NATIONAL BANK OF CANADA
FINANCIAL MARKETS

June 15, 2020

"A pandemic deficit, not a structural deficit"

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Highlights

- **Economic outlook** – COVID-19 and its associated disruptions look to translate into a real GDP contraction of 6.3% in 2020. Adding the impact of lower oil prices, nominal output is set to shrink by 12.8% this year. This outlook reflects the middle of three scenarios (i.e., Scenario 2) previously telegraphed on April 17th. As in other jurisdictions, temporary job losses are driving the unemployment rate sharply higher. Employment was off 10% from February to May, and on a full-year basis, Saskatchewan now pegs its 2020 unemployment rate at 8.6% vs. last year's 5.4%. It's worth noting that the unemployment rate is the second lowest in the country. To some extent, income support programs limit the hit to wages and salaries, although unprecedented shutdowns mean consumer spending is nonetheless down sharply. Saying all that, the COVID-19 hit is meant to be temporary, with the growth outlook for 2021 deemed "positive". The province anticipates 4.6% real GDP growth next year. A pick-up in global growth is expected to key a rebound in oil prices, lifting nominal output 7.2% in 2021. Overall, you could call this "measured optimism". Given the high degree of uncertainty still embedded in economic projections, the budget's 2020-21 real GDP planning assumptions are reasonably close to consensus: -6.6% this year, followed by 5.2% in 2021. The budget does not offer a longer-term economic outlook. For those counting COVID-19 cases, Saskatchewan's per capita case counts are ~80% below the national average, with the fatality rate more like 90% below the national average. These stats give the province confidence it can re-open and control the virus' spread.
- **Restated results for the 2019-20 fiscal year** – Its mid-June and the focus is rightly on the 2020-21 fiscal year. However, unofficial results show the arrival of the virus and the related destabilization of global growth meant 2019-20 ended on a weak fiscal note. So relative to a budget plan calling for a $34 million surplus—which was meant to end a string of deficits dating back to the 2015 oil price collapse—Saskatchewan remained in the red to the tune of $319 million in 2019-20. The main story, relative to the late-2019 guidance was a $490 million revenue hit, which was predominantly due to net investment losses and only partially offset by lower spending vs. the prior year's Q3 update.
- **Outlook for 2020-21 fiscal year** – In Saskatchewan and elsewhere, the fiscal hit captured at the tail end of 2019-20 amounts to a warmup act for a much more severely impacted 2020-21. In Saskatchewan's case, a budget deficit of $2.4 billion (>3% of GDP) is now foreseen, which again compares to balanced pre-virus budgetary trajectory. The budget does not set out targets beyond the current 2020-21 fiscal year. As we've seen elsewhere, longer-term fiscal guidance awaits a more becalmed environment when economic risks and uncertainty hopefully dissipate. Indeed, Finance Minister Donna Harpauer indicated a plan to bring the budget back to balance "over time" will be developed in the coming months. Stay tuned. The minister likewise emphasized that Saskatchewan entered the COVID-19 crisis for a position of relative fiscal health vs. other provinces, calling the projected shortfall a "pandemic deficit" not a "structural deficit". The budget includes a $200 million health and public safety contingency, designed to add a measure of fiscal prudence should a second wave of the virus emerge later this year.
- **Revenue picture** – Overall, the revenue outlook is consistent with the "Scenario 2" economic outlook cited above, which assumes a gradual re-opening (which started in May) and a substantial economic recovery by the second half of the fiscal year (i.e., September 2020). Notwithstanding initial success in terms of re-opening the provincial economy, "considerable uncertainty with respect to the pace and strength of economic recovery exists". At this point, the pandemic and many related/vital tax deferrals means the 2020-21 revenue picture is set to wilt some $1.2 billion or 8.3% vs. the prior fiscal year. The budget notes that "every own-source revenue category is projected to decline". Specifically, tax revenue is seen off 4.6% from 2019-20 (aided by positive prior-year adjustments for income taxes), while the non-renewable resource take is forecast to plunge a much deeper 43%. The resource revenue decline works out to ~$750 million, capturing significantly lower oil prices and production levels, plus a further hit from lower potash prices. Federal transfers, while accounting for a smaller share of revenue (~20%) than many other provinces (since Saskatchewan does not qualify for Equalization), are nonetheless slated for 7.6% growth. In terms of new initiatives, Saskatchewan is re-introducing automatic annual indexation of personal income tax brackets (for the 2021 tax year), bringing in a new investment incentive for the fertilizer sector, extending an incentive for exporters in the manufacturing/processing sector, and moving to ensure "non-resident businesses" fairly collect sales tax in the province. Meanwhile, a new PST rebate (up to 42% of PST paid on new home worth up to $350K) aims to spur construction activity. Elsewhere, an Oil Infrastructure Investment Program is meant to prod new/expanded pipeline development, with three new trade offices to be developed in Japan, India and Singapore.
- **Key energy price assumptions & sensitivities** – For 2020-21, the budget assumes WTI averages US$30/bbl. (The prompt contract traded at US$37/bbl on budget day.) The light-heavy price differential is pegged at 40% of WTI (i.e., US$12/bbl for the fiscal year vs. ~US$8/bbl today). Official sensitivities imply each US$1/bbl change in WTI is worth C$11 million to the province, all else equal. As for potash, the average price for 2020-21 is assumed to be US$188/KCl tonne, which is down from US$223 in 2019-20. Fiscal sensitivities put the impact of a US$10 change in the per KCl tonne price at C$64 million. Note that lower commodity prices often go hand-in-hand with a cheaper loonie, so it's important to bear in mind that each 1 US cent change in the Canadian dollar is worth $22 million to Saskatchewan on an annualized basis.

