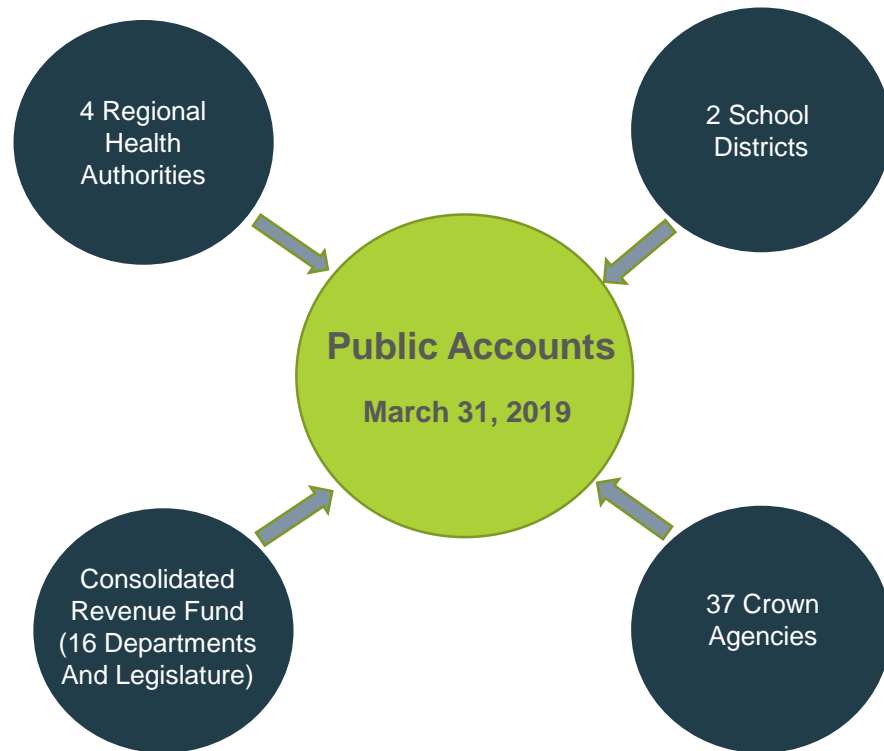


Financial Condition of the Province



OFFICE OF THE AUDITOR GENERAL
NEWFOUNDLAND AND LABRADOR

Consolidated Summary Financial Statements



- Most complete information about the financial position and operating results of the Province.
- Principal means by which Government reports to HOA and the public on its accountability and stewardship of public funds.

Chapter 3: Financial Condition of the Province

Provides an overview of:

- Financial indicators
- Financial position and operating results for fiscal 2018-19
- Comparative information (10 years)
- Government's economic outlook (2019 to 2022)
- Government's fiscal outlook (2020 to 2023)
- Risks to fiscal outlook

Financial Indicators



Financial Indicators

Sustainability – whether a government is living within its means

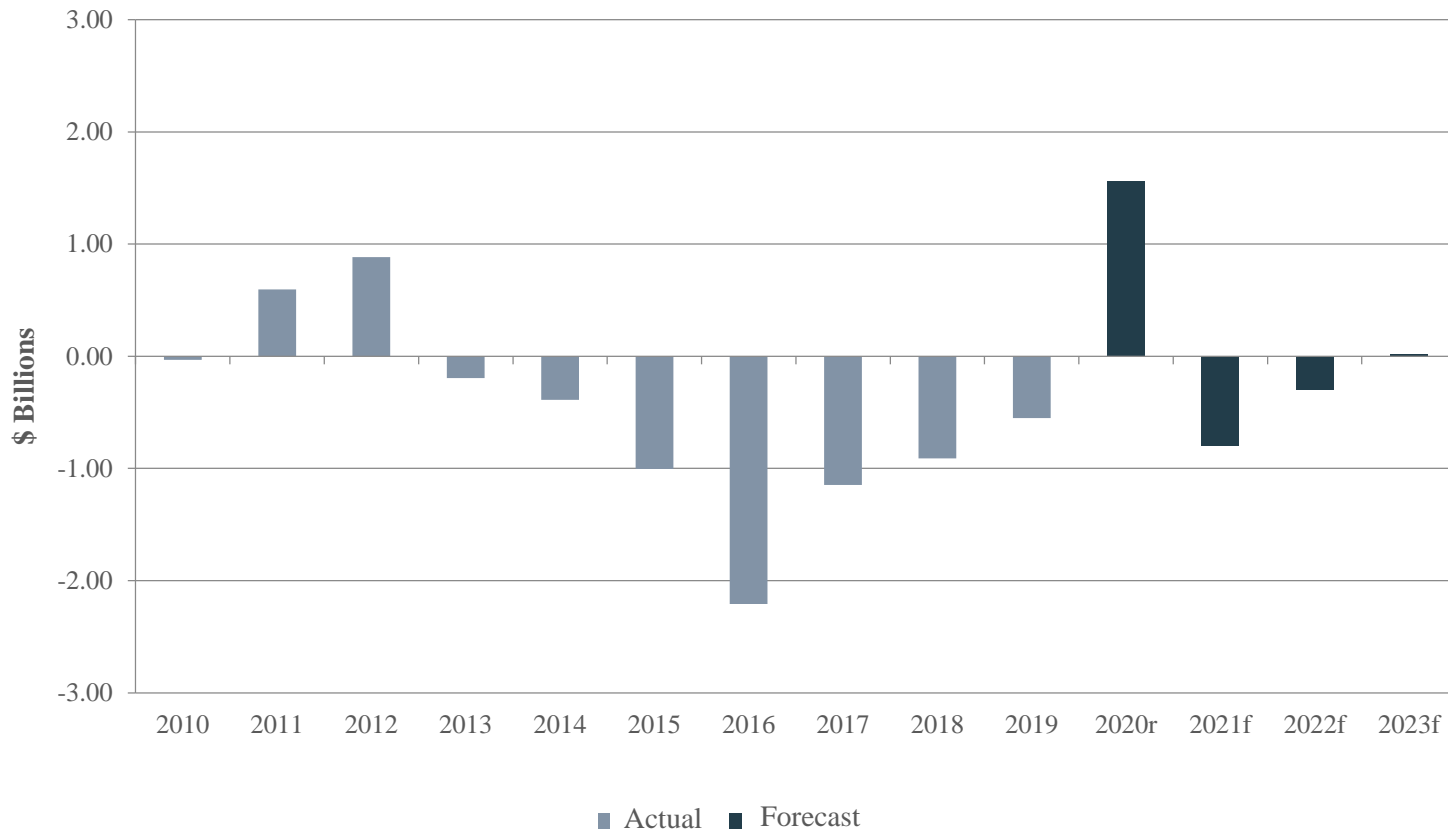
Vulnerability – the extent to which a government relies on sources of funding outside its control to pay for existing programs and services

Flexibility – whether a government can meet rising commitments by expanding its revenues or increasing its debt

Sustainability

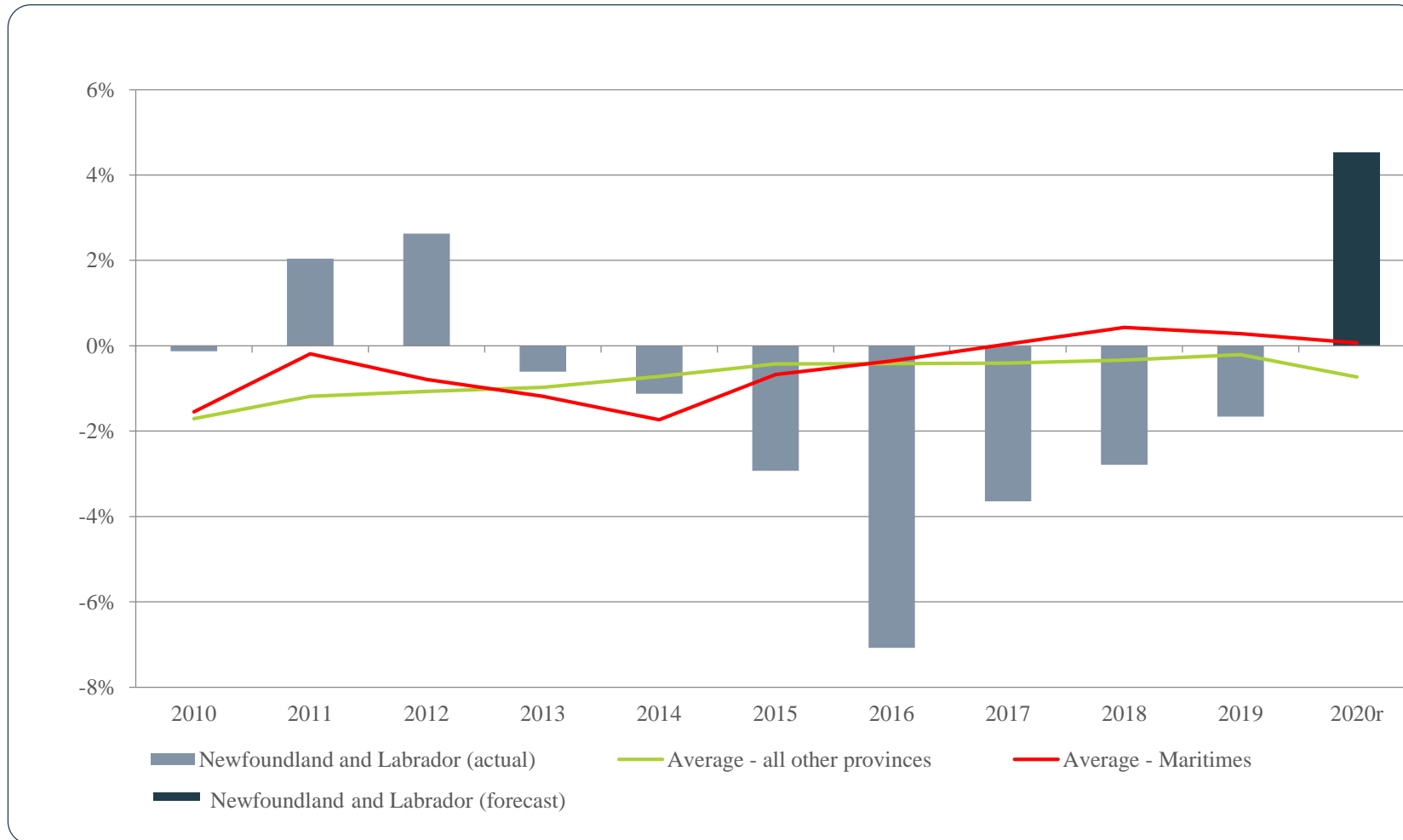
- Annual surplus or deficit
- Surplus/deficit as a percentage of GDP
- Net debt
- Net debt per capita
- Net debt as percentage of GDP

Sustainability – Surplus/Deficit



- ▶ \$0.55B deficit for 2018-19.
- ▶ \$6.4B cumulative deficits over the last 7 years.
- ▶ \$1.56B surplus for 2019-20; down from \$1.92B in Budget 2019
 - ▶ includes \$2.5B revenue for Hibernia Backed Annuity Agreement (Atlantic Accord agreement) - otherwise projected deficit of more than \$0.9B.
 - ▶ accounting treatment of provincial taxes from CHHC
- ▶ Deficits of \$0.8B and \$0.3B projected for 2020-21 and 2021-22 with return to small surplus in 2022-23.

