

2008-09 Fall Update

CURRENT ENVIRONMENT

The world economy is much different than it was at the beginning of the fiscal year. Economic growth in 2008 was expected to be modest in developed countries, and would slow, but still be relatively strong, in emerging economies such as China and India. World economic growth had been expected to rebound in early 2009.

There were few tangible signs in April of the looming credit crisis in financial markets, which would eventually work its way into the real economy where businesses, employees, pension plans and savings would be impacted. There was no indication that massive interventions would be required by countries across the world to provide liquidity to frozen capital markets, to assist key sectors and provide economic stimulus.

Canada operates in a global economy with many trading partners, including the United States. The global economic slowdown is being felt in Canada. A large portion of the Newfoundland and Labrador economy is resourced-based and the global economic downturn has reduced demand for oil and minerals and depressed prices. The impacts on the Newfoundland and Labrador economy have now taken hold, as we are experiencing job losses at Wabush Mines and the Grand Falls-Windsor newsprint mill. As well, the Iron Ore Company of Canada has announced a review of its expansion plans and the North Atlantic refinery has delayed its expansion plans.

We are experiencing the realities of operating in a global market place in a time of economic downturn. Reversing this trend cannot be achieved by one country. The G20 countries are taking coordinated action to make credit available, improve investor and consumer confidence and provide economic stimulus in the period of downturn. The consensus among economists is that the economy will worsen in the next six to twelve months, but begin to improve in late 2009 or early 2010.

Much of the coordinated interventions by members of the G20 have been in the area of monetary policy where measures have been implemented to restore liquidity and confidence to capital markets. In Canada, monetary policy is the role of the federal government. The federal government, and provincial governments, can provide leadership with economic stimulus. This economic stimulus can include maintaining and accelerating infrastructure spending, creating employment, lowering taxes to free up more money to spend in the province, reducing debt and continuing with prudent fiscal management.

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Government is in the third year of an aggressive infrastructure strategy that is currently valued in excess of \$4 billion, including in excess of \$500 million this year, with a minimum of \$500 million planned to be spent in each of the next two years. The strategy includes the new construction and maintenance of roads and bridges, the building of new ferries, schools and health care facilities, and work on water and sewer projects in communities throughout the province. These projects are currently underway or are in development stages. They provide, on average, about 6,500 person years of employment a year including spin-offs.

In addition, planned private sector construction expenditure over the next few years, such as the Vale Inco Hydromet facility, White Rose expansion, Hibernia South and the Hebron project will contribute to gains in major project employment with project construction employment reaching 4,250 person years in 2009 and 7,300 person years in 2010.

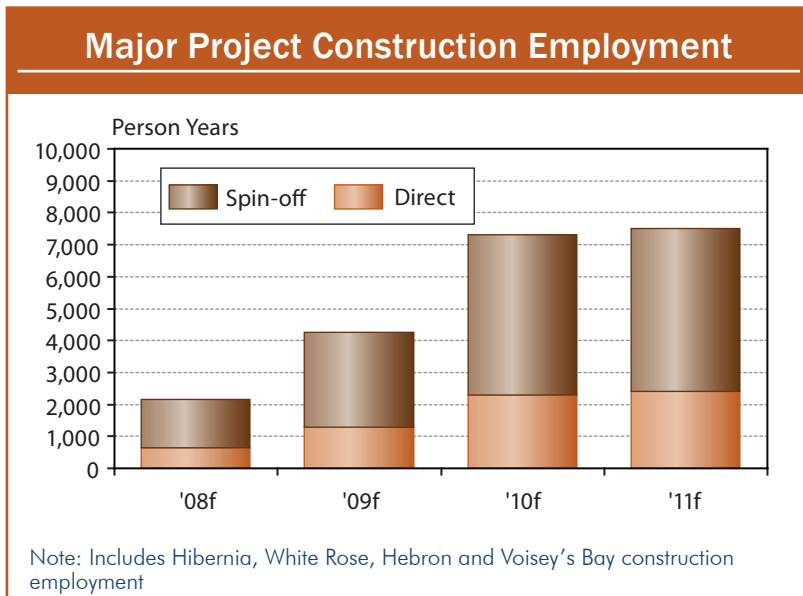
Tax reductions provide economic stimulus by providing people with more disposable income to spend, and by leaving businesses with more of their profits to re-invest and hire new employees. In the last two years, \$342 million annually has been passed back to taxpayers through the reduction of personal income taxes, enhancement of the seniors' benefit, payroll tax relief, the elimination of the 15 per cent tax on insurance, and the reduction of motor vehicle registration fees and ferry rates.

Debt reduction reduces interest costs. As compared to 2003-04, the province saves about \$200 million annually on debt servicing. This money is put back to work by re-investing in programs such as health care and education which not only improve the quality of life, but stimulate the economy.

The 2008-09 Fall Update provides a revised economic forecast for the 2008 calendar year, and a revised budgetary forecast for the 2008-09 fiscal year. Projections for the coming year will be released in Budget 2009.

