



Provincial Budget Briefs

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SASKATCHEWAN BUDGET 2020

The Province of Saskatchewan was on track to balance its budget for the first time since 2014's oil price shock throughout much of last year. However, the impact of COVID-19 on the economy and provincial revenues unfortunately prevented that and the Province now estimates a mild deficit of \$319mn in fiscal 2019/20 and a record \$2.4bn shortfall in 2020/21. That deficit is driven by both the expected decline in revenues (largely resource revenues but also Provincial Sales Tax) and higher spending. The spending projection for this year also includes a \$200mn health and public safety contingency as a measure of prudence in case there is a resurgence of the virus this year. Due to the increased uncertainty, only projections for the current fiscal year were provided. Saskatchewan's borrowing requirements will double to \$4.5bn in 2020/21 from \$2.1bn in 2019/20 of which \$4.34bn will be in long-term debt. To date, the Province has borrowed \$1.9bn or around 44% of its term debt requirement.

Table 1					
	2018/19	2019/20			2020/21
\$Millions	Actual	19 Budget	20 Budget	Change	20 Budget
Revenue	14,449	15,025	14,887	-138	13,649
Own Source	10,657	11,478	11,442	-36	10,133
<i>% change</i>	8.5	5.1	7.4	2.2	-11.4
Federal Transfers	2,509	2,467	2,590	123	2,787
Net Income from Crowns	1,284	1,081	855	-225	729
Expenditures	14,717	14,991	15,206	216	16,075
Program Spending	14,080	14,296	14,531	235	15,357
<i>% change</i>	-1.5	1.6	3.2	1.6	5.7
Public Debt Charges	637	694	675	-19	718
Surplus/(Deficit)	-268	34	-319	-354	-2,426

Saskatchewan Economy to See Big Contraction, but It's Not Alone

Like every other province in Canada, and most countries around the world, the Saskatchewan economy has been hit hard by the impact of COVID-19 and the physical distancing measures put in place to prevent its spread. The Province expects that real GDP will fall by 6.3% this year, with nominal GDP down by an even worse 12.8% thanks to the impact of lower commodity prices. The lower prices for oil and potash are also impacting real activity as well, with investment in the oil sector expected to be down 37% this year and production almost 14% lower than 2019. The unemployment rate is expected to average 8.6% this year – a more than 3%-pt rise from 2019 but below

the current 12.5% level due to workers being allowed to return to their jobs as the economy reopens. The Province stated that the economic assumptions used in today's budget were in line with the second (middle) of the three possible scenarios they identified in their April 17th guidance on the potential path of future revenues.

Despite the negative of having a higher reliance on commodities, the Saskatchewan economy has some advantages over other provinces which means the decline in real GDP foreseen this year is roughly equal to the national figure. Its large agricultural sector, for which exports are up more than 20% year-over-year, means that total exports out of the province have fallen much less than in many other parts of the country. Success in bringing COVID-19 case counts down should also reduce the risk associated with reopening the economy in the coming months, while the Province's expanded capital spending plan will also support the recovery particularly in 2021.

Table 2	Key Assumptions		
YY % Chg	2019	2020	2021
Economic Assumptions			
Real GDP	0.4	-6.3	4.6
<i>Private Sector Average</i>		-6.6	5.2
Nominal GDP	3.3	-12.8	7.2
Employment Growth (K)	10.4	-15.8	6.8
Unemployment Rate (%)	5.4	8.6	7.6
Retail Sales	-0.5	-18.8	4.5
Financial Assumptions			
	2019/20	2020/21	
Exchange Rate (US\$/C\$)	75.19	71.00	
WTI (US\$/bbl)	54.80	30.00	
Potash (US\$/KCl tonne)	223	188	

Fiscal Projections - One Year At A Time

Due to the still uncertain outlook regarding the path of COVID-19 infections and the impact those could have on the local economy as well on external trade, today's budget only included a one-year outlook for fiscal 2020/21 as well as updated estimates for the 2019/20 fiscal year.

The budget projections for this year show a record \$2.4bn deficit, which based on the Province's own GDP forecasts would be almost 3.5% of nominal GDP. Revenue is forecast to be \$1.2bn (or 8.3%) lower than in fiscal 2019/20, with own-source revenue down by 11.4%. Non-renewable resource revenue is expected to be \$1.0bn this year, a decline of \$753mn compared with last year thanks largely to lower oil prices and production. Tax revenues are expected to be down \$350mn, led by Provincial Sales Tax and Fuel Tax takes. These revenue declines will be offset partly by higher transfers from the Federal Government.

