Ontario Fiscal Situation—As Expected with Challenges Ahead

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- The Province of Ontario published its Public Accounts for the 2017/18 fiscal year on Friday, posting a deficit of $3.7 billion. Recall that the Budget plan laid out by the Wynne Government had estimated a small surplus for the fiscal year. This difference follows the inclusion of valuation allowances for the net pension assets for the Ontario Teachers' Pension Plan and the Ontario Public Service Employees Union Pension Plan, expenses related to the reduction in electricity rates and the Budget reserve of $0.6 billion.

- As a result of the Report of the Independent Financial Commission of Inquiry, the projected deficit for the current fiscal year of $15 billion will more than double the projections in the Wynne Government's last budget.

    - ◊ While this represents a significant departure from the Budget Plan, these revisions were largely expected as they reflect the Auditor General's proposed accounting treatment of net pension assets of the Ontario Teachers' Pension Plan and Ontario Public Service Employees Union Pension Plan, and recommendations related to the accounting treatment of the Fair Hydro Plan. These changes account for $5.1 of the $8.3 billion difference between the current treatment and that used in the Budget Plan.

    - ◊ The remaining difference reflects an increase in the reserve from $0.7 to $1 billion, and $2.9 billion that largely reflects changes in economic circumstances.

- As the Commission's report is, for the most part, in line with expectations, we do not anticipate an impact on credit ratings at this point, though it will likely affect the borrowing plan. At a minimum, financial requirements will need to cover the shortfall associated with the change in economic circumstances. Moreover, the report paints a bleak picture of Ontario's finances. The Government has a large hole to fill, one that cannot be filled rapidly owing to a number of reasons:

    - ◊ Economic growth will slow in the years to come. Our most recent forecasts point to growth slowing from the 2.8% pace set in 2017 to roughly 2% in the next two years. As a result, the revenue environment will be less favourable than that enjoyed by the Wynne Government.

    - ◊ The pace of consolidation will need to consider economic conditions. With growth roughly at potential in Ontario, eliminating the budget will represent a drag on activity. The extent to which the drag materializes will of course depend on how much and how fast the Government chooses to improve its finances.

- ◊ The Ford Government has committed to cut expenditures by $6 billion. This would make a big dent in the budgetary hole, but more actions will be necessary to redress public finances.
- ◊ It will be politically challenging for the Government to proceed with the $6 billion reduction it is currently planning to undertake. The scope for larger cuts is clouded by even greater political challenges.
- ◊ The Government will need to consider delaying tax relief until its books are closer to balanced. If a more rapid path to balance is required, it may be necessary to supplement the expenditure cuts with targeted tax increases.

- With spreads on Ontario debt higher than those on Québec provincial debt, the Government may be tempted to pursue an aggressive path to fiscal rectitude. As it develops its fiscal plan, the Government should carefully calibrate its response by balancing the consequences of its adjustment plan on the economy against the benefits flowing from a better budgetary position. Just as important, the Government will need to lay out a credible long-term plan to improve its fiscal position. Our assessment of its fiscal strategy will reflect these considerations when the Fall Statement is released.