Alberta’s budget shows that it is making progress on its efforts to restrain spending, reduce its deficit and contain debt growth. However, the recent decline in oil prices is a clear risk should it persist. The outgoing 2019/20 deficit is projected to be almost $1.2bn less than at the time of last October’s budget, albeit a more modest $264mn when adjusting for provisions and allowances. While the average WTI oil price assumption of US$58/bbl looks high given the market moves of this week, the forecast for a wider WCS-WTI differential than current levels adds a degree of conservatism. As such, the $6.8bn deficit projected for the upcoming 2020/21 fiscal year, versus $7.5bn in 2019/20, already assumes a $1.6bn reduction in resource revenue. In line with October’s budget, fiscal 2020/21 will see the largest decline in operating expenses, at 1.7%, which will help offset the projected decline in revenue. The long-term borrowing amount for 2020/21 is $17.1bn, which is rising from a lower revised amount of $8.0bn in 2019/20. The latter is down mainly due to a significant drop in the province’s financing requirements as a result of a lower deficit, the closure of regulated funds announced in last year’s budget and improvements in cash management, among other factors.
Moderate Growth Anticipated

Real GDP growth is expected by the province to clock 2.5% in 2020, slightly more than half a percent above the private sector average, aided by exports, a rise in oil production and investment outside of the oil and gas sector. While the real GDP forecast is above the private sector average, it is still only expected to translate into nominal GDP growth of 2.8% for the current year thanks to a weak deflator linked to the assumption of a wider WCS-WTI differential.

The energy price assumptions that underpin today's budget would have been set some weeks ago, and no one could have foreseen the recent dramatic fall in oil prices based on coronavirus fears. As such, the US$58/bbl average forecast for WTI prices in upcoming fiscal 2020/21 suddenly looks optimistic. However, if global fears ease, we would expect to see oil prices rebound as the year goes on. Moreover, a relatively conservative projection for the WCS-WTI differential (rising to US$19.10/bbl from the current year's US$14.70) means that projections for Western Canadian Select don't seem quite as high relative to the current spot rate.

Modestly Ahead of Plan in 2019/20

For the outgoing 2019/20 fiscal year, the deficit is now expected to come in at $7.5bn, which is around $1.2bn lower than was anticipated at the time of 2019’s October budget. That’s partly explained by a lower provision for unwinding the previous government’s crude-by-rail program ($1.3bn versus $1.5bn previously) and the removal of the previous $680mn contingency. Excluding provisions and contingencies, the revised projected deficit of $6.3bn is modestly slimmer than the $6.5bn expected at budget time.

There has been some good news on the revenue side, with investment revenue running nearly $1.0bn ahead of previous plans. That accounted for all of the improvement in total revenues, and helped offset a $0.4bn upgrade in the estimate for operating expenses and higher spending on disaster assistance ($1.2bn versus $0.6bn previously assumed). At the same time, however, these investment gains are non-operational in nature and will be difficult to count-on in future periods.

Moreover, while the deficit for the current fiscal year is slimmer than anticipated back in October, it is still wider than the $6.7bn outcome for fiscal 2018/19. Of course, the recent decline in energy prices presents a downside risk to resource revenues in the final month of the fiscal year.

Staying The Course in 2020/21 and Beyond

Today’s budget didn’t waver from the previous plan to return the government’s finances to balance by 2022/23, through a combination of spending restraint and corporate tax cuts designed to support growth. The estimate for upcoming fiscal 2020/21 shows the deficit slimming to $6.8bn, including a $750mn contingency for unforeseen costs. That would cover potential disaster assistance costs, as well as other unforeseen increases in costs or lost revenue. In keeping with the prior budget, there was no money specifically set aside for disaster assistance in 2020/21 or beyond. The corporate tax rate will be reduced again by 1% to 9% in January 2021 and then to 8% by January 2022, as per the prior budget’s commitment.
Also as announced in Budget 2019, the Alberta Child and Family Benefit will begin on July 1st, costing an estimated $230mn.

Due to the projection for a wider WCS differential in fiscal 2020/21 than in the outgoing fiscal year, today’s budget projections already incorporate a fairly significant decline in resource revenue of nearly $1.6bn. However, given the ongoing concerns of coronavirus and its impact on global oil prices, there’s still downside risk to this should oil prices not recover from their recent slump. Operating expenses are projected to be cut by 1.7% in the coming fiscal year. Note that back in the prior budget, 2020/21 was always anticipated to see the largest reduction in spending, and the projected spending cut in Budget 2020 is almost identical to that anticipated last October. The average reduction in operating expenses over the three years is 0.8% a year.

