

ALBERTA BUDGET 2014

March 7, 2014

Swinging back to surplus

Alberta Finance Minister Doug Horner yesterday presented a fairly upbeat picture of his province's fiscal situation in Budget 2014, which contrasted with the rather morose tone of previous years' budgets. At this time last year, for instance, the government was contending with significantly lower-than-expected oil prices that wreaked havoc on the prior year's non-renewable resource revenues (which came in \$4.1 billion short of expectations), thereby causing the 2012/13 deficit to be much larger than anticipated. No doubt, partly behind Minister Horner's cheerfulness yesterday was the reverse phenomenon—oil prices this past year turned out stronger than he envisioned in Budget 2013 and non-renewable resource revenues are now set to overshoot expectations by \$1.3 billion in 2013/14. The unanticipated strength in that revenue source almost singlehandedly balances the books in 2013/14 for Minister Horner. It also sets a solid starting point for the 2014 budget projections. This would cheer up any finance minister.

Budget surpluses according to the new fiscal framework...

According to the new presentation format introduced last year, Budget 2014 shows that the Operational Plan was in a \$1.4 billion surplus in 2013/14 (substantially better than the \$451 million deficit forecasted in Budget 2013, and despite an unplanned \$1 billion spike in provincially-funded disaster assistance spending related to last summer's floods). It projects further operational surpluses during the next three fiscal years: \$2.6 billion in 2014/15, \$2.0 billion in 2015/16 and \$3.2 billion in 2016/17. The Alberta government adopted a unique fiscal framework in Budget 2013 which consists of three main reporting structures: the Operational Plan (handling day-to-day program delivery), the Savings Plan (monitoring the government's various savings vehicles) and the Capital Plan (outlining province's plan for capital spending on infrastructure). See our [commentary on Budget 2013](#) for more details on the new fiscal framework.

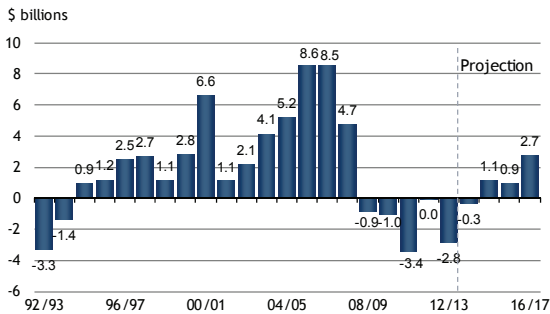
...and the old

While the new framework has some merits, the concept of operational balance is not strictly comparable to the fiscal balance shown in budgets prior to last year or in other provinces' budgets. Adjusting figures to reconcile with the old presentation format reveals that the Alberta government posted a \$335 million deficit in 2013/14, down from a \$2.8 billion shortfall in 2012/13 and a forecasted \$2.0 billion deficit for 2013/14 in last year's budget. The reconciled accounting still shows surpluses for the next three years, however, although smaller: \$1.1 billion in 2014/15, \$941 million in 2015/16 and \$2.7 billion in 2016/17.

Strong population growth and bitumen royalties propel revenues

Budget 2014 does not introduce any new taxes or major spending initiatives. It expects strong revenue growth of 5.4% in 2014/15, fuelled in large part by Alberta's rapidly growing population. Non-renewable resource revenue is forecasted to rise by 6.7% reflecting a solid increase in bitumen royalties (which will account for 61% of non-renewable resource revenues, up from 25% five years ago). This increase will result entirely from higher expected production levels of bitumen in the province, as the government assumes prices to ease somewhat (WCS to dip from C\$78.54 in 2013/14 to C\$77.18

Alberta government fiscal balance (old framework)



Note: Balance numbers were calculated using the old methodology for comparison purpose
Source: Government of Alberta Finance, RBC Economics Research

Robert Hogue
Senior Economist
(416) 974-6192
robert.hogue@rbc.com

in 2014/15). It must be noted that (conventional) oil royalties are forecasted to decline over all three years of the plan and natural gas royalties to increase modestly in 2014/15 before falling subsequently.

Spending restraint in place

On the expenditure side, the Alberta government will continue to show restraint. It intends to limit operating expense growth at 3.7% in 2014/15 (excluding the one-time disaster assistance in 2013/14). While this will be more than the 2.7% increase in 2013/14, it will remain below the combined growth rates of population and inflation (5.0%), implying that on a real per capita basis, operating expenses will decline. Spending on health-related items will continue to claim the lion's share of operating expenses (48%) and will grow by 3.6% from 2013/14.

Introducing new endowments in the Savings Plan

Perhaps the main new measures appearing in Budget 2014 are a series of new endowments in the province's Savings Plan. The government is committing \$1.4 billion to the creation of two innovation-focused endowments within the Alberta Heritage Trust Fund: the Social Innovation Endowment and the Agriculture and Food Innovation Endowment. The budget also states that a new account—the Alberta Future Fund—will be established within the Alberta Heritage Savings Trust Fund (HSTF) with an initial capitalization of \$200 million “to finance other, yet to be determined, province-building opportunities”. These endowments and accounts will be capitalized by reallocating a portion of the existing assets of the HSTF. The government further announced that it will provide \$200 million in additional capitalization to the Alberta Heritage Scholarship Fund, which will be dedicated to trades-focused education. The total value of Alberta's savings plan is projected to rise by \$720 million in 2014/15 to \$23.9 billion, and forecasted to reach \$26 billion by 2016/17.

