Newfoundland and Labrador: 2019–20 Budget

GETTING BY WITH A LITTLE HELP FROM THE FEDS

- **The Province of Newfoundland and Labrador's budget for fiscal year 2019–20 (*Budget*; FY20) outlines a $1.9 bn[1] surplus in FY20, with deficits forecast for FY21–22 and a return to balance in FY23** (chart 1)**.**
- **The surplus in FY20 solely reflects the accounting treatment of Atlantic Accord revenues booked this fiscal year on an accrual basis. The Province intends to direct those funds towards the reduction of its net debt and borrowing.**
- **Key new policy developments were relatively modest despite a looming election, and the previously announced elimination of the automobile insurance tax and measures to support economic diversification.**
- **We support the Government's decision to reduce its hefty debt burden, but a return to sustainable balance by FY23 will continue to rest on the Province's ability to meet increasingly ambitious spending cut targets.**

AGREEMENT WITH FEDERAL GOVERNMENT ALTERS FISCAL LANDSCAPE

Revenues associated with Newfoundland and Labrador's new Atlantic Accord agreement with the Federal Government, re-signed earlier this month, are behind a monumental improvement to the bottom line this year. The agreement awards a greater share of offshore oil royalties generated at the Hibernia offshore oil field to Provincial coffers during 2019–56. The Province will book the $2.5 bn net benefit for that period in FY20, a move that it attributes to its accrual accounting system. Accordingly, it outlines revenues of $10.4 bn this fiscal year—some $2.6 bn more than forecast in last year's budget and a 33.5% increase over FY19.

As promised, the Government intends to direct Atlantic Accord proceeds towards debt reduction. Net debt of $13.8 bn is expected in FY20, $1.6 bn lower than anticipated for last fiscal year as of the Q2-FY19 mid-year update and less than 40% of nominal GDP. The Province foresees a net debt-to-GDP ratio near 40% through FY23, far less than the share nearer 50% forecast in the 2018 budget.

The revenue infusion lowers FY20–23 borrowing needs by a cumulative $400 mn relative to projections in last year's budget. Borrowing of $1.2 bn is forecast for FY20; it is then set to hold steady in FY21, fall to $0.7 bn in FY22, and rise to $1.7 bn in FY23. Net new borrowing over that period is expected to total $2.1 bn during FY20–23, of which $1.16 bn is anticipated for FY20 (table, p.3).

SIGNIFICANT CHANGES TO ECONOMIC OUTLOOK

Newfoundland and Labrador's economic forecast was also revised substantially. Robust real economic growth of 4.1% is projected in calendar year 2019, with another 2.4% spike anticipated in 2021; last year's plan assumed more moderate fluctuations (chart 2). The changes relate to major project activity. In 2019,

[1] Figures reported in Canadian dollars unless otherwise stated.

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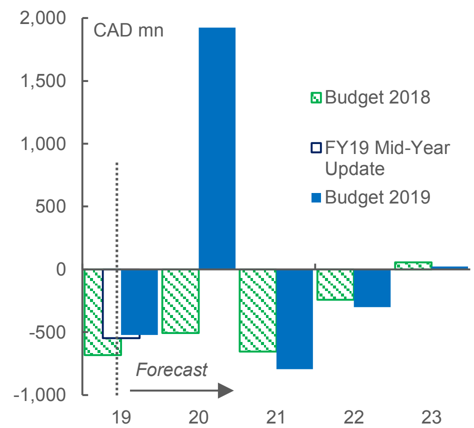
Chart 1

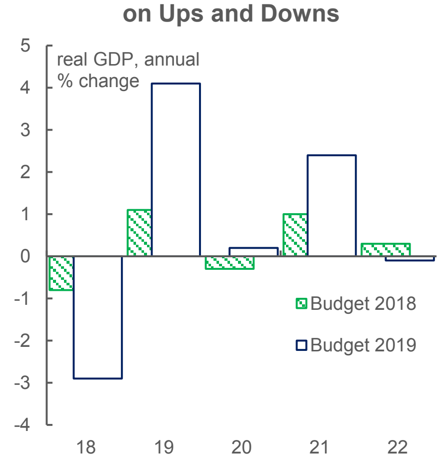
Newfoundland and Labrador's Budget Balances



Sources: Scotiabank Economics, NL Finance.

Chart 2

Fiscal Planning Built on Ups and Downs

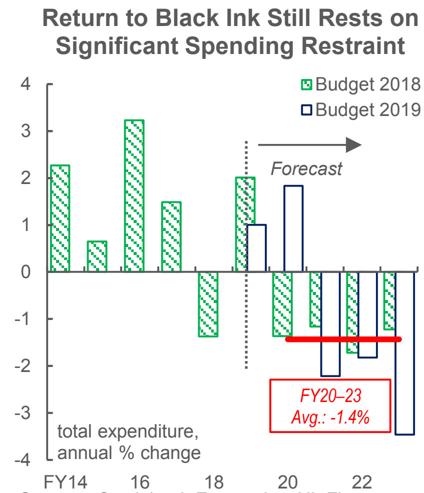


Sources: Scotiabank Economics, NL Finance.

employment and capital outlays related to the Vale underground mine and West White Rose venture are expected to peak as work on two aquaculture projects proceeds and Hebron oil production ramps up. Further development of the province's offshore oil resources and a diminished drag from the conclusion of the Muskrat Falls project are forecast to contribute to another jump in 2021.

