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Alberta gets mojo back, slays deficit as economy flies, revenues surge

By Warren Lovely and Daren King

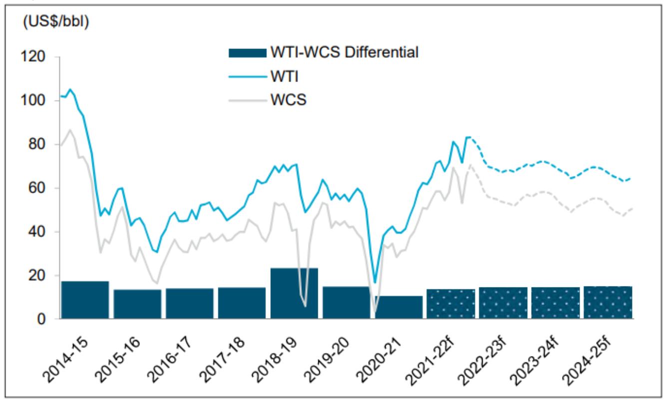
Highlights

A resurgent energy sector and increasingly broad-based/vibrant economic growth have seen revenue not merely bubble up, but jet higher. A dramatically brighter revenue picture, combined with spending restraint, allows for swift progress on deficit reduction. Budgetary red ink, once thought to be flowing freely, was mostly sopped up in 2021-22, where a residual shortfall of $3.2 billion is now estimated. That's $15 billion better than what was planned for this time last year—a monumental in-year improvement if ever there was one. Despite an arguably conservative stance on oil prices (e.g., WTI assumed to average US$70/bbl in 2022-23), Alberta expects to be in surplus in 2022-23 and each year of the fresh three-year fiscal plan. The government is understandably pumped, Premier Kenney labeling this a "banner day", as the province moves back into the black for the first time since 2014-15. If anything, apparent economic momentum and significant budgetary prudence hint at no-small-amount of fiscal upside, particularly if oil prices stay anywhere near current levels. Considering that each US$1/bbl increase in crude is thought to be worth $500 million (not a typo), crude royalties alone could march seriously higher in future updates. We'd nonetheless caution that the outlook remains uncertain. The COVID-19 virus has yet to be fully vanquished, while oil prices will take their cue from geopolitical developments. Really though, economic and fiscal volatility is nothing new here. While much of the revenue improvement secured over the past year has used for fiscal consolidation (and we'll offer kudos), there's sufficient budgetary latitude to undertake some new investments. Not surprisingly, that includes a focus on enhancing health care capacity. Meanwhile, a comprehensive strategy aims to address labour shortages and skills gaps—an area of focus one images for a number of provinces given tight labour markets. Net debt will end 2021-22 on a much-improved footing, down some $18 billion relative to plan. At 18.3% of GDP, the 2021-22 net debt burden not only bests the original forecast but delivers welcome year-over-year relief. Further progress is eyed from here, debt-to-GDP aimed at less than 15% by 2024-25. As for borrowing, 2021-22's big-time fiscal upgrade saw a good portion of a projected requirement evaporate. And just consider the financing program for the coming fiscal year, where a scant $2.6 billion of gross bond issuance has been flagged (not for government but for self-supporting entities and Crowns). That's a mere fraction of what this province was issuing not all that long ago. All told, this is a major economic and fiscal makeover, and one that is unambiguously credit positive.

