CIBC CAPITAL MARKETS

Economics

PROVINCIAL BUDGET BRIEFS

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Ontario budget 2024

Ontario is now projecting a $3bn (0.3% GDP) deficit for the outgoing 2023/24 fiscal year, which is modestly wider than expected in last year's budget but not quite as bad as projected in the most recent fiscal update. Spending is tracking higher than initial expectations, thanks in large part to wage settlements, and that higher base also impacts future budget projections. Higher spending, combined with expected weakness on the revenue side as the economy slows, means the deficit is projected to rise to $9.8bn (0.9% GDP) in fiscal 2024/25. While long-term borrowing is expected to be lower than in the outgoing year, that's because the province is increasing short-term funding by $5.0bn, while drawing down $1.0bn from cash. Meanwhile, the province borrowed more than initially planned in fiscal 2023/24 to raise cash holdings which can be used to smooth future borrowing requirements. The $38.2bn in long-term borrowing required for the upcoming fiscal year still represents an increase relative to last year's budget and is also slightly higher than the mid-year update.

Table 1: Summary of fiscal position: (C$billions)

Fiscal measure	2022/23 Actual	2023/24 23 Budget	2023/24 24 Budget	2023/24 Difference	2024/25 24 Budget	2025/26 24 Budget	2026/27 24 Budget
Revenue	192.9	204.4	204.3	-0.1	205.7	217.4	226.6
Own source	161.6	169.6	169.5	-0.1	169.4	179.9	187.9
• % change	4.6	0.3	4.9	4.6	-0.1	6.2	4.4
Federal transfers	31.3	34.8	34.8	0.0	36.3	37.5	38.7
Expenditures	198.8	204.7	207.3	2.6	214.5	220.6	224.1
Programs	186.4	190.6	194.5	3.9	200.6	205.9	208.9
% change	9.3	0.7	4.3	3.6	3.1	2.6	1.5
Public debt charges	12.4	14.1	12.8	-1.3	13.9	14.7	15.2
Less: reserve	-	1.0	0.0	-1.0	1.0	1.5	2.0
Budgetary balance	-5.9	-1.3	-3.0	-1.7	-9.8	-4.6	0.5

Economy to almost stall in 2024, before accelerating again

Ontario's economy performed better-than-expected in 2023 despite the higher interest rate environment, with real GDP now estimated to have risen by 1.2%. That compares to a forecast in last year's budget for only 0.2% growth. However, as the year progressed, signs of a slowdown became more apparent, and the province now expects weaker growth in 2024, with GDP forecast to rise only 0.3% in real terms and 2.7% in nominal terms. The unemployment rate has been rising, and is forecast to average 6.7% this year, up from 5.7% in 2023, as demand for labour has failed to keep pace with strong population growth. As interest rates start to fall, household consumption and business investment are expected to accelerate and see real GDP average just over 2% between 2025 and 2027. Nominal GDP is forecast to average just over 4% during that period.

As has been common since the pandemic, the province also included projections under faster and slower economic scenarios. The slower scenario includes a modest recession (-0.6% real GDP in 2024) and a slightly shallower recovery. Under this scenario, the budget deficit would be $3.5bn wider in fiscal 2024/25 than in the base case, with this gap growing to $8.0bn by 2026/27.

Table 2: Key assumptions (Y/Y % chg)

Economic assumptions	2023	2024	2025	2026	2027
Real GDP	1.2	0.3	1.9	2.2	2.2
• Private sector consensus	-	0.4	2.0	2.3	2.3
Nominal GDP	4.1	2.7	3.9	4.3	4.1
Employment	2.4	0.8	1.7	1.4	1.4
Unemployment rate (%)	5.7	6.7	6.6	6.4	6.2
Nominal HH consumption	6.0	3.5	4.1	4.3	4.2
Housing starts (K)	89.3	87.9	92.3	94.4	95.8
Corporations net op. surplus	-12.6	-4.7	3.5	7.9	6.0
Consumer price index	3.8	2.6	2.0	2.0	2.0

Table 3: Key financial assumptions

Financial assumptions	2023	2024	2025	2026	2027
3-month T-Bills (%)	4.8	4.4	3.0	2.6	2.6
10-year GoC Bonds (%)	3.3	3.2	3.1	3.3	3.5
Exchange rate (US¢ / C$)	74.1	74.6	77.6	78.2	77.0
WTI (US$/bbl)	78.0	79.0	78.0	77.0	78.0

Deficit to widen, return to balance delayed

For the outgoing 2023/24 fiscal year, a deficit of $3.0bn is now expected. While that is a deterioration relative to last year's budget projection for a $1.3bn shortfall, it is a $1.6bn improvement relative to the third-quarter update. Compared to Budget 2023, revenues are tracking very close to prior expectations. However, expenditure is $2.6bn higher, with program spending nearly $4.0bn more than initially budgeted for. That includes a $2.6bn increase in spending in today's budget, in large part driven by higher health and education wage settlements following previous restraint under Bill 124. The spending projections for 2023/24 still include a $0.5bn contingency fund balance, which is available to offset any additional spending needs that may arise, although the reserve of $1.0bn has been drawn down to zero.