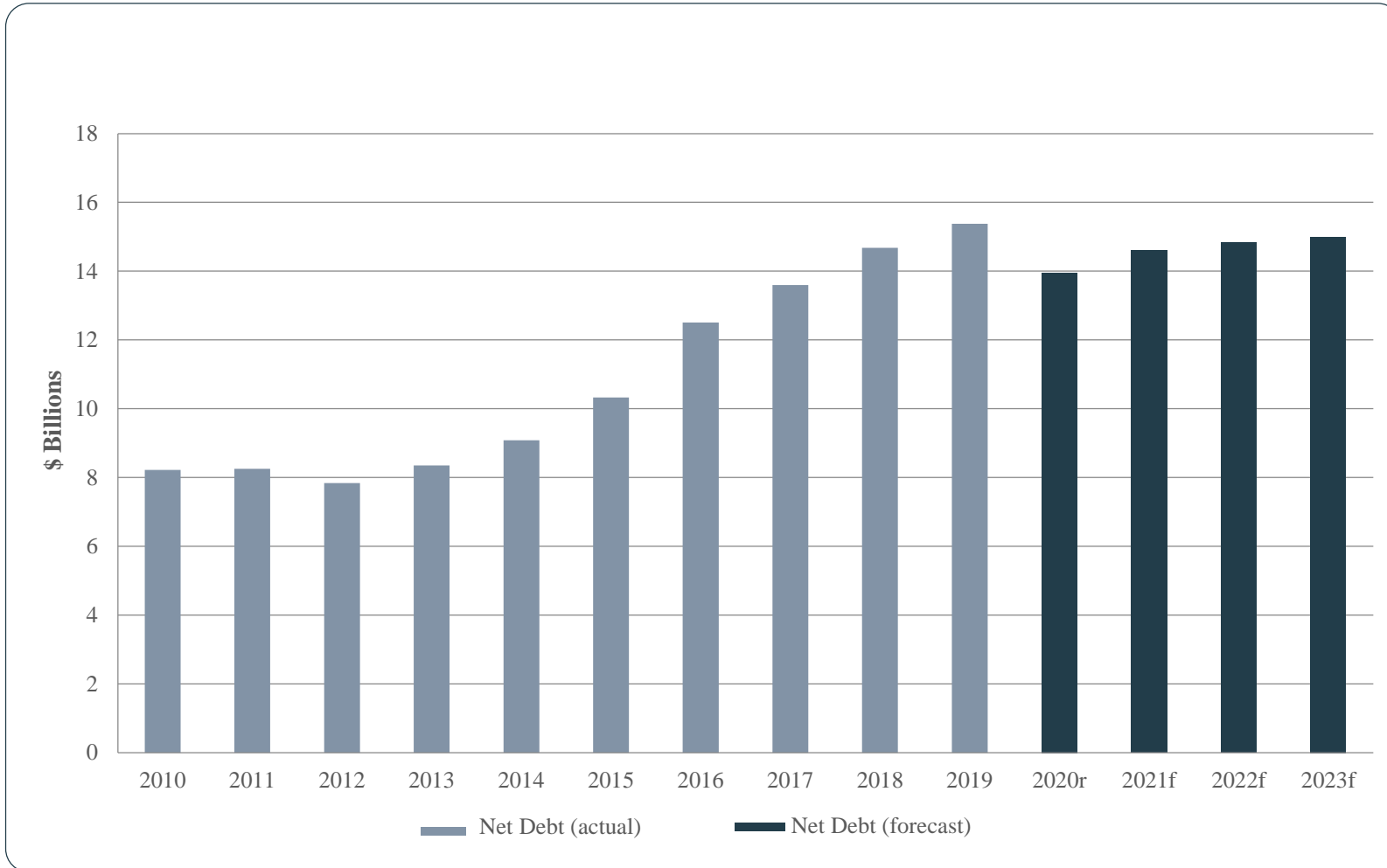
Sustainability – Surplus/Deficit as % of GDP



▶ 1.7% for 2018-19 - the second highest in Canada.

▶ Improve to 4.5% for 2019-20 - primarily attributable to \$2.5 B in Atlantic Accord revenues.

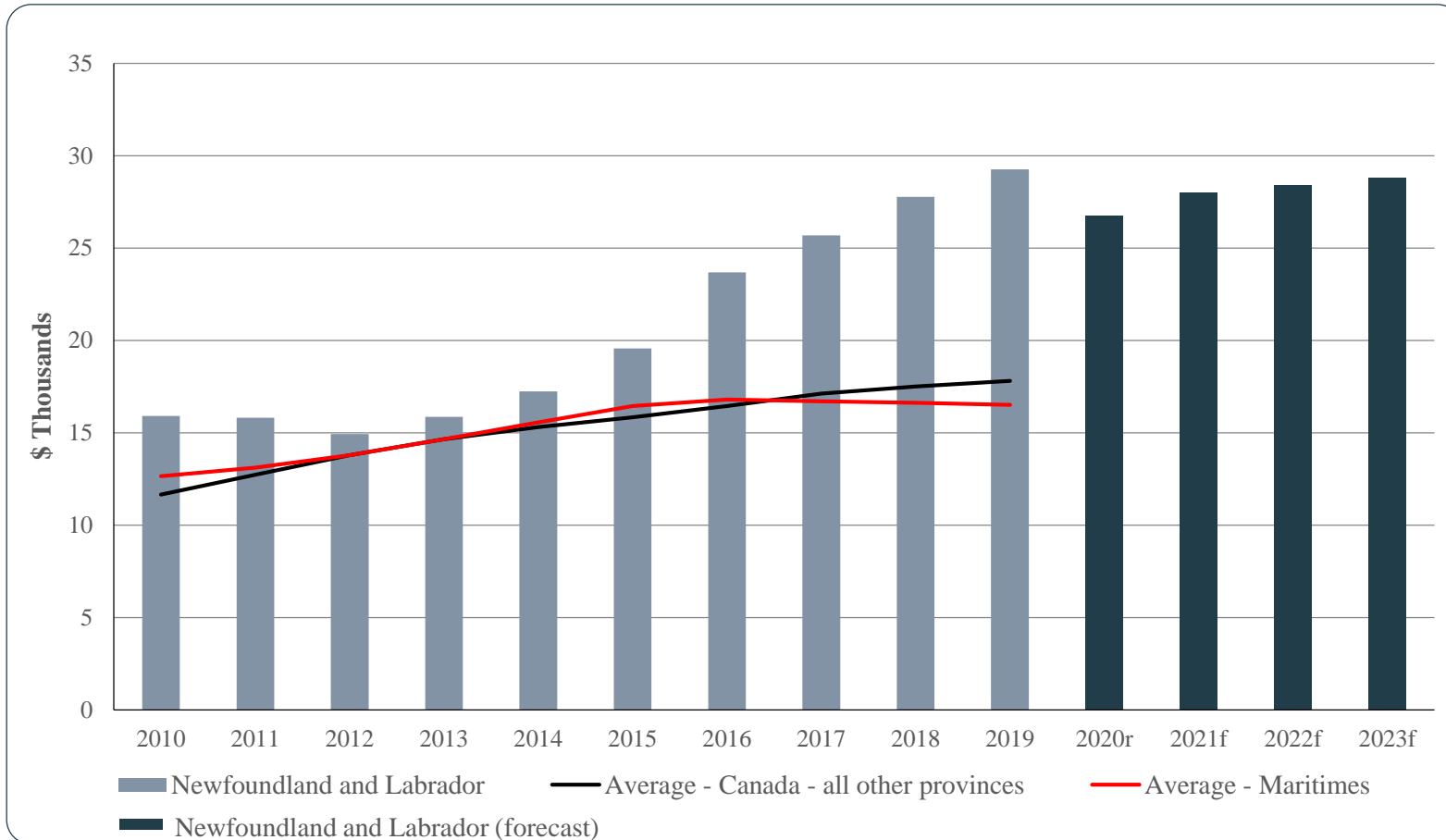
Sustainability – Net Debt



- ▶ \$15.4 B at March 31, 2019 - highest level in the Province's history.
- ▶ Decrease projected for 2020 – primarily due to Atlantic Accord revenues of \$2.5 B - will start to increase again due to projected deficits to \$15.0 B by 2022-23.



