Fall Update 2009-10

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Current Environment

The world economy has undergone significant fundamental changes in the last year, with the collapse of financial markets in the United States and Europe resulting in the worst global recession since the Depression. In recent months, however, the worst appears to be over and signs of recovery have emerged. Across the developed world negative economic growth is expected for 2009, with recovery taking hold in the second half of this year or early 2010. Meanwhile, major economies, such as India and China, have maintained positive growth throughout the recession.

In March, the global economic outlook was bleak. Firms were faced with contracting credit markets, stock markets had declined sharply, oil was barely over $44 a barrel and employment and gross domestic product (GDP) across developed economies was shrinking. Central banks drastically cut interest rates and governments responded with massive fiscal stimulus packages to support their economies. In recent months, signs of an economic recovery have appeared. Japan, Germany and France showed positive GDP growth in the second and third quarters of 2009 and the U.S. followed suit in the third quarter, posting an annualized growth rate of 2.8%. In addition, credit markets have improved, enhancing prospects for capital expansion in many industries. Commodity prices are up—including oil, which has traded in the $75 to $80 range in recent weeks. Economic activity in China and India has been bolstered by robust public sector stimulus programs and both nations are expected to post strong growth in both 2009 and 2010.

This strong economic activity has spread throughout Southeast Asia and neighbouring regions and has improved the global economic outlook. In fact, in early October, Australia, a major trading partner with China, became the first G-20 nation confident enough about a sustained recovery to raise interest rates. In Canada, the recession appears to have ended as well with third quarter GDP showing modest positive growth. Labour markets also appear to be stabilizing—in October the unemployment rate was 8.6%, virtually unchanged from August.

Despite these improvements there are still concerns as the U.S. unemployment rate continues to climb, hitting double digits in October for the first time since 1983, and consumer confidence has not fully rebounded. With the U.S. being Canada's and Newfoundland and Labrador's largest trading partner there has been a weakening in export markets, which has contributed to a downturn in manufacturing and exports nationally and provincially. The provincial newsprint industry has been negatively impacted by the closure of the Grand Falls-Windsor mill and recent slowdowns at the mill in Corner Brook. As well, exports in the mining industry have lagged and 2009 has proved to be an especially difficult year for the fishing industry.

Although the global economy is still in a weakened state, a recovery has taken hold and countries are now focused on ensuring stability in the months and years ahead. International meetings have included discussions on how central banks and governments can implement strategies for removing stimulus packages without damaging the economic recovery. The International Monetary Fund has adjusted its forecasts upward and is predicting global GDP growth of 3.1 per cent in 2010.

Economic Performance

In Canada, all provinces are expected to record an annual decline in GDP this year and most provinces have posted employment losses.

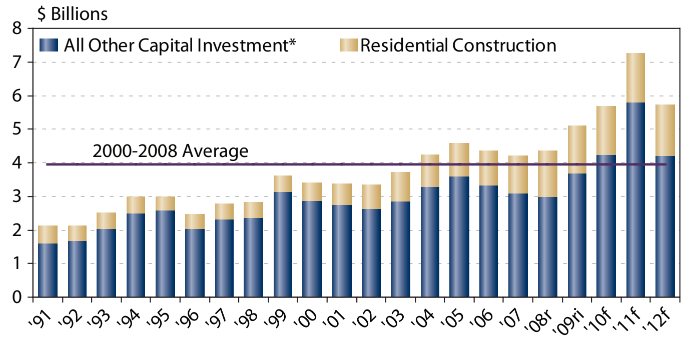
For Canada as a whole, and for most provinces, the contraction in GDP is due mainly to declining exports and, to a lesser extent, shrinking consumer spending and private sector investment. Exports have undergone a significant contraction resulting from the drop in world demand for commodities such as oil and minerals as well as manufactured goods such as automobiles. Domestic demand has weakened because of lower consumer and business spending as a response to employment losses, declining wealth credit tightening and overall lower confidence in the economy.

Newfoundland and Labrador's export sector has been impacted by the recession. Real GDP is expected to decline 8.5% this year, due entirely to lower exports. Exports, which contributed over 50% to the province's GDP in 2008, are expected to decline as a result of natural declines in oil production as well as lower mineral, newsprint and fish production. The drop in oil, mineral and fish prices since last year is also resulting in lower export values.

