Credit Rating Agencies Satisfied with Ontario's Progress to Fiscal Balance

Ontario's debt is rated by four principal international credit rating agencies[1], which typically publish an annual update of their view of the Province's finances and the quality of Ontario's debt based on the budget and other financial statements. This note provides a summary of Ontario's current credit ratings as well as some general background on the significance and implications of credit ratings.

Following the tabling of Ontario's 2016 Budget, each of the four rating agencies affirmed their current rating of Ontario's debt. While S&P, DBRS and Fitch maintained a stable outlook on the Province's rating, Moody's revised its outlook back to stable from negative. A "stable" outlook indicates that each of the agencies believes that Ontario's rating is unlikely to change over the next two years.

Ontario's 2016 Credit Ratings*

S&P	DBRS	Fitch	Moody's
A+	AA-	AA-	AA
(5th highest rating)	(4th highest rating)	(4th highest rating)	(3rd highest rating)

Source: S&P, DBRS, Fitch and Moody's

* Based on a standardized scale that includes 10 levels for investment grade debt. See Appendix for each agency's rating scale.

Prior to the 2008-2009 recession, Ontario maintained a 'double A' credit rating from three of the four rating agencies, with Moody's rating Ontario one level higher at AA+. Following the 2008-09 recession, Ontario's financial results deteriorated with large budgetary deficits and a sharp increase in its debt burden. As a result, all four rating agencies downgraded Ontario's credit rating with DBRS and Fitch dropping Ontario's rating by one level from AA to AA- and Moody's from AA+ to AA. S&P downgraded Ontario's credit on two separate occasions -- from AA to AA- in 2009 and by a further level to A+ in 2015.[2]

The agencies' affirmation of Ontario's credit rating following the 2016 budget indicates that they believe the Province has taken adequate steps on both revenues and expenditures to achieve its plan to restore fiscal balance by 2017-18. In addition, while each agency's rating methodology differs slightly, they all believe that Ontario's debt burden (both as a percent of GDP and revenues) has likely peaked and would be expected to decline modestly over the next three fiscal years.

This consensus view of the rating agencies is consistent with the FAO's own analysis published in the *Spring 2016 Economic and Fiscal Outlook*, which concluded that the Province should be able to achieve fiscal balance in 2017-18 and that Ontario's debt-to-GDP ratio would decline modestly over the next five years.

Rating Agencies Anticipate Fiscal Challenges for Ontario Beyond 2017-18

Beyond 2017-18, the rating agencies generally assume that the Province will maintain fiscal balance based on its ability to restrain expenditure growth and increase revenues as required. Even so, the agencies all expect that the Province will be "challenged" to maintain expenditure restraint indefinitely, given mounting spending pressures. In fact, S&P

[1] The principal international credit rating agencies are Moody's Investors Service (Moody's), S&P Global Ratings (S&P), DBRS Limited (DBRS) and Fitch Ratings (Fitch).

[2] This was the first time that S&P's credit rating for Ontario dropped below the 'double A' (or AA) category.

anticipates that the Province will post moderate deficits (on an adjusted basis[3]) beginning in 2018-19, that will persist over the forecast horizon, largely as a result of the Province's large infrastructure investment plans.

Debt Burden Remains a Key Weakness for Ontario's Credit Rating Outlook

In addition to the challenges of maintaining fiscal balance, the agencies continue to emphasize that the Province's relatively high debt burden compared to other provinces and international peers, remains a key weakness for Ontario's credit outlook. Indeed, Ontario's relatively high debt burden was an important determinant behind both Fitch and S&P's decision to downgrade the Province's credit rating in December 2014 and July 2015.

If Ontario's fiscal balance were to return to deficit beyond 2017-18, either through an easing of expenditure management restraint or through unexpected weakness in revenues (as a result of slower than expected economic growth), the agencies would be expected to revise Ontario's credit outlook to negative followed by a potential credit rating downgrade. A credit rating downgrade could lead to higher borrowing costs for Ontario and a more difficult fiscal position.

