SASKATCHEWAN BUDGET 2015
March 19, 2015

Weathering the energy downturn

With much speculation surrounding the adverse impact of the low crude oil price environment on the fiscal position of oil-producing provinces, a degree of clarity was provided yesterday with the release of Saskatchewan's 2015 Budget. As the first of the large oil producing provinces to release their outlook for the upcoming fiscal year, the Saskatchewan government provided an assessment of the hit to the bottom line resulting from the sharp decline in crude oil prices. As expected, the challenging oil price environment contributed to deterioration in the province's budget balance in the 2014/15 fiscal year, which is projected to be a surplus of $40.5 million, $70 million below the estimate one year ago. Despite downward price pressures set to intensify in 2015, the province expects to post an improved surplus of $107 million in 2015/16 and sustain positive budget balances through the four-year fiscal plan.

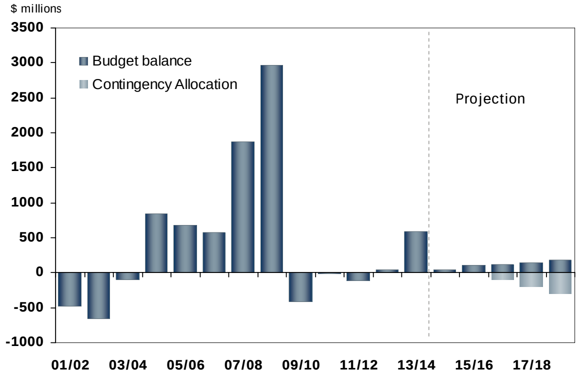
In the face of a deteriorating fiscal outlook resulting from the protracted period of crude oil price declines, the Saskatchewan government set its sights on mitigating the brunt of the resource revenue hit in 2015/16 by altering current revenue measures alongside a focus on restraining expenditure growth. Leading up to the budget release, Premier Wall opined that the PST revenue sharing with municipalities currently in place would likely be revisited along with a possible increase in education property taxes. In the event, both measures were left unchanged. Instead several tax initiatives were proposed including:

- A Manufacturing and Processing Exporter Tax Incentive will provide non-refundable tax credits to eligible businesses that expand their full-time workforce in each year over the 2015 to 2019 period.
- A Potash Production Tax, effective January 1, 2015, allows all capital expenditures to be deductible at a 120% rate (compared to 35% previously); however, amounts from the deductions will be recorded over a longer period of time, resulting in an "immediate temporary increase" in government revenues from the potash sector.
- Corporate Income Tax Rebate for primary steel producers to promote capital investment in the sector (a minimum of $100M in new or expanded productive capacity).

"Rainy day" fund helped to weather the oil price storm

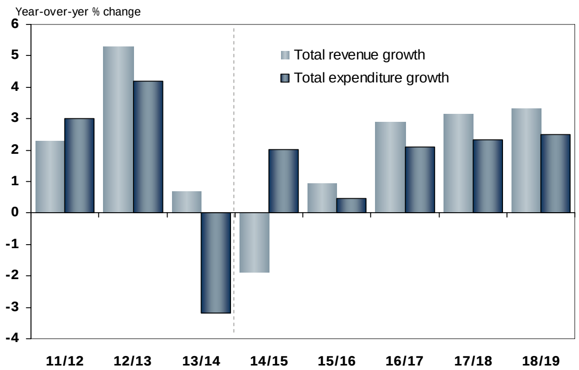
The negative fiscal impact of the energy downturn was tempered by a reallocation of funds from the province's Growth and Financial Security Fund into the General Revenue Fund, to the tune of $255 million in 2014/15. Beginning in the 2013/14 fiscal year, the GFSF was made up of two components, the 'GFSF – Security fund' to provide financial assistance as needed to offset downward fiscal surprises and the 'GFSF – Growth' fund to financially support economic development initiatives in the province. The surprise oil price shock spurred the government to shift $105 million out of the Security Fund and an additional $150 million from the Growth Fund into the General Revenue Fund in 2014/15 (in contrast to the Budget 2014 projected transfer into the GFSF). With no foreseeable deposits, these actions are resulting in the overall balance of $191 million as of March 31, 2015 (compared to the Budget 2014 esti-

Saskatchewan budget balance



Source: Saskatchewan Ministry of Finance, RBC Economics

Growth projections



Source: Saskatchewan Ministry of Finance, RBC

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mate of $499 million) remaining unchanged over the next year.

