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Ontario's Fiscal 2017–18 Mid-Year Update … Adding to an Ambitious Agenda

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Ontario's Budget Balances

FY17 Final:	-$991mn (-0.1% of GDP)
FY18–20:	Unchanged forecast of balanced books each year

Borrowing

FY17 Final: $27.0bn	
FY18 Budget: $26.4bn	**Update: $25.8bn**
FY19 Budget: $32.2bn	FY20 Budget: $37.8bn

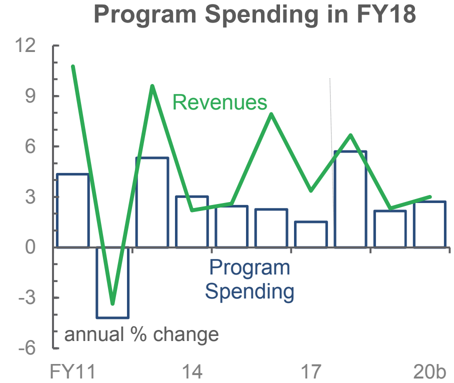
- **At mid-year,** a number of changes net to a modest $0.1 billion of additional revenue in both fiscal 2017–18 (FY18) and FY19, as program spending adds $0.2 billion this fiscal year and next and $0.1 billion in FY20. To keep books balanced, the reserve in each year's *Budget* estimates is trimmed by $0.1 billion, leaving annual cushions of $0.5 billion for FY18 and FY19 and $0.8 billion for FY20.
- **Net debt,** as measured by the Province, is still expected to climb $10.0 billion during FY18, pushed above the FY17 rise of just $6.3 billion as capital spending is reprofiled. Infrastructure investment is then expected to elevate net debt by $11.4 billion in FY19 and $12.6 billion in FY20. Net debt is forecast to fall from 38.0% of GDP in March 2017 to 37.2% a year later, and then stabilize in the 37% range through March 2020.
- **Still intact are Ontario's targets** for net debt to drop to 35.0% of GDP by March 2024 and 27% of GDP, the pre-recession level, by March 2030.
- **The reduced FY18 long-term public borrowing plan** is largely due to the $0.5 billion improvement in the final FY17 deficit that raised the pre-borrowing available. As of November 14, financing of $24.2 billion is completed, with a weighted average term of 12.8 years and 37% done in foreign currencies.

REVENUE DETAILS

Integral to Ontario's deficit elimination is a four-year upswing in real GDP from calendar 2014 to 2017 with annual gains averaging 2¾%. The government's assumption of a 2.8% real GDP increase for 2017 is a half a percentage point ahead of the *Budget* forecast, and a rising GDP deflator adds 2½% to nominal GDP growth. Ontario estimates that the Province's stronger economic outlook offers $0.9 billion boost to its FY18 bottom line, easing to $0.7 billion in FY20, even though nominal GDP growth settles back to a 2018-20 average of 4.1%.

Also buoying FY18's projected 6.7% revenue gain is the introduction of carbon allowance receipts, expected to approach $1.8 billion in their first full year. A pick-up in Ontario Lottery and Gaming Corporation income adds $200 million in this year. The cooling in resale housing activity, however, is expected to trim $270 million from the FY18 Land Transfer Tax.

Stepped-Up Revenue & Program Spending in FY18



Source: Ontario Finance.

Processing 2016 tax returns lowered projected personal income tax and Ontario Health Premium receipts in FY18 by $1.8 billion, but raised corporate income tax by $1.6 billion.

The *Fall Statement* launches $0.5 billion on new measures for small business, including a reduction in the small business corporate income tax rate from 4.5% to 3.5% this January. The tax cut is estimated to lower provincial receipts by $90 million in the first year, FY19, offering some offset to the scheduled minimum wage increase in January 2018 from $11.60/hour to $14.00, and a further rise to $15.00 a year later. With Ottawa reducing its small business rate from 10.5% to 10% for 2018 and 9.0% as of 2019, the combined federal/Ontario small business rate will drop from the current 15.0% to 12.5% in January 2019.

Additional SME support includes targetting one-third of provincial procurement for them by 2020. Small business also will benefit from many of the measures applying to all firms, such as the modernization and enrichment of Ontario's apprenticeship system for employers, support for FinTech (text box p.3) and the recently released *Global Trade Strategy*. Among the recommendations in this Strategy is identifying e-commerce markets where Ontario firms are presently under-represented. Cost reductions restraining employers' premiums continue at the Workplace Safety and Insurance Board, with a recently negotiated conversion of its pension plans to joint trusteed status.

CURRENT & CAPITAL EXPENDITURES AND BORROWING

After constraining annual program spending growth to an average 2.3% over the four years to FY17, initiatives previously announced account for much of the 5.7% FY18 increase in program outlays, with some top-ups for ongoing multi-year initiatives such as expanded daycare. In this *Update*, a renewed focus on Seniors begins with increased community hub support, 5,000 new long-term care beds by 2022 and more funding for hospices. On an already full agenda, more action is promised in coming months, such as multiple measures to streamline residential development approvals, auto insurance reform and further attention to restructuring income security.

