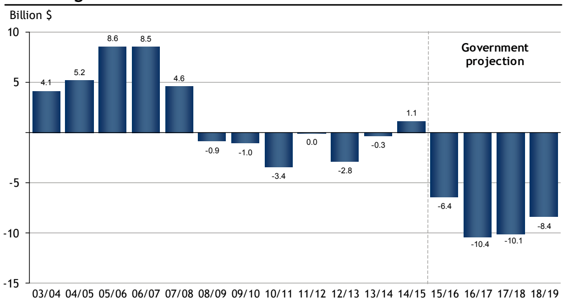
ALBERTA BUDGET 2016

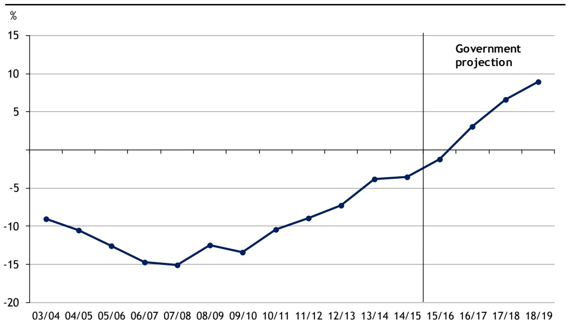
April 15, 2016

Alberta government fiscal balance



Source: Alberta Treasury Board and Finance, RBC Economics Research

Alberta's net debt-to-GDP ratio



Source: Alberta Treasury Board and Finance, RBC Economics Research

Budget assumptions

	2015	2016	2017	2018	2019
Real GDP growth (%)					
Budget 2016	-1.5	-1.4	1.9	2.8	2.7
RBC	-1.8	-1.6	2.0	-	-
Nominal GDP growth (%)					
Budget 2016	-11.4	-4.3	8.0	8.2	6.4
RBC	-10.6	-3.7	10.2	-	-
Crude oil prices - WTI US$/bbl					
Budget 2016	49	38	51	62	67
RBC	49	40	57	70	-

Source: Alberta Treasury Board and Finance, RBC Economics Research

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Red ink and plenty of it for a long time

- In the face of the tremendous economic adversity, the Alberta government opted for the go-slow approach to turn its budget situation around. It projects budget deficits in each year of its fiscal plan to 2019. In his press conference, Finance Minister Joe Ceci indicated that his government is "aiming to return to balance by 2024". This is fully four years later than expected this past October in Minister Ceci's 2015 budget.
- The provincial deficit is forecasted to balloon to a record high of $10.4 billion in FY16/17 (3.3% of GDP) from $6.3 billion in FY15/16 (1.9% of GDP), and remain high at $10.1 billion in FY17/18 before easing to $8.4 billion in FY18/19. No projections were provided beyond FY18/19.
- Non-renewable resource revenues are forecasted to fall by a further $1.1 billion to $1.4 billion (or 3.3% of total revenues) in FY16/17 after plummeting by $6.5 billion in FY15/16. This source of revenue is projected to recover only partially during the remainder of the fiscal plan.
- The government will introduce a new economy-wide carbon tax on January 1, 2017, that will generate $274 million in FY16/17 rising to $1.7 billion by FY18/19.
- Program expenses are slated to rise by 3.2% in FY16/17 and an average of 3.8% in the following two years.
- The province will be in a net debt position in FY16/17 after nearly two decades in net asset position. The contingency fund was depleted at the end of FY15/16.

Tough economic times make for a lousy backdrop for the budget

Alberta's 2016 budget unveiled yesterday comes only five months after the release of Budget 2015, which was the New Democratic Party's government first since winning the May 2015 provincial elections. Despite this short time span between budgets, much has changed for Alberta's budget picture. Economic conditions in the province unfortunately have deteriorated since October last year and global oil prices have remained stubbornly low (notwithstanding a recent uptick). The Alberta government therefore was compelled to downgrade further its expectations for both provincial economic growth and oil prices substantially in yesterday's budget. The government now projects a second-consecutive contraction in the provincial economy in 2016 (real GDP falling by 1.4% following a decline of 1.5% in 2015) instead of a modest growth (+0.9% in Budget 2015), and has cut its assumption for the West Texas Intermediate by 38% in 2016 to an average of US$38/barrel from US$61/barrel previously. Moreover, the government drastically revised downwardly its nominal GDP assumption (the measure of economic activity that more closely drives government revenues) to -4.3% in 2016 from the earlier forecast of +4.0%—a downswing of 8.3 percentage points. Needless to say that weaker expected economic conditions and oil prices significantly dimmed the near-term outlook for revenues. Provincial revenues are now projected to fall for a second consecutive year in FY16/17 by $1.6 billion (3.6%) with non-renewable resource revenue accounting for most ($1.1 billion) of this decline.

Deficit to balloon to $10.4 billion in FY16/17...

Despite these intense revenue pressures, the Alberta government has remained steadfast in both continuing to grow its funding for programs and services, and fostering the diversification of its economy. In FY16/17 it plans to boost program spending by $1.5 billion (3.2%), including $563 million more for health care (an increase of 2.8%) and $434 million more for education (an increase of 3.2%). The province also expects to spend an extra $221 million in debt service expenses in FY16/17 relative to FY15/16. Altogether, declining revenues and rising expenditures are projected to deepen last year's record deficit ($6.4 billion) to the tune of $3.3 billion. The deficit for FY16/17 reaches $10.4 billion when accounting for a risk adjustment (contingency factor) of $0.7 billion that the government introduced for the first time in this budget in recognition of the high degree of uncertainty surrounding budget assumptions—especially those pertaining to oil prices.

