



Moody's Investors Service

Credit Opinion: **Manitoba, Province of**

Global Credit Research - 25 Jan 2010

Canada

Ratings

Category	Moody's Rating
Outlook	Stable
Bonds	Aa1

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Key Indicators

Manitoba, Province of (Year Ending 3/31)

	2004	2005	2006	2007	2008	2009
Net Direct and Indirect Debt as a % of Revenues	112.0	97.6	92.1	93.7	97.1	99.4
Net Direct and Indirect Debt as a % of GDP	25.2	24.6	23.7	22.7	24.8	25.3
Cash Financing Surplus (Requirement) as a % of Revenues	(8.0)	1.5	(1.7)	3.3	(4.5)	(3.4)
Consolidated Surplus (Deficit) as a % of Revenues	(7.2)	6.0	3.5	3.9	4.6	3.6
Interest Expense as a % of Revenues	9.5	7.6	7.4	7.6	6.6	6.4
Intergovernmental Transfers as a % of Revenue	32.2	31.4	28.9	30.4	28.9	29.9
Real GDP Growth (%) [1]	2.2	2.6	3.3	3.6	2.0	-0.2

[1] Corresponds to calendar year.

Opinion

SUMMARY RATING RATIONALE

The Province of Manitoba's Aa1 rating reflects the province's sound fiscal plan, which has produced balanced fiscal outcomes in recent years. While modest cash requirements have increased the province's stock of debt, additions to debt have been roughly in line with economic and revenue growth, keeping the province's debt burden relatively stable. The province's fiscal flexibility is high and the proportion of revenue consumed by interest payments remains low at an estimated 6.0% in 2009-10. The Aa1 rating is also supported by the province's diversified economy, which tends to underperform the Canadian average

in boom years, but outperform in years of weak economic conditions, providing a measure of stability.

National and International Peer Comparisons

The Province of Manitoba is rated in the mid-range of Canadian provinces, whose ratings remain in a narrow range of Aaa-Aa2. Manitoba's debt burden, while higher than that of some of its Western Canadian peers, remains below the Canadian median. Moreover, the province's diversified economy presents a source of stability relative to Canadian peers and is considered a credit positive. On an international basis of comparison, Manitoba benefits from a higher degree of fiscal flexibility than many of its international sub-sovereign peers--including the highly-rated Australian states and German Länder--owing to the high degree of fiscal flexibility inherent in the way Canadian provinces operate, supporting the high investment-grade rating.

Credit Strengths

Credit strengths for Manitoba include:

Well-structured fiscal framework and strong track record of fiscal prudence

Moderate debt burden

Diversified, stable economy

Mature institutional framework providing considerable fiscal policy flexibility

Credit Challenges

Credit challenges for Manitoba include:

Expense pressures coupled with slowing revenue growth apply pressure to fiscal outcomes in the near term

Rating Outlook

The outlook is stable.

What Could Change the Rating - Up

Many years of stronger than expected fiscal performance leading to a material and sustained reduction in the province's debt burden could apply upward pressure on the rating. An upgrade to Aaa is considered unlikely in the near term, given the current economic environment.

What Could Change the Rating - Down

A loss of fiscal discipline, combined with a prolonged economic downturn that would impair the province's revenue generating capacity on more than a temporary basis and an increase in debt and debt service ratios, could exert downward pressure on the rating.

DETAILED RATING CONSIDERATIONS

The rating assigned to Manitoba reflects the application of Moody's Joint-Default Analysis (JDA) rating methodology for regional and local governments (RLGs). In accordance with this methodology, Moody's first establishes the baseline credit assessment (BCA) for the jurisdiction and then considers the likelihood of support coming from the federal

government to avoid a default by the jurisdiction, should this extreme situation ever occur.

Recent Developments

In late December 2009, the province released its second quarter (unaudited) financial report. Updated projections for 2009-10 as a whole point to an expected deterioration in fiscal outcomes with both lower revenues (partly due to lower than expected federal transfers) and higher expenses expected compared to budget. A consolidated deficit of \$592 million (roughly 5% of revenues) is now projected, compared to a roughly balanced consolidated outcome previously budgeted.

Baseline Credit Assessment

The Province of Manitoba's BCA of 3 (on a scale of 1 to 21 in which 1 represents the lowest credit risk) reflects the following factors:

Financial Position and Performance

Manitoba recorded a series of positive consolidated fiscal outcomes in recent years, owing to the province's containment of expense growth below revenue growth in most years. Between 2004-05 and 2007-08, consolidated surpluses averaged 4.5% of revenue, or 1.1% of GDP. As such, Manitoba's record of strong fiscal performance positioned the province well as the Canadian economy entered recession in 2008.