Ontario's Budget Arithmetic
$ billions except where noted

	FY17	FY18	
	Final	Budget	Q2
Pers.Inc.Tax & ON Health Premium	34.2	38.821	37.0
Corporations Tax	14.9	13.8	15.4
Land Transfer Tax	2.7	3.1	2.9
Other Taxes	42.5	44.3	44.6
Tax Revenue	**94.3**	**100.1**	**99.9**
Gov't Business Ent. Income	5.6	4.9	5.1
Other Non-Tax Revenue*	16.3	19.0	19.0
Federal Transfers	24.5	26.1	26.2
of which Equalization	2.3	1.4	1.4
Total Revenue	**140.7**	**150.0**	**150.1**
Total Program Spending	130.0	137.2	137.4
Debt Service** / Revenue	11.7	12.2	12.2
Total Expenditure	**141.7**	**149.4**	**149.6**
Reserve	0.0	0.6	0.5
Surplus (Deficit)	**-1.0**	**0.0**	**0.0**
Annual Change, %			
Pers.Inc.Tax & ON Health Premium	*-1.0*	*13.4*	*8.0*
Corporations Tax	*30.1*	*-7.1*	*3.5*
Tax Revenue	*2.8*	*6.1*	*5.9*
Total Own-Source Rev.	***2.8***	***6.7***	***6.6***
Federal Transfers	*6.1*	*6.3*	*6.8*
Total Revenue	***3.4***	***6.6***	***6.7***
Total Program Spending	*1.5*	*5.5*	*5.7*
Total Expenditure	***1.5***	***5.4***	***5.6***
Memo Items, %			
Own-Source Rev. / GDP	14.6	14.8	14.8
Program Spending / GDP	16.4	16.4	16.4
Budget Balance / GDP	-0.1	0.0	0.0
Debt Service** / Revenue	8.3	8.2	8.2

* Third party revenues for hospitals, school boards & colleges included in Other Non-Tax Revenues and allocated by expenditure. ** Ex interest capitalized during construction of $158mn in FY17 and $292 mn in FY18. Source: Ontario Finance; Statistics Canada; nominal GDP forecasts: Scotiabank Economics.

For infrastructure, the hefty $20.8 billion FY18 program is unchanged apart from minor tweaks in a couple of categories. In the long-term infrastructure plan promised this Fall, the GO Regional Express Rail will remain a major commitment. With another issue intended in FY18, Ontario's Green Bond financing already totals $2.05 billion, with up to $1.77 billion allocated to Metrolinx.

Concern over geopolitical risks is prompting Ontario to complete its FY18 borrowing program in Q3 and then preborrow for FY19. Facilitating financing is the solid demand for Ontario bonds in foreign currencies, convincing the Province to lower its domestic financing target from a 75% share to 66.7%. Ontario's liquid reserves are presently high at more than $30 billion. As interest rates begin to rise, the Province will assess whether it remains cost-effective to continue extending the term of its debt.

OUTLOOK

Despite the Ontario economy's buoyant 2017 expansion, slower output gains are anticipated thereafter. Several fiscal events are also expected to constrain Ontario's revenue growth such as diminished Equalization and the removal in 2018–19 of the *Debt Retirement Charge* for all power customers. The higher debt service anticipated with rising interest rates further limits the flexibility around future program spending, as does the multi-year time frame for many of the government's current program commitments. Unexpectedly strong economic growth has supported the last stages of Ontario's deficit elimination, but this economic boost is unlikely to remain as strong as Ontario grapples with the multiple challenges of sustaining balanced books.

Recent Policy Developments

Financial Services and Technology

To position Ontario as a leader in FinTech, the government proposes a strategy to build on the province's considerable existing capacity in technology and the financial services. Elements of the first phase are summarized below.

- A Regulatory Super Sandbox will allow FinTech businesses to test new products, services, delivery mechanisms and business models with consumers in market situations for a limited time and on a small scale, while interfacing with multiple regulators to ensure consumers' or other businesses' protection.
- An Ontario Fintech Accelerator Office will work with firms on business formation and expansion, while helping them to navigate multiple regulatory frameworks. The Office is intended to provide specialized guidance, complementing existing support for business innovation.
- A small $8 million pilot program would focus on enabling partnerships between institutional lenders and FinTech firms to help small businesses access financing. The objective is to use new technologies in financial services to aid small businesses in their difficult search for capital and lower their financing costs.

For private-sector defined benefit pension plans, a new framework includes measures to help protect workers' benefits while aiding corporate competitiveness alongside a new framework for target benefit multi-employer pension plans to assist their long-term sustainability. Ontario also is exploring new approaches to assist the efficient drawdown of Seniors' savings that allows funds to last through retirement.

New regulation is promised to oversee financial planners and to better protect investors in syndicated mortgages.

Climate Change

Maintaining that a linked cap-and-trade market is the most cost-effective way for Ontario to achieve its greenhouse gas (GHG) reduction targets, Ontario in September joined Quebec and California and the first joint auction is early in 2018. Ontario is jointly designing carbon offsets with Quebec to increase emitters' compliance options.

In setting up the framework for a second compliance period extending from 2021 to 2030 after the first 2017–20 compliance period, Ontario is considering a more gradual constant reduction rate in the cap. The government, however, has committed to a 37% decrease in GHG emissions below 1990 levels by 2030, following the 15% reduction target set for 2020.