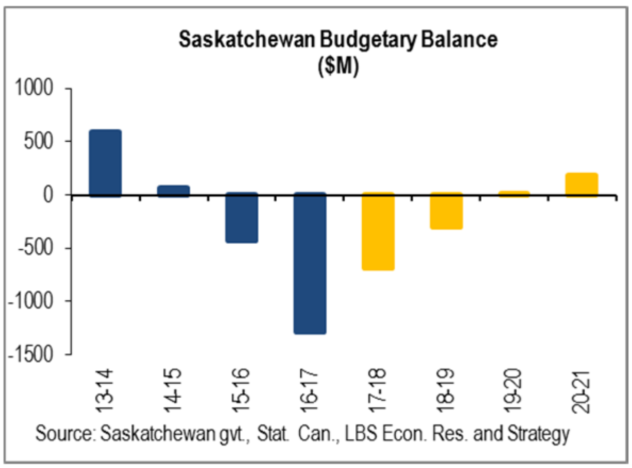
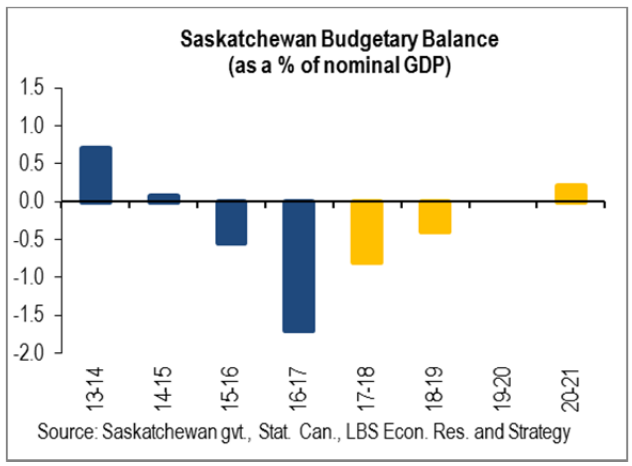
The 2017 Saskatchewan Budget: Austerity measures propose to eliminate deficit in three years

Saskatchewan's financial position has deteriorated rapidly over the last two years due to depressed crude oil and potash prices. The fall in resource revenues, from $2.6B in FY 2014-15 to only $1.3B in FY 2016-17, largely contributed to the huge deficit of $1.3B registered in FY 2016-17 (representing 1.7% of NGDP; see charts below). This outcome is substantially worse than the $0.4B shortfall projected in the last year's budget and above the $1.0B deficit estimated at the mid-year update.

Under such challenging fiscal circumstances, the provincial government has decided that it cannot just sit back and wait for commodity prices to rebound. Accordingly, this budget includes a new plan to rapidly eliminate the deficit by FY 2019-20, over a three-year period. The improvement would begin immediately with the deficit projected to be cut by half to $685M in FY 2017-18.





The restoration of a sustainable fiscal trajectory is notably based on the Province's growing reliance on provincial sales tax (PST) revenues. The PST is a more stable source of fiscal revenue compared to the volatile royalty revenues tied to crude oil and potash prices. Specifically, the PST rate was increased from 5% to 6% on March 23th, 2017. On the same day, the PST tax base was also expanded to children's clothing, restaurant meals, snack foods, insurance premiums, renovation and new home construction services, etc. Altogether, this major overhaul is expected to almost double PST revenues (from $1.1B in FY 2016-17 to $2.0B in FY 2017-18).

Besides the PST enhancements, the budget proposes minor tweaks to targeted tax expenditures as well as tobacco and liquor tax rate increases. The personal income and corporate income tax rates will also be modestly reduced twice, in mid-2017 and 2019, contributing to foster economic growth. All in all, total revenue is projected at $14.2B in FY 2017-18, up 3.4% from the previous year.

The other principal austerity measures expected to contribute to eliminating the deficit relate to spending. Indeed, several spending cuts were announced in this budget. The most important is the incorporation of a $250M (3.5%)

reduction in public sector compensation for FY 2017-18 which represented 48% of total spending last year. Although the allocation of these expected savings has not been specified to the various ministries yet, employees from crown corporations, health regions, school divisions and post-secondary education sectors are expected to be affected.

In addition to these public sector salary reductions, the education, health and agriculture ministries will see their funding reduced in FY 2017-18 compared to FY 2016-17. The Saskatchewan Transportation Company, the provincially owned bus company, will also be shut down. Further cuts could be announced in future years since a review of the province's income assistance programs is currently underway. Altogether, total expenses are projected to decline by 2.9% in FY 2017-18 relative to FY 2016-17.

A Credible Plan Put Forward

In summary, this budget put a heavy emphasis on controlling the controllable. Moving away from resource revenues is a good policy decision since there is still much uncertainty regarding the oil outlook (as we explain in more detail in our Alberta budget write-up available at www.vmbl.ca). To deal with unexpected declines in commodity prices, the $685M deficit includes a large $300M contingency. In our view, the credibility of this deficit-reduction plan is further reinforced by our own view that WTI crude oil prices over the coming three years will most likely be above what is currently assumed in this budget. Indeed, we expect WTI crude oil prices to reach $US67 per barrel at the end of 2017 and average $US70 in 2018. Meanwhile, the Saskatchewan Ministry of Finance forecasts WTI crude oil prices to increase from an average of US$43 in 2016, to US$55 in 2017, US$60 in 2018 and US$69 in 2019.

In conclusion, the Saskatchewan government does not want to take the chance of running structural deficits. This approach contrasts with what we've observed from the Alberta and federal governments. Moreover, the Saskatchewan government is taking all the necessary actions to avoid further downgrades (the S&P rating agency downgraded the Province from triple-A to double-A+ in mid-2016). This approach will also bring down significantly the Province's borrowing requirements (from $3.2B in FY 2016-17 to 2.5B$ in FY 2017-18). Post-budget release, investors need to monitor whether the government will deliver on its promises. If this is the case, it will likely support spreads on Saskatchewan's bonds.

Sébastien Lavoie | Chief Economist

514 350-2931 | lavoies@vmbl.ca