- **Economic outlook** – After being hit twice in 2020 by the pandemic and falling oil prices, Alberta's economy is estimated to have rebounded by 5.8% in 2021, supported by increased oil production and recovering activity in virtually all sectors of the economy. For 2022, the budget assumes real GDP growth of 5.4%. That may appear somewhat optimistic compared to the average forecast of the private sector at 4.5% and ours at 4.1% (the highest forecast of all Canadian banks being at 5.0%). Taking into account this recent/expected growth, GDP is expected to have returned to its record level established in 2014. As per the budget forecast, Alberta's real GDP is expected to grow by 3.5% in 2023, 3.0% in 2024 and 2.8% in 2025, all of which are stronger than those predicted by the private sector. Nominal GDP, which is a better proxy for government own-source revenue, is also expected to grow significantly in 2022, supported by high oil and commodity prices in general. Indeed, the budget is based on 11.2% growth in nominal GDP in 2022, higher than the consensus, but in line with our forecast. Nominal GDP is then expected to grow by 6.5% in 2023 and between 4.3% and 4.5% in the following two years, which may appear as an optimistic forecast according to the private sector. However, we'd emphasize that oil price forecasts appear quite conservative, particularly relative to prevailing levels and the current strip pricing. On a calendar year basis, Alberta assumes that WTI averages US$73/bbl in 2022, which is safely below our current forecast of US$ 80-85/bbl. Moreover, with the price of WTI above USD$90 in the last few days due to the conflict in Ukraine, risks appear to be to the upside when it comes to Alberta's oil price projection. Fiscal year oil price assumptions and related fiscal sensitivities are discussed below.
- **Outgoing year budget balance (2021-22)** – Fiscal 2021-22 will be remembered as a year when Canada's provinces saw their collective fiscal fortunes improve mightily. Nowhere was this more evident than in Alberta. Recall that the province's 2021 budget, presented almost exactly a year ago (less a day), planned for a $18.2 billion deficit (estimated to be 5.4% of GDP). But it didn't take long for the fiscal upgrades to roll in. And with today's budget, the 2021-22 deficit has been chopped down to $3.2 billion (<1% of GDP). Revenue exploded higher by $18 billion, topping last year's budget plan by an astonishing 40%. No province has enjoyed a larger relative revenue beat, which in a sense highlights Alberta's more volatile economic and revenue model. Resource royalties contributed significantly, which is no real surprise given WTI averaged US$74/bbl vs. the US$46/bbl planning assumption. Indeed, just under 60% of the revenue windfall (vs. Budget 2021) can be directly traced to resource revenue. Still, there were meaningful revenue gains on most other fronts (e.g., personal income tax, corporate income tax, investment income, federal transfers). As a reminder, Alberta has no provincial sales tax, but if it did, returns would likely have been handsome, given improving labour market conditions and more confident consumers. Relative to this revenue juggernaut, regular program spending was held more or less in line with budget, although COVID-related pressures and disaster/drought relief did outstrip contingencies. All told, of the $18 billion in above-plan revenue, 83% was assigned right to the bottom line—a responsible approach for a province that had built up considerable debt in the preceding years.

