

Current Global Economic Environment

The global economy continues to struggle against a backdrop of unresolved fiscal and economic issues. Expectations for 2013 are currently lower than they were earlier in the year due mainly to poorer than anticipated performance in the United States and China. The United States, the world's largest economy, continues to deal with recurring political and fiscal issues which have served to undermine growth. Growth in China continues to moderate. Across Europe, the fiscal policy responses to contain debt have negatively affected economic growth, especially in unemployed ridden southern countries. Northern European countries appear to be making some headway. The latest forecast from the International Monetary Fund pegs global economic growth at 2.9% in 2013, below the 3.2% recorded in 2012. Projections for 2014 are somewhat higher.

The U.S. economy has been softer than expected and economic data have been sending mixed signals. While GDP and employment have recorded some significant gains, the housing sector and consumer spending, which were previously important contributors to the improvements in the U.S. economy, have been showing signs of weakness. These sectors have been impacted by increases in mortgage rates, slow income growth, tax increases and uncertainty created by recurring fiscal and political issues around budget funding and raising the debt ceiling. Further, the impending tapering of stimulative measures by the Federal Reserve could have significant economic implications for the economy, including potential pullback in stock prices and further increases in interest rates.

The sovereign debt crisis in Europe and the subsequent austerity measures have caused that region to move in and out of recession and unemployment to rise dramatically in many countries. Nevertheless, some recent economic indicators have been better than expected and this has raised hopes that Europe may be entering a period of recovery especially among large countries like the United Kingdom and Germany. Real GDP in the EU grew by 0.3% and 0.2% in the second and third quarters, respectively. Consumer confidence has risen sharply and it is expected that expansion will continue.

China's real GDP growth slowed to between 7% and 8% in the first three quarters of 2013, compared to an average annual growth above 10% over the last decade. Recent actions by the Chinese government to stimulate business investment may be dampening the downward momentum that the country was experiencing. The Chinese government hopes to improve sentiment which will provide a boost to the economy going forward.

Commodity prices, although volatile throughout much of 2013, have remained at fairly elevated levels. Brent crude oil, the benchmark for globally traded oil and Newfoundland and Labrador offshore oil is expected to average around US\$108.15/barrel in 2013, compared to US\$111.63/barrel in 2012. Iron ore prices averaged about 5% higher during the first three quarters compared with the same period of 2012.

Economic Performance

Canada

Canadian economic growth has also been soft in 2013 with a delayed pick-up in exports and business investment. Currently, real GDP is expected to expand by 1.7% this year and rise to 2.4% in 2014. The country is a major commodity exporting nation, and as such, has benefited from solid energy and minerals prices. However, the U.S. is Canada's largest trading partner by far. Therefore, a resolution to economic and fiscal turmoil in the U.S. would ultimately strengthen economic prospects for Canada as well.

Canada's employment increased from about 17.7 million in December 2012 to 17.8 million in October 2013, an increase of 126,300 jobs. The unemployment rate fell from 7.1% to 6.9% in October.

Newfoundland and Labrador

The provincial economy has shown substantial growth over the last decade and this growth has continued in 2013. Economic conditions in Newfoundland and Labrador remain strong this year with growth stemming from increases in investment, consumption and exports. The Department of Finance is presently projecting real GDP growth of 5.8%, the highest among provinces. This growth is slightly below Budget due to lower than anticipated increases in iron ore production. Most economic indicators have performed well, although their performance has not been as strong as anticipated at Budget.

Economic Indicators, 2003-2013			
	2003	2013	% Change
Capital Investment (\$M)	3,712	11,045	197.5
Employment	211,800	233,900	10.4
Average Weekly Earnings (\$)	640	947	48.0
Personal Income (\$M)	12,989	22,127	70.4
Disposable Income (\$M)	10,210	17,564	72.0
Retail Sales (\$M)	5,736	8,575	49.5
Housing Starts (units)	2,692	2,900	7.7
Consumer Price Index (2002=100)	102.9	125.8	22.3
Unemployment Rate (%)	16.4	11.5	-4.9 ppt
Real Gross Domestic Product (\$2007 M)	25,288	29,188	15.4

Capital investment in the province is expected to total about \$11.0 billion this year, an increase of 10% over 2012—another record year. While the continued development of major projects, in particular Hebron and Muskrat Falls, is the primary reason behind the increase in investment, solid commercial and residential expenditures also contributed to high levels of investment spending.

Consumer spending has been robust. The value of retail sales increased 4.4% during the first nine months. Gains were recorded in most sales categories, but the growth was largely attributable to strong car sales. Over 28,000 new cars were sold in the province in the first nine months, 5.8%

more than the same period of 2012. New car sales in 2013 are on track to post the highest number on record.

Provincial exports are expected to increase by about 5% in real terms this year due primarily to a rebound in oil production and higher iron ore output. Production at Vale Newfoundland and Labrador's operations at Voisey's Bay, Labrador is expected to decrease in 2013. The company plans to ship over \$1.0 billion of metal concentrates in 2013, down about 19% compared to 2012, mainly due to lower nickel production and prices. Oil production is expected to rise by about 17% to 84.5 million barrels as all projects post increases after significant maintenance downtime last year.

Labour market performance has remained solid. From January to October average employment was 1.5% or 3,500 higher than the same period of 2012. Gains in employment have resulted in a substantial drop in the unemployment rate. The unemployment rate for 2013 is expected to average 11.5%. If realized, this would be the lowest annual unemployment rate in the province since 1973.

