MANITOBA BUDGET 2013

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Higher sales and "sin" taxes do not prevent larger deficits and a delayed return to balance

Larger budget deficits, a retail sales tax increase and a two-year delay to a projected return to surplus marked the highlights of the Manitoba Budget 2013, released yesterday. Amidst weaker-than-expected fiscal results in the current year and revised revenue and expenditure growth profiles, larger deficits are now projected in each of the next 3 years with a return to surplus not expected until 2016/17. With soaring flood costs driving the 2011/12 deficit to nearly $1 billion, the 2012/13 budget shortfall is estimated to show an improvement at $583 billion, though this is significantly higher than the $460 million forecasted estimate in last year's budget. An improvement is expected in 2013/14 with an estimated shortfall of $518 million, falling further to $365 million in 2014/15 and $164 million in 2015/16 before returning to small $49 million surplus in 2016/17. These projections represent more than $1 billion in cumulatively higher deficits from the previous Budget 2012 projections and rely upon $150 million each year in in-year adjustments to offset the persistent gap between expenditures and revenues. In-year adjustments/lapses are meant to capture unforeseen department budget savings and upward revenue surprises in the fiscal year. To its credit, the Manitoba government is taking advantage of recent federal government infrastructure initiatives; however, this does come at the cost of a one percentage point increase in the provincial sales tax, rising to 8% effective July 1, 2013. While Budget 2013 presented a disappointing fiscal outlook for the province, the government has maintained its commitment to return to budget balance, only the path there looks to be longer and very much reliant once again on unspecified expenditure reductions and/or revenue enhancements.

Weaker than expected fiscal results for 2012/13

After facing its largest budget deficit in 2011/12 at nearly $1 billion in part due to costs associated with severe spring flooding, the province's deficit for 2012/13 is estimated to be $583 million, nearly half of 2011/12's budget shortfall. However, this marks a sizeable increase from the $460 million forecasted estimate for 2012/13 presented in last year's budget. This deterioration is the result of in-year adjustments declining to $57 million from an initial estimate of $241 million, despite realized expenditure reductions of $128 million related to the Program Portfolio Management Review process (included in Budget 2012 to "reduce expenditures while protecting key government programs and services"). While there was a small increase in total revenues relative to the initial budget estimate (0.1% to $13.8), debt servicing cost savings of $38 million contributed to total expenditures dipping 0.3% to $14.4 billion, thus providing a partial offset to the larger deficit estimate.

Modest deficit improvement for 2013/14, but risks remain

The fiscal outlook for 2013/14 is expected to set the path for the province to return, albeit gradually, to a budget surplus over the medium term. For the upcoming fiscal year 2013/14, a modest improvement in the deficit to $518 million in 2013/14 is largely attributable to $150 million in unspecified department budget savings and/or upward revenue surprises. With expenditures projected to grow slightly faster than revenues in 2013/14, a failure to realize these positive surprises in the upcoming fiscal year could impede the return to budget balance further.

Retail sales tax increase to provide a boost to revenues in 2013/14

Total revenues are projected to rise by 3.2% (or $418 million) to $14.2 billion in 2013/14 driven by a 6.4% jump in tax revenues to $7.4 billion. An increase in the provincial retail sales tax from 7% to 8% is expected to boost 'other tax' revenues (not including income tax revenues) to $4.0 billion, a surge of 10.6% or $385 million. Taxation revenues will now represent the largest source of revenues at 28.4% surpassing federal transfers at 27.1%, which are projected to see a modest drop of 1.3% to $3.8 billion on account of a 3.9% decline in equalization payments to $1.8 billion. The recently amalgamated Manitoba Liquor and Lotteries Corporation (Budget 2012 announced the merger of the liquor and lottery commissions into one entity) is expected to contribute $615 million in revenues, leading the Net Income of Government Business Entities to rise 7.7% to $740 million.

