2016 ALBERTA BUDGET

TD Economics

April 14, 2016

ALBERTA TO FACE A DECADE OF DEFICITS

Highlights

- The Alberta government tabled its 2016-17 Budget today, with very few surprises.
- The sharp drop in oil prices has weighed heavily on government revenues, and resource revenues have fallen to levels not seen in over 40 years.
- Amid the revenue shortfall, the government has chosen to maintain its commitment to investing in infrastructure, while offering a modest amount of new measures to help support the economy in time of need. Of note, the government has earmarked $250 million to its job plan, to help encourage jobs, investment and economic development and almost $700 million per year to household financial support.
- The province announced the details of the carbon tax plan in today's budget. While an increase in fuel taxes will be partly offset by consumer rebates for lower-to-middle income households and a reduction in the small business tax rate, the new tax is expected to generate $2.4 billion annually in revenue once fully implemented in fiscal 2017-18.
- The government will look for efficiencies and cost cutting measures to help make up for the additional spending measures and drop in revenues. Expense growth is expected to be capped to just 2% per year over the Budget plan.
- Overall, the budget deficit is expected to reach $10.4 billion in 2016-17 or 3.3% of GDP and the government does not plan to balance its books for at least the next decade. The province's borrowing requirements have increased, with the net debt-to-GDP ratio rising to 15.5% of GDP by 2018-19 – but Alberta still remains less indebted than most other provinces.

The Alberta government tabled its 2016-17 Budget today, which offered very few surprises. The document highlighted a weaker economic backdrop in Alberta than was expected at the time the last budget was tabled just six months earlier. The low oil price environment has delivered the Alberta economy a hefty income shock, weighing heavily on government coffers as resource royalties falling to a four-decade low. In the wake of falling revenues, the government has opted to refrain from significant spending cuts, instead delivering a modest amount of fiscal stimulus for both business and families and proceeding with the $34 billion capital spending plan set out in Budget 2015. This budget introduced the Alberta job's plan which is a series of tax incentives and investments to encourage hiring and investment. As such, the Alberta deficit is expected to reach $10.4 billion (3.3% of GDP) in FY2016-17, almost triple the plan from the October budget

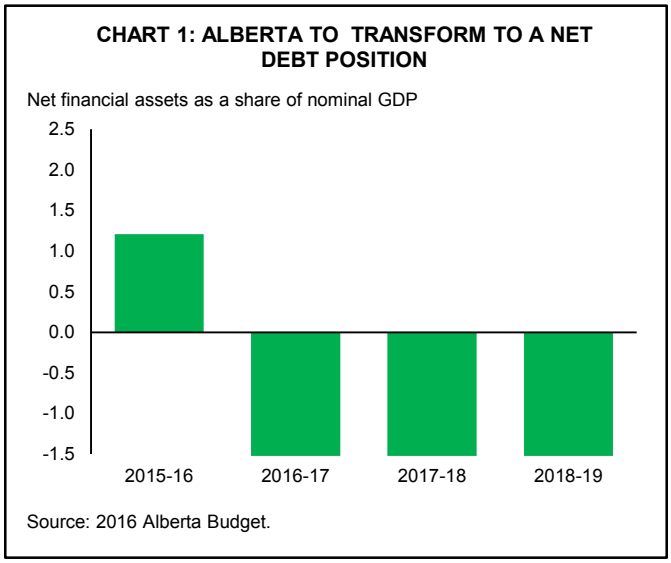

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TABLE 1: ECONOMIC ASSUMPTIONS [Annual percent change unless noted otherwise]					
	Actual	Forecast			
	2015-16	2016-17	2017-18	2018-19	2020
Real GDP*	-1.5	-1.4	1.9	2.8	2.7
Nominal GDP*	-11.4	-4.3	8.0	8.2	6.4
Exchange rate (USD/CAD)	76.0	73.5	75.5	77.5	-
WTI (US$ per barrel)	45.0	42.0	54.0	64.0	-
WTI-WCS (US$ per barrel)	13.4	15.2	17.5	18.5	-
Natural gas** (US$/MMBTU)	2.30	2.40	2.80	3.00	-

*GDP numbers are estimates and are based on a calendar year. For example, 2015/2016 estimates are for calendar year 2015.
**Alberta reference price adjusted for exchange rate and transportation costs.
Source: 2016 Alberta Budget, Bloomberg and Haver Analytics.

and the largest deficit since the mid-1980s. The road back to balance will be a decade long journey. More deficits will necessarily lead to higher borrowing. The Alberta net debt-to-GDP ratio is expected to reach 9.6% in 2016-17 and continue to climb to 15.5% by 2018-19. However, even then Alberta will still have a lower net debt-to-GDP ratio than any other province in Canada relative to the size of the economy.

