# Ontario: 2018–19 Budget

## A FULL AGENDA

- **After eight years of deficit elimination effort,** Ontario reports a modest $642 million surplus for fiscal 2017–18 (FY18).
- **The return to red ink from FY19 to FY24** results in a cumulative deficit of almost $32 billion, before balanced books are regained in FY25 and a $2.6 billion surplus is forecast for FY26.
- **With an election around the corner, proposed program spending initiatives extend and expand the government's past priorities** to accelerate progress on making life more affordable and economic growth more inclusive. Since *Budget 2017,* Ontario's planned investments total $5.7 billion in FY19, rising to $8.3 billion in FY21, representing a cumulative $20.3 billion.
- **Ontario's Infrastructure Plan,** expanded last year to more than $190 billion over 13 years, is now announced as $230 billion over 14 years.
- **Personal income tax (PIT) reform,** effective July 1, 2018, will remove Ontario's two-tier surtax and replace the existing five brackets with seven. Ontario's top effective rate is unchanged at 20.53% and most taxpayers will not be affected. However the change makes the PIT somewhat more progressive and raises FY19 revenue by $275 million.
- **Net debt,** as measured by the Province, has fallen from the March 2015 peak of 39.3% of GDP to just below 37% this March. It then turns higher to more than 38½% of GDP by March 2022, before edging lower to 35½% by March 2026.
- **Long-term public borrowing** in FY18 of almost $34 billion includes $11.5 billion of pre-borrowing that holds forecast FY19 funding at $31.7 billion, a $0.5 billion decrease from last year's estimate. Borrowing in FY20 of $36.7 billion is $1.1 billion less than a year ago, before rising to $41.3 billion in FY21.

## OVERVIEW

**Ontario's real GDP growth** is forecast to slow from an estimated 2.7% in calendar 2017 to 2.2% this year and an average of 1.9% over 2019 and 2020. Ontario is still incorporating significant prudence in its financial estimates, although the annual reserves are trimmed to $0.7 billion, even in the outer years. However, the real GDP growth assumed from calendar 2018 to 2022 is slightly less than the average of private-sector forecasters and the Operating and Capital Contingency Funds total $1.6 billion in FY19.

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**Ontario's Budget Balances**

**Fiscal 2016–17 (FY17)**
Final: -$991mn (-0.1% of GDP)

**FY18**
Budget: $0mn
Q3: +$642mn (+0.1% of GDP)

| Budgets: FY19b | FY20b |
|---|---|
| -$6.7bn | -$6.6bn |
| **FY21b** | **FY22b** |
| -$6.5bn | -$5.6bn |
| **FY23b** | **FY24b** |
| -$4.0bn | -$2.5bn |
| **FY25b** | **FY26b** |
| $0bn | +$2.6bn (+0.2% of GDP) |

**Borrowing Requirements**

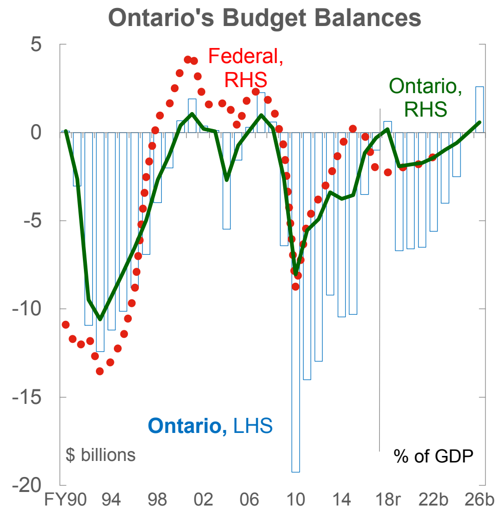
| | | | |
|---|---|---|---|
| FY18 | $33.9bn | FY19b | $31.7bn |
| FY20b | $36.7bn | FY21b | $41.3bn |

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

## NEAR-TERM REVENUE AND EXPENDITURE DETAILS

**The FY18 surplus** largely reflects the unused $0.6 billion reserve. Though revenues were $117 million ahead of *Budget* and savings on the debt service totalled $281 million, they barely outweigh a $356 million rise in program spending, pressured by Health and Post-Secondary Education.

**Revenue growth** is forecast to slow from 6.7% in FY18 to 1.5% in FY19 before returning to 3.6% average annual gains from FY20 to FY22. In contrast, the planned rise in program spending is 12.2% (+$15.9 billion) over FY18–FY19, with further increases averaging 3.0% over the following three years. The lack of progress in reducing the deficit from FY19 to FY21 reflects that many of the major program initiatives build over the next two years for full implementation as the next decade begins, leaving little room for sizeable expenditure declines without scaling back existing services.



