

2018 Ontario Economic Outlook and Fiscal Review

OVERVIEW

- The Province of Ontario's 2018 Economic Outlook and Fiscal Review, released today, projects a \$14.5 bn¹ deficit for fiscal 2018–19 (FY19) (chart 1).** This exceeds the *Budget 2018* estimate of a \$6.7 bn shortfall but undershoots the forecast \$15 bn restated deficit figure identified by the *Independent Financial Commission of Inquiry* (Commission).
- The government is offering some tax relief and also taking steps to reduce spending.** The \$500 mn deficit reduction reflects \$3.2 bn in program spending cuts versus the Commission baseline plus \$2.7 bn in lower revenue.
- New policy changes include a tax credit for low-income families and individuals and a rent control exemption.** Major announcements on election priorities such as improving business competitiveness and transit and spurring new housing construction likely await a spring budget.
- Debt and borrowing mirror the updated deficit.** Borrowing requirements for FY19 are expected to total \$33.2 bn—\$1.5bn more than planned in the March Budget but \$1.9bn lower than estimated by the Commission. Net debt climbs to \$347 bn—exceeding 40% of GDP for only the third time since FY91 (chart 2)—more than the March 2018 Budget projections but an improvement versus the Commission.
- Details on the government's approach to achieving fiscal balance will be released in the 2019 Budget,** but it is clear this will require significant expenditure restraint in the future.

REVENUE DETAIL

Foregone cap-and-trade proceeds due to cancellation of the prior administration's program are expected to reduce revenues by \$1.5 bn vs. Commission figures in FY19—by far the largest component of the revision. The government continued to emphasize its opposition to the federal carbon tax, and plans to release its "made-in-Ontario" climate change plan.

Cancellation of other tax measures planned by the prior administration are forecast to reduce revenues by a further \$308 mn vs. the Commission baseline. The government will not proceed with previously announced Ontario Personal Income Tax changes, phasing out of the Small Business deduction, research & development tax credit enhancements.

The new Low-income Individuals and Families Tax (LIFT) Credit, a signature policy announcement, is estimated to reduce revenue by \$125 mn in FY19. Expected to be implemented January 1st, 2019, it offers up to \$850 in tax relief for individuals (\$1,700 for couples), with benefits clawed back for annual individual incomes over \$30,000 and annual family incomes over \$60,000. The Province anticipates that 90% of tax filers with taxable incomes below \$30,000 will pay no Ontario Personal Income Tax once the measure is in effect.

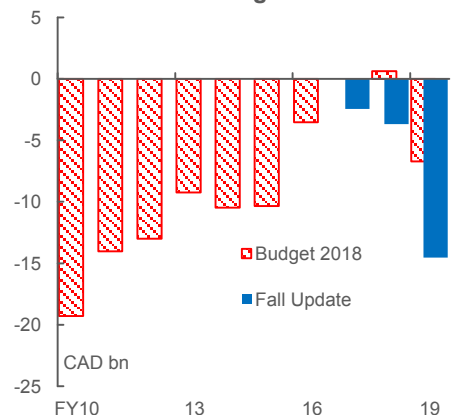
¹ Figures reported in Canadian dollars unless otherwise stated.

CONTACTS

Marc Desormeaux, Provincial Economist
 416.866.4733
 Scotiabank Economics
marc.desormeaux@scotiabank.com

Chart 1

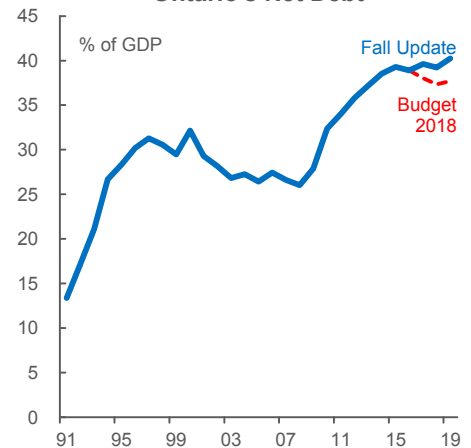
Ontario's Budget Balance



Sources: Scotiabank Economics, Ontario Finance, Ontario Independent Financial Commission of Inquiry.

Chart 2

Ontario's Net Debt



Sources: Scotiabank Economics, Ontario Finance.

A range of other factors drove the FY19 revenue forecast update. These include small revisions to expected proceeds from cannabis implementation, lower revenues from Hydro One—and Ontario Power Generation, a freeze for driver's license fees and provisions for further tax measures to bolster economic growth. This latter item could include measures complementing any federal policies with respect to expensing of new depreciable assets.

