

2012-13 First Quarter

Fiscal Update and
Economic Statement



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ACTUAL RESULTS

For the first three months of 2012-13

Method of Consolidation

This financial summary is prepared on the same basis as used in *Budget 2012*.

The results of all government departments, funds and agencies, except those designated as government business enterprises, are consolidated on a line-by-line basis. Revenue and expense transactions between consolidated entities have been eliminated.

The accounts of provincial agencies designated as government business enterprises are included on the modified equity basis, the equity being computed in accordance with International Financial Reporting Standards applicable to those entities.

The accounts of the Alberta Innovates corporations and the Crown-controlled SUCH sector organizations such as school boards, universities, colleges, technical institutes, and Alberta Health Services that are controlled by the government are not included in this fiscal summary. These Crown-controlled entities are consolidated on a line-by-line basis in the consolidated financial statements forming part of the Government of Alberta Annual Report.

Basis of Financial Reporting

The consolidated fiscal summary reports revenue (including gains from disposal of tangible capital assets), expense (including amortization, loss on disposal and write-down of tangible capital assets), and surplus / (deficit).

Revenue and expense are recorded using the accrual basis of accounting. Cash received for goods or services which have not been provided by period end is recorded as unearned revenue.

Expense includes the province's cash payments towards the unfunded pension liabilities. Expense excludes the change in the unfunded pension liabilities, which is a non-cash expense that does not affect borrowing requirements.

Debt servicing costs include interest payable and amortization of discount on debt issues.

Compliance with *Fiscal Responsibility Act*

Under the *Fiscal Responsibility Act*, operating expense increases, excluding those for dedicated revenue-operating expense, are limited to 1% of total budgeted ministry operating expense. In addition, actual expense for a fiscal year shall not exceed revenue plus any amounts allocated from the Sustainability Fund.

The results for the first three months of 2012-13 are in compliance with the requirements of the *Fiscal Responsibility Act*.

CONSOLIDATED FISCAL SUMMARY ^a**for the three months ended June 30, 2012***(millions of dollars)*

	2012-13	First Three Months	
	<u>Budget</u>	<u>Budget</u>	<u>Actual</u>
Revenue:			
Income taxes	13,785	3,197	3,298
Other taxes	4,106	931	929
Non-renewable resource revenue	11,198	2,779	1,891
Transfers from Government of Canada	4,915	1,226	1,285
Net income from commercial operations	2,279	570	605
Premiums, fees and licences	1,391	348	644
Investment income	1,794	449	437
Other	795	199	220
	40,263	9,698	9,309
Expense:			
Program Expense:			
<i>Investing in Families and Communities:</i>			
Culture	233	50	40
Health	16,642	3,826	3,819
Human Services	4,282	1,020	1,019
Justice and Solicitor General	1,293	349	354
Municipal Affairs (excluding Municipal Sustainability Initiative)	433	98	122
Municipal Sustainability Initiative	896	896	896
Tourism, Parks and Recreation	182	46	44
<i>Securing Alberta's Economic Future:</i>			
Education	6,542	1,505	1,488
Enterprise and Advanced Education	3,011	661	650
Infrastructure	1,361	231	232
Service Alberta	318	64	63
Transportation	1,885	339	346
Treasury Board and Finance	1,327	217	218
<i>Advancing World-leading Resource Stewardship:</i>			
Aboriginal Relations	154	32	32
Agriculture and Rural Development	1,000	150	144
Energy	543	95	88
Environment and Sustainable Resource Development	609	120	105
International and Intergovernmental Relations	36	5	5
Disaster / emergency assistance	44	8	71
Executive Council	54	14	11
Legislative Assembly	133	33	26
Total Program Expense	40,978	9,759	9,773
Debt Servicing	531	133	124
Less: In-year Savings	(360)	-	-
Total Expense	41,149	9,892	9,897
Surplus / (Deficit)	(886)	(194)	(588)

^a Budget numbers have been restated to reflect the re-organization of government ministries established by Orders in Council under the *Government Organization Act*, on May 8, May 24 and July 11, 2012.