Capital Plan funded by higher direct borrowing in 2014/15 but diminishing thereafter

The Capital Plan contains \$19.2 billion in infrastructure projects over the next three years, including \$6.6 billion in 2014/15. This \$6.6 billion in 2014/15 will represent a significant 21.2% increase over 2013/14, reflecting new funding for the Southwest Calgary Ring Road, and higher sums for roads, schools, health care and post-secondary facilities. The government re-iterated that it remains open to consider public-private partnership “where it makes financial sense to do so”. Financing the Capital Plan's will be done primarily via direct borrowing to the tune of \$4.9 billion (excluding \$900 million of refinancing) in 2014/15, \$4.6 billion in 2015/16 and \$2.7 billion in 2016/17. These borrowing levels will compare to \$3.6 billion in 2013/14 and \$925 million in 2012/13. The sharp drop-off in the last year of the plan will reflect the fact that funding presently going to the Contingency Fund will be directed to the Capital Plan after the Contingency Fund reaches its target level of \$5 billion in 2014/15.

Good reasons to feel upbeat

Overall, Budget 2014 provides good reasons to feel upbeat about Alberta's fiscal situation. Revenues are flowing (thanks to a booming economy and rapidly rising bitumen production), spending is under control, infrastructure challenges are being addressed and budget surpluses are returning. That being said, the very volatile nature of one of the government's key source of revenue—resource royalties—imposes caution. Even though the government bases its projection on reasonable and, in our view, conservative, economic and energy price assumptions, the picture can change—and, indeed in the past, has changed—quickly. The new fiscal framework in large part was designed to attenuate the revenue volatility; however, it is unlikely able to prevent an unexpected oil price shock from damaging the bottom line.

Alberta's fiscal plan

\$ billions	Forecast	Estimate	Budget 2014 Target	
	2013-14	2014-2015	2015-16	2016-17
Operational Plan				
Net Operational Revenue	43.7	43.1	44.0	46.3
Operational Expense:				
Operating Expense (net of in-year savings)	37.1	38.5	39.9	40.9
Endowment Fund / Account Expense	0.2	0.2	0.3	0.3
2013 Alberta Flood Assistance	3.6	0.2	0.1	0.0
Provision for Disaster / Emergency Assistance	0.1	0.2	0.2	0.2
Amortization / Inventory Consumption	1.0	1.0	1.1	1.1
General Debt Servicing Costs	0.4	0.4	0.4	0.6
Total Operational Expense	42.4	40.4	41.9	43.1
Operational Surplus	1.4	2.6	2.0	3.2
Savings Plan				
Contingency Account	4.7	5.0	5.0	5.0
Heritage Savings Trust Fund:				
Alberta Future Fund	-	0.2	0.4	0.7
Advanced Education Endowment	1.2	1.4	1.4	1.5
Agriculture and Food Innovation Endowment	-	0.2	0.2	0.2
Social Innovation Endowment	-	0.5	1.1	1.1
Other	13.9	12.8	12.8	13.6
HSTF Total	15.1	15.1	16.0	17.2
Medical Research Endowment Fund	1.4	1.4	1.4	1.4
Science and Engineering Endowment Fund	0.8	0.8	0.9	0.9
Scholarship Fund	0.8	1.0	1.0	1.1
Cancer Prevention Legacy Fund	0.5	0.5	0.5	0.5
Total Balance	23.2	23.9	24.8	26.0
Total Annual Savings	1.8	0.7	0.9	1.2
Capital Plan				
Capital Plan Spending:				
Investing in Families and Communities	2.3	3.0	2.9	2.7
2013 Alberta Flood Assistance	0.2	0.4	0.3	0.2
Securing Alberta's Economic Future	2.6	2.9	3.1	2.9
Resource Stewardship	0.3	0.3	0.4	0.2
Legislative Assembly	0.0	0.0	0.0	0.0
Total Capital Plan Spending	5.4	6.6	6.6	6.0
Capital Plan Financing:				
Direct Borrowing*	3.6	4.9	4.6	2.7
Alternative Financing	0.4	0.2	0.3	0.5
Transfer from Contingency Account	-	0.8	1.2	2.3
Revenue Received for Capital Purposes	0.5	0.6	0.5	0.4
Other	1.0	0.2	0.2	0.1
Total Capital Plan Financing	5.4	6.6	6.6	6.0
Capital Debt Servicing Costs	0.2	0.4	0.6	0.8
% of Operational Revenue	0.6%	1.0%	1.4%	1.8%

* Excludes \$905 million of refinancing in 2014-15.

The material contained in this report is the property of Royal Bank of Canada and may not be reproduced in any way, in whole or in part, without express authorization of the copyright holder in writing. The statements and statistics contained herein have been prepared by RBC Economics Research based on information from sources considered to be reliable. We make no representation or warranty, express or implied, as to its accuracy or completeness. This publication is for the information of investors and business persons and does not constitute an offer to sell or a solicitation to buy securities.

