

Newfoundland and Labrador: 2018–19 Budget

BALANCING PRIORITIES TO BALANCE THE BOOKS BY 2022–23

- The revised \$812 million deficit for fiscal 2017–18 (FY18) is \$34 million wider than *Budget*, but it testifies to the repair accomplished since the FY16 shortfall of \$2.2 billion (bottom chart).
- A modest surplus is still targeted for FY23, but weaker revenues over the next half decade contribute to a \$0.7 billion widening of the cumulative deficits projected from FY19 to FY22.
- Net debt, as measured by the Province, is expected to climb by just \$890 million during FY19, following the \$1.04 billion FY18 rise. From an estimated 45.7% of GDP as of March 2018, the government expects net debt to peak in March 2021 above 49% of GDP, before dropping back to less than 47% by March 2023.
- Long-term direct government borrowing (not including Newfoundland and Labrador Power) for FY18 is estimated at \$1.175 billion, rising to \$1.45 billion in FY19.

OVERVIEW

Revenues in FY18, virtually unchanged from *Budget*, are expected to weaken relative to last year's forecast beginning in FY19. From FY19 to FY23, this *Budget's* forecast lowers average annual revenue growth to 1.9% annually, from last year's expectation of 2.4% gain. Thus receipts over the next five years are a \$1.28 billion lower than the *Budget 2017* forecast.

Planned expenditures over the next half decade are a cumulative \$0.3 billion lower, declining by an average 0.6% annually. After rising in FY19, total spending drops 5.4% over the following four years, a plan that is expected to require both restraint and restructuring as a rising debt service further limits program spending room.

An Oil Revenue Risk Adjustment is incorporated again this year, albeit at more modest levels, rising from \$25 million in FY20 to \$85 million in FY23. Further insurance on the near-term bottom line forecasts is the conservative assumption of Brent oil prices averaging just US\$63/barrel in both FY19 and FY20. As well, provincial real GDP is assumed to fall a further 0.8% in calendar 2018 and recover by a modest 1.1% in 2019. Relatively moderate increases are assumed for the GDP deflator, leaving nominal GDP growth positive, but just 1.3% and 1.8% for the two years, respectively.

Over a challenging half decade, *The Way Forward* remains the government's blueprint to improve government efficiency and public-sector outcomes and encourage a stronger, more diversified economy. Working in tandem with the *Cabinet Committee on Jobs*, greater private-sector investment is sought.

REVENUE AND EXPENDITURE DETAILS

With revenues in FY18 estimated to rise by a moderate 2.6%, the significant deficit improvement relies on scaling back expenditures by 1.8%. In FY19,

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Newfoundland and Labrador's Budget Balances

Fiscal 2016–17 (FY17)

Final: -\$1.1bn (-3.7% of GDP)

FY18

Budget: -\$778mn (-2.4% of GDP)

Rev: -\$812mn (-2.5% of GDP)

Budgets: FY19

-\$683mn (-2.1% of GDP)

FY20b

-\$507mn

FY21b

-\$654mn

FY22b

-\$243mn

FY23b

+\$56mn (+0.1% of GDP)

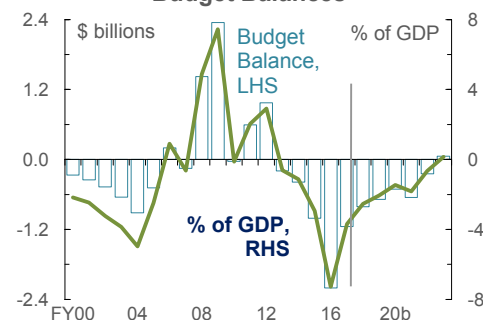
Borrowing Requirements

FY18 \$1.175bn

FY19 \$1.450bn

Source: Newfoundland and Labrador Finance; Statistics Canada; nominal GDP forecasts: Scotiabank Economics.

Newfoundland and Labrador's Budget Balances



Sources: Newfoundland and Labrador Finance; Statistics Canada; nominal GDP forecasts: Scotiabank Economics.

revenue growth is expected to strengthen to 4.5%, boosted by federal transfers climbing a further 5.3% after a 12.5% upswing in FY18 (side chart and table, p. 3). As well, non-renewable resource receipts are forecast to rise 7.6% as offshore oil production jumps 6.4% with the output increase at Hebron, the Province's new fourth offshore oil field, more than offsetting the anticipated declines across the Hibernia, Terra Nova and White Rose fields.

