Fiscal Update Deck

Office of the Budget
MINISTRY OF FINANCE

OFFICE OF ECONOMIC POLICY
OEP
MINISTRY OF FINANCE

TBS

Presentation to Cabinet on January 30

Confidential Advice to Cabinet

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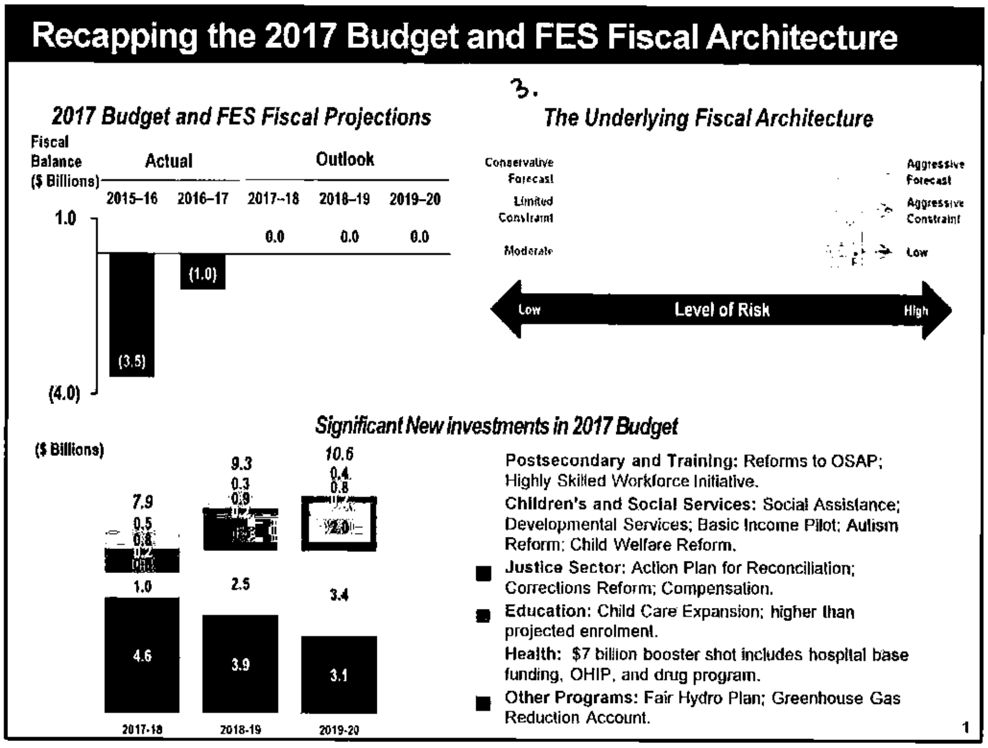


Deputy Thompson:

First Click: As you're aware, **The 2017 Budget forecasted a balanced budget in each plan year**: 2017-18, 2018-19 and 2019-20, and these balanced budget targets were **reaffirmed in the 2017 FES.**

Second Click: In the 2017 Budget, significant investments were made across all sectors.

[PLACEHOLDER FOR TBS INPUT ON SIGNATURE INVESTMENTS]

Third Click: However, in order to publish a balanced outlook while still making these investments, the fiscal plan included a number of stretched assumptions and significantly increased the level of risk taken on.

The building blocks of any fiscal plan are the revenue forecast, the expenditure plan and the amount of prudence that is built into it. In a plan that includes balanced upside and downside risks, those blocks would be somewhere in the middle of that sliding scale.

The 2017 Budget included aggressive assumptions that moved each of these blocks towards the riskier end of this continuum, which ultimately reduced the government's flexibility to address risks. This is particularly true in the revenue forecast.

We've mentioned these assumptions to you before, but it's worth reminding you of them, because how they are playing out now is impacting the our current outlook.