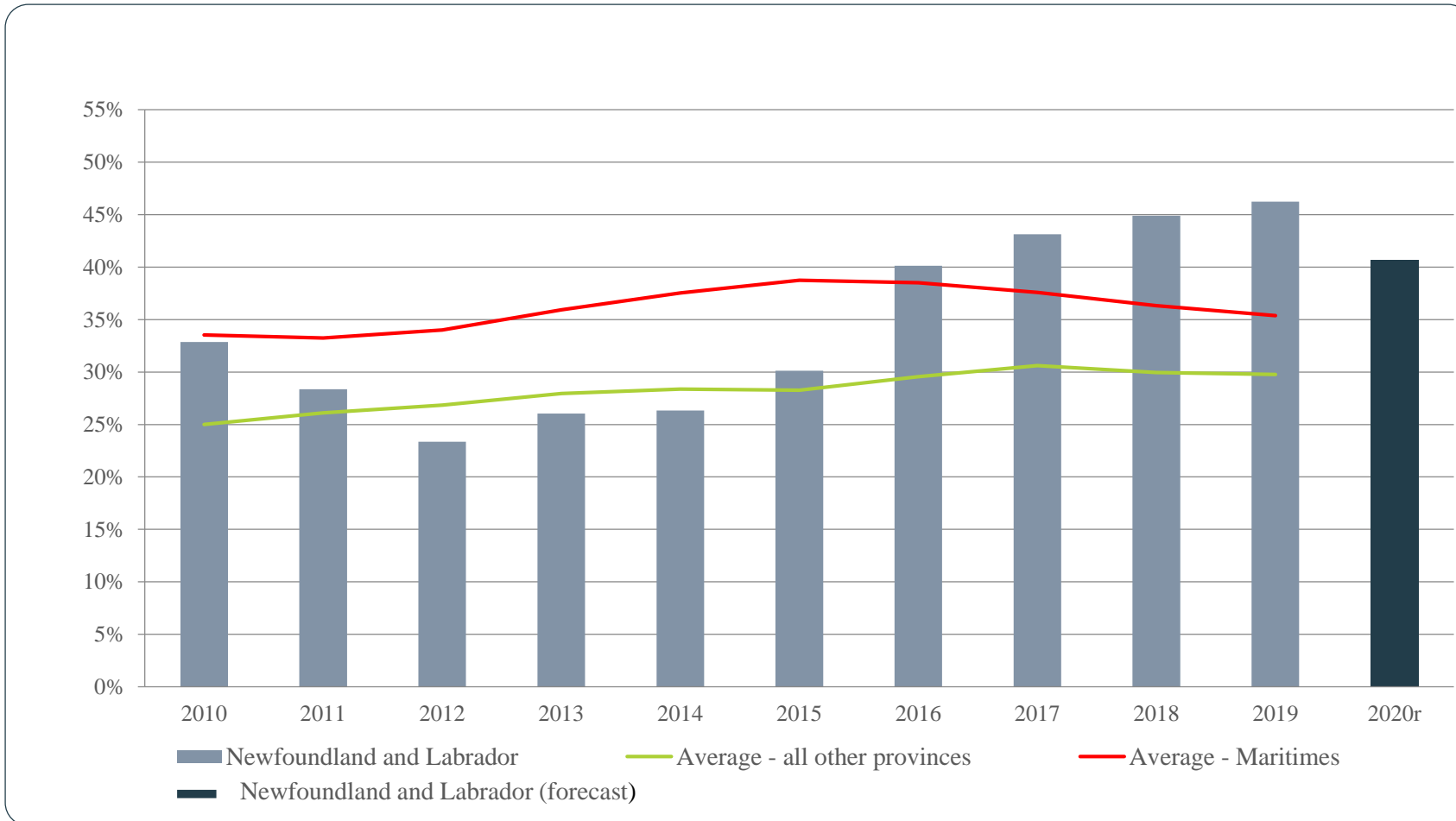
Sustainability – Net Debt per Capita



- ▶ \$29,250 at March 31, 2019 - the highest in the Province’s history and significantly higher than both the average of all other provinces and the Maritimes.
- ▶ Forecast decrease to \$26,748 at March 31, 2020 - primarily attributable to \$2.5B Atlantic Accord revenues.
- ▶ Forecast increase to \$28,812 by 2023 - once again approaching the 2019 level.



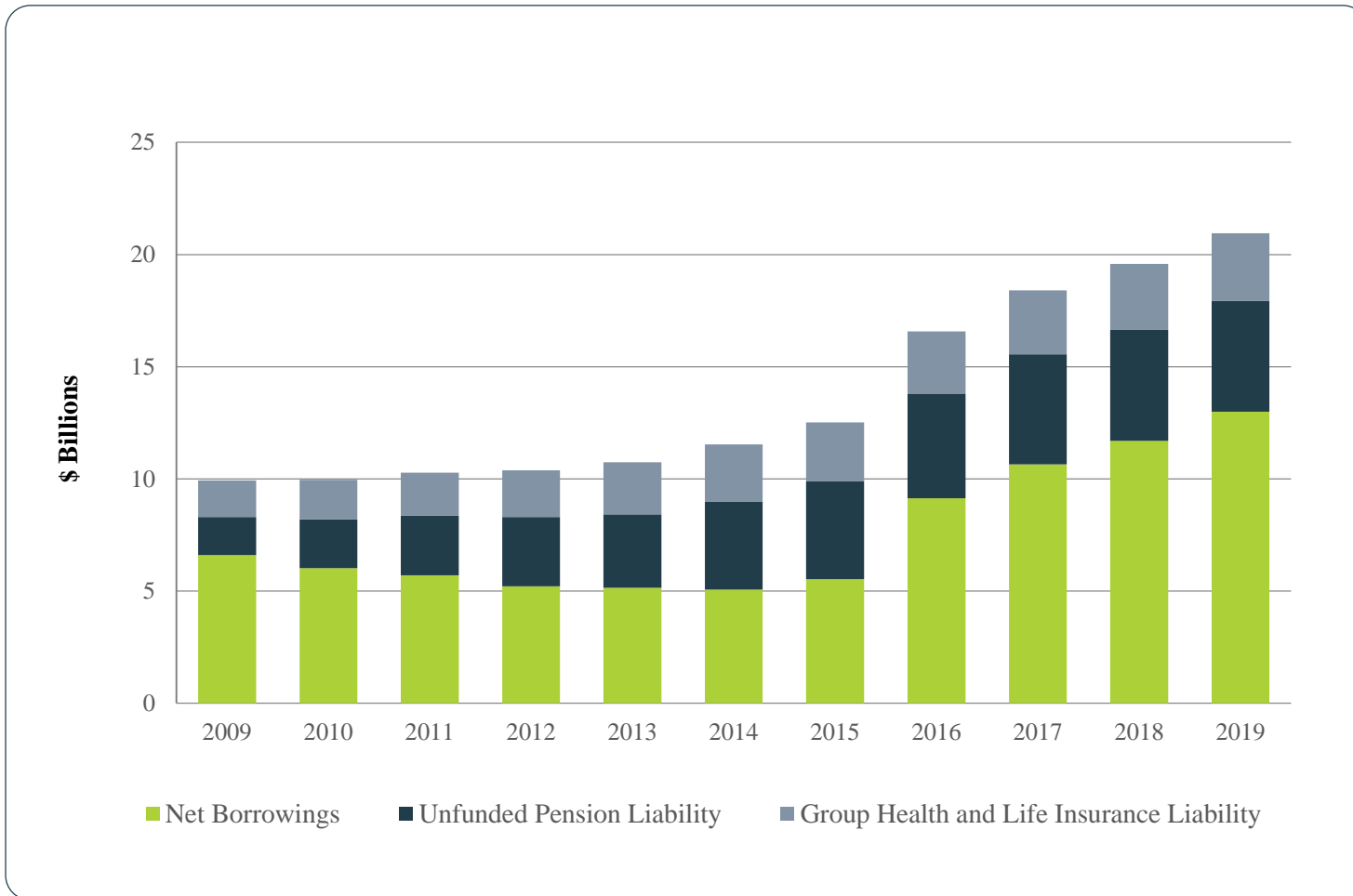
Sustainability – Net Debt as % of GDP



- ▶ 46.3% at 31 March 2019 - significantly higher than the average of 29.8% of all other provinces.
- ▶ Forecasted improvement in 2019-20 to 40.7% - due to \$2.5B Atlantic Accord revenues.
- ▶ Forecasted net deficits and modest GDP growth beyond 2019-20 could continue to increase the ratio of Net Debt to GDP in the future.



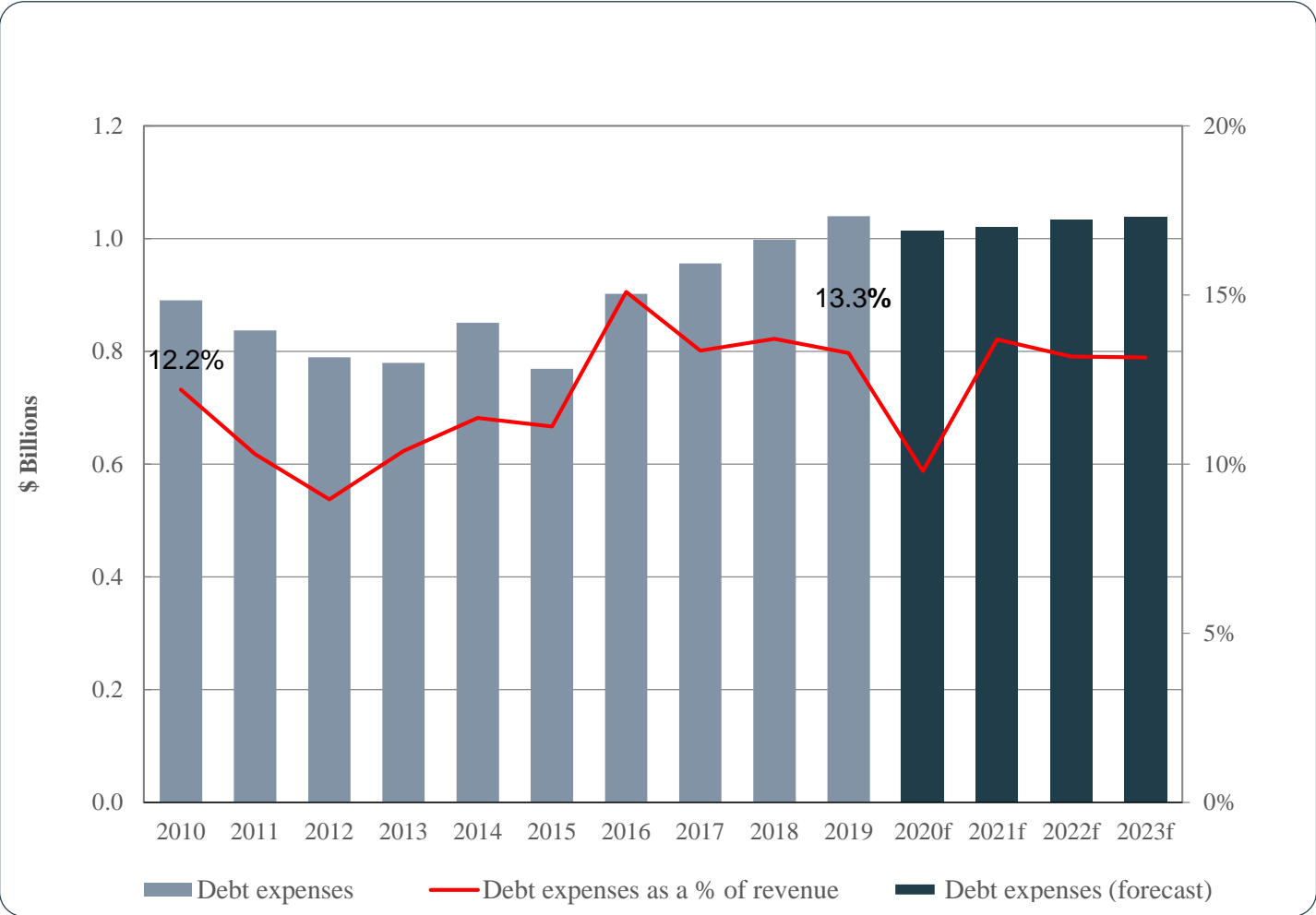
Flexibility – Liabilities for Net Borrowings and Post-Retirement Benefits



- ▶ \$21 B at March 31, 2019 – does not include borrowings of GBEs/GBP (Nalcor, NLC, ALC).
- ▶ Increased 111% over last ten years.



