BUDGET ANALYSIS

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Newfoundland and Labrador: Budget 2023

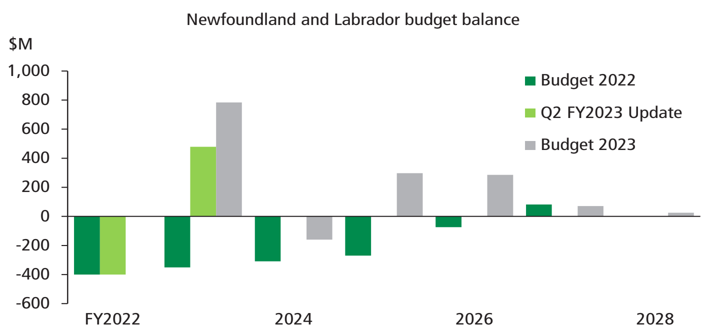
Huge Revenue Boost Unlocks New Spending, Sets Up Surpluses Later

By Marc Desormeaux, Principal Economist, and Marc-Antoine Dumont, Economist

HIGHLIGHTS

- Newfoundland and Labrador's (NL) 2023 budget projected a return to deficit in the coming fiscal year after the surprise surplus in fiscal year 2022–23 (FY2023). It then expects to return to black ink through FY2028 (graph 1).
- Borrowing requirements for FY2024 are set at $1.5B, with $600M related to debt maturities.
- Both offshore royalties and tax revenues are expected to ease in FY2024 but remain high.
- With the benefit of slightly higher revenues throughout the forecast period, the province increased spending plans over the forecast. But restraint remains part of the plan to sustain balance, with total expenditures expected to decline by 1.3% from FY2025 to FY2028.
- Despite weakening crude values, capital investment activity is expected to rise by a solid 11% in calendar year 2023. This is among the reasons behind our view that the province will avoid the worst of the coming Canadian economic downturn.
- We expect bond spreads to continue to track oil price movements over the near-term. Achievement of fiscal targets should offer more support over time.

GRAPH 1
Deficit this Year, Surpluses Thereafter



Sources: Newfoundland and Labrador Ministry of Finance and Desjardins Economic Studies

Our Takeaways

This is clearly a positive report for NL. Benefiting from the surge in commodity prices, the province is in position to project much-improved budget balances throughout the forecast horizon, and it is making progress on bending its debt path lower. The Rock also has much stronger near-term economic prospects than most provinces, helped by major project activity and relatively little exposure to the housing market. Pocketbook relief looks reasonably targeted and incremental, and unlikely to spur further inflationary pressures.

But structural challenges remain. New healthcare spending reflects the needs of an aging population, but also adds to the cost base and slows the reduction of NL's debt burden—the largest as a share of GDP in any Canadian province. And there are of course ongoing risks to capital projects—a major source of growth in the province—and infrastructure plans in the form of labour and input product shortages. Going forward, Newfoundland and Labrador will need to stay laser-focused on long-run fiscal sustainability.

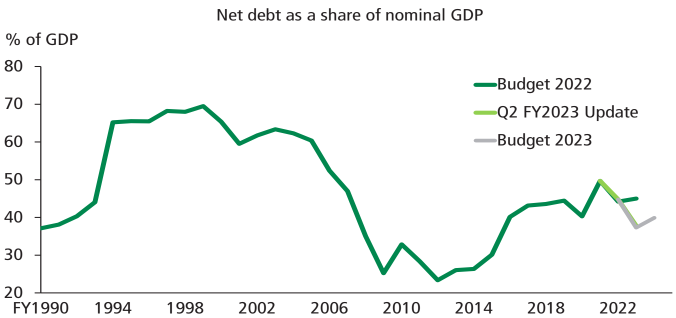
Deficit in the Coming Year, Followed by Surpluses

Following this year's unexpected surplus, Newfoundland and Labrador anticipates a return to red ink in the coming fiscal year. That will be followed by a projected bounce back into surpluses afterward through FY2028. Current projections are for a surplus of $784M (1.9% of nominal GDP) in FY2023, a deficit of $160M (-0.4%) in FY2024, and then surpluses of $297M (0.7%), $286M

(0.7%), $71M (0.2%), and $25M (0.1%), in FY2025, FY2026, FY2027, and FY2028, respectively.

