

2019 Alberta Budget

Spending Restraint Marks the Landscape

Omar Abdelrahman, Economist | 416-734-2873
 Derek Burleton, Deputy Chief Economist | 416-982-2514

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Highlights

- In its first budget, Alberta’s UCP government provided a roadmap aimed at returning the province’s books to the black by FY 2022-23.
- Despite the unveiling of some revenue-raising measures, the incorporation of previously-announced corporate tax cuts alongside only modest growth in the economy are expected to hold revenues roughly flat over the first two years of the forecast, before picking up thereafter.
- This left expenditure restraint to do most of the heavy lifting. A combination of flatlining growth in healthcare and K-12 education spending, cuts to advanced education and other programs, and a scaling back of the capital plan will take program and total spending down over the next few years.
- Total borrowing requirements will increase until FY 2020-21 before declining by 2022-23. If the budget plan is achieved, the net to debt to GDP is expected to reach 11.2% by 2023.

The newly-elected UCP government showcased its first budget today, with its plan centered on eliminating an annual budget shortfall – estimated this year at \$8.7 billion (2.4% of GDP) - by FY 2022-23 (Chart 1). If achieved, this would be a year earlier than that planned by the previous government last spring.

As expected, the expenditure side of the ledger drives the planned return to balance. Indeed, operating spending is expected to shrink by a cumulative 2.8% over the four-year forecast horizon (0.7% on average). In order to achieve this goal, the government is targeting non-core areas and municipal capital grants, while pledging to flatline core health and K-12 education areas. Meanwhile, revenue growth is expected to be almost flat in the first two years (0.5%) before picking up in the latter two years. Corporate income tax cuts and the removal of the carbon tax surcharge contribute to a softer near-term outlook for the revenue take over the first two years of the forecast horizon, while expectations of improved business investment, GDP growth, and resource revenues drive an acceleration in revenue gains in the latter part of the horizon.

Beyond these specific revenue and cost measures, a number of other new policy initiatives were outlined in this budget. For instance, the government highlighted a focus on restoring competitiveness in the province – including efforts to reduce red tape, and an enhanced capital cost allowance program. Additionally, the budget outlined some changes to other tax credit programs and to its economic diversification plan efforts, notably in the petrochemical manufacturing industry.

Alberta Economic Assumptions						
[Per cent, unless otherwise noted]						
Calendar Year	2018	2019F	2020F	2021F	2022F	2023F
Real GDP growth	2.2	0.6	2.7	2.9	3.0	3.0
Nominal GDP growth	5.0	3.5	2.5	5.9	5.8	6.3
CPI inflation	2.4	1.7	1.8	1.9	2.0	2.0
Employment growth	1.9	0.9	1.6	2.0	2.2	2.1
Population Growth	1.5	1.6	1.6	1.7	1.9	2.0
Fiscal Year	17-18	18-19	19-20	20-21	21-22	22-23
WTI Oil (US\$/barrel)	53.7	62.8	57.0	58.0	62.0	63.0
WTI-WCS Differential (US\$/barrel)	14.4	23.3	14.2	18.4	21.0	17.1
Natural Gas (C\$/GJ)	1.8	1.3	1.3	1.6	1.9	2.0
Canadian Dollar (US cents)	78.0	76.3	75.0	76.0	77.0	78.0

Source: 2019 Alberta Budget, TD Economics

A path to balance by FY 2022-23

The government is benefitting from a better starting point than had been forecast in the 2018 budget. The Province’s year-end update and its public accounts estimated a deficit of \$6.7 billion for the past fiscal year (FY 2018-19), around \$2.1 billion lower than estimated in Budget 2018. This improvement was driven by higher-than-expected personal and corporate incomes taxes and increased bitumen royalties. The reversal of the \$0.5 billion risk adjustment also contributed to the improvement. Expenses, on the other hand, came in slightly higher than expected, mostly due to outlays for flood assistance. As a share of GDP, the Province’s deficit is currently one of the highest in Canada at 1.9%, but is still an improvement from the 3.6% mark in the aftermath of the oil shock in 2016. This share is expected to edge up this fiscal year to 2.4%, mostly as a result of a \$1.5 billion provision for the crude-by-rail divestment the government has committed to. The deficit will then resume a downward trajectory thereafter, until the province hits a \$0.6 billion surplus in FY 2022-23.

