March 16, 2017

Counting on economic recovery and spending management to curb deficits

Highlights

- The 2016-17 statement of operations is the same as that published in the Third Quarter Update, so the deficit stays as $10.806 billion or 3.5% of GDP.
- The deficit for the coming fiscal year 2017-18 is budgeted at $10.344 billion (3.2% of GDP), including a $500-million risk adjustment. For 2018-19 the projected shortfall is $9.709 billion (including a $700-million risk adjustment) and for 2019-20 it is $7.227 billion (including a $1-billion risk adjustment). The projected deficit reduction is based on revenue growth of 4.8% in 2017-18 and 7.3% on average in 2018-19 and 2019-20, with a strong contribution from non-renewable resource revenue. Operating expense is projected to grow 2.2% in 2017-18 and 2.7% on average over the following two fiscal years.
- The budget assumes WTI at US$55 a barrel in 2017-18 with a light-heavy differential of US$16 a barrel. Oil prices are expected to trend higher in the later years of the plan: WTI is seen averaging $59 in 2018-19 and $68 in 2019-20 with a light-heavy differential of $18 in 2018-19 and $18.60 in 2019-20. Production of raw bitumen is assumed to grow from 2.5 million barrels per day in 2016-17 to 2.9 million in 2017-18, 3.2 million in 2018-19 and 3.3 million in 2019-20.
- The Canada-U.S. exchange rate is assumed to remain at 76 cents in 2017-18, the same as in 2016-17, and then appreciate slightly to 77.5 cents in 2018-19 and 78 cents in 2019-20.
- A risk adjustment is explicitly built into the fiscal framework (i.e., added to the deficit), and provides some padding should economic forecasts prove optimistic. For instance, fiscal sensitivities suggest that a WTI price decline of US$1/bbl would cost the province $310 million and a $1 increase in the light-heavy differential would remove another $285 million; while a one cent increase in the value of the Canadian dollar would shave about $215 million in revenue.
- After a two-year recession, real GDP is assumed to expand 2.6% in 2017, 2.2% in 2018 and 2.4% in 2019. Nominal GDP is assumed to grow 5.3% in 2017, 5.4% in 2018 and 6.2% in 2019. Employment is assumed to grow 0.9% in 2017 and 1.5% on average over the following two years. The unemployment rate is assumed at 8.0% in 2017, declining to 7.1% in 2019. Population is projected to increase 1.4% per year on average from 2016 to 2020.
- The Capital Plan will support $32.8 billion in infrastructure projects over the four years from FY 2017-18 through 2020-21.
- The debt consisting of liabilities for capital projects and of borrowing for the Fiscal Plan is assumed to grow from 6.1% of GDP at the end of FY 2015-16 to 10.6% at the end of the current month, 13.8% in the coming fiscal year, 17.1% in 2018-19 and 19.5% in 2019-20. Total liabilities, which include items such as liabilities of Alberta Capital Finance Authority and pension liabilities, will exceed financial assets at the end of the current fiscal year. In other words, the province will be in a net debt position instead of a net financial assets position.
- Borrowing requirements take account of borrowing for the Fiscal Plan (borrowing to finance deficit after cash adjustments), for the Capital Plan and for provincial corporations, and of refinancing of maturing debt. These requirements are projected at $18.7 billion in 2017-18, $17.7 billion in 2018-19 and $18.4 billion in 2019-20.

Alberta – 2017 Budget

2016-17

The statement of operations released today for the fiscal year ending March 31 is practically the same as that released a month ago in the Third Quarter Update. So the deficit is still estimated at $10.8 billion, or 3.5% of GDP. Revenue is running $1.5 billion above plan. About a third of that excess is due to federal Wood Buffalo wildfire assistance. The remaining $1 billion has accrued despite a $981-million shortfall in corporate income tax (partly due to to the Wood Buffalo wildfire) that almost offset a $1.1-billion increase over budget in non-renewable resource revenue. The gain was due mostly to stronger-than-expected equity markets that boosted investment income and to higher federal transfers (other than the wildfire assistance).

Expense was $2.6 billion higher than budgeted. The overrun came from a $774-million increase in operating expense, from the accounting for coal phase-out agreements (see Climate Leadership Plan operating expense in the table on page 4) and from a $1.1-billion addition to disaster assistance. The increase in total expense was somewhat limited by a greater reduction in the valuation of unfunded pension liabilities.

The $700-million risk adjustment reduced the effect of the expense overrun on the deficit, which is estimated to come in $444 million over budget at $10.8 billion.

