Scotiabank

GLOBAL ECONOMICS

FISCAL PULSE

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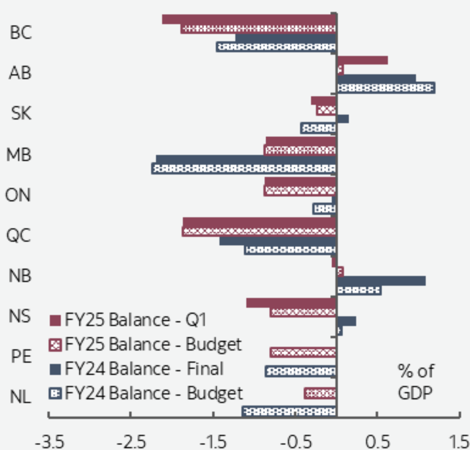
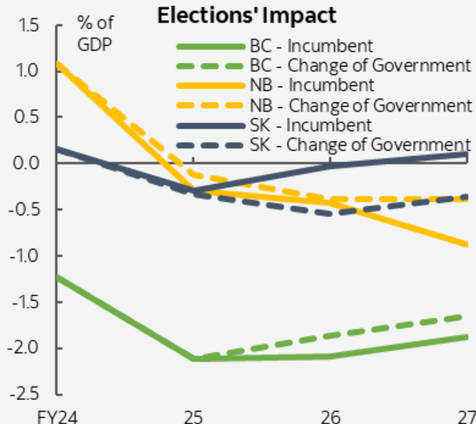
Chart 1



Sources: Scotiabank Economics, Statistics Canada, Budget Documents.

Chart 2



Note: not considering the reprofiling of expenditures.
Sources: Scotiabank Economics, Statistics Canada, Budget Documents, Party Platforms.

The Good, the Bad, and the Cautious

PROVINCIAL FALL FISCAL UPDATES PREVIEW

- **While the overall fiscal outlook remains stable, emerging cracks call for increased fiscal discipline and prudent planning in the fall updates (chart 1). British Columbia (B.C.) and Quebec have experienced deteriorations in their fiscal outlooks, adding to their already significant shortfalls.**
- **Easing downside risks to the macroeconomic backdrop is positive, but not material enough to help with the provinces' fiscal outlook.**
- **Oil-producing provinces should continue to fare better, provided that balanced demand and supply pressures sustain crude price stability.**
- **Cost overruns are likely to exert additional pressure on spending, particularly in areas such as staffing and climate-related expenses.**
- **Upcoming elections in B.C., Saskatchewan, and New Brunswick introduce significant fiscal uncertainty (chart 2). B.C. faces a highly competitive race with major campaign promises that could alter the province's fiscal trajectory, while New Brunswick's fiscal outlook remains stable despite a tight race. Saskatchewan's political landscape appears stable, with the Saskatchewan Party likely to stay in power.**
- **The provinces would be well-advised to navigate the renewed uncertainty with caution. Lean economic updates that avoid or minimize major new spending initiatives would align with the limited revenue upside and the fiscal space required to address a range of priorities. Additionally, it is important to consider the fiscal position relative to the economic cycle. Despite softening economic conditions, provincial fiscal policies remain largely stimulative as measures from earlier budgets continue to be implemented. This further underscores the need to hold the line on spending to ensure fiscal sustainability.**

