

May 31, 2017

The FAO's Spring 2017 Economic and Fiscal Outlook Statement by the Financial Accountability Officer

Good morning.

Today I provided to the Speaker, for tabling, the Financial Accountability Offices' Spring 2017 Economic and Fiscal Outlook for the Province of Ontario.

The report provides the FAO's current economic forecast and an assessment of the Province's fiscal outlook, incorporating information from the 2017 Ontario Budget.

Based on our analysis, the FAO is projecting continued Ontario budget deficits over the next five years.

For the current fiscal year, we are projecting an improvement in the deficit, the result of strong tax revenue growth and a one-time boost in non-tax revenue. But beginning next year, the FAO projects a steady deterioration in Ontario's budget deficits due to moderating revenue growth combined with higher expenses.

The Economic Outlook

Let me begin with the FAO's economic outlook – which provides the foundation for our fiscal projections.

The Ontario economy outperformed expectations in 2016, with real GDP growing 2.7 per cent and nominal GDP – the broadest measure of the government's tax base – rising 4.6 per cent. Last year marked the third consecutive year of solid economic growth for Ontario.

The FAO expects the economy's momentum to continue into 2017, with real GDP forecast to rise by 2.4 per cent. Consistent with the consensus outlook of private sector economists, we anticipate Ontario's economic growth will moderate slightly over the next four years, with average annual gains of 2.0 per cent.

But, there are risks to the economic forecast. In particular, the policy direction in the U.S. remains uncertain. This uncertainty could deter Ontario business investment, hurting the province's economic prospects. Domestically, Ontario's surging housing market continues to be a major concern. A sharp correction in housing prices could reverberate beyond the housing market and lead to broader, economy-wide impacts.

The Fiscal Outlook

The FAO's forecast for continued strong growth in the economy is a key input into our projection for government revenues.

For 2017-18 – the year the government has committed to balancing the budget – strong economic growth will lift tax revenues. But the budget will also benefit from a \$3.0 billion boost in one-time non-tax revenues this year. These temporary revenues include an increase in federal transfers for infrastructure, additional sales of public assets -- including the recent sale of Hydro One equity -- and additional, one-time cap and trade proceeds.

However beginning next year, the growth in tax revenues is projected to moderate while the boost from one-time non-tax revenues will end. Also, as a result of the continued relative strength of Ontario's economy, the Province will no longer be eligible for Equalization payments from the federal government, beginning in 2019-20.

On the expense side of the ledger, the FAO projection includes program spending growth of 3.3 per cent per year over the outlook.

The program spending outlook is based on the government's 2017 Budget and includes significant new spending across all sectors, including the new children and youth Pharmacare program, higher operating funding for hospitals, 24,000 new child care spaces, and the government's new 'Fair Hydro Plan'. As a result, spending is now forecast to be significantly higher than projected in the FAO's fall outlook.

Combining the revenue and expense projections provides the FAO's outlook for Ontario's budget balance.

In this report, we have presented two projections for the budget balance -- both including and excluding the impact of pension assets from the government's two jointly sponsored pension plans.

These two projections for the budget balance reflect the disagreement between the government and the Office of the Auditor General on the application of government accounting standards for these pension plans.

By presenting the budget balance under both accounting treatments, the FAO's intention is to help members of the Legislative Assembly better understand the implications of these different accounting interpretations on the Province's fiscal position.

Based on the Auditor General's recommended accounting treatment for these pension assets, the FAO is projecting significant budget deficits over the entire outlook. On this basis, it is unlikely that the government will balance the budget without significant fiscal policy adjustments to raise revenue or lower expense.

Under the government's accounting presentation, the FAO projects that a balanced budget is within reach in 2017-18 -- in part because of the significant one-time revenues that I described earlier. Beyond 2017-18, the deficit is projected to deteriorate steadily due to rising expenses and slower revenue growth. On the government's accounting basis, staying in balance after 2017-18 will also likely require additional fiscal policy measures.

It is also important to recognize that under the government's accounting presentation, the Province would be expected to receive a qualified opinion from the Auditor General's review of the 2016-17 Public Accounts.

Debt

Based on the Auditor General's recommended accounting presentation, the FAO is projecting Ontario's net debt will increase by \$76 billion over the next five years to more than \$390 billion. On this basis, Ontario's net debt-to-GDP ratio will edge higher to 40.3 per cent by 2021-22.

By comparison, based on the government's accounting presentation, the FAO projects Ontario's net debt will increase by \$62 billion to \$365 billion by 2021-22. Using the government's accounting presentation, the FAO projects the net debt-to-GDP ratio will edge down slightly to 37.5 per cent by 2021-22.

In the 2017 Budget, the government set an interim debt-to-GDP target of 35 per cent by 2023-24 and committed to lowering the ratio to 27 per cent by 2029-30.

Given the FAO's projection of rising deficits and the government's planned infrastructure investments, achieving these debt targets will likely require significant additional fiscal measures under either accounting presentation.

Summary

This is the FAO's fourth, bi-annual report on Ontario's economic and fiscal outlook. In the past two reports, I have concluded that the government is likely to achieve its goal of a balanced budget in 2017-18. However, those reports have also concluded that maintaining a balanced budget over the outlook will require additional fiscal adjustments to raise revenue or restrain expense growth.

Those conclusions have not changed with today's report. Based on the government's accounting presentation, balancing the budget this year is within the government's reach. However, balancing the budget this year also relies on a \$3 billion one-time boost in non-tax revenues – a boost which includes additional sales of public assets.

Going forward, our analysis shows that maintaining a balanced budget – under either the Auditor General's recommended accounting treatment or the government's own accounting presentation – will require additional fiscal adjustments.

In short, the government has more work to do if it intends to set the Province's finances on a course for balanced budgets in the years to come.

Thank you.

I am happy to take questions.

-- Check Against Delivery --

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