Research Update:

Province Of Alberta Long-Term Rating Lowered To 'A' From 'A+' On Pandemic-Driven After-Capital Deficits; Outlook Stable

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Overview

- The fiscal shock from the COVID-19 pandemic has further worsened Alberta's budgetary balances, which had not yet recovered from the slump in oil prices that began in 2014, to a greater degree than we had expected.
- Reflecting the province's large after-capital deficits, which will average more than 25% of total revenues during fiscal 2020-2024, we have lowered Alberta's stand-alone credit profile (SACP) by one notch. Accordingly, we are lowering our long-term issuer credit and senior unsecured debt ratings on the Province of Alberta to 'A' from 'A+' and affirming our short-term rating at 'A-1'.
- The stable outlook reflects our expectation that post-pandemic economic growth and continuing expenditure management in the next two years will lead to steady improvements in the province's budgetary balances, debt burdens, and debt service coverage (DSC).

Rating Action

On May 17, 2021, S&P Global Ratings lowered its long-term issuer credit and senior unsecured debt ratings on the Province of Alberta to 'A' from 'A+'. At the same time, S&P Global Ratings affirmed its 'A-1' short-term rating on the province. The outlook is stable.

Outlook

The stable outlook reflects our expectation that robust economic growth over the next few years and continuing expenditure management will lead to steady improvements in the province's budgetary balances such that the debt burden begins to stabilize near 300% of operating revenues toward the end of our two-year outlook horizon. Furthermore, shrinking after-capital deficits should lead to a strengthening of DSC levels.

Downside scenario

Over the next two years, a slower-than-expected economic recovery and larger and persistent after-capital balances, coupled with the absence of timely responses by the government to implement new fiscal measures intended to restore fiscal sustainability, could lead us to revise the outlook to negative or lower the ratings.

Upside scenario

The resumption of robust economic growth coupled with clear progress on increasing fiscal sustainability, manifested in the next two years by steadily declining after-capital deficits, a stabilizing or declining debt burden, and improving DSC levels over the forecast horizon, could lead us to raise the ratings.

Rationale

The downgrade is the culmination of the two powerful economic shocks that Alberta has endured in the past six years. The province entered the pandemic in a position of relative fiscal weakness because of the prolonged effects of the slump in oil prices that began in late 2014. From this starting point, steps taken to control the pandemic and to safeguard the health and safety of citizens drove up health care and education expenditures and trimmed revenues. Budgetary results deteriorated and Alberta's tax-supported debt burden rose to a greater extent than was the case for all other Canadian provinces. Consequently, Alberta's operating and after-capital deficits, which are the largest of any local and regional government in the country this fiscal year and last, caused us to lower the SACP by one notch.

The recovery should provide economic and fiscal relief to the province. S&P Global Economics' current baseline assumption is that Canada's real GDP will rebound 5.5% in 2021 following a 5.4% contraction in 2020. We expect the economy will reach pre-pandemic levels by the end of this year when the national unemployment rate should be 7.6% (see "Economic Outlook Canada Q2 2021: Consumer Spending Could Set The Pace Of Recovery," published March 30, 2021, on RatingsDirect). Alberta's real GDP contracted by 7.8% in 2020, which lagged the national decline of 5.4%. Similarly, we expect the province's economic rebound in 2021 of 4.8% will lag the national increase of 5.5%. For 2022 and 2023, the provincial economy should outperform the national averages on expected increases in investment.

The prospects for the province's oil industry have improved in the past year as prices have strengthened thanks to supply cuts and improving demand conditions. On March 8, 2021, S&P Global Ratings raised its price assumptions for West Texas Intermediate (WTI) for the remainder of 2021 and 2022 (see "S&P Global Ratings Revises Oil And AECO Natural Gas Price Assumptions And Introduces Dutch Title Transfer Facility Assumption," published March 8, 2021). We expect WTI prices will now average US$55/barrel (bbl) for the remainder of 2021 and 2022; however, our assumption of US$50/bbl is unchanged for 2023 and beyond. The strengthening of WTI prices in 2021 and 2022 should boost resource revenues by about 45% in the 2021-2022 fiscal year (ended March 31) and aid Alberta's fiscal recovery.

