

BUDGET ANALYSIS

Ontario: Budget 2018 Deficits Will Soon Be Back!



HIGHLIGHTS

- ▶ Better economic conditions should put the province back in the black in 2017–2018.
- ▶ A substantial increase in spending is, however, forecast for subsequent fiscal years.
- ▶ The Ontario government is therefore expected to run a deficit again from 2018–2019 to 2023–2024.
- ▶ The 2018 budget includes \$20.3B in new spending over three years.
- ▶ The Ontario government's net debt will increase considerably in the coming fiscal years.

The 2017–2018 Surplus Will Be an Exception

With annual real GDP growth of about 2.8% between 2014 and 2017, Ontario's economy stood out from the rest. This improved the provincial government's fiscal balance from -\$10.3B in 2014–2015 to -\$1.0B in 2016–2017. The Ministry of Finance is projecting that the 2017–2018 fiscal year might even end in the black with a surplus of \$0.6B.

This surplus could be short-lived, however, as today's fiscal projections include a substantial rise in program spending in the years to come, with an average of 4.3% for the next three years. The 2018–2019 fiscal year could again close with a deficit of roughly \$6.7B. No real improvement is expected thereafter, as the deficit will likely remain at around \$6.5B until 2020–2021. After that, the deficit is expected to gradually shrink and may take until 2024–2025 to be back in positive territory.

TABLE 1
Summary of transactions

IN \$B (EXCEPT IF INDICATED)	ACTUAL	PROJECTIONS			
	2016–2017	2017–2018	2018–2019	2019–2020	2020–2021
Total revenues	140.7	150.1	152.5	157.6	163.8
<i>Variation (%)</i>	3.4	6.7	1.5	3.4	3.9
Program spending	-130.0	-137.5	-145.9	-150.4	-155.8
<i>Variation (%)</i>	1.5	5.8	6.1	3.1	3.6
Debt charges	-11.7	-12.0	-12.5	-13.1	-13.8
<i>Variation (%)</i>	1.0	2.2	4.8	4.4	5.3
Total expenses	-141.7	-149.5	-158.5	-163.5	-169.6
<i>Variation (%)</i>	1.5	5.5	6.0	3.2	3.7
Reserve	---	---	-0.7	-0.7	-0.7
Budgetary balance	-1.0	0.6	-6.7	-6.6	-6.5
Net debt	301.6	308.2	325.0	342.8	360.1
<i>In % of GDP</i>	38.0	37.1	37.6	38.2	38.6

Sources: Ontario Ministry of Finance and Desjardins, Economic Studies

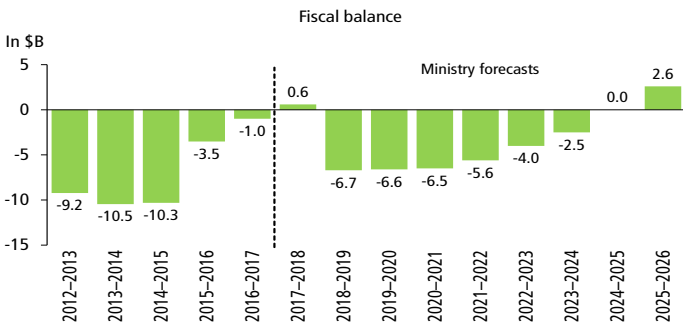
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NOTE TO READERS: The letters k, M and B are used in texts and tables to refer to thousands, millions and billions respectively.

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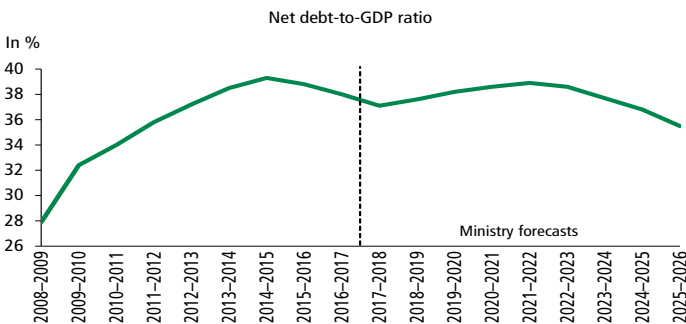
GRAPH 1
The Ontario government will quickly be back in the red



Source: Ontario Ministry of Finance

Under these circumstances, the Ontario government’s net debt will grow significantly in the coming fiscal years, potentially increasing from \$301.6B at March 31st, 2017, to \$360.1B at March 31st, 2021. This growth outpaces that of Ontario’s economy such that the net debt-to-GDP ratio will begin to increase again slightly as of 2018–2019, ending three consecutive years of decreases.

