2019 Ontario Budget

A Road Map to Balance

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Highlights

- The Ontario government has landed on a 5-year deficit elimination plan that, if achieved, would set the stage for a gradual reduction in the Province's elevated debt to GDP ratio.
- The 5-year horizon strikes a reasonable balance between undertaking necessary restraint but not at a pace that could severely impede the province's economic expansion.
- Still, the planned restraint won't be pain free for a province that already ranks the lowest among its provincial counterparts in per capita program spending. The government's plan to push ahead with tax relief in the future has increased the burden on spending restraint to achieve its balanced-budget goal.

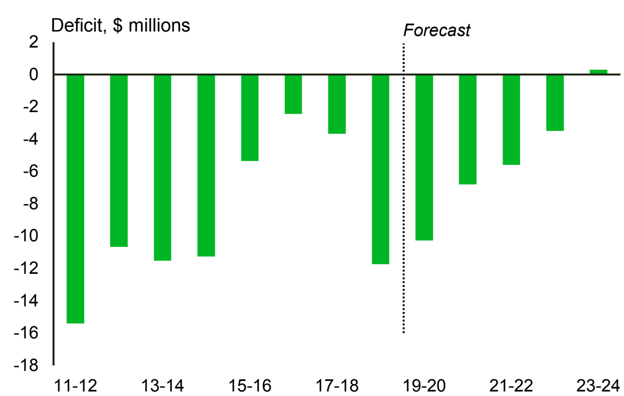
In its inaugural budget, Ontario's PC government has laid out its much-awaited plan to eliminate the Province's budget deficit – currently estimated at just under $12 billion – over the next five years. However, only minor progress is forecast to be made on the province's elevated debt load, with the net debt to GDP ratio set to rise modestly over the medium term before heading lower by FY 2023/24.

While the government is counting on a steady but moderate expansion in the economy to sustain revenues, its deficit elimination plan relies most heavily on reducing spending growth well below its recent trend rate. This focus on curtailing spending has been further sharpened by the government's decision to proceed with $1 billion in annual tax cuts that had been promised earlier.

FY 2018/19 deficit trimmed again

Suffice to say, estimates of the last fiscal year's shortfall have gone through some dramatic changes. The $6.7 billion deficit projected by the prior government was re-cast as $15 billion by the new government, owing to their adoption of accounting practices recommended by the Auditor General. The shortfall was then revealed to be $14.5 billion in last year's fall fiscal update, as revenue reduction measures (the ending of cap and trade, most significantly) were more-than-offset by savings accrued through the cancellation of prior spending initiatives.

Chart 1: Deficit To Be Eliminated



Source: Ontario Budget 2019

The government now pegs last year's deficit at $11.7 billion, or roughly $2.8 billion less than presented in the fall update. The improvement largely came on the revenues side of the ledger, with the government's intake expected to come in some $2.6 billion higher than previously expected on the back of stronger economic growth. As a share of GDP, the deficit tipped the scales at 1.5% last fiscal year – the highest since FY 2014/15 though well shy of the peak of 3% reached during financial crisis and the 4% highs in the early 90's recession.

All told, an improved starting point sets the government on a sounder fiscal footing for this year as it works towards its deficit reduction goal.

Revenue expectations backed by prudent economic assumptions

To get back to balance, the government's plan partly hinges on what we believe to be reasonably prudent forecasts for economic growth. From 2019 to 2021, nominal GDP growth is pegged to average 3.3%, slightly below our own forecast of 3.5%. This implies a modest upside risk to the revenue projection. The government calculates that each 1 percentage point in added GDP growth translates into a $705 million boost to the bottom line.

These growth expectations yield moderate revenue gains on the order of around 3% annually over the next three years Federal transfers are set to expand, but by less than own-source revenue, constrained by a drop to zero in equalization payments. Thereafter, revenue growth is expected to accelerate modestly.

