

NEWFOUNDLAND & LABRADOR BUDGET 2015

April 30, 2015

Oil price slump's fallout: big deficits and tax hikes

- Record deficit projected in FY15/16
- Oil price slump costs \$1.5 billion in lost revenues in FY15/16
- Return to budget balance delayed by three years to FY19/20
- Provincial economy projected to contract until 2018
- Government raises the HST rate, adds two new income tax brackets for higher income earners

Record deficit in FY15/16

Newfoundland and Labrador was the last of Canada's oil producing provinces to table its 2015 budget today and, as widely expected, the news was grim. The provincial government projects a record deficit of \$1.1 billion in FY15/16, surpassing the previous high of \$924 million registered just last year (which was revised upward from \$916 million in the December 2014 update and \$538 million in Budget 2014).

Balanced budget delayed until FY19/20

Even grimmer was the fact that the government does not expect to balance its books before FY19/20—forecasting deficits of \$889 million in FY16/17, \$490 million in FY17/18 and \$195 million in FY18/19—fully three years later than planned in Budget 2014.

Oil price plunge devastates revenues

Clearly the plunge in oil prices poses tremendous challenges for the Province, which drew 30% of its revenues from offshore oil royalties as recently as FY13/14 (the share subsequently plummeted to 23% in FY14/15). The provincial government estimates that lower-than-anticipated oil prices drilled an \$830 million hole in its revenues last year and will carve \$1.5 billion from the revenues it expected for FY15/16 in Budget 2014. Offshore oil royalties are projected to plummet by 23% for the second straight year to a 10-year low of \$1.2 billion in FY15/16. The government then expects that rising prices (Brent recovering from US\$62/barrel in 2015 to US\$80 by 2017 and US\$90 by 2020) and, eventually, increasing oil production will set the stage for a recovery in offshore oil royalties over the medium term.

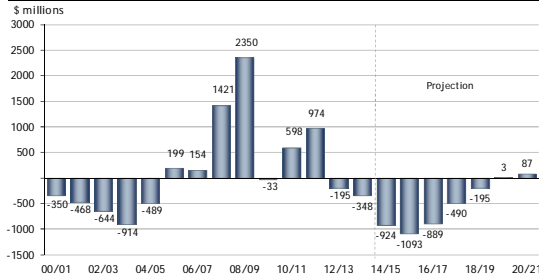
Provincial economy to contract until 2018

Moreover, the challenges will be compounded by a prolonged projected slump in the provincial economy. The government now expects that its economy will contract in each of the next four years. Including a 1.6% decline estimated in 2014, the government forecasts that provincial real GDP will drop by 6.5% cumulatively by 2018.

Five-year fiscal recovery plan

In response to this significantly deteriorated outlook for the Province, Finance Minister Ross Wiseman today announced a five-year fiscal recovery plan that outlines specific measures his government intends to pursue to eliminate the deficit by FY19/20. This plan contains measures aiming at both boosting revenues and restraining growth in expenditures.

Newfoundland & Labrador budget balance

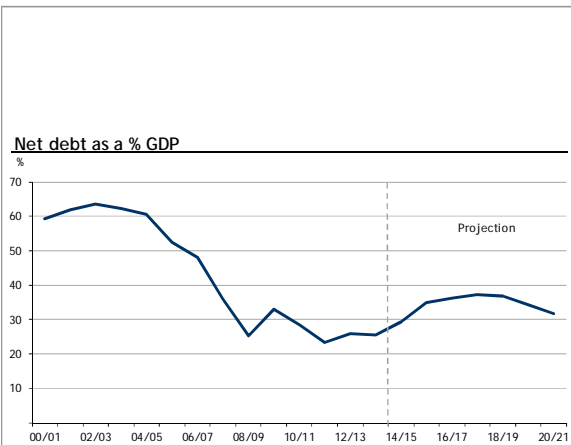


Source: Newfoundland & Labrador Ministry of Finance, RBC Economics Research

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Taxes are going up

On the revenue side of the ledger, Minister Wiseman announced a 2 percentage point increase in the provincial portion of the HST (raising the overall rate from 13% to 15%), effective January 1, 2016; the addition of two new tax brackets for high-income earners (kicking in at \$125,000 in taxable income and \$175,000, respectively) starting on July 1, 2015; and a rise in the Financial Corporations Capital Tax rate from 4% to 5%, retroactive to April 1, 2015. Altogether, these measures, as well as other increased fees are expected to bring in \$122 million in extra revenues in FY15/16 and \$254 million annually when fully implemented.

No major spending cuts...

On the expenditure side, Minister Wiseman made it clear that his government is mindful of the risk that major spending cuts would pose to the weak provincial economy; still, he stressed his government’s commitment to a “culture of cost management”, the first of eight long-term principles guiding the fiscal affairs of the province. To this end, the Province soon will hire an external consultant to find efficiency improvements in government programs. In recent days, Minister Wiseman announced that his government intends to eliminate 1,420 public service jobs through retirement and other means of attrition over the next five years in an effort the “right-size” the public service of the province.

...but cost management still high on the agenda

Cost management efforts will help to limit program expenditure growth to just 1.4% in FY15/16 and an average of 1.1% in the following four years until the budget is balanced in FY19/20. This would represent a material slowing from the average of 2.0% in the past five years.

Capital expenditures easing

Capital expenditures also are part of the government’s fiscal discipline agenda. Minister Wiseman indicated that after investing nearly \$6 billion in the past 11 years, his government intends to pull back until oil revenues rebound. He expects infrastructure spending to fall to \$660 million in FY15/16 from slightly more than \$700 million in FY14/15. That being said, the government will boost its equity investment in Nalcor (the province’s energy company) over the coming years to support the development major hydroelectric projects in the province. In FY15/16, the equity investment will be \$760 million. The budget stated that the Province’s last equity injection into Nalcor will be made in FY17/18.

Borrowing requirements to jump in FY15/16

The Province expects its borrowing requirements to jump from \$786 million in FY14/15 to \$2.0 billion in FY15/16 due to the larger budget deficit, capital plan, strategic investment in Nalcor and elimination of the public sector pension unfunded liability. The Province expects to borrow an additional \$2.85 billion in total in the following three fiscal years.



Budget assumptions

	2014	2015	2016	2017	2018	2019	2020
Real GDP growth (%)							
Budget 2015	-1.9	-0.3	-1.6	-1.6	-0.6	4.1	5.1
Private sector average*		-0.4	-0.6	-	-	-	-
RBC	-2.6	0.8	0.2	-	-	-	-
Brent oil price (US\$/barrel)							
Budget 2015	99	62	71	80	84	87	90
Private forecaster average	99	59	73	80	85	87	90
RBC	99	60	79	-	-	-	90**

* As of April 15, 2015

** Long-term outlook

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

Newfoundland & Labrador fiscal plan

(\$ millions)	2015-16f	2016-17f	2017-18f	2018-19f	2019-20f	2020-21f
Total revenues	6,976.4	7,480.2	7,835.6	8,245.3	8,500.9	8,627.2
Gross Expenses						
Program expenses	7,182.0	7,418.4	7,328.2	7,422.7	7,492.8	7,537.8
Debt servicing expenses	887.8	951.0	997.2	1,018.0	1,005.0	1,002.0
Total Gross Expenses	8,069.8	8,369.4	8,325.4	8,440.7	8,497.8	8,539.8
Surplus/(Deficit)	(1093.4)	(889.2)	(489.8)	(195.4)	3.1	87.4

Source: Newfoundland & Labrador Ministry of Finance, RBC Economics Research

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