



Financial
Accountability
Office of Ontario

ECONOMIC AND BUDGET OUTLOOK

ASSESSING ONTARIO'S MEDIUM-TERM BUDGET PLAN

Fall 2019

About this document

Established by the *Financial Accountability Officer Act, 2013*, the Financial Accountability Office (FAO) provides independent analysis on the state of the province's finances, trends in the provincial economy and related matters important to the Legislative Assembly of Ontario.

The FAO's Economic and Budget Outlook (EBO) reports are released each spring and fall, providing an assessment of the province's medium-term economic performance and fiscal position.

This report was prepared by Jay Park, Zohra Jamasi, Edward Crummey, Paul Lewis, Sabrina Afroz and Laura Irish, under the direction of David West. External reviewers were provided with earlier drafts of this report for their comments. However, the input of external reviewers implies no responsibility for this final report, which rests solely with the FAO.

The content of this report is based on information available to November 29, 2019. Background data used in this report are available upon request.

In keeping with the FAO's mandate to provide the Legislative Assembly of Ontario with independent economic and financial analysis, this report makes no policy recommendations.

FAO's Fiscal Projections

The FAO forecasts provincial finances based on projections of existing and announced revenue and spending policies. The FAO's tax revenue projections are based on an assessment of the outlook for the provincial economy and current tax policies. Given the government's discretion over spending, the FAO adopts the government's announced spending plans from fiscal documents and incorporates policy announcements as appropriate. All average annual growth rates in this report are calculated using the year before the first indicated year as the base.

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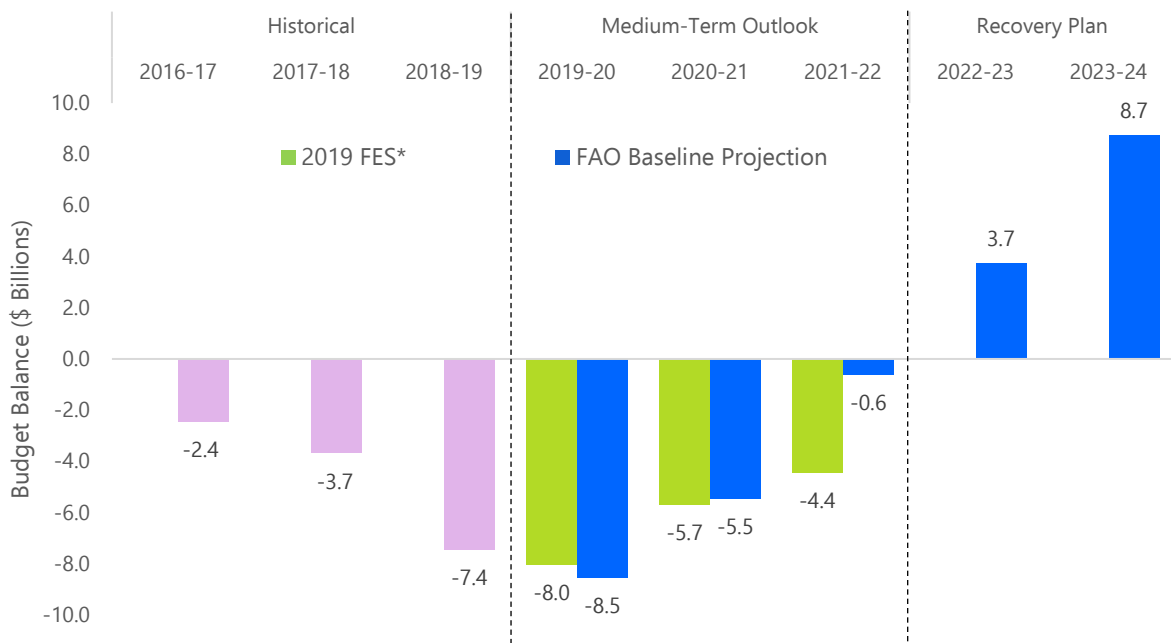
1 | Executive Summary

Ontario's economy grew at a solid pace over the past five years, with real GDP rising by 2.4 per cent per year on average. However, ongoing global uncertainty, a moderating US economy and rising interest rates are expected to slow Ontario's economic growth over the next five years, with real GDP projected to increase at an average annual pace of 1.7 per cent during 2019 to 2023.

Softer economic growth coupled with recent policy changes will slow revenue growth to just 0.8 per cent in 2019-20, the slowest gain since the 2008-09 recession. Despite significant spending restraint by the government, the FAO projects that slower revenue growth will increase Ontario's budget deficit to \$8.5 billion in 2019-20, up from \$7.4 billion last year, marking the third consecutive year of higher deficits.

Over the next four years (2020-21 through 2023-24), the FAO projects average annual revenue growth of 3.7 per cent. The FAO's baseline projection also adopts the government's spending plan,¹ which limits program spending increases to 1.4 per cent per year on average.² On this basis, the FAO projects a rapid improvement in Ontario's fiscal position, with an almost balanced budget in 2021-22 and a large \$8.7 billion surplus by 2023-24. This dramatic improvement in the budget balance is driven primarily by the government's plan to significantly limit program spending.

FAO projects a balanced budget in two years, excluding unannounced policies



Source: Ontario Public Accounts, 2019 Ontario Economic Outlook and Fiscal Review and FAO.

* Budget balance is presented before the reserve.

¹ The government's spending plan is based on updated program spending by sector from the "2019 Ontario Economic Outlook and Fiscal Review" (referred to as the Fall Economic Statement or FES) combined with program spending growth assumed in the 2019 Ontario Budget for 2022-23 and 2023-24.

² The FAO's baseline projection also excludes any unannounced revenue or spending measures included in the government's fiscal plan.

