ECONOMIC VIEWPOINT

Six Predictions for Alberta's Mid-Year Fiscal Update

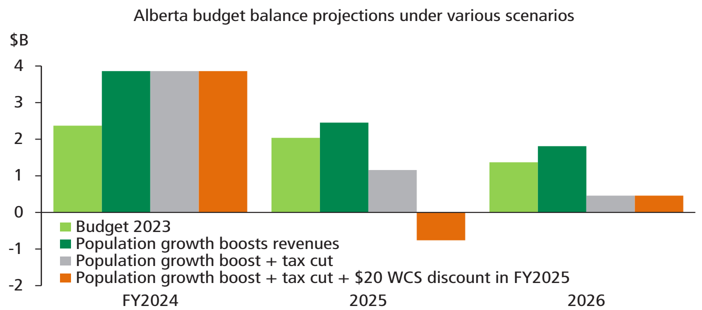
By Marc Desormeaux, Principal Economist

Summary

In this preview, we make six predictions about Alberta's upcoming fiscal year 2023–24 (FY2024) mid-year fiscal update and economic statement. The key takeaway is that Alberta's planned surpluses look secure (graph 1).

- **Prediction #1:** We see some potential revenue upside from WTI prices, but this probably won't show up in mid-year projections.
- **Prediction #2:** WCS spreads will be just as important as WTI prices.
- **Prediction #3:** Skyrocketing population growth is great for Alberta's economy but may not have as much impact on public finances as it did in other provinces.
- **Prediction #4:** Big downward revisions to the tax base—like the ones we've seen in other provinces—are possible but unlikely.
- **Prediction #5:** Tax cuts announced during the provincial election campaign could reduce the fiscal margin for error, but probably not enough to undo planned surpluses.
- **Prediction #6:** Bond spreads should continue to track WTI prices closely.

GRAPH 1
Only A Confluence of Adverse Fiscal Events Would Undo Alberta's Plans for Balance



Sources: Alberta Treasury Board and Finance, Alberta United Conservative Party and Desjardins Economic Studies

Introduction

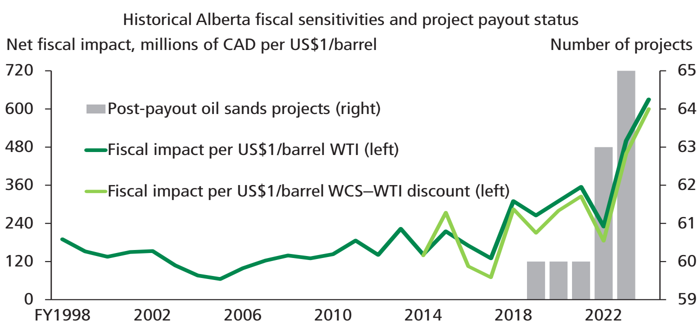
With Alberta's FY2024 mid-year fiscal update and economic statement set for release this week, we make six predictions and discuss their implications for investors, policymakers and the province's public finances. Towards the end of the note, we also detail a few scenarios for possible budget balances. Even though there are risks, Alberta looks very unlikely to lose the surpluses it planned until at least FY2026 in this update. Under the scenarios we ran, only a significant and prolonged Alberta oil price discount blowout combined with personal income tax cuts resulted in a deficit. And these scenarios all assumed a full drawdown of fiscal plan contingency funds.

1. We see some potential revenue upside from WTI prices, but this probably won't show up in mid-year projections.

Even though WTI fell to the low $70s this month, we see upside potential for crude and bitumen royalties in the mid-year update. We're now more than halfway through FY2024, and WTI has averaged more than the US$75/barrel the government projected in the first quarter update, while the WCS discount is close to the US$15/barrel forecast. At this point in the year, it'll take substantial weakness in the US oil price to reverse the tailwind to royalties. And we don't think that's likely: we're forecasting WTI prices higher than the Alberta government is. Since the Q1 FY2024 update, WTI has benefited from OPEC+ cuts and a classic geopolitical risk premium. We think it would take an unwind of those effects plus a deep contraction in demand to bring WTI prices sustainably below US$70/barrel in the coming months.

