March 22, 2017

A plan to return the budget to balance in three years

Highlights

- Saskatchewan's 2016-17 deficit is now estimated at $1.3 billion (1.7% of GDP), $247 million more than in the Mid-Year Update. The increase comes mostly from larger-than-expected program expenses swollen by higher crop-insurance claims after a poor harvest.
- For 2017-18 the deficit is forecast at $685 million, a $604 million improvement over the fiscal year about to end. The 2017-18 revenue outlook includes a net $908 million in new tax measures.
- A smaller shortfall of $304 million is projected for 2018-19, and a return to balance in the following year.
- Saskatchewan's three personal income tax (PIT) rates and the general Corporation Income Tax (CIT) rate will be lowered half a point effective July 1, 2017 and another half-point effective July 1, 2019.
- The tax credit rate for eligible dividends will be reduced in quarter-point increments in each of the 2017 to 2020 taxation years. This change will reduce the dividend tax credit rate from 11% currently to 10% by 2020. The Labour-Sponsored Venture Capital Tax Credit rate is reduced from 20% to 15% effective for the 2018 taxation year.
- The Manufacturing and Processing Profits Tax reduction, which lowers the general CIT rate on eligible income by up to two percentage points, is maintained.
- The Saskatchewan Commercial Innovation Incentive will reduce the CIT rate to 6% on taxable income earned from the commercialization of qualifying intellectual products for a period of 10 years, extendible to 15 years if the qualifying product is developed substantially in Saskatchewan. The R&D Tax Credit is reformed to better target small and medium-sized innovation companies.
- Effective March 23, 2017, the Provincial Sales Tax (PST) rate is increased to 6% from 5% and Tobacco Tax rates are increased to 27¢ per cigarette from 25¢. Effective April 1, 2017, some Provincial Sales Tax (PST) exemptions are eliminated, notably for children's clothing and for restaurant meals and snack foods. Effective July 1, 2017, PST will apply to insurance premiums. Effective April, 1, 2017, most exemptions to the Fuel Tax are eliminated.
- The Budget incorporates measures aimed at reducing the province's public-sector payroll by $250 million.
- Real GDP growth is assumed at 0.8% in 2017 and an average 1.9% over the next three years. Nominal GDP growth is assumed at 4.9% in 2017, 5.7% in 2018 and 4.5% in 2019. Employment is assumed to recover the 2016 loss only in 2018.
- The price of West Texas Intermediate (WTI) oil is expected to average US$55 a barrel this year, up from $43.40 a barrel in 2016. In following years, WTI is projected to increase $4 or $5 a year. Potash prices are expected to increase somewhat in 2017 but to remain more or less flat in 2018 and 2019. The Canadian dollar is assumed to depreciate somewhat from 75.5 cents US on average in 2016 to 74.7 cents in 2017, and then appreciate to 75.7 cents in 2018 and 77.1 cents in 2019.
- Public debt, which amounted to 13.9% of GDP at the end of March 2015, is expected to reach 20.9% of GDP at the end of the current fiscal year, March 31. Smaller deficits are assumed to slow the growth of this ratio thereafter, taking it to 24.6% of GDP in 2021.
- Borrowing requirements, estimated at $3.4 billion in 2016-17, are projected to decrease to $2.7 billion in the coming fiscal year (including $377 million for refinancing maturing debt) as a result of lower requirements for government operations, more than offsetting an increase in requirements of Crown Corporations and the government's Capital Plan.

Saskatchewan – 2017 Budget

NATIONAL BANK OF CANADA FINANCIAL MARKETS

The Third Quarter Update

The deficit for 2016-17 is forecast in the Third Quarter Update at $1.3 billion (1.7% of GDP), $247 million more than in the Second Quarter Update. The change comes mostly from an increase in program expenses, more specifically from significantly higher crop insurance claims.

