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# Balanced budget delayed as rebuilding continues

By Daren King, Warren Lovely & Taylor Schleich

## Highlights

A less prosperous economic backdrop, undermined by high interest rates and inflation, has weighed on Ontario's public finances, with the result that the $1.3 billion deficit forecast in the previous budget for the 2023-24 outgoing fiscal year has been re-evaluated at $3.0 billion (but remains lower than the $5.6 billion forecast during the FES) due to higher-than-expected expenses. While the economic outlook for the coming year remains difficult, with real GDP growth expected to be just 0.3% in 2024, the 2024 Budget forecasts a widening deficit of $9.8 billion (0.9% of nominal GDP) due to spending growth outpacing revenue growth, and pushes back the return to balanced budgets by one year to 2026-27. Dubbed 'Building a better Ontario', the budget provides additional funding to municipalities to provide additional housing-enabling infrastructure (roads, bridges, water supply), extending high-speed internet coverage, connecting more people with primary care teams and to address health care staffing needs. In addition of strengthening the Non-Resident Speculation Tax and removing Ontario's proportion of the HST on new purpose-built rental units (like previously announced), the budget now allows municipalities to impose a tax on vacant dwellings and reduce property taxes on new purpose-built rentals. Regarding debt, the government has reiterated its commitment/intention to keep debt-to-GDP below 40%. At 38.0% in 2023-24, the net debt-to-GDP ratio is set to rise to 39.2% in 2024-25, then to 39.5% in the last year of deficit in 2025-26, before declining to 39.1% in 2026-27. The interest bite looks to be 6.8% of revenue in the coming fiscal year and is not to exceed 7.5%. Notably for bondholders, Ontario is telegraphing a significantly smaller bond program, Budget 2024 setting out $38.2 billion in gross long-term bond supply for the coming 12-month period. For the sake of perspective, this gross bond tally works out to roughly $2,400 per Ontarian, leaving the relative bond program some 29-38% below the average outlined in the eight other provincial budget so far tabled in 2024 (depending on your method of weighting).

- **Economic outlook** – Ontario's economy was surprisingly resilient in 2023, as historical population growth supported growth despite restrictive monetary policy and high inflation. Initially forecast at 0.2% in the previous budget, the province's real GDP is estimated to have grown by 1.2% in 2023, a slightly higher rate than the national average. To the great benefit of public finances, nominal GDP growth for 2023 is estimated at 4.1%, much higher than the 2.8% expected in the 2023 budget and 2.7% for Canada as a whole. Ontario's economy has been supported by the strongest demographic growth in its modern history, with the working-age population growing by 3.1% from July 2022 to July 2023. This significant population growth resulted in the creation of 101.3K jobs on average in 2023, or a 2.4% growth. Despite this vigour, the labour market has not been able to fully absorb this strong population growth. As a result, the unemployment rate in the province rose from 5.2% in February 2023 to 6.5% in February 2024, a much greater deterioration than that seen nationally. Looking ahead, the budget is based on growth forecasts that have been revised downwards, with real GDP in 2024 expected to grow by only a marginal 0.3%, which is 0.1%-pt lower than the average forecast of the private sector economists. For 2025, real GDP growth should be higher at 1.9% (average private sector forecast at 2.0%), then rise to 2.2% in 2026 and 2027. Even more important for public finances, Ontario's nominal GDP in 2024 is expected to grow by 2.7%, which is roughly in line with the private sector's forecast of 2.8%. Nominal GDP should then rise by 3.9% in 2025 (slightly below the 4.0% expected by the consensus), 4.3% in 2026 and 4.1% in 2027. As for the labour market, job creation should continue to lag population growth in 2024, with unemployment rate rising from 5.7% on average in 2023 to 6.7% in 2024.The unemployment rate should then return on a downward trajectory, reducing to 6.6% in 2025 and 6.4% in 2026.

