Update on the Fiscal Outlook

Office of the Budget
MINISTRY of FINANCE

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TBS

Presentation to Cabinet on October 4, 2017

49 of 55

Cab Submission File

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140/2017
iNfo 566

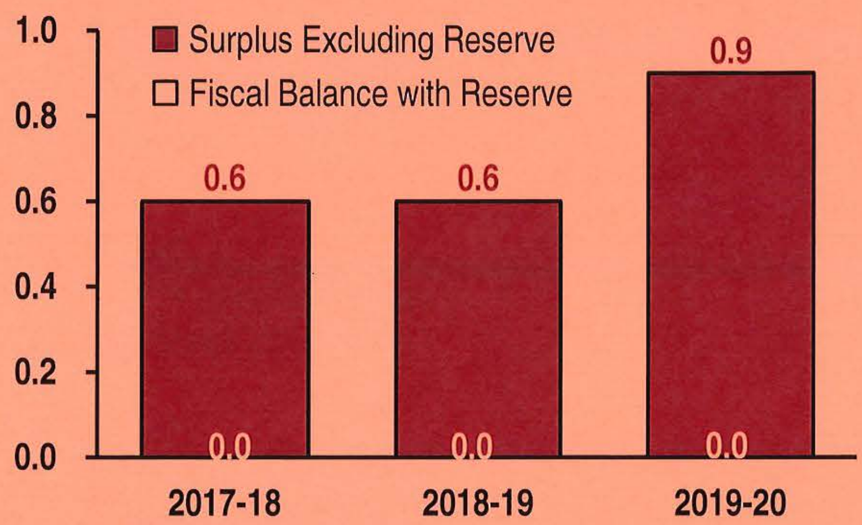
Purpose

- Provide a status update on the fiscal outlook for 2017-18 to 2020-21, based on latest forecasts and assessment of risks as compared to the 2017 Budget.
- Provide context for key fiscal decisions that will need to be addressed in the coming months.

Recapping the 2017 Budget Fiscal Architecture

2017 Budget Fiscal Targets

Fiscal Balance
($ Billions)



Net Debt-to-GDP

	2016-17	2017-18	2018-19	2019-20
Outlook	37.8%	37.5%	37.3%	37.2%
Targets	▪ 35% in 2023-24 ▪ 27% in 2029-30			

- Ratio peaked in 2014-15 at 39.1%
- 1% change in the GDP would impact ratio by ~0.5 percentage points.

Historically low reserve of $0.6 billion in 2017–18 and 2018–19, $0.9 billion in 2019–20.

Key Revenue Assumptions (2017–18 to 2019–20)

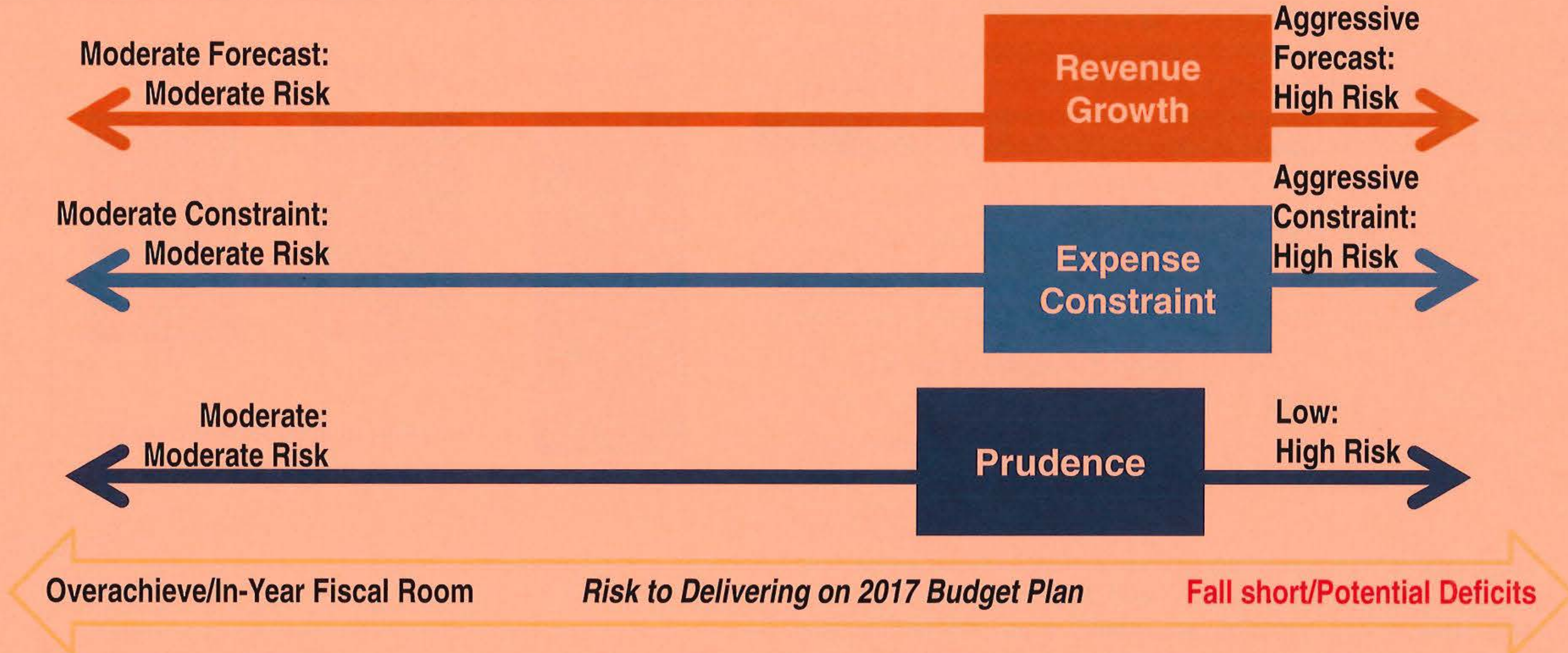
- The forecast assumed **revenue growth continues at a stronger pace than would normally be forecast given the economic outlook** and removed prudence from the nominal GDP forecast as well as assumed a modest slowing of the housing market.
- Incorporated **High-Yield Tax assumptions** of $1.3 billion in 2017–18, $1.8 billion in 2018–19, and $2.2 billion in 2019–20, and zero PIT tax planning.
- Included **Revenue Integrity Targets** of $0.1 billion in 2017–18, $0.2 billion in 2018–19, and $0.4 billion in 2019–20.
- Assumed no year-over-year decline in **Equalization Payments in 2018-19 (flat-lined at $1.4 billion).**
- Excluded potential accounting impacts that amount to $0.5 billion in 2018–19 and 2019–20.

