An Assessment of Ontario's Medium-term Economic and Fiscal Outlook

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Financial Accountability Office of Ontario

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Financial Accountability Office of Ontario

Established by the *Financial Accountability Officer Act, 2013* (the Act), the Financial Accountability Office (FAO) provides independent analysis on the state of the Province's finances, trends in the provincial economy and related matters important to the Legislative Assembly of Ontario.

The FAO produces independent analysis on the initiative of the Financial Accountability Officer. Upon request from a member or committee of the Assembly, the Officer may also direct the FAO to undertake research to estimate the financial costs or financial benefits to the Province of any bill or proposal under the jurisdiction of the legislature.

This report was prepared by Luan Ngo and David West. Peter Harrison provided comments.

This report is based on information available to October 16, 2015. Background data used in this report data is available upon request.

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1\ Introduction and Summary

Introduction

A key element of the mandate of the Financial Accountability Office is to provide independent analysis on the state of the Ontario economy and the government's finances. To fulfill this mandate, the Financial Accountability Office (FAO) will produce a number of regular reports over the course of the fiscal year, assessing the current economic outlook and the government's fiscal plan.

This inaugural report on Ontario's economic and fiscal situation and outlook begins with a brief overview of economic trends over the past fifteen years to provide historical context for the current outlook. The report then examines recent economic developments and the short-term economic outlook. Given the current economic outlook, the report provides an assessment of the Province's fiscal plan, relative to the 2015 Budget outlook and in light of the 2014-15 Annual Report released on September 28, 2015. The report concludes with a presentation of alternative revenue and spending scenarios to highlight key risks to the fiscal plan.

As the newly created Financial Accountability Office continues to grow and develop capacity, future versions of these economic and fiscal assessments will evolve to ensure that they are effective and useful documents, responding to the needs of the members of the Ontario Legislative Assembly.

Summary

Over the past decade, the Ontario economy has struggled in a challenging global economic environment. Sharp swings in key external factors — most importantly the Canadian dollar exchange rate and commodity prices — have contributed to a decline in Ontario's competitiveness and a loss of export markets. These challenges have led to a deteriorating economic performance, including slower GDP growth and weaker labour market outcomes.

The decline in Ontario's economic performance, exacerbated by the global recession of 2008-2009, has contributed to a difficult fiscal position for the Province.

In the 2015 Budget, the government presented a fiscal plan that includes returning the budget to balance by 2017-18. The government's fiscal plan is based on a relatively robust outlook for revenue growth combined with significant restraint in the growth of program spending.

+ The budget plan includes revenue growth averaging 4.3 per cent annually over the next three fiscal years, slightly stronger than the budget forecast for nominal economic growth, but well above the 2.6 per cent average annual growth in revenue over the past four years.

+ The budget plan also assumes program spending growth averaging 0.5 per cent annually over the next three years, below the 1.4 per cent pace of program spending growth over the past four years. The planned growth in spending is also well below the expected growth in population and price inflation — key drivers of government expenditures.

Based on current economic indicators, and consistent with the current private sector forecast consensus, economic growth in 2015 is expected to be significantly slower than projected at the time of the 2015 Budget. Slower economic growth is expected to reduce revenue this year and over the medium term compared to the budget forecast.

The $1 billion reserve combined with the government's history of managing program spending below budget projections should more than offset the impact of lower revenue in 2015-16. As a result, the Province would appear to be on track to beat its 2015-16 deficit target of $8.5 billion.

However, to balance the budget in 2017-18, the pace of deficit reduction must accelerate sharply to over $4 billion per year in 2016-17 and 2017-18. Given the government's ambitious plans to limit program spending growth combined with relatively robust assumptions for revenue growth, the FAO developed alternative scenarios to assess the risks of the government not achieving its fiscal targets.

Specifically, the scenarios — based on reasonable assumptions — assess the impact on the budget balance if revenue growth was to be slightly more moderate or if program spending was to be slightly higher.

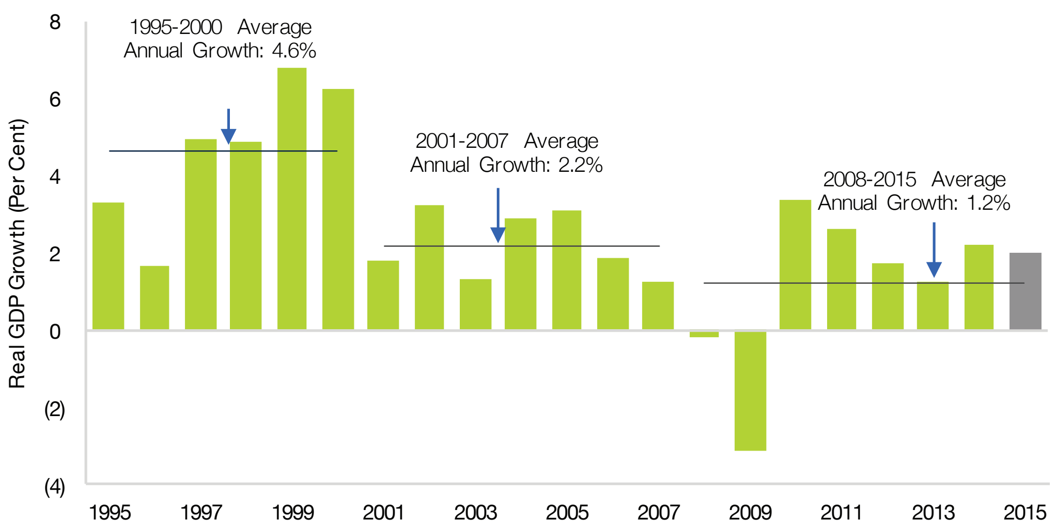
These alternative scenarios demonstrate that the risks to the government's current fiscal plan are significant and biased downwards. In particular, if program spending continues to rise at its recent pace and if revenue growth is somewhat more moderate than projected in the budget (but still faster than the past four years), a deficit of approximately $3.5 billion in 2017-18 would be expected, in the absence of other policy actions.

2 \ An Overview of Ontario's Economic Performance

A challenging global economic environment contributed to a decline in the average pace of Ontario's economic growth over the past two decades. Swings in key external factors, notably commodity prices and the Canada-U.S exchange rate, dramatically shifted business fundamentals and competitiveness for many of Ontario's important industries, contributing to slower economic growth.[1]

The global recession of 2008-2009 amplified an already difficult economic climate in Ontario. The United States, Ontario's most important trading partner, experienced the sharpest declines in employment and output since the 1930s. The value of Ontario's merchandise exports to the U.S dropped by over 30 per cent in 2008 and 2009.

FIGURE 1: Ontario's Economic Growth has Slowed



Source: Ontario Ministry of Finance, Statistics Canada, Financial Accountability Office of Ontario.

1 Many economic commentators have pointed to weak productivity growth as a key contributor to Ontario's disappointing economic performance over the past decade. However, a detailed analysis by the Centre for the Study of Living Standards (CSLS) concluded that weak export growth was one of the main causes of the drop in Ontario's productivity growth. The study noted that Ontario's weak export growth was largely the result of weak demand growth in the U.S., a loss of competitiveness largely due to the high value of the Canadian dollar over the period up to 2012, and the rise of new low cost emerging market economies. As a result, while improving Ontario's productivity performance is critical to improving Ontario's future economic performance, Ontario's weak productivity growth over the past decade was an outcome of its economic performance as much as it was a contributor. See "Ontario's Productivity Performance, 2000-2012: A Detailed Analysis", CSLS Research Report 2015-04, June 2015.

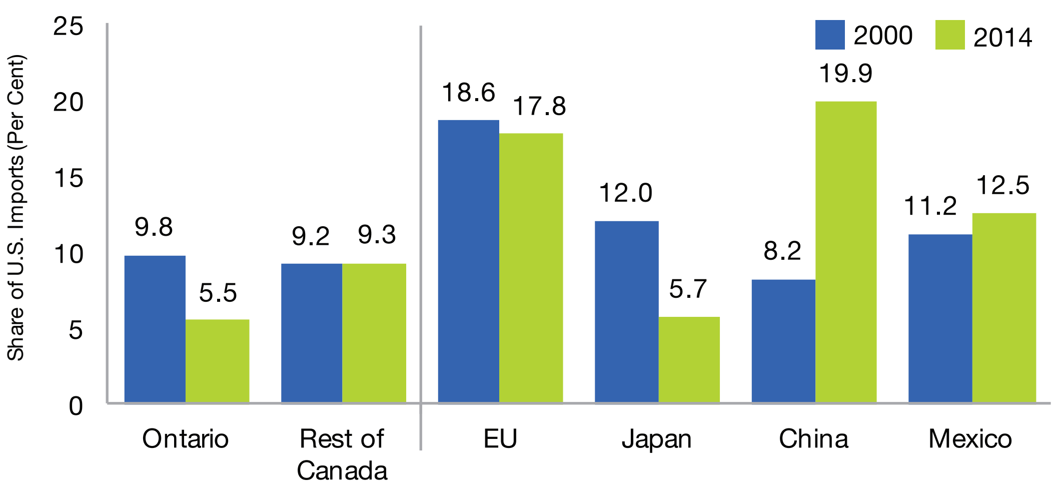
Growth in Ontario's economy has slowed markedly since the robust expansion of the late 1990s. Over the period from 1995 to 2000, the average annual growth rate of real GDP was 4.6 per cent. For the period from 2001 to 2007, average growth declined by more than half to 2.2 per cent. Over the past eight years, starting with the beginning of the global recession and including an estimate of 2.0 per cent for 2015[2], Ontario's real economic growth has averaged just 1.2 per cent per year (Figure 1).

