NEWFOUNDLAND & LABRADOR BUDGET 2017

TD Economics

April 6, 2017

STAYING THE COURSE

Highlights

- Last year's restraint measures helped to generate a positive revenue surprise in FY2016-17 and a significantly lower estimated deficit of $1.1 billion.
- There were no new tax increases in today's budget. In fact, the gasoline tax implemented last year will be scaled back this year. Instead, focus of further deficit reduction has shifted to the spending side of the ledger.
- The Province remains on track to return to balance by FY 2022-2023. However, net debt remains a challenge, as it is expected to reach nearly 50% in the current fiscal year.

The key theme of today's Newfoundland and Labrador's budget is staying the course. Last year's budget focused on kick-starting the multi-year task of deficit elimination largely on the back of tax hikes and fee increases. While these restraint measures have been felt throughout the entire province, they also helped to generate a positive revenue surprise in the 2016-17 fiscal year and a significantly lower estimated deficit. With limited tax room, the government did not announce any new tax hikes in this year's budget. In fact, the increase in the gasoline tax that came into effect last year will be scaled back this year. Instead, focus of further deficit reduction has shifted to the spending side of the ledger, and allocating limited resources to support industry growth.

The updated Budget Plan aims to fully eliminate the shortfall by FY2022-2023, but that achievement could be reached a year earlier if the amount set aside to counter unforeseen forecast risk is not needed. That said, net debt remains a major vulnerability for the province given that it is the highest in the country, sitting at close to 50% of GDP.

Deficit shrinking faster than expected

The deficit for FY 2016-17 came in at $1.1 billion (3.6% of GDP) – well ahead of the $1.8 billion shortfall anticipated in last year's budget and the $1.6 billion forecast in the Fall Fiscal Update. The key driver behind this outperformance was on the revenue side, stemming largely from the oil sector. Indeed, the uptick in oil prices in the final quarter of the year, as well as higher-than-expected offshore production drove oil royalty revenues higher.

Challenging economic environment

Going forward, a challenging road lies ahead for the Newfoundland and Labrador economy; however the government sees some bright spots over the medium term, including the oil, mining and tourism industries, as well as opportunities for the aquaculture, lumber and agri-food

NEWFOUNDLAND AND LABRADOR ECONOMIC ASSUMPTIONS
[Per cent change unless otherwise noted]

	2016*	2017	2018	2019	2020
Real GDP	-0.7	-3.8	-0.2	0.3	-0.6
Nominal GDP	-0.4	1.8	3.2	4.5	2.0
Unemployment Rate (%)	13.4	13.9	15.5	16.5	16.6
Employment ('000s)	232.6	228.3	221.8	217.2	214.5
Real Retail Sales	-1.6	-3.0	-2.6	-1.4	0.2
Household Disposable Income	-0.3	-0.4	-0.3	1.6	1.9
Population ('000s)	530.1	527.3	525.0	522.1	519.4

Note: * - Estimate
Source: Newfoundland and Labrador Department of Finance.

Dina Ignjatovic, Economist, 416-982-2555

sectors. Still, it is anticipating a significant contraction in economic growth this year, and the unemployment rate is forecast to reach 13.9% on average. Nominal GDP will fare much better, returning to growth territory this year thanks to the assumption of gradually rising commodity prices. The economic projections contained in the Budget Plan are generally more conservative than our own; however the near-term oil outlook – with Brent forecast to average US$56 per barrel over the FY2017-18 – is roughly in line with ours.

Deficit reduction on track

As previously indicated by the government, Budget 2017 did not contain any new tax hikes or fee increases. In contrast, the gasoline tax increase that was implemented last year will be cut by 8.5 cents – about half – beginning on June 1st, and reduced by an additional 4 cents on December 1st. The remaining 4 cents will be reviewed during the Fall Fiscal Update. Overall, revenues are expected to edge up only slightly this year.

As such, it will be up to the spending side of the equation to further rein in the deficit. The government anticipates a $283 million (3.4%) reduction in expenditures this year, resulting from changes to the management structure, zero-based budgeting, savings from agencies, boards and commissions, annualized savings and actuary and accrual adjustments. While negotiations with public service unions have yet to be completed, the government plans to propose legislative changes to freeze wages for management and non-union employees for this year. This presents some risk to the spending projections contained in the Budget should these wage freezes not materialize.

That said, the government maintains its commitment to key priority areas including education and skills development, healthcare and infrastructure. It is making an effort to maximize federal funding, including a $3 billion five-year infrastructure plan.

All told, the deficit is projected to come in at $778 million (2.6% of GDP) for FY 2017-18, slightly ahead of the government's $800 million target. Spending restraint will be a key theme going forward, with total expenditures in FY2022-23 to be constrained to a level in line with that in the current fiscal year. In real terms, this implies a nearly 5% reduction in spending per year over the next five years. Largely reflecting the better starting point, the $620 million budget "gap" that was estimated for FY 2021-22 in last year's budget has now been reduced to $72 million net of a $120 million risk adjustment. Thus, if the risk adjustment is not needed, the province could be in balance that year.

NEWFOUNDLAND AND LABRADOR FISCAL POSITION

[C$ millions, unless otherwise noted]

	2017 Budget				
Fiscal Year	**16-17**	**17-18**	**18-19**	**21-22**	**22-23**
Revenues*	**7,320**	**7,339**	**7,711**	**8,172**	**8,282**
% change	--	0.3%	5.1%	2.7%	1.3%
Expenditures	**8,400**	**8,117**	**8,305**	**8,124**	**8,118**
% change	--	-3.4%	2.3%	-0.8%	-0.1%
Surplus (+)/Deficit (-)	**-1,080**	**-778**	**-594**	**48**	**164**
Revenue Risk Adjustment	0	0	-50	-120	-140
Adjusted Surplus(+)/Deficit(-)	**-1,080**	**-778**	**-644**	**-72**	**24**
% of GDP	-3.6%	-2.6%	-2.0%	-0.2%	--
Deficit Targets	-1,830	-800	-650	0	100
Net Debt	**14,251**	**15,234**	--	--	--
% of GDP	47.6%	49.9%	--	--	--

* Includes net income of Government Business Enterprises.

Source: Newfoundland and Labrador Department of Finance

Borrowing to slow but debt burden still concerning

A major challenge and a focus of credit rating agencies is the province's debt burden. A lower deficit and pre-funding has helped to set the stage for sharp reduction in estimated borrowing requirements in the upcoming year relative to last – to $400 million from $2.4 billion. While a lower gross borrowing requirement is a positive sign, net debt is still expected to rise by nearly $1 billion in the current fiscal year, reaching $15.2 billion. This will push the net debt-to-GDP ratio to around 50%, which is well below the 70% peak in the late 1990s, but still up sharply from the 30% seen in FY 2014-15 and the highest among the provinces. This lofty debt burden will remain a concern among credit rating agencies, particularly as trends in bond yields continue to head higher from the lows seen last year and the cost to service the province's debt takes up a larger share of revenues.

Bottom Line

The restraint measures taken in last year's budget have helped to improve Newfoundland and Labrador's fiscal position. Budget 2017 is very much a plan to stay the course. No new revenue generating measures were announced, leaving further deficit reduction up to the spending side of the equation. Overall, the deficit is on track to be eliminated by 2022-23, at which point the government may need to shift its sights to reducing its high debt burden.