Newfoundland and Labrador: 2020–21 Fiscal Update

PANDEMIC, GLOBAL OIL PRICE SHOCK EXTEND RECOVERY

SUMMARY

- **COVID-19 is expected to drive Newfoundland and Labrador's fiscal year 2020–21 (FY21) deficit to a near-record $2.1 bn (and a record 7.3% of nominal GDP)** (chart 1) **according to a fiscal update released Friday.**
- **The government foresees a net debt burden equal to 57% of provincial output in FY21, and projects borrowing requirements $2 bn higher than previously penciled in for the year.**
- **Those forecasts mirror a challenging outlook for the resource-intensive economy and stepped-up spending to address the pandemic.**

OUR TAKE

As in other provinces, Newfoundland and Labrador's finances have been hit hard by the COVID-19 pandemic and the global oil price shock. Though the estimated impacts on overall economic growth and treasury revenues are less than those witnessed during past downturns, the Province nevertheless faces a much deeper deficit and heavier debt load than anticipated just few months ago. A prudent oil price assumption and Newfoundland and Labrador's share of at least $146 mn of Ottawa's $19 bn "Safe Restart" program—not included in the update—present some upside potential for this year`s bottom line.

Despite a relatively modest COVID-19 caseload that enabled earlier re-openings, the economy still faces a multiyear recovery. With global crude markets in the midst of a potentially lengthy rebalancing process, prospects for economic and revenue gains beyond FY21 are more modest than previously. Population declines will likely be exacerbated by lower immigration flows. The path to black ink by FY23 was also already based on ambitious spending cut targets, and the Province will now need to balance support for a hard-hit resource-based economy with long-run financial sustainability. Future debt loads may also be impacted by obligations related to the Muskrat Falls dam. A medium-term fiscal framework will be an important tool to navigate these factors.

ECONOMIC OUTLOOK

Unsurprisingly, and like virtually every Canadian jurisdiction, Newfoundland and Labrador's revised economic outlook is more downcast than before the pandemic. Dampened by COVID-19-related restrictions, total employment is forecast to fall by 5.6%—the worst result in more than 40 years for which jobs data exist—with retail sales and household income also set to witness record declines. The considerably weaker economic conditions plus ongoing population declines are expected to result in just 883 housing starts this calendar year—the fewest since at least 1955.

The Rock's exposure to weakness in the oil and gas sector adds to its economic challenges. The Province expects Brent crude prices to average just

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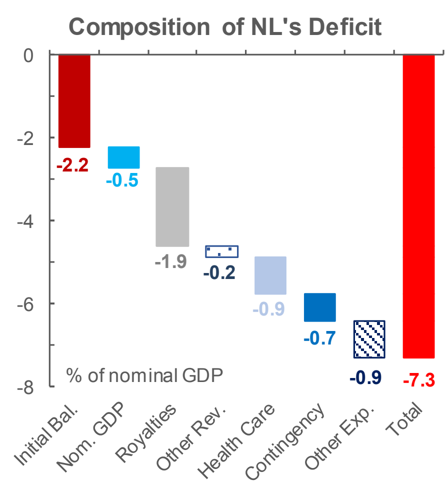
Table 1

Updated Fiscal Forecast
$ millions except where noted

	FY20		FY21	
	Nov.'19	Jul.'20	Bud.	Jul.'20
Total Revenue* (mn)	7,457	6,934	7,442	6,811
% change	*-4.7*	*-11.4*	*-0.2*	*-1.8*
Total Expenditure (mn)	8,401	8,390	8,238	8,958
% change	*0.3*	*0.1*	*-1.9*	*6.8*
Budget Balance (mn)	-944	-1,456	-796	-2,147
% of GDP	*-2.8*	*-4.2*	*-2.2*	*-7.3*
Net Debt	14.0	—**	*14.6*	*16.7*
% of GDP	*40.7*	*—***	*40.8*	*57.0*
Borrowing Req. (mn)	1.2	—**	*1.2*	*3.2*

* FY20 revenues and balances net of one-time, $2.5 bn Atlantic Accord booking. ** Not available. Sources: Scotiabank Economics, NL Finance.

Chart 1



Sources: Scotiabank Economics, NL Finance.

34 USD/bbl this fiscal year—half of the Budget 2019 projection—amid cratered global demand and the effects of the early 2020 Saudi-Russian oil price war. It rightly incorporates a conservative projection—our most recent forecasts assumed a mean Brent benchmark of more than 38 USD/bbl in FY21.

Still, the roughly 3% implied real output contraction (i.e. the 2020 forecast relative to the projection for 2019 released in December) is far more modest than consensus expectations. This appears to reflect a couple of factors. First, investment sits well below the heights reached in 2016 when construction activity peaked on the $14 bn Hebron offshore oil platform (chart 2); as such, large downward revisions to 2020 capital outlay projections apply to a low base. As well, oil production is up more than 15% y/y ytd through May 2020 (chart 3), bolstered by the continued ramp up at Hebron field, now in its third full year of operation. That contrasts with 2009, when crude output plunged by 22% and real GDP dropped by more than 10%.

