Ontario: 2021–22 Mid-Year Update

ECONOMIC GROWTH DRIVES SIGNIFICANTLY NARROWER DEFICIT

- **Budget balance forecasts: -$21.5 bn (-2.3% of nominal GDP) in FY22, -$19.6 bn (-2%) in FY23, -$12.9 bn (-1.2%) in FY24. For FY22–23, that is a nearly $20 bn improvement versus Budget 2021 projections** (chart 1)**.**
- **Net debt: expected to stabilize near 43.5% of nominal GDP in each of the next three years, 5–6 ppts lower than the rising trajectory outlined in Budget 2021** (chart 2, p.2)**.**
- **Fiscal anchors: province remains focused on containing net debt-to-GDP, debt service-to-revenue, and net debt-to-revenue ratios; all are now on flatter and much lower trajectories than forecast in Budget 2021.**
- **GDP growth forecast: +4.3% real growth in 2021 and +4.5% in 2022—stronger than prior projections—with nominal output and tax revenue forecasts revised significantly higher in light of recent GDP inflation.**
- **Borrowing program: total long-term public borrowing of $42 bn in FY22, $45.3 bn in FY23, and $45.9 bn in FY24; reductions versus Budget 2021 largely reflect improved budget balance projections.**
- **The Update's much-improved fiscal trajectory should be well-received by rating agencies and Ontario's creditors, and the plan leaves room for upside in the near-term.**
- **Despite supply chain issues and COVID-19 risks, stronger-than-forecast FY21 results and continued economic recovery likely mean that Ontario will not be the only province to report improved fiscal results this fall.**

OUR TAKE

As widely expected following the budget balance improvement reported in the FY21 Public Accounts, Ontario finds itself on a much stronger fiscal trajectory. This reinforces the benefits of prudent fiscal planning, and reflects a degree of discipline. The March 2021 fiscal blueprint was based on conservative economic assumptions and built in substantial financial contingencies; both paved the way for an own-source revenue windfall in FY21. The Province has also—wisely in our view—held off on spending that windfall and opted to reduce its debt burden. The step change in this respect should be well-received by credit rating agencies.

Continued prudence beyond this year and next leaves further upside for Ontario's bottom line. Budget 2021 linked every 1 ppt in nominal GDP growth with $1.1 bn in tax revenues—on this basis, the nominal output growth forecast of 9% this year—1.4 ppts below the private-sector average—could be expected to add $1.5 bn in receipts to the bottom line. Another $10.7 bn in special COVID-19 funding—$4 bn more than in Budget—and a $1 bn forecast allowance in FY22 offer additional upside potential. Continued presentation of projected budget balances (chart 3, p.2) under higher- and lower-than-baseline growth scenarios (chart 4, p.2) provides welcomed transparency in light of a still-uncertain outlook.

CONTACTS

Marc Desormeaux, Senior Economist
416.866.4733
Scotiabank Economics
marc.desormeaux@scotiabank.com

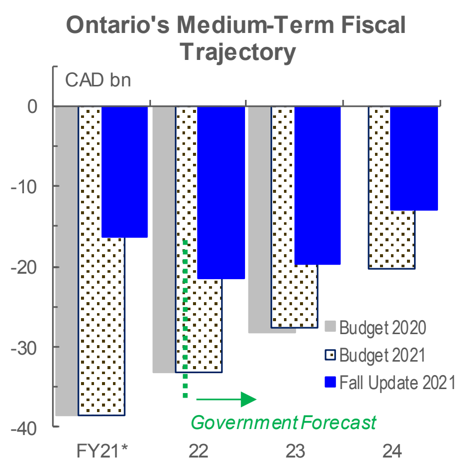
Laura Gu, Economist
416.866.4202
Scotiabank Economics
laura.gu@scotiabank.com