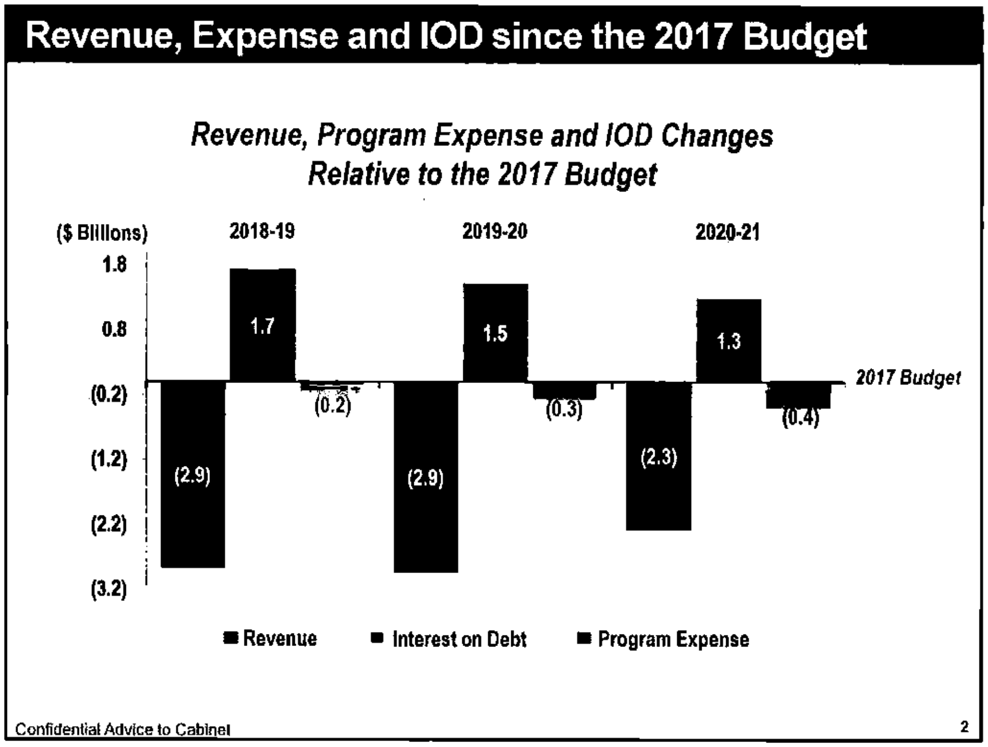
On the revenue side, the 2017 Budget assumed that taxation revenue would outpace nominal GDP; the forecast assumed strong housing market growth; and the forecast flat-lined Equalization payments despite signs that Ontario may falling out of the program. We also made a decision not to take on the impact of accounting changes in the electricity sector but we knew at some point we would need to build that in.

In addition, we included targets to achieve additional revenue through addressing the underground economy, closing tax loopholes and reviewing revenues from GBEs.

Year savings targets were increased and contingency funds were lowered.

In summary – in order to publish a balanced outlook while accommodating significant new investments, the 2017 Budget removed several of the normal shock absorbers from the fiscal plan as the Minister said in his remarks.

Keep this in mind as we move through the following handful of slides. By stretching our assumption at the time of the 2017 Budget, we have limited our ability to accommodate downside risks or accommodate new investments while maintaining a balanced outlook.



DEPUTY THOMPSON:

First Click: As I said, we knew when we built the 2017 Budget fiscal plan that some of the risk we built in to the plan were likely to materialize - and this is part of what you're seeing here.

Current projections are showing that over the next two years, revenues are almost $3 billion less than what was forecast at the time of the Budget and we're seeing declines in the final year of the outlook as well. These declines are driven by:

- Lower taxation revenue from a slowing housing market, lower than expected 2016 personal income tax assessments and lower Corporate income tax yields
- A lower Equalization entitlement
- And, lower income from GBEs as a result of OEB rate decisions and the impact of accounting changes

These downside pressures have been partially offset by strong economic growth, as well as some potential interest on debt savings – which are reflected in the orange bars.

DEPUTY ANGUS:

Second Click: What you're seeing layered on here is the impact of expense decisions since the 2017 Budget. Both investments made in the Fall Economic Statement as well as decisions approved in principle through the PRRT process have resulted in an increase to program expense of approximately $1.3 billion to $1.7 billion in each year.