That forecast deficit is $854 million worse than budgeted last spring. Revenue fell $329 million short, with taxation revenue revised down $522 million and non-renewable resource revenue revised down $206 million. In both cases the shortfall is blamed mostly on weakness in the resource sector. But that shortfall was largely offset by a $686-million upward revision of federal transfers. Of that amount, $365 million, due primarily to the recognition of a fair value of the federal dams transferred to the province, came since the Second Quarter Update. So on net, the decrease in total revenue is in good part explained by a non-recurring $235.5-million Workers' Compensation Board return of surplus funds to employers, booked in the table on page 4 as reduced net income from Government Business Enterprises.

Expenses ran $525 million over Budget. Most of the overrun, $232 million, was booked since the Mid-Year Update and was due to higher crop insurance claims related mostly to poor harvest conditions.

Budget 2017-18 objectives

The collapse of oil and potash prices that began three years ago has significantly hit taxation revenue as well as non-renewable resource revenue, since not only mining, oil and gas output but the economy as a whole has been in recession over the last two years. This year's budget sets a course of response to this challenge and return to balance over three years. This is to be accomplished by spending control, expansion of the base of consumption taxes, an increase in the PST rate and reduction or elimination of some tax credits.

The budget lowers income tax rates and provides support to the economy with infrastructure investment (the Saskatchewan Builds Capital Plan) amounting to $1.6 billion in 2017-18 plus $2.1 billion in investment by Crown Corporations, for a total of $3.7 billion.

Budget measures

Budget 2017 introduces a wide range of revenue measures.

Saskatchewan's three personal income tax (PIT) rates and the general Corporation Income Tax (CIT) rate will be lowered half a point effective July 1, 2017 and another half-point effective July 1, 2019. By the latter date the general CIT tax rate will be 11%, the lowest rate in Canada.

The tax credit rate for eligible dividends will be reduced in quarter-point increments in each of the 2017 to 2020 taxation years. This change will reduce the dividend tax credit rate from 11% currently to 10% by 2020. The Labour-sponsored Venture Capital Tax Credit rate is reduced from 20% to 15% effective for the 2018 taxation year. The Employee's Tools Tax Credit is eliminated effective in the 2017 taxation year.

The Saskatchewan Commercial Innovation Incentive will reduce the CIT rate to 6% on taxable income earned from the commercialization of qualifying intellectual products for a period of 10 years, extendible to 15 years if the qualifying product is developed substantially in Saskatchewan. The R&D Tax Credit is reformed to better target small and medium-sized innovation companies.

The Manufacturing and Processing Profits Tax reduction, which lowers the general CIT rate on eligible income by up to two percentage points, is maintained.

Effective April 1, 2017, the Budget eliminates some Provincial Sales Tax (PST) exemptions, notably for children's clothing and for restaurant meals and snack foods. Effective July 1, 2017, PST will apply to insurance premiums. Effective April 1, 2017, most of the Fuel Tax exemptions are eliminated.

Effective March 23, 2017, the PST rate is increased to 6% from 5% and Tobacco Tax rates are increased to 27¢ from 25¢ per cigarette, tobacco stick or gram of cut tobacco. To mitigate the effect of the PST changes for lower-income residents, the Saskatchewan Low-Income Tax Credit is enhanced effective July 1, 2017.

Effective April 1, 2017, the commissions paid to businesses for tax collection and remittance are discontinued.

In total, measures taken this year will add a projected $908 million to tax revenue.

The cost of compensation across the public sector is about $7 billion annually. The budget includes a reduction of $250 million, or 3.5%, in total public-sector compensation expense. In 2017 the government is winding down the Saskatchewan Transportation Company, whose operation would have cost $85 million in subsidies over the next five years, and the Executive Air Service. Other decisions have resulted in substantial reductions, deferrals and suspensions of funding in many areas.

A $300-million contingency protects against unexpected in-year revenue declines and unforeseen expense pressures due to higher-than-projected utilization and natural disasters like forest fires and floods. For 2017-18 it is estimated that:

• a US$1 per barrel change in the fiscal-year average WTI oil price would result in an estimated $16-million change in oil royalties;

• a change of US$10 per KCl tonne (C$22 per K_2O tonne) in the average realized 2017 potash price would result in an estimated $37-million change in potash royalties; and

• a change of 1 cent US in the fiscal-year average exchange rate would result in an estimated $22-million change in non-renewable resource revenue.