- **Medium-term fiscal outlook (2022-23 & beyond)** — The budgetary makeover is far from a one-year story. With the revenue base having been dramatically recast and the economy displaying encouraging momentum, Alberta pledges to balance the budget in 2022-23, remaining in surplus for the entirety of the three-year fiscal plan. Specifically, the budget projects a $0.5 billion surplus for 2022-23, followed by surpluses of $0.9 billion and $0.7 billion in the subsequent two fiscal years. Alberta last balanced the books back in 2014-15 and had run a deficit of ~$17 billion as recently as 2020-21. No question then, this is very substantial and rapid fiscal consolidation. For additional context, the combined budget balance covering the four-year period from 2020-21 to 2023-24 has now improved by a cumulative $39 billion (or almost $10 billion a year) vs. what was projected only one year ago. The government titled this budget "Moving Forward", and that's an apt description for the revised budgetary trajectory (applying equally well to the recent economic record).
- **Revenue outlook** — Alberta will be hard pressed to repeat the revenue growth enjoyed in 2021-22. Experience tells us that years like that come around once in a blue moon. But an ongoing economic recovery and firm oil prices should allow the province to consolidate its recent revenue gains, the top line pushed a bit further ahead over the medium term. For 2022-23, total revenue of $63.1 billion might be up just 0.8% year-on-year but would nonetheless stand fully $20 billion higher vs. 2020-21 (i.e., two-year annualized growth of 20%+). Alberta's revenue bite—that is the own-source revenue share of provincial GDP—remains light vs. provincial peers, testifying to a low-tax philosophy which in turn bolsters competitiveness. Breaking things down, non-renewable resources look to remain an important part of the revenue story, slated to account for 22% of total revenue in the fiscal year ahead. Given buoyant economic conditions, income tax (both personal and corporate) is thought to have additional upside. Federal transfers could also build on 2021-22, aided by a one-time $750 million fiscal stabilization payment (related to the revenue hit sustained in 2020-21). On that note, Alberta continues to press its case for lifting the cap on fiscal stabilization payments retroactively, with the old arbitrary cap having cost the province an estimated $2.4 billion by its count. Alberta would also like to see the thresholds for stabilization payments relaxed/reduced (for resource and non-resource revenues alike). While we're on the subject of federal support, Alberta is firmly united with its provincial peers in seeking a substantial and permanent increase in the federal share of total health care funding. Having made what we consider to be a compelling argument for additional federal support for what is the single largest provincial expenditure item, the ball is now squarely in Ottawa's court. In the wake of a provincial referendum on Equalization, Alberta continues to advocate for amendments to the formula, specifically as it relates to so-called 'floor payments' and the treatment of non-renewable resource revenue. Elsewhere, Alberta's budget allows for a degree of normalization in investment returns after some pretty heady results of late. Revenue is assumed to grow at an average rate of 1% over the final two years of the fiscal plan, an outlook that allows for declining resource royalties as prices trend down. Which brings us to…
- **Energy price assumptions & related sensitivities** — After a surprisingly robust oil price recovery in 2021-22, Alberta's budget is based on average WTI price of US$70/bbl for fiscal 2022-23. Somewhat lower levels have been penciled thereafter: US$69/bbl for 2023-24 and US$66.5/bbl for 2024-25. Consistent with past practice, the province has opted to set its nearer-term crude oil price assumptions below those generated via a pre-budget benchmarking exercise. As we've recently been reminded, geopolitical developments can make for choppy conditions, but on budget day the prompt contract for WTI was trading ~US$94/bbl. This is Alberta, so the light-heavy price differential remains an important consideration. The budget assumes the differential widens modestly from US$13.6/bbl in 2021-22 to US$14.3/bbl in the coming fiscal year, edging out a bit more in each of the two subsequent years. The differential is driven by pipeline economics, with overall export capacity set to improve over time. Official sensitivities, which must be interpreted with caution, suggest that each US$1/bbl change in WTI could have an annualized fiscal impact of $500 million, while a US$1/bbl change in the light-heavy differential could be worth $460 million, *all else equal*. As always, it's important to control for the interplay between oil prices and the Canadian dollar exchange rate. Higher US$ oil prices boost the royalty outlook, but each one cent appreciation in the loonie has a negative fiscal/translational impact of $445 million. We'd note that these assumed fiscal sensitivities have increased significantly vs. prior budgets, and hint at substantive revenue upside should oil prices remain near current levels. Meanwhile, natural gas price assumptions allow for a moderation in Alberta's benchmark price to C$3.2/GJ in 2022-23, compared to the outgoing fiscal year provisional average of C$3.4/GJ. A 10-cent change in the average natural gas price is worth $10 million to the government, all else equal. For the growing number of investors sensitive to ESG considerations, the budget details a framework designed to burnish Alberta's case as a responsible energy producer.

Chart 8: Light-heavy differential to reflect pipeline economics
Oil prices



Sources: Alberta Energy and Alberta Treasury Board and Finance; f-forecast

Sensitivities to Fiscal Year Assumptions, 2022-23[a]
(millions of dollars)

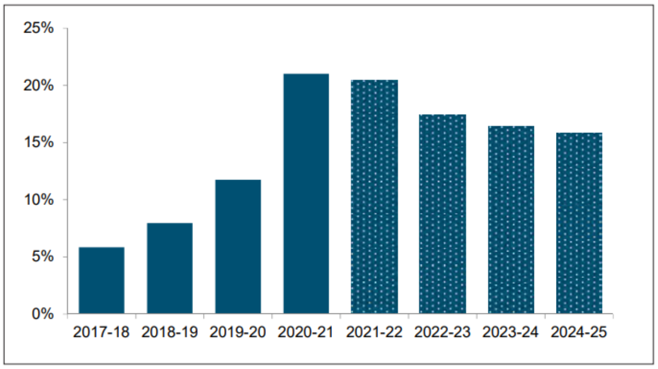
	Change	Net Impact
Oil price (WTI US$/bbl)	-$1	-500
Light-heavy oil price differential (US$/bbl)	+$1	-460
Natural gas price (Cdn$/GJ)	-10¢	-10
Exchange rate (US¢/Cdn$)	+ 1¢	-445
Interest rates	+1%	-525
Primary household income	-1%	-160

[a] Sensitivities are based on current 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.

