March 22, 2017

THRIFT'S THE WORD IN SASKATCHEWAN BUDGET 2017

Highlights

- The Government of Saskatchewan's deficit is estimated to have reached $1.29 billion in FY2016-17, or almost triple that expected in Budget 2016.
- The Budget Plan tabled today acts to aggressively tackle the deficit, by way of raising $900 million in new revenue generating measures and considerable expense cutting, while the capital expenditure plan was kept largely intact.
- Overall, the deficit is expected to be cut in half in the upcoming fiscal year, and a return to balance is expected by fiscal year 2019-20.
- Provincial debt will continue to increase, with the net debt-to-GDP ratio expected to reach 15.2% in the upcoming fiscal year.

Thrift was the key word in Saskatchewan government's Budget 2017 plan. Low commodity prices have had a far more significant impact on provincial government revenues than previously projected, pushing the deficit to $1.29 billion (1.7% of GDP) in fiscal year (FY) 2016-17. This threw the government off course to balance the budget in the upcoming fiscal year. The current deficit is the highest since 1992 for the province, and the largest across provinces outside of Alberta and Newfoundland relative to the size of their economies. Still, the province remains committed to getting back to balance. In order to do this, the government introduced a number of new revenue generating and cost cutting measures in today's budget to help balance the books in the next three years, including a much anticipated increase in the provincial sales tax from 5% to 6% and eliminating a number of tax credits. The Province expects to largely continue with its 5-year capital expenditure plan laid out in last year's budget, which will mostly be funded through debt. Net debt-to-GDP is expected to climb to 15.2% by the end of the next fiscal year, though Saskatchewan would remain one of the least indebted provinces.

Province to raise nearly a billion by increasing taxes

The Province of Saskatchewan has built its budget around a relatively optimistic outlook for commodity prices. The price of oil is expected to edge up to US$55 in 2017 and climb to almost $70 a barrel by 2020 according to the West Texas Intermediate measure. Natural gas prices are expected to increase by 58% this year in Canadian dollar terms. Rising commodity prices, should they materialize, would boost nominal GDP growth to an average of 4.8% per year over the next four years. While our near-term oil price forecast is similar, the price has recently traded below US$50 offering some downside risk to the forecast.

SASKATCHEWAN ECONOMIC ASSUMPTIONS
[Per cent, unless otherwise noted]

Fiscal Year	2016*	2017F	2018F	2019F	2020F
Real GDP growth	-0.2	0.8	2.0	1.9	1.8
Nominal GDP growth	-3.2	4.9	5.7	4.5	3.9
Employment growth (000s)	-5.2	1.2	4.9	5.5	5.3
WTI Oil (US$/barrel)	43.4	55.0	60.0	65.0	69.0
Natural Gas (C$/GJ)	2.06	3.25	3.25	3.30	3.40
Potash (US$/KCl tonne)	171.9	175.7	178.2	181.6	184.9
Canadian Dollar (US cents)	75.5	74.7	75.7	77.1	77.8

Source: Saskatchewan Budget 2017, TD Economics. *Actual.

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However, Saskatchewan is not only counting on rising commodity prices to bring it back into balance. Instead, the Province has tabled a plan to overhaul its tax system, shifting away from corporate and personal income taxes towards consumption taxes. It also implemented some new revenue generating measures. The big ticket item in this budget was the raising of the provincial sales tax by one percentage point to 6%, and broadening the tax base to include items such as restaurant meals, construction projects, and children's clothing. Some other revenue generating measures include:

- Increased taxes on tobacco and alcohol
- Increase in the education property mill rate
- Eliminating and reducing a number of tax credits available to households and businesses, including the education and tuition tax credit
- Increasing corporate tax rates on financial institutions and credit unions

Additional revenue generated from these measures will be partly offset by a cumulative one percentage point decline in the corporate and personal income tax rates between 2017 and 2019 and enhanced low income tax credit. However, Saskatchewan has also suspended the indexation of income tax brackets, which could lead to a higher tax burden for individuals on the margin.

On net, the new tax structure will generate an additional $900 million in revenues per year, lifting the overall take back to pre-2014 levels by the upcoming fiscal year. These moves should enable some diversification of the revenue base, with non-renewable resources expected to fall to 10% of the total in the upcoming fiscal year – nearly half of its share in fiscal 2014-15.