...and stay high at $10.1 billion in FY17/18

Somewhat surprisingly, the government projects the deficit to remain little changed at $10.1 billion in FY17/18 even though it expects the economy to begin to recover. In fact, nominal GDP is forecasted to rebound strongly by 8.0% in 2017 (reflecting positive real growth in the provincial economy and rising commodity prices). The government projects its revenues to surge by $3.6 billion (8.7%) in FY17/18; however, a substantial $2.5 billion (4.9%) increase in expenditures—mostly in non-core programs—and a $0.8 billion boost to the risk adjustment provide significant offset. One of the factors contributing to the rise in both revenues and expenditures will be the introduction of a new carbon tax in 2017.

Carbon tax: a new source of revenue… and reason for spending

Initially announced in November 2015 when the government unveiled its climate strategy, a new "economy-wide" carbon tax will be imposed starting on January 1, 2017, at the rate of $20/tonne (the effect on gasoline prices will be an increase of 4.49 cents per litre), rising to $30/tonne in 2018 (6.73 cents per litre of gasoline). The new tax will raise $274 million in FY16/17 rising to $1.7 billion by FY18/19. Including the existing carbon levy on the province's large industrial emitters, Alberta's carbon levies are expected to bring in $9.6 billion in gross revenue over five years. The government will offer rebates to lower and middle income families to the tune of $2.3 billion over five years, and implement a small business tax reduction ($865 million), which will lower the net proceeds to $6.4 billion. The government pledges to invest these net proceeds on a variety of projects supporting renewable energy, green infrastructure (including public transit) and energy efficiency.

Some relatively small measures to stimulate the economy

The title of Budget 2016—The Alberta Jobs Plan—would suggest a strong emphasis on economic stimulus measures to reinvigorate the province's job market; however, the budget content is rather light on new such initiatives. The most noteworthy measures introduced today were a cut to the small business income tax rate (from 3% to 2%) and a $250 million package over two years to support job creators (that will include new tax credits and new funding to spur innovation, regional economic development and training). Of course, a centerpiece of the Alberta government's economic stimulus strategy remains its $34.8-billion, 5-year capital plan that it announced in the October budget. The plan calls for $8.5 billion to be spent in FY16/17 and $8.2 billion in FY17/18.

Alberta's contingency fund: all gone

The significant budget shortfall last year compelled the government to dip repeatedly into its contingency fund. So much so that the government completely depleted the fund by the end of FY15/16.

Financing requirements to increase significantly

The government expects that its direct borrowing for capital purposes and the fiscal plan will rise from $7.0 billion in FY15/16 (when it borrowed only for capital purposes) to $10.4 billion in FY16/17 (including $5.4 billion to fund the fiscal plan) and $14.5 billion in FY17/18 before easing to $12.8 billion in FY18/19. Total financing requirements, which include borrowings by provincial corporations, are projected to rise from $10.3 billion in FY15/16 to $14.1 billion in FY16/17 and $19.8 billion in FY17/18 and then slow to $16.6 billion in FY18/19. All these estimates represent significant upward revisions from earlier profiles.

Province to swing into a net debt position

The increase in the provincial debt arising from higher budget deficits, hefty capital spending and depletion of the contingency fund will swing the province toward a net debt position if FY16/17 for the first time in nearly 20 years. The government expects its net asset balance of $4.0 billion in FY15/16 to turn into a net debt position of $10.0 billion in FY16/17 that will rise to $33.1 billion by FY18/19. Still, as a share of GDP, Alberta net debt (8.9% in FY18/19) would remain very low compared to other provinces. Finance

Minister Ceci indicated that his government will remove the self-imposed debt limit of 15% as a share of GDP to obtain greater financial flexibility.

Commentary

Clearly the current difficult economic situation in Alberta is taking a substantial toll on the provincial government finances and it is acceptable to run a budget deficit in such circumstances. Fiscal policy, after all, provides greater benefits when it plays a countercyclical role. Given Alberta's very strong fiscal position going into this downturn (net asset position), it can afford to run a string of deficits, even relatively large ones, provided that its spending focuses on stoking the economy and that a well-articulated exit strategy is at hand once the economy is back on track. This latter point is missing from Budget 2016. While the deficit is projected to be reduced by the terminal year of the fiscal plan (FY18/19), it will remain high at $8.4 billion (2.2% of GDP) for a provincial economy projected to grow by an average of 2.5% between 2017 and 2019, and more importantly, when nominal growth is forecasted to be very strong at an average of 7.5% during this time period. It is disappointing that a complete roadmap to a balanced budget was not included in Budget 2016. At his press conference, Finance Minister Ceci's stated that his government aims to balance the books by 2024 but offered no concrete plan of action to get there. It would not take many more hefty deficits to squander Alberta's enviable fiscal position. Credit rating agencies no doubt are taking notice.

Alberta's fiscal plan*

$ billions	Actual	Forecast	Budget 2016 Estimate	Target	Target
	2014-15	2015-16	2016-17	2017-18	2018-19
Revenue	**49.5**	**42.9**	**41.4**	**45.0**	**49.6**
Non-renewable resource revenue	8.9	2.5	1.4	*2.8*	*4.2*
Expense	**48.4**	**49.3**	**51.1**	**53.6**	**56.0**
Program expense	47.6	48.6	50.1	*52.2*	*54.0*
Debt servicing costs	0.7	0.8	1.0	*1.4*	*2.0*
Risk adjustment			**-0.7**	**-1.5**	**-2.0**
Surplus (deficit)	**1.1**	**-6.4**	**-10.4**	**-10.1**	**-8.4**
Net financial assets (debt)	**13.1**	**4.0**	**-10.0**	**-22.7**	**-33.2**

*Figures are presented on a consolidated basis.