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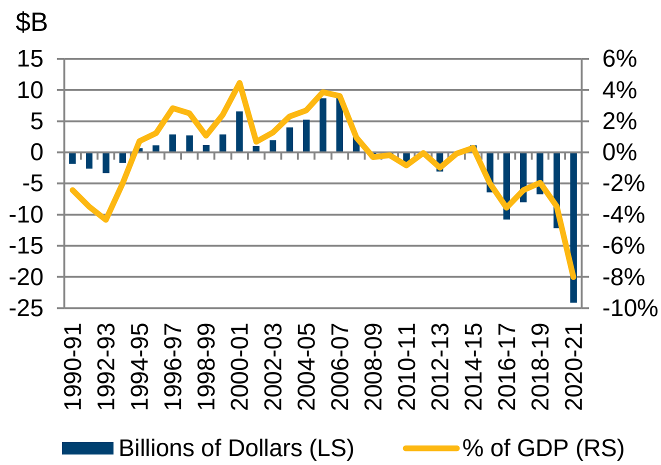
Alberta First Quarter Update – "Double Whammy"

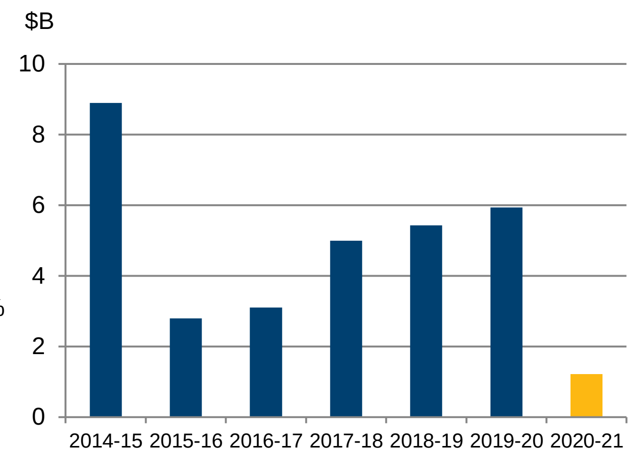
During a news conference on Tuesday, Alberta Premier Jason Kenney warned that the province had been hit by a "double whammy": depressed energy prices and a global recession triggered by Covid-19. The First Quarter Fiscal Update presented today quantifies the extent of the damage and updates the February budget framework, delivered before the pandemic. Alberta faces its largest deficit on record in dollar terms at $24.2B, $16.8B more than anticipated at the time of Budget 2020. As a share of GDP (-8.0%), it represents the largest figure since at least the early 1990s, before Premier Ralph Klein's era (chart 1).

Chart 1: Alberta Budgetary Balance



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

Chart 2: Non-Renewable Resource Revenue



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

Oil collapse lead to record drop in revenue

Similar to many provinces, the brunt of the fiscal impact comes from the revenue side of the ledger. Total revenues were revised down a staggering $11.5B or 23.1% relative to budget expectations. Lower income tax revenue explains nearly 40% of this revision. The government expects nominal GDP to plunge 13.9% this year, in contrast to the 2.8% positive growth figure used last February (we pegged Alberta's nominal GDP growth in 2020 at -12.8% in our most recent provincial forecasts). Particularly, both oil prices and crude production have been significantly revised down for FY 2020-21. The government forecasts WTI oil prices to average US$36/bbl, US$22 less than in the budget. Crude production is poised to drop 13% during the same period. As a result, the province estimates non-renewable resource revenue at only $1.2B (chart 2), about a quarter of the intake expected last February. $1.2B corresponds to the lowest level of non-renewable resource revenue since the early 1970s according to the First Quarter document. One positive development consists of the tighter WTI-WCS spread observed since the beginning of this year. Indeed, the Province's pipeline capacity proved sufficient to meet refining demand. Also, US oil producers reduced their output. At US12.50$, the WTI-WCS price differential forecast is US$6.60 lower than in the February budget.

Covid-19 forces upward revisions to operating expenses

Prior to the pandemic, the UCP government's fiscal plan relied on a 2.0% contraction in total expenditures in FY 2020-21 in order to achieve a balanced budget in FY 2022-23. However, Covid-19 derailed this plan since public health spending was rightfully prioritized. The government's response plan includes $3.0B in operating expenses (financial support to businesses and individuals, health care and long-term care), $0.6B for the acquisition of personal protective equipment and $0.6B in capital grants for municipalities. Total expenditures now amount to $62.6B, a 9.3% increase relative to Budget.

Borrowing requirements almost doubling from budget

All in all, the sizeable deficit and capital plan will lead the Province to borrow $30.0B this year, up from the $17.1B estimate of last February and three times the size of last year's $9.2B borrowings.

In light of this challenging financial situation, the First Quarter document includes a section advocating for the removal of the $60 per capita cap on the federal Fiscal Stabilization Program. Without this cap arbitrary implemented in 1987, Alberta would receive $3.7B more in federal transfers in FY 2020-21. Investors will need to keep an eye on future discussions relative to federal-provincial assistance. This being said, the First Quarter update included additional support from Ottawa: federal transfers were revised up by $846M to $10B, including amounts from the Safe Restart Agreement, the Carbon Economic Leadership Fund and the Site Rehabilitation Program.

Finally, the provincial government has also implemented policies to improve economic potential over time. The corporate tax rate was cut from 10% to 8% effective on July 1st. This measure, along with new financial incentives for tech companies, is expected to foster innovation, new investment and job creation. The large $10B capital plan will also support the recovery.

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