Key Expense Assumptions (2017–18 to 2019–20)

- **Net increase in program expense of $16.4 billion over three years** compared to the *2016 Budget* to invest in every sector and increase overall average spending growth from **1.9% to 2.9%** -- with a particular focus on **health and education.**
- However, overall program spending **remains constrained** – continues to decline as a share of GDP; overall growth slower than inflation+population.
- **Contingency Funds** at $0.6 billion in 2017–18; grows to $1.8 billion in 2019–20 (including set aside for MoFwd Outside the GTHA of $0.7 billion)
- **Year–end Savings** targets of $1.2 billion in 2017–18 and 2018–19, and $1.1 billion in 2019–20.
- **Program Review Savings** targets of $750 million in 2018–19 and 2019–20.
- Limited **Interest-on-Debt** prudence over the outlook. Continued interest rate increase may result in IOD pressures.

2017 Budget: Underlying Fiscal Architecture

- While the 2017 Budget fiscal plan projected a balanced budget, the underlying fiscal architecture and assumptions are strained – making the plan vulnerable to critique and risk.
- The published fiscal architecture limits the ability **to adjust to adverse events and** provides limited room for error, reduced flexibility for downside risks and additional investments.



Impact of Revenue Information Received to Date

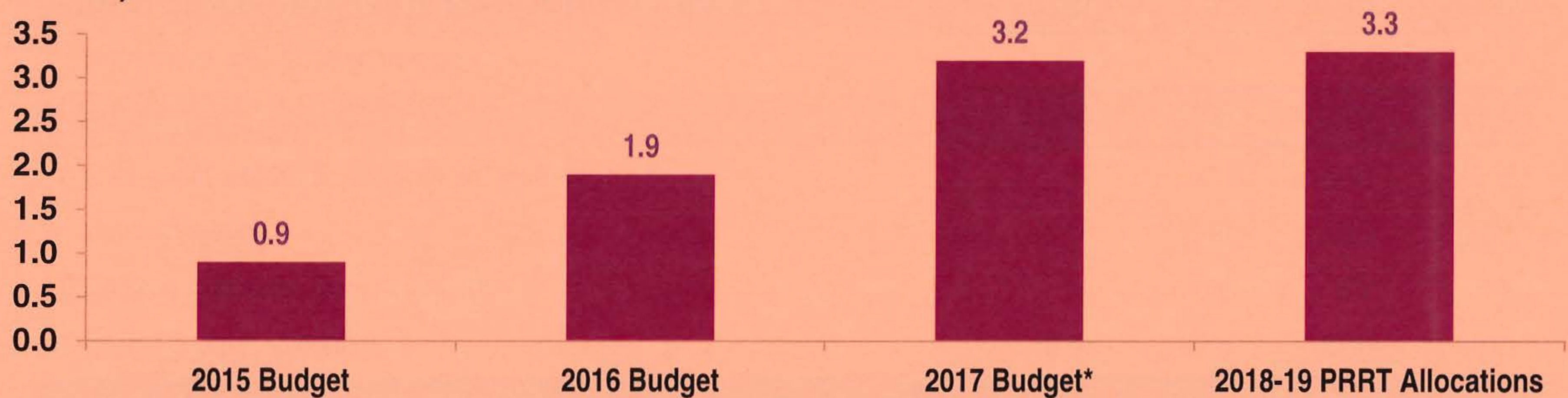
Change from 2017 Budget ($ Billions)	2016-17	2017-18	2018-19	2019-20
2016-17 Public Accounts	(0.6)	(0.5)	(0.5)	(0.5)
Revised Economic Growth Outlook	–	0.6	0.5	0.4
Housing Market	–	(0.6)	TBD	TBD
Post Public Accounts Revenue Information	–	(0.7)	(0.3)	(0.3)
Subtotal	**(0.6)**	**(1.2)**	**(0.3)**	**(0.4)**
Hard Risks: Equalization and IFRS	–	–	(1.2)	(0.5)
Total Change [Excluding Fiscally-Neutral Items]	**(0.6)**	**(1.2)**	**(1.5)**	**(0.9)**

