Scotiabank.

GLOBAL ECONOMICS

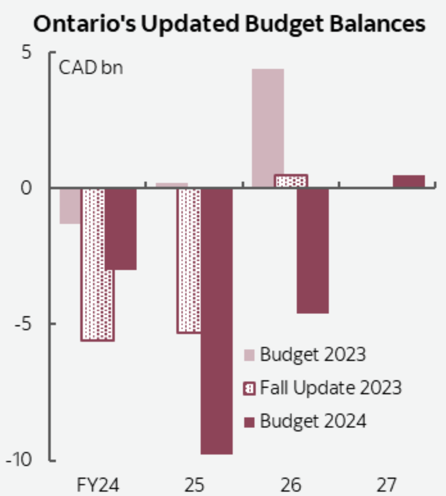
FISCAL PULSE

March 26, 2024

Contributors

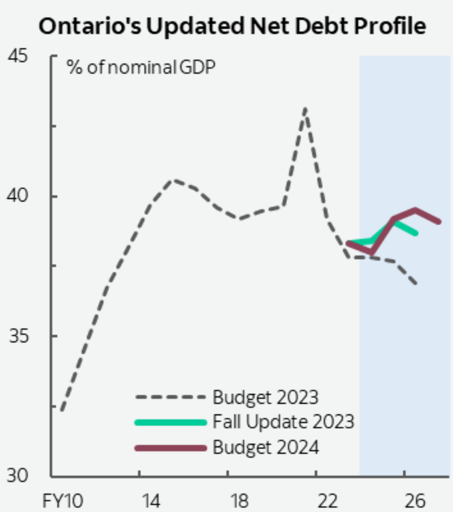
Laura Gu
Economist
Scotiabank Economics
416.866.4202
laura.gu@scotiabank.com

Chart 1



Sources: Scotiabank Economics, Ontario Finance.

Chart 2



Sources: Scotiabank Economics, Ontario Finance.

Ontario: 2024–25 Budget

DELAYED PATH TO BALANCE REMAINS PRUDENT AND STEADY

- **Budget balances: -$3.0 bn (-0.3% of nominal GDP) in FY24, before widening to -$9.8 bn (-0.9%) in FY25 and -$4.6 bn (-0.4%) in FY26—respective deterioration of -$4.5 bn and -$5.2 bn since the November 2023 update; a surplus is forecast in FY27 at $0.5 bn (0.0%)—one year later than previously anticipated (chart 1).**
- **Net debt: expected to climb from 38.0% of nominal output in FY24 to 39.2% in FY25 before peaking at 39.5% in FY26—a slightly higher trajectory than projected in the Fall Economic Statement but still sits below the debt-to-GDP target of 40% (chart 2).**
- **GDP growth forecast: +0.3% real growth and +2.7% nominal growth in 2024—weaker than prior projections (+0.5% and +2.9%); 2025 growth assumptions also lowered slightly to +1.9% in real term and +3.9% in nominal term.**
- **Borrowing program: total long-term public borrowing of $41.8 bn in FY24, $38.2 bn in FY25, $37.7 bn in FY26—a combined increase of $8.6 bn over three years versus the November 2023 projection—and $32.8 bn in FY27.**
- **Ontario's Budget 2024 appears conservative and pragmatic, with increased spending largely warranted amid public wage pressures and population growth. While the updated plan reveals weaknesses in the bottom line, resulting in deeper deficits and a postponed return to balance, it appears characteristically conservative with significant prudence built-in, ensuring its debt burden remains manageable.**

OUR TAKE

In line with the prevailing trend among other Canadian jurisdictions releasing their 2024 budgets, Ontario's Budget 2024 sees deterioration driven by a weaker growth outlook and heightened spending, yet maintains its dedication to prudent planning. Following slight improvement in FY24, the province projects larger deficits in the next two fiscal years, with shortfalls increasing by a total of $9.7 bn versus the November 2023 update. The return to balance was delayed yet again by one year to FY27. The projected FY25 deficit of -$9.8 bn (-0.9% of GDP) is underpinned by conservative growth assumptions and sizable buffers, likely representing an upper-bound estimate. Over the medium term, the current consolidation plan rests upon optimistic assumptions as the macro backdrop improves—own-source revenue is projected to grow at 5.3% annually over the next two years and program expense is expected to grow at 2.0%, leading to a rapid reduction in deficit.

Following a downward revision in revenue due to the tax reassessment, the government anticipates continued weakness to drive revenue projections moderately lower in the near term (chart 3). The province's own-source revenue projection was reduced by -$1.9 bn for FY25 and -$3.1 bn for FY26, partly reflecting the impact of the federal government's cap on international students (-$1.4 bn in FY25 and -$1.7 bn in FY26). Despite short-term challenges, the government remains optimistic, projecting robust growth rates of 4.9% annually in Personal Income Tax and 5% in Corporate Tax over the planning horizon. Federal transfers have also been adjusted upwards, reflecting a higher growth trajectory averaging 3.6% annually.