Today’s budget plan offers provides clarity and transparency on the details of the path to balance. Compared to the previous plan in Budget 2018, this plan places more weight on keeping a lid on spending, with less reliance on revenue gains (Table 2).

Economic projections mostly prudent

The province’s projections (Table 1) assume a broadly flat and prudent WTI price profile (reaching US\$63 by 2023). If there is some downside risk to the budget’s oil price forecast, it centers on the expectation of a narrowing in the WTI-WCS differential from US\$21 in FY 21-22 to US\$17 in FY 22-23. The budget assumes the completion of the Trans Mountain pipeline by 2022Q4 and the Keystone XL pipeline by early 2023, which are expected to narrow the discount.

Near-term economic growth assumptions appear prudent. The estimates assume a muted economic performance in the near-term, as the province’s oil curtailment plan weighs on oil production growth. This leaves real GDP growth at 0.6% in 2019 and 2.7% in 2020. Beyond next year, the government’s forecasts are higher reflecting improvement in oil sector activity. annual real GDP growth is anchored at 3% between 2021-23, which compares to our prevailing

view of around 2%-2.5%. Following a recommendation from the Blue Ribbon Panel report, the budget has also included a forecast allowance of \$450 million in 2023 as a buffer once the budget is balanced.

Expenditure side of the ledger driving path to balance

As presaged in the MacKinnon report’s recommendations and the government’s platform, the expenditure side of the ledger does the heavy lifting. Most of the reductions and freezes are implemented with the aim of bringing Alberta’s real per capita spending closer to national benchmarks. The plan outlines a 0.2% decline in total spending and a 0.7% decline in operating spending on average during the four years, leaving the latter below the sum of population and CPI inflation growth. The average 0.7% reduction in program spending –while still difficult, is less drastic than the austerity period seen between 1993-96, when average annual total spending fell by around 5.9% and program spending fell by around 6.5%.

Funding to front-line services will remain, and an effective flatlining to healthcare and K-12 education services implies real per capita reductions over the horizon. This is achieved through a combination of reshuffling of funds between programs, and an emphasis on finding efficiency improvements. As expected, advanced education spending will decline over the trajectory (by an average of 3% per year). Driving this is an end to the province’s tuition freeze, and a new funding model to incentivize efficiencies and a focus on skill shortages and job outcomes. The province has also eliminated tuition and education tax credits. Other

Chart 1: Pledged Balance by 2022-23

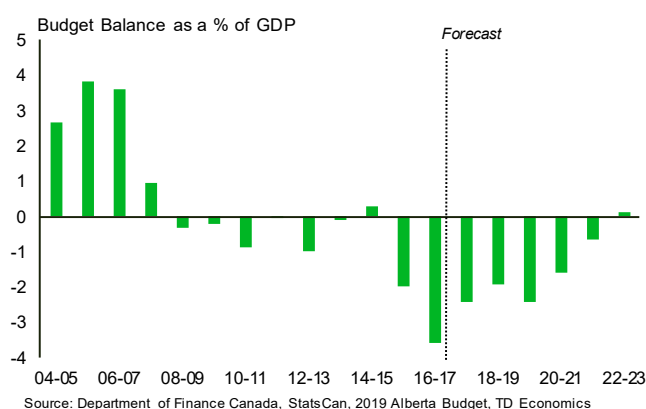
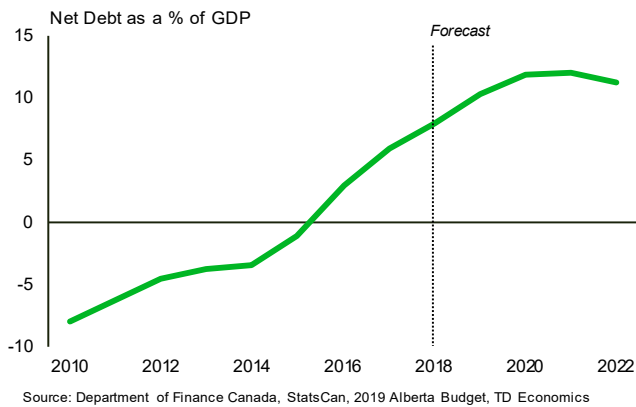


Chart 2: Net Debt to GDP to Edge Down



measures introduced include a temporary pause for the indexation of some non-refundable tax credits and income tax bracket thresholds to CPI, which would gradually increase revenues as incomes rise. More broadly, the size of the public sector workforce is expected to shrink – with that mostly done through attrition (although some layoffs are likely).

