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## Return to a balanced budget on the horizon

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### Highlights

Given a contracting economy in 2023, due in particular to lower production and the value of commodities important to the province's finances (oil and nickel) and a drop in investment in the residential construction sector, the projected deficit of \$160 million for the 2023-24 fiscal year ending has been revised significantly upwards to \$433 million. Despite an anticipated deficit of \$152 million for the upcoming 2024-25 fiscal year, the 2024 Budget forecasts a return to black ink as early as 2025-26 and for all subsequent years until 2028-29. However, this budget planning is based on particularly optimistic economic growth assumptions, resulting from the implementation of several major investment projects over the next few years, which could easily prove to be off track. Among the budget's major orientations are record investments of \$4.1 billion in health care (40% of spending), as well as amounts for the elderly, housing and poverty reduction. In addition, the budget maintains a number of measures announced in recent years to help with the cost of living, such as the 8.05 cent per litre rebate on gasoline, and does not include any new taxes, tax increases or fee increases for a third year in a row. As for the province's indebtedness, the budget forecasts that the net debt to GDP ratio will decline from 45.1% in 2023-24 to 44.1% in 2024-25, despite the deficit, thanks to a recovery in economic growth. On borrowing requirement, Newfoundland and Labrador expects to issue a larger \$2.8 billion in 2024-25, following on a \$2.2 billion gross borrowing program from 2023-24.

- **Economic outlook** – In 2023, Newfoundland and Labrador's economy was undermined by the growing impact of restrictive monetary policy, but also by a decline in oil and nickel production, as well as a significant drop in investment in residential construction. As a result, the province's real GDP is estimated to have contracted by 2.1% in 2023, the worst performance of any Canadian province. As for nominal GDP, which has a greater influence on public finances, it is estimated to have contracted a significant 6.2% in 2023, the drop in production of certain commodities also amplified the fall in prices. Despite this underperformance by the economy, it should still be noted that Newfoundland and Labrador's population is set to grow by a robust 1.3% in 2023, the highest rate since 1972. Furthermore, the strength of the labour market has more than absorbed this significant demographic growth, with the unemployment rate averaging 9.9% in 2023, the lowest ever recorded. Looking ahead, the budget is based on ambitious growth forecasts based on the delivery and start of production of several major investment projects (such as Terra Nova, West White Rose, and Voisey's Bay mine). In the event of delays, lower production or weaker than expected commodity prices, these forecasts can quickly become outdated. For 2024, the budget forecasts a rebound in real GDP of 5.1%, boosted by increase in exports, the start of production at Terra Nova and major investment in the construction of West White Rose. Real GDP growth is then expected to rise to 6.9% in 2025 and 7.3% in 2026 (with West White Rose coming on stream), before slowing to 4.9% in 2027 and 4.2% in 2028. As for nominal GDP, it should grow by 5.8% in 2024, 3.7% in 2025, 6.2% in 2026, 5.9% in 2027 and 4.5% in 2028. Regarding the labour market, the unemployment rate should remain relatively stable at 10.0% in 2024, before falling again to 9.4% in 2025, 8.7% in 2026 and 8.3% in 2027, then rise slightly to 8.6% in 2028.
- **Outgoing year budget balance (2023-24)** – Newfoundland and Labrador now estimates the 2023-24 budget shortfall at \$433 million (1.1% of GDP). Last year, the province had pegged the deficit \$160 million, which is roughly where it was tracking when the mid-year update was published in the fall. The deterioration reflects revenues coming in 1.4% below budget and expenses coming in 1.4% above budget. The revenue revisions can be traced to lower-than-planned federal transfers and offshore royalties. Meanwhile, spending in the general government sector drove the expense miss, while the social and resource sectors came in line with or below plan.
- **Medium-term fiscal outlook (2024-25 & beyond)** – 2024-25 is expected to be Newfoundland and Labrador's second consecutive year in deficit as the budget signals a \$152 million shortfall, equivalent to 0.4% of GDP. While not balanced, it's an improvement over 2023-24 as revenues are seen as jumping by 7.8%. That's expected to be driven by offshore royalties surging \$624 million (+67%) and transfers from the federal government rising \$475 million (+25%). Spending pressures are also evident, with expenses set to rise 4.6%. The 2024-25 deficit that's been signalled means the return to balance will again be pushed out a year relative to last year's guidance. The province now sees 2025-26 as the next time the budget balance will be written in black ink. Specifically, a \$58 million surplus has been telegraphed (or 0.1% of GDP). Deficits are expected to remain in the same neighbourhood over the fiscal years spanning 2026-27 to 2028-29. Over that 4-year period beyond 2024-25, revenue is expected to remain roughly flat (+0.1%/year) while expenses are seen as modestly shrinking (-0.7%/year). Just like in last year's budget, Newfoundland and Labrador has opted to embed an 'oil risk adjustment' in its fiscal forecasts. That starts in 2025-26 at starting at \$20 million and grows to \$70 million/year by the final year of the plan. That's a nod to the inherent volatility in oil prices.
- **New initiatives** – As it is the case for most of the provinces, the primary focus of the 2024 Budget is health care. As such, health care investment reached their highest level ever at \$4.1 billion (40% of the budget). This includes \$30 million to hire additional health care providers for the 19 existing family care teams and to create new teams, \$10 million to help recruit and retain health care professionals, and \$2 million to increase the number of Faculty of Medicine seats. The budget also aims to help seniors, with \$10 million for a new Seniors' Well-Being Plan and \$70.3 million for the Seniors' Benefit. Among other initiatives, there is \$50 million for a

