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Alberta Budget 2009

Crumbling resource revenues; record deficit

Bucking the general trend of fiscal pump priming, the Alberta government opted to hold the line on stimulus spending and attendant deterioration in fiscal balances in the budget it presented yesterday. In the face of an unprecedented drop in revenues, it plans to *cut* overall expenditures and slow infrastructure investment in the 2009-10 fiscal year, a significant shift in direction from rapid increases over the past several years. Yet fiscal restraint will not prevent a deficit. In fact, the province is projecting its largest deficit – $4.7 billion – on record. Moreover, it sees red ink through 2011-12 as the expected gradual pace of recovery in the resource sector and the provincial economy in general will contain the rebound in revenues. To make up for the projected shortfalls, the Alberta government will dip into its Sustainability Fund, which had been built in booming times for such an eventuality.

Budget highlights

Total revenues are projected to fall by 11% in 2009-10 with own-source revenues dropping 13% and transfers from the federal government rising 8.8%. Total revenues are expected to rebound next fiscal year, rising by 7.5% with positive contributions from the major sources.

Non-renewable resource revenues are expected to plummet by 52% in 2009-10, including the effect of $842 million worth of royalty tax credits and drilling stimulus incentives. They are projected to partly recover next fiscal year, growing by 25% on the basis of natural gas prices moving to C$6/gigajoule (Alberta reference point) from C$5.50/gigajoule this year and crude oil prices (WTI) climbing to US$64.50/barrel from US$55.50/barrel.

Investment income is expected to rebound (to $1.8 billion in 2009-10 and $1.9 billion in 2010-11) after suffering a huge decline ($1.9 billion) last year because of stock market-related losses by the Alberta Heritage Savings Trust Fund and other endowment funds.

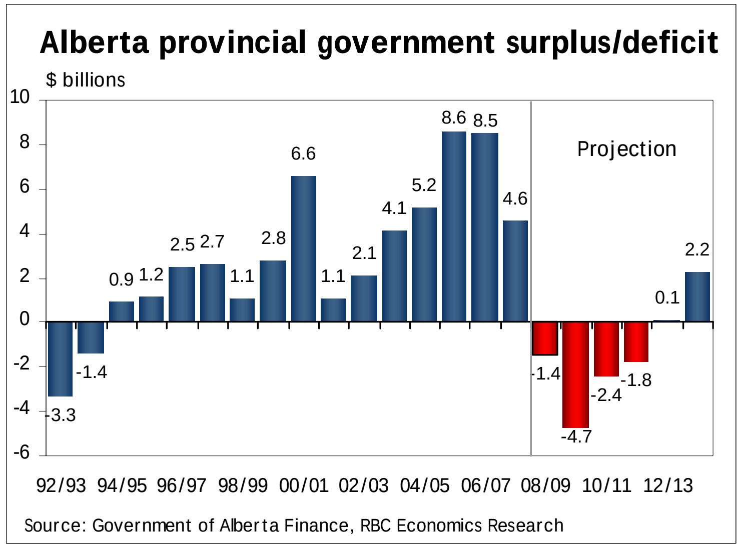
Corporate income tax is projected to drop by 35% in 2009-10 as the recession and downturn in the resource sector pound corporate profits. The budget sees a 6.1% increase next year alongside improving economic conditions.

Program spending will be reduced by 1.8% in 2009-10 and expanded by 5.6% in 2010-11 compared with increases averaging 11.4% in the past five years. Health expenditures will be among those cut this year.

The **three-year Capital Plan** (2009-12) has been boosted to $23.2 billion, an increase of $1 billion – or 4.5% – relative to the plan presented in last year's budget (2008-11) though the additional spending is scheduled in years two and three, as the capital outlays in 2009-10 have been reduced.

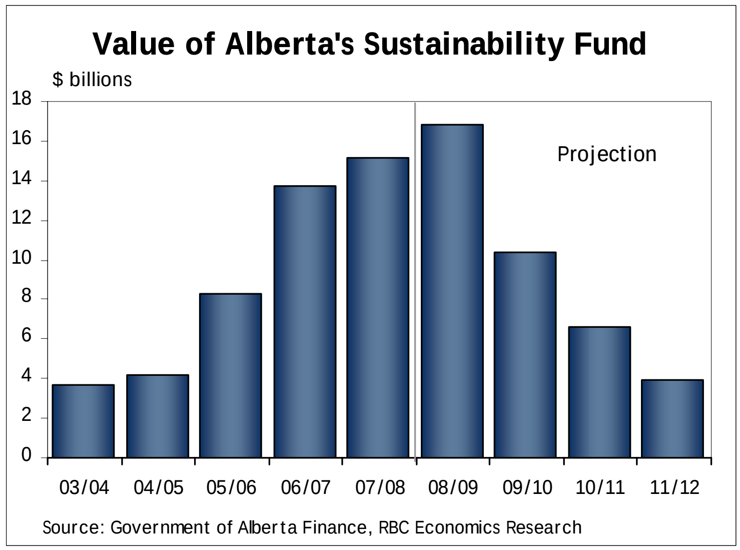
The **budget deficit** of $1.4 billion last year – the first in 15 years in the province – is projected to balloon to $4.7 billion this year (including $215 million in "value review savings" that have yet to be identified) before gradually declining towards balance by 2012-13. However, the return to balance assumes $2 billion per year in 2010-11 and subsequent periods in "fiscal correction" measures that have not been defined.

The **Sustainability Fund** will be drawn upon to cover the budget shortfalls. As a result, the value of the Fund will drop significantly in coming years.



Commentary

The freefall in oil and gas prices since they reached stratospheric levels in the middle of last year has put Alberta's budget situation on the spot. With each US$1/barrel drop in the crude oil price costing the province C$143 million in revenues and C$0.10/gigajoule drop in the natural gas price taking away C$126 million, it was clear that an enormous hole would appear on the revenue side. Yesterday's budget indeed confirmed the high degree to which the province's strength over the past many years has relied on the good fortune of the resource sector.



By choosing to keep its hand off the fiscal stimulus tap the Alberta government is, at least implicitly, assuming that its economy – now facing the most intense recessionary conditions in the country – will heal on its own as a global recovery spurs energy markets to health. This scenario appears reasonable, as the energy price assumptions in the budget are close to RBC's (we forecast crude oil at US$57/barrel this calendar year and US$65/barrel next) and economic growth assumptions similar to ours this year (2% decline vs. RBC's 2.3% drop) but modestly more pessimistic in 2010 (1.8% growth vs. RBC's 2.6% advance). However, the budget leaves little room for any downside risks. If energy markets fail to recover as planned the Stelmach government will need to work that much harder to define what precise form the $2 billion per year "fiscal correction" measures will take to achieve a budget balance in three years.

Alberta's fiscal plan

$ billions	Actual	Forecast	Estimate	Target	Target
	2007-08	**2008-09**	**2009-10**	**2010-11**	**2011-12**
Revenue	38.2	35.6	31.7	34.0	36.4
Expense	33.6	37.1	36.4	38.4	40.1
Surplus/ (deficit) before correction	4.6	-1.4	-4.7	-4.4	-3.8
Fiscal correction	-	-	-	2.0	2.0
Withdrawal from Sustainability Fund	-	1.4	4.7	2.4	1.8
Adjusted Surplus	4.6	-	-	-	-

Source: Government of Alberta Finance, RBC Economics Research