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# Fiscal Pulse

## Newfoundland and Labrador's 2009-10 Budget — Working Through the Global Retrenchment

A robust \$1.3 billion surplus is estimated for fiscal 2008-09 (FY09). With revenue recognition from the 2005 *Atlantic Accord*, the FY09 surplus soars to \$2.4 billion. Dampened by the substantial economic and financial market turmoil around the world, the Province projects a \$750 million deficit for FY10. For FY11, a more modest \$141 million shortfall is forecast, with the government planning to return to balanced books no later than FY12.

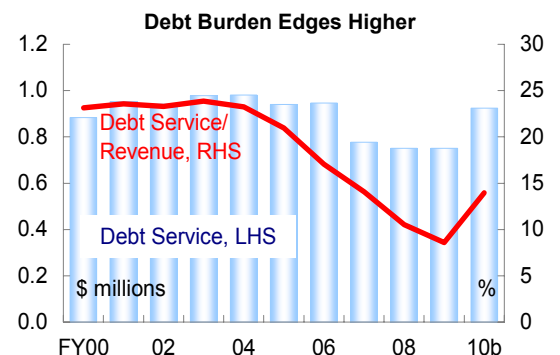
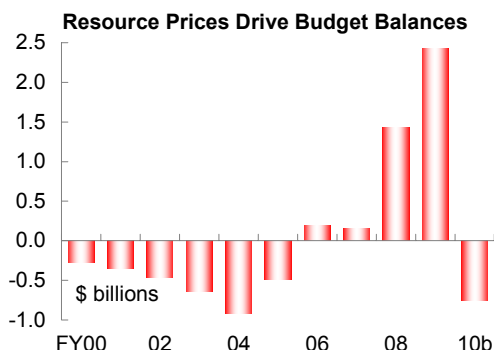
As in FY09, Newfoundland and Labrador plans no borrowing in FY10.

**A robust 15% gain in FY09 own-source receipts**, following a 42% surge in FY08, has catapulted Newfoundland and Labrador to "have" status within Canada's federation. The Province's cumulative surplus over the four years to FY09 tops \$4.2 billion. For FY10, Newfoundland and Labrador highlights two key developments that drive the deficit. The first is a \$414 million shortfall in NL's anticipated *1985 Atlantic Accord* payment for FY10. This reflects a one-year change by the federal government in the Equalization calculations for FY10. If this change is not reversed over the following two years, the Province estimates that its remaining *1985 Accord* payments from FY10 to FY12 would fall from \$2.7 billion to \$1.2 billion. The second development is a \$383 million charge for FY10 related to the impact of equity market declines on the market value of NL's pension funds.

**Newfoundland and Labrador from March 2005 to March 2008 scaled back its unfunded pension liability** from \$3.93 billion to \$1.46 billion. Adverse financial markets have contributed to an estimated \$241 million increase in pension liabilities in FY09 and a \$594 million surge in FY10. With retirement benefits steadily rising by just over \$110 million each year, the combined unfunded obligation rises from just under \$3.0 billion entering FY09 to \$4.0 billion at the end of FY10. Newfoundland and Labrador estimates that its total net debt, after dropping from the recent peak of \$11.9 billion in March 2005 to \$7.9 billion in March 2009, will edge close to \$9.0 billion by March 2010.

**The Province's longer-term outlook remains anchored by further expansion of its resource sector.** Construction is expected to begin this year on a \$2.2 billion commercial-scale hydromet nickel processing plant. In the offshore energy sector, the gradual depletion of oil reserves will be addressed with the White Rose expansion project and Hibernia South. A fourth field, Hebron, is in the pre-Front End Engineering and Design phase, and environmental assessments are under way for the 2,800 MW Lower Churchill Falls hydro-electricity project and the Labrador-Island Transmission Link.

**The Province estimates 1.8% real GDP growth for 2008**, with strong resource prices until later in the year lifting nominal GDP 13.8%. For 2009, the anticipated fall in the volume and value of exports is





expected to lead to a 7.7% decline in real GDP and a 29% drop in nominal GDP. As global resource demand gradually recovers, output growth in 2010 is expected to strengthen to 1.7%. To better reflect economic growth that generates income for residents, Newfoundland and Labrador has developed an adjusted GDP that excludes production-related income of the non-resident owners of the mega-projects, such as the offshore energy developments and the Voisey's Bay nickel mine. On this adjusted basis, the Province expects real growth to slide from 3.2% in 2008 to -1.3% in 2009, rebounding to 3.5% in 2010 and 2.6% in 2011.

