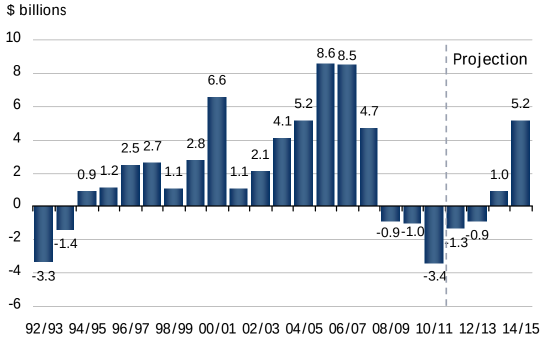
ALBERTA BUDGET 2012

February 10, 2012

Economic growth keeps budget cash flowing

The 2012 Alberta budget, presented yesterday, contained no new revenue-raising measures or significant spending restraint. Instead, the fiscal plan relies on strong economic growth and natural resource revenues to return the province to fiscal balance by 2013/14. The deficit is expected to be $886 million in 2012/13, up slightly from the $681 million predicted for this year in the 2011 budget. This is expected to be the province's final year in the red, with a $952 million surplus planned for 2013/14. Surging resource revenues, increases in federal transfers and slower program spending growth are expected to lead to a much larger surplus of $5.2 billion in 2014/15. As in previous years, the province will rely on its Sustainability Fund to finance this year's deficit, with the balance of the fund expected to fall to $3.7 billion by the end of this fiscal year. The government plans to begin restoring the fund in 2014/15.

Alberta government fiscal balance



Source: Government of Alberta Finance, RBC Economics Research

Budget Highlights

Revenues are forecast to increase by 4.6% in 2012/13 to $40.3 billion, driven mainly by a projected 10% increase in personal and corporate income taxes. The increase is based on expected ongoing growth in personal income and corporate profits, as no new tax measures were introduced in the budget. Other tax revenues are also projected to increase (4.4%), as are investment income (19.9%) and transfers from the federal government (4.0%.) Natural resource revenues are expected to fall slightly (-0.7%), due largely to a decrease in revenues from “bonuses and sales of Crown leases.” Revenue from this component was particularly strong in 2011, and is projected to return to more normal levels in 2012. Growth in natural resource revenues is expected to resume in future years, with projected growth of more than 19.0% in each of 2013/14 and 2014/15. This is due mainly to an expected jump in bitumen royalties as an increasing number of projects reach the “payout” stage, at which point royalty payments increase. When combined with expected ongoing strength in personal and corporate income tax revenues and an anticipated 15.7% increase in federal government transfers in 2014/15 (when the new per capita health funding formula takes effect), this means that the revenue outlook for the province is quite rosy over the medium term.

Planned program expenditures are forecast to rise by 3.3% in 2011/12 to $40.6 billion, relative to last year. Excluding $595 million in disaster relief payments in 2011/12, program expenditures are expected to rise by a stronger 4.8% in 2012/13. The biggest increases are in health expenditures (up 6.9%) and social services (up 9.9%.) The increase in healthcare was driven primarily by a 6% increase in base funding, along with a $267 million commitment to support new healthcare capacity. The increase in social services spending was also broad-based, with strong increases planned in a large number of social programs. The biggest spending commitment in this area was a $271 million increase in support for the severely handicapped. Program expenditure growth is expected to remain healthy at 4.6% in 2013/14, with the rate of growth expected to fall to 1.9% in 2014/15.

Capital spending (which is amortized over the life of new capital assets and so is not fully included in current expenditures) is expected to be $5.7 billion

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in 2012/13, slower than the $6.3 billion pace of spending in 2011/12. This still remains high by historical levels: average capital spending by the province over the decade preceding the recession was around $2.3 billion per year. The government's three year plan for 2012-15 includes $16.5 billion on capital investment, slower than the $17.6 billion plan presented in last year's budget for the period 2011-14. The slowing in capital spending will be seen primarily in the areas of transportation and education. Although the government is permitted under provincial legislation to borrow to finance capital spending, it does not plan to do so in the upcoming years. **Total financial requirements** of provincial corporations will be $3.5 billion.

The Sustainability Fund is expected to have a balance of $3.7 billion at the end of fiscal year 2012/13, falling to $2.4 billion by the end of 2013/14. (Although the province will be in surplus in the latter year, the Fund balance will continue to fall due to capital and other cash adjustments.) This is an improvement over last year's projections of $2.4 billion and $1.7 billion for the same years. However, it still represents a significant deterioration in the fund's assets, which were nearly $15 billion at the end of 2009/2010. The government plans to begin restoring the fund in 2014/15, with the budget plan showing an increase in fund assets to $4.8 billion by the end of that fiscal year.

Discussion

Due to the Alberta government's heavy reliance on volatile natural resource revenues, fiscal outcomes in the province can be difficult to predict. However, we believe that the government has left itself a solid cushion by using relatively conservative assumptions for key economic variables. The WTI price of oil used in the budget plans for 2012/13 is US$99.25/barrel, which is below our forecast of $100/barrel for 2012. The projected price of natural gas ($3/GJ) is also below our forecast, while the exchange rate forecast (0.986 USD/CAD) is in line with our estimates. Based on the sensitivities presented in the budget, using our forecasts in place of the budgetary assumptions suggests that the deficit could be as much as $700 million lower than planned in 2012/13.

The government's estimates of program expenditure growth also appear to be reasonable. The planned 4.8% growth in program expenditures for 2012/13 (excluding disaster relief) is below the province's 10-year average program expenditure growth of 6.9%, but well above the 2.5% average that has prevailed over the past three years. It is also in line with the province's recent population growth plus inflation, which is the rate of growth necessary to keep per capita spending constant.

While we are reasonably confident that the fiscal plan will allow the Alberta government to return to budget balance on schedule, it is important to note that this is being accomplished through strong economic growth and natural resource revenues, rather than through fiscal restraint. While the province is fortunate to be able to rely on these factors to keep its books balanced, this does not eliminate the need for fiscal discipline. The Sustainability Fund is a case in point: the current plan does not see the balance of the fund grow until 2015, a full five years after the end of the recession. According to budget forecasts, revenues will be in their fourth consecutive year of growth by that point, with an average annual growth rate of 8.8% over the period. A more restrained approach to fiscal planning would allow the province not only to rebuild its fiscal cushion sooner, but to begin saving a part of its non-renewable resource revenues for the long-term instead of using them to finance current expenditures.

Alberta's fiscal plan

$ billions	Actual	Forecast	Estimate	Budget 2012 Target	
	2010-11	2011-12	2012-13	2013-14	2014-15
Revenue	**35.0**	**38.5**	**40.3**	**44.0**	**49.0**
Expense	**38.4**	**39.8**	**41.1**	**43.0**	**43.9**
Program expense	38.0	39.3	40.6	42.5	43.3
Debt servicing costs	0.5	0.5	0.5	0.5	0.6
Surplus/ (deficit) before correction	**-3.4**	**-1.3**	**-0.9**	**1.0**	**5.2**

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