Office of the Budget
MINISTRY of FINANCE

Financial Accountability Officer Report:
Spring Economic and Fiscal Outlook

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ISSUE

- The Financial Accountability Officer (FAO) will be releasing a report on May XX, which assesses Ontario's medium-term economic and fiscal outlook.
- This represents the spring update to the FAO's planned release of semi-annual medium-term outlook reports.
- The spring report incorporates economic and fiscal information released since the FAO's fall 2016 report (released November 3, 2016). This includes:
    - New economic data that impacts their revenue and interest on debt outlooks; and
    - New spending commitments from the 2017 Budget.
- The FAO has presented two fiscal projections in its spring report:
    1. A projection that includes the impact of the net pension assets of jointly sponsored pension plans, based on the Auditor General's recommended accounting treatment, and
    2. A projection that excludes this impact based on the government's fiscal presentation in the 2017 Budget as recommended by the Pension Asset Expert Advisory Panel.
- Both presentations used by the FAO project deficits in each year over the outlook period (2016–17 to 2021–22).
- In the spring report, between 2017 and 2020 the FAO left their real GDP growth projection little changed, on average, compared to the outlook presented in its fall report. The FAO modestly raised its projection for Ontario nominal GDP by 0.1 percentage points annually, on average.

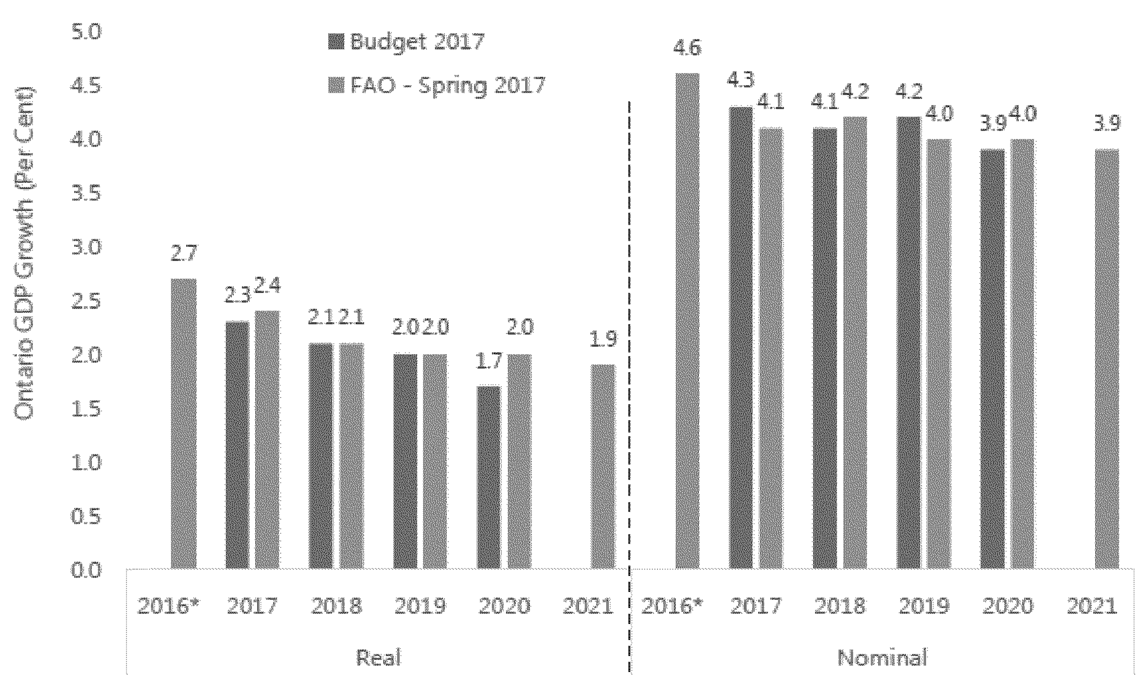
KEY FINDINGS

- The report is divided into two main chapters:
    1) The **Economic Outlook** chapter presents the FAO forecast for Ontario's economy out to 2021, and includes a discussion of potential risks.
    2) The **Fiscal Outlook** chapter presents the FAO forecast for revenue, expense and the surplus/deficit between 2016-17 and 2021-22.

