Market View
Economics and Strategy

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Alberta public accounts: No better place to start

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Remember the boring old days pre-COVID, before government budgetary results were placed on a wild teeter totter? Back then, the publication of the annual public accounts barely registered for all but the most dedicated of analysts. Well, those days are gone. In our new pandemic world, reported fiscal results continue to usher in major-league adjustments vs. prior thinking. For many provinces, these 'surprises' are of the very best variety. The latest example and author of what will likely be some constructive 2021-22 public accounting: oil-rich Alberta.

With the dust fully settling on fiscal 2021-22—the 12-month period that ended March 31, 2022—Alberta has confirmed a budget surplus of $3.9 billion. That's equivalent to a bit more than 1% of GDP or nearly 6% of revenue. The final tally is a notable improvement vs. the latest estimate of a $3.2 billion deficit (from the February 2022 budget). Never mind that Alberta at one point feared it would spill more than $18 billion in red ink in 2021-22. This then confirms a provincial fiscal turnaround for the ages, although we'd note that Alberta is hardly alone in bettering its fiscal targets. Indeed, you'll be forgiven for feeling a bit of déjà vu. A year ago, the release of 2020-21 public accounts kicked off what was to be a fantastic array of fiscal beats from coast to coast… a fiscal upgrading process that is continuing, in spite of global economic worries.

While the magnitude of Alberta's 2021-22 fiscal revision is truly enormous, the mechanics of moving from a planned deficit to a budgetary surplus are easy enough to follow. Quite simply, all kinds of revenue soared, topping a very conservative Budget 2021 plan by almost $25 billion or more than 50%! Spending, on the other hand, was held much closer to plan, up $2.5 billion or a comparatively modest +4% vs. the original budget projection. That's part of what has been a relatively disciplined approach to spending under the current UCP government, which bears watching as party leadership transitions and as affordability pressures mount at the same time government revenue pours in.

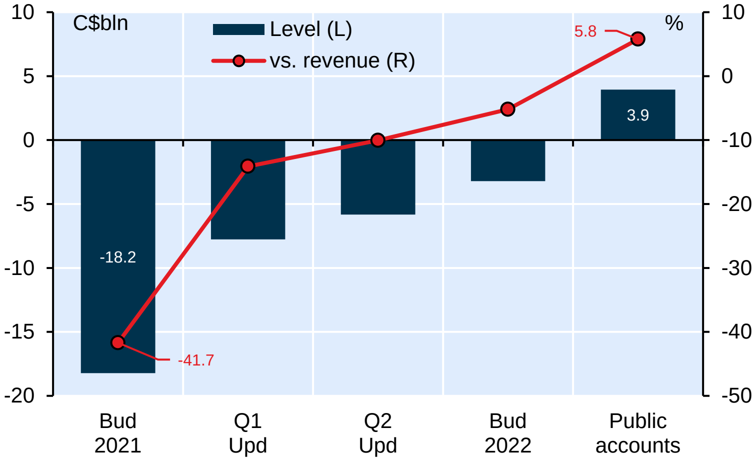
Alberta's 2021-22 surplus—the first since 2014-15 and only the second in the post-GFC era—produced a welcome reduction in the level of net debt. True, the balance sheet still shows the impact of the earlier outsized deficits run after the oil price collapse of 2015, but by provincial standards Alberta's net debt burden sits at the low end of spectrum. Credit rating agencies may not give any of our provinces particularly impressive marks on debt loads, but when it comes to debt affordability (as measured via the interest bite) Alberta is in a generally enviable position vs. its provincial peer set.

