NATIONAL BANK OF CANADA FINANCIAL MARKETS

April 12, 2022

Fiscal recovery meant to gather steam in 2022-23

By Warren Lovely and Daren King

Highlights

Cameron Friesen is back at the helm in Finance, and his 2022 budget shows Manitoba's diversified economy operating at a high level and the province's finances on an improving track. Relatively buoyant own-source revenue growth combined with significant federal transfers allowed the province to cover extraordinary drought-related supports in 2021-22 while still beating the original deficit target. The deficit is meant to step down appreciably in 2022-23, running at $548 million or a relatively contained 0.6% of GDP. This despite fresh efforts to shore up the health care system and address affordability pressures. In light of lingering uncertainties, the budget sets aside planning contingencies. A fresh medium-term plan shows the deficit declining each year through 2025-26, with a balanced budget pledged telegraphed by 2028-29. That might not be the most aggressive deficit elimination timeline, but other key financial metrics have clearly improved vs. prior guidance. At 36.5%, 2021-22's debt-to-GDP ratio was down year-on-year and comes in nicely below plan. That measure is meant to return to pre-COVID levels over the coming four fiscal years. Debt servicing costs will increase as interest rates move up, but the interest bite will remain lighter than the weighted provincial average at a fairly modest 5.3%. A $4.7 billion, the gross borrowing program for 2022-23 includes $1.6 billion in pre-funding, which is designed to maintain a six-month cash buffer. That's part of a prudent liquidity management strategy. Gross borrowing is more a function of refinancing than net new requirements and is likewise inclusive of requirements for provincial Crowns (notably Manitoba Hydro). Overall, Manitoba's budget commits to an improving fiscal track, while signaling a declining debt load and manageable borrowing requirement for an issuer adept at sourcing funding from various currency markets in a variety of formats.

- Economic outlook — After being among the provinces least impacted by the pandemic due to its more diversified economy, it is estimated that Manitoba's nominal GDP rebounded by 10.4% in 2021. The labour market is doing well, with employment levels in March 2022 now exceeding pre-pandemic levels and the unemployment rate at only 5.3%. Manitoba's economy is expected to continue to grow in the coming years, supported by wage and household consumption growth, population growth and strong exports. In 2022, the budget assumes real GDP growth of 3.6% based on the average private sector forecast. Manitoba's real GDP is then expected to grow by 2.8% in 2023. The budget assumes nominal GDP growth of 5.8% in 2022, which seems conservative compared to our own forecast. Indeed, with current high commodity prices, it would not be surprising to see nominal GDP grow more strongly than anticipated in the budget, implying prospective support for certain government revenues. Nominal GDP growth is expected to moderate to 4.4% in 2023. Employment growth is expected to be 2.3% in 2022 and 1.2% in 2023, bringing the unemployment rate down to 5.2% and 5% respectively.
- Prior fiscal year budget balance (2021-22) — Manitoba's budget provides a third update to the 2021-22 budget balance, projecting of deficit of $1.393 billion, equivalent to 1.7% of GDP. Subject to final adjustments via the public accounts, last fiscal year's deficit was roughly $200 million lighter than planned for in April 2021 (deficit forecast at $1.597 billion). While the latest budgetary tally isn't quite as rosy as December's Q2 report, Manitoba has nonetheless participated in a striking and broad-based budget beat, as all ten provinces plus the feds returned a stronger-than-planned budget balance for 2021-22 relative to Budget 2021 forecasts. Manitoba's narrower shortfall (vs. budget) reflects a more buoyant revenue picture. Total revenue jumped some $850 million or nearly 5% above plan. Many own source revenue streams (e.g., personal and corporate income taxes, sales taxes) and federal transfers topped expectations. These gains were more than sufficient to offset lower net income at GBEs, including an outright loss at Manitoba Hydro. Total spending ran $650 million over budget, with that bulk of that linked to higher claim payouts in the agriculture sector following a severe drought. There was also an extra $100 million in COVID relief payments.
    - Manitoba Hydro results for 2021-22 – For the nine months ended December 31, 2021, Manitoba Hydro recorded a consolidated net loss of $234 million, compared to modest net gain of $34 million in the year-earlier period. The loss is largely due to a drop in export revenues on lower generation (which itself reflects low water levels), higher power purchases/imports, alongside higher financing charges and larger depreciation expense (as Keeyask came into service). Hydro expects a full-year loss of potentially $220 million vs. an original plan for a $190 million net profit. Note that Manitoba's PUB approved a 3.6% interim rate increase for January 2022, falling short of the 5% increase Hydro had sought (to offset the low water/drought impact).
- Medium-term fiscal outlook (2022-23 & beyond) — With a positive revenue base effect extending to 2022-23, and total spending slated to decline, Manitoba foresees notable progress on the deficit this fiscal year. A shortfall of $548 million has been planned for, equivalent to 0.6% of GDP. That balance is arrived at after setting aside $200 million in general contingencies, with an additional $630 million in COVID-related contingencies/response/recovery funding included as part of total expenditures—all of which is a nod to a still-uncertain economic and public health outlook. The fresh medium-term outlook sees the deficit falling to $440 million in 2023-24, declining further in each of the two subsequent years to ultimately reach $260 million come 2025-26. Manitoba aims to balance the books by 2028-29. Keying on the current 2022-23 fiscal year, revenue is expected to advance by 4.6% vs. the much-improved 2021-22 base (excluding contingencies). A resilient and reopening economy, alongside firm labour

