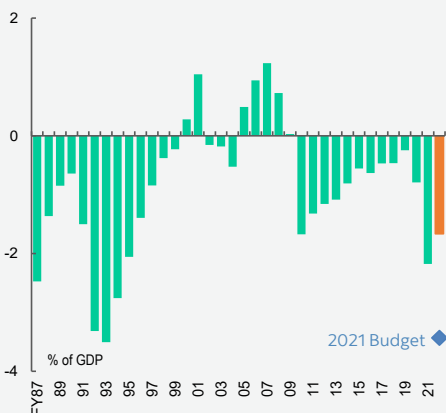


Contributors

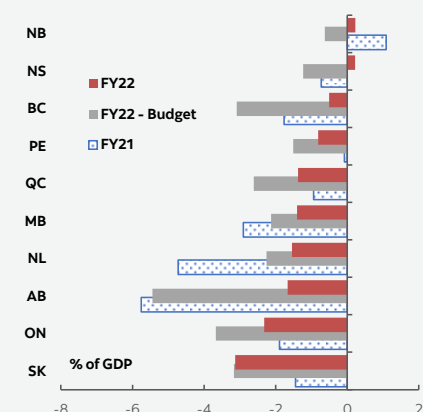
**Laura Gu**  
Economist  
Scotiabank Economics  
416.866.4202  
[laura.gu@scotiabank.com](mailto:laura.gu@scotiabank.com)

Chart 1  
Provincial Budget Balance Projections



Sources: Scotiabank Economics, Statistics Canada, Budget Documents.

Chart 2  
Provincial Budget Balance Projections



\* Before Stabilization Reserve transfers and accounting changes. Sources: Scotiabank Economics, Statistics Canada, Budget Documents.

# Treading Lightly into Another Budget Season

## PROVINCIAL FISCAL ROUNDUP

- As budget season is set to kick off later this month, we set the scene with a round-up of the latest fiscal projections by provinces and the drivers behind the numbers.
- A stronger-than-anticipated economic rebound coupled with upside inflation surprises saw government revenues surge across the country with projected deficit spending by provinces slashed nearly in half, at an aggregate of \$40.2 bn (1.7% of GDP) in FY22.
- Provinces signaled fiscal discipline by banking most of the revenue windfalls while maintaining spending levels largely as planned. Mid-year revisions to spending plans were modest compared to the large upward revisions in revenues.
- Nominal growth assumptions underpinning the largely improved budget deficits remain conservative and could have a positive impact of approximately \$3–11 bn on the aggregate figure when the fiscal year comes to a close.
- Furthermore, about \$20 bn has been set aside in various provincial contingency and reserve funds. Omicron-related impacts may absorb some of these, otherwise these funds could further reduce deficits.
- Provinces’ combined debt burden is substantially improved owing to better bottom lines in FY22, with expected net debt to run at 34.1% of GDP (versus earlier-projected 39%). This would put aggregate debt slightly down from 34.9% in FY21.
- Provinces’ borrowing requirements are also expected to come in much lower than previous estimates in budgets, totaling \$93 bn for the four largest provinces (ON, QC, AB and BC). Additional narrowing of final deficits could further reduce provinces’ financing needs, possibly supporting pre-borrowing activity in light of rising rates.
- We expect revenue windfalls to wind down in FY23 and 24 as economic activity normalises. While provinces have maintained spending discipline so far, it may be increasingly challenging to hold the line against growing populations, no shortage of social spending pressures, and two provincial elections on the horizon. Provinces may want to continue holding that line to avoid adding fuel to already elevated inflationary pressures now that the output gap is closed.

## PROVINCES HEAD INTO BUDGET SEASON IN GOOD SHAPE...

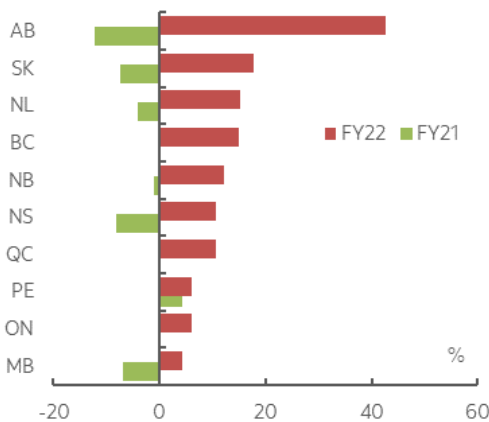
Heading into 2022, Canadian provinces found themselves on stronger fiscal trajectories, with the economic recovery across the country proving to be more resilient than anticipated at last budget time. In their fiscal updates released before the onset of omicron-related impact at the end of 2021, the ten Canadian provinces slashed their forecasted budget deficits by a sum of \$39 bn, to an aggregate of \$40.2 bn (1.7% of GDP) in FY22. This represents a slight improvement from the \$47.4 bn (2.2% of GDP) aggregate deficits recorded in FY21, close to the level in the year following the GFC as a share of GDP, and well below those recorded amid the early 1990s budget crisis (chart 1).