Deconstructing Ontario's growth over these periods reveals the main cause for the sharp slow-down.[3] From 1995 to 2000, Ontario's economic growth was relatively balanced, with household spending, business investment, government expenditures and net trade (exports less imports) all contributing positively to overall growth. In contrast, Ontario's economic growth over the past eight years has been largely driven by household spending, residential investment and government expenditures. On average, net trade and business investment have been a drag on overall economic growth since 2007.

The sharp decline in the contribution of net trade to Ontario's overall economic growth is largely a story of weak international exports. In 2014, Ontario's real international exports were more than two per cent below their peak levels before the 2008-2009 recession.

The rise of emerging economies over the past decade exacerbated the challenges for Ontario exporters by intensifying competition for key international markets. In 2000, Ontario merchandise exports to the U.S. represented 9.8 per cent of total U.S. imports. By 2014, Ontario's share had dropped to just 5.5 per cent (Figure 2).

FIGURE 2: Ontario's Declining Share of the U.S. Market



Sources: Industry Canada, U.S. Census Bureau and FAO calculations.

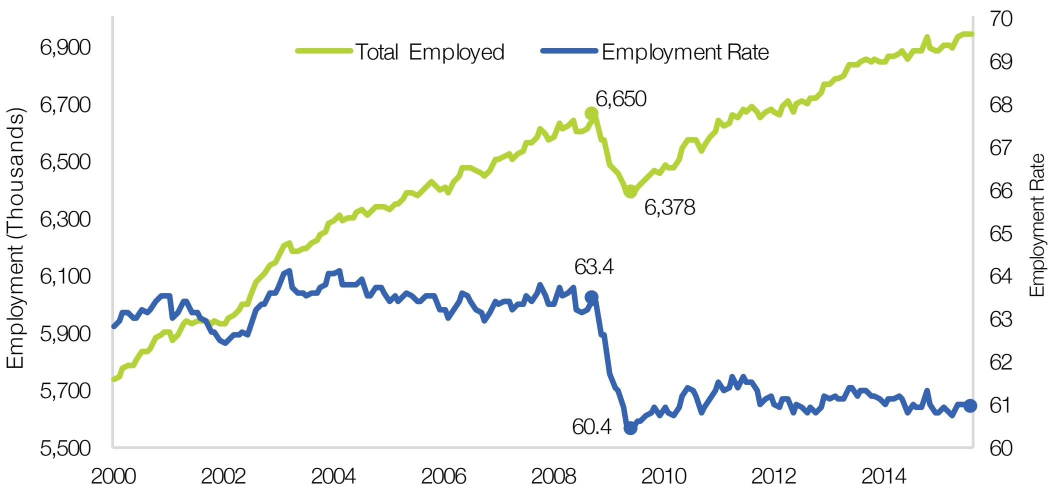
2 Based on current private sector forecasts (Figure 5).
3 Based on Statistics Canada's Provincial Economic Accounts and the Ministry of Finance's Ontario Economic Accounts.

The slower pace of economic growth and the lingering effects of the 2008–2009 recession have also impacted Ontario's current labour market performance.

From October 2008 to June 2009, Ontario employment dropped by approximately 4.1 per cent or 270 thousand jobs. As the Ontario economy recovered from the downturn, employment rebounded relatively quickly. By the spring of 2011, less than two years into the recovery, employment was at its pre-recession level. The pace of Ontario's job recovery following the global recession was much quicker than in the U.S. or other G7 countries.

Despite the apparently solid rebound in Ontario's employment, other indicators suggest that Ontario's labour market performance continues to be relatively weak. Ontario's employment rate — the share of the adult population with a job — dropped sharply during the recession and remains approximately 2.5 percentage points below its pre-recession level, as employment gains have not kept pace with growth in the adult population. An additional 285 thousand jobs is required to return Ontario's employment rate to its pre-recession levels.

FIGURE 3: Ontario's Employment Rate has not Recovered

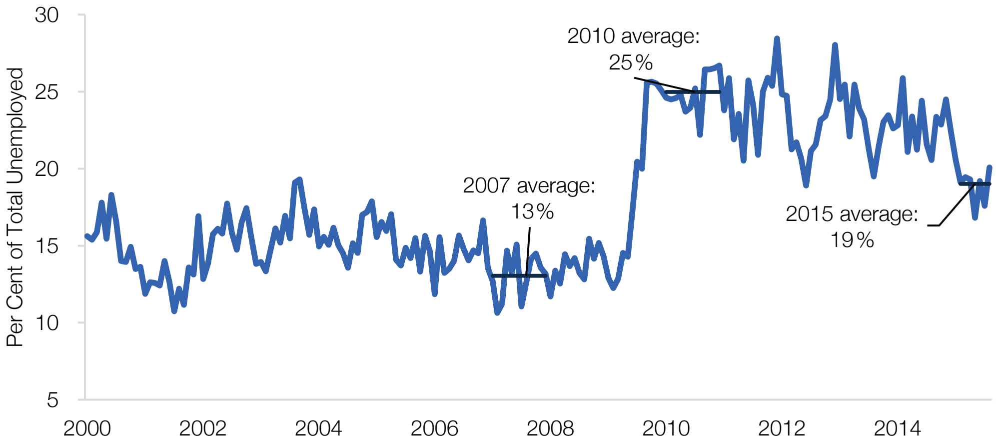


Source: Statistics Canada, Financial Accountability Office of Ontario

Long-term unemployment[4] as a share of the total number of unemployed has also worsened compared to pre-recession levels (Figure 4). The share of long-term unemployment increased sharply during the recession from 13 per cent in 2007 to 25 per cent in 2010. Although the share of long-term unemployed has declined moderately since 2010, it remains at 19 per cent, six percentage points higher than prior to the recession. Research has shown that long-term unemployment can seriously damage a worker's long-term prospects, reducing earnings and increasing the likelihood of remaining unemployed.[5]

4 Long-term unemployment is defined as being out of work for more than 27 weeks.
5 Zmitrowicz, K., Khan, M. *Beyond the Unemployment Rate: Assessing Canadian and U.S. Labour Markets Since the Great Recession.* Bank of Canada. 2014.

FIGURE 4: Ontario Long-Term Unemployment Remains Elevated



Source: Statistics Canada, Financial Accountability Office of Ontario.

Economic Developments since Budget 2015

The Canadian and Ontario economies were weaker over the first half of 2015 than anticipated in the 2015 Budget. Although the early-year weakness in the economy was largely a reflection of temporary factors — an unusually harsh winter, a labour dispute at west coast U.S. ports, and temporary shut-downs at a number of auto assembly manufacturers in Ontario — it is expected to have an impact on the full-year performance of the economy.

Economic indicators released so far in 2015 have been generally mixed, suggesting an uneven pace of growth across the economy. Employment and GDP growth were weaker than anticipated but household spending and the residential housing market have outperformed projections. Growth rates of personal and corporate incomes were similarly uneven over the first half of 2015. Ontario labour income over the first six months of 2015 was up by approximately four per cent compared to 2014, in line with Budget projections. In contrast, net operating surplus of corporations is lower so far in 2015 on a year-over-year basis, compared to the budget projection of 5.0 per cent growth.

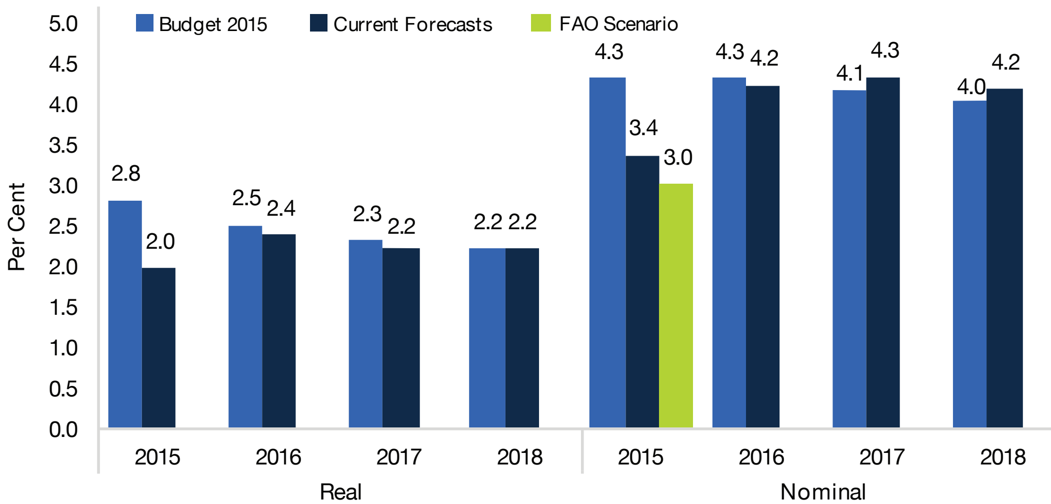
TABLE 1: Performance of Selected Economic Indicators for Ontario, 2015

(per cent change)	Budget 2015 Projection	Current 2015 year-over-year growth
Employment	1.1	0.7
Retail Sales	4.2	4.5
Housing Starts	3.4	19.1
Labour Income	4.0	3.8
Net Operating Surplus	5.0	(2.6)

Sources: Statistics Canada, Ontario Ministry of Finance, Canada Mortgage and Housing Corporation and FAO Calculations
Notes: Year-over-over growth rates are calculated by comparing available monthly or quarterly data in 2015 to the same period in 2014. Year-to-date housing starts are based on actual unadjusted urban-area data.

