Alberta: 2018–19 Budget

ADJUSTING AS THE ECONOMY RECOVERS

- **Alberta's *Budget*** outlines a path to black ink by fiscal 2023–24 (FY24), with progress tilted toward the forecast's outer years. Improvements to the bottom line are a modest $0.3 billion in FY19 and $0.9 billion in both FY20 and FY21, before accelerating to an average $2½ billion annually from FY22 to FY24.
- **Relative to last year's *Budget* forecasts,** the FY18 and FY19 deficits are expected to be $1.4 billion and $0.9 billion narrower, followed by an FY20 shortfall that is $0.7 billion wider. A challenge for FY19–FY21 is the light-heavy oil price differential that the government assumes will average close to US$22/barrel. Bitumen's share of Alberta's oil output is currently over 85%.
- **The Capital Plan,** after a record $9.2 billion estimated outlay in FY18 as some municipal grants were brought forward, is scaled back through FY24, with the government acknowledging that less stimulus is needed as the economy regains traction.
- **Net financial debt,** as measured by the Province, is expected to be $5.4 billion dollars less Alberta's 2017 forecast by March 2020. Absolute increases for Net Financial Debt are projected to diminish from an estimated $11.4 billion in FY18 to $8.4 billion by FY21 and reach roughly zero by FY24. Long-term borrowing of $15.4 billion is forecast for FY19, and then levels off at $17½ billion in FY20 and FY21 (chart and table, p.4).

OVERVIEW

An important assist in the government's fiscal repair is the province's stronger-than-expected recovery last year, as reflected in the FY18 Q3 update (here). In the *Budget,* real GDP growth of 4.5% is assumed for calendar 2017 and 2.7% for 2018. From 2019 to 2024, output gains are expected to average a very solid 2.5% annually.

Offering some insurance on the projected FY19–FY21 deficits are risk adjustments of $0.5 billion, $0.7 billion and $1.0 billion, respectively, and relatively conservative WTI oil prices (bottom left table, p.2).

Diversification efforts are stepped up. To broaden and raise value-added in the energy sector, a recently announced three-prong strategy introduces: a second phase for the *Petrochemicals Diversification Program* in FY21; incentives to capture more natural gas liquids for further processing as of FY22; and, an effort to spur partial upgrading of bitumen in FY20. Outside of the energy sector, the existing *Alberta Investor* and *Capital Investment Tax Credits* will be extended to FY22 ($60 million annually); a refundable *Interactive Digital Media Credit* to attract entrepreneurs will be launched in April ($20 million annually) and 3,000 new post-secondary technology spaces will be created over the next five years (at a final cost of $43 million annually).

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Alberta's Budget Balances

Fiscal 2016–17 (FY17)
Final: -$10.8bn (-3.4% of GDP)

FY18
Budget: -$10.5bn (-3.1% of GDP)
Q3: -$ 9.1bn (-2.7% of GDP)

Budgets: FY19	**FY20b**
-$8.8bn(-2.5% of GDP)	**-$7.9bn**
FY21b	**FY22b**
-$7.0bn	**-$4.3bn**
FY23b	**FY24b**
-$1.4bn	**+0.7bn(+0.2% of GDP)**

Net Financial Assets

FY17
Final: -$8.9bn (-2.8% of GDP)

FY18
Budget: -$22.6bn (-6.7% of GDP)
Q3: -$20.3bn (-6.0% of GDP)

Budgets:
FY19b **-$30.5bn** **(-8.5% of GDP)**
FY20b **-$39.8bn** **FY21b** **-$48.2bn** **(-12.3% of GDP)**
FY22b **-$53.9bn** **FY23b** **-$56.2bn**
FY24b **-$56.0bn (-12.4% of GDP)**

Borrowing Requirements
FY19b **$15.4bn**
FY20b **$17.6bn** **FY21b** **$17.5bn**

Source: Alberta Finance; Statistics Canada; nominal GDP forecasts: Scotiabank Economics.

