A continuing streak of black ink

By Warren Lovely and Taylor Schleich

Highlights

Few governments can claim to have travelled through the pandemic with their budget balance relatively intact. New Brunswick is one. New Brunswick was the sole province to balance its budget in 2020–21, extending a surplus streak that kicked off in 2017–18. Despite originally planning for a deficit Budget 2021, the latest (Q3) tally estimates a $488 million surplus for the outgoing 2021–22 fiscal year, as a variety of revenue streams (own-source and transfers) surpassed expectation. Budget 2022 sees the black ink streak extending another three fiscal years, out to 2024–25 (at least). After addressing budget pressures and providing new tax relief, the province plans for a $35 million surplus in 2022–23, followed by average surpluses of $30 million/year. As special factors fade (and tax relief kicks in), total revenues look to be limited to 1.2% in the coming fiscal year. Meanwhile, the government is transitioning away from virus-related spending in order to bolster capacity and resilience longer term, leaving total spending up 5.5%. Net debt is ending 2021–22 at a significantly lower level than planned, the absolute level of debt having declined for three straight years. The corresponding debt-to-GDP ratio has eased appreciably. Leverage should continue to recede from here, the debt-to-GDP ratio projected to fall to roughly 30% in the coming fiscal year and dipping to ~28% by 2024–25. The interest bite is likewise quite manageable, debt servicing set to consume just 5.6% of total revenue. Last year’s borrowing requirement collapsed as the fiscal year progressed, allowing New Brunswick to easily secure $400 million in pre-financing. As it stands, just under $1.6 billion in gross borrowing is needed for the province in 2022–23, almost of all it to cover a heavier dose of maturities. There are additional requirements for NB Power ($200 million) and NB MFC ($150 million). All together then, we’re talking about $1.94 billion in gross financing for all entities. But with New Brunswick’s budget balanced, leverage on a sustained downward trajectory, debt clearly affordable and the outstanding stock of provincial bonds set to see little growth, it’s hard not to like what’s happening here.

▪ Economic outlook — New Brunswick estimates its economy expanded 3.4% in real terms in 2021. While this is below the 2021 Canadian growth rate (4.6%), the province’s outperformance in 2020 means overall output was closer to a full recovery than the rest of the country. In addition to strong consumption, New Brunswick credited its solid performance to export growth, a significant pick-up in manufacturing sales and a vibrant real estate market. Looking ahead, the budget notes that 2022 growth is expected to come in at 2.2%—still above potential and three ticks below our own forecast for the province, suggesting there’s some modest upside risk embedded in the budget. As we’re seeing across the country, it’s on nominal GDP where growth has been more striking. New Brunswick’s nominal output rose 8.2% in 2021 after a modest 1.3% decline in a COVID-riddled 2020. Nominal growth should remain robust in 2022 (+6.2%), before moving down to 3-4%/year through the remainder of the forecast horizon. While the province expects to see continued growth in many key economic sectors this year (i.e., exports, manufacturing, tourism, natural resources, housing), it noted that labour shortages and capacity constraints could hold back investment and economic activity in some parts of the economy. When it comes to the labour market, New Brunswick is looking for employment growth to decelerate from 2.5% in 2021 to 1.4% in 2022. Still, this rate of growth is faster than the province’s expected population/labour force increase (0.9%/0.8%), which should lead to a declining unemployment rate. Notably, the province lags the overall Canadian economy in employment growth relative to the pre-pandemic economy and it cites an aging population, labour shortages, low immigrant retention as downside risks to the labour market outlook. Overall, while risks to the economic outlook remain (globally, not just in New Brunswick), 2022 looks to be another solid year. As we recently explored, the surge in both international and interprovincial immigration should continue to be a tailwind for the province’s economy in the years ahead, as it boosts one of the few remaining affordable housing markets.