That said, even with WTI tracking well above the last projection, the province probably will and definitely should be conservative in its crude forecasts. Though we don't foresee a deep or long-lasting drop in crude values over the next year, there's still uncertainty hanging over commodity prices at the current juncture. This includes the ongoing prospect of a global economic slowdown or recession and risks related to economic growth in China—the world's largest commodity consumer. Moreover, in recent plans, the government has demonstrated a tendency towards greater prudence in its oil price projections. This increased buffer mirrors the rising sensitivity of Alberta's revenues to crude values (graph 2). That's because many large oil sands projects have now recouped their initial capital costs and are subject to higher royalty rates, a trend that should continue as we first highlighted here.

GRAPH 2
Alberta's Finances Are More Sensitive to Oil Prices than Ever



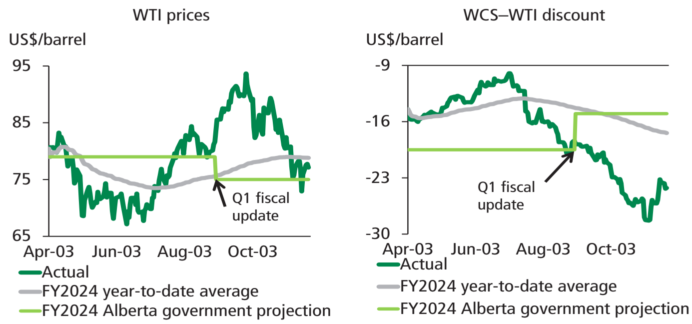
Sources: Alberta Treasury Board and Finance, Alberta Ministry of Energy and Desjardins Economic Studies

2. WCS spreads will be just as important as WTI prices.

The huge widening of the WCS discount to WTI over the past month has been more jarring and more consequential than recent volatility in WTI. A tighter-than-anticipated discount helped offset the fiscal drag from a weak American price benchmark earlier this year. But more recently, refinery downtime in the key US Gulf Coast region, a jump in Alberta production following a summer maintenance period, and the latest TMX pipeline construction delay blew the discount out to an 11-month high. That looks likely to undermine the effect of this fall's WTI gains on the budget balance (graph 3).

This discount blowout has big implications for Alberta's public finances, particularly if it proves persistent. Just like with WTI, the province's budget balances are historically sensitive to the WCS differential, and that sensitivity should only grow over time as production becomes more oriented towards heavy sour crude.

GRAPH 3
Oil Prices Are at Loggerheads



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

That means government assumptions about whether and how quickly demand for and supply of Alberta oil realign will be vitally important for the province's fiscal trajectory beyond this year. We suspect that the discount will normalize by the spring of next year—in line with the expected TMX in-service date—but there is risk in this respect.

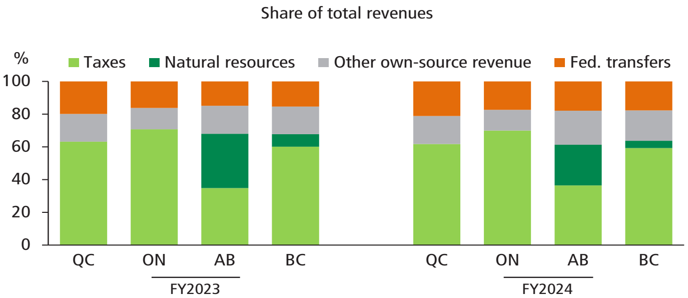
3. Skyrocketing population growth is great for Alberta's economy but may not have as much impact on public finances as it did in other provinces.

Of all of Canada's provinces, Alberta has arguably been the biggest beneficiary of the country's multi-decade-high population growth that has dominated economic headlines this year. In the year to July 1, 2023, Alberta's headcount gains outpaced those of all other jurisdictions, with strong contributions from international immigration, movement from other provinces, natural growth and temporary migration. That has kept home sales activity well above pre-pandemic levels in Calgary and Edmonton even with much higher interest rates. We think this population surge may continue and propel growth in Wild Rose Country over the next several years, particularly given how many young people are moving there in search of cheaper housing.

