DEALING WITH A STRUCTURAL DEFICIT WILL TAKE MORE THAN ONE BUDGET

Highlights

• The New Brunswick government is forecasting a deficit of $255 million in fiscal 2014-15 (0.8% of GDP). This matches the Q3 estimate published in February and represents a $136 million improvement relative to the Budget 2014 projections. The improved fiscal position reflects an unexpected one-time boost to revenues on account of positive prior year adjustments to HST and Conditional Grants.

• The deficit is forecast to widen to $477 million in fiscal 2015-16 (1.4% of GDP). Revenues are projected to rise 0.6%, while expenditures are expected to increase 1.5%. Net debt is estimated at $12.0 billion (37% of GDP) in fiscal 2014-15 and $12.6 billion (37.5% of GDP) in fiscal 2015-16. No medium term fiscal details were released, but the government still aims to return to a budgetary balance position by fiscal 2020-21 as per its pre-election platform.

• There were a slew of new revenue-raising and spending measures included in today’s budget. Major announcements include the removal of a daily maximum cap on nursing home care, a rise in health care premiums, a reduction in the number of teaching positions, and hikes to income taxes on high earners and fuel taxes. The HST remained unchanged.

• In December, the government tabled its capital budget for fiscal 2015-16 which pegged total investment spending at $597 million, up 8% from fiscal 2014-15. The new capital plan includes the Strategic Infrastructure Initiative that targets $600 million in capital spending over the next four years. These outlays are intended to provide a short-term boost to job creation and create positive spin offs over the long run.

Today’s budget can be viewed as a first step along a path to place New Brunswick’s finances on a more sustainable fiscal position. Recall that in January, the government introduced a strategic program review with the goal of re-engineering government. The government indicated that it is considering all options, including the monetization of assets. As the strategic program review is still ongoing, a detailed medium-term fiscal plan was not provided today. Indeed, the government signaled that the findings from the program review would be implemented in next year’s budget. In the meantime, some important reforms, notably to the personal income tax system, were unveiled.

New initiatives introduced to address structural deficit

The fiscal challenge is daunting. The government estimates a structural deficit on the order of $400 million and has been in a deficit position since fiscal 2008-09. As such, the government decided not to wait for the results from the program review and introduced a number of measures — on both the revenue and expenditure sides of the ledger — to chip away at the structural gap. The demographic challenge facing the province was a key factor driving some of the expenditure-related initiatives. Major announcements include:

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• The progressivity of the income tax system will be increased. Effective January 2015, two new tax brackets will be introduced. Taxable income between $150 – $250K will be subject to a provincial income tax rate of 21%. Taxable income above $250K will see their tax rate increase to 25.75%. The previous tax rate for both income brackets was 17.84%. These initiatives are expected to generate an additional $30 million in revenues.

• The fuel tax will increase by 1.9 cents per litre on gasoline and 2.3 cents per litre on diesel fuel. This brings the combined federal and provincial gasoline and motive fuel tax rates to 25.5 cents per litre. These tax rate changes are projected to generate an additional $28 million annually. These changes are effective midnight tonight.

• The maximum daily amount seniors pay for nursing home care will be removed. This amount had previously been capped at $113 per day. The province will continue to subsidize the costs of care for those who need it. Liquid financial assets will not be exempt from the assessment of a senior’s ability to pay for long-term care at nursing home facilities (the government will review and consult on this policy before introducing in the fall).

• Health care premiums for seniors will be increased in a progressive manner. Drugs for low-income seniors will continued to be subsidized through a separate plan.

• The number of teaching positions will be reduced by 3% (or 249 positions) with bulk of positions eliminated through attrition. The government highlighted that the number of K-12 students has fallen more than 20% since 2000, while the number of teachers has increased.

• Courthouses that are no longer required and Service New Brunswick outlets will be shut.

• Grants to postsecondary institutions will be frozen.

The government also announced initiatives aimed at small businesses to boost competitiveness. The small business tax rate has been reduced to 4% from 4.5% (effective January 2015). The New Brunswick Dividend Tax Credit structure was also modified so that the tax credit on dividends matches the small business corporate tax rate (previously 5.3%). Effective for investments made after March 31, 2015, the Small Business Investor Tax Credit rate will rise from 30% to 50%. This enhancement will increase the maximum tax credit from $75K per year to $125K per year for New Brunswick individuals who invest in eligible small businesses in the province. This measure will provide an estimated $5 million in additional tax relief annually.

Fiscal diligence the modus operandi

After surging 6.3% in fiscal 2014-15, the government expects revenues to inch up 0.6% in fiscal 2015-16 to $8.3 billion. The government notes that the boost to revenues in fiscal 2014-15 partially reflected an unexpected one-time boost to revenues on account of positive prior year adjustments to HST and Conditional Grants. With these sources one-time in nature, a flatter revenue-intake forecast is in the cards for the upcoming year. That said, an improving economy and new revenue raising measures will provide some underlying strength to coffers in the fiscal year ahead.

