Fiscal Strategy:
Ontario's Third Quarter Finances Building Blocks

Office *of the* Budget
MINISTRY *of* FINANCE

Presentation to FPC on January 25, 2017

Preliminary Draft

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Context

Under the *Fiscal Transparency and Accountability Act, 2004* (FTAA), the Third Quarter Finances is required to:

- Be released on or before February 15th (publication can be delayed if a letter is sent to the Clerk).
- Include updated information about the major components of revenue and expense **for the current fiscal year only.**

It also provides an **opportunity for the government to reiterate key fiscal messages** from the Budget or pre-condition for future updates.

A Third Quarter Finances has only been published once in the last eight years (in 2012-13).

- The infrequent publication provides the government with some flexibility on how to present its fiscal update (i.e., update could be presented relative to the 2016 Budget, 2016 FES or both, as was done in 2012-13).

Key stakeholders like the Financial Accountability Officer and rating agencies will assess the fiscal outlook and narrative.

- Both have acknowledged that balance is within reach in 2017-18, but have also highlighted key risks to the 2016 Budget fiscal plan.

Purpose and Key Decisions

To **confirm the approach to publishing Ontario's Third Quarter Finances, including:**

- The core updates to **the fiscal outlook and supporting revenue and expense details** to be published, as well as the **fiscal narrative and messaging**.
- Positioning the content and the rollout of Third Quarter Finances relative to the release of the Pension Panel's Report and recommendations.
- **Confirm release date** and determine if a letter to the Clerk is required.

Evolution of the 2016-17 Outlook

- The Third Quarter Finances could present a fiscal update relative to the 2016 Budget or FES.
- The 2016 FES highlighted Ontario's stronger economy and the government's approach to fiscal management, which supported strategic investments in new child care spaces, hospitals and electricity cost relief for consumers.
- To support these investments while accommodating the Pension Adjustment, the government took on a number of fiscal tools in order to meet its targets.

2016 Budget Fiscal Plan $ Billions	2016-17	Change to FES 2016-17	FES Outlook 2016-17
Revenue	**130.6**	*2.1*	**132.7**
Expense			
Programs	122.1	*3.1*	125.3
Interest on Debt	11.8	*(0.4)*	11.4
Total Expense	**133.9**	*2.7*	**136.6**
Surplus/(Deficit) Before Reserve	**(3.3)**	*(0.6)*	**(3.9)**
Reserve	1.0	*(0.6)*	0.4
Surplus/(Deficit)	**(4.3)**	*(0.0)*	**(4.3)**

Total revenue changes of $2.1 billion, consisting of:

- Base Forecast Change $1.0 billion
- Reversal of Homecare $(0.2) billion
- Federal Agreements $0.4 billion
- Higher assumed revenue to accommodate pensions $0.9 billion

Total expense changes of $2.7 billion, consisting of:

- In-Year Approvals $0.2 billion
- Pension Adjustment of $2.2 billion
- Electricity Cost Relief $0.3 billion
- Support for Hospitals $0.1 billion
- Green Investment Fund $0.3 billion
- New Federal Agreements $0.4 billion
- Contingency Fund Offsets $(0.5) billion
- Interest on Debt Savings $(0.4) billion

Change to the Reserve $(0.6) billion

End of Year Projection for 2016-17

- An early-read indicates that end of year projections for the 2016-17 deficit could range from $0.6 billion (if there is a significant improvement to the outlook) to $2.7 billion (if there is a moderate improvement to the outlook) by year end.

