October 27, 2016

Newfoundland and Labrador's FY17 Update … The Projected Deficit Narrows

Newfoundland and Labrador Budget Balances
FY16 Final: -$2.2bn (-7.2% of GDP)
FY17 Budget: -$1.83bn (-6.1% of GDP) Revised: -$1.58bn (-5.3% of GDP)

Borrowing
FY17 Budget: $3.4bn **Revised: $2.9bn, of which $2.4bn borrowed to date**

REVENUE AND EXPENDITURE DETAILS

The $246½ million improvement in the projected deficit for fiscal 2016-17 (FY17) is the result of:

- Raising FY17 revenues by $217 million;
- Lowering program spending by $111 million;
- Adding $131½ million to the debt service; and
- Trimming the risk adjustment from $125 million to $75 million in light of the revenue improvement.

Driving the higher FY17 revenue estimate is a revision in oil royalties from $502 million to $601 million. Over the first six months of this fiscal year (April 2016 to September 2016), a 30% y/y surge in offshore oil production is reported. The government has raised its assumption of FY17 oil production by 4 million barrels to 70 million barrels, and its estimate of the average Brent oil price from the *Budget* estimate of US$40/barrel to US$45.

Offsetting reported program expenditure savings are higher interest charges, primarily related to revised actuarial assumptions for pension and other post-employment benefits.

Buoyed by higher offshore oil production, NL forecasts a 0.6% rise in provincial real GDP for 2016. The government then assumes a return to declining provincial output over the next four years as several major projects are completed, though their forecast of a 4.5% contraction in 2017 and a 2.6% drop in 2018 are followed by more modest annual corrections of less than 1.0% over the following two years.

Net debt as of March 2017**,** as measured by the Province, is revised slightly lower to $14.6 billion (48.8% of GDP), following net debt of $12.65 billion (41½% of GDP) in March 2016. The reduction of the FY17 borrowing requirement is largely due to higher revenues and cash-flow savings related to infrastructure outlays.

With this *Update*, the government repeats its commitment to its *Budget 2016* fiscal targets, and a surplus is still planned for FY23. The Premier is expected to shortly release a 'vision document' to grow the economy, provide more efficient public services and restore fiscal balance. Going forward, all spending decisions will be justified on a year-by-year basis.

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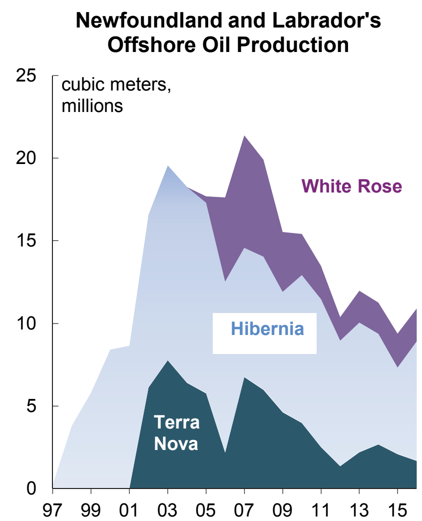

*2016 based on January-September data.
Source: Canada-Newfoundland and Labrador Offshore Petroleum Board.

With respect to Muskrat Falls, yesterday the Province announced actions, in partnership with the Innu Nation, the Nunatsiavut Government and the NunatuKavut Community Council, to address issues surrounding the pending flooding of the Muskrat Falls reservoir. Indigenous leaders will arrange an independent review of the engineering reports on the timing and rationale for the initial reservoir impoundment. If this review affirms the initial impoundment, water levels in the reservoir will be raised to the minimum acceptable level for the winter. In the spring, water from the reservoir will be released to its natural flow to allow additional mitigation measures, to be agreed upon by an *Independent Expert Advisory Committee* of federal, provincial, municipal and indigenous representatives.

OUTLOOK

After the roller coaster ride in provincial oil royalties, with FY16 receipts of $514½ million just one-third of the FY15 level, we continue to expect a gradual recovery in royalties through FY19. Scotiabank Economics looks for Brent oil prices to strengthen from a US$45/barrel average in calendar 2016 to US$54 next year and US$58 in 2018 when initial production at the fourth offshore field, Hebron, is expected to ramp up.

Yet even with Newfoundland and Labrador's oil royalties turning higher and the *Update's* improved FY17 bottom line forecast, the government correctly acknowledges its steep fiscal repair commitment, hence the attention to the upcoming policy statement.