The province has scaled down its capital spending plan, with an emphasis on restraining capital grants to municipalities. On that note, the government has also ended grants for the Petrochemical Feedstock Infrastructure Program and the Partial Upgrading Program, although the royalty credit scheme to the Petrochemical industry will continue.

Some of the areas receiving increased funding include mental health and addiction, and social services – namely childcare benefits. For instance, the budget introduces a new Alberta Child and Family Benefit program.

Measures aimed at boosting competitiveness

The budget includes measures aimed at enhancing competitiveness. Notably, the government made good on its plan to slash the corporate tax rate from 12% to 8% by 2022. This move will leave Alberta with the lowest CIT rate among the provinces, as the government attempts to restore an Alberta Advantage in this area of corporate tax competitiveness. The government estimates that the impact on real GDP growth from this measure is between 0.3%–0.4% annually from 2020 to 2023.

The other key tax reduction initiative that was already announced and implemented ahead of today's budget was the cancellation of the provincial carbon tax. This will cost the government around \$1.2 billion in foregone revenues this year. Keep in mind that the federal government has already announced a plan to push ahead with its federal carbon tax backstop beginning in January 1, 2020, although any revenue raised will be recycled to households and businesses in the province. The provincial government also introduced its Technology and Innovation Emissions Reduction system, which aims to focus on large emitters.

Also in the vein of lifting business competitiveness, government has emphasized a focus on its red tape reduction plan and incorporated is a new enhanced capital cost allowance structure. The latter allows for tax deferrals for companies that make new investments in Alberta.

Net debt as a share of GDP to edge down

Total borrowing requirements will increase to \$15.3 billion next year before dropping to \$12.6 billion by 2022–23. The province's net debt to GDP ratio is set to increase to 12% in 2022 before dropping to 11.2% by 2023, which is lower than envisaged in the 2018 budget. This still leaves Alberta in a better spot than all provinces.

Bottom Line

The government's budget plan strikes a good balance between addressing the deficit in a reasonably timely fashion but not at such a hurried pace that it could knock Alberta's still-fragile near-term growth outlook off track. As the deficit falls, Alberta will maintain its status as the province with the lowest debt burden among the provinces, while the government moves to re-establish its advantage on the corporate tax front. The greatest challenge will be keeping a lid on spending over a four-year period. Still, the government has indicated that much of the savings can be secured through means such as attrition and finding efficiencies in programs. Over the longer-term, a challenge remains to lower reliance on volatile non-renewable resources.

Alberta Government Fiscal Position					
[C\$ billions unless otherwise indicated]					
	2018-19	2019-20	2020-21	2021-22	2022-23
	Actual	Forecast	Target	Target	Target
Revenue	49.6	50.0	50.1	53.6	57.5
% Change	4.9	0.8	0.1	7.1	7.3
Non-Renewable Resource Revenue	5.4	6.5	5.4	6.7	8.6
% Change	20.6	20.2	(17.5)	25.1	27.5
Other Revenue	44.2	43.5	44.7	46.9	49.0
% Change	4.2	(1.6)	2.8	4.9	4.4
Total Expense	56.3	56.5	55.2	55.5	55.8
% Change	1.8	0.4	(2.3)	0.5	0.5
Operating Expense	48.4	48.2	47.3	47.2	47.1
% change	4.0	(0.5)	(1.8)	(0.3)	(0.2)
Crude-by-rail provision	-	1.5	-	-	-
Contingency	-	0.7	0.8	0.8	0.8
Revenue Forecast Allowance	-	-	-	-	0.5
Surplus (Deficit)	(6.7)	(8.7)	(5.9)	(2.6)	0.6
% of GDP	(1.9)	(2.4)	(1.6)	(0.7)	0.1
Net Financial Debt	27.5	36.6	43.7	46.9	46.4
% GDP	7.9	10.2	11.8	12.0	11.2
Heritage Savings Trust Fund	16.0	16.2	16.5	16.9	17.2

Source: 2019 Alberta Budget.

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