Interestingly, there was no specific mention in today's budget of the personal and corporate tax relief that had been promised in the government's election platform. However, Ministry officials confirmed that the revenue forecasts include a provision for the 20% cut to the middle income tax rate pledged on the campaign trail. However, the previously-pledged 1 ppt cut in the corporate tax rate has been dropped. In its place stands the accelerated capital cost allowance introduced in the fall fiscal update. This allowance (known as the "Ontario Job Creation Investment Incentive") allows an immediate, 100% write-off for manufacturing and clean energy equipment, with a lesser write-off for other assets. It is forecast to cost $3.8 billion in foregone revenue over six years.

As pledged on the campaign trail, the government has introduced a new refundable childcare tax credit (dubbed the "CARE Personal Income Tax Credit"), based on a tax filer's family income and eligible expenses. The government estimates that the credit could provide about 300,000 families with up to 75% of eligible child care expenses. The government is proposing to eliminate the Estate Administration Tax (charged when an estate certificate issued) for taxable estates with assets of $50,000 less.

Ontario Economic Planning Assumptions
[Percent change unless otherwise noted]

	2018	2019	2020
Real GDP	2.2	1.4	1.6
Nominal GDP	3.4	3.4	3.4
Unemployment Rate (%)	5.6	5.5	5.5
Employment	1.6	1.3	1.0
Housing Starts (thousands)	77.2	76.0	77.3
Existing Home Sales	-13.4	4.9	1.7
Average Home Prices	-2.7	4.0	3.1

Source: Ontario Ministry of Finance, as at April 2019

Program spending to ease substantially

To make headway on the deficit, the government is planning to reduce program spending well below its recent trend rate. Restraint will be evenly spread out, with program spending projected to be flat this year, before growing at a modest pace thereafter. Factoring inflation and population growth, spending is projected to decline outright over the next several years, representing the weakest profile since the Harris government in the 1990s.

The education and post-secondary and training sectors are set to see particular restraint, with the former growing at a mere 1% pace, on average, through FY 2021-22. Postsecondary and training expenditures are forecast to drop by an average of 1% over the same time, weighed down by cuts to university college tuition fees and a less generous student loan (i.e., OSAP) program.

Regarding the province's other big-ticket item, healthcare spending is projected to moderate to 1.6% on average over the next three years, less than half of its recent 10-year trend rate. The establishment of a single health agency is projected to provide some $350 million in annual savings to the government, with additional savings

Government of Ontario Fiscal Plan [C$ billions unless otherwise noted]						
	2019 Budget Plan					
Fiscal Year	18-19	19-20	20-21	21-22	22-23	23-24
Revenues	**150.8**	**154.2**	**159.8**	**163.7**	**168.5**	**175.1**
% change	0.1	2.3	3.6	2.4	2.9	3.9
Expenditures	**162.5**	**163.4**	**165.6**	**168.2**	**170.7**	**173.2**
% change	4.7	0.6	1.3	1.6	1.5	1.5
Reserve	0.0	1.0	1.0	1.0	1.3	1.6
Budget Balance	**-11.7**	**-10.3**	**-6.8**	**-5.6**	**-3.5**	**0.3**
Net Debt	**343.4**	**359.9**	**372.3**	**382.4**	**388.4**	**391.3**
% of GDP	40.2	40.7	40.7	40.6	39.8	38.6

Note : Numbers may not add up due to rounding.
Source: Ontario Ministry of Finance, as at April 2019

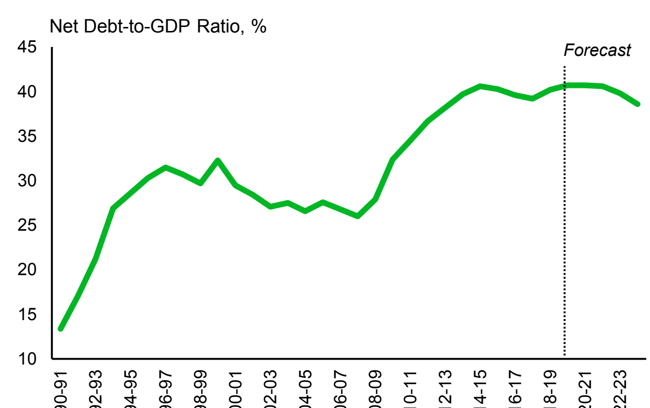
accrued through changes to the OHIP+ program. Amid the cuts, there were some announcements of new spending, including $3.8 billion over 10 years for mental health and addictions, and $1.5 billion over 5 years for 15,000 new long-term care beds.