Manitoba's economic outperformance in 2008 relative to Canada (discussed below) was reflected in the province's 2008-09 fiscal results. Year-on-year revenue growth slowed to 3.8%, as strong growth in personal and corporate income tax receipts (7.4% and 5.2% growth respectively) was partially offset by lower net income from government business enterprises. The combination of modest revenue growth and year-on-year expense growth of 4.9%--driven essentially by health care expenses (growth of 8.6%) and partially offset by a lower rate of increase (1.8%) for debt service as well as an absolute decline in education expenses --generated a consolidated surplus of C\$470 million, equivalent to 3.6% of revenue, or 0.9% of GDP. This financial performance is in stark contrast with that of other Canadian provincial governments whose finances were hit harder by the impacts of the global economic downturn. On a cash basis of accounting, the consolidated surplus translated to a financing requirement of C\$440 million, or 3.4% of revenue (0.9% of GDP). This reflects primarily the accrual accounting presentation and the difference between amortization and cash outlays required for capital expenditures.

Updated projections for 2009-10 as a whole point to an expected deterioration in fiscal outcomes with a consolidated deficit of \$592 million (roughly 5% of revenues) now projected.

Manitoba, like other Canadian provinces, has experienced fiscal pressures with the economic downturn; however, the magnitude of the fiscal deterioration in Manitoba is low relative to most other provinces. The Province of Manitoba has a strong track record of fiscal prudence and is expected to continue with these fiscal management practices. This fiscal prudence, combined with the strong provincial economic performance relative to the rest of the country, ensures strong debt servicing ability, supporting the province's high investment-grade rating.

Debt Profile

While the province's net direct and indirect debt increased from roughly C\$10 billion at March 31, 2005 to approximately C\$13 billion at March 31, 2009, absolute increases in the stock of debt were roughly matched, proportionally, by growth in nominal GDP and provincial revenues. As a percentage of GDP, net direct and indirect debt remained stable at roughly 25% between 2004-05 and 2009-10, while this measure of debt as a percentage

of revenue remained in the 100% range over this period. These debt ratios are considered manageable for Manitoba given the high degree of fiscal flexibility inherent in the institutional framework governing the way Canadian provinces operate.

In 2007-08, the province debt-financed C\$1.5 billion of the Teachers' Retirement Allowance Fund (TRAF) unfunded liability. Investments held for the TRAF and the Civil Service Superannuation Fund (CSSF), which totaled C\$2.2 billion in 2007-08, were reclassified and irrevocably restricted for pension purposes in 2008-09. As a result of the debt-funding of pension liabilities, the province's unfunded pension obligations declined to C\$2.0 billion at the end of 2008-09 (15.7% of revenue), from C\$3.3 billion at March 31, 2004 (32.9% of revenue). The government expects to continue this policy of debt-funding pension liabilities. Moody's considers unfunded pension liabilities as debt-like and takes them into account when establishing a government's credit profile. As such, Moody's views Manitoba's debt-funding of unfunded pension liabilities as credit-neutral.

Governance and Management Factors

Manitoba, over the past several years, has relied on multi-year fiscal planning, prudent economic and revenue assumptions and ongoing expense restraint to maintain a strong financial profile. Overall, Manitoba displays strong governance and management factors. Fiscal management measures are supported by comprehensive and transparent financial reporting that is typical of governments in advanced industrial economies.

Economic Fundamentals

The Manitoba economy is highly diversified, which helps to reduce economic volatility associated with business cycles and certain specific local industries. The service sector--including finance and insurance, real estate, public administration and transportation--accounts for an estimated 72% of real economic output, contributing to the province's overall economic diversity.

The Manitoba economy tends to underperform the Canadian economy in times of rapid economic growth and to outperform in economic slowdowns. The province's high degree of economic diversity--which implies the absence of a dominant sector that could act as a catalyst for growth in boom years and a drag on the provincial economy in recessions--is one factor that could explain these trends. The province's economic diversity represents a major source of credit strength, ensuring a broad and productive tax base for the government.