- Significant risks remain regarding the revenue outlook, with information that could have a significant impact arriving after FES. Key risks include:
  - Revisions to the economic growth outlook
  - Evolution and outlook for the housing market
  - Finalization of 2016 tax assessments
  - Updated HST and Equalization entitlements
  - Revised Government Business Enterprise net income projections
  - Potential impact of Federal tax and program changes

Average Program Expense Growth

- The preliminary allocations provide for overall program expense growth averaging 3.3% between 2016-17 and 2020-21.
  - This is higher than past years (*2016 Budget*: 1.9%; *2015 Budget*: 0.9%).
- Ministries' preliminary allocations for the 2018-19 PRRT include TB/MBC Board approvals with out-year impacts which add $0.1 billion in pressure to the fiscal plan in each year over the outlook.

Average Annual Program Expense Growth
(Per cent)



*2017 Budget reflects growth between 2016-17 and 2020-21, updated for actual results and restatement for line-by-line BPS consolidations.

Impact of Expense Information Received to Date

- Since the 2017 Budget, **select** TB/MBC board **approvals have been offset** from contingency funds, new revenue sources, or transfers between ministries.
- Aside from items built into ministries' allocation, other out-year impacts will be **addressed through the PRRT process**.
- In addition, ministry identified **high-likelihood risks** amounting $3.4 billion by 2020-21 **will need to be managed**.

Preliminary Allocations

In-year approvals with multi-year impacts.

***Examples Include*:**

- Rural and Northern Education Fund
- Nishnawbe Aski Nation Education Funding
- GO-TTC Discounted Double-Fare Initiative

2018-19: $0.1B **2019-20**: $0.1B **2020-21**: $0.1B

Out-Year Impacts to be Addressed through PRRT

In-year approvals with multi-year impacts, where scale and timing are to be confirmed will be assessed through the PRRT.

Include:

- OHIP (OMA 2.6% mandate)
- Child Care (operating for 100k spaces)
- Achieving Excellence/Whole Child

2018-19: $0.7B **2019-20**: $1.0B **2020-21**: $1.2B

High-Likelihood Risks Continue to be Monitored

Pressures that are likely to materialize, but continue to evolve amount to $1.7B in 2018-19; $3.2B in 2019-20; and $3.4B in 2020-21.

