Ontario’s 2017–18 Budget

BALANCED AS PROMISED

- **The revised deficit** for fiscal 2016-17 (FY17) is $1.5 billion, a modest -0.2% of GDP and a $2.8 billion improvement from *Budget. And then the books are forecast to be balanced for the following three fiscal years.*
- **Ontario’s healthy economic expansion** represents a key assist. The Province assumes that its real GDP growth, after a 2.6% average annual increase in the past two years, will advance by 2.2% on average over 2017-18 and just under 2.0% for 2019-20. Revenues during FY18 and FY19 are expected to be almost $7.0 billion higher than last year’s *Budget* forecast.
- **The government will continue to focus on economic growth and job creation to support expanded programs.** Program spending in FY18 will jump by 4.8%, with increases averaging 2.4% over the following two years. Centrepice initiatives include the introduction of OHIP+, universal drug coverage for all children and youth, as of January 2018 and three, three-year Basic Income Pilots in Hamilton, Lindsay and Thunder Bay. The government’s commitment to make life more affordable for Ontarians has recently included substantive measures to address the affordability of power for households and businesses and initiatives to stabilize housing in Southern Ontario’s Greater Golden Horseshoe[1].
- **The Infrastructure Plan** is extended by one year to stretch over 13 years from FY15 to FY27, and planned outlays total more than $190 billion. This leaves about $156 billion for the next ten years, and for FY18, a 41.7% surge to $20.3 billion is planned, from an estimated $14.3 billion in FY17.
- **Net debt**, as measured by Ontario, peaked at 39.1% of GDP in March 2015 and is expected to drop to about 38% by March 2017. The $7.4 billion increase in net debt during FY17 is expected to be just over half of the *Budget* estimate, and the smallest rise since FY08.
- **From FY18-FY20, the rise in the net debt reflects only infrastructure investment,** less amortization.have accounted for 61% of the absolute increase in Ontario’s measured net debt from FY09, when the net debt was just under 28% of GDP, to FY17.
- **Because the planned rise in capital investment is steep** over the next three years, the drop in net debt relative to GDP is more muted, dropping to 37¼% of GDP by March 2020.
- **Long-term public borrowing,** slightly higher that *Budget* in FY17 at $27.0 billion, will be similar in FY18 at $26.4 billion. For FY19 and FY20, anticipated financing rises to $32.2 billion and $37.8 billion, respectively as borrowing for capital climbs and maturities expand.

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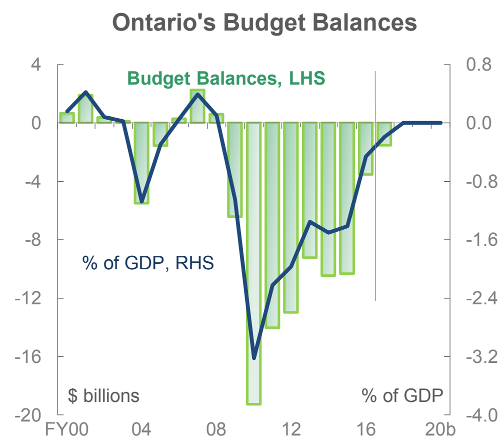
Chart 1



Source:: Ontario Finance; Statistics Canada; nominal GDP forecasts: Scotiabank Economics.

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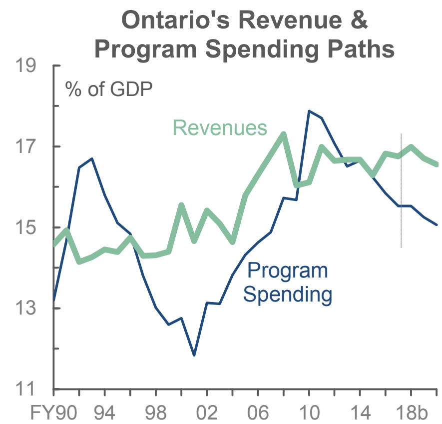
[1] See: *Ontario’s Fair Housing Plan: Multiple Measures with Uncertain Impact* (April 20, 2017).

THE REVENUE BOOST

The government for FY17 continued to improve upon the *Budget* estimates. From FY11 to FY17, reported deficits relative to the path laid out by *Budget 2010* are almost $27 billion narrower over the last seven years. Aided by historically low interest rates, the projected debt service of $11.6 billion is $4.6 billion less than the *Budget 2010* (chart 4).