Economic Outlook

- The FAO has left its forecast for Ontario real GDP growth little changed, on average, over the 2017 to 2020 period relative to its fall forecast, though it included a modest downward revision in 2017 and upward revision in 2019.
- The FAO forecast is broadly consistent with the private sector economists' view that stronger international exports and business investment will be key drivers of Ontario's overall economic growth over the next several years.
- The FAO forecast for real GDP growth is 0.1 percentage points stronger annually, on average, than the 2017 Budget forecast between 2017 and 2020.
- The FAO believes the balance of the risks to the economic outlook is tilted to the downside, particularly risks associated with a correction in Ontario's housing market. (p. 12 – Economic Chapter).

Solid Economic Performance Expected Over Outlook



* 2016 are actuals

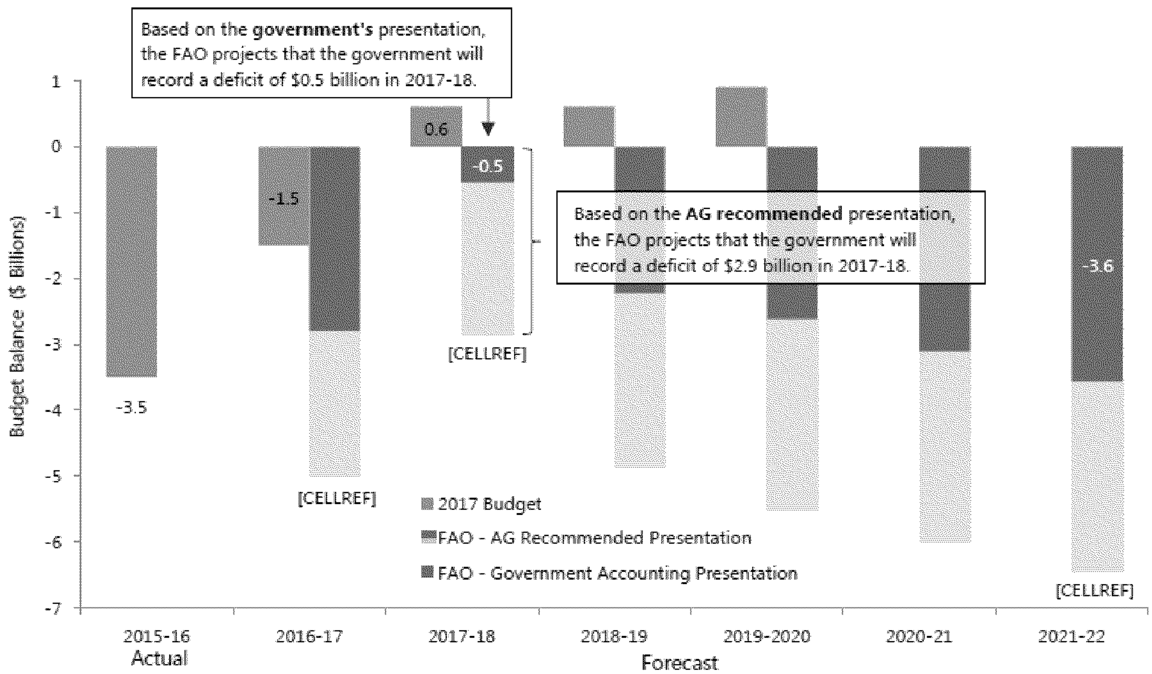
Source: Ontario Economic Accounts, Budget 2017 and FAO

Fiscal Outlook

- The FAO's current projection of the outlook for budget balance has generally deteriorated relative to the FAO's fall 2016 projection.

