

## NEW BRUNSWICK BUDGET 2014

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### Waiting for a turnaround in the economy

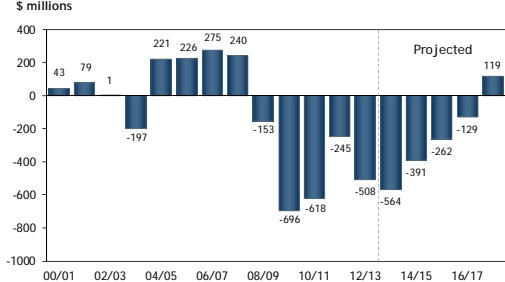
In Budget 2014, released yesterday, the New Brunswick government largely maintained the plan that it presented in Budget 2013 with greater dividends expected from an improving economy going forward. Following the introduction of several tax measures meant to boost revenues in 2013, this year the government opted to rely on a strengthening economy and the “maturation of previously announced tax changes” to stem what has become a persistent deterioration in revenues. Revenues for 2013/14 are tracking \$287 million below the initial Budget 2013 estimates due to weaker-than-expected income and sales tax revenues. To its credit, the government found some savings on the expenditure side, and these are providing a partial offset; however, the budget shortfall is projected to be \$564.1 million in 2013/14, \$85 million larger than the estimate at the time of Budget 2013. The government projects that a rebound in revenues will lift the budget balance to a deficit of \$391 million in 2014/15, although this is also a significant upward revision to the \$271 million deficit projection in Budget 2013. On a positive note, the province extended its fiscal plan to 2017/18 to show a return to surplus (\$119 million by 2017/18). This target is contingent on economic growth in the province accelerating to a relatively brisk pace by 2015 (2.1%) and remaining robust thereafter (at an average of 1.8% per year or double the 0.9% 10-year average), and a quickening pace of employment and wage growth spurring renewed strength in consumer spending. While there is much work ahead by the province to achieve this target, the development of a number of new projects may help to bring light to the end of New Brunswick’s long path to budget balance.

#### Improving economic growth to boost revenues in 2014/15

Weak economic growth in the past decade has persistently proven to be a challenge for the province, hindering its ability to meet revenue targets in recent years. This was again the case in 2013/14 when real GDP growth was effectively nil in 2013 (the government estimates a rate of just 0.1%, compared to a forecast of 0.5% at Budget 2013), thereby causing revenues to fall by 1.0% from 2012/13. In 2014/15, the government expects the benefits of revenue generating tax initiatives, introduced in Budget 2013, will begin to materialize and provide an end to the fiscal deterioration. Despite tax increases coming into effect on July 1, 2013, a full year of increased tax revenue and improved economic conditions are expected to drive double digit gains in personal income tax and corporate income tax revenues (10.5% and 14.4%, respectively). Strengthening consumer spending is also expected to support a 7.9% rise in Harmonized Sales Tax revenues. Collectively, own-source revenues are projected to climb by 5.8% and contribute to an overall 4.3% annual rise in total revenues in 2014/15. Notably, this would represent the strongest revenue growth in the province since 2010/11.

Beyond 2014/15, the fiscal plan relies on fairly aggressive revenue targets, showing rises of 3.3% annually through the forecast horizon. While this compares to 1.3% average growth over the past five years and is a percentage point above the previous revenue profile, the government is counting on a “number of promising projects on the horizon” to spur economic growth and subsequent revenue gains. In doing so, the government took a different approach in Budget 2014 than a year earlier by not introducing revenue-boosting initiatives such as tax increases instead stating that “further measures to address our fiscal situation today would only weaken our economic recovery”. The 2014 budget projects total revenues to

New Brunswick budget balance



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rise by 3.0% in 2015/16 to \$8.3 billion, and then by 3.4% to \$8.6 billion and 3.5% to \$8.9 billion in the following two fiscal years.

### **Major project developments spur a positive economic outlook**

The Ministry of Finance forecasts growth in the province of 1.1% in 2014, with economic performance restrained by sluggish employment growth and lower than expected levels of trade and consumer spending. Growth is expected to accelerate in 2015 to 2.1% with economic benefits stemming from international trade on account of the Comprehensive Economic and Trade Agreement, and the construction of the Sisson Brook tungsten mine. While the growth outlook in 2014 is similar to RBC's forecast for 1.0% growth, our expectation is that benefits from projects such as the Energy East pipeline will likely accrue over the medium-term, beyond 2015. As a result, our 1.4% forecast in 2015 is a conservative estimate relative to the government's forecast.

