Sébastien Lavoie • Chief Economist
514 350-2931 • LavoieS@vmbl.ca

Dominique Lapointe, CFA • Senior Economist
514 350-2924 • LapointeD@vmbl.ca

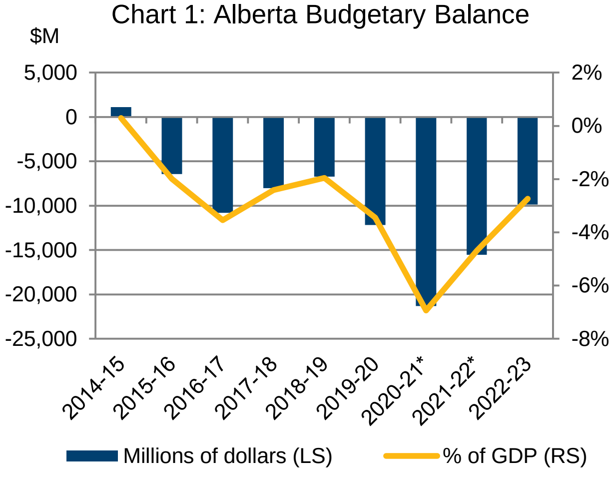
24 November 2020

Alberta Mid-Year Fiscal Update – On the Verge of Turning the Corner

Projected at $6.8B in the March budget and $24.2B in the August First Quarter Update, Alberta's deficit for FY 2020-21 was revised down to $21.3B (6.9% of GDP) in today's Mid-Year Update (chart 1). Borrowing requirements are unchanged at $29.9B relative to the First Quarter Update.

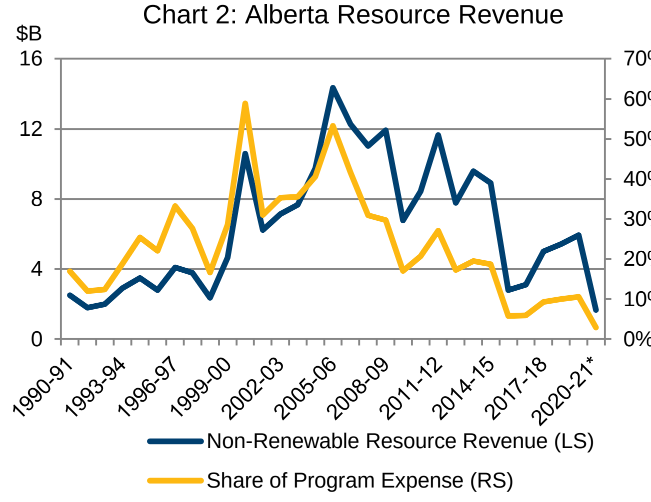
The big picture is simple: the pandemic added a cyclical deficit on top of a structural deficit initially caused by the downtrend in non-renewable resource revenue observed since 2015 (chart 2). Encouraging vaccine news strongly supports the idea of a positive turnaround, namely smaller deficits in the next two years (chart 1). This being said, several other factors could alter the Province's fiscal path: the duration of social and economic restrictions announced earlier today by Premier Jason Kenney in response to rising coronavirus cases; the wide-ranging implications of the Biden Presidency; the OPEC+ meeting on November 30th; and the future public policy choices relative to Alberta's high taxation capacity.

Chart 1: Alberta Budgetary Balance



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

Chart 2: Alberta Resource Revenue



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

Higher federal transfers and firmer oil prices improve revenue projections

The Mid-Year update projects total revenue at $41.4B in FY 2020-21, almost $3B higher than in the First Quarter Update and $9B lower relative to Budget 2020. The single largest revision relates to the addition of $1.4B in federal transfers. The slight improvement in the economic outlook will also add $0.7B to taxation revenue, investment income and timber royalties.

