June 1, 2016

SASKATCHEWAN ON TRACK TO BALANCE IN 2017-18 DESPITE DOWNTURN

Highlights

- The Government of Saskatchewan tabled the FY 2016/17 budget today, with little as far as new initiatives.
- The deficit is expected to reach $434 million (0.5% of nominal GDP) in FY 2016/17, pushing net debt up to $13.2 billion, or about 17.6% of nominal GDP.
- The budget plan focused on modest measures to control expenses and raise revenue. In line with its election platform, the government did not introduce or raise taxes.
- The debt burden remains manageable and the deficit is comparatively small. Moreover, the government presented a fairly concrete plan for return to balance.

Saskatchewan's recently re-elected Saskatchewan Party government tabled its Fiscal Year (FY) 2016/17 budget today. This budget plan acknowledges that government revenues this fiscal year will increase a modest 1.1% from the last fiscal update, though a more substantial decline from Budget 2015 exists as non-renewable resource revenue is squeezed by nearly a billion dollar. Nonetheless, the government will raise spending by 1.1% in part to help sustain services during the economic downturn leading to a second consecutive budget deficits, projected to equal $434 million in FY2016/17. The budget focuses heavily on a commitment to return to balance in FY2017/18, while maintaining funding and investments in key programs and infrastructure projects, as well as introducing no new taxes or tax increases this year.

Returning to balance in such a short time-frame hinges on the reversal of economic fortunes in the province, a modest rebound in commodity prices next year, and some expenditure restraint.

SASKATCHEWAN GOVERNMENT FISCAL POSITION
[Millions of C$, unless otherwise noted]

	2014	2015 Budget	2016 Budget			
Fiscal Year	2014-15	2015-16*	2015-16*	2016-17	2017-18	2018-19
REVENUES	**14,179**	**14,280**	**13,868**	**14,024**	**14,464**	**14,780**
% change	--	0.7	-2.2	1.1	3.1	2.2
EXPENDITURES	**14,106**	**14,173**	**14,295**	**14,458**	**14,458**	**14,675**
% change	--	1.0	1.3	1.1	0.0	1.5
Surplus (+)/Deficit (-)	**73**	**-48**	**-427**	**-434**	**6**	**55**
% of GDP	0.1	(0.1)	(0.6)	(0.6)	0.0	0.1
Net Debt	**4,615**	**5,105**	**5,552**	**7,164**	**9,133**	**--**
% of GDP	5.6	6.2	7.2	9.6	11.5	--

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

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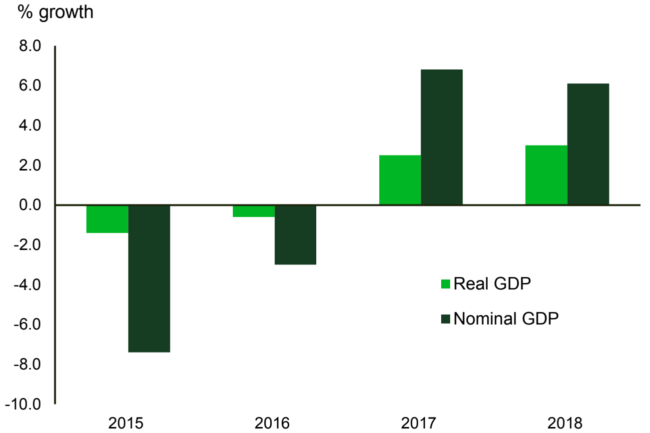
ECONOMIC GROWTH EXPECTED TO ACCELERATE OVER THE LONG TERM



Source: Saskatchewan Budget 2015, TD Economics.

Prudent assumptions underpin economic growth forecast

The Budget 2016 plan relies on relatively conservative economic assumptions for the province. The government expects the economy to contract both in real and nominal terms this year, before staging a rebound in 2017 (see chart 1). The government projects a more severe economic contraction in 2016 followed by a stronger recovery than our own forecast, but growth over 2016 and 2017 is on average in line with our recent outlook.

Crude oil prices, quoted at the West Texas Intermediate benchmark, are assumed to average US$40.50 in 2016, before rising to US$51.00, only modestly higher than the current spot prices and below our own forecast of US$50.00 and $55.00 respectively. This presents some upside potential as far as economic activity and resource revenue are concerned this year and next.

The government's assumptions on oil & gas drilling activity as well as potash and uranium production appear reasonable, with both prices and activity expected to improve slightly next year. Moreover, the plan is based on an exchange rate assumption which sees a rise in the value of the Canadian dollar towards 77 U.S. cents next year, somewhat higher than our current view and allowing for a further upside to the revenue forecast.

These generally conservative assumptions should provide some cushion to meet revenue growth targets should a modest downside risk materialize. However, this cushion is partly offset by somewhat optimistic assumptions for Canadian and U.S. economic growth.

