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Revenue surge leads to surplus & lower debt/lighter borrowing

By Daren King & Warren Lovely

Highlights

Newfoundland and Labrador's fiscal and economic update reveals how the province's finances have benefited from better-than-expected economic conditions and higher-than-planned oil prices, as a projected \$351 million deficit for 2022-23 has transformed into a \$479 million surplus. This net \$830 million improvement in the province's fiscal balance was made possible by a significant increase in revenues of \$1.334 billion, a surge only partially offset by a \$504 million increase in expenses. This resulting fiscal enhancement reduces the province's estimated borrowing requirement from \$2.7 billion to \$1.8 billion and lowers the fiscal year-end level of net debt by more than \$1 billion relative to the budget plan. The government also announced its intention to contribute \$157 million to the newly established Future Fund, reflecting \$107 million from non-renewable resource royalties received in 2021-22 and an additional one-time payment of \$50 million based on the 2022-23 projected increase in revenues.

	Budget 2022-23	Fall Update 2022-23	Variance
Revenue	9,070	10,404	1,334
Expenses	9,421	9,925	504
Surplus (Deficit) \$M	(351)	479	830
Borrowing Requirement	2,700	1,800	(900)
Net Debt	17,054	16,035	(1,019)

Source: Fiscal and Economic Update document of Newfoundland & Labrador Ministry of Finance

The much-improved revenue picture can be explained by increases in the offshore royalties, corporate income tax, personal income tax and sales tax categories. Not surprisingly, the improvement in the province's finances draws particular support from a higher-than-expected oil prices. Brent crude was originally thought to average US\$86 per barrel for the 2022-23 fiscal year, but today's update lifts the fiscal year projection to US\$102/bbl. Recall that at the time of the budget, it was estimated that for every dollar increase in the price of a barrel of oil, there would be an additional \$13 million in revenue. The significant boost to offshore royalties is not exclusively explained by a rise in prices, but also by an increase in production. Indeed, oil production was initially estimated at 83.1 million barrels and is now projected at 86.0 million barrels. Notwithstanding the major budgetary uplift telegraphed here, we would caution that oil prices have come under more recent pressure, owing to a deteriorating global economic outlook (at the time of writing, Brent was trading around US\$92/bbl). At a minimum, that suggests that oil royalty momentum could fade, with the potential for downward adjustments (to average price and resulting revenue) if today's crude prices persist through fiscal year end.

	Budget 2022	Fall Update 2022	Variance
Oil Price			
\$US per barrel	\$86	\$102	\$16
\$CDN per barrel	\$108.45	\$131.27	\$22.83
Exchange Rate (CAD to USD)	0.793	0.777	-0.016
Oil Production (Million barrels)	83.1	86.0	2.9
Budget Impact (Total Royalties)	\$865.7 M	\$1,240.3 M	\$374.6 M

Source: Fiscal and Economic Update document of Newfoundland & Labrador Ministry of Finance

In general, Newfoundland and Labrador's finances have benefited from economic conditions that were much more favourable than expected. Although real GDP growth is only expected to increase from 0.5% to 0.9% in 2022, nominal GDP growth has jumped from

3.6% to 10.1%. That reflects the above-noted upgrade to key commodity prices (significantly boosting the province's terms of trade) and also picks up higher levels of consumer price inflation that have been observed worldwide.

The province is benefiting from a stronger-than-expected labour market, as the average unemployment rate forecast for 2022 has dropped from 11.7% to 10.9%. In September, the unemployment rate fell to 8.2%, its lowest level since comparable data began to be published in 1976. The household sector is also doing better than expected. The expected increase in household income has risen from 3.2% to 7.2%, leading to an increase in retail sales, where the growth forecast for 2022 has been boosted from 3.5% to 6.0%. Population growth was also strong in the province as it recorded its fifth consecutive quarterly growth, its highest quarterly increase in recent history and largest annual population gain since 1976. With such significant population growth, the housing sector is also on track to perform better than expected, with the 2022 housing starts forecast increasing from 6.7K to 18.1K.

Budget 2022 vs. Fall Update 2022 (per cent change unless otherwise indicated)

	Budget 2022f	Fall Update 2022f	Difference (pp)
Nominal GDP	3.6	10.1	6.5
Real GDP	0.5	0.9	0.4
Household Income	3.2	7.2	4.0
Retail Sales	3.5	6.0	2.5
Consumer Price Index	3.9	6.5	2.6
Housing Starts	6.7	18.1	11.4
Capital Investment	4.8	4.7	-0.1
Population	0.4	1.1*	0.7
Employment	2.6	3.9	1.3
Unemployment Rate (%)	11.7	10.9	-0.8
Oil Production (millions of barrels)	82.3	85.2	2.9**

f: forecast

*: actual

** : millions of barrels

pp: percentage point difference

Source: Statistics Canada; Department of Finance

Finally, the Government's strategic plan underlined three elements to support balanced budgets, lower the cost of borrowing, and decrease debt. First, it wants to fix the financing of the Muskrat Falls Project through rate mitigation and a \$5.2 billion agreement with the federal government. The second element is to have a prudent fiscal governance, including expenditure control, transformation and modernization of government, strengthening the role of the Auditor General and balanced budget legislation. Lastly, it aims to have responsible debt management, including effective treasury management, improved liquidity, optimizing investment performance and establishing the Future Fund.

Current long-term credit ratings – S&P: A, Stable | Moody's: A1, Stable | DBRS: A(low), Stable

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

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