Expenses are forecast to increase by \$1.1bn, or 7.2%, of which just over \$700mn, or two-thirds, is related to COVID-19 spending. Additional spending measures announced since March 18th and included in today's budget projections include:

- \$171mn for new capital stimulus funding for third parties, including \$150mn for the Municipal Economic Enhancement Program.
- \$150mn for the Accelerated Site Closure Program for reclaiming inactive oil and gas wells/facilities.
- \$56mn for the Temporary Wage Supplement helping lower income essential workers
- \$50mn Saskatchewan Small Business Emergency Payment supporting small and medium sized businesses.
- \$50mn emergency pandemic support for First Nations.

A \$200mn health and public safety contingency was also included in the spending projections as a measure of prudence in case there is a resurgence of the virus later in the year which imposes more pressure on the health service.

While the Province had expected to run a balanced budget in fiscal 2019/20, and had been on track to do so, the impact of COVID-19 on spending and revenues in the fourth quarter of the year means that a slim \$319mn deficit is now estimated.

Saskatchewan's Borrowing Requirements To Double

Saskatchewan's borrowing requirements will double to \$4.5bn in 2020/21 from \$2.1bn in 2019/20. The increase stems largely from augmented General Revenue Fund requirements arising from the COVID-19 pandemic. The impact from the crisis will see that rise from \$112mn in 2019/20 to \$2bn in 2020/21. In addition, borrowings on behalf of Crown Corporations are increasing by \$377mn to just over \$1bn; whereas the borrowing requirement for the Saskatchewan Capital Plan will add only \$100mn over last year.

The Province plans to fund most of its requirements through the Canadian public debt markets (i.e. \$4.3bn or 97%), with the balance from short-term debt. Net of debt maturities of just over \$1.0bn, total public debt balances are forecasted to increase by \$3.0bn year-over-year to \$24.4bn at March 31, 2021. This will bring the gross debt-to-nominal GDP ratio to just under 35%. On a net debt basis, this ratio is closer to 15%.

Saskatchewan does not usually do any pre-funding but has done so occasionally in order to secure long-term borrowing for capital projects when interest rates are low.

Saskatchewan's borrowing program is focused only on the domestic bond market. The Province's last international transaction occurred in 2006 and was in Swiss Francs. To date, the Province has borrowed \$1.9bn or around 44% of its \$4.34bn term debt requirement.

In May, the Province announced an enhanced capital plan of \$7.5bn over two years. The first year of that plan, the current 2020-21 Capital Plan, entails \$3.1bn in spending combining \$1.3bn of Executive Government Spending (i.e. Saskatchewan Capital Plan) and \$1.75bn for crown corporations. Priority areas of investment cover new and existing infrastructure in health care, K-12 schools, post-secondary institutions, highways, and bridges. With respect to crown spending, the largest component is for SaskPower (\$846mn) for the renewal of its distribution

Table 3		Financing Plan and Debt Balances¹		
\$Millions	Actual F2018-19	Forecast F2019-20	Budget F2020-21	
Borrowing Requirement				
General Revenue Fund (GRF)	975	112	2,000	
Saskatchewan Capital Plan*	1,500	1,300	1,400	
Crown Corporations	684	681	1,058	
Total	3,159	2,093	4,458	
Borrowing Sources				
International	-	-	-	
Canadian Debentures	2,750	1,943	4,340	
Short-term debt	391	123	118	
CPP	18	27	-	
Total	3,159	2,093	4,458	
Public Debt Balances				
GRF operating debt	6,150	6,150	7,300	
Saskatchewan Capital Plan	4,194	5,403	6,691	
Other Govt Service Organizations	449	402	346	
Crown Corporations	8,961	9,377	10,032	
Total	19,754	21,332	24,369	

¹ We show the latest available forecast at the time of the budget.

Fiscal years ending March 31.

* Saskatchewan Capital Plan borrowing for 2018-19 includes \$900mn for 2018-19 requirements and a pre-borrowing of \$600mn for 2019-20 requirements

Reconciliation of Public Debt:

Forecast, March 31, 2020 public debt	21,332
Add: 2020-21 borrowing requirements	4,458
Less: 2020-21 maturities of public debentures	(1,436)
Less: 2020-21 maturities of CPP debentures	(76)
Less: 2020-21 maturities of other term debt	(53)
Less: 2020-21 reductions in short-term debt	(22)
Add/(Less): 2020-21 change in sinking fund balances	166
Forecast, March 31, 2021 public debt	24,369

and transmission system along with the expansion and renewal of its electricity generation assets. The electric utility is moving toward a goal of achieving a 40% reduction in CO₂ by 2030. The second largest share is for SaskEnergy (\$407mn). The remainder (\$496mn) covers investments by SaskTel and SaskWater.