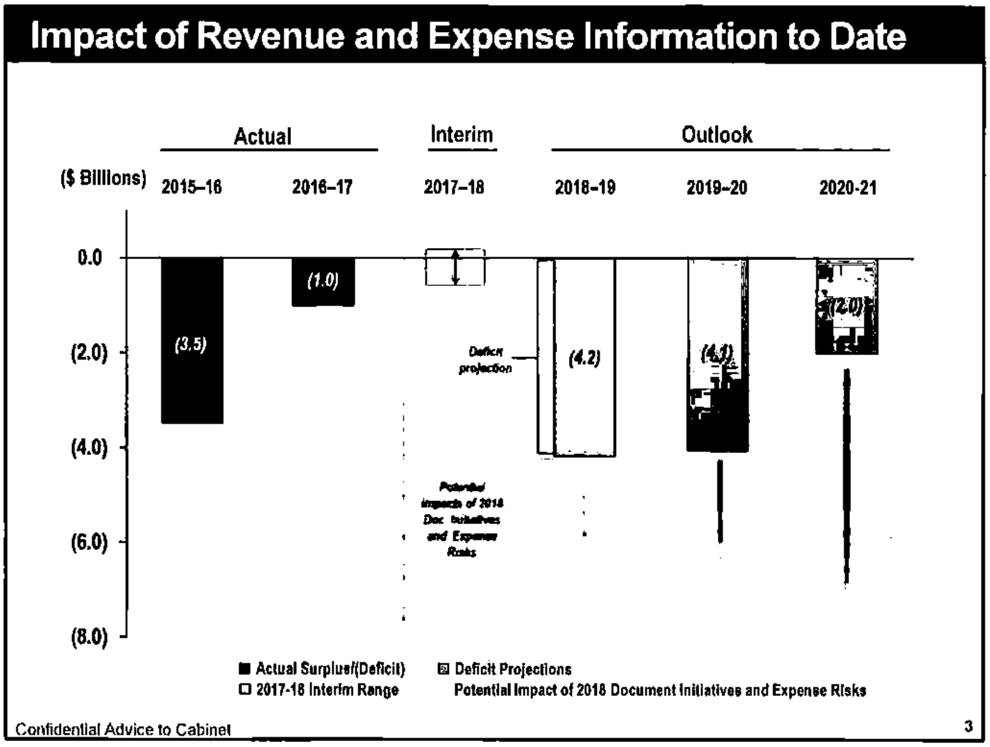
These investments are necessary to maintain the government's commitments and current footprint. This includes funding for:

- Higher-than-forecasted OSAP growth and increased graduate enrollment;
- the government's 100,000 child care commitment;
- increases to maintain service enhancements for the hospital sector;
- continued investments to modernize the justice sector;
- out-year investments for the Seniors' and Small business initiatives announced in the Fall Economic Statement;
- transit investments, including continuation of the GO-TTC discounted double-fare initiative; and
- a number of smaller investments to continue programs across other ministries.

[SUGGEST DELETE: It's important to note that some of the program expense decisions made have no impact on the fiscal plan – for example, in 2018-19, $0.7 billion of the $1.7 billion increase is offset, and this may include offsets from revenue and federal flow-throughs, which are also built into the fiscal plan.

The bottom line impact of program expense decisions made through the PRRT process, when taking into account revenue impacts and other fiscally neutral transactions, is roughly $1 billion in each of the three years]

The impact of all of this is reflected in the next slide, which I'll turn back to Scott to walkthrough.



DEPUTY THOMPSON:

First Click: Taken together, the impact of higher expense and lower revenue shown on the previous slide results in significant deficits relative to government's balanced budget targets over the outlook – over four billion dollars short of publishing a balanced budget in the next two years, and 2 billion short in the last year. .

Second Click: However, if you then layer on the potential impact of expense risks, some of which we have a good degree of certainty will materialize, and the potential impact of any new investments the government may wish to announce as part of the 2018 Budget, the deficit outlook increases substantially.