markets, should lend important support to many own source revenue streams. Manitoba is due a larger Equalization entitlement in 2022-23, while other non-COVID federal transfers are likewise growing. In all, federal transfers are thought to account for 32% of total revenue this fiscal year, once again surpassing the long-term average of 28%. Total expenditures are due to decline on a year-on-year basis as COVID-related pressures fade. Excluding contingencies and virus-related expenditures, base spending is budgeted to grow a fairly contained 2.5% in 2022-23. A noted fiscal anchor entails keeping total expenditure below 25% of GDP and for 2022-23 that metric looks to come in at 23.4%.

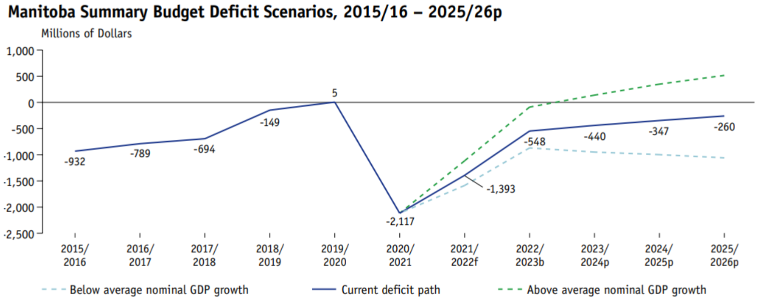
- Budgetary scenarios – The budget outlines faster and slower growth scenarios. The former sees the deficit all but erased this fiscal year. There's still near-term fiscal improvement under the slower growth scenario, as extraordinary outlays ease. But should growth fail to live up to expectations, Manitoba's deficit could drift a bit wider starting in 2023-24.

- Key budget initiatives across five core themes – In the wake of the pandemic, Manitoba's budget is focused first on strengthening the health care system. To this end, $110 million will be invested to address the backlog of diagnoses and surgeries caused by the crisis. There is also an investment of $11 million to increase nursing enrolment in Manitoba's post-secondary institutions and $17 million for the implementation of a five-year mental health and community wellness plan. Due to the recent rise in the cost of living, the budget also aims to make life more affordable by increasing the rebate on the Education Property Tax Rebate to 50%, introducing a new Residential Renters Tax Credit, expanding eligibility for the Child Care Subsidy Program and reducing vehicle registration fees by $10. The third focus of the budget is to help build the economy by launching a new Venture Capital Fund with an initial investment of $50 million to support local businesses and by investing $5 million in immigration programming to help attract newcomers. The fourth objective is to invest in communities, with $326 million over two years set aside to make child care more affordable and accessible by creating 716 spaces in new child-care centers and supporting 50 new home-based-spaces this year. The budget also provides $100 million over three years to support arts, culture, and sport organizations. The final focus of the budget is environmental protection with $50 million over two years for accelerating the remediation and rehabilitation of orphaned and abandoned mine sites, $10 million for forestry programs and over $14 million for provincial parks.

- Capital plan – A new three-year capital plan aims to improve financial transparency. The plan, spanning 2022-23 to 2024-25, foresees relatively "steady growth" while prospective projects are reviewed. For the current fiscal year, total strategic infrastructure investments approach $3.2 billion, inclusive of roughly $1.1 billion for Crowns (notably Hydro). The province is committed to developing a long-term capital strategy, which will seek to address long-run infrastructure needs in a fiscally and environmentally sustainable yet efficient manner. More details to come in the next year.