Updated Fiscal Forecast
$ billions except where noted

	FY21	FY22		FY23	
	Final	Mar. '21	Nov. '21	Mar. '21	Nov. '21
Total Revenue	**164.9**	**154.0**	**168.6**	**160.2**	**171.5**
Own-Source	131.0	126.6	138.9	132.6	143.8
Fed. Transfers	33.9	27.4	29.7	27.6	27.7
Total Expenditure	**181.3**	**186.1**	**189.1**	**186.3**	**189.6**
Programs	169.0	172.8	176.1	172.4	176.5
Health	64.4	69.8	69.9	68.5	71.6
Education	28.4	31.3	30.8	31.3	31.3
Other	57.1	65.0	64.7	72.6	70.2
COVID-19 Funding	19.1	6.7	10.7	2.8	3.4
Debt Service	12.3	13.3	13.0	13.9	13.1
Reserve	**0.0**	**1.0**	**1.5**	**2.0**	**1.5**
Balance	**-16.4**	**-33.1**	**-21.5**	**-27.7**	**-19.6**
% of GDP	*-1.9*	*-3.7*	*-2.3*	*-2.9*	*-2.0*
Net Debt	**373.6**	**439.8**	**402.4**	**472.9**	**430.2**
% of GDP	*43.9*	*48.8*	*43.4*	*49.3*	*43.5*
Debt Service					
% of Revenue	*7.5*	*8.6*	*7.7*	*8.7*	*7.6*

Sources: Scotiabank Economics, Ontario Finance.

Chart 1



* Fall Update figure is final result.
Sources: Scotiabank Economics, Ontario Finance.

The bulk of projected budget balance improvement stems from stronger revenues. This fiscal year, total revenues are expected to come in $14.6 bn higher than anticipated at budget time, while total spending was revised only $3 bn higher. The latter increase relates to new time-limited COVID-19 spending, which may be linked to a push-forward of health spending foregone last year as a result of a later-than-anticipated fourth pandemic wave. Outer-year program spending targets are only modestly higher than in Budget 2021.

Policy measures look appropriately targeted but unlikely to generate a significant boost to near-term economic growth. Further assistance for sectors like tourism and hospitality recognize that these continue to be particularly hard-hit by pandemic restrictions and uncertainty. Various measures to support retaining, upskilling, and workforce capacity growth acknowledge the challenges presented by acute labour shortage across the province. Planned infrastructure expenditures—estimated at $52.6 bn during FY22–24—represent an increase of only $1.3 bn for that period versus the March fiscal plan, though their 1.8% share of forecast nominal GDP is not inconsequential.

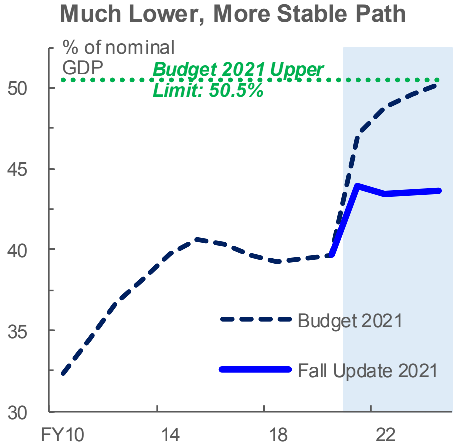
An increase in federal transfers also contributes to the expected improvement in the bottom line this fiscal year. The bulk of the $2.3 bn increase relative to the March Budget is sourced from the “Other Federal Payments” umbrella category, which presumably reflects additional COVID-19-related supports from Ottawa. Beyond FY22, transfer payment projections are in line with the previous financial blueprint.

Long-term public borrowing is forecast to total $42.0 bn in FY22, $45.3 bn in FY23, and $45.9 bn in FY24, respective reductions of $12.7 bn, $13.8 bn and $9.3 bn, versus 2021 Budget projections. Downward revisions mirror narrower-than-forecast deficits. This fiscal year’s $42 bn includes $6 bn in pre-borrowing for FY23; at October 19, 2021, 69% of planned borrowing had been completed. To date in FY22, about three-quarters of borrowing has been completed in Canadian dollars—via 25 syndicated issues and a Green Bond—within the 65–80% target range. In the lower-growth scenario, the government projected long-term borrowing to rise towards $52.3 bn in FY24. In the optimistic scenario, long-term borrowing eases to $37.5 bn by FY24.