Also in line with the prior budget, a 20% tax will be applied on vaping products, which is expected to bring in $4mn in 2020/21, while the tourism levy will also now be applied to short-term rentals.

Long-Term Debt Borrowing Needs Step Up, Before Trending Down

Alberta’s future borrowing requirements are expected to be satisfied mainly with long-term debt. The three year horizon projects long-term debt issuance averaging $13.1bn per year. The long-term borrowing amount for 2020/21 is $17.1bn, which is increasing from a lower revised amount of $8.0bn in 2019/20. Long-term borrowings are then planned to drop to $11.6bn in 2021/22 and to $10.7bn in 2022/23.

It should be noted that the long-term borrowing amount of $8.0bn for the outgoing 2019/20 year is coming in substantially below what was projected in the fall budget (i.e. $12.2bn). This decline is mainly the result of a significant drop in the province’s financing requirements for the fiscal plan ($674mn instead of the $3.8bn projected last fall) and for other general purposes ($1.3bn instead of $2.4bn). Specifically, the province cites “The reduced borrowing requirements result from a lower deficit, the closure of regulated funds announced in Budget 2019 and improvements to cash management, among other factors.”

Comparing both budgets, cumulative long-term borrowings were $51.7bn for the period 2019/20 through 2022/23 in Budget 2019 versus $47.4bn in today’s budget ($4.3bn less). Hence, the province is expecting to further flatten the future debt curve. Net of approximately $15.3bn in maturities (averaging $5.1bn per annum) over the period, suggests incremental debt of $32.1bn.

Annual borrowing amounts include $2.5bn in pre-borrowing for cash management purposes in 2020/21 and 2021/22, which then rises to $5.0bn in 2022/23. These amounts are to augment cash reserves for annual debt maturities and other requirements. Alberta currently has $76.1bn in outstanding marketable debt of which approximately 35% matures in the next five years.

| Table 3 |
|------------------|------------------|------------------|------------------|------------------|
|                  | 2019/20 | 2020/21 | 2021/22 | 2022/23 |
| **Borrowing Requirements** |         |         |         |         |
| Borrowing for Capital Purposes | 7,577   | 7,322   | 5,805   | 5,498   |
| Borrowing for Fiscal Plan       | 674     | 4,776   | 3,855   | 2,686   |
| Borrowing for Other General Purposes | 1,314 | -       | -       | -       |
| Borrowing for Prov Corp’s      | 355     | 2,616   | 1,633   | 2,434   |
| Borrowing for GBE’s            | 672     | 1,077   | 620     | 625     |
| **Total**                      | 10,592  | 15,791  | 11,913  | 11,243  |
| **Funding Requirements**       |         |         |         |         |
| Money Market Debt              | 2,500   | -1,500  | 250     | 550     |
| P3’s                           | 113     | 151     | 46      | -       |
| Long Term Debt                 | 7,979   | 17,140  | 11,617  | 10,693  |
| **Total**                      | 10,592  | 15,791  | 11,913  | 11,243  |
Alberta’s 2020 Capital Plan calls for average spending of $6.4bn per year over the three year period; with a total cumulative investment of $19.3bn. Municipal support makes up the largest portion at 32%, followed by capital maintenance and renewal at 16%, health care at 14% and roads and bridges at 13%. In 2019, Alberta scaled back its capital plan by roughly -12% compared to the 2018 Capital Plan over the multi-year planning period. The 2020 Capital Plan of roughly $6.4bn per annum is relatively in line with the average spending projection in last year’s budget (~$6.0bn).

Alberta’s debt requirements have been funded through an expanded and diversified borrowing platform. This platform covers:

- Domestic C$ (short-term) Promissory Note
- Domestic C$ Platform for benchmark and MTN issuance
- Australian Medium Term Note programme
- Global US$ Bonds (SEC Registered)
- Global Multi-Currency Medium Term Note - (Rule 144A inside the U.S. and Regulation S globally)
- US$ Commercial Paper program

Alberta’s borrowing strategy is focused on ensuring liquidity and control of supply through:

- Maintaining larger domestic benchmark issues
- Infrequent domestic MTN issuance
- Monitoring secondary market liquidity
- Target issuance of 30-40% to international markets, specifically:
  - Liquid US$ global issues in 3, 5, 7 and 10 years
  - SEC registered, large US$ benchmarks
  - Sterling benchmarks
  - Euro benchmark issues
  - MTN and structured issues in other currencies

**Government Seeks to Stabilize Alberta’s Credit Risk Profile While Stimulating Economy**

In our opinion, Alberta’s path to balance is complex and entails significant execution risk with respect to oil prices and production, pipeline infrastructure, political risk pertaining to environmental matters and relations with First Nations, growth-boosting tax cuts and spending restraint. The quickly deteriorating global economic backdrop further adds to these challenges.

