



March 18, 2015

OIL PRICE DROP LEADS TO FISCAL RESTRAINT

Highlights

- The Saskatchewan government projected a \$40 million surplus for fiscal 2014-15, down from the \$71.5 million surplus estimated in the mid-year update. The narrowing of the surplus largely reflected lower non-renewable resource revenues which were weighed down by the drop in oil prices.
- The government projects narrow surpluses over the fiscal plan (hovering around 0.1%-0.2% of GDP). In fiscal 2015-16, an estimated surplus of \$107 million will be achieved with both revenues and expenses growing by 1.2% relative to Budget 2014. Program spending in the priority areas of education, health and social services and assistance are estimated to rise by just under 2%. Spending outside these core services is projected to decline 0.6%.
- Today's budget outlined a four-year, \$5.8 billion infrastructure plan – the Saskatchewan Builds Capital Plan. In fiscal 2015-16, \$3.3 billion in capital outlays are targeted with \$1.3 billion allocated for core infrastructure spending. Another \$2 billion will be channelled towards Crown Corporations. Public debt as a share of GDP will increase to 16.7% this fiscal year before moving lower to 15.3% by fiscal 2018-19.
- There were no tax hikes announced in today's budget. Two new growth-oriented tax incentives were introduced. (1) The Manufacturing and Processing Exporter Tax Incentive provides tax credits to export-related corporations that increase their number of full-time employees. (2) An income tax rebate for primary steel producers was also unveiled to bolster capital spending.
- A number of tax expenditures were adjusted to account for the lower spending environment. The Potash Production Tax has been changed to defer the timing of capital deductions in order to provide an immediate and temporary increase in revenue from potash companies. The total amount of deductions producers receive from their capital spending will now be utilized over a longer period of time.

In the weeks leading up to today's budget, Premier Wall had been transparent regarding the challenges the low oil price environment posed for the Province. He also made it clear that a balanced budget would be the target. And, with today's budget projecting a razor thin surplus of \$40 million for fiscal 2014-15, the government has been true to its word.

A lower oil price environment will translate into weaker revenue intake for the government in fiscal 2015-16. As such, with balanced budgets in mind, the fiscal plan calls for a control on program spending.

Economic growth expected to decelerate over 2015-16 period

The drop in oil prices presents the greatest hurdle for the Saskatchewan economy this year and is expected to lead to a contraction in oil output in 2015. And, while Saskatchewan's economy benefits from a higher degree of resource diversity than its oil-producing counterparts, the oil and gas sector still accounts for significant 15% of real GDP. The government pegs real GDP growth in 2015 at 0.8%.

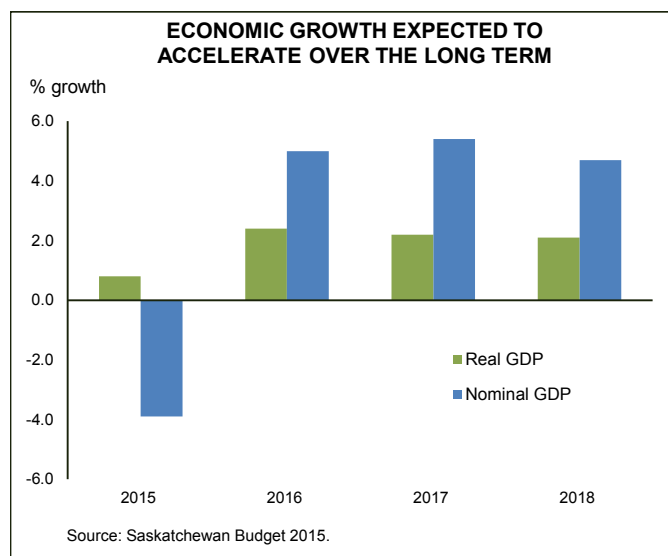
This represents a marked slowdown from the 4.5% trend growth recorded over the 2010-2013 period. Nominal GDP is forecast to contract 3.9% in 2015. The government estimates a bounce back in growth in 2016 (real GDP: +2.4%, nominal GDP: +5%). This two year forecast is very much in line with our own.

Despite the near term challenges, the longer-term economic prospects for Saskatchewan are one of the more upbeat in Canada. Strong gains in labour productivity will ensure that Saskatchewan sits near the top of the growth charts over the long term. As such, the government can rely on a solid revenue intake in the outer years of its four-year fiscal plan.

Oil prices impact revenues...leads to fiscal restraint

Saskatchewan has faced challenging times on the commodity front over the past few years. In fiscal 2013-14, non-renewable resource revenues (NRR) were negatively impacted by the break-up of the Belarusian potash cartel that led to a drop in potash prices. This year, the drop in the price of oil has punched an even bigger hole in the NRR intake line. Indeed, the WTI price of oil currently sits under US\$45 per barrel – less than half the price recorded in early July. And, with NRR accounting for about 1/5th of total revenues, volatility on this income stream has posed a challenge for the government.

