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TD Economics

Ontario Fall Economic Outlook & Fiscal Review

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HIGHLIGHTS

- Weaker economy trims revenue outlook by nearly \$1 billion owing largely to lower-than-expected corporate profits.
- Accordingly, a \$500 million deficit projected for FY 08-09
- Government provided little fiscal guidance for FY 09-10 and beyond
- In our view, budget position on track for a planning deficit (i.e. after reserve) of as much as \$4-\$5 billion.
- This \$4-5 billion is a “status-quo” outcome that does not factor in any additional major changes to tax and spending programs.
- These parameters could be altered going forward. As highlighted today, the government announced plans a complete examination of its spending.

While Provincial and territorial premiers met for a Council of the Federation meeting in downtown Montreal recently to discuss possible responses to the current economic situation, Ontario Premier McGuinty forewarned his constituents to brace for difficult times ahead. With the release of Ontario Finance’s “Economic Outlook and Fiscal Review” yesterday afternoon, we got peek of what this will look like from a fiscal standpoint.

In the near term, the highlight of this update is no doubt the fact that the government is on a path to record a \$500 million deficit for the current fiscal year (FY 08-09). In March, the government had planned a \$750 million reserve, from which it announced yesterday that it would draw \$550 million to partially offset its weaker-than-anticipated revenue intake.

In recent communications, TD Economics has made the point, along with other economists, that there is nothing

ONTARIO GOVERNMENT'S FISCAL POSITION				
(Millions of dollars, unless otherwise noted)				
	Actual		Budget 08	Fall update
	06-07	07-08	08-09	08-09
Revenues	90,397	97,122	96,920	96,002
% change	7.3	7.4	-0.2	-1.2
% of GDP	16.2	16.7	16.3	16.2
Expenditures	88,128	96,522	96,170	96,302
% change	5.0	9.5	-0.4	-0.2
% of GDP	15.8	16.6	16.2	16.2
Programs	79,297	87,608	87,279	87,411
% change	5.9	10.5	-0.4	-0.2
% of GDP	14.2	15.1	14.7	14.7
Debt charges	8,831	8,914	8,891	8,891
% of rev.	9.8	9.2	9.2	9.3
Balance	2,269	600	750	-300
% of GDP	0.4	0.1	0.1	-0.1
Reserve	0	0	750	200
Budget balance	2,269	600	0	-500
% of GDP	0.4	0.1	0.0	-0.1
Acc. Deficit	106,776	105,617	105,617	106,117
% of GDP	19.1	18.1	17.7	17.8

Source: Ontario Ministry of Finance.

inherently wrong with running a budget deficit during a period of cyclical slowdown as long as it is contained and does not extend out for years. The \$0.5 billion shortfall is but 0.1% of nominal GDP, while the accumulated deficit-to-GDP will not increase in FY08-09 – in fact edging lower by 0.3 percentage points from the last fiscal year to settle at around 17.8%. By our calculation, the fiscal position is headed for a much more significant deterioration in FY 09-10. Yet there was little guidance provided on how long the period of red ink might last. For those details, we will likely have to stay tuned for budget 2009.

The most important developments since the March Budget 2008 lay clearly on the revenue side. When compared to Budget 2008, weaker revenues account for 87% of the current deficit forecast, while higher-than-expected expenses account for the remainder. The 2008 real GDP growth outlook for the province had been trimmed by a

percentage point from 1.1% to 0.1%, which is close to that of TD Economics (0.3%).

At the time of Budget 2008, total revenues were expected to be very near \$97 billion, whereas the revenue outlook currently stands at \$96 billion. Within revenue sources, it is the corporate tax receipt outlook, lowered by \$880 million, that leads the overall downward revision. Corporate profits were forecast to rise by 4% at the time of the Budget, while the government now expects corporate profits to slide by 5%, in line with the latest private sector forecasts. Declines in other revenue sources – namely land transfer and gasoline tax receipts – were partially offset by higher-than-expected federal government transfers. On the expenditure side, not much has changed since Budget 2008, save for \$100 million higher-than-expected outlays related to OHIP. However, this conceals the fact that the government will work this year to secure some modest spending savings in the order of \$100 million by slowing down some new spending.

“Status-quo” deficit as high as \$4-5 billion in 09-10

The fiscal challenges for the province will only intensify in FY 09-10, as real economic growth remains negligible. However, this combined impact of the slowdown in 2008 and 2009 is likely to hit the books harder. Although the government did not provide an updated forecast on FY 09-10, we estimate that the government’s “status-quo” planning deficit (i.e., budget balance after deducting the usual reserve amount and not building in any additional tax and spending changes) could be as high as \$4-\$5 billion. That amount is not far off the shortfall the government faced when it came into office in 2003 but well below the deficits in Ontario in the early 1990s. But while the McGuinty government managed to eliminate its earlier shortfall in 2 years,

ONTARIO ECONOMIC & FINANCIAL ASSUMPTIONS				
(Per cent change, unless otherwise noted)				
	TD Economics*		2008 Fall Update	
	2008	2009	2008	2009**
Real GDP	0.3	0.8	0.1	0.7
Nominal GDP	2.5	2.4	2.1	2.2
CPI	2.6	2.0	2.3	2.0
Employment	1.4	-0.4	1.5	0.4

*As at Oct. 2008. Source: Ontario Ministry of Finance
** Average private-sector forecast

the process was supported by booming revenue growth. Although we expect the economy to strengthen by the second half of 2010, we don’t foresee revenues coming back all that strongly over the medium term, especially as corporate tax-loss carry forwards kick in.

In sum, the government will face difficult choices as it plans its 2009 budget. At the very least, a timetable will need to be established on when the fiscal balance will be brought back into line. The government has indicated that it will carry out a broad examination of its spending. In any event, we would argue against undertaking quick fixes to resolve its near-term budget difficulties.

The province’s near-term fiscal challenges do not negate the need for longer-term thinking. As we discuss at length in “Time for a Vision of Ontario’s Economy”, the province is facing significant challenges that won’t be resolved even by a medium-term recovery in the U.S. economy. It is important that the government begin the process of developing a blueprint for where it wants to take the economy down the road and how it will get there so that when activity firms – probably by late 2009 – it can hit the ground running. In the meantime, policy areas that don’t require major fiscal outlays, such as enhancing trade, should continue to be pursued vigorously.

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