Since the recent collapse in oil prices, the Alberta government has been forthright in spelling out the sizeable fiscal challenge the province faces. Today’s budget confirmed that the fiscal gap under a status-quo scenario would reach around $7 billion in fiscal 2015-16, or lead to an accumulated deficit of more than $20 billion over the next three years. The government unveiled a multi-year plan to address this budget shortfall by using three main levers: controlling spending, revenue raising measures and drawing down on the contingency account. In addition, a 10-year plan was introduced to place the province’s finances on a more stable longer-term footing. The 10-year plan included a strategic path to becoming less reliant on non-renewable resource revenues (NRR) – or getting off the “oil price rollercoaster”. By 2019-20, the government will split the income generated from NRR 50/50 towards operational purposes and savings.

Revenues dragged down by oil prices

The volatility in oil prices and resource revenues has been the main culprit behind the swift negative turn in fiscal fortunes. Indeed, NRR account for a significant portion of revenue intake. A recent report by the government illustrated that over the past ten years, NRR have accounted for around 30% of total government revenues on average.

As such, all eyes were focused on the government’s assumptions regarding oil prices for its fiscal
forecast. The budget assumes that the West Texas Intermediate (WTI) price of oil will average US$55 per barrel in fiscal 2015-16, US$63 per barrel in fiscal 2016-17 and US$75 per barrel in fiscal 2017-18. This marks a sharp drop from the assumptions made in Budget 2014 (see Chart) but are broadly consistent with our own forecast. The spread between WTI and Western Canada Select (WCS) is projected to average around US$20 per barrel over the fiscal forecast with a slightly wider spread (US$23 per barrel) forecast in the outer years reflecting constraints in pipeline work. Natural gas prices are also forecast to move lower in fiscal 2015-16, which is expected to take another bite out of NRR. The Canadian dollar is forecast to average 81.5 US cents in fiscal 2015-16 which will slightly mitigate the effects from lower oil prices (see Table on page 3 for more details regarding economic assumptions).

All told, NRR are expected to plummet to $2.9 billion in fiscal 2015-16 – a 67% decline from fiscal 2014-15. Looking forward to fiscal 2019-20, NRR is estimated to increase at an average annual rate of 32% reaching $8.7 billion in fiscal 2019-20 – essentially the same level in fiscal 2014-15.

Other revenue streams will also be impacted by the low oil price environment. Personal income tax revenue intake will slow in fiscal 2015-16 (+2.6%), reflecting weaker population and income growth. Corporate tax revenue is expected to fall 21% in fiscal 2015-16. Both revenue streams are expected to move higher over the fiscal forecast on account of rising economic activity and oil prices, and in the case of PIT, tax measures (discussed below).

When all is said and done, total revenues are projected to fall by 11.4% in fiscal 2015-16, before bouncing back strongly over the next two years (average growth of 7.2%). Thereafter, total revenues grow at a rate of 4.5% through fiscal 2019-20.

Revenue raising measures introduced

To combat the hit to revenues the government has introduced a number of revenue raising initiatives. In total, these initiatives amount to $1.5 billion in fiscal 2015-16 and grow to $2.7 billion by fiscal 2019-20. Major initiatives include:

- A new Health Care Contribution Levy that applies to individual taxable income over $50K (to a maximum of $1K). This levy will become effective July 2015 and increases in $200 increments as income rises. It is estimated that the levy will generate $396 million in fiscal 2015-16 and rise to $567 million by fiscal 2019-20. It will be administered through the tax system to minimize costs.

- The progressivity of the personal income tax system will be increased. Effective January 2016, two new tax brackets will be introduced. Taxable income over $100K will subject to a provincial income tax rate of 11.5%. The new tax rate will be phased in over three years. Taxable income above $250K will be subject to a temporary three year tax measure that adds an additional 0.5 points to the tax rate. These initiatives are expected to generate...
The government acknowledges that Ministries will have to absorb around $1.9 billion in fiscal 2015-16 associated with anticipated cost pressures reflecting a rising population, salary settlements and inflation. This estimate rises to $3.8 billion by fiscal 2017-18. As such, the government has indicated it needs to find efficiencies in the way it administers programs. After years of rapid spending growth, the government highlights that program outlays on a per capita basis hover $1,300 higher per person in Alberta compared to the national average. This higher spending is not concentrated in one area, as per capita spending in health, education and social services all exceed the national average.