- **Expenditure profile** – While revenue is off, COVID-related spending measures (on top of some pre-crisis commitments) contribute to a $869 million or 5.7% increase in total expenditures vs. the latest estimate for 2019-20. (The spending increase is closer to $1.1 billion or 7.2% if the basis of comparison is the original 2019 budget plan.) New virus-related spending measures (a fraction of which are covered within existing funds) include but are not limited to:
  - $150 million for shovel-ready municipal infrastructure projects via the new Municipal Economic Enhancement Program;
  - $150 million in reclamation funding for inactive oil and gas wells/facilities;
  - $56 million for a temporary wage subsidy program for lower income essential workers;
  - $50 million in emergency financial support for hard hit small and medium-sized businesses;
  - $50 million of emergency support for First Nations and Métis organizations to help offset the revenue hit from the closure of casinos;
  - A variety of other measures, including commercial rent assistance, supports for livestock producers and for the corrections/justice system. Additionally, extra monies are being added to the capital plans for government-owned assets (e.g., schools, hospitals and highways), which is part of an infrastructure stimulus program announced in May and worth $2 billion, which is designed to bolster jobs and growth.
- **Debt outlook** – Saskatchewan is a low-debt jurisdiction by provincial standards; relatively low financial leverage helps to explain above-average credit ratings. The province estimated its net debt-to-GDP ratio at 15.1% at the end of 2019-20, with the majority of Canada's provinces posting debt ratios in excess of 30% for that period. As FinMin Harpauer argues, low debt provides flexibility during the crisis. In 2020-21, net debt is set to grow $2.8 billion to $15.1 billion, which combined with sharply lower nominal GDP will mean a sizable year-over-year increase in the debt burden to ~20%. The majority of this year's debt increase can be traced to COVID-19 impacts, while the remainder is tied to capital investments that had been outlined prior to the virus outbreak. Of the $7.54 billion two-year capital plan, crowns account for $3.434 billion (which is keyed more than anything by SaskPower's investments in the electricity system). The budget assumes short-term financing rates of 1% and 2.5% for long-term debt. A 1%-pt parallel shift in interest rates (vs. budget assumptions) would impact financing charges by $68 million in the first full year.
- **Long-term borrowing requirement** – After borrowing $2.1 billion in 2019-20, Saskatchewan's larger deficit and enhanced capital program result in a gross funding need of $4.46 billion this fiscal year. This year's figure includes $1.9 billion of COVID-related borrowing to maintain services/investments, which is added to pre-existing capital spending commitments and refinancings. Saskatchewan, like many of the provinces, got its borrowing program off to fast start and, as of budget day, had completed $1.9 billion of term funding. As in prior years, all of the completed amount has been sourced domestically, although deals have already covered a variety of terms and have been both fixed and floating. At this point, there's roughly $2½ billion to go, with more than three quarters of the fiscal year still left to run. Granted, there is a general election to work around, with the vote needing to be held no later than October 26th.
- **Long-term credit ratings** – S&P: AA, Stable | Moody's: Aaa, Stable | Morningstar DBRS: AA, UR-Neg | Fitch: AA, Stable

