## The Current Global Economic Environment

2010 has been a turbulent year for the global economy, requiring the ongoing scrutiny and, at times, the undivided attention of global leaders, policy makers and financial regulators. After posting one of the worst economic recessions in decades, the global economy is expected to grow in 2010. The International Monetary Fund (IMF) estimates that global GDP will grow by 4.8 per cent this year—a solid performance given the recent uncertainty.

However, growth has been uneven as Asian countries such as India and China and a host of other emerging market nations contributed disproportionately to global growth. A large stimulus program in China saw considerable funds injected into infrastructure. Continued economic expansion in Asia has resulted in a growing demand for commodities like oil, copper, and iron ore.

While some countries, particularly emerging markets, did well, others posted below average performances due, in part, to less than favourable government deficit and debt levels. Sovereign debt concerns emerged in Europe in the spring. In May, a US$145 billion bailout program orchestrated jointly by the IMF, European Commission (EC) and the European Central Bank (ECB) was needed to stabilize Greece's economy due to concerns over its ability to service its debt. A subsequent US$1 trillion emergency fund was made available to other troubled EU countries as Greece's problems spilled over, affecting countries like Spain, Portugal, Italy, and Ireland, as borrowing costs rose. This has led to increasing economic uncertainty across the globe. These countries posted negative or below average growth this year.

Growth in the U.S.—the world's largest economy—lost momentum after the first few months of this year and the unemployment rate has remained at stubbornly high levels. The recovery in the labour market has been lackluster and the economy has only regained about one-fifth of the jobs lost during the recession. The U.S. housing market continues to demonstrate weakness with housing starts at historically low levels. This weak pace of recovery prompted the U.S. Federal Reserve to announce on November 3, 2010 its intention to buy US$600 billion of long-term U.S. Government debt over seven months (also known as Quantitative Easing 2 (QE2)). This action is intended to lower longer-term borrowing costs and the value of the U.S. dollar. This, in turn, is expected to help U.S. exporters and stimulate investment, and, as a result, foster employment and economic growth in the U.S., which is the largest market for Newfoundland and Labrador exports.

The latest IMF forecast calls for global GDP growth of 4.2 per cent for 2011, with emerging economies such as China and India continuing to be the engines of growth. Growth in advanced economies will be challenged by difficult labour market conditions and fiscal realities. While unemployment rates are set to fall, rates are expected to remain high by historical standards. In this environment, interest rates will likely remain low for some time; and growth in these advanced economies is expected to remain subdued in the near-term. Nevertheless, with strong growth in emerging economies, commodity markets are expected to remain strong and this will benefit commodity producing regions of Canada.

## Economic Performance

Economic growth resumed in Canada in the third quarter of 2009 and has since recorded four consecutive quarters of positive real GDP growth. For 2010, real GDP growth in Canada is expected to be about 3 per cent. Furthermore, by August of this year, employment had fully recovered the 400,000 jobs lost during the recession. All provinces are expected to record an annual increase in GDP this year and most provinces have posted employment increases in the first 10 months of the year.

Increased demand and, consequently, prices for many commodities have benefited resource sectors in several provinces. In addition, a rebound in housing and continued public sector infrastructure programs have aided economic growth across the country.

Economic Indicators Forecast
2010, Budget vs Fall

| | Budget | Fall | Change |
|---|---|---|---|
| **Real GDP (%)** | 4.0 | 5.4 | +1.4 pp |
| **Personal Income (%)** | 3.9 | 4.2 | +0.3 pp |
| **Retail Sales (%)** | 5.0 | 4.4 | -0.6 pp |
| **Housing Starts (units)** | 3,102 | 3,510 | +408 units |
| **Capital Investment (%)** | 23.0 | 23.0 | 0.0 pp |
| **Employment (%)** | 2.3 | 3.5 | +1.2 pp |
| **Unemployment Rate (%)** | 14.9 | 14.5 | -0.4 pp |
| **Population (%)** | 0.5 | 0.3 | -0.2 pp |