The province's real GDP is expected to contract slightly in 2009 (-0.2% compared to -2.4% for the country as a whole), again outperforming the national average. Manitoba's labour market remains tight as the 2008 unemployment rate of 4.2% was one of the lowest in the country and well below the national average of 6.1%. As of late 2009, the provincial unemployment rate was estimated to have climbed moderately to 5.2%, remaining among the lowest in the country.

Operating Environment

The national operating environment in which Manitoba operates is typical of advanced industrial economies, characterized by high GDP per capita, low GDP volatility and a high ranking on the World Bank's Government Effectiveness Index, all of which suggest a minimal level of systemic economic, financial and political risk. As evidenced by Canada's record of continued economic expansion and political stability, the macroeconomic environment is robust and federal government institutions are responsive. Accordingly, the conditions that have historically preceded national crises associated with widespread defaults of regional and local governments are not present in Canada.

Institutional Framework

The Province of Manitoba, like all Canadian provinces, enjoys significant flexibility in its financial management. Compared to their counterparts in other countries, such as the German Länder and the Australian states, Canadian provinces enjoy far greater autonomy in terms of both the spending and revenue sides of their budgets. Unfettered access to a broad range of tax bases and the ability to alter expenditure programs provide Canadian provinces with substantial flexibility to meet fiscal challenges. As such, Canadian provinces benefit from a high degree of fiscal policy flexibility that is more akin to that of sovereign governments than to many of their international sub-sovereign peers. These positive institutional factors increase Canadian provinces' ability to manage through economic downturns and handle relatively high debt burdens. In conjunction with the high degree of fiscal flexibility, a system of fiscal transfers from the federal government, which seeks to reduce the fiscal disparities across the country, also provides support to Canadian provinces' creditworthiness.

Extraordinary Support Considerations

Moody's assigns a very high likelihood that the federal government would act to prevent a default by Manitoba, reflecting our assessment of the incentive provided by the risk to the federal government's reputation if Manitoba were to default. It also reflects indications of a moderately positive national government policy stance, as illustrated by the flexibility inherent in the system of federal-provincial transfers.

Moody's rating committee also assigns a high default dependence level reflecting the significant overlap of the economies and revenue bases of the province and federal government.

Output of the Baseline Credit Assessment Scorecard

In the case of Manitoba, the BCA scorecard (presented below) generates an estimated BCA of 3, in line with the BCA of 3 assigned by the rating committee.

The BCA scorecard, which generates estimated baseline credit assessments from a set of qualitative and quantitative credit metrics, is a tool used by the rating committee in assessing regional and local government credit quality. The credit metrics captured by the scorecard provide a good statistical gauge of stand-alone credit strength; however, the estimated BCAs generated by the scorecard do not substitute for rating committee judgments regarding individual baseline credit assessments, nor is the scorecard a matrix for automatically assigning or changing these assessments. Concomitantly, scorecard results have limitations in that they are backward-looking, using historical data, while the assessments are forward-looking opinions of credit strength. Moreover, the limited number of variables included in the scorecard cannot fully capture the breadth and depth of our analysis. Nevertheless, the performance statistics captured in the scorecard are important and, in general, higher ratings can be expected among issuers with the highest rankings from the scorecard.

ABOUT MOODY'S SUB-SOVEREIGN RATINGS

National and Global Scale Ratings

Moody's assigns national scale ratings in certain local capital markets in which investors have found the global rating scale provides inadequate differentiation among credits or is inconsistent with a rating scale already in common use in the country. Moody's National Scale Ratings are opinions of the relative creditworthiness of issuers and issues within a particular country. While loss expectation will be an important differentiating factor in the ultimate rating assignment, it should be noted that loss expectation associated with National Scale Ratings can be expected to be significantly higher than apparently similar rating levels on Moody's global scale. Moody's National Scale Ratings rank issuers and issues in order of relative creditworthiness: higher ratings are associated with lower

expected credit loss.

National Scale Ratings can be understood as a relative ranking of creditworthiness (including relevant external support) within a particular country. National Scale Ratings are not designed to be compared among countries; rather, they address relative credit risk within a given country. Use of National Scale Ratings by investors is only appropriate within that portion of a portfolio that is exposed to a given country's local market, taking into consideration the various risks implied by that country's foreign and local currency ratings.

The Moody's Global Scale rating for issuers and issues in local currency allows investors to compare the issuer's/issue's creditworthiness to all others in the world, rather than merely in one country. It incorporates all risks relating to that country, including the potential volatility of the national economy.

