Ontario's 2016–17 Q3 Update

Ontario's Budget Balances
FY16 Final: -$5.0bn (-0.7% of GDP) **Restated: -$3.5bn (-0.5% of GDP)**
FY17 Budget: -$4.3bn (-0.5% of GDP) Q1:-$4.3bn Q2:-$4.3bn
Q3: -$1.9bn (-0.2% of GDP)

Net Debt[1]
FY16 Final: $305.2bn (40.0% of GDP) **Restated: $294.6bn (38.6% of GDP)**
FY17 Budget: $308.3bn (38.8% of GDP) Q2:$317.9bn **Q3:$304.9bn (38.3% of GDP)**

OVERVIEW

Ontario's projected return to balanced books as of fiscal 2017-18 (FY18) is reinforced by its Q3 report for fiscal 2016-17 (FY17). The Province enters FY18 with a fiscal position improved from the *Budget* outlook — its FY17 own-source receipts are $2.7 billion higher; its program spending is $1.1 billion larger but still less than 2.0% above FY16; and the Q2 expectation of a $0.4 billion debt service saving remains intact.

This update reverses the pension accounting changes announced last Fall. These changes, recommended by Ontario's Auditor General, raised the Province's accumulated deficit and its net debt by $10.7 billion as of March 2016, and introduced in its annual operating budgets increases in its Pension Adjustment that climbed from $1.5 billion in FY16 to $3.7 billion in FY19 (see *Fiscal Pulse*: Ontario's Fiscal 2016-17 Q2 Update). The independent Pension Asset Expert Advisory Panel appointed by the Province in November 2016 issued a report last week here recommending that the Province's share of the net pension assets of Ontario's two large jointly sponsored pension plans[2] be recognized in the Province's financial statements, realigning the estimates with the *2016 Budget* framework. The government is accepting the Panel's recommendation.

For FY16, returning to the former pension accounting treatment narrows the final deficit to $3.5 billion *(table, p.2)*. For net debt, as measured by Ontario, the $10.7 billion downward revision as of March 2016 trims the debt burden to 38.6% of GDP. Revised, Ontario's net debt during FY16 climbed by $10.0 billion, following the FY15 jump of $17.4 billion, and an increase similar to FY16 is estimated for FY17.

Ontario's long-term FY17 public borrowing requirement of $23.8 billion is completed. As of February 10th, $0.8 billion is pre-borrowed for FY18, and the Province anticipates additional pre-borrowing if market conditions are favourable.

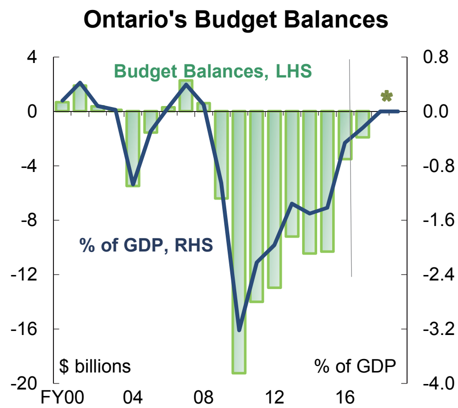
REVENUE DETAIL

With growth in Ontario's FY17 own-source receipts revised from 0.4% to 3.0%, the surge in own-source revenues from FY15 to FY17 totals a hefty 16.0%, as solid real GDP growth averaging an estimated 2.6% from calendar 2014 to 2016 facilitates deficit elimination. In addition to the lift arising from the processing of

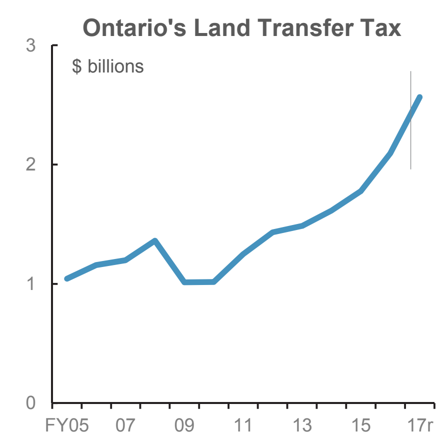
[1] Net debt as measured by Ontario. [2] The Ontario Public Service Employees' Union Pension Plan and the Ontario Teachers' Pension Plan.

CONTACTS

Mary Webb
416.866.4202
Scotiabank Economics
mary.webb@scotiabank.com



* Balanced books. Source: Ontario Finance; Statistics Canada, nom. GDP forecasts: Scotiabank Economics.



Source: Ontario Finance.

2015 income tax returns, corporate taxes benefitted from tax reassessments for the years prior to 2015.

With Ontario's buoyant housing market, the FY17 Land Transfer Tax is expected to be $0.5 billion ahead of *Budget* at a record $2.6 billion *(bottom chart, p.1)*. As well, Ontario's housing market activity is expanding the Province's share of the Harmonized Sales Tax (HST) pool, lifting the 2015 HST entitlement estimates.

