May 31, 2016

# MANITOBA BUDGET TAKES MODEST STEPS ON A LONG ROAD TOWARDS BALANCE

### Highlights

- The Government of Manitoba tabled the FY 2016/17 budget today, with very little as far as surprises.
- While the government introduced a few measures to modestly ease expenses and raise revenues, the budget continues what has been a decade of expenses outstripping revenues.
- The deficit is expected to clock in at $911 million (1.3% of nominal GDP) in FY 2016/17, pushing net debt up to $23 billion, or 33.8% of nominal GDP.
- The debt burden remains manageable and the deficit is not alarming, particularly in light of a relatively robust growth outlook. However, the lack of a concrete plan for dealing with the budgetary gap remains a concern and implementing such a plan should be a key deliverable for the new government.

Manitoba's newly elected Progressive Conservative government tabled its Fiscal Year (FY) 2016/17 budget today – just over a month after being elected. Today's provincial budget painted a starkly different fiscal picture than that presented just a few months back by the prior government. According to the document, had the government stayed the course, the deficit would have reached roughly $1.1 billion in FY 2016/17 – almost double that estimated only twelve weeks ago by the prior government and the largest deficit on record for the province. Still, Premier Brian Pallister's team has managed to find some opportunities to modestly scale back spending and lift revenues this fiscal year. The new initiatives should contain the deficit to a still hefty $911 million (or $890 million for core government activities) in FY 2016/17, down from $1,011 million last fiscal year. Net debt is expected to reach $23.1 billion this fiscal year, or 33.8% of nominal GDP. We anticipate that a medium-term plan to tackle Manitoba's debt problem will be outlined in a future Budget document, although the government has at this point suspended the balanced budget legislation and does not plan to balance its books until at least 2020.

### It's NOT the economy…

Manitoba differs from its Prairie provincial peers in that its deficit position and rising debt load is less tied to deteriorating economic conditions and more related to a longer-term trend whereby expense growth has outstripped that of revenues. In fact, the FY2016/17 budget plan was built on provincial economic growth assumptions that are relatively robust. Real and nominal GDP are forecast to increase at an average rate of 2.1% and 3.6%, respectively, between 2015 and 2017 – an outlook very much in line with our own view.

**TABLE 1: MANITOBA GOVERNMENT FISCAL POSITION**

[ C$ millions, unless otherwise indicated ]

| | Actual | Forecast | Plan |
|---|---|---|---|
| *Fiscal Year* | **14-15** | **15-16** | **16-17** |
| **Revenues** | 14,739 | 14,769 | 15,230 |
| % change | 3.7 | 0.2 | 3.1 |
| **Expenditures** | 15,191 | 15,780 | 16,291 |
| % change | 3.1 | 3.9 | 3.2 |
| **In-Year Adjustments/Lapse*** | - | - | **-150** |
| **Summary Net Income** | -452 | -1011 | -911 |
| % of GDP | -0.7 | -1.5 | -1.3 |
| **Summary Net Debt** | 18,963 | 21,395 | 23,149 |
| % of GDP | 29.5 | 30.9 | 33.8 |

* Increase in revenue and/or decrease in expenditures.

Source: Manitoba Finance, Budget 2016, TD Economics.

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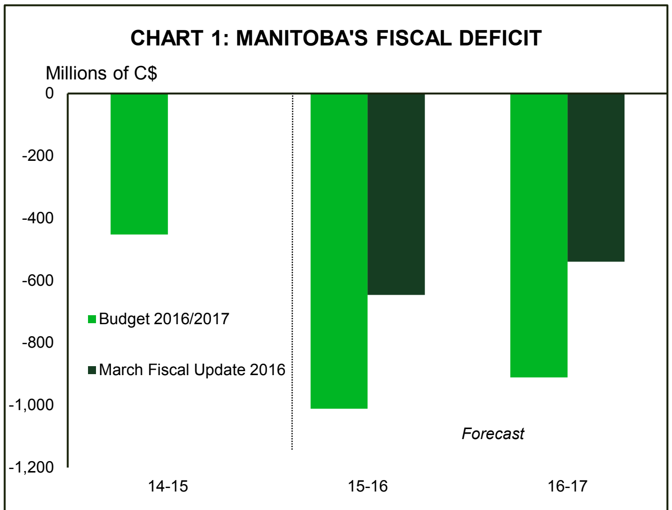


Source: Manitoba Budget 2016, TD Economics.

### Raising revenue by eliminating expensive tax credits

In order to help deal with the sizable deficit, the provincial government has revamped the Senior's SChool Tax Credit. Previously, the tax credit amounted to $470 per senior household. The credit will still be awarded, and could reach as much as $470 per senior-headed low-income household. But, it will be scaled back by 2% of income over $40,000, with households who earn more than $63,500 no longer be eligible for this credit. This measure will boost coffers by $44.5 million dollars in FY 2016/17.

The government will use some of the resulting savings related to revamping the senior education tax credit to help alleviate the income tax burden of Manitoba households and businesses – who face some of the highest tax rates across the country. The Budget provides enhanced tax credits to businesses and proposes a plan to index the personal basic exemption amount and personal income tax brackets to inflation. The latter measures are projected to exempt an additional 2,770 individuals from paying any provincial income taxes, and reduce the annual tax bill for medium- and high-income households by $10 and $67, respectively.