**Revenue windfalls and prudent fiscal planning drove balance sheet improvements in some provinces, while lingering uncertainties still affect others (chart 2).** Compared with FY21, five out of ten provinces (AB, NL, MB, BC, NS) are now projecting an improved budget balance in FY22, including NS looking at a year in the black (NB is the only other jurisdiction projecting a surplus in FY22). AB and NL have pencilled in the largest improvements, partly due to higher oil prices. Meanwhile, unforeseen drought-related

increases in expenditures outweighed strong revenue gains in SK. ON also expects a larger deficit as a share of GDP in FY22 owing to a stronger starting point from FY21, as well as a postponement of previously planned FY21 pandemic spending.

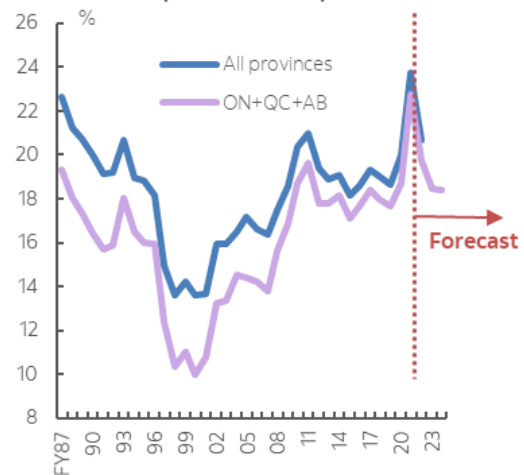
**Stronger revenue outlooks stem from a combination of higher-than-anticipated growth (particularly in nominal terms), as well as additional federal transfers announced after provincial budgets.** Provinces' FY22 own-source revenues were revised up by a total of \$43 bn to \$392 bn, 12.7% higher than recorded in FY21. The largest year-over-year gains were seen in oil-producing provinces, which benefited from a more favourable oil price outlook after taking a hit from a slump in oil revenues in FY21 (chart 3A). Provinces also revised up federal transfers projections by a total of \$8 bn, a combination of increases in proportion to the improvement of nominal GDP and one-time bumps related to COVID-19. Though less dependent on these pandemic supports than last year, federal transfers are still set to make up 21% of total revenues in FY22 (chart 3B). The major provinces (ON, QC and AB—no medium-term update on BC) currently expect federal transfers as a share of revenues to gradually return to the pre-pandemic normal in FY23 and FY24, largely due to the end of COVID-related funding.

**Chart 3A**  
Own-Source Revenues (yoy % change)



Sources: Scotiabank Economics, Statistics Canada, Budget Documents.

**Chart 3B**  
Federal Cash Transfers (% of revenue)

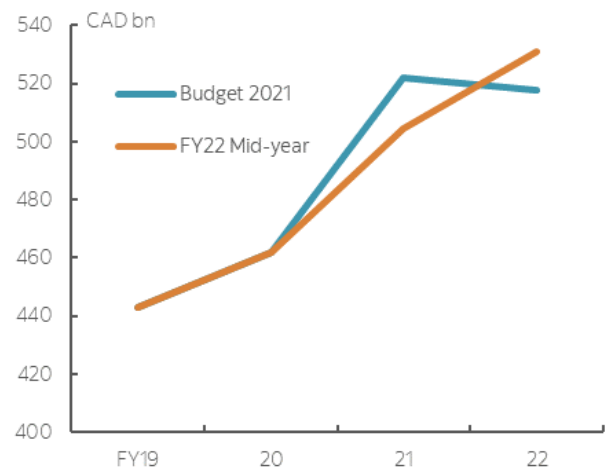


Sources: Scotiabank Economics and Budget Documents.

**Provinces are banking these revenue windfalls while maintaining spending levels as planned.** For the most part, these considerable revenue surpluses are expected to go into reducing budget deficits as most provinces refrain from spending it. Mid-year revisions to spending plans were modest compared to the large revenue revisions. On aggregate, provincial spending is set to grow further in FY22 (chart 4), mainly due to some carry-over expenses from the previous year's delayed programs, as well as slightly increased fiscal outlays in health care for some jurisdictions. On net, the provinces' aggregated spending is projected to be one percentage point lower than in FY21 as a share of GDP, but it would still remain elevated at 22% of GDP in FY22, versus the 20% average in the decade before COVID-19.