CONSOLIDATED FISCAL SUMMARY ^a**for the three months ended June 30, 2012***(millions of dollars)*

	2012-13	First Three Months	
	<u>Budget</u>	<u>Budget</u>	<u>Actual</u>
Capital Investment:			
<i>Investing in Families and Communities:</i>			
Culture	3	1	-
Health	77	8	9
Human Services	11	3	3
Justice and Solicitor General	109	37	37
Municipal Affairs	64	14	-
Tourism, Parks and Recreation	14	3	2
<i>Securing Alberta's Economic Future:</i>			
Education	4	1	1
Enterprise and Advanced Education	5	1	1
Infrastructure	398	68	49
Service Alberta	53	3	3
Transportation	1,384	180	137
Treasury Board and Finance	33	8	2
<i>Advancing World-leading Resource Stewardship:</i>			
Agriculture and Rural Development	11	3	2
Energy	17	4	2
Environment and Sustainable Resource Development	32	1	1
Legislative Assembly	3	1	-
Total Capital Investment	2,218	336	249

^a Budget numbers have been restated to reflect the re-organization of government ministries established by Orders in Council under the *Government Organization Act*, on May 8, May 24 and July 11, 2012.

ECONOMIC OUTLOOK

Alberta economy stays strong amid global uncertainty

Despite a difficult global economic climate, Alberta's economy has fared well so far in 2012. Business investment has been robust, mainly fueled by gains in oil-related activity. A strong labour market, including nation-leading job gains, has attracted large numbers of migrants and driven up consumer spending and housing activity.

Overall, real GDP is on pace to expand by 3.8% this year, unchanged from

Budget 2012. Solid gains in business investment, consumer spending and housing are expected to fuel growth in Alberta's economy this year (Figure 1). This comes after Alberta led all provinces with estimated real GDP growth of 5.2% in 2011, up from 3.5% estimated in *Budget 2012*.

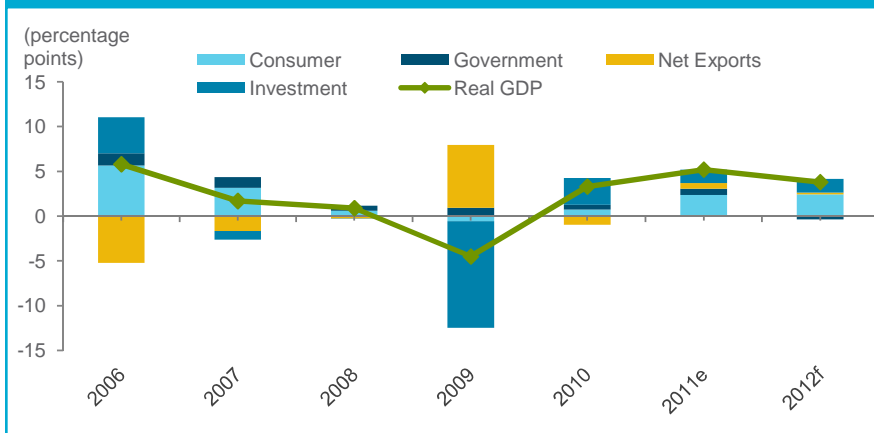
As a trade- and commodity-driven economy, Alberta is highly susceptible to developments in the global economy. A resurfacing of Euro

zone debt tensions combined with moderating emerging market growth have already injected fresh uncertainty into financial markets. This has contributed to a pullback in oil prices and put downward pressure on the value of exports and corporate profits. While the real economic growth forecast for 2012 is unchanged, the nominal outlook and underlying real growth drivers are somewhat different than expected at *Budget 2012*:

- A downward adjustment to energy prices has lowered expectations for oil and gas exports, nominal GDP and corporate profits.
- Residential construction and consumer spending have been revised higher because of better-than-expected results so far this year.
- While the employment forecast is unchanged, stronger-than-expected levels of interprovincial migration to Alberta have led to an upward adjustment to population growth. This has helped moderate expected wage gains.

