Saskatchewan: 2018–19 Outlook

LINGERING CHALLENGES, EVOLVING STRENGTHS

- **Having recouped its 2015–16 real GDP contraction with a buoyant 2.9% gain last year, Saskatchewan's economic growth is forecast to slow substantially to 1.5% in 2018 before accelerating to 1.8% the following year.**
- **Household spending and infrastructure outlays are expected to be key sources of weakness this year, with a return to job creation in 2019 likely to push consumer expenditures higher that year.**
- **Diversification across resource sectors and international markets, as well as anticipated gains in domestic manufacturing output bode well for continued export growth.**

EMPLOYMENT SOFTNESS, INFLATION TO WEIGH ON HOUSEHOLDS IN 2018

Weak, albeit improving employment growth is expected over the forecast period, contributing to muted gains in household expenditures. Unlike Alberta, where job creation responded strongly to broad-based economic growth in 2017—with help from major projects approved prior to the commodity price correction and the Fort McMurray reconstruction—Saskatchewan hiring remains weak. Provincial employment is down 0.3% y/y ytd as of August, ensuing 1.1% job losses during 2016–17. A gradual recovery is expected, resulting in flat employment growth this year, with rising borrowing costs instilling greater consumer caution. In 2019, forecast job creation of 0.5% should prompt households to begin to loosen the purse strings.

Wage growth should mirror job creation, exacerbating the softness in consumer spending. From January to June, average weekly earnings for payroll employees advanced just 0.8% versus the same period last year—the second weakest gain of any province—and retail sales are up a tepid 0.7% y/y ytd. The expected pickup in hiring this year and next should gradually absorb some of the labour market slack and slowly push wages higher.

Saskatchewan's recent pickup in inflation is diminishing buying power. Core CPI from January to July is up 2.3% versus year-ago levels, sharply accelerating over the 1.4% gain in 2017 and trailing only BC to date this year (chart 1). This likely reflects lingering effects of the Provincial Sales Tax (PST) hike from 5% to 6% implemented last year as a provincial deficit-reduction measure. Higher gas prices are also weighing on consumers' pocketbooks. We foresee some cooling of inflation in 2019 as oil price gains slow and the PST increase pass-through fades, though the tax's recent expansion to include used light vehicles and energy efficient appliances may push prices up for those items.

Solid population gains projected at about 1.2% for 2017–18 and 1.5% in 2018–19 should put a floor under consumption. Interprovincial migration will likely continue to drag on population growth near-term, but recent outflows should ease as better labour market conditions increasingly draw job seekers from other provinces. Births are expected to continue to significantly outnumber deaths over

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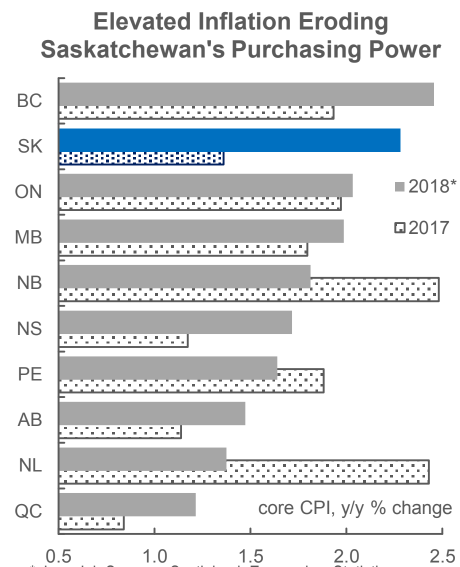
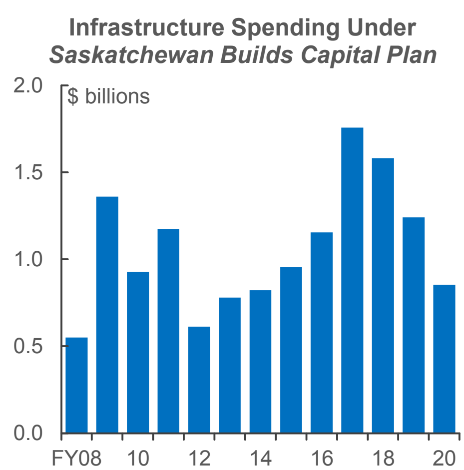
Chart 1



* Jan.–Jul. Sources: Scotiabank Economics, Statistics Canada.

Chart 2



Source: Saskatchewan Finance.

the forecast period given Saskatchewan's young age profile. Rising federal immigration targets in 2018 and 2019 provide a basis for the attraction of greater numbers of newcomers.

