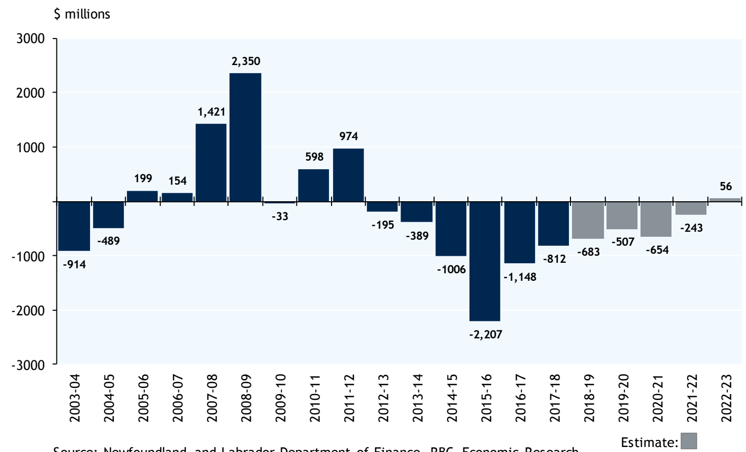
NEWFOUNDLAND & LABRADOR BUDGET 2018

March 28, 2018

Highlights

- Budget 2018 reasserts the government's commitment to return to a surplus position by FY22/23. This occurs despite deficit levels in the intervening fiscal years being raised slightly.
- This improving fiscal position relies heavily upon aggressive expenditure restraint which is projected to decline on average by 0.6% per year over the five fiscal years up to FY22/23. The budget indicates the savings are expected to be largely achieved by cost restraints though little in the way of costing detail is provided to assess the likelihood of success.
- The budget does propose some revenue measures such as cutting the tax on auto insurance as well as lowering the threshold for payroll tax to be paid by employers.



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

Overview

The Newfoundland and Labrador government continues to present a very challenging fiscal plan as outlined in Tuesday's Budget 2018 presentation. In broad outline, it represented very little change from what was contained in Budget 2017. As well, there were only modest new initiatives on the revenue/tax side. The main thrust of its fiscal plan remained the laudable goal of returning to surplus by FY22/23. However, to achieve this, very significant expenditure restraint will need to be realized through the medium term. In fact, the amount of restraint is slightly greater than what was suggested in Budget 2017. Between FY17/18 and FY22/23 expenditure will decline on average by 0.6% per year. In contrast, Budget 2017 had implied essentially no growth in expenditures over this period. Budget 2018 indicated that this restraint would be broadly achieved by very stringent cost controls. For example, the government did point out that it had secured a four-year wage freeze with its public sector employees. However, with limited detail provided as to actual cost savings from this and other initiatives, there remains uncertainty as to whether the government's expenditure reductions will be achieved.

Table 2: Economic Assumptions

Year-over-year % change	Estimate		Projection			
	2017	2018	2019	2020	2021	2022
Budget 2018						
Real GDP growth	-3.4	-0.8	1.1	-0.3	1.0	0.3
CPI	2.4	2.0	2.2	2.1	2.6	2.0
Nominal GDP growth	4.2	1.3	1.8	1.2	3.5	3.0
Unemployment Rate*	14.8	14.8	15.4	15.6	15.3	15.1
RBC Economics						
Real GDP growth	-1.8	-2.0	3.4			
CPI	2.4	1.5	1.7			
Nominal GDP growth	1.7	0.7	5.0			
Unemployment Rate*	14.8	15.6	15.9			

*Average level, **Average level, fiscal year

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

Budget Balance Profile

The government continues to project a return to a surplus position by FY22/23 with Budget 2018 showing a slightly larger surplus that year of $56 million compared to the year-ago figure of $24 million. However, it was also the case that the deficit estimates over the prior five years are also larger. For the FY17/18 that is just ending, the deficit was revised up to $812 million from the previously estimated $778 million. The government indicated that the shortfall could be solely attributed to the $37 million in severance expenses that result from the recently agreed to public sector collective agreement. This was viewed as an upfront cost that would be more than offset by savings in the public sector wage bill over the medium term. The deficit in FY18/19 was revised up as well to $683 million from the $644 million projected a year ago. The government indicated that the 'miss' was largely attributable to two factors. There was a further $52 million hit to expenditures reflecting the remaining one-time severance payment to public sector workers. The government also revised downwardly oil revenue "due to lower production and changes to the US-Canada exchange rates." Some offset was pro-

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vided by government opting to drop the FY18/19 oil risk adjustment factor of $50 million that was applied to lowering the deficit. In the three subsequent fiscal years, FY19/20 through FY21/22, the deficits are projected at $507 million, $654 million and $243 million relative to $342 million, $324 million and $72 million, respectively, projected in Budget 2017.

