2018 ONTARIO ECONOMIC OUTLOOK AND FISCAL REVIEW

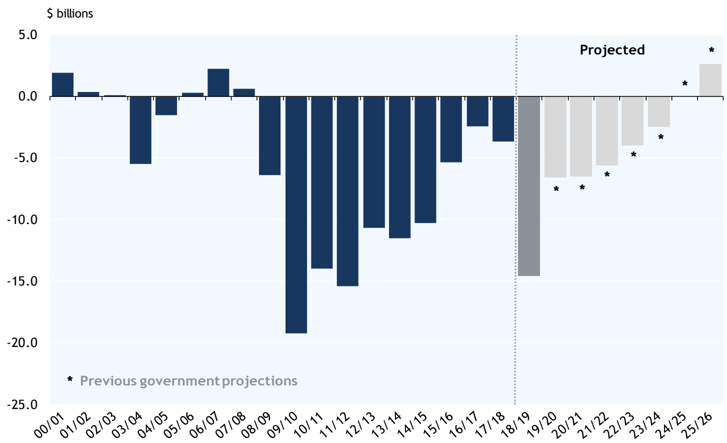
November 16, 2018

Larger deficit for longer?

- *New Ontario government projects a $14.5 billion deficit in 2018-2019.*
- *$3.2 billion in program spending savings found though $2.7 billion of them ‘spent’ on various forms of tax cuts.*
- *No firm timetable to balance the books.*
- *Net debt-to-GDP ratio to increase from 39.2% to 40.5% this fiscal year.*

When Ontario’s new Finance Minister Vic Fedeli accepted the recommendations of the Independent Financial Commission of Inquiry in September following a line-by-line review of the government’s books, he knew it wasn’t going to make his task of balancing the provincial budget any easier. Instead of dealing with a $6.7 billion deficit in the current 2018-2019 fiscal year as the previous government projected in its March, 2018, budget, he now had to wrestle with a gigantic $15 billion shortfall—the third largest in the province’s history. That’s a deep hole to climb out of to say the least.

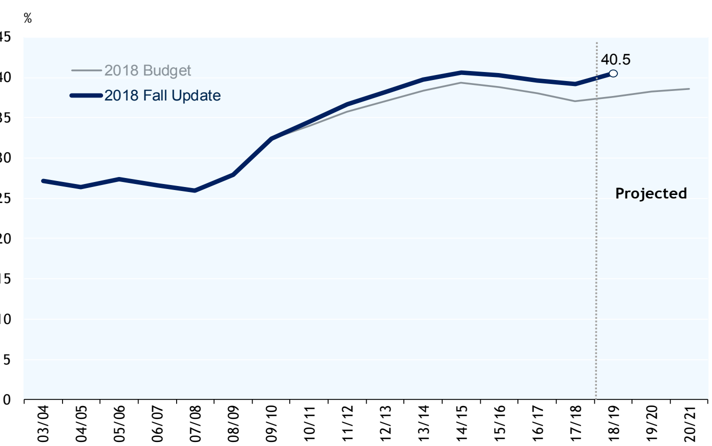
Ontario budget balance



Source: Ontario Ministry of Finance, RBC Economic Research

It wasn’t that conditions had collapsed in the interim. The bulk of the upward revision reflected accounting changes advocated by the province’s auditor general ($5.1 billion) and an increase in the contingency reserve ($0.3 billion). A slight downgrade in the economic outlook did impact revenues ($1.5 billion) though the remaining $1.4-billion adjustment came from the reversal of the year-end savings the previous government intended to squeeze out from expenses.

Net Debt as % of GDP



Source: Ontario Ministry of Finance, RBC Economic Research

We thought that simply reinstating the last item—a natural thing to do for a government dedicated to find efficiencies—offered an excellent opportunity to get a strong head-start in slaying the deficit for this new government. At the very least it would set the tone for future efforts.

Minister Fedeli did find $3.2 billion in program spending savings in yesterday’s fall fiscal review; however, his government ‘spent’ $2.7 billion of them in the form of various tax cuts (and the elimination of tax increases planned by the previous government). In the end, only $0.5 billion are being shaved off the 2018-2019 deficit—now projected to be $14.5 billion. It is still the third largest in Ontario’s history. So much for a strong head-start!

The size of Ontario’s budget deficit isn’t the whole issue here.

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We find the absence of a firm timetable to get back to balance quite disappointing. We didn't expect a full-blown multi-year fiscal plan so soon into the new government's mandate but committing only to "returning the province to balanced budgets on a modest, reasonable and pragmatic timetable" leaves the impression that progress will be slow in the coming years. Previous Liberal governments took nine long years to (nearly) eliminate a $19 billion deficit through some turbulent economic times during and after the global financial crisis. Meanwhile the provincial net debt ballooned from $157 billion in 2007-2008 to $314 billion in 2016-2017.

Economic growth assumptions

	2015	2016	2017	2018	2019	2020	2021
Real GDP growth (%)							
Budget 2018	2.9	2.6	2.7	2.2	1.8	1.9	1.7
Fall Update	2.5	2.3	2.8	2.0	1.8	1.7	1.5
RBC	2.9	2.6	2.7	2.0	1.9	-	-
Nominal GDP growth (%)							
Budget 2018	5.0	4.3	4.4	4.1	3.9	4.0	3.9
Fall Update	4.6	4.4	4.1	3.8	3.8	3.5	3.2
RBC	5.0	4.3	4.4	3.8	4.0	-	-

*As of Nov. 15, 2018

Source: Ontario Ministry of Finance, RBC Economics Research

The bigger issue in our view is the timing of the current deficit. It comes when the economy is running at capacity. It provides fiscal stimulus to an economy that doesn't need it. This is the phase of the business cycle when a government should instead prepare for the next economic downturn. Our advice to Minister Fedeli is to take maximum advantage of the current strong economy to make as much progress as possible in restoring Ontario's fiscal position.

Delaying action to a time when the outlook is less certain raises could complicate things down the road for a government carrying a significant debt load. Net debt is projected to reach $347 billion at the end of this fiscal year, the service of which will cost the government $12.5 billion in interest payments. That's the fourth largest expenditure item in the budget after health care, education and social services. Relative to GDP, Ontario's net debt will jump from 39.2% in 2017-2018 to 40.5% in 2018-2019, just shy of the record 40.6% in 2014-2015.

Total funding requirement in 2018-2019 is now expected to be higher at $42.1 billion compared to $37.3 billion in the 2018 budget. Pre-borrowing done last year means that total long-term public borrowing is expected to be $33.2 billion this fiscal year.

As for specific measures announced yesterday, we are pleased to see the launch of an action plan to bring new ownership and rental housing supply more quickly into the marketplace. Also, the government is re-introducing a rent control exemption for new units, which should promote construction of purpose-built apartment buildings over time.

Ontario's fiscal plan

($ billions)	Actual		March budget	November update
	2016/17	2017/18	2018/19	2018/19
Total revenues	140.7	150.6	152.5	148.2
Total expenditures	143.2	154.3	158.5	161.8
Program spending	131.5	142.4	145.9	149.2
Interest on public debt	11.7	11.9	12.5	12.5
Reserve	-	-	0.7	1.0
Surplus/(Deficit)	(2.4)	(3.7)	(6.7)	(14.5)

Source: Ontario Ministry of Finance