FISCAL DETAILS

Net of the one-time, $2.5 bn Atlantic Accord payment booked in FY20, total revenues are expected to fall by 1.8%. That seemingly moderate drop compares to pre-pandemic expectations of flat receipts, and would represents the worst decline since the 14% plunge at the height of the last commodity price crash in FY16. Weaker offshore royalties are responsible for a $560 mn downward revision to revenues since last year's budget plans. Though that drop is significant, the roughly $1 bn decline in total revenues now anticipated for the two years to FY21 is about $500 mn less than the drop witnessed over the two years to FY16.

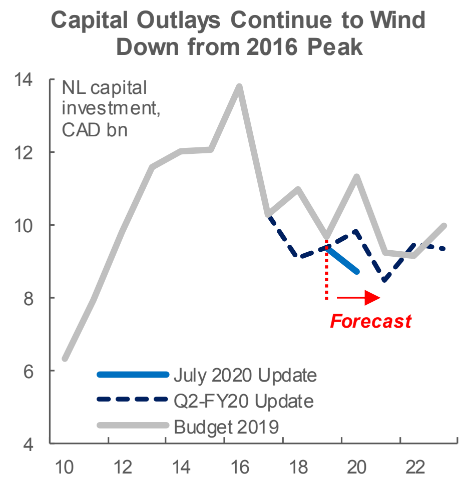
The Province penciled in a 6.8% increase in total spending for this fiscal year—the steepest percentage climb since FY10, when infrastructure outlays and tax cuts were deployed to fight the effects of the last recession. That contrasts with prior plans to reduce expenditures as a means to return to black ink by FY23, but is a less pronounced jump than anticipated in most other regions. The largest single variation from budget relates to a $261 mn funding allocation for regional health bodies, with pandemic contingencies eroding a further $200 mn from the bottom line. The Province noted that relative to most other Canadian jurisdictions, it has kept its total pandemic spending contained.

At $2.1 bn, the projected fiscal shortfall would be the second-largest since at least FY87, but at 7.3% of nominal GDP, that deficit would account for the largest output share reported over that span. The previous record nominal shortfall of $2.2 bn (7.1% of nominal GDP) was achieved in FY16. The new FY21 figures reflect the Province's challenging pre-pandemic fiscal position and an uneven economic performance since the last commodity price downturn.

Net debt is expected to jump, but come up short of the prior record. Newfoundland and Labrador's 57% net debt-to-GDP ratio outlined for this year is substantially higher than the 41% anticipated at budget time and the largest announced by any province thus far, but less than the 60–70% burden carried during FY94–05 (chart 4).

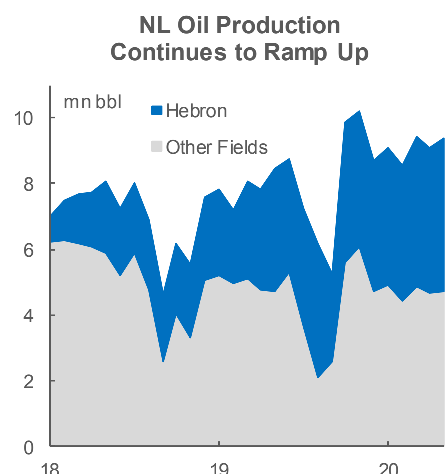
In line with updated deficit and deficit paths, FY21 borrowing requirements are expected to shift to $3.2 bn—$2 bn more than anticipated as of *Budget 2019*.

Chart 2



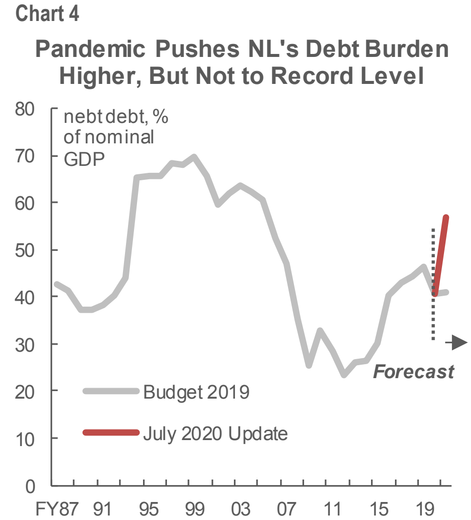
Sources: Scotiabank Economics, NL Finance.

Chart 3



Sources: Scotiabank Economics, Canada-Newfoundland and Labrador Offshore Petroleum Board.

Chart 4



Sources: Scotiabank Economics, NL Finance.