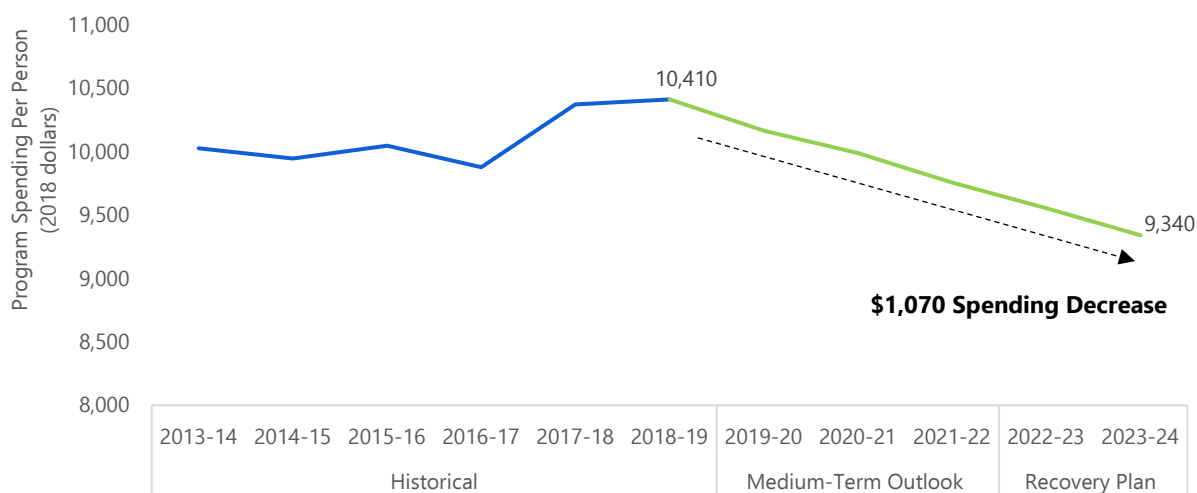
In sharp contrast to the FAO's projection, the government's 2019 Fall Economic Statement forecasts a more modest improvement, with the budget deficit declining from \$8.0 billion³ this year to \$4.4 billion by 2021-22. In the Fall Economic Statement, the government also reaffirmed its commitment to balance the budget by 2023-24, effectively two years later than the FAO's baseline projection.

Government forecast includes unannounced tax cuts and spending measures

Importantly, the government's fiscal plan includes tax cuts and spending programs that have not been publicly disclosed. The FAO's baseline projection excludes these unannounced measures because they are not reflected in current legislation and have not been formally proposed by the government. However, implementing the unannounced measures would delay the achievement of a balanced budget and result in an additional \$13.5 billion in net debt by 2023-24.

The government's fiscal plan hinges on successfully limiting the growth in program spending in order to deliver new tax cuts while still balancing the budget by 2023-24. If the government achieves its spending plan, program spending would be reduced by \$1,070 per person, or by 10 per cent, over the next five years.

The government plans to reduce spending per person by \$1,070 over five years



Note: Estimates for program spending in 2022-23 and 2023-24 are based on program spending growth rates from the 2019 Ontario Budget.

Source: Ontario Public Accounts, 2019 Ontario Budget, 2019 Ontario Economic Outlook and Fiscal Review and FAO.

The extent to which the fiscal plan will deliver a sustainable improvement to Ontario's finances depends on the success of the government's policies to change public services, particularly in the areas of health and education. However, based on the FAO's analysis, the demand for public services will exceed the government's planned program spending by approximately \$5 billion by 2021-22, after accounting for the government's measures to cut costs. There is a significant risk that the fiscal plan will not provide sufficient resources to meet future ongoing demand for key public services.

³ In the Fall Economic Statement, the government projected a budget deficit of \$8.0 billion for 2019-20 before the reserve or a \$9.0 billion deficit including the reserve.

2 | Economic Outlook

Overview

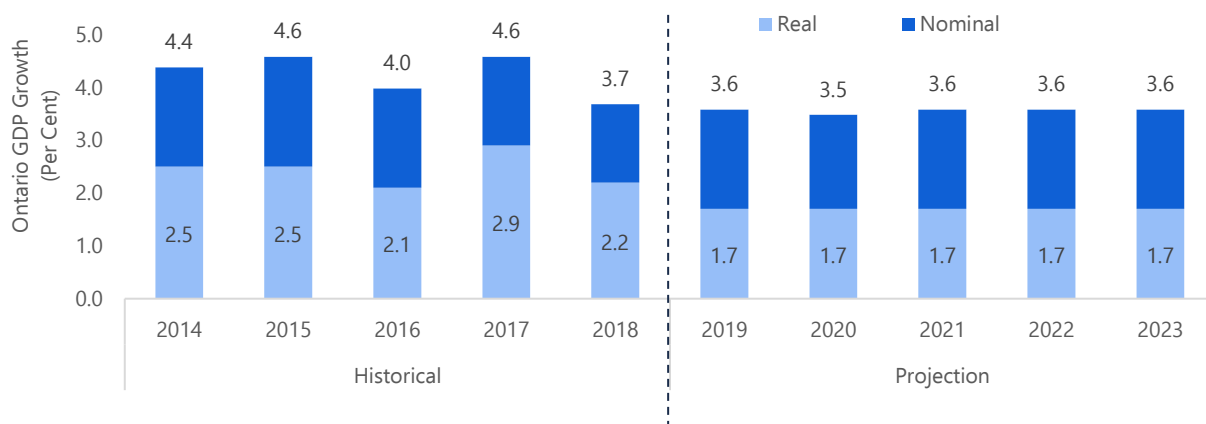
Ontario's economy grew at a solid pace over the 2014 to 2018 period, with real GDP rising by 2.4 per cent per year on average. Strong gains in household spending and residential construction led overall growth, supported by low interest rates and a surge in population growth. However, Ontario's growth softened in late 2018 and early 2019, reflecting the impact of global trade uncertainty and modestly higher interest rates. On an annual basis, the FAO projects real GDP growth will slow to 1.7 per cent in 2019, with declines in residential construction and business investment offset by a gain in net exports and continued growth in household spending.

Ontario's labour market has performed well over the past several years, with ongoing employment growth and a steady decline in the unemployment rate. Employment gains have been especially strong in 2019. As a result, the annual unemployment rate is projected to remain at 5.6 per cent this year, the lowest rate since the late 1980s.

Over the outlook, the FAO projects the pace of economic growth in Ontario will remain moderate, with real GDP rising at an average annual rate of 1.7 per cent over 2019 to 2023. Elevated levels of household debt will limit growth in household spending and residential investment, while a slowing US economy and ongoing geopolitical uncertainty are expected to dampen Ontario's exports and business investment.

Nominal GDP – the broadest measure of the tax base – increased by 3.7 per cent in 2018, down noticeably from average gains of 4.4 per cent over the previous four years. Slower growth will continue in 2019 and over the outlook, with nominal GDP projected to grow at an average annual rate of 3.6 per cent.