Revenues in FY17 were a hefty $2.6 billion above *Budget,* raising growth from the expected 1.7% to 3.8%. Program spending is expected to be $1.4 billion higher than planned, reflecting pressures on all the major programs, but a $0.5 billion saving on the debt service offers a partial offset.

Chart 2



Source: Ontario Finance.

For FY18, a 6.3% surge in total receipts is forecast, anchored by solid tax expansion and the $1¾ billion of revenues expected from carbon allowances. For the next two years, revenue growth is expected to average a more moderate 2.7%. Federal transfers post a modest drag, in part due to the lower Equalization payments anticipated with Ontario's strong economic growth relative to the national average.

An area of uncertainty is the Land Transfer Tax that has escalated, alongside a very robust Greater Golden Horseshoe housing market, from $1.8 billion in FY15 to an estimated $2.7 billion in FY17. A further increase in this Tax to $3.1 billion in FY18 includes a new 15% transfer tax on non-resident home purchases as of last week. It also incorporates the Province's assumption that home resales will advance 4.3% this year and 2.8% next year after a 9.7% jump in calendar 2016, while resale home prices, after a 15.3% escalation last year advance a further 7.4% and 5.4% in 2017 and 2018, respectively. This projection reflects the government's objective of stabilizing the housing market, but projecting receipts is currently complicated.

Tax changes add just $75 million to FY18 receipts, escalating to $235 million in FY19. The increase is largely driven by a higher Tobacco tax. After the measures totaling $2.5 billion for Ontario taxpayers over three years to lower power prices on average for households by 25% and then restrict subsequent annual increases to the rate of inflation for at least four years, tax relief is understandably modest and centred on a refundable 15% Seniors transit credit as of July 1 at an annual estimated cost of $10 million. Municipalities will be granted the authority to municipalities to levy a hotel tax.

Ontario estimates its Marginal Effective Tax Rate (METR) on new capital investment by business to be 16.9% in 2016, down from 33% in 2009 and significantly lower than the current 34% US rate. Ontario's METR is expected to edge lower as input tax restrictions associated with the HST are phased out.

Carbon allowance proceeds are expected to generate $1¾ billion in FY18. The first compliance period started on January 1, 2017, and Ontario participated in its first allowance auction with Quebec and California in March 2017. The FY18 allowance proceeds will be primarily used for: assisting homes and businesses on low-carbon technologies ($800 million); implementing the Green Investment Fund and other investments ($410 million); modernizing transit and commuter cycling ($420 million); facilitating electric vehicles ($90 million). The government is developing carbon offsets and Ontario-based voluntary carbon offsets.

REINFORCED EXPENDITURE

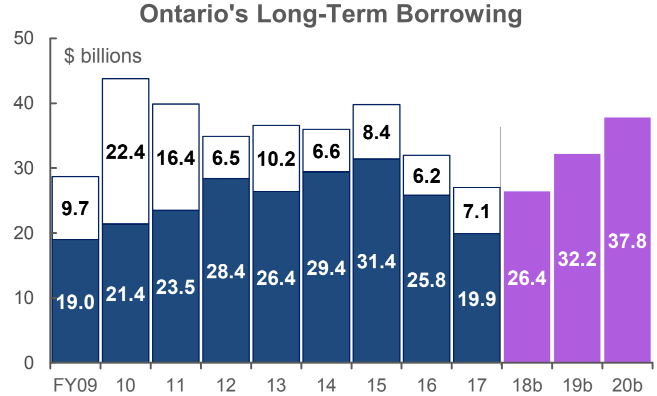
The broad expenditure increase in FY18 allows health spending increases across Ontario's four major program areas. Post-Secondary Education and Training leads with a 7.7% hike, Social Services outlay will rise 4.3% as assistance in the upcoming year climb 2.0% and health plus K-12 Education advance by 3.0%.

In the Fall of 2017, the restructured Ontario Student Assistance Program will provide a single upfront grant to cover tuition for more than 210,000 students and reduce costs for many more, with aid extend to adult learners. Moreover, 80% of the students from families with incomes less than $90,000 will not have to repay the grants and the minimum salary for repaying the provincial portion of these grants will be raised by $10,000 to $35,000. Diverse initiatives across the Province include further attention to Community hubs, expanded work-related experience opportunities for students and subsidies for new child care spaces.

The Province plans further expenditure adjustments to raise government's effectiveness. For example, A Behavioural Insights Unit is helping to better design programs and The Digital Government Action Plan is intended to accelerate and simplify service delivery. The government will continue to carefully oversee collective bargaining outcomes across the public sector and efforts continue with the federal government to limit tax evasion in the underground economy.

