October 30, 2024

Upside revenues drive marginal spending and fiscal consolidation

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Highlights

Despite less vigorous economic growth compared to 2023, Ontario's economy is expected to fare better in 2024 than originally anticipated thanks to another record year for population growth. Ontario's Fall Economic Statement (FES) ushered in distinctly good news on the fiscal front too. The trajectory for the budget balance has been shifted up with this year's expected shortfall being shaved down to $6.6 billion from the $9.8 billion penciled into Budget 2024. Together with positive revisions to 2023-24 (crystallized in the *Public Accounts*), there is now an impressive $9.1 billion less red ink expected through the four years ending 2026-27 (relative to Budget 2024). While the province remains focused on returning to balance and reaffirmed their 2026-27 timeline, we'd note the 2025-26 budget is technically balanced before the $1.5 billion reserve is accounted for. Notably, the province was able to provide the much-improved fiscal guidance even after some non-trivial spending initiatives and tax cuts, including a $200 'rebate' for taxpayers with an estimated $3.0 billion price tag. There are fiscal risks, however. The recent revision to immigration targets, which should have a disproportionate impact on Ontario, could be a drag on the province's finances. Meanwhile, the improved budgetary outlook and resulting markdown of borrowing needs led to the closely watched net debt-to-GDP trajectory being revised down 1.4%-pts versus Budget 2024 (to 37.8% of GDP in 2024-25). The interest on debt-to-revenue ratio (i.e., the interest bite) was also marked down from the budget (from 6.8% to 6.0%). As for the specifics on borrowing, there's $0.7 billion less to be done this year than earlier anticipated. The province has completed 85% of their official requirement ($37.5 billion) at what amounts to the 58% mark of the fiscal year. Fair then to label Ontario's funding program as comfortably 'ahead of schedule'

- **Economic outlook** — Although economic growth in Ontario slowed in the first half of 2024 compared to the previous year due to the impact of high interest rates, GDP has so far grown at a greater rate than the national average this year, supported by strong population growth. In addition, Ontario's economic performance since the start of the year has been better than previously anticipated in the 2024 Budget, leading to an upward revision of real GDP growth for 2024 from 0.3% to 0.9%. In subsequent years, growth is expected to improve to 1.7% in 2025 (revised from 1.9%) thanks to lower interest rates and to reach 2.3% in both 2026 and 2027 (revised from 2.2%). Nominal GDP growth in 2024 has also been revised upwards compared to the Budget, from 2.7% to 3.8%, explaining the positive surprise on the province's revenues. For the coming years, Nominal GDP should grow by 3.9% in 2025 (unchanged from the Budget) and by 4.4% in 2026 (revised from 4.3%) and 2027 (revised from 4.1%). While these forecasts were cautiously below the median forecasts of private-sector economists as of September 19, the significant revisions to immigration targets announced last week by the federal government add further uncertainty to the ability of the Ontario economy to achieve such growth. Indeed, Ontario will be disproportionately impacted compared to other Canadian provinces by the desire to reduce the weight of non-permanent residents to 5% of the total population by 2026, since they currently represent 8.5% of the Ontario population compared to 7.3% of the population in the country as a whole. Furthermore, Ontario, which also welcomes a significant proportion of permanent residents, will also be more affected by the reduction in permanent resident targets. As for the labour market, Ontario has continued to post job creation since the start of 2024 but has been unable to keep pace with population growth. As a result, the unemployment rate increased from an average of 5.7% in 2023 to an average of 6.8% for the first three quarters of 2024. For this reason, the average unemployment rate for 2024 has been revised upwards to 6.9%, compared with 6.6% in the Budget. It should then remain stable at 6.9% in 2025 (revised from 6.6%) before declining to 6.3% in 2026 (revised from 6.4%) and 6.0% in 2027 (revised from 6.2%). Given that the recent rise in the unemployment rate is due in particular to a significant increase in the unemployment rate among new immigrants, lowering the immigration thresholds could limit the damage to the job market and bring the unemployment rate down more rapidly.

