April 10, 2018

Sticking to the plan: On track for a surplus in 2019-20

Highlights

- Saskatchewan's 2017-18 deficit is now estimated at $595 million (0.8% of GDP), $13.6 million more than in the mid-year update and $101 million less than in the 2017-18 Budget.
- For 2018-19 the deficit is forecast at $365.3 million (0.4% of GDP), a $230 million improvement over the fiscal year just ended. Surpluses are projected over each of the following three years, amounting to $212 million (0.2% of GDP) in fiscal year 2021-22. Expense control is a key element in keeping on track with the plan to eliminate the deficit.
- No increases in tax rates, but the second stage of the personal income tax rate reduction (half a percentage point scheduled to take effect on July 1rst 2019) is postponed for the time being. Also, the Budget announces the elimination of the PST exemption for used light vehicles and on Energy Star ® certified appliances, effective April 11, 2018. The 2018-19 Budget does not incorporate any revenue from the sale of cannabis in this initial year.
- The Budget introduces the Saskatchewan Value-added Agriculture Incentive that will provide a non-refundable Corporation Income Tax credit equal to 15% of qualifying new capital expenditures, the Saskatchewan Technology Start-up Incentive will provide a non-refundable tax credit equal to 45% of qualifying new investments made in eligible small businesses.
- From 1.5% assumed in 2017, real GDP growth is forecast to rise at 1.3% in 2018 and an average 2.3% over the next four years. Nominal GDP growth, assumed at 4.9% in 2017, is forecast at 4.0% in 2018, with growth averaging 4.4% over the next four years.
- The price of West Texas Intermediate (WTI) oil is expected to average US$59 a barrel this year, up from $US50.78 a barrel in 2017. WTI is projected to stay at $US59 in 2019 and to increase to $US62 in 2020, $US68 in 2021 and $US72 in 2022. From $US180.58 per KCl tonne in 2017, potash prices are expected to increase to $US190.43 in 2018 and to rise by about $US3 dollar a year afterwards. The price stated in $CAD, on which royalties are based, is forecast to increase from $384 per K_2O tonne in 2017 to $398 in 2018 and to hover without tendency around that level over the next four years. The Canadian dollar is assumed to appreciate somewhat each year over the planning horizon, therefore not contributing to increase resource revenue.
- Public debt, which was estimated at 22.5% of GDP at the end of last March, is expected to reach 24.4% of GDP at the end of the current fiscal year, and to top at 25.1% of GDP at the end of the fiscal year 2019-20, the ratio projected to edge down in the next two years.
- The borrowing requirements, estimated at $2.4 billion in 2017-18, are estimated to be $3.2 billion in 2018-19. Of this amount, $586 million is for the purpose of refinancing maturing debt, $400 million is increased debt for GRF operations, and the majority of the remaining amount is to assist with the financing of capital expenditures. The 2018-19 borrowing requirements include $600 million of borrowing that pertains to capital expenditures of 2019-20.

The third quarter update

In the third quarter financial update, 2017-18 budget figures were restated to conform to the Public Accounts regarding pension expense. Pension costs on an accrual basis are now included in expense and deficit calculations. In the table on page 4, this restatement affected the 2017-18 budget figures in the following way:

- Debt servicing was increased by $224.8 million.
- Program expenditures was decreased by $213.5 million, of which $112.3 million applied to education.

In the third quarter financial update, the deficit for 2017-18 was forecast at $595 million (0.8% of GDP), $13.6 million more than in the mid-year update and $101 million less than in the (restated) 2017-18 Budget. Compared to the mid-year update, revenue was revised down $168.6 million mainly due to downward revisions to taxation revenue and federal transfers (these were partly offset by upward revisions in Government business enterprise (GBE) net income, non-renewable resources revenue and other own-source revenue) while expenditures were revised down $155.3 million.

On the path to deficit elimination

In 2017-18, faced with challenging years marked by resource revenue that declined by more than $1 billion, due largely to low oil and potash prices, the Government charted a three-year plan to reduce the province's dependency on resource revenue and balance the budget in 2019-20. Budget 2018-19 keeps that plan on track by controlling government spending, while at the same time making important new investments targeted in health, education and social services.

