NATIONAL BANK OF CANADA FINANCIAL MARKETS

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Rising cost of living cushioned by additional income

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Highlights

Newfoundland and Labrador's budget mirrors those of other provinces as revenues have been revised upward significantly as a result of a stronger than expected economic recovery. In fact, following a stunning 21.9% growth in nominal GDP in 2021, the deficit for the fiscal year just ended has been reduced by $426 million to $400 million. Based on these growing revenues, the budget deficit should be only $351 million in 2022-23 and a balanced budget should be reached in 2026-27. A portion of the additional revenue will be used to combat the rising cost of living by providing a tax vacation on home insurance and a 50% discount on the cost of registering passenger vehicles, light trucks and cabs for the next year. New tax credits for companies have also been put in place to help them in their ecological transition and their capital investment. Net debt, while ending 2021-22 at a lower than planned level, remains high by provincial standards. Progress on the deficit is expected to be offset by increased investment, with the net debt to GDP ratio rising from 41.4% in 2021-22 to 44.1% in 2022-23. The interest bite, measured versus revenue, should ease up slightly this fiscal year given the expected recovery in nominal output. As for borrowing, the gross bond program is estimated at $2.7 billion, with $1.7 billion due to a heavier year for maturities and $1 billion in net bond supply.

- Economic outlook — After being hit by both the pandemic and the drop in oil prices, Newfoundland and Labrador has erased much of the effects of the crisis on its real GDP, which is estimated to have grown by 3.5% by 2021. This growth was made possible by the rebound in consumer spending, exports, and real estate activity. The recovery in oil prices and rising inflation in 2021 has also helped boost nominal GDP by an impressive 21.9%, further fuelling government revenues. The labour market has also recovered well from the crisis. Indeed, after losing 32.4K jobs at the beginning of the pandemic, the level of employment in February was 2.2% higher than its pre-crisis level. The unemployment rate has also fallen sharply, coming close to its pre-pandemic level at 12.3% in February. In 2022, it is estimated that the province's real GDP will grow by only 0.5%, which is conservative by comparison of our forecast of 3.0%. It should then increase by 3.4% in 2023 and by 2% on average between 2024 and 2026. It should be noted, however, that these forecasts do not take into account the effect of the Bay du Nord project investment, which is expected to be in service in 2028. After the spectacular jump in nominal GDP in 2021, it is expected to increase more moderately by 3.6% in 2022 and decrease by 3.0% in 2023 following the decrease in the price of oil and other commodities. On the labour market, the unemployment rate is expected to fall back below its pre-pandemic level in 2022 to 11.7%. It should then gradually decline from 11.5 percent in 2023 to 10.3 percent in 2026.
- Outgoing year budget balance (2021-22) — The 2022 budget is built upon the foundation of these results. Newfoundland and Labrador now estimate the 2021-22 deficit at $400 million. That marks a roughly $426 million net fiscal improvement over the $826 million in red ink previously outlined in the May 2021 budget. As per the government: "strong fiscal management and increased revenues continue to counter the effects of a volatile oil industry and the Covid-19 pandemic." Including the improvement vs. plan in 2021-22, the province's deficit was around 1% of GDP, highlighting the progress towards fiscal repair. The budget tables for an improving fiscal trajectory which will benefit from economic growth and higher oil prices. The better-than-planned budgetary tally owes partly to a revenue boost, as an extra $145 million was realized here (+1.7% above plan) but the bigger contribution came via a spending level that was $281 million below budget.
- Medium-term fiscal outlook (2022-23 & beyond) — The improved budgetary backdrop carries over to 2022-23 and beyond. A deficit of $351 million is planned for the current fiscal year, equivalent to 0.9% of GDP. Progressively smaller deficits are foreseen over the medium term, giving way to a balanced budget in 2026-27. While there's no set-aside in 2022-23, Newfoundland and Labrador has opted to embed an 'oil risk adjustment' starting at $10 million in 2023-24 and growing to $50 million/year by the final year of the fiscal plan. That's a nod to the inherent volatility in oil prices. A closer look at the five-year fiscal plan shows 1.3% average annual revenue growth. That seemingly subdued revenue growth pace in part captures the assumed pullback in oil prices noted above, and more-or-less matches the forecasted average growth rate for nominal GDP over that period. With revenue growing somewhat modestly, getting to balance by 2026-27 will involve sustained restraint in spending. As per Budget 2022, total expenditures are projected to average a scant 0.1%/year through 2026-27. Such sustained cost containment could be difficult, particularly if affordability concerns remain rampant, hinting at some risk to the fiscal plan here.
- New initiatives — The main focus of this budget was to address the rising cost of living. As such, no provincial taxes or fees were increased this year. To take a weight off the shoulders of Newfoundlanders, the budget includes the removal of the 15% retail sales tax on home insurance and taking 50% off registration fees for passenger vehicles, light-duty trucks and taxis for a period of one year. The budget also includes $46 million to reduce the cost of child care from $35 per day 18 months ago to $10 per day by January 2023. This measure will save a family $6,300 per child compared to 2020. Another $7 million is allocated for the Physical Activity Tax Credit, which provides families with a refundable tax credit of up to $2,000. An additional measure included in the budget is to expand the MetroBus/GoBus pass for income support client program to include seniors receiving the Guaranteed Income Supplement, as well as youth-in-care receiving youth services programming. Another focus of the budget was to support

industries and businesses. To achieve this, the budget includes a new green technology tax credit of 20% to help businesses with specific capital costs for green activities such as equipment for energy conservation and clean energy generation and efficient use of fossil fuels. Another tax credit for manufacturing and processing investment of 10% will support the manufacturing, fishery, farming, and forestry sectors to invest in capital equipment. The last major axis of the budget was to support the health and education with notably $14 million to improve access to primary health care, $3.3 million for the air ambulance program, $2.5 million for a new Alcohol Action Plan, $2.5 million for a new Life Promotion Suicide Prevention Action Plan, and $3.1 million in additional funding for teaching services to meet the rising student population.

