

ECONOMIC RESEARCH AND STRATEGY



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Alberta 1st Quarter Fiscal Update – Significant Surplus to Pay Down Debt and Save for the Future

Alberta's public finances improved due to the global geopolitics of energy according to [the 1st Quarter Fiscal Update](#). The projection of record-breaking resource revenues of \$28B for the current FY 2022-23 underpins what could become the highest fiscal surplus in dollar terms in the Province's history. At \$13.2B, the projected surplus compares to the 2022 budget surplus forecast of \$0.5B. \$13.2B represents 3.1% of nominal GDP, shy of the 3.8%-3.9% figures registered during the mid-2000s decade. In contrast to these old days when Premier Ralph Klein sent big "prosperity" checks to every single individual, markets will notice today's preference for fiscal responsibility. Indeed, the UCP government says surplus cash will go mostly to short- and long-term debt issuance reduction. The remaining will be dedicated to the Heritage Fund, Alberta's main long-term savings fund.

Total borrowing requirements are projected to fall from \$3.5B to \$1.2B in FY 2022-23. Short-term money market borrowing falls from \$0.8B to zero. Put simply, the large surplus cash position eliminates the need to borrow on money markets, something the province usually does to make short-term loans to provincial corporations. Long-term debt issuance declines from \$2.6B to \$1.1B. Some bonds maturing will not need to be rolled over. According to the 1st Quarter Fiscal Update, the government already paid off \$1.9B in debt during the April to June period and plans to pay down \$8.1B during the July-September. Debt maturities of \$5.1B are coming between September and March 2023, led by the larger amount of \$1.7B in September. When we look further away, debt maturities stand at \$6.7B in FY 2023-24 and \$5.5B in FY 2024-25.

Second, the [Heritage Fund](#) could record the largest one-year increase in history. The \$2.9B intended boost will come from a dedication of surplus cash (\$1.7B) and potential investment income of \$1.2B. The book value of the fund, composed of 48% in equities, 33% in inflation sensitive/alternative assets and 20% in fixed income, could increase to \$20B at the end of FY 2022-23, the equivalent of 5% of nominal GDP and 26% of total revenues.

Projection of total expenses did not materially change, edging up from \$52B in the 2022 budget to \$53B. In contrast, total revenues are revised up by \$13B to \$76B, led by the \$14B upward revision to resource revenues suddenly making one-third of all revenues. Due to the high inflation environment, the government announces a re-indexation of tax brackets effective this year, a measure costing only \$0.3B and giving a benefit of \$300 for the average income earner. The record-high resource revenue projection of \$28B reflects higher production relative to previous periods when WTI oil also stood at very high levels. In addition, the weaker Canadian dollar today versus the 2011-14 and 2005-07



period contributes positively to the cash flow windfall of energy companies selling in USD. The 1st Quarter Update assumption for the CADUSD stands 77 cents for FY 2022-23.

[Total oil production in Alberta](#) is up modestly year-to-date (+2.4%), reflecting a softening in oil sands output and a surge in conventional production. The International Energy Agency projects a pale 1.1% increase for global oil supply in both 2022 and 2023. Investors will have to monitor global developments that could lead to lower or higher oil prices relative to the 1st Quarter Update WTI assumption of US\$92.50/bbl for FY 2022-23. In comparison, the budget 2022 projection was US\$70/bbl and Saskatchewan's assumption used in last week's fiscal update is US\$5 higher. A deeper fading in global economic momentum could lead to lower oil demand and prices. On the supply side, a potential new Iran deal could increase supply although OPEC members hint at new output cuts. Various estimates of Iranian oil sitting in storage tankers and vessels range between one full day and half-a-day of global consumption. Also, if the current pace of drawdown continues, US Strategic Oil Reserves could be depleted in about one year. Of course, the energy short-term picture from Alberta's standpoint is not perfect. [Total natural gas production](#) in Alberta increased to one of its highest levels lately but remains significantly lower than 10-15 years ago, thus not contributing as before to the Province's fiscal coffers. Also, high natural gas prices lead to higher refining costs for heavy crude, widening the gap of WCS versus WTI.

In the separate 2022Q2 Canadian GDP report released Tuesday, Statistics Canada mentioned the solid increase in business capital investment was notably tied to oil & gas investment in Alberta. This being said, Alberta's economic recent strengthening is more than an oil-income boost story. Recent discussions between our economic team and stakeholders in the mortgage market indicate capital chasing returns on investment is moving into the Alberta housing market. Thus, we see the recent return of housing starts to the 40K annualized clip for the first time since 2014-15 as sustainable. Alberta is also, unsurprisingly, home of tighter resale housing conditions relative to other provinces, led by an elevated 0.6 sales-to-listings ratio. For the first time since 2014, Alberta's unemployment rate of 4.8% is below Ontario (5.3%) and almost matches BC (4.7%). The 2022 crop season is definitively better than a year ago and the Province cites in the 1st Quarter Update improvements in services and tourism sectors.

In summary, the Russian invasion of Ukraine brings energy security to the forefront and lead to impressive short-term financial benefits for the Province of Alberta. The 1st Quarter Fiscal Update's breakdown of financial assets and liabilities ultimately trickles down to a \$13B positive net asset position for FY 2022-23. Beside the good news story in the near term, the main challenge remains the Province's adaptation to the global long term energy transition and net zero CO2 objectives. The Province continues to prepare for a lower emission future, notably publishing the [Hydrogen Roadmap](#) last year. The idea is to use large natural gas reserves combined with emissions capture technology to make blue hydrogen. Clearly not ecofriendly relative to green hydrogen, some research goes further and stipulates blue hydrogen's carbon footprint is worse than natural gas. Other critics say green hydrogen is too expensive and less reliable due to the utilization of wind and solar, although a growing number of companies and countries have announced large green hydrogen investments in recent months.

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