

A longer term approach to a balanced budget

Highlights

- The 2009-10 fiscal year is ending with a deficit estimated at \$21.3 billion, \$3.4 billion less than the \$24.7 billion projected in last fall's financial review.
- Elimination of the deficit is projected for 2017-18, two years later than in last year's budget.
- Infrastructure investment is budgeted to increase to \$13.2 billion in 2010-11, from \$11.1 billion in 2009-10.
- Real GDP is assumed to grow 2.7% in 2010, 3.2% in 2011 and 2012 and 3.0% in 2013.
- Funding to be provided for 20,000 new spaces in colleges and universities this September.
- Public-sector pay to be frozen.
- Health spending growth is to be capped at 3% annually through 2012-13.
- Program spending growth is to be held to an average 1.9% annually after 2012-13.
- The borrowing requirement will be in the neighbourhood of \$40 billion for each year through 2012-13. About 38% of the borrowing over this period will be for refinancing.
- The ratio of accumulated deficit (total debt minus total assets) to GDP is projected to peak at 29.2% in 2013-14.

Summary

It may seem surprising that the deficit for the fiscal year just ending is \$3.4 billion less than was projected last fall, especially since revenues are revised downward \$239 million. Lower program spending accounts for \$1.9 billion of the difference. Among the major factors here were lower-than-expected cost associated with the H1N1 virus and spending restraint. However, an unspecified part of the difference is due to postponement of infrastructure projects (resulting in lower federal transfers, explaining the downward revision of revenues). Debt service cost were \$476 million less than projected, and the \$1.2-billion reserve set aside last fall was not used.

The budget tabled today by Finance Minister Dwight Duncan sets out a number of initiatives. The first is a plan to halve the deficit in five years (from \$21.3 billion in 2009-10) and eliminate it in eight years. This plan includes a two-year pay freeze for non-unionized public-sector employees and no provision for pay raises in future union contracts. The government will aim to keep a tight rein on spending sufficient to hold its basic operating expenses to the 2010-11 level or lower over the medium term. After 2012-13, program spending growth is to be held to an average 1.9% annually.

A second aim of the budget is to attract foreign students to Ontario universities and colleges. Funding is provided for the addition of 20,000 spaces in these institutions and their "aggressive" promotion abroad. A third aim is development of the northern Ontario economy, through measures including an industrial electricity rate program under which an average \$150 million annually will be spent over three years to reduce electricity prices by about 25% for large industrial

ECONOMIC AND STRATEGY GROUP – 514.879.2529

Stéfane Marion, Chief Economist and Strategist

General: National Bank Financial (NBF) is an indirect wholly owned subsidiary of National Bank of Canada. National Bank of Canada is a public company listed on Canadian stock exchanges. ♦ The particulars contained herein were obtained from sources which we believe to be reliable but are not guaranteed by us and may be incomplete. The opinions expressed are based upon our analysis and interpretation of these particulars and are not to be construed as a solicitation or offer to buy or sell the securities mentioned herein. ♦ Canadian Residents: In respect of the distribution of this report in Canada, NBF accepts responsibility for its contents. To make further inquiry related to this report or effect any transaction, Canadian residents should contact their NBF Investment advisor. ♦ U.S. Residents: NBF Securities (USA) Corp., an affiliate of NBF, accepts responsibility for the contents of this report, subject to any terms set out above. Any U.S. person wishing to effect transactions in any security discussed herein should do so only through NBF Securities (USA) Corp. UK Residents: In respect of the distribution of this report to UK residents, NBF has approved this financial promotion for the purposes of Section 21(1) of the Financial Services and Markets Act 2000. NBF and/or its parent and/or any companies within or affiliates of the National Bank of Canada group and/or any of their directors, officers and employees may have or may have had interests or long or short positions in, and may at any time make purchases and/or sales as principal or agent, or may act or may have acted as market maker in the relevant securities or related financial instruments discussed in this report, or may act or have acted as investment and/or commercial banker with respect thereto. The value of investments can go down as well as up. Past performance will not necessarily be repeated in the future. The investments contained in this report are not available to private customers. This report does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for the securities described herein nor shall it or any part of it form the basis of or be relied on in connection with any contract or commitment whatsoever. This information is only for distribution to non-private customers in the United Kingdom within the meaning of the rules of the Regulated by the Financial Services Authority. ♦ Copyright: This report may not be reproduced in whole or in part, or further distributed or published or referred to in any manner whatsoever, nor may the information, opinions or conclusions contained in it be referred to without in each case the prior express written consent of National Bank Financial.

companies that commit to increasing their electricity efficiency. Other initiatives include the implementation by 2015-16 of a full-day learning program for four- and five-year-olds and a wide-ranging water strategy. These measures are of course additional to infrastructure investment.

The province's accumulated deficit (total debt minus total assets), which bottomed out at 18% of GDP in 2007-08, is projected to peak in 2013-14 at 29.2%, which is still less than the 32.9% of 1999-2000.

Measures to control spending, the key to deficit reduction, are unquestionably the salient focus of this budget. They are certainly welcome, but will they suffice? The assumption of 2.7% economic expansion in 2010 is prudent relative to the consensus expectation of 3% growth. In 2011, however, we think GDP may grow more slowly than the government projects. The budget document would indicate that a one percentage point change in real GDP assumptions affects revenue estimates by \$750 million. Recognising this purely as a guideline and that the actual impact can vary significantly depending on the composition and the source of changes in GDP growth, this rule can help keep in perspective a key source of risk to the Ontario budget plan.

Marc Pinsonneault

Ontario

	Interim	Plan	Outlook	
	2009/10	2010-2011	2011/12	2012/13
\$ billions				
Revenue	96.4	106.9	107.8	112.0
Own-Source revenue	65.7	71.6	74.9	79.3
<i>Personal Income Tax</i>	24.0	25.9	26.7	28.3
<i>Retail Sales Tax</i>	17.4	19.1	20.3	21.4
<i>Corporations Tax</i>	5.4	7.4	8.0	9.4
<i>Education Property tax</i>	5.7	5.3	5.3	5.3
<i>Ontario Health Premium</i>	2.7	2.9	3.0	3.2
<i>Other</i>	10.5	10.9	11.6	11.9
Federal Transfers	18.6	23.7	21.5	21.1
Income from Government Business Enterprises	4.1	4.2	4.4	4.6
Other Revenue	8.0	7.4	7.0	7.0
Expenses	117.7	125.9	124.1	126.9
Program Spending	108.8	115.9	112.9	114.3
Interest on Debt	8.9	10.0	11.1	12.5
Reserve	-	0.7	1.0	1.0
Surplus (Deficit)	(21.3)	(19.7)	(17.3)	(15.9)
Net Debt	193.2	220.0	245.0	267.8
Accumulated Deficit	134.6	154.3	171.6	187.5
Borrowing Requirement	43.8	39.7	38.8	40.2
Surplus (Deficit)	21.3	19.7	17.3	15.9
Maturities	14.4	15.6	14.0	17.3
Redemptions	0.4	0.4	0.4	0.5
Investment in Capital Assets	8.5	9.8	10.6	10.4
Others	(0.8)	(5.8)	(3.5)	(3.9)

Source: 2010 Ontario Budget, Ontario Ministry of Finance.