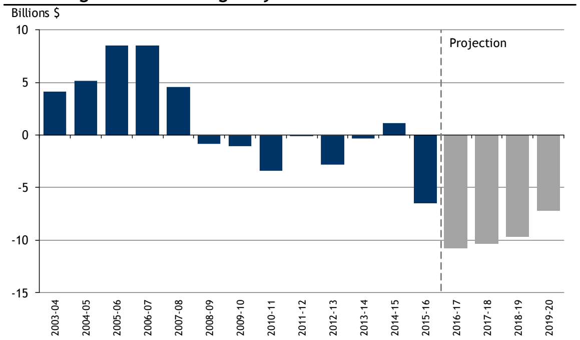
ECONOMICS | RESEARCH

ALBERTA BUDGET 2017

March 17, 2017

More Red Ink Instead of Austerity for Alberta

Alberta government budgetary balance



Source: RBC Economics Research, Alberta Finance and Treasury Board

The title of Alberta's 2017 budget – Working to Make Life Better – conveys the provincial government's focus on making investments and preserving services for Albertans at the expense of a rising deficit. In order to avoid cuts at the expense of social programs, the government has plotted path of deficit reduction that relies on rising resource prices and economic growth rather than government action. After a deep economic contraction in 2016, the government expects economic growth to rebound in the years ahead. The economic recovery will be particularly rapid on a nominal basis (GDP growth of 5%+ per year through 2020) as oil prices rise. The budget forecasts steadily rising oil prices with WTI reaching $71/bbl by 2020. A speedy rebound in economic activity attended by a pickup in population growth and a strengthening labour market will help drive revenues higher. Absent government action or a stronger-than-expected recovery in resource royalties however, the hangover from low energy prices and increases in government spending will continue to mean large deficits through the forecast horizon and beyond.

Table 1: Economic Assumptions

Year-over-year % change	Forecast				
	2016	2017	2018	2019	2020
2017 Budget					
Real GDP growth	-2.8	2.6	2.2	2.4	2.5
CPI	1.1	1.9	2.0	2.0	2.0
Nominal GDP growth	-5.3	5.3	5.4	6.2	5.8
Unemployment Rate*	8.1	8.0	7.6	7.1	6.3
Employment growth	-1.6	0.9	1.4	1.6	1.8
WTI ($/bbl)*	43	54	58	66	71
RBC Economics					
Real GDP growth	-3.0	2.1	3.3		
CPI	1.1	2.6	2.0		
Nominal GDP growth	-4.9	9.2	8.4		
Unemployment Rate*	8.1	8.4	7.5		
Employment growth	-1.6	0.3	1.1		
WTI ($/bbl)*	43	56	63		

*Average level

Source: RBC Economics, Alberta Treasury Board and Finance

Fiscal Balance

Compared with the 2016 budget, Alberta's near term fiscal situation has deteriorated. Forecasted revenues for 2016-17 improved by $1.5bn on the back of higher resource royalties, but the province is expecting expenses to rise by $2.7bn as a result of booking long-term costs associated with closing coal-fired power plants and disaster relief in the wake of wildfires in the Wood Buffalo region. For this fiscal year and beyond, the deficit is expected to close gradually as revenue growth outpaces spending. While the budget is expecting higher resource revenues through the forecast horizon than were budgeted last year, the profile of projected tax receipts has been lowered. On the expenditure side, the budget lays out increased spending on health and education and continues the large five-year capital spending program laid out last year. In addition to measures introduced in Budget 2016, new initiatives include a ceiling on electricity rates, reducing fees for K-12 education, and improving energy efficiency. Spending increases on these and other programs are boosting program expenditures by $1.3bn in 2017-18 and $1.0bn in 2018-19 relative to last year's budget. The upshot is that despite a reduced risk adjustment, the fiscal profile for the coming years has also deteriorated from last year's budget. The deficit for 2017-18 has been revised up to $10.3bn (from $10.1bn) and the deficit for 2018-19 to $9.7bn (from $8.4bn).

Oil Prices

Alberta's fiscal balance is tethered to oil prices and Budget 2017 uses a profile for oil prices from 2017 to 2020 that is broadly consistent with private sector forecasts. There may be upside to government resource royalties given RBC's more optimistic take on oil prices. Still, given that fluctuations in oil prices can have significant impacts on the deficit, it is prudent to provision for risk. Budget 2017 includes $0.5bn in risk adjustments in 2017-18, rising to $1.0bn in 2019-20. For reference, the net impact of a one dollar decline in the price of oil (USD, WTI basis) worsens the budget balance by $310mm per year.

