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Ontario Budget 2009

Impact of the recession is evident but is it being sufficiently countered?

Highlights

The Ontario budget clearly reflects the impact of the provincial economy in recession. The cumulative deficit in the two upcoming fiscal years (fiscal years 2009-10 and 2010-11) has ballooned by \$26.3B reflecting in part a projected sharp falloff in revenue growth. (The \$18B cumulative deficit that the Finance Minister warned about a number of weeks ago reflects fiscal years 2008-09 and 2009-10.) The other key factor in the deterioration in the fiscal numbers is a sharp jump in expenditures that is led by the increased spending on infrastructure (though the budgetary impact of \$6.6B is much smaller than the actual provincial expenditure of \$27.5B as these assets have been “amortized to expense over their useful lives”). This additional spending is the main initiative to counter the economic downturn. The budget does contain various tax cuts though they do not kick in until 2010 or later. The timing seems to have largely been determined by the proposed July 1, 2010 implementation of the harmonization of the provincial sales tax (PST) with the federal GST, which provides the revenue to fund many of these tax cuts. This additional revenue comes from both the widening of the tax base from what the PST currently applies plus the federal government providing the province with \$4.3B in payments to help with the transition. The argument could be made that these tax cuts should have been more quickly implemented to address the current marked economic weakness. An additional criticism of today’s budget was that it did little to counter concerns that a move into deficit could prove hard to reverse. Though the document indicates a return to a balanced budget, it does not occur until fiscal 2015-16. As well, little detail is provided as to how this will be achieved other than maintaining that growth in program expenditure will be held below projected revenue growth.

Analysis

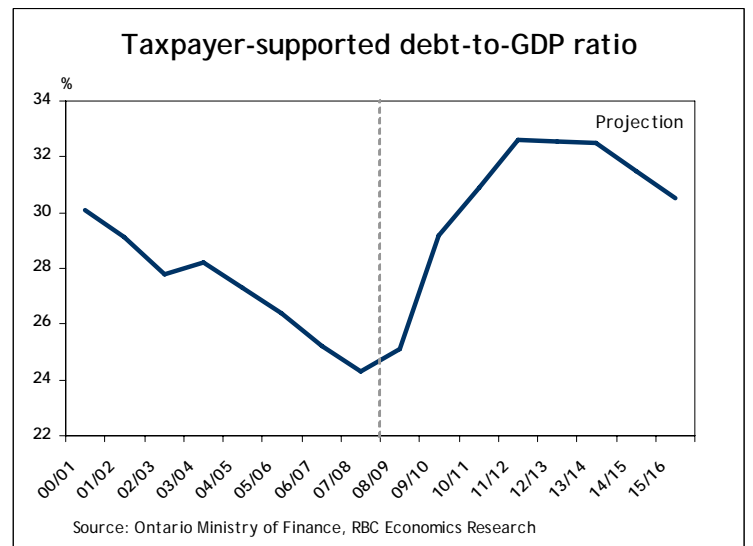
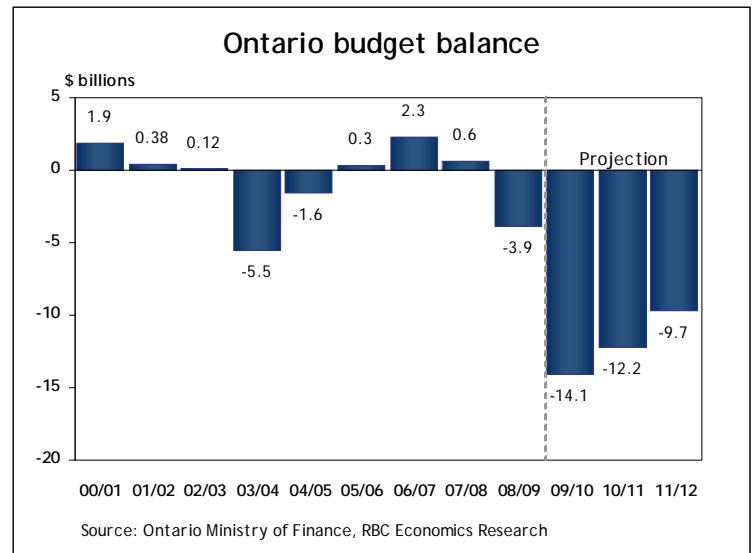
As has increasingly been the practice among fiscal authorities in recent years, a number of key budget proposals are finding their way into the media in the weeks and days before the official release. Today’s Ontario budget was no different. Ontario Finance Minister Duncan indicated that the two-year deficit would balloon to \$18B with today’s budget providing the actual breakdown of \$3.9B in fiscal 2008-09 and \$14.1B in fiscal 2009-10. The deficit remains high in fiscal 2010-11 though moves slightly lower to \$12.2B. (In their fall economic statement the government was projecting a deficit of only \$0.5B in fiscal 2008-09 and a balanced budget in fiscal 2009-10 and fiscal 2010-11). In today’s budget the province does not return to a balanced position until 2015-16. The budget also reflected the widely publicized \$27.5B in infrastructure spending over fiscal years 2009-10 and 2010-11. However, the budgetary impact is a much smaller \$3.2B and \$3.4B over these two fiscal years as the government appears to have amortized to expense these capital investments over their useful lives. As expected, the majority of the infrastructure spending will be aimed at investment in public transit, highway construction, health and education.