To compensate for the withdrawal of funds from the Security Fund and maintain “prudent and sustainable fiscal management”, the government introduced a contingency allocation as part of its fiscal framework beginning in 2016/17. Funds totalling $600 million will be allocated in the final three years of the plan ($100 million, $200 million and $300 million, respectively) to provide a financial cushion for unforeseen adjustments to revenues/expenditures, the capital plan and debt charges. With this contingency inclusion, the province is slated to remain in surplus through the projection period with consecutive balances of $121 million, $148 million and $182 million beginning in 2016/17. (In contrast to previous years, the fiscal plan made no mention that these surpluses incorporate legislated equally-sized transfers needed to replenish the Growth and Financial Security Fund.)

Upside surprises in 2014/15 despite lower budget balance

The hit to 2014/15 revenues resulting from the sharp and sustained decline in crude oil prices since June 2014 was more than offset by strength in other revenue components (notably higher federal transfers owing to flood disaster relief), resulting in total revenues surprising to the upside in 2014/15 at $14.15 million, 0.3% above the initial Budget 2014 estimate. (This still represents a 1.9% decline from the $14.4 billion in revenues recorded in 2014/15). A $259 million decline in oil resource revenues from the Budget 2014 estimate predominantly reflected the lower crude oil price environment, although firm prices in the first half of the fiscal year and a lower Canadian dollar tempered the weakness. Strong potash sales and higher than expected prices for the commodity helped to mitigate the impact of the crude oil price shock, rising $166 million to keep overall non-renewable resource revenues only modestly below the Budget 2014 estimate, at $2.6 billion (19% of total revenues) compared to $2.7 billion at the time of last year’s budget.

The downside surprise on the revenue side of the ledger was the weak performance of taxation revenues in 2014/15, which declined $196 million to $6.6 billion (nearly 50% of total revenues). This compares to a 7% increase projected in Budget 2014. Deterioration in the province’s bottom line in 2014/15 was further amplified by higher expenses related to one-time charges resulting from the severe floods in the south-eastern regions of the province in summer 2014. The government set aside $150 million in the first quarter to cover the costs associated with the heavy rainfalls, although with the final charges exceeding this allowance and savings elsewhere only providing a partial offset, expenditures are expected to come in $108 million above the initial Budget 2014 estimate at $14.1 billion.

Crude oil price impact to intensify in 2015/16

The persistence of challenging conditions in the resource sector (with WTI forecast at US$53/bbl in 2015 compared to Budget 2014 projection of $92/bbl) is dampening the province’s revenue outlook, although in contrast to the budget presented a year ago, the energy price slump is accounting for the weakness while renewed strength in potash (and a lift to potash revenues owing to the tax initiative) provides an anchor to non-renewable resource revenues. For the upcoming 2015/16 fiscal year, total revenues are projected to improve, edging up by 0.9% to $14.3 billion despite low crude oil prices weighing on non-renewable resource revenues (slated to fall 6.9% to $2.5 billion). The projected revenue increase reflects a rebound in taxation revenues (up 2.8% to $6.8 billion) led by stronger personal income tax revenues on account of positive employment and wage growth, albeit softer than the 2014 forecasted increases.

Firm revenue growth anticipated

Energy sector weakness and an attendant softening in oil resource revenues is anticipated to dissipate over the projection period, resulting in non-renewable resource revenues projected to rise 3.3%, on average, annually through to 2018/19. The share of total revenues accounted for by non-renewable resources revenues is expected to remain at 17% over the fiscal plan, however, representing a decline from the 19% share recorded in 2014/15. Improved resource sector revenues are expected to be accompanied by firm tax revenue growth (3.1% average annual growth), and together accounting for two-thirds of total revenues, are expected to support total revenues rising at an average annual rate of 3.1% to reach $15.66 billion by 2018/19.

Health and Education driving expenditure increases

Total expenditures are projected to rise 0.5% to $14.2 billion in 2015/16 from the revised 2014/15 starting point (and 1.2% above the initial Budget 2014 estimate). The marginal increase predominantly reflects spending increases in health and education, which together account for two thirds of total expenditures. Over the entire fiscal plan including 2015/16, total expenses are projected to increase annually by an average of 1.8%, thereby representing a downward shift from the 2.5% annual average recorded over the period since 2010/11.

