



A Soft Landing

Saskatchewan's Economic Profile and Forecast

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BUILDING THE NEW WEST

This research report is part of the Canada West Foundation's ***Building the New West (BNW) Project***, a multi-year research and public consultation initiative focused on the strategic positioning of western Canada within the global economy. Five key priorities emerged from an extensive research and consultation process and provide a framework for the ***Building the New West Project***:

- The West must create the tools to attract, retain, and build HUMAN CAPITAL;
- The West must continue ECONOMIC DIVERSIFICATION;
- The West must strengthen its TRANSPORTATION INFRASTRUCTURE;
- The West must promote the global competitiveness of its MAJOR CITIES; and
- The West must develop new ways of facilitating REGIONAL COORDINATION.

To learn more about the ***BNW Project***, please visit the Canada West Foundation website (www.cwf.ca).

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INTRODUCTION

Saskatchewan's economy posted real growth in 2003 of 4.5% — the second-highest provincial growth rate in the country. Expansion that year was bolstered by good crop yield and quality from the previous year, as well as strong prices for natural resources.

Economic growth slowed from this pace in 2004, largely because of poorer crop conditions. However, record-high oil prices, strong demand for other natural resources, solid housing construction, gains in manufacturing, and surging exports (despite a rising Canadian dollar) continued to lift Saskatchewan's economy. In the fall of the year, the provincial government announced that it had joined Alberta and Ontario as a "have" province.

In 2005 and 2006, Saskatchewan will see a soft landing from the strong growth rates posted in 2003 and 2004 (*Figure 1*). Growth will slow but certainly not collapse. Continued strength in natural resource production, moderate gains in agricultural incomes, and a new reputation in scientific research will propel the economy forward. Some dark clouds could also be on the horizon. A strong Canadian dollar, possible increases in interest rates, and higher energy input prices will weigh down the expansion. Crude oil production will continue to be a major contributor to the economy and to provincial government coffers. Oil prices are expected to remain strong, but are likely to come down somewhat from the record high levels posted in 2004.

FIGURE 1: Forecasts for the Saskatchewan Economy

FORECASTS FOR REAL GDP GROWTH:	
2004:	3.0%
2005:	2.6%
2006:	2.6%
ECONOMIC STRENGTH DRIVEN BY:	
<ul style="list-style-type: none"> • Strong mineral and metal prices • Modest gains in farming income (assuming re-opening of US border to live cattle) • Research 	
ECONOMIC GROWTH HAMPERED BY:	
<ul style="list-style-type: none"> • Continued strength in the Canadian dollar • Potential of rising interest rates • Potential of a softer housing market • Higher energy input prices 	

SOURCE: Canada West Foundation.

AGRICULTURE

Saskatchewan has a diversified agricultural sector with a wide mix of grains, oilseeds, specialty crops, and livestock farming. While total agriculture makes up less than 9% of total provincial GDP, the broader agricultural economy — including farm inputs, services to agricultural clients, and food processing — accounts for a much greater portion of the total economy.

As *Figure 2* indicates, total cash receipts for the first three quarters of 2004 are higher than the same period in 2003. This is primarily because of better crop growing conditions in 2003, which led to higher receipts for crops carried forward into the winter and spring of 2004. Receipts for the two largest cash crops for Saskatchewan — wheat and canola — were both up markedly in 2004.

FIGURE 2: Total Cash Receipts, Saskatchewan
(\$ millions)

	Jan-Sep 2003	Jan-Sep 2004	% Change
Wheat (Excluding Durum)	\$ 405	\$ 489	+ 20.8%
Durum Wheat	264	208	- 21.1%
Oats	49	51	+ 3.7%
Barley	83	162	+ 95.3%
Flaxseed	71	66	- 6.7%
Canola	384	621	+ 61.7%
TOTAL (All Crops)	\$ 1,940	\$ 2,494	+ 28.5%
Cattle	\$ 413	\$ 407	- 1.5%
Calves	106	83	- 22.0%
Hogs	205	246	+ 20.1%
Dairy	94	93	- 1.2%
TOTAL (All Livestock)	\$ 958	\$ 969	+ 1.1%
Total Direct Payments	\$ 979	\$ 716	- 26.9%
Total Receipts	\$ 3,877	\$ 4,179	+ 7.8%

SOURCE: Statistics Canada.