However, the signs point to a smaller impact on revenues in Alberta than in the other three large provinces. Tax revenues—which would normally benefit the most from the additional labour and business income generated by strong population growth—make up a small share of own-source receipts (graph 4 on page 3). This reflects Alberta's low personal and corporate income tax rates versus other Canadian jurisdictions, as well as its reliance on natural resource revenues.

The province could increase spending to support the needs of its growing population, but there are constraints in this respect. A key fiscal anchor in place since Budget 2023 limits operating spending to the rate of population growth plus inflation *projected for the prior year at the time of Budget 2023*. That means

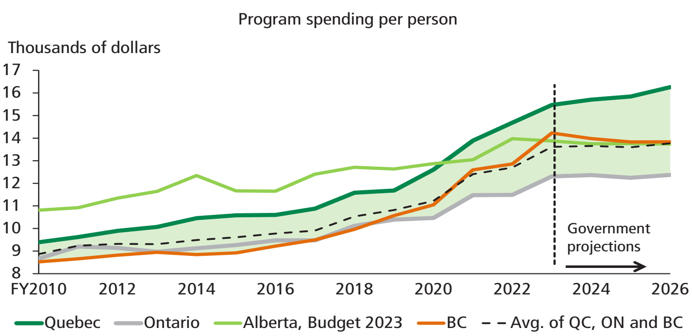
GRAPH 4
Taxes Make Up a Relatively Small Share of Alberta's Revenues



Sources: Statistics Canada, Institut de la Statistique du Québec, Alberta Treasury Board and Finance, British Columbia Ministry of Finance and Desjardins Economic Studies

spending growth caps won't be adjusted based on this year's headcount surge until Budget 2024. A secondary fiscal guideline upheld in Budget 2023 aims to keep Alberta spending at or below the per-person rate in the other three large provinces. In their mid-year fiscal updates, Quebec, Ontario and BC largely maintained prior spending targets despite large boosts to their population projections. This puts the three-province average of per capita program expenditures on track to stay where it is for the next few years, leaving little room for Alberta to lift its own spending (graph 5). Still, Alberta finds itself in quite a different position than in the decade before the pandemic, when per-person expenditures far outpaced those of the other three large provinces. Spending restraint exercised by multiple provincial administrations during that period has brought Wild Rose Country in line with the average for Quebec, Ontario and BC.

GRAPH 5
Per-Person Spending Reductions in Other Provinces Leave Little Room for Increases in Alberta



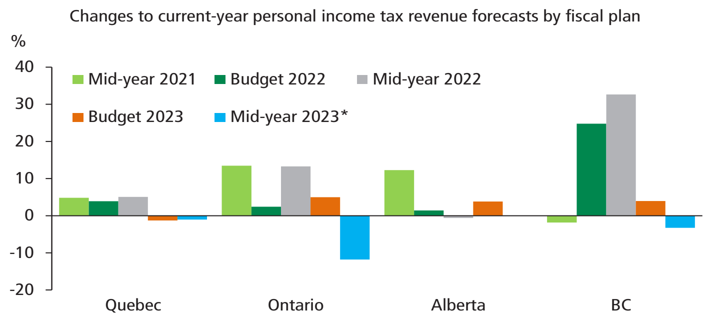
Sources: Statistics Canada, provincial budget documents and Desjardins Economic Studies

4. Big downward revisions to the tax base are possible but unlikely.

Big downward revisions to the tax base are another important trend we've seen in some jurisdictions. Recall that Ontario's Fall Economic Statement delayed the province's planned return to balance by one year after a nearly $9B underperformance in personal income taxes (PIT) significantly weakened its outer-year revenue trajectory. This was driven by federal government reassessments of prior years' tax receipts, which also led BC to downgrade its PIT revenue forecasts for the next three fiscal years.