With work on Newfoundland and Labrador's resource projects winding down over the next two years,

the Province assumes further employment declines of 1.0% in calendar 2018 and 1.8% in 2019, lifting the average unemployment rate to 15.4% next year. Recognizing the continuing squeeze on households and businesses, the tax on automobile insurance will be trimmed by a minimum of 5% from calendar 2019 to 2022 beginning with a 2 percentage point reduction in the rate next January. The Public Utilities Board is currently reviewing automobile insurance rates with its recommendations expected by June to assist government action by the Fall. To help smaller firms and encourage hiring, the threshold for the payroll tax on employers will be lifted from \$1.2 million to \$1.3 million. The independent review of the Province's tax system is proceeding with options for simplification and increased competitiveness to be considered for *Budget 2019*.

To support households and reinforce residential construction activity, \$1 million is earmarked for a new *Home Purchase Program*, beginning April 1st, 2018, that offers \$3,000 grants for down payments on newly constructed homes valued under \$400,000 (including HST). The Province also replaces the existing *Down Payment Assistance Program* with a new \$1.25 million *First-time Homebuyers Program* that offers enhanced eligibility and benefits relative to the prior program.

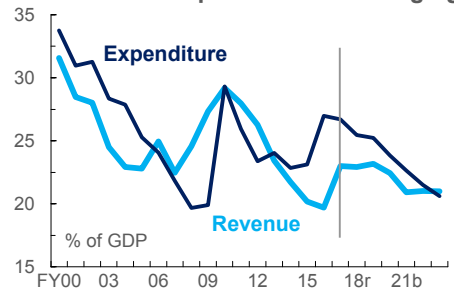
Expenditure efficiencies over the past year include: decreasing the government's leased space by 10%; trimming 795 positions within government departments; partnering with the other Atlantic Provinces for more secure, lower-cost driver license issuance; and savings from partnering with the private-sector on a design-build-finance-maintain arrangement for the Corner Brook long-term care facility.

This year, the four-year collective agreement with the Newfoundland and Labrador Association of Public and Private Employees, extending to March 2020 and including a four-year wage freeze, will guide the government's other labour negotiations (Appendix, p.4). Across the Province's broader public sector, work force management, with a large number of employees eligible for retirement, will trim positions through attrition. An independent committee will compare NL's post-secondary education system with institutions in other jurisdictions to explore changes that will facilitate better outcomes on a more cost-efficient basis.

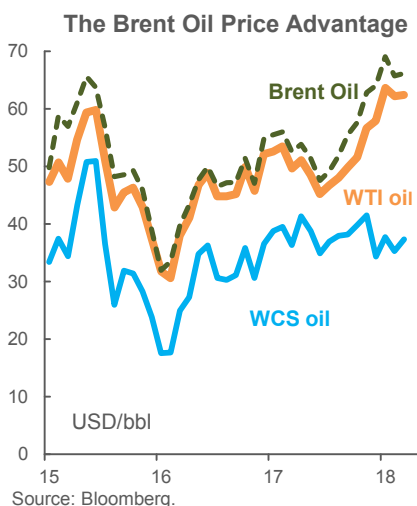
CAPITAL SPENDING AND BALANCE SHEET

Infrastructure spending of \$620 million is outlined for FY19, following the \$455 million FY18 plan, as part of the Province's \$2.28 billion five-year infrastructure program. Newfoundland and Labrador's commitment to obtain maximum benefit from the federal funding available is evident in recent infrastructure announcements. The Province is detailing the municipal projects over three years

Revenues & Expenditures Converging



Sources: NL Finance; Statistics Canada; nom. GDP forecasts: Scotiabank Economics.



Source: Bloomberg.

Newfoundland and Labrador's Longer-Term Outlook

\$ millions except where noted

Economic Growth, annual % change	18f	19f	20f	21f	22f
Real GDP	-0.8	1.1	-0.3	1.0	0.3
Nominal GDP	1.3	1.8	1.2	3.5	3.0
Employment	-1.0	-1.8	-1.0	-0.2	-0.3
Key Assumptions	FY19b	FY20b	FY21b	FY22b	FY23b
Canadian Dollar, US¢	79.0	79.6	80.4	80.8	81.3
Brent Oil Price, US\$/bbl	63.0	63.0	67.0	71.0	74.0
Revenues, annual % ch.	4.5	1.1	-3.0	4.1	2.8
Expenditures, annual % ch.	2.5	-1.4	-1.2	-1.7	-1.2

FY19 Sensitivities Brent oil prices: +US\$1/bbl—royalties rise by \$22.7mn.
Canadian dollar: +1¢(US)—royalties fall by \$17.0mn.

