March 16, 2017

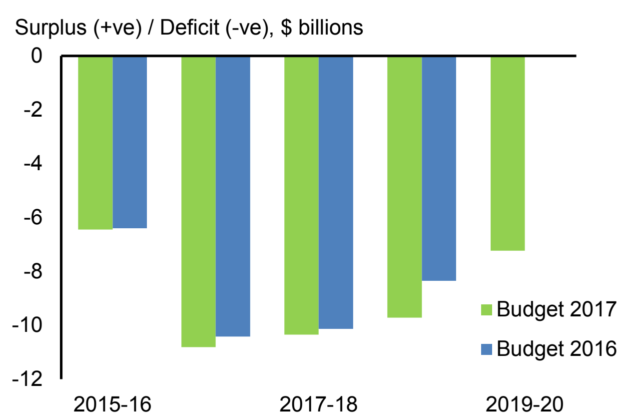
ALBERTA REMAINS FOCUSED ON THE ECONOMY, WHILE COUNTING ON OIL PRICES TO REBOUND

Highlights

- Despite a larger than expected deficit in Fiscal Year (FY) 2016-17, the Alberta government plans to be closer to plan in the upcoming fiscal year, due to a rise in revenues from bitumen royalties and the carbon levy. Revenue growth has been downgraded beyond the upcoming fiscal year, amidst lower expectations for nominal GDP growth.
- The plan also incorporates a bit more spending restraint after expenses jumped 9.8% in FY2016-17. The government remains committed to investing in health care, education and social services, but plans to find $200 million in savings this and next fiscal year, with an additional $100 million the following fiscal year through efficiencies and compensation reductions.
- The deficit is estimated to have reached $10.8 billion in FY2016-17, and is expected to decline to $10.3 billion and $9.7 billion in the coming fiscal years. A more gradual return back to balance is now embedded in this budget, with a balanced budget not expected until FY2023-24. Debt requirements are expected to rise, bringing the net debt-to-GDP ratio above 12% by FY2019-20.

The Alberta Government tabled its 2017 budget today, with little in the way of any major surprises. The deficit in fiscal year 2016-17 is now estimated to be $10.8 billion, or $500 million higher than expected at the time of last year's budget due to a higher than expected 9.8% increase in expenses. Some of the budgetary gap is likely to be made up in the coming fiscal year through higher revenue from bitumen royalties and the carbon levy. However, while the economy and employment are expected to improve through 2017 and beyond, the recovery in nominal GDP is expected to be shallower than was expected last year, and weaker tax revenue amidst higher spending is expected to lead to a more gradual reduction in the deficit beyond the upcoming fiscal year. Alberta's government does not expect to return to surplus unit FY2023-24. Even then, deficit reduction plans hinge heavily on the improvement in prices and investment in the oil industry. The Alberta government also included an additional $1.4 billion to its capital spending plan over the next four years, to be funded through debt. As such, the net debt-to-GDP ratio is now expected to reach 10.2% this fiscal year, and climb to 12.4% by FY2019-2020.

CHART 1: MEDIUM-TERM FISCAL PLAN BUDGET BALANCE



Source: 2017 Alberta Budget.

Expenses drive deficit higher, spending restraint to get them back in line

The miss on the deficit in FY2016-17 can be attributed to higher health care, education and

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social service expenses to the tune of $2 billion, despite the $700 million risk allowance. Budget 2017 does not propose to scale back those expenditures, with the government remaining committed to its Budget 2016 plan to invest in these programs. Rather the government will temper future expense growth by beefing up its plan to restrain spending through finding efficiencies, such as a reduction in government salaries and perks. The government plans to save up to $200 million in fiscal years 2017-18 and 2018-19 and a further $100 million in 2019-2020 through finding efficiencies and scaling back compensation. In doing so, the government is targeting expense growth of 2.6% between FY2017-18 and FY2019-20, slower than planned for in Budget 2016 after the splurge in the last fiscal year.

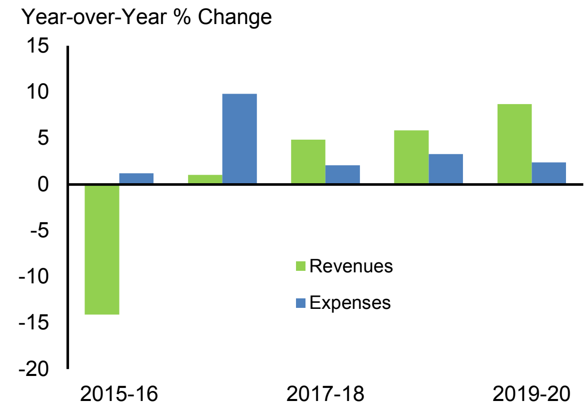
Revenue beat expectations in the near-term, but to lose steam in second half of budget plan

In addition to expense restraint, the narrowing in the deficit in FY2017-18 is expected to come through stronger revenues, due to bitumen royalties and the carbon levy, which together should account for an additional $1.8 billion in revenue coming fiscal year. However, underlying these one-time boosts to revenues, Alberta has lowered its revenue expectations throughout the rest of the plan, due to still weak personal income and corporate tax revenues and softer economic assumptions. While the oil price forecast has been left largely unchanged relative to Budget 2016, the Alberta government cut the nominal GDP growth forecast from an average of around 8% per year in fiscal years 2017-18 and 2018-19 to an average of 5.7% between 2017 and 2020. The government has also introduced a few, minor revenue cutting measures, such as extending the tuition freeze and capping the education property tax bill rate. As such, the government lowered its expectations for revenue growth to an average of 6.5% between this fiscal year and 2019-2020, compared to the target of 10% in last year's budget. Importantly, 40% of the improvement in revenues beyond this fiscal year is expected to come from higher oil bitumen royalties.

