



HIGHLIGHTS

- Deficit of \$19.7bn (3.3% of GDP) is projected for FY 10-11, but better deficit profile from fall update.
- No major surprises in spending or taxes, with government committed to implementing plans laid out in previous year's budget.
- Aim to restrain spending growth by freezing salaries and curbing the health care "Pac Man".
- Ontario projects an elimination of its deficit by FY 17-18 (two years later than projected in Budget 2009).
- Net debt to rise to over 40% of GDP by FY 12-13, and only slowly ease from that historic high as the budget is balanced - a possible red flag for rating agencies.
- By rolling over maturing debt at favourable interest rates, Ontario expects to maintain low effective interest rates on its debt (though this is subject to substantial risk around market conditions).
- Growth projections are conservative, with GDP growth slowing in the later years, but many recent tax measures should spur Ontario's productivity.

Derek Burleton, AVP and Director of Economic Analysis
416-982-2514
mailto:derek.burleton@td.com

Grant Bishop
Economist, Canada
416-982-8063
mailto:grant.bishop@td.com

A LONG ROAD BACK TO BALANCE

As was widely expected, the Ontario government has laid down a plan that stays the course on previously-announced short-term stimulus measures, before gradually whittling down the shortfall to zero by FY 17-18. The chosen time frame for a zero deficit has been extended by a full two years compared to that envisaged in Budget 2009, when the government (and private-sector economists) were just beginning to grapple with the severe impacts of the recession. Looking out beyond the next year, the government continues to bank on allowing the temporary stimulus programs to expire and holding trend spending growth to less than 2% per year beginning in FY 12-13 in order to achieve its objectives.

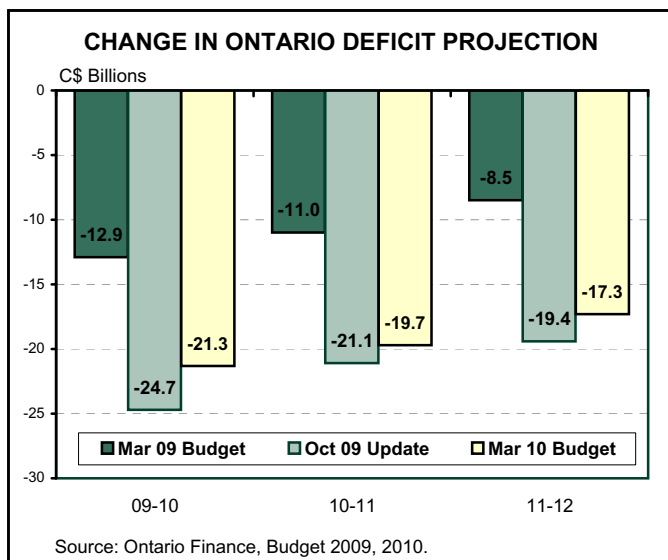
In terms of specific measures, today's budget was devoid of major surprises. Consistent with this month's Speech from the Throne, the government made room in its spending envelope to allocate additional core funding to high priorities in the short term – notably post-secondary education, Northern/Aboriginal communities, child care and full day learning for children 4-5 years. The government also confirmed that it will press ahead with reforms to the retail sales tax and a string of tax reductions announced last year, but no new major tax increases (nor decreases) were unveiled. Asset sales will continue to be mulled over as part of the government's review of operations, but, as expected, no specific plans on assets were announced today.

