Rating Report

Province of Ontario

DBRS

Insight beyond the rating.

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Ratings

Debt	Rating	Rating Action	Trend
Issuer Rating	AA (low)	Confirmed	Stable
Long-Term Debt*	AA (low)	Confirmed	Stable
Short-Term Debt	R-1 (middle)	Confirmed	Stable

*Includes debt issued by the Ontario Electricity Financial Corporation based on its status as an agent of the Crown.

Rating Update

On April 24, 2018, DBRS Limited (DBRS) confirmed the Issuer Rating, Long-Term Debt rating and Short-Term Debt rating of the Province of Ontario (Ontario or the Province) at AA (low), AA (low) and R-1 (middle), respectively. The trends on all ratings are Stable.

The Province accomplished its long-sought goal of balancing the provincial budget in 2017–18, achieving a modest surplus of $642 million. On a DBRS-adjusted basis, recognizing capital investment on a pay-as-you-go basis, this equated to a deficit of $4.4 billion, or 0.5% of gross domestic product (GDP).

In March 2018, the Liberal government tabled a pre-election budget in which the government abandoned its commitment to balanced budgets and reducing the debt-to-GDP ratio. The budget proposed $20.3 billion in new initiatives over a three-year period. In the absence of substantive offsetting revenue measures to pay for the new initiatives, the Province is planning to incur deficits ranging between $6.5 billion and $6.7 billion over the period. This equates to DBRS-adjusted deficits ranging between $10.5 billion and $13.0 billion, or 1.2% to 1.4% of GDP. The budget plan suggests a return to balance would occur in the mid-2020s, providing the economic expansion continued unabated and expense growth can be constrained.

The policy shift clearly demonstrates the elected government is no longer committed to disciplined fiscal policy. Rather than shifting to a neutral or conservative fiscal policy stance and rebuilding budget and balance sheet flexibility, the government proposed to pursue expansionary fiscal policy potentially near the peak of the business cycle when the economy is already at or near full capacity.

If the budget plan is implemented as proposed, DBRS-adjusted debt will likely stabilize around 43.0% of GDP over the medium term. While halting the improvement in the debt-to-GDP ratio, the outlook is not inconsistent with the AA (low) ratings. However, the policy shift increases the risk that the Province's ratings may come under pressure in the future. In past recessions, budgetary results have weakened and the debt-to-GDP ratio has increased sharply. If such circumstances were to materialize, Ontario's ratings could be adversely affected.

At this time, the outlook for budgetary results and debt is uncertain and will depend on the outcome of the June 7, 2018, provincial election. DBRS understands that the Province will seek to pass the budget before the writ of election is issued; however, implementation of the substantive budget measures will not occur unless the Liberal government returns to office. Current polls suggest a change in government is possible. The direction of fiscal policy under an alternative government is not clear at this time.

DBRS expects the ratings to remain stable in the near term. A downgrade could occur if debt were to rise sharply because of a downturn in the economy or a deterioration in the budgetary outlook beyond what is already proposed in the 2018 budget. An upgrade could occur if there was a significant reduction in the provincial debt burden to a level commensurate with the AA-range ratings.

Financial

	For the year ended March 31				
	2019B	**2018P**	**2017**	**2016**	**2015**
Debt/GDP	43.3%	43.9%	43.8%	44.3%	44.6%
Surplus (deficit)/GDP	(1.2%)	(0.5%)	(0.7%)	(1.7%)	(2.1%)
Federal transfers/total revenue	17.2%	17.0%	17.7%	17.7%	18.6%
Interest costs/total revenue	7.7%	7.4%	7.7%	8.0%	8.1%
Real GDP growth	2.2%	2.7%	2.6%	2.9%	2.7%

Notes: B = budget. P = projected. GDP on a calendar year basis.
Source: Province of Ontario, Statistics Canada, DBRS calculations.

Issuer Description

Ontario is Canada's largest province with a population of 14.4 million and accounts for about 40.0% of the country's economic output. The Province is located in Central Canada and has a large, diversified economy that is highly integrated with the U.S. and global economies.

Rating Considerations

Strengths

(1) Large, diversified economy

Ontario has a large and diversified economy with a mix of industries, including traditional sectors, like manufacturing and resource development, and a large and well-developed services sector, which includes technology, financial services and other professional services. Ontario's economy benefits from favourable demographics, high net in-migration, high levels of post-secondary education and strong trade linkages in North America and globally. This results in relatively strong economic growth and translates into rising revenue and debt capacity for the Province.

(2) Capacity to raise revenue

Ontario has a competitive overall tax system, and among provinces, per-capita revenue is relatively low. The Province has the capacity to raise revenue if required.

(3) Effective borrowing platform

Ontario has excellent market access. The Province has well-established borrowing programs in Canada, the United States, Europe and a number of other markets. The Province has a large and growing investor mix and is able to issue large amounts of debt with little impact on pricing. In addition, the debt stock is prudently structured to reduce risk associated with refinancing and changing interest and exchange rates.

(4) Ample liquidity to manage risk

The Province maintains a large liquidity reserve to manage risks related to its borrowing program. The liquidity reserve is now in excess of $30.0 billion, which provides ample cash to meet large single-day maturities or fund operating requirements should market conditions deteriorate. The Province also maintains significant excess capacity on its short-term Canada/U.S. borrowing platforms.

Challenges

(1) Relatively high debt burden

The Province's debt-to-GDP ratio, projected to be 43.3% of GDP in 2018–19 and is high for a AA-rated province. Over the medium term, the debt burden would likely remain near the current level if the budget is implemented as proposed and economic expansion continues as expected. The Province is no longer targeting a reduction in the debt-to-GDP ratio and the ratio will remain substantially higher than the pre-recessionary lows (25% to 26%) for the foreseeable future.