rental housing development loan program, \$2 million to hire 22 new full-time correctional officers, and \$36 million over four years to build more than 100 new homes in Corner Brook. Although these are not new measures, the budget does retain some measures announced in the past to help with the cost of living, such as the 8.05 cent reduction per litre of gasoline, the 50% reduction in vehicle registration costs, the home heating supplement for furnace and stove oil, and the elimination of the retail sales tax on home insurance. Furthermore, no provincial taxes or fees were increased for a third year in a row.

- **Oil price assumptions & official sensitivities** – The budget is based on an average of US\$82/bbl for Brent in 2024-25 and that price is seen as gradually moderating to US\$77/bbl through the outer years of the fiscal plan. For context, the prompt Brent contract is currently hovering just above \$85/bbl. If the economic scenario presented in the budget holds, oil royalties should constitute 15% of revenues in 2024-25, up from 10% in the outgoing fiscal year. The Canadian dollar is also an important input to the fiscal plan and that is assumed to average US\$0.747 in 2024-25. The outer years of the plan see the Canadian dollar stronger than the 2024-25 assumption by 1-3%. As for sensitivities, the province estimates that each dollar per barrel is worth \$24 million and each 1 US cent change in the exchange rate is worth \$26 million.
- **Debt outlook & interest bite** – In the coming fiscal year (2024-25), Newfoundland and Labrador expects to add ~\$580 million in new debt, net liabilities ending the year at \$17.8 billion. The corresponding debt burden, equivalent to 44.1% of GDP or more than 170% of total revenue, resides at the high end of the provincial spectrum. Still, given the relatively modest budget shortfall and based on assumed GDP/revenue growth, closely watched relative leverage metrics are expected to improve (i.e., decline) vs. 2023-24 levels. Moreover, the expectation of sustained surpluses starting in 2025-26, combined with relatively healthy economic growth (nominal GDP growth averaging ~5%/year in the out years), would imply steady progress on the debt burden over the medium term. Gross debt expenses are slated ease slightly in 2024-25, this \$1.15 billion expense item comprising a smaller share of total budgeted outlays and likewise consuming less of the revenue dollar. Specifically, the interest bite is set to ease from 12.2% to 11.2% in 2024-25, which is welcome since Newfoundland and Labrador's spends relatively more servicing the debt than all provincial peers.
- **Borrowing requirements** – The province's gross borrowing requirement reflects the relatively modest budgetary shortfall, capital needs, efforts to bolster prudential liquidity and, of course, refinancing activity. Following on a \$2.2 billion gross borrowing program from 2023-24, Newfoundland and Labrador expects to issue a larger \$2.8 billion in 2024-25. Stripping out \$1.2 billion in scheduled debt maturities, the effective stock of bonds is scheduled to increase by \$1.6 billion. For additional perspective, the 2024-25 gross requirement (\$2.8 billion) is equivalent to roughly \$5,000 in per capita terms or 27% of total revenue, this latter stat residing at the higher end of the range telegraphed in other 2024 provincial budgets. (Based on the eight provincial budgets thus far tabled, gross long-term borrowing needs range from 13% to nearly 30% of revenue, with some degree of nuance/uncertainty always attached to official program estimates.) Investors may have noticed that Newfoundland and Labrador is hardly alone in telegraphing larger borrowing needs. Of those same eight provincial budgets we've thus far waded through, New Brunswick is alone in formally telegraphing reduced long-term bond supply for 2024-25 vs. what was completed in 2023-24. For provincial bond watchers, Ontario (March 26<sup>th</sup>) and Manitoba (April 2<sup>nd</sup>) will round out this year's budget season.
- **Current long-term credit ratings** – S&P: A, Stable | Moody's: A1, Stable | DBRS: A, Stable  
Refer to our *Provincial Ratings Snapshot* for additional colour on specific credit rating drivers/considerations.