- The FAO's forecast, based on the Auditor General's recommended accounting treatment of jointly-sponsored pension plans, projects deficits of $5.0 billion in 2016–17, $2.9 billion in 2017–18, $4.9 billion in 2018–19, and $5.5 billion by 2019–20 (excluding the reserve). This represents a slight improvement in the deficit for 2016–17 but deterioration in 2017–18 and over the outlook compared to the FAO's fall report.
- The FAO also projects that a balanced budget is "within the government's reach in 2017–18" when using the government's accounting method.
- Using the government's accounting treatment of net pension assets the FAO is projecting budget deficits of $2.8 billion in 2016–17, $0.5 billion in 2017–18, $2.2 billion in 2018–19, and $2.6 billion by 2019–20 (excluding the reserve). This represents an improvement in the deficit for 2016–17 and 2017–18, but deterioration over the outlook compared to the FAO's fall report. By comparison, the 2017 Budget projects a $1.5 billion deficit in 2016–17 and surpluses of $0.6 billion in 2017–18 and 2018–19, and a $0.9 billion surplus in 2019–20, excluding the reserve. The FAO also makes projections out to 2021–22 with increasing deficits forecast for those years as well.
- The FAO's projection for an improved deficit in 2017–18 is due to robust economic performance in 2016 and 2017, compared to the FAO's fall estimates, and a one-time revenue increase in 2017–18 from increased federal transfers for infrastructure, additional revenue from asset sales and cap and trade proceeds. (p. 3 – Fiscal Chapter).
- Beginning in 2018-19, the FAO projects that the deficit will gradually deteriorate due to moderate revenue growth, the absence of one-time non-tax measures, and higher program expenses. (p. 1 – Fiscal Chapter).
- That FAO believes that "staying in balance after 2017–18 will likely require additional fiscal policy measures." (p. 1 – Fiscal Chapter).

Ontario's Budget Balance*



* Budget balance excluding reserve.
Source: 2015-16 Public Accounts, 2017 Budget and FAO

Key factors driving change since the 2016 FAO fall report:

- Increases in Provincial tax revenue of $2.3 billion in 2016–17 and $4.1 billion in 2017–18 (stronger than expected PIT revenue) due to improving economic growth in 2017
- Declines in Ontario's equalization entitlement. Beyond 2018–19, the FAO is projecting that Ontario will no longer be entitled to Equalization payments – a reflection of the continued strength of the Ontario economy
- Significant new spending across all sectors, including a new children and youth Pharmacare program, increased funding for hospitals, new child care spaces, and electricity cost relief under the Fair Hydro Plan
- Revised estimates for net pension asset expense of jointly sponsored pension plans

Developments since 2016 Fall EFO (AG Recommended Presentation)

	2016-17	2017-18	2018-19	2019-20	2020-21
FAO's Fall 2016 Budget Balance Forecast	-5.2	-2.6	-2.8	-3.3	-3.7
Developments Since Fall 2016					
Revenue					
Stronger Economic Outlook	2.3	4.1	3.9	4.4	4.7
Lower Federal Transfers[1]	-0.3	0.2	-1.3	-2.4	-2.2
Other Revenue Changes	0.1	0.1	-0.5	-0.6	-0.6
Total	2.1	4.4	2.1	1.3	1.8
Expense					
Children and Youth Pharmacare, and Fair Hydro Plan[3]	0.5	1.3	1.3	1.3	1.3
Revised Pension Asset[4]	0.7	0.8	1.1	1.4	1.4
Other Expense Increases	0.7	2.5	1.7	0.9	1.4
Total	2.0	4.6	4.1	3.6	4.1
Total Developments	0.2	-0.3	-2.1	-2.3	-2.3
FAO's 2017 Spring Budget Balance Forecast	-5.0	-2.9	-4.9	-5.5	-6.0

Notes:

1. Change in federal transfers forecast mainly due the reduction in Ontario's Equalization payment.

2. Other revenue changes include the $0.5 billion re-profiling of cap-and-trade proceeds from 2016-17 to 2017-18, and an increase in sales and rentals for 2017-18.

3. In the 2016 Fall EFO, the FAO included $1 billion in expenses from the HST rebate on electricity bills beginning 2017-18, which is now part of the Fair Hydro Plan. As a result, the FAO estimates that the incremental impact of the Fair Hydro Plan is $0.8 billion, compared to the Fall.