Because of a sharp drop in exports due to BSE and the closed US border, cattle and calf receipts were down sharply in the first nine months of 2004. Cattle and calf receipts made up over half of all livestock income in 2003. However, a jump in hog production and receipts more than offset the losses in the beef sector, leading to a modest 1.1% increase (year-to-date) in total livestock receipts over the January-September 2004 period. Direct payments to producers through a variety of programs (Net Income Stabilization Account payments, crop and hail insurance, income disaster assistance, etc.) were down by over a quarter during this nine-month period.

Crop conditions in the spring of 2004 started out promising, but a major killing frost in late summer in many parts of the province resulted in greatly reduced yields and quality. Cold temperatures also delayed the fall harvest, and in some areas the crops remain unharvested under the snow.

Statistics Canada's recent forecast for crop production indicates that total Saskatchewan wheat and canola production will still be higher in 2004 than in 2003 (Figure 3). However, while yields may be high, quality (and thus income from sales) is likely to be down considerably. This will have a dampening effect on income in 2005.

FIGURE 3: Crop Production Estimates, Saskatchewan
(Thousands of Tonnes)

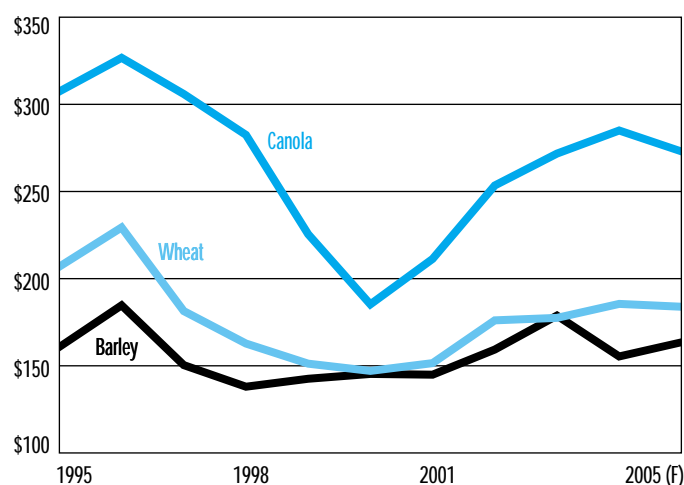
	1994-2003 (Average)	2003 (Actual)	2004 (Nov Estimate)	% Change*
Winter Wheat	102.9	144.2	171.5	+ 18.9%
Spring Wheat	8,484.1	7,077.4	8,143.4	+ 15.1%
Barley	4,315.1	4,354.5	5,007.7	+ 15.0%
Canola	2,778.9	2,676.2	2,903.0	+ 8.5%
Durum Wheat	3,614.2	3,211.4	3,946.3	+ 22.9%
Oats	1,366.6	1,202.9	1,434.3	+ 19.2%
Dry Peas	1,276.3	1,469.6	2,476.7	+ 68.5%

SOURCE: Statistics Canada. Change is Actual 2003 compared to the November estimate for the 2004 year. The 2004 forecast is based on surveys taken on October 22 and November 19, 2003, and released December 8, 2003.

Grain prices have risen somewhat from the lows of the early 1990s, and are expected to remain fairly stable in 2005. According to *TD Economics Commodity Price Report*, the benchmark price for wheat is expected to average \$US 184/tonne this year — a level not seen since 1997. Modest price increases are forecast for barley. While prices for canola are expected to soften this year, they will remain at relatively high levels compared to the last five years (Figure 4). But as mentioned above, even if these price levels are sustained, it is the loss of quality that is likely to drag down total crop receipts for Saskatchewan in 2005.