Improving oil prices notwithstanding, we believe that Alberta's fiscal recovery will still be incomplete by the end of the 2023-2024 fiscal year. The province has not established the timeline for a return to balance in this year's budget--it intends to commit to a timeline after the effects of the pandemic have passed. The fiscal recovery will rely on economic growth and continuing strict expenditure management to do much of the heavy lifting, and these efforts can often take longer than expected to come to fruition and might not fully address the imbalance between revenues and expenditures. The twin shocks from the pandemic and the oil price slump have deepened the province's budgetary deficits and could delay its recovery, with the result that Alberta's key fiscal and debt metrics could continue to lag those of peers.

Budgetary results will improve in fiscal 2021-2022 as the pandemic wanes but liquidity metrics have weakened.

Budgetary results have materially deteriorated since the onset of the pandemic. Increased health care spending and lower resource revenues stemming from a significant drop in the WTI benchmark turned operating revenue growth negative, although transfers for pandemic support from the federal government blunted some of the decline in fiscal 2020-2021. Health care and education spending rose significantly. We expect operating and after-capital deficits to have bottomed out at 39% and 54% of operating and total revenues, respectively.

Operating and after-capital deficits should improve moderately in fiscal 2021-2022 to 33% and 46% of operating and total revenues, respectively, and then strengthen more robustly in the following fiscal years. We expect that the operating deficit for the fiscal 2021-2022 – 2023-2024 period will average 23% of operating revenues. We forecast the average after-capital deficit for the period will be 34% of total revenues, triggering a one-notch adjustment as per our global criteria. Although Alberta possesses tax advantages compared with other Canadian provinces, this flexibility has not been used yet to improve the province's fiscal position.

Debt has increased as budgetary results have worsened. We expect that tax-supported debt will reach almost C$150 billion or 305% of operating revenues by the end of fiscal 2023-2024. The debt level was about 205% of operating revenues at the end of fiscal 2019-2020, at the onset of the pandemic. Our calculation of tax-supported debt includes guarantees and obligations under public-private partnership agreements. Interest expense has also risen. Interest will represent 6.5% of operating revenues in fiscal 2021-2022 and average 6.3% for the fiscal 2020 -2021 – 2022-2023 period. We continue to view the province's contingent liabilities as neutral to our debt assessment. The largest contingent liability is for 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 less than 20% of fiscal 2021-2022 revenues.

Alberta's large after-capital deficits are weighing on the province's near-term internal liquidity, which has weakened since the onset of the pandemic. We estimate that the province's free cash and investment balances will represent less than 30% of the next 12 months of debt service. The ratio has declined substantially from the previous year due to after-capital deficits and interest expense that the pandemic elevated. We expect the coverage ratio will improve as the pandemic wanes and budgetary balances improve, which tempers our view of the decline in the DSC ratio. We estimate free cash balances and investments will be about C$22.5 billion in the next 12 months, which is largely unchanged from the previous year. The province's access to external liquidity remains strong. With an expanding market presence, Alberta continues to demonstrate its strong access to Canada's well-developed capital markets.

The provincial economy will expand in 2021 with real GDP growth of almost 5% as the pandemic wanes.

The provincial economy will expand in 2021 as the economy normalizes with increasing vaccination rates. We expect real GDP will increase 4.8% in 2021, following a 7.8% contraction the previous year. The trajectory of Alberta's real GDP will broadly follow that of the country, with the province lagging the national rates in 2020 and 2021 but outpacing them in 2022 and 2023 as investment in the province increases. Alberta's GDP per capita will comfortably exceed the national average of about US$49,900 for 2021. The economy possesses strong fundamentals, despite its concentration in the oil and gas industry. The industry, including supporting activities, typically represents more than 20% of GDP at basic prices, which tempers our economic assessment because of the associated economic and fiscal volatility.

The United Conservative Party government, which holds a large majority in the Legislature, has the political capacity to enact reforms. In Budget 2021, the province's fiscal plan for the pandemic recovery period centers on steadily managing down expenditures as the economy and revenues rebound, and accelerated investment resulting from the reduction in corporate income tax rates the government implemented in 2019. The province has not established the timeline for a return to balance in this year's budget.