Retirement income security remains a focus. For pension plans in Ontario, the framework for a new solvency funding framework will be released this spring, with draft regulations this Fall. Proposed regulations on a framework for target benefit multi-employer pension plans also are promised for the Fall. For Defined Contribution Pension Plans, Ontario is exploring new approaches to the payout phase.

Chart 3



Weighted-average term of borrowings, years:
8.6 8.1 12.8 13.0 12.4 13.6 14.1 14.2 13.9
Source: Ontario Financing Authority.

EXPANDED INFRASTRUCTURE

Of the $156 billion infrastructure funding slated from FY18 to FY17, $56 billion (36%) is directed to transit, $26 billion (16.7%) to highways, and capital grants of more than $20 billion (12.8%) for hospitals and almost $16 billion (10%) for school boards. A *Long-Term Infrastructure Plan* is promised by the end of 2017.

The Trillium Trust is on track to realized $5.7 billion from asset optimization, with the $538 million net revenue gain from the sale of Hydro One shares in 2016 bring total inflows to $5.3 billion. In addition, Ontario Power Generation has reached an agreement to sell its Toronto head office with net revenues of over $200 million expected.

With respect to borrowing, Ontario is significantly raising its cash position, by $3.0 billion in FY17 and another $6.0 billion in FY18. It is a prudent measure, in part looking to the substantive maturities in the following two years.

OUTLOOK

This government's commitment to attain balanced books was demonstrated by the insurance built around last year's *Budget* estimates. The reserve was $1.0 billion in FY17 climbing to $1.2 billion in FY19; the Capital and Operating Contingency Funds totaled $1.2 billion and the economic forecast was conservative. This year the underlying economic assumptions remain reasonable, but the reserve is $0.6 billion in both FY18 and FY19, rising to $0.9 billion in FY20 and the Contingency Funds total $615 million. Admittedly less insurance, it should still be sufficient, although Ontario, referencing assistance to its softwood lumber industry with the 19.88% US countervailing duty announced this week, is certainly aware of the potential risks in policy changes south of the border.

As the US and other trading partners seek lower corporate income tax rates and a simpler regulatory environment, Ontario's should continue to seek new competitive advantages. With the strength of its business service sector, the METRS on services should be reassessed to move them closer to the rates applying to goods producers.

Progress in reducing its net debt relative to GDP may be greater than Ontario has laid out. Similar to other Provinces such as Alberta, in FY17, not all the infrastructure funding was spent, with the $14.2 billion revised estimate $1.9 billion less than the *Budget* plan. It is very likely that Ontario's infrastructure investment increases through FY20 will be very substantial but somewhat less than currently planned.

The government states that with a balanced *Budget* comes greater flexibility to face the demographic challenges of the next decade and the inevitable economic challenges and one-time events. Another aspect of prudence, therefore, should be the careful management of Ontario's expanded social program commitments. A concluding graph in this *Budget* shows net debt declining back to the pre-recession level just under 26% of GDP by March 2031, illustrating the second and very substantive stage of fiscal repair.

THE FISCAL PLAN: BY THE NUMBERS

Ontario's Economic Assumptions
annual % change except where noted

Scotiabank Economics, April 6, 2017

	16e	17f	18f
Canada-Real GDP	1.4	2.3	2.0
U.S.-Real GDP	1.6	2.3	2.4
Ontario- Real GDP	2.7	2.5	2.2
Nominal GDP	**4.2**	**4.8**	**4.0**
Employment	1.1	1.5	1.1
Housing Starts,000s	75	78	72
T-bills,3-mos,%*	0.5	0.5	0.9
Cda Bonds,10-yr,%*	1.3	1.8	2.2
Cdn Dollar, US¢*	76	73	75.5
WTI Oil,US$/bbl*	43	53	56

