December 7, 2017

FAO'S FALL 2017 ECONOMIC AND FISCAL OUTLOOK

On December 11, 2017, the FAO will release its fall 2017 assessment of Ontario's medium-term economic and fiscal outlook.

The FAO is projecting very strong growth for the Ontario Economy in 2017 along with a budget deficit of $4.0 billion.

By 2021-2022, the FAO is projecting a budget deficit of $9.8 billion and $75 billion will be added to Ontario's net debt, increasing the net debt-to-GDP ratio to over 41 per cent.

SUGGESTED RESPONSE

- **I would like to thank the Financial Accountability Officer (FAO) for releasing his fall economic and fiscal outlook for Ontario. The government values the FAO's work.**
- **My government is committed to a responsible fiscal plan that provides the conditions for all Ontarians to thrive.**
- **And, due to our prudent fiscal management and Ontario's robust economic growth, we are projecting a balanced budget for the first time since the onset of the global recession in 2008.**
- **As well, taxation revenue growth projected in the *2017 Budget* aligns with growth actually experienced in recent years.**
- **We also remain on track to balance the budget this fiscal year as well as in 2018–19 and 2019–20.**
- **This is something that has been achieved only eight times in the last 40 years in Ontario.**
- **The government builds prudence into its economic forecast. Since the time of the *2017 Budget*, private sector forecasters have revised up their economic growth projections for Ontario over the 2017-20 period, reflecting the strength in the Ontario economy.**
- **We will continue moving forward on our fiscally responsible plan that creates fairness and opportunity for all Ontarians.**

If asked about debt-to-GDP ratio:

- **The net debt-to-GDP ratio peaked at 39.3 per cent in 2014-15 and has been on a declining trend since then. It is projected to be 37.3 per cent at the end of 2017-18, 0.2 per cent lower than was forecast in the 2017 Budget. This ratio is projected to continue to decline to 37.1 per cent in 2018–19.**

- **The first very important step in reducing debt is to balance the budget. Balanced budgets from 2017–18 onwards will ensure that the increase in net debt is limited to net investments in capital assets.**

- **We are making the biggest investment in public infrastructure in Ontario's history. We have a plan to invest more than $190 billion over 13 years, starting in 2014–15. These strategic investments will not only create jobs, but will also contribute to the economy growing at a faster rate than the net debt.**

- **The positive impact of capital investments on the Province’s economy was confirmed by the Centre for Spatial Economics which reported recently that, over the long term, GDP in Ontario increases by $6 for every dollar of public infrastructure spending.**

- **The government is setting an interim net debt-to-GDP ratio target of 35 per cent by 2023–24 and continues to maintain a target of reducing the net debt-to-GDP ratio to its pre-recession level of 27 per cent, currently projected to be achieved by 2029–30.**

- **In June 2016, the International Monetary Fund (IMF) released a report recommending that Canadian “fiscal policy should be pro-growth.” Christine Lagarde, Managing Director (IMF), also expressed her support for the government’s growth strategy and agreed that investment in infrastructure should be an essential element of the strategy.**

If asked about accounting treatment of pensions:

- **The government continues to move forward and present the province’s finances fairly and accurately and in accordance with Canadian Public Sector Accounting Standards (PSAS). Ontario has a strong track record of producing high-quality financial reports on a timely basis. The Auditor General’s qualified opinion is based on a different interpretation of PSAS for net pension assets and recognition of market accounts.**

- **Last year there was a disagreement among the province’s professional accounting staff and the Auditor General’s Office on the appropriate application of PSAS regarding pension accounting. As a result, the Pension Asset Expert Advisory Panel was established to deliver independent advice and recommendations on the issue to the province.**

- **The independent panel members concluded the province’s share of the net pension assets of both the Ontario Teachers’ Pension Plan and the Ontario Public Service Employees’ Union Pension Plan should be recognized in Ontario’s financial statements.**

- **After significant deliberation, including consideration of the recommendations of the panel, Ontario confirmed that the accounting for these plans prior to 2015-16 was appropriate, and are prepared in accordance with public sector accounting standards for pension asset accounting. The 2016-17 financial statements include these pension assets, and we continue to apply the accounting treatment of pension assets that the province has used consistently since 2001. In addition, the 2015-16 financial statements were restated to include these assets.**

If asked about accounting treatment of the Fair Hydro Plan:

- **The province will prepare its consolidated financial statements in accordance with Public Sector Accounting Standards (PSAS).**

- **The proposed accounting for the Ontario Fair Hydro Plan (OFHP) reflects the economic substance of the transaction by differentiating costs borne by taxpayers versus those borne by ratepayers.**

- **PSAS is silent on a key accounting issue regarding the OFHP – the standards neither explicitly permit, nor prohibit, the recognition, measurement, presentation, or disclosure of rate-regulated activities.**