Summary of Ontario's Economic Outlook

(Per Cent)

	2023	2024p	2025p	2026p	2027p
Real GDP Growth	1.4	0.9	1.7	2.3	2.3
Nominal GDP Growth	4.3	3.8	3.9	4.4	4.4
Employment Growth	2.4	1.4	1.5	1.4	1.2
CPI Inflation	3.8	2.5	2.1	2.0	2.0

p = Ontario Ministry of Finance planning projection based on external sources as of September 19, 2024.
Sources: Statistics Canada and Ontario Ministry of Finance.

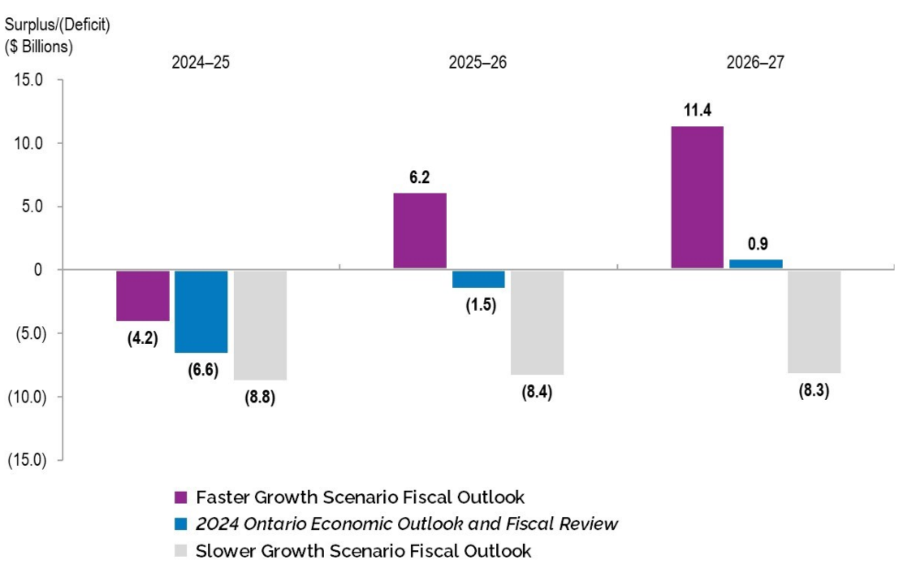
- **Revised 2024-25 budgetary outlook** — $3.2 billion was slashed from the shortfall signaled in the spring budget as the deficit is now telegraphed to be $6.6 billion (0.6% of GDP). For the budgetary beat, the province can thank a major improvement to the revenue outlook as there's now expected to be an additional $6.9 billion (+3.4%) flowing into government coffers. Stronger income tax (+5.6% vs. budget), sales tax (+3.1%) and corporate tax (+12.0%) receipts were responsible for the bulk of the improved guidance. On the other side of the income statement, the province was able to mark down its projected interest expenses by $1.2 billion. Between this and the unplanned revenue, additional spending power became available and indeed, program expenses are set to come in $5 billion (2.5%) higher than Budget 2024 guidance. Most notably, marginal spending will be directed to fund the $200 "rebate" for Ontario taxpayers while an additional $1 billion has been allocated to the health envelope. Finally, the reserve for the year remains set at $1 billion, which provides Ontario with marginal budgetary upside if all revenue and spending come in as planned.

- **Future year budgetary outlook (2025-26 and 2026-27)** — The budgetary outlook is rosier in the next two years too. The projected shortfall for 2025-26 has been cut by $3.2 billion to just $1.5 billion (0.1% of GDP). Note that this is equivalent to the budgeted reserve which means a return to black ink *next year* is within reach. Meanwhile, the small surplus that had been penciled in for 2026-27 ($0.5 billion) now looks a bit healthier at $0.9 billion (0.1% of GDP). The $2.0 billion reserve set aside for this outermost year remains unchanged from the budget. Like updated 2024-25 guidance, both revenue and expenses in these outer years are up versus the earlier fiscal plan but the $7.5 billion of additional inflows comfortably offset the $3.9 billion of expense growth. Excluding the expected decline in interest costs, additional program spending (+$5.4 billion) still comes in shy of marginal revenues.

