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

The Current Global Economic Environment

In a normal business cycle, economies would be well into recovery from the 2008-2009 recession by now. However, many countries around the world are still struggling to achieve sustained, robust economic growth and have not yet recouped losses suffered during the recession. As such, global economic uncertainty persists two years after the recession.

In the euro area, the stressed fiscal position of a number of nations continues to be a drag on economic recovery. Concern over debt and the mismatch between revenues and spending in Greece, Portugal, Ireland, Spain and Italy has significantly increased borrowing costs and led to austerity measures that further curtailed growth for these nations. The pain was dispensed even farther afield as banks holding claims to the debt of these countries saw the value of their assets fall with the rising interest rates on government bonds.

After moving in a piecemeal fashion to address the situation for most of the year, in late October European leaders committed to a more aggressive, comprehensive approach to deal with the sovereign debt crisis. The bailout mechanism for stressed European nations was increased from 440 billion euros to 1 trillion, leaders negotiated a “voluntary” 50 per cent write-down of privately held Greek debt and Italy committed to deeper austerity measures.

Nevertheless, the debt write-downs and looming increased capital requirements for European banks could increase borrowing costs for businesses and consumers and force banks to reduce lending. These factors may dampen growth prospects across the Continent. The International Monetary Fund (IMF) projects real gross domestic product (GDP) growth of 1.6 per cent for the euro area in 2011. More significantly, in the most sovereign debt-troubled nations growth rates are weak, ranging from -5.0 per cent in Greece to just 0.8 per cent in Spain in 2011.

In the United States economic weakness persists, evidenced by debt concerns, sluggish job growth, low levels of consumer and business confidence and a weak housing market. Employment, as of October 2011, was still 4.3 per cent below employment levels at the start of the recession and the unemployment rate, at 9.0 per cent, has recorded no improvement throughout the year. Consumer confidence is at levels similar to those seen during the 2008-2009 recession and housing starts and new home sales remain at historical lows. However, current economic data is sending mixed signals with real GDP growth accelerating throughout the year. For the year as a whole, expectations for growth in the U.S. are in the neighbourhood of 1.6 to 1.7 per cent.

There continues to be strong growth in developing countries—especially China and India, which are expected to see GDP growth of 9.5 per cent and 7.8 per cent respectively in 2011. Growth in these countries has helped sustain commodity prices throughout 2011 and GDP growth globally. The IMF, despite reducing its economic outlook in September, is still projecting 4.0 per cent global GDP growth in 2011 and 2012.

Economic Performance

The Canadian economy has been somewhat resilient through the recent bouts of economic volatility because of its commodity-exporting nature. Canada has benefited from strong commodity prices for energy and minerals, which have been buoyed by demand from Asia. However, Canada was not immune to the uncertainty in the global economy and dimming recovery. As the year progressed, growth slowed with quarterly, annualized GDP growth falling to -0.4 per cent in the second quarter. This was primarily a reflection of the downturn in the U.S. and Europe, leading to reduced exports. However, a return to growth is expected in the third quarter as real GDP for July and August increased by 0.3 and 0.4 per cent respectively. For the year as a whole GDP growth of 2.3 per cent is projected.

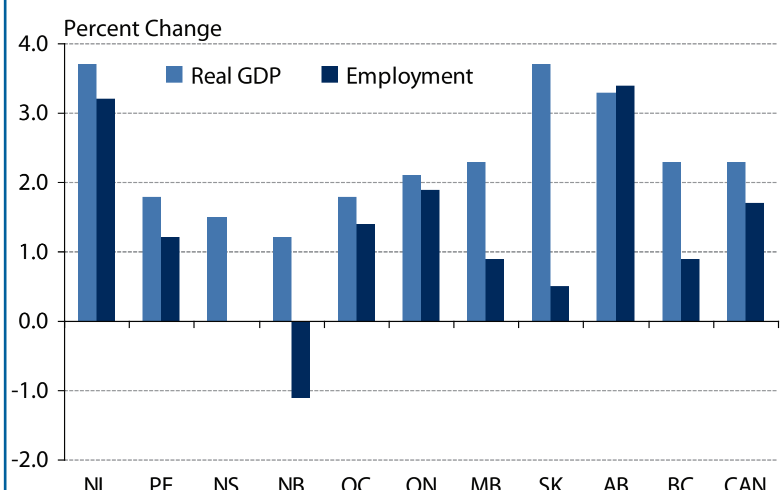
Employment in Canada as of October was 17.3 million, above the pre-recession high-water mark of 17.2 million recorded in October 2008. The unemployment rate in October was 7.3 per cent, well below the recession high of 8.7 per cent posted in August 2009.