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

**Among the new commitments** is $2.2 billion over three years to provide, as of September 2020, free licensed child care for children 2½ years to kindergarten age. Ontario estimates that every public dollar invested in child care creates a $2.47 benefit in working hours and wages to the Ontario economy. OHIP+, the prescription drug coverage for four million youth under 25 years introduced in January at an annual $465 million cost, will be expanded to cover more than two million Seniors as of August 2019. This will eliminate the income deductibles and co-payments under the current plan regardless of an individual's income and the Seniors expansion is expected to have an annual $575 million cost by FY21. A new *Ontario Drug and Dental Program* will be introduced for individuals in summer 2019 to cover 80% of prescriptions and dental expenses up to $600 for couples and $50 per child; an additional four-year investment of $2.1 billion is directed to mental health; hospitals funding is boosted by a further $0.8 billion; and social and disability assistance will be simplified and rates will be increased by 3% annually for three years starting this Fall.

**Tax measures in the *Budget*** have a relatively modest revenue impact, adding $0.5 billion in FY19, rising to $0.8 billion in FY21. Further effort on closing tax loopholes is expected to account for $0.2 billion annually. Ontario estimates that its portion of the federal Cannabis Excise Duty will rise to $115 million by FY21.

**Assisting business** is further investment in human capital. Ontario is planning to increase the number of post-secondary students graduating in science, technology, engineering and mathematics (STEM) disciplines by 25% over the next five years to 50,000 per year, giving Ontario the highest number per capita of postsecondary STEM graduates in North America. Further investment over ten years of $0.9 billion is promised for the *Jobs and Prosperity Fund* and $0.5 billion for the *New Economy Fund*.

**With respect to climate change,** five auctions for allowances have raised nearly $2.3 billion for Ontario. As of January 2018, Ontario is part of Quebec's and California's linked marketplace for allowances which Ontario believes will give its firms more choice as they seek to reduce emissions at the lowest cost possible. A comprehensive *Greenhouse Gas Reduction Account Annual Report* will be released in 2018.

## THE LONGER–TERM FORECAST

**From FY22 to FY26, the government's "Recovery Plan"** is based upon a reasonable assumption of annual revenue gains averaging 3.3%, aligned with and slightly lower than Scotiabank Economics' assumption of nominal GDP growth. Total spending is forecast to decelerate to just over 2.0% annually over the four years to 2026. This could be a tall order given possible spending pressures from the new programs and the service demands anticipated from an expanding Seniors cohort.

**During this round of deficit reduction,** annual savings on the debt service may not prove as material as they were over the past decade. As monetary accommodation is progressively unwound around the world, interest rates are expected to trend higher. The projected debt service in Ontario's *2010 Budget* proved too pessimistic (bottom chart), but this *Budget's* projections once again suggest that the Province's debt service may broach $16 billion.

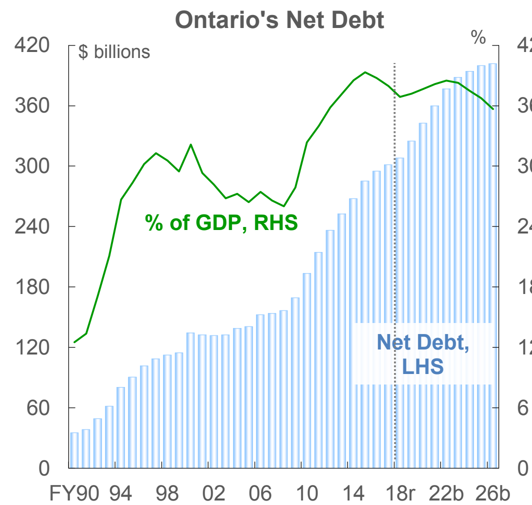
## CAPITAL SPENDING, NET DEBT AND BORROWING

**Ontario's infrastructure investment** in FY18 is now expected to be $3.1 billion below the $20.3 billion *Budget* plan at $17.2 billion, with transit accounting for much of the shortfall. For FY19, an ambitious plan is once again outlined at $21.1 billion, with transit's share more than one-third.

