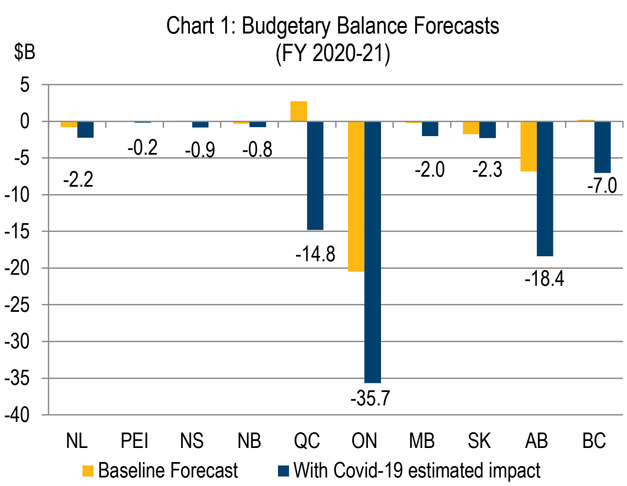
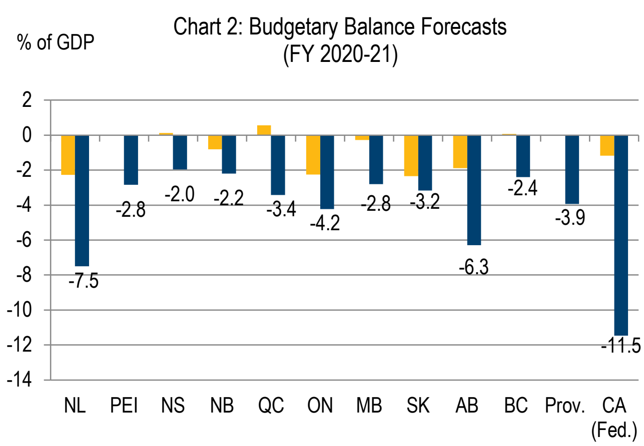
Laurentian Bank Securities
ECONOMIC RESEARCH
AND STRATEGY

Provincial Outlook – The fiscal impact of Covid-19

An update to a singular 2020 Budget Season

The 2020 Budget Season coincided with the emergence of the coronavirus. Provincial governments released their budget at the same time as the ravaging effect from Covid-19 was slowly taking place. Consequently, most governments based their fiscal framework on an economic outlook that unfortunately did not reflect the reality of what was to come. To prevent contagion, provinces had to shut down a wide swath of their economy in late March and early April, triggering a recession with devastating blows on taxation revenue. Governments also announced unprecedented measures to support businesses, individuals and health care delivery. The result will be record high budgetary deficits in many provinces. We estimate the combined provincial deficits to reach $84B (3.9% of GDP, chart 1 and 2) in FY 2020-21, up from a modest $9B (0.4% of GDP) in FY 2019-20. In comparison, the combined provincial deficit reached $26B (1.7% of GDP) in FY 2009-10. However, provincial deficits this year pale in comparison to the federal government's shortfall which could reach close to $250B on the back of federal emergency programs such as the Canada Emergency Response Benefit and the Emergency Wage Subsidy.





Note: The *Baseline* Balance and GDP forecasts are based on/or extrapolated from the latest provincial and federal Fiscal Update or Budget. Saskatchewan: *Revenue Scenario 1* and expenditure *estimates* for *Baseline*. Quebec balance *before* transfers to the Generations Funds.
Source: Provincial, Federal governments and LBS Econ. Res. and Strategy.

Higher borrowing requirements and BoC intervention

In turn, deterioration in budgetary deficits will boost borrowing requirements. We estimate that provinces will borrow a combined $150B in FY 2020-21, a $64B increase from FY 2019-20 and more than 60% above the $93B original estimate based on the latest official provincial projections (table 1).[1] The *net* amount outstanding of provincial bonds this year could increase by less than our $150B issuances projection as the Bank of Canada (BoC) is currently conducting its first ever [Provincial Bond Purchase Program](#) (PBPP) capped at $50B in the secondary market. Since its first PBPP operation on May 7 the BoC has bought $1.9B of provincial bonds.

Net debt-to-GDP, the most widely used measure for indebtedness comparison, is poised to rise to record levels in some provinces but to a lesser extent than for the federal government. In Ottawa, we forecast the net debt to GDP

[1] The provincial fiscal estimates assume no change in scheduled Government of Canada transfers and do not include the impact of lower interest rates on public debt service. Revenue forecasts are based on LBS nominal GDP forecasts. Additional impact from lower commodity prices are based on provincial sensitivity tables and LBS calculations.

ratio to jump from 35% to 50% (chart 3), the highest level since 2001, before Canada managed to upgrade its credit rating to AAA. While forecasts regarding the depth of the recession vary widely, the economy likely bottomed in April. The early signs of a recovery in May provide an opportunity to comment on the economic outlook in each province and update fiscal forecasts for FY 2020-21.

