BUDGET ANALYSIS

Alberta: 2022–23 Mid-Year Fiscal Update

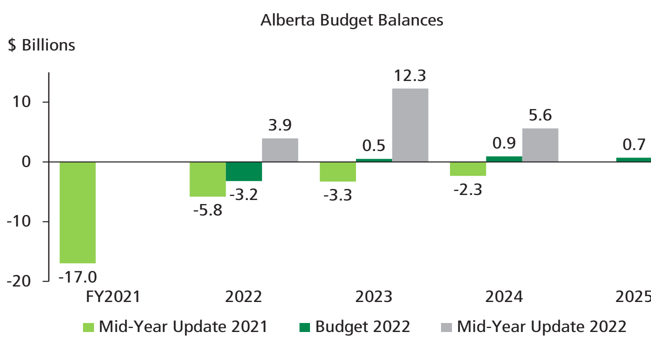
Wild Rose Country's Wild Ride Continues

By Marc Desormeaux, Principal Economist

HIGHLIGHTS

- Alberta's budgetary projections were much improved as expected. The province is still on track for an all-time high surplus in FY2023 after a record deficit only two years ago. Near-record surpluses are now forecast in FY2024 and FY2025 as well (graph 1).
- Provincial borrowing requirements are now projected at $1.4B in FY2023, $825M in FY2024, and $3.8B in FY2025. Those are respective decreases of $2.1B, $7B, and $1.9B versus Budget 2022.
- Natural resources revenues made up almost all of the gains since Budget 2022. The government raised WTI price forecasts but kept them well below private-sector expectations with fiscal sensitivities to WTI and the WCS-WTI discount at record highs in Budget 2022.
- New policy was focused on inflation relief. The measures detailed in the update put Alberta towards the middle of the pack in terms of affordability assistance as a share of GDP.

GRAPH 1
Near-Record Surpluses in Outer Years of Forecast



Sources: Alberta Treasury Board and Finance and Desjardins, Economic Studies

- Alberta's debt repayment plan is proceeding. It still intends to repay $13.4B in FY2023, with interim allocations of $2.3B and $1.4B for the same purpose in FY2024 and FY2025, respectively.
- The headline numbers show a monumental fiscal improvement as expected, but downside risks to Alberta's outlook are not to be overlooked.

The Bottom Line

The headline numbers show a monumental fiscal improvement as expected, but downside risks to Alberta's outlook are not to be overlooked. A surge in royalties brings record or near-record surpluses in each of the next three fiscal years. The ambitious debt repayment plan is also proceeding, which over time should reduce an already low debt burden and help Alberta's bond yields trade tighter to Canadian benchmarks. But broadening the revenue base beyond natural resources remains a challenge, and the province's finances are as sensitive to oil price movements as ever. As well, spending targets may prove challenging in an environment of high inflation and robust population growth. And as in other provinces, any broad-based household transfers implemented in the coming months could stoke inflationary pressures.

Near-Record Surpluses Anchored by Resource Revenues

With oil prices trading 20–30 US$/barrel higher than forecast in Budget 2022 for most of this year, the key question was how much stronger non-renewable resource revenues would be. The government expects that after nearly doubling the prior record this year, resource receipts will top $19B in FY2024 and hit almost $16B in FY2025. Those are improvements of $6.9B and $5.1B in those years relative to Budget 2022. They drove almost

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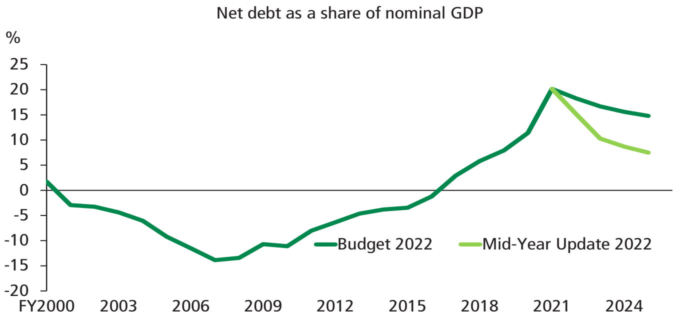
all of gains projected for the provincial surplus, now forecast to reach $5.6B (1.2% of GDP) in FY2024 and $5.3B (1.1%) FY2025. Corporate income tax projections also rose throughout FY2023 to FY2025; other revenues were largely unchanged.