- Oil price assumptions & official sensitivities – On the subject of oil, the budget is based on an average of US$86/bbl for Brent in 2022-23, with each dollar per barrel worth an estimated $13 million (on a full-year basis). We'd note that Brent was hovering right around US$100/bbl on budget day. While the stronger oil price backdrop is obviously supportive for the province's finances, a declining level of oil production suggests oil royalties will account for a smaller share of provincial revenue (est. 9.5% for 2022-23). Beyond the current fiscal year, oil price planning assumptions split the difference between high and low external forecasts, with Brent expected to average US$78/bbl in 2023-24 before falling to sub-$70 starting in 2025-26. We'd caution that the exchange rate must always be controlled for, given the interplay between oil prices and CAD. It's believed that a one cent strengthening of the loonie would erase $14 million from full-year royalties on translational effects, all else being equal. The budget assumes the Canadian dollar averages 0.793 cents U.S. this fiscal year (i.e., CAD of 1.261 in 2021-22). Depreciation is assumed on the longer term, the loonie hovering at 78 cents starting in 2024-25.
- Debt outlook & interest bite — Consistent with the improved budgetary picture, net debt is ending the 2021-22 fiscal year at a lower-than-expected level. At $16.5 billion, the latest estimate for 2021-22 compares favourably to the $17.2 billion forecast in Budget 2021. Considering the deficit and capital requirements, net debt is slated to end 2022-23 at $17.1 billion, which represents an increasing share of nominal GDP at 44.1% (vs. 41.4% in 2021). Meanwhile, gross debt expenses are set to edge up to $956 million, consuming some 10 ½ % of total revenue—the highest interest bite of all the provinces although down a touch vs. the prior fiscal year.
- Long-term borrowing requirement — For 2021-22, actual gross bond issuance landed a bit below the Budget 2021 projection. Compared to the $1.7 billion originally flagged, the province issued $1.55 billion in new term debt in 2021-22. Gross bond supply is due to pick up in 2022-23, the gross bond program estimated at $2.7 billion. Note, however, that the larger dose of supply is really a function of elevated maturities, as there's $1.7 billion coming due in 2022-23. Looked at another way, net bond supply (i.e., gross less maturities) will be $1.0 billion, moderating on a fiscal year-over-year basis which is consistent with the improved budgetary track.
- Current long-term credit ratings — S&P: A, Negative | Moody's: A1, Negative | DBRS: A(low), Stable

  Refer to our *Provincial Ratings Snapshot* for additional colour on specific credit rating drivers/considerations.

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Newfoundland & Labrador

$000,000	Budget 2021/22	Actual 2021/22	Budget 2022/23	Outlook 2023/24	2024/25	2025/26	2026/27
Fiscal Revenue	7,938	8,166	8,156				
Provincial tax sources	4,044	4,494	4,473				
Personal Income Tax	1,613	1,584	1,666				
Sales Tax	1,214	1,433	1,295				
Corporate Income Tax	469	663	737				
Mining Tax and Royalties	64	191	120				
Other Taxes	684	623	654				
Offshore Royalties	1,059	1,136	866				
Other Provincial Sources	512	578	432				
Program Expenses	8,349	8,145	8,465				
Debt Servicing	995	918	956				
Total Gross Expenses	**9,344**	**9,063**	**9,421**	**9,268**	**9,243**	**9,115**	**9,106**
Consolidated surplus (deficit)	**(826)**	**(400)**	**(351)**	**(309)**	**(270)**	**(74)**	**82**
as a % of revenue	-9.7%	-4.6%	-3.9%	-3.7%	-3.6%	-1.6%	0.0%
as a % of GDP	-2.1%	-1.0%	-0.9%	-0.8%	-0.7%	-0.2%	
Debt servicing as a % of revenue	11.7%	10.6%	10.5%				
Offshore Royalties as a % of revenue	12.4%	13.1%	9.5%				

Net Debt and Total Debt

	Budget 2021/22	Actual 2021/22	Budget 2022/23
Net Debt, beginning of period	**16,294**	**16,016**	**16,513**
+ Deficit (surplus)	826	400	351
+ Acquisition of Tangible Capital Assets	437	441	525
- Amortization of Tangible Capital Assets	339	344	336
= Net Debt - End of period	**17,218**	**16,513**	**17,054**
of which: Borrowings net of Sinking Funds	17,157	16,974	17,800
Unfunded Pension and Retirement Benefits Liability	4,032	3,888	3,756
Deferred Pension payments - Promissory note	4,050	4,050	3,965
Other financial liabilities less financial assets	8,021	8,399	8,468
Net debt - End of period as a % of GDP	44.7%	41.4%	44.1%
Debt, beginning of period	**24,035**	**24,108**	**24,912**
Debt retirement, T-Bills and sinking funds	(469)	(532)	(1,873)
Borrowings	1,700	1,550	2,700
Increase (decrease) in promissary notes	(80)	(80)	(84)
Increase (decrease) in unfunded pension liability	(38)	(229)	(228)
Increase (decrease) in post-retirement benefits liability	91	95	96
Debt, end of period	**25,238**	**24,912**	**25,522**

Source: Budget documents of Newfoundland & Labrador Ministry of Finance.

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