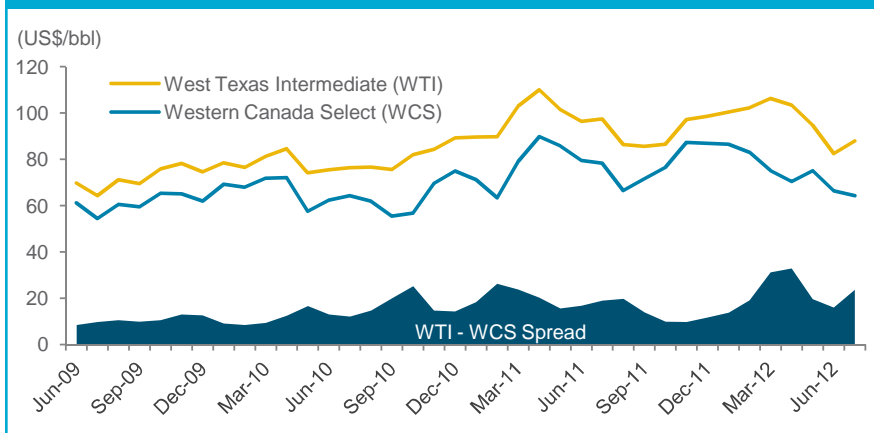
Downside risks to the Alberta outlook remain elevated due to unresolved problems in Europe and ongoing turmoil in financial markets.

FIGURE 1. Contribution to Alberta Real GDP Growth



Source: Alberta Treasury Board and Finance

FIGURE 2. Oil Prices



Source: Alberta Energy

Alberta Business Sector

Oil prices remain volatile

Oil markets have been volatile this year, reacting to heightened uncertainty in the global economy (Figure 2). After averaging well above \$US100/bbl in the first quarter of calendar year 2012, West Texas Intermediate (WTI) dropped to a 10-month low of just over \$US78/bbl in late June. WTI has since rebounded to over \$US90/bbl as of mid-August and is now forecast to average \$92.75/bbl in 2012-13.

ECONOMIC OUTLOOK

Business activity stays healthy

Business investment is expected to post a solid increase in 2012, despite oil and gas price declines. Led by spending in the oil sands, energy-related investment remains a key growth driver.

Rising oil production continues to drive up energy exports, more than offsetting continued declines in natural gas shipments. Since May, lower oil prices have pulled down Alberta's year-over-year growth in nominal exports (Figure 3), and hurt producer cash flow and profits. Growth in the average number of rigs drilling has also started to ease when compared to last year's levels.

Outside of oil and gas extraction, business activity has been brisk. Manufacturers have seen shipments jump 10.6% in the first half of 2012 over last year, propelled by refined petroleum products, machinery and equipment and fabricated metals. Alberta crop producers are primed for a much better year, as growing conditions have been relatively favourable and crop prices have soared amid drought conditions in the US and Eastern Europe. Farm cash receipts hit a record in the first quarter, rising by 28.3% over the same time last year.

Corporate profits revised lower for 2012

The forecast for corporate profits has fallen, mainly reflecting developments in energy markets. The moderation in WTI combined with the wider-than-expected differential between the WTI price and the price of Alberta oil (e.g. Western Canada Select), as shown in Figure 2, have contributed to the revised 2012 corporate profits outlook. A sharp drop in forecast natural gas prices, from \$3/GJ to \$2/GJ in 2012-13, has also weighed on profits. Overall, corporate profits are now expected to increase by only 2.6% in 2012.