With stronger surpluses, Alberta's net debt is expected to fall to just 7.5% of GDP in FY2025, the lowest since FY2018 (graph 2). Borrowing requirements are now forecast at $1.4B in FY2023, $825M in FY2024, and $3.8B in FY2025. As in the Q1-FY2023 update, all borrowing this fiscal year is expected to be conducted by provincial corporations and government business enterprises.

GRAPH 2
Alberta's Debt Load Lowered Again

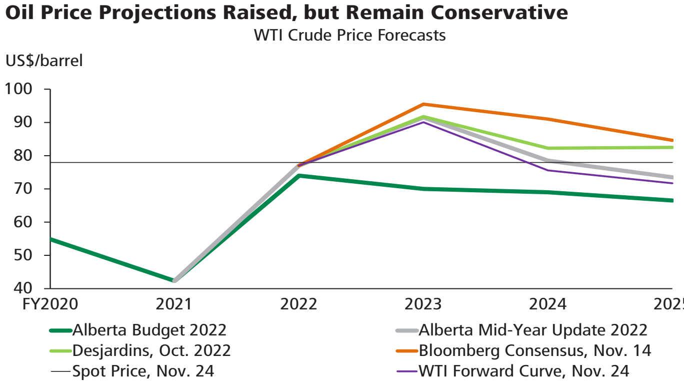


Sources: Alberta Treasury Board and Finance and Desjardins Economic Studies

Increases to WTI, Light-Heavy Oil Price Discount Forecasts

Projections for both WTI and the WCS differential to WTI were revised higher versus Budget 2022. WTI is now expected to average 91.50 US$/barrel, 78.50 US$/barrel, and 73.50 US$/barrel in FY2023, FY2024, and FY2025, respectively. Those are in slightly below the Bloomberg consensus forecasts and the average across the survey of forecasters cited in the update (graph 3).

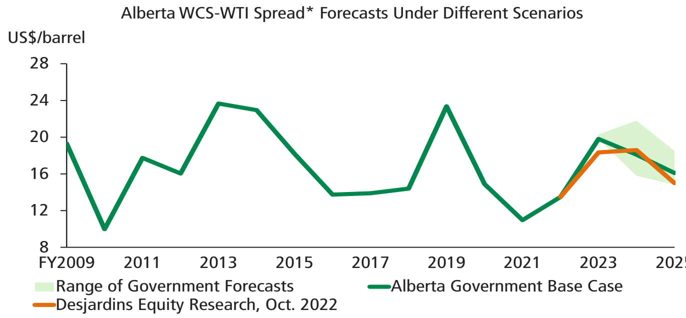
GRAPH 3
Oil Price Projections Raised, but Remain Conservative



Sources: Bloomberg, Alberta Finance and Treasury Board, and Desjardins, Economic Studies

For WCS's discount to WTI, which recently blew out to more than 30 US$/barrel, the province widened its forecasts for this year and next by 3.90 US$ and 3.70 US$ versus Budget. That is close to the latest Desjardins Equity Research projections. Under a downside scenario devised by the province, the discount would widen to 22 US$/barrel next year (graph 4).