Non-renewable resources projected to boost revenue

Revenue is budgeted to grow $2.1 billion or 4.8% in 2017-18. Almost two-thirds of the increase, or $1.3 billion, is expected to come from non-renewable resource revenue, which would then account for 8.3% of revenue against 5.3% in 2016-17. At $3.8 billion, it would still be $5.2 billion lower than in 2014-15. The budgeted increase from 2016-17 comes mostly from bitumen royalties resulting from higher oil prices, rising production and lower operating costs and capital spending.

Tax revenue is budgeted to increase $1.2 billion or 5.9% from 2016-17, with $0.8 billion of that coming from application of the Climate Leadership Plan carbon levy over a full fiscal year. Personal income tax is budgeted to decline $282 million. However, 2016-17 revenue included a $510-million positive prior-years adjustement. Without this adjustment, base personal income tax revenue is budgeted to increase 2.1% in 2017-18 from 2016-17. Corporate income tax is budgeted to increase $574 million, or 17.2%, over 2016-17, a year in which the Wood Buffalo wildfire crimped profits. The 2017 rebound is expected to come from higher oil prices, reduced costs and strong export growth, the latter assisted by a low Canada-U.S. exchange rate.

Budgeted revenue growth in 2017-18 is limited by a $693-million decline in investment income, as accumulated embedded gains of prior years have been realized.

The strong contribution of bitumen non-renewable resource revenue, especially bitumen royalty revenue, is projected to continue out to the forecast horizon. It is projected to contribute 42% of the 7.3% average annual rise of total revenue in 2018-19 and 2019-20. By 2019-20, it is projected to make up 12.8% of total revenue. That said, revenue excluding non-renewable resources is still projected to grow at an average annual rate of 4.6%, reflecting a sustained economic recovery.

Managing expense

An improving revenue outlook does not change the continuing centrality of responsible management of operating expense in the government's plan to reduce the deficit. Operating expense growth is projected to be held to 2.2% in 2017-18 and 2.7% on average over the next two years. This is well below the combined rates of population growth and inflation, projected to average 3.3% over the next three years.

Total public-sector compensation, including that of teachers, doctors and nurses, amounted to 55.6% of total operating expense (including the Climate Leadership Plan) in 2016-17. This wage bill is projected to grow 1.4% next year, 2.1% in 2018-19 and 1.8% in 2019-20. By 2019-20, its share of total operating expense is expected to fall to 54.9%.

Deficits and Capital Plan mean increased debt

The deficit for 2017-18 is projected at $10.3 billion, including a $500-million risk adjustment. Given the difference between projected revenue growth and projected expense growth, the deficit is expected to shrink to $9.7 billion (including a $700-million risk adjustment) in 2018-19 and to $7.2 billion (including a $1-billion risk adjustment) in 2019-20.

Even if deficits are set to decline, the combination of their magnitude with a $32.8-billion off-budget capital plan over the next four years implies an increase in debt. At 6.1% of GDP (or $20 billion) as of last March 31, the total of liabilities for capital projects and direct borrowing for the Fiscal Plan is forecast to grow to 10.6% of GDP at the end of the current month, to 13.8% in the coming fiscal year, to 17.1% in 2018-19 and to 19.5% in 2019-20. At that point it is projected to amount to $71.1 billion. To arrive at the total liability on the province's balance sheet, we have to include other items such as the liabilities of Alberta Capital Finance Authority and pension liabilities. As of March 31 this year, total liabilities estimated at $74.5 billion will exceed financial assets (held in a variety of funds including the Heritage Fund and by the Capital Finance Authority, equity positions, etc.). In other words, the province will be in a net debt position instead of a net financial assets position.

Borrowing requirements

The source of funding represented by the Contingency Account is set to be exhausted by the end of the next fiscal year, increasing borrowing requirements. The latter are dictated mainly by budget deficits (borrowing for the Fiscal Plan), by borrowing for capital purposes and by borrowing for provincial corporations, plus refinancing. The borrowing requirement, which was $8.9 billion in 2015-16 and is estimated at $15.6 billion for the fiscal year now ending, is projected to jump to $18.7 billion in the coming fiscal year and to stay at roughly that level in the following two fiscal years — $17.7 billion in 2018-19 and $18.4 billion in 2019-20. The latter figure may surprise, given the projected reduction of the budget deficit, but borrowing requirements in that year will be boosted by a $3.9-billion refinancing of maturing debt.

