

## Changing Gears

Fiscal Year 10/11

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**The Province of Ontario is projecting a \$19.7 bln deficit in FY2010/11, in a sparse budget tabled amid an evolving economic recovery.** There are no new major tax changes (beyond the impending HST), and the Province has begun to plant the seeds of future spending restraint. The shortfall clocks in at 3.3% of GDP, and will be followed by another six years of red ink before returning to balance in FY2017/18, by far the longest and deepest stretch of projected deficits among the Canadian provinces. A quickly developing theme this budget season is the choice between: a) immediate spending restraint, or b) allowing the economic recovery to take firmer root. Ontario is leaning toward the latter, despite being the least able among the provinces to do so.

As already announced, the Province's FY2009/10 deficit is now pegged at \$21.3 bln, a \$3.4 bln improvement from the Fall update, but still much worse than the \$14.1 bln projected at

this time last year. Revenues were revised down slightly from the Fall projection to \$96.4 bln, mostly due to changed timelines for Federal infrastructure funding. Meantime, program spending was revised down 1.8% to \$108.8 bln, reflecting lower-than-expected H1N1 costs and the pushing out of some infrastructure-related spending.

**Revenue is expected to rise a strong 10.8% to \$106.9 bln in FY2010/11** as the economic recovery drives income tax receipts. Personal and corporate tax revenue will rise 7.9% and 37%, respectively, this coming fiscal year—while the jump in the latter seems large, corporate tax revenues are still down more than 40% from two years ago. Federal transfers will rise 27.4%, which includes temporary payments related to the infrastructure program and HST implementation. As advertised, there are no major new tax measures in this budget. Instead, the HST and other measures outlined last year will take effect as planned—this includes modest personal and corporate tax relief, credits for low-income individuals and rebate cheques that effectively pass along the Federal government's contribution to the HST implementation effort.

**Program spending is expected to rise 6.5% to \$115.9 bln in FY2010/11**, with interest costs

### Highlights

- Budget deficit of \$21.3 bln in FY2009/10; \$19.7 bln in FY2010/11. Return to balance in FY2017/18.
- No new major tax initiatives. HST, tax cuts and rebates to continue as planned.
- Spending growth held to 1.8% per year on average through FY2017/18.
- GDP growth of 2.7% in 2010 and 3.2% in 2011.

### Fiscal Outlook

(C\$ billions)

	estimate	— forecast —		
	09/10	10/11	11/12	12/13
Revenues	96.4	106.9	107.7	112.0
Expenditures	117.7	125.9	124.1	126.9
Operations	108.8	115.9	112.9	114.3
Debt Service	8.9	10.0	11.1	12.5
Budget Balance				
Before Reserve	(21.3)	(19.0)	(16.3)	(14.9)
Reserve Allowance	0.0	0.7	1.0	1.0
Budget Balance	(21.3)	(19.7)	(17.3)	(15.9)

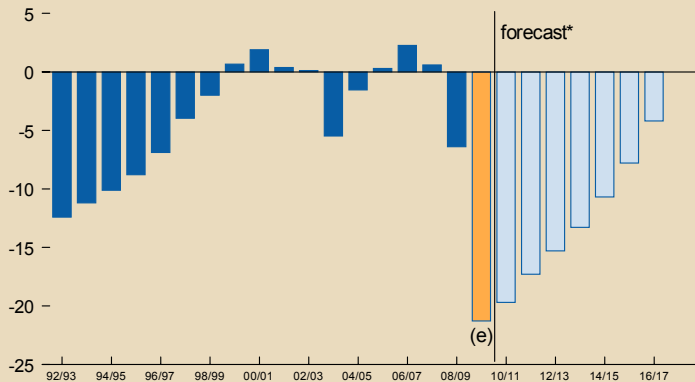
( ) = deficit

Note: Totals may not add due to rounding.

Source: Provincial forecasts

**Budgetary Balance**

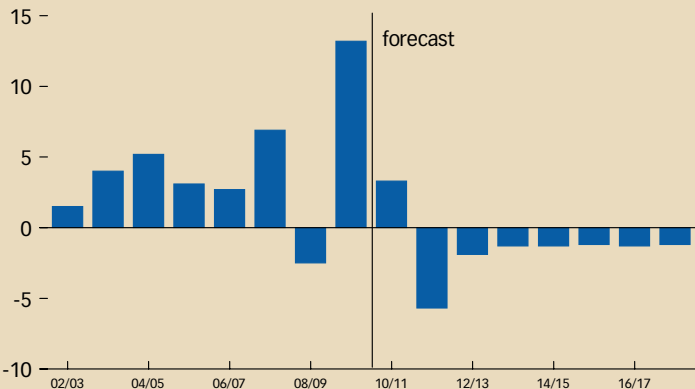
(\$ billions)