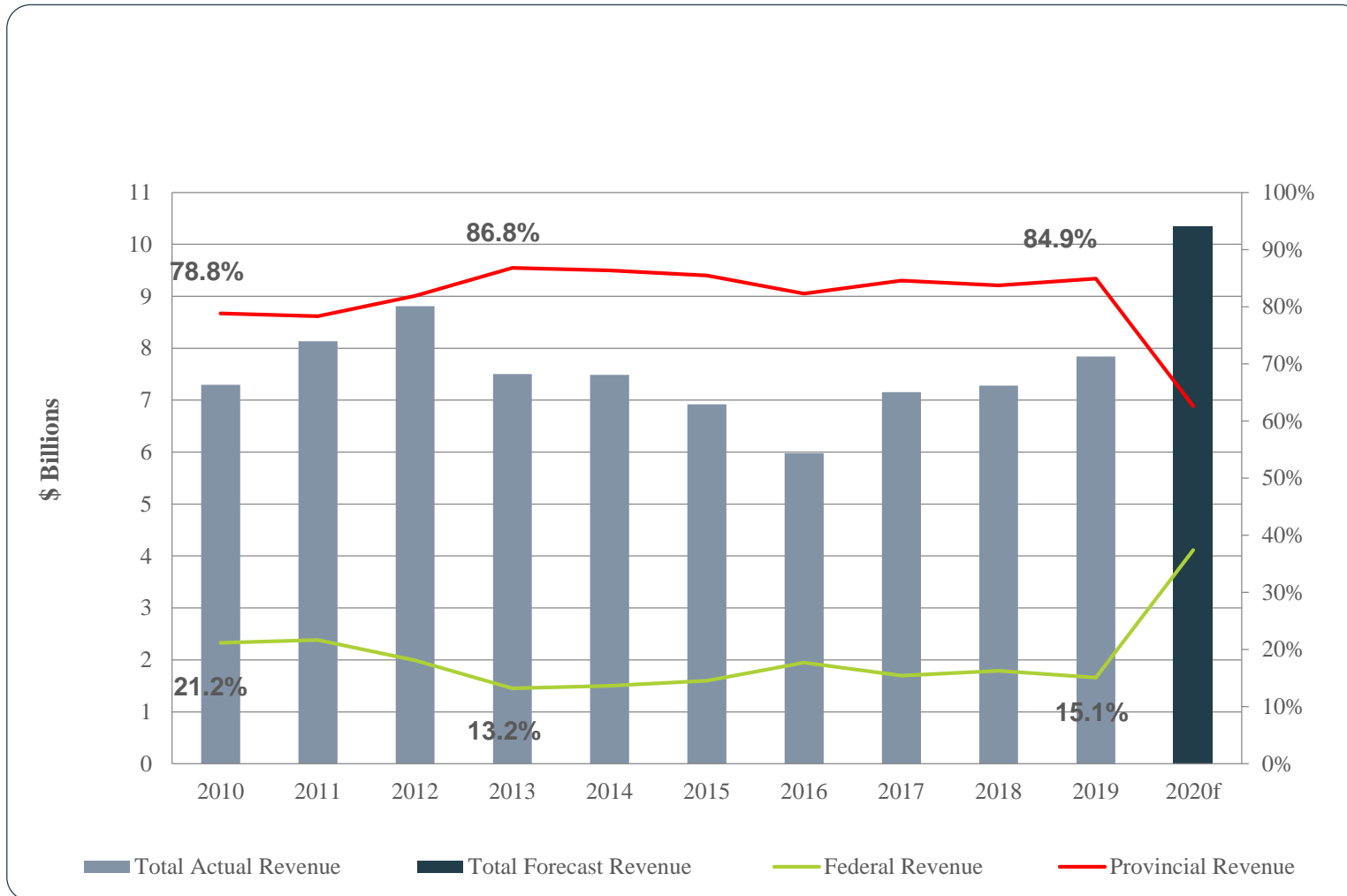
Flexibility – Debt Expenses as % Total Revenue



- ▶ 12.0% average over last 10 years.
- ▶ 13.3% average over last 5 years.
- ▶ Budget 2019 forecast between 2020-2023, for every dollar of revenue generated, 12.5% allocated to debt expense.
- ▶ Between 2020-2023, expect to borrow up to \$4.8 B.



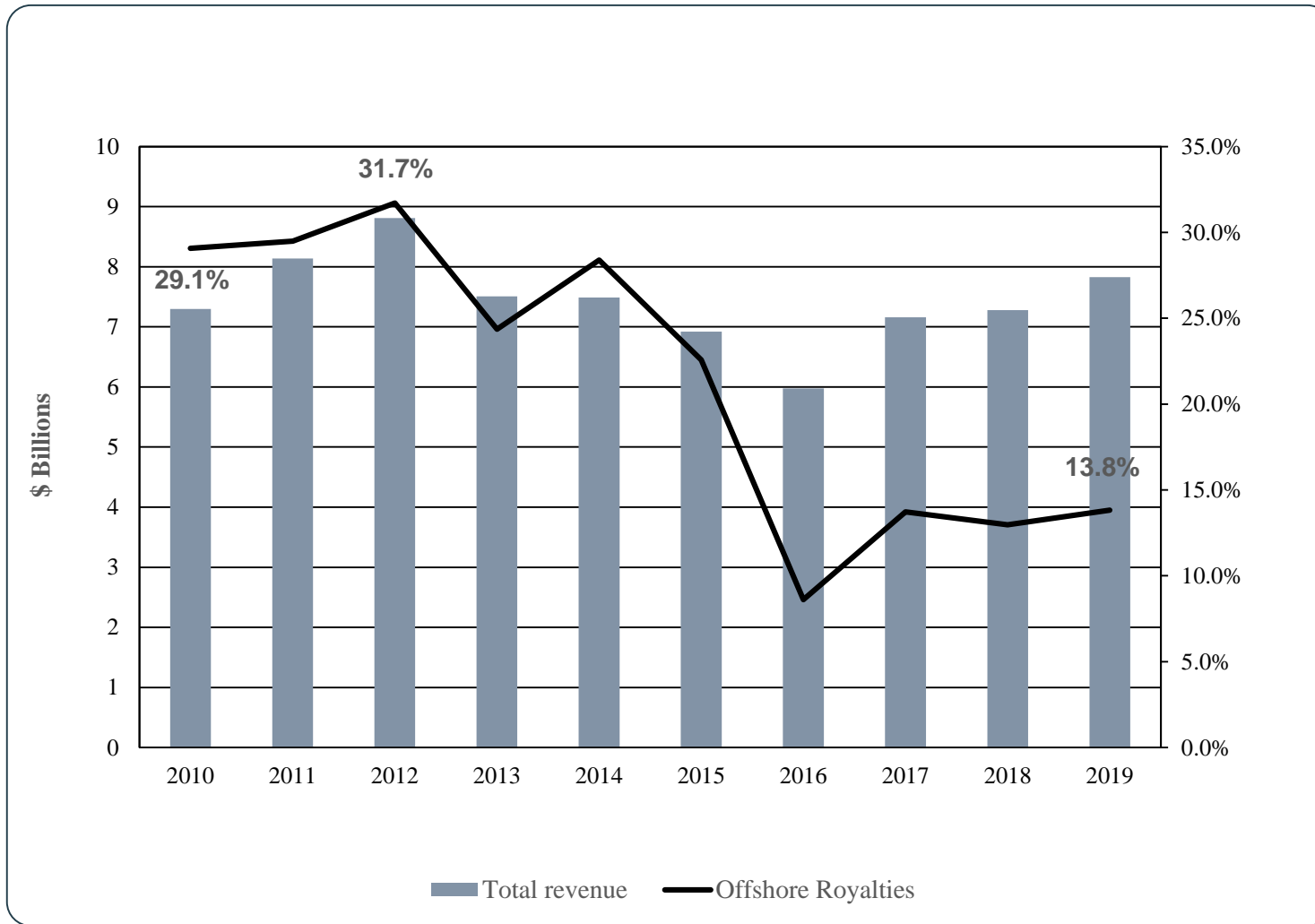
Vulnerability – Federal vs Provincial Revenues as % of Total Revenue



- ▶ Province has become more reliant on own source revenues (2020 sharp change due to \$2.5B Atlantic Accord revenues).
- ▶ Own source revenues include oil royalties that are subject to volatile pricing and production swings, and changes in exchange rates – factors outside of Government’s control.



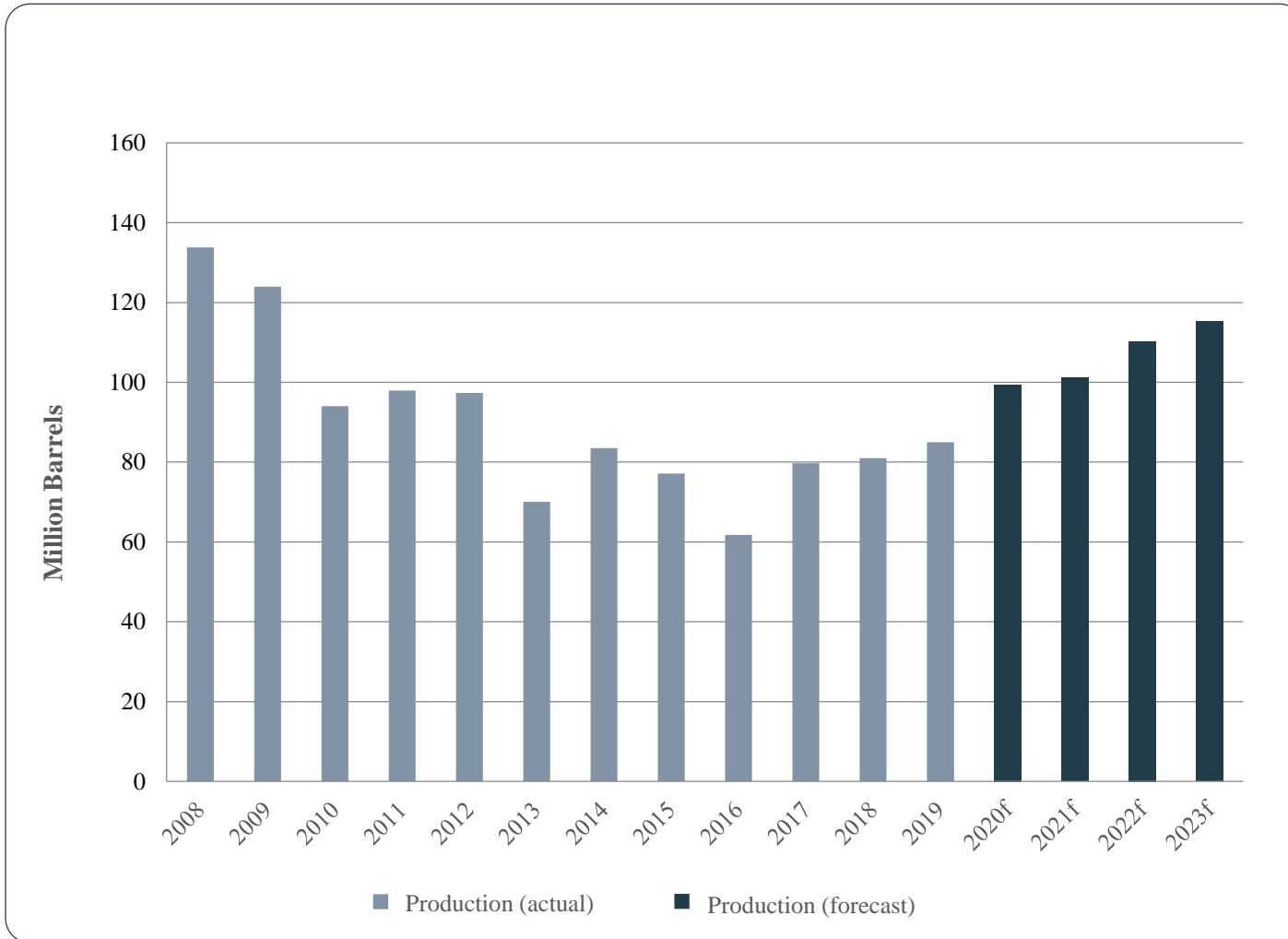
Vulnerability – Oil Royalties as % of Total Revenue



- ▶ 21.5% revenues over last ten years - peak of 31.7% in 2012.
- ▶ 14.3% over last 5 years.
- ▶ 13.8% in 2019.