Most importantly, fiscal revisions/upgrades won't end with the 2021-22 public accounts. If you haven't already noticed, Alberta is riding elevated commodity prices to some very impressive economic gains. We expect provincial nominal GDP to register another burst in 2022 (>20%). And the related potential upside on resource royalties is rather striking. As a reminder, the province's 2022 budget assumed WTI would average US$70/bbl in fiscal 2022-23. It's still relatively early days, just one quarter of the fiscal year in the books, but so far WTI has averaged US$109/bbl. So there's plenty of scope for oil prices to falter without destabilizing Alberta's fiscal framework. Looked at another way, if oil prices were to remain anywhere near current levels, Alberta would likely enjoy billions upon billions of dollars in bonus resource revenue. After all, official sensitivities suggest a US$10/bbl 'surprise' on WTI might translate into C$5 billion in marginal royalties, *ceteris paribus*. Sure, you should treat these sensitivities with caution, but at this point Alberta's high-vol revenue model is working quite nicely indeed.

As for what to do with all the extra revenue that looks to bubble up in 2022-23? That will largely be for the incoming premier and finance minister to decide. After all, Jason Kenney is stepping aside and his former right-hand man/finance minister, Travis Toews, is one of a few contesting the UCP leadership. Whoever takes over leadership of the party (and thus the province) is going to have some serious decisions to make… billions and billions and billions of them in fact. A nice problem to have, even if Albertans have learned that things can change fast.

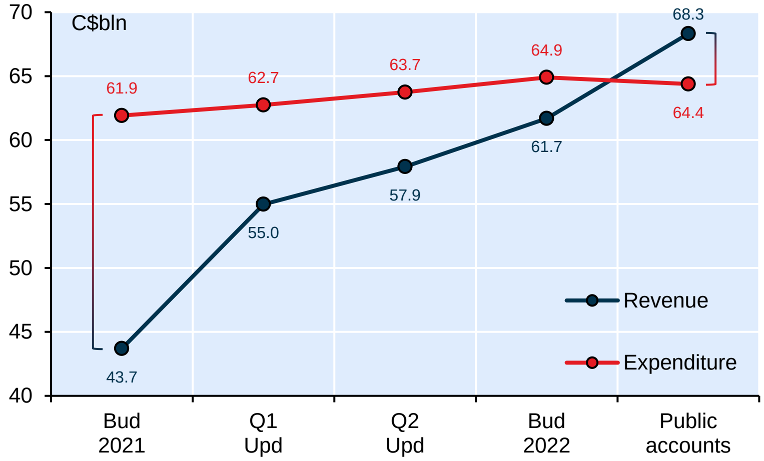
Our recommendation: Stay long (or get long) Alberta bonds, given ongoing fiscal/rating upside and distinctly positive supply technicals.

Chart 1: $18bln *deficit* transformed into nearly $4bln *surplus*
Evolution of Alberta 2021-22 budget balance: Budget plan to actual



Source: NBF, Alberta

Chart 2: Alberta revenue came roaring back in 2021-22
Evolution of Alberta 2021-22 revenue & spending: Budget plan to actual

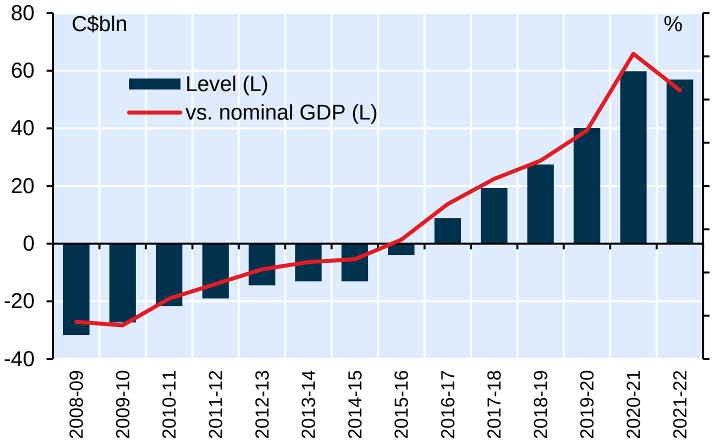


Source: NBF, Alberta

Talk about a fiscal transformation! Alberta at one point planned for a $18 billion deficit in 2021-22. When all was said and done, the province notched its first surplus since 2014-15 and only the second positive balance in the post-GFC era. From the moment Budget 2021 dropped, revenue all but exploded higher, with fully 90% of unplanned revenue going right to the bottom line. Bondholders rejoice.

