Comparing the 2017 FAO Fall Outlook with the 2017 FES

Office *of the* Budget MINISTRY *of* FINANCE

OFFICE OF ECONOMIC POLICY OEP MINISTRY OF FINANCE

TBS

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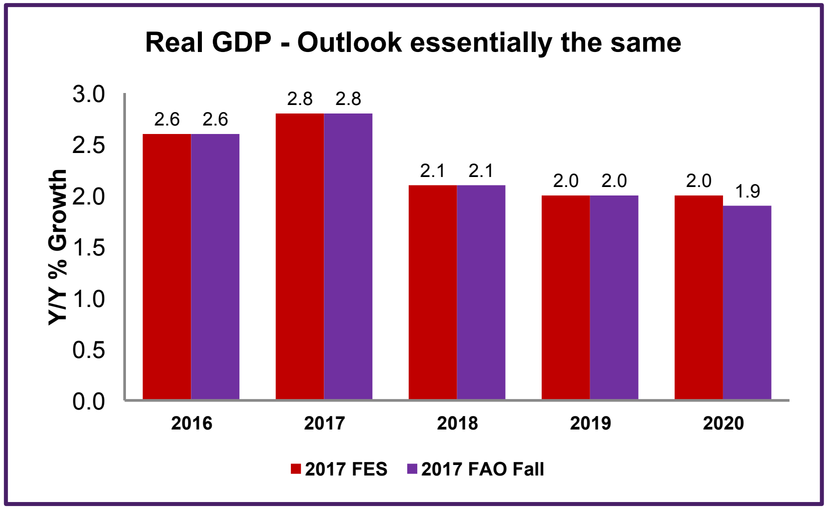
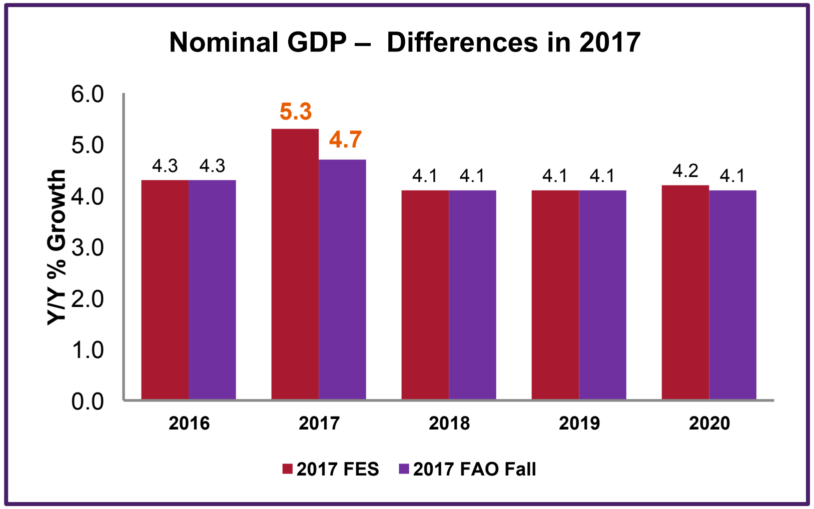
Highlights

- The FAO's 2017 Fall Economic and Fiscal Outlook report was released on Dec. 11, 2017 and included the **FAO's economic outlooks to 2021 and fiscal projections to 2021-22**.
  - This represents **two more fiscal years** than the government's Fall Statement outlook (with fiscal projections out to 2019-20), and **one more year of economic forecasts** (vs. government's 2020 projection).
- **The FAO's economic outlook calls for slower overall growth than the government's forecast** -- particularly for 2017 as a whole, and for components of growth that drive provincial revenues -- which results in a lower revenue outlook over the planning horizon.
- **The FAO presents two program expense outlooks which only differ in whether or not they include the Auditor General's recommended accounting treatment** of the Fair Hydro Plan and net pension assets of jointly sponsored pension plans.
- Using the government's accounting presentation (i.e. excluding the AG's recommended treatment), **the FAO is projecting a small surplus in 2017-18 and subsequent deficits of $1.9B in 2018-19, gradually increasing to $9.8B by 2021-22**.
  - Excluding the AG's recommended accounting framework, the difference between the government's balanced budget projections and the FAO's forecast of deficits over the 2017-18 to 2019-20 period are **entirely due to a lower revenue outlook**.
  - While the FAO **aligns its outlook for program expense** with the government's over the 2017-18 to 2019-20 period, (excluding accounting differences), it does provide for a **lower interest on debt outlook** than the government's projections.