It is too soon to make predictions for crop conditions this year. However, a recent forecast suggests that the risk of major grasshopper infestations is low and restricted to a few scattered areas. Farmers are hoping for good winter and spring moisture conditions.

FIGURE 4: Crop Prices
(1995-2005 Forecast in \$US/tonne)



SOURCE: Wheat: Canadian Wheat Board (historic). Barley and Canola: Canadian Grain Commission (historic). Years 2004 and 2005 are TD Economics forecasts. Pricing Units for Wheat: Can., St. Lawr., CWSR, 13.5%, \$US/tonne. Pricing Units for Canola: WCE cash, 1 Can. Vancouver, \$US/tonne. Pricing Units for Barley: Malting, CWSR, Spec. Select 6R, Thunder Bay, \$US/tonne.

Livestock farming accounts for approximately one-quarter of total agricultural receipts in the province. Prior to the outbreak of BSE, roughly half of the livestock income in Saskatchewan was from cattle and calves. Because of the US border closing in the spring of 2003, Saskatchewan cattle and calve receipts were down in the first nine months of 2004 by 1.5% and 22%, respectively.

With the recent announcement of a re-opening of the US border to Canadian live cattle exports, 2005 should see a sharp rebound in cattle prices and receipts. The border is scheduled to re-open in early March 2005. However, with the third case of mad cow discovered in Alberta in mid-January, there are some fears that the USDA will be forced to reconsider the resumption of trade of live cattle. Legal actions taken by US lobby groups have added pressure to keep the border closed. Clearly, if the border does remain closed or if re-opening is delayed several months past March, this will be another difficult year for cattle ranchers.

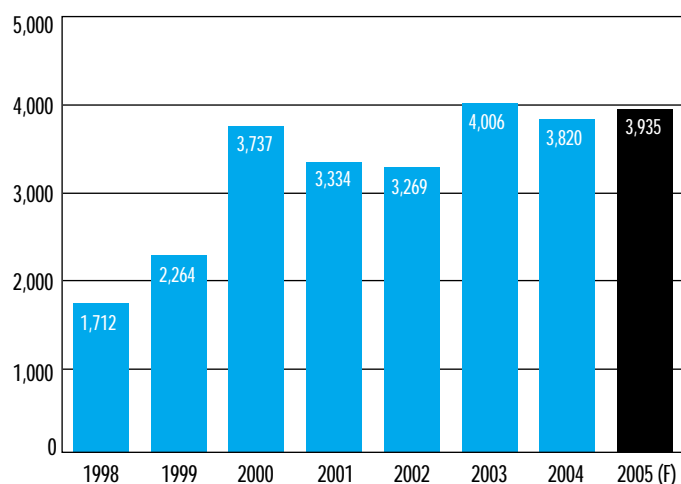
OIL, GAS, AND MINING

As the second largest producer of crude oil in Canada, Saskatchewan enjoyed the benefits of high prices in 2004 and into 2005. Largely due to the royalty revenues brought in by the provincial government from crude oil, Saskatchewan has joined Alberta and Ontario as "have" provinces. In the first ten months of 2004, exports of crude oil from Saskatchewan were up nearly

22% from the same period in 2003 (see Figure 8, page 4). While growth in the total volume of crude oil production was relatively flat in 2004 (up 1.1% to 18.2 million cubic metres in the first nine months), the value of production was up close to 10% due to high prices.

Volume and value of crude oil production in 2005 will again depend on price. Prices have come down somewhat from their record highs of \$US 55/bbl set last year, and are currently trading in the range of \$US 43-48/bbl. According to the *Petroleum Services Association of Canada*, total oil and gas wells drilled in Saskatchewan in 2005 are forecast to be 3,935, up approximately 3% for 2004, and just short of the record of 4,006 set in 2003 (Figure 5). If prices remain at or above their current levels, 2005 could see another increase in value of production (although it is likely to be somewhat less than the sharp 14% increase posted last year).

