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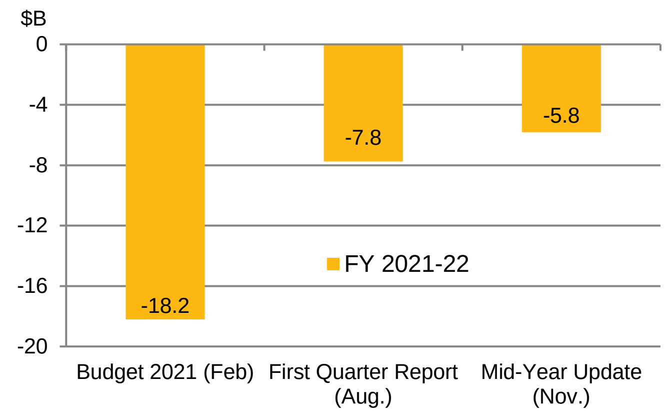
Alberta Mid-Year Update: The Cyclical Upswing Continues

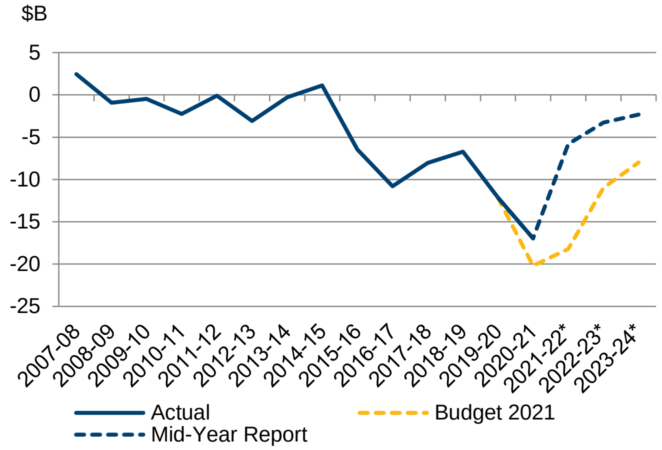
Alberta presented on November 30th its Mid-Year update. Stronger nominal GDP propelled by commodity prices leads to another revision to this year's estimated budget shortfall. After cutting its deficit forecast by more than half in the August report, the government now projects a modest $5.8B shortfall for FY 2021-22 (1.7% of GDP; chart 1). The $1.9B Mid-Year downward revision to the deficit reflects a broad-based $2.9B increase in revenue, partly offset by $1.0B in additional spending.

Chart 1: Alberta Budgetary Balance Forecast



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

Chart 2: Alberta Budgetary Balance Forecast



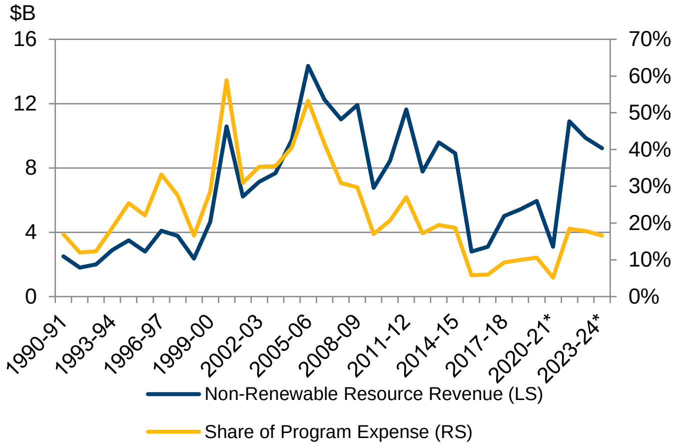
Source: Alberta Government and LBS Econ. Res. and Strategy.

Royalties hit a decade-high

First, like other provinces such as Ontario, BC and Saskatchewan, 2020 tax assessments grow the tax base, boosting FY 2021-22 taxation revenues. Somewhat stronger-than-expected nominal GDP growth in 2021, from 15.7% to 18.1%, also increases taxation income. Overall, Alberta's own-source revenue excluding royalties and federal transfers are up $2.1B relative to the First Quarter Report, reaching $35.6B. Second, this fall's bull market in oil prices also benefited the province. The Ministry of Finance expects WTI oil prices to average US$71/bbl in FY 2021-22, US$5 more than in the First Quarter Update and US$25 more than in the February budget. As a result, Alberta now projects bitumen royalties to reach $7.6B this fiscal year, $600M more than the September report and $6.1B more than in the budget. Other royalties, including crude oil and natural gas, approximately provide another $600M revenue boost.

Total royalties to the province are expected to reach a decade-high of $10.9B in FY 2021-22, more than when a barrel of oil still sold for more than US$100 in 2013 and 2014 (chart 3). On top of rising prices, oil production has gone up 9% year-to-date. The Canadian Association of Petroleum Producers also mentioned through media that higher prices have brought forward more oil sands projects into "payout mode", a phase in which royalty rates generally increase from 1-9% of gross revenue to 25-40% of net revenue.

Chart 3: Alberta Ressource Revenue



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

Investors should consider that the province elaborated oil forecasts before the apparition of the Omicron variant tanked oil prices from US$74/bbl a week ago to US$65/bbl as of writing. This poses a threat to the 2022 oil outlook and could very well generate more volatility in Alberta's own source-revenue. Fortunately, the province already embedded lower oil prices of US$64/bbl in both 2022 and 2023 in its fiscal framework, assuming the current global demand-supply imbalance will not last. If risk-off sentiment takes place next year, a lower Canadian dollar would provide an additional natural hedge.

On the expenditure side, severe droughts this summer will increase claims on the agriculture support fund and the AgriRecovery fund. The government plans $2.1B for emergency and disaster assistance, $1.4B going to agriculture and the remaining $0.5B to be allocated. Regarding program expenditure, fiscal discipline continues to prevail. Expenditures excluding provisions and COVID-19 recovery expenses are broadly unchanged from both Budget 2021 and the First Quarter Report, at $57.3B.

Medium-term fiscal outlook indicates further improvement

This year's fiscal framework represents a drastic change relative to last year. Indeed, at 5.8% of GDP, the FY 2020-21 deficit ended up the biggest among provinces. At 1.7% of GDP, this year's shortfall is lower than in Saskatchewan (3.1%) Ontario (2.2%), Manitoba (1.9%) and similar to BC (1.7%). Accordingly, the government revised down its borrowing program to $12B, from $17B in the First Quarter Report. To date, 36% of that program has been completed.

Balanced budget in sight?

In its February 2020 budget released just before the pandemic, the UCP government aimed at resorbing the deficit by FY 2022-23. Because of this year's commodity boost, total revenues have exceeded Budget 2020 forecasts. Elevated COVID-19 spending and provisions for natural disasters have delayed the government's medium-term balanced budget objective. Going forward, the government projects a reduction in base program expenditures. At term, this is expected to help generating a $2.3B deficit in FY 2023-24, down from an $8B forecast in Budget 2021 (chart 2). At 0.6% of GDP, this relatively small shortfall places within sight a balanced budget.

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