#### The 24.5% correction in total revenues forecast for FY10

reflects a decrease of almost 21% in the Province's own-source receipts and a 33% reduction in federal transfers. Offshore royalties plus mining taxes and royalties (which topped 40% of Newfoundland and Labrador's own-source receipts in FY09), are forecast to fall in FY10 by \$914 million and \$226 million, respectively, accounting for almost all of the expected own-source revenue decline. The Province assumes an average oil price of US\$50/barrel for FY10, down from US\$86.44 in FY09 and a 21% decline in oil production in 2009. The projected softening in personal income tax receipts in FY10 is expected to be recovered in stronger corporate income tax returns. Federal transfers in FY10 are forecast to fall to just over 26% of Newfoundland and Labrador's total revenues, from almost 34% four years ago.

**Following sizeable tax cuts in the prior two Budgets** with broad personal income tax relief, this *Budget* offers targeted tax savings. Measures include making the Dividend Tax Credit rate for eligible dividends more competitive with other Provinces with an increase from 6.65% to 9.75% and lifting the threshold for the small business corporate income tax from \$400,000 to \$500,000 as of 2009.

**Program spending in FY09**, while \$154 million less than *Budget*, is still 12.4% ahead of FY08. For FY10, with the objective of stimulating and strengthening the economy, a 15.6% program spending increase is planned. Supporting personal income and expenditures across the Province are retroactive pay increases for a large segment of the public sector with four-year collective agreements that compensate for previous wage restraint. After an increase in population in 2008 for the first time since 1992, the Province's forecast of further modest gains over the next two years despite negative natural change should also support domestic demand.

**Health and community service** expenditures are expected to rise 9.6% in FY10 as the government responds to the Cameron inquiry and the Task Force on Adverse Health Events. Actions include investing \$21 million this year in laboratory services, cancer care and health information management, hiring recruitment staff to focus first on physicians and then on other health care professionals, and adding spaces at Memorial University for health care professionals. **For post-secondary education**, the tuition freeze will be maintained and, with the goal of offering the nation's best student aid package, new measures include eliminating interest on Newfoundland and Labrador Student loans.

**Central to the government's stimulus is ramping up infrastructure spending more than 50% in FY10 to \$800 million**, within the Province's existing multi-year capital strategy to build for future growth. Projects will be spread across regions and sectors, with almost 30% for roads, 20% for health care facilities and equipment, 19% for education and 13% for municipal infrastructure. Nalcor, the provincial energy corporation, will add to activity with projects totaling \$48 million. Renewal of the provincial ferry fleet will be launched this year with \$44 million towards the construction of two new ferries at Marystown as planning is advanced on an additional two ferries.

**The risks inherent in being a price taker in global markets for its key industries** are fully recognized by Newfoundland and Labrador. The Province's economic assumptions for 2009 appear reasonable. For 2010, in the current uncertain global economic and financial environment, the possibility exists for only a gradual economic recovery, with the global price rebound for resources such as base metals subdued next year. Nevertheless, bolstered by the fiscal repair already undertaken, the Province is proceeding with a broad range of infrastructure investments and economic development plans to underpin future growth — a strategy the government believes will allow Newfoundland and Labrador to take full advantage of the range of resource projects under way or planned.

#### Newfoundland and Labrador's Budget Arithmetic

\$ millions except where noted

	FY09		FY10
	Budget	Rev.	Budget
Tax Revenue	2,206	2,528	2,465
Offshore Royalties	1,719	2,226	1,313
Mining Tax & Royalties	259	353	128
Other Own-Source Rev.*	978	1,053	976
Federal Transfers	1,827	2,591	1,731
<b>Total Revenue*</b>	<b>6,989</b>	<b>8,752</b>	<b>6,612</b>
Program Spending	5,721	5,567	6,438
Debt Service	724	751	924
<b>Total Expenditures</b>	<b>6,445</b>	<b>6,319</b>	<b>7,361</b>
<b>Surplus</b>	<b>544</b>	<b>2,434</b>	<b>-750</b>
<b>Memo Items, %</b>			
Own-Source Rev.*/ GDP	16.0	19.1	16.0
Program Spending / GDP	17.7	17.3	21.1
Debt Service / Revenue*	10.4	8.6	14.0
<b>Annual Change, %</b>			
Tax Revenue	-15.8	-3.5	-2.5
Own-Source Revenue*	-3.6	15.1	-20.8
Federal Transfers	2.2	44.9	-33.2
Total Revenue*	-2.1	22.6	-24.5
Program Spending	15.5	12.4	15.6
Total Expenditures	13.0	10.8	16.5

\* Includes government business enterprise net income.