Approximately 50% of spending is allocated to public sector compensation. The government has indicated that it will honor current contracts but will target upcoming bargaining negotiations to bring public sector compensation in line with the current fiscal environment – including essential services models. All told, the government expects to cut 2,000 FTEs and freeze management salaries in Alberta Health Services.

**Capital spending to receive necessary lift**

Despite the clamp down on program spending, the budget is heavy on capital and infrastructure spending. Capital spending totaling $29.5 billion is earmarked over the next 5 years. The plan embeds almost $5 billion for capital maintenance and renewal, almost tripling the previously budgeted amount.

These monies will be invested in projects targeting a number of infrastructure objectives:

- $7.9 billion in municipal infrastructure;
- $6.7 billion towards the provincial highway network – including ongoing work around the Edmonton and Calgary ring roads;

**Program spending to be curtailed**

The program spending side of the ledger will also be leaned on to address the fiscal gap. Total expenses for fiscal 2015-16 will be held to $48.4 billion, down 0.7% or $300 million lower than fiscal 2014-15. Looking ahead, spending will be kept on a tight leash and is forecast to advance at an average rate of 0.8% over the following two fiscal years until the government returns to a surplus position. Expenditure control will be practiced across all major spending lines.
• $5 billion for schools;
• $3.4 billion for health care facilities;
• $2.3 billion for government infrastructure;
• $1.1 billion for post-secondary facilities;
• $800 million for flood recovery projects.

Direct borrowing for the capital plan is forecast at $19.2 billion over the next four years, with $5.7 billion set for fiscal 2015-16. Total financing requirements total $9.7 billion in fiscal 2015-16 (up from $6.6 billion in fiscal 2014-15) and remain elevated over the course of the capital plan. As a result, Alberta current net asset position transforms into a net debt position in fiscal 2016-17, rising as high as 1.4% of GDP by fiscal 2017-18 before returning to a net asset position in fiscal 2019-20.

10-year fiscal plan tabled alongside budget

In an effort to help set the Province on a better fiscal footing, the government introduced a 10-year fiscal plan along with the budget. The plan is based on three principles:

1. Strong fiscal foundation: The government has tabled a medium term plan to get the budget back to balance and look for efficiencies in program spending.

2. A lasting legacy: The government will end Alberta’s over-reliance on energy revenues while making important capital investments. Beginning in 2018-19, 75% of energy revenues will go to program spending. By 2019-20, only 50% will be used for program spending with 25% dedicated to paying down debt or the contingency fund, 25% will be directed to the Heritage Savings Trust Fund. Over time, as contingency fund is replenished and debt is paid off – 50% of energy revenues will be directed to the Heritage Fund. The Heritage Fund is forecast to have a book value total of $34 billion by 2024-25 – more than double its current value.

3. Securing Alberta’s future: Building a stronger economy and society through a number of channels such as transforming Alberta’s relationship with Aboriginal peoples, investing in children and becoming environmental leaders.

The long-term plan is underpinned by a return to solid economic growth and steady population gains. The government projects real GDP growth to average above 3% over the 2017-20 period. Population growth is assumed to hover just under the 2% mark. In that vein, the continued commitment to infrastructure spending is warranted.

Bottom line

In our report released last week, we highlighted that the government faced a structural deficit and recommended a longer-term approach to putting the province’s finances on a more sustainable footing. Today’s budget implements many of those ideas.

In particular, the Alberta government’s willingness to move sooner, rather than later, to tackle its fiscal challenge should be applauded. With the aim of targeting a budgetary balance by fiscal 2017-18, the government has found an appropriate balance in our view between exacerating an already soft economic backdrop by restraining spending too aggressively and avoiding a long drawn out deficit elimination cycle that makes the budget more susceptible to nasty surprises. A continued commitment to infrastructure investment is warranted. And, given its excellent credit rating, the government can access debt markets cheaply to finance these projects.

The goal of becoming less reliant on NRR to fund its operational plan is also a step in the right direction. Reducing volatility in its revenue stream will help the Province be less at the whim of commodity markets – and get off the rollercoaster.
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