Sovereign bond markets—Ontario’s included—continue to be driven by global developments exogenous to Ontario’s policy actions. Over the course of the pandemic, Ontario’s offerings have commanded high demand evidenced in tight spreads against GoC benchmarks, though more recent tightening at least partly reflects broadly improved risk sentiment. Smaller deficits today—and lower supply to market—may amplify that dynamic. As with all provinces, interest rate risk nevertheless persists, driven by central banks’ removal of support, but budget assumptions appear appropriate while continued efforts to term out its debt (projected at 10.9 years this year) and pre-borrowing activity provide a buffer against these exogenous risks.

Chart 2

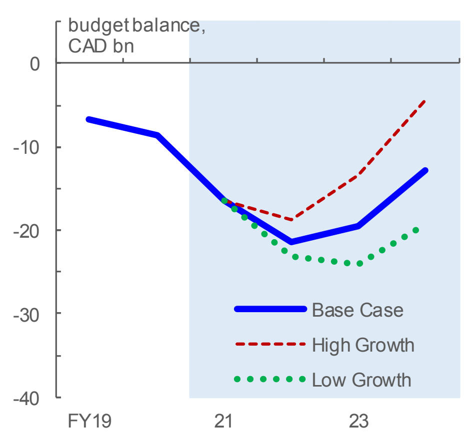
Revenue Gains Put Net Debt on Much Lower, More Stable Path



Sources: Scotiabank Economics, Ontario Finance.

Chart 3

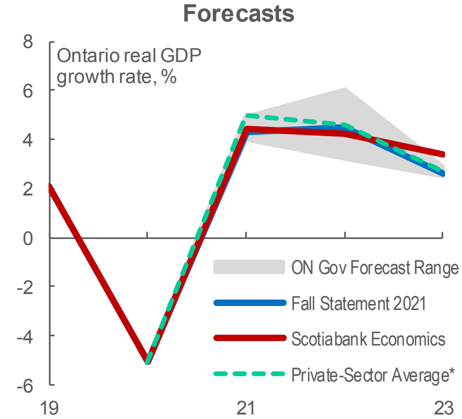
Ontario's Deficit Scenarios



Sources: Scotiabank Economics, Ontario Finance.

Chart 4

Comparing Ontario Growth Forecasts



* At Oct. 1, 2021.
Sources: Scotiabank Economics, Ontario Finance.

SUMMARY OF KEY POLICY MEASURES AND ANNOUNCEMENTS

Policy measures detailed in the update were organized into three key categories: COVID-19-oriented support (“Protecting Our Progress”), longer-term infrastructure investments (“Building Ontario”), and “Working for Workers”, which consists largely of labour market-related measures.

COVID-19-oriented supports included: funds for continued vaccination efforts, money for additional hospital and intensive care unit capacity, and funds to hire more nurses, practical nurses, and personal support workers. The province also aims to expand home and community care services, will invest in new personal protective equipment with the new school year in full swing, and offer a range of supports for retirement and long-term care homes. Like other provinces, Ontario continues to advocate for greater levels of annual federal health care funding via the Canada Health Transfer (CHT).

Policies related to “Building Ontario” included details on a range of transit infrastructure investments—notably the promised Highway 413 that will serve the York, Peel and Halton regions and Toronto-area subway expansions. The government also announced a $1 bn allocation towards development of road network to support development of the Ring of Fire mining region in Northern Ontario. It will continue to expand high-speed internet access and will establish a new Housing Affordability Task force to complement ongoing efforts to boost residential construction.

Major initiatives in the “Working for Workers” category were the already announced increase in Ontario’s minimum wage to $15/hour on Jan. 1, 2022, extension of the Jobs Training Tax Credit to 2022, and enhanced eligibility for the Second Career Program—which retrains unemployed workers—for immigrants, gig workers, and persons with disabilities. The government will also offer a tax credit equal to up to 14.5% of Ontario residents’ eligible expenses on within-province tourist activities. The province further emphasized its estimated $10.1 bn in business cost savings this year through various tax incentives and fee reductions, and recent commitments from major auto manufacturers to invest in Ontario’s electric vehicle supply chain capacity.