For the upcoming fiscal year, the deficit is expected to widen to $9.8bn. That would represent almost 1% of nominal GDP, and contrasts with the expected return to balance anticipated for fiscal 2024/25 in last year's budget. Revenue projections for the upcoming fiscal year are $7.3bn lower than they were in Budget 2023, and represent a slight decline on a year-over-year basis. The weaker economic outlook is partly to blame for that shift, with projections for personal income taxes in particular much lower. However, the province is also now projecting that "other non-tax revenue" will decline largely due to a decrease in third-party revenues from colleges due to the government's cap on international students. Revenue projections in this area are $1.2bn lower than in last year's budget. The province also announced that it was extending the temporary cuts to gas tax, at a cost of $620mn in fiscal 2024/25.

While spending isn't increasing quickly over the forecast horizon (averaging growth of just over 2.5% a year), a higher base from the outgoing fiscal year means that expenditure projections are higher than in last year's budget. Indeed, for upcoming fiscal 2024/25, program spending is $4.6bn higher than in Budget 2023. Relative to the updated projections for fiscal 2023/24, most of the increase in spending this year comes from "other programs" which includes funding to provide high speed internet across the province and spending to aid development of Ontario's auto manufacturing and electric vehicle battery production. Higher program spending is offset somewhat by debt interest charges tracking lower than expected in Budget 2023, thanks to prudent fiscal management over the past year.

Contingencies included in today's budget are on average not as large in Budget 2023, but still add a degree of prudence. The Contingency Fund is set at $1.5bn for fiscal 2024/25 to help mitigate expense risk, while a reserve of $1.0bn in the upcoming fiscal year increases to $2.0bn by fiscal 2026/27.

Stronger economic growth in 2025/26, combined with expectations that spending increases will be kept below the pace of nominal GDP growth, will see the deficit shrink to $4.6bn for that year with a balance achieved in fiscal 2026/27 - two years later than projected in last year's budget.

Long-term borrowing estimates are on a downward trend

For the fiscal year ending later this week, the province has completed $41.8bn in long-term funding vs the third quarter estimate of $33.6bn required. That is also higher when compared to the $32.2bn that was completed in fiscal year 2022/23. In Budget 2023, long-term borrowing was originally estimated at $27.5bn, but the increase in the deficit forecast, a change in Non-Cash and Cash Timing Adjustments, and higher year-end cash levels for future needs saw that total rise to what was completed.

Of that total completed, $35.9bn was funded in the domestic markets which also included $3.0bn worth of green bonds and $2.6bn worth of Floating Rate Notes. The remaining amount was funded internationally with the largest amount in USD (C$4.0bn equivalent), while the rest was in EUR (C$1.8bn) and AUD (C$0.03bn). That translates into 86% completed domestically which was inside the province's target range of 75-90%. The range will remain unchanged for this upcoming year, but will be adjusted if necessary in response to evolving investor demand.

As for this upcoming fiscal year, total funding requirements are forecasted to be $44.2bn. That is projected to be funded through an increase of $5.0bn in short-term borrowing, $1.0bn drawdown from year-end cash and cash equivalents, and $38.2bn in long-term borrowing. That is an increase in long-term borrowing of $9.5bn from budget 2023 and $0.8bn higher than the recent economic outlook and fiscal review (aka mid-year update).

One change to note is, starting in 2024/25, pre-borrowing will be reflected as part of the increase in year-end cash and cash equivalents instead of a direct decrease in the upcoming year's borrowing requirements. That allows the province to allocate cash in years that it is needed, instead of all in the upcoming year. For this outgoing year, that account increased by $9.3bn vs. expectations of no change in the third quarter update. That has allowed the province to allocate $1.0bn towards lowering this upcoming year's borrowing and lowering 2025/26's requirement by $8.3bn.