Alberta Household Sector

Alberta leads the nation in job growth

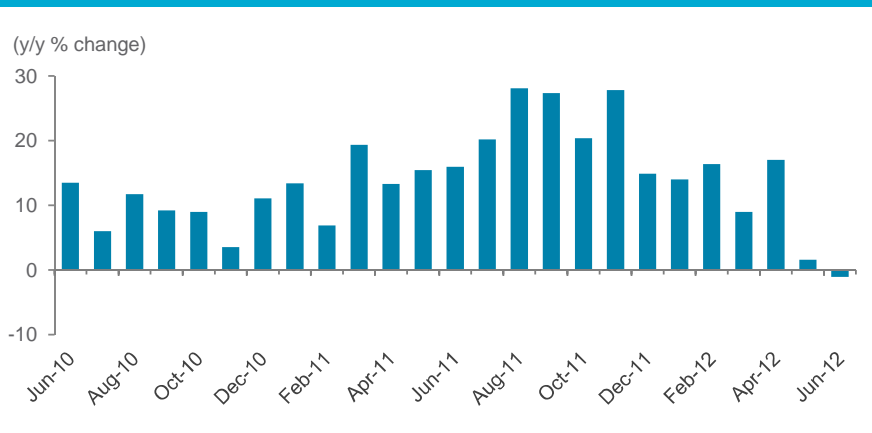
Firmly set in expansion mode, Alberta companies continue to add to payrolls. Alberta employment is up 3.2% in the first seven months of 2012 over the same time last year, the strongest growth in Canada. The province continues to create jobs at a time when Canadian employment growth has virtually stalled. With year-over-year job growth now starting to moderate (Figure 4), the *Budget 2012* forecast of 2.7% for 2012 remains on track. Alberta's unemployment rate is the lowest in the country at 4.6%, and is

expected to average 4.9% this year, unchanged from *Budget 2012*.

Net migration jumps

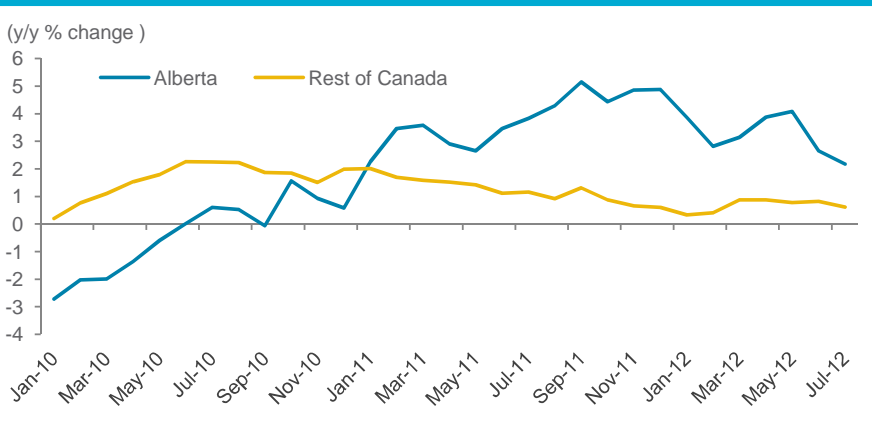
Attracted by job opportunities, Alberta has become the destination of choice for migrants. Alberta gained 13,396 people from other provinces between January 1 and March 31 of 2012, the strongest quarterly gain since 2006 and the ninth straight quarter of net interprovincial inflows (Figure 5). Given higher-than-expected inflows of provincial migrants, Alberta's population is now expected to expand by 2.1% in 2012, up from the *Budget 2012* forecast of 1.8%.

FIGURE 3. Alberta Export Growth



Source: Statistics Canada

FIGURE 4. Employment Growth



Source: Statistics Canada

ECONOMIC OUTLOOK

Weekly wage growth moderates

The large inflows of workers to Alberta has helped keep weekly wage growth contained. In the first five months, average weekly earnings (AWE) have increased 2.4%, a deceleration from the 4.6% growth recorded last year. While AWE has slowed, average hourly earnings in the Labour Force Survey have continued to grow at a strong pace, and hours worked continues to trend higher. After an estimated 6.7% gain in 2011, total personal income is forecast to increase 6.2% this year, in line with *Budget 2012*.

