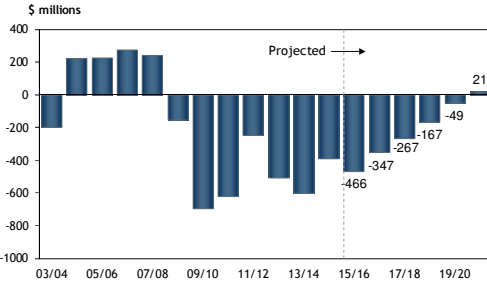


## NEW BRUNSWICK BUDGET 2016

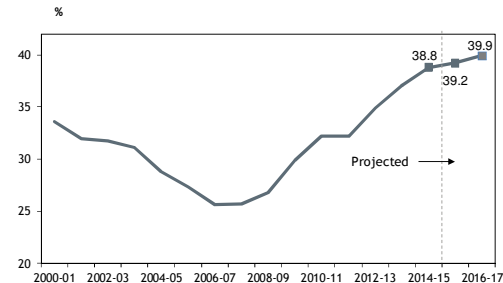
February 2, 2016

**New Brunswick budget balance**



Source: New Brunswick Ministry of Finance, RBC Economics Research

**New Brunswick net debt-to-GDP**



Source: New Brunswick Ministry of Finance, RBC Economics Research

### Budget assumptions

	2015	2016	2017
<b>Real GDP growth (%)</b>			
Budget 2015 planning assumption	1.3	0.4	0.3
RBC*	1.0	1.2	1.5
<b>Nominal GDP growth (%)</b>			
Budget 2015 planning assumption	3.3	1.9	1.6
RBC*	2.6	2.8	3.5

\*Reflects December 2015 Provincial Forecast

Source: New Brunswick Ministry of Finance, RBC Economics Research

### Hiking taxes to set the stage for ‘sustainable budgets’

The New Brunswick government set in motion a plan to address its fiscal challenges with the release of Budget 2016 today. The launch of a Strategic Program Review in 2015 was meant to identify measures that the government could take to tackle a structural deficit that it estimated was as large as \$600 million. This comprehensive review resulted in a broad sweep of recommendations that included cost curbing measures and revenue enhancing initiatives. The most prominent, a proposed 2 percentage point increase in the province’s Harmonized Sales Tax, provided the cornerstone of the government’s 2016 fiscal plan. Finance Minister Melanson opined that while the HST increase was seen as a “last resort”, the alternative would have been “deep cuts” in health care and education spending. The tax adjustment was one measure amongst many that the government expects will provide a “balanced” approach to ensure “sustainable budgets” in the future.

The wave of initiatives set to be implemented over the forecast horizon is largely contributing to the province’s plan to return to budget surplus in 2020-21. In the interim, the government expects that its fiscal challenges will ease only gradually over time with a deficit of \$347.0 million projected in 2016-17 compared to the revised \$466.4 million shortfall estimated for 2015-16. The path to surplus will be a relatively long one with three years of deficits planned following 2016-17 (-\$267 million, -\$167 million and -\$49 million in 2017-18, 2018-19 and 2019-20, respectively). The projected surplus in 2020-21 is slim (\$21 million), although the plan incorporates a cumulative \$250 million contingency reserve spread across the 5-year plan that, if untapped, could speed up the government’s return to surplus (\$100 million in 2016-17 and decreasing by \$25 million in each year thereafter).

### Better-than-expected starting point in 2015/16

Budget 2016 attempts to hit the reset button for the province by incorporating numerous initiatives aimed at positioning the province for a more sustainable fiscal future. The starting point for this plan is a sizeable estimated deficit of \$466.4 million in 2015/16. This represents a slight improvement from the initial Budget 2015 estimate of \$476.8 million; however, it reflects a \$50 million reduction in the initial contingency reserve of \$150 million (now \$100 million). Moreover, as a share of the economy, the deficit represents the third highest shortfall amongst the provinces (at -1.4%) next to only oil-exposed Newfoundland & Labrador (-5.7%) and Alberta (-1.8%).

### Implementing initiatives from *Choices to Move New Brunswick Forward*

The implementation of the Strategic Program Review is estimated to improve the province’s bottom line by \$589 million through the forecast horizon, with savings equally distributed between expenditure cuts and revenue-boosting measures. Of the latter, the well-telegraphed increase in the province’s Harmonized Sales Tax, from 13% to 15% as of July 1, 2016, will be accompanied by a 2 ppts increase in the General Corporate Income Tax rate, currently at 12%, and a phased-in increase in the levies placed on tobacco products over the next two years. The real property transfer tax, which is based on the percentage of a home price that is paid upon purchase, will also rise from 0.5% to 1% as of April 1, 2016.

