ECONOMICS | **RESEARCH**

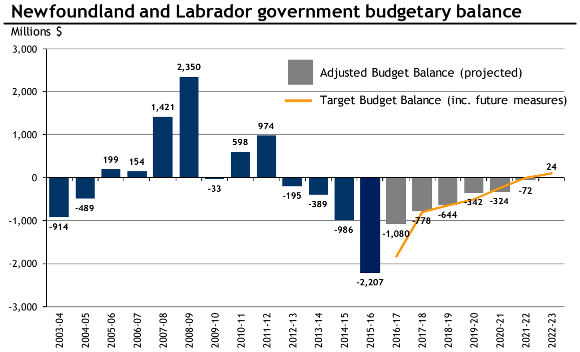
NEWFOUNDLAND & LABRADOR BUDGET 2017

April 7, 2017

Sticking to the plan to stabilize public finances

- The provincial government expects to cut its budget deficit by 28% to $778 million in FY17/18 from a downwardly revised $1.1 billion in FY16/17.
- It will do so primarily by reducing expenses.
- Budget 2017 has no tax increases; offshore royalties are slated to fall by more than 8%.
- The government expects to lower its borrowings by $2.5 billion to $400 million; however, the provincial debt continues to rise rapidly.
- The longer-term fiscal plan is to eliminate the deficit entirely by FY22/23.

Newfoundland and Labrador government budgetary balance



Source: RBC Economics Research, Newfoundland and Labrador Department of Finance

Deficit reduction is on track

On the heels of a very tough 2016 budget delivered a year ago—which included both extensive tax increases and deep spending cuts—Newfoundland and Labrador's 2017 budget no doubt brought some relief to many in the province as 1) it confirmed that the government is on track to stabilize its finances and 2) no significant new measures have been introduced to do so. In fact, Finance Minister Cathy Bennett indicated that the fiscal year that ended last week likely resulted in a smaller deficit than previously expected. Originally projected to be $1.8 billion in Budget 2016 and subsequently revised downwardly to $1.4 billion in the 2016 fall update, the deficit for FY16/17 is now expected to come in lower still at $1.1 billion. The downward revision to last year's deficit since Budget 2016 reflects higher revenues than expected (to the tune of $504 million, almost of this increase coming from stronger offshore royalties), lower expenses than expected (-$81 million) and the removal of the $125 million revenue risk adjustment factor.

Expenditure savings to further reduce the deficit in FY17/18

Minister Bennett also indicated that she expects her government to 'beat' its deficit target of $800 million for FY17/18 set in last year's budget and projects a deficit of $778 million. This represents an improvement of $302 million relative to last year's deficit thanks mostly to ongoing expense reduction efforts that are expected to generate $283 million in savings (taking expenditures down by a hefty 3.4%). Revenues are slated to rise only slightly by $19 million (0.3%)—constrained by a still-weak economy and an anticipated $81 million drop (-8.3%) in offshore oil royalties (to $882 million). The government expects the provincial economy to continue to contract in 2017 at a rate of -3.8%, thereby constituting a fourth-straight year of recession for the province. However, nominal GDP in 2017 is projected to rise (by 1.8%) for the first time in four years due to higher prices for the province's goods and services. The lower-than-expected offshore royalties deficit reflects a projected decline in oil production, only partially offset by a modest increase in crude oil prices (from an average of US$52 per barrel in FY16/17 to an average of US$56 per barrel in FY17/18 for the Brent benchmark). The budget

Robert Hogue
Senior Economist
416-974-6292
robert.hogue@rbc.com

does not contain any new taxes or tax increases. In fact, the main revenue measure is a partial rollback of the temporary gas tax introduced in last year's budget that will be implemented in two stages: a 8.5 cents per litre reduction on June 1, 2017, followed by an additional 4 cents per litre cut on December 1, 2017.

Budget surplus by FY22/23 by holding the line on spending

The longer-term fiscal plan shows that the government expects to make steady progress on eliminating its deficit during the next five years and return into a small surplus position by FY22/23. The plan counts on revenue growth to average 2.4% per year during that interval and expenditures to remain effectively unchanged, which is quite an ambitious target. The government points to the fact, however, that holding the line on spending in this way would merely equate FY22/23 expenditures with FY07/08 expenditures on a per capita and inflation-adjusted basis. The period that followed FY07/08 saw a sharp rise in provincial expenditures. The longer-term fiscal plan includes an explicit prudence factor—an 'oil revenue risk adjustment'—that increases from $50 million in FY18/19 to $140 million in FY22/23. Unfortunately, there is no such prudence factor in FY17/18.

