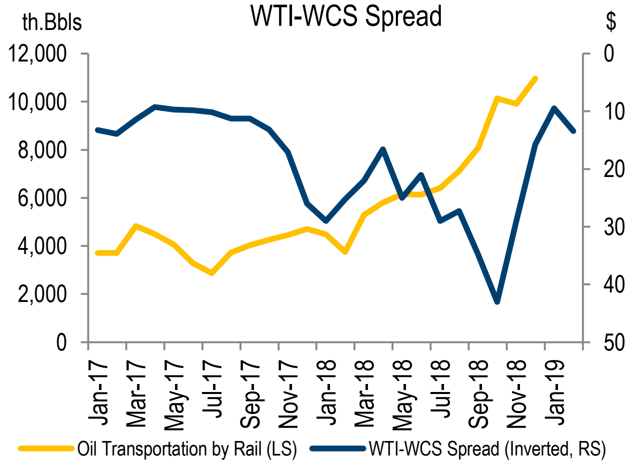
Alberta 3rd Quarter Update: Improved financial situation in 2018-19 and a fiscal update similar to a budget

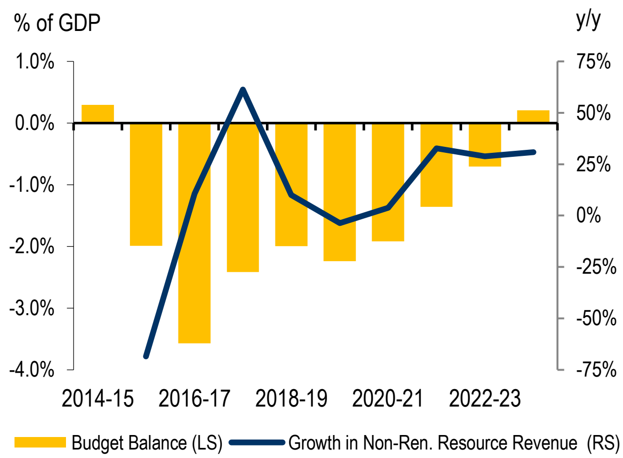
The Government of Alberta released its Third Quarter Fiscal Update yesterday. The deficit is projected at $6.9B (2% of GDP) for FY 2018-19. This marks a $1.9B and $0.6B improvement relative to Budget 2018 and the Second Quarter Fiscal Update, respectively. Relative to Budget, the main source of improvement comes from non-renewable resource revenue ($1.7B) propelled by higher WTI crude oil prices and a lower Canadian dollar. Moreover, on the back of the temporarily mandated reduction in oil production and the continuous increase in crude-by-rail shipments, the WTI-WCS price differential narrowed considerably (chart 1). Also, the $500M contingency reserve is unlikely to be used with only a month left in FY 2018-19, improving the budgetary balance by the same amount.

Chart 1- Monthly Oil Transportation by Rail vs WTI-WCS Spread



Sources: NEB, Bloomberg Finance L.P.and LBS Econ. Res. and Strategy.

Chart 2 - Alberta Fiscal Framework



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

For the first time ever, this fiscal update includes a forward-looking section entitled the "Path to Balance". In this section, the proposed path targets a balanced budget in FY 2023-24, the same target as previously set in Budget 2018. Such a path is usually included in a full Budget. **As such, with provincial general elections to be held at or before May 31st 2019, there is a strong probability that the government does not present a budget prior to the spring elections, possibly making this fiscal update the NDP's electoral platform**.[1] Two other features of this fiscal update suggest there could be no budget before the spring election. First, the Province has built a $6.3B contingency account, enough cash to continue operating during FY 2019-20 during the election campaign. Second, the NDP government summarizes its actions since taking office in 2015 and mentions its policy engagements for the years to come.

[1] According to the latest polls, the United Conservative Party (merged from the former Progressive Conservative and the Wildrose Parties) has 52% of the voting intentions, followed by the NDP with a 28% voting share.

In the economic outlook supporting the path to balance, the government significantly revised down its nominal and real GDP growth forecast for 2019 (from 4.3% to 1.4% and 2.5% to 1.6%, respectively). This downward revision reflects in part lower WTI crude oil prices expectations relative to 2018 (US$59 vs US$62 per barrel). Also, mandatory cuts to oil production will entail a pullback in conventional oil investment and stagnation in oil sands investment in 2019. This being said, investors should not forget the positive momentum in business investment observed in non-energy sectors as the province continues to diversify the economy. Altogether, the deficit is expected to increase modestly to $7.9B (2.2% of GDP) in FY 2019-20, before shrinking to zero by 2023-24 (see chart 2). A 31% average annual surge in natural resource revenue between 2021 and 2023 underpins the elimination of the deficit, driven by three factors: higher WTI crude oil prices (broadly in line with our estimates)[2], rising production, and the fact that several oil sands projects are poised to reach profitability. Finally, the path to balance in FY 2023-24 assumes enhanced market access. One constructive step was announced last Friday, as the National Energy Board recommended approval of the Trans Mountain pipeline. The federal government continues its consultations that are expected to end in June before making a final decision. Also, the Alberta government intends to restrain operating expenditure growth below 3.0% between FY 2020-21 and 2022-23, lower than the historical average growth.

Finally, long-term borrowing requirements are expected to reach $19.6B in 2018-19, of which $19.1B (97%) has been completed. For the years to come, Alberta's important capital plan will support borrowing requirements by about $6.5B per year on average while the shrinking deficits will require less financing (see table). Overall, the net debt-to-GDP ratio is expected to increase from 8.1% in FY 2018-19 to 13% in 2023-24. While trending up, it is very likely to remain the least indebted Canadian Province.

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Financing Needs ($B)	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Long-Term Borrowing Requirements	13.5	19.6					
Deficit (surplus)	8.0	6.9	7.9	7.1	5.3	2.9	-0.9
Capital Plan	9.0	6.6	6.4	6.8	7.1	6.4	5.6
Deficit + Capital Plan	17.0	13.5	14.3	13.9	12.4	9.3	4.7

Sources: Government of Alberta and Laurentian Bank Securities.

[2] We forecast US$67 WTI crude oil prices by year-end 2019 and 2020.