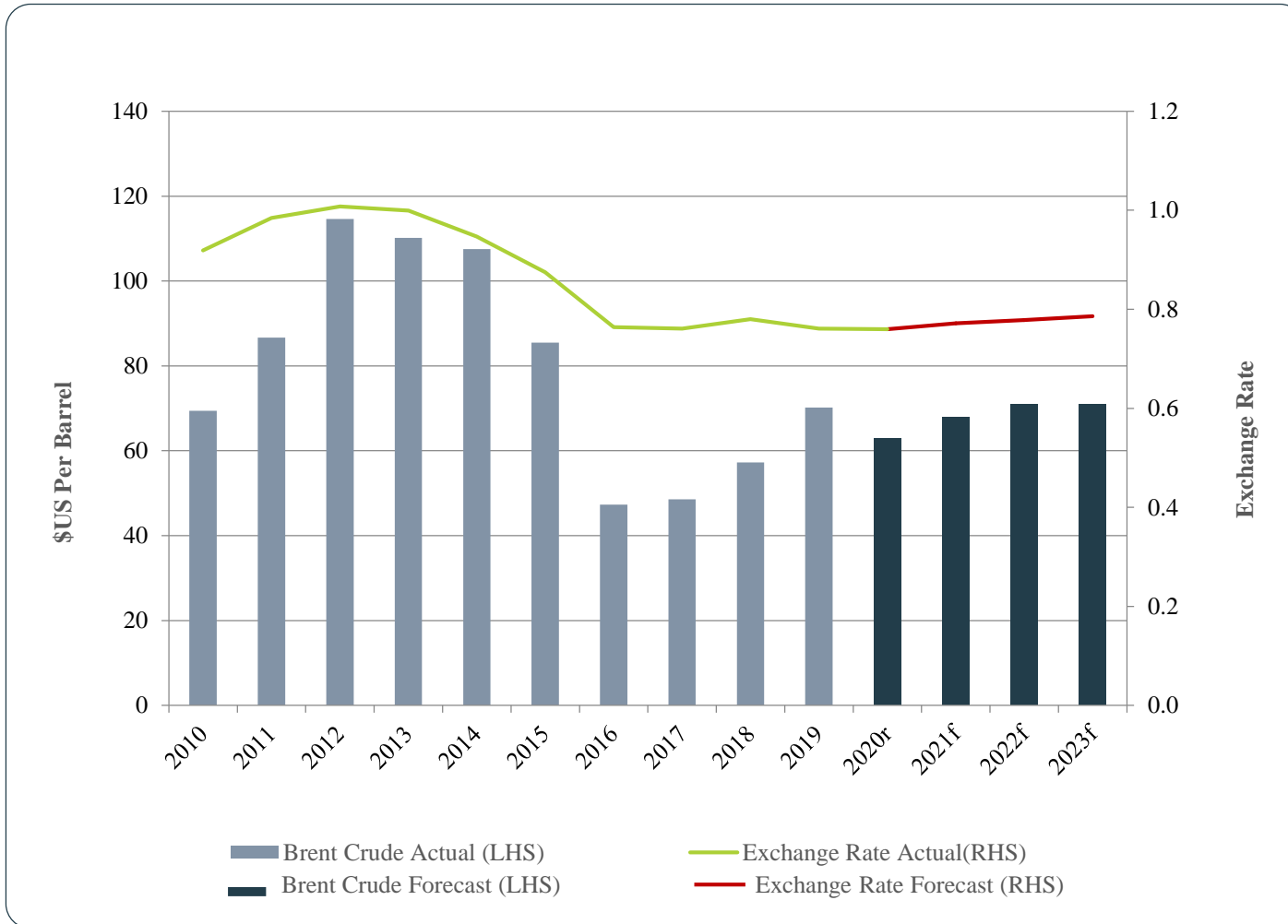
Vulnerability – Annual Oil Production



- ▶ Overall downward trend since 2008 level of 133.8 M barrels.
- ▶ 85.0M barrels in 2018-19.
- ▶ Budget 2019 forecast increase to 99.4M in 2019-20, reaching 115.2M in 2022-23.



Vulnerability – Avg Monthly Spot Price and CAD/US Exchange Rate



Oil Prices

- ▶ Peaked in 2012 at \$US114.58 per barrel.
- ▶ 2018-19 averaged \$US70.40.
- ▶ Fall Update for 2019-20 downward to \$US63.
- ▶ Budget 2019 forecast steady increases to \$US71 by 2022-23.

Exchange Rates

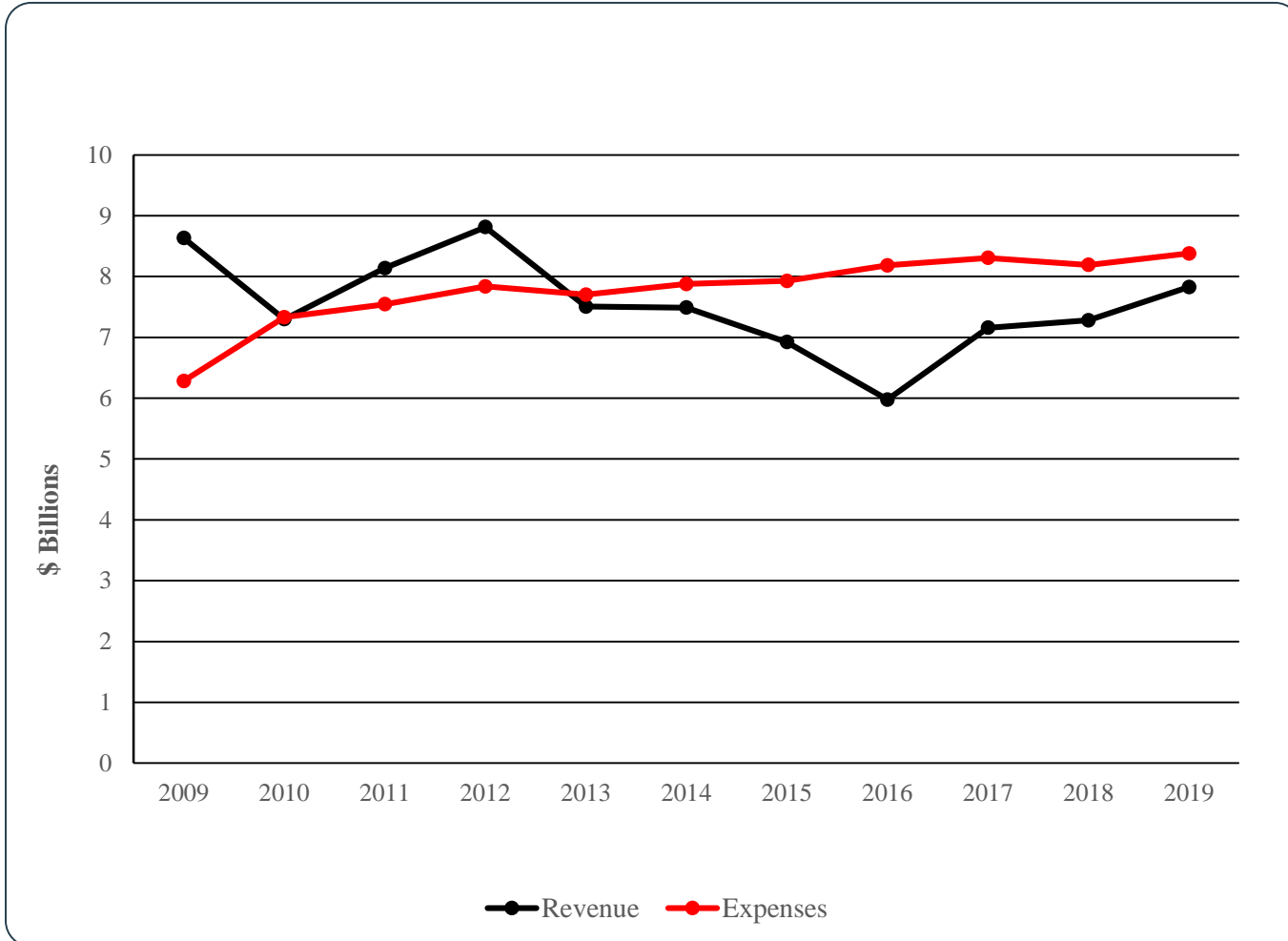
- ▶ Average exchange rate declined to 0.761 in 2018-19.
- ▶ Fall Update for 2019-20 of 0.76.
- ▶ Budget 2019 forecast steady increases to 0.786 by 2022-23.



Other Financial Highlights – Revenues and Expenses



Financial Highlights – Revenues and Expenses



- ▶ 33% increase in expenses over 10 years (from \$6.3B to \$8.4B - \$2.1B increase).
- ▶ 9.0% decrease in revenues over 10 years (from \$8.6B to \$7.8B - \$0.8B decrease).
- ▶ Deficits totaling \$6.4B over last 7 years).