Ontario economic growth has slowed



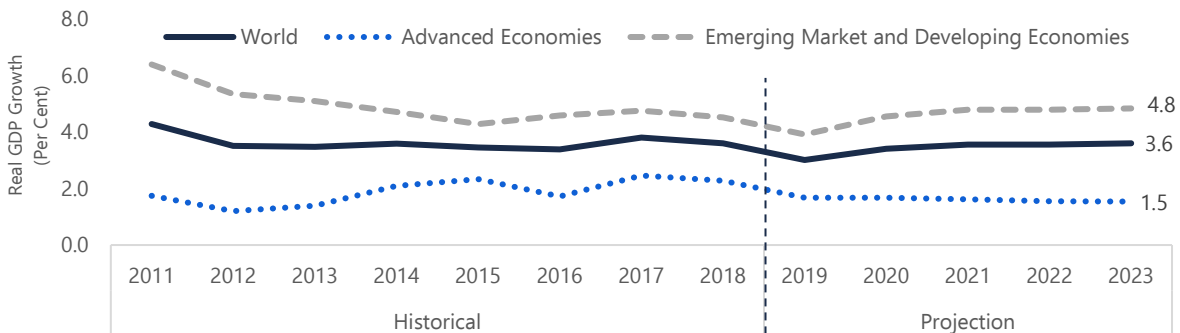
Source: Statistics Canada and FAO.

The domestic and foreign risk factors for Ontario’s economic outlook have changed little since the spring. These factors include volatile global trading relationships, which will hold back business investment and exports, and elevated household indebtedness, which will continue to weigh on consumer spending. Uncertainty related to these factors could lead to even slower future growth for the Ontario economy, negatively impacting the Province’s fiscal outlook.⁴

IMF revises global economic outlook lower

The global economy grew by 3.6 per cent in 2018, slowing in the second half of the year due to trade tensions, geopolitical uncertainty and country-specific developments such as Brexit negotiations in the United Kingdom. In this volatile global environment, recessions have occurred in Italy, Argentina, Mexico and Turkey. Global trade and industrial production have slumped further in 2019. As a result, the International Monetary Fund (IMF) downgraded its global economic growth projection to 3.0 per cent this year, the slowest pace since the 2008 global financial crisis and a considerable downward revision from the IMF’s spring forecast.⁵ The IMF anticipates that challenges to global trade arrangements will continue to impact growth in 2020. Over the outlook, the IMF projects global economic growth will gradually recover to 3.6 per cent.

Weaker global growth in 2019 followed by steady growth over outlook



Source: International Monetary Fund, World Economic Outlook, October 2019.

For advanced economies, growth is expected to slow sharply from 2.3 per cent in 2018 to 1.7 per cent in 2019, with weaker growth in all G7 countries.⁶ In particular, there has been little progress in talks between the US and China on trade and technology, Germany continues to suffer from a sluggish manufacturing sector, and Brexit remains uncertain. In addition, slower labour force growth from an aging population in many advanced economies is expected to continue to weigh on GDP growth over the longer term.

For emerging market and developing economies, growth is expected to moderate from 4.5 per cent in 2018 to 3.9 per cent in 2019 due to weaker global demand and region-specific factors such as a slowdown in domestic demand in China and India, as well as political tension in the Middle East.⁷ Prospects for Latin America have been revised down considerably, while a solid recovery is anticipated for emerging Europe and sub-Saharan Africa.

⁴ See [Assessing the Impact of an Economic Downturn on Ontario’s Finances](#), FAO, June 2019, for an assessment of the impact of an economic downturn on the Province’s fiscal position.

⁵ [World Economic Outlook](#), International Monetary Fund, October 2019. In its World Economic Outlook from April 2019 and October 2018, the IMF forecasted annual world economic growth of 3.3 per cent and 3.7 per cent in 2019, respectively.

⁶ Ibid.

⁷ [World Economic Outlook](#), International Monetary Fund, October 2019.

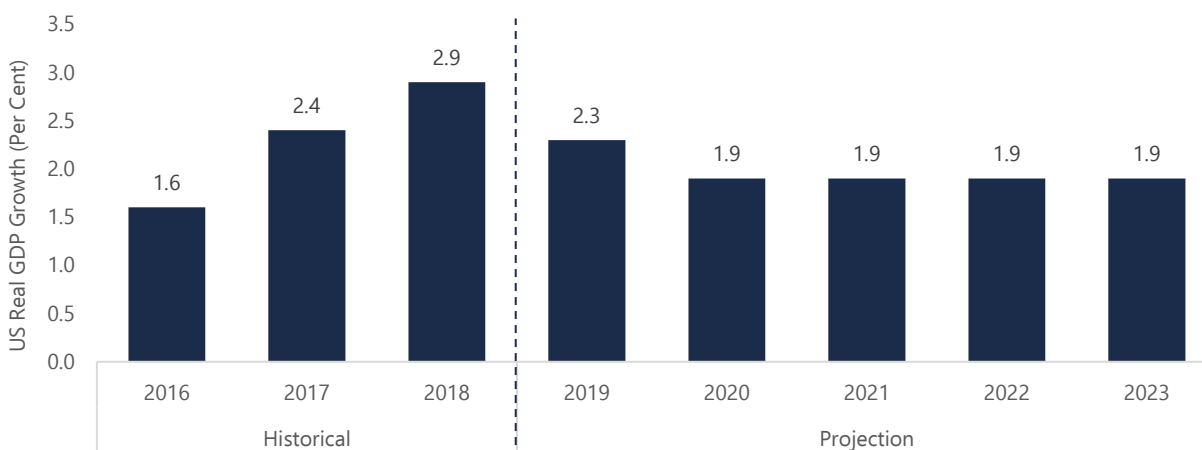
United States

The US economy posted strong growth in 2018, with real GDP rising 2.9 per cent. However, the pace of growth moderated in the second and third quarters of 2019 reflecting slower business investment and exports. The US labour market remained very tight with the unemployment rate reaching its lowest point in 50 years,⁸ while solid employment growth and improved wage gains continue to support strong increases in personal consumption.

The US Federal Reserve lowered the federal funds rate for the first time since the 2008 recession, reducing the rate three times since July to a 1.5-1.75 per cent range. The US central bank cited trade policy uncertainty, slower global demand and low inflation as the main reasons for its decision to lower the policy interest rate, and also signalled that any future rate cuts would be dependent on the economy's performance.⁹

Going forward, US growth is projected to moderate, with real GDP rising 2.3 per cent in 2019 and 1.9 per cent annually over the 2020-23 period. The trade dispute between the US and China is expected to continue holding back economic growth next year, while both monetary and fiscal policy should provide some offsetting stimulus.

US economy expected to moderate as trade uncertainty continues



Source: US Bureau of Economic Analysis and FAO.

China

China's economic growth slowed in 2018 as household spending and domestic investment weakened.¹⁰ In 2019, real GDP growth could slow further as external demand for Chinese goods continues to be impacted by US tariffs and global economic trends.

Earlier in the year, China responded to the economic slowdown with fiscal stimulus and a devaluation of its currency. Policymakers are expected to introduce further fiscal support if slowing capital investment and the trade dispute with the US continue to hold back economic activity.

⁸ In September 2019, the US unemployment rate was 3.5 per cent, the lowest rate since August 1969.