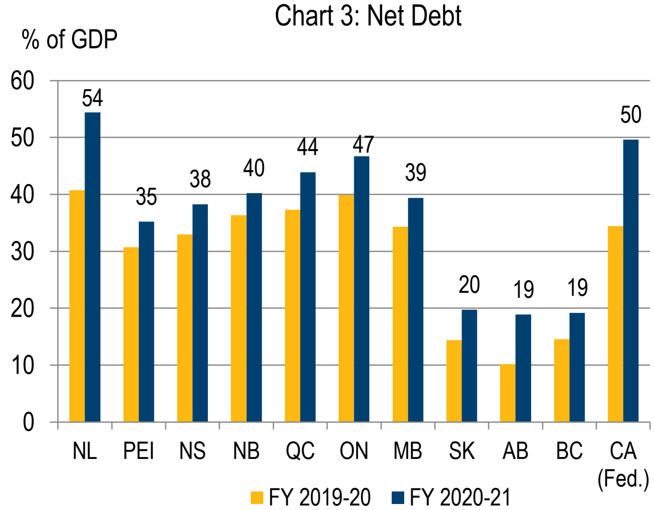
Table 1 - Financing Program (Long-Term Borrowing Requirements, $B)

	2019-20	2020-21 Initial	2020-21 Forecast
NL	1.2	2.0	3.4
PEI	0.1	0.1	0.3
NS	1.6	1.5	2.4
NB	1.9	1.2	1.7
QC	20.0	13.9	31.4
ON	39.5	40.1	55.3
MB	4.4	5.2	7.0
SK	1.9	3.8	4.3
AB	8.9	17.1	28.7
BC	6.9	8.6	15.8
Total prov.	**86.4**	**93.4**	**150.3**
Canada (Federal Gov)	126.5	200.0	344.0

Note: Excludes short-term financing. Reflects the change in fiscal position implied by our forecasts. Fed. Gov. and PEI initial are estimated.

Source: Provincial and federal governments, LBS calculations.

Chart 3: Net Debt



Notes: Fiscal data gathered from provincial/federal latest Budget/Fiscal Update. Sources: Provincial Governments, Government of Canada and LBS Econ. Res. and Strategy calculations.

British Columbia

Due to its proximity to Asia, BC was the first province hit by Covid-19. Thanks to strong social distancing guidelines and an impressive amount of tests conducted, the province has successfully “flattened the curve”. With only 2530 cases in total, the infection rate remains low. As opposed to many other provinces, some non-essential services were allowed to continue operating. The construction of large projects such as LNG Canada and the hydroelectric Site-C continued during the pandemics. The second phase of the 4-phase reopening plan is underway since May 19 and includes food, retail and personal care services and outdoor activities. All in all, we forecast BC to experience the mildest recession among provinces in 2020 (see our nominal GDP forecasts on table 3 at the end of this document). With a budget deficit forecast at 2.4% of GDP and some the lowest net debt-to-GDP ratio across provinces at the end of 2020, the negative outlook recently placed by S&P on BC’s AAA-rating is not worrisome.

Alberta

The province faces the dual problem of Covid-19 and low oil prices. The energy patch was already going through a number of difficulties prior to the pandemic and the collapse in global oil demand made it worse. Facing WCS prices averaging US$7 in April, producers had no choice but to slash capital expenditure and cut production. CAPEX could fall 65% in 2020 according to IHS and production could be reduced by 1.1M bbl/day, or 25%, in 2020Q2 relative to 2019Q4. Ressources revenue could come in $3B short of expectations, but would be supported by a tighter WTI-WCS spread and a lower Canadian dollar. A silver lining resides in the fact that very few new coronavirus cases were discovered in the past two weeks. The first phase of the reopening plan began on May 14th and includes most services industries. An important caveat is that restaurants and bars are only allowed to serve at 50% of their capacity. Improving economic activity will help the government coping with an estimated $18B deficit (6.3% of GDP) in FY 2020-21. Alberta’s low public debt comes in handy as the net debt-to-GDP ratio could almost double from a year ago to 20% but still remain among the lowest in Canada.

Saskatchewan

Saskatchewan was the first province to implement its reopening plan. The mild spread of coronavirus cleared the way for citizens to resume retail and recreation activities faster than in most provinces according to Google movement data (table 2). People are driving more than prior to coronavirus, as measured by the usage of Apple maps (chart 4). The province released in April revenue estimates under three different Covid-19 scenarios. Based on current oil and potash prices as well as the ongoing recovery in the province, the 2nd scenario calling for a 13% nominal GDP decline in 2020 appears the most likely outcome. As a result, resources revenue could come in almost $1B lower than in FY 2019-20. At 3.2%, our deficit-to-GDP estimate is way below the 7% record set in FY 1991-92. Since then, Saskatchewan reduced its net debt-to-GDP from 47% to 14% pre Covid-19. Hence, the province has fiscal room to navigate through the crisis.