Marc Pinsonneault

Alberta – 2017 Budget

NATIONAL BANK OF CANADA FINANCIAL MARKETS

Alberta

(millions of dollars)
CONSOLIDATED FINANCIAL STATEMENT BASIS

	Actual 2015-16	Budget 2016-17	Forecast 2016-17	Budget 2017-18	Target 2018-19	Target 2019-20
Revenue	**42,500**	**41,435**	**42,938**	**45,015**	**47,643**	**51,782**
Personal income tax	11,357	11,405	11,459	11,177	11,609	12,159
Corporate income tax	4,195	4,325	3,344	3,918	4,464	5,072
Climate Leadership Plan Revenue Initiatives	-	274	230	1,038	1,396	1,416
Other taxes	5,168	5,763	5,513	5,629	5,854	6,015
Non-Renewable Resource revenue	2,789	1,364	2,430	3,754	4,226	6,628
Transfers from the Government of Canada	7,142	7,278	7,943	7,988	7,870	8,079
Investment income	2,544	2,115	2,886	2,193	2,231	2,315
Net Income from Government Business Enterprises	2,570	2,416	2,404	2,506	2,568	2,662
Premiums, Fees and Licences	3,574	3,649	3,646	3,683	3,770	3,863
Other	3,161	2,846	3,083	3,129	3,655	3,573
Expense	**48,942**	**51,097**	**53,744**	**54,859**	**56,652**	**58,009**
Operating expense incl. re-allocation and in-year savings	43,189	44,094	44,868	45,850	47,097	48,363
Climate Leadership Plan operating expense	-	325	1,380	868	1,395	1,053
Climate Leadership Plan capital grants	-	5	-	68	411	580
Capital grants to local authorities and others	1,911	2,288	2,221	3,302	2,572	2,289
Disaster / emergency assistance	563	246	1,354	235	201	200
Amortization / inventory cionsumption / loss on disposals	3,131	3,208	3,242	3,375	3,448	3,577
Debt servicing costs	776	996	1,027	1,398	1,807	2,286
Pension provisions	(630)	(65)	(348)	(237)	(279)	(339)
Risk adjustment		(700)	-	(500)	(700)	(1,000)
Surplus (Deficit)	**(6,442)**	**(10,362)**	**(10,806)**	**(10,344)**	**(9,709)**	**(7,227)**
Contingency account - balance at beginning of year	6,529	3,793	3,625	2,299	-	-
Surplus (deficit)	(6,442)	(10,362)	(10,806)	(10,344)	(9,709)	(7,227)
Pension provisions	(630)	(65)	(348)	(237)	(279)	(339)
Direct borrowing for Capital plan	7,016	5,035	4,686	5,954	5,779	6,131
Capital investment	(3,888)	(5,237)	(4,149)	(4,786)	(4,069)	(3,913)
Amortization and other cash adjustments	1,040	1,467	1,396	752	420	(1,142)
Direct borrowing for the Fiscal plan	-	5,369	7,895	6,362	7,858	6,490
Contingency account - balance at end of year	**3,625**	**-**	**2,299**	**-**	**-**	**-**
Capital plan	**6,558**	**8,481**	**7,320**	**9,175**	**7,996**	**8,137**
Capital grants	1,911	2,288	2,221	3,302	2,572	2,289
Climate Leadership Plan	-	5	-	68	411	580
Capital investments	4,647	6,188	5,099	5,805	5,012	5,268
Contingency account	3,625	-	2,299	-	-	-
Other financial assets	60,400	61,343	62,657	62,607	64,357	66,644
Pension liabilities	10,566	10,873	10,218	9,981	9,702	9,363
Direct borrowing for capital projects	16,309	21,369	21,020	26,984	32,774	38,916
Liabilities of self-supporting lending organizations	17,941	18,632	18,783	18,968	19,663	20,418
Other liabilities	15,328	20,489	24,480	29,789	37,394	42,905
Net financial assets	**3,881**	**(10,020)**	**(9,545)**	**(23,115)**	**(35,176)**	**(44,958)**
Non financial assets (net of amortization)	44,661	48,457	47,281	50,507	52,859	55,414
Net assets (variation equals surplus (deficit))	**48,542**	**38,437**	**37,736**	**27,392**	**17,683**	**10,456**
Financing requirements	**8,895**	**14,148**	**15,574**	**18,662**	**17,724**	**18,374**
Term debt borrowing for provincial corporations	1,879	3,744	2,993	6,346	3,587	1,968
Direct borrowing for capital purposes	7,016	5,035	4,686	5,954	5,779	6,131
Re-financing of maturing debt	-	-	-	-	500	3,785
Direct borrowing for the Fiscal Plan	-	5,369	7,895	6,362	7,858	6,490

Source: Alberta 2017 Budget

Alberta – 2017 Budget

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