ECONOMIC PERFORMANCE

Newfoundland and Labrador's economic performance this year is not expected to be impacted significantly by the global financial crisis and subsequent world economic slowdown. To date, weakening demand for many



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commodities and declining prices have impacted some operations in the mining sector. However, provincial domestic demand is solid with strong gains in consumer spending, housing starts, and capital investment.

Real Gross Domestic Product (GDP) growth for 2008 is currently forecast at 2.2%. Economic growth will stem mainly from gains in mineral production and strong domestic demand. The GDP forecast has been revised upward from -2.0% at Budget, primarily because of higher levels of oil production than expected at Budget time, but also supported by stronger than expected retail sales and housing starts.

The province's labour market continued to perform well in 2008. Employment growth has been revised upward slightly from the Budget forecast, and growth of 1.6% is expected for the year. Employment growth is expected to exceed labour force growth, resulting in a decline in the unemployment rate to 13.1%. This is the lowest unemployment rate for the province since the early 1970s.

Personal income and disposable income are expected to post gains of 5.2% and 5.8% respectively due to increased employment, wage gains and tax reductions.

At Budget time, it was estimated that housing starts would remain at levels similar to 2007. However, buoyed by consumer optimism and employment and income gains, housing starts are now expected to increase by 17.4% for the year to 3,111 units.

Similarly, resulting from strong gains in disposable income and solid consumer confidence, retail sales for 2008 are expected to increase by 8.1%, up from the Budget forecast of 6.5%.

Newfoundland and Labrador's population increased by 1,436 from July 1, 2007 to July 1, 2008, representing the province's first annual population increase in 16 years.

Economic Indicators

2007 and Outlook 2008
(percentage change except where indicated)

	2007	2008	
		Budget	Mid-Year Revised
Real Gross Domestic Product	9.1	(2.0)	2.2
Other Economic Indicators			
Retail Sales	9.0	6.5	8.1
Personal Income	5.9	4.9	5.2
Disposable Income	6.2	5.5	5.8
Capital Investment	(7.3)	15.0	15.0
Consumer Price Index	1.5	2.0	2.8
Housing Starts (units)	2,649	2,657	3,111
Labour Market			
Employment (000s)	217.1	220.4	220.5
Employment	0.6	1.5	1.6
Unemployment Rate (percent)	13.6	12.4	13.1
Population	(0.8)	0.0	0.3

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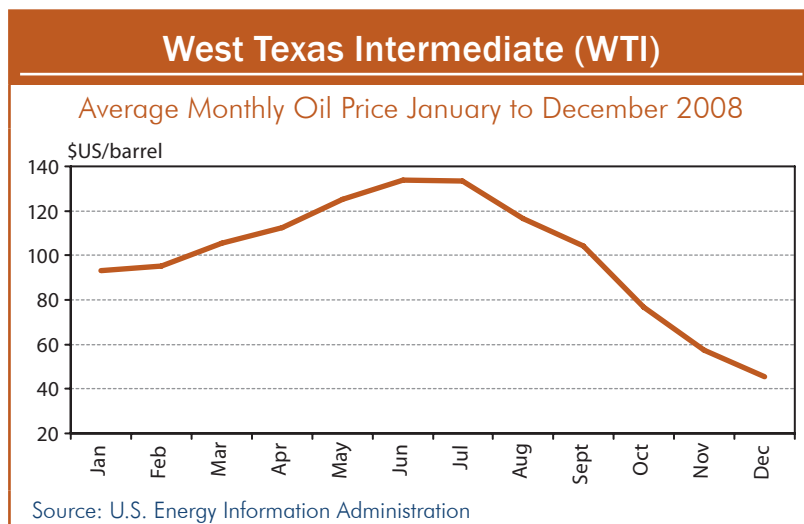
FISCAL UPDATE

At the time of Budget 2008, a surplus of \$543.9 million was anticipated. A surplus of \$1,266.1 million is now expected, representing an increase of \$722.2 million. The increase is attributable to higher own-source revenues, offset somewhat by lower net income from Government Business Enterprises.

Consolidated Statement of Operations 2008-09			
(\$ Millions)	Budget	Mid-Year	Change
Revenue	<u>\$6,355.8</u>	<u>\$7,084.5</u>	<u>\$728.7</u>
Net Expenses			
Program	5,299.9	5,297.6	2.3
Debt Servicing	724.5	727.1	(2.6)
	<u>6,024.4</u>	<u>6,024.7</u>	<u>(0.3)</u>
Net Income from Government Business Enterprise	<u>212.5</u>	<u>206.3</u>	<u>(6.2)</u>
Surplus	<u>\$543.9</u>	<u>\$1,266.1</u>	<u>\$722.2</u>

Revenues

At Budget, the Provincial Government based its oil royalty forecast upon an average price of \$US87 per barrel. Since Budget, the price of light sweet crude rose to a high of \$US145 per barrel before receding to a low near \$US40 per barrel. Thus far in the fiscal year, the average price for Newfoundland and Labrador crude has been \$US104 per barrel. Higher oil prices in the first eight months of the fiscal year, as well as higher than anticipated production, has resulted in an upward revision to offshore royalties from \$1,719 million to \$2,202 million, an increase of \$483 million. This revised estimate assumes a price of \$US40.00 per barrel for the remainder of the fiscal year.



