Provincial Budget Briefs

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SASKATCHEWAN BUDGET 2018

Having pushed back its timeframe for balance in last year's Budget, this year Saskatchewan remains *On Track* to eliminate its deficit by 2019/20. The just-finished 2017/18 fiscal year is projected to have seen a deficit of $595mn, which is $100mn lower than anticipated a year ago and around half the shortfall seen in the prior year. A further widening of the tax base for PST, to include light vehicles, and continued spending restraint is expected to see the deficit narrow further to $365mn in 2018/19 before achieving a balance the following year. While the projections no longer have a contingency, which last year was $300mn, neither do they have an allowance for compensation savings. The projections are also based off fairly conservative forecasts for commodity prices and nominal GDP growth. Despite the shrinking deficits, borrowing requirements are slated to be $837mn higher in 2018/19 at $3.2bn, largely due to capital spending under the Saskatchewan Builds program and pre-funding for the 2019/20 fiscal year which isn't typical for the Province.

Table 1

$Millions	2016/17 Actual	2017/18 17 Budget	2017/18 18 Budget	2017/18 Change	2018/19 18 Budget	2019/20 18 Budget	2020/21 18 Budget	2021/22 18 Budget
Revenue	**13,626**	**14,165**	**13,943**	**-222**	**14,244**	**14,761**	**15,114**	**15,518**
Own Source	9,825	10,658	10,314	-344	10,704			
% change	*-5.3*	*8.5*	*5.0*	*-3.5*	*3.8*			
Federal Transfers	2,955	2,454	2,442	-11	2,462			
Net Income from Crowns	846	1,054	1,187	133	1,078			
Expenditures	**14,844**	**14,811**	**14,538**	**-273**	**14,609**	**14,755**	**15,006**	**15,306**
Program Spending	14,300	14,205	13,935	-271	13,954			
% change	*-2.4*	*-0.7*	*-2.6*	*-1.9*	*0.1*			
Public Debt Charges	544	606	603	-2	655			
Human Resources Comp. Measures		250	0	-250				
Contingency		-300	0	300				
Surplus/(Deficit)	**-1,218**	**-696**	**-595**	**101**	**-365**	**6**	**108**	**212**

Saskatchewan Back on a Steady Growth Path

Saskatchewan's economy is expected to see steady growth again in 2018, with the 1.3% gain forecast for real GDP largely unchanged from the 1.5% now estimated for 2017. The deceleration in nominal GDP growth is slightly more pronounced (from 4.9% in 2017 to 4.0% in 2018) although that projection is based off fairly conservative commodity price forecasts compared to current spot rates. WTI oil prices, for example, are projected to average $59/bbl both this year and next, which compares to a current spot of $65/bbl and year-to-date average of close to $63/bbl.

The Province's projection for 1.3% growth in real GDP this year is below a median of 2.0% from other forecasters, although growth in 2019 is expected to be higher than that same consensus. However, the averages of the two years together are very similar. The Province stated it had revised down its estimate for 2018 growth due to the shutdown of the McArthur River mine for much of this year which would significantly reduce uranium production. The longer-term projections for around 2¼% real and 4¼% nominal GDP growth would still be well below the average rates seen prior to commodity prices slumping in late 2014-early 2015.

Table 2	Key Assumptions			
Y/Y % Chg	2017	2018	2019	2020-22
Economic Assumptions				
Real GDP	1.5	1.3	2.5	2.2
Private Sector Average	-	*2.0*	*1.9*	-
Nominal GDP	4.9	4.0	4.3	4.4
Employment Growth (K)	-0.9	2.5	4.6	5.3
Unemployment Rate (%)	6.3	6.1	5.9	5.6
Retail Sales	4.0	2.7	2.5	2.6
CPI	1.7	2.3	1.8	1.9
Financial Assumptions				
Short-term Interest Rate (%)	0.70	1.42	2.27	2.71
10-year GoC Bonds (%)	1.79	2.61	3.38	3.59
Exchange Rate (US¢/C$)	77.1	78.4	79.1	82.3
WTI (US$/bbl)	50.8	59.0	59.0	67.3
Natural Gas (C$/GJ)	2.26	2.55	2.60	2.90
Potash (US$/KCl tonne)	181	190	193	200
Wheat (C$/tonne)	230	238	232	237

Note: 2020-22 is a three-year average

Deficit Falling, More Progress Expected

The just finished 2017/18 fiscal year is now expected to have seen a $595mn deficit, which is around $100mn lower than had been assumed at the time of last year's budget. While own source revenue growth was weaker than had been expected, that was offset by stronger revenue from crown corporations and lower program spending. The 2.6% reduction in program spending now estimated for 2017/18 follows a reduction of similar magnitude in the prior fiscal year, and is larger than the decline projected in Budget 2017.