Housing market on the upswing

Alberta's housing market has picked up markedly this year, lifted by increased migration to the province and record low mortgage rates. Housing starts are up 46% through the first seven months over last year, bouncing back from an unusually weak first half in 2011. As a result, housing starts are now forecast at 29,500 this year, up from *Budget 2012* forecast of 28,200. In the resale market, Alberta has moved into seller's territory. Home resales have outpaced new listings, bringing the sales-to-listing ratio to 0.61 as of July, just above the 0.60 seller's market threshold.

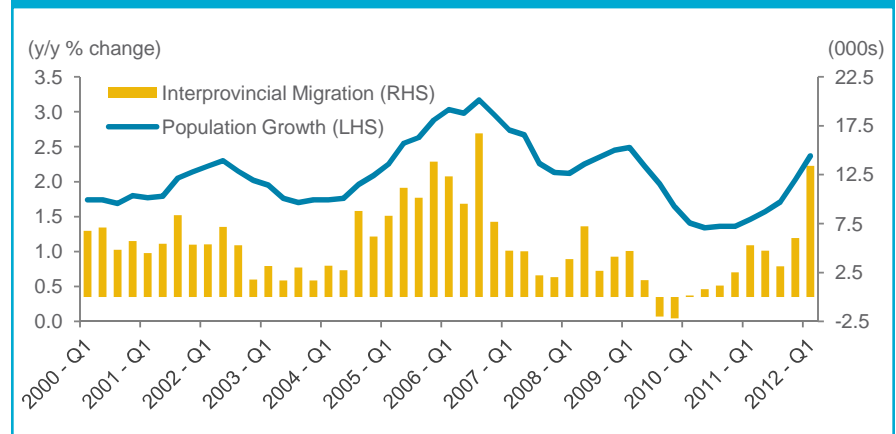
Alberta's consumers boost economy

Households are doing their part to sustain Alberta's expansion. A robust labour market and inflows of migrants have contributed to more consumer spending in Alberta. Retail sales have surged 8.8% in the first half of 2012 over last year, the fastest growth among the provinces. As a result, the outlook for real consumer spending growth in Alberta has been revised upward to 4.4% in 2012.

Inflation stays in check

Through the first seven months of the year, consumer price inflation has remained tepid, averaging only 1.4%. Weak growth in housing and

FIGURE 5. Alberta Net Interprovincial Migration



Sources: Statistics Canada and Alberta Treasury Board and Finance

vehicle prices, along with lower energy prices, have kept inflation contained. However, there is a risk that inflation could creep higher. Lower energy prices have already subtracted from inflation and are unlikely to have the same moderating effect going forward. Drought conditions in key producing regions should put upward pressure on food prices, and there is a risk that housing price gains could pick up given the uptick in housing demand. Overall, consumer price inflation is expected to average 1.9% in 2012, down from the *Budget 2012* forecast of 2.5%.

Global Outlook and Risks

Alberta's solid expansion comes at a time of weakness in the global economy. Global economic growth is expected to slow this year, mainly reflecting the effects of the Euro zone debt crisis. Although the Alberta economy has performed well to date, risks remain elevated given the uncertain state of the global economy.

- The Euro zone economy is expected to mildly contract in 2012 as the debt crisis continues without a long-term solution in sight. An escalation in the crisis could further dampen economic growth and could impact global financial stability.
- Euro zone woes have spilled over to other regions of the global economy including emerging markets, which have already decelerated. A further slowdown of emerging market growth could test the resiliency of the global economy, and further push down commodity prices.
- Rising North American oil supplies and a lack of pipeline access to alternate markets have affected the price received by Alberta oil producers. Further pricing pressure presents a downside risk to the Alberta economy.
- The Canadian dollar has seen bouts of volatility throughout this year. Currently, Canada is viewed as a safe haven for international capital, which has contributed to the loonie's recent appreciation. Continued strength in the value of the Canadian dollar poses a risk to export growth.
- Alberta has the lowest unemployment rate in Canada. A further tightening in the labour market could worsen skilled labour shortages and drive up business costs.

