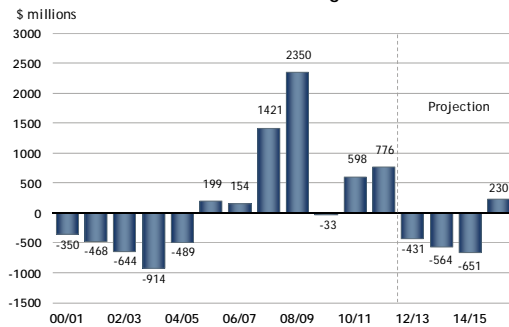


## NEWFOUNDLAND & LABRADOR BUDGET 2013

March 27, 2013

Newfoundland & Labrador Budget Balance



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

### Challenged by natural resource volatility

The Newfoundland & Labrador 2013 budget, released yesterday, presented an aggressive plan to contend with the challenges presented by volatility in the mining and oil and gas sectors. With royalties making up the largest component of the province's revenues, this volatility was apparent in the past 12 months with large swings in the 2012/13 deficit projections – rising from \$258 million in last year's budget to \$726 million in the mid-year update and moving down to yesterday's new estimate of \$431 million. The deficit is projected to grow in 2013/14 to \$563.8 million (was \$433 million in Budget 2012) rising further to \$650.5 million in 2014/15 before returning to a small surplus of \$230.4 million in 2015/16, one year later than was projected in Budget 2012. With the highest program expenses per capita of all provinces, the Budget focuses on expenditure restraint. The Government aims to rein in expenditure to "bring expenditures back in line with revenues" to ensure an "expenditure base that is sustainable in the future". As a result, the government plans to hold the line on expenditures for a sustained period of time, while annual average revenue growth is projected to improve slightly from earlier projections.

#### 2012/13 deficit revised lower from the mid-year update estimate

The mid-year update in December 2012 estimated the deficit for the current fiscal year ending March 31 at \$726 million (up from \$258 million in last year's budget), the result of lower commodity prices and lower-than-expected production in the mining oil and gas sectors. The 2012/13 deficit is now pegged at \$430.9 million for 2012/13. While there was a small reduction in expenses relative to the mid-year update, most of the deficit improvement since the mid-year update lies on the revenue side. Offshore royalties are estimated to be \$97 million higher than the mid-year update (although this is partly offset by a downward revision to mining tax revenues to the tune of \$14.5million). Tax revenues were revised higher by \$195 million on account of a \$113 million boost to sales tax revenues. Total revenues are projected to be 4.1% higher than the mid-year update at \$7.0 billion despite Net Income of Government Business Enterprises falling 7.3% to \$238.5 million. Program expenses remain relatively unchanged from the mid-year update, revised 0.1% lower to \$6.6 billion while debt servicing costs are tracking 1.2% below the December estimate at \$808 million.

#### Flat revenues projected in 2013/14

For the upcoming 2013/14 fiscal year, total revenues are projected to remain relatively flat at \$7.0 billion, edging up only 0.1%. A 5% lift to Net Income of Government Business Enterprises is expected to mask a 1.1% drop in the province's own-source revenues, dipping below \$6 billion. Softer own-source revenue growth can largely be attributed to a 9% drop in taxation revenues as corporate income taxes are estimated to plunge 46% to \$393 million. The downward pressure on revenues is muted however, in part due to an expected rebound in offshore oil production. Despite lower assumed crude oil prices (Brent US\$105 per barrel compared the average of US\$111 in 2012/13, and the US\$124 assumed in Budget 2012), a rebound in offshore oil production is expected to boost offshore royalties by 9.3% to \$2.1 billion. As the largest single component of revenues, offshore oil royalties will represent 35% of the province's own-source revenues, up from an estimated 32% in 2012/13, though below the 5-year average of 37%. Federal transfers are expected to rise 8% to \$786 million in part due to a \$50.5 million (11.5%) increase in Health Transfers. Total revenues are projected to

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decline 0.9% in 2014/15 to \$6.9 billion before surging 12.6% to \$7.8 billion in 2015/16.