The PST base expansions and rate increase, as well as other revenue measures, will of course act to brake GDP. But the government considers that this effect will be largely offset by stimulus from income tax reductions, ongoing investment in infrastructure and increased operating spending.

Prudent assumptions for commodity prices

As oil prices recover somewhat, supporting an increase in drilling, and the global economy gains momentum, Saskatchewan's export-based economy is poised for growth in 2017. Real GDP growth is assumed at 0.8% in 2017 and an average 1.9% over the next three years. Nominal GDP growth is assumed at 4.9% in 2017, 5.7% in 2018 and 4.5% in 2019. Employment is assumed to recover the 2016 loss only in 2018.

Commodity prices are expected to improve, but at no frenzied pace. WTI oil is expected to average US$55 a barrel this year, up from $43.40 in 2016. In following years, WTI is expected to increase $4 or $5 a year. So in 2019, the year of projected return to budget balance, WTI is assumed to average US$65. Potash prices are expected to increase somewhat in 2017 but to remain more or less flat in 2018 and 2019.

The Canadian dollar is assumed to depreciate somewhat from 75.5 cents US on average in 2016 to 74.7 cents in 2017, and then appreciate to 75.7 cents in 2018 and 77.1 cents in 2019.

Changing the trajectory of deficits

Revenue for 2017-18 is budgeted at $14.2 billion, up about $141 million from the projection included in last year's budget and up $471 million (3.4%) from forecast revenue in 2016-17. Taxation revenue is budgeted to surge $948 million to $7.3 billion. Most of this increase is due to the PST measures outlined above, which are expected to increase revenue by $889 million. Non-renewable resource revenue is budgeted to increase $127 million to $1.4 billion (much lower than the $2.6 billion earned in 2014-15). These increases are budgeted to be partially offset by significant declines in federal transfers and in other own-source revenue. In 2016-17, federal transfers were inflated by transfer to the province of federal dams ($650 million), by federal disaster assistance related to wildfires and flooding in recent years ($85 million) and by flow-through funding from the federal Post-Secondary Institutions Strategic Investment Fund ($65 million). The drop in other own-source revenue is due mainly to a budgeted decrease in premium revenue at Saskatchewan Crop Insurance Corporation and lower land sales at the Ministry of Agriculture.

Net income from Government Business Enterprises is budgeted to improve $285 million, reflecting the effect last year of the Workers' Compensation Board return of surplus funds to employers.

Before the $250-million reduction in public-sector compensation, this year's budgeted expenses are up $342 million (2.4%) from last year's budget.

The budgeted 2017-18 deficit of $685 million, after the planned reduction in compensation costs and the contingency allowance, is a little more than half that forecast for 2016-17. The deficit is projected to be eliminated two years later, with total revenue growing 3.7% on average over these two years and spending growth held to 1.2%.

Debt and borrowing

Deficits are projected to increase the debt of Government Service Organizations from 5.2% of GDP at the end of March 2015 to 11.5% four years later. In parallel, Government Business Enterprise debt is projected to grow from 8.7% of GDP in 2015 to 10.9% in 2017 and 11.8% in 2021. So total public debt, which amounted to 13.9% of GDP in 2015, is projected to rise to 20.9% at March 31 this year and 24.6% at March 31, 2021.

Borrowing requirements, estimated at $3.4 billion in 2016-17, are projected to shrink in the coming fiscal year to $2.7 billion (including $377 million for refinancing maturing debt), due to a reduction in requirements for Government's operations which more than offset larger requirements for Crown Corporations and Government's Capital Plan.

Borrowing requirements, estimated at $3.4 billion in 2016-17, are projected to shrink in the coming fiscal year to $2.7 billion (including $377 million for refinancing maturing debt) as a result of lower requirements for government operations, more than offsetting an increase in requirements of Crown Corporations and the government's Capital Plan.