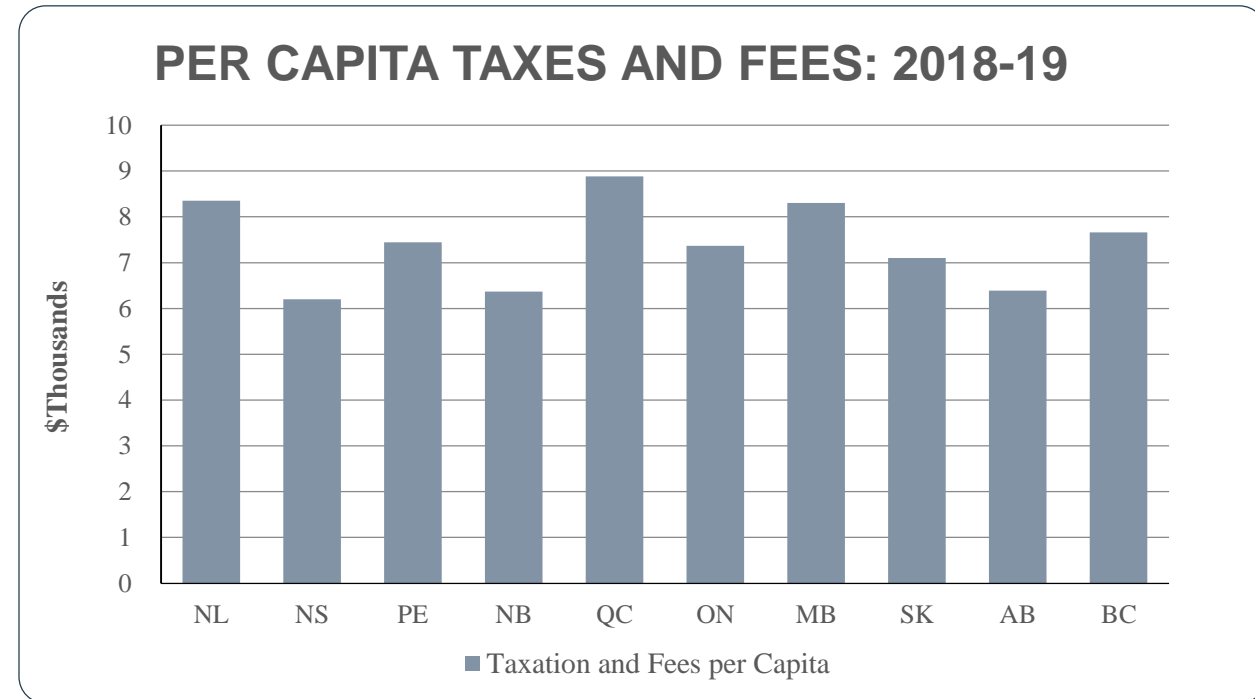
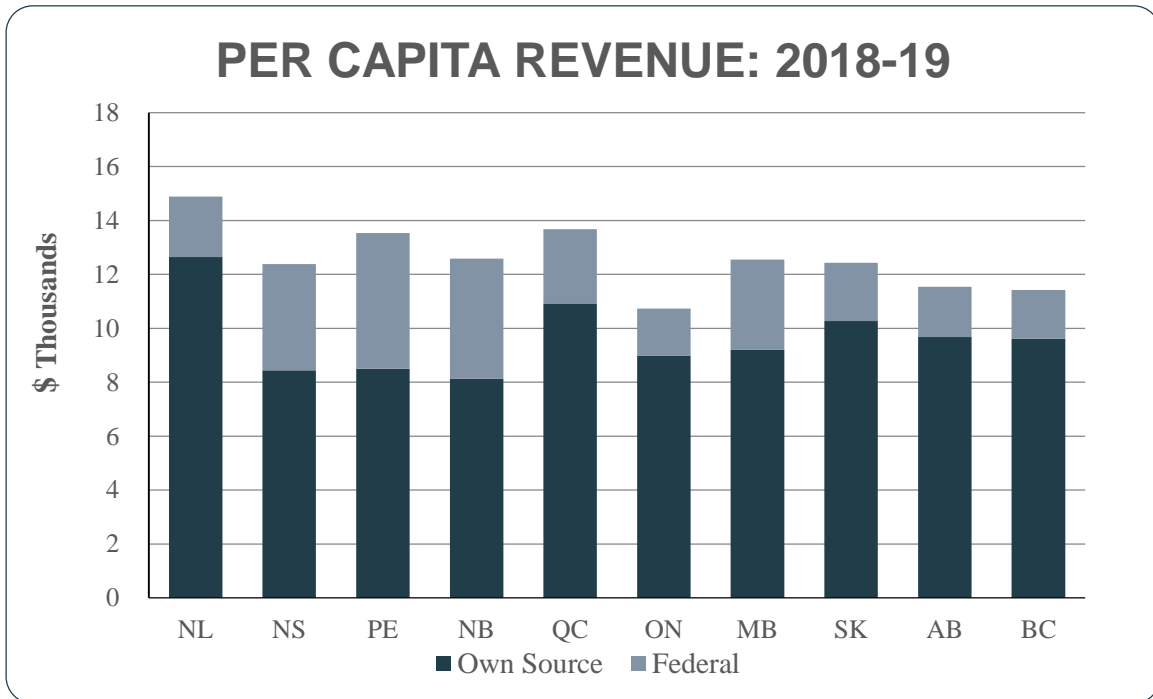
Financial Highlights - Revenues

10-Year/5-Year Trend of Change in Total Revenue (\$Millions)							
Revenue Type	2008-09	2013-14	2018-19	5-Year Trend (2014-2019)		10-Year Trend (2009-2019)	
				Amount	%	Amount	%
Oil Royalties	\$ 2,239	\$ 2,126	\$ 1,083	\$ (1,043)	-49%	\$ (1,156)	-52%
Personal Income Tax	900	1,222	1,548	326	27%	648	72%
Corporate Income Tax	520	358	378	20	6%	(142)	-27%
HST and Other Taxes	1,359	1,625	2,118	493	30%	759	56%
Other Revenues	1,056	1,136	1,518	382	34%	462	44%
Federal Transfers	2,558	1,020	1,182	162	16%	(1,376)	-54%
Total Revenues	\$ 8,632	\$ 7,487	\$ 7,827	\$ 340	5%	\$ (805)	(9%)

- ▶ Change in composition of revenues over 10 years.
- ▶ Decline in oil revenues and federal transfers.
- ▶ Partially offset with increases in PIT, HST and other taxes and revenues.



Financial Highlights - Revenues

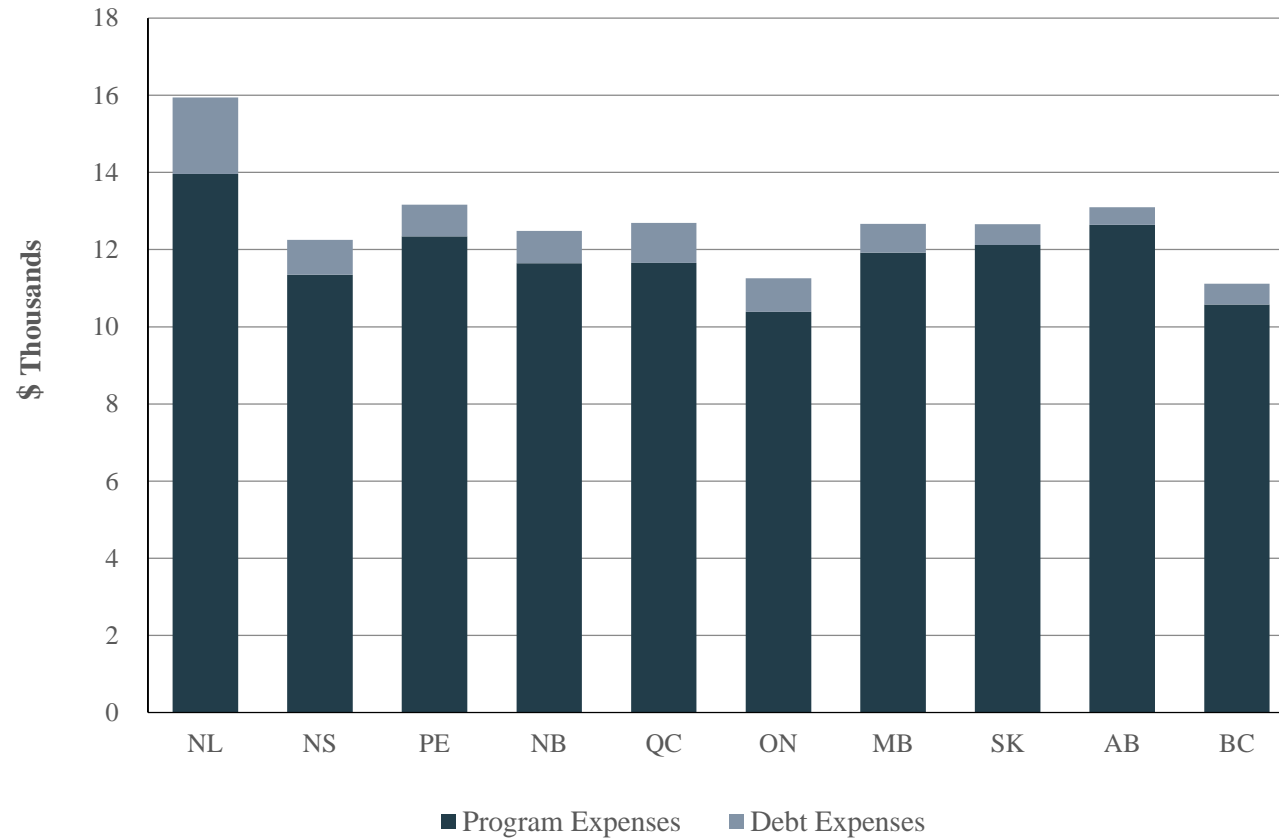


- ▶ On a per capita basis, NL generates more revenue than every other province.
- ▶ NL also has one of the highest tax burdens on a per capita basis in the country.



Financial Highlights - Expenses

PER CAPITA EXPENSES: 2018-19



- ▶ NL spends more per capita than every other province by a considerable margin and more than our per capita revenues.
- ▶ As noted on last slide – on a per capita basis, NL generates more revenue than every other province and also has one of the highest tax burdens on a per capita basis in the country.
- ▶ Suggests that revenue is not the primary issue creating the deficits but the level of spending.