	Significant Year-end Improvement		Moderate Year-end Improvement
	2016 Budget **(4.3) billion**		**2016 Budget** **(4.3) billion**
+	Pension Adjustment and Tools	+	Pension Adjustment and Tools
	2016 FES **(4.3) billion**		**2016 FES** **(4.3) billion**
+	Higher Revenue ***1.7 billion***	+	Higher Revenue ***0.7 billion***
−	Re-profiling Cap and Trade Proceeds ***0.5 billion***	−	Re-profiling Cap and Trade Proceeds ***0.5 billion***
−	Lower Net Contribution from Assets Optimization ***75 million***	−	Lower Net Contribution from Assets Optimization ***75 million***
−	Accounting Adjustments: Accounting Framework (IFRS) ***75 million*** Unchanged Contaminated Sites	−	Accounting Adjustments: Accounting Framework (IFRS) ***75 million*** Contaminated Sites ***50 million***
	Unchanged Program Expense		Higher Program Expense ***1.0 billion***
+	Reverse Pension Adjustment ***2.2 billion***	+	Reverse Pension Adjustment ***2.2 billion***
+	Lower Interest on Debt ***0.1 billion***	+	Unchanged Interest on Debt
+	Reduce Reserve ***0.4 billion***	+	Reduce Reserve ***0.4 billion***
	Early-Read **(0.6) billion**		**Early-Read** **(2.7) billion**

Treatment of Pension Adjustment

Panel Recommendation

- The Pension Asset Expert Advisory Panel will be releasing its findings in the coming weeks.
  - The report is expected to include advice that the net pension asset be recognized in the Province's financial statements.
  - If taken on, would result in a positive fiscal impact in all years.

Treatment of Pension Adjustment

- The Third Quarter Finances provides the government with an immediate opportunity to align its fiscal strategy with recommendations of the panel, and frame the pension narrative in advance of the 2017 Document.
- While the reversal of the Pension Adjustment will result in an improved 2016-17 deficit, expectations may need to be tempered about how much fiscal room is created in the out-years due to growing pressures.
- For consistency and comparability, an adjustment to the 2015-16 actuals may be required to reflect the government's decision to adopt the Panel's recommendations. The adjustment to historical results would impact the previously reported net debt and deficit results.

Key Building Blocks

- In addition to the reversal of the Pension Adjustment, other key building blocks will either need to be reported in the Third Quarter Finances or be considered for the 2017 Document.

Report in Q3	Could Report in Q3	Report in Document
Pensions $2.2 billion Reverse Pension Adjustment for OPSEU and TPP	**Cap and Trade** $0.5 billion Recognize 2016-17 auction proceeds in 2017-18	**Reserve** $0 - $0.4 billion Reduce reserve from $0.4 billion
Expense Approvals Minuted before December 31, 2016	**HST** $0.9 billion	**H1 & OPG Accounting (IFRS)** $75 million smoothed – $1 billion non-smoothed
	Asset Optimization $75 million Lower net contribution from asset optimization	**Interest on Debt** $0 - $63 million

/ Potential Improvement to gap

/ Potential Improvement/ deterioration to gap

/ Potential deterioration to gap

Outstanding Information

- **Outstanding Information** could materially impact the **2016-17 outlook** in advance of the 2017 Document.

Revenue	Expense
▪ Revisions to economic outlook	▪ Ministry Q3/interim submissions
▪ Ongoing provincially-administered tax receipts	▪ Consolidations and other technical adjustments
▪ Non-tax revenue updates from Ministry PRRT submissions	▪ Interest on debt forecast updates
▪ Net income updates from government business enterprises	▪ Contaminated sites liabilities
	▪ Update pension expense forecast