For 2018-19, the deficit is projected at $365 million, $230 million less than the forecast for 2017-18. Total revenue is expected to improve $300 million (+2.2%) while expense is projected to increase $71 million (+0.5%). Excluding debt servicing, the projected increase in program expenditures is even thinner, at $20 million (+0.1%).

The increase in total revenue is due to higher tax revenue, non-renewable resource revenue and federal transfers, partially offset by decreases in GBE net income and other own-source revenue. Tax revenue is budgeted to increase $419 million from the 2017-18 forecast. Provincial Sales Tax (PST) revenue is budgeted accounts for $226 million, primarily due to the elimination of the PST exemption on used light vehicles, the full-year impact of last year's expansion of the PST to insurance premiums (excluding agriculture, life and health premiums), and growth in the taxable base as a result of increased economic activity. Individual and Corporation Income Tax revenue are budgeted to increase $129 million and $31 million, respectively. The increases are primarily due to significant negative prior-year adjustments experienced in 2017-18 that are not forecast to repeat in 2018-19. All other taxes are budgeted to increase by a combined $33 million.

Non-renewable resource revenue is assumed to increase by $62 million, while remaining well below levels experienced in recent years. The 2018-19 Budget forecast of $1.5 billion is $1.1 billion lower than actual revenue collected in 2014-15. Oil and natural gas royalties are budgeted to increase of $39 million from the 2017-18 forecast, with oil production edging up 0.4%. Potash revenue is forecast to increase $9 million. Resource Surcharge revenue is forecast to increase $20 million, largely due to higher oil and potash prices.

GBE net income is forecast to decrease $109 million largely reflecting declines of $101 million and $25 million at the Workers' Compensation Board and the Auto Fund, respectively, primarily due to one-time investment gains in 2017-18 that are not budgeted to repeat. In addition, SaskEnergy is budgeted to decline $36 million, primarily due to an expected return to normal weather conditions and more typical gas marketing volumes. These declines are partially offset by a $39 million increase at SaskPower mainly due to the 3.5% rate increase that became effective on March 1, 2018 and an $11 million increase at SaskTel due to expected growth in business and consumer revenue.

Other own-source revenue is budgeted to decrease $92 million, largely due to non-recurring revenues in 2017-18 that are not budgeted to repeat, including investment earnings, agricultural land sales, gains on the sale of assets, out-of-province fire-fighting recoveries and miscellaneous refunds.

Federal transfers are forecast to increase $20 million. The Canada Health Transfer and Canada Social Transfer will increase by $26 million and $6 million, respectively. All other federal cost-sharing agreements are budgeted to decrease $12 million, largely due to lower infrastructure contributions related to agreements and projects that are winding down.

From 2018-19 to 2021-22, total revenue is assumed to grow at an annual average of 2.9%, while expense growth is pegged at 1.6%. This explains why a surplus is assumed to emerge next year and to expand in the two following years.

Expense control

The fact that in 2018-19, expense is projected to be at about the same level as the 2017-18 forecast reflects the continuation of the Government's efforts to carefully manage spending. Many ministries and agencies are forecasting lower spending than in the previous fiscal year. Controlling compensation costs, the largest single component of Government's expense, is key to keeping Saskatchewan's fiscal plan on track. In addition to negotiated settlements, there is a target to achieve $70 million in savings over two years, $35 million in this Budget and a further $35 million next fiscal year. This is largely through efficiency initiatives and attrition.

An example of achieving efficiencies through positive change is the creation of a single Saskatchewan Health Authority. The consolidation of 12 regional authorities was completed last year. Greater integration and coordination has resulted in savings of $19 million in this Budget, from salaries, the amalgamation of IT services, and lower board costs. The Ministry of Central Services has reduced the size of its government vehicle fleet budget by 14.7%, saving more than $5 million, in part by using private rental cars where it proves to be more efficient and cost effective.

