

January 30, 2018

New investments mean one year delay in return to balance

Highlights

- New Brunswick bettered its key fiscal targets in 2017-18 and by a non-trivial margin. The outgoing fiscal year's deficit looks to be coming in \$77 million below target, at \$115 million or 0.3% of GDP, while net debt is climbing by a smaller-than-planned amount.
- Ahead of September's general election, the government is using the 2018 budget to make investments in three priority areas: youth employment, seniors and economic competitiveness. There were no new taxes or fee increases.
- So there's \$73 million of new, targeted spending and a previously pledged cut in the small business tax rate (to 2.5% as of April 1st). The result is a deficit of \$189 million for 2018-19—larger than the outgoing year or what was telegraphed in the 2017 budget.
- As a share of GDP, the coming year's deficit works out to 0.5%. That's hardly an outsized budget shortfall, but the new investments outlined today mean the province is delaying its return to balance by one year, to 2021-22. All told, the four-year cumulative deficit from 2017-18 to 2020-21 is up \$195 million vs last year's medium-term plan.
- Net debt is expected to increase \$372 million to \$14.47 billion in 2018-19, with the resulting net debt-to-GDP ratio largely unchanged at a snick below 40%. That debt ratio places New Brunswick towards the higher end of the provincial spectrum.
- There's \$2.458 billion of gross borrowing flagged between now and the end of 2018-19. That's comprised of \$2.308 billion for the province and NB Power (inclusive of nearly \$200 million of remaining funding tied to 2017-18) and an additional \$150 million for NB MFC.
- After 2017's 1.3% expansion, real GDP is expected to advance by 1.1% this year—largely in-line with consensus expectations. Nominal GDP growth is pegged at 2.5% for 2018. Both real and nominal growth step down longer-term, pulled lower by demographic headwinds tied to a relatively older population.

New investments in priority areas

Ahead of a September general election, New Brunswick's government used its 2018 budget to outline new investments in three priority areas—youth employment, seniors and competitiveness. These investments will result in a larger deficit in the year ahead, relative to a notably better-than-planned result for 2017-18 or the preliminary fiscal projection set down a year ago. It also means a one year delay in the return to balance, to 2021-22.

Near-term fiscal trajectory

For 2017-18, New Brunswick appears increasingly well positioned to better its original budget target. The latest estimate for the outgoing year puts the deficit at \$115 million, equivalent to a relatively modest 0.3% of GDP. That's a non-trivial improvement of \$77 million compared to last year's plan, benefiting from firmer corporate income tax receipts and additional sales tax revenue. The province did a nice job holding spending largely in-line with plan in 2017-18.

Having undertaken new investments in this budget, New Brunswick puts the 2018-19 deficit at \$189 million (or 0.5% of GDP). There were no new tax taxes or fee increases. In fact, top-line revenue growth will be held to 1.8% in the year ahead, expanding slower than nominal GDP due to a cut in the small business tax rate to 2.5% effective April 1st (a move announced back in November). Elsewhere, the budget assumes a near-5% gain in personal income tax revenue, relative to a downwardly adjusted 2017-18 base. Sales tax revenue draws support from employment/person income growth. A larger equalization entitlement, meanwhile, accounts for the bulk of the increase in total federal transfers, which comprise roughly 36% of ordinary revenue in 2018-19.

The budget includes \$73 million in new targeted investments designed to bolster economic competitiveness, spur youth employment and aid seniors. Here's where NB is headed on each of these three priority areas:

Youth employment — \$28 million to help tackle an “unacceptably high youth unemployment rate”. This includes additional money for a Youth Employment Fund, summer jobs for post-secondary students, measures to retain graduates, and promoting awareness of available programming;

Seniors — \$20 million across a range of programs to “help seniors stay engaged, active, and independent in their homes”. New Brunswick has the oldest population in Canada, and the government is clearly mindful of the financial and economic pressures brought about by population aging;

Economic competitiveness — \$25 million to spur competitiveness and protect what is “one of the most export-dependent provinces” in Canada. The focus here is on enhanced productivity, growing exports and accelerating innovation. New investments in some cases build on earlier commitments.

From a departmental perspective, total expenditures are set to grow -2.5% in 2018-19, keyed by health, education and tourism.

Delaying return to balance by 1 year

When it comes to the medium-term outlook, New Brunswick is projecting fiscal progress in each of the three years from 2019-20 out to 2021-22.

Specifically, the province anticipates running a \$124 million deficit in 2019-20. The deficit is expected to shrink to \$79 million in 2020-21, before returning to surplus in 2021-22 (\$69 million in the black). Over that three-year period, the budget assumes average annual revenue growth of 2.4% against <1.5% average annual gains in total spending. That's a fairly restrained spending profile (i.e., it's a contraction in real, per capita terms), particularly in the final year of the plan, when nominal expenditure growth slows to just 0.65%.