All told, revenues are forecast to increase a meagre 1.2% in fiscal 2015-16 relative to Budget 2014, largely weighed down by an expected 9% drop in NRR. The WTI price of oil is estimated at US\$57 per barrel in fiscal 2015-16, which is slightly stronger than our forecast (US\$52 per barrel). This implies there is some downside risk to the revenue fore-



SASKATCHEWAN ECONOMIC ASSUMPTIONS				
[Per cent, unless otherwise noted]				
Fiscal Year	2015	2016	2017	2018
Real GDP growth	0.8	2.4	2.2	2.1
Nominal GDP growth	-3.9	5.0	5.4	4.7
CPI inflation	1.7	2.5	2.1	2.1
Employment growth (000s)	3.8	5.0	4.7	5.9
Unemployment rate	4.3	4.5	4.6	4.6
Retail sales	4.4	5.2	4.8	4.9

Source: Saskatchewan Budget 2015.

cast in fiscal 2015-16. But, with TD Economics’ Canadian dollar forecast also lower than that assumed in the budget assumption, the exchange rate could help to mitigate the oil-induced hit to revenue. Program spending growth will also be held to 1.2% relative to Budget 2014, with expenditure lines outside the core health, education and social services and assistance categories down 0.6%. This is an ambitious spending target given the above average growth in population the province has experienced in recent years. Indeed, the meek expenditure forecast implies a decline in spending in real per capita terms.

Over the medium term, narrow surpluses are forecast (around 0.1%-0.2% of GDP). Revenues are projected to exhibit a rising growth profile through fiscal 2018-19 – averaging 3.1% growth. The government notes that this is consistent with the expected acceleration in economic growth. Oil prices are also expected to rise but only reach a high of US\$86 per barrel by fiscal 2018-19. Both these macro assumptions are in line with our own forecasts. Fiscal restraint is set to continue over the medium term – with expense growth expected to average 2.3%, representing only a slight deceleration in spending relative to the experience since 2009-10 (+2.7% average). The medium term plan also incorporates a contingency allocation beginning in fiscal 2016-17.

No tax hikes, but some noteworthy announcements

Today’s budget contained no new tax increases. The government did introduce two new tax incentives aimed at promoting job creation and capital spending. The Manufacturing and Processing Exporter Tax Incentive provides tax credits to export-related corporations that increase their number of full-time employees. An income tax rebate for primary steel producers was also unveiled to bolster capital spending.

In line with controlling spending, some tax expenditures were trimmed. The budget highlighted the following changes:

SASKATCHEWAN GOVERNMENT FISCAL POSITION						
[Millions of C\$, unless otherwise noted]						
	2014 Budget	2014 Forecast	2015 Budget			
Fiscal Year	2014-15	2014-15	2015-16*	2016-17	2017-18	2018-19
REVENUES	14,109	14,147	14,280	14,692	15,154	15,658
% change	--	--	1.2	2.9	3.1	3.3
EXPENDITURES	13,999	14,106	14,173	14,471	14,806	15,176
% change	--	--	1.2	2.1	2.3	2.5
Surplus (+)/Deficit (-)	110	41	107	121	148	182
% of GDP	0.1	0.0	0.1	0.1	0.2	0.2
Net Debt	4,546	5,105	6,718	--	--	--
% of GDP	5.5	6.2	8.5	--	--	--

*Per cent change in revenues and expenses relative to Budget 2014.
Source: 2015 Saskatchewan Budget.

- The Active Families Benefit will be income-tested so that it is only available to families with net incomes below \$60,000.
- The Graduate Retention Program will become a non-refundable tax credit. Post-secondary graduates who stay in the province will still be eligible to receive the full amount of their tuition back (to a max of \$20,000) through a reduction in their provincial income tax. They now will have up to ten years, instead of seven, to use this tax reduction.
- The Research and Development Tax Credit will now be fully non-refundable and the rate is being reduced from 15 per cent to 10 per cent of qualifying research and development expenditures.
- The Potash Production Tax has been changed to defer the timing of capital deductions in order to provide an immediate and temporary increase in revenue from potash companies. The total amount of deductions producers receive from their capital spending will now be utilized over a longer period of time.

Capital plan remains on course

Today's budget introduced a new capital plan – the Saskatchewan Builds Capital Plan – which ensures that infrastructure spending remains elevated as the population continues to swell. Indeed, over the 2009 to 2014 period, Saskatchewan's population increased by 8.7 per cent, faster than the 5.7% rate recorded at the national level. Though we note the pace has been slowing over the past few quarters,

likely owing to deterioration in economic prospects. A return to the top of the growth charts should coincide with a pick-up in population growth.

Capital outlays will be targeted towards infrastructure needs for transportation, municipalities, education, health care and government services. The Plan will be financed through a combination of revenue received for capital purposes, P3s, capital market borrowing and operational cash. Borrowing for the Capital Plan in fiscal 2015-16 is estimated at \$700 million, which brings total borrowing requirements up to \$2.1 billion and will lift public debt to \$13.3 billion, or 16.7% of GDP, before grinding lower to 15.3% by fiscal 2018-19.

Bottom line

Minister Krawetz's was faced with the challenge of a low oil price environment heading into his final budget. But, with an ongoing commitment to expenditure management combined with a mix of strong resource diversity, he leaves Saskatchewan in a good position to record a surplus in fiscal 2015-16 and beyond. As such, Saskatchewan is on track to join a relatively short list of provinces targeting black ink in this year's budget round.

By prioritizing capital spending in an otherwise tight budget, the government can both boost long-term growth prospects and accommodate the province's rapidly increasing population. Over the next few years, Saskatchewan can take advantage of continued low market interest rates and its strong credit rating to fund the capital program.



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