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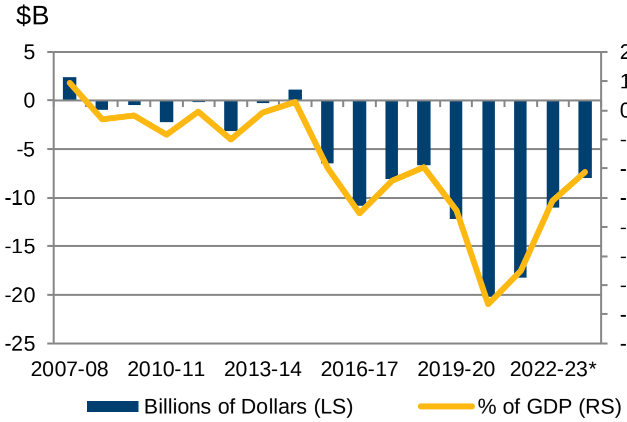
The 2021 Alberta Budget – Fiscally Energized Short-Term, New Anchors to Guide the Medium-Term Path

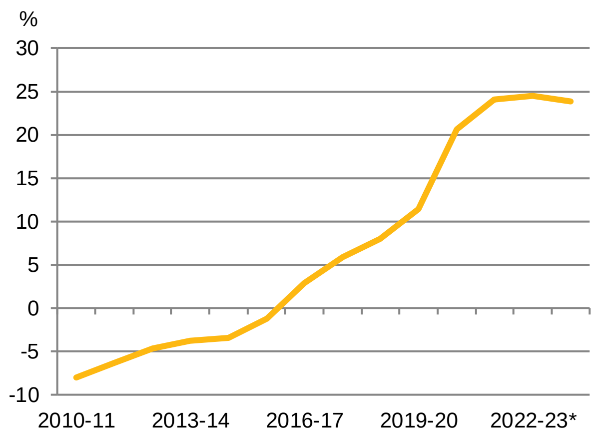
The global reflation theme dominating market discussion is Alberta's ally these days. The strong 8.8% nominal GDP rebound forecast in 2021 in one factor contributing to the positive turnaround in public finances after the $20.2B deficit for FY 2020-21 estimated for the end of March. However, Alberta's new deficit estimate of $18.2B in FY 2021-22 marks an upward revision from the $15.5B figure of the November Mid-Year Update (chart 1). The revision comes from sizeable $2.5B contingencies for COVID-19 relief, economic recovery and disaster assistance introduced in today's fiscal framework. Own-source revenue have been revised up by 2.3% relative to November, more than the 1.8% upward revision to operating expenditures.

Chart 1: Alberta Budgetary Balance



Source: Alberta Government and LBS Econ. Res. and Strategy.

Chart 2: Alberta Net Debt-to-GDP



Source: Alberta Public Accounts, Budget and LBS Econ. Res. and Strategy.

The central scenario used is cautious with respect to the pace of the economic recovery. Another layer of prudence resides in royalties. The commodity space meaningfully improved since the November Mid-Year Update. As of writing, WTI oil spot prices trade at around US$63/bbl, in line with the levels that prevailed in January 2020, prior to the pandemic. The price for natural gas, at US$2.76/MMBtu, follows a similar pattern. Alberta remains very prudent relative to its assumptions regarding energy prices. It forecasts WTI crude oil to average US$46/bbl in FY 2021-22, virtually unchanged from November. Moreover, the US$15 WTI-WCS differential forecast is slightly wider than current futures contracts. Granted, the oil futures market is currently in backwardation, meaning investors believe that the current repricing in supply/demand is unsustainable. OPEC+ could increase its output as soon as next week, limiting the scope for further increase in crude oil prices. However, baring an adverse scenario regarding COVID-19, some upside risks could easily materialize, improving the $2.9B resource revenue forecast for FY 2021-22, as well as other sources of taxation revenue (chart 3).

Cyclical deficit to shrink, too early to discuss about balanced budget

Budget 2021 also presents a snapshot of the fiscal stance after the pandemic. The deficit is projected to fall substantially to $11B (3.1% of GDP) in FY 2022-23 due to diminishing COVID-19 expenses, unchanged program spending and own-source revenue going back to pre-COVID levels.

