BUDGET ANALYSIS

Alberta: Budget 2024

Investing in the Future

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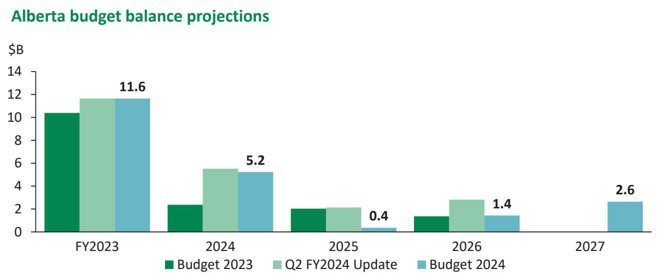
HIGHLIGHTS

- Alberta's fiscal year 2024–25 (FY2025) budget continued to pencil in surpluses for the foreseeable future, though these were smaller than in the last two updates (graph 1). Table 1 on page 2 summarizes the province's updated projections.
- Base case budget balance and debt projections set Alberta up to maintain arguably the strongest financial position of any province.
- Fiscal sensitivity to crude values remains historically high and could increase over time, but the province built in significant prudence via bigger contingencies and very conservative oil price forecasts.
- Although population growth forecasts were again increased, spending restraint remains in place. Operating expenditures are set to decline in real per capita terms over the forecast horizon.
- The province will invest an additional $2B back into the Heritage Fund in FY2025 as part of long-run efforts to build intergenerational wealth. This will be sourced from cash already set aside in the Alberta Fund, with a longer-term plan to be released later this year.
- The province now expects to borrow $13.8B in FY2024, $19.8B in FY2025, and $4.4B in FY2026, respective modifications of +$7B, +$14B, and -$11B versus Budget 2023 plans. The profile shift reflects pre-borrowing activity intended to repay debt maturing in 2025.

Graph 1
Surpluses Intact, but Diminished



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Our Takeaways

The bottom line: Budget 2024 affirms Alberta's strong financial position relative to the rest of Canada. While its fiscal plan is based on reasonable economic and commodity price assumptions, it also highlights challenges the province is facing. These include historically high and potentially rising sensitivity to oil price movements and effectively absorbing decades-high population growth. The good news is that the province starts this year in good fiscal shape, has built a huge amount of prudence into its plans, and has taken a meaningful step towards building long run intergenerational wealth.

First and foremost, Alberta's base case projections set it up to maintain arguably the strongest financial position of any province. Although forecast surpluses were reduced versus prior plans, it's still one of the only jurisdictions expected to stay in the black for the foreseeable future. Moreover, its debt burden remains the lowest of any Canadian province (graph 2 on page 2).

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TABLE 1
Alberta's Updated Fiscal and Economic Forecasts

$M (UNLESS OTHERWISE INDICATED)	2023–2024		2024–2025		2025–2026		2026-2027
	Q2 FY2024	**Bud. 2024**	**Q2 FY2024**	**Bud. 2024**	**Q2 FY2024**	**Bud. 2024**	**Bud. 2024**
Total revenues	74,305	75,628	73,157	73,537	74,956	76,051	78,816
% change	*-2.4*	*-0.6*	*-1.5*	*-2.8*	*2.5*	*3.4*	*3.6*
Bitumen and crude oil royalties	17,480	17,506	15,319	15,317	15,001	15,554	15,577
% change	*-16.2*	*-16.0*	*-12.4*	*-12.5*	*-2.1*	*1.5*	*0.1*
Total expense*	68,661	70,394	69,520	71,170	70,640	72,614	74,176
% change	*6.5*	*9.2*	*1.3*	*1.1*	*1.6*	*2.0*	*2.2*
Operating expense	57,357	57,876	58,581	60,124	59,573	61,595	62,798
% change	*4.8*	*5.7*	*2.1*	*3.9*	*1.7*	*2.4*	*2.0*
Debt charges	3,157	3,136	3,253	3,365	3,398	3,121	3,174
% of total revenues	*4.2*	*4.1*	*4.4*	*4.6*	*4.5*	*4.1*	*4.0*
Contingency	123	0	1,500	2,000	1,500	2,000	2,000
Budget balance	**5,521**	**5,234**	**2,137**	**367**	**2,816**	**1,437**	**2,640**
Net Debt, % of GDP	*9.0*	*9.3*	*8.5*	*9.1*	*7.5*	*8.5*	*7.7*
Alberta Capital Plan	7,744	7,077	8,253	8,299	7,203	8,376	8,363
Total borrowing requirements**	**6,666**	**13,768**	**6,065**	**19,800**	**15,043**	**4,376**	**8,012**
Real GDP, % change	*2.8*	*2.9*	*2.6*	*3.3*	*3.0*	*2.8*	*2.6*
Nominal GDP, % change	*-2.3*	*3.5*	*3.9*	*6.1*	*4.2*	*5.5*	*4.9*
Population, % change	*4.1*	*3.7*	*2.9*	*2.3*	*2.3*	*2.0*	*1.6*
Total CPI inflation, % change	*3.5*	*2.5*	*2.5*	*2.2*	*2.2*	*2.2*	*2.2*

