FALL 2015 ONTARIO FISCAL AND ECONOMIC UPDATE

TD Economics

November 26, 2015

SLOWER NEAR-TERM GROWTH WON'T THROW ONTARIO OFF TRACK

- In the 2015 Ontario Economic Outlook and Fiscal Review released this afternoon, Ontario Minister of Finance Charles Sousa provided an updated outlook for the provincial economy and its fiscal situation. Despite a weaker economic backdrop, the Ontario government announced it is still on track to balance its budget by FY2017-18. Meanwhile, net debt will likely stabilize at a marginally higher-than-previously projected 40.2% of GDP this year, before edging slightly lower in FY2017-18.
- The deficit is anticipated to clock in at $7.5 billion (1.0% of GDP) in FY2015-16, or about $1 billion less than was projected in 2015 Budget. The deficit is expected to narrow to just $4.5 billion by FY2016-17 with the budget balanced in FY2017-18.

Ontario government lowers its economic expectations…

- Lower oil prices, a weaker Canadian dollar, and strong U.S. economic growth are seen as the three key factors underpinning the relatively robust economic outlook for the Province.
- According to the update, which applies some prudence to what is otherwise a private sector average, the Ontario economy is estimated to expand by about 1.9% this year – a marked deterioration from the 2.7% real GDP growth that was penciled in during the 2015 Ontario Budget. The deterioration in nominal GDP is even more stark, with 2015 growth of 2.9% expected in current dollars – about 1.3 percentage points lower than in the last Budget.
- The outlook for 2016 and 2017 remained largely intact. Growth is expected to average 2.2% next year – about 0.2 percentage point slower than in 2015 Budget – and accelerate to 2.3% by 2017 (0.1pp higher than expected at Budget time). Nominal GDP growth was also little changed from the projections published at the 2015 Budget, with 2016 growth of 4.2% (unchanged from Budget) and 4.4% in 2017 (+0.2pp higher than in Budget document).
- Given the substantial near-term weakness, the level of nominal GDP will remain lower over the medium-term than expected at the time of the 2015 Budget.

…but boosts revenue expectations

- Still, despite the current year downgrade in nominal GDP, which is expected to reduce revenues by about $500 million this fiscal year, the Province's total revenue projection for FY2015-16 is $125.6 billion, or about $1.2 billion higher than forecast in the 2015 Budget. This improvement is largely a function of additional revenues from the Hydro One initial public offering (+$1.1 billion) and prior-year adjustments related to personal income and corporate taxes (+$600 million).

ONTARIO ECONOMIC PLANNING ASSUMPTIONS
Annual, percent change (unless otherwise noted)

	2014	2015	2016	2017	2018
Real GDP Growth					
2015 Fall Update	2.7	1.9	2.2	2.3	2.1
2015 Budget	2.2	2.7	2.4	2.2	2.1
TD Economics**	2.7	2.0	2.4	2.0	1.8
Nominal GDP Growth					
2015 Fall Update	4.1	2.9	4.2	4.4	4.2
2015 Budget	3.6	4.2	4.2	4.2	4.1
TD Economics**	4.1	2.9	4.4	4.0	3.8
Canadian Dollar (US$ per C$)					
2015 Fall Update	90.5	78.5	75.5	78.0	82.0
2015 Budget	90.5	79.5	80.0	85.0	89.0
TD Economics**	90.5	78.3	73.2	80.5	83.3
3-month Treasury Bill Rate* (%)					
2015 Fall Update	0.9	0.5	0.6	1.5	2.7
2015 Budget	0.9	0.6	1.1	2.5	3.4
TD Economics**	0.9	0.5	0.5	0.9	1.7
10-yr Gov't Bond Rate* (%)					
2015 Fall Update	2.2	1.5	2.0	3.1	3.8
2015 Budget	2.2	1.8	2.7	3.8	4.2
TD Economics**	2.2	1.6	2.0	2.4	2.9

Notes: *Government of Canada securities; **As at November 2015.
Sources: Ontario Ministry of Finance; TD Economics.

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- Medium-term revenues are also expected to be higher than forecast in the 2015 Budget. While the lower level of nominal economic activity is projected to subtract $300 to $400 million from revenues in FY2016-17 and FY2017-18, respectively, this is expected to be more than offset by higher revenues from Ontario's Cap and Trade program (+0.3 and +1.3 billion, respectively) and a higher tax revenue base (+100 million each).
- As such, revenue is now expected to grow by an annual average of 4.5% between 2015-2016 and 2017-2018 – slightly higher than the 4.3% planned for in the Budget.

