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Quick Hit — Oil bounce makes room for fiscal progress in Alberta

Oil prices are today stronger than at any time in the past two and a half years. West Texas Intermediate (WTI) has broken above US$57/bbl, bouncing ~35% higher off mid-June lows—not too shabby. We won't pretend to have a *strong* view on where oil prices head from here. Fact is, we're aiming to type this quick, lest the volatility in commodity markets render our thoughts moot before they touch the page. While US$57/bbl WTI might not trigger a tidal wave of reinvestment in Canada's relatively higher-cost oil sands, fiscally speaking, ascending crude prices are undeniably good news for Alberta's treasury.

Consider Alberta's key planning assumptions. Back in March, when the province set down its 2017 budget, WTI was expected to average US$55/bbl during the 2017-18 fiscal year (which runs April 1, 2017 to March 31, 2018). Oil prices weren't terribly cooperative in the early stages of the fiscal year, prompting a downgrade to US$49/bbl in a Q1 fiscal update (released in August). Predictably, the weaker oil price forecast weighed on Alberta's revenue outlook, contributing to a larger underlying deficit and forcing a draw on its "risk adjustment". As of the Q1 update, Alberta pegged its 2017-18 underlying deficit at $10.3 billion, equivalent to more than 3% of nominal GDP, with the risk adjustment halved to $0.25 billion.

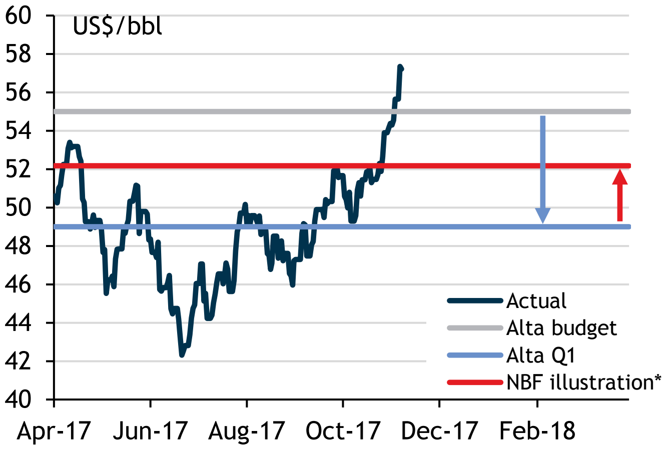
But sharply higher oil prices mean things are looking up (relatively speaking). Prudence argues for deliberate/thoughtful adjustments to budget planning assumptions, so Alberta could be understandably reticent to boost its official WTI forecast *too much* in its Q2 update (expected later this month). Strategists, however, can fly fast and loose. By way of illustration then, assume current levels for WTI, the light-heavy differential and the C$ hold through fiscal year-end. In such a scenario, there might be ~$850 million of upside for Alberta's oil royalties, all else equal. To be clear, that's our number, not an official fiscal revision, relying on published sensitivities and assuming no change in anticipated oil production. Alberta's Q2 update likely won't make as significant an upward adjustment to royalties. Refer to the detailed table on page 2 for a mechanical breakdown and some important caveats.

Now, oil royalties are but one piece of Alberta's fiscal puzzle, and it's fair to say that personal/corporate income tax returns are still feeling lingering effects of earlier economic weakness. Nonetheless, resurgent crude prices could bolster confidence and lead to a pick-up in broader measures of economic health/momentum (e.g., our *Index of Provincial Economic Momentum* or the province's *Alberta Activity Index*, both of which had stalled out a bit in the summer). There are some encouraging signs, including a surge in full-time jobs (+2.8% yr/yr) and growing oil production/exports. All in all, we see Alberta's 4.5% real GDP advance topping the 2017 provincial growth charts, followed up by a 2.2% expansion in 2018. (Refer to our Monthly Economic Monitor for detailed provincial forecasts.) If you find yourself on the defensive side the fence, kept up at night by elevated housing valuations and/or NAFTA worries, consider that Alberta appears relatively less exposed than many other provinces on both of these fronts.

To be fair, Alberta's medium-term budget assumptions are predicated on a continued rally in oil prices over *multiple* years: US$59/bbl WTI for fiscal 2018-19, rising to US$68/bbl in fiscal 2019-20—forecasts that look a little less ambitious of late. The light-heavy differential bears monitoring, with pipeline capacity constraints a long-standing issue. Medium-term net funding needs are likewise elevated, a key driver of absolute and relative spreads. Moreover, we've not addressed the spending side of the fiscal equation, where medium-term plans call for noted restraint. Still, for the first time since oil prices really cracked, an expected recovery in oil royalties and the potential release of the residual risk adjustment give Alberta a good chance of beating its budget in 2017-18. That's a non-trivial consideration for bond investors, given that Alberta borrows, in part, to finance an operating shortfall. It may be a long road back for Alberta, but you've got to start somewhere and, to us, the time for fiscal progress has arrived.