GRAPH 2
Ontario’s debt ratio will start to increase slightly again



Source: Ontario Ministry of Finance

The Ontario Government Is Cranking Up Its Spending

With the fast-approaching provincial election on June 7, 2018, the Ontario government could not resist the temptation to introduce a smorgasbord of new budgetary expenditures to appeal to a wide range of voters. The 2018 budget therefore provides for \$20.3B in new spending over three years, including \$5.7B in the first year, \$6.3B in the second year and \$8.3B in the third year. Below is a summary of the key measures:

- ▶ \$1.3B to provide better health care for everyone in Ontario;
- ▶ \$1.2B to improve access to a full range of mental health and addictions services for children, youth and adults;
- ▶ \$2.2B to continue to increase access to affordable child care and introduce free preschool for children aged two-and-a-half until they are eligible for kindergarten starting in September 2020;
- ▶ \$2.3B to embark on a multi-year plan to reform income security;
- ▶ \$1.8B to expand services and enable choice, independence and inclusion for individuals with developmental disabilities;
- ▶ \$1.0B to expand OHIP+ to seniors by providing prescription drugs free to anyone aged 65 and over;
- ▶ \$0.7B to support seniors to live independently;
- ▶ \$0.8B to reduce prescription drug and dental costs;
- ▶ \$0.9B to build upon and strengthen economic foundations, support the development of local talent and entrepreneurs, and encourage the growth of businesses.

With respect to budgetary revenue, the Ontario government is proposing to, in particular, eliminate the personal income surtax, change the personal income tax rates and brackets, and raise the Ontario Charitable Donations Tax Credit starting from the 2018 taxation year.

For businesses, the government is proposing to raise the Ontario Research and Development Tax Credit, a 3.5% non-refundable tax credit on eligible R&D expenditures. Companies that qualify for this credit and incur eligible R&D expenditures on or after March 28, 2018, could receive an enhanced rate of 5.5% on expenditures over \$1M in a taxation year.

Medium-Term Projections Are at Risk

The economic forecasts used in the budget assume that Ontario’s economy will continue to grow at about 2% at least until 2021. In our view, however, there is a significant risk that Ontario’s economy will weaken considerably in the next few years. The problem is not so much with Ontario, but rather with the global economy, which is currently going through an exceptionally long growth cycle. Some imbalances are bound to appear sooner or later, which could lead to a sharp downturn in the global economy, particularly that of the United States. This would have major implications for Ontario. Under such circumstances, it is likely that the gradual reduction in the budgetary deficit and the return to equilibrium anticipated by the Ministry of Finance for 2024–2025 will be difficult to achieve.

TABLE 2
Economic and financial forecasts

VARIATION IN % (EXCEPT IF INDICATED)	2017		2018f		2019f	
	2018 Budget	Desj. Group	2018 Budget	Desj. Group	2018 Budget	Desj. Group
Real GDP	2.7	2.8	2.2	2.0	1.8	1.9
Nominal GDP	4.4	4.4	4.1	3.7	3.9	4.0
Employment	1.8	1.8	1.7	1.3	1.1	1.2
Treasury bills—3-month	0.7	0.7	1.4	1.4	2.2	2.1
Federal bonds—10-year	1.8	1.8	2.4	2.5	3.0	2.9
Exchange rate (US¢/C\$)	77.0	77.0	80.1	79.1	80.9	80.3
Real GDP—United States	2.3	2.3	2.8	2.8	2.4	2.5

f: forecasts; NOTE: Data may not add to totals due to rounding.

Sources: Ontario Ministry of Finance, Statistics Canada and Desjardins, Economic Studies

That said, Ontario still has some wiggle room in its fiscal balances. Even though its net debt-to-GDP ratio will increase in the coming years, it will still be below that of more heavily indebted provinces, like Quebec. However, if nothing is done to eventually change course, things may be different because Quebec and other provinces already achieve balanced budgets.