Oil royalties are pegged at $1.7B for FY 2020-21, representing a $0.4B improvement relative to the First Quarter Update. It stands in sharp contrast with the days when WTI crude oil prices averaged $US100/bbl, often generating between $8B and $12B annually in non-renewable resource revenue (chart 2). Looking ahead, Phase 3 trial data showing the high effectiveness of three COVID-19 vaccines clearly reinforces the outlook for oil demand in the medium term, boosting crude oil prices by about 13% relative to before the Pfizer announcement on November 9. Investors are now turning their attention toward the OPEC+ series of meetings next week. The initial plan to ease production cuts from 7.7M bpd to 5.7M bpd starting in January 2021 could be extended to the entire first quarter of 2021. This would allow OPEC+ to further reduce inventories and ease supply-demand imbalance in global oil markets. As of writing, WTI crude oil prices traded around $US45/bbl, in line with the government's average forecast for FY 2021-22. For FY 2022-23, the $US55/bbl assumption used by the government is in line with our forecast.

Earlier this morning, Premier Jason Kenney announced new social and economic restrictions as the Province registered more new daily COVID-19 than British Columbia, Ontario, and Quebec recently. Alberta has been home to the second highest number of new cases per capita in the country for almost three weeks, behind Manitoba. These new restrictions, not included in this afternoon's Mid-Year Update, could weigh down on multiple sources of taxation revenues for the remainder of the current fiscal year ending on March 31st. Nonetheless, 2021 is poised to become a constructive transition year with mass immunization. Accordingly, the government's 5% target for annual average revenue growth from 2021 to 2023, led by a full recovery in personal income taxes, education property taxes and non-resource renewal revenue, is credible.

Spending restraint remains a priority

In response to the lower structural intake for oil royalties, one key objective of the Alberta government is to bring spending-per-capita in line with other provinces. The March budget plan included a 3.5% reduction in program spending over 3 years. However, the pandemic forced the government to increase spending by $5.4B. For the next two fiscal years, Alberta targets a 3% annual average decline in program spending. The fiscal framework also includes a $750M contingency as a cushion in case of a more pessimistic pandemic scenario.

Fiscal anchors

On top of the expenditure projections, the government introduces three fiscal "anchors" as a mean to provide investors with transparency and predictability: aligning per capita spending with comparator provinces (as mentioned above); keeping net debt-to-GDP "well below 30%" (it is now estimated to reach 21% in FY 2020-21 and climb to 25% in FY 2022-23); and establishing a plan to balance the budget once the pandemic is over.

To Watch: Post-COVID immigration, tax policy choices and Biden's climate policies

Thanks to very encouraging developments relative to vaccines, the world is moving closer to the light at the end of the tunnel. A fast growing population has historically been an advantage to increase Alberta's tax base. As such, the eventual end of the pandemic should quickly reverse the province's net total migration outflow observed in 2020Q2, a first since the early 1990s. Indeed, international immigration all but ceased with the first wave. The negative interprovincial migration flow continues due to an unemployment rate persistently above 10%.

The deficit will shrink by about half to $9.9B deficit in FY 2022-23 (2.7% of GDP, chart 1), if everything goes as planned. In order to completely eliminate the deficit, further actions will be required. For instance, the Province benefits from a very high fiscal capacity, or ability to raise the current low tax burden. Alberta is likely to continue to impose the lowest personal income and corporate tax rates of all provinces, but discussions about introducing a sales tax gain ground. To be clear, Finance Minister Travis Toews reiterated that his government had no intention to introduce a provincial sales tax, or any tax increase, in the near future. However, he acknowledged in mid-November that the suggestion could be considered after the pandemic is over and spending restraints have been put in place.

Finally, incoming U.S. President Joe Biden signaled several times his intention to cancel the XL Keystone pipeline if elected. The project would add 830K bpd in oil transport capacity. Jason Kenney's administration continues to discuss with both Democrats and Republicans supporting the pipeline. Also, Joe Biden's climate change policies include the possibility of imposing a carbon border tax fee on U.S. imports of Canadian oil products. Ottawa could ask for an exemption.

Sébastien Lavoie | Chief Economist
514 350-2931 | lavoies@vmbl.ca

Dominique Lapointe, CFA | Senior Economist
514 350-2924 | lapointed@vmbl.ca