The current plan incorporates appropriate levels of prudence in three folds—conservative growth assumptions, a contingency fund and a reserve (chart 4). Ontario's nominal growth forecast is 2.7% this year and 3.9% next year—a hair below the private-sector averages. The economic resilience observed so far this year prompted us to revise our 2024 nominal growth forecast upward to 3.6% while adjusting 2025 forecast downward to 3.5%. The latest developments suggest significant upside potential for FY25 and moderate downside risk for FY26. Budget 2024 links every 1 ppt in nominal GDP growth with $1.1 bn in tax revenues—based on that figure, the difference could reduce the FY25 shortfall by $1 bn. The budget maintains $1 bn in reserve for FY25 which goes up to $2 bn in FY27—and combined with the $1.5 bn in Contingency Fund in FY25—offers more buffer and ensures that the province's fiscal path remains on track.

Medium-Term Fiscal Projections
$ billions except where noted

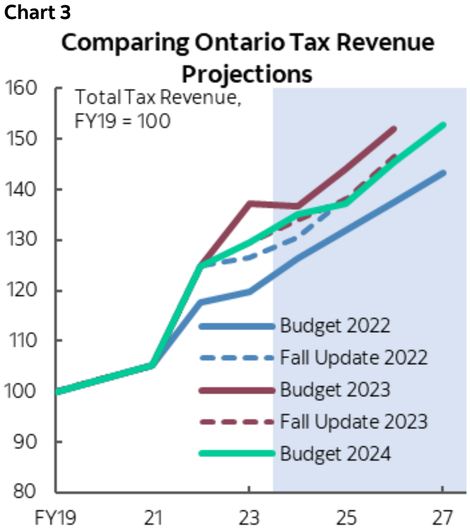
	FY24		FY25		FY26		FY27
	Nov. '23	Mar. '24	Nov. '23	Mar. '24	Nov. '23	Mar. '24	Mar. '24
Total Revenue	**201.8**	**204.3**	**206.7**	**205.7**	**220.0**	**217.4**	**226.6**
Own-Source	166.7	169.5	171.3	169.4	183.0	179.9	187.9
Fed. Transfers	35.1	34.8	35.4	36.3	37.0	37.5	38.7
Total Expenditure	**206.4**	**207.3**	**210.5**	**214.5**	**217.5**	**220.6**	**224.1**
Programs	193.0	194.5	196.2	200.6	202.3	205.8	208.9
Health	81.2	84.5	84.2	85.0	87.6	88.0	89.9
Education	34.7	36.6	36.4	37.6	37.5	38.8	39.4
Other	77.1	73.4	75.6	78.0	77.2	79.0	79.6
Debt Service	13.4	12.8	14.3	13.9	15.2	14.7	15.2
Reserve	**1.0**	—	**1.5**	**1.0**	**2.0**	**1.5**	**2.0**
Balance	**-5.6**	**-3.0**	**-5.3**	**-9.8**	**0.5**	**-4.7**	**0.5**
% of GDP	*-0.5*	*-0.3*	*-0.5*	*-0.9*	*0.0*	*-0.4*	*0.0*
Net Debt	**416.1**	**414.8**	**435.5**	**439.1**	**449.1**	**459.8**	**474.5**
% of GDP	*38.4*	*38.0*	*39.1*	*39.2*	*38.7*	*39.5*	*39.1*
Debt Service							
% of Revenue	*6.6*	*6.3*	*6.9*	*6.8*	*6.9*	*6.8*	*6.7*

Sources: Scotiabank Economics, Ontario Finance.

The province's spending profile saw a material boost (chart 5), driving the majority of the deterioration, yet the increases are largely warranted. Program spending is anticipated to exceed the fall update projections by $4 bn in FY25 and $3.1 bn in FY26, reflecting higher expenses in health, education and compensation-related costs. Budget 2024 incorporates the impact of the Bill 124 court decision on compensation-related costs, adding $4.1 bn in FY24 since the Third Quarter Finances. Interest on debt has been marked down as a result of lower-than-projected borrowing costs, saving the province $1.5 bn over three years.

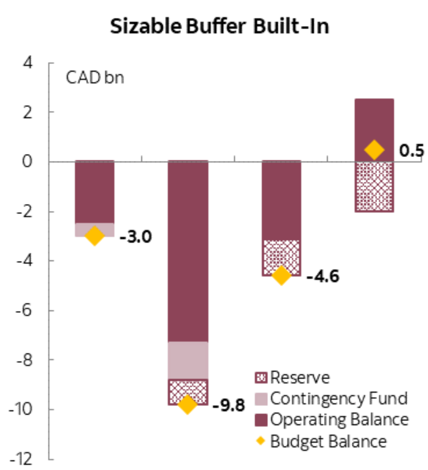
Additional measures introduced in the budget appear incremental and targeted, primarily focusing on enhancing ongoing initiatives. The signature policy is the $1.8 bn over three years for housing-enabling municipal infrastructure projects through the $1 bn in the new Municipal Housing Infrastructure Program and quadrupling the Housing-Enabling Water Systems Fund to $825 mn for municipal water infrastructure projects. The budget also dedicates over $900 mn to help address immediate financial sustainability challenges faced by the province's postsecondary education sector. As an effort to reduce costs, the gas tax relief was extended to the end of 2024 at a cost of $620 mn.