STAYING THE COURSE WITH CRACKS APPEARING

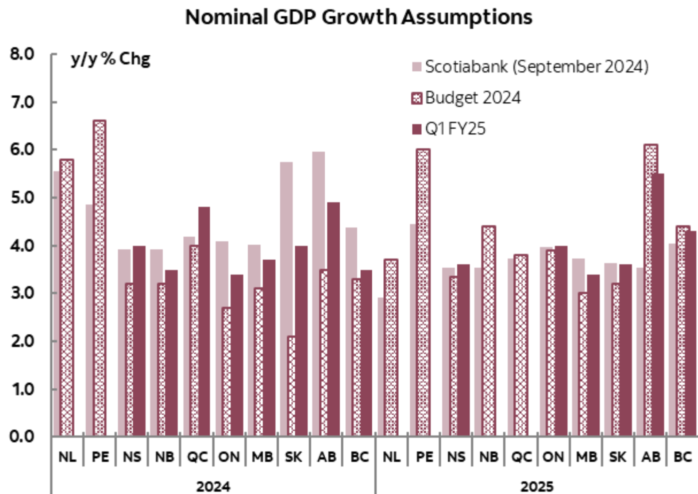
The fiscal trajectory remained largely unchanged in most provinces. Alberta stood out as the only province with an improved budget balance projection, thanks to a $2.7 bn revenue windfall leading to a larger-than-anticipated surplus in FY25. Other jurisdictions, such as Ontario, Saskatchewan, Manitoba, and New Brunswick, benefited from a slightly stronger handoff from the previous fiscal year, which effectively absorbed the marginally higher expenses.

While the overall outlook has remained consistent since the budget season earlier this year, some notable deteriorations have been observed over the summer and early fall (chart 1 again). B.C. has raised its deficit projections over the three-year planning horizon, with this year's deficit increasing by $1 bn due to overshooting fire management and higher debt-servicing costs. The significant rise in fire management costs was expected, given the initially low budget. The government has been revising spending upwards over the past few years, and further revisions are likely, especially with the upcoming election. Quebec reported a larger-than-anticipated deficit of $8 bn for FY24, driven by rising staffing costs, which could further exacerbate this fiscal year's already substantial projected deficit of around $11 bn. These two provinces are projected to end the fiscal year with the deepest deficits of close to 2% as a share of nominal output. Nova Scotia has also experienced some fiscal deterioration, mostly due to compensation increases and costs associated with extreme weather events adding to the spending pressure in the province.

MACRO BACKDROP BETTER BUT NOT GREAT

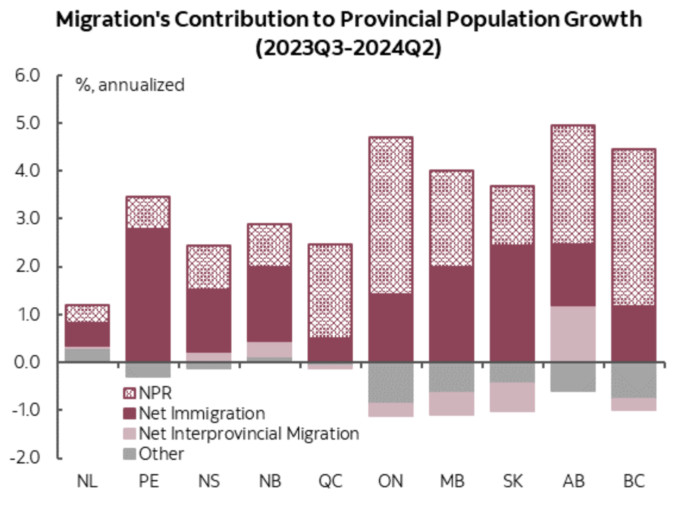
While downside risks to the macroeconomic backdrop have eased, the outlook remains uncertain and challenging. Central bank rate cuts are being rolled out due to increased confidence in inflation control, and geopolitical events have put upward pressure on commodity prices. These factors have mitigated some of the downside risks that were prevalent earlier this year during the budget season. All provinces have revised their growth forecasts upward to align with our projections (chart 3).

Chart 3



Sources: Scotiabank Economics, Budget Documents.

Chart 4



Sources: Scotiabank Economics, Statistics Canada.

Despite the improved economic outlook, we do not anticipate significant revenue surprises. Growth is expected to remain sluggish across the country for the remainder of the fiscal year. As a result, the upcoming fall updates could reveal further fiscal deterioration in some provinces, as costs are likely to exceed projections with limited revenue upside to offset these rising expenses.

