

Newfoundland & Labrador Budget Highlights

Highlights and analysis of Newfoundland & Labrador's FY19/20 budget

April 16, 2019, 1:00 pm

A Temporary Surplus

Robert Kavcic, Senior Economist • robert.kavcic@bmo.com • 416-359-8329

The Province of Newfoundland & Labrador is projecting a hefty \$1.9 billion surplus in FY19/20 (more than 5% of GDP), fully on the back of an accounting move that books new future Atlantic Accord revenues in the current fiscal year. Recall that the Atlantic Accord Review will see \$2.5 billion flow to the Province (with no restrictions on use) by 2056, with most of it front-end loaded by 2030. Excluding this impact, the underlying deficit sits at \$575 million, a touch wider than the \$522 million now expected for FY18/19—the latter is slightly smaller than the \$547 million expected in the most recent fiscal update. Looking ahead, the Province expects the deficit to widen next fiscal year, before gradually returning to balance in FY22/23, a timeline that is unchanged from that laid out a year ago. Net debt is pegged at just under 40% of GDP this fiscal year, down from 45% in FY18/19—the discounted future Atlantic Accord revenue stream reduces net debt today. Notably, that now technically leaves Ontario with the largest net debt burden as a share of the economy. This pre-election budget rolls out some new spending measures, but restraint remains a theme later on. There were few major changes on the taxation front, though the Province is phasing out the tax on automobile insurance, and remains committed to removing the deficit-reduction (income tax) levy at the end of this year.



Revenue, including the net income of government business enterprises and Atlantic Accord impact, is forecast to surge in FY19/20, to \$10.4 billion. Excluding the latter, underlying growth is a modest 1.3%, with taxation and offshore royalties nudging slightly higher. Brent crude prices are expected to average \$65, down from \$70.40 last fiscal year, and then rise gradually to \$71 by FY21/22. While the Province is not building in a risk adjustment for the current fiscal year, it returns later in the forecast horizon, rising to \$70 million by FY22/23—that buffers downside risk to oil by nearly \$5. The Canadian dollar is pegged at 77 US cents this fiscal year. Given the current level for Brent crude is about \$5 higher and the loonie is about 2 cents weaker, these assumptions start the fiscal year on a somewhat conservative foot.

The budget estimates are also based on the assumption that the Newfoundland & Labrador **economy will rebound** 4.1% in 2019 after a 2.9% decline last year. Private and public-sector capital spending have peaked, but Hebron oil production is expected to ramp up this year, and iron ore production should bounce after a strike weighed on output last year. Nominal growth is expected to run at a cooler 2.6%. Longer term, the province still faces a challenging economic backdrop as demographics act as a drag.

Total spending is projected to rise 1.8% in FY19/20, with debt service costs pushing above the \$1 billion mark. Longer term, total

**Table 1
Fiscal Summary**

Newfoundland & Labrador (C\$ mlns ¹ , except where noted)				
	Est. 18/19	— Forecast —		
	19/20	20/21	21/22	
Revenues ²	7,751	10,350	7,462	7,838
Expenditures	8,273	8,425	8,238	8,088
Revenue Risk Adj.	—	—	(20)	(50)
Budget Balance	(522)	1,925	(796)	(300)
Net Debt	15,414	13,768		
As a percent of GDP:				
Budget Balance	(1.5)	(5.5)	(2.2)	(0.8)
Net Debt	44.9	39.1		
As a percent of revenue:				
Debt Service	12.8	9.8		
Offshore Royalties	13.6	10.9		
Federal Transfers	15.8	37.4		
Key assumptions: ³				
Brent Crude (US\$/bbl)	70.4	65.0	68.0	71.0
C\$ (C\$/USD)	76.0	77.0	77.0	78.0
Real GDP (% chng)	-2.9	4.1	0.2	2.4

Source: Provincial Budget () = deficit ¹ consolidated
² includes GBEs. FY19/20 includes +\$2.5 billion impact from Atlantic Accord Review ³ figures are for calendar year (FY19/20=CY19)

spending will fall gradually after this year's pre-election bump, but the sub-\$8 bln target for total spending by FY22/23 still holds. Keep in mind that the Newfoundland & Labrador population is contracting as well (-0.7% y/y as of 2019Q1), so this becomes less of a challenge than if growth was running strong as in most other provinces.

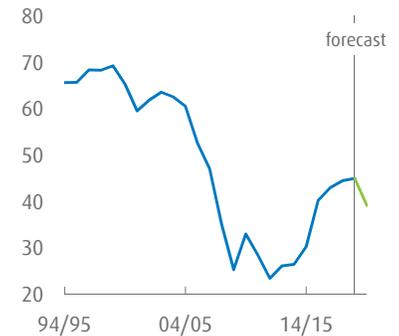
The Province faces a **\$1.2 billion gross borrowing requirement** in FY19/20 (\$1.16 billion net), which is still chunky. Overall borrowing through FY22/23 totals \$4.8 billion, which is down \$400 million versus what was expected for the same period, a year ago—Atlantic Accord cash flow lowers the amount. **Net debt falls by \$1.6 billion to \$13.8 billion by the end of FY19/20**, as future cash payments get booked on the balance sheet today. That will pull the net debt-to-GDP ratio down below 40% for the first time in five years. But, we'll just note that the underlying deficit remains, and net debt could resume its upward move next year.