There continues to be a divergence among provinces in terms of economic performance. Commodity-producers such as Alberta, Saskatchewan and Newfoundland and Labrador are taking advantage of high commodity prices and continued strong demand from emerging markets. These provinces are expected to do better than others in real GDP growth this year, and Alberta and Newfoundland and Labrador are expected to lead the way in employment growth (see chart). Nonetheless, all provinces are expected to record an increase in GDP this year and most are expected to post employment gains.

The Department of Finance's forecast for real GDP growth for the province for 2011 is 4.9 per cent, an upward revision of 1.9 percentage points from the Budget forecast primarily due to higher than expected oil production. Oil production is expected to total 98.9 million barrels for the calendar year compared to an expectation of 85.9 million barrels at budget time. Employment is forecast to grow by 2.8 per cent, similar to the Budget forecast.

Investment, largely related to the development of major projects in the province, is a key driver behind economic expansion this year. Total capital investment is expected to be $8.0 billion in 2011, a 21.9 per cent increase over 2010.

Economic Indicators Forecast, 2011



Source: Consensus of the major banks and Conference Board of Canada

Construction activity at Vale's nickel processing facility in Long Harbour is in high gear; IOC expansion activities in Labrador City are progressing; the Hebron oil project is ramping up; and other oil-related projects, such as White Rose and Hibernia expansions, are contributing as well. These projects, combined with the continuation of government's infrastructure strategy, are generating thousands of direct jobs and economic spin-offs throughout the province. The construction industry is reaping the benefits of this increase in investment, as evidenced by an increase in monthly average employment of 3,400 to the end of October.

Other industries in the province have also performed well this year. The mining industry is benefiting from strong demand and high commodity prices; non-resident tourist numbers remain at high levels; the aquaculture industry continues to expand and create economic wealth in rural areas of the province; the retail sector is benefiting from increased incomes; and transportation services are being boosted by higher levels of economic activity.

Economic Indicators Forecast
2011, Budget vs Fall
(per cent change unless otherwise indicated)

	Budget	Fall	Change
Real GDP	3.0	4.9	+1.9
Personal Income	5.5	5.8	+0.3
Retail Sales	4.2	4.8	+0.6
Housing Starts (units)	3,294	3,351	+57
Capital Investment	27.2	21.9	-5.3
Employment	3.0	2.8	-0.2
Unemployment Rate (%)	13.8	12.5	-1.3
Population	0.3	-0.1	-0.4

Labour market conditions in the province continue to be strong. From January to October employment averaged 2.9 per cent higher than the same period of 2010. Employment growth is being driven by major project development activity and related spin-offs, continued increases in consumer spending, and strong public sector spending. Gains in employment have led to a decline in the unemployment rate—the unemployment rate in 2011 averaged 12.6 per cent to October, 2.0 percentage points lower than the first ten months of 2010 and the lowest for this time period in 36 years. Labour market strength is also evidenced by rising wage rates. Average weekly earnings increased by 4.9 per cent in the first eight months of the year compared to the same period in 2010. Labour income in the province increased by 7.0 per cent in the first half of the year, aided by gains in employment and wages.

High levels of consumer confidence, combined with job and wage gains, have led to an increase in consumer spending. Retail sales rose by 4.8 per cent in the first eight months of the year, compared to the same period in 2010.