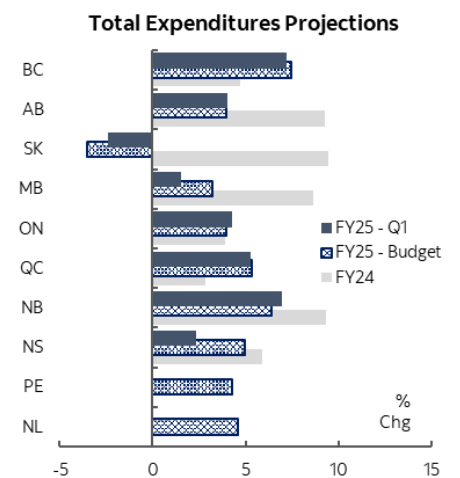
Developing stories on population growth could be a concern to the provincial governments as they plan for the upcoming year. Population growth remains elevated this year, with 80% of gains still driven by net inflows of non-permanent residents (NPRs)—consistent with the provinces' expectations at Budget time. To curtail the NPR population to 5% of the overall populace within three years, the federal government instituted a cap on international student permits on September 1, 2024. This measure will notably affect Ontario and B.C., reducing admissions by over half this academic year. The Maritime provinces are also considerably impacted (chart 4). Similarly, the federal government enacted reductions to the Temporary Foreign Worker Program. Although NPR inflow has decelerated, the overall level continues to ascend, indicating a lag in achieving the target. With the current NPR population at 7.3% of the total population, attaining the 5% target will necessitate time. That said, this curtailment poses headwinds to growth, particularly affecting Ontario, B.C., and the Maritime provinces more than other regions.

Optimism regarding commodities, though volatile, has been baked into the current outlook, consistent with Scotiabank's baseline view, benefiting oil-producing provinces. Alberta forecasts WTI to average US$76.5/bbl per barrel, while Saskatchewan projects an average of US$81/bbl in FY25. Since the start of this fiscal year, WTI has averaged US$78/bbl. In our baseline view, we anticipate that WTI prices will hover around this level, as balanced demand and supply pressures are expected to stabilize crude prices over the next few months. The improved outlook has also been bolstered by a narrower light-heavy differential, thanks to increased pipeline capacity. This is particularly beneficial for Alberta, where a US$1/bbl change in the spread translates to an additional $600 mn in revenue.

ANTICIPATE COST OVERRUNS

The provinces have so far done a good job of holding the line on spending (chart 5). Not much new spending has been announced since the budgets, aside from campaign promises from the three provinces facing elections. However, as we approach the fall updates, the possibility of major spending announcements cannot be ruled out.

Chart 5



Sources: Scotiabank Economics, Budget Documents.

The provinces are facing significant cost pressures, which make it increasingly difficult to maintain the spending discipline outlined in their current plans. In Budget 2024, the provinces have committed significant investments to address a slew of priorities, including housing affordability, rising staffing costs, and natural disasters. Expenditures are projected to grow by 4.6% in FY25, slightly below last year's growth rate. Some provinces, such as Nova Scotia, B.C., and New Brunswick, have reported cost overruns due to staffing expenses, particularly in the healthcare sector, where costs are 3–4% higher than initially budgeted. Climate-related expenses have also emerged as a major risk. B.C. added $653 mn in wildfire response costs to levels more aligned with previous years (chart 6), accounting for half of the total expenditure increases. Alberta allocated $573 mn from its $2 bn contingency fund for emergency and disaster assistance in response to an active wildfire season (chart 7).

Some provinces, particularly those experiencing higher net debt growth, might revise their debt service cost projections upward due to a higher-than-anticipated interest rate trajectory. However, the impact should be limited given the longer-term nature of their debt structures. Currently, the rise in debt servicing costs does not pose a significant risk to provincial finances. In their latest projections, the provinces expect the debt service ratio to peak at around 6.1% in FY25, which remains below the 7–8% range observed in the decade preceding the pandemic.

