The 2019 Saskatchewan Budget: Putting behind the commodity shock

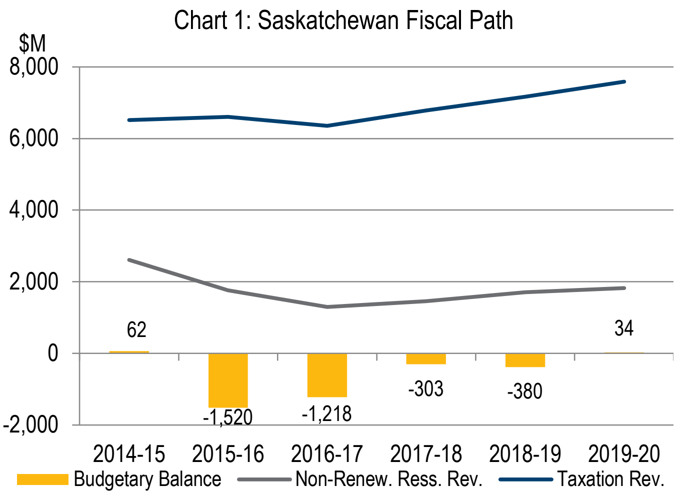
Four years ago, Saskatchewan was hit by the collapse in oil, natural gas and potash prices. The province's non-renewable resources revenue, which accounted for a fifth of the province's revenue in FY 2014-15, dropped by an average annual rate of 29% in FY 2015-16 and 2016-17. Also, as the economy slowed down and the unemployment rate increased from 3.7% in late-2014 to almost 7% in late-2016, taxation revenues stagnated. Facing its largest budget shortfall as a percent of GDP since 2002 (1.9%), the government embarked on an austerity program with the goal of getting back to balance within three years.

Budget 2019 confirms the completion of the program. A combination of spending restraints and a rebound in commodity prices fuelling revenues enabled the government to meet its fiscal target and balance the budget with a small $34M surplus forecasted for FY 2019-20 (chart 1). Despite a large increase in taxation revenues (+5.8%) and non-renewable resources revenues (+7.1%, mostly driven by potash revenues), the government is keeping a lid on program spending growth in FY 2019-20 (1.6% excluding debt charges). Stronger revenues allow the government to inject additional money in health care (an additional $30M for mental health services), social services ($56M) and education ($26M for K-12 education).

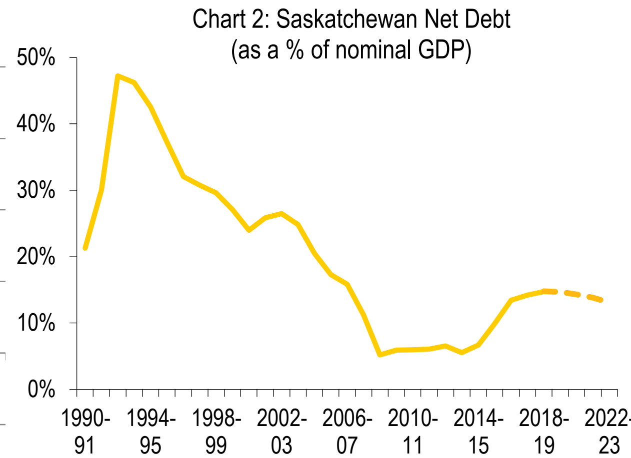
Also, the budget does not introduce new major tax increases or reductions. We will keep an eye on government business enterprises as their net income has been volatile in recent years. For instance, Saskatchewan's Workers' Compensation Board which projected net income to the government of $15M in Budget 2018 actually registered a $157M net loss for FY 2018-19.[1] Net income from SaskEnergy is also budgeted to decline by almost half, from $117M to $64M in FY 2019-20.