- **Spending outlook** — Credit the Alberta government for laying out and sticking with a more disciplined path for program spending. As previously noted, "regular" program outlays stuck close to plan in 2021-22. For the coming fiscal year, regular operating expense will grow little more than 2%, the pace of increase slipping below that threshold in the final two years of the fiscal plan. In other words, the spending trajectory continues to be characterized by noted restraint, despite the vastly improved revenue profile, demonstrating how serious Alberta is about bringing its relative spend in line with key provincial peers. There's been some exceptional spending pressures in recent years of course, linked to the pandemic and natural disasters. But the budget sees those pressures easing in 2022-23 and beyond, related contingencies stepping down as a result. Specifically, the budget embeds a $750 million COVID contingency for 2022-23, on top of a $1 billion contingency for disaster assistance and other potential pressures (e.g., utility bill relief). With the budget now balanced, one assumes the government could face mounting pressure to steer future marginal revenue surprises to new spending initiatives and/or public sector wage enhancements, but we will need to wait and see. For now, a few targeted investments focus on enhancing health care capacity, improved child care/education and certain growth initiatives, most notably a comprehensive plan to ease labour shortages and address skills gaps. Beyond operational spending, a three-year capital plan totaling just over $20 billion keys on the critical infrastructure needed to grow, diversify and protect the economy. That includes the development/enhancement of hospitals, schools, advanced education facilities, transportation networks and critical municipal infrastructure, alongside strategic investments in broadband, affordable housing, flood mitigation, clean hydrogen, public safety, sports and recreation, etc.

- **Debt outlook** — Having rewritten the budget balance in wholesale fashion, it stands to reason that debt will end 2021-22 on a considerably brighter note than what was originally projected. Net debt, estimated to be $64 billion as at March 31, 2022, is currently tracking $18.2 below the Budget 2021 forecast. (Taxpayer-supported debt has been marked down similarly.) That reflects the considerably smaller deficit for the outgoing fiscal year, as well as final positive adjustments to 2020-21 (confirmed in the public accounts). Moreover, with modest surpluses now replacing deficits in the future years, the improvement to Alberta's debt trajectory is compounded over time. To illustrate: In Budget 2021, it was assumed that net debt would end 2023-24 at $102.1 billion. The revised forecast is for $64.7 billion in net debt by 2023-24, a considerably positive restatement that dovetails with the cumulative budget improvement discussed earlier. As a share of GDP, Alberta's debt burden has been revised to 18.3% for 2021-22, that key measure improving on a year-over-year basis and landing well shy of the Budget 2021 forecast (24.5%). With three years of surpluses assumed and nominal GDP expanding, it's believed that net debt-to-GDP ratio will fall below 15% by 2024-25. Recall that Alberta had earlier established a 30% cap on net debt-to-GDP as but one fiscal anchor, but in light of the overall financial improvement, this rule looks to be a non-factor for some time. Notwithstanding what had been rapid debt accumulation through 2020-21, Alberta maintains a relatively lower debt burden than most provinces. Note that Alberta's relatively low level of net financial liabilities captures outsized endowment funds, the Heritage Savings Trust Fund perhaps the most well known (where a year-end balance of $17.5 billion has been projected for 2022-23). The interest bite is likewise quite manageable, as the $2.7 billion in consolidated debt charges are due to consume 4.3% of total revenue in the coming fiscal year (the taxpayer-supported interest bite being even smaller at 3.9%).

Net Debt to GDP



- **Long-term borrowing requirement** — All of the preceding fiscal commentary starts to get very real when you look at the impact on Alberta's borrowing program. Total borrowing needs dropped to $8.6 billion in 2021-22, compared to planned requirement north of $24 billion in Budget 2021. As a result, the province was able to back away from debt capital markets for long stretches, picking its spots and generally erasing any lingering investor fears about being over-served Alberta bonds. For the coming fiscal year, there's effectively no growth in taxpayer-supported debt. That means a fairly modest $3.5 billion gross borrowing requirement is really for self-supporting entities and GBEs. If you're counting, that $3.5 billion requirement has collapsed by more than $15 billion relative to what was flagged in last year's budget. Moreover, a portion of that new, lower amount is likely to be financed in the money-market, leaving just $2.6 billion of gross bond supply for the coming fiscal year—a mere fraction of what Alberta was issuing when deficits were the order of the day. Again, we'd highlight scope for further fiscal improvement, most notably as it relates to the US$70/bbl WTI forecast for 2022-23. It's conceivable that there may no cash needs at all, although we're reminded that things can change quickly. It's suggested that borrowing needs could increase somewhat in later years. But the $7.5 billion and $5.1 billion of long-term bond issuance being estimated for 2023-24 and 2024-25 respectively would still be quite modest by almost any yardstick. The issuance outlook is an extremely compelling technical. And It's a nice position to be in as a province, having little to no debt to finance just as the central bank starts to think about putting bonds back to the market, policy rates start moving up and financial conditions risk tightening. All in all, the broader narrative of surging revenue, evaporating deficits and reduced funding needs has contributed to a material tightening in Alberta credit spreads vs. provincial peers—a process that still has some room to run in our opinion.

