

Economics

PROVINCIAL BUDGET BRIEFS

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Ontario budget 2023

Ontario's budget shows much slimmer near-term deficits, and an earlier return to sustained balances, than had been anticipated a year ago. The deficit for the outgoing 2022/23 fiscal year is now expected to be only \$2.2bn (0.2% GDP), which represents a marked reduction from the \$19.9bn shortfall first budgeted for, with the improvement driven by higher tax revenues. For the upcoming 2023/24 fiscal year, the deficit is expected to slim slightly further, to \$1.3bn, even under a base case economic scenario which shows very little GDP growth. With the province having undertaken significant pre-funding in the current fiscal year for 2023/24, and with the operating deficit expected to slim, long-term borrowing is anticipated to be \$4.6bn lower, at \$27.5bn. That would represent the smallest borrowing plan since fiscal 2016/17.

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

Fiscal measure	2021/22 Actual	2022/23 22 Budget	2022/23 23 Budget	2022/23 Difference	2023/24 23 Budget	2024/25 23 Budget	2025/26 23 Budget
Revenue	185.1	179.8	200.4	20.6	204.4	213.0	226.0
Own source	154.5	148.8	169.1	20.3	169.6	177.9	188.9
• % change	17.9	3.4	9.5	6.1	0.3	4.9	6.2
Federal transfers	30.6	31.0	31.3	0.3	34.8	35.1	37.1
Expenditures	183.0	198.6	202.6	4.0	204.7	210.8	217.5
Programs	170.5	185.1	189.1	4.1	190.6	196.4	202.5
% change	0.9	6.3	11.0	4.7	0.7	3.0	3.1
Public debt charges	12.6	13.5	13.4	-0.1	14.1	14.4	15.1
Less: reserve	0.0	1.0	0.0	-1.0	1.0	2.0	4.0
Budgetary balance	2.1	-19.9	-2.2	17.7	-1.3	0.2	4.4

Ontario economy to stall under high interest rates

Ontario's economy continued to grow strongly in 2022, with real GDP growth of 3.7%, a little above the Canadian average. Real GDP surpassed its pre-pandemic level by 4% as of the third quarter of 2022. The projection for real GDP growth in 2023 is 0.2%, while nominal GDP is expected to grow by 2.8%, with both estimates one tick below the private sector average. Job creation is expected to slow, but remain positive thanks to strong labour force growth, while the unemployment rate is expected to rise to about 6.5% over the next two years, as the economy slows under the weight of higher interest rates. The province anticipates further adjustment in the housing market in 2023, with a 8.9% drop in home resales, before a strong rebound in 2024 and a return to levels that are in line with fundamentals in 2025 and 2026. The economy overall should start to rebound in 2024, with real GDP expected to grow 1.3%, before accelerating to about 2.5% in 2025 and 2026. Similarly, nominal GDP is projected to increase by 3.6% in 2024 and about 4.5% thereafter.

As has been the case in recent years, the province also laid out alternative scenarios for faster and slower growth, along with their implications for budget balance. Under the faster scenario, nominal GDP rises by 6% this year, while under the lower growth scenario it only increases by 1%. Under the faster scenario, the province would see a surplus of \$4.4bn in fiscal 2023/24, while under the slower growth scenario, there would be a \$5.0bn deficit.

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

Economic assumptions	2022	2023	2024	2025	2026
Real GDP	3.7	0.2	1.3	2.5	2.4
• Private sector consensus	-	0.3	1.4	2.6	2.5
Nominal GDP	9.4	2.8	3.6	4.6	4.5
Employment	4.6	0.5	1.0	1.7	1.7
Unemployment rate (%)	5.6	6.4	6.6	6.3	6.3
Nominal HH consumption	12.6	5.1	4.1	4.3	4.2
Housing starts (K)	96.1	80.3	79.3	82.7	83.2
Corporations net op. surplus	5.0	-8.2	-0.5	9.2	9.1
Consumer price index	6.8	3.6	2.1	2.0	2.0

Table 3: Key financial assumptions

Financial assumptions	2022	2023	2024	2025	2026
3-month T-Bills (%)	2.3	4.3	3.3	2.5	2.4
10-year GoC Bonds (%)	2.8	3.1	3.1	3.1	3.2
Exchange rate (US\$/C\$)	76.8	74.4	76.5	77.6	78.5
WTI (US\$/bbl)	95.0	83.0	80.0	79.0	79.0

Slimmer deficits, and earlier return to balance

Stronger-than-expected revenue growth sees Ontario projecting smaller deficits than had been anticipated in last year's budget, as well as an earlier return to sustained balances (after a brief return to surpluses in fiscal 2021/22). The deficit for the outgoing 2022/23 fiscal year is now expected to be a modest \$2.2bn (0.2% of nominal GDP), which is much smaller than the \$19.9bn deficit that had originally been budgeted for. Own source revenues are running slightly more than \$20bn above what had been expected, which is largely the result of higher taxation revenue due to new assessments for 2021 and prior years.