We forecast that Saskatchewan housing starts will fall from 5,000 units in 2017 to just 3,800 units this year before rising to about 4,500 units in 2019. Year-end 2017 per capita completed and unabsorbed units were 218% and 64% above their 2010–16 annual averages in Regina and Saskatoon, respectively, building on the housing overhang accumulated post-commodity price correction. The glut of unabsorbed dwellings, weak household income gains and stricter mortgage stress tests implemented January 1st that are discouraging marginal buyers from entering the market should keep new residential building in check in 2018. In 2019, an improving labour market is expected to drive starts modestly higher.

INFRASTRUCTURE PULLBACK ALSO EXPECTED TO POSE A DRAG

Infrastructure spending is another key contributor to modest economic growth this year and next. The Province projects a 22% reduction in capital outlays in FY19 via the *Saskatchewan Builds Capital Plan*, with another 31% fall estimated for FY20 (chart 2, p.1). In addition to *Capital Plan* expenditures, crown corporations expect to contribute infrastructure spending of just over $1.5 bn in FY19, in line with FY18. Average annual expenditures by crown corporations are forecast to average $1.4 bn annually from FY19–22.

STABLE BUSINESS INVESTMENT, WITH DOWNSIDE RISK

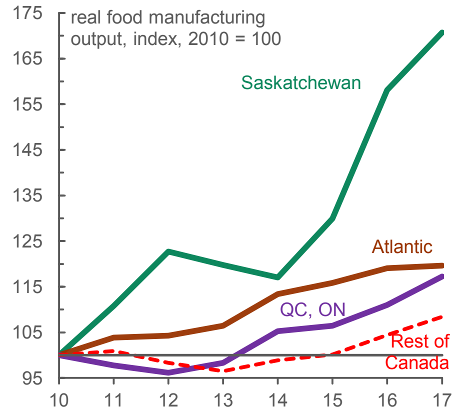
The outlook for oil & gas investment is generally positive with some potential downside. Six steam-assisted gravity drainage (SAGD) projects are under construction or under development in the Lloydminster area, each of which has a capital cost of about $350 mn and estimated production capacity of 10,000 bpd. Interest is also building in Saskatchewan's helium drilling industry. Yet investor sensitivity to light-heavy oil price differential fluctuations is likely to be heightened following the quashing of Trans Mountain pipeline expansion project (TMEP) approval. The Line 3 pipeline refurbishment's go-ahead is encouraging, but pipeline opposition and rail service disruptions remain possible stumbling blocks for energy investment.

Other mining investment also faces mixed prospects. Recent uranium mine closures, with prices for the commodity expected to remain depressed over the forecast horizon, are expected to weigh on capital expenditures in the sector. However, the $1.7 bn K3 potash mine expansion is progressing in Esterhazy, with scheduled completion in 2024.

We look for non-residential, non-mining business investment to hold steady in 2018 and 2019. Work on the Regina Bypass—a public-private partnership building a $1.9 bn ring road around the capital's south end—and the Chinook Power Station—a $680 mn natural gas-powered electricity generation plant—will continue until late 2019. A $42 mn Saskatoon sports complex and a planned 44,000-sq. ft. cannabis production plant near Regina may assist provincial industrial and commercial building, which rose 10% y/y from Q4-2017 to Q1-2018—the best two-quarter result since 2014.

Chart 3

Food Processing is a Strength for Saskatchewan



Sources: Scotiabank Economics, Statistics Canada.

Saskatchewan Profile, 2017*

Population, July 1	1.2 mn (11.7% of Cda)
annual % change	*1.3*
Saskatoon CMA	324,000 (27.8% of SK)
annual % change	*2.9*
Regina CMA	253,000 (21.8% of SK)
annual % change	*2.4*
Rest of Saskatchewan	587,000 (50.4% of SK)
annual % change	*0*
Real GDP, Chn. 2007$	64.3 bn (3.2% of Cda)
Per Capita Nom. GDP, $000	68.2 (117% of Cdn avg.)

