

# Provincial Budget

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## The 2015 Alberta Budget: The Oil Shock Leads to a Fiscal Makeover

The 2015 Alberta budget features the introduction of a makeover to the province's fiscal framework. With WTI oil prices averaging nearly US\$100 during 4 consecutive years after the "Great Recession", the province comfortably relied on elevated oil revenues to finance the highest per capita spending and the lowest tax burden in the country.

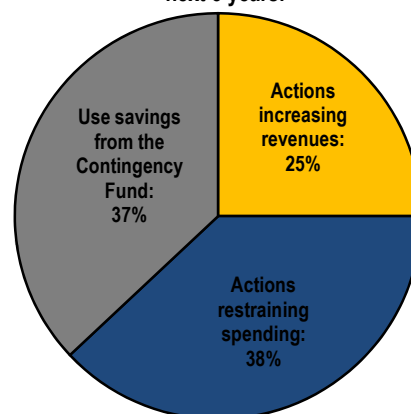
With the tremendous tailwind coming from oil, last year's budget was based on the assumption that WTI oil prices were going to average US\$95 for the next 3 years. But the sudden decline in crude oil prices reminded us that having a fiscal framework largely dependent on volatile oil prices, and unpredictable strategic decisions by global oil producers, is a risky proposition. Indeed, the recent oil shock will lead to a significant revenue gap: the province anticipates \$43.4B in total revenues for FY 2015-16, a 11% from the \$49.0B tally of FY 2014-15. Hence, the province now projects a \$5.0B deficit in FY 2015-16. In light of these deteriorating figures, a makeover to bring more predictable revenues was necessary. The creation of a more sustainable revenue path in the long term is what the 2015 Alberta budget is all about. Soon, we could see an end to "speculative" budgeting.

At the time of writing this budget, the economic outlook was still highly uncertain. So far, companies in the oil sands sector cut staff along with capital spending, deferring future oil projects. The full magnitude of the downturn for the Alberta economy and the timing of an eventual rebound are unknown given the several possible scenarios that could play out in the global oil market. In turn, the various oil assumptions (WTI, WCS, CAD) used in this budget are appropriately conservative (see table below). Notably, the budget includes a gradual increase in WTI crude oil prices over time (US\$54 in FY 2015-16, gradually trickling up to US\$84 in FY 2019-20). Meanwhile, total oil production in Alberta is projected to rise significantly during the next 5 years, from about 2.9 million barrels per day today to 4.1 million barrels per day in 2020, since oil sands companies currently in operation benefits from a breakeven marginal extraction cost below current oil prices. This uptrend in oil production is the main factor that will keep real GDP growth in positive territory.

Besides the expected improvement in the volume and the value of oil production, the Alberta government plans to eliminate its deficit over the next 3 years by using a new strategic approach based on 3 levers. Firstly, the budget includes dozens of tax rate and fee increases that will generate approximately \$1.5B annually, shaving 25% of the revenue gap (see chart).

These tax initiatives include a new health care contribution levy and the implementation of a progressive personal income tax system. Secondly, 38% of the revenue gap will be eliminated by virtually freezing program spending at \$42B from FY 2015-16 to FY 2017-18. Given the 1.7%-2.0% annual growth in the population of Alberta, program spending per capita is projected to move closer to the national average within the next 3 years. There was no need to go for outright severe reductions in the level of program spending given that the province was in an enviable net asset position before the oil shock. Instead, the government will use savings from the Contingency Account, the third lever, to eliminate the remaining 37% of the revenue gap. This reserve fund will be drawn down to \$1.0B in FY 2016-17 from its FY 2014-15 year-end balance of \$6.5B.

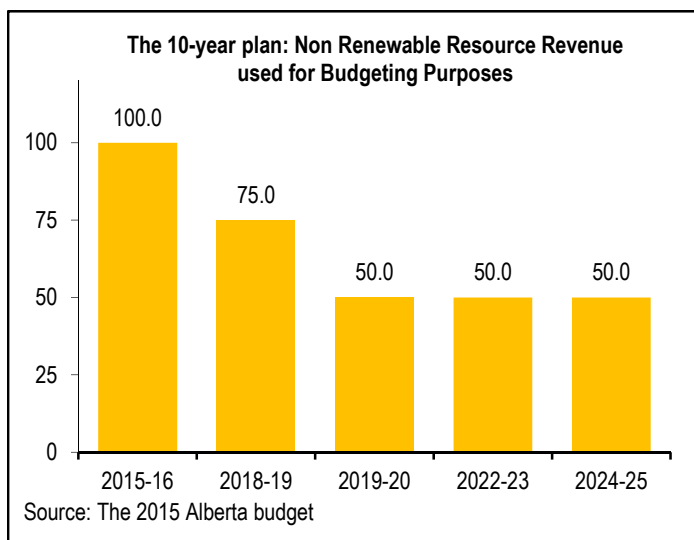
**A balanced approach to close the revenue gap over the next 3 years:**



Source: The 2015 Alberta budget

These 3 levers will contribute to bring the budgetary balance into a mild surplus position by FY 2017-18. They also mark the beginning of a 10-year plan the government is looking forward to put in place to gradually end the entire utilization of non-renewable resource revenues for budgetary purposes. Starting in FY 2019-20, 50% of the non-renewable resource revenues will be saved to rebuild the Contingency Account, to reduce capital debt and to increase the value of the Heritage Fund (see chart).

