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Relative fiscal discipline on display

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Highlights

At a time when many provinces are running deficits and accumulating debt, Alberta's fresh fiscal plan is comparatively conservative. There's always potential economic and fiscal uncertainty here, given Alberta's reduced reliance on federal transfers and the long-standing leverage to natural resources (which account for an important share of the revenue dollar). With a weaker global economic backdrop likely to keep a lid on energy prices, a smaller budget surplus is in store. But there's a desire to stay on a balanced path, thereby limiting debt accumulation. It's an approach that differs from what we've seen in other 2024 provincial budgets, when new spending commitments can mean large(r) shortfalls. After notching a surplus of more than $5 billion in 2023-24, Alberta is projecting a relatively narrow surplus of $400 million for 2024-25, where $2 billion of contingencies have been set aside. The coming year's budget projections are based on an average WTI price of US$74.00/bbl, with the corresponding light-heavy differential pegged at US$16.00/bbl on a fiscal year basis. Overall, surpluses have been marked down vs. prior guidance, but the province's net debt load is to remain contained. Net debt is already less than 10% of GDP, with Alberta's interest bite looking equally favourable relative to the provincial average. Surplus cash is being channelled to the Heritage Fund, a plan to aggressively build up this vital Fund to follow. Seemingly at odds with the balance budget, Alberta's stated gross borrowing requirement is jumping up to $19.8 billion for 2024-25, but that's inclusive of almost $12 billion in pre-financing of debt due to mature in 2025-26. Essentially getting more of those maturities out of the way earlier means a temporary boost in bond issuance, to be followed by a much more restrained pace of issuance in 2025-26 and beyond.

- Economic outlook – Alberta's economy enjoyed a major boost in 2023, with its population growing by 4.1% compared with the previous year. This was the strongest demographic growth of any Canadian province, and the largest recorded in the province since 1981. As a result, real GDP in Alberta is estimated to have grown by 2.5% in 2023, more than double the increase seen nationally, despite oil production growing only marginally and natural gas production remaining stable compared to 2022. However, nominal GDP has in contrast fallen by 4.1% in 2023, undermined by a fall in the oil price and the price of natural gas, which has more than halved. It should also be noted that the labour market is performing well, with the number of jobs increasing by 3.6% on average in 2023, the second-highest growth rate of all the provinces (after PEI). However, this pace has not been sufficient to fully absorb the strong population growth, with the unemployment rate rising from 6.0% in January 2023 to 6.2% in January 2024. Looking ahead, the Budget 2024 is based on real GDP growth of 2.9% in 2024, as future interest rate cuts stimulate consumption and investment despite slower population growth and little increase in oil and gas production. This growth rate seems particularly optimistic since it is more than twice as high as the average private sector forecast of 1.3%. Real GDP should then grow by 3.3% in 2025 (also very optimistic compared with the 2.4% expected by the private sector average), 2.8% in 2026 and 2.6% in 2027 (similar to the consensus). In terms of nominal GDP, which has a greater impact on public finances, the Budget forecasts an increase of 3.5% in 2024 (in line with the average forecast), driven by robust wage increases and a smaller light-heavy differential despite the expectation of a slight decrease in oil prices and a moderate recovery in natural gas prices. Nominal GDP should then grow by 6.1% in 2025 (vs. 4.6 for the average of private sector forecast), 5.5% in 2026 and 4.9% in 2027 (similar to the consensus). Regarding the labour market, job creation is expected to slow to 3.0% in 2024, pushing the unemployment rate up from an average of 5.9% in 2023 to 6.5% in 2024. The unemployment rate should then start to fall again over the next few years, settling at 6.0% in 2025, 5.8% in 2026 and 5.6% in 2027.
- Outgoing year budget balance (2023-24) – There's still a month left in this fiscal year but it's clear that Alberta is going to end up running a surplus for a third straight year in 2023-24. Technically, the $5.2 billion (1.2% of GDP) estimated for this outgoing year is off a touch from the $5.6 billion (1.3% of GDP) surplus that was pencilled into November's mid-year update, as expense growth (+2.5%) outpaced revenue growth (+1.8%). Still, this latest tally is much better than the $2.4 billion surplus that was originally budgeted a year ago (that's true even if you exclude the contingency that had been budgeted). What's the source of the beat versus last year's budget? Not surprisingly, it's from beefier revenues which came in 7% above plan. Personal income taxes, corporate taxes, recourse revenues (i.e., bitumen royalties) and investment income were the biggest contributors. Spending was also above budget (+5.4%) due largely to wildfire and agriculture disaster assistance.
- Medium-term fiscal outlook (2024-25 & beyond) – An assumed moderation in oil prices is expected to yield lower resource revenues which, given this item's sizeable share in the overall revenue pie (~25%), means total receipts are expected to decline in 2024-25. Still, the nearly 3% drop in revenues won't be enough to push the province into red ink. While there will be pressure on operating expenses in 2024-25, the removal of a $2.9 billion line item– wildfire and agriculture disaster assistance–means total expense growth will be contained to just over 1%. That should leave a narrow $400 million surplus (0.1% of GDP). A $2 billion contingency offers some additional wiggle room for this estimate.