⁹ [Transcript of Chair Powell's Press Conference](#), Federal Open Market Committee, October 30, 2019.

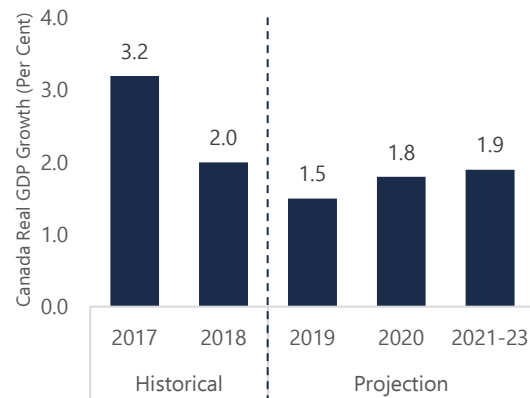
¹⁰ [World Economic Outlook](#), International Monetary Fund, October 2019.

Canadian growth to slow in 2019

In 2018, Canadian real GDP increased by 2.0 per cent, down significantly from a 3.2 per cent gain in 2017, due to weaker household consumption and residential construction. While Canada's economy rebounded from a slow start to 2019, growth is expected to soften in the second half of the year as a temporary boost in exports dissipates. Overall growth in 2019 is expected to moderate to 1.5 per cent largely due to modest growth in business investment and exports.

Over the 2021-23 outlook, real GDP is expected to increase by an average of 1.9 per cent annually, supported by a steady labour market, stable energy sector output and improved trade conditions.

Canadian real GDP growth to slow in 2019

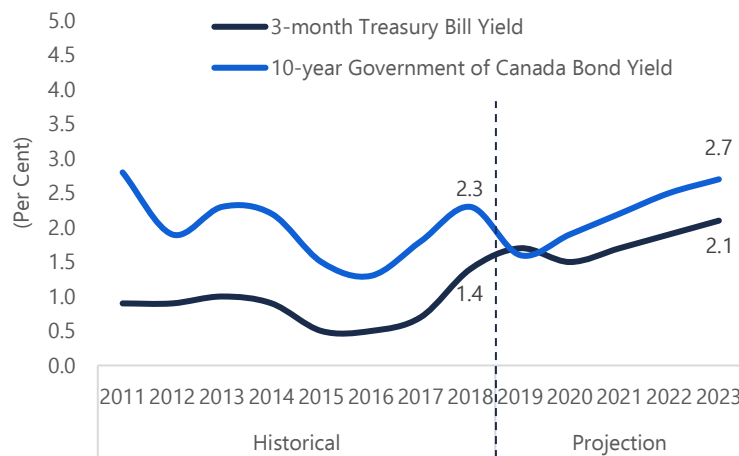


Source: Statistics Canada and FAO.

Interest rates to rise gradually

In contrast to other central banks, including the US Federal Reserve, the Bank of Canada has not adjusted its policy interest rate¹¹ since October 2018, when it raised the rate by 25 basis points to 1.75 per cent. In its October 2019 Monetary Policy Report, the Bank cited a healthy labour market, steady growth in consumer spending and a recovery in housing activity as positive signs for the Canadian economy, which it projected to grow near potential in 2020 and 2021.¹² With inflation projected to hover around the Bank's target of 2 per cent,¹³ future interest rate decisions will depend on the resilience of the Canadian economy in an environment of slower global growth and ongoing trade conflicts.

Interest rate increases to pause until 2021



Source: Statistics Canada and FAO.

Based on the latest policy position of the Bank of Canada and recent trends in Canadian treasury bill and bond yields, the FAO outlook incorporates a modest but gradual rise in interest rates over the outlook.

¹¹ The policy interest rate is the "target for the overnight rate," which is the rate at which major Canadian financial institutions can borrow from one another.

¹² [Monetary Policy Report](#), Bank of Canada, October 2019.

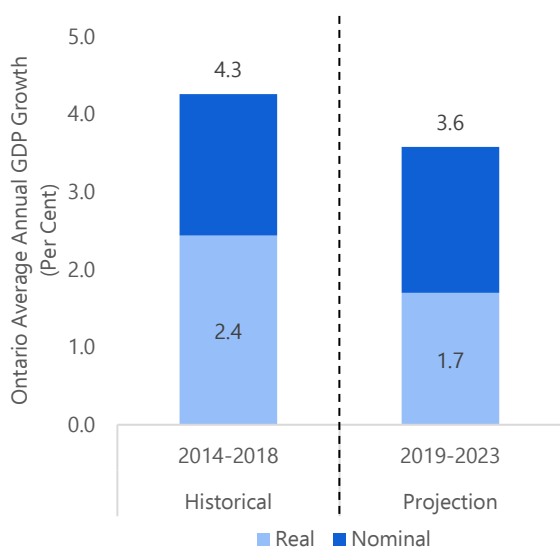
¹³ Ibid.

Ontario's economic growth has slowed

Ontario's economy grew at a solid pace over the 2014 to 2018 period, with real GDP growth averaging 2.4 per cent annually, supported by strong gains in household spending and residential construction. However, the province's growth began to falter at the turn of the year, reflecting the impact of global trade uncertainty on exports and investment, and modestly higher interest rates, which tempered household spending and the housing market. While the trade sector provided a boost to growth in mid-2019, Ontario's domestic demand – household spending, government expenditures and business investment – recorded almost no growth from the third quarter of 2018 through the second quarter of 2019.

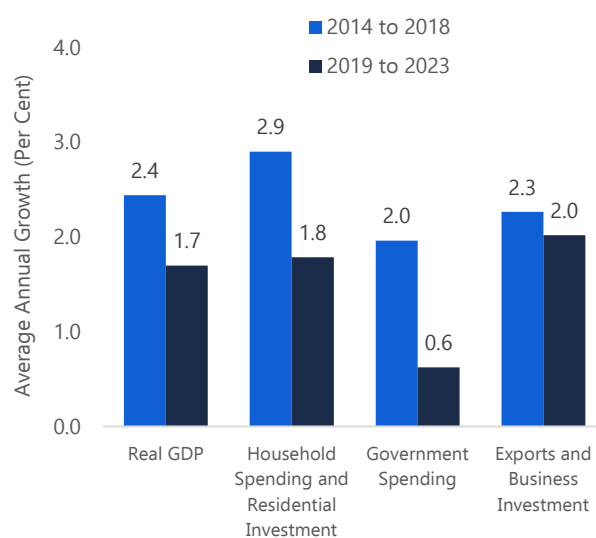
Going forward, elevated levels of household debt are expected to hold back consumer spending, while an uncertain global environment will weigh on exports and investment. The Ontario government's plan to restrain program spending will also contribute to an outlook for relatively modest economic growth. Overall, the FAO is projecting real GDP growth will average 1.7 per cent annually over the outlook, compared to 2.4 per cent over the previous five years.