Potential improvement to gap

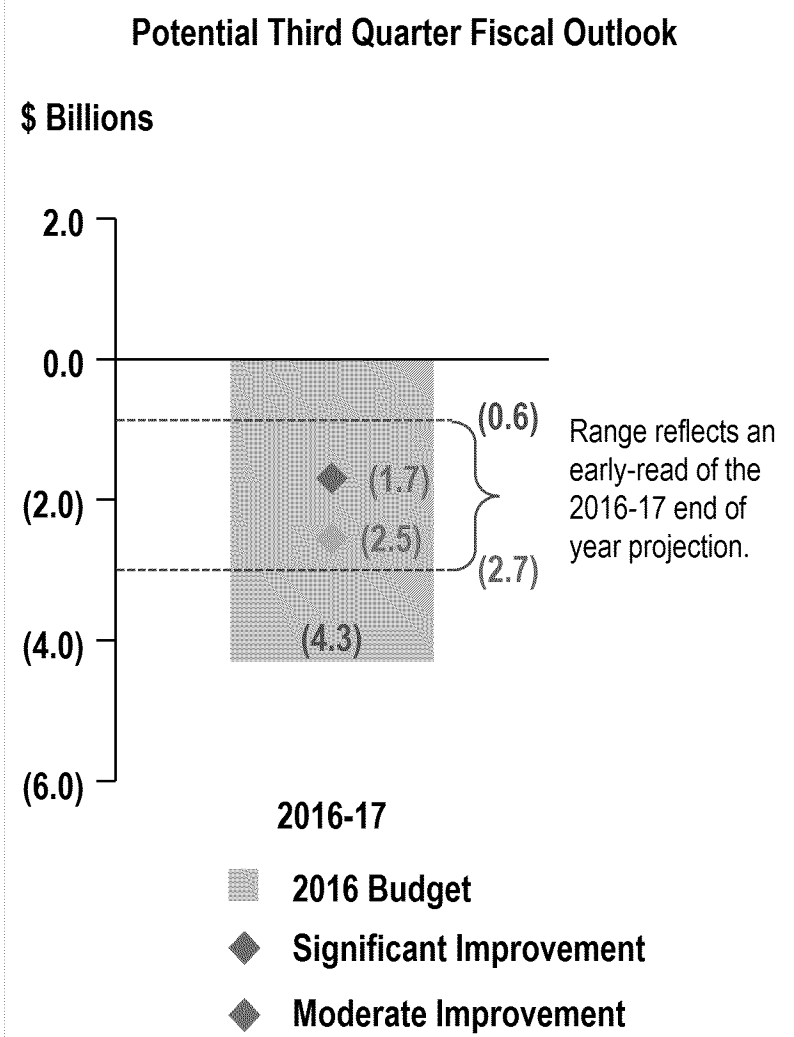
Potential improvement or deterioration to gap

Potential deterioration to gap

Principles for the 2016-17 Outlook

- Based on an early-read of end of year projections, the government may want to report an outlook that protects against risks or other changes that could adversely impact the Province's fiscal performance between now and the Budget, and ultimately, Public Accounts.
- For example, based on current information and taking into account key building blocks, Q3 could present a deficit ranging from $2.5 billion (moderate improvement) to $1.7 billion (significant improvement).

Moderate Improvement	Significant Improvement
Takes on the following key building blocks: • **Pensions** $2.2 billion • **Cap and Trade** $(0.5) billion	Takes on the following key building blocks: • **Pensions** $2.2 billion • **Cap and Trade** $(0.5) billion • **HST** $0.9 billion • **Asset Optimization** $(0.1) billion



Fiscal Narrative to Support Pension Reversal

The narrative could build on the 2016 FES, focusing on the investments the government is making in priority areas while remaining committed to balance the budget in 2017-18. This narrative would be further supported by highlighting the reversal of the pension adjustment, and could make room for announcements leading up to the release of the 2017 Document.

- *The government is projecting a **deficit of $X.X billion in 2016-17**, an improvement of $X.X billion since the 2016 Ontario Economic Outlook and Fiscal Review forecast.*
- *The Pension Asset Expert Advisory Panel recently released its report on the treatment of pension assets, including a recommendation that the net pension asset be recognized in the Province's financial statements.*
- ***The government is adopting the Panel's recommendation** by reversing the Pension Adjustment included in the 2016 Ontario Economic Outlook and Fiscal Review outlook. The reversal of the Pension Adjustment will result in a significant improvement in the 2016-17 outlook and could support additional investments in 2017-18 and beyond.*
- *The government is projected to beat its deficit target for the **eighth year in a row**.*
- *The impact of the reversal will change the net debt and accumulated deficit projections for 2016-17 by $X.X billion and $X.X billion, respectively. As a result, the government is projecting a net debt-to-GDP ratio of X.X per cent, an improvement of X.X percentage points compared to the 2016 FES.*