- **Outgoing fiscal year update (2023-24)** – While budgetary guidance was consistently upgraded during the last fiscal year, the positive momentum wasn't carried into 2023-24. In the 2023 budget, the province was forecasting a modest $1.3 billion deficit (0.1% of GDP) and by the Fall Economic Statement, the expected shortfall grew to $5.6 billion deficit (0.5% of GDP). Since then, the bottom line has firmed up a bit although the net result is weaker than expected a year ago. Officially, the province is flagging a $3.0 billion shortfall (0.3% of GDP) for 2023-24 with the final budget balance to be confirmed via forthcoming public accounts. The in-year deterioration was an entirely an expenses story, as topline revenues came in almost exactly in line with the budget plan. Instead, program spending was the culprit (+$3.8 billion or +2.0%) as outlays on health, education and justice contributed most significantly to the revision. Interest on debt was materially lower than planned in Budget 2023 (-$1.3 billion or -9%). Needless to say, Ontario isn't the first province to see its fiscal fortunes sour over the course of 2023-24.

- **Coming fiscal year outlook (2024-25)** – A larger than planned deficit for the outgoing fiscal year gives way to a larger than planned deficit in the coming fiscal year. Specifically, the province is guiding towards a $9.8 billion deficit for 2024-25 which represents 0.9% of Ontario's $1 trillion-plus nominal GDP. The province, as usual, has included a reserve to absorb any unplanned revenue/spending shocks (more on that below). What's driving budgetary pressures? Not surprisingly, it's net new spending outpacing revenue growth. Consistent with a sluggish GDP growth outlook, receipts for the coming year are seen growing just 0.7%. That's broken down into a 1.5% increase in tax revenue, a 4.3% rise in federal transfers and a combined 8.5% drop in Government Business Enterprises (GBE) receipts and other non-tax revenue sources (the latter reflecting forgone revenue due to the federal government's cap on study permits). Meanwhile, expenses are set to rise 3.5% thanks to increases in both program spending and interest on debt. We'd note that two-thirds of the marginal spending can be attributed to the 'other program expenses' envelope. This reflects investments in high-speed internet, the auto sector (e.g., EV battery production) and housing-enabling infrastructure.