FIGURE 5: Oil & Natural Gas Wells Drilled, Saskatchewan (1998 to 2005 Forecast)



SOURCE: Petroleum Services Association of Canada.

In terms of value of production, natural gas is far less significant for Saskatchewan than is crude oil. Nonetheless, the value of natural gas has more than tripled since the mid-1990s and in 2003 it came close to overtaking potash in terms of value of production (Figure 6). Again, as with crude oil, this has been a factor of high prices rather than a marked increase in volume.

Uranium and potash are also staple resources in Saskatchewan. The value of production of both of these has been flat over the past few years, but 2004 appears to be a strong year. Through September, the value of potash sales was up 28% from 2003. Likewise, the value of uranium production was up 6%.

FIGURE 6: Value of Mineral Sales, Saskatchewan (Major Commodities Only, in \$ millions)

	Uranium	Potash	Natural Gas	Crude Oil
1996	\$ 667.6	\$ 1,115.9	\$ 392.5	\$ 3,137.6
1997	556.9	1,525.0	421.4	2,904.3
1998	N/A	1,663.1	421.9	1,979.4
1999	N/A	1,682.3	611.3	3,095.1
2000	419.2	1,744.3	1,093.9	5,078.4
2001	561.8	1,621.9	1,268.2	3,748.1
2002	593.1	1,717.7	911.6	4,715.1
2003	548.8	1,631.6	1,536.5	4,819.2
2004 (Jan-Sep)	402.6	1,654.2	1,213.0	4,224.5
% Change (Jan-Sep 2003 to Jan-Sep 2004)	+ 5.9%	+ 28.4%	- 0.4%	+ 13.5%

SOURCE: Saskatchewan Industry and Resources.

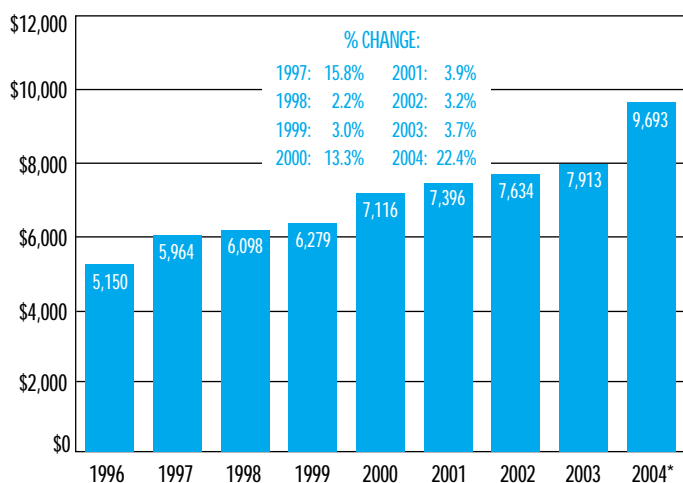
On the horizon, exploration for diamonds in central Saskatchewan has generated some excitement for the possibility of a new mining sector in the province. The potential for large-scale mining (in the order of magnitude of the activity in the Northwest Territories) and additional diversification away from agricultural has added to the economic optimism in the province.

MANUFACTURING

Despite the continued dominance of farming and resources, Saskatchewan's economy has shown promising signs of diversification. Manufacturing shipments from the province have expanded steadily (Figure 7). Since 1996, the total value of shipments has increased from approximately \$5.1 billion to over \$7.9 billion – an increase of 55%. Increases were particularly evident in food processing, fabricated metals, wood products, and refined petroleum products.

Strong growth in manufacturing appears to be continuing. In the first eleven months of 2004, manufacturing shipments were up 22.4% over the same period in 2003. The largest percentage gains in 2004 are in wood products (+53.4%), chemicals (+21.8%), electrical equipment (+18.5%), and fabricated metal (+17.5%).