▪ Revised budgetary picture for outgoing 2021–22 fiscal year — Budget 2021, presented just over one year ago, originally planned for a deficit of $245 million in 2021–22 (equivalent at the time to 0.6% of GDP). Since then, New Brunswick has repeatedly upgraded the fiscal picture... and by no small margin A Q1 update converted the deficit into a modest surplus of $38 million. By mid-year, the projected surplus was revised up to $89 million. Then came the latest estimate (via last month’s Q3 update), where a nifty surplus of $488 million was telegraphed. All told, it amounts to a very material budgetary improvement vs. the original/cautious budget plan. Any number of own-source revenue streams defied expectations in 2021–22, covering everything from sales tax to personal income tax, corporate income tax to property transfer tax, and beyond. There were additional/above-plan transfers from the federal government to boot. Incremental spending linked to new collective agreements meant total expense topped budget by roughly $100 million or less than 1%. Still, of the $832 million in unplanned revenue, almost 90% was steered right to the budgetary bottom line. Add in the positive effect from final revisions to 2020–21 and New Brunswick’s debt level looks to end the fiscal year far, far below plan. Refer to debt outlook section.

▪ Fiscal outlook for 2022–23 and beyond — After chalk up more than $1 billion in combined surpluses over the past five fiscal years, Budget 2022 aims to keep New Brunswick on a balanced fiscal path through the medium term. A $35 million surplus has been planned for 2022–23, followed by two more years in balance (surpluses averaging $30 million/year to 2024–25). In light of the outgoing year’s revenue pop, top-line revenue growth is expected to moderate to 1.2% ascertained extraordinary gains fail to repeat
and as tax relief kicks in. Federal transfers are poised to account for 38% of ordinary revenue, up slightly vs. the prior year’s share. A variety of strategic investments, including a significant provision for wage settlements, would see total spending advance ~5½% in 2022-23 before decelerating to a sub-2% annualized clip thereafter. For the full three-year fiscal plan to 2024-25, average annualized revenue growth is estimated at 1.4%, or half the 2.8% average annual tally for total expenses.

- **Select budget initiatives** – Among other things, the budget prioritizes housing, health care, support for the vulnerable/needy, while simultaneously seeking to drive economic growth and maintain a sound fiscal trajectory. The budget sets out more than $3.2 billion for health care, with stabilizing and rebuilding the province’s health care system a stated priority. Increasing the supply and quality of senior care is also a prominent objective and recipient of funding given the province’s older population. Meanwhile, in partnership with the federal government, New Brunswick will invest $500 million over the next 5 years into bolstering the early learning and childcare sector, in addition to other investments in education. To aid housing affordability (and pursuant to an earlier pledge), provincial property tax rates will move lower over three years starting in 2022. Non-owner-occupied properties (e.g., apartment buildings) will see the biggest relief (~50%), with other residential and non-residential properties seeing a 15% reduction. Rents will be retroactively capped at 3.8% in 2022, equivalent to the prior year’s increase in CPI. The federally mandated carbon tax rates rise from $40/tonne to $50/tonne on April 1st, adding over 2.2 cents a litre to the price of gasoline (all else equal). New Brunswick will steer more resources into its Climate Change Fund. To offset the impact of the enlarged carbon tax, the province is moving to increase the basic personal amount and the low-income tax threshold for the 2022 tax year, saving personal taxpayers some $40 million.

