2012-13 FALL UPDATE

Hon. Thomas W. Marshall, Q.C.
Minister of Finance and President of Treasury Board

Current Global Economic Environment

The end of the latest recession has not brought with it the robust economic growth many had hoped for. Developed countries around the globe, especially in Europe, are struggling with large deficits that are to a significant extent the legacy of economic stimulus measures enacted to combat the recession. Austerity measures implemented to rein in deficits have further hampered economic growth throughout 2012 and the effects are being felt in developing nations and, consequently, commodity markets.

Europe has been the epicentre for sovereign debt troubles in developed countries, having spent the better part of the last two years fighting to contain the problems that have emerged in Greece, Portugal, Ireland, Spain and Italy. Austerity measures combined with euro area commitments to bail out current and future troubled national governments and to reform banking regulations have mostly contained the borrowing costs of the struggling nations. Europe is starting to experience the side-effects of government belt tightening. In the third quarter of 2012, real GDP growth in the European Union (EU) was essentially flat after posting three consecutive quarters of negative growth. Unemployment rates are reaching unprecedented levels. In the 27 EU member states the rate is at the highest mark on record and in Greece and Spain it has surpassed 25%.

The slowing of economic growth globally combined with unresolved domestic fiscal policy issues constrained growth in the U.S. in 2012. Financial institutions remain unclear about future regulations and businesses in general are uncertain about future tax burdens and government spending as the Federal Government's "fiscal cliff" looms at the end of December 2012. The "fiscal cliff" involves $560 billion in projected net savings stemming from automatic tax increases and spending cuts designed to reduce the deficit in fiscal 2013. If allowed to proceed, these measures could tip the economy into recession. Consequently, quarterly annualized real GDP growth in the U.S. hasn't topped 2.0% through the first three quarters of the year even as the housing market has shown promising signs of recovering. Nevertheless, the U.S. economy is expected to grow 2.2% in 2012.

The downturn in Europe and weak growth in the U.S. are impacting other regions of the world, most significantly Asia. Year-over-year growth in the value of exported goods out of China has slowed from a post-recession high of nearly 50% in the spring of 2010 to less than 10% as of September 2012. The picture is worse in India where year-over-year growth in the export of goods has been negative for six of the last seven months. As a result, real GDP growth has slowed markedly in these countries.

This slowdown has been reflected in prices for major commodities. Brent crude oil, the benchmark for globally traded oil and Newfoundland and Labrador offshore oil, has fallen from US$125.45/barrel in March 2012 to US$111.71/barrel in October. This despite civil unrest in Syria and tensions on the rise elsewhere in the Middle East. Meanwhile, iron ore prices as of early November have fallen roughly 20% from April highs. These developments present significant headwinds for Newfoundland and Labrador exporters and provincial government revenues even as record investment brings unprecedented employment and income levels to the province.

These challenges with respect to commodities are expected to persist throughout 2013. The International Monetary Fund (IMF) is forecasting both fuel and non-fuel commodity prices to decline next year. Despite these hurdles the IMF believes that global economic growth will accelerate in 2013. Global real GDP is forecast to increase 3.6%, up from 3.3% forecast for 2012.

Economic Performance

Economic activity in Canada this year has expanded at a faster pace than in most other major advanced economies, thanks primarily to easier credit availability and favourable commodity market conditions early in the year. Real GDP in Canada grew at an annualized rate of 2.0% in both of the first two quarters of 2012. Meanwhile Canada's economy added 212,800 jobs from December 2011 to October 2012 while the labour force increased by 223,000. The unemployment rate fell 0.1 percentage points over the first 10 months of the year to reach 7.4% in October.

It is important to acknowledge that Canada remains exposed to the global economy. The main external risks pertain to a further escalation of the euro area debt crisis and a significant slowdown in China. This would continue to dampen commodity prices as has occurred in recent months. On the domestic side, a sharp or sustained decline in housing prices could seriously set back a visibly leveraged household sector with spillover impacts on consumer spending. Household debt in Canada as a per cent of disposable income reached 165.8% in the second quarter of 2012; the highest rate since at least 1990.

Current forecasts peg growth in the Canadian economy at 2.0% in 2012 and 2.1% in 2013.