Private-sector forecasts of Ontario economic growth have been revised lower since the 2015 Budget to reflect the generally weaker than expected performance of the economy over the first half of the year (Appendix I). The most recently available private sector forecasts of real GDP growth average 2.0 per cent for 2015, down sharply from 2.8 per cent at the time of the 2015 Budget.

FIGURE 5: Private Sector Outlook for Ontario Economic Growth



Source: Ontario Ministry of Finance Survey of Forecasters (Budget 2015 and October 13, 2015) and Financial Accountability Office of Ontario.

The downward revisions to nominal GDP growth forecasts for 2015 are equally pronounced. The current average private sector forecast for nominal GDP growth in 2015 is 3.4 per cent, down from 4.3 per cent at the time of the 2015 Budget.

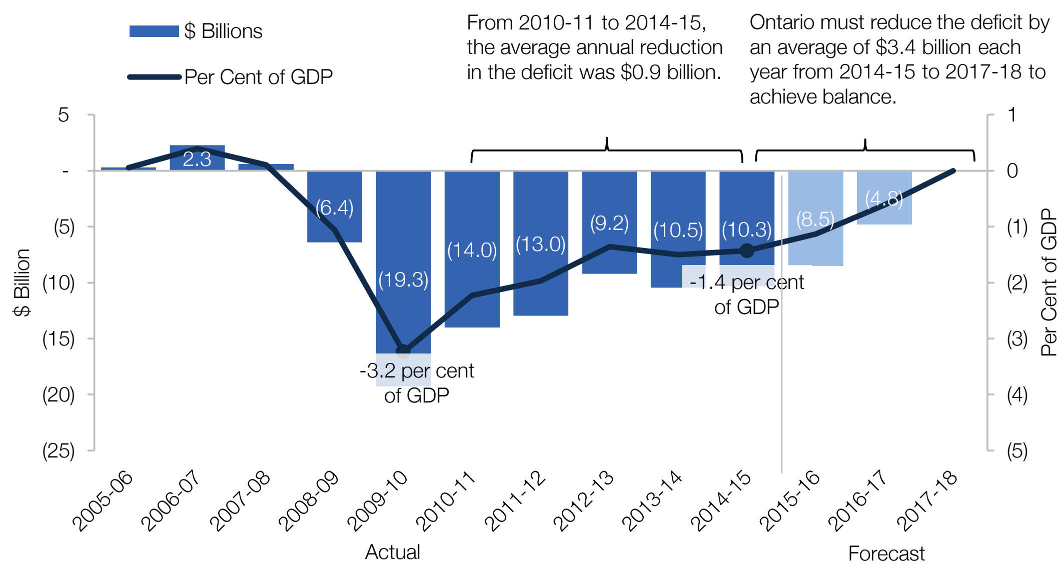
However, a lowered forecast of 3.4 per cent annual growth in 2015 may still prove to be too strong. Based on the Ministry of Finance's Ontario Economic Accounts, nominal GDP increased by 0.5 per cent in both the first and second quarters of 2015.[6] Assuming nominal GDP rebounds relatively strongly over the second half of 2015 — with quarterly growth averaging 1.3 per cent (or over five per cent at annualized rates) — the annual growth rate for 2015 would reach just three per cent.

6 Ontario Economic Accounts — Second Quarter of 2015, Ontario Ministry of Finance.

3\ Ontario's Past Fiscal Performance and Medium-Term Outlook

The 2008-2009 recession resulted in a significant deterioration in Ontario's fiscal position. Total revenue dropped $6.6 billion in 2008-09 and by a further $1.2 billion in 2009-10. Between 2007-08 and 2009-10, personal income tax revenue dropped 8.1 per cent while corporate tax revenue dropped by over 50 per cent. At the same time, Ontario's program spending increased sharply by $11.5 billion in 2009-10 from the previous year, largely as a result of stimulus measures intended to support the economy during the recession.[7] As a result, Ontario recorded deficits of $6.4 billion in 2008-09 and $19.3 billion in 2009-10 (Figure 6).

FIGURE 6: Ontario Budget Balance



Source: Ontario Budgets and 2014-15 Public Accounts
Notes: Data labels indicate value in $ billions unless otherwise indicated. No adjustments have been made for changes in accounting treatments.

In the three years following the recession, Ontario was able to achieve steady improvements in its fiscal position, reducing the deficit to $9.2 billion by 2012-13.[8] However, over the past three years, there has been little change in the budget balance with the 2014-15 Public Accounts reporting a $10.3 billion deficit, a $0.2 billion improvement over 2013-14 (Appendix II).

7 Stimulus measures included increased funding for infrastructure investment, employment training, and auto sector support (2009 Budget, pp. xi-xii).
8 One-time savings from changes to teachers' benefits and a one-time boost from corporate tax revenue contributed to the significant year-over-year improvement in 2012-13.

2015 Budget Fiscal Plan

In the 2015 Budget, the Ontario government maintained its commitment to achieving a balanced budget by 2017-18 (Table 2), consistent with the fiscal recovery plan first published in the 2010 Budget.

Over the period from 2010-11 to 2014-15, Ontario reduced the deficit by an average of $0.9 billion per year. To achieve balance in 2017-18, the government plans to reduce the deficit by an average of $3.4 billion per year, a rate of improvement nearly four times greater than the pace of the past four years.

TABLE 2: Ontario 2015 Budget Fiscal Plan

($ Billions)	2014-15 Actual	2015-16 Plan	2016-17 Outlook	2017-18 Outlook
Revenue	118.5	124.4	129.4	134.4
Expense				
Programs	118.2	120.5	120.6	120.0
Interest on Debt	10.6	11.4	12.4	13.2
Total Expense	128.8	131.9	133.0	133.2
Reserve	–	1.0	1.2	1.2
Surplus / (Deficit)	(10.3)	(8.5)	(4.8)	-

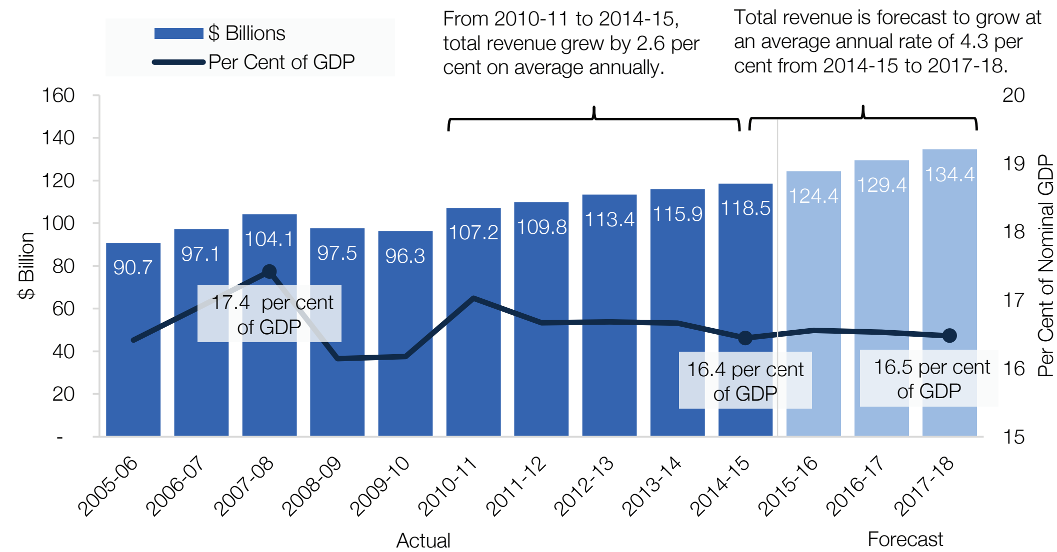
Sources: 2014-15 Public Accounts and 2015 Ontario Budget
Note: Numbers may not add due to rounding.

The budget's fiscal plan to balance in 2017-18 includes both relatively strong increases in total revenue combined with sharply lower program spending growth.

