

Ontario public accounts: In a word, 'wow'

By Warren Lovely

Under normal circumstances, the release of backwards-looking public accounts for a provincial government might not warrant its very own *Market View* note. But when the province is Ontario (i.e., a vital bellwether given its outsized weight) and when the final accounting developments are so overwhelming material, you'll forgive us for taking a closer look.

With the release of the 2020-21 public accounts, Ontario dismantled a good deal of last fiscal year's budget deficit. In the final analysis the deficit was cut to C\$16.4 billion (Chart 1) or a snick less than 2% of GDP. Back on March 24th, in Budget 2021, Ontario was still estimating a shortfall at C\$38.5 billion. So this is a monster fiscal revision. What gives? As we've been consistently telegraphing, spring-time budgets had looked ultra conservative (in Ontario and most other provinces). A variety of important revenue streams fared *much* better than previously anticipated, actual own-source revenue coming in nearly C\$13 billion or >10% above the latest estimate (refer to detailed Table on page 2). Meanwhile, billions in program spending failed to materialize, with total expense cut by C\$9 billion. Put these two figures together and you get a C\$22 billion net budgetary improvement over the course of six months. (That's like erasing C\$120 million in red ink per day.) Importantly, there are no accounting hijinks here, the provincial Auditor General giving the public accounts a clean bill of health in the form of an 'unqualified opinion'.

Despite last year's monumental economic hit associated with COVID—witness declines in provincial GDP and employment—Ontario's revenue grew by 5.6% in 2020-21 vs. the prior fiscal year (Chart 2). Somewhat remarkably, own-source revenue was actually up a bit (not down), as various government supports bolstered personal and corporate incomes. Extraordinary support from Ottawa also meant federal transfers surged 34% year-on-year. Technically, 97% of last year's revenue growth owes to extra GoC transfers. All this helps explain the clear de-linking of nominal GDP and total provincial government revenue last fiscal year (Chart 3). In another sense, this highlights just how supportive federal fiscal policy has been during the pandemic era, to say nothing of fresh promises made during the recent federal election.

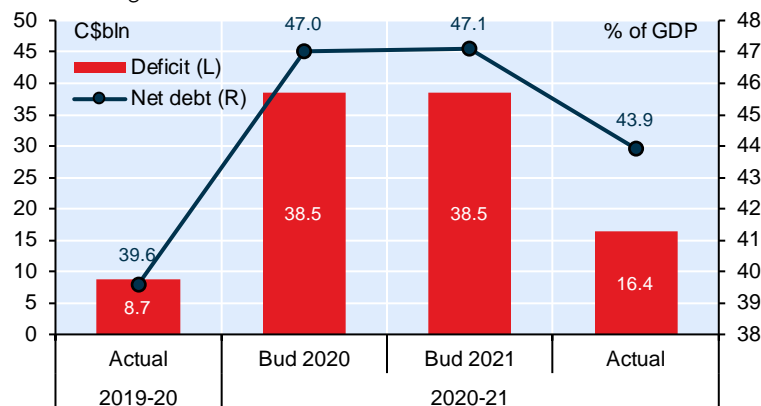
Ontario's massive fiscal improvement means considerably less debt was added in 2020-21 than previously telegraphed. Specifically, Ontario's net debt ended the fiscal year at C\$373.6 billion. Yes, that's a higher debt level than the prior fiscal year, since there was still a budget deficit and capital spending to account for. But net debt ended up roughly C\$26 billion lower than March's projected tally, easing the debt burden by the equivalent of C\$1,750 for every Ontarian. The debt-to-GDP ratio was still relatively high at 43.9%, but as with the income statement, balance sheet developments are undeniably constructive. Moreover, Ontario's interest bite declined to just 7.4% of revenue, not far from an historic low (Chart 4). Ontarians, like most Canadians, may be worried about the rising cost of living and deteriorating housing affordability, but at least their provincial government has a relatively affordable debt burden. Moreover, credit Ontario (and other provinces) with having consistently extended the term of its debt... a strategy the feds only recently caught on to. It means quite-controlled interest rate reset risk in provi land, something that will presumably become a growing focus as we step ever closer to Bank of Canada interest rate hikes.

Ontario's improved fiscal picture should partially carry over to the current fiscal year. There's a very positive revenue base effect at play, as own-source revenue ends 2020-21 at a higher level than what was last forecast for 2021-22. So assuming Ontario's economic recovery remains on track, there's scope for significant upward revisions to this year's revenue above and beyond what was flagged in Q1 (as much as C\$10 billion perhaps?). On program spending it's less clear, as the province could push unspent commitments into the current fiscal year. We'll see.

A final non-trivial point... The reduced red ink confirmed for 2020-21 implies that Ontario's start-of-year cash position was *considerably* better than previously assumed. Think of this as an immensely positive prior-year cash adjustment, akin to super pre-financing. Irrespective of how much and how quickly this year's deficit is taken down, the public accounts (on their own) hint at a major reduction in official long-term borrowing needs with the release of the *Fall Economic Statement* (coming no later than November 15th). It follows that the prospective mark-down of official requirements would significantly advance funded status once the *FES* lands. For the time being, Ontario presents itself as 46% funded, with C\$24.6 billion of a C\$53 billion requirement have been completed. All told, the much healthier budgetary picture/cash position helps explain Ontario's relatively patient approach to the market of late and is clearly supportive of the province's credit spreads.

