

SASKATCHEWAN BUDGET 2014  
March 20, 2014

## No longer relying on the rainy day fund to balance its books

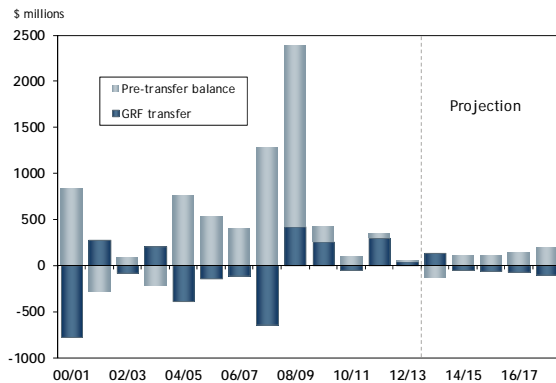
As was largely expected heading into Saskatchewan's budget, released yesterday, challenging conditions in the mining sector contributed to a notable deterioration in the province's revenues and ultimately weighed on the province's bottom line. Potash prices surprised to the downside in 2013/14 contributing to a \$119 million drop in non-renewable resources revenues compared to the Budget 2013 estimate and as a result, the General Revenue Fund (GRF) surplus is now projected to be \$25.2 million lower than forecasted one year ago, coming in at \$7.2 million in 2013/14. The budget impact would have been greater; however, the government is relying upon a \$135 million transfer from the Growth and Fiscal Security Fund (GFSF) to support a budget surplus in 2013/14, thereby maintaining twenty years of consecutive surpluses. The surplus is expected to grow in 2014/15 to \$52.7 million, rising to \$101.0 million by 2017/18. In accordance with provincial legislation, these surpluses incorporate the province's plan to replenish its "rainy day" and economic development fund, the GFSF, with equally-sized transfers through the projection period.

The deterioration in the operating balance was overshadowed by the government's shift in focus towards a summary (consolidated) budget presentation. On the basis of recommendations by the Provincial Auditor, the budget documents will now emphasize "the big picture" by incorporating all aspects of government revenue and spending in determining the province's bottom line. Thus, total revenues and expenditures will now include both Government Business Enterprises and Government Service Organizations. Collectively, the summary budget indicates that the province is expected to record a larger \$591 million surplus in 2013/14 compared to \$150 million initially projected in Budget 2013 and will be followed by a \$71 million surplus in 2014/15. The GFR remains unchanged however and is now referred to as the Core Operational Plan. With the operational funds continuing to require Legislative Assembly approval and reflecting the government-controlled operations, the underlying budget structure remains unchanged.

### Surplus in 2013/14 with help from the "rainy day" fund

Saskatchewan was faced with weathering a storm in 2013/14 as weaker-than-expected potash revenues saw the province dip into its "rainy day" fund to maintain operational budget balance. A \$179 million decline in potash revenues from the Budget 2013 estimate largely reflected a \$70/tonne differential in the potash price forecasts (\$325/KCI tonne in Budget 2014 compared to \$395 at the time of last year's budget) while a higher average West Texas Intermediate oil price and stronger oil production provided a partial offset. Overall, the downward impact was sufficient to push operating revenues lower in 2013/14 to \$11.5 billion, to mark the slowest pace of revenue growth (at 0.3%) since a decline in 2009/10. As a result, the pre-transfer operational surplus of \$32.4 million projected in Budget 2013 is expected to instead be a deficit of \$127.8 million. To offset this sizeable deterioration, the government is withdrawing \$135 million from the GFSF instead of depositing funds into it (a \$32.4 million

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Source: Saskatchewan Ministry of Finance, RBC Economics Research

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transfer into the fund was initially projected in Budget 2013), resulting in the GRF remaining in surplus in 2013/14.

### **Operating revenues to rebound in 2014/15**

For the upcoming 2014/15 fiscal year, operational revenues are projected to rebound, rising by 3.9% to \$11.9 billion. This improvement reflects broad based gains led by a \$193 million (or 3.3%) boost to taxation revenues, expected to reach \$6.2 billion in 2014/15. Strengthening personal income tax and provincial sales tax revenues are projected to more than offset a decline in corporation income tax revenues. A combination of higher sales volumes and a lower exchange rate are expected to offset a lower price forecast for potash with this commodity revenue rising to \$397 million in 2014/15 from \$340 million in the previous year. In similar fashion, an increase in oil production in the upcoming fiscal year is expected to offset a softer forecasted oil price (US\$94.25 per barrel in 2014/15 from US\$98.13 in 2013/14). Collectively, these increases are set to lift non-renewable resources revenues to \$2.7 billion in 2014/15, up 5.6% from 2013/14; however, at 23% of total operating revenues, this component remains well below the 28% share seen in 2012/13. Federal transfers are also slated to rise in 2014/15 with legislated increases in both the Canada Health Transfer and Canada Social Transfer.

### **Medium-term revenue profile shifts down**

With the resource sector surprising to the downside in 2013/14, the government is taking a more cautious approach to its medium-term revenue outlook relative to Budget 2013 (when the government projected potash revenues would rise by nearly 31% in 2013/14 led by a strong recovery in potash sales). The deterioration in non-renewable resource revenues in 2013/14 resulted in the operating revenue growth profile shifting lower with total revenues expected to increase on average by 2.7% through the projection period (compared to 3.9% in Budget 2013). Over the four-year period, non-renewable resources revenues are expected to rise by an average 2.9% annually, thereby representing a significant downward shift from the 8.8% annual projection as part of last year's budget plan. This in part reflects the potash price forecast being revised significantly lower, falling to US\$274US/KCl tonne in 2014/15 and holding relatively steady thereafter. Tax revenue growth is expected to lead overall revenue growth through the projection period with average annual growth of 3.6% to be supported by strengthening economic growth and a rising population (compared to 2.7% in Budget 2013). As a result, this component will account for a slightly greater share of operating revenues by 2017/18 (53% compared to 52% in 2014/15). On a year by year basis, operating revenues are planned to rise by 2.5% in 2015/16 followed by 2.7% and 3.0% in 2016/17 and 2017/18, respectively.