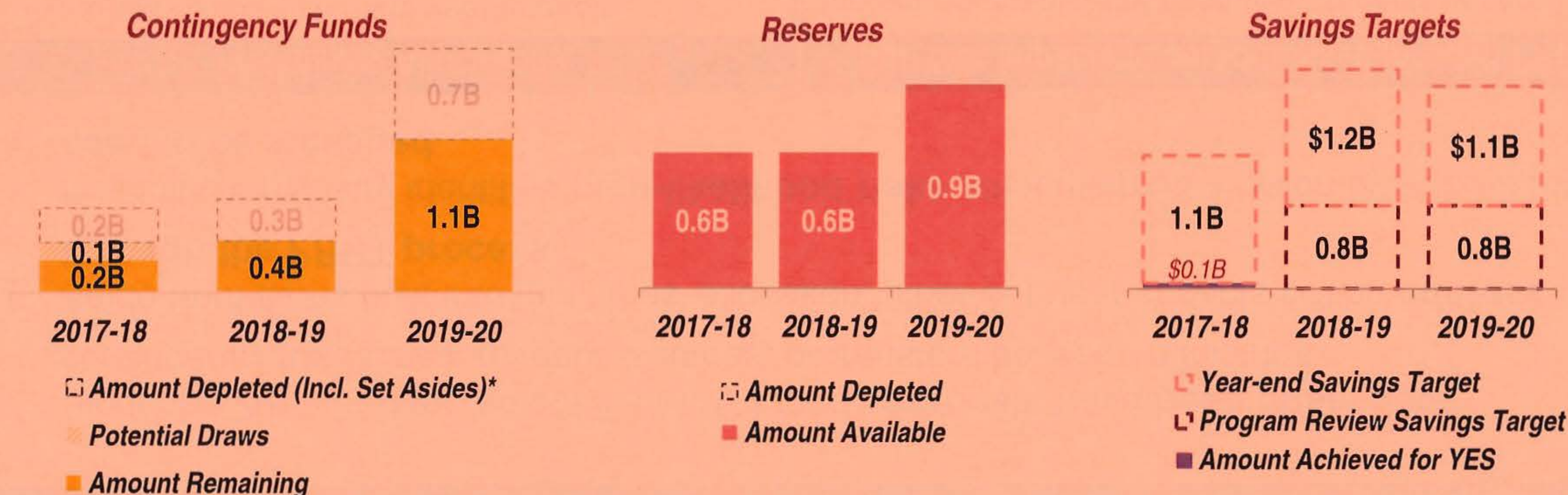
Examples Include: Compensation Risks, Capital Risks, and Aboriginal Issues and Land Claims

* The above does not include the impact of potential new/emerging policies or a FES/Document initiatives envelope.

Updates to Prudence

- There is currently $**0.2 billion remaining in the contingency fund in 2017-18** after accounting for amounts that have been set aside or drawn down (or potential draws) to fund in-year expense approvals.
- The **reserve** is unchanged and remains at historically low levels.
- To date, $50 million of the $1.2 billion 2017-18 Year-End Savings (YES) target has been achieved.
  - YES targets as well as the Program Review Savings Targets that are built into the plan beginning next year will need to be met in all years in order to maintain balance over the outlook.
- **Additional savings** – beyond the year-end and program review savings target – (e.g., boulder targets) **have been assumed in the fiscal plan** and may be challenging to achieve.

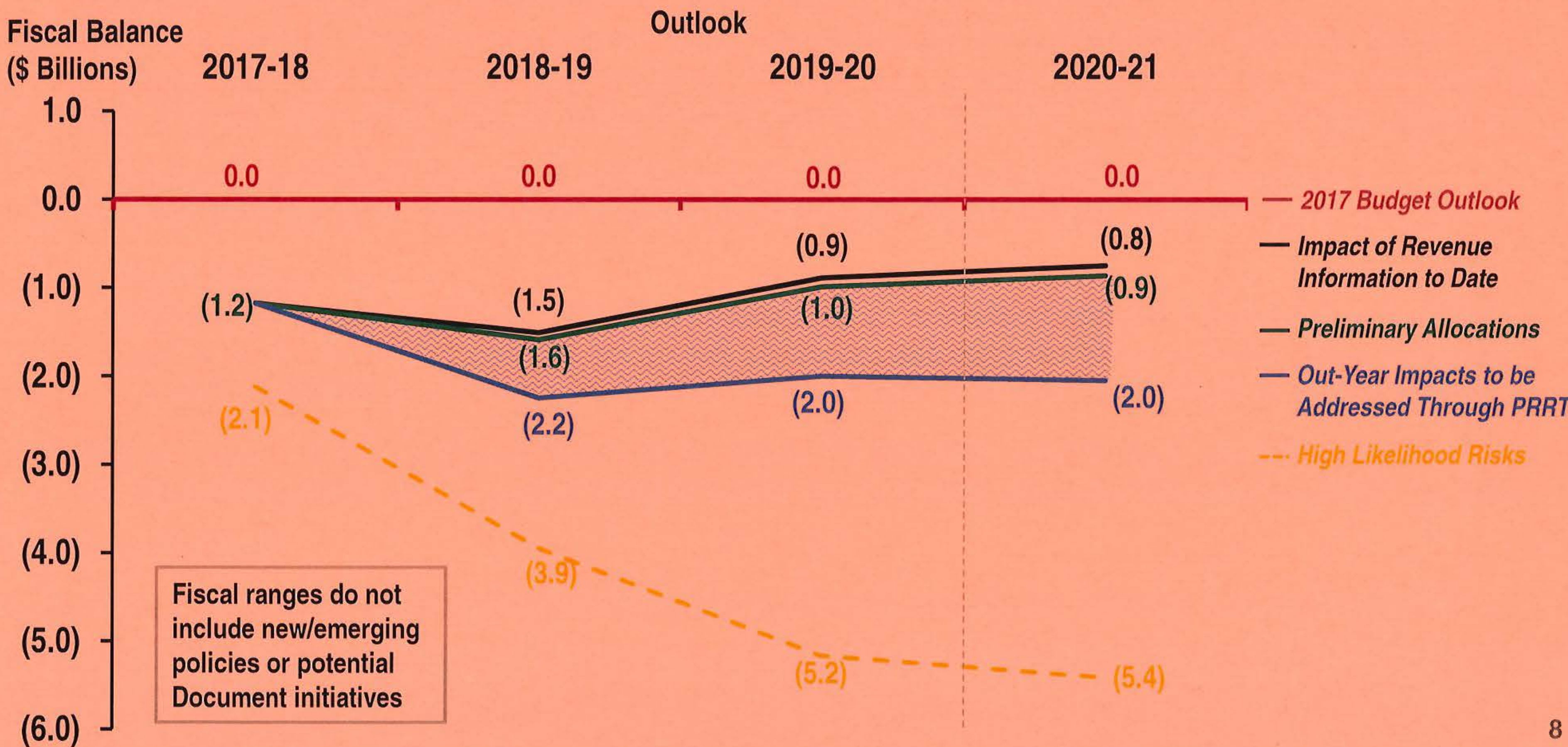
Current Balance of Unallocated Fiscal Prudence