* Sources: Newfoundland and Labrador Finance, Statistics Canada.

financed under the *Small Communities Fund* of the *New Building Canada Fund* with the Province's contribution almost \$19 million that leverages municipal money and \$12½ million from Ottawa. The federal government also is providing over half of the funding for a \$40 million investment in high-speed internet to remote and rural communities under its *Connect to Innovate* program. From the second phase of the federal *Investing in Canada Plan*, Newfoundland and Labrador expects about \$556 million over the next decade.

The required equity investment in Nalcor to support the completion of the Muskrat Falls hydro-electricity will be \$0.7 billion this year. The project as of December 2017 was on track with the revised budget and completion schedule presented last June (see Appendix).

After Muskrat Falls is completed, the government remains committed to ensuring that its electricity rates are competitive with other Atlantic provinces. Efforts to curtail future power rates include: continuing to purchase and import less expensive power via the Maritime Link and the Labrador Island Link; bringing surplus power in Labrador to the Island; exporting surplus recall energy from the Upper Churchill Falls hydro-electricity installation and expanding the customer base for power purchases within the Province.

To help realize the long-term potential of its offshore oil & gas sector, the government intends to establish the oil & gas subsidiary of Nalcor Energy as a stand-alone corporation working directly with the Department of Natural Resources.

Net new long-term borrowing over the next half decade is now expected to be \$1.4 billion higher, of which \$1.1 billion is due to changes in cash flows related to Nalcor.

OUTLOOK

Newfoundland and Labrador continues with a multi-prong approach to putting the province on a more sustainable fiscal footing. With oil & gas plus other mining accounting for one-quarter of the Province's economy in 2016, significant diversification is a longer-term effort. The Province, however, has several sizeable advantages including tidewater access for its exports and the premium that Brent oil prices continue to command over WTI prices.

The projected budget shortfalls from FY19 to FY21 average about \$600 million annually, leaving substantive deficit reduction to the last two years of the forecast period. It is possible, however, that more deficit improvement will be realized over the next two fiscal years given the relatively conservative assumptions underlying the *Budget* estimates. After FY20, a gradual but steady rise in Brent oil prices is assumed from US\$67/barrel in FY21 to US\$74 by FY23 (table, p.2). The key challenge in the government's plan, in addition to resource price volatility, is accomplishing the projected expenditure restraint, recognizing the difficulties of an extended austerity effort.

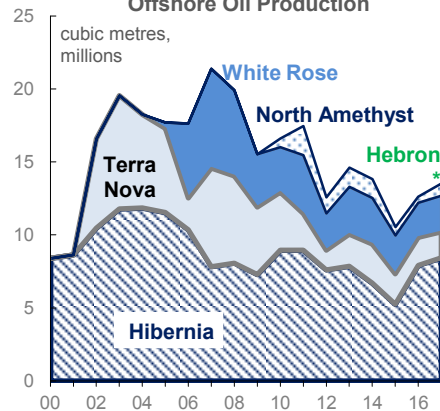
Newfoundland and Labrador's Budget Arithmetic

\$ millions except where noted

	<u>Budget</u>	<u>Rev.</u>	<u>Budget</u>
Tax Revenue	3,925	3,809	3,865
Offshore Royalties	882	930	1,000
Gov't Bus. Ent. Net Income	441	374	429
Other Own-Source Rev.	835	985	1,071
Total Own-Source Revenue	6,082	6,098	6,365
Federal Transfers	1,257	1,242	1,308
Total Revenue	7,339	7,340	7,673
Program Spending	7,004	7,183	7,349
Debt Service	1,112	969	1,007
Total Expenditures	8,116	8,152	8,356
Oil Revenue Risk Adjustment	0	0	0
Budget Balance	-778	-812	-683
Memo Items, %			
Own-Source Rev./ GDP	19.0	19.0	19.2
Fed. Transfers / Total Rev.	17.1	16.9	17.0
Offshore Royalties / Total Rev.	12.0	12.7	13.0
Program Spending / GDP	21.9	22.4	22.2
Budget Balance / GDP	-2.4	-2.5	-2.1
Debt Service / Revenue	15.2	13.2	13.1
Annual Change, %			
Tax Revenue	5.3	2.2	1.5
Own-Source Revenue	0.5	0.7	4.4
Federal Transfers	13.8	12.5	5.3
Total Revenue	2.54	2.6	4.5
Program Spending	-4.7	-2.3	2.3
Total Expenditures	-2.3	-1.8	2.5

Sources: Newfoundland & Labrador Finance; Statistics Canada; nominal GDP forecasts: Scotiabank Economics.