### **Expenditure growth to remain contained**

Total expenditures are projected to rise by \$212 million (1.8%) to \$11.8 billion in 2014/15. The increase is being driven by a 4% rise in total health expenses and a 2.8% lift in total education spending, which together account for just over half of total expenditures. Operating expenses (excluding capital transfers) are projected to reach \$11.5 billion in 2014/15, an increase of 1.8% following a 1.2% rise in the previous year.

Over the entire fiscal plan, total expenses are projected to increase annually by 2.5%, thereby representing a downwardly revised growth profile from the 3.0% annual growth projected in Budget 2013.

### **Capital spending to rise**

Core government capital spending is projected to increase in 2014/15 by \$39 million (3.4%) to \$887 million. Capital transfers are slated to jump by 27.5% to \$331 million while government-owned infrastructure investment is set to ease to \$556 million from \$598 million in the previous year. Despite the moderation in the latter, transportation investment is projected to remain robust, with \$374 million planned for 2014/15 to support highways upgrades throughout the province.

### **Replenishing the Growth and Fiscal Security Fund**

Beginning in the fiscal year 2013/14, the GFSF has been segmented into two components to reflect its dual purposes. The 'GFSF – Security fund' will provide financial assistance as needed to offset downward fiscal surprises while the 'GFSF – Growth' fund will act as a source of funds to promote the economic development of the province. On account of the withdrawal to fund the General Revenue Fund, the Security balance is projected to decline to \$381 million by the end of 2013/14 from an opening balance of \$512.7 million as of April 1, 2013. In the absence of a transfer into the growth fund in 2013/14, the balance has remained unchanged at \$150 million. Going forward, transfers from the General Revenue Fund will be directed to replenishing the security fund until the balance reaches \$500 million, planned for in 2016/17, and will then be directed to the growth fund. Collectively, the total GFSF balance is projected to increase to \$584 million by the end of 2014/15 and rise in the three years thereafter to reach \$807 million.

### **Provincial general government debt to remain unchanged**

Provincial general government debt is expected to remain unchanged at \$3.8 billion for the fourth consecutive year in 2014/15. Total public debt – which includes debt from crown corporations and government enterprises – is projected to rise to \$11.2 billion by March 31, 2015 from \$10.4 billion at March 31, 2014. By the end of the 2017/18 fiscal year, total public debt (including GRF and other debt) is projected to fall to 13.6% of GDP from a peak of 14.2% in 2014/15.

### Borrowing requirements

General government borrowing requirements are expected to reach \$550 million in 2014/15 with the purpose of refinancing maturing debt. This represents an increase from \$468.4 million in 2013/14. In contrast, the borrowing requirements of crown corporations are projected to fall to \$962.4 million (from \$1.61 billion in the previous year) with funds allocated for the financing of capital expenditures.

### Futures Fund...in the future...

Apart from the shift in accounting focus, the Saskatchewan Budget was largely void of material changes or new initiatives. An exception was the introduction of a new regulatory regime in the oil and gas industry that aims to replace existing licensing fees with a single levy, moving the system to a model of 'cost recovery'. Overall, the government sees this change as an improvement in efficiency.

Leading up to the budget, there was discussion of whether the province would adopt a savings structure fund similar to the Heritage Fund in Alberta to manage its non-renewable resource revenues. While the government announced its intention to create a Saskatchewan Futures Funds and will consider capping non-renewable resource revenues at 26% of operating revenues (with the excess allocated to debt or the savings fund), the government will wait until the provincial debt is repaid. As well, with non-renewable resources revenues expected to remain at 23% through the projection period, the announcement has no impact on the government's budget plan.

### Modest assumptions in an uncertain potash climate

Saskatchewan's economy performed above the national average in 2013 led by robust growing conditions in the agricultural sector. The positive budget impact was more than offset, however, as potash prices significantly weighed on fiscal revenues. Going forward, the government has lowered its potash price forecast although it remains above RBC's price forecast by as much as US\$65mt in 2014. While there are downside risks to the sector (with the potential for a flood of supply coming from Russian-based Uralkali), the government has, in our view, presented a reasonable economic growth profile. Real GDP is forecasted to grow by 2.2% in 2014, broadly in line with RBC's forecasted 2.0% growth. We believe there is scope for improvement in 2015 with our forecasted 2.7% representing a modestly higher rate of growth than the government's projected 2.3% pace. Overall for Budget 2014, the shift in focus to a summary budget structure does not alter the underlying components of the province's fiscal situation. Underlying operational revenues and expenses remain unchanged and continue to fund the operations of the government and indicate that province will remain in surplus through the projection period.

## Saskatchewan's fiscal plan

(\$ millions)	Actual	Forecast	Planned	Projected		
	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
Total revenues	11,424	11,463	11,909	12,206	12,536	12,912
Total expenditures	11,409	11,591	11,803	12,098	12,400	12,710
Net operations	15.9	(127.8)	105.4	108.0	136.0	202.0
Net transfer from (to) the GFSF	42.0	135.0	(52.7)	(54.0)	(68.0)	(101.0)
Surplus	57.9	7.2	52.7	54.0	68.0	101.0

Source: Saskatchewan Ministry of Finance, RBC Economics Research

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