(2) Consistency and coherence of fiscal policy

The elected government has signalled that it is no longer committed to balanced budgets or prudent, countercyclical fiscal policy. The fiscal policy direction put forth in this budget appears inconsistent with the Liberal government's fiscal legislation and much of the government's messaging over the past decade. Despite the economy being at or near full capacity, the Province has proposed new debt-financed spending measures to, in part, stimulate economic activity. The Province has proposed a plan to return to balance, as required by legislation, but DBRS questions the credibility of that plan in light of the recent policy reversal.

(3) High electricity prices and electricity system debt

Provincial electricity policy has contributed to high prices and substantial electricity system debt. Ontario's electricity prices have risen significantly over the past decade, diminishing Ontario's competitiveness and prompting concerns by households and businesses. In response to political pressure, the Province announced a series of new policy interventions in March 2017. The changes have reduced household electricity prices by 25%, on average. The policy measures have a direct impact of about $1.6 billion on the fiscal plan (2018–19) and will lead to about $20.0 billion in electricity system debt over the next decade, which will be repaid by consumers in the future. This is in addition to the $19.1 billion in Ontario Electricity Financial Corporation (OEFC; rated AA (low) with a Stable trend by DBRS) debt currently outstanding.

2018–19 Budget

Exhibit 1. DBRS-Adjusted Surplus(Deficit)-to-GDP

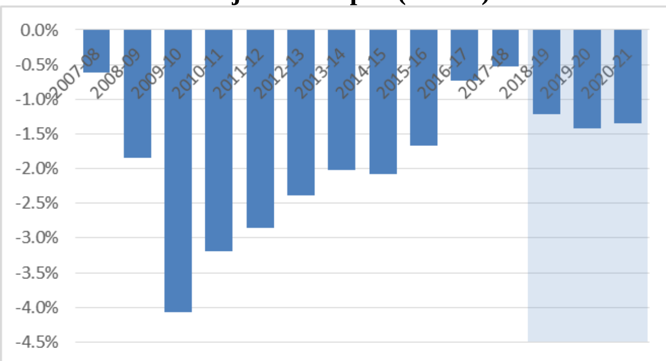
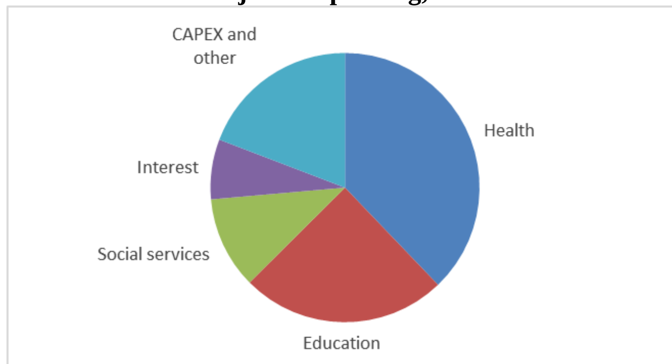


Exhibit 2. DBRS-Adjusted Spending, 2018-19



Ontario's 2018–19 budget outlined a significant shift in provincial fiscal policy. For much of the past 15 years, provincial fiscal policy has been guided by the principles set out in the Liberal government's *Fiscal Transparency and Accountability Act, 2004*. That legislation requires the government to maintain a prudent debt-to-GDP ratio, to plan for a balanced budget unless Executive Council deems it prudent because of extraordinary circumstances to plan for a deficit and to have a plan for achieving a balanced budget if the government does plan for a deficit.

Since the financial crisis, the Province has continuously reiterated its commitment to these fiscal policy principles, frequently citing, as evidence, its deficit-reduction plan and its budget outperformance. The Province was, as recently as last fall, still reiterating its commitment to balanced budgets and a gradual reduction in the debt-to-GDP ratio.

The policy shift signals that the elected government is no longer committed to balanced budgets even in the best of economic circumstances. With the Provincial economy now at or near full capacity, prudent fiscal policy would generally dictate a shift to a neutral or conservative fiscal policy stance. Ontario has, however, opted to pursue expansionary fiscal policy with the goal, in part, to stimulate near-term growth. The shift to deficit spending at this stage of the business cycle creates the risk of structural budget imbalances.

The budget proposes an expansion of government health and social programming aimed at ensuring all Ontarians share in the benefits of economic growth and prosperity. While many of the program announcements are focused on the near term, the Province is continuing to invest in critical infrastructure and enhance access to education and child care in a bid to support long-term potential output growth (i.e., productivity growth, labour force expansion, etc.).

DBRS now understands that the government will seek to pass the budget before the June 2018 election. However, the public service will revert to a caretaker role once the writ of election is issued (expected May 9, 2018), and much of the substantive work on the new program announcements will pause. Implementation of the policy measures will depend on the outcome of the June election. At this time, a change in government appears possible.

The budget projects a deficit of $6.7 billion in 2018–19, which equates to a DBRS-adjusted deficit of $10.5 billion, or 1.2% of GDP. DBRS makes a number of adjustments to reported results/budget projections to improve comparability between provinces. For Ontario, the most significant adjustments include recognizing capital investment on a pay-as-you basis and removing budgetary reserves and contingencies.

The 2018 budget, like previous budgets, includes significant prudence. These measures are intended to address unforeseen spending pressures, revenue volatility and statutory spending (e.g., response to disasters, litigation, etc.). In the past, the prudence in budget estimates has enabled the Province to outperform its budget projections in most years. For 2018–19, explicit measures of budgetary conservatism include

- A budget reserve ($700.0 million) and contingencies ($1.6 billion),
- A revenue forecast based on an economic forecast that is modestly weaker than the private-sector consensus (approximately $100 million) and
- A prudent interest rate forecast that assumes interest rates rise quickly to historical levels.