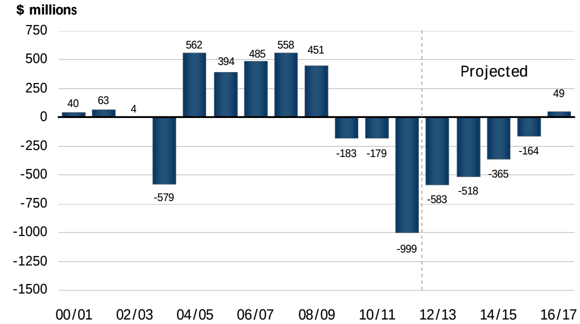
In last year's budget, several new initiatives were introduced to set the province on the path to balance. These included an expansion of the provincial sales tax to items previously not taxed and increased user fees, however, the government refrained from implementing increases to either the province's sales or income tax rates. Given the weaker-than-expected fiscal results and in light of recent federal government initiatives, Budget 2013 set forth to increase the provincial sales tax rate one percentage point to 8%, providing a $278 million boost to taxation revenues in 2013/14. On a per household basis, the increase is estimated to impact the wallets of Manitobans to the tune of $25 per month. The increase, however, is intended as a "time-limited" initiative to take advantage of the federal government's 10-year Building Canada Plan and whose expiry will coincide with the end of the federal program. The revenue stream provided by the initiative (combined with previous allocations to infrastructure for a total of 2pp of the PST) is intended to match federal infrastructure funding and will be allocated to a 'Manitoba and Building Plan', with every dollar to be spent on infrastructure, backed by legislation. A previously announced $250 increase to the basic income tax exemption is expected to offset the tax increase for the "benefit of all taxpayers" while the budget states an increase in the minimum wage to $10.45 from $10.25 is "a policy that helps the lowest income earners and their families most of all". (Generally, an increase in the basic income tax exemption is a greater benefit to those individuals with higher marginal tax rates).

In addition to the retail sales tax increase, a 10.6% surge in 'other tax' revenues is to be supported by additional tax rate increases, thus collectively offsetting various tax credit initiatives introduced in the Budget. Effective today, the tax collected on tobacco will rise 4 cents per cigarette to 29 cents providing $17.2 million in additional revenue. An additional $12.5 million revenue boost is expected to come from a one percentage point increase on the Corporation Capital Tax on Financial Institutions, rising to 5% from 4% (rose from 3% in Budget 2012). Various tax credits proposed in the Budget provide a partial offset to the revenue lift, with the largest expected to be the Seniors' School Rebate, equating to a $50 million annual offset to total revenues.

Health and education spending to lift total expenditures

Total expenditures are budgeted to rise 3.1% (or $443 million) to $14.8 billion in 2013/14, with program expenditures increasing at the same rate to $14.0 billion. Debt servicing costs are projected to rise a more modest 2.3% to $839 million. While this marks a significant slowing in public spending relative to the average pace of growth of 8.3% since 2002/03, expenditure growth is expected to exceed the rate of revenue growth; thus, tempering the improvement in the 2013/14 budget shortfall. The increase in program spending is largely on account of growing expenditures in the health and education sectors which collectively make up 68% of program expenditures. These sectors are each slated to rise 4.5% in 2013/14 with health spending rising to $5.7 billion and education increasing to $3.8 billion. More modest increases of 2.1% and 0.7% for Family Services and Community, Economic and Resource Development to $1.1 billion and $2.5 billion, respectively,

Manitoba budget balance



Source: Manitoba Ministry of Finance, RBC Economics Research make up the remainder of the spending growth. Expenditure savings are expected to come from containing administrative costs, reducing the civil service by 600 over a three-year period and continuing a 20% rollback on salaries for government ministers.