### Newfoundland & Labrador

\$000,000	Budget	Forecast	Budget	Outlook			
	2023/24	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
Fiscal Revenue	8,683	8,585	8,585				
<i>Provincial tax sources</i>	4,405	4,411	4,406				
<i>Personal Income Tax</i>	1,843	1,813	1,816				
<i>Sales Tax</i>	1,431	1,640	1,486				
<i>Corporate Income Tax</i>	496	330	506				
<i>Mining Tax and Royalties</i>	104	112	116				
<i>Other Taxes</i>	530	516	481				
<i>Offshore Royalties</i>	1,100	927	1,551				
<i>Other Provincial Sources</i>	487	853	616				
<i>Government of Canada</i>	2,229	1,937	2,412				
Net Income of Government Business Enterprises	1,006	969	856				
<b>Total Gross Revenue</b>	<b>9,689</b>	<b>9,554</b>	<b>10,296</b>	<b>10,311</b>	<b>10,365</b>	<b>10,366</b>	<b>10,349</b>
Program Expenses	9,126	8,815	9,333				
Debt Servicing	723	1,172	1,115				
<b>Total Gross Expenses</b>	<b>9,849</b>	<b>9,987</b>	<b>10,448</b>	<b>10,233</b>	<b>10,268</b>	<b>10,238</b>	<b>10,219</b>
<b>Consolidated surplus (deficit)</b>	<b>(160)</b>	<b>(433)</b>	<b>(152)</b>	<b>78</b>	<b>97</b>	<b>128</b>	<b>130</b>
Oil risk adjustment	-	-	-	(20)	(45)	(60)	(70)
<b>Adjusted surplus (deficit)</b>	<b>(160)</b>	<b>(433)</b>	<b>(152)</b>	<b>58</b>	<b>52</b>	<b>68</b>	<b>60</b>
as a % of revenue	-1.7%	-4.5%	-1.5%	0.6%	0.5%	0.7%	0.6%
as a % of GDP	-0.4%	-1.1%	-0.4%	0.1%	0.1%	0.1%	0.1%
Debt servicing as a % of revenue	7.5%	12.3%	10.8%				
Offshore Royalties as a % of revenue	11.4%	9.7%	15.1%				

### Net Debt and Total Debt

<b>Net Debt, beginning of period</b>	<b>15,699</b>	<b>16,510</b>	<b>17,236</b>
+ Deficit (surplus)	160	433	152
+ Acquisition of Tangible Capital Assets	726	648	820
- Amortization of Tangible Capital Assets	359	356	390
<b>= Net Debt - End of period</b>	<b>16,226</b>	<b>17,236</b>	<b>17,818</b>
of which: Borrowings net of Sinking Funds	17,515	19,529	22,281
Unfunded Pension and Retirement Benefits Liability	3,726	3,791	3,691
Deferred Pension payments - Promissory note	3,876	3,876	3,781
Other financial liabilities less financial assets	8,890	7,995	7,822
<i>Net debt - End of period as a % of GDP</i>	39.9%	45.1%	44.1%

Source: Budget documents of Newfoundland & Labrador Ministry of Finance.

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