GRAPH 4
WCS Discount Expected to Remain Wide



* Budget 2022 associated every 1 US$/barrel with a $460 million net fiscal impact
Sources: Alberta Treasury Board and Finance and Desjardins Economic Studies

We think the province wisely planned based on conservative oil price assumptions. This year, the government expects non-renewable resource revenues to make up about 44% of own-source receipts, more than triple the share in the five years before the pandemic. We also noted in [Seven Burning Questions on Alberta's Finances] that record high fiscal sensitivities to oil prices mean there is outsized risk with overestimating crude values. This fiscal year's record WTI sensitivity of $500M per 1 US$/barrel is likely to increase next year. Accordingly, light oil prices could add roughly $2B to the bottom line if prices were to evolve in line with Desjardins Economic Studies' latest projections.

That said, the province's real GDP projections look optimistic. The 2.7% gain pencilled in for next year contrasts with our own projection of less than 1% and an average of 1.9% across the survey of private-sector forecasters. Desjardins Economic Studies was one of the first shops to call for a recession next year in Canada. We do expect Alberta to fare well relative to other provinces given support from still-high oil prices and limited exposure to the housing market downturn. However, there are downside risks to the province's revenue profile to the extent that economic conditions evolve in line with our base case.

New Policy Targets Affordability, Risks Stoking Inflation

Per announcements this week, new policy was concentrated in measures to help with the rising cost of living. These include indexation of income tax brackets to inflation, and extension of the fuel tax holiday. We noted in [The Impact of Inflation on Different Income Levels in Canada] that before the pandemic, private transportation costs were primarily incurred by higher-income households. Still, the fuel tax holiday should provide a degree of relief from one of the key components of the rising cost of living in the current context. Previously announced plans to send direct transfers to households with children and seniors were not explcitly mentioned in the document.

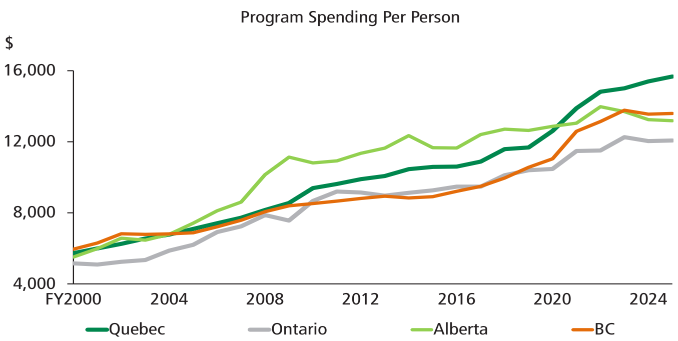
Reflected as spending allocations of $1.3B in FY2023 and $1.2B in FY2024, the package of measures amounts to about 0.3% of nominal provincial GDP. That would bring Alberta's total affordability support for this fiscal year announced since Budget 2022 to about 0.4% of nominal GDP, towards the middle of the provincial pack. See Table 1 in [More Money, More Problems - What a Recession Could Mean for Ontario's Budget Balance].

Spending Increased Incrementally

As it did following past revenue windfalls, Alberta used new fiscal room to incrementally raise spending. As of budget season 2022, the province had planned the most moderate increases in spending of any jurisdiction to FY2025. Program spending is now expected to grow by 10% from FY2020 to FY2025: more than the 7% forecast in Budget 2022 but less than the 24–33% range for Quebec, Ontario, and BC.

With strong population growth near 2% expected throughout the next four years, Alberta's per-capita program expenditures are set to come in lower than BC's by the middle of this decade but lag those of Ontario (graph 5). Both Budget 2022 and this update listed alignment with the other large provinces on this front as a fiscal anchor.

GRAPH 5
Alberta's Spending to Approach Ontario's



* Ontario figure based on province's July 2022 demographic projections.
Sources: Finance Canada, provincial budget documents, and Desjardins Economic Studies

Amid robust population growth and inflation expected to top 6% this year and 3% next year, maintaining the rate of spending pencilled into this update may prove challenging. Elevated price gains may also put upward pressure on public sector wages and by extension program spending, a risk we've noted across the provinces. Alberta's economic outlook forecast also assumed that wage growth would catch up to inflation in the coming years.

