Alberta: 2018–19 Q3 Update

SUMMARY

- **The Province of Alberta yesterday published its Third Quarter Fiscal Update and Economic Statement (*Update*) for fiscal year 2018–19 (FY19). With an election looming, the *Update* was accompanied by a revised fiscal blueprint to FY24.**
- **A $6.9 bn[1] deficit is projected for FY19—$582 mn less than anticipated in Q2 and $1.9 bn narrower than outlined in the March 2018 Budget (table 1). Modestly higher revenues and expenditure offset each other, and the prior forecast risk adjustment of $500 mn was relinquished.**
- **The Province still intends to balance the books by FY24, but fiscal repair is more tilted towards the outer years (chart 1, p.2).**
- **The FY19 net debt estimate is in line with the Q2 forecast, but financing requirements shifted higher.**

ECONOMIC CONDITIONS

Economic growth projections for calendar year 2018 were largely unchanged but the 2019 real GDP forecast was revised down to 1.6% from 2.0% in Q2. The softer profile largely reflects the government-mandated oil production cuts, though the Province noted the marked narrowing of the WTI-Western Canada Select (WTI) discount following the curtailment policy. A light-heavy oil price differential of US$23.50 is now anticipated in FY19—far less than the discount over US$29 forecast in Q2. The differential is expected to remain near US$23 over the next three years.

As oil production returns to full capacity in calendar 2020, Alberta's economy is expected to expand by 2.9%—0.5 ppts higher than outlined in Budget 2018. Stepped-up manufacturing output via construction of petrochemicals and partial upgrading facilities and additional capacity at the Lethbridge potato processing plant is also forecast to contribute to growth. Beyond 2020, average annual advances of 2.6% are projected, in line with the province's underlying potential.

FISCAL PROJECTIONS

Provincial revenues remain on a fundamentally stronger trajectory than expected a year ago in Budget 2018. Recall that the Q2 Update revealed a boost to personal income tax receipts vis-à-vis prior years' adjustments. Stronger WCS prices are also expected to lift FY19 bitumen royalties $199 mn higher than anticipated as of the second quarter. Given the boost in FY19 and a more modest oil production forecast for calendar year 2019, the government looks for FY20 revenues to advance just 4.0% instead of the 5.6% outlined in Budget 2018. A rise approaching 10% is expected to ensue in FY21.

The government plans to bring forward a significant portion of its spending (chart 2, p.2), and now intends to keep nominal total expenditures flat during

[1] Figures reported in Canadian dollars unless otherwise stated.

CONTACTS

Marc Desormeaux, Provincial Economist
416.866.4733
Scotiabank Economics
marc.desormeaux@scotiabank.com

Rebekah Young
Director, Fiscal & Provincial Economics
416.862.3876
Scotiabank Economics
rebekah.young@scotiabank.com

Fiscal Update

$ millions except where noted

	FY19		
	Budget	Q2	Q3
Personal Income Tax	11,387	12,129	12,137
Corporate Income Tax	4,551	4,189	4,088
Carbon Levy	1,356	1,309	1,302
Other Taxes	5,605	5,575	5,562
Total Tax Revenues	**22,899**	**23,202**	**23,089**
Non-Renewable Resource Revenue	3,829	5,322	5,521
Investment Income	2,884	2,619	2,541
Other Own-Source Revenue	10,050	10,217	10,130
Total Own-Source Revenue	**39,662**	**41,360**	**41,281**
Federal Transfers	8,218	8,245	8,368
Total Revenue	**47,879**	**49,605**	**49,649**
Program Spending	**54,258**	**54,742**	**54,705**
Debt Service	1,027	982	981
General & Capital Plan Debt Service	895	893	893
Total Debt Service	1,922	1,875	1,874
Total Expenditure	56,181	56,617	56,579
Risk Adjustment	500	500	0
Consolidated Balance	**-8,802**	**-7,512**	**-6,930**
Net Financial Assets	-29,585	-28,116	-28,127
Financing Requirements	26,106	25,175	29,935
Annual Change, %			
Tax Revenue	*10.3*	*11.8*	*11.2*
Non-Renewable Resource Revenue	*-23.1*	*6.8*	*10.8*
Total Own-Source Revenue	***-0.1***	***4.2***	***4.0***
Federal Transfers	*8.0*	*8.4*	*10.0*
Total Revenue	*1.2*	*4.9*	*5.0*
Program Spending	***0.7***	***1.6***	***1.5***
Total Expenditure	***1.6***	***2.3***	***2.3***
Memo Items, %			
Own-Source Revenue / GDP	11.3	11.8	11.8
Program Spending / GDP	15.5	15.6	15.6
Consolidated Balance / GDP	-2.5	-2.1	-2.0
Debt Service / Revenue	4.0	3.8	3.8
Net Financial Assets / GDP	-8.5	-8.0	-8.0