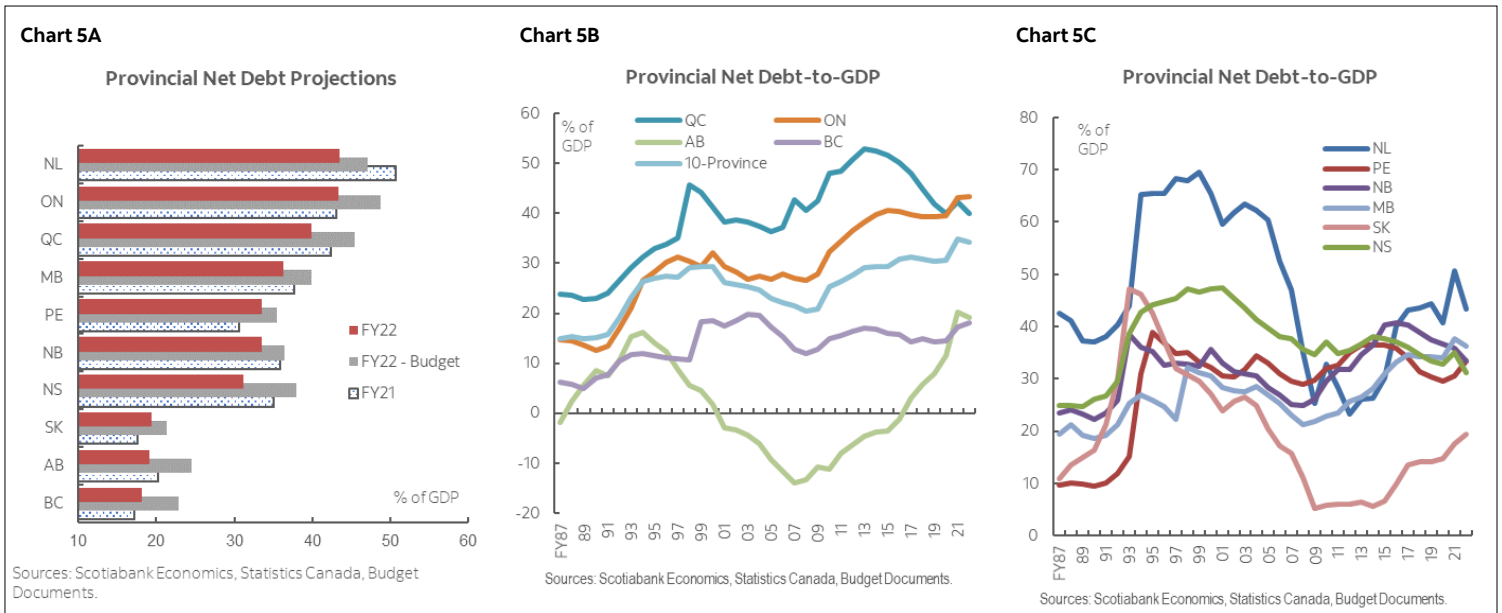
**Helped by narrower forecasted deficits, the combined debt burden of provinces is substantially better than anticipated in FY22.** With deficits coming in at half of the previously anticipated level, the aggregate provincial net debt is expected to run at 34.1% of GDP instead of 39.3% projected at budget time, and down from the 34.9% seen in

**Chart 4**  
Provincial Total Expenditures



Sources: Scotiabank Economics and Budget Documents.

FY21. Variance in debt trajectories across provinces reflects differences in starting positions, impact from commodities prices, COVID-19 impacts (and responses), as well as varying degrees of prudence built into fiscal plans (charts 5A, 5B and 5C).