The outlook for Brent oil prices is more modest than last year. The Province forecasts a per-barrel value of USD 65 for Brent in FY20, with a gradual rise to USD 71 by FY23; *Budget 2018* built in a sharper climb towards almost USD 75. As prior years, the Government included an oil risk adjustment to safeguard against movements in the price of its key natural resource.

Chart 3



Sources: Scotiabank Economics, NL Finance.

NEW POLICY MEASURES

Policy measures detailed in *Budget* were largely related to pocketbook relief. The retail sales tax on automobile insurance will be eliminated as of July this year and will be retroactive to April 16, 2019. The temporary deficit reduction levy, put in place in July 2016 in the depths of the Province's fiscal shortfall, is still expected to be lifted by the end of 2019.

To contain hydro rates increases—a spectre raised by the expected completion of the Muskrat Falls hydroelectric project, over budget, next year—the Province yesterday unveiled a framework to cap the average residential rate at 13.5¢/KWH in 2021. It estimates that inaction will result in a rate of 22.9¢/KWH in that year. The plan will require $725.9 mn that is expected to be raised via crown corporation dividends and cost savings plus a range of supports from the Federal Government, with the latter—expected to be in the range of $200 mn—still to be confirmed.

Other measures were concentrated in economic diversification initiatives, and health and education spending. These include supports for the ocean technology, fishing, tourism, and offshore oil and gas sectors; funds for affordable child care and classroom resources; and construction of long-term care homes, mental health facilities, and a new hospital. Infrastructure spending is expected to total $594.3 mn in FY20, with support for new and existing schools, roads and bridges, affordable housing, and municipal infrastructure.

FISCAL PLAN STILL RELIES ON SPENDING RESTRAINT

Changes to the forecast for revenues after the Atlantic Accord windfall and subsequent return to normal levels mirror changes to the economic outlook. In line with the upward revision to calendar year 2021 growth, a 4.9% climb in provincial receipts is expected in FY22 rather than the 4.1% outlined in last year's budget. The Province then looks for revenue gains to ease to just 0.8% in FY23 (table, p.3).

As outlined in last year's budget, a return to balanced books by FY23 relies on a 1.4% average annual contraction in total spending, but expenditure plans have been re-profiled. FY19 spending is on track to meet the target set last year, with cost savings expected to be realized via factors such as attrition, reductions in the Government's lease space and the size of its vehicle fleet, and further use of zero-based budgeting. Yet the 1.8% rise in total expenditures forecast for FY20 will necessitate even deeper cuts in the outer years of the planning horizon than expected last year. The most challenging times will likely come in FY23, when a 3.5% reduction is penciled in (chart 3) and calendar year 2022 real GDP is expected to fall.

OUR TAKE

We support the Government's intent to use Atlantic Accord revenues to step up reduction of its substantial debt burden, though the magnitude of that reduction looks to be an artefact of the Province's accounting framework. Over time, this will likely put downward pressure on Provincial interest costs, which as of FY18 were more than $700 higher than in any other jurisdiction in Canada on a per-person basis. The move should also provide a modest buffer against Muskrat Falls project debt risks, cited by market watchers as a significant contingent liability that could put downward pressure on the Province's credit rating, though ratings agencies will likely await further details of the electricity rate mitigation strategy.

Still, the Province's fiscal outlook remains exceedingly challenging. The 2.5% average annual cuts to total expenditure planned for FY21–23 have been achieved at the provincial level only once before since FY86—in Alberta in the early 1990s amid a period of historic austerity. That level of restraint may be even more challenging for Newfoundland and Labrador in the current era with population aging set to further erode the labour pool and pushes up healthcare costs. With the benefits of ongoing diversification efforts not likely to be felt in the medium-term, revenue generation is also highly dependent on major project timelines, thus the trajectory outlined here could be derailed if delays materialized.

Borrowing Program

$ millions except where noted

	FY20	FY21	FY22	FY23	Total
Gross Borrowing	1.20	1.20	0.70	1.70	4.80
Net New Borrowing	1.16	0.43	0.35	0.14	2.08

Sources: Scotiabank Economics, Newfoundland & Labrador Finance

Path to Balance

$ millions except where noted

	FY19	FY20	FY21	FY22	FY23
Total Revenue	7,751	10,350	7,472	7,838	7,901
% change	*8.3*	*33.5*	*-27.8*	*4.9*	*0.8*
Total Expenditure	8,273	8,425	8,238	8,088	7,808
% change	*-0.4*	*1.8*	*-2.2*	*-1.8*	*-3.5*
Oil Revenue Risk Adj.	0	0	20	50	70
Budget Balance	**-522**	**1,925**	**-786**	**-300**	**23**

Sources: Scotiabank Economics, Newfoundland & Labrador Finance