2015 ONTARIO BUDGET

April 23, 2015

Mostly about building infrastructure but deficit reduction also on the agenda

- Ontario's 2015 budget elevates infrastructure investment as a top priority for the government.
- The commitment to eliminate the provincial deficit by FY17/18 is maintained.
- In fact, the fiscal plan revises the next two years' projected deficits slightly downward to $8.5 billion in FY15/16 (from $8.9 billion previously) and $4.8 billion in FY15/16 (from $5.3 billion previously).
- Faster-growing economy to provide a boost to revenues in the short term; however, program expenditure restraint over the entire fiscal plan remains key to eliminating the deficit by FY17/18.
- Substantial investments in public infrastructure will be funded in part by asset sales.
- The weight of the province's debt is projected to ease over the medium term at slightly lower levels than previously projected.

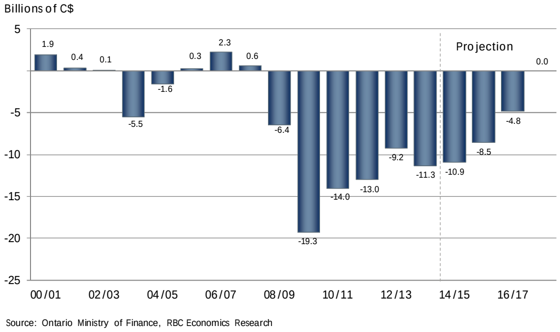
Top priority: building transit infrastructure

Transit infrastructure spending clearly emerges as the main priority for the Ontario government in Budget 2015. This theme was launched last year with Budget 2014 announcing a plan to invest $130 billion on public infrastructure over a 10 year period. Today, Finance Minister Charles Sousa upped the ante for transportation infrastructure in the province by boosting the allocation to the Moving Ontario Forward plan by $2.6 billion to $31.5 billion with a portion being allocated specifically for transit in the Greater Toronto and Hamilton Area. In total, transportation and public transit infrastructure will represent at least half of the government's 10-year $130 billion infrastructure plan. To pay for this substantial infrastructure build, the Ontario government will dedicate certain revenues (part of the gasoline tax), squeeze out additional tax revenues (e.g., raising the aviation fuel tax, instituting high-occupancy toll lanes on some highways), sell provincial assets (e.g., up to 40% of Hydro One), tap federal money and, last but not least, borrow.

Other priority: eliminating the deficit

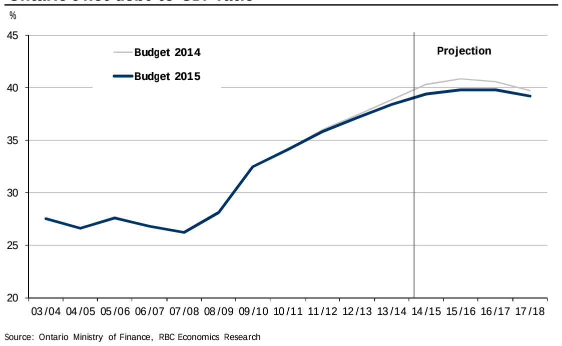
While the focus of Budget 2015 is on building infrastructure, balancing the provincial books still remains a priority for Minister Sousa's government, although the target date for achieving it remains two years away (FY17/18)—unchanged from earlier fiscal plans. Until then, downwardly revised deficits of $8.5 billion and $4.8 billion are now projected in FY15/16 and FY16/17, respectively. These projections represent a noticeable improvement from the

Ontario budget balance



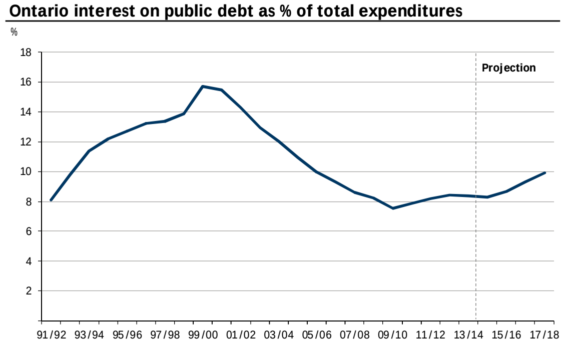
Source: Ontario Ministry of Finance, RBC Economics Research

Ontario's net debt-to-GDP ratio



Source: Ontario Ministry of Finance, RBC Economics Research

Ontario interest on public debt as % of total expenditures



Source: Ontario Ministry of Finance, RBC Economics Research

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Budget assumptions

	2014	2015	2016	2017	2018
Real GDP growth (%)					
Budget 2015	2.2	2.7	2.4	2.2	2.1
Private sector average*	2.2	2.8	2.5	2.3	2.2
RBC	2.5	3.3	2.7	-	-

* As of March 31, 2015

Source: Ontario Ministry of Finance, RBC Economics Research

$10.9 billion deficit now expected for FY14/15 (downwardly revised from $12.5 billion in Budget 2014) and from a deteriorating trend in the past two years.