Investing more in Nalcor and on infrastructure

Finance Minister Bennett indicated that her government will make a further equity investment of $485 million in Nalcor, the province's energy crown corporation. She noted, however, that this would represent a smaller capital infusion into the corporation than in FY16/17 when the government invested more than $1.3 billion. Nalcor is struggling amid significant delays and cost overruns at its multi-billion-dollar Muskrat Falls hydroelectric project. Aside from this investment, the budget contains a five-year, $3 billion infrastructure plan, which in part leverages funding from the federal government. The plan allocates $573 million to FY17/18, unchanged from last year.

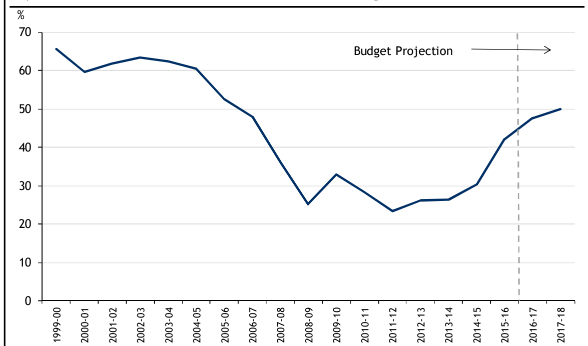
Cutting back on borrowing...

The government intends to slash its borrowing by $2.5 billion this year with a view toward reducing borrowing costs. It now plans to borrow $400 million in FY17/18, which would be down from $2.9 billion in FY16/17. Budget documents show that $4.9 billion in borrowing has been completed since January 2016.

...yet the provincial debt continues to rise

Despite borrowing less this year, Newfoundland and Labrador's debt will continue to rise rapidly. The province's net debt is expected to climb from $14.3 billion (46.7% of GDP) at the end of FY16/17 to $15.2 billion (49.9%) at the end of FY17/18. This increase follows a 55% ballooning in the province's debt in the past three years. Net debt was $9.1 billion or 26.4% of GDP in FY13/14. Newfoundland and Labrador's high and still-mounting indebtedness significantly reduces the province's fiscal flexibility. It is the reason that compelled the government to impose such tough medicine in last year's budget at a time when the provincial economy needed a boost. It is also the reason why the government will need to stick to that medicine for a few more years until the provincial fiscal health is restored.

Newfoundland and Labrador net debt-to-GDP ratio



Source: RBC Economics Research, Newfoundland and Labrador Department of Finance

Table 1: Budget Summary (millions of dollars)

	Revised	Projection					
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Budgetary Revenues	**7,320**	**7,339**	**7,711**	**7,996**	**7,959**	**8,172**	**8,282**
Program Expenses	7,433	7,107					
Public Debt Charges	967	1,010					
Total Expenses	**8,400**	**8,117**	**8,305**	**8,258**	**8,188**	**8,124**	**8,118**
Adjustment for Risk	0	0	-50	-80	-95	-120	-140
Budgetary Balance	-1,080	-778	-644	-342	-324	-72	24

Source: Newfoundland and Labrador Department of Finance

Table 2: Economic Assumptions

Year-over-year % change	Estimate	Projection				
	2016	2017	2018	2019	2020	2021
2017-18 Budget						
Real GDP growth	-0.7	-3.8	-0.2	0.3	-0.6	0.2
CPI	2.7	2.9	2.4	2.2	3.8	2.4
Nominal GDP growth	-0.4	1.8	3.2	4.5	2.0	2.3
Unemployment Rate*	13.4	13.9	15.5	16.5	16.6	17.2
RBC Economics						
Real GDP growth	0.8	-3.6	-0.3			
CPI	2.7	3.5	1.9			
Nominal GDP growth	-0.9	1.2	4.5			
Unemployment Rate*	13.4	14.8	16.3			

*Average level, **Average level, fiscal year

Source: RBC Economics Research, Newfoundland and Labrador Department of Finance