Now you may be thinking that the picture can't be this bad – or that you've heard this before, but we've still managed to hit our targets. What is important to understand is that this year is different. The assumptions that we took on in the 2017 budget stripped away a lot of the ability to absorb and accommodate downside pressure like this.

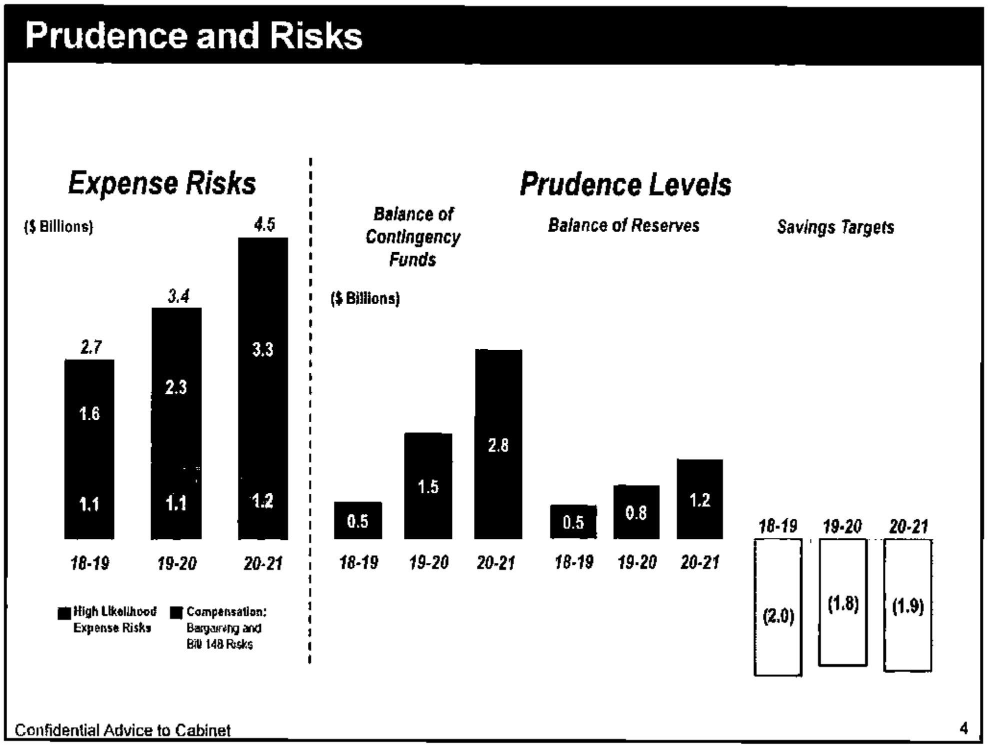
And while it's true that this is a starting point –as the minister said, we will be going back to look at all our assumptions, on revenue and expense including any approvals in principle that may be worth re-visiting, though it is unlikely that simply revisiting assumptions will get us back to balance.

DEPUTY ANGUS:

<u>2017-18</u> For 2017-18 there are a range of possible outcomes but balance is within reach. .

However, in order to hit balance, Ministries will not only need to manage their pressures, but help the government achieve it s $1.2 billion savings target. All information to date suggests there is no revenue upside and there will be no IOD savings. This means that there is no room for ministries to come in at year-end above plan.

We have seen interim numbers that ministries have submitted and we know that more work needs to be done by ministries to manage pressures and we will be working with you to support this.



DEPUTY ANGUS:

<u>First Click:</u>

<u>Risks</u>

As with every business planning cycle, we also asked ministries to identify the expense risks they would be managing over the next three years.

A number of risks identified are consistent with prior years, for example, emergency forest firefighting, agriculture risk management programs, and social assistance forecasts; however, there are a number of new and emerging risks identified, including forecast pressures in OSAP and Grants for Student Needs beyond what was approved in PRRT, as well as several land and flood claim negotiations expected to be finalized in 2018.

There are also compensation risks associated with upcoming and on-going labour negotiations for doctors, the education and social services sectors, the Ontario Public Service, as well as compensation risks associated with the implementation of Bill 148 that was recently discussed at Cabinet.