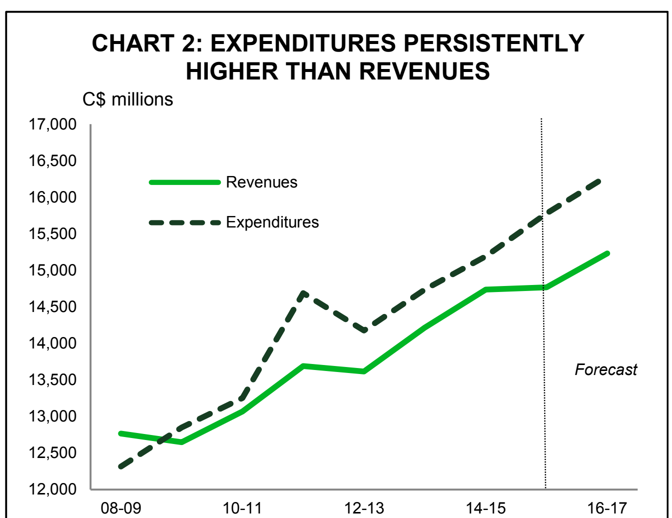
On net, the new measures will still net the province an additional $36.6 million in revenues during FY2016/17. As such, revenues are expected to be 1.8% higher in FY2016/17 than expected by the prior government at the time of their last fiscal update.

### Spending restraint is the name of the game, but that's still to come

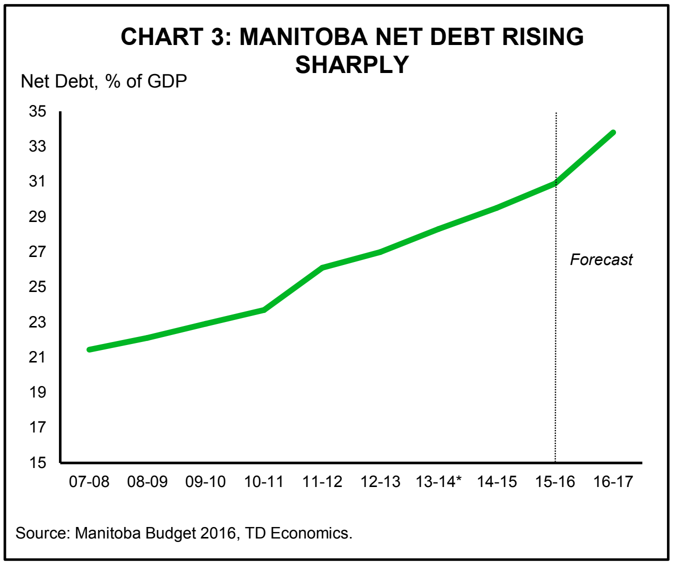
Most of the changes relative to the last budget have been on the expense side and concentrated in health care – a category which accounts for nearly 40% of expenditures. The current government has also expanded the budget for most key departments, and particularly for the Department of Families, which offer social support to families in need.

Like most other provincial governments, the newly elected Manitoba government will focus on skimming fat and finding efficiencies within existing operations to restrain spending growth. But, most of this will be done in future budgets. Today's budget merely kicks off this process by proposing a plan to create a "Value for Money Review" board, which will look for potential cost savings in government. The ultimate goal will be to restrain core government spending growth below a 3% pace over the medium-term, and we look forward to the details likely shared in upcoming budgets. For the time being, the 2016 Budget Plan did find some low-hanging fruit, which helped to cut expenses relative to what they would have been under the status quo. These measures include:

- Reducing cabinet by one-third ($4 million in savings), which resolving the East Side Road authority with the mandate to repatriate the funds into the Manitoba Department of Infrastructure
- Outsourcing the collection of property tax credits and rebates for seniors to the CRA ($900 thousand in savings)
- Reducing advertisements to promote government, with the money instead spent on supporting provincial trade and tourism.



Source: Manitoba Budget 2016, TD Economics.




Despite these measures, expenditures in FY2016/17 are projected to come in about 5% higher than was projected by the prior government.

Capital investments will rise by about $1.0 billion relative to last year, including investments for education and training as well as investment in infrastructure to help prepare the city to host the Canada Summer Games in 2017. Overall, capital investments are expected to total more than $1.8 billion in FY2016/17. However, this is still down about $50 million relative to last year's budget pan.

### Borrowing requirements rising

The sharp deterioration in the deficit over the last year led the Government of Manitoba to draw down the Fiscal Stabilization Fund by $105 million last fiscal year for debt repayment. The current government does not plan to dip further into the emergency fund this year, and instead plans to fund Manitoba's widening deficit and increase in infrastructure spending through more debt. Overall, borrowing requirements will rise by $6.5 billion this year, of which $2.2 billion will be used for refinancing. With provincial net debt rising to $23.1 billion, debt servicing costs now account for 5.4% of total expenditures or 1.3% of nominal GDP – which has actually held steady over the last five years.

### Bottom line

The budget released today by the recently elected government provided some modest measures to boost revenues and ease expense pressures in Manitoba. Still, expenditures are expected to outpace revenues, with the resulting deficits leading to rising debt levels in the province. At this point, the debt burden remains manageable and the deficit is not alarming, particularly in light of a relatively robust growth outlook. However, the lack of a concrete plan for dealing with the budgetary gap remains a concern.

Implementing such a plan should be a key deliverable for the new government, particularly amidst the relatively healthy economic backdrop in which to tackle the fiscal challenge. Such a move would put the provincial finances on a more sustainable track and mitigate the risk to its credit rating – already downgraded last year after the previous government missed projections and failed to provide a plan to get back on track.

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