	FY19			
	Budget	Q1	Q2	Q3
Bitumen royalty	1,785	2,390	2,787	3,387
Crude oil royalty	1,053	1,256	1,318	1,171
Natural gas and by-products royalty	541	591	718	446
Bonuses and sales of Crown leases	327	370	360	369
Rentals and fees / coal royalty	123	130	138	148
Total	**3,829**	**4,737**	**5,321**	**5,521**

Sources: Alberta Finance; nominal GDP forecasts: Scotiabank Economics.

FY23–24. A detailed breakdown of costs was not offered, but the shift presumably reflects previously announced provincial investments in crude-by-rail transportation to provide additional takeaway capacity until pipelines are built. Total expenditures are expected to come in $9.7 bn higher than slated in Budget 2018 during FY20–22. As in Budget 2018, the Province affirmed that it will limit annual growth in operating expenses to the sum of gains in Alberta's consumer price index plus population.

***Alberta Capital Plan* outlays were similarly re-profiled.** Capital expenditures are still expected to peak in FY22, but at $7.1 bn rather than the prior estimate of $6.4 bn. During FY20–22, total capital outlays are forecast to come in $2.0 bn higher than outlined in Budget 2018, and a further $1.2 bn revision relative to the prior blueprint is anticipated in FY23.

DEBT AND BORROWING DETAILS

Financing requirements are expected to come in $4.8 bn higher than anticipated as of the second quarter. The most substantial change from the prior forecast was a $5.4 bn increase in direct borrowing for the Fiscal Plan.

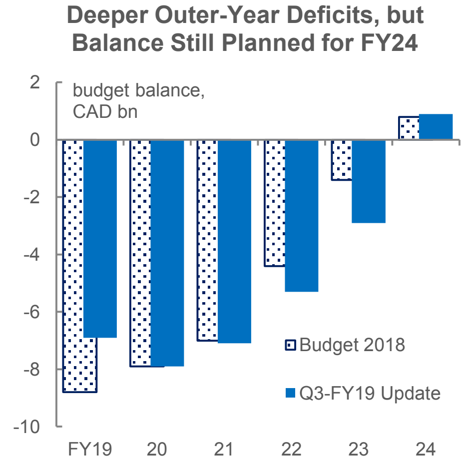
The forecast for FY19 net debt is unchanged from Q2. Advance borrowing of $6.3 bn for FY20 is reported as a commensurate increase in Alberta's contingency account; this anchors the $6.5 bn upward revision in net financial assets. This is expected to help to offset an equivalent rise in the Government's liabilities.

OUR TAKE

Absent more information, this *Update* seems to confirm our prior suspicion that the Government's purchase of rail cars would come at a significant cost. Both spending growth and pre-borrowing are stepped up, with investments in rail capacity acknowledged as a key element of Alberta's longer-term fiscal blueprint.

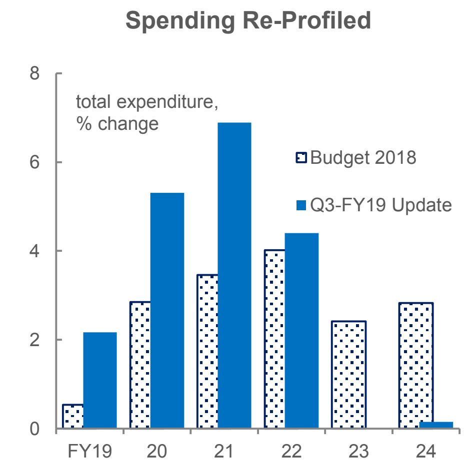
We commend the Province's conservative WCS discount projections. Our most recent forecast of a light-heavy oil price differential of just US$20 in 2019 and 2020 certainly suggests that Alberta's revenue intake could surprise on the upside. Yet financial planning on the basis of weaker prices is always prudent, and the move is made even more so given the Province's post-recession experience with volatile resource revenues.

