Five Themes for Provincial Budget Season

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We're in the thick of the provincial budget season right now, with some provinces tabling their Fiscal Year ("FY") 2022/2023 documents already. This article outlines five emerging themes for the group from an economic and fiscal perspective.

Balanced growth

Canada is known for wide regional growth disparities, but all provinces are rebounding with very strong and above-potential growth this year. That said, we rank Alberta at the top of the pack, thanks to the income-boosting effect of high oil prices, a resurgent housing sector and what appears to be consumer and business confidence not seen since before oil prices plunged in 2014. Often when Alberta (and other oil-producing provinces) surges, other areas of Canada slump. Recall that when Alberta posted average growth of 5.5% between 2011 and 2014, Ontario and Quebec averaged just 1.7%, with two of those years in the low 1% range. But that's not likely the case this time, with Central Canada, on average, expected to grow around the 3% mark through 2023. Strong local job markets and a still-subdued loonie are helping.

Oil windfall

The Province of Alberta is projecting a small C$511 million surplus in FY22/23, the first in eight years. The budget was built on C$70 West Texas Intermediate ("WTI"), along with nearly C$2 billion in contingencies, leaving plenty of upside to run well into surplus. Alberta's base sensitivity at these levels implies that a C$1 increase in oil prices adds about C$500 million to revenue. And, with a stable currency and light-heavy differential, it's not hard to conceive upside in the C$5-to-$10 billion range, all else equal. Newfoundland & Labrador and Saskatchewan (add in potash prices too) will also see significant boosts.

Eyes on Elections

Dramatic improvements in the fiscal picture versus a year ago couldn't come at a better time for the handful of provinces going to the polls in the near future. As we wind down FY21/22, recall that the combined provincial deficit (currently pegged at C$24.6 billion) was estimated at C$76.2 billion after the initial budget season a year ago, a massive in-year improvement. With much fuller (or less drained) coffers, Ontario has delayed its 2022 budget ahead of a June 2 election; Quebec rolled out more than $3 billion ($500 per person with income below $100,000 in 2021) in direct payments to individuals ahead of their October 2022 vote; and, Alberta will surely be deciding how to best deploy their windfall ahead of May 2023. Combined, this could all add some incremental fiscal support as Ottawa scales back.

Borrowing

With the largest province still to table their 2022 plans, we don't have a final borrowing amount yet, but the total looks to remain large. We'd estimate something in the C$110-to-$115 billion range, which would be down from the pandemic peak of around C$150 billion, but still above the pre-COVID run rate of closer to C$80 billion. While some provinces, like Alberta, will have very little to do this year, others (see British Columbia below) are looking at a much more active borrowing program.

Spreads in focus

Consider two major themes in provincial spreads as we wind down the budget season. First, geopolitical tension and potentially aggressive tightening cycles from the Federal government and the Bank of Canada have seriously derailed risk sentiment and associated assets. Indeed, the broad provincial group has seen 30-year spreads widen to as much as 94 basis points ("bps") versus Government of Canada Treasury Bills and Bonds ("GoCs") in recent days, from just over 70 bps at the start of the year. This is not crisis-level pricing (they topped 130 bps at the start of the pandemic), but it's notable in that wider spreads and higher underlying GoC yields have lifted new borrowing costs well off the lows for the group. Second, there have been some meaningful shifts in relative pricing below the surface. Alberta long-term bond yields now trade slightly through Ontario, a 23 bp improvement from a year ago (thank you, oil prices). British Columbia, on the other hand, has widened to levels rarely seen outside of crisis situations alongside a weaker near-term fiscal outlook.

For more information, please speak with your BMO financial professional.