4. In the 2016 Fall EFO, the FAO assumed $1.5 billion in adjustments for net pension assets of jointly sponsored pension plans. The government has revised its estimate of the impact to $2.2 billion in 2017-18, increasing to $2.9 billion by 2020-21.

Source: FAO

Revenue Assumptions

- Compared to the FAO's fall forecast, from 2016-17 to 2019-20, on average, total revenue is projected to be $2.5 billion higher annually mostly because of higher taxation revenue, partially offset by lower Federal Transfers and other Non-Tax revenues.

FAO Revenue Difference (Spring 2017 less Fall 2016)

$ Billions	2016-17	2017-18f	2018-19f	2019-20f	Annual Average
Taxation Revenue	**2.8**	**4.2**	**4.4**	**4.9**	**4.1**
Government of Canada Transfers	-0.4	0.2	-1.3	-2.4	-1.0
Government Business Enterprises	0.3	-0.4	0.0	0.1	0.0
Other Non-Tax Revenue	-0.6	0.4	-1.1	-1.3	-0.7
Total Non-Tax Revenue	**-0.7**	**0.2**	**-2.4**	**-3.6**	**-1.6**
Total Revenue	**2.1**	**4.4**	**2.1**	**1.4**	**2.5**

  - Taxation revenues are projected to be, on average, $4.1 billion higher annually due to stronger economic growth as nominal GDP growth is, on average, projected to be 0.4 percentage points higher annually.

- More specifically, corporate profits are projected to be 3.3 percentage points higher annually, boosting Corporations Tax revenue. Higher labour income is expected to raise Personal Income Tax revenue while Ontario's strong housing market boosts Sales Tax and Land Transfer Tax revenues.
- Lower Federal Transfers reflects mostly the FAO's projection that Ontario will no longer be entitled to Equalization payments beyond 2018-19.
- Non-Tax revenues are lower, mainly because of the revisions to the multi-year asset optimization target to reflect the progress made so far and revised projections for Carbon allowance proceeds.

- Compared to the 2017 Budget, the FAO total revenue is lower mostly because of taxation revenue and, to a lesser extent, Federal Transfers.

FAO less Ontario 2017 Budget Outlook ($ Billions)					
	2016-17	2017-18	2018-19	2019-20	Average
Taxation Revenue	-1.2	-1.4	-2.3	-3.0	-2.0
Government of Canada Transfers	-0.1	0.0	-0.8	-0.8	-0.4
Government Business Enterprises	0.0	0.0	0.0	0.0	0.0
Other Non-Tax Revenue	0.0	0.0	0.0	0.0	0.0
Total Revenue	**-1.2**	**-1.3**	**-3.1**	**-3.7**	**-2.4**

- FAO's projection for the composition of nominal GDP such as compensation of employees, net operating surplus and household consumption, are all lower than the 2017 Budget projection.
- The 2017 Budget assumed higher yields from CIT and HST compared to recent projections, reflecting recent tax revenue performance. These yields also exceed those assumed by the FAO.
- The FAO projection for PIT is consistently lower than the 2017 Budget. This is likely due to a downward adjustment in each year reflecting tax planning that may have occurred in 2015 by high-income earners -- no details were provided by the FAO. The 2017 Budget only included an allowance for PIT planning in 2016-17.

- FAO's federal transfer outlook is lower than assumed in the 2017 Ontario Budget, probably due to FAO's assumption that Ontario will no longer receive Equalization payments starting in 2019-20 as Ontario's fiscal capacity improves relative to other provinces.
- The FAO's government business enterprise net income outlook and other non-tax revenue is the same as reported in the 2017 Budget.

