

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 programming 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

CONTACTS

Rebekah Young
Director, Fiscal & Provincial Economics
 416.862.3876
 Scotiabank Economics
rebekah.young@scotiabank.com

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

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

Ontario's Modestly Narrower Deficit Projections

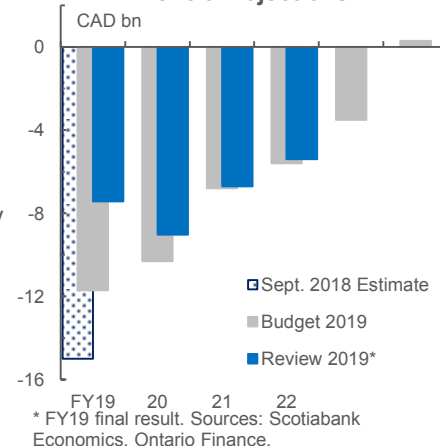


Chart 2

Spending Plans Shift, Real Cuts Still Expected

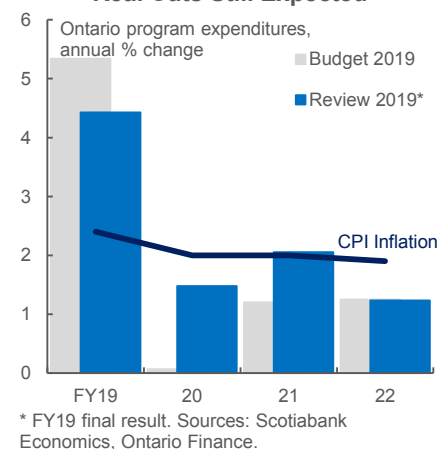
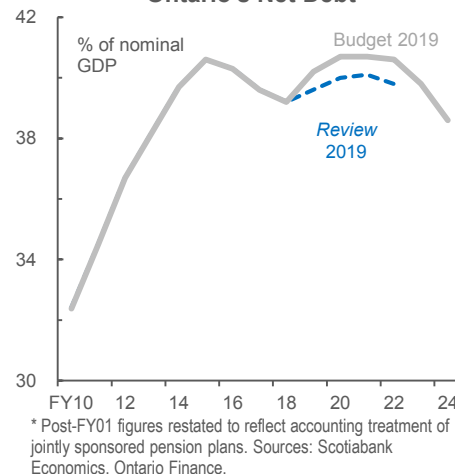


Chart 3

Ontario's Net Debt*



This report has been prepared by Scotiabank Economics as a resource for the clients of Scotiabank. Opinions, estimates and projections contained herein are our own as of the date hereof and are subject to change without notice. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness. Neither Scotiabank nor any of its officers, directors, partners, employees or affiliates accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents.

These reports are provided to you for informational purposes only. This report is not, and is not constructed as, an offer to sell or solicitation of any offer to buy any financial instrument, nor shall this report be construed as an opinion as to whether you should enter into any swap or trading strategy involving a swap or any other transaction. The information contained in this report is not intended to be, and does not constitute, a recommendation of a swap or trading strategy involving a swap within the meaning of U.S. Commodity Futures Trading Commission Regulation 23.434 and Appendix A thereto. This material is not intended to be individually tailored to your needs or characteristics and should not be viewed as a "call to action" or suggestion that you enter into a swap or trading strategy involving a swap or any other transaction. Scotiabank may engage in transactions in a manner inconsistent with the views discussed this report and may have positions, or be in the process of acquiring or disposing of positions, referred to in this report.

Scotiabank, its affiliates and any of their respective officers, directors and employees may from time to time take positions in currencies, act as managers, co-managers or underwriters of a public offering or act as principals or agents, deal in, own or act as market makers or advisors, brokers or commercial and/or investment bankers in relation to securities or related derivatives. As a result of these actions, Scotiabank may receive remuneration. All Scotiabank products and services are subject to the terms of applicable agreements and local regulations. Officers, directors and employees of Scotiabank and its affiliates may serve as directors of corporations.

Any securities discussed in this report may not be suitable for all investors. Scotiabank recommends that investors independently evaluate any issuer and security discussed in this report, and consult with any advisors they deem necessary prior to making any investment.

This report and all information, opinions and conclusions contained in it are protected by copyright. This information may not be reproduced without the prior express written consent of Scotiabank.

™ Trademark of The Bank of Nova Scotia. Used under license, where applicable.

Scotiabank, together with "Global Banking and Markets", is a marketing name for the global corporate and investment banking and capital markets businesses of The Bank of Nova Scotia and certain of its affiliates in the countries where they operate, including, Scotiabanc Inc.; Citadel Hill Advisors L.L.C.; The Bank of Nova Scotia Trust Company of New York; Scotiabank Europe plc; Scotiabank (Ireland) Limited; Scotiabank Inverlat S.A., Institución de Banca Múltiple, Scotia Inverlat Casa de Bolsa S.A. de C.V., Scotia Inverlat Derivados S.A. de C.V. – all members of the Scotiabank group and authorized users of the Scotiabank mark. The Bank of Nova Scotia is incorporated in Canada with limited liability and is authorised and regulated by the Office of the Superintendent of Financial Institutions Canada. The Bank of Nova Scotia is authorised by the UK Prudential Regulation Authority and is subject to regulation by the UK Financial Conduct Authority and limited regulation by the UK Prudential Regulation Authority. Details about the extent of The Bank of Nova Scotia's regulation by the UK Prudential Regulation Authority are available from us on request. Scotiabank Europe plc is authorised by the UK Prudential Regulation Authority and regulated by the UK Financial Conduct Authority and the UK Prudential Regulation Authority.

Scotiabank Inverlat, S.A., Scotia Inverlat Casa de Bolsa, S.A. de C.V., and Scotia Derivados, S.A. de C.V., are each authorized and regulated by the Mexican financial authorities.

Not all products and services are offered in all jurisdictions. Services described are available in jurisdictions where permitted by law.