Chart 1: Oil price surge good news for Alberta

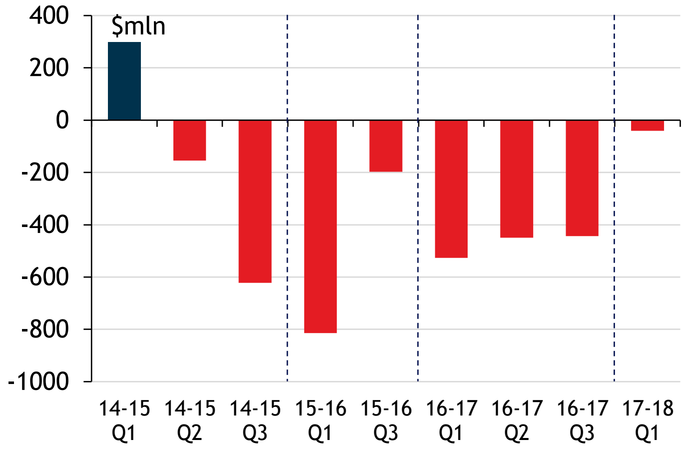
WTI price vs Alberta 2017-18 FY forecasts & NBF illustration



*Source: NBF, Alberta, Bloomberg | *2017-18 fiscal year average assuming current level (US$57/bbl) persists through March 31, 2018*

Chart 2: Fiscal upside for 2017-18?

Difference in Alta budget balance: Quarterly updates vs FY target



Source: NBF, Alberta | Note: Revision to official budget balance target in each quarterly report, grouped by fiscal year starting in 2014-15

Table 1: An illustration of the fiscal impact of current oil prices and exchange rate, *all else equal*

Fiscal impact on Alberta, Saskatchewan & Newfoundland and Labrador from oil price, light-heavy differential and C$

Oil price (WTI & Brent)		Fiscal YTD[1] US$/bbl	Current 11/7/2017 US$/bbl	Full year average[2] US$/bbl	Planning assumption[3] US$/bbl	Difference vs budget US$/bbl	Fiscal sensitivity[4] C$mln	Fiscal impact[5] C$mln
Alberta	WTI	48.90	57.14	52.15	49.00	3.15	310	976
Saskatchewan					49.75	2.40	17	41
Newf & Lab	Brent	52.28	63.73	56.80	56.00	0.80	22	17

Light-heavy oil price differential		Fiscal YTD[1] US$/bbl	Current 11/7/2017 US$/bbl	Full year average[2] US$/bbl	Planning assumption[3] US$/bbl	Difference vs budget US$/bbl	Fiscal sensitivity[4] C$mln	Fiscal impact[5] C$mln
Alberta	WCS vs WTI	-10.59	-14.00	-11.94	-12.20	0.26	285	73

Exchange rate	Fiscal YTD[1] US¢/C$	Current 11/7/2017 US¢/C$	Full year average[2] US¢/C$	Planning assumption[3] US¢/C$	Difference vs budget US¢/C$	Fiscal sensitivity[4] C$mln	Fiscal impact[5] C$mln
Alberta	77.46	78.72	77.96	77.00	0.96	-215	-206
Saskatchewan				76.00	1.96	-26	-51
Newf & Lab				75.00	2.96	-16	-48

Combined fiscal impact: Illustrative purposes[6]	C$mln
Alberta	843
Saskatchewan	-10
Newf & Lab	-30
3-province total	**803**

Specific notes:

1. Fiscal YTD represents average from April 1, 2017 to current

2. Full year average for fiscal 2017-18 based on fiscal YTD and extension of current price through March 31, 2018

3. Alta & Sask planning assumptions from Q1 updates; N&L based on 2017 budget

4. Fiscal sensitivity represents net fiscal impact (all else equal) from one unit change in variable, as per provincial governments

5. Fiscal impact based on difference vs budget multiplied by official fiscal sensitivity

6. Combined fiscal impact adds fiscal impacts from each of oil price, differential and exchange rate

General notes: Full year averages are presented for illustrative purposes; fiscal sensitivities are to be interpretted with caution; in some cases, official sensitivities are not presented for all variables; figures relate to 2017-18 fiscal year only

Sources: NBF, provincial governments, Bloomberg

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