FAO Economic Outlook As Compared to 2017 FES

- 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 still at the bottom of the current range 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 government's 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.





FAO Economic Outlook Compared to 2017 FES

- In addition to the differences in expected nominal GDP growth, the composition of growth in the FAO's economic projection has important implications for the fiscal forecast.
- The FAO's projections for key revenue drivers such **as labour income, corporate profits and household spending are significantly lower outlooks than the FES projections**.

Comparison of FES and FAO Outlook for Economic Variables

	% Change Over Previous Year				
	2017	**2018**	**2019**	**2020**	**2017-20 Average**
Labour Income					
FAO Fall 2017	4	4.5	4.3	4.1	4.2
2017 FES	4.3	4.7	4.8	4.4	4.6
Diff FAO - FES	*-0.3*	*-0.2*	*-0.5*	*-0.3*	*-0.4*
Corporate Profits					
FA0 Fall 2017	11.7	2.2	3.7	4.4	5.5
2017 FES	16.1	2.9	2.8	3.7	6.4
Diff FAO - FES	*-4.4*	*-0.7*	*0.9*	*0.7*	*-0.9*
Household Spending					
FA0 Fall 2017	4.7	4.2	4.1	3.9	4.2
2017 FES	5.1	4.3	4.3	4.3	4.5
Diff FAO - FES	*-0.4*	*-0.1*	*-0.2*	*-0.4*	*-0.3*

- **The FAO has also consistently underestimated economic growth prospects for the Province** – not just for specific components of economic growth, but overall growth itself.

Comparison of FAO Economic Projection to Actual

	2016 % Change Over Previous Year		
	FAO Spring 2016	**Actual**	**Diff FAO - Actual**
Nominal GDP	3.4	4.3	*-0.9*
Real GDP	2.4	2.6	*-0.2*
Corporate Profits	0.3	7.3	*-7.0*
Labour Income	4.0	3.3	*0.7*
Household Spending	4.4	4.2	*0.2*

FAO Revenue Outlook As Compared to 2017 FES

- **The FAO's lower outlook for the economy as a whole in 2017 and key components of growth result in an average annual revenue growth of 3.2 per cent from 2016-17 to 2019-20, compared with the government's Fall Statement projection of 4.0 per cent**.
  - The FAO projections for **taxation revenues are $2.9 billion lower by 2019-20** than the projections in the 2017 FES due to the FAO's lower projected growth for key economic drivers such as household spending, labour income and corporate profits.
  - In addition, the FAO also suggests that revenue growth beyond 2017-18 significantly declines because of a number of **"one-time 2017-18 revenues"** including: an increase to sales and rentals from sale of final tranche of H1, higher federal transfers for infrastructure (PTIF), and a one-time boost from an additional Cap and Trade auction.
    - While revenues such as federal transfers and cap and trade revenues should be considered fiscally neutral (i.e. offset by expense), the FAO estimates that these one-time revenues in 2017-18 will amount to $4.5 billion – a significant amount that that will not continue into the future.
- As the FAO largely aligns with the government on program expense (excluding differences in accounting treatment), **the difference between the 2017 FES Outlook for balanced budgets and the FAO's fiscal projections are essentially due to the FAO's lower revenue outlook**.