REVENUE DETAILS

After Alberta's revenues surged almost 11% in FY18, receipts are forecast to rise in FY19, but only by 2.1%. To achieve some deficit reduction, expenditure growth is held to a minimal 0.4% that requires program spending to drop 0.6% to accommodate the higher debt service anticipated (bottom chart). This is a tall order, but some spending room already is opened up over the next two years by the government's decision to bring forward into FY18 $800 million in municipal capital grants from FY19 and FY20. Declines in several other spending areas are expected, such as a further 6.6% drop in pension provisions in FY19.

Dampening receipts in FY19 is a forecast fall in resource revenues of 15½% (-$705 million) in FY19 despite an expected rise in oil production of almost 10% as output ramps up at recently completed oil sands facilities. The weakness is largely due to the first full year of wider light-heavy oil price differentials. Alberta only projects resource revenues to match and surpass their FY18 level in FY21 and the light-heavy differential is not assumed to average less than US$19.00/barrel until FY24.

There also are other sources of revenue weakness anticipated for FY19. Investment income is expected to fall back by $0.2 billion on the expectation that financial markets are likely to reset over the next year after several years of strong returns which enabled significant gains to be realized from asset sales in the Heritage and endowment funds. Net income from government business enterprises is projected to slip by $0.5 billion in FY19 with last year's upswing in the Balancing Pool net income not expected to be repeated.

Tax receipts, however, are expected to climb 8.0% in FY19, anchored by growth in personal income taxes strengthening from 0.9% in FY18 to almost 5.0% in FY19 in response to the government's forecast of a 2.0% rise in employment in calendar 2018 and a pick-up in average wage increases. From the legalization of cannabis, Alberta estimates that the Cannabis Tax will generate revenues of $26 million in FY19 and $80 million in FY20 for the Province, as well as somewhat higher earnings for the Alberta Gaming and Liquor Commission. Revenues from the Carbon Levy, which will be recycled according to the *Climate Leadership Plan,* are expected to jump from $1.0 billion in FY18 to $1.4 billion in FY19 with the rate increase from $20/tonne of carbon dioxide equivalent to $30 as of January 2018

Relief in terms of taxes and fees for residents is extended several ways in this *Budget.* The *Education Property Tax* will not be increased in 2018–19, providing a saving of $114 million. For post-secondary students, the tuition freeze will be extended for a fourth year.

Deficit reduction only becomes easier after FY19 when Alberta forecasts that revenue growth will pick up to 5.7% in FY20, and then average a robust 7% over the following four years, assisted by the government's assumption that WTI oil prices reach US$73/barrel by FY24. This allows total expenditure increases of 2.9% in FY20 and an average 3.7% in FY21 and FY22. But in

Alberta's Budget Assumptions

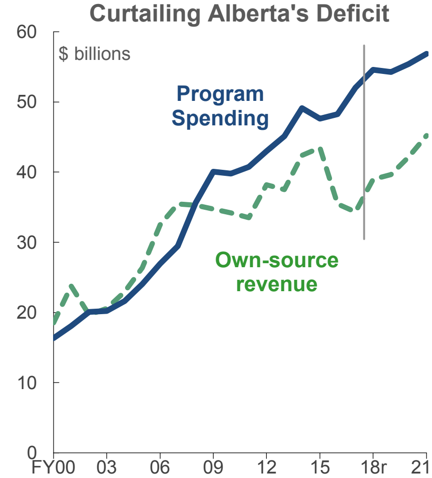
Economic Growth, annual % ch.	2016	17e	18f	19f	20f
Real GDP	-3.7	4.5	2.7	2.5	2.4
Nominal GDP	-4.9	6.8	4.7	4.3	5.6

		FY18				
Key Resource Assumptions	**FY17**	**Budget**	**Q3**	**FY19b**	**FY20b**	**FY21b**
Canadian Dollar, US¢	76.2	76.0	78.0	80.0	80.0	80.0
WTI Oil Price, US$/bbl	47.9	55.0	54.0	59.0	60.0	63.0
Light-Heavy Differential, US$/bbl	13.9	16.0	14.5	22.4	21.0	22.3
WCS at Hardisty, Cdn$/bbl	44.7	51.3	50.4	46.0	48.8	50.9
Natural Gas Price, Cdn$/GJ	2.0	2.9	1.9	2.0	2.2	2.4
Oil Production, annual % ch.	-0.6	11.5	10.9	9.7	4.0	4.2
Revenues, annual % ch.	-0.8	6.2	10.8	2.1	5.7	6.4
Expenditures, annual % ch.	8.2	3.5	5.4	0.4	2.9	3.4