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Today's budget also made it official that they planned to implement the harmonization of the 8% PST and the 5% federal GST for a combined tax rate of 13%. The new tax will be introduced July 1, 2010. The move to a harmonized rate should be applauded in terms of removing the inefficiencies of the current PST that applies to business inputs which raises production costs. One earlier reservation by the provincial government about the move to harmonization was that the GST had a much broader tax base that included items the McGuinty government preferred to have kept exempt. (On this front, the provincial government won some concessions retaining exemptions for such areas as children's clothing and footwear.) This wider tax base did provide the benefit of bringing in additional tax revenue to the province to the tune of \$3.8B over fiscal 2010-11 and 2011-12. However, a new element that emerged in today's budget was that the federal government was also providing Ontario with \$4.3B over these two years to help with the transition. This has allowed the provincial government scope to introduce some sizeable tax relief to those deemed unduly hurt by the new tax but also allowed the Ontario government to lower the tax burden on both households and businesses. For example, effective January 1, 2010 the lowest tax bracket will be lowered by 1 percentage point to 5.05% from 6.05% currently. Similarly it was announced that the general corporate income tax rate was being cut to 12% from 14% though not until July 1, 2010 (and to 10% by 2013). Though these tax cuts are welcome and should help boost growth and productivity over the medium term, the delay until 2010 does little to counter the current economic weakness. A 2010 implementation is largely a reflection of the means to fund these cuts not starting to flow until then. Given the severity of the downturn, the argument could be made to accelerate the cuts and take the temporary hit to the deficit that would be reversed in 2010. However, currently proposed these tax changes have negligible net impact on the overall budget balance (\$400 million) over fiscal 2009-10 and fiscal 2010-11.



With tax changes having a negligible net impact what causes the deficit to balloon a cumulative \$26.3B over fiscal years 2009-10 and 2010-11? Projected slower economic growth has reduced revenue growth by \$11.3B. The severe economic slump in the U.S. and other major world economies made Ontario one of the first provinces to enter recession in 2008 and the Government expects weakness in the global economy to continue to weigh on provincial growth in 2009. Eventually lower interest rates and global policy actions are expected to stabilize the global economy, however the Government's near-term outlook for Ontario remains bleak. They expect provincial GDP to contract 2.5% in 2009 (slightly weaker than RBC's call of -1.9%), weighed down by a 9.7% decline in exports, before rebounding to 2.3% in 2010 (RBC 2.4%). Expenditure changes account for an even greater \$21.4B. This reflects a number of initiatives with the most sizeable being the infrastructure spending initiatives. The province has also added a contingency fund of \$3.1B in fiscal 2009-10 "in recognition of ongoing global economic uncertainty." The main offset is \$5.2B coming from the federal government which includes changes to CHT funding and equalization payments.

The budget is projecting a return to a balanced position though not until fiscal 2015-16. As well, this balance is only achieved by very weak program expense growth of 2.3% per year which is one-half of the projected growth in revenues of 4.6% from 2012-13 to 2015-16. No details were provided in terms of what action will be taken to constrain program spending growth to 2.3% compared the recent run rate over the previous five years of 8.2%.

The weakened fiscal position of the province was evident in the net debt-to-GDP numbers which are now projected to rise over the next three years to a near term peak of slightly under 33%. By 2015-16 the ratio drops to 30.5% as the deficit is gradually eliminated by that terminal year. It is of note that the accumulated deficit-to-GDP ratio peaks at a lower 23.1% as the latter does not reflect the actual expenditure on the various capital projects but rather an amortized value. The ambitious capital spending program has contributed to the province's borrowing requirement ballooning as well to \$34.8B, \$34.3B and \$32.1B over fiscal years 2009-10 to 2011-12. In the 2008 budget, the province was projecting a borrowing requirement of \$24.3B and \$20.9B for the first two years (with no projection provided for fiscal 2011-12).

Ontario fiscal plan

(\$ billions)	<u>Actual</u> 2004/05	<u>Actual</u> 2005/06	<u>Actual</u> 2006/07	<u>Actual</u> 2007/08	<u>Interim</u> 2008/09	<u>Budget</u> 2009/10	<u>Outlook</u> 2010/11 2011/12	
Total revenues	77.8	84.2	90.4	97.1	93.4	96.0	103.6	104.4
Total expenditures	79.4	83.9	88.1	96.5	97.3	108.9	114.6	112.9
Program spending	70.0	74.9	79.3	87.6	88.5	99.6	104.7	101.9
Interest on public debt	9.4	9.0	8.8	8.9	8.9	9.3	9.9	11.1
Reserve	-	-	-	-	-	1.2	1.2	1.2
Surplus/(Deficit)	(1.6)	0.3	2.3	0.6	(3.9)	(14.1)	(12.2)	(9.7)

Source: Ontario Ministry of Finance, RBC Economics Research