- **Debt outlook & interest bite** – As per the Q3 update, net debt is estimated to end 2021-22 at $12.98 billion. That would be $1.15 billion lower than plan, capturing both 2021-22’s surprisingly robust budget balance and significantly positive revisions to the preceding fiscal year (confirmed in the public accounts). The net debt level also constitutes an outright reduction relative to the prior fiscal year. That’s in fact the third consecutive year-over-year decline in the level of net debt, which you can label as legit debt consolidation. With the budget balanced, the future trajectory for net debt is primarily a function of net tangible capital investment. Reflecting the previously tabled capital budget, net debt is seen rising just $15 million in 2022-23 and a decidedly contained $88 million over the full three-year financial plan. Compared to nominal GDP, the net debt ratio took a significant step down in 2021-22, the current estimate of 31.9% standing 4.5% pts below plan. Now, New Brunswick may not be the only province beating its budget in 2021-22, but sustained budgetary outperformance vs. most provincial peers is nicely reflected in relative debt ratios. As of 2021-22, NB had chopped more than 8–pts from its net debt ratio over five years, whereas the weighted provincial average had moved up during that time. New Brunswick’s budget projects an even lighter debt burden ahead, net debt–to-GDP hovering just above 30% in 2022-23 and dipping to 28.2% by 2024-25. As it relates to debt affordability, the situation is also relatively sound/stable. Notwithstanding an expectation of higher interest rates, debt servicing costs are slated to ease slightly in 2022-23, consuming just 5.6 cents of the revenue dollar (2021-22: 5.7%).

- **Borrowing requirement & funding strategy** – Given a rapidly evolving fiscal outlook, New Brunswick’s net financing needs underwent a fair transformation in 2021-22. The province started the fiscal year with a gross borrowing requirement of $1.85 billion. But by the time the Q3 update landed last month, underlying cash needs were barely 40% of the original plan. Considering the ~$1.1 billion of long-term financing that the province has secured, New Brunswick will go into 2022-23 pre-funded to the tune of $400 million. That’s a nice place to be given still–elevated uncertainty, less–than–fully–predictable financial conditions and a rising path for policy rates on either side of the Canada/U.S. border. Controlling for pre-funding in hand, gross requirements for the government amount to just under $1.6 billion for the coming fiscal year. That may seem out of step with a budget surplus and capital spending needs, but really captures a heavier year for maturities. Expressed another way, pre-funding almost fully offsets the government’s net requirement, meaning 2022-23’s gross borrowing need by and large amounts to refinancing activity. There are additional requirements for NB Power, equivalent to $200 million, due to be sourced by the province and on–lent in order to secure the most favourable terms/rate. There’s also the standard annual requirement for NB MFC ($150 million). Adding it all up and controlling for pre-funding, we’re talking about a total gross requirement of $1.94 billion for fiscal 2022-23. The funding strategy can be expected to key on regular domestic benchmarks, although as we’ve seen in the past, private placements could be considered on a case–by–case basis. While we consider there to be sufficient capacity for New Brunswick in the domestic market, the province retains the option to explore international funding opportunities to the extent foreign markets prove attractive/efficient and afford access to a wider/more diverse investor base. All told, it’s a manageable borrowing program, one that is hardly out–of–step with the requirements on display in many other provincial jurisdictions. Finally, to the extent that much of the planned borrowing is to refinance maturing debt, New Brunswick’s outstanding stock of marketable bonds won’t be growing much at all. That’s a positive technical consideration and one that is very much rooted in the fundamental fiscal outperformance on display to these past five fiscal years.

- **Current long–term credit ratings** – S&P: A+, Stable | Moody’s: Aa2, Stable | DBRS: A(high), Stable

[Refer to our Provincial Ratings Snapshot for additional colour on specific credit rating drivers/considerations]
## COMPARATIVE STATEMENT OF SURPLUS OR DEFICIT

($ Thousands)

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<tr>
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<th>2022 Estimate</th>
<th>2022 Revised</th>
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### Multi-Year Plan ($ millions)

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<th>2022-2023 Budget</th>
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<td><strong>Revenue</strong></td>
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<td><strong>Surplus (Deficit)</strong></td>
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<td>(Increase) Decrease in Net Debt</td>
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<td>(109)</td>
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<td><strong>Net Debt-to-GDP (%)</strong></td>
<td>30.1%</td>
<td>29.3%</td>
<td>28.2%</td>
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New Brunswick 2022 Budget
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