

# ECONOMIC RESEARCH AND STRATEGY



**LAURENTIAN BANK  
SECURITIES**

May 31, 2021

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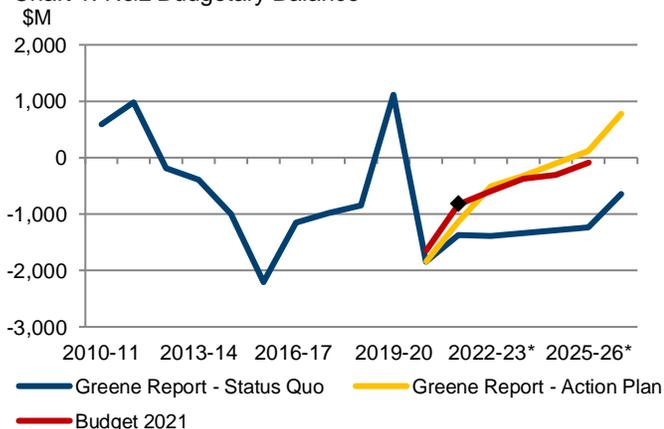
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## Newfoundland and Labrador Budget 2021 – Better near-term outlook but difficult decisions ahead

Minister of Finance Siobhan Coady presented today her first budget since Premier Andrew Furey secured a Liberal majority in the House of Assembly at the March 2021 General Elections. Budget 2021 does not implement the major recommendations brought forward by Moya Greene in her much-anticipated [Big Reset](#) report published a few weeks ago. Nonetheless, today's report sets the table for a comprehensive overhaul of the province's fiscal position in the years to come at the same time as transitioning the province to a post-COVID world.

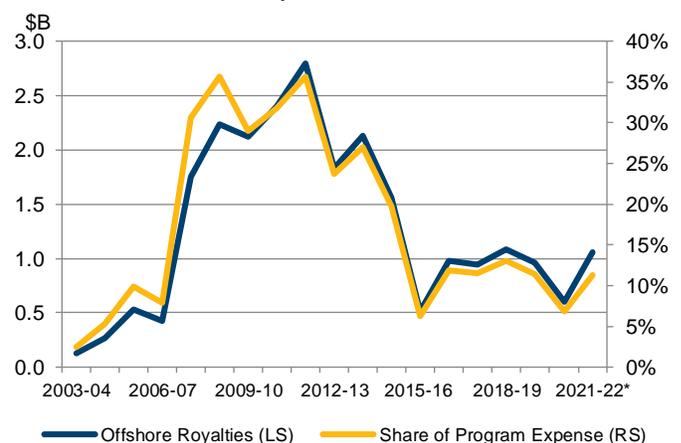
Budget 2021 starts on a positive note. The projected deficit for FY 2020-21 is revised down to \$1.6B (5.2% of GDP) from \$1.8B in the September 2020 Budget. The bulk of the revision comes from lower-than-anticipated program expenditures (-\$280M). Stronger-than-projected crude oil prices improved the bottom line by \$64M through higher offshore royalties. This better starting position allows the government to forecast a deficit shrinking by half to \$826M (2.3% of GDP) in FY 2021-22, equivalent to the shortfall registered in FY 2018-19 before the Atlantic Accord and the COVID-19 pandemic (chart 1). After declining 26% in FY 2020-21, own-source revenue jumps 20% in FY 2021-22 to reach \$6.6B, above pre-pandemic record levels. All major tax categories strongly rebound. Unlike other provinces, federal transfers are poised to increase by 31% in FY 2021-22 to reach \$1.9B. Recalling that N&L does not qualify for equalization payments, cost-shared and other temporary federal grants linked to the coronavirus explain this year's increase in GoC transfers.

Chart 1: N&L Budgetary Balance



Source: NL Government, *The Big Reset - The report of the Premier's economic recovery team (Greene Report)*, LBS Econ. Res. and Strategy.

Chart 2: N&L Offshore Royalties



Source: N&L Public Accounts, Budget and LBS Econ. Res. and Strategy.



### **Royalties double but important challenges remain for the oil and gas industry**

After collapsing to their lowest level since FY 2006-07, offshore royalties should benefit from higher crude oil prices this year. OPEC+ members' reluctance to ease output cuts and the very slow response from American producers continue to support Brent oil prices close to \$US70/bbl. While we continue to anticipate a softening in crude oil prices by the end of this year, current spot prices pose an upside risk to the budget assumption of US\$64/bbl average price and \$1.1B offshore royalty forecasts. For each US\$1/bbl increase in oil prices, the province collects about \$19M more in royalties. To place these developments into perspective, N&L royalty regime only covers 11% of total expenditures for FY 2021-22, down from as much as 35% when global crude oil prices hovered around \$US100/bbl.