Forecasting oil prices a mug's game

The biggest difference (and challenge) in the current budget relative to the one presented in October is related to the economic assumptions. Admittedly, most economic forecasters have had a challenging time predicting oil price movements over the last few years and very few expected prices to get this low for this long. As such, the government has shaved almost US $20 per barrel off its oil price forecast for FY2016-17, relative to that presented in Budget 2015. The government now forecasts oil prices to average $42 per barrel in FY2016-17, with prices edging up to $64 per barrel by FY2018-19 – a projection in line with TD Economics view. However, in order to compensate for risks tied to oil price forecasts, the government has actually worked in a risk adjustment into the deficit estimate, which is based on oil prices actually averaging $10 lower than the private sector forecast. The government projects the two year contraction in economic output over 2015 and 2016 to be followed by the slowest recovery in recorded history. Nominal GDP is expected to contract by over 15% over the two years and by 2017 to come in $5 billion below the level forecast in October's budget. Budget 2015 assumed a modest recovery beginning this year.

Revenues nosedive with little offset to reduced royalties, but will rebound with the carbon tax

The biggest driver of the deficit is an estimated $8 billion slump in revenues related to the oil price collapse. In FY2016-17, resource revenues (royalties and other revenues) are expected to fall by almost 80% since FY2014-15 to their lowest level in over 40 years. The remaining part of the decline in revenues is related to a reduction in taxes, reflecting lower corporate profits and household income.

Revenues are expected to bounce back sharply in FY2017-18 and beyond, as the economy and oil prices begin to gradually recover. However, over half of the revenue growth is expected to be driven by the introduction of the carbon tax plan, scheduled for January 1st, 2017. The carbon tax was introduced in the last budget, but the details were sparse until Budget 2016. The tax on fuels is expected to increase to $20 per tonne in 2017 and $30 per tonne in 2018. Most Alberta households will receive annual rebates of between $300 and $540 per household, based on household size and income. Moreover, the Alberta government has lowered the small business tax credit to 2% from 3% to help offset some of the cost of the carbon tax. However, on net, the new carbon tax is expected to raise almost $1.2 billion in FY2017-18 and $2.4 billion in each of the subsequent years. Higher personal income taxes announced in the last budget, but implemented in Budget 2016 are also expected to help offset the negative hit to government coffers from a low oil price environment.