- **Revised medium-term outlook** – Ontario's return to black ink has been delayed another year (now to 2026-27), continuing the trend observed over recent updates: Budget 2023 forecast a return to balance in 2024-25 which was subsequently pushed to 2025-26 in the Fall Economic Statement. Specifically, the province now sees the deficit moderating to $4.7 billion (0.4% of GDP) in 2025-26 before returning to balance in 2026-27. This budgetary consolidation assumes solid revenue growth of 5.0% per year (over the outer two years of the outlook) and disciplined program spending growth of 2.0%. Interest on debt, predictably, is seen rising at a quicker pace (+4.6%).
- **Alternative fiscal scenarios** – The global economy may have avoided a hard landing after a historic monetary policy tightening cycle but there's still plenty of uncertainty on the horizon. Credit Ontario for once again detailing faster and slower growth scenarios and the impact on key fiscal metrics. When it comes to the budget balance, a slower growth scenario—characterized by a 0.6% contraction in real GDP for 2024—would see the 2024-25 shortfall rise from a projected $9.8 billion to $13.3 billion. Under this slower growth scenario, Ontario would not return to balance by 2026-27. The faster growth scenario, however, would accelerate the return to balance. Real GDP growth of 1.4% in 2024 (and roughly 2.5% thereafter) would see a more modest $6.1 billion deficit in 2024-25 and a small surplus in 2025-26.
- **New initiatives** – The budget's plan to "build a better Ontario" is laid out as a two-pronged approach, focused on (a) growing the economy by spurring investment and building infrastructure and (b) improving public services (including healthcare) and keeping cost down.
    - In its plan for 'Building Ontario', the province will invest $1 billion in the new Municipal Housing Infrastructure Program to facilitate housing construction (road, bridge, etc.) and $825 million to the Housing-Enabling Water Systems Fund to increased access to financing for housing-related water and wastewater infrastructure projects. The budget also plans to invest $200 million over 3 years in the Community Sport and Recreation Infrastructure Fund to build new facilities, such as hockey rinks and community centres. Among the other measures worth mentioning, the budget significantly increases the sums allocated to improve high-speed internet access across Ontario, with $1.3 billion allocated this year, up from $300 million in each of the previous few years.
    - Unsurprisingly, a key focus of 'Working for You' is related to health care. The government pledges an additional $546 million over three years, starting next year, to connect approximately 600K people with primary care teams, $743 million over three years to address health care staffing needs, an additional $396 million over three years for mental health and addiction services, and another $155 million to build more long-term care homes faster. Another aim of the budget is to keep costs down for Ontarians. To this end, the budget announces the extension of the rebate of 5.7 cents per litre on gasoline and 5.3 cents per litre on diesel until 31 December 2024. In addition, the government will be extending subsidies to reduce household electricity bills and has announced the "modernization" of the car insurance system to allow people to opt out of certain protection in order to reduce premiums. This section of the budget includes several measures to maximize the use of the housing stock by strengthening the Non-Resident Speculation Tax, but also by allowing municipalities to impose a tax on vacant homes. In addition, as previously announced, the budget removes the Ontario's portion of the Harmonized Sales Tax on qualifying new purpose-built rental units and enable municipalities to lower property taxes on those units.
- **Contingencies/prudence & official sensitivities** – Consistent with past practice, the budget incorporates meaningful prudence across a few dimensions. First, there are the sub-consensus forecasts for real GDP growth in 2024 and beyond. Then, there's reserves. For the coming fiscal year (2024-25), $1 billion has been set aside. This grows to $1.5 billion for 2025-26 and to $2 billion for 2026-27. There's another important buffer in the form of a standard contingency fund, amounting to $1.5 billion for 2024-25 and increasing further throughout the medium-term outlook (note that there's also $0.5 billion still available in 2023-24 contingencies). All told, we consider this meaningful prudence outright and by provincial standards. To be treated with caution, official fiscal sensitivity analysis suggests a 1%-pt 'surprise' on nominal GDP growth is worth ~$1.1 billion in total taxation revenue/year. On the expense side, it's believed that a 1%-pt parallel shift up in Ontario borrowing rates adds roughly $700 million to the interest bill in year one (the province assumes 3-month and 10-year GoC yields average 4.4% and 3.2%, respectively in 2024).
- **Debt burden & interest bite** – Ontario's net debt is now projected to end 2023-24 a touch below $415 billion. Consistent with revisions to the budgetary balance, the latest estimate for the level of net debt marks an erosion vs. Budget 2023 but is a modest improvement relative to the more recent Fall Economic Statement. The same holds for debt-to-GDP, where we will have more to say in a moment. A larger deficit alongside tangible capital investments should see some $24 billion of net debt taken on in 2024-25, net financial liabilities projected to end the fiscal year at $439 billion. Putting that number in context, Ontario's forecasted level of net debt would equate to 39.2% of nominal GDP. While this key debt-to-GDP ratio—one of three noted debt sustainability metrics the province targets—would be higher than where 2023-24 looks to be ending up (38.0%), the government has reiterated its commitment/intention to keep debt-to-GDP below 40%. Strictly speaking, Budget 2024 sees net debt-to-GDP edging a bit closer to this 40% threshold in 2025-26 (peaking at 39.5%), before a return to balance helps to turn the tide towards reduced leverage starting in 2026-27 (39.1%). It's not uncommon to scale net debt to revenue, and this happens to be another debt

sustainability metric Ontario focuses on. Here, as previously identified in the FES, the stated 200% threshold appears has been breached in 2023-24 and debt-to-revenue is due to move further away from the target in the coming fiscal year (planned to hit 214% in 2024-25). Under the base line economic scenario, Ontario may need until 2029-30 to get debt-to-revenue back below 200%. The other key debt metric relates to the interest on debt-to-revenue ratio, often referred to as the 'interest bite'. To us, debt affordability trends are less-than-alarming in Ontario. Indeed, interest on debt (or IOD) is set to consume a manageable 6.3% of revenue in 2023-24, setting a new cyclical low and less of a 'bite' than was flagged in both Budget 2023 and the more recent FES. Of note, assumptions for the average annual borrowing rate have been reset lower relative to this time last year. Even with some expected interest rate relief in 2024 and 2025, the larger debt load will add some marginal pressure on this ratio (albeit from the new, lower base). The interest bite is seen edging to 6.8% in 2024-25 and staying there for 2025-26. Nonetheless, the budget projects that this closely watched measure will remain below the stated limit of 7.5%, that commitment having been earlier established.

