Striking Balance

A Publication of BMO Capital Markets Economic Research • Douglas Porter, CFA, Chief Economist, BMO Financial Group

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The **Province of Ontario is projecting a small $1.3 billion deficit for FY23/24**, roughly in line with the $2.2 billion shortfall now expected for FY22/23. These deficits weigh in at just 0.1% or 0.2% of GDP, and the upcoming fiscal year builds in an explicit $1 billion reserve allowance, so one can think of the budget as effectively balanced. Recall that Ontario already ran a small surplus in FY21/22, so this would mark three years of effectively balanced books.

In a nutshell, revenues have surged alongside a strong post-pandemic economic recovery and high inflation, while spending has fully kept pace. From FY21/22 (when the budget first returned to balance), revenues have jumped more than 10%, while base program spending surged almost 20% (some time-limited COVID and one-time items have fallen out). To be fair, the CPI in Ontario is up 12% over the past two years, and the population has grown by 4%, highlighting the upward pressure on nominal spending.

Over the medium term, Ontario sees small surpluses beginning in FY24/25, along with a downward drift in the net debt-to-GDP ratio from this year's 37.8% mark.

Summary of Major New Policy Measures:

- Ontario Made Manufacturing Investment Tax Credit: A 10% refundable **corporate tax credit for capital investment in buildings, machinery and equipment used in manufacturing** or processing in the province. The credit is available for qualifying investments up to $20 million per tax year. The cost is estimated at $215 million in FY23/24.
- Extending the **gas tax** cut for another year, to the end of 2023.
- Enhancements to the Guaranteed Annual Income System program for **seniors** by expanding eligibility and indexing benefits to inflation, as of July 2024.
- The previously announced extension of the phase-out range for the **small business corporate tax rate** will apply to tax years starting on April 7, 2022. The phase-out range would apply to businesses with $10-50 million in taxable capital employed in Canada.

Fiscal Outlook
Ontario (C$ blns, except where noted)

		22/23e	23/24f	24/25f	25/26f
Revenues		200.4	204.4	213.0	226.0
Expenses		202.6	204.7	210.8	217.5
Programs		189.1	190.6	196.4	202.5
Debt Service		13.4	14.1	14.4	15.1
Budget Balance before reserve		(2.2)	(0.3)	2.2	8.4
Reserve Allowance		—	1.0	2.0	4.0
Budget Balance		(2.2)	(1.3)	0.2	4.4
Net Debt		395.8	406.4	420.3	429.9
As a percent of GDP:					
Budget Balance		(0.2)	(0.1)	0.0	0.4
Net Debt		37.8	37.8	37.7	36.9
As a percent of revenue:					
Debt Service		6.7	6.9	6.8	6.7
Federal Transfers		15.6	17.0	16.5	16.4
Key assumptions:					
Real GDP	(% chng)	3.7	0.2	1.3	2.5
Nominal GDP	(% chng)	9.4	2.8	3.6	4.6
10-Year GoC	(%)	2.8	3.1	3.1	3.1

Note: GDP figures are for calendar year (FY22/23 = CY22)
Source: Provincial Budget *( ) = deficit; e = estimate; f = forecast*

Borrowing Requirements
Ontario (C$ blns)

	23/24	24/25	25/26
Deficit/(Surplus)	1.3	(0.2)	(4.4)
Capital Investment	13.6	18.6	18.8
Non-Cash Adjustments	(9.2)	(11.7)	(14.0)
Other Loans/Adjustments	0.2	(0.9)	0.0
Debt Maturities	31.2	27.9	33.1
Funding Requirement	37.0	33.7	33.4
Dec./(Inc.) in S-T Borrowing	—	—	—
Inc./(Dec.) in Cash	5.0	(5.0)	—
Preborrowing	(14.5)	—	—
Long-Term Borrowing	27.5	28.7	33.4

Source: Provincial Budget

- Ambitious **capital plan** of over $184 billion over ten years, with the bulk of spending going into projects to expand public transit and highways, and upgrade health care and child care infrastructure.
- A **review of the tax system** will *"prioritize competitiveness and long-term growth in the province, as well as the fairness and effectiveness of tax relief and supports"*. There are no changes in this budget.
- Focus on **skills development** and training, with an eye on skilled trades and health care.

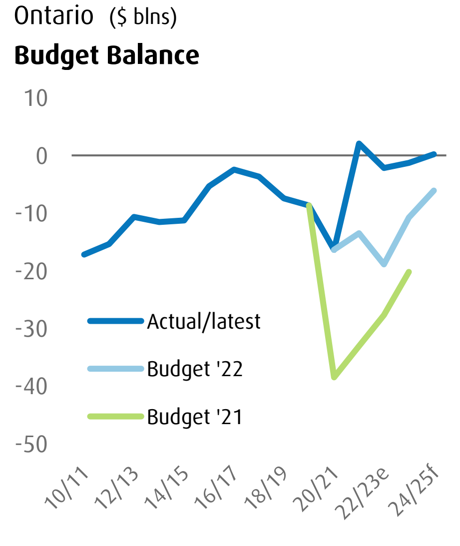
Total revenues are expected to rise 2% to $204 billion in FY23/24, boosted by federal transfers, thanks in part to the new health care funding agreement. Meantime, tax revenues are expected to be flat this year as higher personal incomes are offset by an over 10% drop in corporate taxes from the pending economic slowdown.