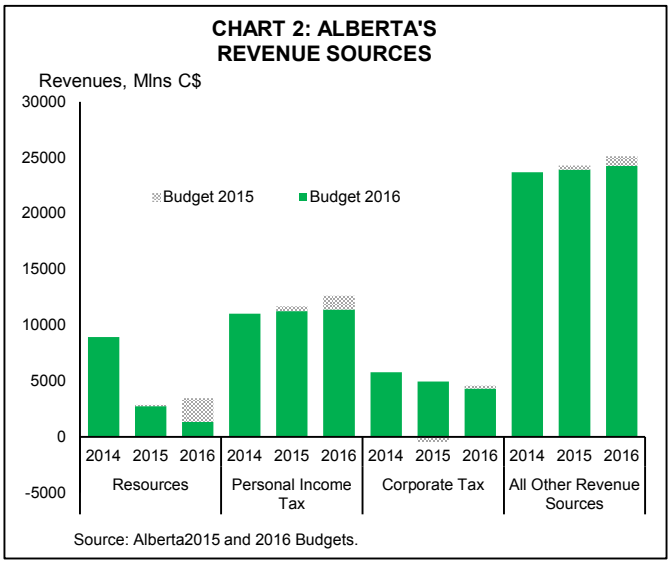

TABLE 1: ALBERTA GOVERNMENT FISCAL POSITION [Millions of C$, unless otherwise noted]				
	Forecast	Estimate	Target	
Fiscal Year	2015-16	2016-17	2017-18	2018-19
REVENUE	**42,938**	**41,376**	**44,988**	**49,617**
% change	-13.2	-3.6	8.7	10.3
RESOURCE REVENUES	2,474	1,364	2,753	4,225
% change	-72.4	-44.9	101.8	53.5
OTHER REVENUES	40,464	40,012	42,235	45,392
%change	-0.2	-1.1	5.6	7.5
EXPENDITURE	**49,331**	**51,097**	**53,619**	**55,968**
% change	2.0	3.6	4.9	4.4
PROGRAM SPENDING	**48,576**	**50,101**	**52,187**	**53,965**
% change	2.0	3.1	4.2	3.4
DEBT SERVICING COSTS	**755**	**996**	**1,432**	**2,003**
% revenues	1.8	2.4	3.2	4.0
SURPLUS (+)/DEFICIT (-)*	**-6,393**	**-10,421**	**-10,131**	**-8,351**
% of GDP	-1.9	**-3.3**	**-2.9**	**-2.2**
BORROWING AS A % OF GDP	6.0%	9.6%	13.1%	15.5%
NET FINANCIAL ASSETS	**4,021**	**-10,020**	**-22,658**	**-33,181**
(financial assets less liabilities)				
% of GDP	1.2	-3.1	-6.6	-8.9
CONTIGENCY ACCOUNT	**3,793**	-	-	--
HERITAGE SAVINGS TRUST FUND	**19,278**	**19,631**	**19,993**	**20,428**

Note: All figures are presented on a Consolidated Financial Statement Basis.
*Less Risk Adjustment Beginning 2016-17
Source: 2016 Alberta Budget

Alberta will not cut spending, but practice spending restraint

As widely expected the Budget 2016 brought with it some new modest stimulus measures, on top of the $34.8 billion in capital spending already laid out in Budget 2015. The stimulus measures outlined in today's budget are small and unlikely to move the needle much in terms of the deficit or the impact on GDP. These initiatives include:

- The job plan. The government earmarked $250 million to help encourage hiring, investment in new businesses and investment in training and apprentice programs. About half of that stimulus will be provided through tax credits.
- Almost $700 million in support to households. This includes the introduction of a new Alberta Child Care Benefit and extending the Enhanced Alberta Family Employment Tax credit. The government is also increasing money available for support payments available to households by $480 million per year.
- The climate leadership investment. The additional revenue raised by the carbon levy will all be re-invested in green infrastructure and energy efficient investments.

Amid the huge hit to revenues, the government has decided to follow the lead of most other provinces across Canada by turning to operating expense control, while continuing to prioritize investment in infrastructure. The costs savings are expected to be generated through government wage freezes, the amalgamation of a number of agencies, boards or commissions and the deferral of some election platform initiatives such as $25 a day daycare and the reduction of education fees. The government will defer $118 million worth of platform initiatives in FY2016-17 and a further $208 million in FY2017-18. These measures are small relative to the size of the budget however, with the biggest spending restraint expected to come by capping health spending to 3% per year. The aim would be to "bend the cost curve" in Minister Joe Ceci's words, while increasing the services available to households. Alberta has the youngest population across Canada, yet the highest per capita health costs.

Borrowing requirements rise quickly, but still comparatively low

Alberta's strong fiscal position leading up to the oil price crash has put in a relatively strong position to handle the revenue shortfall caused by the low oil price environment. But, the province has already worked through its savings while the contingency account is expected to be wiped out through FY2016-17. As such, Alberta's borrowing requirements have increased substantially relative to Budget 2015, although still remain modest. The government estimates that net debt-to-GDP will continue to rise to 15.5% by FY2018-19. Meanwhile, while markets are penalizing Alberta for its economic woes through increased risk premiums, the province's debt service costs are expected to only edge up to 4% of revenues by FY2018-19.

Bottom line

Rating agencies have recently put Alberta in the spotlight. S&P downgraded Alberta to AA+ and Moody's maintained its Aaa rating but gave the province a negative outlook. Rating agencies were looking to today's budget for a credible plan to slash the deficit that is based on prudent assumptions. In our view, while the lengthy deficit reduction plan exposes the province to some risk, the reasonably prudent budget forecasts could set the stage for the government to better its targets. Other positives reflect the government's still-manageable debt burden and the capacity to further boost revenues through higher taxes if needed to keep the province's fiscal position on an improving track.