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Quick Hit — Rapid debt accumulation in Alberta from low base

Budget season is winding down in Canada, and among a variety of competing themes, Alberta's absolute and relative fiscal standing has generated noted interest. Simply put, the speed with which Alberta's balance sheet has eroded is striking. A decade ago, Alberta boasted a record $35 billion of net financial assets. Those net assets have since evaporated. Even back when times were good (i.e., when oil was riding high), Alberta was in most years drawing on net assets to support public spending. Once the economy turned sour, large deficits and stimulative capital spending pushed debt accumulation into overdrive (Chart 1).

When 2016-17 drew to a close, Alberta found itself with $9.5 billion in net provincial debt, erasing a decade-and-a-half-long claim to fame as the only (net) debt-free province in Canada. Now, economic growth will be back in positive territory in 2017, which alongside firmer oil prices (year-on-year at least) should resuscitate revenue growth. But with only modest progress on the deficit, meaningful debt accumulation is set to continue. We estimate that by fiscal 2020-21, Alberta's net financial position will have eroded by almost $90 billion relative to where it stood in the mid-2000s, adding nearly 30%-pts to the corresponding ratio to GDP. That'll likely exceed (in most cases by a wide margin) the cumulative erosion in net debt burdens recorded in Ottawa and every other provincial jurisdiction since the global financial crisis (Chart 2).

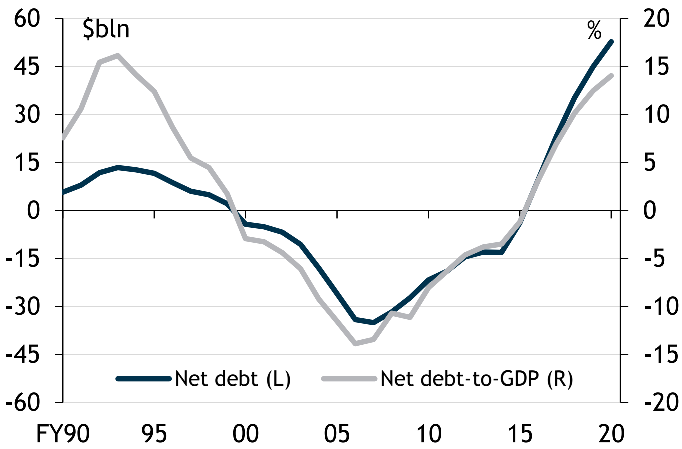
All this extra debt has rating agencies on edge. Alberta has been downgraded four times since late 2015, and currently wears two 'negative' outlooks. Moody's lamented in a post-budget comment: "Alberta's rapidly rising debt burden, protracted deficits and above-inflation expense growth continue to put significant pressure on its rating". S&P isn't in the habit of issuing post-budget comments, but despite downgrading the province twice, that rating agency had Alberta on 'negative' outlook before the budget owing to uncertainty over the ability/willingness to address structural budget shortfalls and limit tax-supported debt accumulation. DBRS, which at this point has the rating on 'stable', likewise warned: "In the absence of meaningful action to address the budget deficit and to slow debt growth, Alberta's debt may exceed levels acceptable for the current ratings".

The threat of further negative rating actions and a relatively hefty borrowing requirement—$18.7 billion in 2017-18 and roughly equivalent needs in each of the two following years—could keep Alberta spreads on the defensive, relative to provinces where a fiscal improvement is more assured, where ratings are stable to improving, and where funding needs are more limited. Of course, oil prices and the related light-heavy differential must always be considered key determinants of where Alberta is going to trade week-to-week or month-to-month; as goes Western Canada Select, so goes Alberta's spread.

If there's a saving grace, and there is, it's the fiscal starting point from which Alberta has eroded. Yes, the province has lost ground relative to many provincial peers (Chart 3), but given ample financial assets, a younger and still-growing population and average to above-average potential GDP growth, Alberta's net burden looks sustainable. Meantime, the overall tax take in Alberta remains low by provincial standards (Chart 4), implying important flexibility should planned increases in oil prices fail to materialize. Per capita spending is also relatively elevated, and could theoretically be restrained down the road. In the end, the immediate reaction to Alberta's budget may be understandable, but diminished as it may be, something of an Alberta advantage remains.

Chart 1: Alberta net debt on the rise

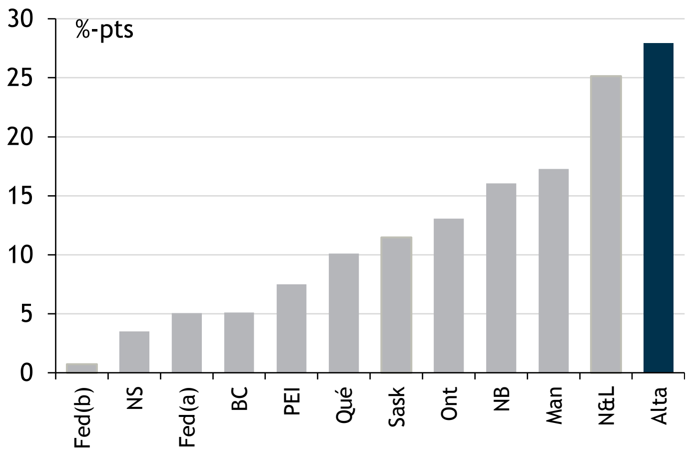
Alberta net debt level & net debt-to-GDP ratio (incl forecast)*



