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Ontario budget aims to 'get it done' with June 2nd election looming

By Warren Lovely, Taylor Schleich & Daren King

Highlights

With Ontario's June 2nd general election barely a month away, the province's PC majority government presented a pro-growth budget Thursday. The budgetary trajectory is notably improved vs. Budget 2021, although more or less in line with more recent estimates from last fall. A shortfall of roughly $20 billion is projected for 2022-23 (1.9% of GDP), a larger deficit than that run in both 2020-21 and 2021-22. Still, two years have been shaved from the 'return to balance' timeline, which is now 2027-28 under baseline assumptions. In light of a vastly improved revenue picture, it's clear that the deficit could have come down faster. Ontario's independent budget watchdog recently argued as much. But the government is opting to use a share of the extraordinary revenue windfall to finance a series of new initiatives. While the budget is entitled a 'Plan to Build', new measures are consistent with the Ontario PCs 'Get It Done' theme for the June 2022 election, making the budget a de facto campaign platform for Team Doug Ford. While the budget lauds a domestic economy operating at a high level, the province is seen to be in need of longer-term vision for sustained growth. There was an ambitious infrastructure plan, action on a raging affordability crisis, alongside incremental funding to bolster health care capacity. Debt burdens and interest bites look more favourable/manageable vs. Budget 2021, and gross borrowing needs have receded materially relative to last year's plan. The long-term borrowing requirement for 2022-23 amounts to $41.5 billion, not far from the $41.1 billion issued last fiscal year and well removed from the pandemic's peak supply. As a reminder, official bond requirements do not incorporate prospective pre-funding, although budgetary prudence alongside the potential for final positive revisions to 2021-22 could ultimately lessen net financing needs. With the writ due to be dropped next week, there appears insufficient time to get this budget passed. So we'll likely be digesting a second Ontario 2022 budget after the vote. Whether it's a simple repeat of today's blueprint or an entirely new thrust is up to voters. In the meantime, look for Ontario to quickly return to debt capital markets, advancing its manageable bond program before another funding blackout period sets in just ahead of the vote.

- **Economic outlook** – Ontario's economy rebounded nicely in 2021, with real GDP increasing by 4.3% after a 5.1% decline the previous year and despite supply chain constraints that particularly affected the province's automotive sector. As a result, Ontario's real GDP in 2021:Q4 stood 0.9% above its pre-pandemic level (from 2019:Q4), a stronger recovery than in the country as a whole (+0.1%). As in other provinces, Ontario's nominal GDP recorded a significant gain, nominal output surging 12.0% in 2021 and clearly supporting a variety of government revenue streams. After losing 1.113 million jobs due to the pandemic, the province's labour market has fully recovered, registering a net gain of 228K jobs in March 2022 compared to February 2020. As a result, the unemployment rate has fallen from 13.2% at the worst of the crisis to 5.3%, a level similar to that before the pandemic. For 2022, the budget assumes real GDP growth of 3.7%, which is conservative compared to the average private sector forecast (4.1%) and NBF's current projection (3.9%). With the recovery now complete, real GDP is expected to grow less forcefully in subsequent years (3.1% in 2023, 2.0% in 2024 and 1.9% in 2025). As for nominal GDP, the budget projects growth of 6.7% in 2022, in line with our forecast but below the average of private sector forecasts. It should then grow by 5.1% in 2023, 4.2% in 2024 and 4.1% in 2025. Since the labour market has fully recovered from the pandemic, employment growth is also expected to moderate in the coming years, slowing from 3.9% in 2022 to 1.2% by 2025.
- **Prior year fiscal update (2021-22)** – Ontario's 2021-22 budget deficit is currently pegged at $13.5 billion (1.4% of GDP). That's more or less consistent with the deficit figure from a Q3 fiscal update presented in February. But it represents a very serious improvement vs. the older/original plan, as Budget 2021 had foreseen some $33 billion in red ink. While the magnitude of this fiscal enhancement is clearly striking, the general storyline was easy enough to follow: The domestic economy proved remarkably resilient, with jobs plentiful and nominal output bounding higher. That in turn led any number of revenue streams to flow thicker/faster than planned. In all, government revenue topped budget by almost $20 billion or 13%, whereas total spending exceeded plan by less than $1 billion. Given the buoyant economic/revenue conditions, a $1 billion reserve was obviously not needed and its release added to the budgetary improvement. We'd note that these are still 'interim' results. Any final revisions could both produce a revenue/spending base effect for 2022-23, simultaneously altering Ontario's start-of-year cash position and resulting financial requirement. So stay tuned for the annual Public Accounts, Volume 1 due to arrive this summer.
- **Current year fiscal outlook (2022-23)** – Ontario plans for a deficit of $19.9 billion in 2022-23, equivalent to 1.9% of GDP. While a larger shortfall than both 2020-21 and 2021-22, this year's budget target once again looks achievable/beatable to us, laden as it is with budgetary prudence (discussed below). Again, if comparisons to prior guidance are you're thing, the budgetary adjustment is clearly net positive vs. Budget 2021 (where the deficit was estimated at $27.7 billion) and essentially in line with November's FES (deficit estimated at $19.6 billion). Total revenue could expand 3.6% vs. the massively improved 2021-22 base, leaving total revenue running miles above the level telegraphed in last year's budget and even surpassing the more recent estimate in November's FES by a nice margin. Some 83% of this fiscal year's revenue pie is own source, with gains in personal income tax, sales tax, GBE net income and other non-tax revenue more than offsetting a give back in corporations tax (where the prior year was simply stellar). The feds are due to kick in the remaining 17% of revenue, amounting to $31 billion. For Ontario, the single largest transfer stream