Financial Highlights – Expenses

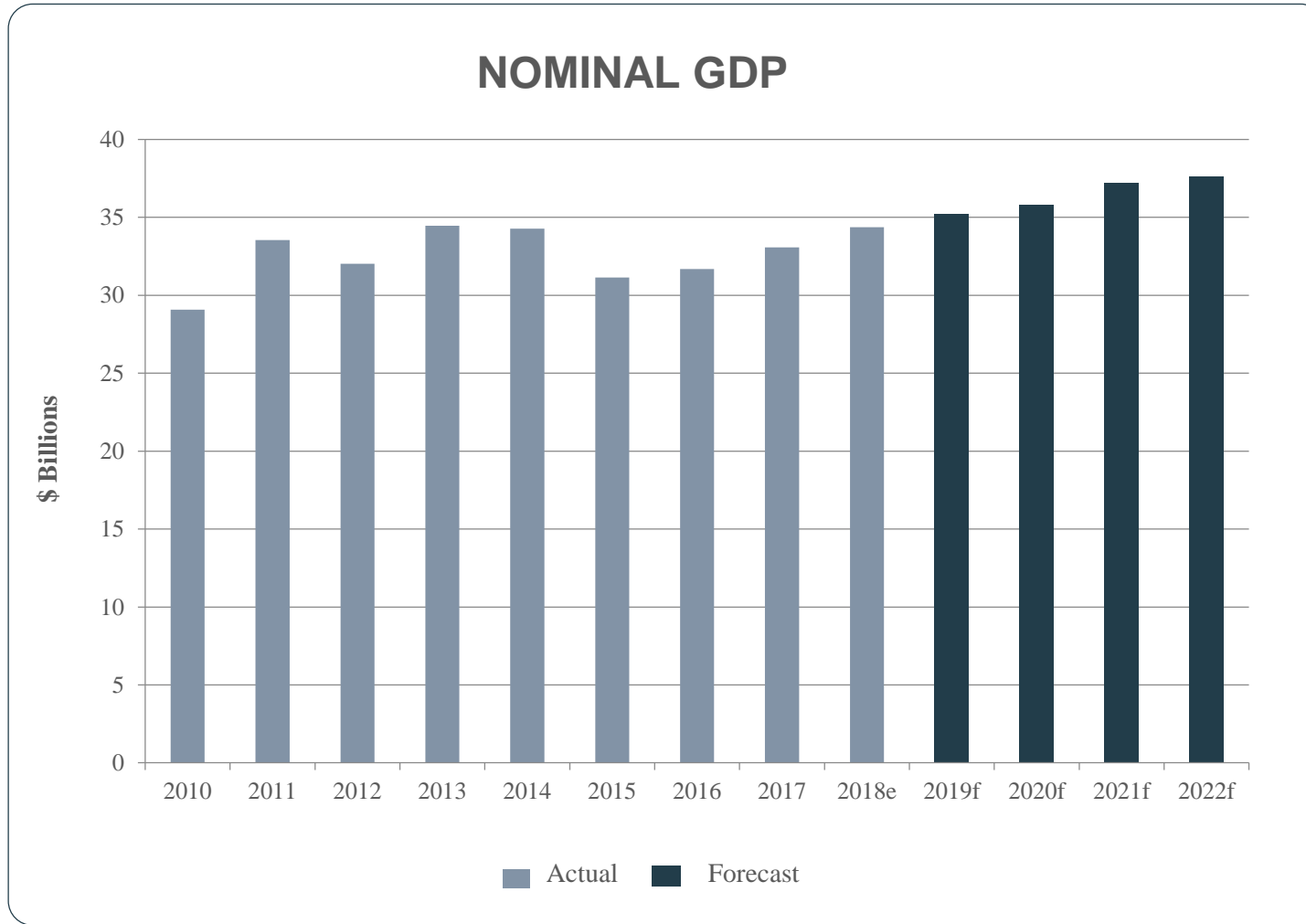
5-Year Trend of Change in Total Expenses (\$Millions) ¹				
Expense by Department or Sector	2013-14	2018-19	5-Year Trend	
			Amount	%
Health and Community Services (HCS)	\$ 2,850	\$ 3,191	\$ 341	12%
Advanced Education, Skills and Labour (AESL)	1,089	1,170	81	7%
Education and Early Childhood Development (EECD)	833	855	22	3%
General Government Sector and Legislative Branch	1,256	1,030	(226)	-18%
Resource Sector - Other	297	289	(8)	-3%
Social Sector - Other	700	804	104	15%
Total Program Expenses	7,025	7,339	314	4%
Debt expenses	851	1,040	189	22%
Total Expenses	\$ 7,876	\$ 8,379	\$ 503	6%

- ▶ 2009-2014 expenses grew by 25.4% - average 5.1% per year.
- ▶ 2014-2019 average rate of growth slowed to 1.3% per year.
- ▶ HCS - \$3.2 billion or 43% program expenses



Economic Outlook



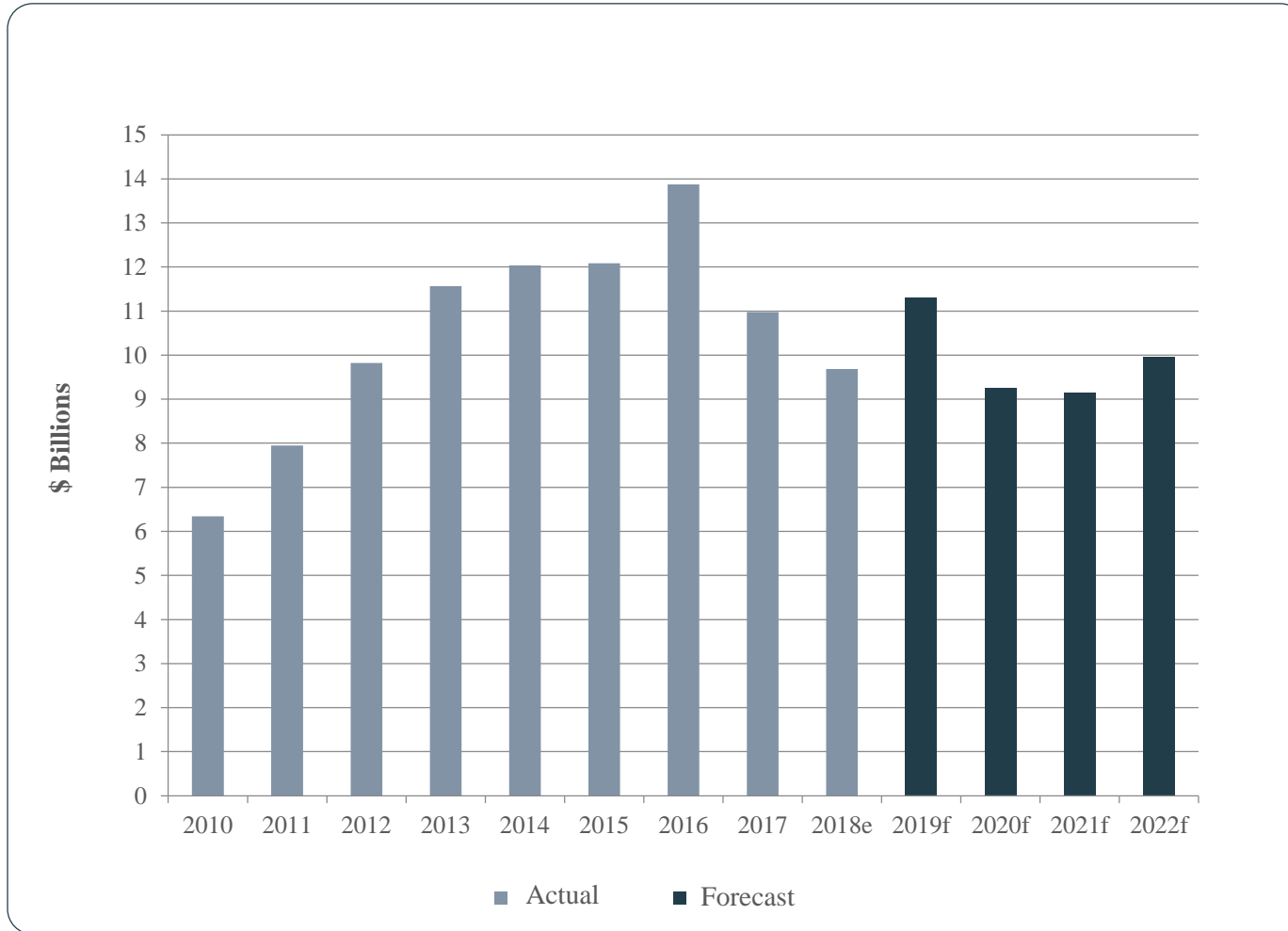


- ▶ Economic growth to continue in 2020 with increased capital investment and increased exports.
- ▶ Beyond 2020 expected to remain challenging with declining construction activity and government spending.
- ▶ GDP growth modest from 2019 to 2022 based on increased oil prices and oil and mineral production.

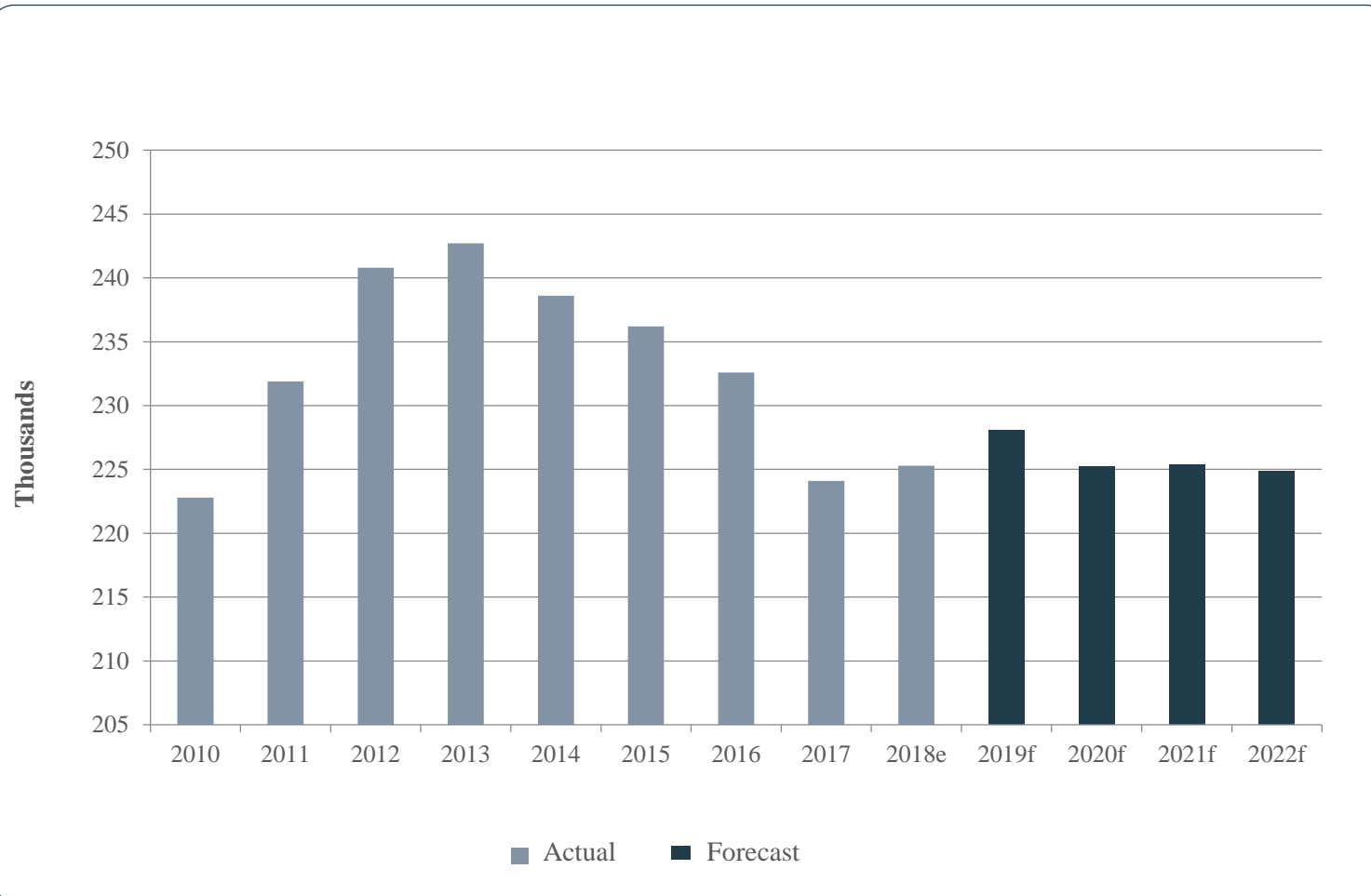


Economic Outlook – Capital Investment

- ▶ Expected to decline from 2019 through 2022 compared to peak in 2016 – will have negative impact on employment, income and revenue to treasury.