The oil industry still plays a vital role in N&L's economy, representing 21% of the Province's nominal GDP. Production jumped by 8.9% in 2020 to 104M barrels. The government projects a moderate reduction in 2021 and 2022. Going forward, the industry faces several challenges. Cenovus has not confirmed its final decision regarding the possible expansion of the White Rose project (9.2M barrels in 2020). Meanwhile, production declined by 11M barrels last year at the Terra Nova platform and it is unclear when it would restart. The lack of foreign interest for exploration in Newfoundland's offshore area is also a long-term concern for the industry. Alleviating the province's reliance on oil and gas revenue is key according to the Greene Report. Indeed, the panel recommends depositing 50% of the oil revenue going forward in a *Future Fund* similar to Norway's sovereign wealth fund to reduce the province's net debt position. Those funds could be further invested into a longer-term green transition project.

### **A balanced budget in FY 2026-27 mostly based on spending restraint**

Program expenditures increase 10% in FY 2021-22. Despite a low number of active COVID-19 cases in Newfoundland and lighter restrictions relative to other provinces, the government continues to provide financial support to households and businesses. As much as \$100M is set aside for testing, PPE procurement and vaccine distribution. Beyond this point, the government sets the table for important spending restraints in order to balance the budget by FY 2026-27. The pace of deficit reduction is similar to other provinces such as Quebec or Saskatchewan. The end of COVID-19 temporary support combined to spending cuts lead total expenditures to decline 9% in FY 2022-23. From FY 2023-24 to FY 2025-26, total expenditures remain virtually unchanged in dollar terms, or negative in real terms after adjusting for inflation. The government announces a major reorganization at NALCOR and a review of the oil corporation in order to find efficiencies, although no savings targets are specified at the moment. Several organizational mergers include the Newfoundland and Labrador English School District into the Department of Education and the corporate services function of the four regional health authorities.

### **Potential future measures from the Greene Report**

Following the release of the Greene Report earlier in May, Premier Furey promised to follow up on the proposed plan, but did not provide details about the exact measures that will be implemented in the future. Thus, the medium-term fiscal outlook presented today could be subject to material modifications. For instance, among other measures, the panel recommended to implement a four-day week for public sector workers when possible, the freezing of the total public sector employees' wage bill and drastic grant reduction to higher education institutions. If fully implemented, including HST and CIT tax increases, the province could balance its budget ahead of schedule and register a substantial \$778M surplus in FY 2026-27 (chart 1).

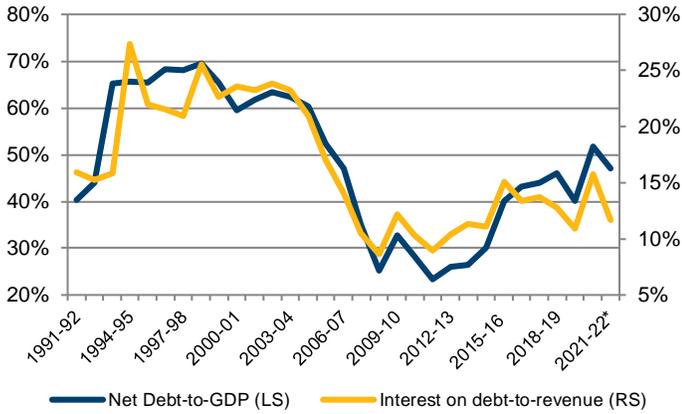
### **High debt levels**

Due to a 16.2% nominal GDP rebound forecast in 2021, Newfoundland and Labrador net debt-to-GDP is projected to move down to 47% in FY 2021-22 from 52% in FY 2020-21 (chart 3). Only Ontario projects a higher net-debt-to-GDP ratio this year (49%). Borrowing requirements are forecast at \$1.7B, down from \$2.8B last year and somewhat lower than we anticipated. Nonetheless, a key investor concern relates to the elevated gross debt level accumulated by N&L, estimated at \$26.1B on a consolidated basis by the Greene panel. Adding all other liabilities such as public sector pension funds and crown corporations' debt, the province's total liability tops \$47B. Consequently, the 12% estimated public debt charges-to-revenue in FY 2021-22 puts a dent in the province's ability to deliver services to its population (chart 3). Beyond addressing the near-term challenges presented by the structural deficit, difficult decisions regarding hydro-electricity assets and the delivery of services will need to be made in order to restore fiscal sustainability.





Chart 3: N&L Fiscal Framework



Source: N&L Public Accounts, Budget and LBS Econ. Res. and Strategy.

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