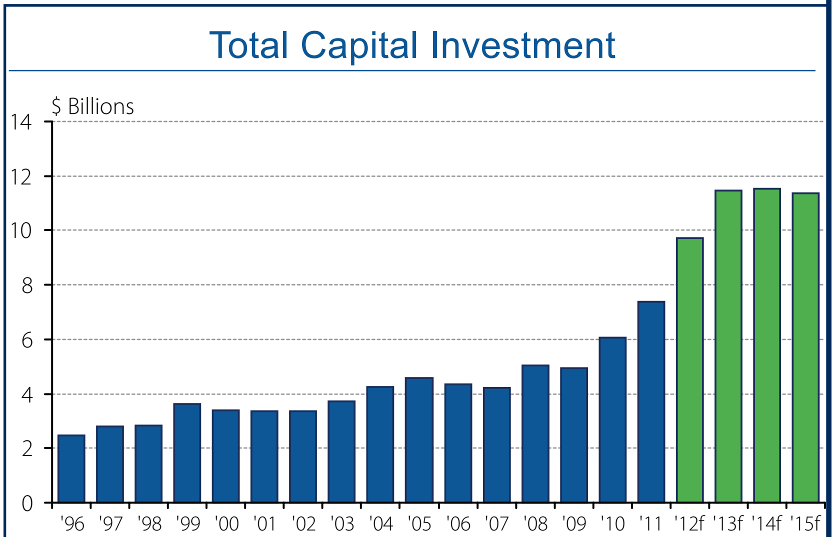
The Department of Finance forecast for real GDP growth in Newfoundland and Labrador in 2012 is unchanged from the Budget forecast at 0.1%. Most other economic indicators have performed better than expected. In particular, investment, retail sales, personal income and housing starts posted notably stronger growth.

The provincial economy is being buoyed by record levels of investment (see chart). Total capital investment is expected to be about $9.7 billion in 2012 which is a 31.7% increase over 2011 and the strongest growth among all the provinces. Continued development of major projects is the impetus behind this growth. Vale's nickel processing facility in Long Harbour was the single largest project under development in 2012 with an estimated $1.2 billion spent this year. Advancement of projects in the oil, iron ore mining and hydro-electric sectors, as well as solid commercial and residential expenditures also contributed to high levels of investment spending. Housing starts are expected to total 3,880, the highest level in over 35 years.

Economic Indicators Forecast 2012, Budget vs Fall
(per cent change unless otherwise indicated)

	Budget	Fall	Change
Real GDP	0.1	0.1	0.0
Personal Income	5.4	6.5	+1.1
Retail Sales	4.0	5.6	+1.6
Housing Starts (units)	3,371	3,880	+509
Capital Investment	30.1	31.7	+1.6
Employment	1.8	1.9	+0.1
Unemployment Rate (%)	12.3	12.5	+0.2
Population	0.5	0.0	-0.5

The high level of investment spending is translating into strong employment, income and retail sales growth in the province. From January to October average employment was 1.9% higher than the same period of 2011 with job gains concentrated in full-time employment. The unemployment rate is expected to decline slightly as employment gains offset an increase in the labour force. The unemployment rate is expected to average 12.5% in 2012; 0.2 percentage points lower than 2011. Average weekly earnings have increased by 5.8% in the first eight months of the year compared to the same period in 2011. At $924, January to August average weekly earnings in Newfoundland and Labrador were the second highest among provinces behind only Alberta, and 3.5% above the Canadian average. These developments have translated into a 5.3% increase in the value of retail sales during the first nine months of 2012 compared to the same period of 2011. While gains were recorded in most sales categories, strong car sales have had the most significant impact on the growth in retail trade. Almost 27,000 new cars were sold in the province from January to September which is 11.6% more than the same period of 2011. New car sales are on track to post the highest number ever recorded in the province.



f: forecast
Source: Statistics Canada; Department of Finance (October 2012 forecast)

Economic Outlook

Economic growth is expected to continue in 2013. Real GDP is expected to increase by 6.7% as higher oil production combined with further growth in iron ore production and investment contributes to high levels of economic output. Construction activity at Vale's nickel processing facility is expected to remain at high levels and the Hebron project will ramp up significantly with GBS construction underway and the commencement of topsides fabrication. Furthermore, development of the Muskrat Falls hydro-electric project is expected to advance.

Employment is expected to grow by 3.1% leading to a 0.9 percentage point decline in the unemployment rate. Employment gains and wage growth are expected to lead to a 6.1% increase in personal income. Increased employment and income will boost consumer spending with retail sales expected to grow by 3.7%. Population growth is expected to resume in 2013 as robust economic conditions result in a return to net in-migration. However, weakening commodity prices which are anticipated through 2013 will present challenges for mining and oil producers as well as government revenues over the coming year.

Fiscal Update

Budget 2012 forecasted a deficit of $258.4 million. The province is now projecting a revised deficit of $725.8 million; a $467.4 million increase from Budget.