The Province has projected modest revenue growth (+1.6% on a DBRS-adjusted basis), which follows the revenue growth of 7.3% in the prior year. Underlying tax (+4.4) and transfer (+2.7%) revenue growth are being offset by declines in government business enterprises' net income and other own-source revenue, both of which are related to policy actions that bumped up revenue in the prior year (e.g., elimination of the electricity debt retirement charge).

The budget includes only modest tax policy changes, the most significant of which are changes to the personal income tax rate structure and the elimination of the surtax. The tax announcements, collectively, will provide about $500 million in incremental revenue in 2018–19 and between $700 million and $800 million in the outer years.

Total DBRS-adjusted expenditures are projected to rise by $8.6 billion (+5.6%), significantly outpacing revenue growth. This follows similarly strong growth (+6.0%) in 2017–18. Expenditure growth is expected to be broad-based in 2018–19, with most ministries seeing moderate-to-strong growth in their appropriations, driven by the announcement of major new spending initiatives.

The new initiatives are to be phased in over the next three years, with a cumulative cost of $20.3 billion over the three-year period. The initiatives include

- Increased funding for hospitals/health care (+$1.3 billion);
- Improved services and access to mental health and addictions services (+$1.2 billion);
- Improved affordability/access to child care, including free preschool for children two-and-a-half and older (+$2.2 billion);
- Social assistance and income security reform (+$2.3 billion);
- Increased support for individuals with developmental disabilities (+$1.8 billion);
- Free prescription drugs (extension of OHIP+) for senior citizens (+$1.0 billion);
- Senior's Healthy Home Program to help with the costs of home ownership (+$0.7 billion);
- New drug and dental program for individuals without workplace coverage (+$0.8 billion); and
- More funding for economic development and similar activities (+$0.9 billion).

By ministry, the largest ministries will see a healthy lift in appropriations: Health and Long-Term Care (+5.1%), Education (+4.4%), Advanced Education and Skills Development (+5.9%) and Community and Social Services (+7.5%).

Ontario's multi-year capital plan remains largely similar to that of previous years, with the government planning to spend $182 billion over the next decade. Capital spending is budgeted to rise strongly (+22.6%) in 2018–19, with growth in both grants and capital investment. Capital investment by the Province (not included in expense) is budgeted to rise by nearly $3.0 billion to $16.1 billion, which follows a similar-sized increase in the prior year. Ontario, like other provinces, frequently underspends its capital appropriation. As such, DBRS assumes only 85% of capital investment is achieved for DBRS-adjusted debt projections.

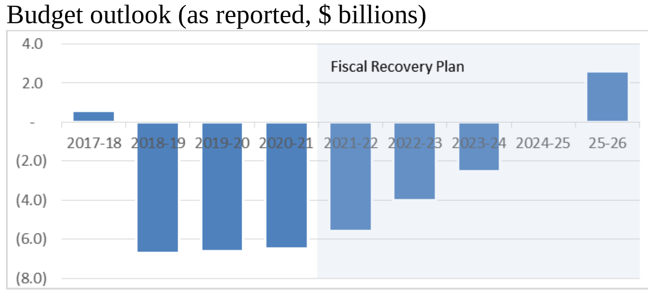
Outlook

The major initiatives announced in the budget are to be phased in over the next three years. As such, there would be a step-up in expense, resulting in deficits ranging between $6.5 billion and $6.7 billion during the 2018–19 to 2020–21 period. On a DBRS-adjusted basis, deficits range between $10.5 billion and $13.0 billion.

The Fiscal Recovery Plan, required by legislation, contained in the 2018–19 budget indicates the government would gradually reduce the deficit beginning in 2020–21 with a return to balance in 2024–25.

The deficit-reduction target in the later years are aspirational. The projections assume that revenue growth returns to trend (3.0% to 3.5% annually) and that the government will limit program expense growth to 2.5% between 2018–19 and 2024–25.

Exhibit 3. Fiscal Recovery Plan
Budget outlook (as reported, $ billions)



Source: Province of Ontario.

While the plan is aspiration, DBRS notes that the Province has outperformed its budget deficit reduction targets in the past andthe 2018 budget outlook does include considerable reserves and contingencies. If revenue growth proves to be stronger than expected (i.e., through economic growth or policy measures) and the various contingencies are undrawn, the Province could meet the schedule put forward in the budget.

However, this forecast also assumes that the economic expansion continues unhindered for another eight years. In past recessions, deficits have widened and debt growth accelerated. A significant deterioration in operating results would put pressure on the credit profile and could have an adverse impact on the ratings.

The outlook for the medium term is speculative and will ultimately depend on the outcome of the upcoming provincial election. Opposition parties have begun to put forward platforms, but the outlook for budget results under an alternative government remains unclear. Further uncertainty stems from the opposition's criticism of the qualified audit opinion and the financing structure used for Ontario's Fair Hydro Plan. If a new government were to change the structure of Fair Hydro Trust's financing or the accounting of the net pension asset, there could be a meaningful impact on the statement of operations and the statement of financial position.

2017–18 Preliminary Results

The Province has projected a surplus of $642 million for the year ended March 31, 2018. On a DBRS-adjusted basis, this equates to a deficit of $4.3 billion (0.5% of GDP), which is also better than what was expected at the time of the last review.

Total revenue growth was strong in 2017–18, rising by $10.2 billion (+7.3%) on a DBRS-adjusted basis. Revenue growth was broad-based, reflecting the ongoing economic expansion, as well as some one-time impacts lifting year-over-year growth. The major lift to revenue came from the introduction of the cap-and-trade carbon pricing scheme (+$2.4 billion), as well as increased federal infrastructure funding (+$0.8 billion) and better results from Ontario Power Generation Inc. (OPG; rated A (low) with a Stable trend by DBRS) and Hydro One Inc. (rated A (high) with a Stable trend by DBRS; collectively, +$0.6 billion).