* Not including contingency. ** Uses Budget 2023 projection for Q2 FY2024
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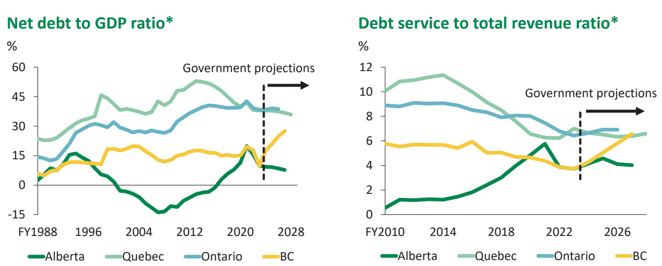
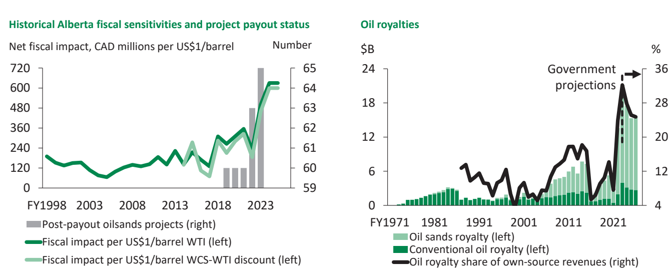
Graph 2
Alberta Has the Lowest Debt Load of Any Province



* Quebec and Ontario and figures based on mid-year FY2024 projections
Provincial budget documents and Desjardins Economic Studies

However, the province's finances are as sensitive to oil prices as they've ever been. For WTI, greater sensitivity reflects more oilsands projects attaining "post-payout" profitability and becoming subject to higher royalty rates; expectations of more heavy sour crude production in the years ahead drives the WCS figure. Of course, every commentary on Alberta's finances will highlight commodity price risk. But record fiscal sensitivity to WTI and the WCS-WTI discount in this budget means even bigger-than-usual deviations in royalty revenues from the baseline government projections—to the upside and the downside—are possible. And over the next three years, provincial revenues are on track to remain almost as reliant on crude values as they were during their FY2023 peak (graph 3). Based on the latest sensitivity estimate of $630M per 1US$/barrel, WTI would only

Graph 3
Still Historically High Fiscal Sensitivity to Oil Prices



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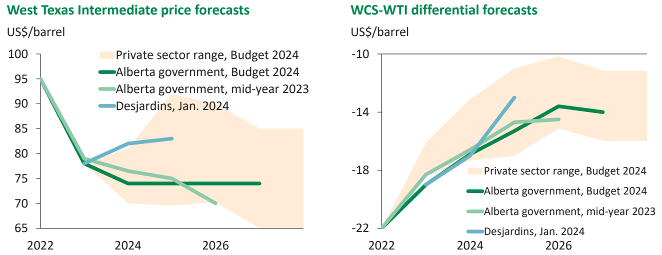
Against that backdrop, the government has huge amounts of prudence built into its plans. For both WTI and the light-heavy price differential, Alberta based its revenue projections on oil prices well below the private sector average (graph 4). Back-of-the-envelope calculations based on the government's fiscal sensitivities suggest a roughly $5B improvement in the bottom line would materialize if Desjardins' WTI price forecasts came to fruition. Budget 2024 also increased contingencies to $2B per year through FY2027, and these can be used to absorb unexpected cost pressures or cover revenue shortfalls.

Graph 4
Conservative Oil Price Projections Present Upside Potential for Alberta's Bottom Line



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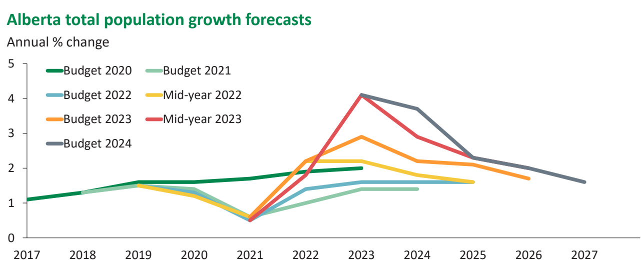
That said, Desjardins Economic Studies still has a below-consensus outlook when it comes to Canadian economic growth this year, which anchors a less optimistic Alberta forecast than the government has assumed here. We're firmly of the view that Alberta has some of the strongest economic prospects of any province this year, but to the extent that it underperforms the hefty 3% real gains assumed by the government, there is downside risk to revenues.