EXPENDITURE DETAIL

The government anticipates in-year savings of \$1.1 bn via public sector expenditure management. It highlighted the previously announced restrictions on ministry discretionary spending and the hiring freeze with respect to services it considers non-essential.

An ongoing review of investments outlined in *Budget 2018* is expected to generate \$1.8 bn in efficiencies this fiscal year. Actions cited included previously planned spending reductions related to cap-and-trade cancellation plus reform to OHIP+ and regional infrastructure projects.

Targeted investments, including outlays on hospital and community beds to relieve stress on the health care system, allocation of new resources to fight violent crime, add 303 mn to Commission spending estimates. Other changes, including changes to the Contingency Fund and offsets for in-year approvals provide a \$485 mn offset.

OTHER ANNOUNCEMENTS

In response to housing affordability challenges, the government is introducing measures to increase housing supply. To encourage new building, an exemption to rent control will take effect on new rental units first occupied on or after November 16, 2018, but will also scrap the Development Charges Rebate Program. Rent control will remain in place for existing tenants. The Ministry of Municipal Affairs and Housing will launch a *Housing Supply Action Plan* in the spring of next year, focusing increasing supply quickly while also rolling out longer term actions over the next 18 months.

To enhance business competitiveness, the government is developing its Open for Business Action Plan with the objective of lowering regulatory red tape by 25% by 2022. It continued to stress its intent to promote Ontario's economic interests at home and abroad and cited its reduction of WSIB premiums and cancellation of the prior government's minimum wage hike and cap and trade program. For transit, it highlighted the recent appointment of a special advisor on uploading public transportation responsibilities to the province.

CONCLUSION

We view this as a placeholder fiscal plan. The fundamental question before its release was how the government would balance significant deficit reduction with the range of potentially costly campaign promises. The modicum of spending restraint on offer versus Commission findings plus tax relief and measures announced prior to the statement should allow it, for now, to straddle that line.

Yet the road ahead remains challenging. Program spending this fiscal year is projected to be just 1.9% lower than the Commission figure for FY18. More substantial cuts over multiple years will likely be necessary to return to balance; for further insight into the Province's longer-term fiscal plans, we await the 2019 Budget.

Governance and Credit

| | |
|-----------------|--|
| Premier | Doug Ford, Progressive Conservative (as of 2018) |
| Legislature | 76 of 124 seats |
| Next Election | June 2022 |
| Credit ratings: | |
| Moody's | Aa2 (N) |
| Fitch | AA- (N) |
| S&P | A+ |
| DBRS | AA (low) |

Sources: Scotiabank Economics, Ontario Legislature, Ratings Agencies.

Economic Assumptions

annual % change except where noted

Scotiabank Economics, October 15, 2018

| | 18f | 19f | 20f |
|--------------------------|------|------|------|
| Canada —Real GDP | 2.1 | 2.2 | 1.8 |
| U.S. —Real GDP | 2.9 | 2.4 | 1.7 |
| Ontario —Real GDP | 2.1 | 2.1 | 1.6 |
| Nominal GDP | 4.1 | 4.6 | 3.7 |
| Employment | 1.5 | 1.1 | 0.9 |
| Housing Starts,000s | 77 | 72 | 72 |
| T-bills,3-mos,%* | 1.4 | 2.4 | 3.0 |
| Cda Bonds,10-yr,%* | 2.3 | 2.8 | 3.2 |
| Cdn Dollar, US¢* | 77.3 | 81.0 | 82.0 |
| WTI Oil,US\$/bbl* | 68 | 72 | 69 |

| | 18f | 19f | 20f | 21f |
|--------------------------|------|------|------|------|
| U.S. —Real GDP | 2.9 | 2.6 | 1.8 | 1.8 |
| Ontario —Real GDP | 2.0 | 1.8 | 1.7 | 1.5 |
| Nominal GDP | 3.8 | 3.8 | 3.5 | 3.2 |
| Employment | 1.5 | 1.2 | 1.0 | 0.8 |
| Housing Starts,000s | 75.0 | 71.1 | 72.0 | 71.4 |
| T-bills,3-mos,%* | 1.4 | 2.1 | 2.5 | 2.6 |
| Cda Bonds,10-yr,%* | 2.3 | 2.8 | 3.3 | 3.4 |
| Cdn Dollar, US¢* | 77.6 | 78.0 | 78.8 | 79.4 |
| WTI Oil,US\$/bbl* | 68 | 69 | 68 | 66 |

Ontario Finance

* Annual averages. Sources: Ontario Finance, Statistics Canada, Scotiabank Economics.