  It's worth adding that the 2023-24 *Public Accounts* unveiled that last year's shortfall was $2.4 billion less than the Budget 2024 estimate. Add it all together and today's update shaves $9.1 billion of cumulative red ink from March's fiscal projections. Needless to say, these are encouraging developments and should be looked upon favourably by rating agencies. At the same time, budgetary risks need flagging and the economic assumptions that help drive these fiscal projections could prove to be too optimistic. That's not the province's fault—after all, they (prudently) assume GDP growth will land slightly below the average private sector projection—but the federal government's recent revisions to their permanent immigration plans are unambiguously negative for the GDP outlook. That may not be significant enough to erase these budgetary improvements, but it does leave the risks to future updates tilted to the downside.

  When it comes to alternative scenarios, the FES presents faster and slower growth scenarios and associated budgetary impacts. Under the slower growth scenario, the 2024-25 deficit would increase to $8.8 billion and remain above $8 billion for the following two years. Meanwhile, the faster growth scenario is consistent with a $4.2 billion deficit this year and surpluses of $6.2 billion and $11.4 billion thereafter.

Ontario Fiscal Outlook Scenarios



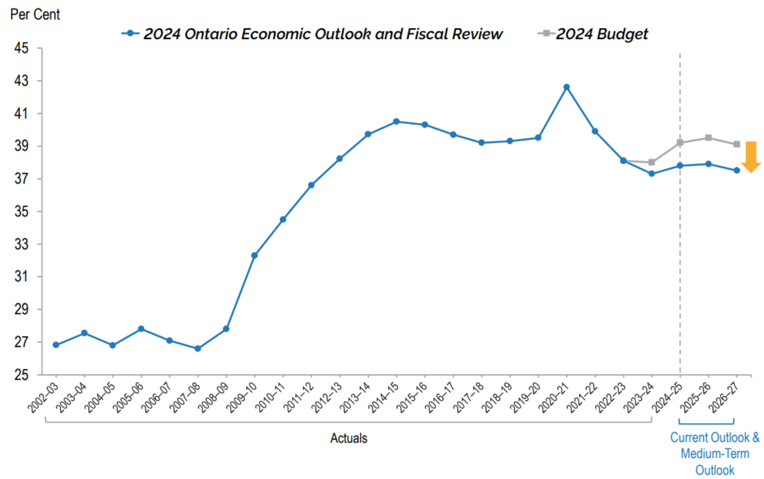
Source: Ontario Ministry of Finance.

- **New initiatives** — Ontario used its mid-year update to initiate or enhance certain policies across the same axes identified in 2023: "Working for you" and "Building Ontario". The first theme includes the most important measure of the FES, a $200 tax rebate to be distributed in early 2025 to all 12.5 million Ontario taxpayers and 2.5 million eligible children (eligible for the Canada Child Benefit). That is expected to come at a cost of $3 billion. Among other measures in the "Working for you" axis, the FES is also announcing the extension of the 5.7 cent per litre gas tax cut to June 2025 (a measure that the government has extended every six months since July 2022). There's also an additional investment of $150M to expand the Ontario Fertility Program and a commitment to introduce a new fertility tax credit in the 2025-26 Budget.

  As for the measures in the "Building Ontario" axis, the FES proposes to invest an additional $94M for the phase 2 of the Life Sciences Strategy and allocates an additional $100M into the Invest Ontario Fund to attract major investments to the province. They also plan to increase the Ontario Municipal Partnership Fund by $100M over the next two years to support economic vitality and sustainability of rural municipalities. Finally, the province announced they will evaluate the feasibility of a new driver and transit tunnel expressway under Highway 401.

