

ALBERTA THIRD QUARTER FISCAL UPDATE

February 24, 2015

Fiscal challenges intensify in Alberta

Fiscal conditions in Alberta continue to deteriorate under the pressure of the persistent decline in crude oil prices, as indicated by the third quarter fiscal update, released today by Alberta Treasury Board and Finance. The updated figures for FY2014/15 confirm the increasing fiscal challenges facing the energy-dependent province, although with details only available for the current fiscal year, the full extent of the fiscal pressures will not be revealed until the release of the forthcoming spring budget. In the event today, the government presented a revised estimate for the 2014/15 budgetary balance of \$465 million compared to \$933 million at the time of the November 2014 mid-year update and \$1,087 in the March 2014 budget. The inclusion of lower economic growth forecasts, however, indicates that the headwinds facing the province's finances will intensify in the upcoming 2015/16 fiscal year.

Revenues remain resilient despite downward price pressures

The protracted period of low crude oil prices is weighing on provincial revenues derived from non-renewable resources, which is now expected to come in at \$8.7 billion in 2014/15, \$503 million lower than the Budget 2014 estimate and \$649 million below the November update. Weaker-than-expected bitumen royalties account for the bulk of the revision with some offset coming from natural gas royalties reflecting higher-than-expected natural gas production. Building upon its revision in the Q2 fiscal update, the government lowered its FY2014-15 forecast for WTI to US\$79.24/bbl from \$95.22/bbl forecast in the March 2014 budget and \$88.88/bbl in November 2014.

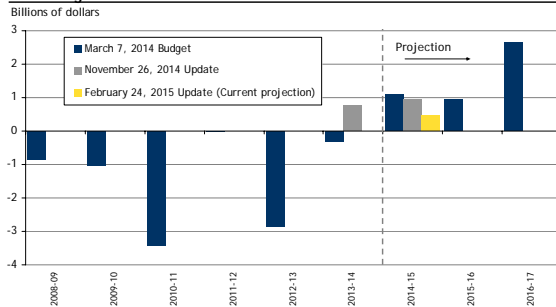
Despite the downward pressure resulting from weak crude oil prices, total revenues are tracking stronger than expected in the current fiscal year. Realized equity portfolio gains are supporting an investment income boost (+\$383 million) while a rise in 'other revenues' is providing a further \$548 million lift. In addition, firmer-than-expected corporate income tax revenues (+\$289 million) are helping to offset weaker-than-expected performance for personal income taxes (-\$128 million).

An unanticipated \$600 million increase in operating expenses related to physician compensation, drug costs and the Canada-Alberta Job Fund is contributing to a revised expenditure estimate of \$44.3 billion, which is \$1.0 billion higher than the Budget 2014 projection. As a result, a \$622 million deterioration in the overall balance for 2014/15 since Budget 2014 reflects these higher-than-expected expenditures more than offsetting the surprise revenue gains.

Contingency account to provide some room in 2015/16?

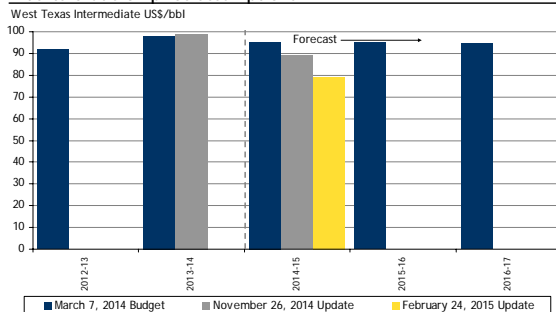
Today's update on fiscal developments revealed a \$1.3 billion increase in the province's Contingency account to \$6.3 billion by March 31, 2015 relative to the \$5.0 billion projected in the previous quarterly update. The Contingency account is meant to offset operational deficits and various other cash requirements and is required under provincial legislation to have a \$5 billion balance. Various adjustments resulted in the increase, however, this account may provide a cushion for the expected hit to provincial finances in the upcoming 2015/16 fiscal year.

Alberta government fiscal balance



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

Alberta crude oil price assumptions



Source: Alberta Treasury Board and Finance, RBC Economics Research

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Headwinds to intensify with the approach of Budget 2015

Beyond the current fiscal year, nominal GDP, the broadest indicator of the tax base, is forecasted to decline sharply — falling by 8.5% in 2015 from estimated growth of +6.2% in 2014 and an initial budget forecast for 2015 of +4.7%. Real GDP was also revised lower with growth forecast to come in at 3.6% in 2014 and 0.6% in 2015 (compared to 3.7% and 3.0%, respectively, in Budget 2014). With labour markets anticipated to come under increasing pressure, the unemployment rate is forecast to rise to 5.4% in 2015 from 4.7% in 2014 (compared to 4.3% in 2015 in Budget 2014).

Since the release of the mid-year budget update in November, the price of WTI crude oil has fallen in excess of 30% and a price rebound in the near-term is not expected. In the report today, the government acknowledged that this decline will create budgetary challenges going forward with energy royalties and income tax receipts expected to come under increasing pressure. This builds upon the recent announcement by the province's Finance Minister that expenditure restraint will be necessary to keep the budget deficit manageable in the upcoming fiscal year. A budget date has yet to be announced, however, a sizeable downward revision to the current \$941 million budget balance projection for 2015/16 is likely a foregone conclusion.

Fiscal year assumptions <i>(Year-over-year % change)</i>	Budget				Mid-Year Update		Third Quarter Update	
	2014	2015	2016	2017	2014	2015	2014	2015
Real GDP growth	3.7	3.0	2.7	2.9	3.8	2.8	3.6	0.6
Nominal GDP growth	6.1	4.7	4.8	5.3	7.3	0.9	6.2	-8.5
Crude oil prices - WTI US\$/bbl	98.2	95.2	94.9	94.8	99.1	88.9		79.2
Crude oil prices - WCS CDN\$/bbl	78.5	77.2	76.6	78.1	80.1	78.1		68.9
Unemployment rate	4.4	4.3	4.3	4.3	4.6	4.5	4.7	5.4

* %, end of period

Source: Alberta Treasury Board and Finance, RBC Economics Research