The Province plans to fund its Capital Plan through a combination of revenue sources which include federal funding and other grants received for capital purposes, public-private partnerships, and capital market borrowing.

Saskatchewan Entered Crisis on Track for Modest Surplus and Low Debt Levels.

Credit Ratings: DBRS Morningstar AA UR NI, Moody's Aaa Stable, S&P AA Stable, Fitch AA Stable

Due to a steady hand approach to prudent fiscal management – a characteristic of the long-standing Saskatchewan Party governing since 2007 – Saskatchewan entered the pandemic-induced crisis on track to delivering a modest surplus in 2019/20 and with low debt levels. Unfortunately, the crisis along with concurrent oil price shock means that Saskatchewan's fiscal plans will take a big step backwards with a projected deficit to GDP of 3.5% in 2020/21. This projection was in line with our expectations.

Notwithstanding this sudden turn in circumstances, we view today's announcement as having only modestly negative credit implications. On a relative basis, the Province entered the crisis with one of the lowest net debt-to-GDP ratios in Canada and in a strong position relative to its global peers. Its reliance on resource revenues fell from a high of 32% of total revenues before the 2014/15 oil price shock to around 12% in 2019/20, of which oil dropped from around 13% to 5%. For 2020/21, resources are projected to account for just 7% of total revenue (oil 2%).

Our view factors in the very high starting point of Saskatchewan's ratings and our anticipation that any rating downgrades will still result in Saskatchewan retaining an average AA-type rating. We highlight that ratings are quantitative, but they are also qualitative and relative. Hence, we anticipate that some rating agencies will be accommodative recognizing that the pandemic is an unprecedented event that is impacting the global economy. Therefore, all governments around the world are being challenged financially.

In April, Moody's released a credit opinion and maintained Saskatchewan's Aaa Stable rating. The agency stated that the credit profile "reflects very strong debt affordability despite a forecasted rise in debt and solid reserve levels from cash and investments relative to the majority of provincial peers. The credit profile also benefits from recent improvements in the Province's fiscal position following several years of economic growth, which will provide a cushion against near-term credit pressures related to the concurrent shocks of lower oil prices and the coronavirus pandemic that will result in lower economic growth and revenues and higher health and social expenditures." Moody's rating on Saskatchewan's is based on a Baseline Credit Assessment rating of aa1, which is notched up one level to Aaa based on the view of a high likelihood of extraordinary support from the Government of Canada (rated Aaa stable). Moody's debt calculation excludes the large crown corporations SaskPower, SaskTel, and SaskEnergy, which it considers to be self-supporting like the other rating agencies.

The other three rating agencies have Saskatchewan solidly in the AA category (i.e. mid-AA). However, we believe that Saskatchewan's metrics will deteriorate to a level that is more consistent with the lower end of the AA category (i.e. AA-). As such, DBRS Morningstar placed the Province's rating under review with negative implications in March citing "The rating actions stem from the deteriorating global economic conditions and the sharp decline in global oil prices caused by the outbreak of the Coronavirus Disease (COVID-19) and measures

taken by Saudi Arabia and Russia to recapture market share. If sustained, DBRS Morningstar believes that these factors will have a material impact on the provincial economic activity and public finances of Canada's main oil and gas (O&G)-producing provinces."

An important aspect of Saskatchewan's assessed debt burden is its unfunded pension liability. It is a factor that is either incorporated into the debt calculation (i.e. DBRS) or in the contingent liability assessment scores of the rating agencies (i.e. Fitch, Moody's, S&P). Saskatchewan has a strong advantage over Canada's other provinces. It closed most of its defined benefit plans for public servants and teachers in the late 70s and early 80s and, over the long run, its cash costs and contingent liabilities will be on a downward trajectory. Saskatchewan continues to benefit from savings related to the Teachers' Superannuation Plan, which are offsetting increasing education costs.

Saskatchewan is required by legislation to hold its general election on or before October 26, 2020. It remains to be seen if the COVID-19 pandemic disrupts this timetable.

As well, we are still expecting that the Province will provide a multi-year forecast as soon as it can provide estimates with reasonable certainty.

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