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Ontario's pre-budget calibration

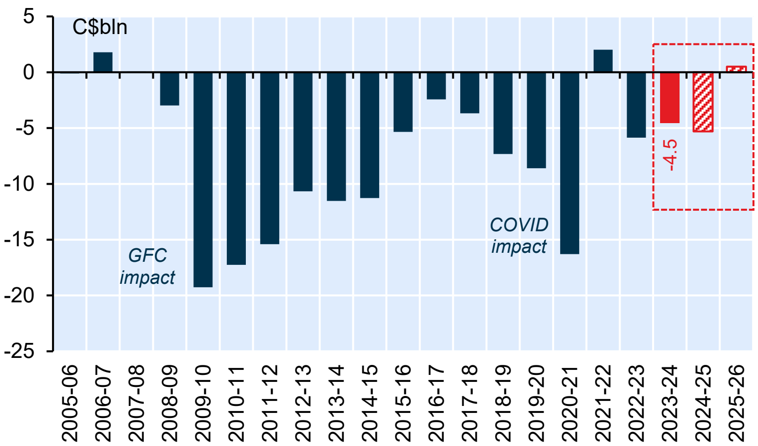
By Warren Lovely

Sometime before the end of March, Ontario will table its 2024 budget. In the lead up to this all-important, multi-year fiscal blueprint, the province offered a Q3 update, adjusting the revenue and spending base for the outgoing fiscal year (2023-24).

At the margin, Ontario's budgetary position has improved vs. November's comprehensive economic statement. A deficit of $4.5 billion is now estimated, equivalent to 0.4% of GDP or 2.2% of total revenue. Recall: The estimated budgetary shortfall was widened to $5.6 billion in November's FES, Ontario's 2023 budget having originally planned for $1.3 billion in red ink.

Chart 1: Putting Ontario's deficit in historical perspective…

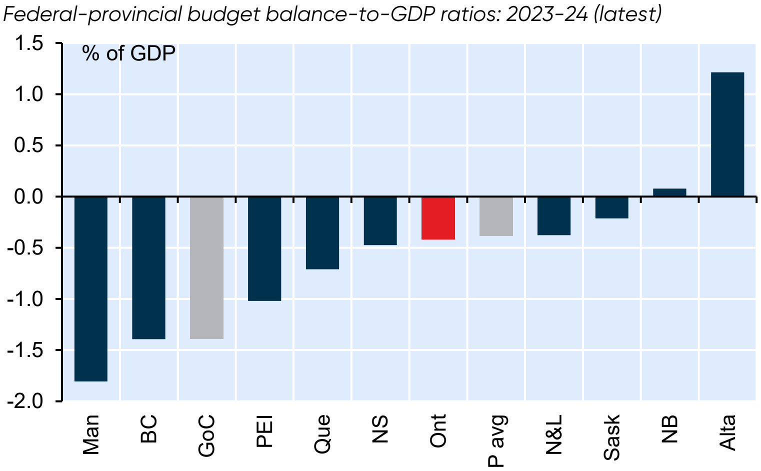
Ontario budget balance



Source: NBF, Ont | Note: 2023-24 as per Q3; future years as per Nov-23 FES

Chart 2: … and relative to where other governments stand

Federal-provincial budget balance-to-GDP ratios: 2023-24 (latest)



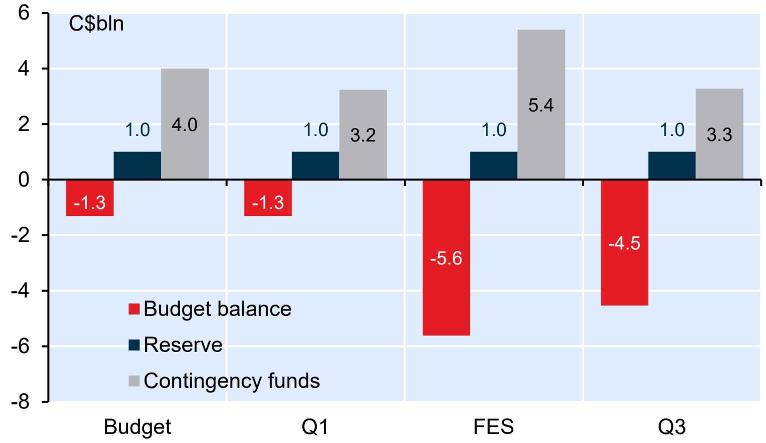
Source: NBF, fed-prov govt's | Note: Latest official balances vs NBF GDP estimates