Deficit to hold steady, debt to accumulate

While the Alberta budget deficit is forecast to come in at $10.3 billion, or 3.2% of GDP, in the upcoming fiscal year, slightly higher than targeted in the budget last year, the combination of weaker revenue generation and higher expenses are likely to keep the budget gap wider for longer. The Alberta government now forecasts the deficit to narrow to just $9.7 billion next fiscal year, about $1.3 billion higher than targeted in Budget 2016. The government plans to balance the budget by 2023-24, through a plan focused on spending restraint and economic improvements. The combination of larger deficits and additional capital spending (roughly 1.4 billion over the next four years) will lead to a faster accumulation in debt. Government borrowing needs are expected to total $45 billion this fiscal year and to climb to $71.1 billion by fiscal year 2019-2020, with the net debt-to-GDP ratio to exceed 12% by then. While Alberta remains as one of the least indebted provinces across the country, it is accumulating debt at a heady pace.

CHART 2: REVENUES VERSUS EXPENSES



Source: 2017 Alberta Budget.

Bottom Line

Today's budget provided little in the way of new revenue and expense measures relative to Budget 2016, with the Alberta Government remaining committed to not cutting expenditures and acting as a shock absorber amidst a still frail economy. The deficit reduction plan, however, is based on a relatively optimistic oil price and employment forecast and hinges on many things to go right – something that may prove challenging amidst the current uncertain economic environment. The pop in expenses tied to social assistance may also prove stickier, given still strong population and high unemployment rates in the province, which could continue to lead to upside surprises to expenditures tied to social programs. Given its current trajectory, the net debt-to-GDP ratio is converging with that in other provinces.

TABLE 1: ECONOMIC ASSUMPTIONS [Annual percent change unless noted otherwise]					
	Actual	Forecast			
	2016	2017	2018	2019	2020
Real GDP*	-2.8	2.6	2.2	2.4	2.5
Nominal GDP*	-5.3	5.3	5.4	6.2	5.8
Exchange rate (USD/CAD)	75.4	75.5	77.1	77.9	78.0
WTI (US$ per barrel)	43.2	54.0	58.0	66.0	71.0
WTI-WCS (US$ per barrel)	13.9	15.3	17.8	18.3	17.6
Natural gas** (US$/MMBTU)	2.49	3.20	3.20	3.40	3.50

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**Alberta reference price adjusted for exchange rate and transportation costs.
Source: 2017 Alberta Budget, Bloomberg and Haver Analytics.

TABLE 2: ALBERTA GOVERNMENT FISCAL POSITION [Millions of C$, unless otherwise noted]					
	Actual	Forecast	Estimate	Target	
Fiscal Year	2015-16	2016-17	2017-18	2018-19	2019-20
REVENUE	**42,500**	**42,938**	**45,015**	**47,643**	**51,782**
% change	-14.1	1.0	4.8	5.8	8.7
RESOURCE REVENUES	2789.0	2430.0	3754.0	4226.0	6628.0
% change	-68.8	-12.9	54.5	12.6	56.8
OTHER REVENUES	39,711	40,508	41,261	43,417	45,154
%change	-2.0	2.0	1.9	5.2	4.0
EXPENDITURE	**48,942**	**53,744**	**54,859**	**56,652**	**58,009**
% change	1.2	9.8	2.1	3.3	2.4
PROGRAM SPENDING	**48,166**	**52,717**	**53,461**	**54,845**	**55,723**
% change	1.1	9.4	1.4	2.6	1.6
DEBT SERVICING COSTS	776.0	1027.0	1398.0	1807.0	2286.0
% revenues	1.8	2.4	3.1	3.8	4.4
SURPLUS (+)/DEFICIT (-)*	**-6,442**	**-10,806**	**-10,344**	**-9,709**	**-7,227**
% of GDP	-2.0	**-3.5**	**-3.2**	**-2.8**	**-2.0**
BORROWING AS A % OF GDP	6.0%	9.6%	13.1%	17.1	19.5
NET FINANCIAL ASSETS	**4,021**	**-9,585**	**-23,206**	**-35,320**	**-45,157**
(financial assets less liabilities)					
% of GDP	1.2	-3.1	-7.1	-10.3	-12.4
CONTIGENCY ACCOUNT	**6,529**	**3,625**	**2,299**	**--**	**--**
HERITAGE SAVINGS TRUST FUND	**15,170**	**15,382**	**15,674**	**15,987**	**16,307**

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