Revenues

Average annual growth in revenues between FY17/18 and FY22/23 of 2.3% is only marginally lower than the 2.4% projected a year ago. Budget 2018 did announce some limited tax reductions. Specifically, it indicated that the government was opting to reduce the tax rate it had introduced in 2016 on automobile insurance by 5 percentage points over the next four years. As well, it announced an easing in payroll taxes by increasing the tax threshold to $1.3 million from $1.2 million. Budget 2018 did not provide any costs estimates for these initiatives so it is unclear the extent to which they account for all or more of the modest reduction in revenue growth.

Expenditures

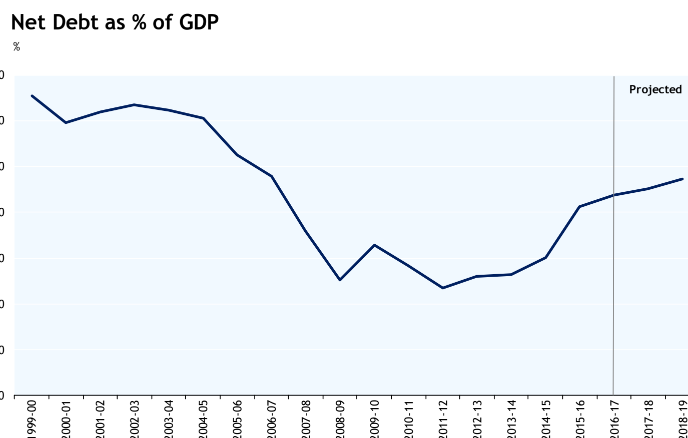
As suggested above the objective of returning to a fiscal surplus by FY22/23 is largely achieved by relatively aggressive expenditure restraint over the intervening years. The fiscal plan assumes expenditures decline on average by 0.6% over the five-year period. The duration of this restraint could well represent a first in the annals of provincial budgets in Canada! Budget 2018 indicates that this will largely be achieved by cost restraint. The budget does indicate a number of initiatives that will help achieve such. However, without a detailed explanation as to exact dollar savings, it is difficult to assess the likelihood of success. If this expenditure restraint is not achieved, the government is unlikely to return to a surplus position by FY22/23.

Budget 2018 continues to insert an 'oil revenue risk adjustment' to the out-years of its fiscal plan to allow for unforeseen weakening in oil prices. This adjustment rises from $25 million in FY19/20 to $85 million in FY22/23. The cumulative amount of $215 million is less than half the $435 million allocated in Budget 2017. This smaller contingency reserve is another factor along with the greater expenditure restraint that contributes to the fiscal balance returning to surplus by FY22/23.

Net Debt

The persistence of deficits contributes to the province's net debt rising in FY18/19 to $15.5 billion (47.3% of GDP) from $14.6 billion (45.1%) in FY17/18. This leaves Newfoundland and Labrador with the highest debt-to-GDP ratio among all of the provinces.

It is of note that despite the FY17/18 deficit being revised higher and thus applying greater upward pressure on debt, the net debt-to-GDP ratio is lower for FY17/18 relative to the 49.9% projected last year. This results from the level of Newfoundland and Labrador's nominal GDP being revised higher over the historical period.



Borrowing Requirement

Budget 2018 indicated that gross borrowing in FY18/19 will jump higher to $1.45 billion from the $0.40 billion in FY17/18. The main factors contributing to the borrowing by the province include cash flow needs for Nalcor Energy, debt repayment, pensions promissory notes and infrastructure spending. Budget 2018 indicated the cumulative net new borrowing had increased by $1.4 billion through FY22/23. Of that amount $1.1 billion reflected increased cash flow needs for Nalcor Energy.

Table 1: Budget Summary (millions of dollars)						
	Revised	Projection				
	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Budgetary Revenues	**7,340**	**7,673**	**7,760**	**7,527**	**7,833**	**8,049**
Program Expenses	7,183	7,349				
Public Debt Charges	969	1,007				
Total Expenses	**8,152**	**8,356**	**8,242**	**8,146**	**8,006**	**7,908**
Adjustment for Risk	0	0	-25	-35	-70	-85
Budgetary Balance	-812	-683	-507	-654	-243	56

Source: Newfoundland and Labrador Department of Finance

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