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Personal income tax (PIT) revenues are expected to be \$157 million higher than the Budget forecast. PIT revenues are forecast using historical data and growth estimates from the federal government. The upward revision is largely attributable to prior year adjustments and new data for the current year, received since the Budget.

Sales tax is expected to be about \$33 million higher than the original forecast, resulting from higher than anticipated retail sales.

At the Finance Minister’s Meeting on November 3, 2008, Newfoundland and Labrador was advised by the federal Minister that the province will be off Equalization in the current fiscal year. No formal communication or data has been received from the federal government to confirm this assessment. At Budget, the Provincial Government had forecast receiving \$18 million in Equalization and \$539 million in Atlantic Accord 1985, with a \$360 million drawdown on the Atlantic Accord 2005 advance payment, a total of \$917 million. The province must make a decision which Equalization program to elect by March 1, 2009.

The revenue estimate for the Canadian Health Transfer and the Canadian Social Transfer has been adjusted upwards by \$5.6 million, reflecting changes in population.

EXPENDITURES

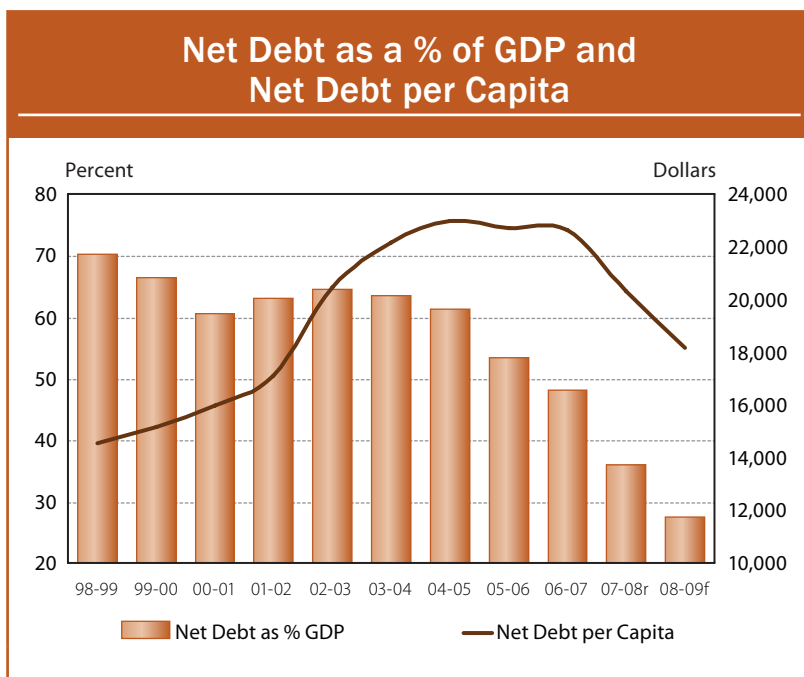
At Budget time, the province forecast net consolidated program expenses of \$5,300 million. It is now expected that these expenses will be very much on target at \$5,298 million.

Debt servicing expenses are expected to be \$2.6 million higher than originally budgeted due to revised estimates of interest costs on unfunded pension liabilities and changes in the \$US exchange rate.

NET DEBT

At the time of Budget 2008, net debt at the end of the fiscal year was expected to be about \$10 billion. It is now expected that net debt will be \$9.2 billion by March 31, 2009, an improvement of \$800 million from the Budget forecast.

By March 31, 2009, it is expected that the province’s net debt to GDP ratio will be reduced to 27.5%, down from the high of 70.2% in 1998-99. Net debt per capita, which reached a high of



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\$22,974 in 2004-05, is expected to decline to \$18,158 in 2008-09. While these are remarkable achievements in a short period of time, in context, the national average net debt per capita is about \$10,000.

OUTLOOK

Newfoundland and Labrador is not isolated from the world economic downturn, and we have begun to see impacts. While real GDP is expected to decline next year due to lower oil production, growth in other economic indicators is expected.

While some major projects may be delayed until the global economy rebounds, other projects are expected to proceed as scheduled. Construction is expected to begin on the \$2.17 billion Vale Inco smelter in Long Harbour this Spring. Work is also expected to commence on the White Rose expansion project, Hibernia South and Hebron. Employment related to construction on major projects is expected to increase by 2,100 to 4,250 person years in 2009, including spin-offs, and is expected to grow by a further 3,050 to 7,300 person years in 2010.

The Provincial Government's infrastructure strategy, in excess of \$4 billion, is expected to produce 6,500 person years of employment in 2009-10 and 2010-11. Investment in information technology, innovation, research and development, aquaculture and business attraction, along with lowering personal income taxes and strengthening our health and education systems will also stimulate the economy. Overall, growth in employment and income is expected to continue as we look ahead.

While Newfoundland and Labrador's fiscal performance over the past several years has been strong, the province is highly dependant upon resource revenues which are expected to constitute over 40% of total revenues in this fiscal year. Fluctuations in oil and mineral prices over the last year underline the need for fiscal discipline to ensure long term sustainability of programs and services. The Provincial Government intends to stay the course as it navigates through this difficult period.