Conclusion

As in every other province in Canada, COVID-19 and the related disruptions, shut-ins, shut-downs and overall global retrenchment have weighed heavily on Saskatchewan GDP and jobs. Rather than getting back to balance in 2019-20 and staying there, the virus has upset the fiscal outlook, robbing the province of revenue and leaving a deficit of $2.4 billion in its wake (for the 2020-21 fiscal year). As in other resource-levered jurisdictions, low oil prices have complicated the revenue picture, although a more-recent firming in commodities prices has eased anxiety (to a degree). Part of the 2020-21 deficit captures an anti-virus action plan and infrastructure stimulus, which complement strong fiscal action being taken at the federal level. Fiscal stimulus, while bolstering recovery prospects, entails extra borrowing and Saskatchewan's gross funding requirements are more than doubling to $4.46 billion this fiscal year. A good portion, $1.9 billion, has already been sourced from the bond market mind you, with today's accelerated borrowing status implying latitude to manage future bouts of market instability and/or an upcoming 2020 election blackout. In general, with the Bank of Canada's large-scale asset purchases sucking up so many bonds, fears of serious bond supply indigestion have been held at bay. Meanwhile, the province sees its relatively low debt ratio as providing a degree of flexibility to respond to the pandemic; we tend to agree. So too, do credit rating agencies. Moody's affirmed the province at Aaa with a "stable" outlook in mid-April, although Morningstar DBRS placed Saskatchewan (along with Newfoundland and Labrador) "under review with negative implications" prior to the budget (on March 19th). All told, COVID-19 has left a serious mark on economic and fiscal performance, with the degree of scarring still somewhat uncertain. While limiting its guidance to the 2020-21 fiscal year, the province sees a case for "measured optimism", anticipating a solid rebound later this year and into 2021, which would set the stage for a gradual fiscal recovery path (the details of which have yet to be worked out).

Saskatchewan

$000 000	Budget 2019-20	Prelim. 2019-20	Budget 2020-21
Consolidated Budget			
Total revenues	**15,025.1**	**14,887.1**	**13,648.7**
Taxes	7,588.5	7,553.3	7,202.8
of which provincial sales tax	*2,304.7*	*2,205.8*	*1,996.0*
Non-renewable resources	1,826.8	1,750.3	997.4
Net income from Government Business Enterprises	1,080.5	855.3	728.8
Other revenue	2,062.1	2,138.4	1,933.1
Transfers from the Government of Canada	2,467.2	2,589.8	2,786.6
Total spending	**14,990.7**	**15,206.4**	**16,074.7**
Program expenditure	14,296.3	14,531.4	15,356.5
As of Health	*5,888.2*	*6,051.4*	*6,176.3*
As of Education	*3,282.5*	*3,501.6*	*3,361.9*
As of Other	*5,125.6*	*4,978.4*	*5,818.3*
Debt servicing	694.4	675.0	718.2
Surplus (deficit)	**34.4**	**(319.3)**	**(2,426.0)**
Public debt (end of year - net of sinking funds)			
General Revenue Fund and Gov. Service organizations	11,934.1	11,954.9	14,336.6
Government Business Enterprises	9,757.8	9,376.6	10,032.6
Total: Public Debt	**21,691.9**	**21,331.5**	**24,369.2**
Net Debt			
Beginning of year	12,131.5	11,923.2	12,288.9
Summary deficit (surplus)	(34.4)	319.3	2,426.0
Acquisition of Government Service Organization Capital Assets	920.3	843.0	1,044.2
Amorization, disposal and adjustments	(655.3)	(796.7)	(637.3)
End of year	**12,362.1**	**12,288.9**	**15,121.8**
Borrowing requirements		**2,092.0**	**4,458.0**
COVID: Crown Corporations		-	229.0
COVID: Capital stimulus		-	300.0
COVID: Geeneral revenue Fund		-	1,350.0
Refinancing maturing debt		196.0	1,096.0
Capital spending		1,896.0	1,483.0
Pension liabilities			
Beginning of year	7,318.2	7,322.5	7,152.3
Adjustment to account for pension costs on an accrual basis	(448.7)	(170.2)	(514.5)
End of year	**6,869.5**	**7,152.3**	**6,637.8**

Source: Budget documents, Saskatchewan Ministry of Finance.

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