Revenue Outlook Comparison							*Avg. Annual Growth*	
($ Billions)	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	*16/17 to 19/20*	*16/17 to 21/22*
2017 FES Outlook	**140.7**	**150.1**	**153.6**	**158.2**			***4.0%***	
Difference in Taxation Revenue		(1.2)	(2.4)	(2.9)				
Difference in Federal Transfers		-	(0.5)	(0.4)				
Difference in Non-Tax Revenues		0.4	-	-				
2017 Fall FAO Outlook	**140.7**	**149.4**	**150.7**	**154.8**	**160.8**	**167.0**	***3.2%***	***3.5%***

FAO Expense Outlook As Compared to 2017 FES

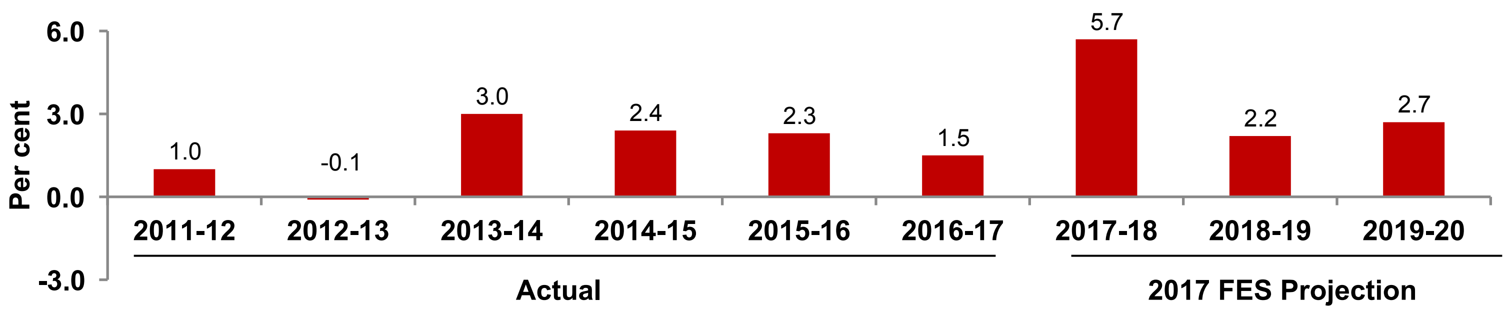
- From 2017–18 to 2019–20, the **FAO's adopts the government's 2017 FES projections for program spending** (excluding AG's recommended accounting treatment).
  - However, when including the combined impact of the AG's recommended accounting treatment for the Fair Hydro Plan and net pension asset adjustments, program spending is approximately $4.2 billion higher in 2017-18, growing to $5.8 billion more in 2019-20.
- The FAO notes that in 2018-19 and 2019-20, annual increases in program spending will be restrained at an average of 2.4 percent, below the growth in what the FAO suggests is the impact of underlying spending pressures. Beyond 2019–20 the FAO projects program spending will need to grow faster -- at an average annual rate of 4.2 per cent – due to the impact of inflation and population growth, particularly in the health and education sectors.
- The FAO's projections for interest on debt are lower than the government's. This may be due in part to lower interest rate or other forecasting assumptions.

Expense Outlook Comparison ($ Billions)	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	*Avg. Annual Growth 16/17 to 19/20*	*Avg. Annual Growth 19/20 to 21/22*
2017 FES Program Expense	**130.0**	**137.4**	**140.4**	**144.2**			***3.5%***	
Adjustment for Pension Assets	1.5	2.3	2.6	2.9				
Adjustment for Fair Hydro Plan	-	1.9	2.7	2.9				
2017 Fall FAO Program Expense	**131.5**	**141.6**	**145.7**	**150.0**	**156.6**	**163.0**	***3.5%***	***4.2%***
2017 FES IOD Expense	**11.7**	**12.2**	**12.7**	**13.3**			***4.2%***	
Difference in Interest on Debt	-	(0.4)	(0.6)	(0.7)				
2017 Fall FAO IOD Expense	**11.7**	**11.8**	**12.1**	**12.6**	**13.2**	**13.8**	***2.5%***	***4.7%***

