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ONTARIO ON TRACK FOR FISCAL BALANCE

Highlights

- The Government of Ontario tabled its 2017 Budget Plan today, indicating that it is on track to record its first balanced budget in a decade this fiscal year. It expects to remain in balance for the following two fiscal years.
- The Budget Plan does not contain any new revenue generating measures, relying only on robust economic growth and carbon allowance proceeds to drive revenues 6.4% higher this year before moderating to under 3% over the subsequent two years.
- There were some new spending initiatives with a focus on healthcare and education, driving spending growth up to 4.7% this year before slowing in line with revenue growth.
- Net debt is expected to edge down to 37.5% of GDP in the current fiscal year, with a medium term plan to reduce it to 35% by FY 2023-24. This remains quite elevated relative to pre-recession levels.

The Government of Ontario tabled its 2017 Budget Plan today, indicating that it is on track to record its first balanced budget in a decade this fiscal year (FY). The balanced projection for FY2017-18 follows a downwardly revised estimated $1.5 billion deficit for FY2016-17.

Budget Plan 2017 did not contain much in the way of new revenue measures, but includes some new spending initiatives, with a focus on healthcare and education. Still, the government plans to maintain the balanced budget for the following two years, with a $600 million reserve allowance built in. Net debt as a share of GDP is expected to edge down slightly to 37.5% in FY2017-18. The province has a medium term goal of bringing that ratio down to 35% by FY2023-24, which is still quite elevated relative to levels seen prior to the recession.

Strong economy generating revenues

Last year's budget gap came in at $1.5 billion, much smaller than the $4.3 billion shortfall expected in the 2016 Budget Plan. The outperformance was driven in large part by higher revenues, with corporate taxes accounting for a significant chunk. Personal income, sales and land transfer taxes were also higher than expected. On the spending front, higher-than-expected spending on healthcare, education and social services was largely offset by lower interest-servicing costs.

Going forward, the government expects Ontario's strong economy to continue generating higher revenues for the Province. Economic growth is forecast to clock in at 2.3% in 2017 and closer to 2% in the following two years with

GOVERNMENT OF ONTARIO FISCAL PLAN
[C$ billions, unless otherwise noted]

	2017 Budget Plan			
Fiscal Year	**16-17**	**17-18**	**18-19**	**19-20**
Revenues	**133.2**	**141.7**	**144.9**	**149.3**
% change	3.8	6.4	2.3	3.0
Expenditures	**134.8**	**141.1**	**144.3**	**148.4**
% change	1.0	4.7	2.3	2.8
Reserve	0.0	0.6	0.6	0.9
Budget Balance	**-1.5**	**0.0**	**0.0**	**0.0**
Net Debt	**301.9**	**311.9**	**323.3**	**335.9**
% of GDP	37.8	37.5	37.3	37.2

Note : Numbers may not add up due to rounding. Source: Ontario Ministry of Finance; As at April 2017.

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employment growth projected to hold at just over 1% over the forecast horizon. On the whole, this is not materially different from our GDP forecast.

The government expects the housing market to cool over the remainder of 2017, as past erosion of affordability and the impact of the recently announced Fair Housing Plan take hold. For the year as a whole, the government expects home sales and prices to rise 4% and 7%, respectively, down from growth of 10% and 15% in 2016. Next year, the Budget Plan projects moderate further growth in activity and prices. There is a great deal of risk surrounding this outlook, particularly for next year due to the uncertainty as to how the new provincial housing measures will ultimately impact the market.

On the other hand, the government has touted Ontario's business environment as highly competitive and is forecasting a fairly robust pace of growth in business investment after this year. Here too risks resides related to tax reform proposals underway in the U.S. targeting a significantly lower corporate income tax rate of 15%. Moreover, any border thickening measures put in place could also hinder Ontario exports and investment. The significant risks surrounding the outlook for the business environment calls for caution as far as the fiscal plan.

Balancing the budget

Revenues are expected to rise by over $8 billion, or 6.4%, in this fiscal year – slightly faster than was projected in last year's budget. Taxation revenue is forecast to grow by over $5 billion, while carbon allowance proceeds are expected to add nearly $1.8 billion. Much of the rise in taxation revenue stems from sales and personal income taxes. However, land transfer taxes are also projected to rise by 17% this fiscal year, despite the anticipated cooling in the housing market. In light of the uncertainty surrounding the outlook for the housing market, this may also prove too optimistic a forecast.

Budget Plan 2017 contained some new spending initiatives focused on healthcare and education, with total spending expected to rise by 4.7% in FY2017-18. The Province is injecting an additional $7 billion (relative to Budget 2016) in healthcare investments, bringing the spending to $11.5 billion over three years. Initiatives will be taken to improve access to care, expand mental health and reduce wait times. These initiatives include several new major hospital projects. Moreover, the Province will launch the OHIP+ program, which will fully cover the cost of prescription medications for everyone up to and including age 24. Certainly a welcomed measure for Ontario families, but a more fiscally prudent approach would have been to apply this on a means-tested basis.

ONTARIO ECONOMIC PLANNING ASSUMPTIONS
percent change (unless otherwise noted)

	2016	2017F	2018F	2019F
Real GDP	2.7	2.3	2.1	2.0
Nominal GDP	4.6	4.3	4.1	4.2
Unemployment Rate (%)	6.5	6.4	6.3	6.2
Employment	1.1	1.3	1.2	1.1
Housing Starts (thousands)	75.0	72.0	68.5	71.0
Existing Home Sales	9.7	4.3	2.8	3.2
Average Home Prices	15.3	7.4	5.4	5.2

Sources: Ontario Ministry of Finance; As at April 2017.

An additional $6.4 billion over three years has been earmarked for education, including infrastructure improvements and enhancing the Ontario Student Assistance Program (OSAP), which will provide 210k students with free post-secondary tuition.

All told, with planned revenue growth outpacing that of spending, the government expects to balance the budget this year, after allowing for a reserve of $600 million. The balanced fiscal position is expected to extend through the next two years, after allowing for reserves of $600 million next year and $900 million in FY2019-20.

Net debt to remain elevated

While eliminating the deficit is a step in the right direction, Ontario's hefty debt burden remains a key issue for the Province. After peaking in FY2014-15 at 39.1%, net debt as a share of GDP has been declining only slowly, reaching an estimated 37.8% in FY2016-17. The Province's balanced fiscal position combined with projections for strong nominal GDP growth should help the ratio edge down to 37.5% this fiscal year.

Budget Plan 2017 expects the debt load to fall further, reaching 35% by FY2023-24. But, this would make for a very gradual decline to more normal levels of debt. The last time the debt-to GDP ratio was below that still-elevated level was in FY2010-11. The lofty debt burden is still manageable given the very low interest rates, but leaves government finances vulnerable to any unanticipated rise in interest rates or a potential downturn in the economy – something that investors will be keeping an eye on.

Bottom Line

Overall, Ontario's Budget Plan marks a milestone, with provincial finances on track to return to black in FY2017-18 and the budget expected to be balanced over the following two years. The Province is banking on a strong economy and a soft landing in housing to keep revenue growth humming along. The government plans to use the additional revenue generated to increase spending on key focus areas, leaving little in the way of surpluses to rein in the debt load. As such, while the government's fiscal position has improved, it is important not to lose sight of the fact that debt remains elevated and the Province remains vulnerable in a very uncertain economic environment.