Slower GDP growth over outlook



Source: Statistics Canada and FAO.

Growth across sectors expected to be slower



Source: Statistics Canada and FAO.

Employment gains to continue over outlook

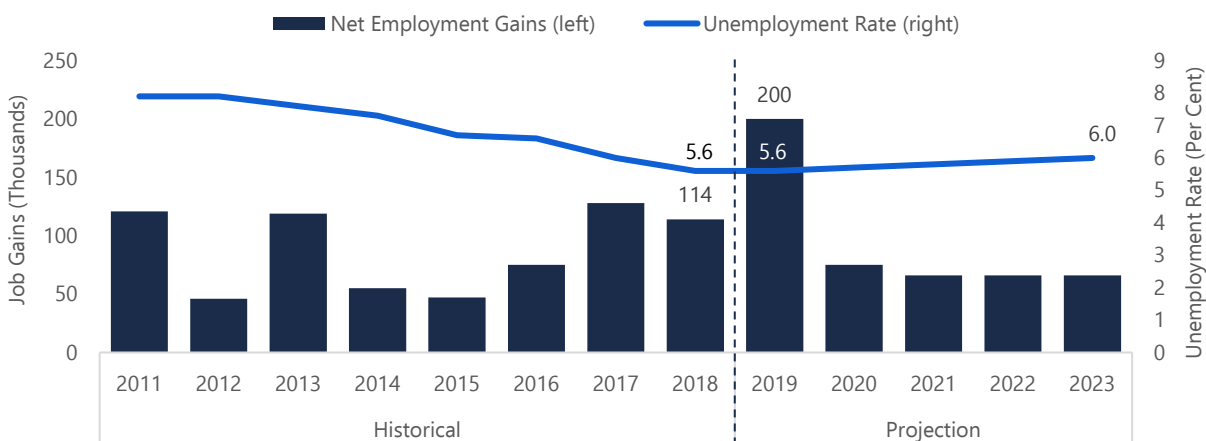
Ontario's labour market performed well in 2018 and 2019, with strong employment growth lowering the annual unemployment rate to 5.6 per cent, the lowest rate since the late 1980s. The FAO projects a net gain of 200,000 jobs in 2019, which would be the largest increase in the level of employment on record.¹⁴

¹⁴ A 200,000 net job gain would represent the largest increase in the level of Ontario employment on record for Statistics Canada's Labour Force Survey, going back to 1976. Notably, a relatively large 40 per cent of the jobs created in 2019 were among the self-employed, more than twice its historical average contribution.

The strong pace of employment growth encouraged a record number of people to enter the job market in 2019, which resulted in an increase in Ontario's overall labour force participation rate for only the second time in the past 10 years.

Over the 2020-23 outlook period, employment growth is expected to average 0.9 per cent annually while the unemployment rate will remain relatively low.

Job gains to moderate, unemployment rate to rise gradually



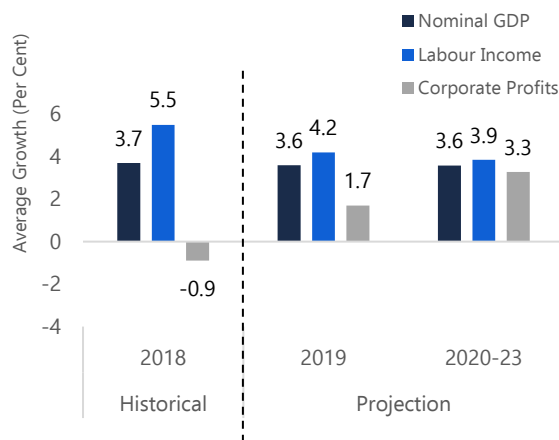
Source: Statistics Canada and FAO.

Economy-wide incomes to slow

Labour income in Ontario increased by a robust 5.5 per cent in 2018, marking the second consecutive year of strong growth amid a tight labour market. In contrast, corporate profits¹⁵ declined in 2018 reflecting a difficult trade environment and a challenging competitive landscape for businesses.

Over the outlook, corporate profits are expected to recover steadily, while labour income gains are projected to continue, but at a more moderate pace. Nominal GDP growth is projected to average 3.6 per cent per year over the outlook.

Labour income growth to moderate



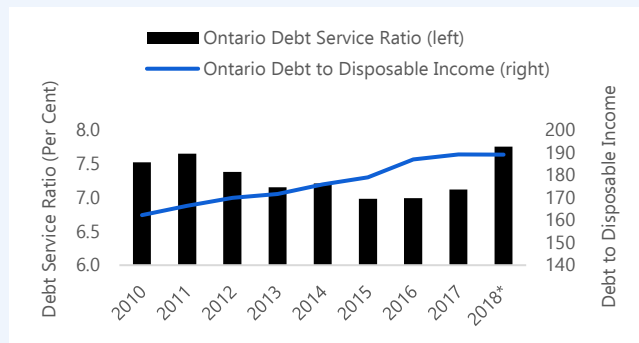
Source: Statistics Canada and FAO.

¹⁵ Statistics Canada refers to corporate profits as the "net operating surplus of corporations" in the System of National Accounts.

Key Risks

Ontario's economy faces several domestic and global risks that could negatively impact growth and the government's fiscal plan.

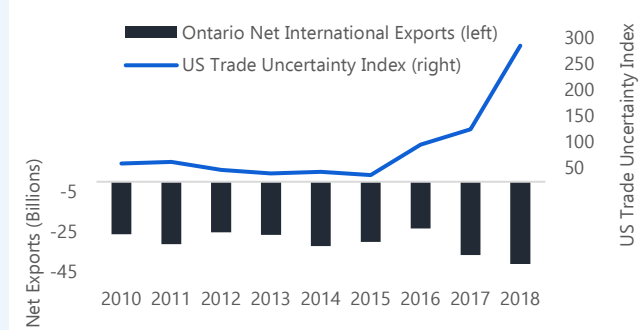
High Household Debt



Source: Statistics Canada. * Ministry of Finance Estimate for debt to disposable income

- Total household debt in Ontario was 189 per cent of disposable income in 2018. The debt service ratio increased in 2018, as households spent a higher portion of their disposable income on interest payments.
- Moderate employment and wage growth and rising interest on debt payments are expected to constrain household spending over the outlook.
- Households are vulnerable to a steeper-than-expected rise in interest rates, which would lead to higher debt service payments and force reductions in discretionary spending.