The Ontario Lottery and Gaming Corporation and the Liquor Control Board of Ontario are propelling government business enterprise income $185 million above *Budget.* Other non-tax revenue for FY17 is less than *Budget,* largely due to a delay into FY18 in realizing the $478 million anticipated from Ontario joining the existing California and Quebec cap-and-trade quarterly auctions for the first time this March.

EXPENDITURE DETAIL

Program spending in FY17 is pushed higher by cancer treatments, the *Ontario Drug Benefit* program and electricity cost relief, with the 8% rebate on consumers' bills introduced in January expected to cost $300 million for Q4 of FY17. Nevertheless, the revised 1.9% FY17 increase still represents a significant real per capita decline, allowing program outlays relative to GDP to continue to trend lower, to an estimated 15.5% share this fiscal year.

For infrastructure expenditures, the Q3 update is unchanged from the mid-year revision that raised the FY17 plan by $1.2 billion to $17.4 billion, representing a 36½% hike over FY16. At $5.4 billion, transit accounts for nearly 31% of the FY17 plan.

OUTLOOK

Ontario cautions that unexpected events, such as updates from its Ministries, business enterprises and consolidated entities, could alter the FY17 deficit estimate. Some of this risk, however, should be covered by the Province retaining $0.4 billion of its initial $1.0 billion reserve for FY17, plus half of its $1.2 billion Operating and Capital Contingency Funds. The government's assumption of provincial real GDP growth remains cautious, at 2.5% and 2.2% for calendar 2016 and 2017, respectively.

For its *2017 Budget,* the government promises balanced books, alongside inclusive growth. In terms of risks, it identifies that reported revenues of its electricity sector business enterprises will reflect a change in the basis of consolidation from the U.S. Generally Accepted Accounting Principles to the International Financial Reporting Standards. This change was effective April 1, 2016, but its impact is not expected to be significant for FY17. There are broader risks, however, including current uncertainty related to new tax and trade adjustments under a Trump administration. Thus, Ontario's practice of layers of prudence, which contribute to its repeated outperformance of budget targets, should continue in this upcoming *Budget.*

Ontario's Budget Arithmetic

$ billions except where noted

	FY16	FY17	
	Revised Final	Budget	Q3
Personal Income Tax	31.1	32.2	32.8
Corporations Tax	11.4	12.1	13.1
Harmonized Sales Tax	23.5	24.0	24.8
Ontario Health Premium	3.5	3.6	3.7
Other Taxes	22.3	20.0	20.4
Tax Revenue	**91.8**	**91.8**	**94.8**
Gov't Business Ent. Income	4.9	5.0	5.2
Other Non-Tax Revenue	8.8	9.1	8.6
Total Own-Source Rev.	**105.5**	**105.9**	**108.6**
Federal Transfers	22.9	24.6	24.5
of which Equalization	2.4	2.3	2.3
Total Revenue	**128.4**	**130.6**	**133.1**
Health	51.1	51.8	52.1
K-12 Education	25.0	25.6	25.7
Post-Secondary Education	7.7	7.9	8.1
Social Services	15.5	15.8	15.9
Other Program Spending	21.7	21.0	21.4
Total Program Spending	**120.9**	**122.1**	**123.3**
Debt Service*	11.0	11.8	11.4
Total Expenditure	**131.9**	**133.9**	**134.6**
Reserve	0.0	1.0	0.4
Surplus (Deficit)	**-3.5**	**-4.3**	**-1.9**
Annual Change, %			
Personal Income Tax	*6.2*	*3.3*	*5.5*
Corporations Tax	*19.6*	*5.4*	*14.6*
Harmonized Sales Tax	*8.1*	*2.2*	*5.6*
Tax Revenue	*11.6*	*0.0*	*3.2*
Total Own-Source Rev.	***8.9***	***0.4***	***3.0***
Federal Transfers	*5.7*	*7.8*	*7.0*
Total Revenue	***8.3***	***1.7***	***3.7***
Health	*2.1*	*1.4*	*2.1*
K-12 Education	*1.5*	*2.6*	*2.7*
Post-Secondary Education	*-0.4*	*2.9*	*5.8*
Social Services	*6.0*	*1.8*	*2.6*
Other Program Spending	*2.2*	*-2.9*	*-1.2*
Program Spending	*2.3*	*1.0*	*1.9*
Total Expenditure	***2.4***	***1.5***	***2.1***
Memo Items, %			
Own-Source Rev. / GDP	13.8	13.3	13.7
Program Spending / GDP	15.8	15.4	15.5
Budget Balance / GDP	-0.5	-0.5	-0.2
Debt Service* / Revenue	8.5	9.0	8.5

* FY16 & FY17 debt service ex $165mn & $183mn of interest capitalized during construction. Source: Ontario Finance, Statistics Canada; nom. GDP forecast: Scotiabank Economics.