The 2018 Manitoba Budget: Making Modest Fiscal Progress But Far From a Balanced Budget

The third budget of Progressive Conservatives (PC) government released on Monday demonstrates modest fiscal progress. However, the main takeaway for bond investors should be that there is no fundamental change to Manitoba's financial situation.

Manitoba Premier Brian Pallister mentioned in a media interview in late February that the deficit is lower than projected for FY 2017-18: a manageable $726M shortfall representing 1% of nominal GDP is expected. This constitutes a $101M improvement relative to the December fiscal update and $114M versus the 2017 budget. Total fiscal revenues were in line with expectations. It is the money spent in some programs and debt servicing costs that came in lower than expected that brought the spending-to-nominal GDP ratio to a 5-year low of 23.9%. The PC government is thus in a position to claim that it has carefully managed public spending, a promise made after winning the general election in April 2016 against the former NDP government.

The 4-year fiscal outlook presented in the 2018 budget is also similar to the outlook proposed in last year's budget. Total spending growth is projected to increase, on average, by only 1.1% per year between FY 2018-19 and FY 2021-22. Capping the increase in health and education spending –representing two-thirds of total expenditures – at only 1% in FY 2018-19 is an ambitious task. During the same 4-year period, total annual fiscal revenue (2.2%) is scheduled to grow twice as fast the projected increase in total annual spending. Altogether, deficits should then shrink slowly over time, to less than 1% of nominal GDP starting in FY 2018-19.

This being said, the fiscal outlook does not propose a plan to quickly return to a balanced budget despite three credit downgrades in a space of three years. The budget documents penciled a small $142M deficit for FY 2021-22, that is only after the 2020 elections. If re-elected, the PC government has pledged to return to a surplus position in 2024. However, this objective might be difficult to achieve given growing signs that the global economy is already in the late stage of the current cycle.

The PC government also announced modest tax breaks in this budget. First, the ceiling to benefit from the small business corporate income tax rate (10.5% instead of 15.0%) will be raised from $400K to $500K in January 2019; matching the threshold already in place in most provinces. This measure will save $6K per year to the average company and cost only $7M for the province. Second, beginning in 2019, the increase in the basic personal exemption will reduce individual taxes by a total of $156M annually. These measures will be in part financed by revenues coming from the new carbon tax, expected to bring $248M per year in the government's coffers. To preserve competiveness, the agriculture sector will be exempt from the tax, which will start at $25 per tonne of carbon dioxide in September 2018. The carbon tax will translate into higher costs for gasoline and natural gas for consumers.

Individuals are also likely to face rising electricity bills since Manitoba Hydro asked the Public Utilities Board for a 7.9% hike in electricity rates, starting April 1st. Manitoba Hydro's debt increased by $1.9B to $16.1B in 2017 because of additional costs related to the Keeyask project located in northern Manitoba. Higher electricity rates are part of the strategy to restore the crown corporation's financial position. It is important for bond investors to follow the developments surrounding Manitoba Hydro's finances since its debt is guaranteed by the Province. Furthermore, about two-thirds of the Province's total borrowing requirements in FY 2018-19 will be tied to the financing of Manitoba Hydro's activities. Overall, borrowing requirements are projected at $6.4B in FY 2018-19, in-between the funding needs observed in FY 2017-18 ($5.6B) and FY 2016-17 ($6.9B).

In summary, the Province's fiscal situation improved modestly since the PC government took office in 2016, thanks to a slower pace in total spending growth and a favorable economic momentum which generated additional fiscal revenues. The $726M deficit registered in FY 2017-18 marked the 9th consecutive annual deficit for the Province. The good news is that none of these were substantial shortfalls. Thus, the net debt-to-nominal GDP ratio never reached a critical level. The ratio is in fact projected to stay a notch below 35% in FY 2018-19 (34.3%), a conservative number from the point of view of investors in the Canadian bond market. The government is also gradually replenishing the fiscal stabilization reserve ($110M outstanding today), an appropriate action in case an unexpected negative development were to occur over the next few years. For instance, restrictions emanating from renewed US trade policies would slow Manitoba's economy, as exports to the U.S. represent two-thirds of the Province's international exports. The White House's decision to exempt Canada from the steel and aluminum tariffs was particularly welcomed news for Manitoba, particularly for its manufacturing sector - representing 10% of GDP - which includes the largest bus manufacturer in North America.

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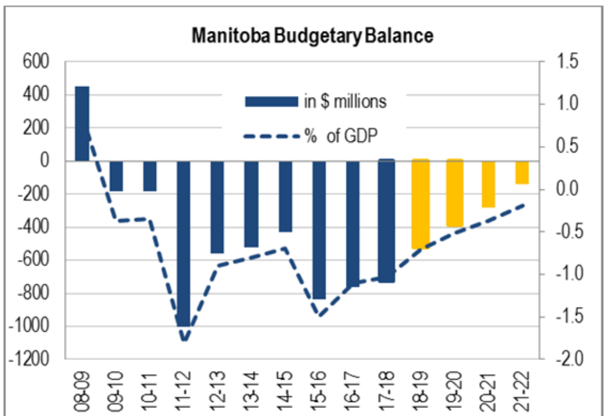
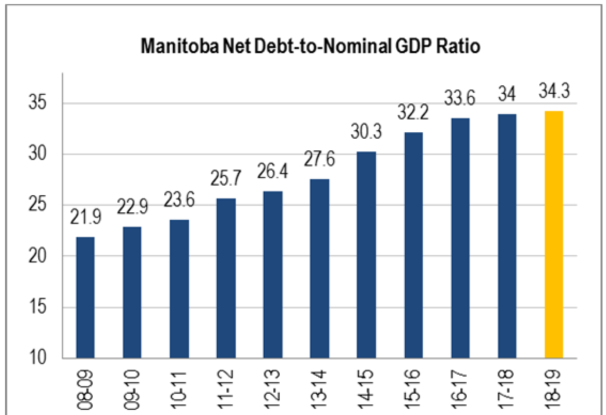


Source: Manitoba government, LBS Econ. Research and Strategy



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