Transfer's from the Federal Government help offset resource revenue drought

Total revenue in 2016-17 is forecast to be $14.0 billion (17.5% of nominal GDP). This figure is 1.1% higher than the 2015-16 revised estimates, but marks a $260 million (1.8%) decline from the figures presented in Budget 2015. The bulk of this decline is related to a $968 million decrease in non-renewable resource revenue from last year's budget projection. However, increases in tax and crown corporation revenue, as well as a large increase in Federal Transfers helped shore-up revenues relative to last year's figures, providing some offset.

The Wall government lived up to its campaign promise and delivered no new taxes or tax increases. An increase of 2.3% in tax revenue from the 2015 forecast update is largely the result of prior-year reconciliation adjustments. Moreover, improved revenues from crown corporations, relative to last year estimates, help offset resource revenue declines.

Rising transfers from the Federal Government account for the bulk in the improvement in provincial revenues, rising 12.3% from the last budget forecast. While some of this money is a one-time transfer – such as $200 million related to the transfer of federal dams to Saskatchewan authority – about one-fifth of the increase represents continued long-term funding.

Overall, the Saskatchewan government managed a relatively modest revenue increase from 2015 forecast update, with the majority of increases in stable long-term source areas. This is promising in their goal for balance in 2017.

Expenditure restraint helps restore balance in 2017

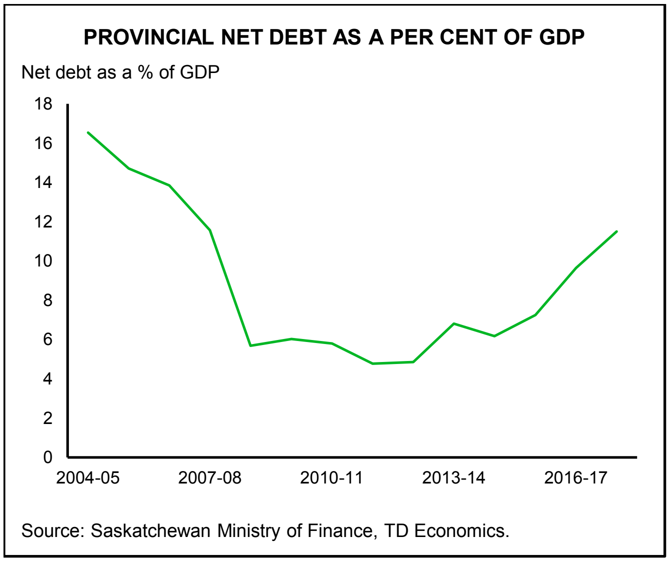
The government expects to spend $14.5 billion (18.1% of nominal GDP), an increase of 2.0% over the last fiscal year. Generally, increases in expenditures followed a hold the line theme, but some significant changes were noted relative to Budget 2015, including:

- A 1.5% ($81 million) increase in health funding,

COMMODITY PRICE FORECAST

	Forecast			
Fiscal Year	2016	2017	2018	2019
WTI Oil (US$/barrel)	40.50	51.00	60.00	70.00
Natural Gas (C$/GJ)	2.70	3.00	3.30	3.50
Potash (C$/$K_2O$ tonne)	457	446	436	433
Potash (US$/KCl tonne)	205	209	213	217
Canadian Dollar (US cents)	75.04	77.75	80.50	82.25

Source: Saskatchewan Budget 2016, TD Economics.



primarily to support higher regional health authority spending

- An 8.1% increase in agriculture spending, related to higher crop insurance liabilities
- A 10.8% increase in community development, related to a $25 million provincial commitment to the Regina stadium project
- A 3.9% increase in transportation spending, allowing for higher funding for highway infrastructure projects

Overall, the budget focused more on expenditure control and targeted investments to help bring the government to balance in 2017. Targeted infrastructure funding should help provide a brace in the current economic cycle, helped considerably by federal transfers.

Spending discipline leads to balanced budget next year

Despite a 39.5% fall in non-renewable resource revenue from last year's budget, the Government of Saskatchewan has laid out a plan to return to balance next year. Importantly, the plan abstains from significant spending cuts, which could threaten to further depress economic activity, while keeping both deficits and debt at very manageable levels.

Such an outcome was partly related to the strong financial position Saskatchewan was in heading into the downturn, with last year's budget projecting a modest ($106.8 million) surplus for FY2016/17. As well, a comparatively low debt burden provides Saskatchewan with some flexibility in managing short-term downturns. Overall public debt, debt including that of crown corporations, is expected to advance $1.6 billion to $7.2 billion or to 9.6% of GDP – one of only two provinces with debt-to-GDP below 10%.

Bottom line

Saskatchewan has been hard-hit by the commodity price downturn, which has resulted in an economic contraction and significant decline in government revenues. The budget presented today by the recently re-elected government provides a reasonable and attainable path back to balance. It relies on modest increases in revenue, related to an improving economic backdrop, coupled with some expense restraint, and appears to strike the right balance of insulating the economy from sharp spending cuts while keeping the deficit and debt burden manageable.

Importantly, a well defined plan back to surplus in a short time-frame and low total debt & debt-to-GDP ratio positions the government well in the event that their economy does not rebound as expected. On the other hand, should the plan evolve as expected, the government will be in a healthy position to consider new spending initiatives next year.

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