- **Debt burden & interest bite** — Given the new and improved 2024-25 budgetary picture (and final adjustments to the prior year, which aided the base or starting point), Ontario sees net debt ending the fiscal year at $429 billion. That's fully $10 billion lower than the level projected in March's budget. An established debt reduction strategy sets limits for relative indebtedness, which involves scaling net debt to nominal GDP and total revenue. On the former test, net debt is now estimated at 37.8% of GDP for 2024-25 vs. the 40% limit. Given the reduced level of debt and a more resilient economy, there's been a nice adjustment vs. a budget plan which eyed a 39.2% debt-to-GDP ratio. The base case forecast sees the debt-to-GDP ratio edging down in each of the next two fiscal years, reaching 37.5% by 2026-27. As for debt-to-revenue, Ontario still expects to modestly exceed a self-imposed limit of 200% in 2024-25. However, the extent of the breach is considerably smaller than the budget plan (now 202% vs. 214% in the Budget). Debt could continue to hover slightly above 200% of revenue next fiscal year, the government's target expected to be achieved/reached by 2026-27. Ontario also focuses on debt affordability, having set a limit of 7.5% for the closely watched interest on debt-to-revenue ratio (i.e., the interest bite). This metric is now projected at 6.0% for 2024-25. Although the interest bite is up from the 5.5% record low established in 2023-24, the FES reveals a non-trivial and relatively larger buffer vs. the policy limit than was anticipated at budget time (6.8%). Moreover, this key ratio is expected to remain relatively contained at 6.3% in each of the next two fiscal years. In absolute terms, the cumulative amount of interest over the four-year period covering 2023-24 to 2026-27 has fallen more than $4 billion since the Budget—welcome relief for a province with no small amount of debt outstanding. (Note: Starting with the 2025 budget, Ontario intends to change the way it reports interest expense, switching from a net to a gross concept. For continuity, however, a net IOD-to-revenue ratio will still be reported.) All told, the improved budgetary path highlighted previously is more than fully reflected in a lighter and more affordable debt burden, something rating agencies are likely to take note of.

Ontario Net Debt-to-GDP Ratio



Sources: Statistics Canada and Ontario Ministry of Finance.

- **Borrowing program** — At the time of the 2024 budget, Ontario's borrowing plan called for $38.2 billion in gross long-term issuance in 2024-25. That figure was nudged a bit lower in an August update to $37.5 billion. That's where it remains as of today's FES, as the net fiscal improvement presents an opportunity to increase cash reserves. For context, the long-term requirement of $37.5 billion is equivalent to a bit more than $2,300 for every Ontarian, which remains comfortably below the weighted average per capita requirement for all provinces in 2024-25 (which is closer to $3,300). Credit Ontario for making significant funding strides early in the fiscal year. At present, $31.4 billion or nearly 85% of the official requirement has been completed at what amounts to the 58% mark of the fiscal year. Fair then to label Ontario's funding program as comfortably 'ahead of schedule'. Progress against the formal borrowing target has been facilitated by $25.3 billion in domestic bond supply. CAD issues currently accounting for 80% of total bond proceeds, consistent with a targeted domestic share of 75-90%. Ontario remains very adept at regularly creating and consistently building large/liquid domestic issues. The province has also remained a leader in the green bond space, having brought two issues this fiscal year, including the first-ever 30-year provincial green bond. Multiple greens per fiscal year remains the expectation going forward. International debt capital markets have served as an important funding source in 2024-25, the province having collectively secured the equivalent of $6.1 billion in USD and AUD trades. Looking ahead, Ontario has lowered its 2025-26 gross long-term requirement to $35 billion, down $2.7 billion from Budget 2024 as next year's improved deficit eases net cash needs. Indicatively, Ontario foresees a $32.6 billion gross term funding need for 2026-27 (which is technically lighter but not materially different from prior guidance). Netting off maturities, we consider the net supply of Ontario bonds flagged here as eminently manageable/digestible, particularly in light of recent fiscal traction, a heretofore resilient domestic economy, favourable liquidity characteristics and upside credit rating risks.

