ECONOMIC RESEARCH AND STRATEGY

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Alberta 2nd Fiscal Update – Largest Surplus and Cash Rich Now but Recession could Prevent Further Improvement

The global energy access problem triggered by the war will lead to the largest fiscal surplus on record. This reality taken from a longer-term perspective is very important strategically, overshadowing by far the near-term fact that the $12.3B new surplus estimate (a gargantuan 2.6% of NGDP) is $0.9B below the previous First Quarter Update estimate. The main modification relates to the enhancement of inflation protective measures costing $1.3B (52% of the upward revision in spending) in FY 2022-23 and a cumulative $2.8B over three years. These measures include checks to families, utility rebates, re-indexation of benefit programs and tax brackets. Based on our provincial monitoring, we find that Quebec and Alberta redistribute a lot more than the ROC in terms of inflation protective initiatives. Overall, total expenses are projected at $64.6B, moderately above the First Quarter Update and 2022 Budget estimates. The 3-year outlook projects no further growth in expenses FY 2023-24 and FY 2024-25, signaling the intention of implementing tight fiscal discipline from the UCP government, which should solidify the province's credit ratings (Fitch: AA- stable; DBRS: AA low, positive trend; Moody's: Aa3, positive outlook; S&P: A+ stable).

Total revenues are revised up by a gentler $1.0B versus the First Quarter Update to $76.9B. Revenues are projected to fall near $70B annually in the following 2 years, based on the projected WTI pullback from US$92 per barrel in FY 2022-23 to about US$75 (US$1/bbl variation translates to a variation of $0.5B in revenue). These assumptions appear realistic. WTI prices are unambiguously extremely favorable, but WCS benchmark prices have been relatively less beneficial for Alberta. The WTI-WCS spread - of US$22 per barrel today - widened substantially this year due in part to the release of US strategic reserves and the sudden increase in Russian exports of high-sulphur fuel oil to Asia. The completion of the Trans Mountain pipeline expansion in late 2023 will contribute to narrow this WTI-WCS spread from an average US$19 in FY 2022-23 to US$17 over the next 2 years. Besides geopolitical developments, investors will have to monitor OPEC's supply reaction to the evolution of the global oil demand-supply market as 2023 unfolds. In addition, US production is also projected to reach a record high of 12M+ barrels next year even if the pace of growth from shale producers slows.

The modest $1B upward revision to total revenues hides larger swings within various categories. For instance, with poor returns from financial markets, investment income from the Heritage and endowment funds is forecast to be down $2.2B relative to the budget. Fortunately, this loss is entirely covered up by a rise in corporate income taxes, projected to reach a record high of $6.3B. And contrary to other provinces, personal income tax revenue is not largely over budget due in part to the indexation of the personal income tax brackets.

Awash in cash with the large $12.3B surplus this year and the projection of sizeable annual surpluses of nearly $5B in FY 2023-24 and FY 2024-25, Alberta will dedicate large amounts to debt repayment and to a lesser extent savings. For instance, debt repayments are projected at $13.4B this year, $2.3B in FY 2023-24 and $1.4B in FY 2024-25. The government also has $5.8B in cash available this year alone. This amount will eventually be dedicated to one of the following options in our view: additional inflation protective measures, future debt reduction, cover unexpected downside events on the revenue side. The consequence of all this is that Alberta will tap the bond market less frequently. FY 2022-23 borrowing requirements are cut by almost two-thirds from $3.5B to $1.4B, entirely for the financing of Government Business Enterprises (including ATB Financial and Alberta Gaming, Liquor and Cannabis Commission). Alberta has borrowed almost $1.2B year-to-date, which could open the doors for pre-financing activity during the remaining of FY 2023-24. Borrowing requirements are projected at a very low $0.875B next year before a rebound to $3.75B in FY 2024-25. All in all, the debt is projected at $79.8B at the end of the current fiscal year, at 9.9% of NGDP.

In summary, a great near term fiscal improvement thanks mostly to nominal GDP soaring at an annual pace of 20%+ for a second year in a row. Large surpluses are projected going forward. However, risks to the outlook are titled to the downside in our view. This fiscal update is founded on a base case scenario including solid real GDP growth expectations of 2.7% and 2.9% in 2023 and 2024, respectively, and a lower nominal GDP growth basis of 1.7% and 2.2%. If a recession occurs, real GDP should come in closer to 0% next year while nominal GDP should fall. Over the next three years, the government projections on real GDP and employment annual growth are on average 1% greater than private sector average forecasts, while the nominal GDP assumptions are very close to the private sector average. The global economic environment, and near-term fiscal trends on both revenue and spending sides, could be materially different when the next provincial general election is held on May 29th, 2023.

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