



OCTOBER FISCAL AND
ECONOMIC UPDATE

FOR RELEASE OCTOBER 18, 2001

Alberta
GOVERNMENT OF ALBERTA

Keeping Albertans Informed

The *October Fiscal and Economic Update* provides an overview of the major fiscal and economic changes that have happened this fall. A complete *Second Quarter Fiscal Update* will be released, as scheduled, by the end of November.

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OCTOBER UPDATE

Highlights

SEPTEMBER 11

The events of September 11, 2001 accelerated underlying economic and energy trends in North America. Economies have weakened more than previously expected and natural gas prices have declined faster than forecast. These developments are having an impact on Alberta's economy and the province's fiscal outlook.

ALBERTA'S ECONOMY

Economic growth in 2001 is expected to remain strong, leading the nation at 4.9%. In 2002, Alberta should still outpace the national economy, but economic growth could temporarily slow to around 2.1%. Employment growth is expected to remain relatively strong and unemployment to remain under 5%.

FISCAL OUTLOOK

Revenue is forecast to be \$1.7 billion lower than estimated in the budget. This reflects declining natural gas prices and lower investment income. Without corrective actions, the province would be facing a \$1.2 billion deficit in 2001-02.

CORRECTIVE ACTIONS

The province will be implementing \$1.26 billion in corrective actions. This includes \$735 million in deferred infrastructure projects and \$525 million in other savings. These steps will result in an economic cushion of \$12 million. The situation will continue to be monitored and, if required, further appropriate actions will be taken to ensure the province's budget is balanced.

CONSOLIDATED FISCAL SUMMARY

(millions of dollars)

	2001-02					
	Budget	1st Quarter	October Update		Change from	
			Without Actions	With Actions	Budget	1st Quarter
Revenue	22,673	22,575	20,937	20,957	(1,716)	(1,618)
Expense						
Program	20,832	21,088	21,088	19,848	(984)	(1,240)
Debt Servicing Costs	750	730	825	825	75	95
Total Expense	21,582	21,818	21,913	20,673	(909)	(1,145)
Net Revenue	1,091	757	(976)	284	(807)	(473)
Less: Net Increase in Capital Assets affecting Operations	274	272	272	272	(2)	—
Economic Cushion	817	485	(1,248)	12	(805)	(473)

Economic Update

NORTH AMERICAN SLOWDOWN

By the end of the summer, it was clear that the U.S. economy had ground to a standstill and that the slowdown was spreading to the rest of the world. Japan was back in recession, Canada was on the brink, and economic growth in Europe had slowed sharply. OPEC had cut production as global oil demand weakened, and natural gas prices had fallen from their winter highs.

POSSIBILITY OF A RECESSION

The terrorist attacks on September 11 have increased uncertainty and weakened consumer and business confidence. A North American recession — technically defined as two consecutive quarters of declining economic output — now seems likely. Analysts are now expecting economic growth for Canada and the United States to be between 1% and 1.5% this year, with the recovery delayed to the second half of 2002. Growth in 2002 is expected to average between 1% and 2%. Much will depend, however, on geo-political developments.

ALBERTA'S ECONOMIC GROWTH REMAINS STRONG THIS YEAR

Economic growth in Alberta is expected to be 4.9% this year, the fastest in Canada. The momentum in the energy sector is helping to keep investment and exports very strong. Overall investment is projected to rise 14.2% according to a recent Statistics Canada

survey, the fastest in Canada. International exports were up 34.7% in the first seven months of this year, while manufacturing shipments were up 5.6%. With a gain of 47,200 jobs in the first nine months, Alberta's unemployment rate stands at 4%, the lowest in twenty years.

Strong employment growth, the lowest unemployment rate in Canada and low provincial taxes have attracted 39,611 people to Alberta from other parts of Canada since the beginning of 2000. Household spending has been very strong, with retail sales up 9.7% in the first seven months of 2001 and housing starts up 9.3% in the first nine months.

ALBERTA'S GROWTH TO SLOW IN 2002

With energy prices coming down more rapidly than expected, the investment outlook has weakened. This, combined with the weaker global outlook, is expected to reduce Alberta's growth to around 2.1% in 2002.

MEDIUM-TERM GROWTH PROSPECTS REMAIN STRONG

Growth is expected to pick up in the second half of 2002 as the United States and the rest of the world economy recovers. The Alberta economy will continue to perform well in the medium term, with growth expected to average between 3% and 3.5%.

ECONOMIC ASSUMPTIONS

	2001		2002	
	Budget	Update	Budget	Update
Real Gross Domestic Product (millions of 1992 dollars)	115,434	115,516	119,623	117,939
% change	4.8	4.9	3.6	2.1
Employment (thousands)	1,627	1,632	1,669	1,661
% change	2.5	2.7	2.5	1.8
Unemployment Rate (%)	4.7	4.6	4.2	4.3

FISCAL ASSUMPTIONS

	Budget	2001-02		Sensitivities	
		1st Quarter	October Update	Change	(millions \$)
Oil Price (WTI US\$/bbl)	25.00	25.63	25.00	-\$1.00	(153)
Natural Gas Price (Cdn\$/mcf)	5.03	4.53	3.75	-10¢	(142)
Exchange Rate (US¢/Cdn\$)	67.8	66.1	64.3	+1¢	(90)
Interest Rates:				-1%	(10)
3-month Canada Treasury Bills (%)	4.75	4.25	3.55		
10-year Canada Bonds (%)	5.50	5.75	5.55		

Fiscal Update

NON-RENEWABLE RESOURCE REVENUE

Total resource revenue is forecast at \$6 billion, down \$1.5 billion from budget and \$1.1 billion from the *First Quarter Fiscal Update*.