Chart 1



Sources: Scotiabank Economics, Alberta Finance.

Chart 2



Sources: Scotiabank Economics, Alberta Finance.

Alberta's return to balance continues to rest fundamentally on significant outer-year expenditure restraint. To put this challenge in perspective, the 0.08% average annual rate of total spending growth planned for FY23–24 has been achieved in the province over a two-year span only four times since FY86. The first three instances occurred in the mid-1990s at the height of a period of austerity; the other took place during FY14–15 following the commodity price rout.

Healthy economic expansion over the longer run will also be key for a return to black ink. The Province's implied assumption of underlying trend growth in the 2.5% range is consistent with our own. Its outer-year forecast of 1.7% mean annual population gains—which will be pivotal to further expansion—is also reasonable. The attraction of new investment will also be crucial in this respect, and will depend at least in part on the viability of large energy projects with ongoing economic diversification efforts likely to be a longer-term process.

Economic Assumptions

	2018		2019		
	Q2	Q3	Budget	Q2	Q3
Real GDP, % change	2.5	2.4	2.5	2.0	1.6
Nominal GDP, % change	4.4	4.7	4.3	3.8	1.4
Employment, % change	1.9	1.9	1.7	1.4	1.3
Unemployment Rate, %	6.7	6.6	6.2	6.3	6.4
Avg. Weekly Earnings, % change	2.5	1.9	2.9	2.7	2.1
Primary Household Income, % change	4.5	4.5	4.7	4.3	3.8
Net Corporate Operating Surplus, % change	16.1	14.2	9.8	6.3	-8.5
Housing Starts, 000s	26.5	26.1	32.0	27.3	26.3
Consumer Price Index, % change	2.5	2.4	1.9	1.9	1.6
Population, % change	1.5	1.5	1.5	1.5	1.5

	FY19	
	Q2	
WTI Oil, USD/bbl	64.00	62.00
Western Canadian Select, CAD/bbl	45.00	50.40
Light-Heavy Differential, USD/bbl	29.25	23.50
Bitumen Production, 000s bbl/day	3,051	3,051
Conventional Oil Production, 000s bbl/day	483	497
Natural Gas, AB Reference Price, CAD/GJ	1.50	1.50
Canadian Dollar, US¢/CAD	77.5	76.2

Source: Alberta Finance.

Financing Requirements

$ millions

	FY19		
	Budget	Q2	Q3
Direct Borrowing: Capital	4,272	4,177	4,533
Direct Borrowing: *Fiscal Plan*	7,038	5,731	11,161
Cash Reserve	5,000	5,000	5,000
Borrowing: Orphan Well Assn.	145	145	145
Borrowing: Working Capital	1,000	1,000	100
Term Debt: Provincial Corporations			
Agriculture Financial Services Corp.	406	323	298
Alberta Capital Finance Authority	3,760	3,924	4,159
Alberta Petroleum Marketing Commission	675	711	719
Alberta Treasury Branches	3,000	3,264	2,994
The Balancing Pool	810	900	826
Subtotal	**8,651**	**9,122**	**8,996**
Total Financing Requirements	**26,106**	**25,175**	**29,935**

Source: Alberta Finance.

Balance Sheet

$ billions

	FY19		
	Budget	Q2	Q3
Heritage Fund & Endowment Funds	20.8	20.8	20.7
Contingency Account	0.0	0.0	6.3
Other Financial Assets	51.2	49.7	49.9
Financial Assets	**72.0**	**70.4**	**77.0**
Liabilities for Capital Projects	33.2	33.1	33.4
Debt: Pre-1992 Teachers' Pension Plan	0.9	0.9	0.9
Direct Borrowing for *Fiscal Plan*	20.1	18.8	24.2
Pension Liabilities	9.1	9.1	9.2
Other Liabilities	38.2	36.6	37.3
Total Liabilities	**101.6**	**98.6**	**105.1**
Net Financial Assets (Debt)	**-29.6**	**-28.1**	**-28.1**

Source: Alberta Finance.