For the 2018/19 fiscal year, the deficit is expected to narrow further to $365mn. While provincial tax rates were left unchanged in this year's budget, following a 1% increase in PST last year, the scope of PST was widened to include light vehicles and energy efficient appliances. Those changes, combined with the full year tax takes from previous changes and a strengthening economy, are expected to result in a 6.2% rise in tax revenue this year compared to last. However, growth in resource revenue is expected to slow, in part due to conservative price assumptions, and revenue from government enterprises is projected to be down. As such, overall projected own source revenue growth of 3.8% is close to the assumption for nominal GDP.

On the expenditure side, program spending is expected to be broadly unchanged following two years of declines, although debt charges are anticipated to rise by a further $52mn. While the deficit projection no longer has a contingency, which last year was $300mn, neither does it have allowance for undetermined compensation savings.

The longer term projections still show the Province returning to balance by 2019/20, with surpluses growing slightly after that. The estimates are based off total revenue growth averaging around 3% during that period, which would be just over 1% lower than the pace of nominal GDP growth projected; while expenses are slated to rise by 1.0% in 2019/20, 1.7% in 2020/21 and 2.0% in 2021/22.

Saskatchewan's Borrowing Requirements Increase with a One-Off for Pre-Funding

Saskatchewan's borrowing requirements are projected to increase by $837mn in 2018/19 to $3.2bn, but this includes $568mn in maturing debt ($550mn maturing debenture and Commercial Paper). Borrowing requirements also include $600mn pre-borrowing for 2019/20 requirements. Public Debt Balances are projected to increase by almost $2.3bn, this is net of maturing debt and changes in sinking fund balances. Most of the increase is for the Saskatchewan Builds capital program, followed by borrowing for Crown Corporations. General Revenue Fund Operating Debt balances are projected to grow more gradually.

Total gross borrowing requirements of $3.2bn will be funded mainly with Canadian debentures of $2.75bn. Net of maturities and sinking fund changes, public debt balances are expected to increase by around $2.3bn to $20.0bn, inclusive of debt borrowed on behalf of Government Service and Government Business Enterprises.

The Saskatchewan Builds Capital Plan (2018/19 to 2021/22) projects total capital investment of around $3.6bn over the four year horizon for various infrastructure and other government projects. This amount includes $1.2bn in 2018/19. Data back to 2007/08 shows peak investment of $1.8bn in 2016/17; tapering gradually thereafter. Including the Crown, total capital spending is over $2.7bn this fiscal year.

Among the Crowns, the largest share of capital investment in 2018/19 is for SaskPower, which projects it will need $883mn mainly to renew its distribution and transmission system along with the expansion and renewal of its electricity generation assets. SaskTel is projecting that it will spend $298mn for its wireless and wireline network. Meanwhile, SaskEnergy will spend $268mn and SaskWater plans to invest $34mn.

Table 3	Financing Plan and Debt Balances[1]		
$Millions	Actual F2016-17	Forecast F2017-18	Budget 2018 F2018-19
Borrowing Requirement			
General Revenue Fund (GRF)	1,608	555	975
Saskatchewan Builds - Capital*	1,000	1,100	1,500
Crown Corporations	795	714	731
Total	**3,403**	**2,369**	**3,206**
Borrowing Sources			
International	-	-	-
Canadian Debentures	3,200	1,950	2,750
Short-term debt	114	385	438
CPP	89	34	18
Total	**3,403**	**2,369**	**3,206**
Public Debt Balances			
GRF operating debt	5,409	5,750	6,150
Saskatchewan Builds - Capital	1,686	2,752	4,194
Other Govt Service Organizations	555	526	431
Crown Corporations	8,321	8,724	9,260
Total	**15,971**	**17,752**	**20,035**

1 We show the latest available forecast at the time of the budget.
Fiscal years ending March 31.

* Saskatchewan Builds - Capital 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, 2018 public debt	**17,752**
Add: 2018-19 borrowing requirements	3,206
Less: 2018-19 maturities of public debentures	(550)
Less: 2018-19 maturities of CPP debentures	(18)
Less: 2018-19 maturities of other term debt	(98)
Less: 2018-19 reductions in short-term debt	(18)
Add/(Less): 2018-19 change in sinking fund balances	(239)
Forecast, March 31, 2019 public debt	**20,035**

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

Saskatchewan as a practice does not do any pre-funding in the capital markets, so this year's budget is a departure from the norm and is being done in order to secure long-term borrowing for capital projects in the current low interest rate environment. Saskatchewan's borrowing plans entail domestic bond issuance only. The Province's last international transaction was in 2006 in Swiss Francs.