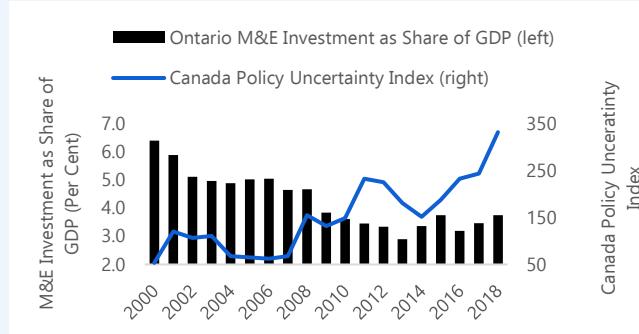
Trade Uncertainty



Source: Statistics Canada and "Measuring Economic Policy Uncertainty" by Scott R. Baker, Nicholas Bloom and Steven J. Davis at www.PolicyUncertainty.com.

- Ontario's economy is highly dependent on trade, with international exports and imports representing about 34 and 39 per cent of nominal GDP, respectively.
- Uncertainty related to US trade policy has risen sharply in the past few years, reflecting the replacement of NAFTA with the new and yet-to-be ratified CUSMA,¹⁶ as well as the introduction of new US tariffs, most significantly on imports from China.
- Ontario's real international exports have lagged overall economic growth in recent years, declining by 0.4 per cent on average annually in 2017 and 2018, in contrast to average annual gains of 5.1 per cent during 2010 to 2016.

Subdued Business Investment



Source: Statistics Canada and "Measuring Economic Policy Uncertainty" by Scott R. Baker, Nicholas Bloom and Steven J. Davis at www.PolicyUncertainty.com.

- Machinery and equipment (M&E) investment is essential to increase production capacity, boost competitiveness and support stronger export growth.
- However, Ontario's M&E investment accounted for just 3.4 per cent of nominal GDP from 2010 to 2018, down from an average of 5.0 per cent between 2000 and 2009.
- Rising uncertainty in the trade and business environment, coupled with a decline in relative competitiveness in the wake of US tax reform,¹⁷ could continue to hold back business investment in Ontario.

¹⁶ NAFTA and CUSMA refer to the North American Free Trade Agreement and the Canada-United States-Mexico Agreement, respectively.

¹⁷ In 2018, the US introduced tax reforms, which included a significant reduction in corporate income tax rates and allowed the immediate write-off of certain capital investments.

3 | Fiscal Outlook

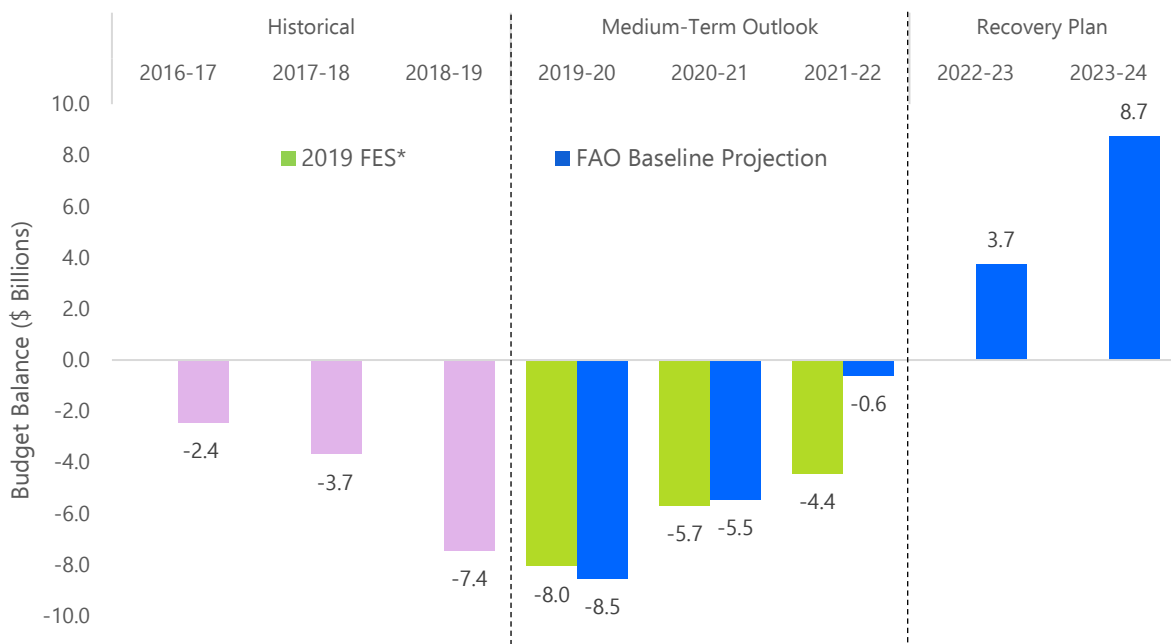
Overview

The FAO projects Ontario’s budget deficit will increase to \$8.5 billion in 2019-20, up from \$7.4 billion last year, marking the third consecutive year of higher deficits. Despite significant spending restraint this year, government policy measures slowed revenue growth even further, widening the 2019-20 deficit.

Under the FAO’s baseline projection,¹⁸ Ontario’s budget would improve rapidly over the outlook, with an almost balanced budget in 2021-22 and a large \$8.7 billion surplus by 2023-24. This dramatic improvement in the budget balance over the next four years is driven primarily by the government’s plan to significantly restrain program spending.

In contrast, the government’s 2019 Ontario Economic Outlook and Fiscal Review (also referred to as the Fall Economic Statement or FES), forecasts a modest improvement in the budget with the deficit declining to \$4.4 billion by 2021-22. Significantly, the government’s fiscal plan¹⁹ incorporates provisions for unannounced tax cuts and new spending programs that delay the achievement of a balanced budget and result in higher provincial debt.

FAO projects a balanced budget in two years, excluding unannounced policies



Source: Ontario Public Accounts, 2019 Ontario Economic Outlook and Fiscal Review and FAO.

* Budget balance is presented before the reserve.

¹⁸ Incorporates the FAO’s revenue outlook and adopts the government’s plans to restrain program spending growth. Unannounced revenue or spending measures included in the government’s fiscal plan are excluded from the FAO’s baseline projection.

¹⁹ As laid out in the 2019 Ontario Budget, updated for new revenue and spending information from the 2019 Fall Economic Statement from 2019-20 to 2021-22.