The government projects revenue to increase at an average of 4.3 per cent per year from 2014-15 to 2017-18 (Figure 7), slightly stronger than the outlook for nominal GDP growth at the time of the budget, and significantly stronger than the 2.6 per cent average annual growth in revenue over the past four years (2010-11 to 2014-15).[9]

9 See Appendix III for more details on the composition of revenue growth.

FIGURE 7: Ontario Total Revenue

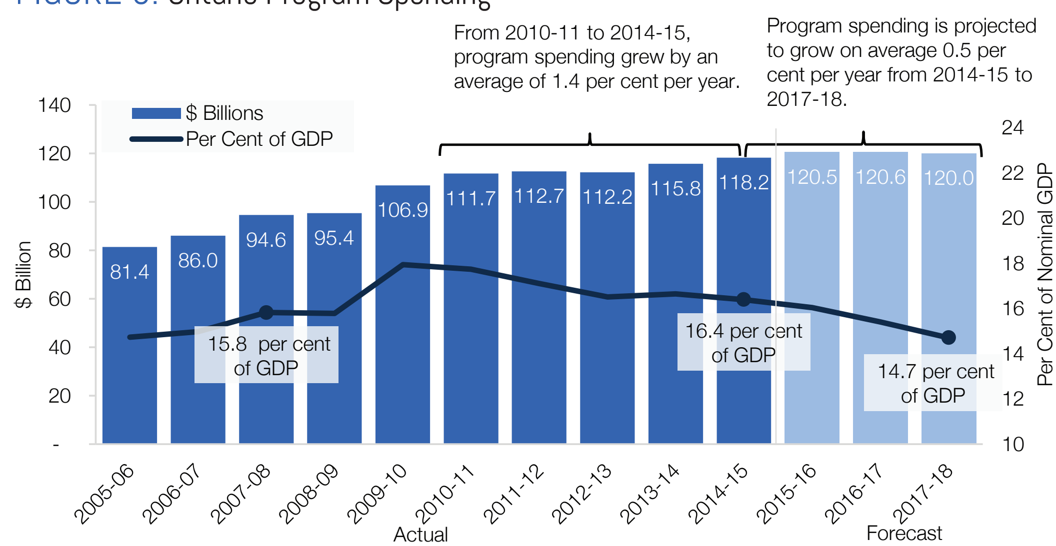


Source: Ontario Budgets and 2014-15 Public Accounts

Notes: Data labels indicate value in $ billions unless otherwise indicated. No adjustments have been made for changes in accounting treatments.

The 2015 Budget is also based on the government's plan to restrain the growth in program spending to just 0.5 per cent per year from 2014-15 to 2017-18 — roughly one-third the average rate of program spending growth over the past four years.

FIGURE 8: Ontario Program Spending



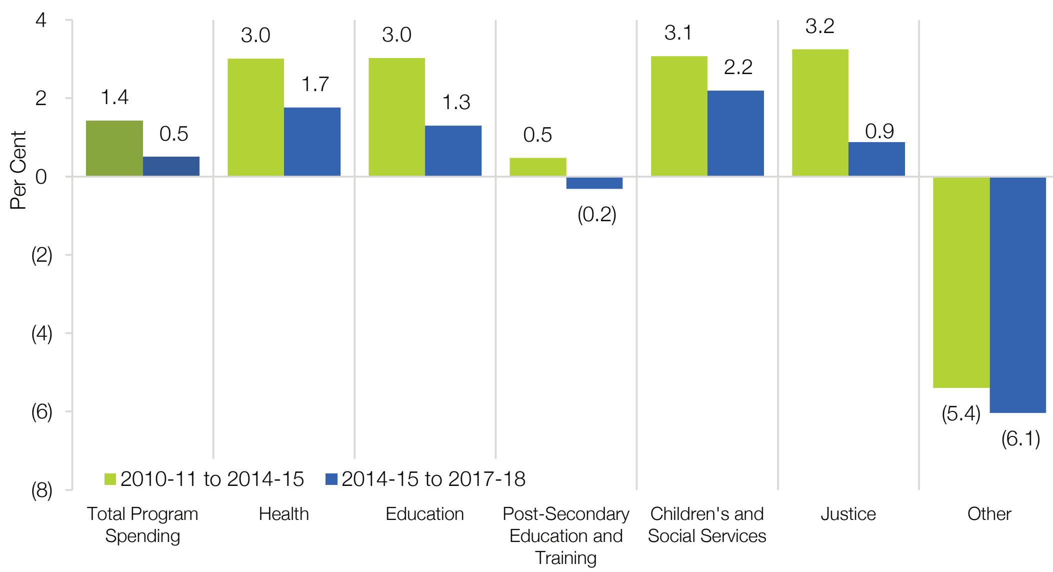
Source: Ontario Budgets and 2014-15 Public Accounts
Notes: Data labels indicate value in $ billions unless otherwise indicated. No adjustments have been made for changes in accounting treatments.

+ Health sector spending is projected to increase by an average of 1.7 per cent per year from 2014-15 to 2017-18, well below the 3.0 per cent annual average pace from 2010-11 to 2014-15. The government expects that measures to reduce physician fees and move towards activity-based hospital funding will contribute to lower growth rates.

+ Education spending is projected to grow by an average of 1.3 per cent per year from 2014-15 to 2017-18, less than half the pace of the past four years. The government expects that measures to consolidate school space will contribute to lower growth in education spending.

+ Spending on 'other' programs is expected to decline by 6.1 per cent on average annually. This reduction includes the elimination of the Ontario Clean Energy Benefit in 2016 (roughly $1 billion in savings), the end of time-limited funding for the Pan Am Games (about $1.1 billion in savings) as well as $500 million in annual expected savings from the current expenditure review process.

FIGURE 9: Ontario Program Spending Growth by Sector



Source: 2015-16 Ontario Budget, 2011-12 to 2014-15 Public Accounts
Note: Teacher Pension Plan expense is included in other programs.

4\ Assessing Ontario's Fiscal Plan

2015-16 Developments

Revenue

Current projections for economic growth in 2015 are considerably lower than at the time of the 2015 Budget, released in April. As discussed in the Economic Developments section, the average private sector forecast for nominal GDP growth — the broadest single measure of the tax base — is currently 3.4 per cent, well below the budget assumption of 4.2 per cent growth. Moreover, based on current data and reasonable assumptions, nominal GDP growth in 2015 could be as low as 3.0 per cent, below the current private sector average.

According to the revenue sensitivities published in the 2015 Budget, each percentage point decline in nominal GDP is estimated to lower total revenue by $885 million[10]. As a result, based on the current forecasts for weaker nominal GDP growth, total revenue would be expected to be $0.7 billion[11] to $1.0 billion lower in 2015-16 than projected in the 2015 Budget.[12] The $1.0 billion drop would leave revenue growth in 2015-16 at 4.1 per cent over the previous year — the highest year-to-year gain since 2010-11 and well above the projected growth in nominal GDP for 2015.

Expense

Over the past five years, actual program spending as reported in the public accounts has been, on average, $2.3 billion lower than projected in that year's budget — partly due to one-time savings. More recently, in 2013-14 and 2014-15, program spending was $1.2 billion lower each year than the original budget plan projection (Appendix IV). As a result, it is reasonable to expect the government will continue to be able to manage program spending for 2015-16 below the original budget plan projection.

10 2015 Budget, pp.273

11 Deconstructing the revenue impact into the major taxes provides similar results. For instance, the projection for labour income and retail sales are largely unchanged from the 2015 Budget projection, while the growth in the net corporate operating surplus is 7.6 percentage points lower (Table 1). Applying the revenue sensitivity for the net operating surplus from the 2015 Budget ($90 million change in revenue for every percentage point difference in growth) yields a revenue loss of about $685 million — similar to the FAO's estimate using aggregate nominal GDP to revenue sensitivities.

12 In the 2015 Budget, the Province announced its plan to sell 15 per cent of Hydro One in 2015-16 with subsequent sales leading to a reduction in provincial ownership to 40 per cent of the company. As a consequence of this sale, the Province has estimated a revenue increase of $2.2 billion due to Hydro One recording a deferred tax benefit, the value of which will change depending on the outcome of the sale (Asset Optimization - Broadening Ownership of Hydro One, Ministry of Energy, October 9, 2015). The one-time impact from this policy action is not incorporated in the report.

Interest on debt (IOD) payments have also been generally lower than projected in the government's budget plan. In 2013-14 and 2014-15, IOD payments were $0.2 billion lower on average per year from the original budget estimate to the final value published in the public accounts.

Alternative Scenarios for 2015-16

The FAO developed two alternative fiscal scenarios for 2015-16 (Table 3). These scenarios are based on assumptions for nominal GDP growth and the government's success in achieving reductions in spending.

Scenario A assumes:

+ nominal GDP grows by 3.4 per cent in 2015; and
+ program spending is $1.2 billion lower and IOD is $0.2 billion lower than projected in the 2015 Budget.