Ontario's Credit Quality Remains High

Despite Ontario's fiscal challenges, the Province's credit rating remains relatively high compared with other Canadian provinces. The rating agencies view Ontario's credit quality as being supported by a number of key credit strengths including a large and well-diversified economy, a strong record of prudent financial management and the high degree of fiscal flexibility inherent in Canada's federal-provincial framework. In general, Ontario's credit rating is comparable to those of Manitoba and Quebec, but lower than Saskatchewan or British Columbia.

Provincial Credit Ratings, 2016

Province	S&P	DBRS	Moody's	Fitch
Alberta	AA (negative)	AA (high, stable)	Aa1 (negative)	
British Columbia	AAA (stable)	AA (high, stable)	Aaa (stable)	AAA (stable)
Saskatchewan	AA+ (negative)	AA (Stable)	Aaa (stable)	AA (stable)
Manitoba	AA- (Negative)	A (high, stable)	Aa2 (stable)	
Ontario	A+ (stable)	AA (low, stable)	Aa2 (stable)	AA- (stable)
Quebec	A+ (positive)	A (high, stable)	Aa2 (stable)	AA- (stable)
New Brunswick	A+ (stable)	A (high, stable)	Aa2 (stable)	
Nova Scotia	A+ (stable)	A (high, Stable)	Aa2 (stable)	
Newfoundland	A (negative)	A (low, stable)	Aa3 (negative)	
Prince Edward Island	A (stable)	A (low, stable)	Aa2 (stable)	

Source: TD Securities and updated by the FAO

[3] Ratings agencies typically make adjustments to the Province's reported fiscal balance to recognize capital expenditures as incurred rather than as amortized.

Background on Rating Agencies

Credit rating agencies are private, for-profit companies which assign a credit rating to the debt of governments or corporations based on the borrower's ability to repay the debt as well as make timely interest payments.

Credit ratings represent an independent opinion on the ability of an individual corporation or government to meet all financial obligations on a timely basis. A credit rating is a relative measure of the probability of default by a government or corporation, based on forecasts of economic and financial variables and an assessment of future developments and risks.

Rating agencies typically also assign "outlooks" to credit ratings. The outlook of a credit rating indicates the likely direction of a borrower's credit rating over the next two years. An outlook can either be stable, negative or positive. A stable outlook indicates that the borrower's rating, all else equal, is unlikely to change in the short term, while a negative or positive outlook indicates that the rating is likely to be lowered or raised over the same period. A change in a credit rating outlook does not necessarily indicate a change in the current credit rating.

Credit Ratings Are an Important Determinant of the Cost of Borrowing

Credit ratings are used by investors to assess the risk of default of a particular borrower, which is used to determine the incremental cost ("credit spread") for a borrower. This credit spread is reflected in the interest rate paid by borrowers, such as Ontario. Generally, all else equal, higher credit ratings result in lower borrowing costs, while lower ratings typically lead to higher borrowing costs.

Debt issuers (governments and corporations) are charged a fee by credit rating agencies to issue a credit rating while investors (purchasers of debt) also pay a fee to access credit reports. The critical importance of an agency's reputation ensures that credit rating agencies strive to provide unbiased and accurate assessments of credit risk.

Appendix

Ratings Agency Translation Matrix

Rating Description	Credit Quality	S&P	DBRS	Moody's	Fitch
		Long Term	Long Term	Long Term	Long Term
Investment-grade	Extremely Strong	AAA	AAA	Aaa	AAA
		AA+	AA (high)	Aa1	AA+
		AA	AA	Aa2	AA
		AA-	AA (low)	Aa3	AA-
	Very Strong	A+	A (high)	A1	A+
		A	A	A2	A
		A-	A (low)	A3	A-
	Strong	BBB+	BBB (high)	Baa1	BBB+
		BBB	BBB	Baa2	BBB
		BBB-	BBB (low)	Baa3	BBB-
Non Investment-grade	Speculative	BB+	BB (high)	Ba1	BB+
		BB	BB	Ba2	BB
		BB-	BB (low)	Ba3	BB-

		B+	B (high)	B1	B+
		B	B	B2	B
		B-	B (low)	B3	B-
		CCC	CCC	Caa	CCC

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