To partially offset the effect of these tax adjustments on households, the govern-

**Laura Cooper**

Economist

(416) 974-8593

[laura.cooper@rbc.com](mailto:laura.cooper@rbc.com)

ment introduced a refundable provincial HST credit. For households whose income is less than \$35K, they will receive a \$300 annual payment. For those earning more than \$35K, the payment will be reduced by two cents for every \$1 of income above \$35K. The government also responded to the Federal Government's introduction of a 33% tax bracket for high-income earners by eliminating the province's top marginal personal income tax rate of 25.75% that was introduced only one year ago. The change, which comes into effect retroactively on January 1, 2016, will also accompany a reduction in the rate for incomes exceeding \$150K (to 20.3% from the current 21%).

### Declining deficits planned before return to surplus in 2020-21

The revenue side of the provincial ledger is projected to get a boost in 2016-17 as the above tax measures come into effect. Total revenues are slated to rise 5.1% to \$8.7 billion led by 6.4% jump in total tax revenues (at \$4.3 billion). A decline in personal income tax revenues is projected to be more than offset predominantly by a 17.8% surge (\$202 million) in revenues from the HST. A greater contribution from corporate income tax revenues is also planned in 2016-17 relative to the previous year with this component set to jump 21.7% to \$276.2 million reflecting the higher corporate tax rate.

Revenue growth is expected to outpace that of expenditures in 2016-17 resulting in an overall improvement in the province's bottom line in the upcoming fiscal year relative to 2015-16. The fiscal plan incorporates a 3.5% increase in total expenditures in 2016-17 to \$8.97 billion. To contain costs going forward, the government announced a 30% reduction in upper and middle-management public sector workers along with a consolidation or elimination of several government operations and programs. Through the projection period, total revenues are slated to increase by 1.9%, on average, annually, which will exceed the projected 1.4% annual increase in total expenditures.

### Capital spending an "important stimulus" to the economy

In a speech accompanying the December 2015 release of the province's 2016-17 Capital Budget, Finance Minister Melanson remarked that the plan was meant to provide "an important stimulus to an economy that is in the middle of a fragile recovery". The planned investment of \$656.1 million for 2016-17, which represents an 11.5% increase from \$588.3 million in 2015-16, is projected to contribute an estimated \$494 million to GDP, according to the government's estimates. The bulk of the capital investment is allocated to transportation and infrastructure investment (\$578 million) which is set to rise 6.0% from the year prior. Beyond 2016-17, capital spending is projected to rise 6.1% to \$696.3 million in 2017-18 and remain broadly unchanged in the fiscal year thereafter at \$696.8 million.

### Net debt to rise in 2016/17

Higher capital spending and the persistence of budgetary shortfalls is contributing to rising net debt levels in the province. By the end of 2016-17, net debt in the province is projected to reach \$13.5 billion, up from an estimated \$13.0 billion as of March 31, 2016. Measured as a share of the economy, the ratio of net debt-to-GDP is projected to rise to its highest level since at least 1980. At 39.9% projected for 2016-17, this compares to an estimated 39.2% in 2015-16.

### Economic outlook

Deterioration in the province's economic outlook is reflected in the government's forecast for 0.4% growth in 2016 following an estimated 1.3% increase in 2015. Weak labour markets and disappointing investment growth are contributing to the forecasted slowdown. The recent closure of the Picadilly potash mine further contributes to the weakness plaguing the province. The economic growth forecast is below RBC's official forecast for 1.5% growth in 2016; however, recent developments in the province indicate downside risk to our outlook. The introduction of revenue boosting initiatives and a degree of fiscal restraint will help the province to navigate its challenging fiscal situation; however, the weak economic backdrop and the potential for a negative spillover into the government's ability to generate sufficient revenues presents a risk to the province achieving its budget targets.

### New Brunswick fiscal plan

\$ millions	Actual	Forecast	Estimate	Plan	Plan	Plan	Plan
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Revenue	8,340	8,296	8,719	8,916	9,089	9,287	9,491
Expense	8,729	8,662	8,966	9,108	9,206	9,311	9,470
Contingency Reserve		100	100	75	50	25	0
Surplus/ (deficit)	-389	-466.4	-347.0	-267.0	-167.0	-49.0	21.0

Source: New Brunswick Ministry of Finance, RBC Economics Research

The material contained in this report is the property of Royal Bank of Canada and may not be reproduced in any way, in whole or in part, without express authorization of the copyright holder in writing. The statements and statistics contained herein have been prepared by RBC Economics Research based on information from sources considered to be reliable. We make no representation or warranty, express or implied, as to its accuracy or completeness. This publication is for the information of investors and business persons and does not constitute an offer to sell or a solicitation to buy securities.