Chart 3



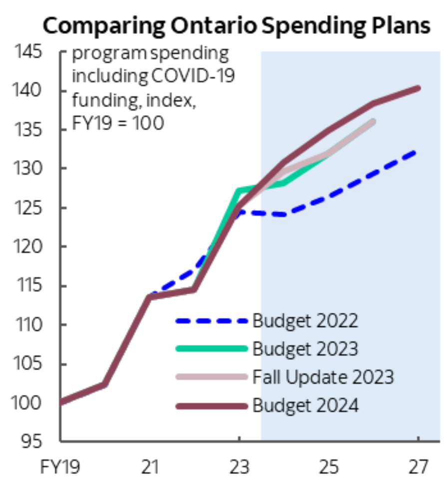
Sources: Scotiabank Economics, Ontario Finance.

Chart 4



Sources: Scotiabank Economics, Ontario Finance.

Chart 5



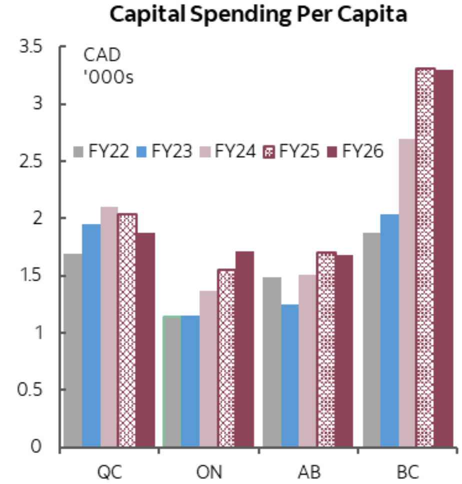
Sources: Scotiabank Economics, Ontario Finance.

The budget unveiled another record-high capital spending plan, underscoring the government's efforts to address the long-standing infrastructure underinvestment. The upgraded Capital Plan totals $190.2 bn over the next decade—$5.2 bn higher than the previous plan. That includes $26.2 bn in FY25—a 25% jump from FY24. Areas in focus include tackling gridlock and saving commuters time, developing more capacity in hospitals and expanding public transit. The ambitious plan allows Ontario to elevate its capital spending to levels more in line with its peers following a history of consistently lagging behind (chart 6). The government has also allocated an initial $3 bn to the new infrastructure bank—the Building Ontario Fund—to attract private capital and support the financing of critical infrastructure projections.

Although deeper deficit projections and increased capital spending send Ontario's debt-to -GDP ratio onto a higher trajectory, the province remains committed to its debt reduction strategy. Net debt-to-GDP is set to rise in the near term from 38.0% of nominal output in FY24 to 39.5% in FY26—still below the government's target of 40%. A downward drift in the net debt-to-GDP ratio can be expected in FY27 as the government balances the book. The province's debt-to-revenue ratio, set at 200%, remains unmet, with a forecasted ratio of 209% in FY27, projected to meet the target by FY30.

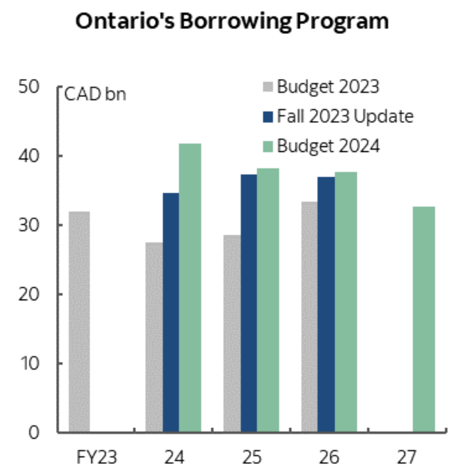
Long-term public borrowing is forecast to total $41.8 bn in FY24, $38.2 bn in FY25, $37.7 bn in FY26—respective increases of $7.1 bn, $0.8 bn and $0.7 bn versus the November 2023 projection—and $32.8 bn in FY27 (chart 7). The $7.1 bn increase in borrowing for FY24 is mainly due to higher year-end cash allocated for pre-borrowing future funding needs, with subsequent increases in the next two years reflecting larger-than-forecast deficits. In FY24, Ontario issued two $1.5 bn Green Bonds, for a total of fifteen issues totalling $18 bn since the program was launched.

Chart 6



Sources: Scotiabank Economics, Budget documents, Statistics Canada.

Chart 7



Sources: Scotiabank Economics, Statistics Canada.