Further out the horizon, the black ink streak is expected to continue. A $1.4 billion (0.3% of GDP) surplus has been pencilled in for 2025-26 and that's expected to grow to $2.6 billion (0.5% of GDP) in the following fiscal year. Throughout the forecast horizon, a $2 billion contingency has been set aside to provide insulation for what can be a volatile revenue stream. To be clear, budget balances over the medium term are a bit skinnier than outlined in earlier updates. The $1.8 billion combined surplus for the next two years (i.e., 2024-25 and 2025-26) is down from the $5.0 billion guidance provided in the mid-year update and $3.4 billion below Budget 2023 estimates. That's partially attributable to lower oil prices that have been marked down.

Beyond the expected revenue drop in the coming fiscal year, receipts are expected to pick back up, rising an average of 3.5% in 2025-26 and 2026-27. That's more to do with income tax growth as non-renewable resource receipts grow more modestly in the budget plan. Stronger revenues aren't the only factor driving the surplus growth out the horizon. While there's a non-trivial jump in operating expenses in 2024-25 (+3.9%), that's set to moderate in future years. Indeed, the 2.2% annual expense growth may well end up being on the more restrained end of the spectrum given the cost-of-living pressures that many governments are feeling compelled to address with new spending initiatives and/or tax relief.

- Energy price assumptions & related sensitivities – Crude oil prices were weaker than the budget planning assumption during 2023-24 (US$79/bbl vs. US$76.50/bbl). For the coming fiscal year (2024-25), WTI is assumed to average US$74/bbl. (The prompt WTI contract closed a bit above US$78.3/bbl on budget day.) The average WTI price is then expected to remain stable until 2026-27. As for the light-heavy price differential—always an important consideration in Alberta—the province assumes US$16.00/bbl for fiscal 2024-25, $2.3 per barrel narrower than the previous year thanks to reduced supply due to a larger-than normal seasonal maintenance by oil sands facilities in spring/summer and stronger US refinery and global demand for heavier crudes over the summer months. The light-heavy differential should continue to narrow, reaching US$13.60/bbl in 2026-2027, thanks in notably to the opening of the TMX pipeline in the second half of 2024. Official sensitivities, which must be interpreted with caution, suggest that each US$1/bbl change in WTI could have an annualized fiscal impact of $630 million, while a US$1/bbl change in the light-heavy differential could be worth $600 million, *all else equal*. These official sensitivities have stepped up in recent years, reflecting (in part) the fact that more oil projects are in the post-payout phase. It makes Alberta's budget even more sensitive to a given swing in crude oil prices. As always, it's important to control for the interplay between oil prices and the Canadian dollar exchange rate. Higher US$ oil prices boost the royalty outlook, but each one cent appreciation in the loonie has a negative fiscal/translational impact of $490 million, *ceteris paribus*. Moving on, natural gas price assumptions call for an improvement from the low levels of 2023-24, with the Alberta benchmark price expected to average C$2.9/GJ in 2024-25. A 10-cent change in the average natural gas price is worth a comparatively modest $10 million to the government.