relates to the Canada Health Transfer, where the total envelop grows in line with nominal GDP growth. Ontario does not qualify for Equalization.

- **Accelerated path to balance** – When it comes to the medium- and longer-term fiscal plan, progressively smaller deficits are still the name of the game. The deficit is set to fall to $12.3 billion in 2023-24, then on down to $7.6 billion by 2024-25. Revenues are meant to grow at an average annual rate of 4.3% over the coming three fiscal years. Base program spending is due to grow at a 5%-plus average annual rate over that same timeframe, but the expiration of time-limited COVID-related outlays will allow for year-over-year deficit reduction. Last spring, Ontario was thinking it might need until the end of the decade to return to balance. Fast forward to Budget 2022 and the deficit era looks as though it could be snapped two years sooner… by 2027-28, based on the latest projections. Truth be told, Ontario could have moved faster on the deficit. That was a key finding in a recent report from the province's independent budget overseer, the Financial Accountability Office or FAO. But as we detail below, Ontario has opted to steer some its revenue windfall to a series of new initiatives designed to (among other things) spur long-term growth, add needed infrastructure, redress affordability pressures and increase health care capacity. It's perhaps noteworthy that this budget falls barely a month before the next provincial general election, and there are plenty of proposed initiatives for voters to mull over. Even if the medium-term attack on the deficit isn't as forceful as serious fiscal hawks might have favoured, the cumulative budgetary improvement vs. Budget 2021 is nonetheless a whopping $94 billion for the full eight-year period inclusive of 2020-21 to 2027-28. Refer to the below table for details. That's clearly nothing to sneeze at and means considerably less debt to finance in what is now a higher interest rate environment.