Economic assumptions and revenue sensitivity

For 2018, crop production is expected to be 34.4 million tonnes, slightly less than in 2017 but still well above the 10-year average. The price of West Texas Intermediate (WTI) oil is expected to average US$59.00 per barrel in 2018, up from US$50.78 per barrel in 2017. As a result, drilling activity is expected to improve. In 2018-19, average realized potash prices are budgeted at US$191 per KCl tonne (C$399 per K2O tonne), up from US$183 (C$388) in 2017-18. Sales are expected to increase from 12.2 million K2O tonnes in 2017-18 to 12.6 million K2O tonnes in 2018-19.

The 10-month suspension of operations at the McArthur River mine beginning in January 2018 is expected to reduce uranium production significantly in 2018. Dampening the outlook for Saskatchewan GDP growth this year. Nonetheless, Saskatchewan real GDP is currently expected to rise by 1.3 per cent in 2018. Nominal GDP is forecast to increase by 4.0 per cent. Growth in 2019 is expected to improve. Real GDP is forecast to grow by 2.5 per cent while nominal GDP is forecast to increase by 4.3 per cent.

The value of the Canadian dollar is projected to average 78.34 U.S. cents in 2018-19, up from an average of 77.82 U.S. cents in 2017-18. As the price of Saskatchewan resources are stated in U.S. dollars on world markets, a higher exchange rate translates to lower prices in Canadian dollars, all else being equal.

For 2018-19 it is estimated that:

• a US$1 per barrel change in the average WTI oil price results in an estimated $16 million change in oil royalties;

• a US$10 per KCl tonne (C$21 per K2O tonne) change in the average realized potash price results in an estimated $35 million change in potash royalties; and,

• a 1 U.S. cent change in the average exchange rate results in an estimated $21 million change in non-renewable resource revenue.

Budget measures

There are no increases in tax rates in the Budget. However, some planned reductions in tax rates or exemptions are foregone. The 2017-18 Budget announced that the personal income tax rates would be reduced in two stages – an initial half-point reduction on July 1, 2017 and a second half-point reduction on July 1, 2019. The 2018-19 Budget announces a temporary freeze to the tax rate reduction plan. For the time being, tax rates will remain at the current level determined by the implementation of the first-stage reduction. Also, the Budget announces the elimination of the PST exemption for used light vehicles and on Energy Star ® certified appliances, effective April 11, 2018.

The Budget introduces the Saskatchewan Value-added Agriculture Incentive that will provide a non-refundable Corporation Income Tax credit equal to 15% of qualifying new capital expenditures, the Saskatchewan Technology Start-up Incentive will provide a non-refundable tax credit equal to 45% of qualifying new investments made in eligible small businesses. The 2018-19 Budget does not incorporate any revenue from the sale of cannabis in this initial year.

Debt and borrowing

Public debt (net of sinking funds) at March 31, 2018 is forecast to be $448.2 million lower than estimated at last year's budget, due primarily to lower GBEs debt. For 2018-19, public debt is expected to increase by $2.3 billion. This is primarily due to $1.5 billion of new borrowings to enable the General Revenue Fund (GRF) to finance infrastructure assets for the Saskatchewan Builds Capital Plan, $0.5 billion of increased debt for the utility Crown corporations and $0.4 billion for GRF operations. These increases are slightly offset by reductions in the debt of other government service organizations.

Public debt, which was estimated at 22.5% of GDP at the end of last March, is expected to reach 24.4% of GDP at the end of the current fiscal year, and to top at 25.1% of GDP at the end of the fiscal year 2019-20, the ratio projected to edge down in the next two years.

The borrowing requirements, estimated at $2.4 billion in 2017-18, are estimated to be $3.2 billion in 2018-19. Of this amount, $586 million is for the purpose of refinancing maturing debt, $400 million is increased debt for GRF operations, and the majority of the remaining amount is to assist with the financing of capital expenditures. The 2018-19 borrowing requirements include $600 million of borrowing that pertains to capital expenditures of 2019-20. Borrowing these funds in advance capitalizes on the current environment of historically low interest rates.