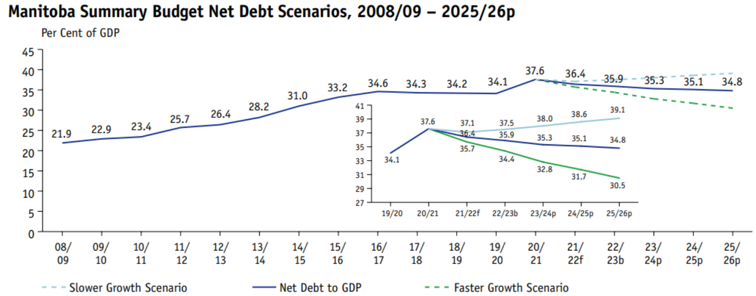
- Debt outlook & interest bite – Summary net debt is estimated to have ended 2021-22 at $29.3 billion. Budgetary improvements contributed to net debt growing at a slower-than-planned rate, as Budget 2021 had originally penciled in a roughly $30 billion summary net debt level. The corresponding net debt-to-GDP ratio stood at 36.4% as of March 31, 2022, which lined up favourably against the 39.9% ratio that had been previously telegraphed. It was also lower than the 37.6% ratio registered in 2020-21, when pandemic impacts drove the deficit north of $2 billion. Manitoba expects to add over $1.2 billion to its net debt in 2022-23 (summary net debt topping $30.5 billion). Still, anticipated growth in the provincial economy suggests the corresponding debt burden could ease to 35.9% of GDP. A degree of additional progress on the debt burden is anticipated further out, debt-to-GDP ultimately forecast at 34.8% by 2025-26. That would essentially return the debt burden to pre-COVID levels, as debt-to-GDP averaged just over 34% before the pandemic struck. Consistent with the faster/slower growth scenarios discussed above, net debt-to-GDP could be down to ~30% by 2025-26 should Manitoba enjoy above average nominal GDP growth. Conversely, a slow(er) growth scenario would place the debt ratio at just over 39% in four years' time, all else being equal. As per the budget: "The fiscal indicator goal for net debt-to-GDP is to be in line with the weighted average for Canadian provinces." Turning to the interest bite, Manitoba's $1,025 million of planned debt servicing costs for 2022-23 would be higher than the prior fiscal year but should nonetheless consume just 5.3% of total revenue (2021-22: 5.2%). Notwithstanding expectations of higher interest rates, Manitoba's debt burden remains affordable, as it does in most provinces where the relatively long weighted average term of outstanding debt generally blunts near-term interest rate risk for this level of government. As yet another fiscal anchor, Manitoba will strive to keep the interest bite below the provincial weighted average.

Manitoba Summary Budget Deficit Scenarios, 2015/16 – 2025/26p



Sources: Manitoba Finance Survey of Forecasters and Manitoba Finance Calculations
Note: The Manitoba Budget 2022 net income (loss) scenarios are based on the average private sector economists' projection for nominal GDP growth without any forecast adjustments. The higher (slower) economic growth scenarios are based on the above (below) average projections for nominal GDP among the economists surveyed.
f - Forecast b - Budget p - Projection

Manitoba Summary Budget Net Debt Scenarios, 2008/09 – 2025/26p



Sources: Manitoba Finance Survey of Forecasters and Manitoba Finance Calculations
Note: The Manitoba Budget 2022 net debt to GDP scenarios are based on the average private sector economists' projection for nominal GDP growth without any forecast adjustments. The higher (slower) economic growth scenarios are based on the above (below) average projections for nominal GDP among the economists surveyed.
f - Forecast b - Budget p - Projection