Domestically, Newfoundland and Labrador is faring much better than other provinces. Consumer confidence has been solid and consumers continue to spend. From January to September, retail sales have increased by 1.5% and this has been achieved despite a significant decline in the sale of new cars which are estimated to comprise about 12% of total retail sales. All other provinces in Canada have recorded declines in retail sales this year. Income gains combined with continued confidence in the economy have supported retail sales. Labour income increased by 4.1% to the end of the third quarter.

Residential building activity has remained robust, but at a somewhat lower pace from last year. In 2008, the number of dwelling starts reached the highest level in 19 years and residential sales activity increased to record levels. Housing starts in the first nine months in Newfoundland and Labrador were down from the record levels of 2008 but are posting a solid showing at almost 2,100 units for the first 3 quarters of 2009. Housing starts were down in nine provinces over this period with Newfoundland and Labrador posting the smallest decline. Nationally, housing starts were down 38% for the period. House prices have continued to be strong this year from January to October the average price of homes sold was 18% higher than the same time last year.

Capital Investment



* Includes non-residential construction and machinery and equipment purchases.
Source: Statistics Canada; Department of Finance

Capital investment spending has been particularly strong in 2009; in the latest forecast it is expected to increase by 17%. Statistics Canada conducted a revised investment survey in the spring which indicated that growth in capital spending on non-residential construction and machinery and equipment 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 higher government infrastructure spending.

The current strength in domestic demand and continued optimism about the development of projects such as the Long Harbour Hydromet Facility and the Hebron oil project are contributing to net in-migration and an increase in the province's population. On July 1, 2009 the province's population was estimated to be 508,925, an increase of 0.5% or 2,484 people over the previous year. This was the largest annual percentage increase in the provincial population since 1983.

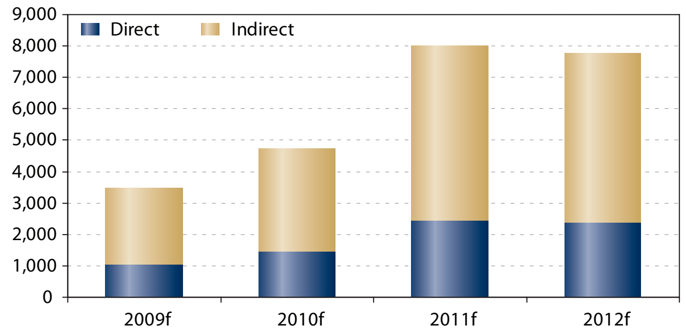
Outlook

Real GDP in Newfoundland and Labrador is expected to resume growth next year as the worldwide recession ends. An anticipated rebound in mineral production and increased construction activity on major projects will help boost growth.

Last spring, construction commenced on the nickel processing facility in Long Harbour, and the Hibernia South MOU was announced in June. Increased activity on these projects, pre-engineering work for Hebron and continued expansion of White Rose satellite fields will push capital investment to record levels in both 2010 and 2011. Employment related to construction on major projects is expected to increase by about 1,300 to 4,700 person years in 2010, including spin-offs, and is expected to grow by a further 3,300 to 8,000 in 2011.

Overall, the medium term economic outlook for Newfoundland and Labrador remains positive despite the recent global economic downturn. While GDP growth will vary depending on major project timelines and oil production, other economic indicators such as employment and income are expected

Major Project Construction Employment



Note: Includes Hibernia, White Rose, Hebron, and Voisey's Bay construction employment
Source: Statistics Canada; Department of Finance

to continue to post solid growth supported by project development. In addition, the unemployment rate is expected to trend down once again and renewed consumer optimism is expected to produce stronger retail sales.

Fiscal Update

The decline in economic activity and the resultant reduction in commodity prices have translated into lower revenues for the federal government and provinces. The federal and provincial governments have therefore chosen to stimulate the economy though infrastructure and other spending. Lower revenues combined with increased expenditures are contributing to deficits in 2009-10 for Canada and most provinces, including Newfoundland and Labrador.

Newfoundland and Labrador had been doing those things necessary to enhance and protect the economy of the province. We reduced taxes, allowing money to be put to use in the provincial economy. We have reduced net debt by approximately $4 billion over a four year period which gave the province the flexibility to weather the economic downturn. We were already executing a long-term strategy which was putting Newfoundlanders and Labradorians to work improving the infrastructure of the province and this initiative is ongoing.

