The 2017 Manitoba Budget: Slowly Bending the Fiscal Cost Curve

The provincial Progressive Conservatives (PC) party inherited a structural deficit when it won a majority government in the general election held a year ago. For the new PC government, the Province's main fiscal vulnerability is the 25% expenditures-to-NGDP ratio. This figure is elevated on a historical basis and relative to other Provinces. Accordingly, the government's recent focus was on finding ways to improve the efficiency of public service delivery to ultimately slow the pace of spending growth. This is what the PC government's second budget is mostly about.

The implementation of tightening measures to gradually bend the fiscal cost curve is based on several reviews conducted by external experts during the last 12 months covering all of the government's departments. Streamlining and consolidation efforts are expected to be implemented across the board, notably in the health care sector which represents 39% of fiscal expenditures. Also, new legislation will limit future wage increases of public sector employees (a 1% increase in wage settlements costs approximately $100M). In addition, a few non-performing targeted tax credits are being eliminated. Altogether, these measures are projected to bring down the annual average growth rate in total spending to 2.4% for the next three years; half the pace registered during the last decade.

This being said, slowing the pace of spending growth will not be enough to balance the books overnight. Total fiscal revenues, supported by a healthy and diversified economy, are forecast to increase by an average annual growth rate of 3.0% during the next three years. With revenue growth projected to outpace spending growth by a small margin, deficits will only narrow modestly. For instance, the $840M (1.2% of NGDP) deficit projected for FY 2017-18 is just a notch below the $872M deficit estimated for FY 2016-17 (1.3% of NGDP). After that, the deficit is forecast to shrink a bit further to $698M in FY 2018-19 and $549M in FY 2019-20 (see chart on page 2). Under such circumstances, it will be difficult for the PC government to fulfill its promise of cutting the provincial sales tax rate from 8% to 7% before the 2020 elections. Also, the moderate $840M deficit projected for FY 2017-18, combined with $1.7B in funding dedicated to the Province's infrastructure program, will maintain borrowing requirements at approximately the same level as last year ($6.728B in FY 2017-18 vs. $6.370B in FY 2016-17); according to the budget documents, $1.1B of the funding for FY 2017-18 has already been completed.

In summary, the Manitoba 2017 budget shows only very gradual progress in tackling the deficit. Relative to other provinces, we see the government's approach as balanced. It does not include deep cutbacks (like Saskatchewan announced in its 2017 budget) or several tax increases (like N&L implemented in 2016). Similarly to the federal and Alberta governments, the Manitoba government has not set a deadline for eliminating its fiscal deficit. Nevertheless, the deficit is expected to slow down the pace of increase in the key net debt-to-NGDP ratio (35% in FY 2016-17). This would be a first step in the right direction to get the public finances in order. The Province's net debt more than doubled during the last decade, rising from $10.8B in FY 2006-07 to $23.1B in FY 2016-17. This surge in public debt led to two credit downgrades, one in mid-2015 from Moody's (to Aa2 from Aa1) and another in mid-2016 from S&P's (to AA- from AA).

S&P's decision to downgrade the Province's debt in 2016 was also based on the rising debt burden of Manitoba Hydro ($16.3B in FY 2016-17). One of the crown corporation's main challenges is the growing competition coming from wind and solar energies on its U.S. export market which is putting downward pressures on electricity prices (and therefore revenues). This issue is extremely important for market participants since the *Manitoba Hydro Act* stipulates that the Province unconditionally guarantees almost all of Manitoba Hydro's debt. In order to improve its vulnerable financial position, Manitoba Hydro made two major announcements in early 2017: 1 - double-digit increases in domestic electricity tariffs over time (likely more than the 3.5% annual increase already forecast for the next 13 years); 2 - a 15% reduction in its workforce in order to cut down costs. Investors need to monitor how the restructuration plan of the crown corporation will evolve since the funding for Manitoba Hydro in FY 2017-18 is projected to account for about half of the total borrowing requirements of the Province ($3.4B of $6.7B).

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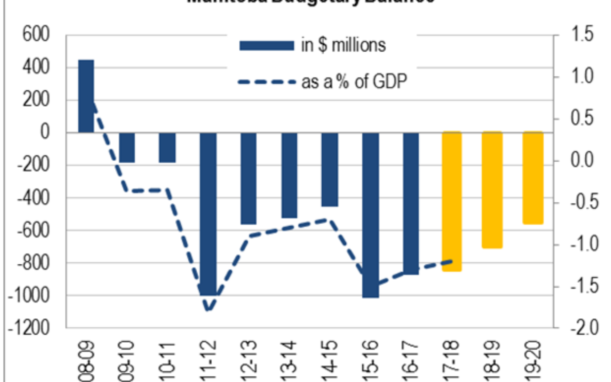
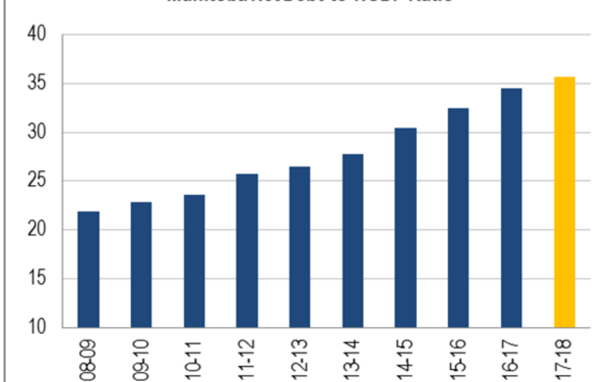


Source: Manitoba government.



Source: Manitoba government

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