

Research Update:

Province of Alberta Upgraded To 'AA-' From 'A+' On Strong Fiscal Performance; Outlook Stable

December 18, 2023

Overview

- Strong oil prices, high tax revenues, and a focus on cost containment in fiscal 2023 and year-to-date in fiscal 2024 have resulted in outsize financial performance for the Province of Alberta that we expect will carry forward in the next two years, despite near-term slowing in the pace of economic growth.
- We expect that with healthy after-capital surpluses, the province's tax-supported debt will remain fairly stable relative to operating revenues and liquidity levels will remain robust.
- As a result, S&P Global Ratings raised its long-term issuer credit and senior unsecured debt ratings on Alberta to 'AA-' from 'A+'. At the same time, we raised our short-term issuer credit rating on the province to 'A-1+' from 'A-1'.
- The stable outlook reflects our expectation that, despite economic headwinds, high oil prices and ongoing expenditure management in the next two years will lead to sustained strong budgetary balances, stable debt levels, and strong debt service coverage.

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Rating Action

On Dec. 18, 2023, S&P Global Ratings raised its ratings on the Province of Alberta, including its long-term issuer credit and senior unsecured debt ratings, to 'AA-' from 'A+'. S&P Global Ratings also raised its short-term issuer credit rating to 'A-1+' from 'A-1'. The outlook is stable.

Outlook

The stable outlook reflects our expectation that despite economic headwinds, strong oil prices and measures taken to support fiscal sustainability bolster the province's ongoing strong budgetary performance. We also expect that small after-capital surpluses will limit increases in the province's tax-supported debt burden and keep it at about 127% of operating revenues, allowing Alberta to fully cover debt service with its internal liquidity.

Downside scenario

We could lower the rating if financial management is not effective in managing volatility and supporting long-term fiscal sustainability or if unexpected shifts in policies result in higher contingent liabilities or materially negatively affect finances, leading us to reassess our view of financial management. In addition, a return to recessionary conditions or a significant drop in oil prices that leads to large and persistent after-capital deficits, coupled with the absence of timely implementation of new measures to restore fiscal sustainability, could lead us to lower the ratings.

Upside scenario

Although unlikely in the next two years, we could raise the ratings if Alberta can meaningfully diversify its economy and decrease its dependence on resource revenues and sustain its fiscal consolidation efforts to manage costs while operating revenues rise such that tax-supported debt falls to less than 60% of operating revenue.

Rationale

We believe that there is greater visibility on the province's fiscal framework, despite the inherent volatility of the province's revenue base. Continued high oil prices have significantly boosted Alberta's operating revenues in the past year. At the same time, the province remains focused on expenditure management, which also contributed to outsize financial results in fiscal 2023 and year-to-date in fiscal 2024. We expect that Alberta will be able to carry this momentum into the next two years as it continues to produce after-capital surpluses. In addition, based on the fiscal framework outlined in the 2023 budget, we expect that the province will continue to pay down maturing debt with a portion of surplus cash, leading to stabilizing debt metrics. As a result, we project that tax-supported debt will represent about 127% of operating revenues in fiscal 2026 and the province's internal liquidity generation will be sufficient to more than fully cover the next 12 months of debt service.

While still leading the country, the province's economic growth will moderate in 2023, and remain relatively stable in 2024.

We expect that while Alberta's pace of economic growth will slow like that of other provinces, strong energy exports, robust net migration, and a healthy labor market will bolster provincial real GDP growth compared with the national economy overall. We estimate that, in line with the provincial midyear update, Alberta's real GDP will increase by 2.6% and 3% in 2024 and 2025, respectively. This is stronger than our national forecast of about 0.8% and 1.5% for 2023 and 2024, respectively (see "Economic Outlook Canada Q1 2024: Growth Is Set To Continue Slowing," published Nov 27, 2023, on RatingsDirect). Alberta's GDP per capita will comfortably exceed the national average of about US\$53,415 for 2023. The economy possesses strong fundamentals, despite its concentration in the oil and gas industry. Including supporting activities, the industry typically represents more than 20% of GDP at basic prices, which tempers our economic assessment because of the associated economic and fiscal volatility.

The UCP government, which holds a reduced majority in the Legislature following the provincial election in May, has the political capacity to enact reforms. Of note, in the past four years, Alberta

successfully brought its spending down, on a per capita basis, so that it is now in line with provincial peers. Budgets are comprehensive and more detailed than those of provincial peers. Annual reports comply with Canadian government standards. The administration is experienced and qualified to effectively implement fiscal policies. Debt and liquidity management policies are prudent, in our view.

As is the case with all provinces, the ratings also benefit from the very predictable and well-balanced institutional framework in which Alberta operates. The Canadian constitution is the cornerstone of federal-provincial intergovernmental arrangements, which we view as mature and stable. The federal government provides revenue support through a number of agreements and transfer arrangements including the ongoing Canada Health Transfer and Canada Social Transfer payments as well as ad hoc situation-specific transfers. In our opinion, the federal government's considerable extraordinary support for individuals, businesses, and lower levels of government throughout the pandemic demonstrates the strength of the Canadian system. In fiscal 2023, the share of total provincial revenues represented by federal government transfers remained relatively stable at about 14% of operating revenues.