We consider the 2023-24 deficit relatively modest from an historical and cross-sectional perspective. Ontario's deficit all but matches the weighted provincial average, with eight of ten provinces and the feds currently projecting budgetary shortfalls for the outgoing fiscal year.

Nor is this the final word on Ontario's 2023-24 deficit, the public accounts providing a final true-up later in the year. We would note the non-trivial prudence still built into the latest deficit tally. That includes a $1 billion reserve. After controlling for a post-FES drawdown of some $2.1 billion, available contingency funds still total $3.3 billion. All else equal, this residual padding provides an offset to any prospective late-fiscal year spending pressures. And if ultimately unneeded, unallocated reserves/contingencies could create scope for further budgetary improvement, perhaps moving the deficit even closer to the original target set out in Budget 2023.

Chart 3: Residual padding in 2023-24 budget estimate

Evolution of Ontario budget balance, reserve & contingencies: 2023-24



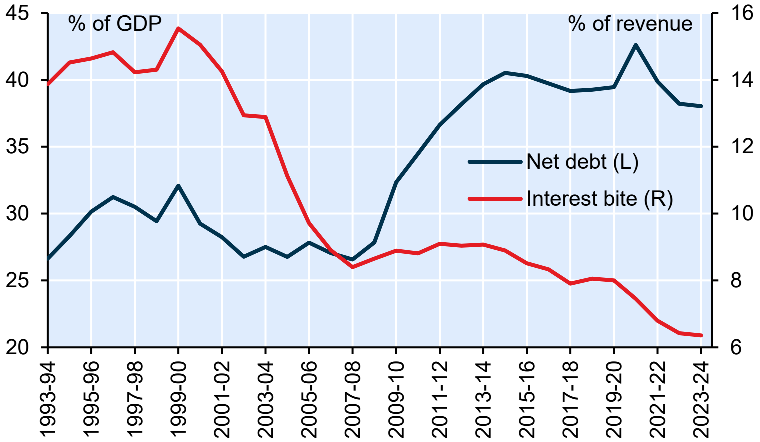
Source: NBF, Ont | Note: As per Q3, contingency is $3.215bln operating & $57mln capital

The $1.1 billion net budgetary improvement vs. November's FES captures a somewhat brighter own-source revenue picture. Specifically, upgrades to personal income tax and sales tax revenue offset a markdown in corporate income tax receipts. Overall, there was more GDP growth in 2023 than the consensus previously estimated. Notwithstanding a modest downgrade to the 2024 growth outlook, the provincial economy is displaying an important degree of resilience in the face of restrictive monetary policy settings in Canada and in Ontario's largest trading partner (the U.S.).

A lighter interest bill is also helping. At $12.9 billion, Ontario's interest on debt (IOD) expense now stands $1.2 billion below the original budget plan for 2023-24. The latest bit of relief (vs. FES) reflects a lower interest rate forecast. And while the debt burden is hardly minimal, give Ontario (and the provincial sector more generally) credit for insulating against big swings in debt charges by locking in more debt for longer. In Ontario's case, an interest bite equivalent to 6.4 cents on the revenue dollar looks to set a fresh low in 2023-24. That stands in noted contrast to the rapid expansion in the federal interest bill, Ottawa now allocating 10% of federal revenue to debt servicing.