pp = percentage points

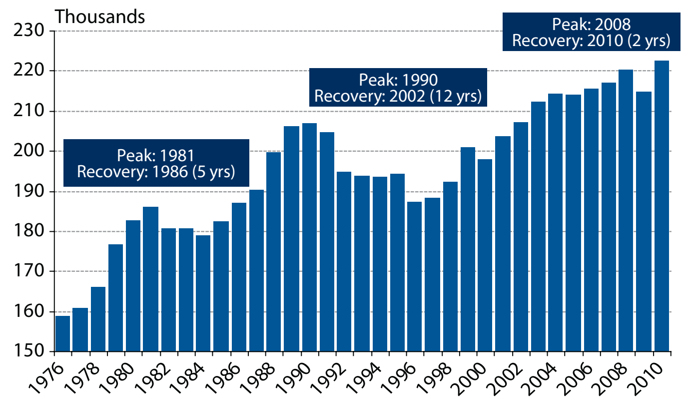
Newfoundland and Labrador is expected to post solid growth this year. Real GDP is projected to increase by 5.4 per cent, primarily due to higher investment spending related to major project development and increased mineral and oil production. This pace of growth is projected to be the highest in the country.

Labour markets have rebounded from the recession-related downturn in 2009. Employment has risen, labour market participation is up and the unemployment rate has resumed its downward trend. Employment increased in each month of 2010 through to October compared to the same month in 2009 and is up 3.5 per cent on average in the first 10 months of the year. In fact, employment growth has been strong enough to recoup losses recorded last year, marking the shortest employment recovery from a recession since at least the 1970s.

Labour income in the province increased by 3.6 per cent in the first half of the year aided by gains in employment and average weekly earnings. Consumer confidence continues to be strong and remains the highest in Atlantic Canada. Income gains combined with continued confidence in the economy have supported consumer spending. From January to September, retail sales increased by 4.0 per cent and the number of new cars sold in the first nine months of 2010 increased by 9.4 per cent compared to the same period of 2009.

The housing sector has continued to be robust this year. Housing starts in the first nine months of the year were up 30.6 per cent compared to the same period in 2009. The residential resale market also posted a solid performance with the number of residential properties sold in the province through the MLS® service remaining at high levels—sales increased by 0.4 per cent in the first 10 months of 2010 relative to the same period in 2009. House prices have continued on an upward trend—from January to October the average price of homes sold was 15.4 per cent higher than the same time last year.

Employment, NL




Source: Labour Force Survey, Statistics Canada; Department of Finance, November 2010 forecast

Capital investment spending remains an area of strength; in the latest forecast it is expected to increase by 23 per cent. Growth in capital spending in the province this year is expected to be the strongest amongst provinces. This positive outlook for provincial investment reflects increased major project expenditures and the continuation of government's infrastructure strategy.

The current strength in the economy and continued optimism about the development of projects such as the Lower Churchill Project, the Long Harbour hydromet facility and the Hebron oil project are contributing to net in-migration and an increase in the province's population. 2010 marked the second consecutive year of population growth after 16 years of decline. As of July 1, 2010, Newfoundland and Labrador's population stood at 509,739, an increase of 0.3 per cent compared to July 1, 2009.

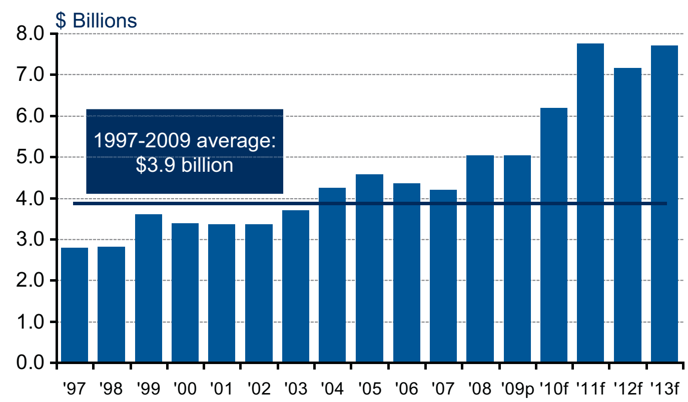
## Outlook

Real GDP in Newfoundland and Labrador is expected to continue to record solid growth next year. Anticipated increases in mineral production and higher levels of construction activity on major projects are important factors behind this positive outlook. Newfoundland and Labrador is expected to be among the leaders in growth again next year and will continue to perform above the national rate.

Construction on the nickel processing facility in Long Harbour will intensify next year. Increased activity on this project and expenditures associated with the IOC expansion, Hibernia South, the Hebron project, development of the White Rose satellite fields and Lower Churchill are expected to result in another record year for capital investment in 2011.

