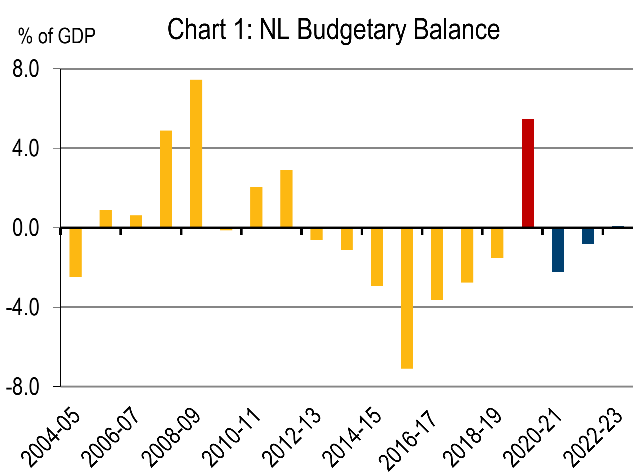
## Newfoundland and Labrador Budget 2019 – Temporary relief from the Atlantic Accord

On April 17th, one day after publishing the 2019 Budget, the Premier of Newfoundland and Labrador Dwight Ball called for provincial elections to be held one month later, on May 16th. With the House of Assembly now dissolved, the approval of the 2019 budget will thus depend on the outcome of the elections. At the beginning of March, polls showed that the ruling Liberal Party was still ahead of the PC Party in voting intentions (45% versus 38%), but the race was getting tighter relative to an earlier poll conducted last November.

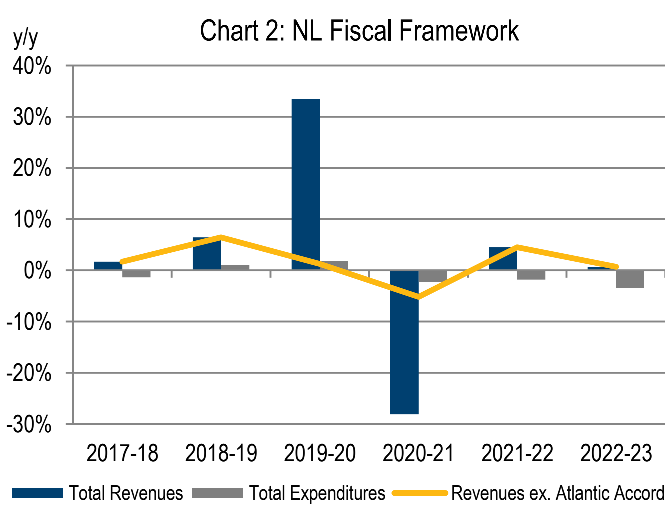
In any case, the NL government will inherit a temporary improvement in the Province's public finances due to the renewal of the Canada Atlantic Accord on April 1st. Indeed, this agreement between the federal government and Newfoundland and Labrador, of which the first version was signed in 1985, allows NL to keep the largest share of the royalties generated off its offshore oil production (the Hibernia oil project). The 2019 version of the Accord includes a net $2.5B transfer from the federal Government to NL over the next 38 years (2019-2056).

Since these funds are "front-end loaded", the NL government can recognize 100% of the $2.5B in revenues for FY 2019-20.[1] This allows total revenues to grow by 33.5% this year. Removing the effect of the Accord, revenues would only grow by a modest 1.3% (chart 2). Combined with the $152M (1.8%) projected increase in total expenditures, the one-time $2.5B windfall allows the government to forecast a very large $1.9B (5.5% of GDP) surplus this fiscal year (chart 1). The strategy is to use most of the payment (the $1.9B surplus out of the $2.5B transfer) for debt reduction immediately, thereby lowering future public debt charges (PDC). In NL, PDC represented a large 13% share of total revenues in FY 2018-19.

Debt redemption for FY 2019-20 will thus allow the province to make a significant one-time reduction in its net debt-to-GDP ratio which should fall by 6 percentage points (from 45% in FY 2018-19 to 39% in FY 2019-20). As a result, Newfoundland's borrowing program will decrease from $1.4B last year to $1.2B this year.




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




Sources: NL Goverment, LBS Econ. Res. and Strategy Calculations.

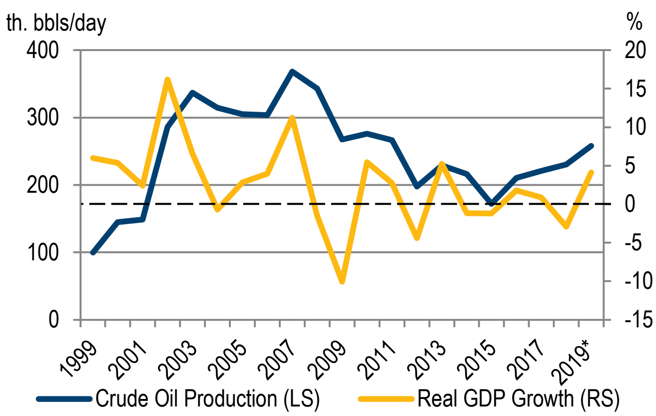
[1] In fact, the actual cash transfer will be $134.9M in 2019.

**Economic and fiscal challenges to persist despite rising oil production**

The province forecasts deficits in FY 2020-21 and 2021-22, before balancing its budget in FY 2022-23. To do this, total expenditures will shrink at an average annual rate of 2.5% for the next three years, a significant 7.3% nominal total decline (chart 2). Moreover, the fiscal framework is elaborated within a volatile economic environment. In 2019, the province expects real GDP to grow by a strong 4.1% as oil production ramps up by 12.1% to reach 258K bls/day (chart 3).

But, from 2020 onwards, economic growth is expected to only average 0.8% annually as the West White Rose offshore oil, Voisey Bay underground mine and Muskrat Falls hydro-electric dam projects will have been completed. Also, despite international migration which has been trending up since 2010, population growth is still expected to decline over the forecast horizon due to low fertility rate and interprovincial migration.

Chart 3: NL Crude Oil Production and Growth




Source: C-NLOPB, Government of NL, Statistics Canada and LBS Econ. Res. and Strategy.

**Key issues to monitor**

- The Atlantic Accord includes a provision engaging the Government of Canada to negotiate with Newfoundland and Labrador on possible **electricity rate mitigation,** made necessary following massive costs overrun in the Muskrat Falls project.[2] Indeed, the federal government has provided NL with a guaranteed loan to finance the hydro-electric dam construction. Under the terms of the loan, NALCOR's (the provincial utilities generator in charge of the project) debt must be recovered from electricity ratepayers, starting in 2021. CBC cites an annual $800M to be recovered in interest payments which would put tremendous pressure on households and businesses using hydro-electricity.

- The PC leader, Ches Crosbie, promises to hold a **referendum on equalization** if his party gets elected on May 16th. Similar to the recent election in Alberta, the core issue is the inclusion of natural resource revenues in the equalization formula.

[2] The original cost estimate was $7.4B. The final cost will be $13.0B. To put it in perspective, this is equivalent to 39% of NL's 2017 GDP. It is the subject of an ongoing public Commission of Inquiry. The government estimates that Muskrat Falls accounts for one third of total provincial debt.

- Brent crude oil prices are forecasted by the NL government at US$65 for FY 2019-20. Although we are less than one month into this fiscal year, Brent oil prices averaged $US71. Since offshore royalties represented 14% of the province's revenues in FY 2018-19, they could provide a fiscal boost this year.

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