Total expenditure growth was similarly strong in 2017–18, rising by $8.7 billion (+6.0%) on a DBRS-adjusted basis. Spending growth was broad-based, with most ministries seeing moderate growth in appropriations. In 2017–18, the Province announced a number of significant spending initiatives, including an increase in hospital funding (+$518 million); the introduction of Pharmacare for individuals under the age of 25 (+$465 million); funding for 24,000 new child-care spaces (+$200 million); and measures to reduce household electricity costs ($1.4 billion). In addition, it was also the first full year of the new cap-and-trade system. Under the governing legislation, the proceeds from the carbon allowance auctions are required to be spent on programs, rebates and incentives to reduce carbon emissions.

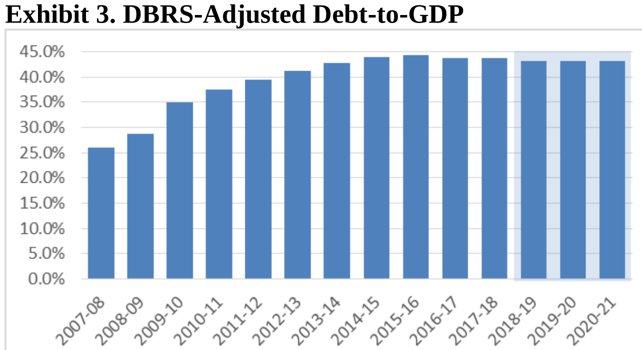
Capital investment was markedly lower than planned. The Province had planned to increase capital investment to $13.1 billion from $10.0 billion the year prior but was only able to realize about $10.7 billion.

Relative to its 2017–18 budget, the outperformance largely reflects the $600 million undrawn budget reserve. Total revenue was marginally higher ($117 million) than expected, which reflects higher net income from government business enterprises and other revenue offsetting the lower-than-expected tax revenue and federal government transfers. Similarly, total expense was modestly higher than expected (+$75 million). Program spending was higher than planned (+$356 million), with increases for health care, post-secondary education and justice, but these were mostly offset by lower-than-expected interest costs (-$281 million).

Ontario has exceeded its deficit targets in each of the last nine years, which reflects the use of budget reserves and contingencies and a conservative interest rate forecast. The cost of in-year spending announcements have often been offset by better-than-expected revenue, and capital investment tends to be lower than budgeted. Taken together, these factors typically result in debt and deficits being lower than projected by the Province.

The Province's budget presentation is consistent with that of its audited public accounts. The Auditor General of Ontario has, however, qualified the financial statements in each of the last two years and has indicated that she is likely to add a further qualification on the 2017–18 financial statements if the Province accounts for the Fair Hydro Plan as currently proposed. The 2016–17 audit report indicated that the deficit was understated by $1.4 billion and that net debt was understated by $12.4 billion (equivalent to 1.6% of nominal GDP). The 2018 budget does not provide disaggregated balance sheet data, but given the performance of the pension plans in recent years and the budget projection for other net assets, the reported net pension asset appears likely to rise. With Fair Hydro Trust having borrowed $1.0 billion in February 2018, the Auditor General of Ontario would likely argue that the deficit is understated by upward of $3.0 billion in 2017–18 and that the net debt is understated by about $15.0 (1.9% of GDP).

Exhibit 3. DBRS-Adjusted Debt-to-GDP



Source: Province of Ontario and DBRS calculations.

Debt Profile

Growth in the provincial debt stock has slowed in recent years as deficits narrowed, enabling a modest improvement in the debt-to-GDP ratio.

In 2017–18, DBRS-adjusted debt rose by $16.7 billion (+4.8%) to $364.6 billion. The DBRS-adjusted debt-to-GDP ratio was largely unchanged at 43.9% in 2017–18.

The overall direction of the borrowing program and strategy remains largely unchanged, with a focus on extending the duration of the debt stock, expanding the investor base and prudently hedging risk.

Ontario continues to have excellent access to debt markets — both domestically and internationally — and has been able to issue large amounts of debt with little impact on pricing. The Province has established borrowing programs in Canada, the United States, Europe and a number of other smaller markets and has seen its international investor base continue to expand in recent years.

The Province has shifted its target for domestic–international issuance. Previously, Ontario sought to accomplish three-quarters of its borrowing in the domestic market and the remaining quarter elsewhere. The Province will now target two-thirds of its issuance to the domestic market. The shift generally reflects the excellent investor receptivity in international markets and the continued desire to expand the investor base. The domestic–international target is not a firm requirement, and the Province will deviate from the target when opportunities to broaden the investor mix or reduce costs arise.

While Ontario does borrow heavily in international markets, the Province swaps back the foreign currency exposure to Canadian dollars. As at March 31, 2018, there was effectively no foreign currency exposure. Similarly, the Province seeks to limit its exposure to rate increases. As at March 31, 2018, only 20% of the debt stock was subject to interest rate reset for the following 12 months.

As at March 31, 2018, the Province was party to derivatives contracts with notional principal amounts totalling $xx.x billion, consisting largely of foreign currency and interest rate swaps. The Province has CSAs in place with its counterparties, which are all large domestic and international banks rated xxx or better.

The Province maintains ample liquidity to reduce the risk associated with its borrowing program. During 2017–18, the unrestricted liquidity reserve averaged $30.1 billion, which was a significant increase over the average size of the reserve in previous years. In addition, the Province maintain significant capacity on its short-term borrowing programs. The Province currently has $xxx billion outstanding on its Canadian and U.S. short-term programs, which is against the authorized limit of $48.0 billion.

Ontario sponsors several defined-benefit pension plans, acting as the sole sponsor for the Public Service Pension Plan and joint sponsor for both the OPSEU Pension Plan and the Ontario Teachers' Pension Plan. Ontario does not report any unfunded pension liabilities in its financial statements. As such, DBRS's measure of tax-supported debt does not include any unfunded pension liabilities.