ELECTION UNCERTAINTY HAS MATERIAL FISCAL IMPLICATIONS

Upcoming elections in British Columbia, Saskatchewan, and New Brunswick introduce significant uncertainty to their fiscal outlooks. In B.C., the race is highly competitive, with leading parties proposing divergent fiscal policies that could significantly alter the province's trajectory post-election. In New Brunswick, the ruling Progressive Conservative Party faces a tough challenge due to the premier's approval rating, but both parties emphasize fiscal discipline, suggesting minimal election impact on the fiscal outlook. Conversely, Saskatchewan's political landscape appears stable, with the Saskatchewan Party likely to remain in power. Key items to watch later in the fiscal year include the potential for an early election in Ontario, with speculation about a spring 2025 vote. Consequently, we might anticipate some major new initiatives to be announced in the upcoming fall economic statement or spring budget.

The election platforms of the major parties in B.C. propose significant tax changes. The ruling NDP party has suggested tax cuts that could reduce revenue by $2 bn annually, and both NDP and the Conservative Party have signaled a potential removal of B.C.'s carbon tax. Both parties emphasize the natural resource sector in their economic policies but diverge significantly in their climate policies. The Conservative Party plans to reverse the NDP's electrification agenda, potentially altering the energy sector outlook in B.C. Both parties have committed to increasing funding for housing affordability and healthcare, which could add $2–3 bn or more to B.C.'s widening deficits over the next fiscal year. While these proposals aim to address key issues, they also risk further deepening the province's fiscal deficit. Nova Scotia might also face an early election ahead of next summer's fixed date.

The election in New Brunswick focuses on cost reduction. Both parties have promised tax cuts, either through HST or PST reductions. The ruling Progressive Conservative Party's proposal is more broad-based, while the Liberals' housing platform is more ambitious. Despite this, the Liberals have promised balanced budgets throughout their mandate. New Brunswick has enjoyed strong fiscal performance, currently in its eighth consecutive year of surplus. Given both parties' emphasis on fiscal discipline, the election's impact on the province's fiscal outlook should be relatively contained.

In Saskatchewan, a change of government is unlikely and the overall election impact on the province's fiscal outlook should be small. The ruling Saskatchewan Party continues to release new policy proposals, including minor tax reductions and increases to the graduate retention program benefit, which have a minimal fiscal impact. In contrast, the NDP has pledged significant funding for