Spring Flood Contingency Fund

On account of rising flood concerns this year (Manitoba is potentially facing 3 floods in 5 years), the province implemented a 2013 Spring Flood Contingency fund setting aside $30 million for the upcoming fiscal year. Taking into account the Disaster Financial Assistance provided by federal government, estimated at $27 million, this contingency fund is expected to require only $3 million from provincial coffers for flood relief. While other spending is planned for water infrastructure development and improvements, the costs associated with the 2011 flood are estimated at over $1 billion and indicate the downside risks of a relatively small financial cushion in case of another such natural disaster.

Beyond 2013/14

An upward shift in the expenditure growth profile combined with lower projected revenues relative to last year's budget projections account for the deterioration in the projected budget deficits through to 2016/17. Initially, projected to climb by 2% annually, on average, total expenditures are now expected to experience annual growth of 2.2%. After 3.3% growth in 2013/14, expenditures are projected to slow in 2014/15 to 1.3% which would mark the slowest rate of expenditure growth in the province since 1996/97 apart from 2012/13. In the final years of the projection period, expenditures are slated to grow by 2.1% annually. In contrast, the revenue profile has been shifted down from Budget 2012 (to 3.2% annually, on average, from 3.6%) despite various tax initiatives providing a near-term lift to taxation revenues. With 3.2% growth expected in 2013/14, revenues are projected to moderate in 2014/15 to 2.4% before accelerating to 3.5% and 3.6% in 2015/16 and 2016/17, respectively. Under these projections, expenditures will exceed revenues each year with improvements in the budget balances relying upon $150 million in annual in-year lapses and/or adjustments (representing unforeseen increases in revenue and/or decreases in expenditures). The failure to realize these positive surprises provide significant downside risk to the government achieving its annual budget projections. That being said, the government has erred on the side of caution with its economic growth assumptions. The budget forecasts real GDP growth of 1.9% in 2013 and 2.3% in 2014, which are well below our own forecasts of 2.7% in both years and could provide some upside risk to the revenue forecasts.

Capital spending to rise

Capital spending is planned to increase 4.7% in 2013/14 or $80 million over 2012/13, and is expected to reach $1.8 billion. Improvements to roads and highways are expected to make up 35% of the spending at $622 million, a 7.2% increase over 2012/13. Health facility spending is slated to get a boost of 40% (or $100 million) in 2013/14 rising to $350 million while capital investments for Universities, Colleges and Public Schools will see an increase of 30% (or $68 million) to $296 million. With an intended focus on "much needed flood related and other infrastructure", $48 million is allocated for Manitoba Floodway and Water Related Infrastructure, a decline of $11 million from 2012/13.

Net Debt to stabilize in 2014/15

Net debt is expected to rise to $17.8 billion by the end of the upcoming fiscal year 2013/14, pushing the net debt-to-GDP ratio to 28.7%. While displaying a rising trend over the past decade, modest deficit improvements coupled with forecasted strengthening in nominal GDP growth is projected to sustain a declining trend in this ratio after stabilizing in 2014/15. According to the government, the net debt-to-GDP ratio "needs to rise in short term as it makes needed investments in infrastructure projects, restores the damage from past floods and invests to mitigate impact of future floods".

Drawing down the Fiscal Stabilization Account

Fiscal Stabilization Account withdrawals are projected to be $100 million in 2013/14 and are to be allocated strictly to debt repayment. With a legislated requirement to withdraw a minimum of $600 million over a five-year period for debt repayment, this builds upon $360 million transferred from the fund over the past 3-years. The fund, established to assist in stabilizing the fiscal position of the government from year to year and improve long-term fiscal planning, is projected to have a balance of $275 million at the end of March 2014.

Manitoba's fiscal plan

$ millions	Actual	Forecast	Budget	Projection		
	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Revenue	13,855	13,764	14,209	14,552	15,067	15,608
Expense	14,854	14,404	14,877	15,067	15,381	15,709
In-year adjustments/lapse	-	-57	-150	-150	-150	-150
Surplus/ (deficit)	-999	-583	-518	-365	-164	49