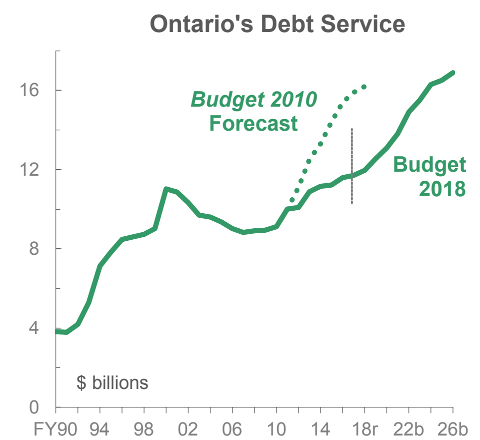
**In addition to the multiple transit projects under way,** Ontario is exploring options for high-speed rail connecting Toronto and Windsor, a 2051 transportation plan is being developed for the Greater Golden Horseshoe, and regional transit fare integration is being pursued in the Greater Toronto and Hamilton Area. Funded by carbon allowance proceeds, discounts are offered to regional transit riders transferring to the Toronto Transit Commission system. The bilateral agreement on transit under Ottawa's *Investing in Canada* program commits $8.3 billion of federal funding over the next decade, with Ontario providing $7.3 billion. This funding will be allocated to municipalities on the basis of ridership with Ontario responsible for 33% of project costs.

**The projected drop in Ontario's net debt relative to GDP** after March 2022 is assisted by rising amortization that increasingly offsets the impact of the Province's ambitious capital plans on net debt. Forecast annual increases in net debt cool from $17.8 billion during FY20 to $1.9 billion by FY26.

**The hefty $11.5 billion pre-borrowing for FY18** reflects additional financing of just over $8 billion, plus the surplus and the substantial re-profiling of capital investment beyond FY18. For FY19, Ontario intends to accomplish two-thirds of its financing in Canadian dollars in the domestic market. Ontario reports that its practice of large liquid 10- and 30-year benchmark domestic bonds has served the Province well and helped to lengthen the average term of its debt from 9.7 years in FY10 to 10.9 years as of December 2017. It is, however, resulting in large cash outflows on single days, and thus Ontario has raised its average unrestricted liquid reserve levels from $21.1 billion in FY17 to $30.1 billion in FY18. Ontario's four outstanding Green Bond issues total $3.05 billion.




Source: Historical net debt data: Moody's Investors Service; Statistics Canada; nominal GDP forecasts: Scotiabank Economics.




Source: Ontario Finance.

## OUTLOOK

**The Ontario economy** appears to be operating at or close to capacity. The *Budget's* surge in spending over the next few years may add to some of the upward pressure anticipated on input costs, wages and prices. In contrast, during the relatively slow growth post-recession recovery, government stimulus occurred in a low-price environment that helped to assure higher value for the taxpayers' dollars.

**Ontario during the first round of scaling back its deficit,** substantively outperformed its annual deficit reduction targets. This was partly due to the government incorporating several types of prudence, but it also reflected a favourable growth period over the past four years. Thus a renewed period of fiscal discipline to hold annual spending growth to 2.0% may be inevitable early next decade.

## Ontario's Economic Assumptions

annual % change except where noted

**Scotiabank Economics, March 6, 2018**

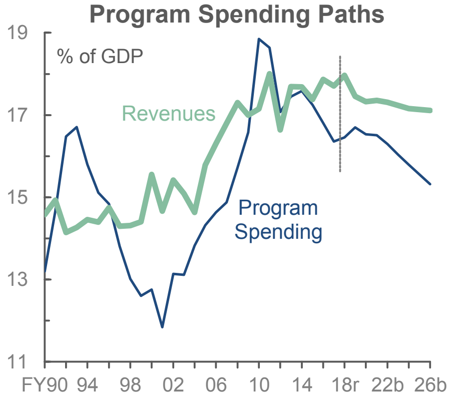
| | 17e | 18f | 19f |
|---|---|---|---|
| **Canada—**Real GDP | 3.0 | 2.4 | 1.9 |
| **U.S.—**Real GDP | 2.3 | 2.7 | 2.2 |
| **Ontario—**Real GDP | 2.9 | 2.3 | 1.9 |
| Nominal GDP | 5.1 | 4.5 | 4.1 |
| Employment | 1.8 | 1.5 | 1.0 |
| Housing Starts,000s | 79 | 75 | 71 |
| T-bills,3-mos,%* | 0.7 | 1.5 | 2.3 |
| Cda Bonds,10-yr,%* | 1.8 | 2.4 | 2.7 |
| Cdn Dollar, US¢* | 77.1 | 79.1 | 81.0 |
| WTI Oil,US$/bbl* | 51 | 57 | 60 |