The housing sector has continued to perform at high levels. Although down from 2010, housing starts remain relatively high and are doing better than expected earlier in the year. MLS sales are slightly above 2010 and average price is up 6.8 per cent through October.

The strength of the provincial economy is evident in final domestic demand, which measures demand in the local economy by summing consumption, investment and government expenditures. Final domestic demand in real terms is expected to increase by 7.8 per cent in 2011, which is greater than real GDP growth because it is unaffected by changes in exports.

Expansion in the economy and increasing employment have served to stabilize the province's population. Prior to 2009, the population had declined for 16 consecutive years because of high levels of out-migration. The province recorded increases in its population in both 2009 and 2010 as net in-migration occurred. Migration trends, and subsequently population levels, will continue to be impacted not only by strength in the local economy but also by labour market demand in other provinces, particularly Alberta. Preliminary data released by Statistics Canada indicates that the population of the province on July 1, 2011 was 510,578, down 0.1 per cent from one year earlier.

Outlook

Economic growth—as measured by real GDP—is expected to slow in 2012 as a result of a decline in exports stemming from lower oil production. However, growth in final domestic demand is expected to continue to be robust, buoyed by higher levels of investment in major projects. Construction activity at the site of Vale's nickel processing facility in Long Harbour is expected to peak next year and the Hebron and Muskrat Falls developments are expected to ramp up, resulting in a further increase in investment expenditures. Strong domestic demand is expected to lead to solid growth in other economic indicators. Both employment and personal income are expected to post solid gains. Increased employment and income, combined with high levels of consumer confidence, will bolster consumer spending—retail trade is expected to continue to record steady growth. Population is expected to increase in 2012 as job openings and continued optimism regarding the strength of the economy result in a return to net in-migration.

Fiscal Update

Budget 2011 forecast a surplus of $59.1 million. The province now expects an improvement of $696.7 million with a surplus of $755.8 million.

Since 2005-06, the province has recorded cumulative surpluses of approximately $4.9 billion. This cumulative improvement in financial performance positions the province to continue on this path of responsible fiscal management through planned debt reduction and a commitment to fiscal sustainability.

Revenue

The province's revenue for the year is now projected to be $728.1 million higher than the forecast at budget time. A number of factors have contributed to this improvement.

Oil royalties are expected to be $681.1 million higher than the Budget forecast. The increased revenue relates primarily to higher production of 19.3 million barrels and an increase in the average oil price. The average price expected to be received for a barrel of oil at budget time was $US108.21 (Cdn-$106.11).The province now expects the average price for the year to be $US113.16 (Cdn- $110.93), an increase of $US4.93 (Cdn-$4.82) per barrel. The projected average exchange rate for the year approximates the $1.02 rate used for the budget.

Consolidated Statement of Operations
Budget vs Mid-year revised 2011-12

($ Millions)	Budget	Mid-Year	Change
Fiscal Revenue	7,123.5	7,804.6	681.1
Net Income of Government Business Enterprises	219.2	266.2	47.0
Total Fiscal Revenue	**7,342.7**	**8,070.8**	**728.1**
Net Expenses			
Program Expenses	6,479.2	6,519.1	(39.9)
Debt Servicing Expenses	804.4	795.9	8.5
Total Net Expenses	**7,283.6**	**7,315.0**	**(31.4)**
Surplus	**59.1**	**755.8**	**696.7**

The balance of the increase in revenue is attributable to the province's return on its investment through Nalcor Energy.

There are no major variances in the other revenue sources although corporate and personal income taxes as well as sales tax may change subject to updates received from the Federal Government later in the year.

Expenses

Expenses are expected to be $31.4 million (0.6%) higher than the Budget forecast. This is partially offset by a decrease in the forecasted debt expense.

Net Debt

Net debt, which peaked at $11.9 billion is now projected to decline by approximately $305 million to $7.7 billion at March 31, 2012 subject to the release of last year's public accounts. This is the lowest level of net debt since 1998-99.