



ONTARIO BUDGET 2010

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In it for (or out of it in) the long haul

Last October, in its Economic Outlook and Fiscal Review, the Ontario government sent shock-waves when it revealed the extent to which its fiscal situation had deteriorated, prompting it to revise its deficit projections upwards not only for the current year but also for the next two. The shortfall was boosted to a record level of \$24.7 billion in 2009-10 and to moderately lower levels of \$21.1 billion and \$19.4 billion in 2010-11 and 2011-12, respectively – up by more than 80% relative to Budget 2009. In the face of this poorer outlook, Premier Dalton McGuinty, in his Throne Speech earlier this month, indicated that his government would “lay out a plan to return the budget to balance” in Budget 2010 but added that it “will not put economic growth at risk by cutting too much, too soon”, as if to set expectations that balancing the books would be a longer term endeavour.

So it is in this context – large deficits for some time to come and a preference to let economic growth do the heavy lifting in bringing the budget to balance – that Budget 2010 was shaped.

Yesterday, Finance Minister Dwight Duncan delivered the first “good news”: the deficit for the fiscal year ending this month is now projected to be smaller than anticipated in October, revised to \$21.3 billion – still a record and almost entirely the result of removing the earlier reserve of \$1.2 billion and most of the operating contingency fund of \$1.9 billion. Today’s budget goes farther in that direction, revising downwards the projected deficits for both 2010-11 and 2011-12, to \$19.7 billion and \$17.3 billion, respectively. However, Ontarians will need to wait until 2017-18 (eight years!) for the books of the province returning to balance – a long-term endeavour indeed. The government’s Fiscal Recovery Plan calls for gradually diminishing shortfalls through 2016-17 and then a zero balance the following year. The budget documents play up the fact that the deficit will be cut in half in five years (by 2014-15) but that would still be close to the previous record levels reached in the early 1990s (unadjusted for inflation). Meanwhile, the province’s net debt (restated to include that of hospitals, school boards and colleges) will continue to rise from \$193 billions (or 34.1% of GDP) in 2009-10 to \$268 billion (40.9% of GDP) in 2012-13. The budget did not provide estimates beyond that year.

Highlights

Revenues in the upcoming year are expected to increase by \$10.5 billion (10.9%), following a decline of \$533 million (0.5%) in 2009/10. The main drivers of the revenue rise are increases of \$2.0 billion (37.0%) in corporations’ tax revenues (thanks to an expected 31% rebound in corporate profits), \$1.9 billion (7.9%) in personal income tax (improved wage growth) and \$1.7 billion (9.2%) in sales tax revenues (pick-up in consumer spending and the expansion of the sales tax base under sales tax harmonization). Federal transfers are expected to jump by \$5.1 billion (27.4%) reflecting the HST transition payments and infrastructure stimulus plans.

Total expenditures are projected to rise by \$8.2 billion (7.0%) to \$125.9 billion in 2010/11. The main program spending increases are tied to the health sector (\$2.6 billion or 6.0%) and a \$1.5 billion (7.3%) increase in “Other expenditure”, predominantly related to the stimulus

spending on infrastructure to help the province “emerge from the economic downturn”. The upcoming year will also see a previously-announced one-time, \$3.2 billion HST transitional support transfer to Ontario households and firms. However, this will be less than the one-time, \$4.0 billion auto bailout during 2009-10.

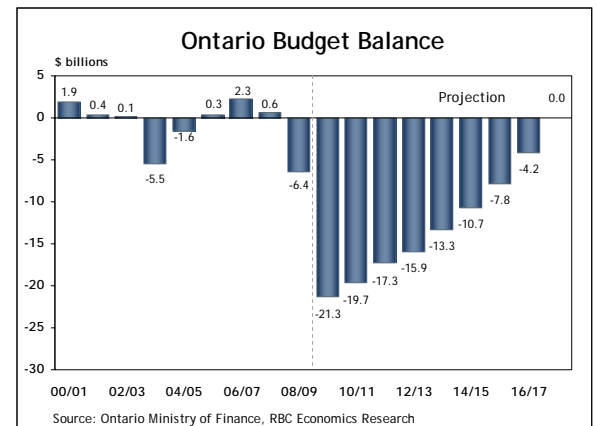
Overall, budget assumptions are reasonably conservative over the next two to three years. It forecasts real GDP to grow by 2.7% in 2010 and 3.2% in 2011, significantly below RBC’s forecasts of 3.3% and 4.1%, respectively. The budget also maintains a \$700 million reserve in 2010-11 and \$1 billion in the two subsequent years (although these are smaller amounts than the \$1.2 billion previously set aside) and a \$1.8 billion operating contingency fund in 2010-11. If unused, they would lower the deficit by \$2.5 billion in 2010-11. Additionally, assuming RBC’s real GDP forecast instead would further reduce the deficit by roughly \$375 million in 2010-11.

However, the extended fiscal plan appears to have relatively restrictive spending growth targets. The government plans to hold spending growth to an average of 1.9% after 2012/13. This would compare to an average of 6.5% in the past eight years. For their part, revenues are targeted to grow by 5.0% on average during that period, which is largely consistent with the government’s average nominal GDP growth forecast of 4.9%.

While the recession hit the Ontario economy very hard last year, its consequences on the fiscal state of the province will be felt for a long time to come. Tough decisions will need to be made to ensure spending growth is kept in check through the long haul.

Public debt

The Ontario government expects its total long-term public borrowing program to decrease slightly to \$39.7 billion in 2010/11 from \$43.8 billion in 2009-10. The budget documents state that at least 50% will be financed in the domestic market. Total borrowings are expected to further decline to \$38.8 billion in 2011-12 but to rise again to \$40.2 billion in 2012-13.



Ontario's fiscal plan

(\$ billions)	Actual	Interim	Plan	Mid-term Outlook		Extended Outlook				
	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
Total revenues	96.9	96.4	106.9	107.7	112.0	117.6	123.4	129.6	136.1	142.9
Total expenditures	103.3	117.7	125.9	124.1	126.9	129.9	133.2	136.5	139.3	141.9
Program spending	94.8	108.8	115.9	112.9	114.3	116.5	118.7	121.0	123.3	125.7
Interest on public debt	8.6	8.9	10.0	11.1	12.5	13.3	14.4	15.4	15.9	16.2
Reserve	-	0.0	0.7	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Surplus/(Deficit)	(6.4)	(21.3)	(19.7)	(17.3)	(15.9)	(13.3)	(10.7)	(7.8)	(4.2)	0.0

Source: Ontario Ministry of Finance, RBC Economics Research

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