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Ontario's fall economic statement

As signaled by both Premier Dalton McGuinty and Finance Minister Dwight Duncan in speeches during the past week, the Ontario budget is now officially headed into a small deficit in the fiscal year ending next March (2008-2009). In the government's fall economic statement released today, Finance Minister Duncan confirmed that the worsening in economic conditions in the province will reduce own revenues by more than \$1 billion compared to budget estimates. Although this was partially offset elsewhere in the budget, such as by a drawdown in reserves, this reduction has resulted in the government projecting a deficit of \$500 million – revised from a projected balance in the March budget and representing the first deficit in Ontario since fiscal 2004-2005.

The government did not provide an updated view for 2009-2010 and, for the time being, is sticking with its call for a balanced budget. However, it would be safe to argue that the real challenge will be to keep the boat afloat next fiscal year.

Statement details

- The forecast for Ontario's real GDP has been revised lower to 0.1% in 2008 from the 1.1% call at budget time and to 0.7% in 2009 from 2.1%. This remains marginally more upbeat than RBC's current forecast of 0.0% and 0.4%, respectively.
- Own revenues are now expected to come in \$1.1-billion below budget, which would represent a 1.5% decline compared to 2007-2008.
- However, some offset will be derived from higher-than-estimated federal transfers to the tune of \$207-million, leaving a hole of \$918-million in total revenues compared to budget.
- Total revenues are now projected to decrease by 1.2% compared to 2007-2008, although this only partially retraces last year's surge of 7.4% that was inflated by an unexpected, last-minute \$5.6-billion surge.
- The downward revision in revenues reflects lower-than-expected receipts from corporate taxes (\$880 million lower than budget), land transfer taxes (\$180 million) and gasoline taxes (\$65 million). Estimated receipts from personal income taxes remain unchanged.
- Total expenditures are now projected to be \$132 million above budget (or a 0.1% increase), resulting primarily from higher utilization-related expenses in the OHIP program. Nonetheless, at \$96.3 billion, this would still represent a small decline compared to 2007-2008 (-0.2%). Interest payments on the public debt are unchanged.

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- The government is reducing its contingency reserve to \$200 million from \$750 million (budget).
- Overall, the budget is now projected to show a \$500 million deficit this fiscal year, following three years of small surpluses.
- Net debt as a percentage of GDP is expected to edge higher to 24.5% from 24.4% in 2007-2008. Similarly, interest on debt as a percentage of revenue is seen to move up a touch to 9.3% from 9.2% last fiscal year.
- The Ontario government remains committed to “pursue strategies to contain spending while doing all it can to protect key investments”.

Discussion

Downward revisions to revenues come as little surprise in the context of the financial crisis and the deteriorating outlook for Ontario's economy. It is clear that, among the provinces, Ontario is the most vulnerable to the unfolding recession in the United States. Although the projection of a deficit is always a disappointment, the provincial government can be forgiven to the extent that it is still mainly sticking to the plan outlined in the March budget and is resisting pressure to open up its cheque book.

Nonetheless, the toughest work remains ahead. Lower revenue estimates for this fiscal year reflect weakness on the corporate side, the cooling of real estate activity and the restraining effects of earlier high gasoline prices. The government has maintained its revenue estimates from the household side (mainly personal income tax and retail sales tax) – the largest component of revenues. This is justified at this stage on the basis of the robust performance in the labour market and retail sales so far this year. However, as the economy slows down further in the months ahead and the pace of job creation decelerates, downward pressures are likely to emerge on that front as well. This is only to highlight the substantial downside risks on the deficit that will test the government's fiscal management in the coming period.

Exhibit 1: Ontario's fiscal plan

(\$ billions)	Actual	Actual	Actual	Actual	Budget	Oct. Update	Outlook	
	<u>2004/05</u>	<u>2005/06</u>	<u>2006/07</u>	<u>2007/08</u>	<u>2008/09</u>	<u>2008/09</u>	<u>2009/10</u>	<u>2010/11</u>
Total revenues	77.8	84.2	90.4	97.1	96.9	96.0	100.6	103.8
Total expenditures	79.4	83.9	88.1	96.5	96.2	96.3	99.6	102.6
Program spending	70.0	74.9	79.3	87.6	87.3	87.4	90.6	93.4
Interest on public debt	9.4	9.0	8.8	8.9	8.9	8.9	9.0	9.1
Reserve	-	-	-	-	0.8	0.2	1.0	1.2
Surplus/(Deficit)	(1.6)	0.3	2.3	0.6	0.0	(0.5)	0.0	0.0
Net provincial debt as % of GDP	27.3	26.5	25.2	24.4	24.2	24.5	24.0	23.8

Source: Ontario Ministry of Finance, RBC Economics Research