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With this bold proposition of gradually moving toward a more stable tax base and away from oil revenues, the province will be less vulnerable to roller-coaster changes in fiscal receipts like the ones they are currently experiencing. In terms of numbers, non-renewable resource revenues accounted for about one-third of total revenue in the last decade. In FY 2015-16, this share is projected to fall to only 6%. The eventual reduction of uncertainty to the revenue outlook is a positive element that should be welcomed by both investors and credit agencies. We are of the view that this 10-year plan, if fully implemented, will support the province's AAA credit rating.

In addition to this new objective of improving the long-term stability of the province's finances, the 2015 budget also includes a hefty 5-year \$30B capital plan in infrastructure projects, including \$5B for the maintenance of existing infrastructure. A large part of this capital plan will be financed through borrowings on financial markets. Borrowing requirements are projected at \$9.7B in FY 2015-16 and slightly north of \$9B for the following 2 years; higher than the amounts borrowed in FY 2015-16 (\$6.6B) and FY 2013-14 (\$8.3B).

In summary, the recent oil shock reminded everyone that elevated oil-related revenues cannot always be taken for granted. Non-renewable resource revenues should be treated as ... non-renewable. Soon, a greater share of the oil windfall will be used to increase savings in future oil boom periods than in the past. In other words, the province of Alberta intends to move closer to Norway's model. Norway's sovereign wealth fund is worth nearly US\$900B, compared to Alberta's \$15B Heritage Savings Trust Fund.

Lastly, on the political front, the fiscal makeover proposed in the 2015 budget could potentially lead to an imminent spring election in the province. An election needs to be held in Alberta before June 1st 2016 according to the *Election Amendment Act*.

Alberta: Fiscal Plan Summary (billions \$)						
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
<b>Operating Plan</b>						
Consolidated Revenue	49.0	43.4	45.8	49.8	52.4	54.4
Consolidated Expense	48.7	48.4	48.9	49.1	50.7	51.9
<b>Consolidated Surplus / (Deficit)</b>	<b>0.3</b>	<b>5.0</b>	<b>3.0</b>	<b>0.7</b>	<b>1.7</b>	<b>2.5</b>
as a % of nominal GDP	0.1	-1.5	-0.9	0.2	0.4	0.6
<b>Savings Plans</b>						
Contingency Account*	6.5	2.5	1.0	2.9	4.6	5.0
Heritage Savings Trust Fund*	15.1	15.3	15.5	15.8	16.1	17.2
<b>Capital Plan</b>	<b>---</b>	<b>6.9</b>	<b>6.5</b>	<b>6.3</b>	<b>5.8</b>	<b>5.5</b>
<b>Financing Requirements</b>	<b>6.6</b>	<b>9.7</b>	<b>9.1</b>	<b>9.6</b>	<b>6.0</b>	<b>2.0</b>
<b>Fiscal Year Assumptions</b>						
WTI (US\$/bbl)	79.90	54.84	62.80	75.14	78.89	83.83
WCS (Cdn\$/bbl)	69.86	46.33	51.12	61.77	65.76	74.23
Oil production conventional (000s / bd)	585	575	566	545	527	510
Oil production raw bitumen (000s / bd)	2,346	2,552	2,676	2,944	3,313	3,567
Total oil production (000s / bd)	2,931	3,127	3,242	3,489	3,840	4,077
<b>Economic Assumptions</b>						
2015	2016	2017	2018	2019	2020	
Nominal GDP growth	-8.1	5.7	7.4	6.1	6.4	6.0
Real GDP growth	0.4	1.7	3.0	3.2	3.2	2.8
Unemployment rate	5.7	5.9	5.3	4.7	4.5	4.4

Source: The 2015 Alberta Budget; \*at End of Year

Alberta : Fiscal Sensitivities for FY 2015-16*		
	Change	Net impact in \$ millions
Oil price WTI (US\$ / bbl)	\$1 decline	-148
Light-heavy oil price differential (US\$/bbl)	\$1 increase	-82
Natural gas price (Cdn\$/GJ)	10 cents decline	31
Exchange rate (US\$/CAD)	1 cent increase	-61
Interest rates	1 % increase	-188
Primary household income	1% decline	-143

\* change in the entire fiscal-year average; Source : The 2015 Alberta budget

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