Marc Pinsonneault

Saskatchewan – 2017 Budget

NATIONAL BANK OF CANADA FINANCIAL MARKETS

Saskatchewan

$000 000	Budget 2016-17	Forecast 2016-17	Budget 2017-18	Plan 2018-19	Plan 2019-20	Plan 2020-21
Consolidated Budget						
Total revenues	**14,023.9**	**13,694.4**	**14,165.1**	**14,694.0**	**15,237.0**	**15,708.0**
Taxes	6,860.9	6,339.0	7,286.6			
of which provincial sales tax	1,312.1	1,184.3	2,049.5			
Non-renewable resources	1,484.9	1,279.0	1,406.4			
Net income from Government Business Enterprises	1,084.4	768.3	1,053.7			
Other revenue	2,088.9	2,117.2	1,964.9			
Transfers from the Government of Canada	2,504.8	3,190.9	2,453.5			
Total spending	**14,458.1**	**14,982.9**	**14,799.8**	**14,948.0**	**15,172.0**	**15,475.0**
Program expenditure	14,160.9	14,687.1	14,502.6			
As of Health	5,588.1	5,668.9	5,588.1			
As of Education	3,688.4	3,729.0	3,688.4			
As of Other	4,884.4	5,289.2	5,226.1			
Debt servicing	297.2	295.8	297.2			
Human Resources Compensation Measures	-	-	(250.0)	(250.0)	(250.0)	(250.0)
Contingency	-	-	300.0	300.0	**300.0**	**300.0**
Surplus (deficit) *	**(434.2)**	**(1,288.5)**	**(684.7)**	**(304.0)**	**15.0**	**183.0**

** Before adjustment to account for pension costs on an accrual basis (see net debt)*

Public debt (end of year - net of sinking funds)

	Budget 2016-17	Forecast 2016-17	Budget 2017-18	2018-19	2019-20	2020-21
General Revenue Fund and Gov. Service organizations	6,389.7	7,680.6	9,062.5	9,900.0	11,200.0	11,900.0
Government Business Enterprises	8,383.2	8,398.6	9,137.5	9,900.0	10,600.0	10,900.0
Total: Public Debt	**14,772.9**	**16,079.2**	**18,200.0**	19,800.0	21,800.0	22,800.0
As a % of GDP	19.9%	20.9%	22.6%	23.2%	24.4%	24.0%

Net Debt

	Budget 2016-17	Forecast 2016-17	Budget 2017-18	2018-19	2019-20	2020-21
Beginning of year	7,649.7	7,899.3	10,643.1	12,243.7		
Summary deficit (surplus)	434.2	1,288.5	684.7	304.0	(15.0)	(183.0)
Acquisition of Government Service Organization Capital Assets	1,789.0	2,165.1	1,487.5			
Amorization, disposal and adjustments	(609.4)	(572.1)	(582.9)			
Adjustment to account for pension costs on an accrual basis	(130.1)	(137.7)	11.3			
End of year	**9,133.4**	**10,643.1**	**12,243.7**			

	Budget 2016-17	Forecast 2016-17	Budget 2017-18
Borrowing requirements	**2,045.1**	**3,419.6**	**2,717.0**
For Crown Corporations	745.1	811.8	1,062.0
For Government - operating	300.0	1,607.8	555.0
For Government - Capital Plan	1,000.0	1,000.0	1,100.0

Pension liabilities

	Budget 2016-17	Forecast 2016-17	Budget 2017-18
Beginning of year	7,911.2	7,922.1	7,784.4
Adjustment to account for pension costs on an accrual basis	(130.1)	(137.7)	11.3
End of year	**7,781.1**	**7,784.4**	**7,795.7**

Source: Budget documents, Saskatchewan Ministry of Finance.

Saskatchewan – 2017 Budget

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

Toronto Office
416-869-8598

Warren Lovely
MD, Public Sector Research and Strategy
warren.lovely@nbc.ca