Partly offsetting the improvement on the revenue side, spending is running \$4bn higher than projected in last year's budget. The fiscal 2022/23 spending figures include \$7.8bn in Covid-19 funding, but going forward, pandemic-related spending will not be accounted separately. There is also \$6.3bn in other spending which the province considers a one-time expense, rather than funding for ongoing programs, with this figure including costs associated with ongoing land and land-related claims with Indigenous communities. There remains a \$1.75bn balance in the Contingency Fund for fiscal 2022/23, which is maintained to mitigate against expense risk. However, the reserve of \$1.0bn, which was included in last year's budget, is no longer required given that the fiscal year is almost complete.

For the coming 2023/24 fiscal year, spending and revenues are both expected to see only modest increases. On the spending side, this is largely because expenditures that are considered one-time items are not repeated. Key areas such as health and education will still see fairly sizeable budget increases, although higher health spending will be partly supported by enhanced transfers from the Federal government. The Contingency Fund in 2023/24 is set at \$4.0bn, while the upcoming fiscal year's forecasts also include a reserve of \$1.0bn to protect against an economic outcome which is more adverse than the base case.

On the revenue side, an increase in personal income tax receipts is expected to broadly offset a decline for corporations tax. In order to support growth and investment within the manufacturing sector, the province introduced a new 10% refundable corporate tax credit for investments in buildings, machinery and equipment. This is expected to cost \$215mn in the 2023/24 fiscal year, rising to \$290mn by fiscal 2025/26. The government also plans to support small business by expanding the phase-out range of corporate income tax.

With overall revenues expected to rise slightly more than spending in the coming fiscal year, Ontario is budgeting for a slimmer deficit of \$1.3bn. That would represent a near-balance excluding the \$1bn reserve. The medium term projections show the province returning to sustained balances by fiscal 2024/25, in contrast to last year's budget which suggested that target would not be reached until fiscal 2027/28. However, under the downside economic forecast, the province would still be running a deficit of \$3.8bn by fiscal 2025/26.

Borrowing at lowest level since 2016/17

For the fiscal year ending next week, the province completed \$32.1bn of funding vs. \$41.1bn the previous year. In Budget 2022, borrowing was estimated at \$41.5bn, but the large drop from both budget and year-over-year was due to the improvement in the deficit forecast as the year progressed, as well as the large amount of pre-funding applied (\$10.3bn). That pre-funding was a result of the swing to a surplus in the 2021/22 Public Accounts. Of that total completed this year, \$28.4bn was funded in the domestic markets which also included \$2.4bn worth of green bonds. The remaining amount was funded internationally with the largest amount in USD (C\$2.9bn equivalent), while the residual was in Pound Sterling (C\$0.8bn equivalent). That translates into 88% completed domestically, which was outside the province's target range of 65-80%. As a result, and based on Ontario's combined experience of the last five fiscal years, the target range for domestic borrowing will now be 75-90% in 2023/24.

Meanwhile, in Budget 2022, an increase of \$3.0bn in short-term borrowing was forecasted for both 2022/23 and 2023/24. However, the lower deficit allowed the province to decrease the amount outstanding in its short-term borrowing program by \$1.3bn in 2022/23 and leave it unchanged for 2023/24. That results in a net \$4.3bn reduction in its short-term borrowing program in 2022/23 compared to the prior forecast.

Overall, due to the improvement in the deficit forecast for the outgoing year, the province was able to allocate \$14.5bn worth of pre-funding for this year. Although higher than usual, that is lower than the \$16.2bn that was completed in 2020/21 for 2021/22.

After incorporating that pre-funding, borrowing for this upcoming year is projected to be \$27.5bn. If that projection holds, that places the total borrowing amount at the lowest level since 2016/17 when the province completed \$27.0bn in long-term debt. Borrowing would have been even lower for this upcoming year, however, the province is choosing to increase its cash and cash equivalents by \$5.0bn.