On Track to Balance

Saskatchewan delivered a budget consistent with its steady hand approach to prudent fiscal management, continuing the track record of the Saskatchewan Party that has been in power since 2007 and that won a third mandate in the 2016 general election on a campaign pledge of sticking to its conservative principles. Today's budget, the first under new Premier Scott Moe, carries on that tradition with a firm commitment to get to balance in 2019/20. This is unchanged following last year's one year delay.

We believe that today's budget is neutral from a credit perspective with the government's unwavering commitment to balance in short order along with the modest and declining deficits along the way.

We highlight that in last year's budget, Saskatchewan exemplified its balanced approach by using a mix of offsetting fiscal measures (PST hike and lower tax exemptions) combined with lower personal and corporate income taxes. This's year budget is largely a placeholder budget with some modest revenue enhancing tax measures.

We highlight that, with the exception of S&P, the other rating agencies have not changed the Province's credit ratings as a result of the oil shock. Moreover, these ratings agencies (DBRS, Fitch, and Moody's) continue to maintain stable rating outlooks. As the one year delay to balance announced last year did not trigger a rating action, we are inclined to believe that today's budget is largely neutral from a credit rating perspective. We are somewhat cautious on Moody's, however, as it continues to maintain its highest rating of Aaa on the province and Saskatchewan's debt levels continue to creep higher. Moody's explicitly states that it expects the debt burden will not exceed 80% of revenues over the next 2-3 years for which we believe will be a delicate balancing act for the province as debt moves higher and revenue growth is restrained by a slower pace of economic growth ahead. For 2017/18, Moody's projects a debt burden ratio of 77.5%, which has little headroom relative to the 80% bar. At the same time, however, this ratio is well within the 65.1-100% band for a the province's current debt anchor score. We highlight that their debt calculation excludes SaskPower, SaskTel, and SaskEnergy, which are considered self-supporting.

With respect to S&P, it downgraded the Province in 2016 from AAA to AA+ Negative. S&P's rating policy generally requires that outlooks be resolved within a three-year time-frame. The rating agency downgraded the province again in 2017 to AA Stable. We believe that the projected metrics are now better aligned with S&P's AA rating category.

Saskatchewan projects its debt/GDP ratio will gradually increase from 17.1% at March 31, 2016, peak at 25.1% in 2020, and then decline modestly to 24.8% at March 31, 2022.

Saskatchewan's debt/GDP ratio is one of the lowest among the Canadian provinces. This ratio, inclusive of adjustments for other imputed debt, is expected to remain within the AA rating criteria of 15-35% as per DBRS's adjusted debt/GDP ratio.

Another aspect of Saskatchewan's imputed debt burden is its unfunded pension liability. We highlight that the province has a strong advantage over Canada's other provinces. It closed 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. In today's budget, Saskatchewan reported that it will save $352mn in the education budget alone related to the Teachers' Superannuation Plan. In fact, on an overall basis, the budget states that "The 2018/19 Budget provides increases for health, social services and assistance, protection of persons and property, as well as the K-12 and post-secondary education sectors. However, total expense is lower than the previous year's budget as a result of lower pension expense, primarily due to a significant decrease in Government's pension liability. Expenses are also projected to be down across many other areas, as entities are managing spending carefully while continuing to provide high quality services to Saskatchewan people."

As the population ages and the age dependency ratio rises, Saskatchewan will be in an increasingly favourable position relative to the other Canadian provinces. We highlight that a province's unfunded pension liability is an important factor in the debt assessment by the rating agencies. It is a factor that is either incorporated into the debt calculation (i.e. DBRS) or in the contingent liability assessment scores (i.e. Fitch, Moody's, S&P).

*Credit Ratings: DBRS AA, Fitch AA, Moody's Aaa Stable, S&P AA — All Outlooks Stable