Key Energy and Economic Assumptions

Fiscal Year Assumptions	2011-12 Actual	2012-13 Budget	2012-13 1st Quarter
Prices			
Crude Oil Price			
WTI (US\$/bbl)	97.33	99.25	92.75
Alberta Wellhead (Cdn\$/bbl) ^a	88.31	90.18	82.07
WCS @ Hardisty (Cdn\$/bbl)	80.72	83.28	72.11
Natural Gas Price			
Alberta Reference Price (Cdn\$/GJ)	2.98	3.00	2.00
Production			
Conventional crude oil (000s barrels/day)	504	524	545
Raw bitumen (000s barrels/day)	1,785	2,045	1,998
Natural gas (billions of cubic feet)	4,439	4,085	4,111
Interest rates			
3-month Canada treasury bills (per cent)	0.89	1.00	1.10
10-year Canada bonds (per cent)	2.47	2.80	2.30
Exchange Rate (US¢/Cdn\$)	100.7	98.6	98.6
Calendar Year Assumptions	2011 Estimates	2012 Budget	2012 1st Quarter
Gross Domestic Product			
Nominal (millions of dollars)	303,494 ^b	306,657	322,487
per cent change	10.6 ^b	7.0	6.3
Real (millions of 2002 dollars)	192,801 ^b	196,913	200,173
per cent change	5.2 ^b	3.8	3.8
Other Indicators			
Employment (thousands)	2,094	2,151	2,151
per cent change	3.8	2.7	2.7
Unemployment rate (per cent)	5.5	4.9	4.9
Average Weekly Earnings (per cent change)	4.6	4.2	3.5
Personal Income (per cent change)	6.7 ^b	6.2	6.2
Corporate Profits (per cent change)	10.1 ^b	11.8	2.6
Housing starts (number of units)	25,704	28,200	29,500
Alberta Consumer Price Index (per cent change)	2.4	2.5	1.9
Population (thousands)	3,779	3,848	3,859
per cent change	1.6	1.8	2.1

^a Refers to the average price per barrel of Alberta light, medium and heavy oil.

^b Alberta Treasury Board and Finance estimate.

REVENUE IMPACTS

Impact of recent economic developments on government revenues

Economy stays strong, but volatility in energy markets weighs on royalties and overall revenues

Amid a slowdown in the global economy, Alberta is expected to meet the real economic growth and employment projections from *Budget 2012*.

Despite Alberta's strong economy, overall government revenues have been negatively impacted by developments in global energy markets since *Budget 2012* was tabled. Markets have been highly volatile since the beginning of 2012-13, reacting to European sovereign debt concerns, slow growth in advanced economies, and a deceleration in emerging market growth. Declines in oil and natural gas prices received by Alberta producers since *Budget 2012* have lowered price expectations for this fiscal year, with negative impacts on royalties paid.

Royalties from crude oil and bitumen production have been the most affected by lower forecast prices. A number of factors have contributed to weaker royalties paid by Alberta oil producers:

- The forecast for crude oil prices in North America (e.g. WTI) has weakened due to global economic uncertainty, weakened demand and increasing US production. The downward revision is consistent with private sector forecasters, who have also lowered their expectations for WTI oil prices (see Figure 1). As prices fall, producers are also subject to a lower royalty rate, thereby paying less royalties.
- The differential between WTI and what Alberta oil sands producers receive on bitumen (e.g. WCS) is now much wider than expected at *Budget 2012*, reflecting pipeline constraints and refinery shutdowns.
- The spread between world prices (e.g. the Brent price) and WTI is wider than expected at *Budget 2012* due to strong increases in North American oil production and limited US pipeline access to markets. This affects producer costs, and hence royalties, because the price of condensate (imported to dilute bitumen for transportation) tracks the Brent price.