Economic Outlook – Employment

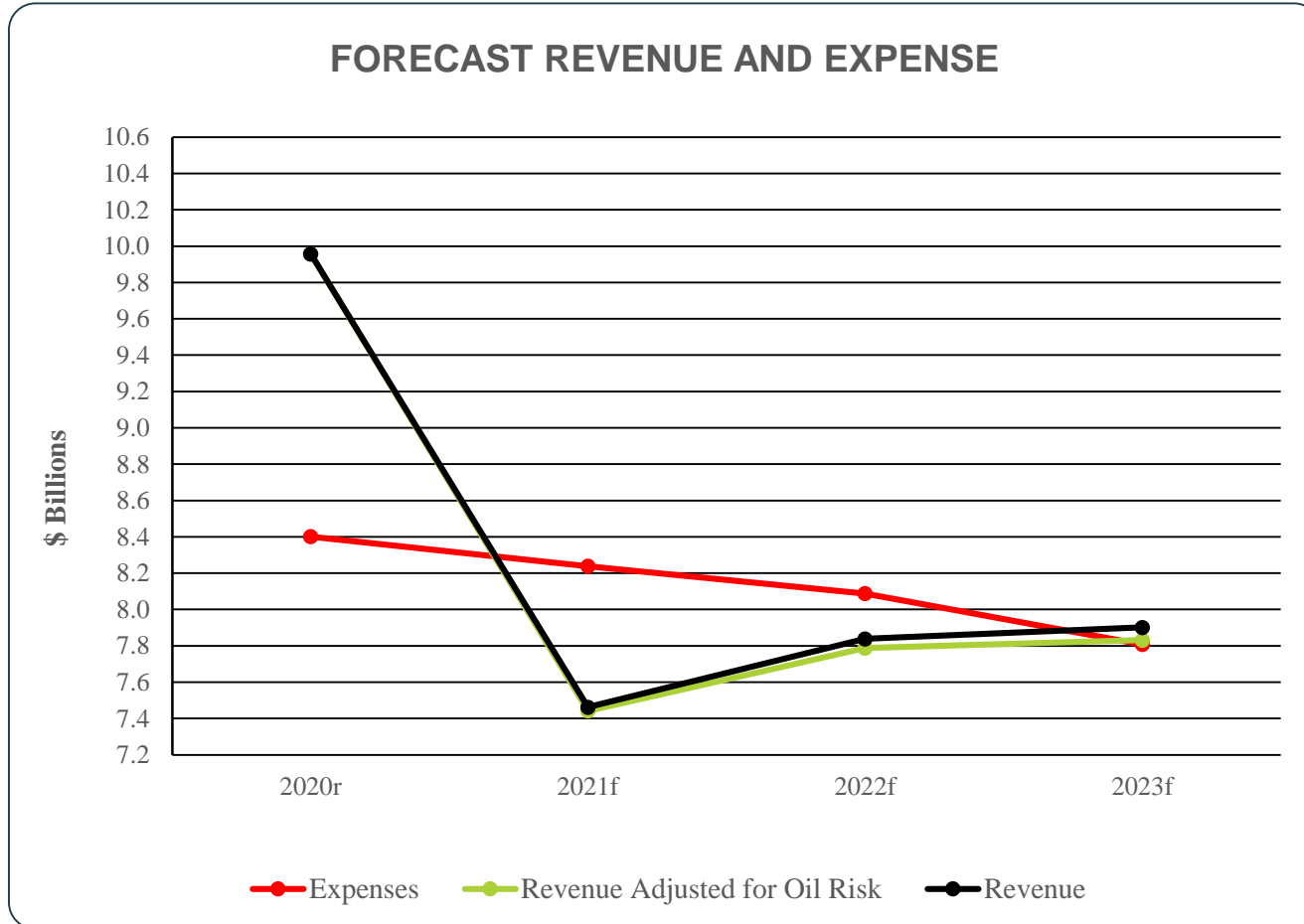


- ▶ Forecast to increase in 2019, followed by decline to 224,900 by 2022 (decrease of 17,800 from 2013 high of 242,700).
- ▶ Decline will have general negative impact on PIT revenue, HST and other consumption taxes.

Fiscal Outlook: 2019-20 to 2022-23



Fiscal Outlook: 2019-20 to 2022-23



Fiscal outlook for 2020 to 2023:

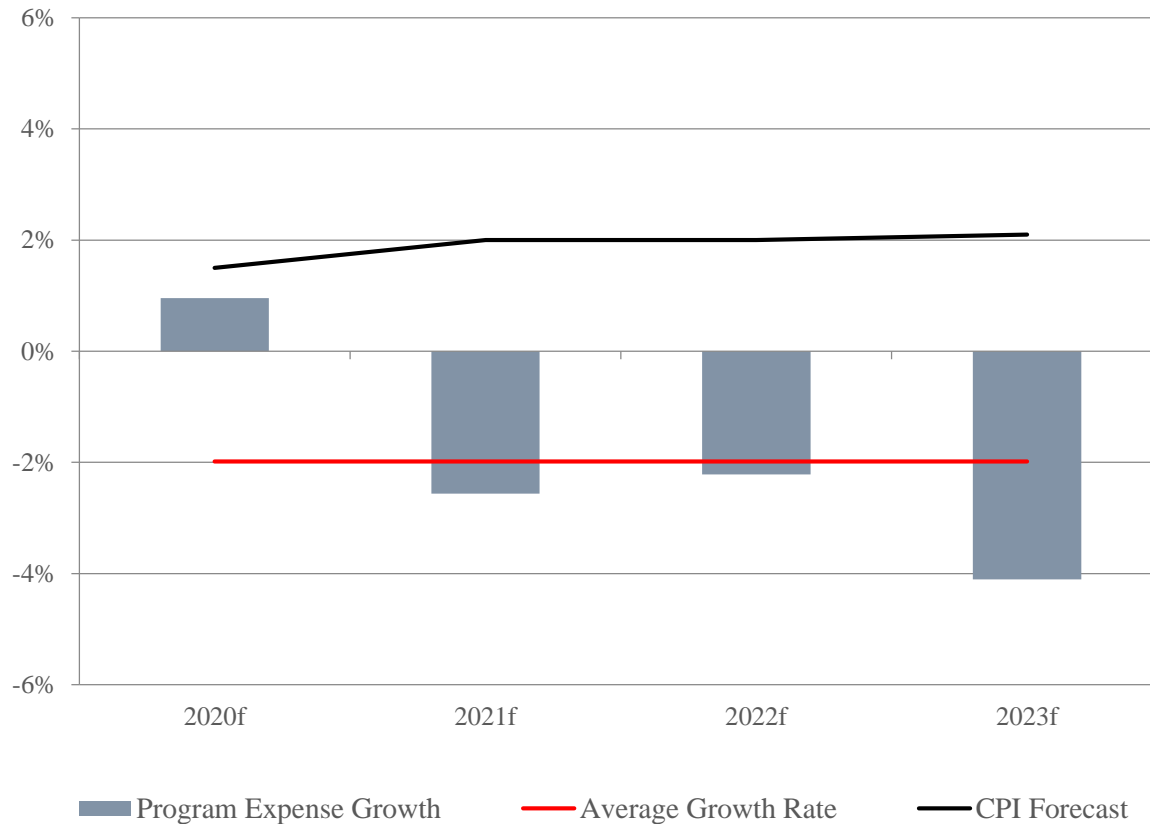
- ▶ \$1.56B surplus in 2020 – due to Atlantic Accord; otherwise would more than \$0.9B deficit.
- ▶ \$0.8B and \$0.3B deficits in 2021 and 2022 respectively.
- ▶ Return to small surplus in 2023 (\$0.023B).

Achieving surplus in 2023 assumes:

- ▶ generally maintaining the same level of revenues in 2023 as 2019; and
- ▶ \$0.6B decrease in program expenses or 1.94% per year.



FORECAST PROGRAM EXPENSE GROWTH



Risks to forecast expenses include, but not limited to:

- ▶ Expected decline in program expenses of 1.94% per year is less than expected rate of inflation.
- ▶ Does not allow for inflation or other pressures (e.g. health care costs, salary increases, etc.).

Risks to forecast expenses include, but not limited to (con't):

- ▶ **Government commitment for electricity rate mitigation:**
 - ▶ \$200M in forecast for 2021 to 2023.
 - ▶ Government announcement on February 10, 2020 on Muskrat Falls Financial Restructuring.
 - ▶ Risk remains for additional cost overruns on Muskrat Falls project.
 - ▶ Assess impact of final rate mitigation plan on valuation of Muskrat Falls assets (i.e. asset impairment) and GBE status of Nalcor.

Risks to forecast revenue include, but not limited to:

- ▶ **Economic forecast based on assumptions** - impacted by global and national economic environments. Province's forecast basis for predicting taxation and other revenues.
- ▶ **Forecast includes Corporate Income Tax** – subject to volatility as some of largest remitters are commodity-based.
- ▶ **Carbon tax revenues** - forecast at \$20 per tonne, commenced in January 2019 increasing to \$50 per tonne for diesel and \$30 per tonne for gasoline by 2023– rate on gasoline and diesel subject to Atlantic parity.
- ▶ **Commodity revenues** - forecast includes increase in oil revenues based on increasing oil prices and production – factors outside the Province's control.

Thank You



OFFICE OF THE AUDITOR GENERAL
NEWFOUNDLAND AND LABRADOR

Independence. Credibility. Integrity.