Looking ahead over the medium-term, borrowing is projected to be slightly up in 2024/25, rising to \$28.7bn, then continue increasing to \$33.4bn in 2025/26. Despite a \$4.4bn surplus projection in that year, the big step up in borrowing is due to maturities of \$33.1bn.

The province also provided what borrowing requirements would look like in both a slower and faster growth scenario for 2023/24 through 2025/26. In a slower growth environment, borrowing would be \$31.2bn, \$34.7bn and \$41.6bn, respectively, while a faster growth would see it reduced to \$21.8bn, \$20.0bn and \$21.8bn.

Table 4: Borrowing requirements (C\$billions)

Borrowing requirements	2022/23 Estimate	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast
Budget (surplus) / deficit	2.2	1.3	-0.2	-4.4
Non-cash and cash timing adjustments	-17.8	-9.2	-11.7	-14.0
Investment in capital assets	11.9	13.6	18.6	18.8
Net loans / investments	-0.3	0.2	-0.9	0.0
Net financial requirement	-4.0	5.9	5.8	0.4
Maturities & redemptions	30.6	31.2	27.9	33.1
Total funding requirement	26.6	37.0	33.7	33.4

Table 5: Sources of funding (C\$billions)

Sources of funding	2022/23 Estimate	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast
Decrease / (increase) in short-term borrowing	1.3	-	-	-
Increase / (decrease) in cash and equivalents	-	5.0	-5.0	-
Preborrowing in 2020/21 for 2021/22	-10.3	-	-	-
Preborrowing for 2022/23	14.5	-14.5	-	-
Total long-term public borrowing	32.1	27.5	28.7	33.4
Net new issues bonds & mtns	1.5	-3.7	0.8	0.3

Capital spending on the rise

While the budget deficit is expected to slim in fiscal 2023/24, spending on capital projects is expected to ramp up. The \$20.6bn capital plan for the upcoming fiscal year would represent a step up from \$17.4bn in 2022/23, while the \$184bn

10-year plan represents a \$25bn increase from last year's budget. The province has dedicated \$27.9bn over 10 years for support the planning and/or construction of new highways, \$70.5bn for transit projects and more than \$48bn for more hospital infrastructure. The province continues to support growth within the mineral-rich areas of northern Ontario, committing close to \$1bn for infrastructure such as all-season roads and broadband connectivity for the Ring of Fire region.

Extending term of debt and ensuring adequate liquidity levels

The province has been extending the term of its debt and the current plan is to maintain the term of debt at no lower than the level it has been at since 2014/15 (10.7yrs). Although interest rates are rising, they are still low compared to historical rates. That will allow the province to reduce refinancing risk on maturing debt. This past year, the weighted-average term of borrowing was 15.0yrs, up from 14.5yrs in 2021/22. Also, the province highlighted that the rise in interest rates will be monitored to determine whether a modest change in debt strategy will be required.

Ontario built a large cash reserve in 2020/21 and 2021/22, reaching \$47.2bn, in anticipation for large cash outflows. That was to ensure they have adequate liquidity, especially on large single day outflows. One such example would be June 2 of this year, which has a \$12.1bn benchmark bond maturing (coupon of 2.85%), as well as multiple other coupon payments on that day for different bonds. However, starting in 2022/23, Ontario began to bring liquid reserves back to pre-pandemic levels and now sits at around \$35.7bn. As forementioned though, the province is increasing cash and cash equivalents by \$5.0bn this upcoming year.

Net debt-to-GDP lower than targeted

Budget 2022 set a number of goals for the province's fiscal performance, including keeping the net debt-to-GDP ratio below 42%. At that time, the ratio was expected to finish the outgoing 2022/23 fiscal year at 41.4%. However, due to a smaller increase in debt due to the reduced deficit projection, combined with higher nominal GDP, the net debt-to-GDP ratio is now expected to be only 37.8% as this fiscal year ends next week. The province has lowered its limit for this ratio in Budget 2023 to 40%, and has also reduced some of its other targets. It will now seek to keep net debt-to-revenue below 200% (currently 198%) and interest on debt-to-revenue below 7.5% (currently 6.7%). For this upcoming fiscal year, those ratios are estimated to be 199% and 6.9%, respectively, still remaining under the target

Looking ahead, while operating deficits are slimming and then turning into surpluses, increased debt linked to capital spending will see the net debt-to-GDP ratio hold broadly steady under the base case economic scenario in 2023/24 and 2024/25, before starting to come down further thereafter. Under the downside economic scenario provided in today's budget, the net debt-to-GDP ratio would rise but, at 39.5% in fiscal 2024/25, peak below the lowered 40% target.

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