Under Scenario A, the government would be expected to achieve a $6.8 billion deficit in 2015-16, or an improvement of approximately $1.7 billion from the 2015 Budget projection.

Scenario B assumes:

+ nominal GDP grows by 3.0 per cent in 2015; and
+ the government will meet its program spending target in the budget.

Under Scenario B, the government would meet the 2015-16 deficit target of $8.5 billion as projected in the 2015 Budget, which includes a $1 billion reserve.[13]

TABLE 3: Alternative Fiscal Scenarios for 2015-16

($ Billions)	Budget 2015	Scenario A	Scenario B
Revenue	**124.4**	**123.7**	**123.4**
Impact due to Lower GDP Growth Risk	-	(0.7)	(1.0)
Expense			
Programs	**120.5**	**119.3**	**120.5**
Interest on Debt	**11.4**	**11.2**	**11.4**
Total Expense	**131.9**	**130.5**	**131.9**
Surplus/(Deficit) without Reserve	**(7.5)**	**(6.8)**	**(8.5)**
Reserve	**1.0**		
Surplus/(Deficit) as reported in Budget	**(8.5)**		

Note: Numbers may not add due to rounding. 2015-16 results exclude any potential impacts from the partial sale of Hydro One.

13 The government includes a reserve as a prudence measure to protect the fiscal plan from adverse changes in revenues and expenses (*Fiscal Transparency and Accountability Act*, 2004).

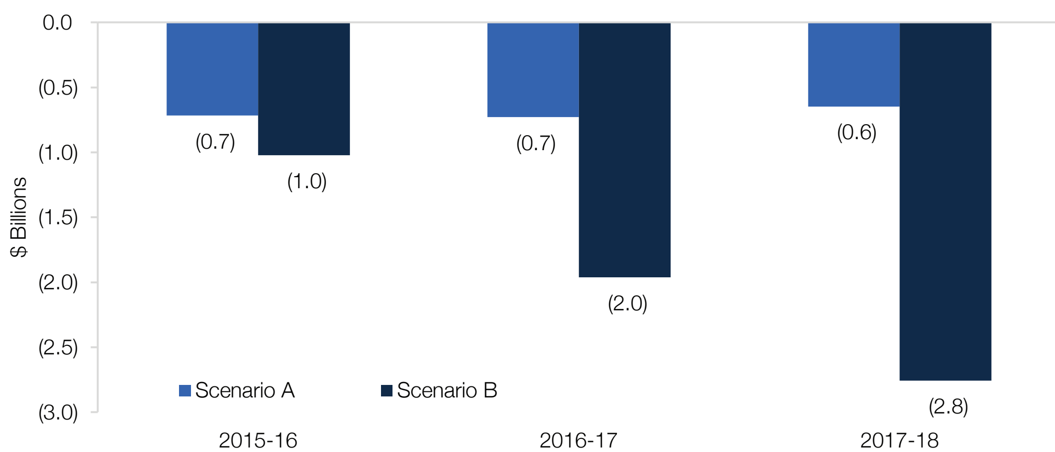
Medium-term Risks to the Fiscal Plan

The 2015 Budget fiscal plan projects a deficit of $4.8 billion in 2016-17 and a balanced budget by 2017-18, including reserves of $1.2 billion for each year. The budget plan is based on revenue growing by an average of 4.3 per cent per year from 2014-15 to 2017-18 while program spending will be limited to growth of 0.5 per cent per year. There are significant risks to the achievement of these targets.

Impact of Slower Revenue Growth

Based on the average private sector forecast, lower economic growth in 2015 is not expected to be offset by higher growth in the following years.[14] Assuming the economy grows at the average rates projected by private sector forecasters over the medium-term, following a temporary setback in 2015, Ontario revenue would be reduced by approximately $0.7 billion each year over medium term. This assumption is reflected in the FAO's Scenario A (Figure 10).

FIGURE 10: Medium Term Risks to the Revenue Outlook



Sources: 2015 Ontario Budget, Financial Accountability Office of Ontario
Note: 2015-16 results exclude any potential impacts from the partial sale of Hydro One.

However, recent revenue growth performance has been well below nominal GDP growth. In 2014-15, revenue increased by 2.3 per cent, compared to nominal GDP growth of 3.6 per cent. Over the past four years, revenue growth has averaged 2.6 per cent per year, approximately 0.9 percentage points lower than the average nominal GDP growth of 3.5 per cent.

14 Average private sector forecasts for 2016 and 2017 are largely unchanged since the release of the 2015 Budget.

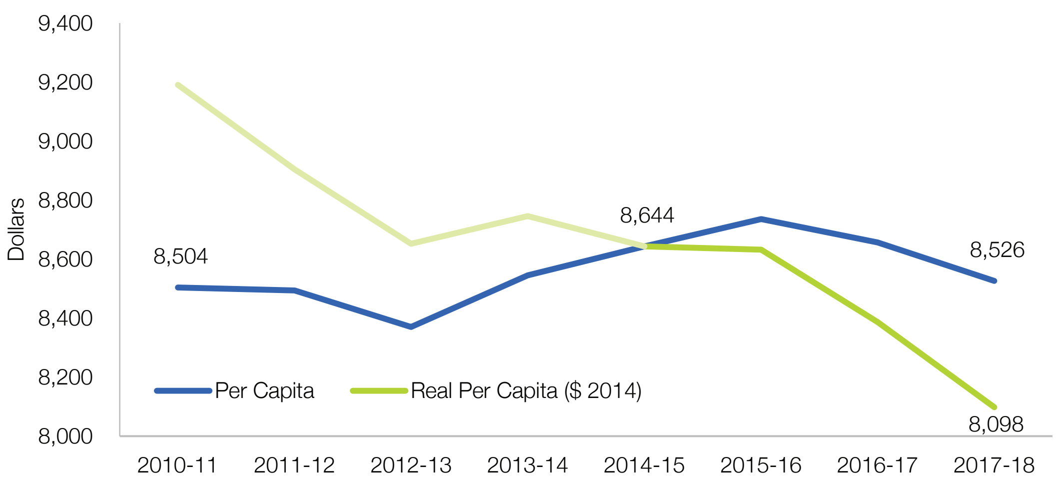
Given the slower growth in revenue compared to nominal GDP in recent years, the FAO evaluated the impact on the government's fiscal plan of a more moderate pace of revenue growth. In Scenario B, revenue is assumed to grow at an annual rate of 3.3 per cent in 2016-17 and 2017-18, approximately 0.9 percentage points lower than the average private sector forecast for nominal GDP growth — matching the experience of the past four years. Under these assumptions, Ontario's revenue would be reduced by $2.0 billion in 2016-17 and by $2.8 billion in 2017-18.

Impact of Higher Spending Growth

The 2015 Budget assumes the government will restrain program spending growth to an average of 0.5 per cent per year over the next three years, down from 1.4 per cent average growth over the past four years.

With Ontario's population expected to grow by approximately 1.0 per cent per year, program spending on a per capita basis will decline from $8,644 in 2014-15 to $8,526 by 2017-18, based on the budget projection. Including the impact of consumer price inflation, expected to be 1.2 per cent in 2015-16 and 2.0 per cent per year over the forecast, per capita program spending in 2014 dollars is expected to decline by six per cent to $8,098, by 2017-18 (Figure 11).

FIGURE 11: Ontario Program Spending Per Capita



Source: Ontario Budgets and 2014-15 Public Accounts

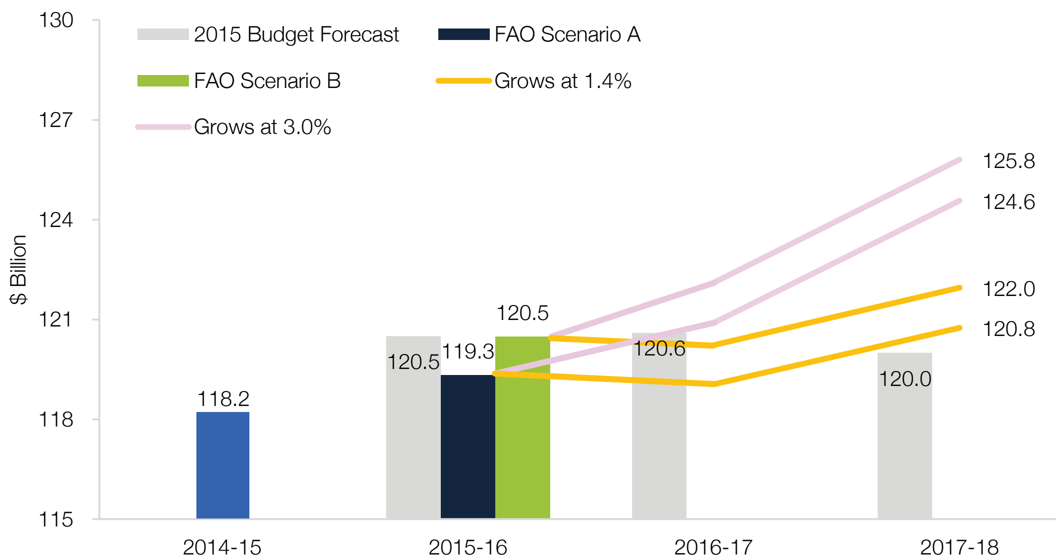
Given the extent and duration of the spending restraint, the government's plan for program spending will face upward pressure from population growth, price inflation and other potential cost increases (Appendix V). Given these pressures, the FAO has evaluated the impact on the fiscal plan of higher increases in program spending over the next two years.

