LONG-FORM MEMBER QUESTION: CREDIT RATING

DEPUTY MINISTER SCOTT THOMPSON

Question:

- What are the plans to keep Ontario's credit rating in good standing?

Answer:

- TBD: Revisions based on updates related to Q3 Finances, once available.

Introduction:

- Following the release of the 2017 Ontario Budget, four credit rating agencies – Moody's, DBRS, Standard & Poor's and Fitch – confirmed Ontario's healthy long-term credit ratings. This reflects rating agencies' confidence in the Government's fiscal plan – and its ability to grow Ontario's economy and create jobs for Ontarians.
- Let me summarize the reports by each of the credit rating agencies.

- First, Moody's.
- Moody's cautioned that the Ontario Fair Hydro Plan, announced in March 2017 to reduce electricity prices, adds credit pressure due to the direct financial impact of the sales tax rebate and the indirect impact of an elevated debt of a provincially owned entity.
- Overall, however, Moody's said its stable outlook for Ontario "reflects Moody's forecast that, as the province moves towards and achieves balanced budgets,

the province's debt burden will improve marginally and interest expense will remain manageable across the medium-term….The policy decision to borrow for infrastructure spending at a time of historically low interest rates, combined with the prudent debt management practices outlined above, has helped to support the province's Aa2 rating."

- Moody's positive outlook for Ontario's credit rating is based on the following credit strengths: prudent debt management, an institutional framework providing significant fiscal policy flexibility, and a large diversified economy supporting a broad and productive tax base.

- Next, DBRS.
- DBRS noted that Ontario's credit profile is stable, but it will remain vulnerable to an economic shock in the absence of a more concerted effort to reduce debt.
- DBRS also commented on the potential downside risks to the economic outlook due to uncertainty regarding the potential renegotiation of NAFTA and U.S. tax policy, as well as political integration in Europe.
- Finally, it noted that elevated household debt and housing market dynamics leave Ontario particularly vulnerable in the event of an unforeseen shock that results in significant job losses or a rapid increase in interest rates.
- Despite these concerns, DBRS expects Ontario's credit ratings to remain stable.
- DBRS said of Ontario, its "ratings remain well supported by the province's large and diversified economy, improving budgetary results and declining debt burden" and that "the return to balance is encouraging and suggests that there will likely be some modest improvement in the Province's credit metrics over the medium term."
- DBRS concluded by saying that Ontario's stable credit profile stems from strength in the underlying economy, which provided incremental revenue more than sufficient to offset the in-year spending pressures.

- Standard & Poor's is next.

- Standard & Poor's believed that Ontario's credit profile is strengthening.
- But before considering a positive rating action, they would need to see sustained improvement in budgetary performance leading to near-balanced after-capital results, coupled with ongoing declines in the tax-supported debt burden, making Ontario's finances more comparable with peers in the 'AA' category.
- Standard and Poor's said it "expects the province of Ontario to benefit from solid economic growth over the next two years, allowing it to generate additional revenues to fund its capital spending plan and stabilize its finances following its eight-year path back to a balanced operating budget."
- Standard & Poor's concluded by saying that its stable outlook reflects expectations that, within the next two years, the Province will sustain a more balanced budgetary performance, including steady liquidity metrics, modest after-capital deficits, and a high but slowly declining debt burden.

- Finally there is Fitch.
- Fitch's report stated that the Province has demonstrated the ability to exert considerable expenditure restraint while instituting revenue changes to achieve its deficit reduction objectives.
- It said Ontario's 'AA-' rating is supported by its wealth, diversified economy and generally sound financial management.
- Fitch's rating reflected the Province's very strong and diversified economy, strong financial management, very predictable and well-balanced institutional framework and low contingent liabilities.
- Ontario's credit profile is stable.

- For Ontario's credit profile to grow in strength, the Province will need to do several things.
- It will need to show a track record of consistent operating surpluses and balanced or near-balanced after-capital results, coupled with continuing declines in direct and tax-supported debt burdens.

- **To that end, Ontario has the following plan to ensure that its credit rating remains in good standing.** It is:
    - Optimizing assets and revenues without causing undue tax burdens on Ontarians.
    - Managing expenses without detracting from the quality of social and health services.
    - Balancing revenues and expenses against each other to manage the debt, and
    - Maintaining a reserve fund to mitigate unforeseen financial risks.
- I will now go into more detail on each of these points.