However, today’s budget does demonstrate a firm commitment to balance by 2022/23. It also demonstrates an ability by the relatively new United Conservative Party government to execute on its first budget (i.e. 2019/20). Overall, we view today’s budget as neutral from a credit perspective, but remain cautious on the road ahead.

By its own projections, Alberta’s debt metrics are projected to peak and then stabilize over the forecast period. The province projects that its Net Financial Debt-to-Nominal GDP Ratio will increase from 10.2% in 2019/20 to a peak of 12.3% in 2021/22, before stabilizing around 11.5% in 2022/23. On the basis of taxpayer supported debt, this ratio rises from 19.4% to 21.7% — stabilizing around that level.

**Credit Ratings — Still Some Risks to the Downside**

Alberta is currently assigned the following long-term ratings by the US and Canadian rating agencies:

- DBRS AA Negative
- Fitch AA Stable
- Moody’s Aa2 Stable
- S&P A+ Stable
DBRS reaffirmed Alberta’s AA rating in December following a review of the October 2019 budget — the first under the United Conservative Party (UCP). However, notwithstanding policy objectives to balance the budget a year earlier than the previous government and plans to further restrain debt growth with a reduced capital program, the rating agency maintained the negative outlook trend citing: “Risks remain skewed to the downside and the UCP government has yet to demonstrate its ability to meet its fiscal policy objectives. The UCP government has put forth an ambitious plan with considerable implementation risk.” DBRS’s projections show that the adjusted debt/GDP ratio will continue rising, but stabilize within the 25-30% range, which is within its 15-35% AA criteria band. In the event of a rating downgrade, we would expect no more than a one notch change, which would still result in Alberta retaining an average AA-level rating among the agencies.

Fitch assigned an initial rating of AA Stable in June 2018, thereby securing Alberta’s average rating in the AA category. The rating was reaffirmed in February 2020 with a stable outlook citing “Fitch expects the province will achieve its articulated fiscal consolidation plan or provide for revisions that are sufficient to achieve its goal of fiscal consolidation by fiscal 2023.”

Moody’s downgraded the province to Aa2 Stable from Aa1 Negative in December, which included a lowering of its Baseline Credit Assessment rating (BCA) to aa3. The province gets a one-notch uplift to Aa2 from the BCA rating due to a high likelihood of extraordinary support from the Government of Canada (AAA) under its Joint Default Analysis (JDA) Methodology. The downgrade reflected “Moody's opinion of a structural weakness in the provincial economy that remains concentrated and dependent on non-renewable resources - - primarily oil -- which causes volatility in financial performance, and remains pressured by a lack of sufficient pipeline capacity to transport oil efficiently with no near-term expectation of a significant rebound in oil-related investments.”

S&P has taken the most aggressive rating stance on Alberta in recent years, having downgraded the province from AAA in 2015 to A+ in 2017. We highlight, however, that under S&P’s revised rating methodology for non-US Local and Regional Governments (LRG), which was implemented in July 2019, we believe that there is more scope to see positive rating momentum over the medium term as Alberta makes progress towards its fiscal goals toward consistent improvement in after-capital deficits and debt burden stabilization.

Alberta’s liquidity is exceptional with its diversified funding platform and substantial holdings of unencumbered and available financial assets. The cornerstone of its strong liquidity is the Alberta Heritage Savings Trust Fund. The Fair Value of the Net Assets of the Fund was $18.0bn at September 30, 2019. The province has stated that it will not draw on the Heritage Fund. This Fund is an internally designated asset under legislation which states “To provide stewardship of savings from Alberta’s non-renewable resources by providing the greatest financial returns on those savings for current and future generations”. Alberta’s financial assets provide substantial coverage of its annual debt service requirements and are expected to remain a multiple above 100% of annual debt service — the threshold upholding the province’s very high liquidity score by the rating agencies.

Although Alberta’s debt has moved higher over the years, Alberta still has one of the lowest debt burdens among the Canadian provinces. Alberta’s fiscal capacity is also the strongest in Canada which is validated by its status as a “have province” under the Equalization framework. Its strong fiscal capacity reflects its significant tax advantage that is underscored by the absence of provincial sales tax and a very competitive income tax structure for individuals, small businesses, and corporations. However, over the past three years, Alberta’s fiscal capacity advantage under the framework has been diminishing somewhat with lower resource revenues and changing economic conditions.