Further upward revisions to population growth projections (graph 5) once again have mixed implications for Alberta's fiscal outlook. On the one hand, strong forecast headcount gains no doubt contributed to expectations of steady outer-year tax revenue gains as well as economic growth projections. On the other hand, even stronger population growth could put pressure on public services and infrastructure, spending on which may have to increase over time to maintain the current level of quality. Alberta is in the midst of the strongest population gains of any province. We think this trend could persist more than it has in the past given the extent to which young Canadians are being drawn to its relatively strong economic outlook and affordable housing.

Graph 5
Population Growth Projections Were Again Revised Higher



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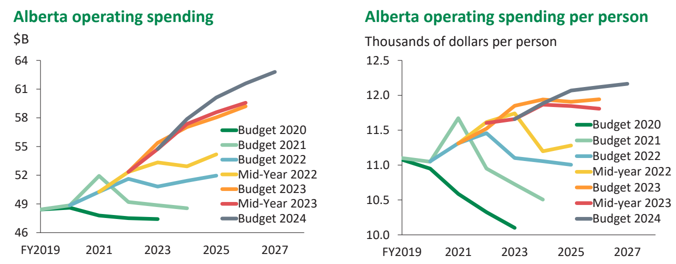
Spending restraint remains in place (graph 6). Consistent with the previously outlined fiscal anchor, Alberta will limit increases in operating expenditures to below the rate of population growth plus total CPI, meaning that this spending is set to decline in real per capita terms over the forecast horizon. Achieving that level of control could prove challenging—for any province—if strong population gains continue. But it's also one approach that can be used to help offset the potential impacts of resource price volatility on the province's fiscal sustainability.

Graph 6
Spending Plans Increased Incrementally



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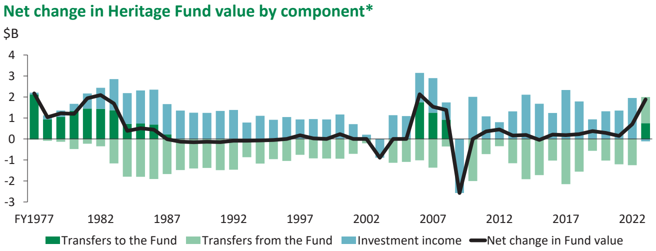
With a strong fiscal starting point and outer-year risks of higher oil price sensitivity becoming clearer, we support Alberta's move to beef up the Heritage Fund. The Fund aims to support intergenerational wealth and longer-run diversification initiatives. This year, the government plans to allocate $2B in cash from the Alberta Fund to the Alberta Heritage Savings Trust Fund. The challenge, of course, will be to stay disciplined with respect to contributions over time. Going forward, there will naturally be an incentive to smooth out potential resource revenue volatility, and that has undermined prior plans to set aside surplus cash. The Heritage Fund's FY2023 Annual Report shows infrequent deposits in the past (graph 7 on page 4). Later this year, the government will publish a long-term plan with details on plans to build the Heritage Fund's value to $250–400B by 2050.

The province now expects to borrow $13.8B in FY2024, $19.8B in FY2025, and $4.4B in FY2026, respective modifications of +$7B, +$14B, and -$11B versus Budget 2023 plans. In FY2027, it

Graph 7
Limited Transfers to Heritage Fund in Recent Years



* According to FY2023 Annual Report of the Alberta Heritage Savings Trust Fund
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forecasts borrowing of $8.0B. The shift in borrowing timelines reflects pre-borrowing activity intended to smooth out last year's back-loaded profile. Budget 2024 noted that a large share of the debt maturing in 2025 was issued during the early stages of the pandemic. At that time, Alberta's ability to choose optimal dates for its bond maturities was limited due to challenges accessing capital markets for governments within Canada and abroad. So, starting in FY2024, Alberta plans to borrow in advance of its immediate cash needs in order to ensure a more cost-effective refinancing path and that future bond maturities will be more easily managed.

Budget 2024 was released after market close, but it shouldn't meaningfully change the outlook for Alberta bond spreads. In the medium term, of course, spreads should continue to track WTI prices closely, mirroring oil's importance to provincial economic and fiscal prospects as well as longstanding bond market convention. But updated sensitivity figures reinforce our argument that investors also need to be attuned to the WCS–WTI differential. They should also follow the supply–demand dynamics of the market for Alberta oil that drive it. Of course, for all provinces, market risk sentiment and the relative strength of fiscal metrics in plans yet to be released will also play a role in spread performance. That said, the sheer amount of upside potential in this plan—via contingencies and conservative oil price forecasts—might lead investors to bake in better fiscal results. That could potentially limit tightening in the event of outperformance, a dynamic we've observed in some other provinces.