Forecasting natural resource revenues had been challenging during stable economic times because of the volatile nature of oil and mineral prices. It is more challenging during this period of economic uncertainty. Following a record surplus of $2.4 billion in 2008-09, Budget 2009 forecasted a deficit of almost $750 million, driven largely by a reduction in natural resource revenues of $1.1 billion combined with lower Atlantic Accord payments and the absence of Equalization payments.

The revenue forecast at Budget was based upon the best available information during that uncertain time. A number of factors, including higher than expected oil prices, indicate an improved fiscal performance. Government now projects a deficit of $443 million in 2009-10, an improvement of $307 million over the Budget forecast. Had it not been for the impact of the changes by the federal government to eliminate benefits under the 1985 Atlantic Accord, amounting to $414 million, fiscal results for 2009-10 would be close to a balanced position.

Consolidated Statement of Operations
Budget vs Mid-year revised 2009-10

($ Millions)	Budget	Mid-Year	Change
Revenue	5,804.2	6,193.9	389.7
Net Income of Government Business Enterprises	189.3	181.9	(7.4)
Total Revenue	**5,993.5**	**6,375.8**	**382.3**
Net Expenses:			
Program Expenses	5,819.2	5,903.3	(84.1)
Debt Servicing Expenses	923.8	915.0	8.8
Total Net Expenses	**6,743.0**	**6,818.3**	**(75.3)**
Deficit	**(749.5)**	**(442.5)**	**307.0**

However, at this time, there are four months remaining in the fiscal year, and there are many factors and uncertainties which may impact year end results.

Revenues

At Budget, revenues were anticipated to be $5,804 million. Revenues are now expected to be $6,194 million, an improvement of $390 million. The projected improvement to revenues is attributable to higher oil royalties, which are expected to be $520 million higher than the Budget forecast. The Budget forecast was predicated upon a price of US$50 with a $0.80 exchange rate. To the end of October, prices have averaged US$64.22 with a $0.89 exchange rate. The revised projections assume a price of US$71.80 with a $0.92 exchange rate for the balance of the year.

The improvements in oil royalties were partially offset by lower corporate income tax, sales tax, mining tax and net income from government business enterprises, while some other revenue sources indicate modest improvements.

Net Expenses

Net Expenses are expected to increase by $75 million over the Budget forecast. Program expenses are expected to increase by $84 million, while Debt Servicing Expenses are expected to decrease by almost $9 million.

Additional expenditures were required to address a number of issues that have arisen since Budget. The Department of Municipal Affairs will require an additional $15.1 million for disaster relief in Daniel's Harbour and Trout River, the re-location of residents of Grand Bruit, and the provision of

Net Debt		
($ Millions)	2009-10 Budget	2009-10 Revised
Net Debt - Begining of Year	7,896.5	7,968.4
Deficit	749.5	442.5
Change in Tangible Capital Assets:		
Acquisition	516.0	422.0
Amortization	(207.5)	(198.5)
Subtotal - Change in TCA's	308.5	223.5
Increase in Net Debt	1,058.0	666.0
Net Debt - End of Year	**8,954.5**	**8,634.4**

grants in lieu for local governments in Central Newfoundland who were severely impacted by the closure of the paper mill. The Department of Municipal Affairs also provided additional assistance to fish harvesters and fish plant workers who were negatively impacted by the challenges in the fishery.

An additional $48 million is being allocated to address other issues related to the closure of the paper mill, most of which will provide severance to former Abitibi workers. Government will also incur additional expenditures in 2009-10 associated with an MOU between the Fish Food and Allied Workers and the Association of Seafood Producers regarding the long term development of the fishery in the province. In connection with this agreement, Government has agreed to provide $3.4 million in rebates and suspension of processing license fees for the 2008 and 2009 fishing seasons. Additional expenditure pressures are also materializing in the Health Care sector.

Net Debt

At Budget time, net debt at the end of 2009-10 was expected to be $8,954 million. With the improvement in financial performance, net debt is now expected to be $8,634 million.

Conclusion

Because a strong foundation was put in place through careful and prudent planning, the Province is well positioned to return to growth in 2010. Taxes have been lowered, provincial debt has been reduced and investments have been made in the areas people consider priorities—critical social programs and infrastructure and economic development. The people of Newfoundland and Labrador are showing confidence in the future of the Province. Incomes are higher, retail sales growth continues, housing starts remain robust, and public and private sector investment continues to provide economic momentum moving into 2010.