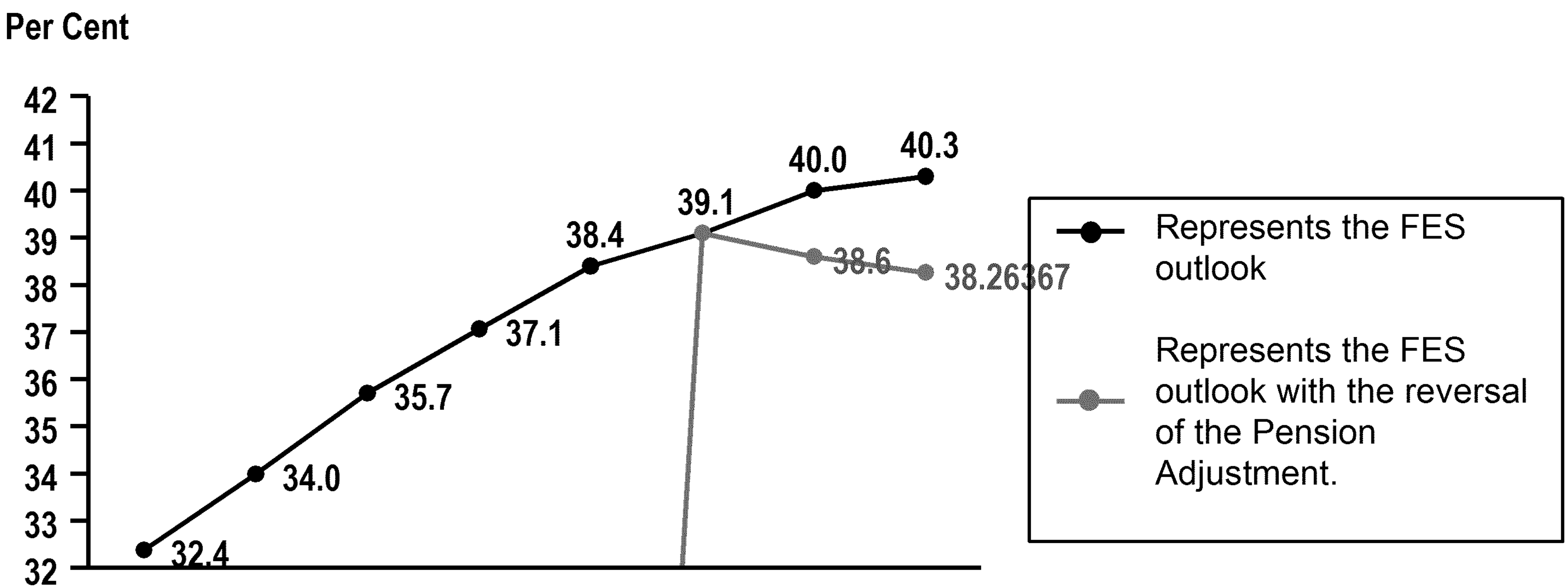
Decisions on Third Quarter Finances Fiscal Strategy

1. Seeking decision on the fiscal outlook and narrative to publish in the Third Quarter Finances.
2. Confirm **release date** and determine if a letter to the Clerk is required.
3. Communication and rollout approach with regards to the timing of the release of the Pension Panel's report and recommendations.

Appendix

Net Debt-to-GDP With Pension Reversal

- Reflects the reversal of the Teachers Pension Plan and OPSEU Pension Plan adjustments, including reversal of the $10.7 billion debt adjustment made in the 2015-16 Public Accounts