Natural gas royalties are forecast to be \$1.7 billion lower than budgeted. Partly offsetting this decline are higher oil royalties (due to a lower exchange rate), and higher land sales.

Natural gas prices are now forecast at Cdn\$3.75 per mcf, down \$1.28 from budget and 78 cents from the first quarter. Economic uncertainty and increased production have combined to weaken prices. For the first six months of the fiscal year, prices have averaged Cdn\$4.78 per mcf. For the second half of the year, prices are expected to average only Cdn\$2.72 per mcf.

Oil prices are expected to average US\$25 per barrel, down 63 cents from the first quarter forecast but unchanged from budget. For the first six months of the fiscal year, prices have averaged US\$27.28 per barrel. For the second half of the year, prices are expected to average only US\$22.72 per barrel.

TAX REVENUE

Income tax revenue is \$125 million higher than budgeted, but \$194 million less than the first quarter forecast. The prior-year adjustment for personal income tax revenue, reported in the first quarter, has been mostly offset by forecast lower revenue due to weakening economic conditions.

Other tax revenue is \$38 million lower than budgeted. Freehold mineral rights tax revenue is \$60 million lower as a result of declining natural gas prices. Partly offsetting this is a \$20 million increase in school property tax revenue due to a reduction in the allowance set aside for assessment adjustments and appeals. Other taxes are \$2 million higher than budgeted.

INVESTMENT INCOME

Weakness in world equity markets has resulted in a \$525 million decline in investment income. This reflects realized capital losses and write-downs of investments, particularly in the technology sector.

TRANSFERS FROM GOVERNMENT OF CANADA

Transfers from the Government of Canada are \$144 million higher than budgeted, reflecting updated data from the federal government.

OTHER REVENUES

No changes have been made to the forecast of other revenues reported in the *First Quarter Fiscal Update*.

DEBT SERVICING COSTS

Debt servicing costs are now forecast to be \$75 million higher than budgeted. This reflects an increase in the foreign exchange provision on US dollar debt due to a lower value of the Canadian dollar.

REVENUE

(millions of dollars)

	2001-02				
	Budget	1st Quarter	October Update	Change from	
				Budget	1st Quarter
Income Taxes	6,051	6,370	6,176	125	(194)
Other Taxes	2,407	2,371	2,369	(38)	(2)
Non-Renewable Resource Revenue	7,536	7,084	6,025	(1,511)	(1,059)
Transfers from Government of Canada	2,078	2,060	2,222	144	162
Investment Income	1,256	1,256	731	(525)	(525)
Other Revenues	3,345	3,434	3,434	89	—
Total Revenue	22,673	22,575	20,957	(1,716)	(1,618)

Corrective Actions

INFRASTRUCTURE DEFERRALS

\$735 million of infrastructure projects have been deferred. This includes \$282 million for health projects, \$109 million for education and post-secondary capital projects, \$280 million in transportation funding and \$64 million in other infrastructure projects. Funding for these projects will be provided as affordable.

Funding will continue to be provided for over \$2.7 billion of infrastructure projects in 2001-02.

ENERGY ASSISTANCE PROGRAMS

Two energy assistance programs included in *Budget 2001* are no longer required. This results in a \$285 million lapse.

Due to the lower than expected electricity prices, the cost of the Market Transition Credit Program was lower than budgeted. A \$40 million lapse was reported in the *First Quarter Fiscal Update*. A further \$160 million lapse is included in this *October Update*. Electricity rebates provided from proceeds of the power auctions will continue as planned.

\$125 million was also budgeted for a Natural Gas Price Protection Program. Due to lower natural gas prices, this assistance will not be required.

OTHER REDUCTIONS

\$240 million in other reductions are planned. Most of these savings will come from a 1% reduction in the base budgets of ministries. This includes a freeze on civil service hiring and discretionary spending.

Additional savings will be achieved through reductions to selected lottery funded programs, withdrawal of planned energy rebates to health authorities and deferring some funding for the remediation of petroleum storage tanks.

The impact of these reductions on individual ministry budgets will be reported in the *Second Quarter Fiscal Update*.

PROGRAM AND CAPITAL EXPENSE

Other than for the corrective actions, no changes have been made to the forecast of program expense and net change in capital assets affecting operations reported in the first quarter.

CORRECTIVE ACTIONS

(millions of dollars)

	2001-02
Infrastructure Deferrals	
Health	282
Education and post-secondary	109
Transportation	280
Other infrastructure capital	64
	<u>735</u>
Energy Assistance Programs	
Market Transition Credit Program	160
Natural Gas Price Protection Program	125
	<u>285</u>
Other Reductions	
1% reduction to base budgets	160*
Other savings	80
	<u>240</u>
Total Corrective Actions	<u>1,260</u>

* Includes \$20 million reduction in the allowance for school property tax assessment adjustments and appeals, which is reported as an increase in school property tax revenue.