Chart 3: A new era of net debt reductions?

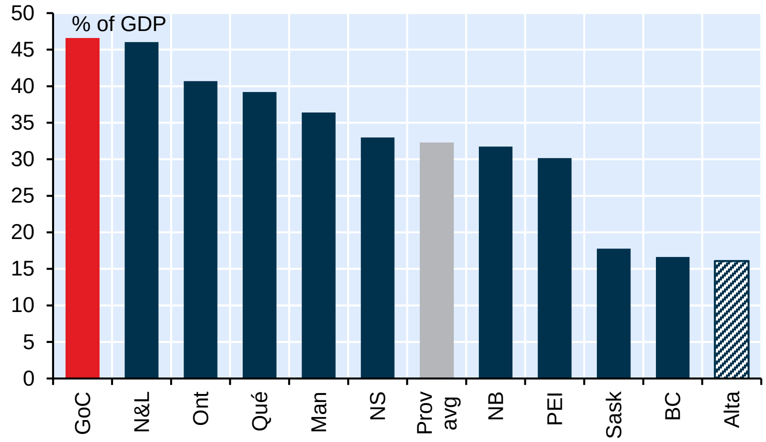
Alberta net debt/(net assets): Level & relative to GDP



Source: NBF, Alberta | Note: Uses NBF GDP est for 2021

Chart 4: Alberta's debt burden relatively low vs. peers

Federal & provincial net debt to GDP ratios: 2021-22 (actual or latest)

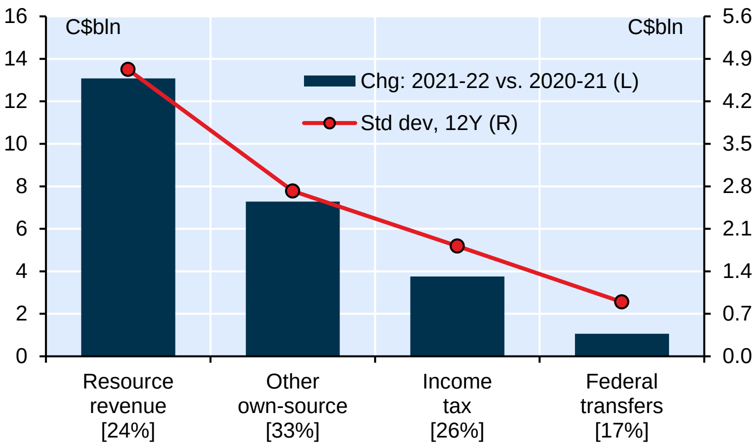


Source: NBF, fed-prov gov'ts | Note: Alta actual, others est; uses NBF GDP est for 2021

While Alberta ran up a lot of debt (and quick) in the wake of an earlier oil price crash, net debt was reduced by roughly $3 billion in 2021-22. Add in sky-high nominal GDP growth and the debt burden was down to roughly 16%, comparing favourably to most provincial peers. Note that other provinces will be offering final revisions to their own 2021-22 finances in the coming weeks and months.