Table 2 - Retail and recreation activity

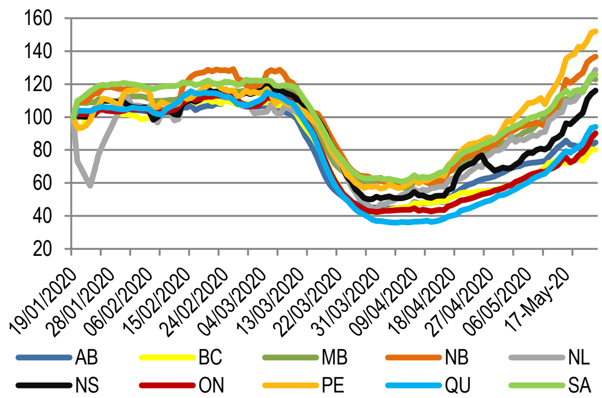
(% Change in visits versus January baseline)

	21-Feb	21-Mar	21-Apr	16-May
NB	-1	-28	-38	-22
MB	2	-25	-42	-26
SA	1	-25	-40	-27
NL	0	-16	-44	-28
NS	5	-20	-48	-32
PE	-1	-35	-42	-33
AB	3	-29	-44	-34
BC	6	-25	-45	-39
QC	1	-36	-59	-45
ON	-1	-31	-56	-45

Note: Calculated as a 7-day moving average.

Source: Google Community Mobility Report. Updated on May 26.

Chart 4: Apple Maps Usage



Note: Shown as a 7-day moving average.
Source: Apple.

Manitoba

At 21 per 100K, Manitoba's coronavirus cases are among the lowest in the country, close to New Brunswick (16) and Prince Edward Island (17). As such, phase 1 of the reopening plan began early. On May 4th, retail, food and personal care services were allowed to operate again. The 2nd phase is expected to begin on June 1st. The provincial government released an emergency supplement to its 2020 Budget in late March. While the economic hit is likely to exceed the document's worst case scenario that assumes nominal GDP coming in 2.4 ppts lower than expected, the diversity of the Manitoba economy shields it somewhat from the commodity shock currently facing energy-producing provinces. Overall, Manitoba is expected to experience a softer economic contraction in 2020 relative to other provinces. S&P revised its outlook for the province's A+ credit rating from *positive* to *stable*. In our opinion, the $2.0B deficit (2.8% of GDP) we forecast is manageable and should prevent an imminent downgrade. The province's $800M "rainy day fund" could also be used to reduce the deficit by almost half and accordingly would lower borrowing requirements below our $7.0B estimate.

Ontario

Ontario is the second hardest hit province by Covid-19. Urban density and Toronto's status as an international business center contributed to the spread of the virus but strict social distancing measures have been implemented early on. As a result, the growth in the number of cases has been broadly stable, despite an increase in testing. The government was able to launch the first phase of its reopening plan on May 19th. Outdoor activities and retail services are allowed. Instead of a full budget, the government released a Fiscal Update in late March. The document included an early assessment of the coronavirus impact on Ontario's economy and public finances. Based on the information collected since, the 2.0% nominal GDP growth assumption used by the Ontario government underestimates the coronavirus damage to the economy. However, the fiscal framework is reinforced by many layers of prudence to cover additional spending and potential revenue shortfall: $1.0B in health contingency fund, $1.3B additional spending contingencies and a $2.5B reserve. The province also provided $2B in financial support to individuals and businesses. All in all, the deficit could come in closer to $36B (4.2% of GDP), up from the $20.5B March 2020 estimate and the largest since FY 1992-93 (as a share of GDP). Net debt-to-GDP would reach a record 47%.

