Ontario: Fiscal 2018–19 Q1 Update

FY19 BOTTOM LINE UNCHANGED FOR NOW

- **With the swearing in of Ontario's new Conservative government in late June, Q1 of fiscal 2018–19 (FY19) is considered the final reporting period of the prior Liberal administration. Thus, this update provides no adjustments to the March 2018 *Budget* forecasts of revenues, expenditures or infrastructure investment for FY19, leaving the projected FY19 deficit unaltered at $6.7 billion (see *Fiscal Pulse* on Ontario's *Budget*, here).**

OVERVIEW

A more comprehensive fiscal update is promised for later this Fall that will include: initial fiscal impacts of the new administration's policy announcements since its election; the results of its *Independent Financial Commission of Inquiry into Ontario's Finances;* and the findings of an outside consultant retained to conduct a line-by-line audit of all government programs and services.

The *Commission* will assess Ontario's accounting practices, including pensions, electricity refinancing and any other issues relevant to finalizing the FY18 *Public Accounts.* It also will assess and advise on Ontario's financial position in FY19 and beyond relative to the March *Budget* estimates to help establish a baseline for future fiscal planning. The Commission's final report is due to the government by August 30th and the *Public Accounts* for FY18 are expected in September.

Ontario's Treasury Board reports that an external consultant has been selected for the line-by-line review. Their review will build on the work of Ontario's Auditor General, assessing current spending and benchmarking against other jurisdictions to identify efficiencies while avoiding job cuts. The public, including Ontario's public servants, will have the opportunity to contribute to this audit. The final findings will be delivered to the government this Fall, and this report plus the Commission's will be made available to the public.

Revenue risks are acknowledged for FY19. After a 2.7% rise in Ontario's real GDP in calendar 2017, Ontario's quarterly *Economic Accounts* report a modest Q1-2018 advance of 1.4% (q/q seasonally adjusted at annual rates), compared with a Q4-2017 increase of 2.5%. Nominal GDP growth slowed to 2.8% in Q1-2018 from 5.8% in Q4-2017. The Ontario economy is sensitive to US trade actions and global trade protectionism. It also is weathering a slowdown in its resale housing market, with unit sales through July dropping nearly 19% y/y and average transaction prices 5.1% lower, potentially impacting Sales Tax and Land Transfer Tax receipts. For calendar 2018, the average of private-sector real GDP growth forecasts has slipped from 2.3% in March to 2.1% in June, and is now slightly below the *Budget* assumption of 2.2%. For calendar 2019, the private-sector average remains 1.9%, leaving the *Budget* assumption somewhat conservative at 1.8%.

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The Auditor General's Recommended Adjustment to Ontario's FY19 Deficit

$ billions except where noted

Payments to Power Generators & Interest on Borrowings	-2.4
Unrecorded Pension Expense	-2.6
Total FY19 Adjustment	**-5.0**
March 2018 Budget: FY19 Balance	-6.7
FY19 Deficit "Identified by OAGO*"	**-11.7**
% of GDP	*-1.3*

*Office of the Auditor General of Ontario.
Sources: Ontario Finance; nominal GDP forecast: Scotiabank Economics.

Ontario also highlights revenue uncertainties related to the processing of 2017 Personal and Corporate Income Tax returns and revisions to Ontario's entitlements under the Harmonized Sales Tax. For FY19 expenditures, unexpected one-time events include the baseline budget revision this summer for front-line forest fire fighting from $70 million to $150 million.

This Q1 *Update* references the Ontario Auditor General's concerns in late April that the March 2018 *Budget* estimates understate: 1) expenses to pay power generators and the related interest on funds borrowed; and 2) the pension expenses related to the Ontario Teachers' Pension Plan and the Ontario Public Service Employees' Union Pension Plan (*Fiscal Pulse*, here). Correcting these understatements for FY19 is estimated to widen the March *Budget* estimate of a $6.7 billion deficit by $5 billion (side table, p.1). The Financial Accountability Office of Ontario in early May accepted the Auditor General's FY19 expense correction, forecast lower revenue of $0.8 billion net of lower projected interest, and without the $0.7 billion reserve, estimated an $11.8 billion deficit for the current fiscal year.

