assumptions, non-residential investment in structures is down 11.4 per cent related to a decrease in institutional and government construction.

Recent manufacturing and export data demonstrate the consequences of recent challenges in the forest products sector. Nova Scotia's forest product exports are down 60 per cent comparing January–July 2012 with the same period in 2011. Nova Scotia's overall manufacturing shipments (seasonally adjusted) declined 12.6 per cent from June 2012 to \$0.77 billion in July 2012. Year-to-date Nova Scotia's manufacturing shipments (January–July 2012) were down 5.5 per cent compared to the same period last year—the slowest growth in the country. Both the Liverpool and Port Hawkesbury paper mills were operating at normal capacity through July 2011.

Nova Scotia's employment has grown by 0.9 per cent comparing January–August 2012 with the same period in 2011. This is consistent with the Budget forecast for employment, but over the same period, Nova Scotia's labour force has grown at a similar pace (0.8 per cent). With employment and labour force growing at about the same pace, average unemployment rate has remained fairly stable at 9.0 per cent, which is above the Budget Assumption.

Although employment growth is consistent with the Budget assumption and labour force has exceeded expectations, Nova Scotia's seasonally adjusted labour income has grown by only 1.8 per cent (total January–June 2012 vs same period in 2011). There has been a notable deceleration concentrated in manufacturing and mining/gas in the first quarter. To date, labour income growth is actually slower than the pace observed at the depth of the global recession in 2009.

Consumer price inflation has slowed in Nova Scotia, easing to 2.2 per cent growth from January–August 2012 (compared with the same period in 2011). Retail spending has grown by only 1.6 per cent through the first two quarters, but this is consistent with the Budget assumption.

Since the preparation of the Provincial Budget, the Federal government has issued more details about its austerity plans, global economic uncertainties have persisted, and the forest products sector has undergone more adjustments.

The Department of Finance monitors a number of uncertainties that could have either downside or upside risks to the economic outlook.

Like many forecasters, the Department of Finance sees significant downside risks in the external environment. Sovereign debt problems in Europe, the "fiscal cliff" in the United States, and restrictive policies in emerging economies could all coincide to slow global economic growth in 2013 and 2014.

There are also upside and downside risks to the provincial economic outlook. In the short run, adjusting to new realities in the forest products sector is likely to reduce exports and labour income. If substantive shipyard work is delayed until the middle of the decade, the effects of the fiscal restraint may be more apparent in Nova Scotia's economy during 2013. However, the risks of Federal fiscal restraint on Nova Scotia are still ambiguous. If labour income growth fails to return to its normal pace of growth, there could be significant negative revision to the outlook for personal income and nominal GDP overall.

Conversely, some of the uncertainties could help economic growth exceed expectations. Major investments like the Maritime Link of the Lower Churchill development and the Shell exploration project are not reflected in these economic assumptions. Both could improve Nova Scotia's economic outlook.