Bottom Line: Brushing aside the accounting in this budget, the Province of Newfoundland & Labrador still faces a challenging situation: a chunky underlying budget deficit and sluggish economy. To be sure, the Province has come a long way since the depths in 2015/16, but there is still work to do post-election.

Chart 1
Net Debt Dips

Newfoundland & Labrador (% of GDP)

Net Debt



Source: Provincial Budget

General Disclosure

"BMO Capital Markets" is a trade name used by the BMO Financial Group for the wholesale banking businesses of Bank of Montreal and its subsidiaries BMO Nesbitt Burns Inc., BMO Capital Markets Limited in the U.K. and BMO Capital Markets Corp. in the U.S. BMO Nesbitt Burns Inc., BMO Capital Markets Limited and BMO Capital Markets Corp are affiliates. This document is issued and distributed in Hong Kong by Bank of Montreal ("BMO"). BMO is an authorized institution under the Banking Ordinance (Chapter 155 of the Laws of Hong Kong) and a registered institution with the Securities and Futures Commission (CE No. AAK809) under the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong). BMO does not represent that this document may be lawfully distributed, or that any financial products may be lawfully offered or dealt with, in compliance with any regulatory requirements in other jurisdictions, or pursuant to an exemption available thereunder. This document is directed only at entities or persons in jurisdictions or countries where access to and use of the information is not contrary to local laws or regulations. Their contents have not been reviewed by any regulatory authority. Bank of Montreal or its subsidiaries ("BMO Financial Group") has lending arrangements with, or provide other remunerated services to, many issuers covered by BMO Capital Markets. The opinions, estimates and projections contained in this report are those of BMO Capital Markets as of the date of this report and are subject to change without notice. BMO Capital Markets endeavours to ensure that the contents have been compiled or derived from sources that we believe are reliable and contain information and opinions that are accurate and complete. However, BMO Capital Markets makes no representation or warranty, express or implied, in respect thereof, takes no responsibility for any errors and omissions contained herein and accepts no liability whatsoever for any loss arising from any use of, or reliance on, this report or its contents. Information may be available to BMO Capital Markets or its affiliates that is not reflected in this report. The information in this report is not intended to be used as the primary basis of investment decisions, and because of individual client objectives, should not be construed as advice designed to meet the particular investment needs of any investor. This document is not to be construed as an offer to sell, a solicitation for or an offer to buy, any products or services referenced herein (including, without limitation, any commodities, securities or other financial instruments), nor shall such information be considered as investment advice or as a recommendation to enter into any transaction. Each investor should consider obtaining independent advice before making any financial decisions. This document is provided for general information only and does not take into account any investor's particular needs, financial status or investment objectives. BMO Capital Markets or its affiliates will buy from or sell to customers the securities of issuers mentioned in this report on a principal basis. BMO Capital Markets or its affiliates, officers, directors or employees have a long or short position in many of the securities discussed herein, related securities or in options, futures or other derivative instruments based thereon. The reader should assume that BMO Capital Markets or its affiliates may have a conflict of interest and should not rely solely on this report in evaluating whether or not to buy or sell securities of issuers discussed herein.

Dissemination of Research

Our publications are disseminated via email and may also be available via our web site <http://economics.bmocapitalmarkets.com>. Please contact your BMO Financial Group Representative for more information.

Conflict Statement

A general description of how BMO Financial Group identifies and manages conflicts of interest is contained in our public facing policy for managing conflicts of interest in connection with investment research which is available at http://researchglobal.bmocapitalmarkets.com/Public/Conflict_Statement_Public.aspx.

ADDITIONAL INFORMATION IS AVAILABLE UPON REQUEST

BMO Financial Group (NYSE, TSX: BMO) is an integrated financial services provider offering a range of retail banking, wealth management, and investment and corporate banking products. BMO serves Canadian retail clients through BMO Bank of Montreal and BMO Nesbitt Burns. In the United States, personal and commercial banking clients are served by BMO Harris Bank N.A., Member FDIC. Investment and corporate banking services are provided in Canada and the US through BMO Capital Markets. BMO Capital Markets is a trade name used by BMO Financial Group for the wholesale banking businesses of Bank of Montreal, BMO Harris Bank N.A., BMO Ireland Plc, and Bank of Montreal (China) Co. Ltd. and the institutional broker dealer businesses of BMO Capital Markets Corp. (Member SIPC), BMO Nesbitt Burns Securities Limited (Member SIPC) in the U.S., BMO Nesbitt Burns Inc. (Member Canadian Investor Protection Fund) in Canada, Europe and Asia, BMO Capital Markets Limited in Europe, Asia and Australia and BMO Advisors Private Limited in India.

"Nesbitt Burns" is a registered trademark of BMO Nesbitt Burns Inc., used under license. "BMO Capital Markets" is a trademark of Bank of Montreal, used under license. "BMO (M-Bar roundel symbol)" is a registered trademark of Bank of Montreal, used under license.

© Registered trademark of Bank of Montreal in the United States, Canada and elsewhere.

TM Trademark Bank of Montreal

© COPYRIGHT 2019 BMO CAPITAL MARKETS CORP.

A member of BMO Financial Group