Absence of the Core Operational Plan in Budget 2015

As was recommended by the Provincial Auditor leading up to last year’s budget, the government presented its fiscal situation on a summary (consolidated) basis. This framework incorporates all aspects of government revenue and expenditures (including Government Business Enterprises and Government Service Organizations) in determining the overall financial position of the province. The adoption of this framework resulted in the absence of the previously presented core operational plan and consequently, a comparable budget balance profile through the projection period.

Saskatchewan Builds Capital Plan

A prominent initiative in the budget was the announcement of the 4-year $5.8 billion Saskatchewan Builds Capital plan to fund core infrastructure projects. In 2015/16, $1.3 billion is allocated for these projects, representing a 39% increase from the core government capital spending estimated in the year prior. This amount is set to peak at $1.7 billion in 2016/17 before easing to $1.2 billion by 2018/19. Over the 4-year plan, transportation infrastructure will account for an increasing share of the allocated funds, rising from 50% in 2015/16 to over 70% in the final year of the plan. Funding for the plan is expected to come from government borrowing ($700 million in 2015/16) as well as a combination of revenue received for public and private partnerships, for capital purposes and available operational cash.

Provincial general government debt

Total public debt – which includes debt from Crown corporations and government enterprises – is projected to rise to $13.3 billion by March 31, 2016 from $11.8 billion at March 31, 2015. Provincial general government debt is expected to account for $5.5 billion of this reflecting $3.8 billion in operating debt of the General Revenue Fund. On account of the sizeable increase in debt outstanding against a backdrop of weak nominal GDP growth, debt as a percent of GDP is projected to peak in 2015/16 at 16.7%. Improving economic conditions will see this ratio fall to an estimated 15.3% by the end of the 2018/19 fiscal year.

Borrowing requirements

General government borrowing requirements are expected to reach $2.07 billion in 2015/16 with the funds allocated for refinancing maturing debt ($509 million), funding the Saskatchewan Builds Capital Plan ($700 million) and funding the capital expenditures of Crown corporations. This represents a sizeable increase from the estimated $1.74 billion in 2014/15 (initial Budget 2014 projection of $1.51 billion). With terms of up to 30 years, the government noted that it is taking advantage of the "most cost-effective time in the province's history" to finance investments. It will invest "at least 2%" of the value of the borrowed amounts to ensure it has sufficient funds to repay the debt when it comes due and the amounts borrowed for infrastructure investment will be identified separately.

Diverging economic growth outlooks

The extent of the energy downturn facing the province was made apparent in the government economic growth forecasts, with the oil price decline contributing to a real GDP growth forecast of 0.8% in 2015 from an estimated 1.4% in 2014. This marks a significant revision from the 2.8% 2015 rate forecast in the mid-year report in November. The Saskatchewan government anticipates that economic conditions in the province will improve in 2016 (with growth of 2.4%) supported by a modest recovery in oil prices (to US$67/bbl from $53/bbl forecast in 2015).

While there are downside risks to our forecast, we expect Saskatchewan's economy to perform only slightly below the national average in 2015 and 2016 at 2.1%, which would represent acceleration from our forecast of 1.1% real GDP growth in 2014. The sustained weakness in crude oil prices and resulting anticipated investment cutbacks prompted us to revise our growth forecast marginally lower (from 2.8% in both 2015 and 2016 in December); however, we remain of the view that strengthening potash production against a backdrop of a weaker Canadian currency will temper the slowing in growth from the energy sector. Moreover, our expectation of a weaker Canadian dollar suggests further upside risks to the government's fiscal outlook. According to the budget documents, a one cent depreciation in the average exchange rate would boost non-renewable resource revenues by $38 million (Our forecast of $0.75 CAD-USD compares to the government's forecast of $0.79 in 2015).

Saskatchewan's Consolidated Fiscal Plan

($ millions)	Actual	Forecast	Planned	Projected		
	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Total revenues	14,418	14,147	14,280	14,692	15,154	15,658
Total expenditures	13,829	14,106	14,173	14,471	14,806	15,176
Contingency Allocation		0.0	0.0	100.0	200.0	300.0
Surplus	588.9	40.5	106.8	121.0	148.0	182.0

Source: Saskatchewan Ministry of Finance, RBC Economics Research