- Long-term borrowing requirement – Manitoba borrowed $4.6 billion in 2021-22. As in years' gone by, new issues were completed in a variety of forms and currencies. Some 60% of funding was steered to the domestic market, while international trades were printed in the U.S., Europe, Australia and New Zealand. For the just-underway 2022-23 fiscal year, gross borrowing requirements (inclusive of Hydro) total $4.7 billion, of which $3.2 billion relates to refinancing. In order to stay six months ahead of underlying cash needs, Manitoba's gross requirement includes over $1.6 billion in planned pre-funding towards 2023-24. Note that the pre-funding/cash buffer is part of an enhanced prudential liquidity strategy established in the wake of the pandemic. Previously, Manitoba aimed to have three months of cash on hand. It is expected that the liquidity buffer will return to pre-COVID levels once the pandemic ends. With the deficit on a declining track and some major Hydro-related capital requirements likewise easing, net new cash requirements will be relatively contained over the medium term. Refinancing activity will pick up, however, the resulting gross borrowing increasing to $5.4 billion for both 2023-24 and 2024-25, before reaching $5.7 billion in 2025-26. On balance, we view Manitoba's stated borrowing requirement as manageable, with this issuer having proven adept at sourcing funding across the globe in a variety of currencies/formats/structures/tenors. The stated debt strategy notes the domestic market is meant to be primary source for long-term issuance, where the focus is on ensuring large benchmark bonds in both 10s and longs. Saying that, Manitoba highlights the benefits of tapping international markets, not least of which is enhanced investor diversification. The province will only issue internationally when it can generate savings vis-à-vis its indicative domestic cost of funds. Moreover, foreign currency risk continues to be fully hedged. Finally, the budget notes that more sophisticated financial risk management is needed, with the province in the process of selecting a new treasury management system.
- Current long-term credit ratings – S&P: A+, Stable | Moody's: Aa2, Stable | DBRS: A(High), Stable
  [Refer to our Provincial Ratings Snapshot for additional colour on specific credit rating drivers/considerations]

Manitoba

$000,000	Budget 2021/22	Forecast 2021/22	Budget 2022/23	Projection 2023/24	Projection 2024/25	Projection 2025/26
SUMMARY BUDGET						
Revenue	**17,938**	**18,692**	**19,353**	**20,007**	**20,610**	**21,265**
Income taxes	4,455	4,917	4,958			
Other taxes	4,280	4,397	4,656			
Fees and other revenues	2,407	2,537	2,528			
Federal transfers	5,640	6,095	6,250			
Net income (loss), government business entreprises	850	448	834			
Sinking funds and other earnings	306	298	327			
Expenditure	**19,435**	**20,085**	**19,901**	**20,447**	**20,957**	**21,525**
Expenditures excluding COVID-19	18,255	18,805	19,271			
of which Debt servicing	*994*	*965*	*1,025*	1,088	1,216	1,414
COVID-19 Expenditures	1,180	1,280	630			
Summary net income	**(1,497)**	**(1,393)**	**(548)**	**(440)**	**(347)**	**(260)**
Debt servicing as a % of revenues	5.5%	5.2%	5.3%	5.4%	5.9%	6.6%
Summary net income as a % of GDP	-2.0%	-1.7%	-0.6%	-0.5%		
SUMMARY NET DEBT						
Beginning of year	**27,635**	**27,424**	**29,272**			
Summary net income	1,497	1,393	548			
Acquisition of tangible capital assets	1,587	1,268	1,573			
Amortization of tangible capital assets	(821)	(813)	(849)			
= Increase in net debt	**2,263**	**1,848**	**1,272**			
Summary net debt at the end of the fiscal year	**29,898**	**29,272**	**30,544**			
Summary net debt as a % of GDP	**39.8%**	**36.4%**	**35.9%**	**35.3%**	**35.1%**	**34.8%**
BORROWING REQUIREMENTS ($ million)						
Refinancing			2,725			
New cash requirements			2,654			
Less Repayments			839			
Less Pre-borrowing			1,509			
Plus Pre-funding			1,644			
Total borrowing requirements			**4,675**			
As of Manitoba Hydro			1,451			