The projected deficit for 2012-13 contrasts with the $5.5 billion in cumulative surpluses recorded from 2005-06 to 2011-12. However, it is these cumulative surpluses that have positioned the province to weather the impact of the current downturn in commodity prices caused by a weaker global economy.

Revenue

The province's revenue for the year is now projected to be $486.9 million lower than budget. A number of factors have contributed to this revision.

Oil royalties are expected to be $436.3 million lower with the decrease primarily due to a lower average oil price. The average price expected for Brent crude at budget time was $US124.12 per barrel. The province now expects the average price for the year to be $US109.53 per barrel, a decrease of $US14.59 per barrel. Production is also expected to decrease by 1.77 million barrels. The average exchange rate for the year is now projected to be $1.01 compared to $1.00 used for the budget.

Mining tax has also been revised downward by $113.5 million versus budget. This is a result of lower commodity prices and lower production than expected, particularly in the iron ore industry.

Corporate income tax is also projected to be lower compared to budget by $47.1 million. This is largely a function of less revenue in the mining and oil and gas sectors.

In contrast, personal income tax is now expected to be $91.9 million higher than budget. This stems from strong growth in personal income flowing from the robust provincial economy augmented by positive adjustments related to prior year revenue estimates resulting from the federal estimation process.

Expenses

Total expenses decreased by $19.5 million (0.3%) which includes a $6.7 million (0.1%) decrease in program expenses and a $12.8 million (1.5%) decrease in debt expenses. Program expenses decreased due to savings realized through various expenditure reduction initiatives implemented during the year, partially offset by unforeseen budget pressures which were absorbed within existing budget allocations.

Consolidated Statement of Operations

Budget vs Mid-year revised 2012-13

$ Million	Budget	Revised	Variance	Percentage
Fiscal Revenue				
Fiscal revenue	6,964.2	6,466.4	(497.8)	-7.1%
Net Income of GBEs	246.3	257.2	10.9	4.4%
Total Fiscal Revenue	7,210.5	6,723.6	(486.9)	-6.8%
Net Expenses				
Program Expenses	6,638.2	6,631.5	(6.7)	-0.1%
Debt Servicing Expense	830.7	817.9	(12.8)	-1.5%
Total Net Expense	7,468.9	7,449.4	(19.5)	-0.3%
Surplus/(Deficit)	(258.4)	(725.8)	(467.4)	180.9%

Net Debt

Net debt is projected to increase by approximately $424 million to $8.9 billion as compared to $8.5 billion projected during the budget. This net debt projection may change pending the release of the 2011-12 public accounts.

Fiscal Outlook

The global economic situation and the impact on commodity prices have created new fiscal challenges for the province.

Over the last eight years, the Provincial Government has exercised responsible fiscal management by balancing investments in programs and services and necessary infrastructure with debt reduction.

Looking forward, the current level of expenses is not sustainable considering long term revenue projections. Significant progress has been made to strengthen the province's fiscal situation and it is important to ensure this momentum is maintained.

To address the fiscal challenge, expenditure reduction is necessary. A number of actions have already been taken including the expenditure reduction plan which was introduced in budget 2012-13, attrition management and a comprehensive review of all programs and services through a process known as the Core Mandate Analysis. All programs and services across government departments, agencies and commissions are being reviewed to identify opportunities for innovation and efficiency to achieve cost savings. Fiscal restraint will also extend into the collective bargaining process and the Provincial Government will also examine options to manage the growth in pensions and post-retirement benefits to ensure their long term sustainability. While timelines will vary with respect to the development and implementation of expenditure reduction initiatives, the impact of these measures will be reflected in Budget 2013-14.

The Government of Newfoundland and Labrador has also committed to achieving a net debt per capita equivalent to the all province average within the next 10 years. This target will provide the framework for the province to achieve its long term fiscal goals.

Reducing the province's reliance on revenue from the oil and gas sector through economic diversification will also support the goal of long term fiscal sustainability. Muskrat Falls is an important part of the fiscal solution as revenues earned on the province's investment will reduce the reliance on non-renewable resource revenues and create a long term revenue stream from a renewable energy resource, with no impact on net debt.

It is critical that the province take steps to ensure long-term fiscal sustainability. The challenge is significant and the choices will not be easy. This government is committed to doing what is necessary to ensure we live within our means and that the fiscal situation is managed responsibly. As indicated earlier, the provincial economy continues to be strong in terms of capital investment, housing starts, employment and income growth. We will build on this momentum to advance a fiscal framework that is sustainable.