The nature of prior revisions suggests this is less likely in Alberta. Granted, Wild Rose Country's last update was published before the September Canada Revenue Agency tax data were revised. However, the province did not experience the same kinds of tax base-driven upward revisions to key revenue categories that have been reversed elsewhere (graph 6). More generally, Alberta's low reliance on personal and corporate income taxes (and high reliance on commodity prices) noted above seems to leave it less exposed to the effects of tax base revisions than Ontario and BC.

GRAPH 6
What Came Up May Come Down (but Likely Not in Alberta)



* Q1 update data used for BC
Sources: Provincial budget documents and Desjardins Economic Studies

5. Tax cuts announced during the provincial election campaign could reduce the fiscal margin for error, but probably not enough to undo planned surpluses.

The United Conservative Party election platform featured two headline policies. One was the extension of the existing fuel tax holiday until the end of this calendar year. This was already incorporated into the first quarter update. The second, more material measure was the planned creation of a lower 8% bracket for the first $60k of earnings, which the UCP estimated would result in foregone revenues of $3.6B over the next four fiscal years.

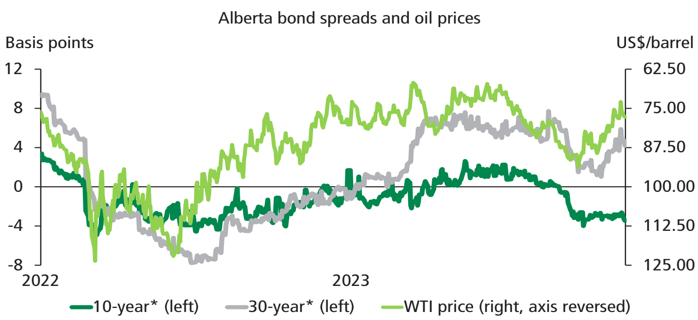
On its own, this tax cut isn't likely to eliminate the surpluses planned for the foreseeable future, particularly with $1.5B in contingencies baked into each year of the fiscal plan at budget time. But it would reduce the margin for error. The UCP platform projected a very slim surplus of just $37M in FY2026. It's easy to envision a scenario where foregone PIT revenues combined with, for instance, weaker royalties and full use of contingencies bring a return to red ink.

6. Bond spreads should continue to track WTI prices closely.

We've noted several times in the past that Alberta bond yields—particularly those in the long end—tend to track WTI prices closely. That's precisely what has happened in recent months (graph 7), and we don't expect that to change in the near term. This relationship mirrors the longstanding links between the crude value and the province's economic and fiscal prospects.

To an extent, our analysis highlights the continued outsized importance of energy prices in any discussion of Alberta's fiscal performance. But as we've noted before, Alberta's financial position is now historically sensitive to the WCS–WTI differential as well. Bond investors should consider this critical indicator—and the supply–demand dynamics of the market for Alberta oil—going forward.

GRAPH 7
The Classic Relationship Has Reemerged for Alberta Bonds



* Constant maturity
Sources: Bloomberg and Desjardins Economic Studies

Other Questions

Alberta's revised Capital Plan will update the timelines for infrastructure spending. We haven't seen any significant delays or reprofiling of expenditures in the provinces that have released mid-year updates so far. But these remain a risk amid construction industry labour shortages, high interest rates and elevated construction costs.

Debt repayment plans are also worth watching, particularly if there are changes to projected budget balances. Recall that Alberta's balanced budget rules require that at least half of surplus cash be allocated towards this goal. Additional potential uses include increased deposits into the Heritage Fund or the new Alberta Fund, which sets aside cash for future policy priorities.

The mid-year plan should provide updated estimates of the cost of this year's record wildfire season. In the first quarter fiscal update, the province stated that $514M had been spent on pre-suppression and response efforts, with a total of $980M allocated to disaster and emergency assistance in FY2024. Of that amount, $905M in funding was expected to be sourced from the $1.5B contingency fund established in Budget 2023.

As with prior updates, we'll be watching how the government characterizes the potential for recession. Our view is that the Canadian economy will experience a mild economic downturn as we approach 2024 and the cumulative effects of sharply higher interest rates are felt. But we think Alberta will avoid the worst because of factors including relatively little exposure to rates, skyrocketing population growth and support from the energy industry.