Expense control also on the docket

In an environment of rising unemployment, expense control poses a particular challenge for the province. While expenses are expected to remain higher than planned in Budget 2016 due to health care costs, the government is trimming some programs to help fill the budgetary gap. First and foremost, the Province plans to save $250 million in compensation costs, a cut of 3.5%, through pay reductions and unpaid days off, although exact implementation remains uncertain. The government is also slashing other costly privileges for government workers, including the removal of airplane service which is expected to save $700,000 annually.

Saskatchewan has also slightly pulled back on program funding for education, to the tune of almost $70 million annually combined between higher education, job training and K-12 funding. The Province will also wind down the Saskatchewan Transportation Company, expected to save some $85 million per year in subsidies and eliminate the first time home buyers plan for a total savings of $8 million.

The combination of these measures is expected to reduce expenditures by 1.2% in FY2017-18 and hold expense growth to an average of 1.5% per year over the budget plan thereafter – well below the combined growth in inflation and population.

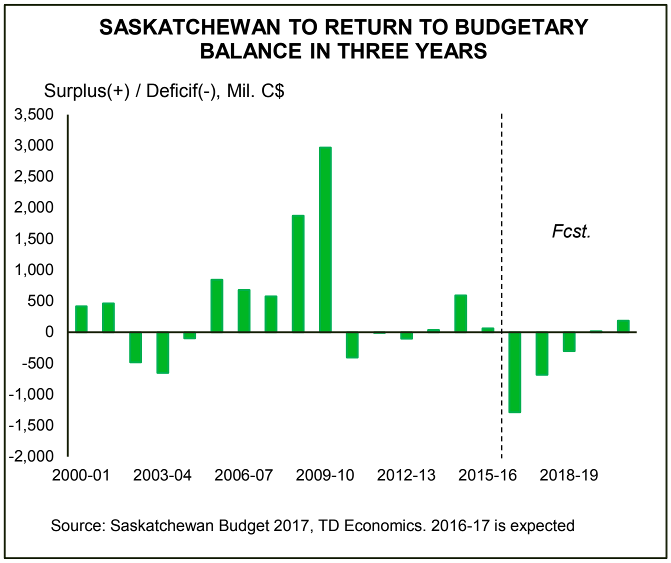
Capital Expenditure to remain on track as debt builds

The government has added in a $300 million contingency into its deficit estimates to help cushion against unforeseeable expenses. Putting it all together, the government of Saskatchewan is expecting the deficit to shrink to just $685 million by FY2017-18, or 0.8% of GDP. Despite the budget-

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

	2016 Budget	2017 Budget				
Fiscal Year	2016-17*	2016-17	2017-18	2018-19	2019-20	2020-21
REVENUES	**14,024**	**13,694**	**14,165**	**14,694**	**15,237**	**15,708**
% change	1.1	-1.3	3.4	3.7	3.7	3.1
EXPENDITURES	**14,458**	**14,983**	**14,800**	**14,948**	**15,172**	**15,475**
% change	1.1	4.8	-1.2	1.0	1.5	2.0
H.R. Measures**	--	--	250	250	250	250
Contingency	--	--	(300)	(300)	(300)	(300)
Surplus (+)/Deficit (-)	**-434**	**-1,289**	**-685**	**-304**	**15**	**183**
% of GDP	(0.6)	(1.7)	(0.8)	(0.4)	0.0	0.2
Net Debt (end of year)	**9,133**	**10,643**	**12,244**			
% of GDP	12.3	13.8	15.2			

*Per cent change in revenues and expenses relative to Budget 2016.
Source: 2017 Saskatchewan Budget, TD Ecoı ** Human resources compensation measures.



ary gap, the province will continue along with most of the capital expenditure plan outlined in last year's budget, most of which are planned to be funded through debt. Borrowing requirements are expected to total $2.7 billion this upcoming fiscal year, of which roughly $2 billion will be used to fund capital expenditures. As such, the net debt-to-GDP is expected to continue to climb, reaching 15.2% in the upcoming fiscal year.

Bottom line

While the commodity price forecast in today's budget is not overly conservative, the Government of Saskatchewan is not relying on it alone to close the budgetary hole. Instead, it has taken relatively aggressive measures to get the budget back into black within the next three years, despite the challenging economic environment in the province. Still, the government expects the current fiscal plan to have a modestly positive impact on the economy over the next five years with lower income and corporate tax rates, combined with the existing capital expenditure plan, expected to help offset any negative economic consequences from the higher PST. While the return back to balance may prove a challenge, particularly should commodity prices struggle to gain momentum, today's budget should put the province on the right path.