Prospects for Saskatchewan's manufacturers in 2005 and 2006 will depend on a few external variables. Interest rate increases in both the US and Canada could take the steam out of the housing market, which would dampen wood product manufacturing (i.e., panel and OSB). However, the potential start of construction of a major northern gas pipeline through the Mackenzie Valley will increase demand for steel pipe.

FIGURE 7: Value of Manufacturing Shipments
(\$ Millions)

SOURCE: Statistics Canada. *2004 estimate based on growth rate from Jan-Nov 2004.

EXPORTS

Despite the sizable depreciation in the value of the US dollar – and the resulting strength in the Canadian dollar – the value of international exports from Saskatchewan continued to soar in 2004. During the period January to October, the value of exports was up nearly 20% from the same period in 2003 (*Figure 8*). The dramatic increase was due to very strong international demand and high prices for oil, natural gas and potash.

The most significant gains by product during this period were wheat (+60%), particle board and oriented strand board (+142%), pipe for oil and gas pipeline (+579%), and barley (+276%). Exports of crude oil also showed considerable growth in value, and now account for over 30 percent of total international exports from Saskatchewan.

Looking to 2005, it is difficult to predict how international exports will fare. The appreciating Canadian dollar has appeared to have little impact on the value of exports so far, but if the loonie continues to climb throughout 2005, it is likely to dampen the value of exports from what they would be otherwise. On the other hand, if the value of the Canadian dollar stabilizes or depreciates somewhat, the value of exports could continue to rise.

Much will also depend on the strength of the international economy in 2005. The US economy – the market for the majority of Saskatchewan's exports – is expected to show real GDP

FIGURE 8: International Exports From Saskatchewan
(Major Commodities, Jan-Oct 2003 and Jan-Oct 2004, \$ 000s Cdn)

	Jan-Oct 2003	Jan-Oct 2004	% Change
Crude Petroleum Oils	\$ 2,591,580	\$ 3,159,948	+ 21.9%
Potassium Chloride	1,562,208	1,729,069	+ 10.7%
Meslin and Wheat	484,280	773,273	+ 59.7%
Durum Wheat	537,079	510,104	- 5.0%
Canola	371,315	422,431	+ 13.8%
Particle Board / OSB	79,295	191,513	+ 141.5%
Peas	120,844	183,684	+ 52.0%
Semi-Chemical Wood Pulp	170,426	165,445	- 2.9%
Pipe for Oil/Gas Pipelines	22,490	152,689	+ 578.9%
Barley	38,494	144,846	+ 276.3%
Lentils	120,962	113,956	- 5.8%
Urea	80,108	101,312	+ 26.5%
Linseed	119,148	94,797	- 20.4%
Natural Uranium	115,798	92,532	- 20.1%
Lumber	71,382	87,660	+ 22.8%
Canola or Colza Oil	55,900	77,152	+ 38.0%
Canola, Colza, or Mustard Oil Nes	51,188	75,092	+ 46.7%
Seeders, Planters, Transplanters	55,762	74,556	+ 33.7%
Malt	57,254	74,279	+ 29.7%
Herbicides	72,616	68,884	- 5.1%
Radio, TV, Radar Parts	20,750	65,364	+ 215.0%
Fine Writing/Printing Paper	52,574	63,920	+ 21.6%
Chemical Woodpulp	65,476	62,411	- 4.7%
Fine Writing/Printing Paper (Rolls)	60,174	57,808	- 3.9%
Oil/Cake of Canola	18,425	51,818	+ 181.2%
SUB-TOTAL (Of Above)	\$ 6,995,529	\$ 8,594,544	+ 22.9%
All Other Products	\$ 1,514,873	\$ 1,578,370	+ 4.2%
TOTAL (ALL PRODUCTS)	\$ 8,510,403	\$ 10,172,913	+ 19.5%

SOURCE: Industry Canada Trade Data On-Line (January 10, 2005).

growth this year in the range of 3% to 3.5%. If interest rates continue to climb from their relatively low rates, American housing construction will slow, which will result in lower demand and prices for particle board and OSB. As well, market prices for agricultural products (wheat, barley, canola) and agricultural inputs (potash) will depend on growing conditions in other major markets such as China, Australia, Brazil, and the US.