Specifically, two alternative assumptions were incorporated into the FAO's scenarios:

+ Program spending grows at 1.4 per cent, equal to the pace of the past four years; and
+ Program spending grows at 3.0 per cent, equal to the approximate pace of inflation and population growth.

Both of these scenarios begin from the FAO alternative scenarios for 2015-16 program spending. In addition, program spending in 2016-17 is adjusted to reflect the elimination of the Ontario Clean Energy Benefit and expiration of funding for the Pan Am Games.

FIGURE 12: Alternative Scenarios for Ontario Program Spending



Sources: 2015 Budget, 2014-15 Public Accounts, Statistics Canada, Financial Accountability Office of Ontario
Note: Estimates for 2015-16 are explained in the 2015-16 Developments section. Estimates for 2016-17 are adjusted to reflect savings from the elimination of the Ontario Clean Energy Benefit and the end of funding for the Pan Am Games.

Starting from the Scenario A base for 2015-16, a growth rate of 1.4 per cent would result in program spending of $120.8 billion in 2017-18. With the same growth rate but starting from the Scenario B base for 2015-16, program spending would be $122.0 billion in 2017-18. If spending were to keep pace with population and inflation, program spending in 2017-18 would be $124.6 billion starting with the Scenario A base in 2015-16 and $125.8 billion from the Scenario B base (Figure 12).

Table 4 presents fiscal projections based on the FAO's alternative scenarios for revenue and program spending growth. These alternative scenarios provide an assessment of the potential risks to the fiscal plan if the government is unable to achieve its program spending restraint targets or if revenue grows at a slightly more moderate pace (Table 4).

TABLE 4: Fiscal Outlook under Alternative Scenarios

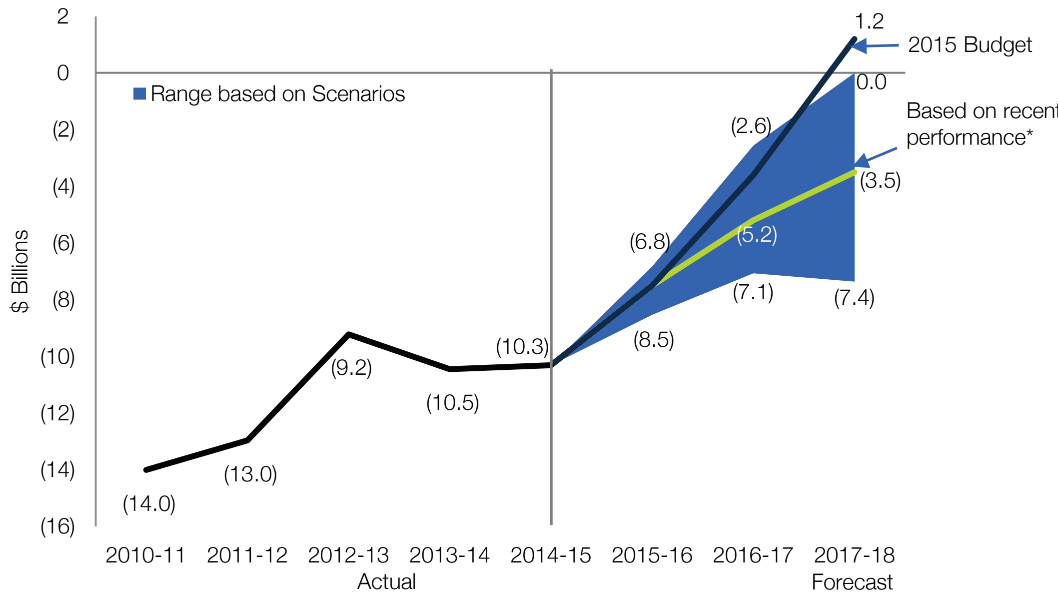
$ Billions	2015-16		2016-17		2017-18	
	Scenario A	Scenario B	Scenario A	Scenario B	Scenario A	Scenario B
Total Revenue						
2015 Budget Forecast	124.4		129.4		134.4	
FAO Scenario	123.7	123.4	128.7	127.4	133.8	131.6
Program Spending						
2015 Budget Forecast	120.5		120.6		120.0	
FAO Short-Term Estimate	119.3	120.5				
Growing at 1.4%			119.1	120.2	120.8	122.0
Growing at 3.0%			120.9	122.1	124.6	125.8
Interest on Debt	**11.1**	**11.4**	**12.2**	**12.4**	**13.0**	**13.2**
Surplus / (Deficit) without Reserve						
2015 Budget Forecast	(7.5)		(3.6)		1.2	
1.4% Program Spending Growth	(6.8)	(8.5)	(2.6)	(5.2)	0.0	(3.5)
3.0% Program Spending Growth	(6.8)	(8.5)	(4.4)	(7.1)	(3.8)	(7.4)

Sources: 2015 Budget, Financial Accountability Office of Ontario
Notes: Program spending estimates reflect the elimination of the Ontario Clean Energy Benefit as well as funding for the Pan Am Games. Scenario A assumes revenue growth consistent with the 2015 Budget for 2016-17 and 2017-18. Scenario B assumes revenue growth of 3.3 per cent in 2016-17 and 2017-18. 2015-16 results exclude any potential impacts from the partial sale of Hydro One.

Figure 13 provides a summary of the range of outcomes for the budget balance (excluding reserve) based on the FAO's alternative scenarios. Based on these scenarios, the deficit would range from $6.8 billion to $8.5 billion in 2015-16, and $2.6 billion to $7.1 billion in 2016-17. In 2017-18, Ontario's budget position could range from either balance to a deficit of almost $7.4 billion.

If the government maintains program spending growth at 1.4 per cent (matching the pace of the past four years) and revenue grows at 3.3 per cent (stronger than the 2.6 per cent pace of the past four years, but below the 4.3 per cent growth assumed in the 2015 Budget), the budget deficit would be approximately $5.2 billion in 2016-17 and $3.5 billion in 2017-18 (see "recent performance" line in Figure 13).

FIGURE 13: Range for Ontario Budget Balance



Sources: 2015 Budget, Financial Accountability Office of Ontario
Notes: Budget balance estimates exclude the reserve. 2015-16 results exclude any potential impacts from the partial sale of Hydro One. *Assumes the 2015 Budget projection for 2015-16, and 3.5 per cent revenue growth, 1.4 per cent program spending growth and IOD as forecast in the 2015 Budget in 2016-17 and 2017-18.

The 2015 Budget projects a return to balance in 2017-18, based on ambitious targets for program spending restraint combined with relatively robust revenue growth. If the government is unable to adequately limit the pace of program spending or if revenue and economic growth were to be slower, the government would be unlikely to achieve its target of balancing the budget in 2017-18.

While the government has been clear that it is committed to achieving a balanced budget by 2017-18, it has released relatively few details on its plans to restrict program spending over the next two years. Given the government's aggressive targets, the lack of disclosure on detailed measures to achieve the plan, and the sensitivity of the deficit to small changes in growth rate assumptions, there are significant risks to the current fiscal plan, in the absence of other policy actions.

Appendices

I. Private Sector Forecasts for Ontario Real GDP Growth

	2015	2016	2017
Conference Board (Jul)	2.0	2.3	1.9
Global Insight (Jul)	2.1	2.7	2.5
The Centre for Spatial Economics (Aug)	1.9	1.7	2.1
University of Toronto Policy and Economic Analysis Program (Jul)	1.6	2.6	2.9
RBC (Sept)	2.1	2.5	
Scotia Bank (Oct)	2.0	2.3	
TD Bank (Oct)	2.0	2.4	2.0
Desjardins (Sept)	1.8	2.3	1.9
Bank of Montreal (Sept)	2.0	2.4	
CIBC (Sept)	1.9	2.4	
Central 1 (Sept)	2.0	2.5	
Laurentian (Sept)	2.0	2.4	2.4
National Bank (Sept)	2.0	2.2	
Private Sector Average	**2.0**	**2.4**	**2.2**

Source: Ontario Ministry of Finance Survey of Forecasters
Note: Private sector forecasts as of October 13, 2015. The months in parenthesis indicate the date of release for each forecast.

II. Ontario 2014-15 Public Accounts

In the 2014-15 Public Accounts, the government reported a deficit of $10.3 billion for 2014-15, $0.6 billion below the interim estimate in the 2015 Budget, and $2.2 billion below the 2014 Budget plan (Table 5).