Real GDP growth is expected to slow to just 0.2% in 2023 before rebounding to 1.3% next year. Those calls are largely consistent with our view (0.3% and 1.4%). It's worth noting that the economic assumptions are a tick lower than the average of the private sector survey, which was locked in before the wave of stronger-than-expected data at the beginning of the year. It's likely that the estimates would have been revised up if conducted today, though the average happens to align with our current call for both years. And, there's no doubt that uncertainty lingers later in 2023. A '**slower-growth scenario**' that more closely resembles a recession (real GDP growth of -0.7% this year) results in a budget deficit of $5 billion in FY23/24. Nominal growth is pegged at 2.8% this year, which matches our call exactly. Still, given the upward revisions to the rest of the country, we believe Ontario will lag behind other provinces this year as weaker housing market activity weighs more heavily.

Meantime, **total spending** is expected to rise at a slower 1% rate in FY23/24, to $205 billion. Base program spending (excluding temporary COVID funding and some one-time items) is projected to jump almost 9% this year, with increases in health care and education driving the gains. Health sector funding will be up a hefty 16.3% from two years ago. Standard contingencies remain in place, with a $1.0 billion reserve allowance this year rising to $4.0 billion by FY25/26.

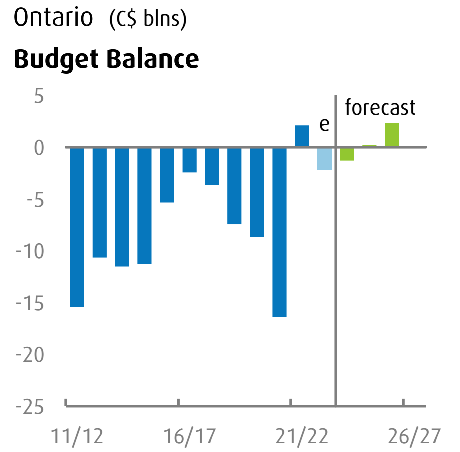
Total long-term **borrowing requirements** are estimated at $27.5 billion, down from $32.1 billion in FY22/23 and the smallest program for Ontario in seven years. That said, the Province did pre-borrow a chunky $14.5 billion ahead of the fiscal year, which they probably ok with—GoC yields have fallen, but provincial spreads have started to widen alongside economic and market uncertainty. Borrowing rises modestly to $28.7 billion in FY24/25 and $33.4 billion in FY25/26. While the operating budget remains in balance or small surplus, capital spending rises meaningfully over that period.

Evolution of the Budget Balance



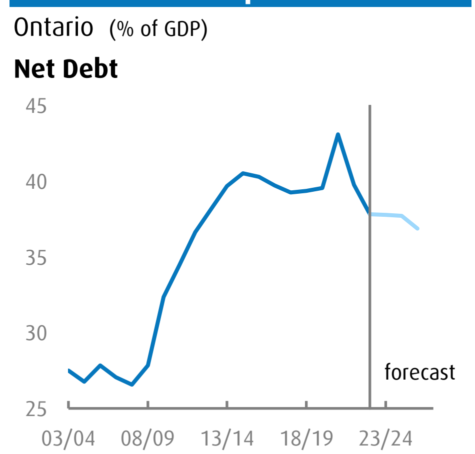
Source: Provincial Budget *e = estimate*

Surplus in Sight



Source: Provincial Budget *e = estimate*

Debt Looks to Step Down



Source: Provincial Budget

Ontario will continue with multiple **green bond** offerings per year, and will look to expand the envelope of projects that will qualify for the program, with some technical wording changes to allow it (e.g., "sustainable" versus "green"). Ontario's substantial **liquidity reserve** has been drawn down from $47.2 billion in FY21/22 to $35.7 billion as of FY22/23. The drift back toward pre-COVID norms around $30 billion is ongoing.

Net debt is expected to finish the year at 37.8% of GDP, unchanged from FY22/23. While downward progress on this metric has stalled, keep in mind that the 2022 budget had the ratio pegged at 41.4% for FY23/24; and the 2021 budget had it at 50.2%. While we figured all along that some of those estimates were excessively negative, the fact is that the current fiscal picture is far better than what we've seen Ontario put on paper in recent years. In that light, **debt service costs** remain well contained at just 6.9% of revenues. Ontario's "**debt burden reduction strategy**" now sets lower caps on three indictors: Net debt-to-GDP at 40%; net debt-to-revenue at 200%; and debt service-to-revenue at 7.5%.

The Bottom Line: Ontario is running balanced budgets and carrying a stable net debt burden at a level far lower than expected one or two years ago. Economic uncertainty no doubt looms for the province, but this is a positive shift from the pre-COVID era that saw 12 consecutive deficits averaging 1.4% of GDP.

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