BUDGET ANALYSIS

Alberta: Mid-year Fiscal Update 2023

Holding the Line on Spending as Oil Prices, Population Boom Fill Coffers

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HIGHLIGHTS

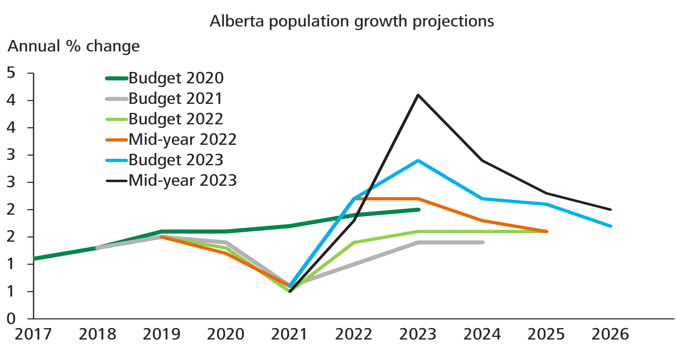
- Alberta's Mid-year Fiscal Update and Economic Statement for fiscal year 2023–24 (FY2024) increased surplus projections for the next three fiscal years. The headliner is a hefty $5.5B surplus in FY2024, more than double the amount previously assumed.
- The province now anticipates that its net debt burden will fall from 9% of GDP this year to 7.5% by FY2026, still far and away the lowest rate of any province. Table 1 on page 2 summarizes key fiscal indicators.
- Forecasts are prudent. Oil price projections on which the plan is based are reasonably conservative, which is appropriate given the present uncertainty about global growth and the province's historic fiscal sensitivity to crude values. Contingencies of $1.5B per year remain in place beyond FY2024.
- New operating spending was incremental—in line with previously outlined spending caps—and a personal income tax cut promised during this year's provincial election campaign is not going ahead at this time.
- Overall, while the global economic backdrop remains uncertain, barring a severe downturn, Alberta's economy and public finances still look likely to avoid the worst.

The Population Boom Is Expected to Persist, Supporting Stronger Revenues

We've noted the strength of Alberta's population gains in many previous reports, and those gains are expected to persist and power stronger tax receipts than predicted in the 2023 budget. The government now expects headcount advances of close to 3% in 2024 and almost 2.5% in 2025. That builds on the surge of more than 4% that was already signalled for 2023 in the Q1 update (graph 1), a rate that would be the strongest since the 1980s. With support from population growth, associated labour market gains, and favourable 2022 tax assessments, personal income tax revenues are now on track to exceed the prior targets by a combined $1.7B over the next three years.

Stronger population forecasts are in line with our own view. We think Alberta's economy stands to benefit from immigration, migration from other provinces, natural population growth and

GRAPH 1
Successive Increases to Population Growth Forecasts



Sources: Alberta Treasury Board and Finance and Desjardins Economic Studies net non-permanent resident admissions over the next few years. The province's significant housing affordability advantage over Ontario and BC is a key reason for that view and could reinforce economic growth going forward.

No Tax Cuts for Now

The Alberta government did not introduce the new tax bracket for incomes under $60k per year, which had been promised in the 2023 provincial election campaign, in this update. According to the Alberta United Conservative Party platform, the move would have eroded revenue by $3.6B in the next four fiscal years and brought the province close to deficit in FY2026.

Tax reductions come with pros and cons. Platform figures suggested that FY2025 would have been the first full year of the policy, but we still think the decision not to go ahead with them at this stage is probably wise. While significant progress has been made in the fight against inflation, too-high price pressures are not gone yet. Lower-income tax bracket reductions generate benefits for those higher up the earnings spectrum, so to the extent that additional cash is spent, it could stimulate consumer demand and re-accelerating inflation. Of course, Alberta's low rates of taxation relative to other parts of the country have long been part of its success in attracting and retaining workers. Accordingly, the move could be more effective if implemented at a later date, once inflation is under more control and softer economic conditions argue for supportive measures.

Spending Projections Were Raised Incrementally

Alberta continues to exercise spending restraint. With the benefit of more revenues, the government lifted operating expense plans, but only by a combined $1.2B over the next three fiscal years. Still, annual spending growth will remain anchored to the rate of population growth plus total inflation projected for the prior year in Budget 2023. Current plans put per-person expenses on track to stay essentially flat for the next three fiscal years (graph 2 on page 3). As we discussed in our mid-year update 2023 preview, Alberta has made significant progress in reducing its per-person expenditure levels in the last 10 years.