Country Ceilings for Foreign Currency Obligations

Moody's assigns a ceiling for foreign-currency bonds and notes to every country (or separate monetary area) in which there are rated obligors. The ceiling generally indicates the highest rating that can be assigned to a foreign-currency denominated security issued by an entity subject to the monetary sovereignty of that country or area. In most cases, the ceiling will be equivalent to the rating that is (or would be) assigned to foreign-currency denominated bonds of the government. Ratings that pierce the country ceiling may be permitted, however, for foreign-currency denominated securities benefiting from special characteristics that are judged to give them a lower risk of default than is indicated by the ceiling. Such characteristics may be intrinsic to the issuer and/or related to Moody's view regarding the government's likely policy actions during a foreign currency crisis.

Baseline Credit Assessment

Moody's baseline credit assessment incorporates the government's intrinsic credit strength and accounts for ongoing operating subsidies and transfers from the supporting government. In effect, the baseline credit assessment reflects the likelihood that a local government would require extraordinary support.

Extraordinary Support

Extraordinary support is defined as action taken by a supporting government to prevent a default by a regional or local government (RLG) and could take different forms, ranging from a formal guarantee to direct cash infusions to facilitating negotiations with lenders to enhance access to needed financing. Extraordinary support is described as either low (0% - 30%), moderate (31% - 50%), high (51% - 70%), very high (71% - 95%) or fully supported (96% - 100%).

Default Dependence

Default dependence reflects the likelihood that the credit profiles of two obligors may be imperfectly correlated. Such imperfect correlation, if present, has important diversifying effects which can change the joint-default outcome. Intuitively, if two obligors' default risks are imperfectly correlated, the risk that they would simultaneously default is smaller than the risk of either defaulting on its own.

In the application of joint-default analysis to RLGs, default dependence reflects the tendency of the RLG and the supporting government to be jointly susceptible to adverse circumstances leading to defaults. Since the capacity of the higher-tier government to provide extraordinary support and prevent a default by an RLG is conditional on the solvency of both entities, the more highly dependent -- or correlated -- the two obligors' baseline default risks, the lower the benefits achieved from joint support. In most cases, the close economic links and/or overlapping tax bases and/or close intergovernmental fiscal

arrangements between different levels of government result in a moderate to very high degree of default dependence.

Default dependence is described as either low (0% - 30%), moderate (31% - 50%), high (51% - 70%) or very high (71% - 100%).

Rating Factors

Manitoba, Province of

Baseline Credit Assessment			Sub-Factor	Sub-Factor	Factor	Total
Scorecard - 2008	Value	Score	Weighting	Total	Weighting	
Factor 1: Operating Environment						
National GDP per capita (PPP basis, \$US)	38,638	1	50.0%	1.00	50.0%	0.50
National GDP Volatility (%)	2.0	1	25.0%			
National Govt Effectiveness Index (World Bank)	1.93	1	25.0%			
Factor 2: Institutional Framework						
Predictability, Stability, Responsiveness	1	1	50.0%	2.08	10.0%	0.21
Fiscal Flexibility (A): Own-Source Revenues	1	1	16.7%			
Fiscal Flexibility (B): Spending	1	1	16.7%			
Fiscal Flexibility (C): Extent of Borrowing	7.5	7.5	16.6%			
Factor 3: Financial Position & Performance						
Interest Payments/Operating Revenue (%)	6.6	9	25.0%	10.50	10.0%	1.05
Cash Financing Surplus(Req)/Total Revenue (%)	-2.8	9	25.0%			
Gross Operating Balance/Operating Revenue (%)	6.8	9	25.0%			
Net Working Capital/Total Expenditures	-22.5	15	25.0%			
Factor 4: Debt Profile						
Net Direct and Indirect Debt/Operating Revenue	99.4	6	50.0%	6.00	10.0%	0.60
Short-Term Direct Debt/Direct Debt (%)	14.4	3	25.0%			
Net Debt/Operating Revenue Trend	2.8	9	25.0%			
Factor 5: Governance & Management						
Fiscal Management	1	1	40.0%	1.00	10.0%	0.10
Investment & Debt Management	1	1	20.0%			
Transparency & Disclosure (A)	1	1	15.0%			
Transparency & Disclosure (B)	1	1	15.0%			
Institutional Capacity	1	1	10.0%			
Factor 6: Economic Fundamentals						
Regional or Local GDP pc PPP -	33,671	1	100.0%	1.00	10.0%	0.10



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