Final Thoughts

Alberta's 2023 mid-year fiscal update and economic statement will contain both old and new storylines. Wild Rose Country's public finances look likely to avoid the downgrades we've seen in some other provinces this fall update season. Moreover, there's both tremendous opportunity and new risk from the strong population growth observed over the last several quarters. But the province's finances are more sensitive to crude values than ever, and the blueprint will be released at a time of uncertainty for Western Canadian oil prices. The good news from a fiscal sustainability perspective is that Alberta enters this period of uncertainty with a low debt burden and some room to increase spending. Investors should take note.

TABLE 1
Budget 2023 Projections

$M (UNLESS OTHERWISE INDICATED)	2022–2023	2023–2024	2024–2025	2025-2026
Total revenues	76,025	70,653	71,724	72,608
% change	*11.3*	*-7.1*	*1.5*	*1.2*
Tax revenues	24,580	24,992	27,055	28,609
% change	*4.6*	*1.7*	*8.3*	*5.7*
Bitumen and crude oil royalties	22,715	15,460	14,661	13,178
% change	*67.6*	*-31.9*	*-5.2*	*-10.1*
Other own-source revenue	11,101	11,594	11,637	11,737
% change	*-17.6*	*4.4*	*0.4*	*0.9*
Total expense	64,313	66,782	68,187	69,739
% change	*-0.1*	*3.8*	*2.1*	*2.3*
Operating expense	55,384	57,038	58,049	59,200
% change	*5.8*	*3.0*	*1.8*	*2.0*
Contingency	1,322	1,500	1,500	1,500
Budget balance	**10,390**	**2,371**	**2,037**	**1,369**
Population (thousands)	4,543	4,674	4,777	4,875
% change	*2.2*	*2.9*	*2.2*	*2.1*
Total CPI inflation, % change	*6.4*	*3.3*	*2.2*	*2.2*

Sources: Alberta Treasury Board and Finance and Desjardins Economic Studies

Appendix – Scenario Details

TABLE 2
Population Growth Boosts Revenue Scenario

$M (UNLESS OTHERWISE INDICATED)	2022–2023	2023–2024	2024–2025	2025-2026
Total revenues	76,120	71,144	72,323	73,233
% change	*11.4*	*-6.5*	*1.7*	*1.3*
Tax revenues	26,524	25,939	27,474	29,052
% change	*12.8*	*-2.2*	*5.9*	*5.7*
Bitumen and crude oil royalties	20,847	15,987	15,075	13,550
% change	*53.8*	*-23.3*	*-5.7*	*-10.1*
Other own-source revenue	11,665	11,087	11,817	11,919
% change	*-17.6*	*-5.0*	*6.6*	*0.9*
Total expense	64,479	66,961	68,369	69,925
% change	*0.2*	*3.8*	*2.1*	*2.3*
Operating expense	54,737	57,217	58,231	59,386
% change	*4.6*	*4.5*	*1.8*	*2.0*
Contingency	0	323	1,500	1,500
Budget balance	**11,641**	**3,860**	**2,454**	**1,808**
Population (thousands)	4,543	4,742	4,851	4,951
% change	*2.2*	*4.4*	*2.3*	*2.1*
Total CPI inflation, % change	*6.4*	*3.3*	*2.2*	*2.2*

Sources: Alberta Treasury Board and Finance and Desjardins Economic Studies

Details of Table 2:

- The population grows according to the first-quarter update forecast in FY2024 and FY2025, then as projected in Budget 2023 in FY2026.
- Operating expenditures are in line with the first-quarter update forecast in FY2024, then grow as projected in Budget 2023 thereafter.
- Bitumen and crude oil revenues grow as projected in Budget 2023 beyond FY2024.
- The projected tax and other own-source revenues per person in Budget 2023 are applied to the updated population forecast.