Newfoundland & Labrador:
Offshore Oil Production



* Hebron production Nov. 2017-Jan. 2018, 000 m³: 249.3 Source: Canada-Newfoundland and Labrador Offshore Petroleum Board.

Appendix — Other Policy Developments

The four-year collective agreement with the Newfoundland and Labrador Association of Public and Private Employees, representing about 20,000 individuals expires March 31, 2020. It includes:

- A four-year wage freeze (a 1% wage increase is estimated to raise provincial spending by more than \$40 million annually);
- Elimination of the earned severance (retirement) benefit accrued by all employees, and its replacement, if an employee is severed, by a payment equal to one week of salary per year of service to a maximum of 20 weeks;
- For new employees, retirement benefits beginning after 15 years, not the current ten years, and graduated premiums will reflect years of service, replacing the existing 50/50 split; and
- No mass lay-offs during the agreement, allowing public service reductions through attrition.

In future negotiations the government wishes to address overtime and sick leave.

Newfoundland and Labrador's Minimum Wage, with April 1 the harmonized date for annual changes in Atlantic Canada, will climb 15¢ to \$11.15 per hour, raising the 150% minimum overtime rate to \$16.73. This rise and future increases are based upon the annual national CPI change, replacing the former ad hoc system to create more transparent, predictable changes.

For The Way Forward, the next industries under Phase Three are: mining to develop a sustainable, competitive framework; forestry to raise timber allocations and harvest levels by 20% by 2020 alongside a diversification plan; and, community sector entities to support the economic contribution of non-profit organizations. Over the past year, ambitious targets and strategies were created with stakeholders for aquaculture, agriculture, technology and the oil & gas sector. In agriculture, the Province aims to double its food self-sufficiency to 20% by 2022, and in 2017 opened up 64,000 hectares of Crown land for farming. Other specific actions include a plan to launch a new International Entrepreneur and International Graduate Entrepreneur categories under the *Provincial Nominee Program* as the Province works towards the goal of 1,700 newcomers by 2022, up from 1,174 in 2017.

The oil & gas plan to 2030 looks to position NL as a globally preferred location for exploration and development with production from multiple basins. Near term this involves: monitoring its international competitiveness; streamlining provincial offshore regulations based on international best practice; working with Ottawa to ensure its proposals support new investment; expanding the Province's world class seismic acquisition and resource assessments, and broadening the base of local support services. The Oceans supercluster bid, selected by the federal government, is led by organizations across the Atlantic Province (with an investor commitment of roughly \$125 million), and benefits for Newfoundland and Labrador's offshore sector are expected.

The government's Made-in-Newfoundland and Labrador carbon pricing plan is expected this spring. The final 4¢ of the Temporary Gas Tax will be phased out as work on the Province's carbon pricing strategy progresses.

The Muskrat Falls hydroelectricity project as of December 2017 was almost 89% complete and was on budget and on schedule with the revised June 2017 (bottom table). First power is expected in autumn 2019 with full power by the summer of 2020. Civil construction risk on the Muskrat Falls project now is declining as activity transitions to installation, integration and commissioning. As of February, Newfoundland is connected to the North American electricity grid via the Maritime Link, raising NL's power system reliability. By mid-2018, Nalcor estimates that the Labrador-Island Link will enter service, offering additional lower-cost power to the Island of Newfoundland.

Muskrat Falls Hydroelectricity Project

	<u>Dec.2012</u>	<u>June</u>	<u>Dec.</u>	<u>Completed</u>
	<u>Sanction</u>	<u>2017</u>	<u>2017</u>	<u>by Dec.17</u>
	\$ billions			% share
Labrador Transmission Assets	0.69	0.89	0.89	99.2
Labrador Island Link	2.6	3.72	3.72	97.7
Muskrat Falls Station (824 MW)	2.9	5.50	5.50	78.0
Contingency Budget	0.37	0.34	0.34	-

Sources: Nalcor, Muskrat Falls Project Oversight Committee, December 2017.

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