Spending in all other categories is forecast to be flat, on average, over the next three fiscal years, constrained by the government's search for "efficiencies" in the broader public sector.

"Open for Business" measures reinforced in the budget

Budget 2019 largely reinforced prior initiatives aimed at cutting labour costs and supporting businesses in the province. These measures include a freeze on minimum wages, a move to reduce payroll taxes, and a pledge to enact a 25% reduction in red tape by 2020 (two years ahead of what was proposed in the fall fiscal update). Alongside these measures, the government plans a minor reduction in the small business tax rate to 3.2% from 3.5%.

Chart 2: Net Debt-to-GDP To Edge Lower



Source: Ontario Budget 2019, TD Economics

The government is also intent on moving forward with a five-point plan aimed at improving the regulatory environment for businesses. Key elements of the plan include the establishment of a task force to reduce regulatory burdens and the creation of the Office of Economic Growth and Innovation. Additional components include measures to protect investors, track the competitiveness of Ontario's capital markets, and ensure economically focused rulemaking in these markets.

Net debt to GDP to edge higher in the near term

Ontario's net debt to GDP ratio is estimated to come in at 40.2% in the current fiscal year, down from the 40.5% expected in its fall update. In the current year, the Province is expected to rank second highest in terms of net debt burden, trailing only Newfoundland and Labrador (45.2%) and just ahead of third place Quebec (40.0%). For the some context, in FY 08-09, the comparable ratio for Ontario was around 27%.

In addition to bringing down the operating deficit steadily going forward, the government is working to rein in sizeable growth in capital spending in part through prioritizing certain areas. Transit for one is expected to capture about 40% of its planned annual infrastructure spend of $14.5 billion over the next three years, while capital outlays targeted at education are set to fall 14%.

But notwithstanding these efforts, Ontario's net debt to GDP ratio is still expected to edge up slightly over the next few years. The government has the debt challenge squarely on its radar, allocating much ink at the front of the budget document to addressing the inherent fiscal and economic risks of a lofty debt burden. As part of its new proposed Fiscal Sustainability, Transparency and Accounting Act, the government will impose new requirements related to setting out goals and plans for reducing the Province's debt burden, including the need to report progress annually in the spring budget. As a start, today's budget makes a commitment (though not an overly ambitious one) to reduce the debt burden to less than 40.8% of GDP that was in place when the new PC government took place.

Notwithstanding the lingering challenge of a high stock of debt, net provincial borrowing requirements are poised to fall over the next few years. On a gross basis, the province's overall funding requirement is expected to rise from $38.6 billion in FY 2018-19 to $42.6 billion in FY 2019-20. However, that increase is due to a $5.5 billion jump in debt maturities relative to last year. More notable is the expected drop in the need to issue longer term public debt, as the government plans to increase use of cash and short-term borrowing in its funding program. As a result, gross long-term debt issuance is projected to drop from $40 billion last year to $36 billion this year and $32 billion next.

Bottom line

After a series of vague promises around deficit reduction, it is nice to see a roadmap towards budget balance including clear multi-year targets and underlying economic assumptions. On this basis there are some positives. While, the cuts will be far from pain free, the 5 year plan in our view represents a decent compromise between moving forward in addressing the province's fiscal challenges and not slaying the deficit too quickly to dramatically undercut the economic expansion. We would still be inclined to lower our prevailing Ontario growth forecast in 2019 and 2020 on the heels of today's budget, but only modestly.

Elements of the government's plan are likely to resonate positively with credit ratings agencies, including a clearly defined path towards balance. However, full judgement will likely be reserved until the government shows it can stick to its plan.