*Source: NBF, Alberta | * Official figures to 2019-20; NBF fcst for 2020-21*

Chart 2: Largest debt increase in Alberta

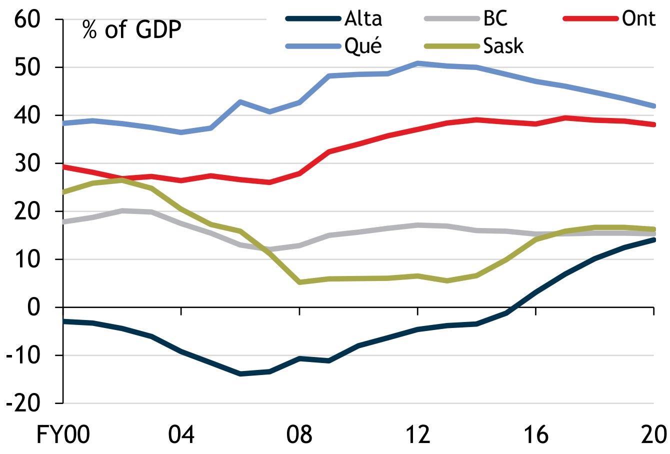
*Erosion in net financial position during debt accumulation periods**



*Source: NBF, fed-prov gov'ts | * See page 2 for timeframes used in above calcs*

Chart 3: Alberta net debt vs provincial peers

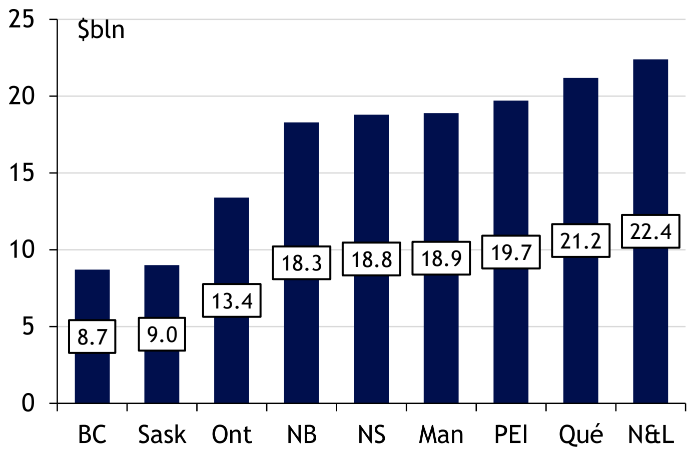
Net debt-to-GDP ratio (incl official & NBF forecasts to 2020-21)



Source: NBF, prov gov'ts

Chart 4: Non-trivial tax advantage

Extra revenue if Alta had same taxes as other provinces



Source: NBF, Alberta 2017 budget | Note: As at 3-Mar-2017, incl carbon taxes

Note to Chart 2: This chart illustrates the cumulative erosion in net financial position at the federal level and in each province as a share of GDP for select periods from 2007-08 onwards. This is meant to put debt accumulation periods into relative context. In Alberta's case, this represents the cumulative increase, expressed in percentage points of GDP, in moving from a net financial asset position in 2007-08 to the NBF-projected net debt position in 2020-21. In all other cases, the figures represent the increase in the net debt-to-GDP ratio over the below timeframes. Some periods are entirely historical, and reflect actual levels. In noted cases, the erosion incorporates government and/or NBF projections for future years.

Specific periods illustrated in chart:
Fed(b) — 0.7%-pts, covering 4-year period from 2015-16 to 2018-19; includes projections for part of period
NS — 3.5%-pts, covering 6-year period from 2009-10 to 2014-15; actuals
Fed(a) — 5.1%-pts, covering 1-year period of 2009-10; federal debt ratio subsequently drifted lower before rising in 2015-16 [see Fed(b) period above]
BC — 5.1%-pts, covering 5-year period from 2008-09 to 2012-13; actuals
PEI — 7.5%-pts, covering 5-year period from 2008-09 to 2012-13; actuals
Qué — 10.1%-pts, covering 5-year period from 2008-09 to 2012-13; actuals
Sask — 11.5%-pts, covering 10-year period from 2009-10 to 2018-19; includes projections for part of period
Ont — 13.1%-pts, covering 7-year period from 2008-09 to 2014-15; actuals
NB — 16.0%-pts, covering 8-year period from 2008-09 to 2015-16; actuals
Man — 17.3%-pts, covering 13-year period from 2008-09 to 2020-21; includes projections for part of period
N&L — 25.1%-pts, covering 9-year period from 2012-13 to 2020-21; includes projections for part of period
Alta — 27.9%-pts, covering 14-year period from 2007-08 to 2020-21; includes projections for part of period

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