2024–25 Borrowing Program and Medium-Term Outlook

($ Billions)

	2024 Budget	In-Year Change	Current Outlook 2024–25	Medium-Term Outlook 2025–26	Medium-Term Outlook 2026–27
Deficit/(Surplus)	9.8	(3.2)	6.6	1.5	(0.9)
Investment in Capital Assets	17.7	–	17.7	20.9	20.6
Non-Cash and Cash Timing Adjustments	(11.0)	–	(11.0)	(12.0)	(13.9)
Net Loans and Investments	(0.3)	1.1	0.8	(0.2)	–
Debt Maturities and Redemptions	28.0	–	28.0	33.1	26.9
Total Funding Requirement	**44.2**	**(2.1)**	**42.2**	**43.3**	**32.6**
Decrease/(Increase) in Short-Term Borrowing	(5.0)	–	(5.0)	–	–
Increase/(Decrease) in Year-End Cash and Cash Equivalents	(1.0)	1.3	0.3	(8.3)	–
Total Long-Term Borrowing	**38.2**	**(0.7)**	**37.5**	**35.0**	**32.6**

Note: Numbers may not add due to rounding.
Sources: Ontario Financing Authority and Ontario Ministry of Finance.

- **Current long-term credit ratings** — S&P: A+, Positive | Moody's: Aa3, Positive | DBRS: AA, Stable | Fitch: AA-, Stable
[Refer to our Provincial Ratings Snapshot for additional colour on specific credit rating drivers/considerations]

Ontario's Medium-Term Fiscal Plan — Details[1]

($ Billions)

	Actual	Current Outlook	Medium-Term Outlook	
	2023–24	2024–25	2025–26	2026–27
Revenue				
Personal Income Tax	50.8	54.8	57.2	60.9
Sales Tax	39.9	40.0	41.0	43.4
Corporations Tax	23.1	27.9	27.6	28.8
Ontario Health Premium	5.0	5.1	5.3	5.6
Education Property Tax	5.8	5.8	5.8	5.9
All Other Taxes	17.3	18.1	20.2	21.2
Total Taxation Revenue	**141.9**	**151.7**	**157.2**	**165.6**
Government of Canada	34.3	36.3	37.6	38.7
Income from Government Business Enterprises	7.4	6.7	7.5	7.5
Other Non-Tax Revenue	22.3	18.0	18.5	18.9
Total Revenue	**205.9**	**212.6**	**220.8**	**230.7**
Programs				
Health Sector	85.5	86.0	88.1	90.0
Education Sector[2]	37.2	37.6	38.8	39.5
Postsecondary Education Sector	13.2	12.2	12.5	13.1
Children, Community and Social Services Sector	19.4	20.0	20.1	20.1
Justice Sector	6.0	6.2	5.7	5.7
Other Programs	33.9	43.6	41.6	45.0
Total Programs	**195.2**	**205.5**	**206.8**	**213.3**
Interest on Debt	11.4	12.7	14.0	14.5
Total Expense	**206.6**	**218.3**	**220.8**	**227.8**
Surplus/(Deficit) Before Reserve	**(0.6)**	**(5.6)**	**(0.0)**	**2.9**
Reserve	–	1.0	1.5	2.0
Surplus/(Deficit)	**(0.6)**	**(6.6)**	**(1.5)**	**0.9**
Net Debt as a Per Cent of GDP	37.3%	37.8%	37.9%	37.5%
Net Debt as a Per Cent of Revenue	198.1%	201.8%	202.6%	200.2%
Interest on Debt as a Per Cent of Revenue	5.5%	6.0%	6.3%	6.3%

[1] For a fiscal summary, in the millions, of revenue, expense and the surplus/(deficit) over the medium-term outlook, see Table 3.1.

[2] Excludes Teachers' Pension Plan. Teachers' Pension Plan expense is included in Other Programs.

Notes: Numbers may not add due to rounding. Current and medium-term outlook primarily reflect information available as of September 30, 2024.

Sources: Ontario Treasury Board Secretariat and Ontario Ministry of Finance.

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