- Debt outlook – After peaking in 2020-21, Alberta has worked down/repaid no small amount of debt. And while the majority of provinces slipped back into deficit in 2023-24, Alberta stayed in the black, allowing for another year of debt repayment. As per the fresh fiscal framework, net debt is estimated to have fallen $4.7 billion in 2023-24 to $40.9 billion. That would bring the three-year cumulative net debt reduction to $18.6 billion vs. 2020-21's peak. For the outgoing fiscal year, the relative debt load works out to less than 10% of GDP (9.3% to be precise), which stands in marked contrast to a weighted provincial average of roughly 30%. Continued budget surpluses should keep Alberta's balance sheet in relatively healthy shape, net debt expected to decline as a share of provincial output each year through 2026-27 (when the net debt ratio should be a comparatively light 7.7% of GDP). Given the relatively low debt burden (by provincial standards), it follows that Alberta's 'interest bite' is more of a 'nibble', debt servicing costs set to consume an average of 4.2% of total revenue over the coming three fiscal years.

  Note that Alberta's 'responsible fiscal management' guidelines require no less than one half of surplus cash to be earmarked to debt repayment. The balance can be invested in the Heritage Fund or spent on one-time items (that require no ongoing funding). Note that the Heritage Fund is an important aspect of Alberta's relative financial/balance sheet advantage vs. provincial peers. Factoring in the continued retention of investment income and the allocation of surplus cash, the year-end balance of the Heritage Fund and other endowment funds looks to breach $26 billion by 2024-25—equivalent to roughly one third of annual revenue or ~15% of GDP. As it relates to the Heritage Fund specifically, Alberta aims to develop a plan to grow this key Fund to between $250-400 billion by 2050—at least a 10-fold increase from current levels. Stay tuned for details.

- Borrowing requirement – There's some important nuance when it comes to interpreting Alberta's borrowing program, so bear with us. Starting in 2023-24, Alberta moved to borrow in advance of its immediate cash needs. (Note that the government's own net financial requirements are relatively contained given continued operational surpluses.) Really, what you see in the updated borrowing table, is a province keen to proactively refinance some sizeable maturities. Recall that considerable debt was taken on at the height of the pandemic, where financial market jitters forced more issuance down the curve (compared to the long(er) terms provinces have historically favoured).

  Officially then, Alberta's total borrowing requirement for 2024-25 is listed as $19.8 billion. But that's inclusive of $11.6 billion of pre-borrowing for debt maturities coming up in 2025-26 (this pre-funding averaging a bit under $3 billion/quarter). It's expected that $2 billion of the total requirement will be sourced from the money market and little bit secured via P3s. That leaves a gross bond program of $17.7 billion or nearly four times what was printed in 2023-24 ($4.5 billion). Strip out the planned pre-financing of 2025-26 maturities and the province's underlying bond requirement looks to reside at the low end of the provincial spectrum when scaled to revenue or population.

In meeting its temporarily increased bond requirement, the focus remains on the development of liquid domestic benchmarks. International funding will be considered if cost savings can be demonstrated. It's expected that the above-noted pre-financing will allow Alberta to better normalize its maturity profile, with related cash to be invested in high quality bonds on a matched-maturity basis. Strictly speaking, bringing more borrowing into 2024-25 will boost total debt outstanding, but would be a wash on a net debt basis, since more financial assets would be steered to a debt retirement fund. Extra debt service costs would likewise be mitigated by incremental investment income (i.e., interest on the invested cash).