Overall, budget 2018 sees New Brunswick taking an extra year to get back in balance compared to the prior budget plan. For the entire four-year period ending 2020-21, the cumulative deficit is up \$195 million vs budget 2017 (total deficit of \$507 million now vs \$312 million combined shortfall previous).

Stable debt ratio, manageable funding

Consistent with 2017-18's budgetary improvement, New Brunswick should record a smaller increase in net debt vs the original plan. Net debt is estimated to end 2017-18 at \$14.1 billion, up \$272 million vs the prior year and equivalent to a snick under 40% of GDP. That places New Brunswick at the higher end of the provincial spectrum debt wise.

Debt projections are limited to the upcoming fiscal year, and here, an enlarged deficit and additional investments in tangible capital (vs the outgoing fiscal year) translate into a \$372 million increase in net debt. Note that as a share of GDP, New Brunswick estimates the net debt burden will be little changed, holding just a touch below the 40% threshold.

As for term funding requirements, the province has telegraphed \$2.458 billion between now and the end of 2018-19. To be precise, that includes \$2.308 billion for the province and NB Power, inclusive of the roughly \$200 million that remains against the outgoing year's program. If you'll forgive a bit of rounding, this ~\$2.3 billion is split roughly a third, a third, a third between net new government requirements, provincial

New Brunswick • 2018 Budget

refinancing needs and requirements for NB Power. (As a reminder, the province borrows on behalf of NB Power and on-lends proceeds.) For completeness, NB Municipal Finance Corporation has gross requirements of \$150 million in 2018-19.

Sustained growth for an older economy

The budget is based on a realistic economic scenario. Real GDP is estimated to have grown 1.3% in 2017, two tenths below the private sector average (which tended to drift higher over the course of the past year). For 2018, the budget assumes 1.1% real GDP growth, largely in-line with the private sector average. The economy looks to be supported by rising employment and gains in various resource sectors. Mining will get a lift from new production sites, while a sturdy US housing market is good news for the forestry sector (notwithstanding softwood lumber duties). Fishing and agriculture are likewise slated for growth. Nominal GDP growth is forecasted at 2.5% in 2018. Like real GDP, nominal growth can be expected to

moderate longer-term, pulled lower by the demographic pressures linked to an aging population.

Private sector investment looks to be a drag in 2018, as major project work winds down. Public sector infrastructure investment is, however, an important offset and a noted driver of long-term growth for this relatively older province. Meanwhile, the legalization of cannabis will provide a modest positive economic benefit in 2018. As for risks, the budget doesn't shy away from the demographic challenges posed by an aging population. US trade protectionism fears are likewise on the radar screen (rightly so), with related uncertainty risking exports and business investment. More positively, NB is positioned to benefit from freer trade with Europe longer-term, while a prospective tungsten mine could likewise bolster the long-term outlook.

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New Brunswick

\$'000	Budget	Revised	Budget	Multi-Year Plan		
	2017/18	2017/18	2018/19	2019/20	2020/21	2021/22
Gross revenue, ordinary account	8,749,709	8,844,074	8,946,303			
Taxes	4,519,020	4,571,170	4,536,650			
Other revenue	1,168,785	1,199,644	1,184,923			
Transfers from Government of Canada	3,061,904	3,073,260	3,224,730			
Sinking fund earnings	188,900	188,900	191,200			
Other accounts	250,084	230,015	289,751			
Gross revenue	9,188,693	9,262,989	9,427,254	9,685,000	9,902,000	10,115,000
Gross expenditure, ordinary account	8,523,323	8,573,350	8,773,358			
Including: service of public debt	701,000	683,000	675,000			
Other accounts	396,513	344,025	357,236			
Amortization expense	460,802	460,840	485,398			
Gross expenditure	9,380,638	9,378,215	9,615,992	9,809,000	9,981,000	10,046,000
Surplus (Deficit)	(191,945)	(115,226)	(188,738)	(124,000)	(79,000)	69,000
Change in net debt						
Net debt (\$ million) at the beginning of the year	13,997.4	13,827.0	14,099.8			
Déficit (excédent)	191,945	115,226	188,738	124,000	79,000	(69,000)
Acquisition of tangible capital assets	630,925	618,465	668,993			
Amortization expense	(460,802)	(460,840)	(485,398)			
Increase (decrease) in net debt	362,068	272,851	372,333			
Net debt (\$ million) as of March 31	14,359.5	14,099.8	14,472.2			
Borrowing requirements (\$ million)				Remaining	Total	
		Completed		2017-2018		
New Long Term Borrowing	813	787	771	26	797	
Refinancing Requirements	980	980	731	-	731	
Borrowing on behalf of NB Electric Finance Corp	470	300	610	170	780	
Other	(133)	(408)	-			
Total New Brunswick and NBEFC borrowing requirements	2,130	1,659	2,112	196	2,308	
NB Municipal Finance Corp.	150	135	150	-	150	
Total	2,280	1,794	2,262	196	2,458	

Source: Main Estimates 2018-2019, Department of Finance, Province of New Brunswick.

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New Brunswick • 2018 Budget

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