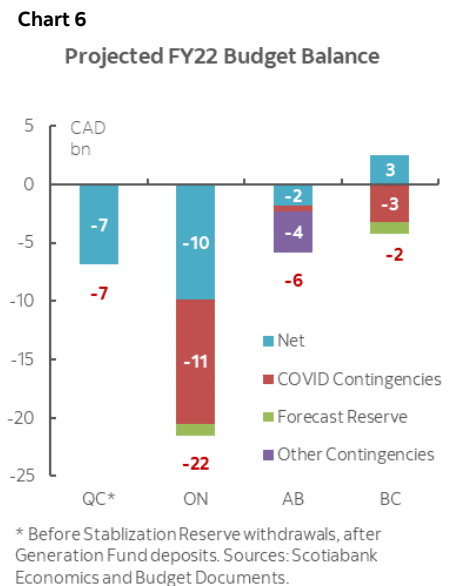


**... AND PRUDENCE REMAINS IN THE UPDATED BASELINE**

**Conservative economic growth assumptions relative to private sector forecasts could offer further upside.** For calendar year 2021, ON and BC penciled in 9% and 11% respective growth in nominal GDP, roughly one percentage point lower than the latest private-sector average. Meanwhile, most smaller provinces (SK, NS and NB) displayed further prudence, discounting over three percentage points in nominal GDP growth from the latest private-sector average. Confident about the province’s economic rebound, QC did not factor in as much prudence as the other provinces, yet the optimistic growth projection is largely warranted. Absent an FY22 reserve, the province has less capacity to absorb omicron-related costs this year than some of its counterparts. However, strong revenue gains in the pre-omicron period may provide an offset, and the \$1.3 bn reserve contingency baked into FY23 plans should limit any ongoing fiscal damage.

**Strong momentum in oil prices could further reduce the deficits forecasted in oil-producing provinces.** The AB government assumed an average WTI price of 70.5 USD/bbl throughout the fiscal year, lower than the average of 72.5 USD/bbl recorded as of January 2022, with two more months of positive outlook remaining. Altogether, we estimate this forecasting prudence could have a positive impact of approximately \$3 bn on the aggregate figure, bringing the combined deficit down to as low as \$37 bn (1.4% of GDP), with some uncertainties around omicron’s impact.

**Further prudence was incorporated in the form of COVID-19 contingencies and other reserves to help absorb additional spending related to omicron and other uncertainties.** Excluding COVID-related spending allocated to a variety of programs, the four largest provinces also set aside a total of \$14 bn as contingencies for FY22, and roughly another \$6 bn reserves for other forecast risks (chart 6). Depending on additional expenses incurred during the omicron wave, a fraction of this sizable fiscal buffer could also be used to reduce the final deficits in FY22.

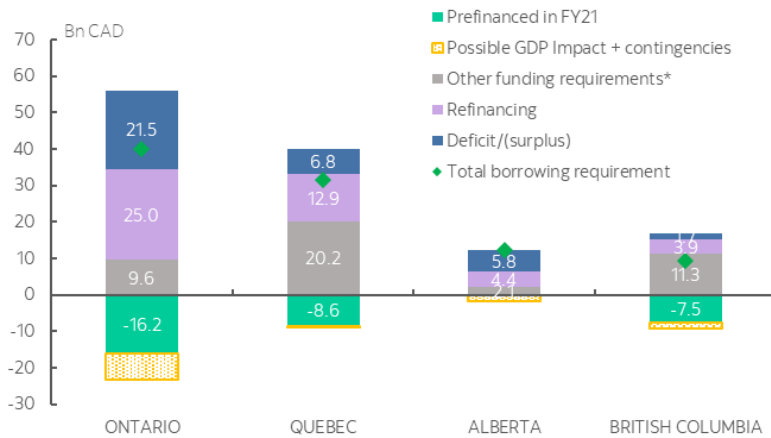


**Our expectation is that omicron-related impacts on provincial bottom-lines should be minimal.** Even a more pessimistic shock to economic growth at the national level of around -5 ppts (saar) in the first quarter could translate into a revenue shock in the order of \$300–400 mn. This is likely an upper-bound, and easily absorbed by conservative growth assumptions even before considering contingencies and reserves. Additional spending poses an upside but the extension of federal programs offsets this and so far additional provincial measures have been relatively contained.

**Provincial borrowing requirements in FY22 were largely reduced from previous estimates in the budgets, and the four largest provinces are projected to borrow a total of \$93 bn (chart 7).** The use of pre-financing helps reduce borrowings in FY22 by over \$30 bn for the four provinces. Additional revenues that resulted from higher growth and inflation assumptions and/or unallocated contingencies could further bring down actual borrowing requirements by up to \$13 bn (though omicron will likely erode some of this potential). Meanwhile, provinces may also opt to increase pre-borrowing for FY23 with an expectation of market tightening ahead. Provincial spreads have been tight throughout FY22 (chart 8), driven by central bank actions and global risk factors more so than by provinces' fiscal positions.