Beyond 2019-20, the province forecasts surpluses to modestly grow to $84M (0.1% of GDP) by 2022-23. This profile will allow net debt-to-GDP to decline from a decade-high of 14.8% in FY 2018-19 to 13.1% in FY 2022-23 (chart 2). It is also worth emphasizing that Saskatchewan's net debt-to-GDP ratio is the third lowest across all provinces (behind Alberta and British Columbia). This low ratio supports Saskatchewan's AA (third highest) ratings by S&P and Aaa (highest) by Moody's.

[1] The government explains this discrepancy by a one-time investment loss not "budgeted to repeat" in FY 2019-20.



Source: Government of Saskatchewan.



Source : Government of Saskatchewan, Government of Canada Fiscal Reference Tables, LBS Econ. Res. and Strategy.

Improving economic outlook beyond 2019

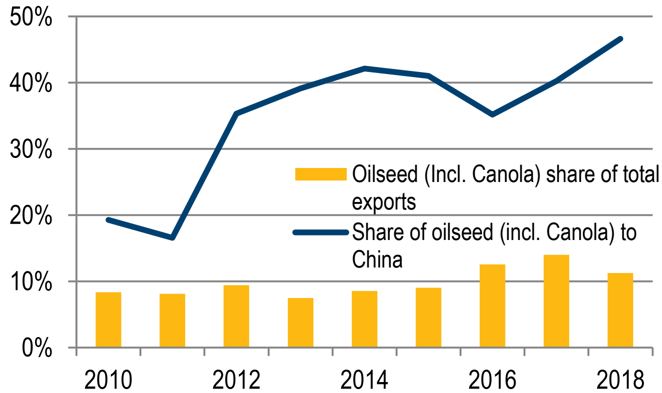
The budgetary outlook is based on an improvement in economic conditions. After two years of recession in 2015 and 2016, Saskatchewan's real GDP grew by 2.2% in 2017 and by 1.0% in 2018. Relative to 2018, lower oil prices of US$58 and an expected 2.8% decline in crude oil production is expected to restrain 2019 real GDP growth at 1.2%. The province anticipates WTI oil prices to increase to US$61 and US$63 in 2020 and 2021, respectively, lower than our long-term WTI forecast (US$67). Moreover, while the province does not expect a large pickup in potash and crop production in 2019, global demand for these products should firm along with the economy going into the next year. Overall SK Finance officials expect real GDP growth to average 2.2% from 2020 to 2023.

Escalating Canada-China tensions a key risk to watch

A key risk to watch in the near-term will be the rising tensions between China and Canada. In recent days, China suspended two of Canada's largest canola producers' import license: Winnipeg-based Richardson International and Regina-based Viterra. Canola prices tumbled. The Canada Council of Canada reported that Chinese importers were no longer ordering Canadian canola at all. Based on our calculations, oilseed exports[2] accounted for 11% of Saskatchewan's nominal exports last year and that 47% of those went to China (chart 3). Therefore, if China maintains its import ban on canola or, worse, extend it to other Canadian agricultural products, the Prairies' economy could underperform relative to budget expectations. For Saskatchewan, one silver lining resides in that two of its largest agricultural industries (wheat and potash) have much smaller ties to China and therefore would be mostly isolated from new tariffs or non-tariffs barriers, assuming prices for those commodities hold on to expectations.

[2] Including Canola, excluding soybean.

Chart 3: Saskatchewan Oilseed Exports tied to China



Source: Innovation, Science and Economic Development Canada, LBS Econ. Res. and Strategy.

Highlights of the borrowing program

- For FY 2019-20, total borrowing requirements are scheduled at $2.3B, down from $3.2B in FY 2018-19. Most of the decline is explained by lower refinancing necessary in the general revenue fund.
- 86% ($2.0B out of $2.3B) of the borrowing program is scheduled to be made in domestic debentures, the same share as last year.
- There is a possibility for the issuer to establish a new 10-year benchmark. At the same time, the flatter yield curve would support the strategy of re-opening the existing 30-year benchmark.

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