ECONOMIC RESEARCH AND STRATEGY

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Alberta Budget 2024

The Ups and Downs of Oil Continue, Very Responsible Management of Public Finances

The cornerstone of Alberta's fiscal path was laid out last week by Premier Danielle Smith: 1) lower oil revenue; 2) prepare for spending restraint; and 3) save today's oil revenues for the future. The 2024 Budget shed details on these three aspects and more.

The title of the budget, "A Responsible Plan for a Growing Province", is very suitable. To begin with, the FY 2023-24 large surplus of $5.2B will be dedicated to debt repayment ($3.2B) and the Heritage Fund (+$2B, bringing it to $21B). This is the reward from the new fiscal framework introduced a year ago in Budget 2023. Without it, the surplus would have been redirected to general revenues as Finance Minister Nate Horner explained during his press conference (and implicitly increasing the risk of implementing recurrent operating spending).

Small surpluses of $0.4B, $1.4B and $2.6B are projected over the next three years. These could evaporate despite the annual $2B contingency cushion, or they could excessively surpass expectations, depending first and foremost on oil market conditions. With Alberta oil production at an all-time high, the fiscal sensitivity to oil developments is equally elevated. WTI crude oil prices are projected at US$74 bbl, assumed in FY 2024-25 and beyond, lower than during the last three years as global oil supply is poised to grow faster than demand (a US$1 variation in WTI over one year swings the budgetary balance by $0.6B).

There have been growing market talks lately about the upcoming completion of the Trans Mountain pipeline (TMX). After the beginning of filling the TMX, the first export of oil to Asia and global markets utilizing TMX is expected to begin at some point this year, perhaps in the second quarter. Budget 2024 is based on further narrowing of the WTI-WCS spread to US$13.60 in FY 2026-27, versus the peak of almost US$21 reached in FY 2022-23. This improvement will contribute to stabilizing total fiscal revenues in years 2 and 3 of the 3-year fiscal outlook (similar to WTI prices, a $US1 fluctuation of the light-heavy WTI-WCS differential had a net fiscal impact of $0.6B). Furthermore, the production phase of LNG Canada in Kitimat BC is expected to support Alberta's natural gas market prices, another positive development that should not be overlooked. Both natural gas and oil domestic production are assumed to edge up in coming years.

One headwind to oil royalties is the assumption of a moderate appreciation of the CADUSD, from 74 cents in FY 2023-24 to almost 80 cents in FY 2026-27 (a one cent appreciation on the CADUSD during a full year translates into a $0.5B negative fiscal impact).

Altogether, Budget 2024 exposes a second consecutive annual decline in total revenues in FY 2024-25, followed by a moderate rebound. With the government of Alberta collecting less revenues than before and operating expenses projected to increase by 3.9%, the FY 2023-24 surplus of $5.2B is almost wiped out instantly. The plan is to soften program spending further after FY 2024-25 to about 2.2% annually, close to half the combination of population growth and CPI inflation. One risk relates to current public sector contracts ending soon. New wage deals could lift the trajectory of the spending path. The United Nurses of Alberta are notably asking for double-digit annual growth in wages.

The other responsible adjustment to the ongoing decline in total revenues relates to the delay of personal income tax cuts. The new 8% bracket on income under $60K will be phased-out over two years, beginning in 2026, as long as the province is on track to avoid deficit territory. Another key responsible feature of Budget 2024 relates to additional efforts to save today's oil revenues to finance future expenses, in other words, sharing the wealth with future generations. Without planning to get to Norway's supersized Wealth Fund of US$1.5T, the Alberta government wants to grow the asset side of its balance sheet by increasing the size of the Heritage Fund from $21B today to $26.5B over 3 years.

On top of oil money piling to the Heritage Fund, the Province plans to maintain an active presence in respect to long-term bond issuance. After tapping the bond market by $4.5B in FY 2023-24, borrowing requirements are projected to increase materially in FY 2024-25 (to $17.7B) for two reasons: First, the Province appropriately reports small surpluses on an accounting basis. However, the Province is short on a cash basis in upcoming years, as the government notably plans to put $2B in the Heritage Fund and $2.3B toward capital spending. Accordingly, this net negative cash balance, higher than $2B annually, will lead to additional long-term borrowing. Second, the Province wants to borrow in advance of the larger-than-usual maturities coming up in mid-2025, five years after the pandemic temporarily froze access to financial markets. As mentioned in the budget: "Between June 2024 and June 2025, $16.7B of the Province's bonds will mature and will need to be refinanced. $10.9B of this debt matures between April and June of 2025." In addition, while long-term debt issuance is poised to soar, the Province plans to significantly reduce money market borrowing from $9.3B in FY 2023-24 to $2B in FY 2024-25.

In summary, the 2024 Alberta budget could be the most fiscally responsible of the entire Canadian budget season, although it is still too early to tell with only BC, NS, and PEI fiscal documents out so far. This fiscal responsibility is justified by high revenue volatility. Geopolitics, global economics, and climate shocks could alter Alberta's revenue outlook quickly. Just in FY 2023-24, drought-related wildfire and agriculture disaster expense came in at $2.9B, more than the annual surpluses or the $2B contingency cushion projected going forward. For bond investors, the biggest news clearly relates to the intent of pre-borrowing a lot more in FY 2024-25 as a proactive move ahead of the large bond maturities arriving near mid-2025.

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