Additional Context on Program Expense

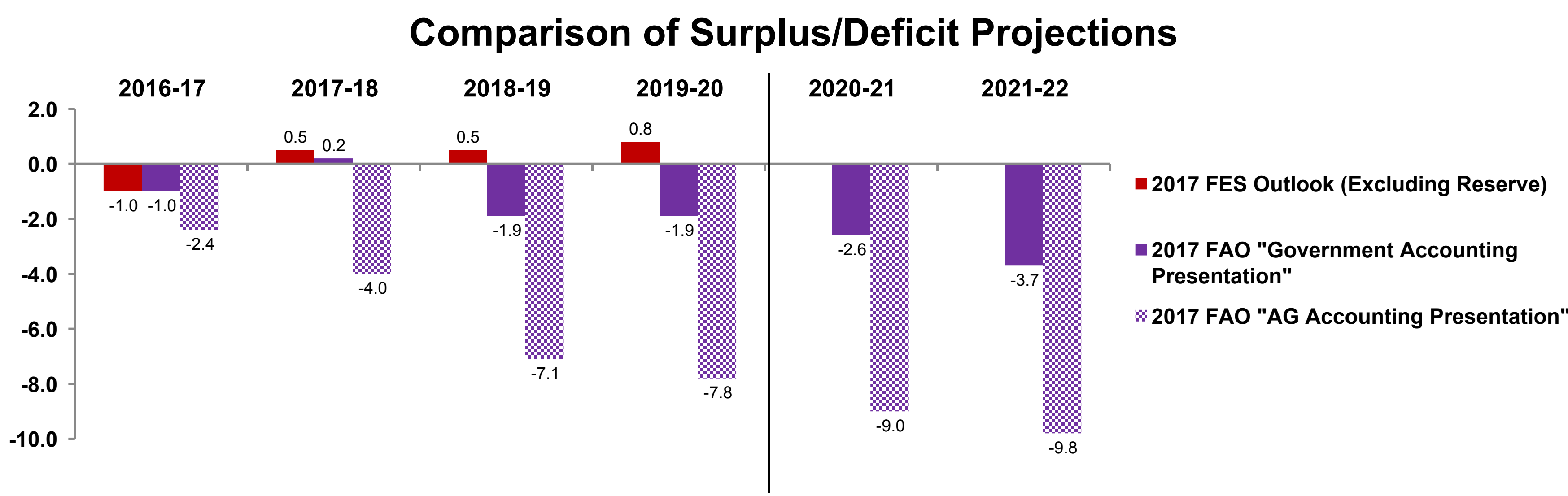
- Consistent with past fiscal reports, the FAO has continued to adopt the government's program expense outlook – which represents 3.5 per cent growth over the period of 2016-17 to 2019-20.
  - However, the FAO notes that the growth rate in some years is below the impact of underlying cost drivers and pressures. As a result, beyond the government's published forecast horizon of 2019-20, the FAO projects 4.2 per cent growth annually, in recognition of factors such as inflation and population growth.
  - Key risks that are currently not funded within the FES fiscal outlook include items such as the impact of **Bill 148, OSAP pressures, Social Assistance caseload risks, and health sector growth of around 3 per cent compared to underlying cost pressures of up to 5 per cent.**
- Between 2016-17 and 2017-18 program expense is projected to grow by 5.7 per cent, driven by:
  - One-time public infrastructure investments as well as the first year of expense related to Ontario's Cap and Trade program – both of which are offset by revenue – as well as implementation of the Fair Hydro plan, OHIP+, and the government's child care investments, all of which have ongoing costs.
  - This is consistent with the FAO's assessment that maintaining the current rate of growth may require further fiscal effort and measures**.**

Government Program Expense Growth (Over Previous Year)