The province's baseline projection puts net debt at 37% of provincial output in FY2023 and 40% in FY2024 (graph 2 on page 2), with the increase reflecting a decline nominal GDP. For FY2023, that debt burden is the third-highest of any province. In the coming fiscal year, it is the highest.

GRAPH 2
NL's Debt Load Shoots Lower, Then Edges Up



Sources: Newfoundland and Labrador Ministry of Finance and Desjardins Economic Studies

Provincial borrowing requirements are expected to come in at $1.5B in FY2024. Of that total, approximately $600M relates to debt maturities. In FY2023, the province borrowed $1.7B.

Revenues Normalize After Last Year's Surge

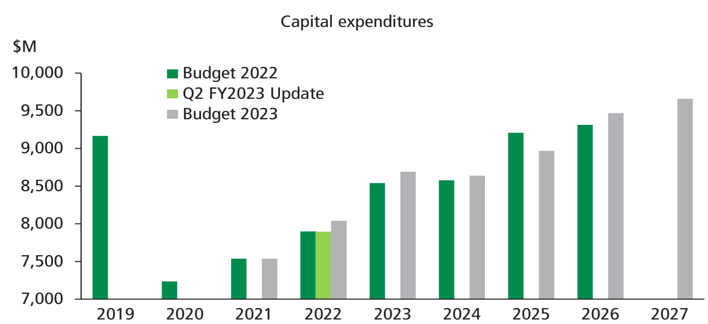
Under a prudent set of assumptions, the government expects oil royalty revenues to come in slightly lower in FY2024 following a jump in FY2023. The province sees Brent crude falling from over US$95/barrel this fiscal year to about US$86/barrel in FY2024. That is above the current level of oil prices after the recent financial turmoil. But it's broadly in line with analyst expectations of a rise from current levels supported by global demand-supply imbalances. Still, resuming oil production at the Terra Nova offshore field is good news, and likely prevents a more significant output decline than projected in the province's base case.

Optimistically, NL expects royalties to make up only about 14% of own-source receipts in both FY2023 and FY2024. That compares to a share of more than 30% in FY2014 (according to the province's Public Accounts) and implies some broadening of the province's revenue base over the last decade.

Other own-source revenues are also set to fall back in FY2024 after surging even more than royalties did in the mid-year fiscal update. That is even though the province forecasts still-solid gains in wages and salaries and employment over the coming year. Given that, forecast drops in personal income and sales taxes suggest that federal tax base adjustments may have been behind at least some of the improvement reported for FY2023. Those effects now appear to be easing, much like what we saw in some other provinces. Still, for FY2024 to FY2027, total revenues are expected to come in at a combined $3.3B higher than in last year's projections. That significantly changes the fiscal outlook for the NL government as it pushes it back into surplus, even with upward revision to expenses.

But as in our own most recent provincial forecasts, major project activity is set to propel growth on The Rock this year. The province expects capital spending to rise by about 11% in 2023—even more than anticipated in last year's budget (graph 3)—to anchor an acceleration of real growth to 2.8%. Population growth forecasts were also revised upward in respect of higher immigration and interprovincial inflows. The Rock's headcount is now expected to advance by over 1.0% in two consecutive years, the first time since the 2008–10 period.

GRAPH 3
Capital Investment Still Expected to Drive NL's Expansion in 2023



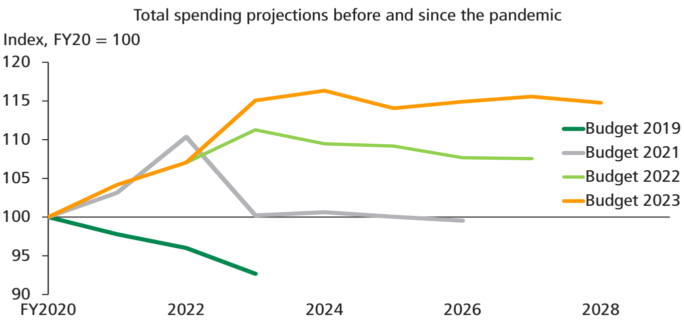
Sources: Newfoundland and Labrador Ministry of Finance and Desjardins Economic Studies