DBRS excludes the debt issued on behalf of the OEFC from the calculation of tax-supported debt, as the cost of this debt is expected to be recovered from ratepayers as opposed to taxpayers.

In March 2017, the Province unveiled its Fair Hydro Plan, which includes, among other elements, the use of debt to refinance a portion of the global adjustment. Effectively, debt is being used to lower prices over the next ten years. The cost of that debt will then be recovered through higher prices in subsequent years. The Province estimates that the annual borrowings will be about $2.5 billion over the first ten years, of which about $1.4 billion will be sourced from debt markets by Fair Hydro Trust (a special-purpose financing trust) and the remaining $1.1 billion by OPG. However, much of the funds provided by OPG will come from the Province in the form of equity injections. The Province will borrow to fund these equity investments, and in the absence of information as to how these equity investments will be recovered, DBRS considers this debt to be tax-supported debt, consistent with established practice. Given the existing size of the Province's debt burden, the incremental borrowing to fund the equity injection is modest.

When creating Fair Hydro Trust, the Province provided the trust's noteholders with a limited guarantee. If the Province makes a substantive change to the *Fair Hydro Plan Act*, its regulations or related legislation/regulations, the Province will assume responsibility for servicing the debt issued by the trust. If this were to occur, DBRS could adjust the Province's DBRS-adjusted debt. The extent of this adjustment would depend on what measures are taken by the Province to limit the balance sheet impacts (e.g., an offsetting equity withdrawal). The increase in DBRS-adjusted debt would likely be modest relative to the overall size of the Provincial debt burden.

Outlook

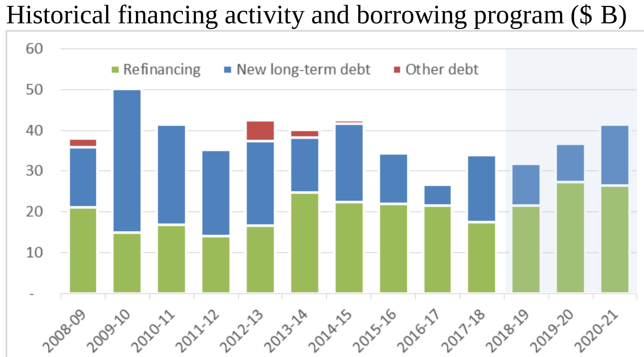
After slowing in recent years, debt growth is expected to accelerate with the planned return to deficit spending. In 2018–19, DBRS-adjusted debt is project to rise by $9.5 billion (+2.6%) to $374.1 billion.

Ontario's credit profile had stabilized in recent years and was beginning to show modest signs of improvement. This trend is now likely to stall or reverse if the budget is implemented as proposed. Previously, DBRS expected that the DBRS-adjusted debt-to-GDP ratio would decline slowly and approach 40% over the medium term. The outlook contained in the budget now suggests that the ratio will remain stable around 43.0% provided that economic expansion continues.

The Province's borrowing requirement for 2018–19 is $31.7 billion,

Exhibit 4. Borrowing Requirement

Historical financing activity and borrowing program ($ B)

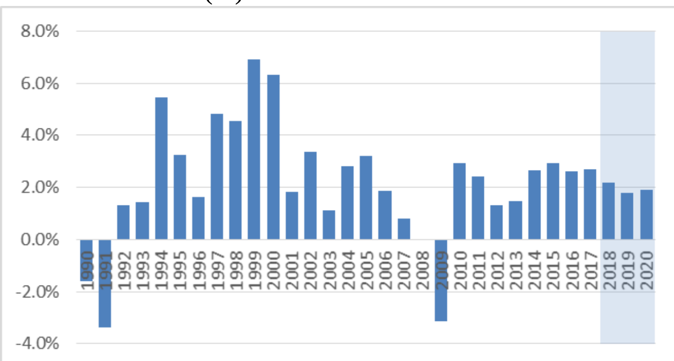


Source: Province of Ontario

which is slightly lower than what was expected at the time of the last review. As at April 20, 2018, the Province has completed $7.5 billion in borrowing. The Province will only issue debt in the domestic market during the election period. If a change in government were to occur, the Province would likely halt issuance until the new government could provide the market with some guidance on the direction of fiscal policy.

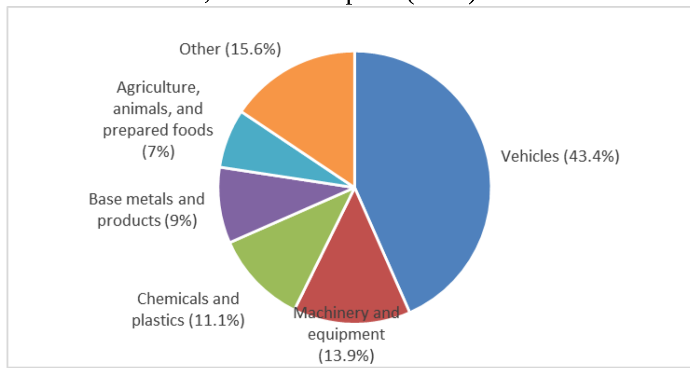
Economy

Exhibit 5. Economic Growth
Real GDP Growth (%)



Source: Statistics Canada/Haver Analytics and Province of Ontario

Exhibit 6. Exports to the United States
Merchandise trade, domestic exports (2017)



Source: Statistics Canada.

Ontario is Canada's largest province with a population of 14.4 million and annual economic output approaching $900 billion. The Province accounts for about 40% of Canada's population and economic activity. The provincial economy is well diversified with a mix of goods- and services-oriented industries, including well-developed technology and financial industries. Over the last two decades, traditional industries have declined in relative importance as knowledge-based and service industries have rapidly grown.