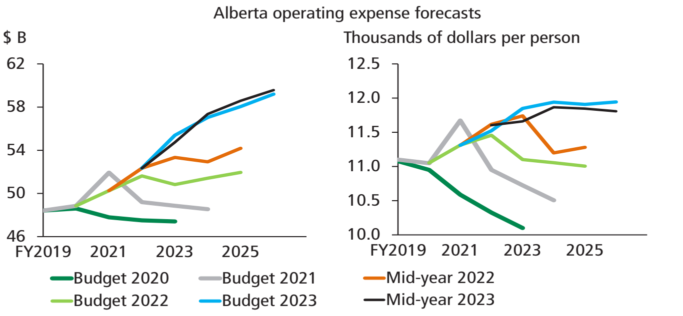
Operating expense projections still include sizeable contingencies. As in Budget 2023, FY2025 and FY2026 plans set aside $1.5B per year that can be used to absorb unexpected cost pressures, or—should they prove unnecessary—improve the bottom line. For FY2024 only, the province also increased disaster and emergency assistance allocations—not part of operating

TABLE 1
Alberta's Updated Fiscal and Economic Forecasts

$M (UNLESS OTHERWISE INDICATED)	2022–2023		2023–2024		2024–2025		2025-2026	
	Bud. 2023	Actual	Bud. 2023	Mid-Year	Bud. 2023	Mid-Year	Bud. 2023	Mid-Year
Total revenues	76,025	76,120	70,653	74,305	71,724	73,157	72,608	74,956
% change	*11.3*	*11.4*	*-7.1*	*-2.4*	*1.5*	*-1.5*	*1.2*	*2.5*
Bitumen and crude oil royalties	22,715	20,847	15,460	17,480	14,661	15,319	13,178	15,001
% change	*67.6*	*53.8*	*-31.9*	*-16.2*	*-5.2*	*-12.4*	*-10.1*	*-2.1*
Total expense	64,313	64,479	66,782	68,661	68,187	69,520	69,739	70,640
% change	*-0.1*	*0.2*	*3.8*	*6.5*	*2.1*	*1.3*	*2.3*	*1.6*
Operating expense	55,384	54,737	57,038	57,357	58,049	58,581	59,200	59,573
% change	*5.8*	*4.6*	*3.0*	*4.8*	*1.8*	*2.1*	*2.0*	*1.7*
Debt charges	2,715	2,829	2,848	3,157	2,805	3,253	3,103	3,398
% of total revenues	*3.6*	*3.7*	*4.0*	*4.2*	*3.9*	*4.4*	*4.3*	*4.5*
Contingency	1,322	—	1,500	123	1,500	1,500	1,500	1,500
Budget balance	**10,390**	**11,641**	**2,371**	**5,521**	**2,037**	**2,137**	**1,369**	**2,816**
Net Debt, % of GDP	*10.2*	*9.8*	*10.2*	*9.0*	*9.7*	*8.5*	*9.1*	*7.5*
Alberta Capital Plan	6,446	5,633	8,005	7,744	7,976	8,253	7,008	7,203
Real GDP, % change	*4.8*	*5.0*	*2.8*	*2.8*	*3.0*	*2.6*	*2.9*	*3.0*
Nominal GDP, % change	*24.0*	*22.0*	*-2.2*	*-2.3*	*3.5*	*3.9*	*3.6*	*4.2*
Population, % change	*2.2*	*1.8*	*2.9*	*4.1*	*2.2*	*2.9*	*2.1*	*2.3*
Total CPI inflation, % change	*6.4*	*6.4*	*3.3*	*3.5*	*2.2*	*2.5*	*2.2*	*2.2*

Sources: Alberta Treasury Board and Finance and Desjardins Economic Studies

GRAPH 2
Spending Increased Only Incrementally, Set to Ease in Per-Person Terms



Sources: Alberta Treasury Board and Finance and Desjardins Economic Studies

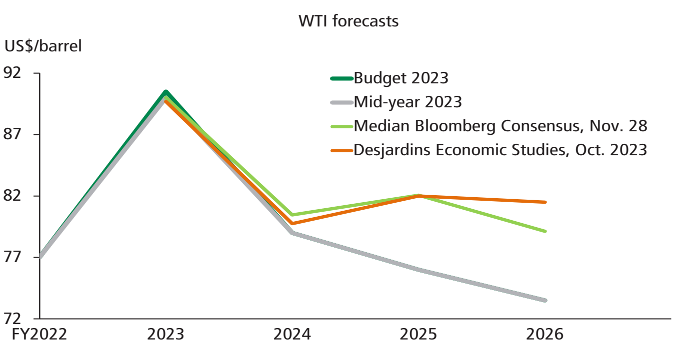
spending—by $1.2B, primarily to address costs associated with this year's record wildfire season. Of course, so long as extreme weather events increase in prevalence, these costs will continue to represent a downside risk for the province.

WTI Forecast Includes Buffers

Of course, no discussion of Alberta's fiscal outlook would be complete without a sense of where oil prices are going. This update builds prudence into forecasts as expected. For calendar year 2024, the government's fiscal plan assumes WTI prices below both the Bloomberg consensus forecast and our own most recent set of projections (graph 3). However, the projection was raised 4 US$/barrel versus the Q1 update, given that recent OPEC+ output cut announcements and geopolitical risk have boosted crude values since then. That strength, plus the contribution of a tighter-than-expected differential between WTI and Western Canadian oil prices earlier this year, have supported oil royalty projections this year, with the stronger starting point expected to carry forward.