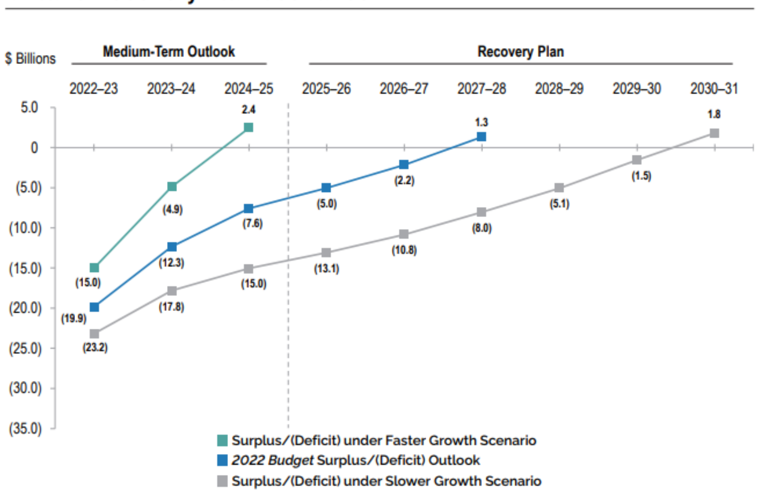
Table: Evolution of Ontario budget balance from Budget 2021 to Budget 2022 (C$bln)

Report (Date)	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Budget 2021 (Mar-21)	-38.5	-33.1	-27.7	-20.2	-17.2	-14.2	-11.2	-7.5	-3.6	**0.9**
Q1 (Aug-21)	-38.5	-32.4								
FES (Nov-21)	-16.4	-21.5	-19.6	-12.9						
Q3 (Feb-22)	-16.4	-13.1								
Budget 2022 (Apr-22)	-16.4	-13.5	-19.9	-12.3	-7.6	-5.0	-2.2	**1.3**	NA	NA
Chg: Bud22 vs Bud21	*22.1*	*19.6*	*7.9*	*7.9*	*9.6*	*9.2*	*9.0*	*8.8*	*NA*	*NA*
Cumulative improvement	*22.1*	*41.7*	*49.5*	*57.4*	*67.0*	*76.2*	*85.2*	*94.0*	*NA*	*NA*
Reference:										
FAO, excl reserve (Apr-22)	-16.4	-8.7	-1.7	1.2	3.4	5.0	7.1	NA	NA	NA

Source: NBF, Ontario, FAO | Note: Figures from budgets & other official fiscal updates include reserve; FAO budget balance projections do not include reserve

- **Alternative fiscal scenarios** – As is becoming customary, alternative scenarios were once again presented. A faster growth scenario, where nominal output expands by nearly 10% this year and tops the planning assumption by 0.5-0.8%-pts/year thereafter, implies the deficit could be erased by 2024-25. Conversely, a slower growth scenario would see deficit reduction not exactly stall, but clearly proceed at much slower rate, a balance budget not coming into focus until perhaps 2030-31.

Ontario Recovery Plan Scenarios



Source: Ontario Ministry of Finance.

- **Select investments/initiatives** – Last year's budget announced a litany of new spending/investment initiatives, largely focused on combatting the effects of COVID-19. While COVID-related spending is down in this fresh fiscal plan, there are still a number of new measures worth highlighting with plenty of dollar signs attached. An ambitious capital spending plan will receive most funding, but Ontario's five-pillared 'Plan to Build' offers much for Ontarians ahead of the coming provincial election:

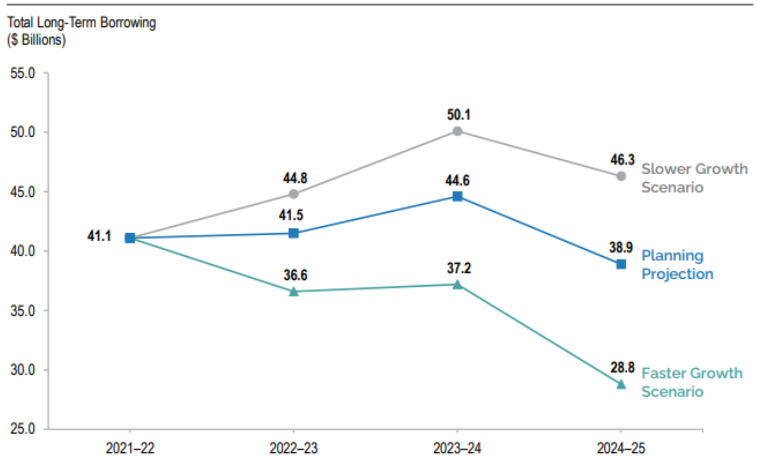
- **Rebuilding Ontario's Economy** – This includes supporting critical mineral extraction in Northern Ontario, creating 'good' manufacturing jobs, particularly in the automotive industry, and investing nearly $4 billion to support province-wide high-speed internet access.
- **Working for Workers** – Key initiatives here include increasing the general minimum wage to $15.50 on October 1st, as well as annual $1 billion investments in employment and training programs.
- **Building Highways and Key Infrastructure** – As part of "one of the most ambitious capital plans in the province's history" ($159 billion over the next 10 years, including $20 billion in 2022-23), the budget signals significant investment in highways, transit and other key infrastructure projects. More specifically, the province has allocated $25 billion for highway projects, $62 billion for public transit and $14 billion in capital grants to build/renew schools and childcare facilities over the next ten years.
- **Keeping Costs Down** – With rising living costs set to be top of mind for voters in June, the budget puts a clear focus on making life more affordable. The budget incorporates/highlights a number of recently announced measures including the refunding/elimination of licence plate renewal fees (costing $1.1 billion in 2022-23) and the 5.7 cent/litre gas tax cut (for six months beginning July 1st at a cost of $645 million). Additionally, the budget proposes to provide additional personal income tax relief for 1.1 million low-income Ontarians (worth $300 per eligible taxpayer, on average). Here, you'll also find reference to the $13.2 billion agreement with the federal government to work towards $10-a-day childcare by 2025. Finally, the government aims to implement a long-term plan to address the housing crisis, including speeding up approvals, prioritizing Ontario homebuyers over foreign speculators and cracking down on unethical developers.
- **A Plan to Stay Open** – Despite the government rolling back COVID restrictions, health care remains a key pillar of the province's spending/investment plans. More than $40 billion over the next 10 years has been allocated to building/improving hospitals (an increase of $10 billion from the government's planned investments laid out last year). Expanding Ontario's health care workforce is a stated priority and the budget earmarks close to a billion dollars in retention bonuses for nurses.

- **Contingencies/prudence & official sensitivities** – Consistent with past practice, the budget incorporates meaningful prudence across a few dimensions. First, there's the sub-consensus forecasts for real GDP growth in 2022 and beyond. For the current fiscal year (2022-23), a reserve of $1 billion has been set aside. Reserves of $1.5 billion/year are included in the outer years of the fiscal plan. There's another important buffer in the form of a standard (i.e., non-COVID) contingency fund, set at $4.6 billion for 2022-23 and increasing thereafter. There's a further $6.9 billion in time-limited COVID-19 funding/extraordinary contingencies for 2022-23. All told, we consider this significant prudence outright and also by provincial standards. To be treated with caution, official fiscal sensitivity analysis suggests a 1%-pt 'surprise' on nominal GDP growth is worth $850 million in taxation revenue/year (all else equal). If there's one area where budget planning assumptions might be more immediately off the mark, it's on interest rates. The budget assumes 10-year Canadas average 2.0% in calendar 2022, a forecast that looks too light at present. Ontario is not alone here, as the rapid onset of rate hikes and the resulting selloff in bond markets have combined to push many budgetary forecasts for interest rate offside. In terms of related sensitivities, it's believed that a 1%-pt parallel shift up in Ontario borrowing rates adds over $700 million to the interest bill in year one.