REPORT SUMMARY

KEY POINTS

Economic Outlook

- The FAO has raised its forecast for Ontario economic growth in 2017 from its spring outlook report. However, despite this upward revision, the FAO forecast is at the bottom of the current range of the MOF survey of private sector forecasts for both real and nominal GDP growth in 2017.
- Beyond 2017, the FAO forecast anticipates growth to moderate as the housing market and consumer spending cool alongside gradually rising interest rates, in line with the FES forecast.
- Over the 2017 to 2020 period, the FAO's forecast for average annual real GDP growth of 2.2 per cent is the same as the 2017 FES outlook.
- However, for nominal GDP growth, the FAO's average annual forecast of 4.2 per cent over the 2017 to 2020 period is slower than the FES projection of 4.4 per cent growth. This difference is explained by a much lower FAO nominal GDP forecast in 2017 compared to the FES (4.7 per cent vs 5.3 per cent).
- The FAO forecast takes into account its estimate of the impact of the new minimum wage legislation, which is expected to boost wage growth over the forecast, but temper employment gains. Even with these employment impacts, the FAO predicts a modest decline in the unemployment rate.

Fiscal Outlook

- The FAO is projecting a budget deficit of $4.0 billion in 2017–18 using the **Auditor General's recommended accounting treatment for both the Fair Hydro Plan and the net pension assets of jointly sponsored pension plans.** In the absence of any fiscal policy changes the deficit grows steadily to $9.8 billion in 2021-22.
- Under the **government's accounting presentation (excluding the AG's recommendations)**, the FAO projects a small surplus for 2017–18 of $0.2 billion (excluding the reserve) and a return to deficits beyond 2017–18 driven by revenue factors - loss of temporary revenues combined with more moderate tax revenue growth.
- The FAO suggests that by not adopting the AG's recommended accounting presentation, the 2017 Budget and the 2017 FES have reduced transparency and clarity of Ontario's fiscal position and Ontario will continue to receive qualified opinions from the AG on its Pubic Accounts.

Budget Balance - FAO's Fiscal Outlook ($ Billions)	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
AG Presentation	-5.0	-2.4	-4.0	-7.1	-7.8	-9.0	-9.8
Government Presentation	-3.5	-1.0	0.2	-1.9	-1.9	-2.6	-3.7
2017 FES -- Excluding Reserve	-3.5	-1.0	0.5	0.5	0.8	N/A	N/A

Revenue Outlook

- The FAO is projecting average annual revenue growth of 3.2 per cent from 2016-17 to 2019-20 as compared with the government's projections of 4.0 per cent. The main drivers are:
    - The FAO projections for taxation revenues are $2.9 billion lower by 2019-20 than the projections in the 2017 FES due to lower projected growth in household spending, labour income and corporate profits.
    - In addition, the FAO continues to highlight a number of one-time 2017-18 revenues, including: increase to sales and rentals from sale of final tranche of H1, higher federal transfers for infrastructure (PTIF), a one-time boost from extra Cap and Trade auction. Taken together the FAO estimates that these amount to $4.5 billion in additional one-time revenues in 2017-18.

Expense Outlook

- From 2017–18 to 2019–20 the FAO's outlook adopts the government's 2017 FES projections for program spending, **adjusted to reflect the AG's recommended accounting presentation.**
    - Both the Fair Hydro Plan and net pension asset adjustment impact the expense side with a combined impact of approximately $4.2 billion in 2017-18.
- The FAO notes that in 2018-19 and 2019-20, increases in program spending will be restrained to an average of 2.4 percent, below the growth in underlying spending pressures. Beyond 2019–20 the FAO projects program spending will grow faster -- at an average annual rate of 4.2 per cent – due to population pressures.

Borrowing and Net Debt

- Using the **government's accounting presentation** net debt-to-GDP is expected to reach 38.5 per cent by 2019–20 and 38.7 per cent by 2021–22. This increases to 41.4 per cent by 2021–22 **under the AG's accounting presentation for jointly sponsored pension plans and the Fair Hydro Plan**.
    - The 2017 FES projected a net debt-to-GDP ratio of 37.0 per cent by 2019–20.