Revenues:

- Total revenues for 2016–17 were $140.7 billion, $2.2 billion higher than the 2016 Budget.
- Additionally, Ontario's total revenues are projected to grow from $140.7 billion in 2016–17 to $158.2 billion in 2019–20.
- This represents an average annual growth rate of four per cent.
- The higher revenues for 2016–17 and the projected growth of revenues through 2019–20 are largely due to three factors:
    - Higher-than-expected tax revenues.
    - Income from government business enterprises and fees, and
    - Transfers from the Government of Canada and other non-tax revenue.
- Growth in revenues over the medium term is driven mainly by taxation revenue, which is projected to increase by $15.6 billion between 2016–17 and 2019–20, or at an average annual rate of 5.2 per cent. The taxation outlook reflects current revenue information and projections for the Ontario economy. Tax revenues were $293 million higher than projected in 2016–17, mainly due to higher-than-expected Harmonized Sales Tax revenue, reflecting stronger growth in Ontario household expenditures.

- The Government of Ontario is also implementing a multi-year strategy to optimize its assets and maximize its revenues through the sales of Hydro One, LCBO head office lands and Ontario Power Generation's head offices. The total amount credited to the Trillium Trust as of March 31, 2017 is $5.3 billion. The net revenue gains from the sale of qualifying assets will be credited to the Trillium Trust for infrastructure investments, such as roads, bridges and public transit, under the Moving Ontario Forward plan. In 2016–17, the Trillium Trust was drawn down by approximately $260 million to help support these projects.
- Finally, Ontario received larger Government of Canada transfers — $145 million higher. This increase reflected new funding for early learning and child care flowing from a bilateral agreement between Ontario and the federal government, as previously reported in the 2017–18 *First Quarter Finances*.
- Notably, the increase in Ontario's revenue is not attributable to increases in personal tax returns.

Expenses:

- Ontario's total spending for 2016–17 was $141.7 billion, $100 million lower than the 2016 Budget.
- Program spending expenses accounted for $130.0 billion.
- Interest on debt expense accounted for $11.7 billion – $0.7 billion below the plan of $12.4 billion.
- This drop was due mainly to lower-than-forecast interest rates, and Ontario's cost-effective borrowing and debt management.
- Going forward, Ontario program expenses are projected to grow from $130.0 billion in 2016–17 to $144.2 billion in 2019–20.
- This represents an average annual growth rate of 3.5 per cent.
- Interest on debt expenses is projected to grow from $11.7 billion in 2016–17 to $13.3 billion in 2019–20.
- This represents an average annual growth rate of 4.2 per cent.

- Total expenses are projected to grow from $141.7 billion in 2016–17 to $157.4 billion in 2019–20.
- This represents a manageable average annual growth rate of 3.6 per cent.
- These increases align with the government's plans for modernizing the public services people rely on every day.
- They are also fiscally sustainable.
- In short, the Ontario government has been managing its program expenses as well as its interest-on-debt expenses.

Balancing Revenues and Expenses:

- To bring the revenues and expenses together…
- Revenue is forecast to increase from $140.7 billion in 2016–17 to $158.2 billion in 2019–20.
- Total expenses are projected to increase from $141.7 billion to $157.4 billion over the same period.
- Based on these estimates, the Ontario government will effectively balance the budget over the next four years.

The Reserve:

- I will now take a moment to address the Province's financial reserve and contingency funds.
- As required under the *Fiscal Transparency and Accountability Act*, Ontario's fiscal plan incorporates prudence in the form of a reserve to protect the fiscal outlook against unforeseen adverse changes in revenue and expenses.
- The current fiscal outlook includes a reserve of $0.5 billion in 2017–18, $0.5 billion in 2018–19 and $0.8 billion in 2019–20.
- The current outlook also maintains contingency funds to help mitigate expense risks that may otherwise negatively impact Ontario's fiscal performance — particularly in cases where health and safety may be compromised, services to the most vulnerable are jeopardized, or natural disasters occur.

Conclusion:

- Credit ratings provide an assessment of a government's credit-worthiness.
- They are a reflection largely based on its capacity to generate revenue to service its debt.
- They consider factors such as a government's economic resources and prospects, industrial and institutional strengths, financial health, and susceptibility to major risks.
- As you know, a credit rating affects the cost of future government borrowing with a lower rating, indicating that an agency believes there is a relatively higher risk that a government will default on its debt.
- Accordingly, investors will lend to the government only in return for a greater risk premium, in the form of higher interest rates.
- A rating downgrade could also shrink the potential market for a government's debt, because some investors will not hold debt below a certain rating.
- Therefore, it is critical that Ontario maintain its credit rating in good standing to manage its debt and preserve its fiscal health.
- Ontario's plan to keep its credit rating in good standing involves the following strategies:
    - Optimizing assets and revenues without causing undue tax burdens on Ontarians.
    - Prudently managing expenses without diminishing the quality of Ontario's services and programs.
    - Balancing revenues and expenses against each other to manage the debt, and
    - Preserving a reserve fund to mitigate unforeseen financial risks.

- Seen as a whole, these strategies will ensure confidence in Ontario's credit-worthiness through its ability to effectively manage its debt obligations.

- Protecting the financing of Ontario's public services will continue to be one of my ministry's highest priorities.
- Thank you.