Economic Outlook

'annual % change except where noted	2010-16	16	17**	18f	19f
Saskatchewan					
Real GDP	2.0	-0.5	2.9	1.5	1.8
Nominal GDP	5.3	-4.0	5.4	4.1	4.1
Employment	1.1	-0.9	-0.2	0.0	0.5
Unemployment Rate, %	5.0	6.3	6.3	6.1	6.0
Housing Starts, 000s	5.2	4.8	5.0	3.8	4.5
Canada					
Real GDP	2.1	1.4	3.0	2.1	2.1
Employment	1.3	0.7	1.9	1.2	1.0

Governance

Premier	Scott Moe, Saskatchewan Party (as of 2018)
Legislature	48 of 60 seats
Next Election	November 2020
Credit ratings:	
Moody's	Aaa
S&P	AA
DBRS	AA

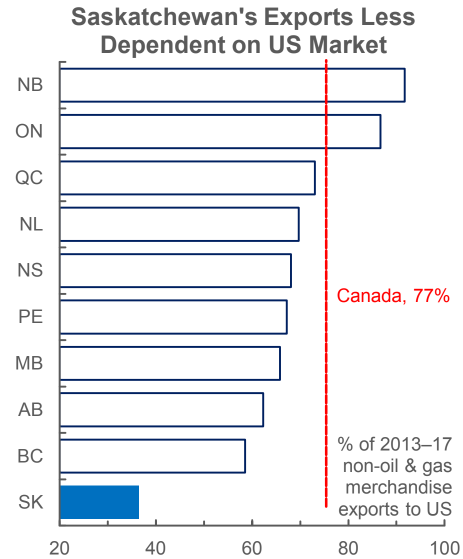
* Figures may not add due to rounding. ** SK real GDP growth, 2017, by industry at basic prices. Sources: Scotiabank Economics, Statistics Canada, CMHC, Saskatchewan Legislature, Ratings Agencies.

EXPORTS TO POST MODERATE ADVANCES

Saskatchewan has the advantage of diversification across several resource sectors, which should mitigate the expected declines in uranium production. First oil at one of the SAGD facilities in early 2019 should assist oil shipments abroad, with a steady rise forecast for the price of oil improving profitability for exporters. The US$3 bn expansion of the Rocanville potash mine completed in October 2017 is expected to boost nameplate capacity by about 3.5 mn bpd. Despite a production stoppage in June, Bethune potash mine output is set to ramp up throughout the forecast. The expansion of sales efforts in Brazil by a potash marketer, coming on the heels of a multinational mining company's exit from the country, also bodes well for external potash shipments.

Agricultural sector exports face headwinds. With dry early-year growing conditions, farmers foresee canola production falling nearly 10% in 2018, after reaching a record high and accounting for 29% of principal field crop output in Saskatchewan last year. Declining yields are also expected for key crops such as barley and wheat. Indian import tariffs on Canadian pulses present another challenge, though consequences are less dire for exports of chickpeas, for which the US and Turkey were the primary destinations last year.

Chart 4



Sources: Scotiabank Economics, Industry Canada.

Food processing should sustain momentum through 2019. Saskatchewan food manufacturing output rose nearly 50% during 2014–17, far outstripping all other provinces (chart 3, p.2). A Vanscoy pulse processing plant—with an expected production capacity of 160,000 MT once operational—could build on this growth. Public- and private-sector funding is earmarked for food processing technologies as part of the Federal Protein Industries Supercluster awarded to the Prairie Provinces. The University of Saskatchewan's $17.5 mn Agri-Food Innovation Centre further aims to develop and commercialize the agri-food sector. The *Saskatchewan Value-Added Agriculture Incentive* offers additional support via a 15% non-refundable tax credit on eligible investments towards upgrading primary agricultural products.

Other manufacturing industries in Saskatchewan will also likely support domestic and external sector activity this year and next. Machinery, concentrated in agricultural equipment, should benefit from Alberta's ongoing recovery, capacity pressures across Central Canada, and a forecast 2.9% average annual climb in US industrial production during 2018–19. A Saskatoon-based bus manufacturer recently won a five-year $22 mn contract to produce buses for Calgary Transit. The prognosis is worse for fabricated metal manufacturers given 25% US tariffs on steel imports and layoffs likely at a Regina firm that was slated to provide the bulk of the pipe needed for the TMEP.

Saskatchewan is well-positioned to weather the global rise of protectionism. Excluding oil & gas products, which are less sensitive to potential NAFTA-related disruptions (see commentary here), Saskatchewan exports are the least dependent of any province on the US market (chart 4). Escalating Sino-American trade tensions could also lift Saskatchewan agricultural exports if China opts to seek high-value agricultural products from outside the US. Interprovincial exports are expected to benefit from the *Canadian Free Trade Agreement* as well as to Saskatchewan's participation in the *New West Partnership* the other western provinces. Finally, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, which could take effect as early as end-2018, should provide increased access to several trade markets.