Source: Provincial forecasts e = estimate \*Includes reserve allowance

**Real Program Spending per Capita\***

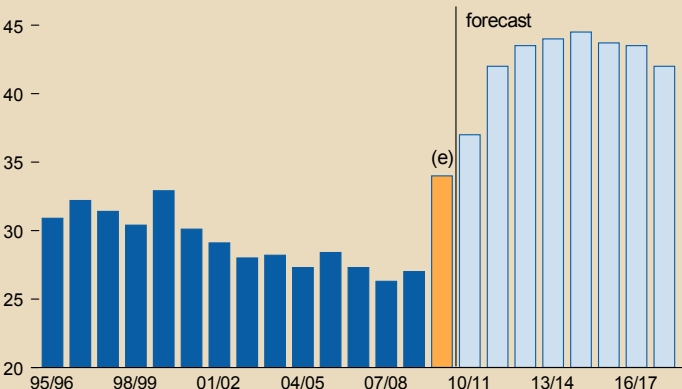
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Source: Provincial forecasts \*Assumes 1.2% population growth

**Net Debt/GDP\***

(percent)



Source: Provincial forecasts e = estimate \*Includes BPS organizations after 04/05

totalling an additional \$10 bln. Healthcare and education will continue to see growth, rising 6% and 3.9%, respectively. Among the key measures will be \$310 mln for 20,000 new post-secondary classroom spaces and a 50% boost to international enrollment, as well as full-day kindergarten. Also boosting the FY2010/11 spending total is \$3.2 bln in transitional support for the HST (ie: rebate cheques) that will disappear by FY2012/13—excluding this, program spending will rise 3.6%. The Province is hesitant to aggressively clamp down on spending growth just yet, preferring to allow the economic recovery to first take deeper root. Instead, the real work to rein in spending will begin next year, and starting in FY2012/13, program spending growth will slow to 1.9% annually through FY2017/18. Health spending growth will be targeted at 3% (a definite challenge), while internal operating expenses will be held at FY2010/11 levels and various public-sector pay structures will be frozen. This will be a stark change from the near-6% annual growth seen during the ten preceding years.

**On a real per-capita basis, program spending will shrink 1.3% per year through FY2017/18** (assuming 1.2% population growth) a level of restraint not seen in the province since the mid-1990s. If the discipline to hit these targets is maintained, and the economic recovery proceeds as forecast—revenues will grow 5% per year through the forecast horizon—Ontario could be nursed back to fiscal health without any major tax increases. However, it will be a long process, depending heavily on the expansion remaining healthy for a prolonged period.

**Ontario will also carry out the second year of its infrastructure program**, investing \$13.2 bln in FY2010/11, up from \$11.1 bln in the prior year. Transportation is the main focus (at \$4.9 bln), while health care (\$2.5 bln) and education (\$1.7 bln) will also be important recipients. Of the total invested this coming fiscal year, \$3.4 bln will be transferred to municipalities and universities.

**Ontario's total long-term borrowing requirements are expected to be \$39.7 bln in FY2010/11** (including \$15.6 bln of refinancing), down

only slightly from \$43.8 bln in FY2009/10, and should average about \$40 bln per year through FY2012/13. Meantime, net debt is expected to rise to \$220 bln in the coming fiscal year, lifting the net debt-to-GDP ratio to 37% from 34% in FY2009/10. The ratio will peak at just below 45% in FY 2014/15, well above the highs seen in the late-1990s. However, debt service costs will remain below 12% of revenue in the coming years versus as much as 17% in the late-1990s. This is manageable, but the growing debt load could pose a threat if interest rates rise materially.

**The Ontario economy has pulled out of recession** as the auto sector is rebounding and domestic demand, led by housing, is gaining strength. Still, the recession left a deep dent in Ontario's economy, and a number of factors will likely temper growth in Central Canada in the coming years—these include a strong loonie, sluggish U.S. consumer demand and fiscal restraint. Indeed, the unemployment rate stood at 9.1% in February, now well above the national rate and a stark change for a province that has historically enjoyed a tighter-than-average labour market. Real GDP will likely grow 2.9% this year and 3.0% in 2011, both slightly below the national rate. This budget is based on assumptions of 2.7% and 3.2%, which we deem reasonable, but not particularly cautious.

**The bottom line:** Despite facing the toughest fiscal challenge in Canada, Ontario is not showing immediate urgency to aggressively rein in spending and the deficit. Instead, the Province will rely on a prolonged economic recovery and modest spending restraint over the next eight years to get the fiscal house back in order.

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