- **Long-term borrowing requirement** –Ontario completed a larger-than-planned $41.8 billion of gross long-term borrowing in 2023-24, an increase vs. the $27.5 billion Budget 2023 plan reflecting a few developments/dimensions. First, the budget deficit was larger than originally planned. Meantime, incremental capital investment combined with various non-cash (and/or cash timing) adjustments further added to borrowing needs. Notably, Ontario's larger 2023-24 bond crop also captured a prudent move to build up cash (i.e., pre-fund future year needs). As it stands, Ontario sees more than $9 billion added to its cash position in 2023-24. A bit of this extra cash is to be drawn upon in 2024-25, with more of it deployed/used in 2025-26, helping to limit overall borrowing requirements. (Notwithstanding a change in official presentation, you can think of this build-up and eventual drawn down of cash as synonymous with pre-financing.) Ontario has recourse to short-term funding markets and with ample room against official limits, the financing plan calls for short-term outstandings to increase by $5 billion in 2024-25. Where does all this leave projected bond supply? Well, after printing that $41.8 billion in 2023-24, Budget 2024 sets out $38.2 billion in gross long-term bond supply for the coming 12-month period. Again, for the sake of perspective, this gross bond tally works out to roughly $2,400 per Ontarian, leaving the relative bond program some 29-38% below the average outlined in the eight other provincial budget so far tabled in 2024 (depending on your method of weighting). Ontario's gross bond needs are to recede a touch to $37.7 billion in 2025-26, easing more notably to $32.8 billion in 2026-27. As with other core elements of the budget, slower and faster growth scenarios are presented for gross bond supply. Looking at 2024-25, for instance, the perceived range of likely outcomes for gross issuance lies between $34.5 billion (if growth is faster) and $41.7 billion (should growth disappoint). When it comes to debt strategy, it's worth reflecting on the fiscal year that was. Of the $41.8 billion printed in 2023-24, a bit more than 85% was completed in the domestic (CAD) market, residing at the higher end of the 75-90% target range for domestic supply. This target range (75-90%) is to remain in place for 2024-25, although Ontario (like other provinces) reserves the right to alter its issuance strategy as investor demand and market dynamics evolve. While partly influenced by the larger CAD share, Ontario opted for term in 2023-24. At 15.2 years, the weighted average term of new supply (all currencies) was the longest in the post-GFC era. The budget notes that interest rates have risen to near historical averages and having succeeded in locking in so much debt for longer there's certainly latitude/scope to adjust the term of debt issuance if investor demand/financial conditions warrant. Having presented an updated Sustainable Bond Framework, Ontario is poised to retain its leadership position in terms of labelled financings. Once again, the stated intention is to 'issue multiple Green Bonds each fiscal year', subject to market conditions, of course. (If you're keeping track, the province's last Green Bond was the first under its new framework and its 15th overall, a testament to its commitment to the space.) Finally, a sizeable liquidity buffer is available, liquid reserves averaging almost $47 billion in 2023-24.
- **Current long-term credit ratings** – S&P: A+, Positive | Moody's: Aa3, Positive | DBRS: AA(Low), Positive | Fitch: AA-, Stable
  *[Refer to our Provincial Ratings Snapshot for additional colour on specific credit rating drivers/considerations]*