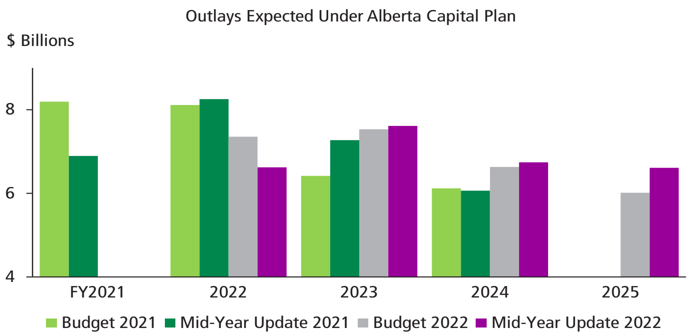
Debt Repayment Plan Details

Alberta's debt repayment plan is proceeding. The province still intends to repay $13.4B this fiscal year, and this plan included interim allocations of $2.3B and $1.4B for the same purpose in FY2024 and FY2025, respectively. The forecast also assumes that a portion of cash from surpluses will go to savings. This includes an estimated at $5.8B in FY2023.

Capital Spending Plans Delayed to Later Years

Infrastructure spending plans were reprofiled, as seen in prior Alberta updates as well as in other provinces. That reflects changes in the timing of major projects, presumably due to the effects of higher labour and input costs. From FY2023 to FY2025, Alberta Capital Plan outlays are forecast to total about $21B, an $800M increase versus Budget 2022 plans. The biggest change comes in FY2025, which now bakes in just a 2% decline versus the prior projection of a nearly 10% drop (graph 6).

GRAPH 6
Project Timelines Again Alter Infrastructure Plans



Sources: Alberta Treasury Board and Finance and Desjardins Economic Studies

Spreads Unlikely to Move Markedly in Short Run

The update was released after market close, but we suspect that investors have already anticipated and priced in the fiscal improvement. The strength of oil prices and coverage of high budget sensitivities made outperformance a foregone conclusion. Alberta 10- and 30-year bond spreads should trade tight to Ontario so long as crude values remain elevated, and in the long run if surpluses are maintained and spending adheres to targets.

TABLE 1
Summary of Transactions

IN $ BILLIONS (UNLESS INDICATED)	2021-2022	2022-2023			2023-2024	2024-2025
	Actual	Bud. 2022	Q1 Update	Q2	Q2 Update	Q2 Update
Total revenues	68.3	62.6	75.9	**76.9**	69.6	69.9
% change	*58.4*	*1.5*	*11.1*	***12.6***	*-9.6*	*0.5*
Non-renewable resources	16.2	13.8	28.4	**28.1**	19.2	16.0
Other own-source	40.6	36.7	34.9	**36.3**	38.8	41.6
% change	*37.4*	*-1.2*	*-14.0*	***-10.5***	*7.0*	*7.1*
Federal Transfers	11.6	12.1	12.6	**12.5**	11.5	12.3
Total spending	64.4	59.4	60.0	**64.6**	63.9	64.5
% change	*7.1*	*-3.6*	*-6.7*	***0.4***	*-1.0*	*1.0*
Program spending	62.1	57.0	57.6	**62.2**	61.5	62.3
% change	*7.3*	*-3.7*	*-2.6*	***0.2***	*-1.1*	*1.3*
Debt charges	2.3	2.4	2.4	**2.4**	2.4	2.2
% of total revenues	*3.3*	*3.8*	*3.2*	***3.1***	*3.5*	*3.2*
Budgetary balance	3.9	0.5	13.2	**12.3**	5.6	5.3
% of GDP	*1.1*	*0.1*	*2.9*	***2.6***	*1.2*	*1.1*
Net Debt						
% of GDP	*15.2*	*16.7*	*10.3*	***9.9***	*8.7*	*7.5*

Sources: Alberta Treasury Board and Finance and Desjardins Economic Studies