Chart 6

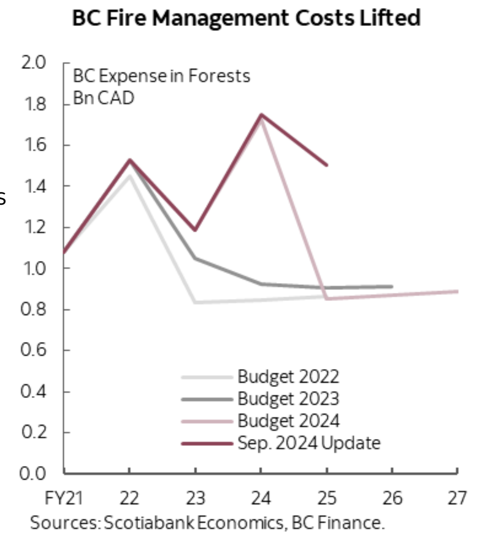


Chart 7

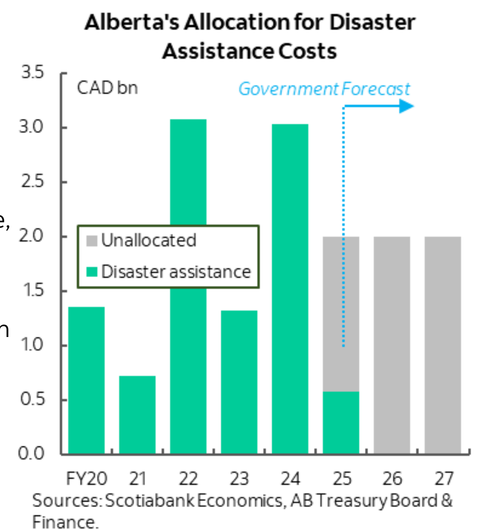
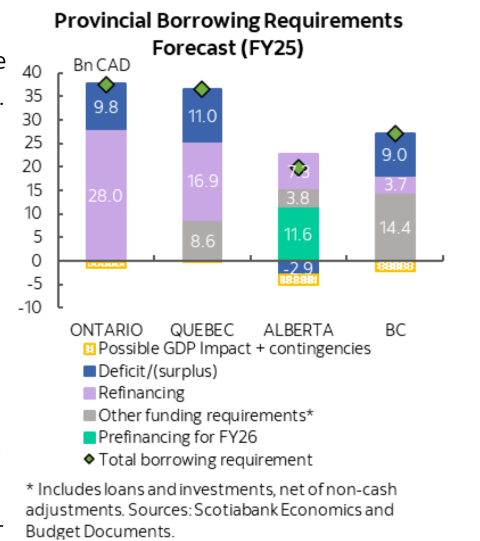


Chart 8



social policies, including an additional $1.1 bn for the healthcare system and $2 bn for education over four years. The NDP has also promised to balance the budget in their first term, likely requiring support from the resource sector and cost savings in some departments.

CREDIT RATINGS IN A CHALLENGING FISCAL LANDSCAPE

The past year has seen frequent credit actions in a challenging fiscal environment (table 1). S&P downgraded British Columbia (B.C.), stripping the province of its triple-A rating and assigning a negative outlook. Moody's, while still rating B.C. at Aaa, has also placed the province on a negative outlook and is closely monitoring the situation. Despite these downgrades, B.C. maintains a relatively low debt load compared to other provinces.

The importance of a robust consolidation plan cannot be overstated. Ontario, despite running persistent and large deficits, has a credible plan to balance its books and has demonstrated discipline in adhering to it. Pursuing aggressive fiscal consolidation amid slowing economic conditions presents significant challenges. The provinces will need to strike a delicate balance: they must sharpen their focus on growth-friendly consolidation measures while preserving the capacity to support long-term growth-friendly initiatives.

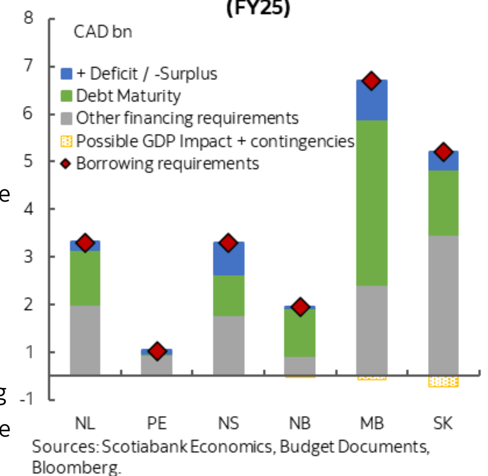
STRONG BORROWING NEEDS PERSIST

The provinces collectively anticipate $2.5 bn more borrowing compared to the time of the Budget, primarily due to larger deficits and increased financing needs in B.C. Looking ahead, In the largest four provinces, unallocated contingencies and revenue upside could reduce supply (chart 8), yet only marginally in the order of $1–2 bn. Echoing previously discussed deficit projections, the potential upside is limited and unlikely to materially alter financing needs. Beyond the largest four provinces, over 40% of financing needs are attributed to refinancing, with the operating balance accounting for a smaller portion (chart 9). While potential increases in program spending could drive higher borrowing needs, the overall impact should be modest.