TABLE 5: 2014-15 Fiscal Performance

	2013-14	2014-15			Change		
($ Billions)	Actual	Plan	Interim	Actual	Plan to Actual	Interim to Actual	Year-over-Year (%)
Total Revenue	115.9	118.9	118.5	118.5	(0.3)	0.0	2.3
Taxation Revenue	80.0	83.4	82.7	82.3	(1.1)	(0.4)	2.9
Personal Income Tax	26.9	29.2	29.0	29.3	0.1	0.3	8.9
Sales Tax	20.5	21.9	21.7	21.7	(0.2)	(0.0)	5.9
Corporations Tax	11.4	10.3	10.1	9.6	(0.7)	(0.5)	(16.3)
Other	21.1	22.0	21.9	21.7	(0.3)	(0.2)	2.8
Government of Canada	22.3	21.9	21.7	21.6	(0.3)	(0.1)	(3.0)
Income from GBEs	5.3	5.0	5.3	5.6	0.6	0.3	5.2
Other Non-Tax Revenue	8.3	8.6	8.8	9.0	0.4	0.2	8.5
Total Expense	126.4	130.4	129.5	128.9	(1.5)	(0.6)	2.0
Program Spending	115.8	119.4	118.8	118.2	(1.1)	(0.6)	2.1
Interest on Debt	10.6	11.0	10.7	10.6	(0.4)	(0.1)	0.6
Reserve	-	1.0	-	-	(1.0)	-	
Surplus / (Deficit)	**(10.5)**	**(12.5)**	**(10.9)**	**(10.3)**	**2.2**	**0.6**	

Sources: 2014-15 Public Accounts and 2015 Ontario Budget
Note: Numbers may not add due to rounding.

Revenue

While total revenue was unchanged compared to the 2015 Budget interim estimates, taxation revenue was $0.4 billion lower. Higher than projected personal income tax revenue of $0.3 billion was more than offset by weaker than projected revenue from corporations and other taxes.

Total revenue increased by 2.3 per cent in 2014-15 compared to average growth of 2.6 per cent over the previous three years.

Expense

Program expense was $0.6 billion below the 2015 Budget projection, while interest on debt was $0.1 billion lower. Lower than projected program expense in 2014-15 would not be expected to have a significant impact on program spending for 2015-16 as Ministry allocations for the year have already been established.

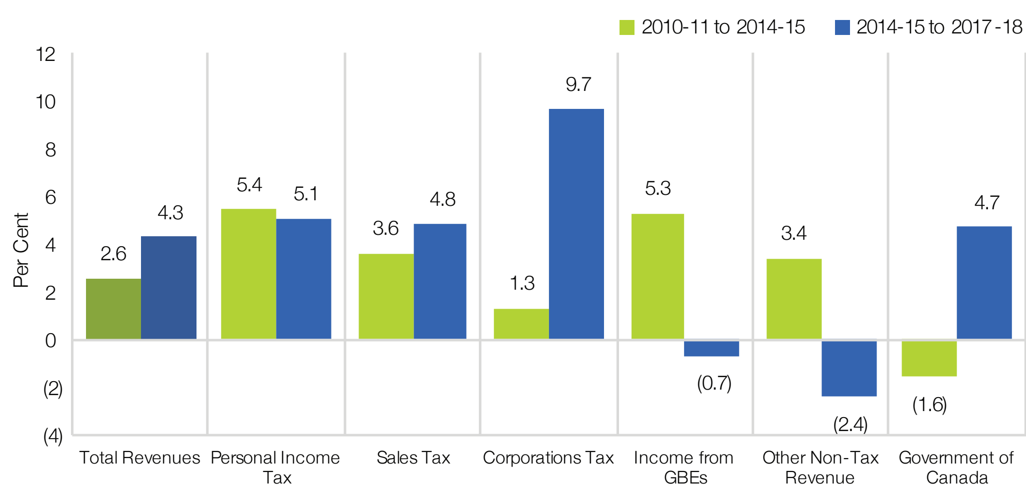
Program expense grew by 2.1 per cent in 2014-15 compared to 2013-14, above the average growth rate of 1.2 per cent over the previous three years.

III. Composition of Ontario Revenue Growth

According to the 2015 Budget, revenue is projected to increase at an average pace of 4.3 per cent per year from 2014-15 to 2017-18 — stronger than the 2.6 per cent average growth recorded from 2010-11 to 2014-15.

+ The government projects personal income tax (PIT) revenue will grow by an average pace of 5.1 per cent over the outlook, slightly slower than average growth over the past four years[15].
+ Revenue from sales taxes is projected to grow by 4.8 per cent per year over the outlook, compared to 3.6 per cent growth over the past four years.
+ Corporations tax (CT)[16] revenue is projected to grow 9.7 per cent per year on average to 2017-18, compared to 1.3 per cent growth over the past four years. Adjusting for one-time factors in 2015-16, CT revenue growth is expected to be 5.7 per cent per year[17] over the outlook.
+ Revenue from government business enterprises is expected to decline 0.7 per cent per year over the next three years after rising 5.3 per cent per year over the past four years.
+ Other non-tax revenue is expected to decline 2.4 per cent on average over the outlook largely due to lower electricity sector revenue including the elimination of the residential portion of the debt retirement charge.
+ Government of Canada transfers are expected to increase steadily by 4.7 per cent per year to $24.8 billion by 2017-18.

FIGURE 14: Ontario Revenue Growth by Component



Source: 2014-15 figures are from 2014-15 Public Accounts. Figures for other years are from 2015 Budget.

15 In 2012, the government increased the PIT rate to 13.16 per cent on taxable incomes over $500,000, expecting to generate nearly $500 million by 2014-15. The government lowered the taxable income threshold in 2014 for the 13.16 rate to $220,000, and introduced a new tax rate of 12.16 per cent for taxable incomes between $150,000 and $220,000.

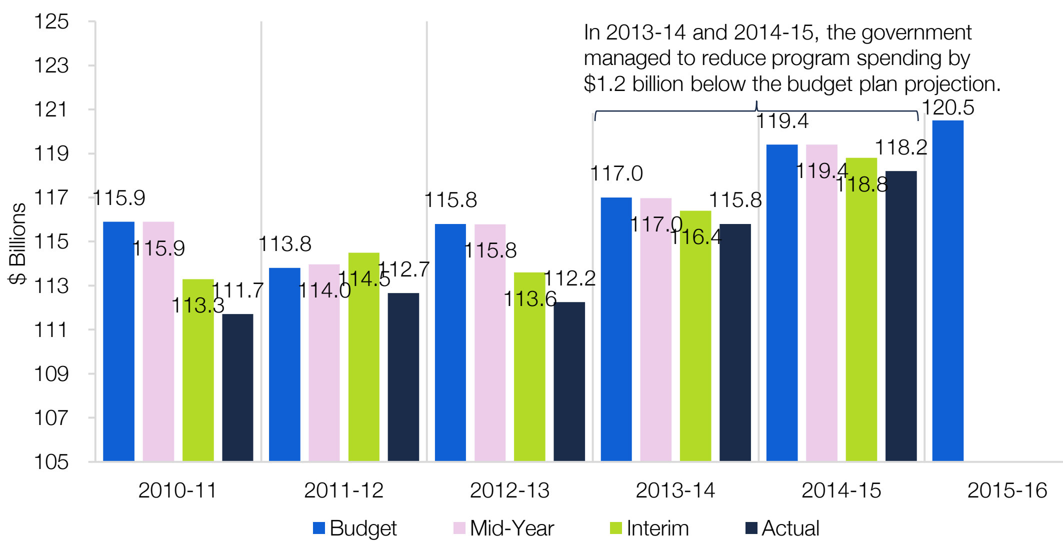
16 Corporations tax includes the corporate income tax, corporate minimum tax and the insurance premium tax.

17 Adjustments include the timing of payments due to the difference between projected corporations tax revenue entitlements and projected federal remittances.

IV. Ontario Program Spending: Projections Compared to Actual

Over the past five years, actual program spending in each year has been on average $2.3 billion lower than projected in that year's budget — partly due to one-time savings. More recently, in 2013-14 and 2014-15, program spending was $1.2 billion lower on average per year from the original budget estimate to the final value published in the public accounts (Figure 15).

FIGURE 15: Forecast of Ontario Program Spending by Estimate



Source: Budgets, Fall Statements and Public Accounts

Ontario's Revisions to its Fiscal Projections

Each year the government publishes a series of revised estimates for its fiscal projections:

+ In the spring budget, the government publishes its fiscal plan estimates for the coming year — indicated by the bar titled "Budget" in the chart above.
+ In the **Economic Outlook and Fiscal Review**, published in the fall at roughly the mid-point of the fiscal year, the government provides updated estimates — the "Mid-Year" bar in chart above.
+ In the budget for the following year, the government publishes revised fiscal estimates for the fiscal year just ending, referred to as "Interim".
+ Finally, in the **Public Accounts**, generally released in late summer or early fall, the government publishes its audited fiscal results for the year that ended in the previous March — "Actual".

Interest on debt (IOD) payments have also been lower than projected in the budget plan. In 2013-14 and 2014-15, IOD payments were $0.2 billion lower on average per year from the original budget estimate to the final value published in the public accounts.