As for future long-term borrowing projections, 2025/26 is estimated to be $37.7bn after drawing down that $8.3bn mentioned above. That is $4.3bn higher than budget 2023 and $0.7bn higher than the mid-year forecast, mostly due to a deficit projection now vs a surplus before. We are seeing funding estimates for 2026/27 for the first time, which are projected to further decrease to $32.8bn.

The province also provided what borrowing requirements would look like in both a slower and faster growth scenario for 2024/25 through 2026/27. In a slower growth environment, borrowing would be $41.7bn, $43.5bn and $40.8bn, respectively, while a faster growth would see it reduced to $34.5bn, $31.1bn and $23.5bn.

Table 4: Borrowing requirements (C$billions)

Borrowing requirements	2023/24 Estimate	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast
Budget (surplus) / deficit	3.0	9.8	4.6	-0.5
Non-cash and cash timing adjustments	-1.6	-11.0	-12.0	-13.9
Investment in capital assets	14.7	17.7	20.2	20.4
Net loans / investments	-0.2	-0.3	0.1	-
Net financial requirement	15.9	16.2	12.9	6.0
Maturities & redemptions	31.2	28.0	33.1	26.9
Total funding requirement	47.1	44.2	46.0	32.8

Table 5: Sources of funding (C$billions)

Sources of funding	2023/24 Estimate	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast
Decrease / (increase) in short-term borrowing	-	-5.0	-	-
Increase / (decrease) in cash and equivalents	9.3	-1.0	-8.3	-
Preborrowing for 2023/24	-14.5	-	-	-
Total long-term public borrowing	41.8	38.2	37.7	32.8

Extending the term of debt and ensuring adequate liquidity levels

The province has been extending the term of its debt, which has provided flexibility in managing the borrowing program and has reduced interest on debt in the short- and medium-term due to rising rates. Since 2010/11, Ontario has issued $137bn in bonds which includes $12.8bn in 2023/24, or almost one-third of total debt outstanding, with maturities of 30 years or longer. Given interest rates have risen to near historical averages, the province will monitor the debt term strategy and make changes in response to levels of interest rates and the yield curve.

Ontario has built a large cash reserve in 2023/24 averaging $46.9bn, which is higher than the average of $36.2bn in the previous year and the average of $29.3bn since 2009/10. That increase reflects higher operating requirements, investments in infrastructure and debt maturities. Also, cash reserves were increased due to the $9.3bn change in year-end cash as previously mentioned. Meanwhile, the province highlighted in the budget that with short-term interest rates higher than long-term rates through 2023/24, holding liquid reserves reduced interest on debt as short-term investments earned more income than their cost of borrowing long-term debt.

Net debt-to GDP peaking in 2025/26

As a result of the continued deficits and capital spending in infrastructure, net debt is expected to have reached $415bn as at March 31, 2024, an increase of some $14bn from the prior year. That would place the net debt-to-GDP ratio at 38.0%, which is an increase of 0.2% from budget 2023. With the increase forecasted in both again this upcoming fiscal year, net debt is projected to increase by over $24bn to $439bn as at March 31, 2025, causing the ratio to increase to 39.2%. That compares to the 37.7% projected for 2024/25 in last year’s budget.

As a result of the deficit forecast and higher capital investments in 2025/26, the ratio is expected to further increase to 39.5% before dropping to 39.1% the following year. Although both 2024/25 and 2025/26 estimates are higher than last year’s budget, and 2026/27 is elevated as well, all are still below the debt sustainability measure target. As in the past, the budget includes a debt burden reduction strategy with specific objectives over the medium-term outlook which include:

- Net debt-to-GDP to stay below 40.0%;
- Net debt-to-revenue to stay below 200%; and
- IOD-to-revenue to stay below 7.5%;

Budget 2024 projects the debt-to-revenue target will not be achieved throughout the horizon (2024/25 – 2026/27), with figures estimated at 213.5%, 211.4%, and 209.4%, respectively. Meanwhile, interest on debt-to-revenue will be achieved every year at 6.8%, 6.8% and 6.7%.

Capital spending continuing to ramp up

Ontario's capital plan increased again in today's budget, with $190.2bn of investments now expected over 10 years. That includes $26.2bn in the upcoming 2024/25 fiscal year, up from $20.9bn in 2023/24. Capital spending is expected to step up again in fiscal 2025/26, to $29.5bn, before easing back in 2026/27. Increased spending in the upcoming year will be driven by transportation and "other" projects, the latter of which includes infrastructure spending related to the planned improvements in high speed internet access across the province.

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