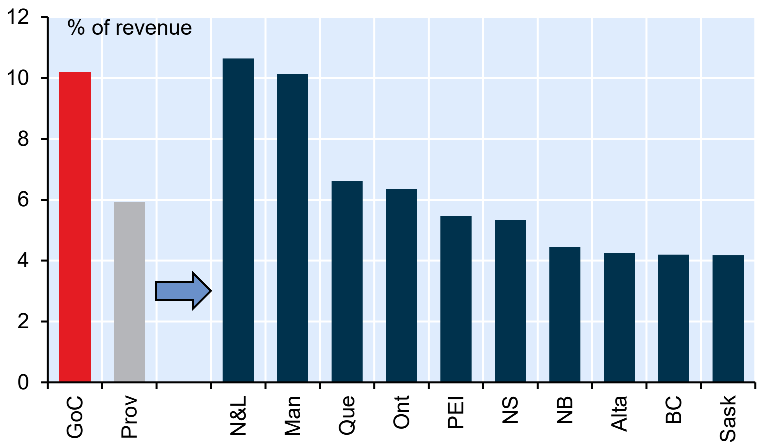
It is likewise worth highlighting the rather 'direct drive' when it comes to changes in Ontario's budget balance and corresponding adjustments in funding needs. Case in point, Q3's $1.1 billion net budgetary improvement is reflected, essentially dollar-for-dollar, in a lower long-term borrowing requirement. That was also the case back when the FES dropped, even if the adjustments were, at that time, going the other way (i.e., larger deficits = more borrowing).

Chart 4: Debt yes, but interest burden well managed
Ontario net debt burden & 'interest bite' (i.e., interest on debt vs. revenue)



Source: NBF, Ont, StatCan | Note: 2023-24 as per Q3

Chart 5: Bigger interest bite at federal level these days
Federal-provincial consolidated 'interest bite': 2023-24 (latest)



Source: NBF, fed-prov gov'ts | Note: Consolidated debt servicing charges relative to total revenue, as per latest official updates; Ontario as per Q3 update

When it comes to funding, the borrowing authority has Ontario quite nicely positioned. The province has thus far sourced the equivalent of $38.6 billion from debt capital markets. That's against the now-downwardly revised $33.6 billion long-term requirement, implying fully 5 yards of pre-funding has already been completed with time yet on the clock. At this point, 85% of 2023-24's gross bond supply has been secured domestically. Further reinforcing the 'locking-in-for-longer' narrative, the 15.2-year weighted average term of completed financings is longer than at any time in the post-GFC crisis.

Appropriately in our view, Ontario will continue to closely monitor markets with a view to securing additional term funding before shutting things down for Budget 2024. That is meant to include another labeled bond offering, issued pursuant to the province's fresh Sustainable Bond Framework. The updated framework broadens the range of eligible projects. In addition to a variety of potential green projects (e.g., clean transportation, clean energy, green buildings, etc.), an array of social projects could also now qualify, including affordable housing and access to essential healthcare, education and childcare (among other items). For additional information on Ontario sustainable bonds, we'd refer you to the official site.

Whether in labeled or conventional format, issued domestically or internationally, Ontario's proactive funding model means a nifty chunk of 2024-25's bond requirement—previously estimated at $37.4 billion—will have been successfully pre-funded in fiscal 2023-24. That, along with sizeable liquid reserves, affords Ontario an important degree flexibility in what is likely to remain a volatile/uncertain economic and financial environment.

Overall, Ontario's Q3 report outlines a modestly enhanced budget base as the 2024 budget comes into focus. A relatively modest deficit has been marked down and there's still notable padding in the 2023-24 deficit estimate. Debt remains affordable, the interest bill having been very effectively managed. The outgoing fiscal year's borrowing requirement has followed the deficit lower, while a meaningful (and still growing) amount of pre-funding will create flexibility on a go-forward basis. It's all mildly encouraging for a province still on 'positive' outlook at three of four major credit rating agencies (S&P, Moody's, DBRS), even if underlying spending pressures (including an enlarged public sector wage bill) and economic risks remain.

Note: We'd refer you to our *Provincial Ratings Snapshot* for credit rating agency colour/context, which is available to interested readers. Separately, the independent Financial Accountability Office of Ontario (FAO) was just out with a detailed economic and budget outlook. The FAO's latest report can be accessed here.

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