Rising wage rates are also evidence of a strengthening labour market. Average weekly earnings increased 2.3% in the first eight months of the year, following growth of 5.4% in 2012. January to August average weekly earnings was the third highest among provinces, behind only Alberta and Saskatchewan. Personal income is expected to rise by 5.4% this year.

Economic Outlook

Economic growth is expected to moderate in 2014 reflecting lower nickel production and less construction investment. While overall capital investment is expected to remain high, there will be a shift to more machinery and equipment, thus generating less local economic activity. The current expectation is that real GDP will remain unchanged. Employment is expected to be stable as major project employment declines from peak levels recorded in 2013. Nonetheless, further income growth is expected as wage gains continue. Higher income will support an increase in retail sales.

Economic Indicators Forecast 2013, Budget vs Fall			
(per cent change unless otherwise indicated)			
	Budget	Fall	Change
Real GDP	6.8	5.8	-1.0
Personal Income	7.3	5.4	-1.9
Retail Sales	4.2	4.6	0.4
Housing Starts (units)	3,520	2,900	-620
Capital Investment	17.4	10.0	-7.4
Employment	2.8	1.5	-1.3
Unemployment Rate (%)	11.5	11.5	0.0
Population	0.3	0.0	-0.3

Fiscal Update

2012-13 Update

At Budget 2013, the deficit for Budget 2012 was projected at \$430.9 million. The unaudited actual deficit for 2012-13 is anticipated to be \$198.8 million. Public Accounts will be released later this month, which will include the final number as reflected in the audited financial statements.

2013-14 Update

Budget 2013 forecast a deficit of \$563.8 million. As a result of better performance to mid-year, notably lower net expenses, the Provincial Government is now projecting a \$450.6 million deficit; a \$113.2 million improvement from Budget. Net debt as of March 31, 2014 is projected to be \$9,123.2 million, \$396.2 million lower than the Budget 2013 estimate.

The Provincial Government is continuing on the path of responsible fiscal management outlined in its 10-Year Sustainability Plan, while remaining focused on ensuring long-term prosperity for the Province.

Revenue

Total revenue for the year is now projected to be \$94.4 million lower than Budget, primarily as a result of lower oil production.

Oil royalties are projected to be \$112.5 million lower than expected due primarily to a longer than anticipated maintenance shutdown at Terra Nova. At Budget, a shutdown of 24 days was anticipated but this was subsequently extended to 75 days. As a result, the production forecast is reduced by 1.99 million barrels. This is offset somewhat by the expectation of a higher average price of \$US107.13, a \$2.13 improvement from \$US105.00 per barrel at Budget. The average exchange rate for the year is also projected to be more favourable, now USD-CAD 0.964 compared to USD-CAD 1.012 at Budget.

Mining tax has also been revised downward by \$30.3 million compared to Budget, the result of lower nickel prices and less iron ore production than expected, lowering the value of production.

Largely a function of reduced profitability in the oil and mining sectors, corporate income tax is also projected to be \$40.5 million lower than Budget.

In contrast, personal income tax is now expected to be \$24.9 million higher than Budget, reflecting higher than expected personal income for prior years. Canada Health Transfer and Canada Social

Update 2012-13 (\$ Million)			
	2012-13 Budget	2012-13 Revised	2012-13 Actuals (Unaudited)
Revenue:			
Revenue	6,964.2	6,762.7	6,787.5
Net Income of GBEs	246.3	238.5	240.7
Total Revenue	7,210.5	7,001.2	7,028.2
Net Expenses:			
Program Expenses	6,638.2	6,624.1	6,447.2
Debt Servicing Expenses	830.7	808.0	779.8
Total Net Expenses	7,468.9	7,432.1	7,227.0
Surplus/(Deficit)	(258.4)	(430.9)	(198.8)

Transfer entitlements show a \$39.7 million increase from incorporating the recently released higher population estimates, which impact current and prior years.

Expenses

Total net expenses are expected to be \$207.6 million, or 2.7%, lower than at Budget. Before the impact of collective agreements is considered, net expenses are \$270.1 or 3.6% lower. Collective agreements signed and pending offset these savings by \$62.5 million.

Some infrastructure projects have encountered unexpected delays, reducing spending this year, while related revenues for cost-shared projects are higher than anticipated at Budget. Projected savings in program spending across departments also is making a significant contribution to the reduction in net expenses.

Consolidated Statement of Operations				
Budget vs Mid-year revised 2013-14				
\$ Million	Budget	Revised	Variance	Percentage
Revenue:				
Revenue	6,756.5	6,659.5	(97.0)	-1.4%
Net Income of GBEs	250.4	253.0	2.6	1.0%
Total Revenue	7,006.9	6,912.5	(94.4)	-1.3%
Net Expenses:				
Program Expenses	6,723.1	6,515.3	207.8	3.1%
Debt Servicing Expenses	847.6	847.8	(0.2)	0.0%
Total Net Expenses	7,570.7	7,363.1	207.6	2.7%
Surplus/(Deficit)	(563.8)	(450.6)	113.2	20.1%

Fiscal Outlook

While the projected deficit and net debt have improved since Budget, the Provincial Government still faces a fiscal challenge and must continue to be prudent this year. Government remains focused on ensuring long-term prosperity for the Province by encouraging job creation, strong communities, a vibrant economy and natural resource development that provide maximum benefit to Newfoundlanders and Labradorians.

Government continues to work towards a surplus in fiscal 2015-16.