Chart 1: Poof! Much of 2020-21's red ink gone in a flash

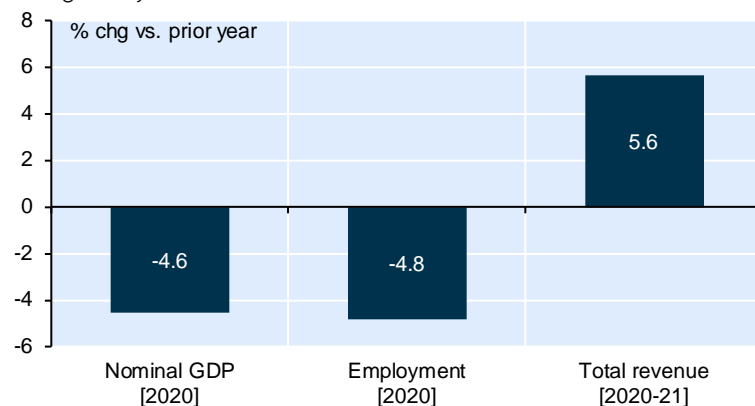
Ontario budget deficit & debt-to-GDP ratio: 2019-20 to 2020-21



Source: NBF, Ontario

Chart 2: Economic hit? Yes... Revenue decline? No!

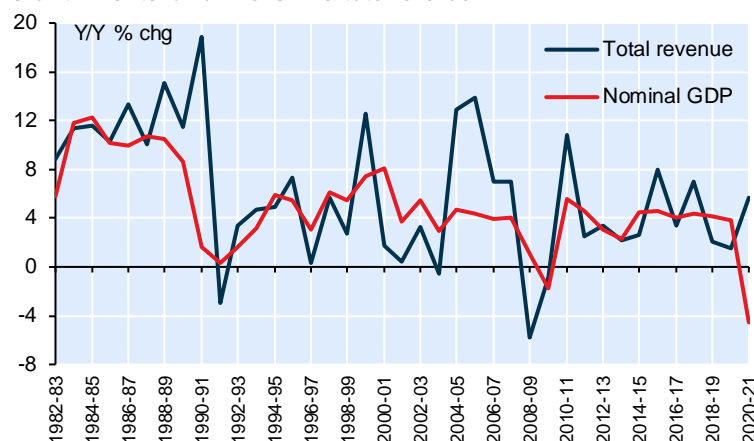
Change in key Ontario economic indicators & total revenue: 2020-21



Source: NBF, Ontario, StatCan

Chart 3: Revenue & GDP de-link, thanks (in part) to Ottawa

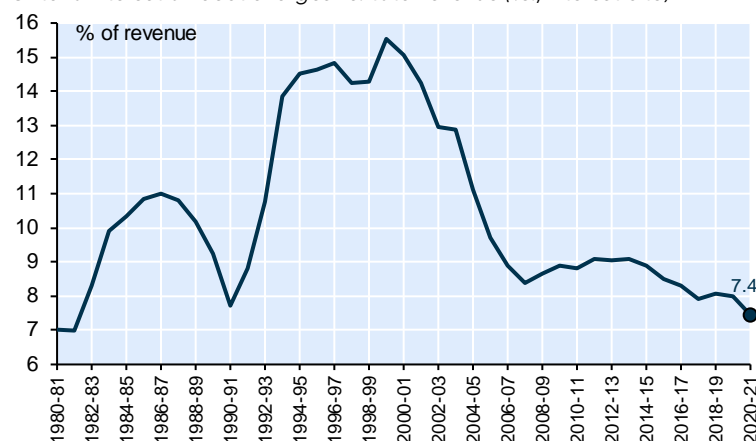
Growth in Ontario nominal GDP & total revenue



Source: NBF, Ontario, StatCan | Note: GDP based on calendar year; total revenue based on fiscal year

Chart 4: Ontario's interest bite near record low in 2020-21

Ontario interest on debt charges vs. total revenue (i.e., interest bite)



Source: NBF, Ontario

Table: Public accounts detail substantial improvement in 2020-21 budget balance, hinting at +ve base effect for 2021-22

Details of Ontario finances, highlighting change in 2020-21 vs. prior fiscal year & earlier projections

C\$/bln	Evolution of 2020-21 finances: Public accounts confirms major improvement!									
	2019-20		2020-21			Change in 2020-21 actual			2021-22	
	Actual	Bud20	Bud21	Actual	Vs. 2019-20	Vs. Bud20	Vs. Bud21	Bud21	Q1 Finances	
Revenue	156.1	151.1	151.8	164.9	8.8	13.8	13.1	154.0	156.9	
Own-source	130.7	117.7	118.1	131.0	0.3	13.3	12.9	126.6	127.5	
Federal transfers	25.4	33.4	33.7	33.9	8.5	0.6	0.2	27.4	29.4	
Expense	164.8	187.0	190.3	181.3	16.5	-5.7	-9.0	186.1	188.3	
Programs	152.3	174.6	177.8	169.0	16.8	-5.6	-8.8	173.0	175.2	
Interest on debt	12.5	12.5	12.5	12.3	-0.2	-0.2	-0.2	13.1	13.1	
vs. revenue (i.e., interest bite)	8.0%	8.2%	8.2%	7.4%	-0.6%-pts	-0.8%-pts	-0.8%-pts	8.5%	8.4%	
Reserve	0.0	2.5	0.0	0.0	0.0	-2.5	0.0	1.0	1.0	
Budget balance	-8.7	-38.5	-38.5	-16.4	-7.7	22.1	22.1	-33.1	-32.4	
Net debt	353.3	398.0	399.5	373.6	20.2	-24.4	-25.9	439.8	439.2	
vs. GDP	39.6%	47.0%	47.1%	43.9%	4.3%-pts	-3.1%-pts	-3.2%-pts	48.8%	48.1%	
vs. Revenue	226.4%	263.4%	263.1%	226.5%	0.2%-pts	-36.9%-pts	-36.6%-pts	285.6%	279.9%	

Source: NBF, Ontario

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