Stronger economic growth will help in the short term

Progress toward erasing the deficit will be facilitated by a modestly stronger provincial economy. A robust increase in taxation revenues of 5.7% is propping up total revenue growth in FY15/16 of 5.0%. Meanwhile, the government intends to hold the line on spending, keeping program expenditure growth at 1.4% although this is not quite as aggressive as the 0.6% growth earmarked for FY15/16 in last year's budget.

Substantial program expenditure restraint over the medium term

Program expenditures are set to rise by 0.3%, on average, through the fiscal plan with an outright decline planned in 2017/18 (up 0.1% in FY16/17 and down 0.5% in FY17/18). Taking into account inflation and population growth, this will mark a period of significant fiscal restraint with real per capital spending set to decline through the fiscal plan. This would contrast the 4.0% total revenue growth planned in the final two years of the fiscal plan.

Contingency reserve to provide some insurance against unexpected events

To guard against downside risks to the profile, the government maintained a $1.2 billion contingency reserve in the outer-years of the plan. For FY15/16, however, the amount allotted has been reduced by $0.2 billion to $1.0 billion. This change accounts for half of the $0.4 billion improvement in the province's bottom line relative to Budget 2014.

Better than expected results in FY14/15

While the $1.6 billion downward revisions to the FY14/15 deficit was good news, much of it resulted from the removal of the $0.7 billion contingency. That being said, the remaining improvement came from savings on the expenditure side of the ledger (including from public sector compensation), which more than offset some weaker-than-anticipated growth on the revenue side.

Crunch time for reducing the deficit

Considering that it took five years to get the deficit down by $8.3 billion from a record high of $19.2 billion FY09/10, the plan to reduce it by a further $10.9 billion in the next three years (this year and the following two) is ambitious. Yet achieving this goal is necessary given the elevated level of provincial debt.

Unlocking asset values

The government announced that its asset optimization review will "unlock" $5.7 billion in value or $2.6 billion more than expected in Budget 2014. This greater amount results from the expected proceeds from partially privatizing

Hydro One (estimated to bring in $4 billion), selling the Province's shares in GM ($1.1 billion or $200 million more than expected previously) and the phasing in of a new levy on beer sales in the province ($100 million per year when fully implemented). The $2.6 billion of unlocked assets will be used entirely to boost the Moving Ontario Forward funds, and therefore will support the government ambitious 10-year infrastructure build.

Debt profile improves slightly

Despite the strong emphasis of Budget 2015 on capital spending, it is encouraging to see that Ontario's net debt profile improved slightly since Budget 2014—now estimated at 39.4% of GDP in March 2015 and projected to reach 39.2% by FY17/18 compared to 40.3% and 39.7%, respected, projected in last year's budget. Ensuring that the weight of the provincial debt remains on a downward course should be key objective for the Province in the coming years, as the government will face rising debt service costs. In fact, interest on public debt will be the fastest rising expenditure item over the medium term, which will divert funds from other uses.

Long-term public borrowing to be reduced

The Province estimates funding requirements to total $35.9 billion in FY15/16 (for its own account as well as for the Ontario Electricity Financial Corporation), which would be modestly lower than requirements of $37.6 billion in FY14/15. Total long-term public borrowing, however, is slated to fall more significantly this year to $31.1 billion from $39.8 billion last year because the Province prefunded $4.8 billion of this year's requirements in FY14/15. Diminishing funding requirements in the following two years reduce expected total long-term public borrowing to $30.4 billion in FY16/17 and $24.4 billion in FY17/18.

Ontario's fiscal plan

($ billions)	Actual		Interim	Plan	Outlook	
	2012/13	**2013/14**	**2014/15**	**2015/16**	**2016/17**	**2017/18**
Total revenues	113.4	115.9	118.5	124.4	129.4	134.4
Total expenditures	122.6	126.4	129.5	131.9	133.0	133.2
Program spending	112.3	115.8	118.8	120.5	120.6	120.0
Interest on public debt	10.3	10.6	10.7	11.4	12.4	13.2
Reserve	-	-		1.0	1.2	1.2
Surplus/(Deficit)	(9.2)	(10.5)	(10.9)	(8.5)	(4.8)	0.0

Source: Ontario Ministry of Finance