Population growth has quickened in recent years as a result of the downturn in resource-producing provinces. Annual growth is now near 1.5%, with natural increase, interprovincial migration and international migration all contributing positively to growth. As is the case for most provinces, Ontario's population is aging, though the median age (40.6 years) remains at the national average and the overall age profile remains similar to that of British Columbia and Québec. The age-related pressures in Ontario are not as pronounced as seen in the Atlantic region.

Ontario's economy has performed relatively strongly over the last three years in response to improving internal and external economic conditions — low interest rates and oil prices, a weak Canadian dollar and the improving U.S. and global economies. In 2017, the Province's economy is estimated to have grown by 2.7%, which places it ahead of many provinces. Growth was driven in large part by strengthening household consumption (+4.0%) and residential construction (+4.4%) and improving business investment.

The labour market continued to perform strongly, adding 128,000 jobs (+1.8%), supporting a further decline in the unemployment rate, which has fallen to 6.0% (2017) from a peak of 8.3% (2009).

The Province's budget forecast expects growth to moderate to 2.2% in 2018 but for growth to remain well balanced. The moderation reflects, in large part, the expectation that growth in household consumption and real estate investment will slow because of rising interest rates, the introduction of the Office of the Superintendent of Financial Institutions' (OSFI) mortgage financing stress test and the various provincial measures intended to cool the housing market.

Nevertheless, Ontario's economy is now at or near full capacity. The labour market is showing signs of tightening, with unemployment rate falling, wage pressures beginning to emerge (fair?) and businesses beginning to ramp-up investment to address capacity constraints. The Province projects relatively strong growth in non-residential investment (+5.0%) and machinery and equipment (+5.3%) in 2018, which is broadly consistent with results from recent business surveys.

The housing market remains a vulnerability to the provincial credit profile. Household debt levels are elevated after years of low interest rates and the rapid increase in housing prices over the last decade. Relatively high debt levels leave households vulnerable to increases in interest rates and employment/economic shocks. A significant deleveraging caused by an economic shock could exacerbate the effect of a downturn on the Provincial credit profile, though the extent of the deterioration would largely depend on the nature and severity of the underlying economic shock and the government's policy response.

The housing market has been resilient because of the persistent demand for housing; however, the recent introduction of OSFI's mortgage financing stress test, rising interest rates and the housing measures introduced in 2017 have supported a rebalancing of the housing market. Price growth has eased and transaction volumes have fallen. The rebalancing is continuing, and the outlook appears more stable.

The outlook for global trade remains another risk to the provincial credit profile, as trade accounts for a meaningful share of provincial economic activity. The rise in protectionist rhetoric and rising risk of disruption in global trade could challenge the Canadian economy and adversely affect Ontario given its more pronounced integration in global supply chains and trade.

The United States is Ontario's largest export market, accounting for 80% of provincial merchandise-goods exports. Ontario's largest goods exports to the United States are vehicles and part (43.4%), machinery and equipment (13.9%), chemicals and plastics (11.1%) and base metals and related products (9.0%). The largest export states are Michigan, California and New York.

Outlook

The Province and private-sector economists are projecting that economic growth will moderate in the coming years, with growth expected to be about 2.0% annually over the medium term. Downside risks to the economic outlook include U.S. trade and fiscal policy, broader trade disruptions, rising interest rates, a strengthening Canadian dollar and oil prices, and possible economic disruptions emanating from Asia or Europe.

Economic Statistics

	2019	2018	2017	2016	2015	2014	2013
Nominal GDP ($ millions)	897,341	863,690	829,984	794,835	762,029	726,053	695,354
Nominal GDP growth	3.9%	4.1%	4.4%	4.3%	5.0%	4.4%	2.2%
Real GDP growth	1.8%	2.2%	2.7%	2.6%	2.9%	2.7%	1.5%
Population (thousands)	14,634	14,439	14,193	13,976	13,790	13,680	13,556
Population growth	1.4%	1.7%	1.6%	1.4%	0.8%	0.9%	1.1%
Employment (thousands)	7,325	7,249	7,128	7,000	6,923	6,878	6,823
Unemployment rate	5.4%	5.5%	6.0%	6.5%	6.8%	7.3%	7.6%
Housing starts	69,500	72,400	79,123	74,952	70,156	59,134	61,085
Retail sales ($ millions)	232,896	224,370	215,120	202,235	188,893	179,100	169,341
Inflation rate (CPI)	2.2%	2.2%	1.7%	1.8%	1.2%	2.3%	1.1%
Household income per capita ($)	40,870	39,724	38,375	37,808	37,170	35,776	34,887

Sources: Statistics Canada/Haver Analytics, Ministry of Finance estimates and projections.

Budget Summary

($ millions)	Budget	Projection				
	2018-19	**2017-18**	**2016-17**	**2015-16**	**2014-15**	**2013-14**
Revenue	151,390	149,023	138,869	130,938	116,448	113,367
Program expenditure	(150,278)	(142,350)	(134,008)	(133,163)	(122,070)	(118,044)
Interest costs	(11,655)	(11,034)	(10,682)	(10,473)	(9,457)	(9,324)
DBRS-Adjusted Surplus (Deficit)	**(10,543)**	**(4,361)**	**(5,821)**	**(12,698)**	**(15,079)**	**(14,001)**
DBRS Adjustments:						
Contingencies and reserves	(2,300)	(50)				
Net non-recurring items	-	-	-	3,175	-	-
Adjustments for capital expenditures (1)	6,139	5,052	4,830	6,009	4,745	3,547
Surplus (deficit), as reported	**(6,703)**	**641**	**(991)**	**(3,514)**	**(10,334)**	**(10,453)**
Gross long-term borrowing requirements	31,700	33,900	27,000	30,100	39,849	35,985
Capital Investment	14,233	10,686	10,045	10,922	9,389	10,322
Total DBRS-Adjusted Debt	**374,122**	**364,623**	**347,884**	**337,544**	**318,696**	**299,502**

