2023 Ontario Budget
Ontario to Keep Spending Taps Open

Derek Burleton, Deputy Chief Economist | 416-982-2514
Rishi Sondhi, Economist | 416-983-8806

March 23, 2023

Highlights

- Benefitting from a better-than-anticipated revenue backdrop, Ontario's government will keep the spending taps open this year for priority areas like healthcare and education while also rolling out tax relief for businesses in the province.
- The government's deficit is forecast to decline in the upcoming year before vanishing in FY 2024/25, although hefty capital spending will keep the debt burden elevated. Of course, this type of spending can enhance Ontario's longer-term growth potential. And, the government's considerable contingencies can be used toward debt repayment, should they not be required.
- Despite the long list of initiatives touted in the budget, there were relatively few new marquee initiatives. Nor were there many notable surprises.

In their first budget since their election win last year, Ontario's government is opting to keep the taps open with respect to program spending, although major new policy initiatives are few. Healthcare spending, in particular, sees a robust gain in the upcoming fiscal year. Policymakers will also keep ample reserves and contingencies on hand as they navigate a challenging economic backdrop with several downside risks, including the most recent bout of financial market turmoil. Meanwhile, manufacturers and small businesses will benefit from tax relief.

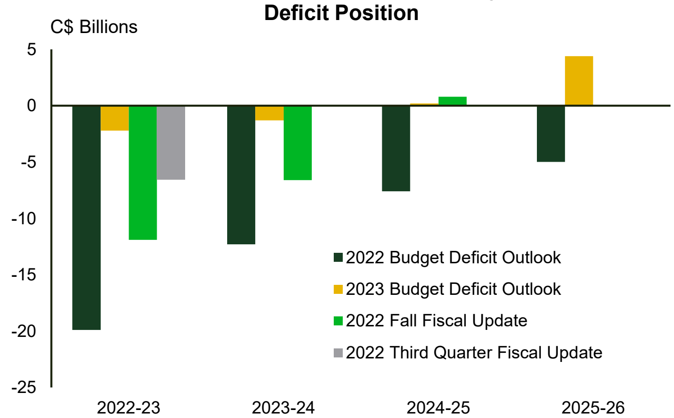
Notably, the government is beefing up its infrastructure spending program over the medium term. This will keep the province's debt burden elevated over the next few years, even as the deficit vanishes by FY 2024/25.

FY 2022/23 Deficit Forecast Shrinks Again

For the 4th time since last year's budget, the FY 2022/23 deficit estimate has been reduced. Policymakers are now forecasting a mere $2.2 billion shortfall, down from $6.5 billion in the February fiscal update. At -0.2% of GDP, Ontario's deficit this past year was in the middle of the range of other provinces who have released their 2023 budgets, with commodity-based provinces posting large surpluses of 1.1 to 2.2% of GDP, while at the opposite end more notable shortfalls are between -0.3% and -0.5%.

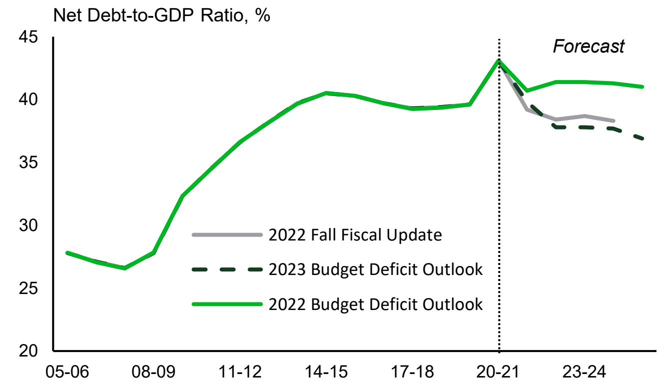
The main upward surprise relative to February was in revenues, which came in $4 billion higher than forecast, due to a solid jobs market that boosted personal income tax receipts. Expenses, meanwhile, were $600 million higher, thanks to an increase in one-off expenses.

