

**Rating Action: Moody's changes outlook to negative on Ontario's Aa2 ratings**

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Global Credit Research - 17 Apr 2018

Toronto, April 17, 2018 -- Moody's Investors Service today changed the outlook on the Province of Ontario's ratings to negative from stable. Concurrently Moody's affirmed the Aa2 issuer and Aa2 senior unsecured long-term debt ratings assigned to Ontario. The province's P-1 short-term rating was also affirmed.

Outlook Actions:

..Issuer: Ontario, Province of

...Outlook, Changed To Negative From Stable

Affirmations:

..Issuer: Ontario, Province of

.... Commercial Paper, Affirmed P-1

.... Issuer Rating, Affirmed Aa2

...Senior Unsecured Medium-Term Note Program, Affirmed (P)Aa2

...Senior Unsecured Medium-Term Note Program, Affirmed (P)P-1

...Senior Unsecured Notes, Affirmed Aa2

...Senior Unsecured Shelf, Affirmed (P)Aa2

RATINGS RATIONALE

OUTLOOK CHANGE TO NEGATIVE FROM STABLE

The outlook change to negative from stable on Ontario's ratings reflects Moody's expectations that spending pressure will challenge the province's ability to sustain balanced fiscal results across multiple years. Furthermore Moody's assumes that the financing requirements will be larger than previously assumed leading to an upward trend in the debt burden and a faster rise in interest expense than previously anticipated.

With an election set for 7 June, the government released a 2018 budget that introduces a number of new spending initiatives and materially increases the capital infrastructure spending relative to previous plans. While this budget may not be implemented post-election, in Moody's opinion it highlights growing spending pressure that will need to be addressed in the near future. As the economy is expected to slow, with real GDP growth forecasted to fall from 2.7% in 2017 to 1.7% by 2021, revenue generation will be slower than previously recorded, limiting the province's ability to rely on revenue growth to balance the spending pressure. Downward pressure on revenue generation would be amplified if the province were to face unexpected negative economic shocks. Furthermore, as sustained low interest rates have pushed consumer debt to record levels over the past decade, the province will likely face increased challenges to introduce new revenue measures despite a high level of policy flexibility.

The province's debt is expected to measure 233% of revenues in 2017/18, up from Moody's previous estimate of 227%. Financing to fund deficits and capital spending will continue to push the debt burden higher, with Moody's expectations that it could exceed 240% by 2021/22. Moody's assesses this level of debt to be elevated compared to similar rated peers. Increased debt financing will also occur during a time of rising interest rates, which will accelerate the increase of the province's interest expense. Measuring an anticipated 8.3% of revenues in 2017/18, which is already the highest measure of Aa2 rated Canadian provinces, interest expense could consume 9% of revenue in 2020/21 and continue to increase thereafter as interest rates are expected to rise. An increasing interest expense is expected to further challenge the budget planning of the province.

## AFFIRMATION OF THE RATINGS

The affirmation of the Aa2 issuer and senior unsecured long-term debt ratings and P-1 short-term debt rating reflects the province's ability to rely on a large, diversified economic base with sound wealth generation that supports a strong provincial revenue base, a greater degree of flexibility relative to global peers to accommodate revenue and expenditure pressures and prudent debt management. These positives offset the downward pressures caused by the elevated debt burden and expectations of rising interest expense.

Ontario's Aa2 ratings incorporate a two notch uplift from its standalone credit quality (Baseline credit assessment (BCA)) of a1. Moody's assumes a high likelihood of support from the Government of Canada (Aaa stable) would be forthcoming to assist Ontario should it require liquidity support.

## WHAT COULD CHANGE THE RATING UP/DOWN

While an upgrade is unlikely, the outlook could be stabilized if the province is able to implement a credible plan that supports a sustainable path of maintaining the debt burden below 240% of revenue and interest expense below 9%. Evidence that the province's debt burden would rise above 240% of revenue or interest expense to exceed 9% of revenue would put further downward pressure on the rating.

The principal methodology used in these ratings was Regional and Local Governments published in January 2018. Please see the Rating Methodologies page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

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