Ontario Budget Highlights

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Highlights and analysis of Ontario's FY19/20 budget | **April 11, 2019, 4:00 pm**

Ontario Deficit Reduction: A Stroll in the (Queen's) Park

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The Province of Ontario is projecting a $10.3 billion deficit in FY19/20 (1.2% of GDP), in a highly-anticipated detail of how the fiscal path might look under the new government. This follows a $11.7 billion shortfall now expected for FY18/19, down from the $13.5 billion estimated in the latest update and $14.5 billion in the initial post-election report—we've suspected all along that the bar was initially set low, and progress has already been made. The Province expects the deficit to shrink gradually before returning to balance in FY23/24, which is largely consistent with pre-budget messaging, though perhaps a tad later than anticipated. In the meantime, net debt will edge up, peaking at 40.7% of GDP in FY19/20 and FY 20/21.

From a policy perspective, this budget rolls out some more election promises, including tax relief worth $2.2 billion in FY19/20, but falling to $1.7 billion by FY21/22. Meantime, the government pledges to crack down on program spending through the forecast horizon—this is marked shift in priorities from recent years.

Summary of Major Policy Measures

Program spending surged 5.3% in FY18/19 but hits the brakes hard this year up just 0.1% and only 0.8% per year through FY21/22. Much of the restraint on spending is expected to be achieved through savings driven by efficiencies in procurement and service delivery. Accordingly, this budget is light on new measures, with much of what was announced already in the media earlier this week.

The newly introduced **Childcare Access and Relief from Expenses** (CARE) tax credit is among the biggest ticket items with a cost of about $390 million per year. The childcare tax credit is income tested and is focused on low income households with benefits starting to decline above $50k in household income and being completely phased out at $150k. The credit is up to $6k per child under 7 years old, then up to $3,750 for ages seven to 16. Children with disabilities qualify for up to $8,250 per year. Clearly there's a focus on low income households which, with the federal child benefits introduced a couple of years ago, add meaningful benefits. However, with benefits fully phased out up the income scale (at both levels of government), the incentive for higher-educated professionals to participate in the workforce could be reduced.

Table 1
Fiscal Summary

Ontario (C$ blns, except where noted)

	Est. 18/19	— Forecast — 19/20	20/21	21/22
Revenues	150.8	154.2	159.8	163.7
Expenditures	162.5	163.4	165.6	168.2
Programs	150.0	150.1	151.9	153.8
Debt Service	12.5	13.3	13.7	14.4
Budget Balance before reserve	(11.7)	(9.3)	(5.8)	(4.6)
Reserve Allowance		1.0	1.0	1.0
Budget Balance	(11.7)	(10.3)	(6.8)	(5.6)
As a percent of GDP:				
Budget Balance	(1.4)	(1.2)	(0.7)	(0.6)
Net Debt	40.2	40.7	40.7	40.6
As a percent of revenue:				
Debt Service	8.3	8.6	8.6	8.8
Federal Transfers	16.6	16.5	16.6	16.6
Key assumptions:				
Real GDP (% chng)	2.2	1.4	1.6	1.5
Nominal GDP (% chng)	3.4	3.4	3.4	3.2
10-Year GoC (%)	2.3	2.1	2.6	3.3

Source: Provincial Budget ( ) = deficit
Note: GDP figures are for calendar year (FY19/20=CY19)

Table 2
Borrowing Requirements

Ontario (C$ blns)

	19/20	20/21	21/22
Deficit	10.3	6.8	5.6
Capital Investment	11.6	11.1	10.5
Non-Cash Adjustments	(7.7)	(7.7)	(7.7)
Loans to Infrastructure Ontario	0.2	0.1	0.2
Other Loans/Adjustments	0.7	0.0	(0.3)
Debt Maturities	27.5	26.4	24.1
Funding Requirement	42.5	36.8	32.5
CPP Borrowing	—	—	—
Dec./(Inc.) in S-T Borrowing	(1.2)	(1.0)	(1.0)
Inc./(Dec.) in Cash	(5.3)	(3.0)	—
Preborrowing	—	—	—
Long-Term Borrowing	36.0	32.8	31.5
Year-ago forecast	*36.7*	*41.3*	*n/a*

Source: Provincial Budget

The other major tax-related measures were all announced in the fall fiscal review. They include the Low-income Individual and Families Tax credit (LIFT) supporting families with low income and costing about $500 million annually. The **Ontario Job Creation Investment Incentive** which is effectively following the federal government measure to allow for accelerated depreciation of some capital spending. This measure will cost $615 million in FY18/19, rise to $1.125 billion in FY19/20, and will be phased out from 2024 to 2027. Also contributing to trimming costs for business is lower **WSIB premiums** (savings estimated at $1.45 billion this year).

As leaked earlier this week, a **new transit plan** is included in the budget. The Province has committed to $11.2 billion of an estimated $28.5 billion to support expanded public transit options, including a redesigned downtown relief line now dubbed the "Ontario Line". The rest of the funds are expected to come from other levels of government and there is an intention to use public-private partnerships when possible to reduce costs. Despite the big-ticket plan, the timeline on the projects is quite long and planned infrastructure spending on transit is largely steady over the next few years before increasing substantially in FY23/24.

Another initiative is providing **low income seniors access to dental care**. The program is to begin in late summer this year and cost $90 million per year.

Other changes include a 10% **cut in postsecondary tuition** starting in the 2019/20 school year, with tuition frozen for the following year as well. In addition, the **Ontario Student Assistance Program** (OSAP) is being reined in to cut the cost of the program while at the same time, increase the focus on providing assistance to lower income families and students.

Lastly, a small measure is to eliminate the **estate administration tax** on those valued $50,000 or less. The cost is a modest $10 million annually and will be effective January 1, 2020.

