Scotiabank

November 6, 2019

Ontario: Fiscal 2019–20 Economic Outlook and Fiscal Review

SUMMARY

- **The Province of Ontario's *2019 Economic Outlook and Fiscal Review* (*Review*), released today, forecasts a $9.0 bn shortfall in 2019–20 (FY20) versus the $10.3 bn anticipated in its April 11, 2019 budget (*Budget*).**
- **The improvement largely reflects windfall revenues from continued strength in labour markets and corporate performance, adding an additional $1.6 bn to revenue forecasts for FY20.**
- **The government has let up modestly—and hopefully temporarily—on expenditure restraint. Net new programming spending amounts to $0.8 bn this year. While the number is small, it largely defers contentious spending cuts while negotiations ensue.**
- **Otherwise, the government sticks to the original path to balance in outer years. The job is a little easier with today's windfall but also tougher as it kicks the can down the road on difficult deliberations.**
- **A downward revision to the debt-to-GDP ratio, now projected at 40.0% in FY20, should help build on recent credit rating stability.**

A MOST-ANTICIPATED SURPRISE

The Ontario government painted a rosier fiscal picture in its *2019 Economic Outlook and Fiscal Review* released today. The FY20 deficit is now projected at $9.0 bn versus the $10.3 bn shortfall anticipated in *Budget* when the path to balance was set. This falls on the heels of final results for FY19 where the final deficit of $7.4 bn was substantially less than $11.7 bn projected (chart 1, p.2).

Strong revenue performance has bolstered the bottom line. Solid personal and corporate tax income revenues are expected to provide an additional $1.6 bn to government coffers with corporate revenues providing the majority of the boost despite its smaller base. As this largely stems from 2018 reassessments, there could still be more steam this year from resilient corporate performance. The government's forecast of a 3% year-over-year drop in corporate revenues in FY20 following FY19's exceptional 6.4% surge likely underestimates the strength. The small business tax cut will erode some of this potential, while its impact on growth will be marginal at best.

The government is taking a calculated risk with its expenditure plans. It lets up modestly in reductions for FY20 through additional allocations of $1.3 bn to programming priorities, funded in part from revenue windfalls along with contingency funds. Net new spending will amount to $0.8bn. Not surprisingly, the new spending reflects areas that have received the greatest backlash since planned cuts were announced. Notably, autism programing is restated permanently, while other areas in health, education and justice receive temporary boosts as negotiations ensue. It has largely deferred difficult decisions, but appropriately has not abandoned them (chart 2, p.2).

Arguably, the only surprise in this much-anticipated revision was that the balance was not better. The Government continues to adopt a very prudent

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Updated Fiscal Figures

$ billions except where noted

	FY19		FY20	
	Bud.	Final	Bud.	Rev.
Personal Income Tax	35.6	35.4	36.6	37.1
Corporations Tax	15.1	16.6	15.2	16.1
Harmonized Sales Tax	26.8	27.8	28.1	28.1
Ontario Health Premium	3.9	3.8	4.0	4.0
Land Transfer Tax	3.1	2.8	2.9	3.0
Other Taxes	19.0	19.1	19.4	19.4
Tax Revenue	**103.6**	**105.5**	**106.1**	**107.7**
Gov't Business Ent. Income	5.3	5.5	5.8	5.8
Other Non-Tax Revenue	17.6	17.6	16.8	16.7
Total Own-Source Rev.	**126.5**	**128.6**	**128.7**	**130.3**
Federal Transfers	26.0	25.1	25.5	25.5
of which Equalization	1.0	1.0	0.0	0.0
Total Revenue	**152.5**	**153.7**	**154.2**	**155.8**
Health	61.2	61.9	63.5	63.8
K-12 Education	29.0	28.9	31.6	31.7
Post-Secondary Education	11.8	12.0	11.4	11.4
Social Services	16.4	16.9	16.7	17.2
Other Program Spending	32.6	29.0	27.0	26.8
Total Program Spending	**151.0**	**148.7**	**150.1**	**150.9**
Debt Service	12.5	12.4	13.3	12.9
Total Expenditure	**163.5**	**161.1**	**163.4**	**163.8**
Reserve	0.7	0.0	1.0	1.0
Surplus (Deficit)	**(11.7)**	**(7.4)**	**(10.3)**	**(9.0)**
Net Debt	**338.5**	**338.5**	**359.9**	**353.7**
Annual Change, %				
Personal Income Tax	*8.2*	*7.5*	*2.8*	*4.2*
Corporations Tax	*-3.0*	*6.4*	*0.2*	*6.4*
Tax Revenue	*3.9*	*5.8*	*2.5*	*4.0*
Total Own-Source Rev.	***0.6***	***2.3***	***1.8***	***3.0***
Federal Transfers	*4.6*	*0.9*	*-2.1*	*-2.1*
Total Revenue	***1.2***	***2.1***	***1.1***	***2.2***
Health	*3.9*	*5.1*	*3.8*	*4.3*
K-12 Education	*0.3*	*-0.1*	*8.6*	*9.2*
Post-Secondary Education	*6.0*	*7.8*	*-3.5*	*-3.6*
Social Services	*-1.8*	*0.9*	*1.6*	*5.0*
Other Program Spending	*22.2*	*8.9*	*-17.1*	*-17.9*
Total Program Spending	*6.1*	*4.5*	*-0.6*	*-0.1*
Total Expenditure	***6.0***	***4.4***	***0.0***	***0.2***
Memo Items, %				
Own-Source Rev./ GDP	14.8	15.0	14.6	14.8
Program Spending/ GDP	17.7	17.4	17.0	17.1
Budget Balance / GDP	-1.4	-0.9	-1.2	-1.0
Net Debt/GDP	**39.6**	**39.6**	**40.8**	**40.1**
Debt Service/ Revenue	8.2	8.1	8.6	8.3

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

approach. It acknowledges its growth outlook is conservatively set below consensus forecasts. It maintains a $1bn buffer on this year's balance, along with another $0.5 bn contingency fund. Revenues could still deliver more upside. Applying today's revenue windfall, along with lower-than-anticipated interest charges, could have reduced the balance by a more substantive $2 bn while still maintaining an appropriately conservative outlook in light of uncertainties ahead.