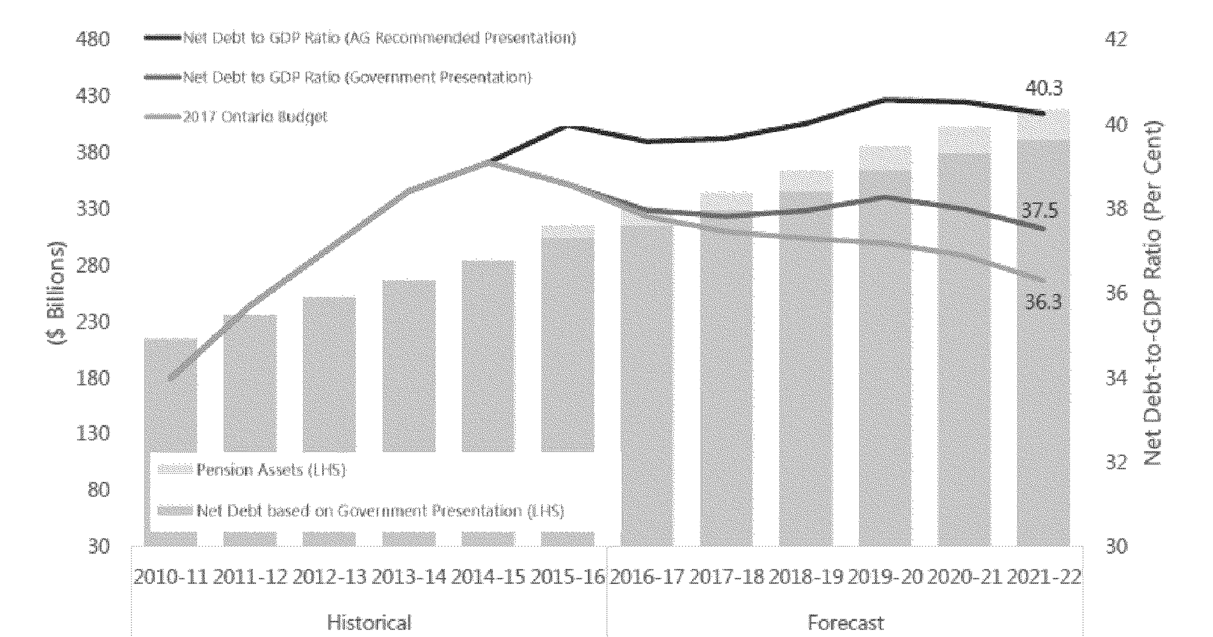
Expense Assumptions [to be confirmed by TBS]

- The FAO assumes the same program expense outlook as the 2017 Budget up to 2019–20, adjusted to reflect the Auditor General's recommended accounting treatment for jointly sponsored pension plans.(p. 4 – Fiscal Chapter).
- The FAO's expense outlook includes new spending commitments announced in the 2017 Budget including a new children and youth Pharmacare program, increased funding for hospitals, new child care spaces, and electricity cost relief under the Fair Hydro Plan. This results in average annual growth in program expense of 3.3% between 2016–17 and 2021–22.
- The FAO also projects that program spending will increase by an average of 3.6% each year beyond 2019–20. The FAO argues that this increase is in line with population growth, aging and price inflation, consistent with its 2016 spring and fall reports.
- The FAO projects that Ontario's interest on debt (IOD) payments will grow at an average annual rate of 4.0% from $11.0 billion in 2015–16 to $13.9 billion by 2021–22, reflecting higher debt and rising interest rates over the outlook. The FAO forecasts that IOD will significantly outpace the growth in program expense over the outlook. (p. 5 – Fiscal Chapter).
- According to the FAO, interest on debt is expected to increase from 8.1% of revenues in 2017–18 to 8.9% by 2021–22. Over the past five years IOD as a share of revenues declined steadily, benefitting from declining interest rates. The FAO argues that this ratio is expected to rise sharply due to projected interest rate increases. (p. 5 – Fiscal Chapter).

Debt Outlook [to be confirmed by OFA]

- Under the Auditor General's recommended accounting treatment of jointly-sponsored pension plans, the FAO expects Ontario's net debt to rise by $76 billion to $392 billion by 2021–22 or 40.3 per cent of GDP, this represents a slightly lower net debt-to-GDP ratio over the plan and outlook period when compared to the FAO's fall forecast. Using the government's accounting method, the FAO expects net debt to increase by $62 billion over the next five years to $365 billion by 2021–22 or 37.5 per cent of GDP, above the 2017 Budget projection of 36.3 per cent.
- The FAO's net debt-to-GDP projections under both accounting presentations, suggests that additional fiscal measures would be required for the government to achieve its interim target of 35 per cent by 2023-24. (p. 6 – Fiscal Chapter).