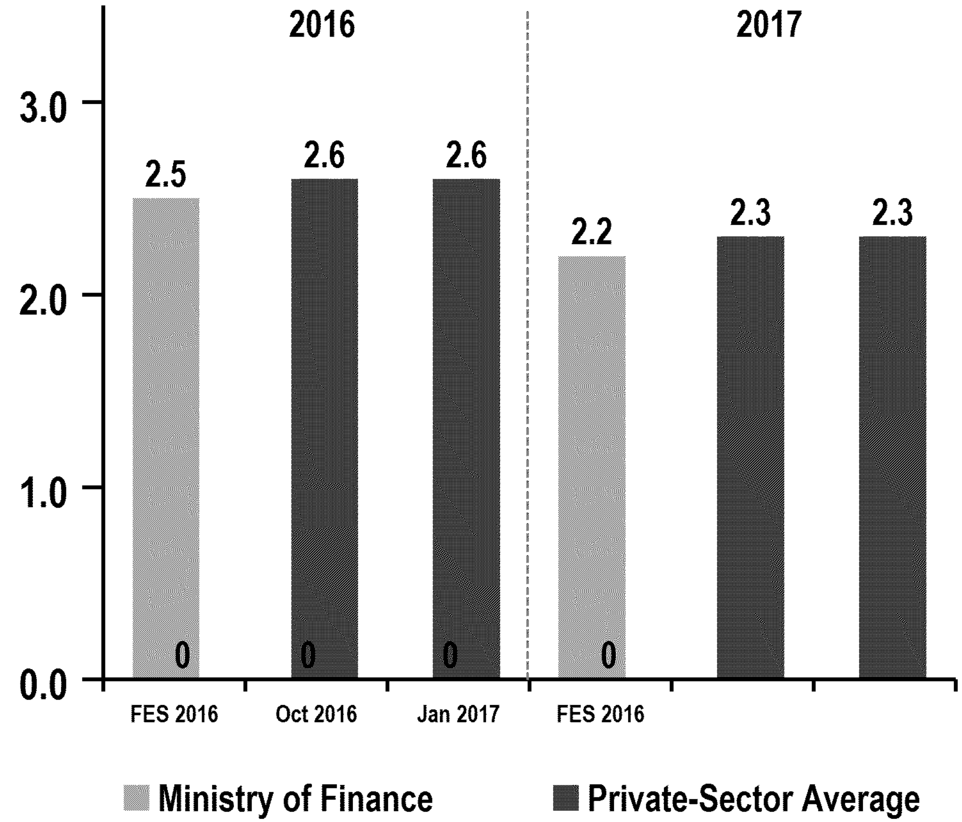
Potential Third Quarter Economic Outlook

Economic Update

- Real GDP increased by 0.7% in the third quarter (July to September) of 2016, after rising 0.2% in the second quarter.
  - Higher exports and continued growth in household spending were the primary drivers of growth
- Information available so far for the fourth quarter (October to December) of 2016 suggest growth at a more modest pace.
- Ontario's economic growth outlook remains consistent with the 2016 FES forecast

Ontario Real GDP Growth Outlook

Per cent change



Potential Third Quarter Revenue Outlook

Revenue Update

- Total revenues are $0.5 billion higher than published at the time of the 2016 Fall Statement. Revenue updates include:
  - An increase in Sales Tax of $0.9 billion reflecting revised federal entitlement estimates capturing Ontario's relatively strong economic and housing market growth.
  - Lower cap and trade proceeds this year reflecting a decision to report projected March 2017 auction proceeds in 2017-18 rather than 2016-17.

$ Billions	2016-17
2016 FES Revenue Outlook	**132.7**
Changes Since 2016 FES	
January 5, 2016 from Dec 15, 2016	
Sales Tax	0.9
Cap and Trade Proceeds	(0.5)
Total Changes	**0.5**
Current Revenue Outlook	**133.2**

Other Accounting Issues

Other Accounting Issues

- The move from U.S. GAAP to IFRS for the consolidation of Hydro One and OPG results in a fiscal impact starting in 2016-17, of either:

Basis of Consolidation of OPG and H1 (US GAAP vs. IFRS)	**Fiscal Impact Relative to FES**				
	2016-17	**2017-18**	**2018-19**	**2019-20**	**2020-21**
Preferred Approach (smoothed IFRS impact)**	**$75M**	**$425M**	**$525M**	**$675M**	**$675M**
High Impact (non-smoothed IFRS impact)**	$1B	$375M	$400M	$400M	$400M

*** OPG's estimate of cumulative impact for 2015-2020 is $2.5B under the preferred approach, and $2.6B under the high impact approach.*