High energy prices and fiscal sustainability measures will support strong budgetary balances and stable debt metrics.

Supportive demand-supply conditions for oil have significantly contributed to the province's growth in revenue. These, in conjunction with the maintenance of more moderate expenditure growth, have resulted in another year of robust fiscal results on both an operating and an after-capital basis. Following the provincial midyear update, we expect that for the fiscal 2022-2026 period, on average, the province will generate operating and after-capital surpluses of about 14% and 6% of operating and total revenues, respectively. Of note, the pronounced volatility of the province's budgetary results tempers our view of the strength of Alberta's fiscal performance.

Through the introduction of its fiscal framework, the province will allocate 50% of its fiscal surplus to debt repayment. As a result, we expect that Alberta's tax-supported debt burden will remain relatively stable. We expect that tax-supported debt will reach about C\$96 billion or about 127% of operating revenues by the end of fiscal 2026. Our calculation of tax-supported debt includes guarantees and obligations under public-private partnership agreements. Interest expense will remain relatively stable and will average about 4% of operating revenues for the fiscal 2023-2025 period. We view the province's contingent liabilities as neutral to our debt assessment. Alberta's largest contingent liability is ATB Financial, a local financial institution wholly owned by Alberta, to whose depositors the province provides a guarantee. As well, the province's credit union sector is a contingent liability. Total contingent liabilities are modest, representing about 11% of fiscal 2024 operating revenues.

Moderate after-capital surpluses will continue to buoy the province's near-term internal liquidity. We estimate that free cash and investment balances of about C\$23.8 billion will represent more than 100% of the next 12 months of debt service. Of note, Alberta's internal liquidity experiences more volatility than that of peers, as after-capital balances can swing dramatically with oil prices. In addition, the province's access to external liquidity remains strong. With an expanding presence, Alberta has strong access to Canada's well-developed capital markets.

Key Statistics

Table 1

Province of Alberta -- selected indicators

(Mil. C\$)	-- Budget year* --					
	2020	2021	2022	2023bc	2024bc	2025bc
Operating revenues	42,589	67,514	75,540	73,708	72,525	75,492
Operating expenditures	55,720	59,291	59,968	63,080	64,862	65,903
Operating balance	(13,131)	8,223	15,572	10,628	7,663	9,589
Operating balance (% of operating revenues)	(30.8)	12.2	20.6	14.4	10.6	12.7
Capital revenues	548	808	580	826	1,202	1,020
Capital expenditures	6,896	6,622	5,644	7,744	7,428	6,483
Balance after capital accounts	(19,479)	2,409	10,508	3,710	1,437	4,126
Balance after capital accounts (% of total revenues)	(45.2)	3.5	13.8	5.0	1.9	5.4
Debt repaid	27,329	32,649	45,672	13,032	8,335	15,563
Gross borrowings	48,204	32,041	32,539	8,801	7,859	19,851
Balance after borrowings	1,396	1,801	(2,625)	(521)	961	8,414
Direct debt (outstanding at year-end)	108,347	107,105	93,874	92,737	92,514	92,899
Direct debt (% of operating revenues)	254.4	158.6	124.3	125.8	127.6	123.1
Tax-supported debt (outstanding at year-end)	111,521	110,245	96,992	95,840	95,617	96,002
Tax-supported debt (% of consolidated operating revenues)	261.9	163.3	128.4	130.0	131.8	127.2
Interest (% of operating revenues)	5.8	3.9	3.7	4.3	4.5	4.5
Local GDP per capita (single units)	67,173	84,272	101,818	97,138	98,413	99,909
National GDP per capita (single units)	58,139	65,651	71,478	72,315	73,210	74,620

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. *Budget year 2023 equals fiscal year 2024.

Ratings Score Snapshot

Table 2

Province of Alberta -- Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	2
Economy	2
Financial management	2

Table 2

Province of Alberta -- Ratings Score Snapshot (cont.)

Key rating factors	Scores
Budgetary performance	3
Liquidity	1
Debt burden	4
Stand-alone credit profile	aa-
Issuer credit rating	AA-

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "Methodology For Rating Local And Regional Governments Outside Of The U.S.," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

Key Sovereign Statistics

Sovereign Risk Indicators, Oct. 9, 2023. Interactive version available at <http://www.spratings.com/sri>

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Economic Outlook Canada Q1 2024: Growth Is Set To Continue Slowing, Nov. 27, 2023
- Sector And Industry Variables | Criteria | Governments | Sovereign Rating Methodology, Sept. 21, 2023
- S&P Global Ratings Has Raised Its Henry Hub Natural Gas Price Assumptions For 2024 And 2025, Nov. 7, 2023
- S&P Global Ratings Definitions, June 9, 2023
- Institutional Framework Assessment: Canadian Provinces, March 14, 2022

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner

and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Upgraded

	To	From
Alberta (Province of)		
Issuer Credit Rating	AA-/Stable/A-1+	A+/Stable/A-1
Alberta (Province of)		
Senior Unsecured	AA-	A+
Commercial Paper	A-1+	A-1

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