TABLE 3
Population Growth Boost + Tax Cut Scenario

$M (UNLESS OTHERWISE INDICATED)	2022–2023	2023–2024	2024–2025	2025-2026
Total revenues	76,120	71,144	71,026	71,883
% change	*11.4*	*-6.5*	*-0.2*	*1.2*
Tax revenues	26,524	25,939	26,177	27,702
% change	*12.8*	*-2.2*	*0.9*	*5.8*
Bitumen and crude oil royalties	20,847	15,987	15,075	13,550
% change	*53.8*	*-23.3*	*-5.7*	*-10.1*
Other own-source revenue	11,665	11,087	11,817	11,919
% change	*-17.6*	*-5.0*	*6.6*	*0.9*
Total expense	64,479	66,961	68,369	69,925
% change	*0.2*	*3.8*	*2.1*	*2.3*
Operating expense	54,737	57,217	58,231	59,386
% change	*4.6*	*4.5*	*1.8*	*2.0*
Contingency	0	323	1,500	1,500
Budget balance	**11,641**	**3,860**	**1,157**	**458**
Population (thousands)	4,543	4,742	4,851	4,951
% change	*2.2*	*4.4*	*2.3*	*2.1*
Total CPI inflation, % change	*6.4*	*3.3*	*2.2*	*2.2*

Sources: Alberta Treasury Board and Finance and Desjardins Economic Studies

Details of Table 3:

- The population grows according to the first-quarter update forecast in FY2024 and FY2025, then as projected in Budget 2023 in FY2026.
- Operating expenditures are in line with the first-quarter update forecast in FY2024, then grow as projected in Budget 2023 thereafter.
- Bitumen and crude oil revenues grow as projected in Budget 2023 beyond FY2024.
- Tax revenues are reduced by the cost of the new personal income tax bracket estimated in the 2023 United Conservative Party Platform (which we scaled up according to changes in the population projection).

TABLE 4

Population Growth Boost + Tax Cut + $20 WCS Discount in FY2025 Scenario

$M (UNLESS OTHERWISE INDICATED)	2022–2023	2023–2024	2024–2025	2025-2026
Total revenues	76,120	71,144	69,106	71,883
% change	*11.4*	*-6.5*	*-2.9*	*4.0*
Tax revenues	26,524	25,939	26,177	27,702
% change	*12.8*	*-2.2*	*0.9*	*5.8*
Bitumen and crude oil royalties	20,847	15,987	13,155	13,550
% change	*53.8*	*-23.3*	*-17.7*	*3.0*
Other own-source revenue	11,665	11,087	11,817	11,919
% change	*-17.6*	*-5.0*	*6.6*	*0.9*
Total expense	64,479	66,961	68,369	69,925
% change	*0.2*	*3.8*	*2.1*	*2.3*
Operating expense	54,737	57,217	58,231	59,386
% change	*4.6*	*4.5*	*1.8*	*2.0*
Contingency	1,322	323	1,500	1,500
Budget balance	**10,319**	**3,860**	**-763**	**458**
Population (thousands)	4,543	4,742	4,851	4,951
% change	*2.2*	*4.4*	*2.3*	*2.1*
Total CPI inflation, % change	*6.4*	*3.3*	*2.2*	*2.2*

Sources: Alberta Treasury Board and Finance and Desjardins Economic Studies

Details of Table 4:

- The population grows according to the first-quarter update forecast in FY2024 and FY2025, then as projected in Budget 2023 in FY2026.
- Operating expenditures are in line with the first-quarter update forecast in FY2024, then grow as projected in Budget 2023 thereafter.
- Bitumen and crude oil revenues grow as projected in Budget 2023 beyond FY2024.
- The projected tax and other own-source revenues per person in Budget 2023 are applied to the updated population forecast.
- Tax revenues are reduced by the cost of the new personal income tax bracket estimated in the 2023 United Conservative Party Platform (which we scaled up according to changes in the population projection).
- FY2025 bitumen and crude oil royalties are reduced by $600M * (16.80 - 20) (i.e., Budget 2023 WCS discount forecast of US$16.80/barrel minus assumed US$20 discount multiplied by Budget 2023 sensitivity estimate of $600M per US$1/barrel for FY2024).