LONG-TERM FISCAL SUSTAINABILITY SHOULD BE TOP OF MIND

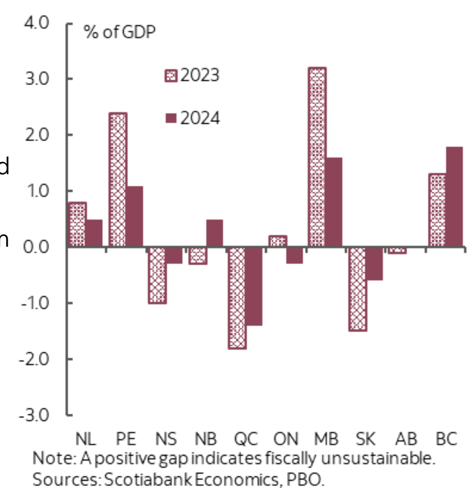
The provinces are grappling with rising expenses as they address structural challenges, including demographic shifts and green transitions, with tepid medium-term growth outlook and high real interest rates further straining fiscal space in most provinces. The Parliamentary Budget Officer (PBO) has assessed that the current fiscal position is sustainable for the subnational sector as a whole. However, the fiscal gap—the difference between current fiscal policy and a sustainable long-term policy—remains wide in provinces such as B.C. and Manitoba (chart 10). With fiscal policies at both federal and provincial levels becoming more expansionary over the past two years, it is crucial to remain mindful of fiscal room and long-term sustainability. Balancing fiscal support with building buffers and safeguarding public finances will be essential to ensure fiscal and economic health in the long term.

Chart 9



Sources: Scotiabank Economics, Budget Documents, Bloomberg.

Chart 10



Note: A positive gap indicates fiscally unsustainable.
Sources: Scotiabank Economics, PBO.

Table 1: Provincial Credit Ratings

Province	FY24 Debt-to-GDP	FY25 Debt-to-GDP	FY24 Surplus+/Deficit- (% of GDP)	FY25 Surplus+/Deficit- (% of GDP)	Credit Rating (S&P/Moody's/DBRS)	Recent Credit Rating Action	Date of Action	Outlook
NL	45.0	44.0	-1.1	-0.4	A/A1/A	(D/D/U)	(01/29/2016 ,07/24/2019, 08/17/2023)	S/S/S
PE	27.4	28.8	-0.9	-0.8	A*/Aa2/A	(N/U/U)	(11/09/2001, 11/14/2006, 08/15/2019)	P/S/S
NS	32.8	34.1	0.3	-1.1	AA-/Aa2/A high	(U/U/U)	(09/14/2018, 11/14/2006, 07/05/2013)	S/S/S
NB	25.6	26.6	1.1	-0.1	A+*/Aa1/A high	(D/U/U)	(06/07/2012, 05/14/2024, 07/30/2004)	P/S/S
QC	38.9	40.3	-1.4	-1.9	AA-/Aa2/AA low	(U/U/U)	(06/16/2017, 11/14/2006, 11/12/2019)	S/S/S
ON	37.3	39.1	-0.1	-0.9	A+*/Aa3*/AA	(D/D/U)	(07/06/2015, 12/13/2018, 06/06/2024)	P/P/S
MB	34.6	36.5	-2.2	-0.8	A+/Aa2/A high	(D/D/U)	(07/21/2017, 07/10/2015, 09/25/2003)	S/S/S
SK	12.6	13.4	0.2	-0.3	AA/Aa1/AA low	(D/D/D)	(06/21/2017, 05/21/2021, 06/18/2020)	S/S/S
AB	9.9	8.6	1.0	0.6	AA-/Aa2*/AA	(U/U/U)	(12/18/2023, 01/25/2023, 09/14/2023)	S/P/S
BC	18.5	22.0	-1.2	-2.1	AA-**/Aaa**/AA high	(D/U/U)	(04/08/2024, 10/05/2006, 05/07/2007)	N/N/S

* Positive outlook. ** Negative outlook.
Sources: Scotiabank Economics, Bloomberg.

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