FY19 Sensitivities WTI oil prices +US$1/bbl: net impact +$265mn
Light-Heavy Differential +US$1/bbl: net impact -$210mn
Canadian dollar +1¢(US) gain: net impact -$198mn

Sources: Alberta Finance, Statistics Canada.

Curtailing Alberta's Deficit



Source: Alberta Finance.

FY23 and FY24, the need to substantively cut the deficit requires that annual spending hikes average just over 2.5%.

EXPENDITURE DETAILS

In addition to its commitment to reduce annual volatility in provincial spending growth, the government in this *Budget* sets the rise in operating expense (net of in-year savings) to fall below Alberta's projected population plus inflation growth by a widening margin from FY19 to FY21. In FY19, the planned operating expense increase is 0.5 percentage points less than the forecast hike in the population/inflation ceiling; in FY21, it is a full percentage point lower. From FY22–FY24, however, growth in operating expense returns to just below the 3.6% ceiling.

The government's commitment continues to keeping the size of Alberta's public service flat, and streamlining its human resources system is underway. Specific savings by area include a new funding agreement with the Pharmacists' Association that will trim costs by $150 million over the next two years. Pending discussions to review with local governments the *Municipal Sustainability Initiative (MSI)* that provides grants for long-term infrastructure, the Province will cut MSI outlays by just over $150 million annually.

CAPITAL SPENDING AND THE BALANCE SHEET

An immediate large policy adjustment critical to easing debt accumulation is the government's announcement to reduce the FY19 Capital Plan nearly 30% from an estimated $9.2 billion in FY18 to $6.4 billion. Over the following three years, the Plan averages $6.1 billion annually before slipping to a $5.0 billion average in FY23–FY24. In just FY19 and FY20, this slices direct borrowing for the Capital Plan by a cumulative $4.4 billion.

The government's financing plan for FY19 includes the $5.0 billion cash reserve announced in the FY18 Q3 *Update*, established in FY18 through short-term borrowing. The Province indicates that the current $10 billion of money market debt outstanding spurred by this initiative is likely to remain in place in FY19.

OUTLOOK

The deficit elimination detail and Alberta's efforts to slow its Net Financial Debt accumulation are both encouraging. Though its net debt as a share of GDP remains very low