Chart 1: The Evolution of Ontario's Vastly Improved Deficit Position



Source: Ontario Budget 2022 and 2023, Ontario Ministry of Finance, TD Economics.

Chart 2: Debt-to-GDP Ratio to Hold Near Current Levels Over the Near-Term



Source: Ontario Budget 2022 and 2023, Ontario Ministry of Finance, TD Economics.

This much improved starting point sets up for a better path for the deficit. Indeed, the government is expecting to run a small deficit of $1.3 billion this year, before flipping into surplus starting in FY 2024/25. In comparison, the deficit was projected to linger through FY 2024/25 in last November's fiscal update.

Potential Downside Risk to the Government's 2024 Growth Forecast

The government is forecasting economic growth to slow from 3.7% in 2022 to a mere 0.2% this year, as the full weight of the Bank of Canada's rate hike campaign bears down on households and business. Nominal GDP growth, meanwhile, is forecast to drop from 9.4% last year to 2.8% in 2023. Both forecasts are slightly below the private sector average, reflecting some caution on the part of policymakers.

The government's projections are largely in line with ours through 2022 and 2023. The big divide comes in 2024, where we are forecasting 2.7% nominal GDP growth, nearly 1 ppt below the government. Our view incorporates the observation that periods of deleveraging following a rise in borrowing costs tend to be prolonged. Combining the government's revenue sensitivities with our nominal GDP forecast suggests that revenues could be $1.2 billion lower in FY 2024/25 than the government expects.

There's also some downside revenue risk for this year. Indeed, we are forecasting a much steeper decline in home prices than the government. Using the government's elasticities implies that land transfer tax revenues could be $150 million lower than policymakers expect in 2023.

Revenue Growth to Gear Down Alongside the Economy

In the upcoming fiscal year, the government is projecting own-source tax revenue growth to slow consistent with weaker economic growth and dragged down by lower consumption and corporate tax receipts.

The corporate tax intake could be also weighed on by the new, 10% refundable corporate income tax credit for manufacturers, which will be worth up to $2 million per year. The tax credit would apply to qualifying investments in buildings, machinery, and equipment and could provide $780 million of support over 3 years. This credit would also offer some relief to manufacturers who are facing challenges over the next few years including a soft global backdrop, weak domestic activity, and the on-going shift away from goods to services spending.

In addition, the government is offering more relief for small businesses by extending the range over which the benefit from the small business tax rate is phased-out to $10-$50 million from $10-$15 million of taxable capital. Meanwhile, households will benefit from the extension of the gas tax and fuel tax rate cuts to December 2023.

In contrast to own-source revenues, growth in federal transfers is forecast to surge 11% in FY 2023/24, benefitting

Ontario Economic Assumptions Under Various Scenarios
[Percent change unless otherwise noted]

Economic Scenario	2022E	2023F	2024F	2025F	2026F
Real GDP (Planning Scenario)	5.2	0.2	1.3	2.5	2.4
Nominal GDP (Planning Scenario)	10.4	2.8	3.6	4.6	4.5
Real GDP (Slower Growth Scenario)	-	-0.7	0.8	2.4	2.3
Real GDP (Faster Growth Scenario)	-	1.3	2.0	2.8	2.7

Source: Ontario Ministry of Finance, as at March 2023.

from an infusion of healthcare funds from the federal government on the heels of the recent federal-Ontario health agreement. After FY 2023/24, overall revenue growth is projected to average trend-like 4% growth.

Notably, the government is pledging a review of the province's tax system, though no other details were provided.

Healthcare Spending to Grow Briskly in FY 2023/24

After shooting 10% higher in FY 2022/23, spending growth is slated to cool to 1.0% in FY 2023/24, reflecting the end of time-limited COVID-19 funding. However, even with this topline slowdown, spending taps will remain wide open in other priority areas.

Base program spending is projected to soar 9% in FY 2023/24, driven by healthcare spending which has been partly funded by new federal transfers. Healthcare funding will also be put towards mental health, accommodating contract increases for the community care workforce, and funding to address staff shortages in the medical care sector.

