ALBERTA BUDGET 2015

October 27, 2015

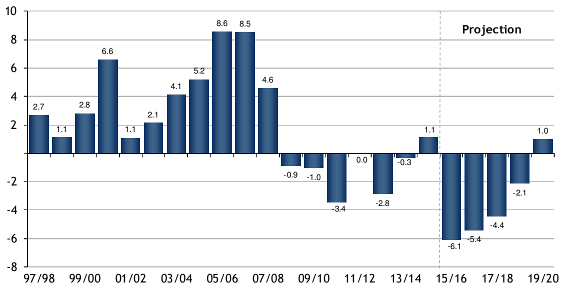
New team, same challenge: drop in oil royalties pushes Alberta budget into record deficit

- Lower oil prices will result in a $6.2 billion downswing in provincial revenues in FY15/16. Non-renewable resource revenues are not expected to recover fully over the remainder of the five-year fiscal plan.
- Record budget deficit of $6.1 billion expected in FY15/16. Further deficits projected in the following three years ($5.4 billion in FY16/17, $4.4 billion in FY17/18 and $2.1 billion in FY18/19) until a surplus of $1.0 billion is achieved in FY19/20.
- The province will swing into net debt position after nearly two decades in net asset position. The contingency fund will be entirely used up by FY17/18.
- The government will ramp up its five-year capital plan by 15% (compared to the March 2015 budget) to boost infrastructure spending to jump start its economy. It plans to raise its capital investments from $7.9 billion in FY15/16 to $8.4 billion in FY16/17.
- The budget sees an increase in spending on core programs but limits increases in other areas such that overall expenditure growth (3.2% in FY15/16, and 2.3% over the entire fiscal plan) is projected to slow down significantly from the average of 5.9% in the past five years.
- No major new revenue initiatives were announced today, although notable increases in personal income tax and corporate income tax have been implemented in recent months.

Oh my, how things have changed!

Today's long-awaited budget in Alberta was no run-of-the-mill affair. It was the first by a provincial government other than Conservative in 44 years, following last May's provincial elections that saw the New Democratic Party win a majority. Perhaps as important was the fact that this budget faced a very different (and much harsher) economic reality than the last budget passed by the provincial legislative assembly in March 2014 (the provincial elections in May effectively killed a budget introduced in March 2015 by the previous government). Back in early 2014, Alberta's economy was the fastest growing among the provinces and was expected to continue to do for years to come. Today, it is in the midst of one of its notorious busts, and unfortunately, it is not projected to boom back as vigorously as it did in past such episodes. The government forecasts real GDP to decline by 1.0% in 2015 and rebound by just 0.9% in 2016 (these are slightly more optimistic than RBC's forecasts for the province of –1.3% and 0.6%, respectively). The government projects nominal GDP to drop more significantly in 2015 by 9.4% and grow by 4.0% in 2016.

Alberta government fiscal balance



Source: Alberta Treasury Board and Finance, RBC Economics Research

Budget assumptions

	2015	2016	2017	2018
Real GDP growth (%)				
Oct. Budget 2015	-1.0	0.9	2.4	2.6
RBC	-1.3	0.6	-	-
Nominal GDP growth (%)				
Oct. Budget 2015	-9.4	4	6.3	6.5
RBC	-8.0	5.5	-	-
Crude oil prices - WTI US$/bbl				
Oct. Budget 2015	50	61	68	-
RBC	51	57	65	-

Source: Alberta Treasury Board and Finance, RBC Economics Research

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

Record deficit in FY15/16...

The government's biggest challenge, of course, is to make do with significantly lower non-renewable resource revenues in a world of lower oil prices. The plunge in oil prices since mid-2014 and its effect on the province's energy sector cost the Alberta government $6.2 billion in lost revenues in FY15/16. Given Alberta's strong reliance on non-renewable resource revenues—they represented more than 15% of total provincial revenues on average in the past several years, although they will represent only 6.3% in FY15/16—this revenue loss was the main factor tipping the budget into deficit. A large deficit. In fact, today's budget shows the province's largest deficit—$6.1 billion for FY15/16—ever recorded in Alberta.

...and more deficits in the following three years

With oil prices assumed to recover only a portion of the recent drop over the coming years (the budget assumes WTI to rise from US$50/barrel in FY15/16 to US$61 in FY16/17 and US$68 by FY19/20, still lower than the US$80 that prevailed in FY14/15), the government is not counting on a quick rebound in non-renewable resource revenues to turn things around. Further deficits therefore are being projected for the next three years—$5.4 billion in FY16/17, $4.4 billion in FY17/18 and $2.1 billion in FY18/19—until a surplus of $1.0 billion is achieved in FY19/20.

Fiscal plan shaped by three guiding principles

The tough economic realities have thrust Alberta's new government into deficit fighting mode, and the fiscal plan presented today is the government's response to address these challenges. The approach adopted by Premier Rachel Notley's government is based three key principles:

- Preserve the stability and effectiveness of front-line public services;
- Map out the way to budget balance over the medium term (with the plan meant to work as a 'shock absorber' for the economy); and
- Present the first steps to stimulate growth in the economy, industrial diversification and job creation.