## Details of Ontario's Fiscal Plan

**($ Billions)**

| | Actual | Interim[1] | Medium-Term Outlook | | |
|---|---|---|---|---|---|
| | **2022–23** | **2023–24** | **2024–25** | **2025–26** | **2026–27** |
| **Revenue** | | | | | |
| Personal Income Tax | 44.2 | 50.6 | 51.9 | 55.1 | 58.3 |
| Sales Tax | 36.1 | 39.8 | 38.8 | 40.6 | 42.7 |
| Corporations Tax | 27.8 | 24.2 | 24.9 | 26.3 | 28.0 |
| Ontario Health Premium | 4.4 | 4.9 | 5.0 | 5.2 | 5.4 |
| Education Property Tax | 6.0 | 5.8 | 5.8 | 5.9 | 5.9 |
| All Other Taxes | 18.0 | 17.2 | 18.2 | 20.4 | 21.0 |
| **Total Taxation Revenue** | **136.5** | **142.5** | **144.7** | **153.5** | **161.3** |
| Government of Canada | 31.3 | 34.8 | 36.3 | 37.5 | 38.7 |
| Income from Government Business Enterprises | 6.1 | 7.3 | 6.8 | 8.0 | 7.8 |
| Other Non-Tax Revenue | 19.0 | 19.8 | 18.0 | 18.5 | 18.8 |
| **Total Revenue** | **192.9** | **204.3** | **205.7** | **217.4** | **226.6** |
| **Base Programs[2]** | | | | | |
| Health Sector | 75.1 | 84.5 | 85.0 | 88.0 | 89.9 |
| Education Sector[3] | 33.6 | 36.6 | 37.6 | 38.8 | 39.4 |
| Postsecondary Education Sector | 11.7 | 12.6 | 12.2 | 12.5 | 13.0 |
| Children, Community and Social Services Sector | 18.0 | 19.4 | 19.9 | 20.1 | 20.1 |
| Justice Sector | 5.3 | 6.1 | 5.9 | 5.6 | 5.6 |
| Other Programs | 30.1 | 35.3 | 40.0 | 40.9 | 40.9 |
| **Total Base Programs** | **173.8** | **194.5** | **200.6** | **205.8** | **208.9** |
| COVID-19 Time-Limited Funding | 6.3 | – | – | – | – |
| Other One-Time Expenses | 6.3 | – | – | – | – |
| **Total Programs** | **186.4** | **194.5** | **200.6** | **205.8** | **208.9** |
| Interest on Debt | 12.4 | 12.8 | 13.9 | 14.7 | 15.2 |
| **Total Expense** | **198.8** | **207.3** | **214.5** | **220.6** | **224.1** |
| **Surplus/(Deficit) Before Reserve** | **(5.9)** | **(3.0)** | **(8.8)** | **(3.1)** | **2.5** |
| Reserve | – | – | 1.0 | 1.5 | 2.0 |
| **Surplus/(Deficit)** | **(5.9)** | **(3.0)** | **(9.8)** | **(4.6)** | **0.5** |
| Net Debt as a Per Cent of GDP | 38.2% | 38.0% | 39.2% | 39.5% | 39.1% |
| Net Debt as a Per Cent of Revenue | 207.6% | 203.0% | 213.5% | 211.4% | 209.4% |
| Interest on Debt as a Per Cent of Revenue | 6.4% | 6.3% | 6.8% | 6.8% | 6.7% |

[1] Interim represents the *2024 Budget* projection for the 2023–24 fiscal year.
[2] For presentation purposes in the *2024 Budget*, one-time COVID-19-related spending in 2022–23 has been included within COVID-19 Time-Limited Funding. This funding is no longer reported separately, starting in 2023–24.
[3] Excludes Teachers' Pension Plan. Teachers' Pension Plan expense is included in Other Programs.
*Note:* Numbers may not add due to rounding.
*Sources:* Ontario Treasury Board Secretariat and Ontario Ministry of Finance.

## Economics and Strategy

### Montreal Office
514-879-2529

**Stéfane Marion**
*Chief Economist and Strategist*
stefane.marion@nbc.ca

**Matthieu Arseneau**
*Deputy Chief Economist*
matthieu.arseneau@nbc.ca

**Kyle Dahms**
*Economist*
kyle.dahms@nbc.ca

**Daren King, CFA**
*Economist*
daren.king@nbc.ca

**Jocelyn Paquet**
*Economist*
jocelyn.paquet@nbc.ca

**Alexandra Ducharme**
*Economist*
alexandra.ducharme@nbc.ca

**Angelo Katsoras**
*Geopolitical Analyst*
angelo.katsoras@nbc.ca

### Toronto Office
416-869-8598

**Warren Lovely**
*Chief Rates and Public Sector Strategist*
warren.lovely@nbc.ca

**Taylor Schleich**
*Rates Strategist*
taylor.Schleich@nbc.ca

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