Ontario's Net Debt to GDP Ratio



Source: Ontario Economic Accounts, 2017 Ontario Budget, and FAO

Accounting Treatment

- The FAO's spring outlook includes a detailed section on the different accounting treatment for net pension assets of jointly sponsored pension plans (Ontario Teachers' Pension Plan and the Ontario Public Service Employees Union Pension Plan) used by the government and the Auditor General.
- The FAO states that in the absence of a written agreement between the co-sponsors of the pension plans, the Auditor General would be expected to provide a qualified opinion on Ontario's 2016-17 Public Accounts.

Risks and Policy Options

- The FAO notes the following risks to Ontario's fiscal plan (p. 7 – Fiscal Chapter):
    - A housing market correction could pose a significant risk for both the broader economy and the fiscal plan through lower taxation revenues
    - Reduced prudence built into program spending in the 2017 Budget compared to the previous budget – reducing flexibility for the government to respond to unexpected events
    - Interest on debt payments are expected to increase, exposing the government to fiscal risk should interest rates rise faster than expected

- Although the FAO projects deficits, the report notes that the government has a broad range of policy options that could improve the Province's fiscal position, including selling additional public assets beyond announced targets.

APPENDIX A – Detailed Comparison of Outlooks

Comparison: 2017 Budget Fiscal Outlook and the 2017 Spring FAO Outlook										
								Avg. Annual Growth		
	Actual		Outlook					16-17	19-20	16-17
$ Billions	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**2020-21**	**2021-22**	**to 19-20**	**to 21-22**	**to 21-22**
2017 Budget										
Revenue	128.4	133.2	141.7	144.9	149.3			3.9%		
Expense										
Program Expense	120.9	123.5	129.5	132.3	135.8			3.2%		
Interest on Debt	11.0	11.3	11.6	12.0	12.6			3.9%		
Total Expense	131.9	134.8	141.1	144.3	148.4			3.3%		
Surplus/(Deficit) Excl. Reserve	**(3.5)**	**(1.5)**	**0.6**	**0.6**	**0.9**					
Reserve	-	-	0.6	0.6	0.9					
Surplus/(Deficit)	**(3.5)**	**(1.5)**	**0.0**	**0.0**	**0.0**					
Net Debt	294.6	301.9	311.9	323.3	335.9					
Change - 2017 Budget to FAO Spring 2017 Report										
Revenue	-	*(1.2)*	*(1.4)*	*(3.1)*	*(3.7)*					
Expense										
Program Expense	-	*2.2*	*2.3*	*2.6*	*2.9*					
Interest on Debt	-	-	*(0.3)*	*(0.3)*	*(0.3)*					
Total Expense	-	*2.2*	*2.0*	*2.3*	*2.7*					
Surplus/(Deficit) Excl. Reserve	-	***(3.5)***	***(3.5)***	***(5.5)***	***(6.4)***					
Reserve	-	-	*n/a*	*n/a*	*n/a*					
Surplus/(Deficit)	-	***(3.5)***	***n/a***	***n/a***	***n/a***					
Net Debt	*10.6*	*14.2*	*17.6*	*23.1*	*29.5*					
FAO Spring 2017 Report										
Revenue	128.4	132.0	140.3	141.8	145.6	150.9	156.4	3.3%	3.6%	3.5%
Expense										
Program Expense*	120.9	125.7	131.8	134.9	138.8	143.8	149.0	3.4%	3.6%	3.5%
Interest on Debt	11.0	11.3	11.3	11.7	12.3	13.1	13.9	2.9%	6.3%	4.2%
Total Expense	131.9	137.0	143.1	146.6	151.1	156.9	162.9	3.3%	3.8%	3.5%
Surplus/(Deficit) Excl. Reserve*	**(3.5)**	**(5.0)**	**(2.9)**	**(4.9)**	**(5.5)**	**(6.0)**	**(6.5)**			
Reserve	-	-	n/a	n/a	n/a	n/a	n/a			
Surplus/(Deficit)	**(3.5)**	**(5.0)**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**			
Net Debt	305.2	316.1	329.5	346.4	365.4	379.4	391.7			
Pension Adjustment	(1.5)	(2.2)	(2.3)	(2.6)	(2.9)	(2.9)	(2.9)			
Surplus/(Deficit) Excl. Reserve and Pension Adj.	**(3.5)**	**(2.8)**	**(0.5)**	**(2.2)**	**(2.6)**	**(3.1)**	**(3.6)**			