**Ontario Finance**

| | 17e | 18f | 19f | 20-21f |
|---|---|---|---|---|
| **Canada—**Real GDP | 3.0 | 2.2 | 1.8 | 1.8 |
| **U.S.—**Real GDP | 2.3 | 2.8 | 2.4 | 2.1 |
| **Ontario—**Real GDP | 2.7 | 2.2 | 1.8 | 1.8 |
| Nominal GDP | 4.4 | 4.1 | 3.9 | 4.0 |
| Employment | 1.8 | 1.7 | 1.1 | 0.9 |
| Housing Starts,000s | 79.1 | 72.4 | 69.5 | 71.6 |
| T-bills,3-mos, %* | 0.7 | 1.4 | 2.2 | 2.7 |
| Cda Bonds,10-yr, %* | 1.8 | 2.4 | 3.0 | 3.5 |
| Cdn Dollar, US¢* | 77.0 | 80.1 | 80.9 | 81.2 |
| WTI Oil,US$/bbl* | 51 | 59 | 59 | 60 |

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

**Ontario's Revenue & Program Spending Paths**




Source: Ontario Finance.

## Ontario's Budget Arithmetic

$ billions except where noted

| | FY18 Budget | FY18 Rev. | FY19 Budget | FY21** Budget |
|---|---|---|---|---|
| Personal Income Tax | 35.0 | 32.3 | 35.6 | 39.7 |
| Corporations Tax | 13.8 | 15.8 | 15.1 | 16.0 |
| Harmonized Sales Tax | 26.0 | 26.0 | 26.8 | 28.9 |
| Ontario Health Premium | 3.8 | 3.7 | 3.9 | 4.3 |
| Land Transfer Tax | 3.1 | 3.1 | 3.1 | n.a. |
| Other Taxes | 18.3 | 18.5 | 19.0 | n.a. |
| Tax Revenue | **100.1** | **99.4** | **103.6** | **112.4** |
| Gov't Business Ent. Income | 4.9 | 6.1 | 5.3 | 6.6 |
| Other Non-Tax Revenue* | 19.0 | 19.3 | 17.6 | 18.0 |
| **Total Own-Source Rev.*** | **123.9** | **124.8** | **126.5** | **137.0** |
| Federal Transfers* | 26.1 | 25.3 | 26.0 | 26.8 |
| of which Equalization | 1.4 | 1.4 | 1.0 | n.a. |
| **Total Revenue*** | **150.0** | **150.1** | **152.5** | **163.8** |
| Health | 57.9 | 58.3 | 61.3 | 66.6 |
| K-12 Education | 27.5 | 27.5 | 29.1 | 31.5 |
| Post-Secondary Education | 10.9 | 11.1 | 11.8 | 12.0 |
| Social Services | 16.9 | 16.8 | 17.9 | 19.8 |
| Other Program Spending | 24.0 | *23.8* | 25.9 | 25.9 |
| Total Program Spending* | **137.2** | **137.5** | **145.9** | **155.8** |
| Debt Service*† | 12.2 | 12.0 | 12.5 | 13.8 |
| **Total Expenditure*** | **149.4** | **149.5** | **158.5** | **169.6** |
| Reserve | 0.6 | 0.0 | 0.7 | 0.7 |
| **Surplus (Deficit)** | **0.0** | **0.6** | **-6.7** | **-6.5** |
| **Net Det** | | | | |
| **Long-Term Borrowing** | **26.4** | **33.9** | **31.7** | 41.9 |
| Refunding | 17.6 | 17.5 | 27.5 | 26.5 |
| **Annual Change, %** | | | | |
| Personal Income Tax | *14.2* | *5.4* | *10.2* | 5.6 |
| Corporations Tax | *-7.1* | *6.2* | *-4.2* | 2.8 |
| Tax Revenue | *6.1* | *5.3* | *4.3* | 4.2 |
| **Total Own-Source Rev.*** | ***6.7*** | ***7.4*** | ***1.3*** | **4.1** |
| Federal Transfers* | *6.3* | *3.2* | *2.7* | 1.5 |
| **Total Revenue*** | ***6.6*** | ***6.7*** | ***1.5*** | **3.7** |
| Total Program Spending* | *5.5* | *5.8* | *6.1* | 3.3 |
| **Total Expenditure*** | ***5.4*** | ***5.5*** | ***6.0*** | **3.5** |
| **Memo Items, %** | | | | |
| Own-Source Rev.*/ GDP | 14.8 | 14.9 | 14.5 | 14.5 |
| Program Spending*/ GDP | 16.4 | 16.5 | 16.7 | 16.5 |
| Budget Balance / GDP | 0.0 | 0.1 | -0.8 | -0.7 |
| Debt Service*†/ Revenue* | 8.2 | 8.0 | 8.2 | 8.4 |

* Third-party revenues for hospitals, school boards & colleges in revenues and allocated by expenditure as of FY18. ** Ex interest capitalized during construction of $301mn in FY18 and $456 mn in FY19.

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

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