We approve of the government's WTI forecasting approach. Given the present level of uncertainty about the course of global economic growth and commodity prices, and the fact

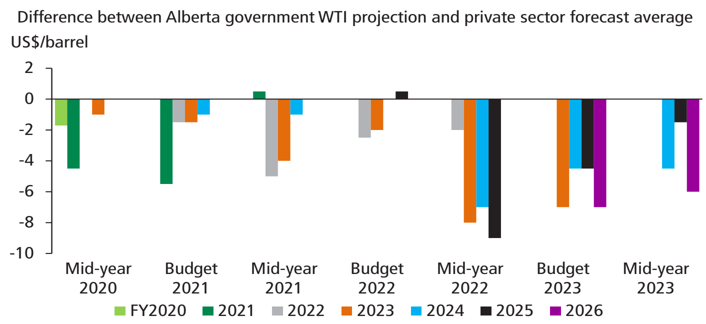
GRAPH 3
WTI Price Forecast Continues to Build in Prudence



Sources: Alberta Treasury Board and Finance, Bloomberg and Desjardins Economic Studies

that Alberta's finances are historically sensitive to crude values, prudence makes sense. Indeed, we've seen government WTI forecasts include bigger and bigger buffers in recent years, presumably in response to the higher fiscal sensitivity (graph 4). With a Budget 2023 sensitivity of $630M per 1 US$/barrel deviation from the forecast, oil prices in line with our projections would lift the bottom line by roughly $500M in FY2024. Based on current projections, there's potentially even more upside next fiscal year.

GRAPH 4
Alberta Oil Price Forecasting Has Become More Conservative



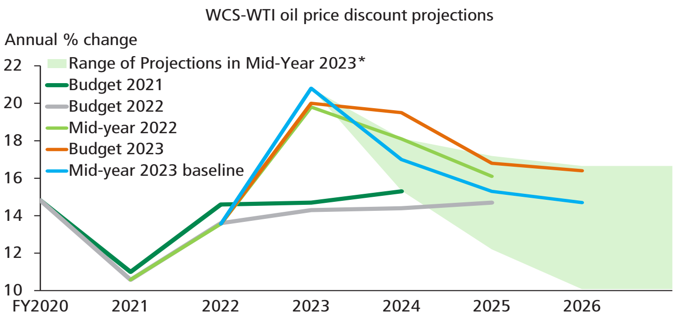
Sources: Alberta Treasury Board and Finance and Desjardins Economic Studies

The Government Expects the WCS Discount to Narrow in the Coming Months

The bigger question coming into the Mid-year update, however, was what might happen to Alberta oil prices. The province's financial position is now just as sensitive to the Western Canada Select (WCS)-WTI discount as it is to WTI itself. This discount recently blew out following a post-maintenance recovery in Alberta production, refinery downtime in the key US Gulf Coast region, and new hurdles for construction of the Transmountain pipeline expansion (TMX).

The government expects the discount to narrow significantly in the coming months as these effects are unwound, with TMX coming online in the second quarter of 2024. A weaker-than-anticipated Canadian dollar is also expected to bolster Alberta heavy oil prices. These are all sensible assumptions at this time, and provincial plans assume a differential larger than the average of private sector forecasts. Should the baseline projection come to fruition, it would support profitability, investment and economic activity in the key energy sector next year alongside rising production. However, there's no denying the risks to the outlook, and the increased importance of supply-demand dynamics for Alberta oil to the province's financial position. Just in the last two years, amid market volatility and a changing commodity price backdrop, WCS discount forecasts have changed significantly (graph 5 on page 4).

GRAPH 5
Recent Blowout Alberta Oil Price Discount Expected to Narrow



* Approximated using calendar year forecasts
Sources: Alberta Treasury Board and Finance and Desjardins Economic Studies

Infrastructure Plans Delayed Again

Reprofiling of forecast Alberta Capital Plan expenditures towards later years highlights an ongoing risk for all provinces. We've seen major project delays many times in jurisdictions across Canada since inflation, construction industry labour shortages, and softening economic growth prospects came to the fore. Alberta's Capital Plan expenditure forecasts were reduced versus Budget 2023 plans in FY2024, but increased in FY2025 and FY2026. In general, of course, we support Alberta's focus on building new infrastructure, as surging population growth increases the needs in this respect.

The document did not update borrowing requirements but did provide details of debt repayment plans. The province aims to pay down $3.2B in FY2024 and $0.5B in FY2025. The Alberta Fund—to which surplus cash is allocated for future policy priorities—will receive deposits of $1.6B this fiscal year and $0.4B next fiscal year. The government continues to anticipate a jump in outer year debt maturities. It forecasts maturities of $7.5B this fiscal year, $6B in FY2025, and $13.2B in FY2026, in line with Budget 2023 estimates.

Alberta bond spreads were largely unchanged in the immediate aftermath of the update's release. Going forward, we expect them to track WTI prices closely, though as we noted above, the WCS-WTI discount should play a larger-than-historical role in Alberta's fiscal performance.