Marc Pinsonneault

Saskatchewan • 2018 Budget

NATIONAL BANK OF CANADA FINANCIAL MARKETS

Saskatchewan

$000 000	Budget 2017-18	Forecast 2017-18	Budget 2018-19	Plan 2019-20	Plan 2020-21	Plan 2021-22
Consolidated Budget						
Total revenues	**14,165.1**	**13,943.0**	**14,243.5**	**14,761.0**	**15,114.0**	**15,518.0**
Taxes	7,286.6	6,796.3	7,214.9			
of which provincial sales tax	2,049.5	1,929.5	2,155.0			
Non-renewable resources	1,406.4	1,419.7	1,482.1			
Net income from Government Business Enterprises	1,053.7	1,186.5	1,078.0			
Other revenue	1,964.9	2,098.2	2,006.5			
Transfers from the Government of Canada	2,453.5	2,442.3	2,462.0			
Total spending	**14,811.1**	**14,538.0**	**14,608.8**	**14,755.0**	**15,006.0**	**15,306.0**
Program expenditure	14,205.4	13,934.7	13,954.2			
As of Health	5,627.4	5,730.0	5,765.3			
As of Education	3,531.0	3,449.4	3,263.3			
As of Other	5,047.0	4,755.3	4,925.6			
Debt servicing	605.7	603.3	654.6			
Human Resources Compensation Measures	(250.0)	-	-	-	-	-
Contingency	300.0	-	-	-	-	-
Surplus (deficit) *	**(696.0)**	**(595.0)**	**(365.3)**	**6.0**	**108.0**	**212.0**
Public debt (end of year - net of sinking funds)						
General Revenue Fund and Gov. Service organizations	9,062.5	9,027.8	10,775.1	12,000.0	12,600.0	13,300.0
Government Business Enterprises	9,137.5	8,724.0	9,259.8	9,500.0	9,700.0	9,800.0
Total: Public Debt	**18,200.0**	**17,751.8**	**20,034.9**	21,500.0	22,300.0	23,100.0
As a % of GDP	22.6%	22.5%	24.4%	25.1%	25.0%	24.8%
Net Debt						
Beginning of year	10,780.8	10,191.9	11,774.6	12,647.8		
Summary deficit (surplus)	696.0	595.0	365.3	(6.0)	(108.0)	(212.0)
Acquisition of Government Service Organization Capital Assets	1,487.5	1,558.9	1,118.0			
Amorization, disposal and adjustments	(582.9)	(571.2)	(610.1)			
End of year	**12,243.7**	**11,774.6**	**12,647.8**			
Borrowing requirements	**2,717.0**	**2,369.3**	**3,206.1**			
For Crown Corporations	1,062.0	714.3	731.1			
For Government - operating	555.0	555.0	975.0			
For Government - Capital Plan	1,100.0	1,100.0	1,500.0			
Pension liabilities						
Beginning of year	7,784.4	7,786.1	7,695.5			
Adjustment to account for pension costs on an accrual basis	11.3	(90.6)	(393.2)			
End of year	**7,795.7**	**7,695.5**	**7,302.3**			

Source: Budget documents, Saskatchewan Ministry of Finance.

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Economics and Strategy

Montreal Office
514-879-2529

Stéfane Marion
Chief Economist and Strategist
stefane.marion@nbc.ca

Paul-André Pinsonnault
Senior Fixed Income Economist
paulandre.pinsonnault@nbc.ca

Krishen Rangasamy
Senior Economist
krishen.rangasamy@nbc.ca

Marc Pinsonneault
Senior Economist
marc.pinsonneault@nbc.ca

Matthieu Arseneau
Senior Economist
matthieu.arseneau@nbc.ca

Angelo Katsoras
Geopolitical Analyst
angelo.katsoras@nbc.ca

Kyle Dahms
Economist
kyle.dahms@nbc.ca

Jocelyn Paquet
Economist
jocelyn.paquet@nbc.ca

Toronto Office
416-869-8598

Warren Lovely
MD & Head of Public Sector Strategy
warren.lovely@nbc.ca

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