### **Easing up on expenditure restraint**

For the second consecutive year, the government showed a better-than-expected expenditure side of the ledger in 2013/14. Total expenditures are tracking 2.4% below the initial Budget 2013 estimate for 2013/14, resulting in a projected savings of \$201 million. As a result of this better starting point, total expenditures are now slated to rise by 1.9% in 2014/15 compared to the previous estimate a year ago for a 0.5% decline. Nearly two thirds of the \$8.4 billion in projected spending is allocated to Health (31%), Social Development (13%) and Education and Early Childhood Development (13%). Beyond 2014/15, the expenditure growth profile has been upwardly revised throughout the forecast horizon with average annual spending growth of 2.4% through to 2017/18 (compared to 1% over the forecast horizon previously). Expenditures are expected to rise by 2.9% in 2015/16, a notable increase from the 0.9% growth projected in last year's budget.

### **Yet-to-be-identified savings to bring the province back to balance**

A higher expenditure path is projected to result in larger deficits throughout the fiscal plan despite a stronger revenue profile. In 2015/16, the deficit is projected to be \$262 million, more than double the estimate of \$102 million presented in last year's budget. Moreover, revenues and expenditures alone yield a different deficit profile than that presented in the budget with the government counting on \$650 million in yet-to-be-identified savings through to 2017/18 cumulatively to achieve a \$119 million budget surplus in that year. It is looking to trim \$125 million permanently off the deficit (via either revenue-boosting or expenditure-saving measures) in 2015/16, followed by an additional \$100 million in 2016/17 and a final \$75 million in 2017/18. The government stated that it is optimistic in the development of the energy industry and natural resource sector "over the next few years" with the province "positioned for additional economic growth and additional revenues". As of yet, these budget savings have yet to be identified. Without these deficit-reducing measures, the province is facing a similar sized deficit in 2017/18 (\$531 million) as it does in the current fiscal year 2013/14 (-\$564 million).

### **Multi-year capital plan focuses on transportation and infrastructure projects**

Of the \$555.2 million in capital spending planned for 2014/15, 42% is allocated for highways, bridges and rural road infrastructure. The construction of public schools and public hospitals are also large ticket items in the province's multi-year capital plan. In 2015/16, capital spending is projected to drop by 12.4% with the completion of a public-private partnership related to the building of the Restigouche Hospital Centre. Across the board gains for transportation and infrastructure are expected to contribute to the \$486.1 million plan in 2015/16 while education and early childhood education are projected to fall. In the final year of the plan, a boost in spending for permanent highways will lift capital spending to \$513.6 million.

### **Net debt-to-GDP ratio to reach highest level in nearly two decades**

With larger deficits in the near-term and a net increase in capital acquisition, net debt in the province is slated to rise from \$11.7 billion as of March 31, 2014 to \$12.2 billion at the same date in 2015. With real GDP growth expected to only modestly pick-up during this period, the ratio of net debt-to-GDP is projected to rise to 37.7% from 36.8%. This would represent the highest this measure has been since 1995 and is well above the 34.2% initially projected for 2014 in last year's budget.

The New Brunswick government is largely maintaining its plan that it put forward in Budget 2013, incorporating a marking-to-market of the revenue and expenditure performance in 2013/14. Through this plan, the government aims to return the province to surplus by 2017/18 relying principally upon a strengthening economy and subsequent revenue gains, as well as yet-to-be-identified deficit-cutting measures. To achieve this goal, the province is confident that the development of several major projects will bring additional economic benefits. These developments, particularly the Energy East pipeline, are tentative at this stage and may provide some downside risk to the budget projections if they do not materialize as planned. While the government has incorporated some degree of fiscal prudence with a conservative economic growth forecast for 2014, the economic outlook beyond the near-term appears to be quite optimistic to us. The relatively robust pace of 2.1% projected in 2015 and 1.8% over the remainder of the forecast horizon compare to average annual growth of only 0.9% over the past decade in the province. That being said, the government has been fairly successful so far at delivering expenditure reductions, which offers some scope for further expenditure savings into the future. Balancing New Brunswick's books will be no easy task in the coming years; however, continued stringent control over the expenditure side of the ledger and, hopefully, better cooperation from the provincial economy will allow the current fiscal plan to succeed.

## New Brunswick fiscal plan

\$ millions	Actual	Estimate	Revised	Estimate	Estimate	Estimate	Estimate
	<u>2012-13</u>	<u>2013-14</u>	<u>2013-14</u>	<u>2014-15</u>	<u>2015-16</u>	<u>2016-17</u>	<u>2017-18</u>
Revenue	7,782	7,994	7,707	8,036	8,281	8,564	8,865
Expense	8,289	8,473	8,271	8,427	8,668	8,918	9,046
Revenue / Expense reductions to be identified:							
<u>2015-16</u>					125	125	125
<u>2016-17</u>						100	100
<u>2017-18</u>							75
Surplus/ (deficit)	-508	-479	-564	-391	-262	-129	119

Source: New Brunswick Ministry of Finance, RBC Economics Research

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