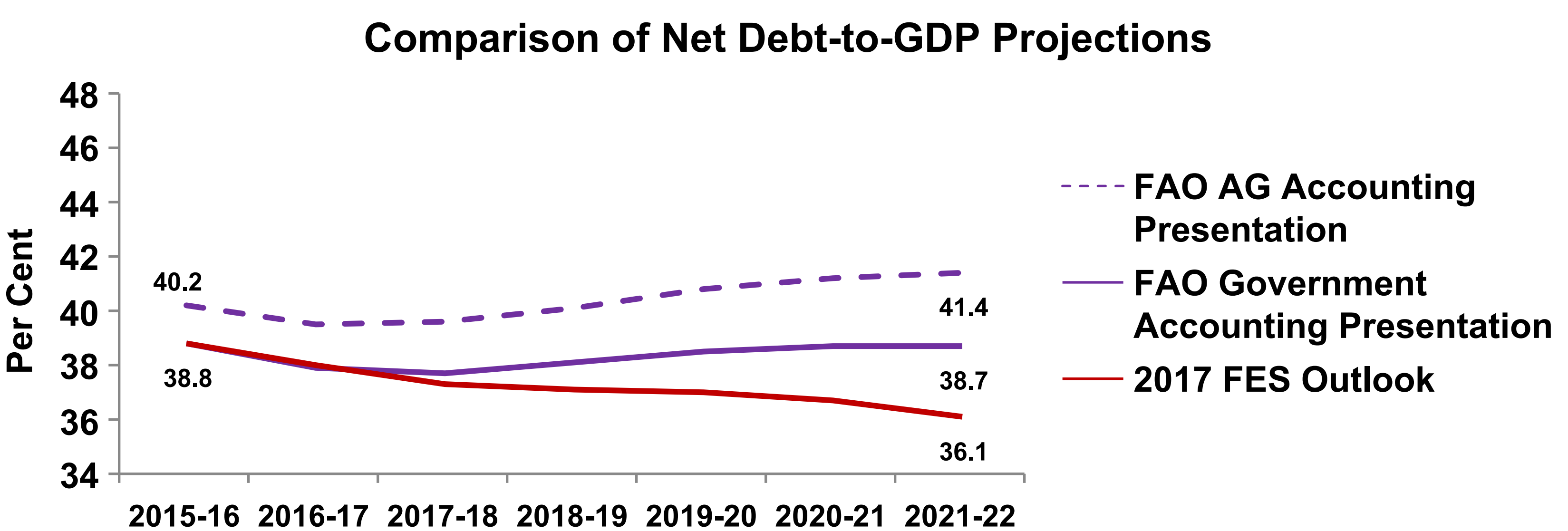
FAO Fiscal Outlook As Compared to 2017 FES

- Taking into account the FAO's differing approach to revenue and expense outlooks, as well as the AG's recommended accounting treatment, **the FAO is projecting a deficit of $4.0 billion in 2017–18.** In the absence of any fiscal policy changes, the deficit would grow steadily to $7.8 billion by 2019-20, and **approach $10 billion by 2020-21.**
  - When excluding **the** AG's recommended accounting treatment, the FAO projects a **small surplus for 2017–18 of $0.2 billion and a return to deficits beyond 2017–18** driven by entirely by the FAO's lower revenue outlook.
- 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**.



FAO Net Debt to GDP vs. FES Targets

- The differences in net debt-to-GDP are due both to the FAO's lower GDP projection as well as projected deficits rather than balanced budgets.
- The FAO report notes that additional fiscal measures would be required for the government to meet its net debt-to-GDP targets of 35 per cent in 2023-24 and 27 per cent in 2029-30.



- Under the Auditor General's Accounting presentation, the FAO projects that Ontario's net debt will increase by approximately $75 billion to over $400 billion between 2016-17 and 2021-22.

Summary: FAO Fall Report vs. 2017 FES Fiscal Plan