Adjustments will become more challenging as the political term advances. Meanwhile, the economy continues to be resilient against heightened global turmoil. Ontario's outlook will also be further underpinned by anticipated easing of monetary policy and more fiscal accommodation from the federal government. Continued consolidation is appropriate at this juncture.

KEY NEW MEASURES

In the *Review*'s signature new policy measure, the Government will follow through on a prior pledge to reduce the small business Corporate Income Tax rate. On Jan. 1, 2020, said rate is set to fall from 3.5% to 3.2%; alongside previously detailed accelerated capital cost allowances, the move is expected to generate $255 mn in tax relief for small businesses in 2020. The Province assumes about $165 mn in revenues will be foregone during FY20–22 due to the policy.

Personal income tax relief on offer was similarly modest. As of Jan. 1, 2020, no Estate Administration Tax will be applied to the first $50k of the value of estates. A range of initiatives—most notably a 2.7 ¢/L reduction in aviation fuel taxes—will address cost of living challenges in Northern Ontario. Offering a partial revenue offset to small business supports, Ontario will reduce non-eligible dividend tax credit rates.

Planned *Capital Plan* expenditures, estimated at $43.7 bn for FY20–22, were largely in line with *Budget* estimates. The largest single revision was a planned spending increase of only $230 mn in FY21 related to transit. The Province's forecast incorporates $10.2 bn in federal infrastructure funds over the next 10 years.

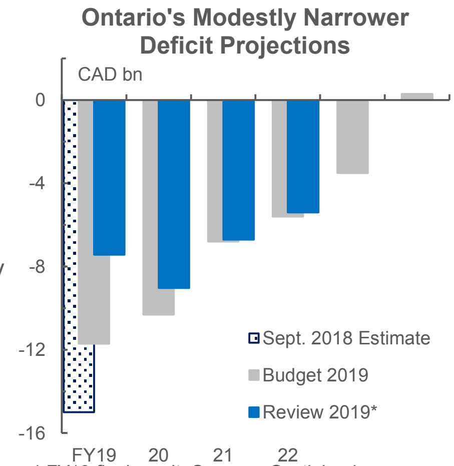
To improve its bottom line, the Province will move forward with a range of public sector transformation initiatives. Chief among these is a plan to centralize its procurement process, which it estimates will generate annual savings of $1 bn over the longer-run. It also aims to improve its digital platforms, and combine the administrative burden of transfer payment delivery. It will further explore opportunities to generate revenues via channels such as advertising and naming rights at properties it owns.

DEBT AND BORROWING

Mirroring changes to budget balances, net debt is forecast to progress on a lower trajectory. The government now expects its net debt to peak at 40.1% of nominal GDP in FY21 and fall to 39.8% the following year, versus prior projections of 40.7% and 40.6%, respectively (chart 3). The Government noted that new accounting treatment of jointly sponsored pension plans also contributed to the revised path.

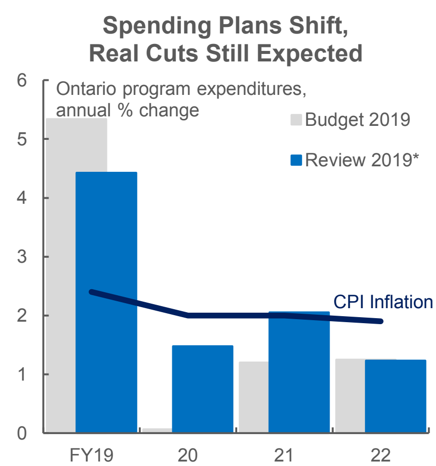
Ontario's expected borrowing requirements for FY20–22 are $5.5 bn lower than as of Budget, with the largest annual downward revision—of $4.1 bn—expected to come this fiscal year as a result of narrower deficits. The Province noted that as of October 24, 2019, roughly two-thirds of FY20 borrowing was complete; it intends to commence pre-borrowing for FY21 before year-end. Nearly 70% of fiscal year-to-date borrowing was in Canadian dollars—within the 70–80% range targeted for each fiscal year. The Government aims to issue its next Green Bond before the end of FY20.

Chart



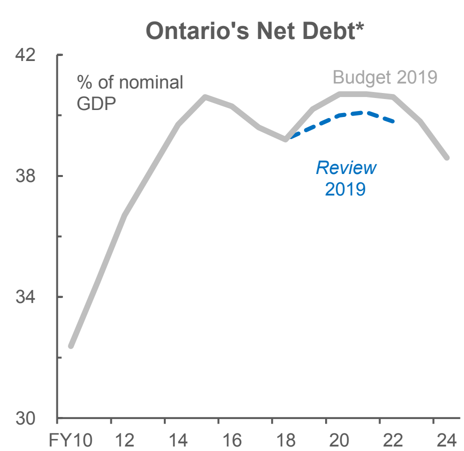
* FY19 final result. Sources: Scotiabank Economics, Ontario Finance.

Chart 2



* FY19 final result. Sources: Scotiabank Economics, Ontario Finance.

Chart 3



* Post-FY01 figures restated to reflect accounting treatment of jointly sponsored pension plans. Sources: Scotiabank Economics, Ontario Finance.