Indeed, today's budget 1) contains no cuts to core programs such as health care, human services and education—in fact, they will grow by an average of 3.0% this year and in the following two years; 2) reveals the chosen path to return to balance: a go-slow approach that will allow declining annual deficits until a surplus is achieved in FY19/20; and 3) scales up infrastructure investment and offers a number of incentives to get the provincial economy going.

Program spending to rise modestly

Program expenditures are projected to rise by 3.1% in FY15/16 and by an average of 1.9% over the next two years. As expected, no cuts were announced to public service payrolls, although hiring restraint will continue. Public sector compensation is budgeted to increase by 3.9% in FY15/16 and by an average of close to 2.5% over the next two years. Health care spending will rise by 2.2% in FY15/16 and by an average of 3.1% in FY16/17 and FY17/18. Non-core program spending is projected to rise strongly by 4.9% in FY15/16 (in part due to a surge in disaster and emergency assistance) but then decline by an average of 2.2% in the next two years.

Path to balance...

The fiscal plan relies heavily on strong revenue growth to eliminate the deficit by FY19/20. This is especially the case for the out-years of the plan (FY18/19 and FY19/20) when revenues are projected to rise by an average of 7.4% annually. Expense growth is projected to be comparatively more subdued, averaging just 2.3% over the entire five-year plan (including a small 1.5% increase in FY19/20). Unfortunately, today's budget provided detailed spending and revenue projections only up to FY17/18—the remainder of the plan shows government targets—which therefore offers only a partial roadmap to the ultimate goal of returning to balance.

...will rely heavily on increased non-energy revenues

While a gradual recovery in oil prices will contribute to increasing non-renewable resource revenues, recently implemented revenue measures will contribute more to the expected rise in revenues over the next two years. These measures include:

- a rise in corporate income tax from 10% to 12% that came into effect on July 1, 2015.
- higher personal income tax rates for higher income earners implemented on October 1, 2015

These and other measures (e.g. higher tobacco and fuel taxes) are projected to bring in $2.3 billion in added revenues in both FY16/17 and FY17/18.

Turning to infrastructure spending to stimulate the economy

Also released today as part of the budget was the final report on the province's infrastructure plans by ex-Bank of Canada Governor David Dodge. The report argues that the Alberta government has the borrowing room to boost capital spending in the province. With this recommendation in hand, the government will increase its Capital Plan to $34 billion over the next five years, thereby representing a 15% boost from the plan proposed in the March 2015 budget. On an annual basis, capital spending will rise from $6.9 billion in FY15/16 to $7.6 billion in FY16/17 and $7.7 billion in FY17/18 before slowing in the last two years of the plan. In effect, this constitutes the core elements of the government's strategy to stimulate the Alberta economy. There were other measures to promote economic growth, however, including a new job creation incentive program (offering grants of up to $5,000 for each full-time equivalent position created by eligible employers).

Using up the contingency fund

There was a balance of $6.5 billion in the contingency fund at the end of FY14/15. The government will use $3.2 billion against its deficit in FY15/16 and the remainder in FY16/17 such that the fund will be depleted at the end of that year.

Direct borrowing to rise

Alberta's direct borrowing requirement will rise from $3.9 billion in FY14/15 to $6.0 billion in FY15/16, $6.7 billion in FY16/17 and $6.8 billion in FY17/18. Total financing requirements, which include borrowings by provincial corporations, are projected to rise from $6.0 billion in FY14/15 to $9.6 billion in FY15/16, $11.4 billion in FY16/17 and $14.3 billion in FY17/18. All these estimates represent upward revisions from earlier profiles.

Province to swing into a net debt position

Because of the string of deficits and increased capital investment, Alberta will see its net financial assets position fall from $13.0 billion in FY14/15 to $3.4 billion in FY15/16 and then swing into net debt of $5.7 billion in FY16/18 and $13.7 billion in FY17/18. This swing would end nearly two decades of being in a net asset position.

Alberta's fiscal plan*

$ billions	Actual	Actual	Oct. Budget 2015 Estimate	Target	Target	Target	Target
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Revenue	**49.4**	**49.5**	**43.8**	**45.7**	**47.9**	**51.4**	**55.3**
Non-renewable resource revenue	*9.6*	8.9	2.8	*3.4*	*4.4*	-	-
Expense	**49.7**	**48.4**	**49.9**	**51.1**	**52.3**	**53.5**	**54.3**
Program expense	*49.1*	47.6	49.1	*50.2*	*51.0*	-	-
Debt servicing costs	*0.6*	0.7	0.8	*0.9*	*1.3*	-	-
Surplus (deficit)	**-0.3**	**1.1**	**-6.1**	**-5.4**	**-4.4**	**-2.1**	**1.0**
Net financial assets (debt)	**13.0**	**13.1**	**3.4**	**-5.7**	**-13.7**	**-**	**-**

*Figures are presented on a consolidated basis.