The FY19 long-term borrowing estimate remains unchanged at $31.7 billion, with $11.7 billion (37%) completed, of which $9.3 billion (79%) was Canadian dollar issues. The Q1 *Update* clarifies that the Auditor General's two recommended accounting adjustments for Ontario's expenses would not affect Ontario's FY19 borrowing requirement. However, if the government decided that the Province rather than Ontario Power Generation or the Fair Hydro Trust would borrow to finance the payments to power generators, then Ontario's FY19 long-term borrowing requirement would rise by $1.4 billion to $33.1 billion.

OUTLOOK

This report and the new administration's multiple announcements to date represent initial information instalments ahead of fuller disclosure of the government's plans in its FY18 *Public Accounts,* a Fall fiscal update for FY19 and the 2019 *Budget* next spring. Some of the government's intentions for substantive restructuring are summarized in the following text box, awaiting fuller explanation as the Ford administration balances its election commitments with the Province's underlying fiscal realities and the outlook for moderating economic growth in Ontario.

Selected Policy Announcements Since Ontario's June 7th Election

PROVINCIAL EXPENDITURE SAVINGS

The prior administration's OHIP+ is amended to require youth up to 24 years of age to use their parents' health insurance for prescription drugs before accessing provincial funding.

For Social Assistance, an accelerated 100-day review is announced to create a sustainable framework to "break the cycle of poverty". The Ford administration's concerns include: the 55% rise over the past 15 years in the number of Ontario adults on Social Assistance with lack of work the primary reason; annual increases of 10,000 in the number of individuals on Disability Support; and the experience of one in five Social Assistance recipients remaining in the program for five years or longer and the return of almost half of the recipients leaving the program. The prior administration's three-year Basic Income research pilot will be concluded. As the review is conducted, March *Budget* initiatives, such as increasing the amount of employment income that can be earned with out impacting benefits from $200 to $400 per month, will be paused. However, during the review, the scheduled 3.0% annual benefit increase will be halved and implemented for Disability Support on September 1 and for Ontario Works payments on October 1.

At York University, binding interest arbitration is adopted for the contract faculty and graduate/teaching assistants on strike since early March, allowing students to return this September.

Ontario, with other Provinces, is requesting increased federal assistance to cover the health, social assistance and employment supports required for asylum seekers and recently arrived government-assisted refugees.

Selected Policy Announcements Since Ontario's June 7th Election *(continued)*

ELECTRICITY SECTOR

At Hydro One, the power transmission utility where Ontario remains the largest shareholder, the CEO and the Board resigned earlier this summer and a new 11-member Board is to be appointed by August 15. Executive compensation will no longer be included in power rate calculations. Hydro One for now is continuing its prior business strategy and in early August announced that it has completed the purchase of Peterborough's local power distribution company.

As of mid-July, 758 renewable energy contracts for projects at an early stage of development will be cancelled and wound down as part of the government;'s plan to trim hydro rates by 12% for families, farmers and small businesses. A legislative amendment will protect hydro customers from cancellation costs and after all anticipated expenses, a net saving of $790 million is anticipated.

THE ENVIRONMENT

Ontario's cap-and-trade framework, expected to generate revenues of almost $2.0 billion in FY19, is revoked as of July 3rd. Trading of emission allowances is prohibited; programs funded by cap-and-trade receipts are cancelled; and a new plan for achieving environmental goals is promised. Participants in the prior cap-and-trade program are eligible for compensation if: they were required to participate; their cumulative expense exceeds their assessed emissions; and they did not pass these costs on to consumers. Signed contracts in areas such as energy efficiency will be honoured.

With respect to carbon pricing, Ontario plans a constitutional reference challenging Ottawa's proposed *Greenhouse Gas Pollution Pricing Act* that creates the federal carbon price backstop in the Ontario Court of Appeal. Ontario also is pursuing intervener status in Saskatchewan's challenge of the federal carbon price backstop in its Court of Appeal. Alberta's opposition United Conservative Party, if it wins the Province's 2019 election, also will challenge the constitutionality of the proposed federal carbon tax.

MUNICIPAL GOVERNMENT

With Ontario's municipal elections every four years scheduled for October 22nd, the Province has trimmed the number of City of Toronto councillors to 25, re-aligning municipal ridings with federal/provincial boundaries to simplify and reduce the cost of governance. Toronto's prior plan would have raised the number of councillors from 44 to 47 based on population growth trends. Toronto's School Boards must now realign their wards to match the new 25 ridings.