While managing risks remains an important ingredient of the fiscal plan and to leaving a healthy tension in the system, the coming year will be more challenging for ministries when taking into account higher savings targets to address and a smaller contingency fund.

As with past years, we are carefully reviewing the risks identified and will work with ministries to develop strategies to mitigate the impacts of these risks and put in place the appropriate monitoring and oversight.

Second Click:

Contingency Fund

The contingency fund is available as a source to address emergency expenditures that are unknown at the beginning of the year, for example forest firefighting.

The contingency fund may also have agreed to set asides at the beginning of the year, where the outcome is not yet fully known, for example, the impact of some upcoming labour negotiations.

The contingency fund is not intended to be a source to offset ministry pressures, which are to be managed from within their approved allocations.

For 2018-19, the level of the contingency fund is small compared to prior years, and with only $0.5 billion, it will need to be reset to a more reasonable level.

Balance of Reserves

When the 2017 Budget fiscal architecture was developed, the reserve was set at historically low levels and was further drawn down at the time of the FES in order to accommodate new investments. Current reserve levels are $0.5 billion this year and next. For 2020-21, the reserve is $1.2 billion and is consistent with what we would traditionally set the reserve at in the last planning year of a budget.

Savings Targets

The fiscal plan also includes savings targets to be achieved, which are roughly $2 billion in each of the next three years.

Savings targets can be used to acknowledge the potential delays in program implementation, general underspending that occurs across ministries on an annual basis, and any planned review of programs.

While savings targets are a common tool used, the level of savings built into the fiscal plan for the next three years is higher and more aggressive than prior years. For example, the target this year is $1.2 billion, and the target last year was $750 million.

In summary, all of the levels of prudence will need to be revisited as we build the 2018 Budget fiscal architecture

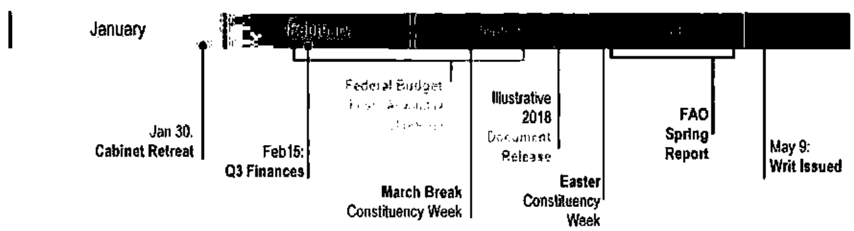
Forthcoming Information will Impact the Fiscal Outlook

Revenue

- Revisions to the economic growth outlook, including the outlook for the housing market;
- Finalization of 2016 tax assessments;
- Revised Government Business Enterprise net income projections; and
- Potential impact of Federal Budget changes
- Meeting with private sector economists

Expense

- 2018 Document initiative decisions
- Interest on debt forecast updates
- Impact of expense pressures that ministries have been asked to manage from within
- Implications of Federal Budget (cost matching requirements)



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DEPUTY THOMPSON:

This slide shows you a road map to early Spring. What's clear, is that we have a lot of work to do between now and 2018 Budget release. For illustrative purposes, we have shown a late March release. We also show potential timing of a Federal Budget, but this is based on historically timing. We do not have any indication from the federal government on their potential timing for their Budget.

The last time we spoke with this table was back in October, when we provided you with a fiscal update.

At the time we were planning for the release of the FES and we had indicated that there was uncertainty in the forecast, both upside and downside risks and that information was yet to come that would impact the forecast.

While a lot of that information is now known - there is some still pending, such as what new investments the government will want to make in the 2018 Budget, we have seen a number of risks materialize. As the Minister indicated, we will have some choices about what impacts we need to take on and what risks we feel we can manage.

So as I said, this is a starting point for planning. We will be going back to look at all our assumptions, on revenue and expense including any approvals in principle that may be worth re-visiting, as well as our prudence levels to see what, if any flexibility may be available to us and we will be coming back to Minister Sousa and Minister McMahon and the Premier with our best advice.