Note: Numbers may not align with report due to rounding.

*** Based on AG recommended accounting treatment with adjustment for net pension assets.**

Comparison: 2016 Fall FAO Outlook Compared to 2017 Spring FAO Outlook										
								Avg. Annual Growth		
	Actual		Outlook					16-17	19-20	16-17
$ Billions	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**2020-21**	**2021-22**	**to 19-20**	**to 21-22**	**to 21-22**
FAO Fall 2016 Report										
Revenue	128.4	129.9	135.9	139.7	144.2	149.1		3.5%		
Expense										
Program Expense*	122.4	123.9	127.2	130.9	135.3	139.9		3.0%		
Interest on Debt	11.0	11.2	11.3	11.6	12.2	12.9		2.9%		
Total Expense	133.4	135.1	138.5	142.5	147.5	152.8		3.0%		
Surplus/(Deficit) Excl. Reserve*	**(5.0)**	**(5.2)**	**(2.6)**	**(2.8)**	**(3.3)**	**(3.7)**				
Reserve	-	-	n/a	n/a	n/a	n/a				
Surplus/(Deficit)	**(5.0)**	**(5.2)**	**n/a**	**n/a**	**n/a**	**n/a**				
Net Debt	305.2	318.5	330.5	343.8	356.8	369.7				
Pension Adjustment	(1.5)	(1.5)	(1.5)	(1.5)	(1.5)	(1.5)				
Surplus/(Deficit) Excl. Reserve and Pension Adj.	**(3.5)**	**(3.7)**	**(1.1)**	**(1.3)**	**(1.8)**	**(2.2)**				
Change - FAO Fall 2016 Report to Spring 2017 Report										
Revenue	-	2.1	4.4	2.1	1.3	1.8				
Expense										
Program Expense*	(1.5)	1.9	4.6	4.0	3.5	3.9				
Interest on Debt	-	0.1	-	0.1	0.1	0.2				
Total Expense	(1.5)	2.0	4.6	4.1	3.6	4.1				
Surplus/(Deficit) Excl. Reserve*	**1.5**	**0.2**	**(0.3)**	**(2.1)**	**(2.3)**	**(2.3)**				
Reserve	-	-	n/a	n/a	n/a	n/a				
Surplus/(Deficit)	**1.5**	**0.2**	**n/a**	**n/a**	**n/a**	**n/a**				
Net Debt	(0.0)	(2.4)	(1.0)	2.6	8.6	9.7				
Pension Adjustment	-	(0.7)	(0.8)	(1.1)	(1.4)	(1.4)				
Surplus/(Deficit) Excl. Reserve and Pension Adj.	**-**	**0.9**	**0.6**	**(0.9)**	**(0.8)**	**(0.9)**				
FAO Spring 2017 Report										
Revenue	128.4	132.0	140.3	141.8	145.6	150.9	156.4	3.3%	3.6%	3.5%
Expense										
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Surplus/(Deficit) Excl. Reserve*	**(3.5)**	**(5.0)**	**(2.9)**	**(4.9)**	**(5.5)**	**(6.0)**	**(6.5)**			
Reserve	-	-	n/a	n/a	n/a	n/a	n/a			
Surplus/(Deficit)	**(3.5)**	**(5.0)**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**			
Net Debt	305.2	316.1	329.5	346.4	365.4	379.4	391.7			
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*** Based on AG recommended accounting treatment with adjustment for net pension assets.**