CONSTRUCTION AND CAPITAL INVESTMENT

Housing starts in 2004 were quite strong, particularly in Regina where starts were up 40% over 2003 levels. Housing starts in Saskatoon were up a more modest 8% over 2003 levels (*Figure 9*). Starts in the province's two major metro regions account for the vast majority of the total provincial housing market.

The value of total building permits (residential, commercial and institutional) was up 3.0% to \$732.7 million during the first eleven months of 2004 over the same period for 2003. A very strong increase in residential building permits (16.4%) was balanced by weak growth in commercial building permits (0.9%) and a decrease in institutional and government permits (down 35%).

Private and public investment in Saskatchewan has been relatively flat over the past few years. Preliminary estimates for 2003 suggest a total value of \$6.6 billion for all new investments in construction (including housing) and machinery and equipment. This compares to \$6.5 billion of new investments in 2002 and a high of \$7.6 billion in 1997. The most recent data for 2004 investment intentions (from February 2004) indicate that capital expenditures will fall to \$6.3 billion – a decrease of about 4%.

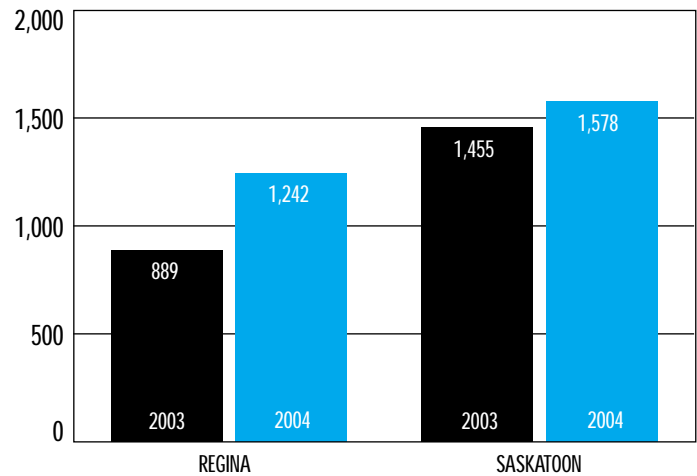
SASKATCHEWAN'S ECONOMY IN 2005 AND 2006

Agricultural incomes in Saskatchewan are expected to increase only modestly over the next two years. Poor quality grains carried over from 2004 and border closures to live cattle until March 2005 (at the earliest) will continue to drag down incomes in the short-term. However, given an assumed border re-opening in 2005, firm or rising prices for grains, oilseeds and livestock, and reasonably good growing conditions, farm incomes should gradually increase. This will boost the spin-off for financial, retail and commercial services in rural areas of the province.

Despite the small gains in agricultural incomes, the farming sector will continue to diminish in significance to the overall provincial economy.

Energy production will continue fueling the provincial economy in 2005. Strong demand for crude oil in the US and internationally is likely to keep prices for crude oil above \$US 35/bbl in 2005.

FIGURE 9: Housing Starts, Metro Areas in Saskatchewan
(January-November 2003 and January-November 2004)



SOURCE: Saskatchewan Bureau of Statistics, Monthly Statistical Review, January 2005.

Prices beyond the short-term are impossible to predict, but given the persistently low inventories of crude oil and the geo-political situation in the Middle East – neither of which are expected to change in the immediate future – it is likely that prices will remain strong. This will bode very well for Saskatchewan's economy. The downside of high energy prices is the pressure they will place on farming and transportation input prices.

In the mining sector, further expansion of potash capacity is expected. As well, Cameco has announced its intentions to proceed with the Cigar Cake Uranium Mine in 2005. This will involve \$450 million in new investment, and will increase production by 60%.