TABLE 5: Comparison of Forecasts for Ontario Interest on Debt Payments

($ Billions)	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2013-14 to 2014-15 Average
Budget	10.0	10.3	10.6	10.6	11.0	11.4	
Actual	9.5	10.1	10.3	10.6	10.6		
Change	0.5	0.2	0.3	0.0	0.4		0.2

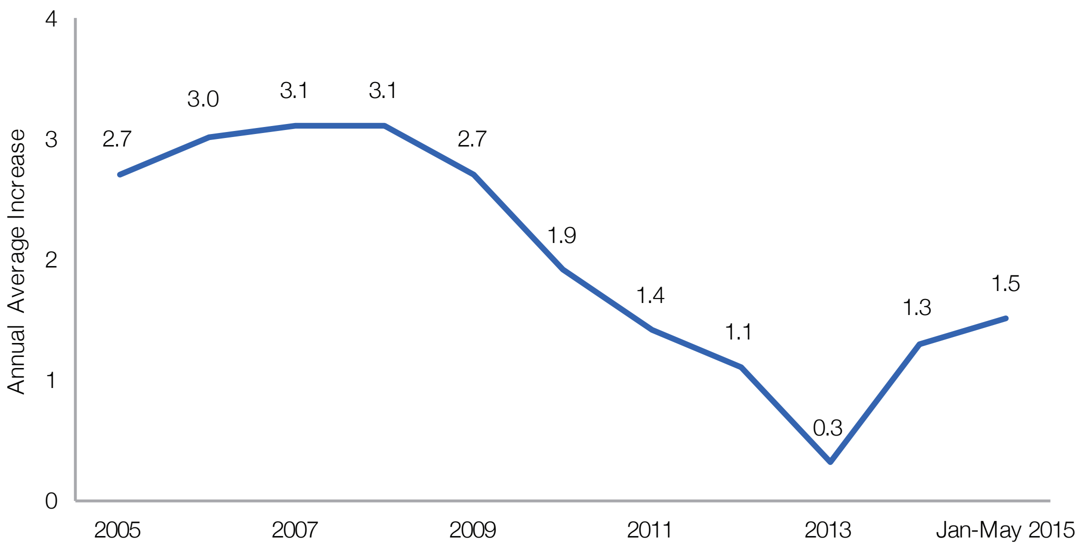
Source: Budget figures are from respective fiscal years' budgets. Actual figures are from 2015 Budget. 2014-15 figures are from 2014-15 Public Accounts.

V. Potential Medium-Term Spending Pressures

Compensation

From January to May 2015, the average wage settlement for Ontario broader public sector employees (excluding municipal workers) provided for a 1.5 per cent annual average wage increase, the highest increase in four years.

FIGURE 16: Wage Settlements for Ontario Broader Public Sector Employees



Source: Collective Bargaining Highlights, Ministry of Labour, May 2015
Notes: Excludes municipal employees.

Ontario Retirement Pension Plan (ORPP)

The Province's request to the Canada Revenue Agency for administrative assistance with the ORRP was refused by the federal government. The impact of the federal government's response on the administrative cost of the ORPP is unclear, as is the status of the request, in light of the federal election.

Interest on Debt

S&P downgraded Ontario's credit rating on July 6, 2015 which could increase borrowing costs.[18] Moody's currently maintains a negative outlook for Ontario's Aa2 rating.[19]

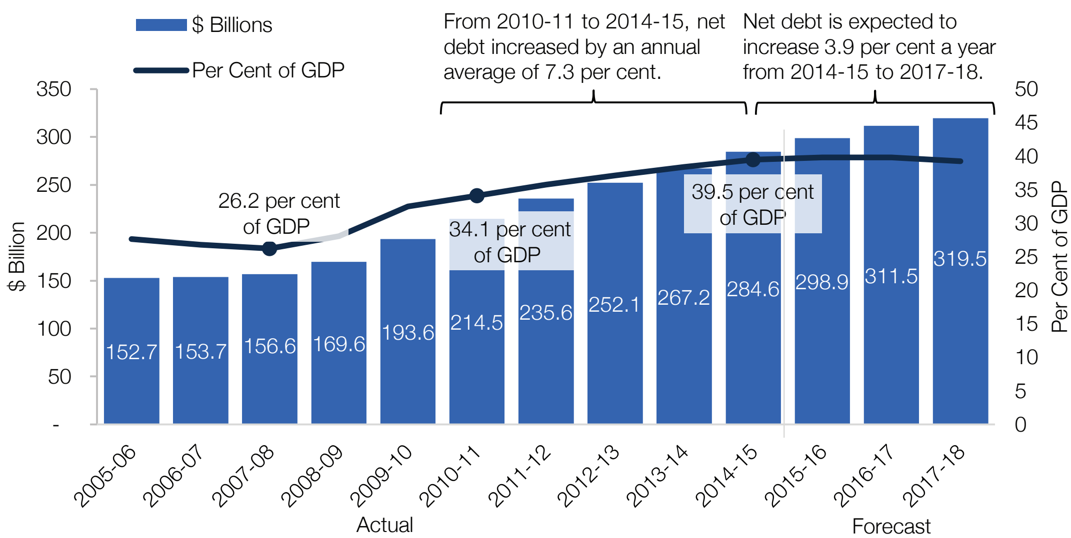
18 Province Of Ontario Downgraded To 'A+' From 'AA-' On Very High Debt Burden And Very Weak Budgetary Performance, Standard & Poor's Ratings Services, July 6, 2015
19 Province of Ontario Credit Ratings, Ontario Financial Authority, Accessed September 16, 2015

VI. Ontario Net Debt and Interest on Debt

The 2008-2009 recession and the resulting large deficits, led to sharp increases in Ontario's net debt (Figure 17). In 2007-08, Ontario's net debt was $156.6 billion or 26.2 per cent of GDP. By 2010-11, Ontario's net debt had increased by over one-third to $214.5 billion or 34.1 per cent of GDP. Assuming the government achieves its fiscal targets, Ontario's net debt to GDP ratio will peak in 2015-16 at almost 40 per cent.

In the 2014-15 Public Accounts Annual Report, the government confirmed its commitment to gradually reduce the net debt to GDP ratio to the pre-recession level of 27 per cent, although no timetable was provided.[20]

FIGURE 17: Ontario Net Debt



Source: Ontario Budgets and 2014-15 Public Accounts
Notes: Data labels indicate value in $ billions unless otherwise indicated.

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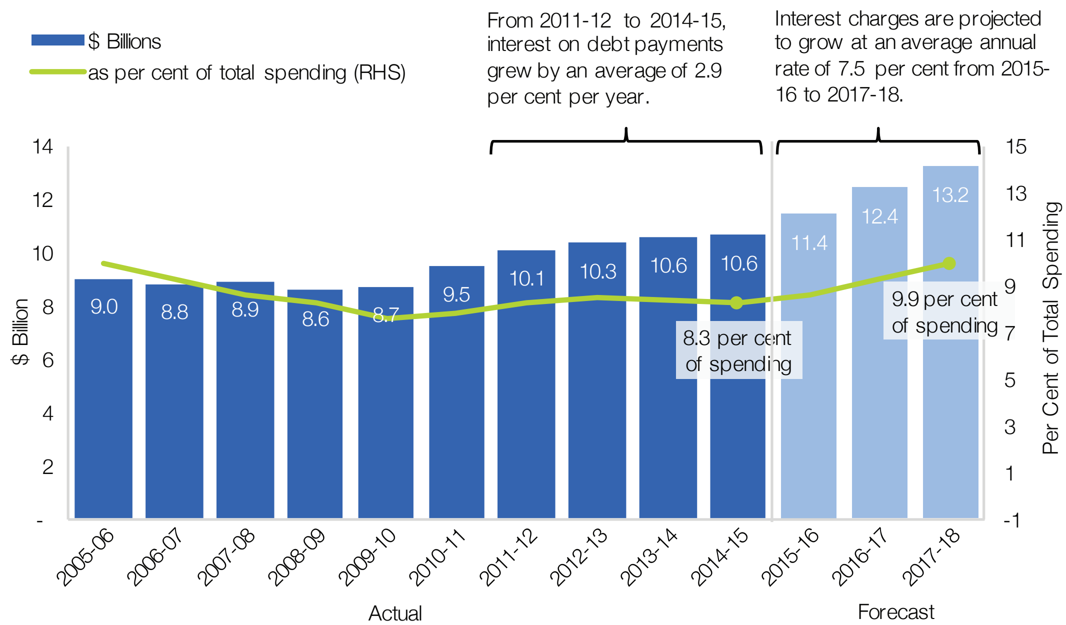
Interest on debt is expected to increase by almost 25 per cent from $10.6 billion in 2014-15 to $13.2 billion by 2017-18, the result of both the rise in net debt and higher expected interest rates. By 2017-18, interest payments are expected to account for almost 10 per cent of total spending.

FIGURE 18: Ontario Interest on Debt



Source: Ontario Budgets and 2014-15 Public Accounts
Notes: Data labels indicate value in $ billions unless otherwise indicated.