Source: Province of Manitoba, *Budget* documents

Economics and Strategy

Montreal Office
514-879-2529

Stéfane Marion
Chief Economist and Strategist
stefane.marion@nbc.ca

Matthieu Arseneau
Deputy Chief Economist
matthieu.arseneau@nbc.ca

Kyle Dahms
Economist
kyle.dahms@nbc.ca

Daren King
Economist
daren.king@nbc.ca

Jocelyn Paquet
Economist
jocelyn.paquet@nbc.ca

Alexandra Ducharme
Economist
alexandra.ducharme@nbc.ca

Angelo Katsoras
Geopolitical Analyst
angelo.katsoras@nbc.ca

Toronto Office
416-869-8598

Warren Lovely
Chief Rates and Public Sector Strategist
warren.lovely@nbc.ca

Taylor Schleich
Rates Strategist
taylor.Schleich@nbc.ca

UK Residents

This Report is a marketing document. This Report has not been prepared in accordance with EU legal requirements designed to promote the independence of investment research and it is not subject to any prohibition on dealing ahead of the dissemination of investment research. In respect of the distribution of this Report to UK residents, NBF has approved the contents (including, where necessary, for the purposes of Section 21(1) of the Financial Services and Markets Act 2000). This Report is for information purposes only and does not constitute a personal recommendation, or investment, legal or tax advice. NBF and/or its parent and/or any companies within or affiliates of the National Bank of Canada group and/or any of their directors, officers and employees may have or may have had interests or long or short positions in, and may at any time make purchases and/or sales as principal or agent, or may act or may have acted as market maker in the relevant investments or related investments discussed in this Report, or may act or have acted as investment and/or commercial banker with respect hereto. The value of investments, and the income derived from them, can go down as well as up and you may not get back the amount invested. Past performance is not a guide to future performance. If an investment is denominated in a foreign currency, rates of exchange may have an adverse effect on the value of the investment. Investments which are illiquid may be difficult to sell or realise; it may also be difficult to obtain reliable information about their value or the extent of the risks to which they are exposed. Certain transactions, including those involving futures, swaps, and other derivatives, give rise to substantial risk and are not suitable for all investors. The investments contained in this Report are not available to retail customers and this Report is not for distribution to retail clients (within the meaning of the rules of the Financial Conduct Authority). Persons who are retail clients should not act or rely upon the information in this Report. This Report does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for the securities described herein nor shall it or any part of it form the basis of or be relied on in connection with any contract or commitment whatsoever.

This information is only for distribution to Eligible Counterparties and Professional Clients in the United Kingdom within the meaning of the rules of the Financial Conduct Authority. NBF is authorised and regulated by the Financial Conduct Authority and has its registered office at 70 St. Mary Axe, London, EC3A 8BE.

NBF is not authorised by the Prudential Regulation Authority and the Financial Conduct Authority to accept deposits in the United Kingdom.

U.S. Residents

With respect to the distribution of this report in the United States of America, National Bank of Canada Financial Inc. (“NBCFI”) which is regulated by the Financial Industry Regulatory Authority (FINRA) and a member of the Securities Investor Protection Corporation (SIPC), an affiliate of NBF, accepts responsibility for its contents, subject to any terms set out above. To make further inquiry related to this report, or to effect any transaction, United States residents should contact their NBCFI registered representative.

This report is not a research report and is intended for Major U.S. Institutional Investors only.

This report is not subject to U.S. independence and disclosure standards applicable to research reports.

HK Residents

With respect to the distribution of this report in Hong Kong by NBC Financial Markets Asia Limited (“NBCFMA”) which is licensed by the Securities and Futures Commission (“SFC”) to conduct Type 1 (dealing in securities) and Type 3 (leveraged foreign exchange trading) regulated activities, the contents of this report are solely for informational purposes. It has not been approved by, reviewed by, verified by or filed with any regulator in Hong Kong. Nothing herein is a recommendation, advice, offer or solicitation to buy or sell a product or service, nor an official confirmation of any transaction. None of the products issuers, NBCFMA or its affiliates or other persons or entities named herein are obliged to notify you of changes to any information and none of the foregoing assume any loss suffered by you in reliance of such information.

The content of this report may contain information about investment products which are not authorized by SFC for offering to the public in Hong Kong and such information will only be available to, those persons who are Professional Investors (as defined in the Securities and Futures Ordinance of Hong Kong (“SFO”)). If you are in any doubt as to your status you should consult a financial adviser or contact us. This material is not meant to be marketing materials and is not intended for public distribution. Please note that neither this material nor the product referred to is authorized for sale by SFC. Please refer to product prospectus for full details.

There may be conflicts of interest relating to NBCFMA or its affiliates’ businesses. These activities and interests include potential multiple advisory, transactional and financial and other interests in securities and instruments that may be purchased or sold by NBCFMA or its affiliates, or in other investment vehicles which are managed by NBCFMA or its affiliates that may purchase or sell such securities and instruments.

No other entity within the National Bank of Canada group, including National Bank of Canada and National Bank Financial Inc, is licensed or registered with the SFC. Accordingly, such entities and their employees are not permitted and do not intend to: (i) carry on a business in any regulated activity in Hong Kong; (ii) hold themselves out as carrying on a business in any regulated activity in Hong Kong; or (iii) actively market their services to the Hong Kong public.