No doubt, dragging out deficit elimination over such an extended period carries with it risks. Notably, there is a heightened probability that nasty economic and financial surprises emerge along the path. The province's net debt-to-GDP ratio is poised to rise from about 25% pre-recession to above 40% by FY 12-13, which

ONTARIO GOVERNMENT FISCAL POSITION									
[C\$ millions of dollars, unless otherwise noted]									
	Est.	Projection							
	09-10	10-11	11-12	12-13	13-14	14-15	15-16	16-17	17-18
Revenues	96,400	106,900	107,700	112,000	117,600	123,400	129,600	136,100	142,900
% change	-0.5	10.9	0.7	4.0	5.0	4.9	5.0	5.0	5.0
% of GDP	17.0	18.1	17.3	17.1	17.1	17.2	17.3	17.5	17.6
Expenditures	117,700	125,900	124,100	126,900	129,900	133,200	136,500	139,300	141,900
% change	13.9	7.0	-1.4	2.3	2.4	2.5	2.5	2.1	1.9
% of GDP	20.7	21.3	20.0	19.4	18.9	18.6	18.2	17.9	17.5
Programs	108,800	115,900	112,900	114,300	116,500	118,700	121,000	123,300	125,700
% change	14.8	6.5	-2.6	1.2	1.9	1.9	1.9	1.9	1.9
% of GDP	19.2	19.6	18.2	17.5	16.9	16.5	16.2	15.8	15.5
Debt charges	8,900	10,000	11,100	12,500	13,300	14,400	15,400	15,900	16,200
% of revenues	9.2	9.4	10.3	11.2	11.3	11.7	11.9	11.7	11.3
Balance	-21,300	-19,000	-16,400	-14,900	-12,300	-9,800	-6,900	-3,200	1,000
% of GDP	-3.8	-3.2	-2.6	-2.3	-1.8	-1.4	-0.9	-0.4	0.1
Reserve	0	700	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Budget balance	-21,300	-19,700	-17,400	-15,900	-13,300	-10,800	-7,900	-4,200	0
% of GDP	-3.8	-3.3	-2.8	-2.4	-1.9	-1.5	-1.1	-0.5	0.0
Acc. Deficit	127,417	147,117	164,517	180,417	193,717	204,517	212,417	216,617	216,617
% of GDP	22.5	24.8	26.5	27.6	28.2	28.5	28.4	27.8	26.7
Net Debt *	193,226	219,991	245,000	267,800	288,758	301,463	310,683	319,217	316,095
% of GDP	34.1	37.1	39.4	40.9	42.0	42.0	41.5	41.0	39.0
Nominal GDP (\$Bn)	567.3	592.2	621.8	654.8	687.5	717.8	748.6	778.6	810.5
% Change	-3.5	4.4	5.0	5.3	5.0	4.4	4.3	4.0	4.1

Source: Ontario Ministry of Finance; post-2011 GDP forecast based on private sector average; Calculations by TD Economics

* Post-2013 values estimated by TD Economics based on Ministry of Ontario data



about \$3 billion in FY 09-10. Consistent with the perking up in the Ontario economy in recent months, private-sector forecasters (on which the government bases its projections) have raised their real GDP estimates moderately for 2010, which is expected to yield additional revenues on the order of \$1 billion beginning in FY 10-11. These changes are captured in the lower deficit profile.

Looking out over the medium term, the private sector continues to bet on a protracted recovery in the Ontario economy owing to the structural problems in the United States, a high Canadian dollar and other longer-term headwinds. Compared to TD Economics, the budget real GDP growth assumptions are similar on average, despite some variation on an annual basis.

The tepid economic recovery projected provides a partial explanation for the slow descent in the deficit over the next few years – a development that no doubt will raise eyebrows among analysts especially given the fact that a number of recent spending associated to the auto bailout, infrastructure and other short-term stimulus measures are only temporary in nature. In addition, sharply rising debt service charges, tax-loss carry-forwards and the implementation of some previously announced tax reductions (i.e., CIT) lead to some stickiness in the deficit.

The debt-charge component of government spending alone contributes between half and a full percentage point to overall outlays throughout the forecast period. Accordingly, in order to make any headway at all on the deficit the government will need to meet its target of constraining program spending growth to about 2% on a trend basis. In order to move it closer to that goal, the government plans to slow down the growth rate of health care spending – the Pac Man of the provincial budget – to about 3% by FY 12-13.