1 DBRS adjusts reported figures to recognize capital expenditures as incurred, rather than as amortized, to improve interprovincial comparability

Selected Financial Indicators
(DBRS-Adjusted)

	Budget	Projection				
	2018-19	**2017-18**	**2016-17**	**2015-16**	**2014-15**	**2013-14**
DBRS-Adjusted Debt as a % of GDP	43.3%	43.9%	43.8%	44.3%	43.9%	43.1%
Surplus (deficit) as % of GDP	(1.2%)	(0.5%)	(0.7%)	(1.7%)	(2.1%)	(2.0%)
Surplus (deficit) as % of revenue	(7.0%)	(2.9%)	(4.2%)	(9.7%)	(12.9%)	(12.3%)
Tax-supp. interest costs as % of revenue	7.7%	7.4%	7.7%	8.0%	8.1%	8.2%
Federal transfers as % of revenue	17.2%	17.0%	17.7%	17.7%	18.6%	19.7%
Program expenditures as a % of revenue	99.3%	95.5%	96.5%	101.7%	104.8%	104.1%
Health spending as a % of total expenditures	37.8%	38.0%	38.7%	38.2%	38.0%	38.4%
Total revenue growth	1.6%	7.3%	6.1%	12.4%	2.7%	2.4%
Program expenditure growth	5.6%	6.2%	0.6%	9.1%	3.4%	0.1%
Total expenditure growth	5.6%	6.0%	0.7%	9.2%	3.3%	0.4%
DBRS-Adjusted Debt as a % of GDP	43.3%	43.9%	43.8%	44.3%	43.9%	43.1%

Background Political Information

Party in Power:	Ontario Liberal Party	Number of seats:	55 out of 107
Premier:	Kathleen Wynne	Next election:	June 2018

Statement of Operations (DBRS-Adjusted)

($ millions)	Budget 2018-19	Projection 2017-18	2016-17	2015-16	2014-15	2013-14
Revenue						
Personal income tax	35,612	32,319	30,671	31,141	29,313	26,929
Sales tax	26,808	25,954	24,750	23,455	21,689	20,481
Corporate income tax	15,137	15,800	14,872	11,428	9,557	11,423
Education property tax	6,076	5,968	5,868	5,839	5,561	5,457
Employer health tax	6,554	6,184	5,908	5,649	5,415	5,283
Ontario Health Premium	3,914	3,679	3,575	3,453	3,366	3,128
Gasoline and fuel taxes	3,483	3,443	3,368	3,210	3,186	3,081
Land transfer taxes	3,142	3,091	2,728	2,118	1,765	1,614
Tobacco and cannabis	1,285	1,251	1,230	1,226	1,163	1,110
Other taxes	563	558	453	470	520	360
Total Tax Revenue	**102,574**	**98,247**	**93,423**	**87,989**	**81,535**	**78,866**
Liquor and cannabis retailing	2,832	2,795	2,938	2,538	2,391	2,280
Lotteries and casinos	2,245	2,509	2,358	2,234	1,995	2,009
Vehicle licence and other fees	3,006	2,957	2,490	2,529	2,126	2,007
Net income from electricity sector (1)	375	1,691	917	1,489	1,994	2,097
Carbon pricing	1,979	2,395			-	-
Broader public sector entities	8,552	8,283	7,957	7,493		
Other revenue	3,821	4,818	4,242	3,525	4,792	3,831
Own-Source Revenue	**125,384**	**123,695**	**114,325**	**107,797**	**94,833**	**91,090**
Equalization	963	1,424	2,304	2,363	1,988	3,169
Canada Health and Social Transfer	20,420	19,673	19,056	18,073	17,255	16,629
Other federal transfers	4,623	4,231	3,184	2,705	2,372	2,479
Total Federal Transfers	**26,006**	**25,328**	**24,544**	**23,141**	**21,615**	**22,277**
DBRS-Adjusted Revenue	**151,390**	**149,023**	**138,869**	**130,938**	**116,448**	**113,367**
Non-recurring revenue (2)				3,219	-	-
DBRS adjustments	1,071	1,113	1,865	1,991	2,098	2,544
Total revenue, as reported	**152,461**	**150,136**	**140,734**	**136,148**	**118,546**	**115,911**
Expenditures						
Health	61,278	58,290	55,945	54,925	50,039	48,933
Education	40,003	38,162	36,334	35,978	32,878	32,117
Social services	17,911	16,842	16,076	15,596	14,683	13,950
Transportation	5,566	5,095	3,636	3,284	2,944	2,823
Public protection	5,625	5,476	5,213	5,148	4,923	4,791
Municipal affairs and housing	1,858	1,877	2,049	1,601	1,591	1,777
Agri., Environment and Resources	5,696	4,849	3,640	3,743	3,835	3,861
General government	3,015	2,584	2,365	2,496	2,671	2,633
Economic development	4,217	3,766	3,596	4,112	3,531	3,380
Other expenditure	(1,028)	357	324	271	230	232
Adjustments for capital expenditures (3)	6,139	5,052	4,830	6,009	4,745	3,547
DBRS-Adjusted Program Expenditures	**150,278**	**142,350**	**134,008**	**133,163**	**122,070**	**118,044**
Tax-supported interest expense	11,655	11,034	10,682	10,473	9,457	9,324
DBRS-Adjusted Expenditures	**161,933**	**153,384**	**144,690**	**143,636**	**131,527**	**127,368**
Budgetary contingencies	1,600	50				
Adjustments for capital expenditures (3)	(6,139)	(5,052)	(4,830)	(6,009)	(4,745)	(3,547)
Other DBRS adjustments	1,071	1,113	1,865	1,991	2,098	2,544
Non-recurring expenditures (2)				44	-	-
Total expense, as reported	**158,465**	**149,495**	**141,725**	**139,661**	**128,880**	**126,365**

(1) Net income of OPG and Hydro One plus revenues of OEFC, less interest on OEFC debt, and costs of power purchase agreements. (2) Excludes non-recurring revenue related to the partial privatization of HydroOne. (3) DBRS recognizes capex as they occur (pay-as-you-go basis).