Alberta's Budget Arithmetic

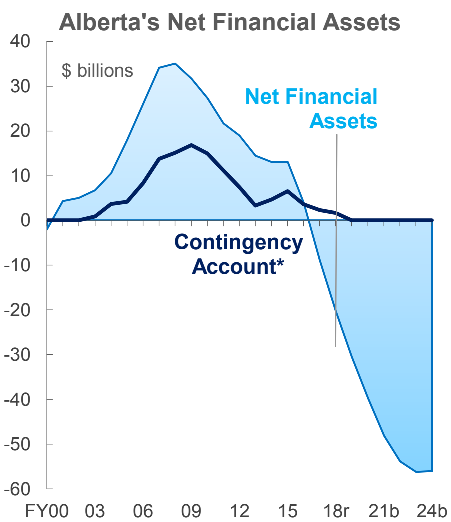
$ millions except where noted

	FY18 Budget	FY18 Q3	FY19 Budget
Personal Income Tax	11,177	10,855	11,387
Corporate Income Tax	3,918	3,852	4,551
Carbon Levy	1,038	1,012	1,356
Other Taxes	5,629	5,492	5,605
Total Tax Revenues	**21,762**	**21,211**	**22,899**
Non-Renewable Resource Revenue	3,754	4,534	3,829
Investment Income	2,193	3,061	2,884
Other Own-Source Revenue*	9,221	10,157	10,049
Total Own-Source Revenue	**36,930**	**38,963**	**39,661**
Federal Transfers	7,988	7,918	8,218
Total Revenue	**44,918**	**46,881**	**47,879**
Operating Expense(net of in-year savings)	45,906	46,370	47,765
Disaster Assistance	235	495	206
Capital Grants	3,302	3,729	1,706
*Climate Leadership Plan : Operating Exp .***	868	577	1,035
Capital Grants	68	391	423
Pension Provisions	-237	-332	-310
Amortization, Inventory Change, Other	3,375	3,362	3,434
Program Spending	**53,517**	**54,592**	**54,260**
General Debt Service	619	594	1,027
Capital Plan Debt Service	779	761	895
Total Debt Service	**1,398**	**1,355**	**1,921**
Total Expenditure	**54,915**	**55,947**	**56,181**
Risk Adjustment	500	0	500
Consolidated Balance	**-10,497**	**-9,066**	**-8,802**
Total Capital Plan with SUCH Sector	9,175	9,165	6,444
Annual Change, %			
Tax Revenue	*7.8*	*5.1*	*8.0*
Non-Renewable Resource Revenue	*21.2*	*46.4*	*-15.5*
Total Own-Source Revenue	***7.6***	***13.5***	***1.8***
Federal Transfers	*0.1*	*-0.8*	*3.8*
Total Revenue	***6.2***	***10.8***	***2.1***
Program Spending	*2.8*	*4.9*	*-0.6*
Total Expenditure	***3.5***	***5.4***	***0.4***
Memo Items, %			
Own-Source Revenue / GDP	10.9	11.5	11.1
Program Spending / GDP	15.8	16.1	15.2
Consolidated Balance / GDP	-3.1	-2.7	-2.5
Debt Service / Revenue	3.1	2.9	4.0
Resource Prices: WTI Oil, US$/bbl	55.00	54.00	59.00
Western Canadian Select, C$/bbl	51.30	50.40	46.00
Oil Production, Bitumen, 000s bbl / day	2,906	2,855	3,163
Conventional, 000s bbl / day	416	449	461
Natural Gas, AB Reference Price,C$/GJ	2.90	1.90	2.00
Canadian Dollar, US¢/C$	76.0	78.0	80.0

* Includes the *Balancing Pool.* Sources: Alberta Finance; Statistics Canada; nominal GDP forecasts: Scotiabank Economics.

relative to a number of its provincial peers, the rise in its debt service is squeezing precious program spending room. The government's decision to re-profile a number of its projects to make way for Alberta's emerging private-sector investment recovery is a well-founded policy shift.

The volatility and risk inherent in the current oil price recovery and the added urgency of ongoing pipeline issues set a steep challenge. Recent US tax reform and the ongoing NAFTA negotiations shadow trade and investment. The Province has assumed robust growth for Alberta through 2024, close to a full percentage point higher than Canada's estimated potential real GDP growth rate as it enters the next decade. The promise of diversification is worthwhile but likely to be slow. Thus in the immediate three-year forecast, stepping up its fiscal repair and the prudence of several key *Budget* assumptions should serve the Province well.



* Plotted to March 2021. Source: Alberta Finance.

Alberta's Balance Sheet

$ billions except where noted

	FY18		FY19
	Budget	Q3	Budget
Heritage Fund & Endowment Funds	20.2	20.3	20.8
Contingency Account	0	1.7	0
Other Financial Assets	43.7	47.6	49.8
Financial Assets	**63.9**	**69.6**	**70.6**
Liabilities for Capital Projects	29.8	29.3	33.2
Debt:Pre-1992 Teachers' Pension Plan	0.9	0.9	0.9
Direct Borrowing for *Fiscal Plan*	15.1	13.1	20.1
Coal Phase-out Liabilities	1.1	1.1	1.0
Pension Liabilities	9.8	9.7	9.4
Other Liabilities	29.9	35.8	36.5
Total Liabilities	**86.5**	**89.8**	**101.1**
Net Financial Assets	**-22.6**	**-20.3**	**-30.5**
% of GDP	*-6.7*	*-6.0*	*-8.5*

Source: Alberta Finance; nominal GDP forecast: Scotiabank Economics.