Expense restraint still planned

- A lower-than-expected interest rate environment is expected to save the government roughly $0.6 billion over the next three fiscal years combined. However, even with substantially reduced interest charges, the Ontario government is expecting average annual expense growth of 1.3% per year between FY2015-16 and FY2017-18, compared to the 1.0% expected in Budget 2015.
- Most of the additional expenses are expected to hit in FY2015-16 and are tied to unexpected one-off events. Higher expenses in FY2015-16 are largely due to the government's intent to invest $325 million in a Green Investment Fund, targeted at reducing greenhouse gas emissions, and an additional $63.0 million in asset management costs associated with the Hydro One initial public offering. Other additional expenses include emergency forest firefighting (+$29.6 million), refugee crisis support (+$3.8 million) and a land claim settlement with Rainy River First Nations (+$4.5 million). The government dug into its contingency fund to cover some of these additional costs, while lower interest rates will help save an addition $140 million in interest costs than was planned for in Budget 2015. Overall expenses are only expected to grow by an average of 0.7% per year over FY2016-17 and FY2017-18.

Implications

- The downgrade to current year economic activity is not surprising given the weak start to 2015, with both GDP and employment figures surprising to the downside. Moreover, the government's assumptions for economic growth over the medium-term appear realistic and are largely in line with our own forecasts for provincial growth.
- We see more risk as far as revenue projections are concerned. The drag on revenue growth from slower economic growth is somewhat less than suggested given the hit to nominal GDP due to what the government chalks up to "favourable compositional factors." At the same time, the additional revenue expected to be generated by the Cap-and-Trade program, while reasonable, is a preliminary estimate.
- Having said that, should revenue hold up as projected, it will help the Ontario government stick to its plans to invest a massive $134 billion in infrastructure over the next 10 years, which could provide a welcome boost to economic activity.
- Expenditures in Ontario have grown by an average annual rate of 5.2% since the late 1980's and by about 2% over the last five years. In light of this, keeping spending growth contained at around 1.3% between FY2015-16 and FY2017-18 – a rate below that of projected inflation – while the economy is growing may be a tall order. As such, getting back to balance by 2017-18 is going to require some hard work on the government's part.

GOVERNMENT OF ONTARIO FISCAL POSITION [C$ billions of dollars, unless otherwise noted]								
	Actual					2015 Fall Update Plan		
Fiscal Year	**10-11**	**11-12**	**12-13**	**13-14**	**14-15**	**15-16**	**16-17**	**17-18**
Revenues	**107.2**	**109.8**	**113.4**	**115.9**	**118.5**	**125.6**	**129.5**	**135.3**
% change	11.3	2.4	3.3	2.2	2.3	6.0	3.1	4.5
% of GDP	17.0	16.6	16.7	16.7	16.4	16.9	16.7	16.7
Expenditures	**121.2**	**122.7**	**122.6**	**126.4**	**128.9**	**132.2**	**132.8**	**134.1**
% change	4.9	1.3	-0.1	3.1	2.0	2.6	0.5	1.0
% of GDP	19.2	18.6	18.0	18.2	17.8	17.8	17.2	16.6
Programs	**111.7**	**112.7**	**112.2**	**115.8**	**118.2**	**120.9**	**120.6**	**121.3**
% change	4.5	0.9	-0.4	3.2	2.1	2.3	-0.2	0.6
% of GDP	17.7	17.1	16.5	16.7	16.4	16.3	15.6	15.0
Debt charges	**9.5**	**10.1**	**10.3**	**10.6**	**10.6**	**11.3**	**12.2**	**12.9**
% of rev.	8.8	9.2	9.1	9.1	9.0	9.0	9.4	9.5
Reserve	0	0	0	0	0	1.0	1.2	1.2
Balance	**-14.0**	**-13.0**	**-9.2**	**-10.5**	**-10.3**	**-7.5**	**-4.5**	**0.0**
% of GDP	-2.2	-2.0	-1.4	-1.5	-1.4	-1.0	-0.6	0.0
Net Debt*	**214.5**	**235.6**	**252.1**	**267.2**	**284.6**	**298.3**	**311.2**	**318.4**
% of GDP	34.0	35.7	37.1	38.5	39.4	40.2	40.2	39.4

Note : Numbers may not add due to rounding. Source: Ontario Ministry of Finance. As at November 2015.