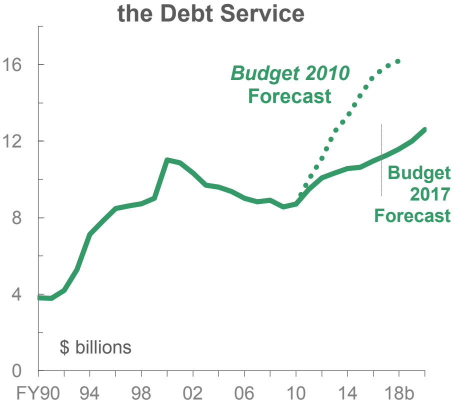
Ontario Finance

	16e	17f	18f	19-20f
Canada-Real GDP	1.4	2.1	2.0	1.8
U.S.-Real GDP	1.6	2.3	2.4	2.1
Ontario-Real GDP	2.7	2.3	2.1	1.9
Nominal GDP	**4.6**	**4.3**	**4.1**	**4.1**
Employment	1.1	1.3	1.2	1.0
Housing Starts,000s	75	72	68.5	71.5
T-bills,3-mos, %*	0.5	0.5	0.8	1.7
Cda Bonds,10-yr, %*	1.3	1.9	2.4	3.1
Cdn Dollar, US¢*	75.4	74.5	75.5	79.3
WTI Oil,US$/bbl*	43	54	59	63

* Annual averages. Source: Ontario Finance, Statistics Canada, Scotiabank Economics.

Chart 4

Ontario's Savings on the Debt Service



Source:: Ontario Finance.

Ontario's Budget Arithmetic
$ billions except where noted

	FY17 Budget	FY17 Rev.	FY18 Budget	FY20** Budget
Personal Income Tax	32.2	32.9	35.0	39.5
Corporations Tax	12.1	13.3	13.8	15.5
Harmonized Sales Tax	24.0	24.7	26.0	28.0
Ontario Health Premium	3.6	3.7	3.8	4.2
Other Taxes	20.0	20.5	21.4	23.1
Tax Revenue	**91.8**	**95.1**	**100.1**	**110.3**
Gov't Business Ent. Income	5.0	5.3	4.9	6.0
Other Non-Tax Revenue	9.1	8.5	11.0	8.1
Total Own-Source Rev.	**105.9**	**108.8**	**116.0**	**124.4**
Federal Transfers	24.6	24.4	25.7	24.9
of which Equalization	2.3	2.3	1.4	n.a.
Total Revenue	**130.6**	**133.2**	**141.7**	**149.3**
Health	51.8	52.2	53.8	58.1
K-12 Education	25.6	25.7	26.5	28.0
Post-Secondary Education	7.9	7.8	8.4	8.4
Social Services	15.8	16.2	16.9	17.4
Other Program Spending	21.0	21.6	23.9	23.9
Total Program Spending	**122.1**	**123.5**	**129.5**	**135.8**
Debt Service*	11.8	11.3	11.6	12.6
Total Expenditure	**133.9**	**134.8**	**141.1**	**148.4**
Reserve	1.0	0.0	0.6	0.9
Surplus (Deficit)	**-4.3**	**-1.5**	**0.0**	**0.0**
Long-Term Borrowing	**26.4**	**27.0**	**26.4**	**37.8**
New	4.8	6.0	8.8	10.3
Refunding	21.6	21.0	17.6	27.5
Annual Change, %				
Personal Income Tax	*3.3*	*5.6*	*6.5*	*6.2*
Corporations Tax	*5.4*	*16.8*	*3.5*	*5.9*
Harmonized Sales Tax	*2.2*	*5.3*	*5.4*	*3.8*
Tax Revenue	*0.0*	*3.5*	*5.3*	*5.0*
Total Own-Source Rev.	***0.4***	***3.1***	***6.6***	***3.6***
Federal Transfers	*7.8*	*6.7*	*5.3*	*-1.5*
Total Revenue	***1.7***	***3.8***	***6.3***	***2.7***
Health	*1.5*	*2.3*	*3.0*	*4.0*
K-12 Education	*2.6*	*3.0*	*3.0*	*2.8*
Post-Secondary Education	*2.9*	*2.0*	*7.7*	*-0.1*
Social Services	*1.4*	*3.7*	*4.3*	*1.6*
Other Program Spending	*-2.9*	*-0.4*	*10.8*	*0.0*
Total Program Spending	***1.0***	***2.1***	***4.8***	***2.4***
Total Expenditure	***1.5***	***2.2***	***4.7***	***2.6***
Memo Items, %				
Own-Source Rev. / GDP	13.3	13.7	13.9	13.8
Program Spending / GDP	15.4	15.5	15.5	15.1
Budget Balance / GDP	-0.5	-0.2	0.0	0.0
Debt Service* / Revenue	9.0	8.4	8.2	8.4

* FY17 & FY18 debt service ex $121mn & $292mn of interest capitalized during construction. ** Average annual % change: FY19-FY20. Source: Ontario Finance; Statistics Canada; nominal GDP forecast: Scotiabank Economics.