Overall, this proactive pre-financing strategy positions Alberta as a relatively frequent issuer for 2024-25. But to the extent the planned pre-financing is carried out, bond requirements would fall appreciably (i.e., normalize) starting in 2025-26. As per the budget, the $17.7 billion in gross bond issuance for the coming fiscal year is to be followed by just $2.9 billion in 2025-26 and $6.5 billion come 2026-27. And at the risk of repeating ourselves, pre-financing should never be confused with the legitimate funding of budgetary shortfalls or outsized capital plans. Budget surpluses are rare these days, with Alberta's projected fiscal and financial track comparing favourably to most provinces. Notwithstanding an uncertain outlook, there's simply more fiscal discipline (and debt containment) on display here than in certain other peers.

- **Current long-term credit ratings** – S&P: AA-, Stable | Moody's: Aa2, Stable | DBRS: AA, Stable | Fitch: AA-, Positive
  [Refer to our Provincial Ratings Snapshot for additional colour on specific credit rating drivers/considerations]

Alberta

(millions of dollars)
CONSOLIDATED FINANCIAL STATEMENT BASIS

	Budget 2023-24	Estimate 2023-24	Budget 2024-25	Target 2025-26	Target 2026-27
Revenue	**70,653**	**75,628**	**73,537**	**76,051**	**78,816**
Personal income tax	14,069	15,239	15,604	16,514	17,512
Corporate income tax	5,911	7,204	7,028	7,052	7,320
Other taxes	5,012	4,470	6,013	6,329	6,535
Resource revenue - Bitumen royalties	12,555	14,367	12,538	12,857	12,888
Resource revenue - other	5,806	5,049	4,777	4,982	5,051
Transfers from the Government of Canada	12,552	12,656	12,640	13,161	13,644
Investment income	3,154	4,467	3,267	3,433	3,672
Net Income from Government Business Enterprises	2,727	2,526	2,123	2,200	2,481
Premiums, Fees and Licences	5,040	5,300	5,384	5,551	5,752
Other	3,827	4,349	4,164	3,973	3,960
Expenses	**68,303**	**70,394**	**73,170**	**74,614**	**76,176**
Operating expense	57,038	57,876	60,124	61,595	62,798
Capital grants	2,821	2,375	3,469	3,576	3,863
Amortization / inventory consumption / loss on disposals	4,418	4,419	4,576	4,695	4,720
Debt servicing costs	2,848	3,136	3,365	3,121	3,174
Pension provisions	(322)	(358)	(364)	(373)	(378)
Surplus (Deficit) before contingency / disaster assistance	66,803	67,448	71,170	72,614	74,177
Contingency / disaster and emergency assistance	1,500	2,946	2,000	2,000	2,000
Surplus (Deficit)	**2,350**	**5,234**	**367**	**1,437**	**2,640**
Financial assets	71,851	90,102	96,651	89,858	93,106
Pension liabilities	7,838	7,914	7,550	7,177	6,799
Direct borrowing for capital projects	42,829	42,530	44,933	47,629	49,756
Other taxpayer supported debt	35,463	33,536	33,445	33,348	33,246
Liabilities of self-supporting lending organizations	17,660	17,915	17,966	18,102	18,055
Other liabilities	14,566	29,106	34,373	24,800	24,468
Net financial assets	**(46,505)**	**(40,899)**	**(41,616)**	**(41,198)**	**(39,218)**
Non financial assets (net of amortization)	61,197	61,294	62,396	63,407	64,055
Deferred capital contributions	(3,844)	(3,847)	(3,865)	(3,857)	(3,845)
Net assets (variation equals surplus (deficit))	**10,848**	**16,548**	**16,915**	**18,352**	**20,992**
Borrowing requirements	**6,666**	**10,768**	**8,200**	**4,376**	**8,012**
Government	5,464	7,330	7,289	3,571	6,853
Provincial corporations	469	525	503	455	459
Government business enterprises	733	2,913	408	350	700
Borrowing sources					
Money market (net change)	-	9,279	2,000	1,500	1,500
Public-private partnerships	64	-	120	-	-
Term debt	6,602	4,489	17,680	2,876	6,512

Source: Government of Alberta, 2024 budget

NATIONAL BANK OF CANADA FINANCIAL MARKETS

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