Spending Lifted Significantly

With additional revenues, NL will raise its spending profile over time. Notably, the province will continue to increase expenditures in FY2024 after overshooting its FY2023 target. With that starting point boost, total expenditures for FY2024 through FY2027 exceed the prior year's targets by a combined $2.3B to partly undo the increase in revenues. The rate of outer-year expenditure cuts was eased as well. From FY2025 to FY2027, the province expects to bring total spending down by 0.7% versus last year's projection of a 1.7% decline over that period (graph 4 on page 3).

New spending appears to primarily reflect healthcare priorities, some of which will be offset by increased transfers from Ottawa. Like all other provinces and territories, Newfoundland and Labrador will receive a top-up to the Canada Health Transfer (CHT) as part of the federal-provincial health accord signed in February. Funds will be allocated to a range of priorities, including the recruitment and retention of health care professionals, support of seniors' care that helps individuals to age in place, and the construction of a new regional hospital. For infrastructure, the province will also invest in provincial road and highway improvements over the next five years.

GRAPH 4
NL Eases Plans for Spending Restraint Again



Sources: Newfoundland and Labrador Finance and Desjardins Economic Studies

Budget also introduced a smattering of pocketbook initiatives. These include the elimination of retail sales tax on personal property insurance, the extension through FY2024 of a 50% reduction in the cost of certain vehicle registrations, and fuel and heating cost reductions. The government also committed to enhancing its Income Supplement, and to building 850 new affordable housing and rental units.

The province further pledged to deposit $127M into its Future Fund. The Fund requires the government to set aside revenues from one-time sources and non-renewable resources as a means to pay down expensive debt and lower its long-term cost of borrowing.

Oil Prices Will Anchor Bond Spread Movements

Like Alberta and Saskatchewan, The Rock's spreads to other issuers tightened in early 2022 when crude values surged, but have widened as the knock-on effects of recent bank failures hammered oil prices. Over time, sustained fiscal improvement and signs of more stable economic growth can help bring yields closer to those of other Canadian government bonds.

The authors thank Farjad Khan of Desjardins Economic Studies for his contributions ot this note.

TABLE 1

Summary of Fiscal Forecasts

	2022–2023		2023–2024		2024–2025		2025–2026		2026–2027		2027–2028
IN $M (EXCEPT IF INDICATED)	**Q2 FY2023**	**Bud. 2023**	**Bud. 2022**	**Bud. 2023**	**Bud. 2022**	**Bud. 2023**	**Bud. 2022**	**Bud. 2023**	**Bud. 2022**	**Bud. 2023**	**Bud. 2023**
Total revenues	10,404	10,525	8,969	9,689	8,998	9,974	9,076	10,055	9,238	9,905	9,802
Total expense	9,925	9,741	9,268	9,849	9,243	9,657	9,115	9,729	9,106	9,784	9,717
Oil Risk Adjustment	—	0	10	0	25	20	35	40	50	50	60
Budget balance	**479**	**784**	**-309**	**-160**	**-270**	**297**	**-74**	**286**	**82**	**71**	**25**
% of GDP	*1.1*	*1.9*	*-0.8*	*-0.4*	*-0.7*	*0.7*	*-0.2*	*0.7*	*0.2*	*0.2*	*0.1*
Net Debt, % of GDP	37.8	*37.3*	*36.9*	*39.9*	—	—	—	—	—	—	—
Borrowing Requirement	1,800	1,700	—	1,500	—	—	—	—	—	—	—
Real GDP, % change	*0.9*	*0.3*	*3.4*	*2.8*	*2.6*	*3.0*	*1.1*	*3.1*	*2.3*	*0.8*	*2.3*
Nominal GDP, % change	*10.1*	*10.9*	*-3.0*	*-3.4*	*1.9*	*2.9*	*1.3*	*3.4*	*3.5*	0.6	4.1

Sources: Newfoundland and Labrador Ministry of Finance and Desjardins Economic Studies