Ontario's Budget Arithmetic

\$ billions except where noted

| | FY17 | | FY18 | | FY19 | |
|-------------------------------|--------------|--------------|--------------|--------------|--------------|---------------|
| | Prior | Restated | Budget | Final | Budget | Q2 |
| Personal Income Tax | 30.7 | 30.7 | 32.3 | 32.9 | 35.6 | 34.9 |
| Corporations Tax | 14.9 | 14.9 | 15.8 | 15.6 | 15.1 | 13.8 |
| Harmonized Sales Tax | 24.8 | 24.8 | 26.0 | 25.9 | 26.8 | 26.7 |
| Ontario Health Premium | 3.6 | 3.6 | 3.7 | 3.7 | 3.9 | 3.9 |
| Land Transfer Tax | 2.7 | 2.7 | 3.1 | 3.1 | 3.1 | 2.7 |
| Other Taxes | <u>17.8</u> | <u>17.8</u> | <u>18.5</u> | <u>18.5</u> | <u>19.0</u> | <u>18.9</u> |
| Tax Revenue | 94.3 | 94.3 | 99.4 | 99.7 | 103.6 | 100.9 |
| Gov't Business Ent. Income | 5.6 | 5.6 | 6.1 | 6.2 | 5.3 | 5.2 |
| Other Non-Tax Revenue | 16.3 | 16.3 | 19.0 | 19.9 | 17.6 | 16.1 |
| Total Own-Source Rev. | 116.2 | 116.2 | 124.4 | 125.7 | 126.5 | 122.2 |
| Federal Transfers | 25.5 | 24.5 | 25.3 | 24.9 | 26.0 | 26.0 |
| of which Equalization | <u>2.3</u> | <u>2.3</u> | <u>1.4</u> | <u>1.4</u> | <u>1.0</u> | <u>1.0</u> |
| Total Revenue | 140.7 | 140.7 | 150.1 | 150.6 | 152.5 | 148.2 |
| Total Program Spending | 130.0 | 131.5 | 137.5 | 142.4 | 145.9 | 149.2 |
| Debt Service | 11.7 | 11.7 | 12.0 | 11.9 | 12.5 | 12.5 |
| Total Expenditure | 141.7 | 143.2 | 149.5 | 154.3 | 158.5 | 161.8 |
| Reserve | 0.0 | 0.0 | 0.0 | 0.0 | 0.7 | 1.0 |
| Surplus (Deficit) | (1.0) | (2.4) | 0.6 | (3.7) | (6.7) | (14.5) |
| Net Debt | 301.6 | 314.1 | 308.2 | 323.8 | 325.0 | 347.1 |
| Long-Term Borrowing | | | | | 31.7 | 33.2 |
| Annual Change, % | | | | | | |
| Personal Income Tax | -1.5 | -1.5 | 5.4 | 7.3 | 10.2 | 6.2 |
| Corporations Tax | 30.1 | 30.1 | 6.2 | 5.0 | -4.2 | -11.8 |
| Tax Revenue | 2.8 | 2.8 | 5.3 | 5.7 | 4.3 | 1.2 |
| Total Own-Source Rev. | 2.8 | 2.8 | 7.1 | 8.2 | 1.6 | -2.8 |
| Federal Transfers | 6.1 | 6.1 | -0.8 | 1.3 | 2.7 | 4.6 |
| Total Revenue | 3.4 | 3.4 | 6.7 | 7.0 | 1.5 | -1.6 |
| Total Program Spending | 1.5 | 1.5 | 5.8 | 8.3 | 6.1 | 4.8 |
| Total Expenditure | 1.5 | 1.5 | 5.5 | 7.8 | 6.0 | 4.9 |
| Memo Items, % | | | | | | |
| Own-Source Rev./ GDP | 14.7 | 14.7 | 15.1 | 15.2 | 14.7 | 14.2 |
| Program Spending/ GDP | 16.4 | 16.6 | 16.7 | 17.2 | 16.9 | 17.3 |
| Budget Balance / GDP | -0.1 | -0.3 | 0.1 | -0.4 | -0.8 | -1.7 |
| Net Debt/GDP | 38.0 | 39.6 | 37.3 | 39.2 | 37.7 | 40.2 |
| Debt Service/ Revenue | 8.3 | 8.3 | 8.0 | 7.9 | 8.2 | 8.5 |

Sources: Ontario Finance; Statistics Canada; nominal GDP forecasts: Scotiabank Economics.

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