Chart 5: Revenue model working quite well of late

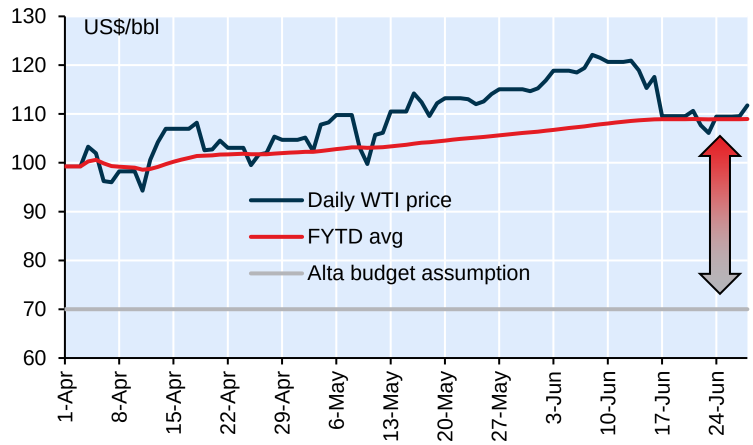
Y/Y change in key Alberta revenue streams: 2021-22 & longer-term std. dev.



Source: NBF, Alberta | Note: SD based on Y/Y chg; figures in [:] are 2021-22 revenue shares

Chart 6: Oil prices hint at massive revenue upside... again!

WTI price: Actual & FY average vs. budget planning assumption for 2022-23



Source: NBF, Alberta, Bloomberg | Note: Budget assumed US$70; current avg US$109

Alberta's revenue model is unique and not without risk. The economy is resource intensive and so too is the government's revenue pie. Roughly one quarter of the revenue dollar came directly from resources in 2021-22 (incl. bitumen royalties). With WTI in triple digits, oil leverage means scope for continued fiscal improvement, particularly given Alberta's US$70/bbl WTI assumption for 2022-23.

Table: Fiscal sensitivity math is pretty striking

Select Alberta fiscal sensitivities to FY assumptions: 2022-23[a]

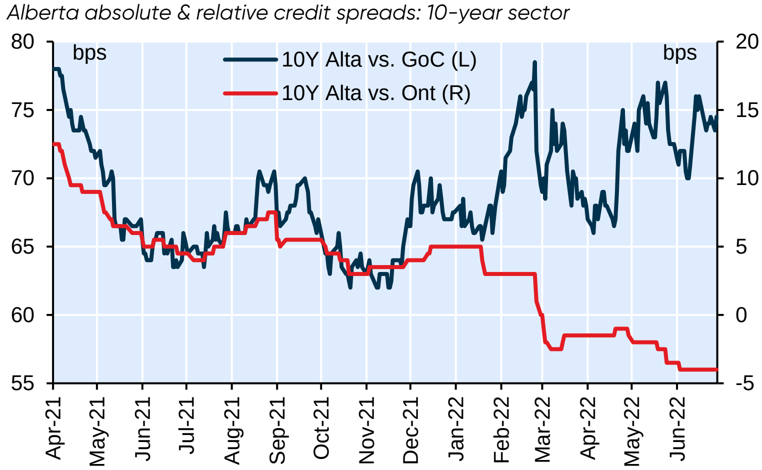
Indicator	Change	Net impact
Oil price (WTI US$/bbl)	-$1	-500
Light-heavy differential (US$/bbl)	+$1	-460
Natural gas price (Cdn$/GJ)	-10¢	-10
Exchange rate (US¢/Cdn$)	+ 1¢	-445
Interest rates	+1%	-525
Primary household income	-1%	-160

[a] Alberta fiscal sensitivities are based on budget assumptions of prices and rates, displaying impacts over a 12-month period. They can vary significantly at different price and rate levels. Energy price sensitivities do not include potential impacts of price changes on land lease sales revenue. Refer to Alberta budget for full details.

Source: NBF, Alberta (Budget 2022)

Chart 7: A tighter basis amidst more anxious credit backdrop

Alberta absolute & relative credit spreads: 10-year sector



Source: NBF | Note: Based on NBF constant maturity C$ spreads

Fiscal sensitivities are to be interpreted with caution, but on the face of it, Alberta's oil price math is something else. It's believed that each US$1/bbl 'surprise' in WTI is worth $500 million to the province. Let's just say we're distinctly in a 'high price' scenario that's apt to throw off many billions of dollars in excess revenue. Future fiscal updates will be something to behold. Stay long!

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