Overall, the budget is light on new spending and policy initiatives as restraint is the name of the game. However, there are still some to-do items on the government's agenda such as improving auto insurance affordability, making alcoholic beverages available at more stores and allowing tailgating at sporting events. Those will have no financial impact.

The borrowing program is pegged at $36 billion in FY19/20, down from $39.6 billion last fiscal year, though the latter includes $12.4 bln in pre-borrowing.

Revenue Sturdy; Spending Taps Close

Total revenue is projected to rise 2.3% to $154.2 billion in FY19/20, led by gains in personal income tax. Despite healthy growth over the past year, FY18/19 revenues were up just by 0.1% from the prior year, weaker than what we saw at the federal level. Recall that scrapping of the cap-and-trade program cut FY18/19 revenues by roughly $2.5 billion versus what was initially projected for that year. A higher tax take was offset by a drop in income from Hydro One and lower non-tax revenues. Net tax measures in this budget will cut FY19/20 revenues by $2.2 billion. Medium-term revenue growth runs around 2.8%, below nominal GDP growth, providing room for some upside surprises.

Real GDP is expected to moderate this year, growing 1.4% after 2.2% estimated in 2018. That's below BMO's 1.7% call for 2019 growth. This reflects a slowdown to around (or modestly below) potential for the province, after a stretch that averaged 2.5% in the four years through 2017—the best such run in more than a decade. Now, residential investment has turned into a drag as an inflated housing market corrects, while consumer spending growth has ebbed as well amid elevated household debt burdens. That said, the Province appears to have built this backdrop into its fiscal plan with relatively **cautious future economic assumptions**. Real GDP is assumed to grow 1.6% in 2020 and 1.5% in 2021, the former being in line with our call. A $1 billion per year reserve allowance is in place through FY21/22, as is the norm.

Total spending is projected to rise 0.6% to $163.4 billion in FY19/20, including $13.3 billion in debt service costs, leaving program spending up 0.1%. Health care and education will each see a roughly 2% boost in spending, though postsecondary is being cut nearly 6%, undoing the past year's unexpected increase. Restraint is the name of the game here with almost no program spending growth this fiscal year and only a planned 1.2% rise next year. Much of the restraint on spending is expected to be achieved through savings driven by efficiencies in procurement, service delivery and reduced bureaucracy. The government notes that all ministries have identified 4% in administrative efficiencies which will save a cumulative $1.7 billion by FY23/24.

Longer term, program spending growth is then expected to settle in around the 1% range in the following three years. Given inflation of around 2% and population growth now a heated 1.8%, this will mark a meaningful contraction in real per-capita terms in the coming years. Of course, program spending had grown at around 4.5% in the three years through FY17/18, so call it payback.

Net Debt Rising; Borrowing Program Steady

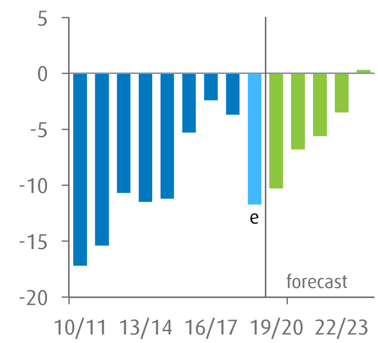
The government has a $42.5 billion total financial requirement in FY19/20, $27.5 billion of which reflects maturities and redemptions. **Long-term public borrowing** will total $36 billion. That's down from FY18/19, which included $12.4 billion in pre-borrowing for the upcoming year. Borrowing then fades to $32.8 billion in FY20/21 and $31.5 billion in FY21/22 due to a drawdown in cash reserves. Keep in mind that, despite the deficit getting revised much deeper in the post-election update, borrowing expectations never changed much (most of the deficit revision was accounting related). Capital spending will hold relatively steady in the coming years.

Net debt is expected to weigh in at 40.7% of GDP by the end of this fiscal year, up 0.5 ppts from the prior year. This ratio has been stuck around the 40% level over the past three years despite a strong run for the economy. In the short term, still-chunky borrowing will keep the ratio elevated. Longer term, a move back toward operating balance will help pull the ratio down—it's expected to peak this year before gently falling starting in FY21/22. In this past fiscal year, 77% of debt issuance was in Canadian dollars, above the 70% target. For FY19/20, the target for Canadian dollar issuance will be a range of 70% to 80% to account for changing market conditions. Meantime, another Green Bond issue is planned for this year. And, the Ontario Savings Bond program has been discontinued in a cost-saving measure following similar moves by other provinces in recent years.

Chart 1
Slow Ride to Balance

Ontario (C$ blns)

Budget Balance

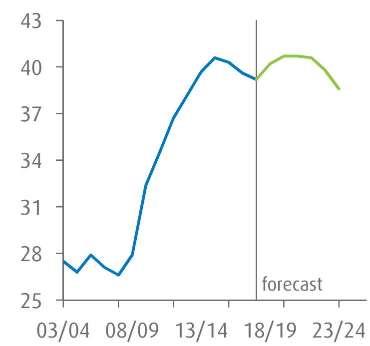


Source: Provincial Budget e = estimate

Chart 2
Debt Rising Again

Ontario (% of GDP)

Net Debt



Source: Provincial Budget

The Bottom Line: This budget marks a clear shift in priorities for the Province of Ontario, both from a policy and a fiscal perspective. From a credit perspective, this could be read as a positive—and there is some recent precedent (see Quebec). A big difference is that Quebec's major policy shift caught the start of an economic acceleration, whereas Ontario's is running into a period of deceleration. In the meantime, Ontario is setting a reasonable bar that they should be able to step over, barring a big decline in the economy.