Comparison: 2017 Fall Economic Statement and the 2017 Fall FAO Fiscal Outlook

$ Billions	Actual 2015-16	Actual 2016-17	Outlook 2017-18	Outlook 2018-19	Outlook 2019-20	Outlook 2020-21	Outlook 2021-22	Avg. Annual Growth 16-17 to 19-20	Avg. Annual Growth 19-20 to 21-22	Avg. Annual Growth 16-17 to 21-22
2017 Fall Economic Statement										
Taxation Revenue	91.8	94.3	99.9	105.1	110.0			5.2%		
Transfers from Gov't of Canada	23.1	24.5	26.2	26.0	25.4			1.2%		
Income from GBEs	4.9	5.6	5.1	5.9	6.2			3.7%		
Other Non-Tax Revenue	16.3	16.3	19.0	16.5	16.6			0.7%		
Total Revenue	136.1	140.7	150.1	153.6	158.2			4.0%		
Expense										
Program Expense	128.1	130.0	137.4	140.4	144.2			3.5%		
Adjustment for Pension Assets	-	-	-	-	-					
Adjustment for Fair Hydro Plan	-	-	-	-	-					
Interest on Debt	11.6	11.7	12.2	12.7	13.3			4.2%		
Total Expense	139.7	141.7	149.6	153.1	157.4			3.6%		
Surplus/(Deficit)	**(3.5)**	**(1.0)**	**0.5**	**0.5**	**0.8**					
Net Debt	295.4	301.6	311.7	323.0	335.6			3.6%		
Change - 2017 Fall Economic Statement to 2017 Fall FAO Fiscal Outlook										
Taxation Revenue	-	-	-1.2	-2.4	-2.9					
Transfers from Gov't of Canada	-	-	0.0	-0.5	-0.4					
Income from GBEs	-	-	0.0	0.0	0.0					
Other Non-Tax Revenue	-	-	0.4	0.0	0.0					
Total Revenue	-	-	(0.7)	(2.9)	(3.4)					
Expense										
Program Expense	-	-	-	-	-					
Adjustment for Pension Assets	1.5	1.5	2.3	2.6	2.9					
Adjustment for Fair Hydro Plan	-	-	1.9	2.7	2.9					
Interest on Debt	-	-	*(0.4)*	*(0.6)*	*(0.7)*					
Total Expense	*1.5*	*1.5*	*3.8*	*4.7*	*5.2*					
Surplus/(Deficit) AG Presentation	***(1.5)***	***(1.4)***	***(4.5)***	***(7.6)***	***(8.6)***					
Surplus/(Deficit) - Gov't Presentation (excl. Fair Hydro Pension Adj.)	***(0.0)***	***(0.0)***	***(0.3)***	***(2.4)***	***(2.7)***					
Net Debt	*11.0*	*12.5*	*17.5*	*24.7*	*32.4*					
2017 Fall FAO Fiscal Outlook										
Taxation Revenue	91.8	94.3	98.7	102.7	107.0	111.3	115.8	4.3%	4.0%	4.2%
Transfers from Gov't of Canada	23.1	24.5	26.2	25.5	25.0	25.8	26.6	0.7%	3.2%	1.7%
Income from GBEs	4.9	5.6	5.1	5.9	6.2	6.5	6.7	3.5%	4.0%	3.7%
Other Non-Tax Revenue	16.3	16.3	19.4	16.5	16.6	17.3	18.0	0.6%	4.1%	2.0%
Total Revenue	136.1	140.7	149.4	150.7	154.8	160.8	167.0	3.2%	3.9%	3.5%
Expense										
Program Expense	128.1	130.0	137.4	140.4	144.2	150.2	156.9	3.5%	4.3%	3.8%
Adjustment for Pension Assets	1.5	1.5	2.3	2.6	2.9	2.9	2.9			
Adjustment for Fair Hydro Plan	-	-	1.9	2.7	2.9	3.4	3.2			
Interest on Debt	11.6	11.7	11.8	12.1	12.6	13.2	13.8	2.5%	4.7%	3.4%
Total Expense	141.2	143.2	153.4	157.8	162.6	169.8	176.8	4.3%	4.3%	4.3%
Surplus/(Deficit) AG Presentation	**(5.0)**	**(2.4)**	**(4.0)**	**(7.1)**	**(7.8)**	**(9.0)**	**(9.8)**			
Surplus/(Deficit) - Gov't Presentation (excl. Fair Hydro Pension Adj.)	**(3.5)**	**(1.0)**	**0.2**	**(1.9)**	**(1.9)**	**(2.6)**	**(3.7)**			
Net Debt	306.4	314.1	329.2	347.7	368.0	386.8	404.4	5.4%	4.8%	5.2%

Note: All surplus/deficits exlcude the reserve. Numbers may not add due to rounding.

Economic Assumptions: FAO vs FES

Real GDP	**2017**	**2018**	**2019**	**2020**	**2017-20 average**
FAO - Fall 2017	2.8	2.1	2.0	1.9	2.2
FES 2017	2.8	2.1	2.0	2.0	2.2
Nominal GDP					
FAO - Fall 2017	4.7	4.1	4.1	4.1	4.2
FES 2017	5.3	4.1	4.1	4.2	4.4
Labour income					
FAO - Fall 2017	4.0	4.5	4.3	4.1	4.2
FES 2017	4.3	4.7	4.8	4.4	4.6
Corporate profits					
FAO - Fall 2017	11.7	2.2	3.7	4.4	5.5
FES 2017	16.1	2.9	2.8	3.7	6.4
Household consumption*					
FAO - Fall 2017	4.7	4.2	4.1	3.9	4.2
FES 2017	5.1	4.3	4.3	4.3	4.5

* Real household consumption plus CPI

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