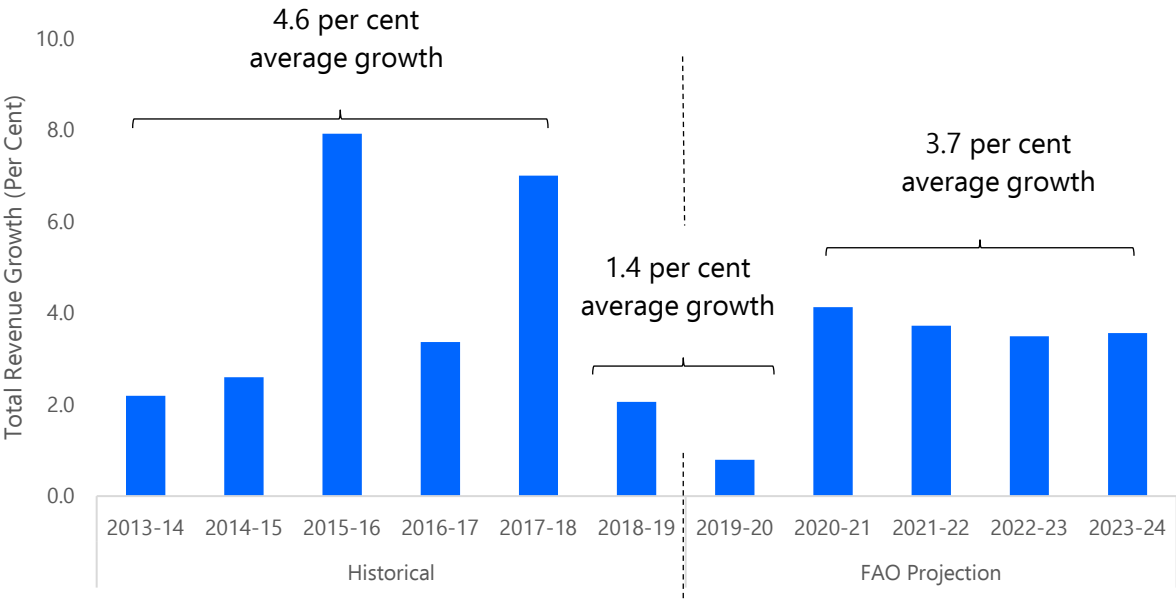
The government’s fiscal plan hinges on significantly limiting the growth in program spending in order to deliver new tax cuts while still balancing the budget. However, based on the FAO’s analysis, the demand for public services will exceed the government’s planned program spending by approximately \$5 billion by 2021-22, after accounting for the government’s measures to cut costs. There is a significant risk that the fiscal plan will not provide sufficient resources to meet future ongoing demand for key public services.

Revenue Outlook

The FAO projects Ontario’s total revenues will increase by a weak 0.8 per cent in 2019-20, following a modest gain of 2.1 per cent in 2018-19. The relatively weak revenue growth over the past two years – averaging just 1.4 per cent – reflects the impact of recent policy changes combined with slower economic growth.

Over the next four years, the FAO projects total revenue growth will improve, averaging 3.7 per cent per year, but will remain below the average annual gains of 4.6 per cent over the 2013-14 to 2017-18 period. Overall, the FAO’s revenue projection has improved since the spring outlook, reflecting the 2018-19 Public Accounts, which reported \$2.9 billion in higher revenues than previously expected.²⁰

Moderate revenue growth expected over outlook



Source: Ontario Public Accounts, 2019 Ontario Economic Outlook and Fiscal Review and FAO.

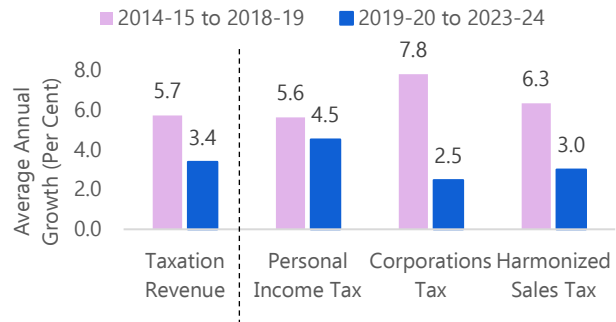
²⁰ Three revenue sources accounted for most of the \$2.9 billion increase in 2018-19: corporations tax was \$1.4 billion higher than expected due to revenue from prior-year tax returns; personal income tax was \$0.4 billion higher, reflecting stronger employment and wage growth; and income from government business enterprises was \$0.6 billion above expectations. See [Understanding Ontario's 2018-19 Deficit](#), FAO, October 2019, for more details.

Growth in tax revenues expected to moderate

After several years of strong economic gains, slower growth over the outlook is expected to dampen revenue increases, particularly from taxation sources. Over the next five years, the FAO projects average annual tax revenue growth of just 3.4 per cent, slower than the 5.7 per cent average gain during 2014-15 to 2018-19.²¹ Slower growth is projected across all three major tax revenue sources.

The impact of slower economic growth on overall revenues is compounded by recent policy measures introduced over the past year. In total, these measures would reduce revenue by \$4.2 billion in 2019-20 and by an average of \$3.4 billion over the remainder of the outlook.²² These revenue policy changes include cancelling the cap and trade program,²³ reversing a number of tax measures included in the 2018 budget,²⁴ introducing the Low-income Individuals and Families Tax (LIFT) credit,²⁵ and paralleling the federal changes to the corporate income tax.²⁶

Slowing economic growth to dampen tax gains



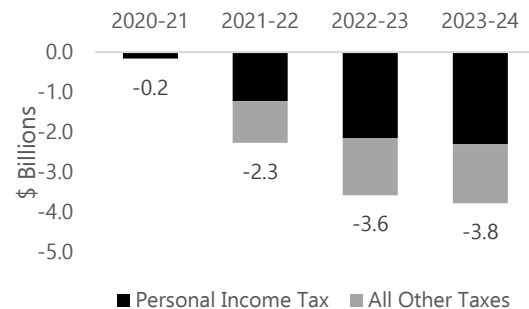
Source: Ontario Public Accounts, 2019 Ontario Economic Outlook and Fiscal Review and FAO.

The government's revenue outlook includes unannounced tax cuts

In the 2019 Fall Economic Statement, the government projected total revenue would reach \$165.4 billion by 2021-22, about \$2 billion lower than the FAO's projection. This is largely the result of lower taxation revenue.

The lower tax revenue forecast in the government's projection is mainly due to the inclusion of unannounced tax cuts, starting in 2021-22.²⁷ While the government has not provided details on design or implementation, the FAO estimates that the tax cuts assumed in the government's forecast will reduce revenues by about \$2.3 billion in 2021-22, growing to about \$3.8 billion by 2023-24.

Revenue impact of unannounced tax policy changes



Source: FAO.

²¹ All average annual growth rates in this report are calculated using the year before the first indicated year as the base. For example, average annual tax revenue growth of 3.4 per cent during 2014-15 to 2018-19 is calculated using 2013-14 as the base year.