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Climate Leadership Plan

Alberta's Climate Leadership Plan (CLP) was first announced in 2015 and includes a raft of initiatives to green the economy. The plan expects to raise \$5.2bn over the next 3 years from payments from large emitters under the Specified Gas Emitters Regulation (\$1.3bn) and the new Carbon Levy (\$3.9bn). The carbon levy sets the price of carbon at \$20 per tonne of CO_2 equivalent in 2017 before rising to \$30 per tonne in 2018. Roughly one-third (\$2.1bn) of the money raised under the CLP will be returned to Albertans through a 1 percentage point cut in the small business tax rate and rebates to households. The remainder will be spent on green infrastructure, improving energy efficiency, on indigenous communities, coal phase-out agreements, and other initiatives.

A small debt burden… for now

As the Province borrows to fund its capital plan and program spending, net debt will expand rapidly. As recently as 2015-16, Alberta had a small surplus in net financial assets as the Heritage Fund and its various endowments exceeded provincial debt. Today, the province has moved to a net debt position of roughly \$10bn which will rise to \$45bn by 2019-2020. Given the low starting position, net debt as a share of GDP will remain low compared with other provinces in the coming years, but under current policies and absent a sharper recovery in oil prices, it is on track to grow rapidly into the future.

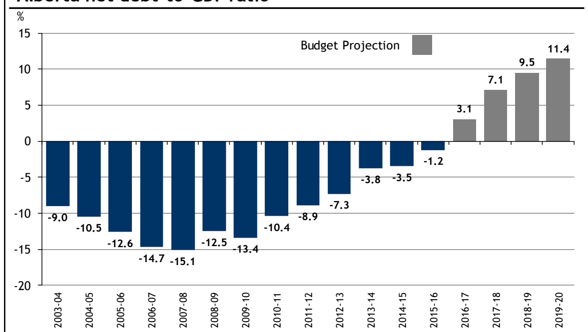
Funding requirements

To fund large deficits in the coming years, the government has revised up their financing needs since Budget 2016. The Province expects that borrowing for capital and fiscal plan purposes will rise from \$12.3bn in 2017-18 to \$14.1bn in 2018-19 before rising further (as debt refinancing needs grow) to \$16.4bn in 2019-20. Over the coming three years, provincial corporations will need to raise \$11.9bn bringing total borrowing requirements in the 3-year budget horizon to \$54.8bn.

Commentary and our take

As we noted last year, the drop in energy prices and the associated downturn in Alberta's economy took a toll on government revenues and it was expected that the government would run significant deficits in response. Unlike other oil-producing provinces, Alberta's uniquely strong fiscal situation gives it the capacity to bear huge deficits in the short-run to avoid punishing austerity in the midst of a downturn. However, those deficits should focus on stoking the economy and putting underused capacity to work with the government charting a course to get out of deficit. Like Budget 2016, Budget 2017 lays out actions to strengthen the economy, but lacks a path back to balanced budgets and this is disappointing. The budget forecasts a deficit of \$7.2bn in 2019-20, equivalent to nearly 2% of GDP in that year, despite rapid nominal GDP growth through the forecast horizon. Moreover, most of the improvement in the budget balance over the fiscal horizon results from a recovery in resource royalties and growth rather than government actions to contain spending or raise revenues. Minister Ceci has said that the province should return to budget balance in 2023-24, but Budget 2017 offers no plan of action to get there. Following last years' budget, Alberta's credit rating was downgraded by a number of credit rating agencies. No doubt they will be taking notice of this year's lack of action given that deficits of this size will rapidly erode the province's enviable fiscal position.

Alberta net debt-to-GDP ratio



*Net financial asset basis
Source: RBC Economics Research, Alberta Department of Finance and Treasury Board

Table 2: Alberta Fiscal Plan (billions of dollars)

	Forecast	Estimate		
	2016-17	2017-18	2018-19	2019-20
Non-renewable resource revenue	2.4	3.8	4.2	6.6
Other revenue	40.5	41.3	43.4	45.2
Total Revenue	**42.9**	**45.0**	**47.6**	**51.8**
Departmental and Other Expenses	52.7	53.5	54.8	55.7
Public Debt Charges	1.0	1.4	1.8	2.3
Total Expenses	**53.7**	**54.9**	**56.7**	**58.0**
Risk Adjustment		-0.5	-0.7	-1.0
Surplus (deficit)	**-10.8**	**-10.3**	**-9.7**	**-7.2**
Net financial assets	-9.6	-23.2	-35.3	-45.2

*based on government estimates
Source: Alberta Treasury Board and Finance

Table 3: Projected Borrowing Requirements (billions of dollars)

	Forecast	Estimate	Target	
	2016-17	2017-18	2018-19	2019-20
Borrowing for provincial	3.0	6.3	3.6	2.0
Direct borrowing for capital purposes	4.7	6.0	5.8	6.1
Refinancing maturing debt			0.5	3.8
Direct borrowing for the fiscal plan	7.9	6.4	7.9	6.5
Total Financial Requirements	**15.6**	**18.7**	**17.7**	**18.4**

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