Chart 7

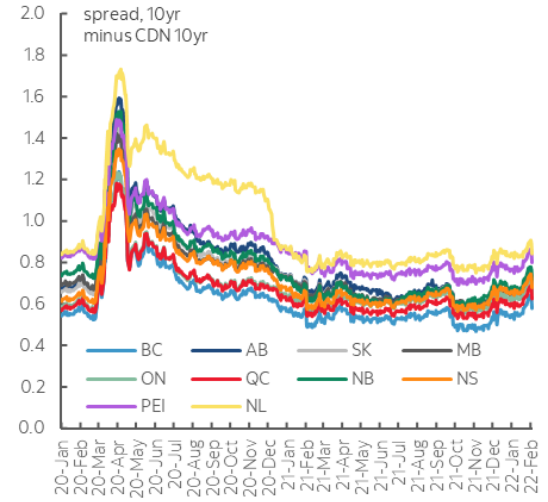
Provincial Borrowing Requirements Forecast (FY22)



\* Includes pre-financing for FY23, loans and investments. Sources: Scotiabank Economics and Budget Documents.

Chart 8

Provincial Ten Year Bond Spreads



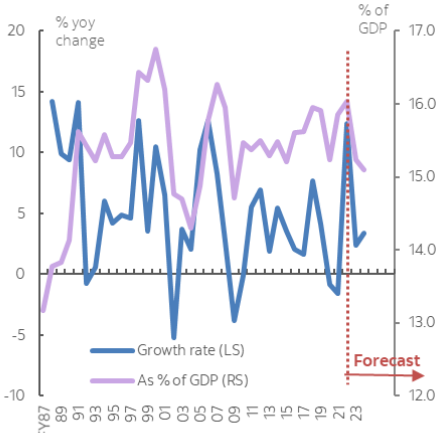
Sources: Scotiabank Economics, Bloomberg.

**AGGRESSIVE FISCAL CONSOLIDATION UNLIKELY IN OUTER YEARS**

**Looking forward, deficits should continue to moderate in the years ahead as pandemic-spending is unwound and contingencies released.** Revenue windfalls have some momentum this fiscal year but will begin to wane quickly in the upcoming years (chart 9). With total spending projected by provinces to decline as a share of GDP (chart 10), aggregated budget balance in major provinces (ON, QC and AB—BC did not update its medium-term forecast) is expected to narrow gradually to just under 1% of GDP in FY24. Against the backdrop of resuming population growth and no shortage of pressure on expenditures, this is an important assumption to watch. Spending promises could also ramp up in the upcoming general elections in ON and QC, though risks might be largely muted given that pre-campaign polling shows leading parties in both provinces sit at or above majority thresholds (chart 11). That said, we are still months away and much can happen in the meantime.

Chart 9

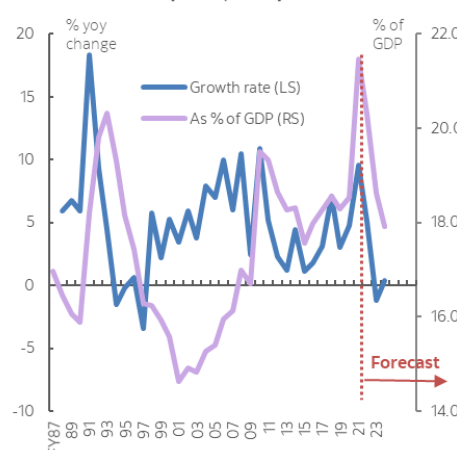
Own-Source Revenues (ON+QC+AB)



Sources: Scotiabank Economics, Statistics Canada, Budget Documents.

Chart 10

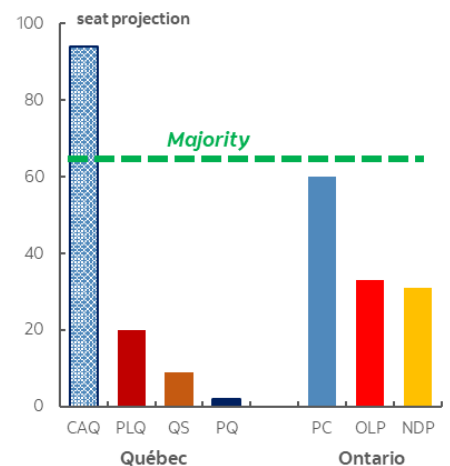
Program Expenditures (ON+QC+AB)



Sources: Scotiabank Economics, Statistics Canada, Budget Documents.

Chart 11

Provincial Elections: Pre-Campaign Polling\*



\* As of January 2022. Sources: Scotiabank Economics, 338Canada.

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