- **Debt burden & interest bite** – Ontario's net debt is estimated to have ended 2021-22 at just under $395 billion, equivalent to 40.7% of GDP. This is considerably less leverage than originally planned, the debt-to-GDP ratio landing some 8%-pts south of the level assumed in Budget 2021. In light of the sustained improvement to the budget balance trajectory, net debt will remain at lower levels than what was foreseen last year. For example, net debt is now due to end 2022-23 at $429 billion vs. the $476 billion level forecast last March. Factor in anticipated growth in nominal GDP and there should be little to no growth in the debt burden (beyond a small uptick to 41.4% in 2022-23). Overall, this is welcome news for a relatively high-debt jurisdiction. Ontario's debt reduction strategy recalibrates the target for debt-to-GDP (to <42% vs. <50.5% in Budget 2021). Net debt-to-revenue is set to rise over the next two years (from 228% in 2021-22 to 239% in 2023-24) but should fall thereafter, all the while remaining comfortably below 250% (a specific target introduced in Budget 2022). Turning to interest charges, it's fair to say that Ontario's debt burden remains affordable despite the aforementioned increase in interest rates. Ontario's interest on debt (IOD) amounted to $13 billion last fiscal year and can be expected to grow at a 4.7% average annual rate over the coming three fiscal years. Still, when scaled to revenue, the interest bite is not particularly punishing, remaining effectively unchanged from 2021-22 at ~7.5% over the fiscal forecast horizon. Though rising rates and widening credit spreads could pose a risk over the medium term, it's expected that the IOD-to-revenue ratio will in all cases hold below the level observed in the wake of the Global Financial Crisis, with Budget 2022 introducing a fresh target of <8%. As we've consistently noted, Ontario and most other provincial debt issues have for many years favoured a relatively longer-term bond issuance strategy. The result is a smaller share of the debt portfolio due to roll over near-term, certainly relative to the federal government. In this way, Ontario has insulated against significant/immediate interest rate reset risk. As one final debt sustainability target, Ontario aims to limit the ratio of maturities-to-net debt at less than 10%. There's currently a nice buffer relative to this new limit, debt maturities-to-net debt estimated at 7.1% for 2022-23.

- **Long-term borrowing requirement** – Ontario issued $41.1 billion in gross long-term debt in 2021-22, a figure that ultimately fell well below the $54.7 billion program telegraphed in Budget 2021. The province was also able to entirely forgo a planned $6 billion increase in short-term outstandings. Last year's funding split saw 78% raised domestically, coming in near the upper end of a 65-80% target range. Meanwhile, the weighted average term of issuance extended to 14.5 years, matching a post-GFC high. It should be noted that last fiscal year's completed issuance included over $10 billion in pre-funding, which gets netted off the gross requirement for the current 2022-23 fiscal year. The result is a $41.5 billion long-term borrowing requirement for the fiscal year that kicked off April 1st. While effectively on par with the prior fiscal year's issuance pace, this year's bond requirement falls (well) short of prior guidance. Recall: Budget 2021 had estimated nearly $60 billion in gross issuance for 2022-23, with that figure chopped down to $45 billion come November's FES. We'd note that Ontario's official requirement does not embed pre-funding towards 2023-24, where a notionally larger requirement awaits ($44.6 billion). Assuming Ontario opts to pre-fund a portion of that amount (a reasonable assumption in our view), this fiscal year's borrowing activity could potentially exceed the level flagged in budget. Leaning the other way, however, is ample budgetary prudence and the potential scope for positive final cash adjustments related to 2021-22, which could ultimately mean a smaller underlying financing requirement. Lots of moving pieces then, but the punch line is that Ontario's net fiscal improvement has been reflected in a smaller-than-expected debt stock and lighter gross borrowing needs vis-a-vis prior guidance. As for borrowing strategy, the province has reiterated a 65-80% target for the domestic share. The budget highlights the beneficial impact of having earlier extended term, as it relates to protecting against higher interest rates. Today's higher borrowing rates will be closely monitored, with abundant flexibility to adjust term as is necessary. On Greens, an update to the Green Bond Framework is being considered, allowing for greater alignment with international standards and potentially allowing for an expansion into sustainable issuance. In the meantime, Ontario's leadership in the Green Bond market will continue to be reinforced via multiple offerings each fiscal year (including again in 2022-23). Ontario has so far conducted 11 Green Bond offerings, with $12 billion currently outstanding. Separately, Ontario has considerable untapped potential in short-term markets, with the funding program anticipated a cumulative increase of $6 billion over the next two fiscal years. Average unrestricted liquid reserves amounted to $47 billion as of March 2022, these cash reserves having been built up as a precautionary measure, given larger anticipated cash outflows during the pandemic. In short, there's ample liquidity and clear/demonstrated access to debt capital markets at home and abroad for what is one of the largest sub-national public sector issuers on the planet.