Beyond healthcare, spending in the education and post-secondary sectors are both projected to grow by 7% in FY 2023/24, bolstered (for example), by the federal/provincial daycare agreement and commitments to expand the number of medical school seats. Meanwhile, social services spending is expected to increase by 5%, supported by the indexation of disability support programs to inflation starting in July 2023.

However, the biggest percentage increase in base spending comes through "other programs" which is set to surge 17% in the upcoming fiscal year. A small part of this reflects the push to improve high-speed internet throughout Ontario and skills training initiatives. However, most of the gain is accounted for by the $4 billion earmarked for contingencies, which makes up 25% of the forecasted gain in FY 2023/24 base spending.

Debt servicing charges are forecast to increase 5% in the upcoming fiscal year, consistent with higher interest rates. However, the average term of the province's portfolio is lengthy at 11.1 years, offering a buffer against elevated borrowing costs. As a share of revenues, debt servicing charges are projected to peak at 6.9% in FY 2023/24. Although a touch higher than the year before, this is still quite low by historical standards.

Capital Spending to Keep Debt Burden Elevated

Ontario's debt level will be kept elevated over the next few years largely on the back of robust capital spending. For the upcoming fiscal year, total infrastructure spending is forecast to jump 18%, which is at odds with the more subdued 5% gain projected in Statistics Canada's latest survey of capital spending intentions. The largest outlays will be for transit, provincial highways, and hospitals in the upcoming fiscal year. However, the biggest increase over the medium term will be for transit, thanks to projects like the Bradford Bypass and the new Highway 413.

From an economic growth perspective, this anticipated surge in infrastructure investment would help offset a slowdown in residential investment, although it could keep some pressure on a construction jobs market that already looks relatively tight. It will also prop up the government's debt-to-GDP ratio, such that it hovers around its FY 2022/23 level of 37.8% for the next couple of years. This will keep Ontario as one of the most indebted provinces. Yet, infrastructure investments can boost productivity, which makes their impact on Ontario's debt levels more tolerable from a longer-term growth perspective.

Notably, Budget 2023 includes an updated debt reduction strategy, with new targets over the medium-term outlook for relevant measures of debt sustainability. The targets are for 1) net debt-to-GDP to remain below 40%, 2%) net debt-to-revenue to be below 200%, and 3) debt servicing as a share of revenues to stay below 7.5%.

Borrowing requirements are expected to total $27.5 billion in FY 2023/24, down from $32.1 billion in FY 2022/23.

Bottom Line

Ontario's much-improved deficit position is welcome, especially as we move through a challenging economic backdrop. Sizeable reserves and contingencies are set to provide a material cushion should conditions deteriorate more than forecast. Note that our 2024 growth projection is already much weaker than the government's.

There's some scope to lower the government's debt burden should their considerable contingencies go unused. There is currently little near-term improvement projected for Ontario's debt ratio, but a big reason for that is infrastructure investment, which can enhance the economy's potential GDP.

Government of Ontario Fiscal Plan [C$ billions unless otherwise noted]				
Fiscal Year	22-23	23-24	24-25	25-26
Revenues	**200.4**	**204.4**	**213**	**226**
% change	8.3	2.0	4.2	6.1
Expenditures	**202.6**	**204.7**	**210.8**	**217.5**
% change	10.7	1.0	3.0	3.2
Program Spending	**189.1**	**190.6**	**196.4**	**202.5**
% change	11.0	0.8	3.0	3.1
Interest Charges	**13.4**	**14.1**	**14.4**	**15.1**
% change	6.3	5.2	2.1	4.9
Reserve	0.0	1.0	2.0	4.0
Budget Balance	**-2.2**	**-1.3**	**0.2**	**4.5**
% of GDP	-0.2	-0.1	0.0	0.4
Net Debt	**395.8**	**406.4**	**420.3**	**429.9**
% of GDP	37.8	37.8	37.7	36.9

Note : Numbers may not add up due to rounding.

Source: Ontario 2023 Budget.