*Set asides are:
Ring of Fire - $0.1B in 2017-18, $0.2B for 2018-19 and $0.2 for 2019-20.
Moving Ontario Forward - $0.1B for 2018-19 and $0.5B for 2019-20.

Impact of the Revenue and Expense Updates

- Impact of revenue information received to date and hard revenue risks result in a gap relative to the governments fiscal targets (black line).
- Layering on preliminary allocations adds approx. $0.1 billion to the current outlook in each year (green line).
- Incorporating approvals with unconfirmed out-year impacts (blue) further deteriorates the outlook. However, the gap remains constrained relative to funding all major ministry identified risks (yellow line).
- Assumes unchanged reserves and c-funds, and the achievement of savings targets. The impact of new/emerging policies or potential FES/Document initiatives has not been included.



Unique Considerations for this Fiscal Cycle

There are a number of unique considerations for this fiscal cycle that impact the context of fiscal planning.

General Factors

- **Pre-Election Report**: The 2018 Document may also inform a Pre-Election Report that would be reviewed by the Auditor General (AG) who will scrutinize the reasonableness of the government's fiscal projections.
    - The AG would expect a signed management representation letter from the Deputy Ministers of MOF, TBS and the Provincial Controller confirming the accounting policies used in preparing the projections follow the generally accepted accounting principles (e.g., average or cautious yield revenue forecast assumptions).
    - In addition, the AG is expected to continue to criticize the government over its accounting treatment of net pension assets and the electricity cost refinancing component of the Fair Hydro Plan.
- **FAO Reports**: The FAO's 2017 Spring Outlook continued to suggest that, while balance in 2017-18 may be within reach, the province will likely return to, and remain in, deficits over the outlook. The FAO's August 2017 commentary on the province's revenue forecast echoed the same sentiment, adding that there appears to be significant downside risk to the government's revenue forecast.

New Fiscal Targets for this Cycle

- **Revenue integrity**: A revenue integrity target has been set in each year over the outlook ($0.1 billion in 2017-18, $0.2 billion in 2018-19, and $0.4 billion in 2019-20) that will need to be solved through measures such as combatting the underground economy and closing tax loopholes.
- **Program review savings target (PRST)**: A $750 million PRST has been set in both 2018-19 and 2019-20. In order to achieve these savings, the government is initiating a multi-year enhanced approach to a line-by-line review, integrated into the PRRT process, with pilots being launched in the fall and results feeding into the 2018 Document.