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 such as the pandemic. For fiscal 2021-2022, these transfers will constitute about 23% of operating revenues. Transfers have been higher during the pandemic because of additional federal funds for pandemic support. The agreements covering ongoing transfers are long-term, formula-driven, and predictable, but can be subject to change. Typically, the federal and provincial governments discuss proposed changes to transfer programs well ahead of their implementation.

Environmental, social, and governance (ESG) factors relevant to the rating action:

Health and Safety

Key Statistics

Table 1

Province of Alberta--Selected Indicators

	--Fiscal year end March 31--					
(Mil. C$)	**2018**	**2019**	**2020bc**	**2021bc**	**2022bc**	**2023bc**
Operating revenues	48,622	45,017	41,156	42,355	46,280	49,740
Operating expenditures	51,514	53,736	57,376	56,325	53,574	53,343
Operating balance	(2,892)	(8,719)	(16,220)	(13,970)	(7,294)	(3,603)
Operating balance (% of operating revenues)	(5.9)	(19.4)	(39.4)	(33.0)	(15.8)	(7.2)
Capital revenues	605	841	923	1,193	966	913
Capital expenditures	6,057	5,564	7,373	7,303	5,776	5,509
Balance after capital accounts	(8,344)	(13,442)	(22,670)	(20,080)	(12,104)	(8,199)

Table 1

Province of Alberta--Selected Indicators (cont.)

	--Fiscal year end March 31--					
(Mil. C$)	**2018**	**2019**	**2020bc**	**2021bc**	**2022bc**	**2023bc**
Balance after capital accounts (% of total revenues)	(17.0)	(29.3)	(53.9)	(46.1)	(25.6)	(16.2)
Debt repaid	36,932	33,513	22,015	15,624	12,370	14,068
Gross borrowings	51,036	42,382	34,936	34,497	25,743	19,874
Balance after borrowings	5,760	(4,573)	(9,749)	(1,207)	1,269	(2,393)
Direct debt (outstanding at year-end)	77,845	89,170	111,953	130,192	143,101	147,854
Direct debt (% of operating revenues)	160.1	198.1	272.0	307.4	309.2	297.3
Tax-supported debt (outstanding at year-end)	80,878	92,290	116,387	134,589	147,409	152,070
Tax-supported debt (% of consolidated operating revenues)	166.3	205.0	282.8	317.8	318.5	305.7
Interest (% of operating revenues)	4.1	5.0	5.8	6.5	6.7	6.7
Local GDP per capita (single units)	79,967	80,903	69,607	75,298	80,169	84,263
National GDP per capita (single units)	60,196	61,466	57,994	63,315	65,056	67,332

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. N/A--Not applicable. N.A.--Not available. N.M.--Not meaningful. Fiscal year is budget year.

Ratings Score Snapshot

Table 2

Province of Alberta--Ratings Score Snapshot

Key rating factors	**Scores**
Institutional framework	2
Economy	2
Financial management	2
Budgetary performance	5
Liquidity	2
Debt burden	5
Stand-alone credit profile	a
Issuer credit rating	A

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, April 12, 2021. Interactive version available at http://www/spratings.com/sri

Related Criteria

- 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: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Economic Outlook Canada Q2 2021: Consumer Spending Could Set The Pace Of Recovery, March 30, 2021
- S&P Global Ratings Revises Oil And AECO Natural Gas Price Assumptions And Introduces Dutch Title Transfer Facility Assumption, March 8, 2021
- Public Finance System Overview: Canadian Provinces, July 18, 2018
- Guidance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- Guidance: Sovereign Rating Methodology, Jan. 22, 2019

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

Downgraded

	To	From
Alberta (Province of)		
Senior Unsecured	A	A+

Downgraded; CreditWatch/Outlook Action; Ratings Affirmed

	To	From
Alberta (Province of)		
Issuer Credit Rating	A/Stable/A-1	A+/Negative/A-1

Ratings Affirmed

Alberta (Province of)		
Commercial Paper	A-1	