ONTARIO MAINTAINS FISCAL PLAN DESPITE WEAKER-TAN-EXPECTED REVENUES

Highlights

• There were few policy announcements to digest in Ontario’s Economic Outlook and Fiscal Review. The updated economic assumptions and fiscal projections keep the government on track to balance the budget in 2017-18, despite some modest tweaks to the profile.
• The deficit target for 2014-15 was maintained at $12.5 billion, as lower-than-planned revenues were offset by lower debt interest charges and a reduction in the contingency reserve.
• An updated economic outlook had little impact on the fiscal plan. The nominal GDP growth forecast is essentially unchanged from the May Budget, as a slightly weaker forecast for real economic growth is offset by a stronger inflation forecast.
• Government revenue measures were confined to enhancements, rather than tax increases. The Government plans on optimizing its take from government businesses and cracking down on the underground economy. As for the expenditure side of the ledger, the government’s lean spending growth targets remain intact.

Earlier this afternoon, the Ontario government released its fall economic statement, formally named the “Ontario Economic Outlook and Fiscal Review.” The publication updated the economic and fiscal assumptions incorporated in the 2014 budget and noted any variances. In line with the most recent private sector consensus forecast, the provincial economic growth assumptions are essentially unchanged from the May budget. A slightly reduced revenue profile is offset by lower debt interest charges to maintain the same path back to budget balance. The government continues to project a return to budgetary surplus by fiscal 2017-18.

Overall economic outlook going according to plan

The Ontario Government’s Review projects that economic growth in the province will accelerate from a disappointing 1.3% in 2013 to 1.9% this year, 2.4% in 2015, and maintaining that pace over the remainder of the horizon. That is a very slight downgrade in real GDP growth from the spring budget. However, due to slightly higher inflation the nominal GDP forecast, which is a reasonable proxy for revenue intake and growth in the tax base, is unchanged. Last month, we updated our Provincial Economic Forecast and TD Economics also expects Ontario’s economic growth to strengthen over the next couple of years. After a number of false starts, a sustained pick up in the U.S. economy is projected to boost Ontario’s manufacturing sector, aided by a weaker Canadian dollar.

Given the dramatic drop in oil prices recently, it is noteworthy
that the economic outlook highlights that lower oil prices on a sustained basis would provide a boost to Ontario’s economy. The Fall Update assumes an oil price (WTI) of $93 per barrel in 2015 and rising slightly thereafter. That assumption is higher than TD Economics’, and as such presents a possible upside to the province’s economic outlook over the next couple of years. Ditto for the Canadian dollar, which the government assumes will be slightly higher than our own view, presenting another source of upside to the province’s economic outlook.

Medium-term interest rates on Treasury Bills and the 10-year Government of Canada bond yield were lowered a touch relative to the budget estimates. The change is in line with expectations for interest rates to remain lower for longer, and the expectation that the Bank of Canada will not raise its overnight rate until the fourth quarter of 2015. Lower rates are expected to lighten the load of debt servicing costs. Even so, eight cents out of every dollar spent goes towards interest on debt. As large deficits continue, this burden will increase, with net debt-to-GDP slated to peak at 40.4% in fiscal 2015-16, before retreating slightly in the ensuing two years.

Primarily a status-quo fiscal plan

On net, there was little change to the overall fiscal plan. For the current fiscal year, 2014-15, the government used a portion of its contingency reserve to keep the deficit at $12.5 billion as projected. Developments since the 2014 budget are as follows:

- Total revenues in fiscal 2014-15 are $509 million lower than budgeted, reflecting lower-than-anticipated tax revenues in 2013-14 that carries forward over the medium term. The largest revenue disappointment was in Corporations tax revenue, which is down $398 million versus budget.
• This fiscal year, total expenses are also below the level projected in May ($208 million) due to lower interest rates and a one-time gain from the sale of asset-backed commercial paper. Despite unplanned program expenditures such as emergency forest firefighting and Ebola containment, offsets from contingency funds left overall program spending in line with budgetary projections.

The government had already raised certain taxes in Budget 2014, so there were no new revenue measures in the Update. Revenue enhancements dominated the update headlines, as the government plans to squeeze more profits out of government business enterprises and capture more tax proceeds currently lost to the underground economy. By taking steps to strengthen revenue integrity, the government generated $380 million in revenues in 2013-14, and plans to build on this progress with new measures. While ensuring the government is collecting as much of the revenues it is entitled to is a worthy goal, these measures are a rounding error relative to the government’s approximately $120 billion total annual revenue take.

In its efforts to “unlock the value of provincial assets”, the Ontario government recently received the initial report of the Premier’s Advisory Council on Government Assets entitled “Retain & Gain: Making Ontario’s Assets Work Better for Taxpayers and Consumers”. The panel’s initial recommendations suggest ways to improve customer service, increase efficiencies and maximize the value of government business to generate better returns for Ontarians. It identified between $2-3 billion that can be realized through selling off parts of Hydro One. It recommends retaining the LCBO in government hands, but various measures including a new pricing strategy, beefing up its online retailing and new store formats could enhance revenues for taxpayers. It also mentions that the relationship between the province and the private beer store monopoly should be revised. The Council will now move to the second phase of its review, and its activities and recommendations will inform the Province’s 2015 Budget process. The government had already booked $3.2 billion of its infrastructure funding to come from asset optimization in Budget 2014.

On the expenditure side, the government has held growth in program spending to an average of 1.2% per year from 2010 to 2014. However, an even tougher task lies ahead, as the government intends to hold program spending growth to an annual average of 0.8% over the next four years. The government said it intends to meet its program review savings target set out for the Program Review, Renewal and Transformation planning process in Budget 2014. The government highlighted its recently ratified a four-year deal with AMAPCEO members, which represents roughly 12,000 public servants, which has a two-year wage freeze, with wage increases in the out years being offset through changes to benefits and entitlements (a net-zero agreement). The government also highlighted it has introduced legislation to control executive compensation costs in the broader public sector, enhancing the governments’ authority over more public-sector organizations.

**Bottom line**

The Economic Outlook and Fiscal Review was largely status-quo, with the deficit still set to be eliminated in 2017-18. Lower interest rates are helping the government continue to meet its deficit-reduction targets, despite a lower revenue projection. However, the difficult work of expenditure restraint continues to loom on the horizon. The government intends to hold spending growth well below inflation over 2015-2018, with the toughest years for restraint in 2016-17 and 2017-18. The government stated that it is meeting its program review goals, but the years ahead will continue to be challenging for the Ontario public sector.

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