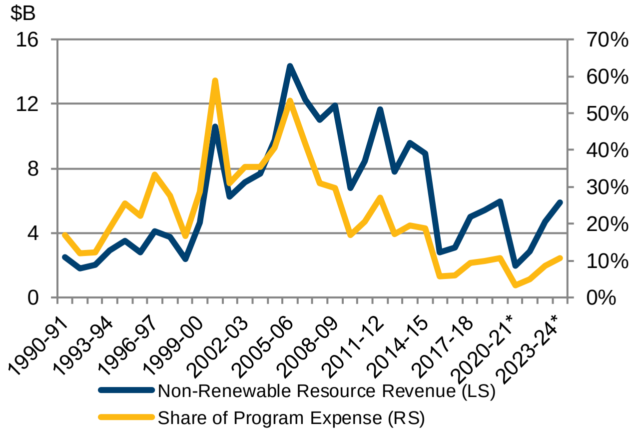
Until vaccination eliminates COVID-19 uncertainty, it was elected to not prematurely present a new balanced budget plan. This will be done after the pandemic. The 3-year fiscal plan projects an $8B shortfall in FY 2023-24, a reliable approximation for the structural deficit to eliminate down the road. The latter could contribute to recurring debates about tax policy choices, particularly the introduction of a provincial sales tax.

Fiscal anchors to guide the medium-term financial strategy
As mentioned in the November Mid-Year Update, Alberta outlined today three fiscal anchors to track progress and make adjustments along the way:

1. Keeping net debt-to-GDP below 30%. The ratio should stand at 20.3% on March 31st, 2021, projected to top at 25% in FY 2022-23 (chart 2);
2. Lowering spending per capita to the average of comparable provinces; above average health care costs per capita notably represent $2.6B;
3. After the pandemic, outlining a plan to eliminate the deficit.

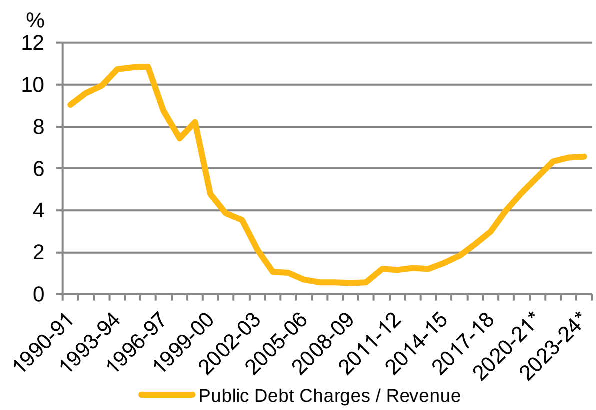
Given the recent global sell-off in bond markets despite a firm commitment by central banks to stay accommodative, investors should also focus on the debt service ratio (DSR: interest on debt as a share of revenue) to assess fiscal risk. At 5.6% in FY 2020-21 and projected at 6.1% in FY 2021-22 (chart 4), Alberta's DSR remains lower than before Ralph Klein's era of fiscal restructuration and below most Canadian provinces (Ontario: 8.2%, Quebec: 6.4%, British Columbia: 4.7%). This low debt level advantage is key in a rising yield environment such as the one we have experienced so far this year, particularly over the past two weeks.

Chart 3: Alberta Ressource Revenue



Source: Alberta Public Accounts, Budget and LBS Econ. Res. and Strategy.

Chart 4: Alberta Debt-Service Ratio



Source: Alberta Public Accounts, Budget and LBS Econ. Res. and Strategy.

Alberta plans to borrow $22.5B in long-term debt in FY 2021-22, after a record $27.8B in FY 2020-21. Of this amount, $4.4B goes to refinancing purposes and less than $1B will be made on behalf of Government Business Enterprises.

Alberta's tax advantage and ESG marketing initiatives

In summary, the improvement in global oil markets, diminishing costs associated to COVID-19 and stable program spending form the three pillars deflating the deficit over the forecast horizon. At the moment, the UCP government prefers to stay away from implementing a sales tax as the real economy remains fragile. After all, the unemployment rate is sticky above 10% and a recent CFIB survey indicates that close to 22% of SMEs are on the verge of closing because of the pandemic. Experts have estimated that every one percentage point in sales tax could generate close to $1B per year in revenue. Thus, markets should take into account Alberta's revenue options, something not available to every other province.

Finally, the Province will allocate some funding to a new ESG Secretariat to come up with a series of programs to promote ESG considerations. Funds will be allocated to discuss low carbon initiatives, carbon capture and the plan for phasing out coal.

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