Key Considerations and Next Steps

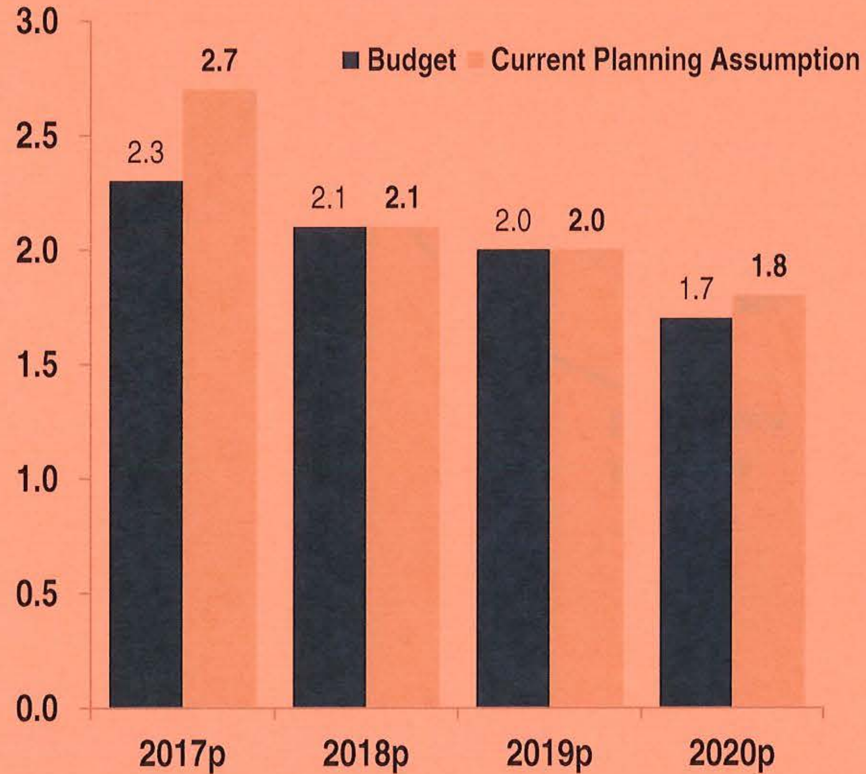
- Development of the 2017 Fall Economic Statement is underway. The FES provides an opportunity to report on progress against the Budget, and either confirm, or pivot the government's fiscal and policy priorities to set the stage for the upcoming Budget.
- The impact of the revenue and expense updates result in a fiscal deterioration compared to the 2017 Budget. However, there is uncertainty in the fiscal plan and a significant amount of information will not be available until later in the year.
  - The Fall Economic Statement may foreshadow risks to the plan rather than build downside revenue into the outlook at this point in the fiscal year
- The development of Ministry PRRTs process will run parallel to the development of the FES. It is important that Ministries stay within their allocations and limit additional pressure on the fiscal plan in order to support balanced budgets.
  - 2018 Document will be released in the Spring and reflect the fiscal impact of allocations and outcomes from the review of PRRT plans. Should the government choose to publish a PER, revenue forecasts and Ministry spending plans will need to withstand the test of reasonableness by the Auditor General.

Appendix

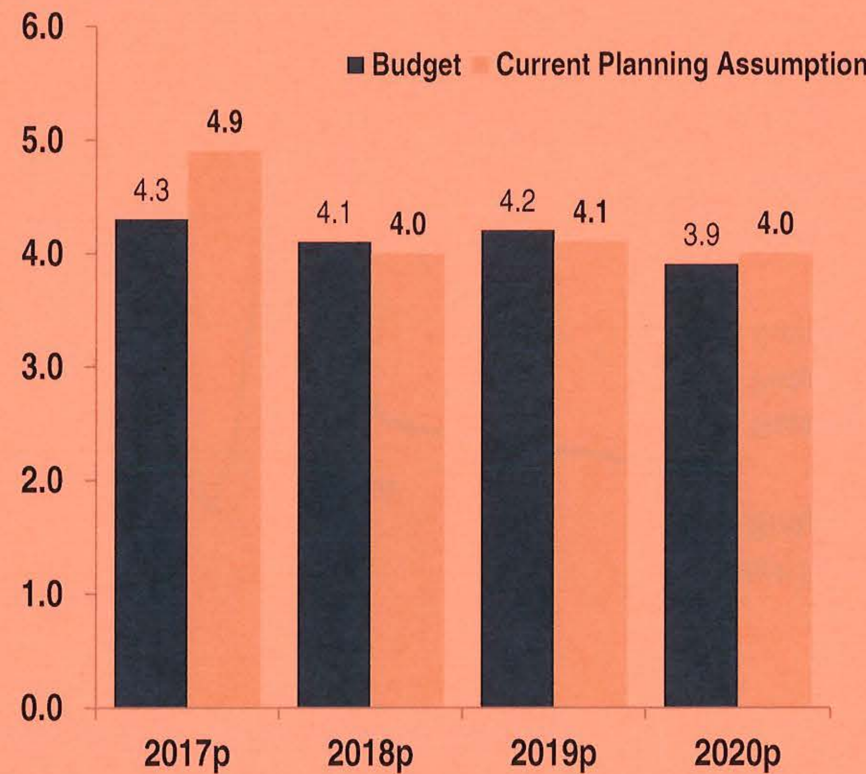
Stronger 2017 GDP Growth since Budget

- Average private sector forecast for 2017 nominal GDP growth has increased 0.7 percentage points based mainly on strong performance in the January to March quarter.