Natural gas royalties have also been adjusted downward on lower forecast prices, as North American supply growth continues to exceed demand growth.

Alberta land sales, which were forecast to decline in *Budget 2012*, are now projected to be even lower. This partly reflects the impact of reduced prices on producer cash flows.

Income taxes tracking slightly higher than Budget

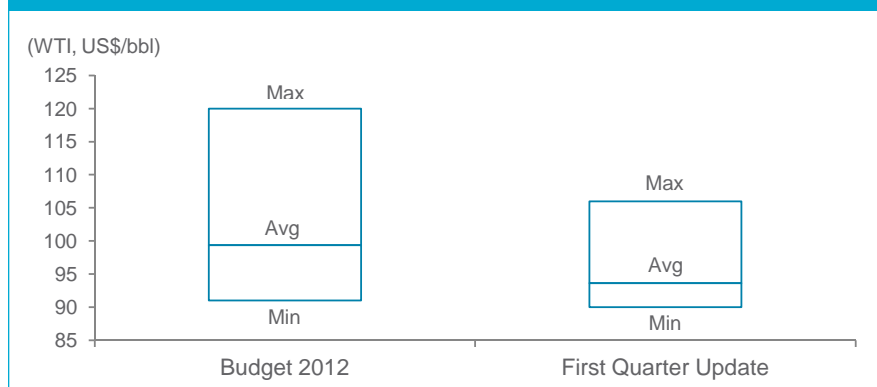
Many Alberta businesses have benefited from strong economic conditions in the province. Despite downward revisions to the corporate profits estimate for 2012, corporate income tax revenue has been revised marginally higher for 2012-13. This reflects much higher-than-expected tax collections in the first four months of the fiscal year.

Albertans have the highest earnings in the country, with average weekly earnings nearly 20% above the national average. Driven by strong employment and wage growth, personal income taxes are expected to increase significantly this fiscal year. The estimate for personal income tax revenue has been revised slightly higher as a result of a better-than-expected initial forecast of personal income tax collected in 2011-12. This results in a higher base upon which to grow in 2012-13.

Higher Deficit Forecast

Primarily due to a lower estimate for resource revenue, Alberta's deficit could range from \$2.3 billion to \$3 billion in 2012-13. The Sustainability Fund balance could therefore range from \$3.7 billion to \$3 billion on March 31, 2013.

FIGURE 1. Private Sector Oil Price Forecast Range 2012



Sources: Alberta Energy and Alberta Treasury Board and Finance, Survey of Private Sector Forecasters

VOLATILITY

Alberta's revenues remain highly volatile and difficult to predict

Non-renewable resources (NRR) provide an important source of revenue for the Government of Alberta. In 2011-12, revenue from NRR accounted for about 30% of total government revenue.

A major challenge with NRR revenue is that it is volatile and therefore inherently difficult to predict. The prices for Alberta's energy products are determined in global markets, and fluctuate widely depending on economic conditions, geopolitical risk and supply considerations. A small change in the price of oil has a large impact on the revenue Alberta collects.

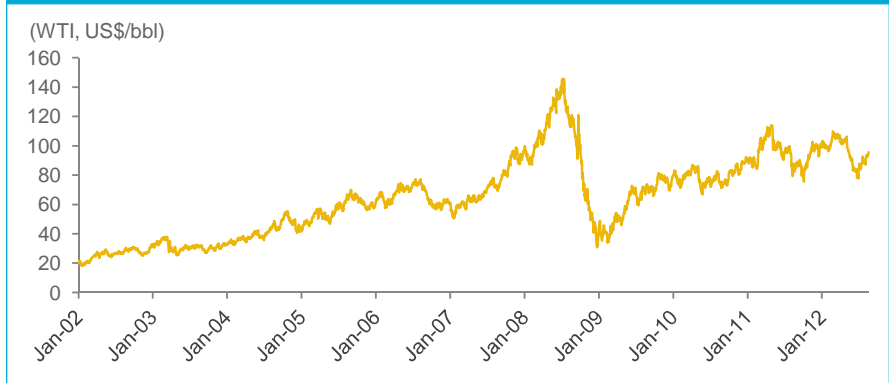
Figure 1 shows that the oil price has fluctuated a great deal over the last 10 years. As a result, the estimated price has deviated from the actual price, and often significantly. In general, as seen in Figure 2, the Alberta government has under-estimated oil prices at budget.