### Fiscal plan shows significant expenditure restraint

Total expenditures are slated to rise 1.9% in 2013/14 to \$7.6 billion. Debt servicing costs are estimated to rise 4.9% to \$0.85 billion with program expenses growing at a more subdued 1.5% pace to \$6.7 billion. The anticipated increase in program expenses is entirely within the General Government Sector and Legislative Branch, with net expenses rising nearly 14% (to \$1.9 billion) on account of an 18.8% surge in Finance spending. The majority of the remaining sectors are projected to decline, including the resource sector (falling 4.3% to \$1.3 billion), and Health and Community services and Education (both down 1.7% to \$2.8 billion and \$0.8 billion, respectively). The budget projects a 29% increase to Municipal affairs (to \$0.2 billion), however. Beyond 2013/14, the fiscal plan shows significant expenditure restraint. Program expenditures are projected to *decline* 0.2% and 0.9% in 2014/15 and 2015/16, respectively, in sharp contrast to the 7.8% annual average growth during the past 10 years.

### Program review generates substantial savings

A pullback in program expenditures in 2013/14 is the result of a core mandate review initiated by the government in Budget 2012 that yielded a reduction in base expenses of \$410 million. This was partially offset by a “\$109 million increase in one-time and annual operational spending”. The restraint in expenditures over the fiscal plan is supported by a reduction in the public sector workforce after an “extensive review and analysis completed over the past year by departments and agencies identified further opportunities for efficiencies and expense reduction”. With approximately 30% of the province’s employment in the public sector, the Government plans to reduce the core public service by 5.4%, or 485 positions. Further layoffs are expected outside of core government departments while some vacant positions will no longer be filled.

### Surge in capital expenditures

Capital expenditures are expected to be \$1.2 billion in 2013/14, a 63% increase from the estimated \$740 million in 2012/13. Capital spending allocated to Natural Resources is projected to double to \$541 million accounting for 45% of capital account expenditures. (Investment initiatives related to Nalcor Energy are projected to provide a \$531 million boost). Transportation and Work, Education and Health and Community Services are also expected to rise, collectively making up 37% of capital expenditures.

### Net debt rising but still below 10-year average

The 10-year Sustainability Plan introduced in the Budget aims to bring the province to “long-term fiscal sustainability”, defined as a reduction in net debt per capita to the all-provincial average within 10 years. With currently the third highest per capita debt levels in the country at \$16,700, total net debt is estimated to be \$8.6 billion in 2012/13 jumping to \$9.5 billion in 2013/14. Nonetheless, net debt is expected to remain below the average of \$9.9 billion witnessed over the past 10 years.

### Conservative assumptions, especially in the outer years of the fiscal plan

Near-term economic assumptions appear reasonable in light of activity rebounding in the energy sector this year. The government expects that this rebound will fuel real GDP growth to 6.8% in 2013, moderately higher than RBC’s forecast for 5.1% growth. In the outer years of the fiscal plan, however, economic activity is projected to slow with oil activity no longer recovering from temporarily depressed levels. The government expects that a pullback in capital investment beyond 2014 along with maturation related declines at the province’s oil fields will weigh on the outlook with real GDP declining 1.6% in 2014 and a further 0.1% in 2015. This reversal in economic growth is highly conservative relative to our own forecast of a real GDP *increase* of 1.3% in 2014, however, the timelines of major projects along with volatility in the energy sector can significantly impact economic growth over the forecast period.

## Newfoundland & Labrador fiscal plan

(\$ millions)	Actual	Estimates	Revised	Estimates	Projection	
	2011/12	2012/13	2012/13	2013/14	2014/15	2015/16
<b>Total revenues</b>	8,582	7,211	7,001	7,007	6,941	7,813
Fiscal revenue	8,316	6,964	6,763	6,757		
Net income of government business enterprises	266	246	238	250		
<b>Total expenditures</b>	7,806	7,469	7,432	7,571	7,591	7,583
Program expenses	7,016	6,637	6,624	6,723	6,711	6,651
Debt servicing expenses	790	832	808	848	880	932
<b>Surplus/(Deficit)</b>	<b>776</b>	<b>-258</b>	<b>-431</b>	<b>-564</b>	<b>-651</b>	<b>230</b>

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

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