- **Current long-term credit ratings** — S&P: A, Stable | Moody's: Aa3, Stable | DBRS: AA(Low), Stable | Fitch: AA-, Stable
  [Refer to our Provincial Ratings Snapshot for additional colour on specific credit rating drivers/considerations]

Alberta

(millions of dollars)
CONSOLIDATED FINANCIAL STATEMENT BASIS

	Budget 2021-22	Budget 2021-22	Budget 2022-23	Target 2023-24	Target 2024-25
Revenue	**43,697**	**61,692**	**62,607**	**63,134**	**63,851**
Personal income tax	11,647	13,261	13,382	14,442	15,455
Corporate income tax	1,891	3,343	4,040	4,517	4,896
Other taxes	5,527	5,456	5,612	5,778	5,913
Resource revenue - Bitumen royalties	1,482	9,515	10,349	9,213	8,160
Resource revenue - other	1,374	3,722	3,491	3,115	2,756
Transfers from the Government of Canada	10,181	11,306	12,054	11,641	11,895
Investment income	2,205	4,660	3,173	3,492	3,699
Net Income from Government Business Enterprises	1,877	2,509	2,435	2,630	2,656
Premiums, Fees and Licences	4,133	4,304	4,490	4,606	4,736
Other	3,380	3,616	3,581	3,700	3,685
Expenses	**61,918**	**64,899**	**62,096**	**62,202**	**63,151**
Operating expense incl. re-allocation and in-year savings	48,280	48,988	50,134	50,944	51,801
Canada-Alberta Early Learning Child Care Agreement	-	134	666	823	992
Capital grants	2,608	2,203	2,148	2,427	2,597
Amortization / inventory cionsumption / loss on disposals	4,009	3,753	4,057	4,161	4,182
Debt servicing costs	2,764	2,401	2,662	2,754	2,837
Pension provisions	(369)	(363)	(289)	(299)	(309)
Surplus (Deficit) before Covid-19/Recovery Plan, contingency	57,294	57,116	59,378	60,810	62,100
Covid-19 / Recovery Plan operating expense, capital grants and inventory consumption	1,148	3,536	968	642	301
Crude-by-Rail Provision	976	925	-	-	-
Contingency / disaster and emergency assistance	750	3,109	1,000	750	750
Contingency - COVID-19 / Recovery Plan	1,750	213	750	-	-
Surplus (Deficit)	**(18,221)**	**(3,207)**	**511**	**932**	**700**
Financial assets	71,168	70,059	66,562	67,726	71,032
Pension liabilities	8,278	8,273	7,984	7,685	7,376
Direct borrowing for capital projects	44,984	44,334	42,979	43,950	45,422
Other taxpayer supported debt	70,819	53,350	51,739	51,686	51,589
Liabilities of self-supporting lending organizations	17,423	17,014	17,172	17,188	17,159
Other liabilities	11,825	11,106	11,751	11,902	13,344
Net financial assets	**(82,161)**	**(64,018)**	**(65,063)**	**(64,685)**	**(63,858)**
Non financial assets (net of amortization)	58,703	58,806	60,501	61,123	61,035
Deferred capital contributions	(3,529)	(3,756)	(3,895)	(3,963)	(4,001)
Net assets (variation equals surplus (deficit))	**(26,987)**	**(8,968)**	**(8,457)**	**(7,525)**	**(6,824)**
Borrowing requirements	**24,046**	**8,624**	**3,478**	**7,825**	**5,650**
Government	22,935	7,145	2,249	6,395	5,192
Provincial corporations	248	305	226	926	174
Government business enterprises	863	1,174	1,003	504	284
Borrowing sources					
Money market (net change)	1,511	4,059	782	298	598
Public-private partnerships	46	43	81	39	1
Term debt	22,489	4,522	2,615	7,488	5,051

Source: Government of Alberta, 2022 budget

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