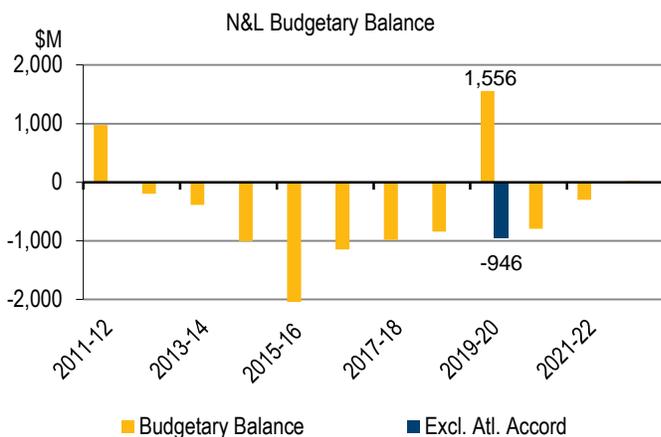


### Newfoundland and Labrador Fall Update: revenues affected by the Hibernia shutdown

Finance Minister Tom Osborne presented today the [2019 Fiscal and Economic Update](#). It is the most important fiscal document to be published following the May 2019 election when the Liberal Party was re-elected with a minority status. NL's finances deteriorated in FY 2019-20 relative to Budget 2019. The surplus, projected at \$1.9B in Budget 2019, is revised down to \$1.6B (4.5% of GDP). Excluding the \$2.5B federal transfer from the Atlantic Accord, there is a \$946M shortfall between revenues and expenses (2.8% of GDP, see chart). Expenses were virtually unchanged (-\$24M). The variation in the budgetary balance is entirely explained by a \$393M downward revision to revenues. Although no detailed breakdown estimates of revenues and expenditures are provided in the [Update Presentation](#), the government revealed in a [press release](#) that the shutdowns of the Hibernia offshore oil platform in July and August are subtracting \$185M in revenues this fiscal year relative to Budget. While accounted as a deferral by the N&L government, the proportion of revenues from this shutdown that will be retrieved next year is unclear to us. Slightly lower Brent oil prices further reduce royalty revenues by \$46M. Also, the domestic economic activity has been weaker-than-expected and likely deteriorated other forms of tax revenues. The Province revised down its 2019 estimates for retail sales and housing starts.



Source: N&L government and LBS Econ. Res. and Strategy.

The Fall Update does not provide a fiscal forecast beyond FY 2019-20. However, besides from the fact that this year's downward revision to revenue appears mostly recurrent, several elements point towards the possible postponement of a balanced budget in FY 2022-23. First, after two rating agencies gave N&L a stable credit outlook in September, Mr. Osborne [mentioned](#) that he has no desire to deeply cut in public services to eliminate the deficit. This week, he also [confirmed](#) that he will let the *temporary deficit reduction levy* expires as scheduled at the end of 2019, an income tax imposed to citizens in December 2015 to help reduce the deficit. The foregone revenue is approximately \$60M annually.

In the medium term, the N&L government continues to face additional fiscal pressure from Muskrat Falls. Starting in 2021, interest payments on the \$12.7B project (37% of GDP) will have to be recouped from electricity ratepayers in N&L in order for Nalcor to meet its financial obligations. To avoid electricity rates from nearly doubling, the province estimates that \$726M will be needed (9% of forecast revenue in FY 2021-22). The Liberal government released its

mitigation [plan](#) in April of this year (see Table 1). It relies on an expected \$200M contribution from the federal government and a negotiation is underway. Two weeks ago, Premier Dwight Ball met with Prime Minister Trudeau in Ottawa. [Media reported](#) that the talks included Muskrat Falls.

On the brighter side, real GDP growth is expected to accelerate from 1.7% in 2018 to 3.1% in 2019 and 2.6% in 2020 due to an increase in non-residential construction activity, oil production and commodity exports. Several mining and oil projects (West White Rose (\$3.2B), Bay du Nord (\$3.2B) and the Voisey's Bay Underground mine (\$2.0B) will underpin the economic potential of the province for the years to come.

<b>Table 1: N&amp;L Plan for Muskrat Falls Electricity Rate Mitigation</b>		
	<b>2021</b>	<b>% of total</b>
<b>Funding requirements (\$M)</b>	<b>725.9</b>	
<b>NL Hydro Net Operations Savings</b>		
Holyrood net fuel savings and inflation impacts	178.2	24.5%
<b>NL Investment</b>	<b>249.1</b>	<b>34.3%</b>
NL Hydro surplus energy	49.1	6.8%
Nalcor dividend	200.0	27.6%
<b>Reducing Expenses</b>	<b>39.4</b>	<b>5.4%</b>
Organizational change	20.0	
Muskrat Falls operations and maintenance	12.0	
Isolated diesel systems	7.4	
<b>Raising Revenue</b>	<b>59.2</b>	<b>8.2%</b>
Fuel Switching / Electrification	15.0	
Add value to energy surplus	35.5	
Holyrood Performance Credits (carbon credits)	8.7	
<b>Collaborate with Government of Canada</b>	<b>200.0</b>	<b>27.6%</b>
Total Provincial Sources	525.9	
Federal Involvement (gap)	200.0	

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Source: N&L Government and LBS Economic research and strategy.

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