Quebec

Quebec is the hardest hit province on a per capita basis with 562 cases per 100K and 56% of all cases reported in the country. The Montreal CMA, home to 55% of Quebec's population, has become the epicenter of the virus in Canada and was excluded from Phase 1 of the government's reopening plan on May 4th. Retail stores in Montreal were only allowed to reopen on May 25th. As a result, the economic contraction in Quebec is likely to be more severe than in most provinces and could shave off $13B (10%) of provincial revenues relative to expectations. Moreover, according to the government, the measures introduced to fight Covid19 will result in $5B of additional spending relative to the Budget 2020 estimate of $110B. The healthy state of public finances before the outbreak will allow the province to weather the storm. Quebec recorded 6 consecutive budgetary surpluses (before transfers to the Generations Fund) and lowered its net debt-to-GDP from 51% in FY 2012-13 to 37% in FY 2019-20. We expect the deficit in FY 2020-21 to come in at $15B (3.4% of GDP). Under this scenario, net debt-to-GDP would climb back to 44%, its highest level since FY 2015-16. Given the unusual circumstances, the various sources of revenues and investment income dedicated to the Generations Fund are likely to be revised down in FY 2020-21, a downside risk to the $2.7B transfer to the Generations Fund projected in Budget 2020 and the overall budgetary balance. Furthermore, the situation could incite the government to take a pause and not dedicate any money to the Generations Fund this year. The government plans to release a Fiscal and Economic Update at the end of June.

New Brunswick

As of writing, only 4 new coronavirus cases have been reported in New Brunswick since the beginning of May. Moreover, 120 out of the 122 patients have recovered. The 3rd phase (yellow) of the government's 5-phases colored reopening plan began on May 22. Retail and outdoors activities and social bubbles are allowed. Most services-oriented activities are reopened, including gyms and indoor recreational activities. This rapid pace of domestic economic recovery will soften the magnitude of the recession in NB. We estimate that the deficit could reach $795M in FY 2020-21 (2.2% of GDP), the largest since FY 2009-10. The province had successfully balanced its books in the past three years and reduced its debt burden, generating some fiscal room to manage the Covid19 fallout.

Nova Scotia

At 108 cases per 100K, the coronavirus has been more prevalent in Nova Scotia than in other Atlantic provinces. Google and Apple data indicate a larger reduction in individuals' mobility relative to NB and PEI (table 2, chart 4). The seafood industry, a key segment of the Nova Scotia economy, has been particularly affected by the collapse in Asian demand. The good news is that the infection curve has been successfully flattened in the past two weeks. A detailed multi-phase plan for reopening the economy has yet to be announced but some restrictions have already been lifted such as outdoor activities and "2-household bubble" gatherings. Despite that we estimate a $855M deficit this year

(2.0% of GDP), Nova Scotia was in a strong fiscal position prior to the crisis. Five consecutive budget surpluses were registered and the net debt-to-GDP ratio stood at 33% in FY 2019-20, down from 47% in FY 2000-01.

Prince Edward Island

A total of 27 cases were found in PEI, the last one reported on April 28. The Island also displays the lower cases per 100K, at 17. The 2nd Phase of the 5-Phase Reopening plan started on May 22 with most retail, outdoors and small social gatherings permitted. The third phase will begin on June 1st. The fishing season for many seafood products, including lobsters and oysters, was postponed until the end of May or beginning of June due to a lack of demand. The tourism industry, a more significant segment of the economy than any other provinces, remains shutdown. Officials mentioned they would synchronize PEI's tourism industry with New Brunswick's guidelines. Despite that S&P revised the Province's credit rating outlook from A (positive) to A (stable), our $197M deficit estimate for FY 2020-21 (2.8% of GDP) remains manageable.

Newfoundland and Labrador

The collapse in Brent oil prices deteriorates heavily the Province's fiscal situation even if Brent prices are currently at US$9 above WCS. We estimate that close to $500M in royalties could be lost in FY 2020-21. Long term prospects for the industry appear gloomier as the Bay du Nord deep water oil project was postponed. The project was supposed to generate $14B in economic activity and $3.5B in royalties over its lifespan. We forecast a $2.2B deficit in FY 2020-21 (7.5% of GDP), raising net debt-to-GDP to 54% a record among provinces. Under those circumstances, the Bank of Canada's provincial money market and provincial bond purchase program provide some relief. The good news is that Covid19 is very much under control in Newfoundland. No new cases have been registered since May 7. The gradual reopening of the domestic economy, scheduled around 5 "alert levels" will support some key sectors. Level 4 was implemented on May 11 and included retail activities and small gatherings.

Table 3 -Nominal GDP Growth (%)

	2017	2018	2019	2020	2021
Canada	5.7	3.9	3.6	-7.1	7.8
N&L	3.7	1.7	4.0	-14.0	5.7
PEI	5.3	4.2	4.4	-5.0	8.0
NS	3.2	3.3	3.2	-5.0	8.0
NB	4.4	3.2	2.7	-4.6	7.4
Quebec	5.0	4.8	4.4	-5.5	8.1
Ontario	4.6	3.7	3.9	-5.1	8.2
Manitoba	5.7	2.2	3.0	-4.3	7.4
Sask	5.1	1.4	2.5	-12.5	8.3
Alberta	9.2	3.8	1.6	-16.5	8.2
BC	7.1	4.5	3.6	-4.3	8.1

Source: Statistics Canada, LBS Econ. Research and Strategy

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