There are plans to freeze salaries of non-union broader public service employees as well as internal administration costs at or below FY 10-11 levels over the medium haul. In

	Share (%) 09-10	Annual Percentage Change			Share (%) 12-13
		10-11	11-12	12-13	
Health	37.0	6.0	4.1	3.1	39.0
Education	17.5	3.9	4.2	3.1	18.1
PSE	6.1	12.5	-12.3	-1.4	5.5
Other	31.9	7.5	-11.9	-1.7	27.5
Debt	7.6	12.4	11.0	12.6	9.9
Total	100	7.0	-1.4	2.3	100

Source: Ontario Ministry of Finance

could raise concerns about a potential ratings downgrade for Ontario. At the same time, however, the government has taken action to mitigate these risks by incorporating into the budget plan reserve allowances and other contingency funds (although the allocated reserves were reduced from last year's budget). What's more, Ontario's economy may be rebounding at a faster pace than what's prudently incorporated into today's budget.

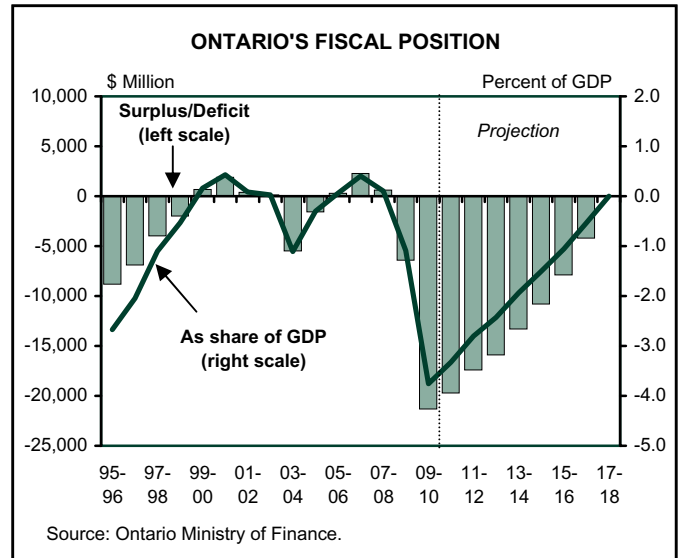
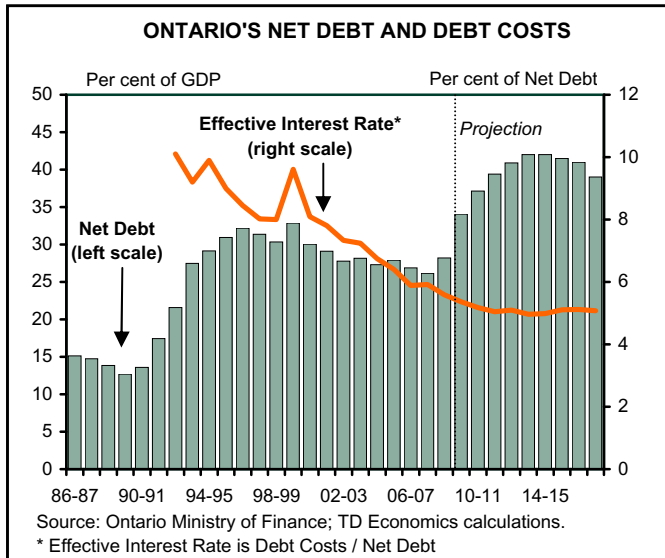
Near-term deficit projections lowered since Update

The government's Fiscal Update last October was particularly eye-opening in that it raised the deficit profile substantially. In that Update, the government hiked its three-year deficit profile by \$10 billion per year beginning in FY 09-10 as shown in the plot below. These revisions were due in large part to the more severe fiscal effects of the recession and the ongoing impact of weaker-than-expected final results for FY 08-09. In addition, the government booked about \$5 billion in one-time expenditures into the current year, largely reflecting the moves to bail out the auto sector and to fight H1N1.

