THE 2014 ONTARIO ECONOMIC AND FISCAL REVIEW

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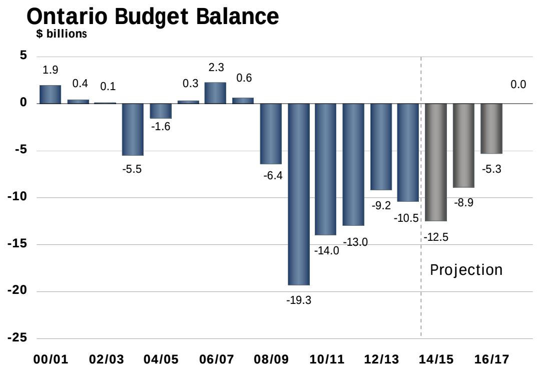
Ontario mid-year fiscal update: on track despite some revenue challenges



Source: Ontario Ministry of Finance, RBC Economics Research

In today's mid-year 2014 *Economic Outlook and Fiscal Review*, Ontario's Finance Minister Charles Sousa stuck to the previously stated path to balance the province's budget by 2017-2018. Deficits of $12.5 billion in 2014-2015, $8.9 billion in 2015-2016, and $5.3 billion in 2016-2017 are still being projected in the intervening years.

However, the revenue profile has been lowered slightly to reflect weaker-than-expected taxation revenues—primarily on the corporate tax side—recorded in the 2013-2014 fiscal year, which set a lower base for subsequent years' revenues. The adjustments resulted in the outlook for total revenues being downwardly revised modestly by $509 million to $118.4 billion in 2014-2015. This downward revision is entirely offset by savings on interest payments related to the province's outstanding debt as well as a $300 million reduction in the $1 billion contingency set aside by the government at the time of the budget. Over the medium term, lower expected interest charges provide the entire offset to the weaker revenue projections. The outlook for program expenditures remained unchanged relative to the July budget.

In his speech today, Minister Sousa stated that he will consider "other tools" as necessary to balance the budget should the revenue outlook fall further from the 2014 budget projections. He did not specify what these tools would be; however, he made it clear that they would not include cuts to "investments in those programs and services that people depend on". He also indicated that there would not be the sale of any of Ontario's major crown corporations (Hydro One, Ontario Power Generation and Liquor Control Board of Ontario). In April 2014, the government named a task force (the Premier's Advisory Council on Government Assets) to recommend ways to "unlock the value of provincial assets". The preliminary recommendations of the Council released in October argued that it would be in the best interest of Ontarians that the provincial government retained ownership of these corporations. Final recommendations are anticipated to be included in the preparation of Budget 2015.

With respect to the economic underpinnings for its fiscal plan (which proved disappointing last year), the government sees evidence that the provincial economy is gaining momentum, although the pace does not appear to be quite as robust as anticipated at budget time. The government now assumes real GDP growth rates of 1.9% and 2.4% in 2014 and 2015, respectively, both just slightly weaker than the 2.1% and 2.5% projected in Budget 2014 but stronger than the 1.3% rate in 2013. Assumptions for nominal GDP, however, were left unchanged at 3.5% in 2014 and 4.4% in 2015.

To guard against unexpected developments the Ontario government maintained a contingency fund of $1.2 billion annually beyond the current fiscal year. A degree of caution was further evident as the government noted that it is currently awaiting "key information" in the current fiscal year that could change the current projections of the underlying budget components. These include final results from 2013 corporate and personal income tax return processing (which account for one third of the province's total revenues) as well as the anticipated Equalization transfer from the Federal government, expected in

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December. The actual realized revenues from these sources therefore have the potential to swing the revenue pendulum in either an up or down direction. A final source of funds is the use of the contingency fund to buffer unforeseen developments as was the case in this budget update.

The good news in today's update is that Ontario's net debt is now projected to be $2.0 billion lower ($287 billion) at March 31, 2015, than projected in Budget 2014. As a percentage of GDP, the net debt profile has been reduced very slightly throughout the projection period, with the peak in 2015-2016 now lowered to 40.4% from 40.8% previously.

Overall, the main take-away from Minister Sousa's update today is that, so far into the 2014-2015 fiscal year, Ontario's budget plan appears to be largely on track. There continues to be some disappointments on the revenue side but these are fairly modest and well within the wiggle room afforded by the budget reserve. We are encouraged to see that revisions to the debt profile, however slim, are the right direction—i.e., down. Still, it remains to be seen whether rating agencies will be satisfied with the evolution of Ontario's fiscal position to date, as well as the plan going forward. Ontario's credit rating is under review by Moody's and Standard and Poor's for a possible downgrade.

Ontario's fiscal plan

($ billions)	Actual	July Budget	November Update	Updated Projected Outlook		
	2013/14	**2014/15**	**2014/15**	**2015/16**	**2016/17**	**2017/18**
Total revenues	115.9	118.9	118.4	124.2	129.0	134.5
Total expenditures	126.4	130.4	130.2	131.9	133.2	133.3
Program spending	115.8	119.4	119.4	120.1	120.2	119.4
Interest on public debt	10.6	11.0	10.8	11.8	12.9	13.9
Reserve	-	1.0	0.7	1.2	1.2	1.2
Surplus/(Deficit)	(10.5)	(12.5)	(12.5)	(8.9)	(5.3)	0.0

Source: Ontario Ministry of Finance, RBC Economics Research

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