Borrowing Outlook Scenarios for Long-Term Borrowing



Sources: Ontario Financing Authority and Ontario Ministry of Finance.

- **Current long-term credit ratings** — S&P: A+, Stable | Moody's: Aa3, Stable | DBRS: AA(Low), Stable | Fitch: AA-, Stable
[Refer to our Provincial Ratings Snapshot for additional colour on specific credit rating drivers/considerations]

- **A final word on process** — Don't confuse us with party whips, but a quick glance at the legislative calendar implies this budget will not be passed before the June 2nd election. Indeed, the provincial legislature is due to be dissolved next week, in order to provide the requisite amount of time for campaigning. So this budget likely won't get much further than first reading. That means we'll most likely need a second attempt at a 2022 budget following the vote. Students of history may recall Ontario's 2014 electoral episode, when a then-Liberal government tabled a budget in early May, immediately requested dissolution, secured re-election in June and went on to re-table essentially the same budget document in July. Can we expect a replay? That's for voters to determine.

Ontario

$ billions	Budget 2021-2022	Forecast 2021-2022	Budget 2022-2023	Target 2023-2024	Target 2024-2025
Revenue	**154.0**	**173.6**	**179.8**	**188.2**	**196.9**
Taxation Revenue	104.8	124.2	126.4	133.2	139.1
Personal Income Tax	36.4	42.3	44.6	47.0	49.6
Sales Tax	27.6	30.4	32.3	34.2	35.7
Corporations Tax	14.4	22.2	19.7	20.4	21.1
Education Property Tax	5.8	5.7	5.7	5.6	5.6
Ontario Health Premium	4.1	4.5	4.7	4.9	5.1
Other	16.6	19.1	19.4	21.0	21.9
Federal Transfers	27.4	29.7	31.0	31.8	33.4
Income from Government Business Enterprises	4.5	5.6	6.3	6.7	7.5
Other non-tax revenue	17.2	14.1	16.1	16.5	16.9
Expenses	**186.1**	**187.1**	**198.6**	**199.1**	**203.0**
Program Spending	173.0	174.1	185.2	184.8	188.1
Interest on Debt	13.1	13.0	13.5	14.3	14.9
Reserve	**1.0**	**-**	**1.0**	**1.5**	**1.5**
Surplus (Deficit)	**(33.1)**	**(13.5)**	**(19.9)**	**(12.3)**	**(7.6)**
As a % of GDP	-3.7%	-1.4%	-1.9%	-1.1%	-0.7%
Net Debt	**439.8**	**394.9**	**428.7**	**450.4**	**468.8**
As a % of GDP	48.8	40.7	41.4	41.4	41.3
Accumulated Deficit	**297.3**	**252.8**	**276.4**	**288.7**	**296.3**
As a % of GDP	33.0	26.0	26.7	26.5	26.1
Interest on debt as a % of revenue	**8.5%**	**7.5%**	**7.5%**	**7.6%**	**7.5%**

Total Borrowing Requirement		**43.1**	**54.7**	**47.6**	**38.9**
of which: Long-Term Public Borrowing		41.1	41.5	44.6	388.9
(Surplus) Deficit		13.5	19.9	12.3	7.6
Maturities/Redemptions		25.0	30.5	31.2	27.8
Investment in Capital Assets		12.9	13.4	13.6	14.8
Pre-borrowing in 2020-2021		(16.2)	-	-	-
Pre-borrowing for 2022-2023		10.3	(10.3)	-	-
Other		(2.4)	1.2	(9.6)	(11.4)

Source: April 2022 Ontario Budget

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