Since the Update, the government's near-term budget profile has improved on the back of downwardly-revised spending estimates. Notably, outlays for H1N1, infrastructure and debt-service charges were scaled back by a total of

	TD Economics*		2010 Budget^	
	2010	2011	2010	2011
Real GDP	3.2	3.0	2.7	3.2
Nominal GDP	4.5	4.8	4.4	5.0
CPI	1.8	2.2	1.9	2.1
Retail sales	4.2	4.3	3.9	4.6
Housing starts ('000s)	67.0	57.0	58.0	60.0
Employment	1.5	1.3	1.1	2.1
Implied Productivity	1.7	1.7	1.6	1.1
Unemployment rate, %	9.0	8.7	9.1	8.5
10-year GoC Bond Rate	3.8	4.5	3.7	4.2

*As at March 2010. ^ Ontario Ministry of Finance



addition to a continued review of departmental programs, the government plans to carry out an assessment of its infrastructure plans by the end of this year with the aim of slowing the pace of some of the planned projects – notably of Metrolinx.

As noted at the outset, new initiatives were relatively modest as a share of the overall budget. Creating 20,000 spaces at colleges and universities will come at a price tag of about \$310 million. A roughly equivalent amount will be earmarked to kick-start the full-day learning later this year. Initiatives aimed at northern communities, including the electricity rate program and an energy credit, amount to about \$200 million per year.

Mixed implications for bond market

Today’s budget has mixed implications for bond markets. The downward adjustment to the deficit profile over the next few years compared to the Fall Update implies about \$8 billion less in funding requirements over that period. Still, news that the province’s net debt-to-GDP is poised to climb above 40% for the first time on record is unlikely to be lost on bond investors. On the plus side, with interest rates expected to move up only gradually, especially for long-term maturities, the cost of the province’s debt is likely to remain favourable. In particular, the effective interest rate, which is represented by the ratio of interest payments to the stock of debt outstanding, is projected to hold at a low 5% (see chart). Ontario’s long-term public borrowing requirements, which include funding the deficit, capital assets and

refinancing needs, are projected to ease slightly from \$43 billion in FY 09-10 to about \$40 billion in each of the next three fiscal years.

Bottom Line

The strategy undertaken by Ontario is becoming a common theme in this year’s federal/provincial budget season. More specifically, governments across the country are preserving the status-quo in the short run to help keep their recoveries on track, before moving to gradually eliminate shortfalls by tightening up on the spending reins. However, because Ontario is beginning in a larger budget hole than the federal government and the other big provinces, its deficit-elimination horizon is relatively prolonged.

In our view, the balance of risks facing the budget projections appears to be skewed to the positive side in the near term – especially in light of the recent momentum that has been building in the Ontario economy. Longer-term, however, the go-slow approach on deficit reduction, the sharply rising net debt-to-GDP ratio and the uncertain impact on economic growth from an aging population clearly represent significant negative risks. Happily, the government has been undertaking a number of measures to raise the economy’s longer-term growth potential, which will help to counterbalance these longer-term risks. In particular, efforts to harmonize the sales tax with the GST and reduce corporate income and capital taxes brighten the long-term outlook for business investment, which in turn, should spur productivity growth in Ontario.



This report is provided by TD Economics for customers of TD Bank Financial Group. It is for information purposes only and may not be appropriate for other purposes. The report does not provide material information about the business and affairs of TD Bank Financial Group and the members of TD Economics are not spokespersons for TD Bank Financial Group with respect to its business and affairs. The information contained in this report has been drawn from sources believed to be reliable, but is not guaranteed to be accurate or complete. The report contains economic analysis and views, including about future economic and financial markets performance. These are based on certain assumptions and other factors, and are subject to inherent risks and uncertainties. The actual outcome may be materially different. The Toronto-Dominion Bank and its affiliates and related entities that comprise TD Bank Financial Group are not liable for any errors or omissions in the information, analysis or views contained in this report, or for any loss or damage suffered.