Overall, the medium-term economic outlook for Newfoundland and Labrador remains positive. While GDP growth will vary depending on major project timelines and oil production, other economic indicators such as employment and income are expected to continue to post solid growth supported by project development. In addition, the unemployment rate is expected to continue to trend downward and positive consumer sentiment is expected to translate into continued strength in retail sales.

Capital Investment, NL




Source: Statistics Canada; Department of Finance, November 2010 forecast

## Fiscal Update

From 2005-06 to 2008-09 the province recorded cumulative surpluses totaling $4.1 billion. Net debt, which peaked at $11.9 billion, was reduced to less than $8.0 billion by March 31, 2009. This cumulative improvement in financial performance has given the province the flexibility to continue with its program of economic diversification and infrastructure renewal.

## Public Accounts, 2009-10

While the Public Accounts for the year past, 2009-10, have not yet been finalized, the province expects to report an improvement from the deficit of $294.9 million projected at the time of Budget 2010. The Public Accounts for 2009-10 will be released once an audit has been completed by the Auditor General.

## Revised Forecast 2010-11

While there were signs of recovery at the time of Budget 2010, the world economy was still in a state of uncertainty. Newfoundland and Labrador weathered the economic tsunami better than most due in large part to its aggressive infrastructure strategy, tax reductions and spending in strategic areas heading into the recession. In Budget 2010, the Provincial Government decided that the time was not right to pull back on the stimulus spending. Over $1 billion was injected into hospitals, long term care homes, schools, roads, bridges, ferries, and other infrastructure. Taxes were once again reduced to benefit seniors, small business and others. Government made new investments in children and youth, and renewed its commitment to poverty reduction. There was a record $2.7 billion allocated for health and community services. These investments set the stage for much of the improvement in the local economy that transpired in 2010.

**Consolidated Statement of Operations**
Budget vs Mid-year revised 2010-11

| ($ Millions) | Budget | Mid-Year | Change |
|---|---|---|---|
| **Revenue** | 6,584.5 | 6,893.1 | 308.6 |
| Net Income of Government Business Enterprises | 206.9 | 201.5 | (5.4) |
| **Total Revenue** | **6,791.4** | **7,094.6** | **303.2** |
| **Net Expenses:** | | | |
| Program Expenses | 6,176.6 | 6,253.0 | (76.4) |
| Debt Servicing Expenses | 809.1 | 829.3 | (20.2) |
| **Total Net Expenses** | **6,985.7** | **7,082.3** | **(96.6)** |
| **Surplus (Deficit)** | **(194.3)** | **12.3** | **206.6** |

Budget 2010 forecast a deficit of $194.3 million. The province now expects an improvement of $206.6 million with a surplus of $12.3 million.

## Revenue

The province's revenue for the year is now projected to be $303.2 million higher than the forecast at budget time. A number of factors have contributed to this improvement.

Oil royalties are expected to be $65 million higher than the Budget forecast. The increased revenue relates to higher production of 12.1 million barrels. Gains in royalties have been mitigated, however, by lower oil prices and increased development and production costs as compared to the Budget forecast.

The average price expected to be received for a barrel of oil at budget time was $US83.48. The province now expects the average price for the year to be $US81.06, a reduction of $US2.42 per barrel. The expected average exchange rate in the budget forecast for oil royalties was $0.955. This has now been revised upward to $0.982.

Corporate income tax revenues are now expected to be almost $165 million higher than originally forecast. Approximately $120 million of this relates to the offshore oil and gas sector. Personal income tax is expected to be more than $31 million higher than the Budget forecast.

Other revenue sources are also expected to change from Budget, notably Mining Tax, Tobacco Tax, Financial Corporations Capital Tax and Net Income from Government Business Enterprises.

## Expenses

Program expenses are expected to exceed the original budget forecast by $76.4 million. This is predominately due to expenditures related to hurricane Igor and adjustments to pension expenses as a result of anticipated changes to actuarial assumptions related to the province's public service pension plans. A number of miscellaneous variances within government departments and entities are also anticipated. Debt servicing expenses are also expected to increase as a result of changes to interest on the unfunded pension liability, also as a result of changes to actuarial assumptions.

## Net Debt

At the time of Budget, it was anticipated that net debt would increase by $699 million over the fiscal year. It is now anticipated that net debt will increase by $489 million, an improvement of $210 million.