As a result of market volatility, adjustments to the Budget estimates are common. Figure 3 shows that over the last ten years, NRR revenue has deviated from budget estimates as much as \$6.7 billion in a single fiscal year.

Figure 3 also illustrates that the Government of Alberta has in its budgets under-estimated NRR revenue in each of the last 10 years: the actual revenue collected was more than estimated at budget. If current trends in NRR revenue collections continue for the remainder of the year, 2012-13 would be the first time in the last 10 years that NRR revenue has been over-estimated at budget.*

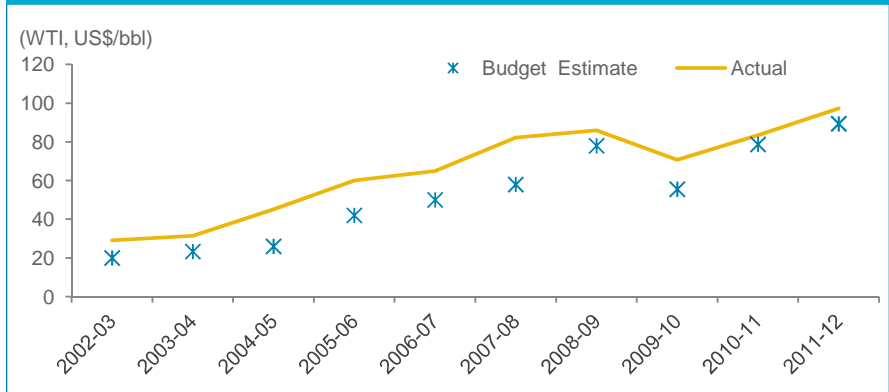
* The last time was 2001-02, when NRR revenue was over-estimated by \$1.3 billion.

FIGURE 1. Daily Oil Prices



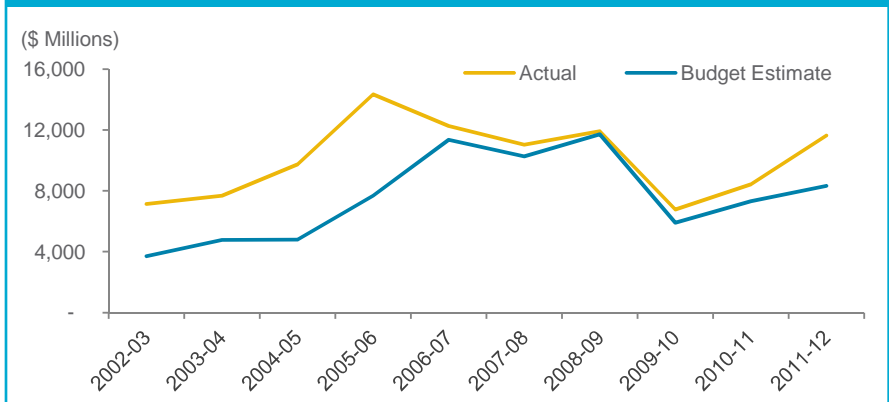
Source: Alberta Energy

FIGURE 2. Annual Oil Prices: Actual and Budget Estimate



Sources: Alberta Energy and Alberta Treasury Board and Finance

FIGURE 3. Non-renewable Resource Revenue



Sources: Alberta Energy and Alberta Treasury Board and Finance

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