Source for GDP Estimates: Scotia Economics.



## Major Budget Highlights

### Revenues (in addition to measures outlined on page 2)

**For the Low-Income Tax Reduction**, higher income thresholds will be introduced for 2009.

**The Labour-Sponsored Venture Capital Tax Credit** will be increased from 15% to 20% and the eligible annual investment will rise from \$5,000 to \$10,000 for 2009 onwards.

**Commercial electrical permit fees** will be reduced effective April 1, 2009.

### Expenditures

**In health care and community services**, the Province will raise the subsidy amounts for individuals in personal care homes and increase salaries for workers in home support and other personal care. The foster care program will be enhanced and a new Department for child, youth and family services will be created.

**The ten-year Poverty Reduction Strategy** was begun in 2006 to address NL's position as the province with the highest poverty rate. With annual investments topping \$100 million, measures this year include expanding the Employment Transitions program, reducing rental rates for affordable housing, establishing a Provincial Homelessness Fund and raising regulated child care subsidies. The minimum wage will be raised from \$8.50/hour to \$10.00 by July 2010.

**For adult corrections**, recommendations of the report, "Decades of Darkness, Moving Towards the Light", released in December, has prompted a further \$6 million investment for FY10 to reform and revitalize the system.

**Nalcor** will receive \$228 million in FY10. The provincial energy corporation has five lines of business: Newfoundland and Labrador Hydro, Churchill Falls, the Lower Churchill Project, Oil and Gas and Bull Arm Fabrication. Also responsible for renewable energy, Nalcor will start up a wind-hydrogen-diesel demonstration plant at Ramea to demonstrate alternative energy for an isolated community.

**Labrador, with the five-year Northern Strategic Plan entering its third year**, will receive \$130 million of provincial infrastructure spending in FY10. Phase III of the Trans-Labrador Highway will be completed, establishing a continuous road-and-marine route from Labrador City to St. John's.

**The Newfoundland and Labrador Research and Development Council** will receive \$25 million to support academic and industrial R&D. Ocean technology remains a major focus, with additional funding for Memorial University's Marine Institute.

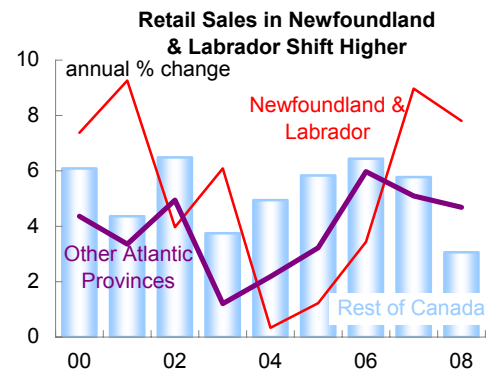
**In the oil & gas sector**, accounting for roughly 36% of NL's GDP and 40% of Canada's conventional light crude oil production, offshore land sales in 2008 approached \$320 million.

**Provincial mineral shipments** rose 22% in 2008, as iron ore output rebounded from the 2007 strike-constrained levels and prices remained healthy until late in the year. Soft global demand has prompted lay-offs and temporary closures for the major nickel and iron ore operations in 2009. For the new nickel-processing plant, an agreement-in-principle in January for an amended Development Agreement provides for increased local benefits, a start on construction this spring, but a 14-month delay in completion to February 2013. Government support includes a rise from \$2.5 million to \$3.0 million for NL's Mineral Incentive Program to help junior exploration firms in obtaining capital.

**Under the ongoing Fishing Industry Renewal Strategy**, \$3.5 million in FY10 will cover the cod recovery initiative, further fisheries technology development and workforce adjustment initiatives. Aquaculture, with record volumes and values in 2008 boosted by harvesting and processing salmon on the South Coast, will receive funding topping \$6½ billion for FY10.

**In the forest sector**, the closure of the Grand Falls-Windsor mill in February leaves only Corner Brook with an operating newsprint mill. A Ministerial Task Force is assessing Central Newfoundland's opportunities, and administration of the Province's Home Heating Rebate program and its Parental Benefits Program will be relocated to Grand Falls-Windsor.

**A collaborative long-term tourism strategy**, "Uncommon Potential", aims to double tourism revenue by 2020. A Tourism Board will be created as a public-private partnership to implement the action plan. Measures include building a stronger relationship with transportation couriers, including airlines and the ferries.



## Scotia Economics

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