Statement of Financial Position (DBRS-Adjusted)
As at March 31($ millions)

	2017	2016	2015		2017	2016	2015
Financial Assets				**Liabilities**			
Cash and cash equivalents	16,401	13,600	15,193	Accounts payable and accrued liabilities	20,248	19,361	20,055
Investments	17,983	21,765	20,366	Debt	346,799	341,558	328,895
Accounts receivable	11,192	11,059	10,306	Deferred revenue and capital contributions	11,538	10,779	10,110
Loans receivable	11,868	11,545	11,125	Pensions and other employee future benefits	10,478	10,751	10,830
Net pension asset	11,033	9,312	7,679	Other liabilities	6,367	6,348	4,878
Other assets	3,036	2,572	2,021	**Net Debt**	**(301,648)**	**(295,372)**	**(284,576)**
Investment in GBEs	22,269	23,572	23,502	Non-financial assets	107,288	102,536	97,065
Total Financial Assets	93,782	93,425	90,192	**Accumulated deficit**	**(193,510)**	**(192,029)**	**(187,511)**
Financial Assets	**16,401**	**13,600**	**15,193**				

Public Sector Debt
As at March 31($ millions)

	2019	2018	2017	2016	2015	2014	2013	2012
Direct debt	339,262	329,609	312,680	303,055	284,819	267,012	251,629	230,314
Local government sector (1)	18,292	18,557	18,857	18,335	17,990	17,570	16,978	20,180
University and hospital sector	6,672	6,561	6,451	5,751	5,816	5,640	5,260	5,052
Alternative financing obligations (P3s)	8,700	8,700	8,700	9,100	8,400	7,500	6,600	4,400
Loan guarantees	900	900	900	1,000	1,400	1,500	1,200	931
Capital leases	296	296	296	303	271	280	299	297
Tax-Supported Debt	**374,122**	**364,623**	**347,884**	**337,544**	**318,696**	**299,502**	**281,966**	**261,174**
OEFC debt (self-supp.) (2)	19,575	19,179	20,422	24,358	25,341	26,146	27,336	26,964
Fair Hydro Trust	3,480	980						
Total public sector debt	**397,177**	**384,782**	**368,306**	**361,902**	**344,037**	**325,648**	**309,302**	**288,138**
Pension Liabilities	-	-	-	-	-	-	-	-
DBRS-Adjusted Debt (3)	**374,122**	**364,623**	**347,884**	**337,544**	**318,696**	**299,502**	**281,966**	**261,174**
DBRS-Adjusted Debt								
Per Capita ($)	25,911	25,690	24,891	24,478	23,647	22,286	21,177	19,691
As a share of GDP (%)	43.3%	43.9%	43.8%	44.3%	44.6%	43.4%	41.8%	39.6%
Direct Debt Breakdown by Currency (4)								
Canadian dollar pay	n.a.	99.8%	99.8%	99.7%	99.7%	99.7%	99.3%	99.1%
Non-Canadian dollar pay	n.a.	0.2%	0.2%	0.3%	0.3%	0.3%	0.7%	0.9%
Fixed/Floating Rate Direct Debt Breakdown (4)								
Fixed Rate	n.a.	79.8%	81.9%	80.1%	82.4%	81.3%	80.4%	83.5%
Floating Rate	n.a.	20.2%	18.1%	19.9%	17.6%	18.7%	19.6%	16.5%
Debt Maturity Profile (4) (6)	**2018-19**	**2019-20**	**2020-21**	**2021-22**	**2022-23**	**2023-24 to 2027-28**	**2028-29+**	**Total**
Total Debt ($ millions)								
Share (%)								

B = Budget. P = Projected. n.a. = not available. (1) Excludes municipal debt obligations funded through OILC which are included in direct debt. (2) Ontario Electricity Financial Corporation is the agency responsible for the servicing and management of the former Ontario Hydro's debt, derivatives contracts, and certain other liabilities. OEFC debt is issued in the name of the Province and is to be recovered from ratepayers. (3) DBRS adjusted debt comprises tax-supported debt and unfunded pension liabilities. (4) Includes hedges. Floating rate debt is defined as debt that matures or is repriced within 12 months.

Rating History

	Current	2017	2016	2015	2014	2013
Issuer Rating	AA (low)	AA (low)	AA (low)	AA (low)	AA (low)	AA (low)
Long-Term Debt	AA (low)	AA (low)	AA (low)	AA (low)	AA (low)	AA (low)
Short-Term Debt	R-1 (middle)	R-1 (middle)	R-1 (middle)	R-1 (middle)	R-1 (middle)	R-1 (middle)

Previous Action ments

- Confirmed, June 28, 2017.

Related Research

- *Ontario's 2018 Budget: Billions for the Ballot*, March 29, 2018.
- *DBRS 2018 Provincial Government Factsheet*, April xx, 2018.
- *Corporate Risk Assessment Scorecard for Canadian Provincial Governments*, April xx, 2018.
- Fair Hydro Trust: Presale Report, April 18, 2018.
- *Rating Canadian Provincial Governments*, May 2017.
- *Rating Canadian Provincial Agents of the Crown*, April 2018.

Previous Report

- Ontario, Province of: Rating Report, July 14, 2017.

Notes:
All figures are in Canadian dollars unless otherwise noted.

For the definition of Issuer Rating, please refer to Rating Definitions under Rating Policy on www.dbrs.com.

Generally, Issuer Ratings apply to all senior unsecured obligations of an applicable issuer, except when an issuer has a significant or unique level of secured debt.