Growth in total expenditures will be held to 1.5% to $8.6 billion - half the rate of growth recorded in fiscal 2015-16. Total spending on health care will be held to 1.5%, while

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>06-07</th>
<th>07-08</th>
<th>08-09</th>
<th>09-10</th>
<th>10-11</th>
<th>11-12</th>
<th>12-13</th>
<th>13-14</th>
<th>14-15</th>
<th>Budget</th>
</tr>
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<tbody>
<tr>
<td>Revenues*</td>
<td>6,756</td>
<td>7,190</td>
<td>7,231</td>
<td>7,121</td>
<td>7,543</td>
<td>7,806</td>
<td>7,788</td>
<td>7,764</td>
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<tr>
<td>% change</td>
<td>5.8</td>
<td>6.4</td>
<td>0.6</td>
<td>-1.5</td>
<td>5.9</td>
<td>3.5</td>
<td>-0.2</td>
<td>-0.3</td>
<td>6.3</td>
<td>0.6</td>
</tr>
<tr>
<td>% of GDP</td>
<td>25.6</td>
<td>25.8</td>
<td>25.4</td>
<td>24.7</td>
<td>25.1</td>
<td>24.9</td>
<td>24.5</td>
<td>24.3</td>
<td>25.4</td>
<td>24.7</td>
</tr>
<tr>
<td>Expenditures**</td>
<td>6,479</td>
<td>6,949</td>
<td>7,383</td>
<td>7,816</td>
<td>8,160</td>
<td>8,051</td>
<td>8,295</td>
<td>8,262</td>
<td>8,510</td>
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<tr>
<td>% change</td>
<td>5.1</td>
<td>7.3</td>
<td>6.2</td>
<td>5.9</td>
<td>4.4</td>
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<td>Contingency Reserve</td>
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<td>--</td>
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<td>--</td>
<td>--</td>
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<tr>
<td>Surplus (+)/Deficit (-)</td>
<td>277</td>
<td>241</td>
<td>-152</td>
<td>-696</td>
<td>-617</td>
<td>-245</td>
<td>-508</td>
<td>-499</td>
<td>-255</td>
<td>-477</td>
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<tr>
<td>% of GDP</td>
<td>1.1</td>
<td>0.9</td>
<td>-0.5</td>
<td>-2.4</td>
<td>-2.1</td>
<td>-0.8</td>
<td>-1.6</td>
<td>-1.6</td>
<td>-0.8</td>
<td>-1.4</td>
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<tr>
<td>Net Debt</td>
<td>6,761</td>
<td>7,152</td>
<td>7,608</td>
<td>8,629</td>
<td>9,700</td>
<td>10,126</td>
<td>11,085</td>
<td>11,641</td>
<td>12,018</td>
<td>12,604</td>
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<tr>
<td>% of GDP</td>
<td>25.6</td>
<td>25.7</td>
<td>26.8</td>
<td>29.9</td>
<td>32.2</td>
<td>32.2</td>
<td>34.9</td>
<td>36.5</td>
<td>37.0</td>
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Note: * Includes contribution to and from Fiscal Stabilization Fund. ** Includes a one-time pension expense for fiscal 2013-14 of $110 million.

spending on education will be held essentially flat. While the government continues to hold the line expenditures, it is committed to improving infrastructure. Indeed, the capital plan estimates published in December pegged total investment spending at $597 million, up from $553 million in fiscal 2014-15. The new capital plan includes the Strategic Infrastructure Initiative that targets $600 million in capital spending over the next four years that is intended to provide a short-term boost to job creation and create positive spinoffs over the long run. The key distinction with this initiative is that projects selected can include non-provincial government assets (e.g. strategic infrastructure projects around the province that is either owned privately or by another level of government).

The government also included a contingency reserve in its fiscal 2015-16 forecast of $150 million to shield the province for any unexpected downside risk. If the reserve is not required, the deficit would come in at $326.8 million.

The government estimates net debt at a still elevated $12 billion (37% of GDP) in fiscal 2014-15 and $12.6 billion in fiscal 2015-16. The long term borrowing program is forecast at just under $2 billion in fiscal 2015-16, up from $1.7 billion in fiscal 2014-15.

And now for some good news…the 2015-16 economic outlook

After declining for two straight years, the government estimates that real GDP growth became positive in 2014, at a slight 0.8%. The good news is that the economy is expected to gain another step over the 2015-16 period. The government expects real GDP to increase 1.8% in 2015, which would mark the strongest pace of growth in five years. A lower Canadian dollar and steady demand from the United States are projected to boost the export sector. An improved outlook for capital spending is also expected to support economic activity. After increasing an estimated 1.9% in 2014, nominal GDP gains are forecast to accelerate to 3.3% in 2015. While this rate of economic activity is still moderate, it will provide support to government coffers relative to the weak gains recorded in recent years.

The demographic challenge for the province is clearly mapped out in its economic assumptions (see Table). In that vein, the commitment to capital spending, and more specifically targeting strategic opportunities that offer the best long term benefit, could help to mitigate these pressures by potentially delivering a boost the province’s longer-term productivity performance.

Bottom line

In its first budget since being elected, the government has recognized the lofty challenges it faces and has taken some first steps to restore New Brunswick’s fiscal order. In January, the government had moved to set up a strategic review panel to get a jump start on addressing the structural deficit. Despite some important announcements today, much of the heavy lifting remains. Prospects for improved economic growth in the province will provide support to the reform process. That said, demographic challenges still exist and given the long road to balance, the government is exposed to unforeseen economic shocks that can set its fiscal path of course. Stay tuned for more details in Budget 2016.
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