Ontario Real GDP Growth (Percent)



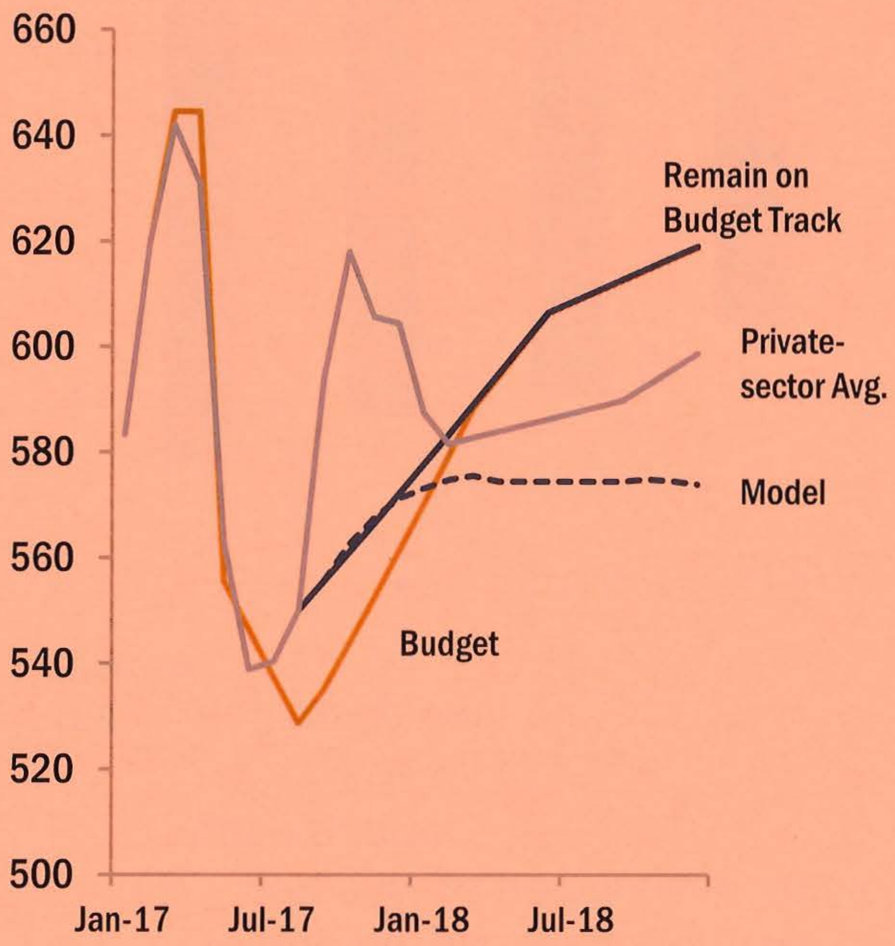
Ontario Nominal GDP Growth (Percent)



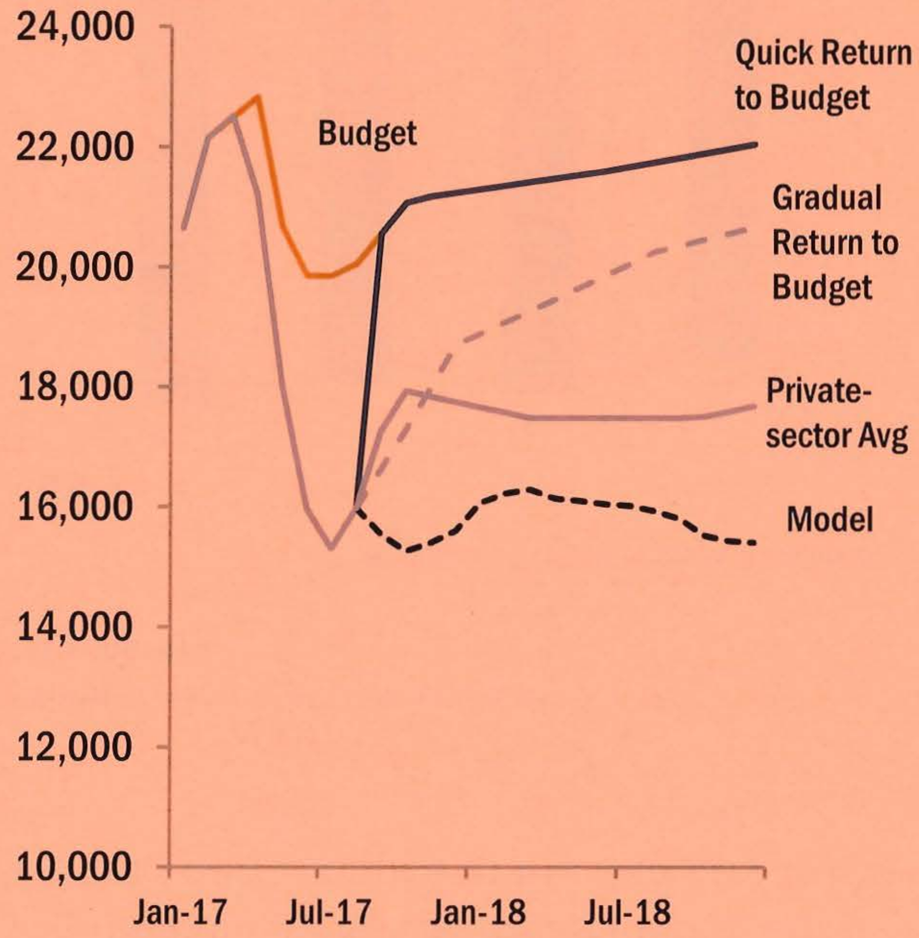
Budget projection: real GDP -0.1 ppts below PSA, nominal GDP equal to PSA
Current planning assumption: real and nominal GDP both 0.1 ppts below PSA
Source: Ontario Ministry of Finance.