Manufacturing is also likely to increase in importance over the next few years. Demand for processed foods will continue to grow. Interest rates in both Canada and the US are expected to show modest increases in 2005, which will act as a drag on housing construction, and thus on demand and prices for wood products. The announcement of a major natural gas pipeline to the Mackenzie Delta – and the eventual commencement of construction – will result in a strong demand for fabricated metal products (e.g., pipe).

As with all other regions in the country, economic performance will depend largely on the value of the Canadian dollar. Nearly two-thirds of Saskatchewan's international exports go to the US; even if the American economy and demand for Saskatchewan's exports are sustained, an appreciating loonie would continue to erode the value received for these exports.

Economists are mixed in their forecasts for the Canadian dollar. However, given the persistence of the US trade deficit (which hit a record high in December of 2004) and the federal budgetary deficit, the momentum in the currency markets appears to be against the US dollar. This would suggest that the Canadian dollar is more likely to appreciate in value against the US dollar in 2005.

It is possible that the Canadian dollar will trade in the \$US 0.82-0.86 range, and could reach \$US 0.88-0.90 by year-end. Given this scenario, the value of exports from Saskatchewan is likely to be flat or even decline slightly in 2005.

On the bright side of currency appreciation is the boost to investment and productivity that will be afforded by businesses in Saskatchewan. Imports of equipment, computers, and other production inputs will be less expensive, which is expected to improve efficiency and corporate profits.

The Bank of Canada is expected to reduce the amount of excess stimulus in the economy by raising interest rates in 2005. But the Bank has also stated that if the exchange rate continues to trade at current levels, it would have a dampening effect on aggregate demand for Canadian goods and services. This makes it difficult to anticipate the Bank's next move on interest rates.

Assuming that the Canadian dollar continues to trade in the range of \$US 0.82-0.86, it is more likely that interest rates will begin to climb in mid-2005. The Bank of Canada's next announcement for the overnight rate comes on January 25, 2005.

Increasingly, the province is gaining a reputation as a centre for scientific research, anchored by the opening of the Canadian Light Source synchrotron at the University of Saskatchewan. This high-tech facility is one of only a few cutting-edge research centres of its kind in the world. Researchers – both academic and commercial – are being drawn to Saskatoon because of the research capabilities offered by the Synchrotron. This will generate an added boost to both the economy and the reputation of Saskatchewan.

CONCLUSION

Despite some major setbacks to agriculture, Saskatchewan's economy performed well in 2003 and 2004. The province posted growth rates in real GDP above the Canadian average in both years.

In the near term, the outlook for growth continues to be positive. Agriculture will continue to play a significant role in the economy, but it will face serious challenges. Energy and mining, scientific research and manufacturing will increasingly fuel provincial economic growth. Unlike agriculture, these three areas of economic strength are much more easily influenced by prudent planning and by creating a positive business environment. That is, the provincial government and industry can exert a much stronger positive role in shaping them than they do agriculture.

The Canada West Foundation expects a soft landing in terms of real GDP growth rates. Growth in 2004 is forecast to have been 3.0%. Economic expansion will moderate to 2.6% in both 2005 and 2006. ■

IDEAS CHANGE THE WORLD



2005 has the potential to be a year of great change in Canada: there has been a federal election, the future of our cities is a hot topic, Canada-US relations are evolving, and the nature of our democracy is being debated.

As Canadians talk about these issues, it is critical that the aspirations, perspectives, and **ideas** of western Canadians are heard.

Through its Western Cities, Building the New West and West in Canada Projects, the **CANADA WEST FOUNDATION** is actively working to generate ideas for positive change and to make sure that the views of western Canadians are an integral part of the national debates during this time of change.

HOW CAN YOU HELP?

Without ideas – and an organized effort to get them heard – change will not happen. This is what the Canada West Foundation does. But, we can't do it without your support. If you want to help ensure that western Canadian ideas are front and centre on the national stage, we invite you to become a FRIEND of the Canada West Foundation by making a donation. Please contact our Director of Finance and Administration Lori Zarembo (403.264.9535 ext. 347 or toll free 1.888.825.5293 or zarembo@cwf.ca) for more information.



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