Uncertainty Surrounds the Housing Resale Market

Ontario MLS Home Resales, Prices
$,000



Ontario MLS Home Resales, Volumes
Level



Sources: CREA and Ontario Ministry of Finance

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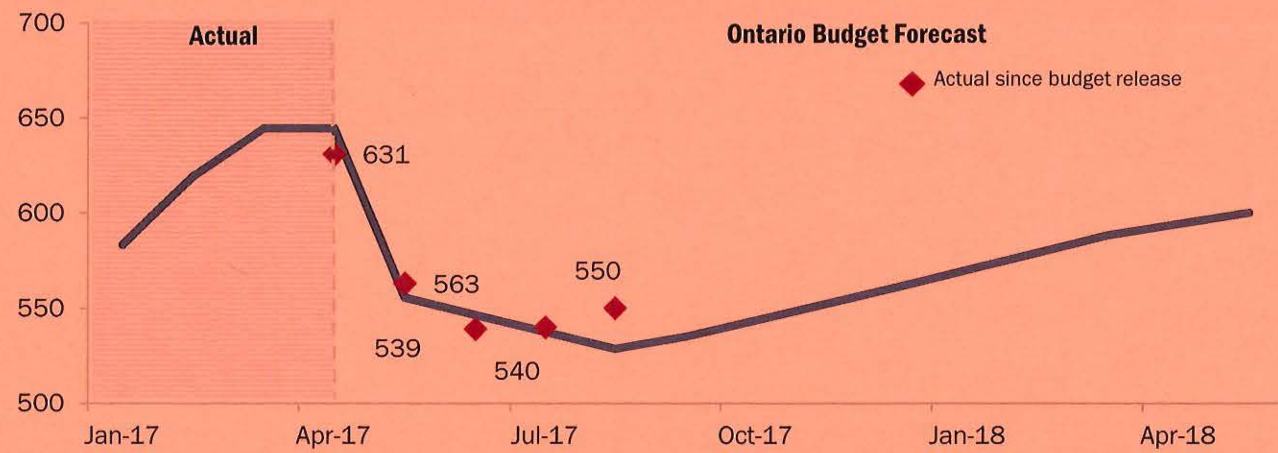
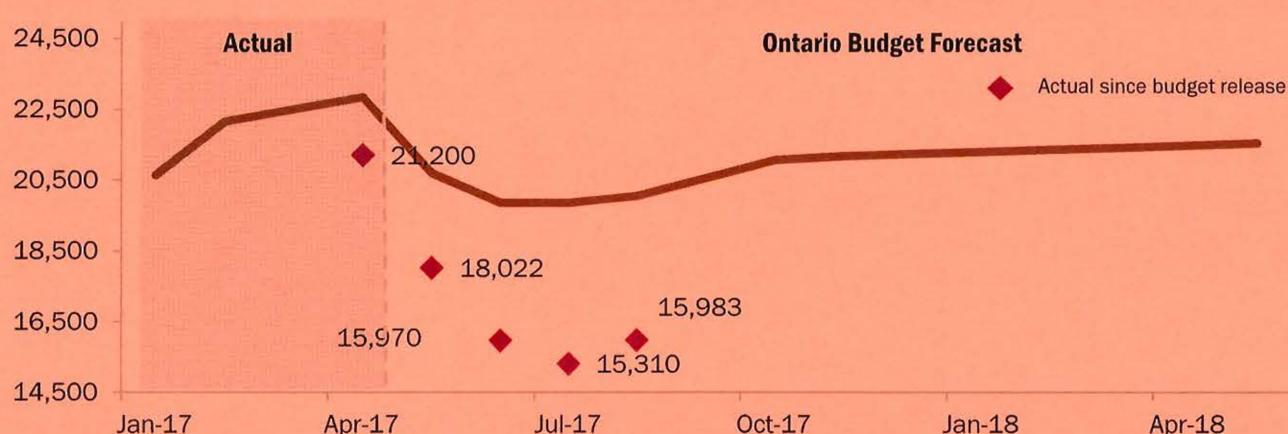
Softer Housing Resale Market

Ontario average resale price, $000s, SA



Ontario resales, units, SA



Source: CREA and Ontario Ministry of Finance.