²² See page 14 of the [2019 Spring Economic and Budget Outlook](#), FAO, May 2019.

²³ The loss of cap and trade revenue is partially offset by lower expenses from related programs. See the FAO's [Cap and Trade report](#), October 2018.

²⁴ Tax changes in the 2018 budget included the elimination of the personal income tax (PIT) surtax and associated adjustments to PIT brackets and rates, and changes to the application of the small business limit and the Employer Health Tax exemption. See the FAO's [2018 Fall Economic and Budget Outlook](#).

²⁵ See [Comparing the LIFT Credit to a Minimum Wage Increase](#), FAO, April 2019.

²⁶ These changes include paralleling the accelerated capital cost allowance measure introduced by the federal government (referred to as the "Ontario Job Creation Investment Incentive" by the Ontario government).

²⁷ These unannounced tax policy changes include reductions in personal income tax and other taxes beginning in 2021-22 and were also incorporated into the 2019 budget's revenue outlook. See page 15 of the FAO's [2019 Spring Economic and Budget Outlook](#) for more details.

FAO medium-term revenue assumptions

Revenue Source	Assumption	Forecast
Taxation Revenue	Grows with key economic drivers including labour income, corporate profits, household spending and GDP. Incorporates announced policy changes, including the Low-income Individuals and Families Tax credit. Excludes unannounced policy changes.	Averages 3.4 per cent over 2019-20 to 2023-24.
Federal Transfers	Based on legislated growth rates and economic forecasts for Ontario and Canada as well as government projections for smaller transfer programs.	Averages 2.8 per cent over 2019-20 to 2023-24.
Government Business Enterprises (GBEs)	Based on government projections from the 2019 Ontario Budget and 2019 Ontario Economic Outlook and Fiscal Review.	Averages 6.2 per cent over 2019-20 to 2023-24.
Other Revenue	Based on government projections from the 2019 Ontario Budget and 2019 Ontario Economic Outlook and Fiscal Review.	Averages 1.1 per cent over 2019-20 to 2023-24.

Source: Ontario Public Accounts, 2019 Ontario Budget, 2019 Ontario Economic Outlook and Fiscal Review and FAO.

Expense Outlook

In the 2019 Fall Economic Statement, the government projected total spending would grow by 1.8 per cent per year on average during the 2019-20 to 2021-22 period. The growth in total spending reflects 1.6 per cent average annual growth in program spending combined with a 3.9 per cent average annual increase in interest on debt payments.

Higher program spending compared to the 2019 budget

The 2019 Fall Economic Statement raised overall program spending growth in 2019-20 and 2020-21 compared to the 2019 budget.²⁸ For 2021-22, program spending is planned to increase by 1.2 per cent, unchanged from the 2019 budget.

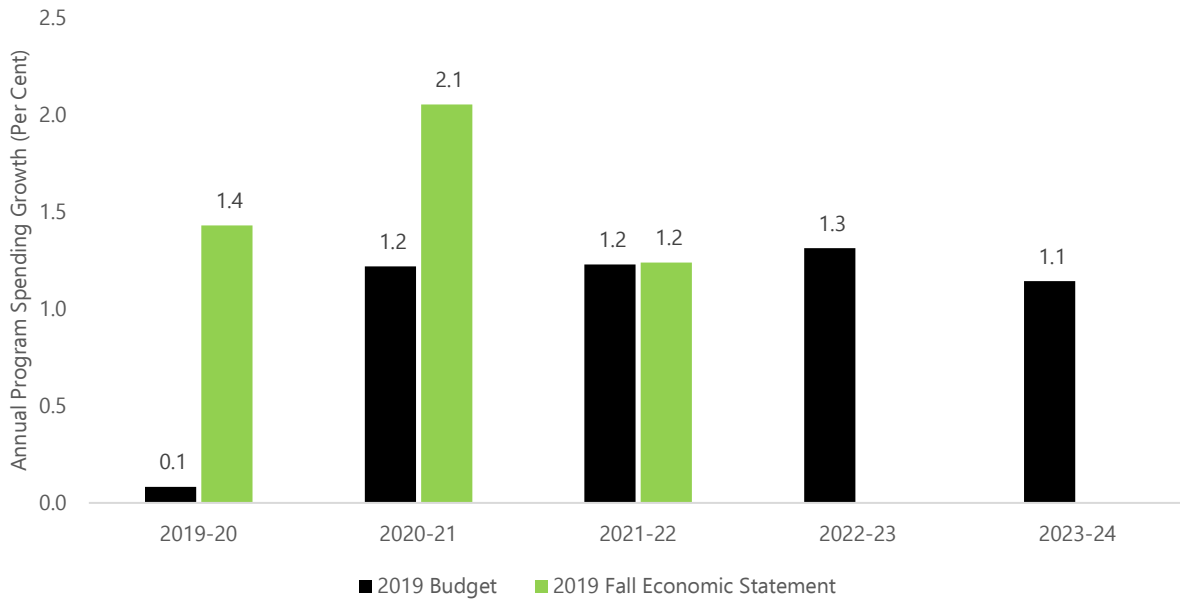
The government did not update its program spending projection beyond 2021-22 in the Fall Economic Statement. However, based on the Fall Economic Statement combined with spending growth assumed in

²⁸ Although the Fall Economic Statement reported an overall increase in program spending of \$0.8 billion in 2019-20, spending by year-end may be lower. The FAO's "Expenditure Monitor 2019-20: Q2" reported that through the first six months of the fiscal year the overall program spending authority was unchanged from the 2019 budget plan.

the 2019 budget outlook, program spending would be expected to grow at an average annual rate of 1.4 per cent over the full five-year outlook.²⁹

Since the 2019 Ontario Budget, the government has announced further changes to a number of previously announced policies, particularly for social services.³⁰ In addition, the Fall Economic Statement included higher spending allocations for the Health sector due to greater-than-anticipated demand for health services, and for Education due to higher funding for childcare programs.

Program spending growth remains modest, despite upward revisions



Source: 2019 Ontario Budget, 2019 Ontario Economic Outlook and Fiscal Review and FAO.

Spending restraint remains over the medium term

For 2019-20, the government increased its planned spending in the Health, Education, and Children’s and Social Services sectors.³¹ Despite these higher funding allocations, planned spending in 18 out of 24 ministries is lower in 2019-20 compared to actual spending in 2018-19. Program spending in Colleges and Universities, Energy, Northern Development and Mines, Municipal Affairs and Housing, and Indigenous Affairs is expected to decline by a combined \$1.7 billion this fiscal year compared to 2018-19. For additional details, see Appendix Table 4.

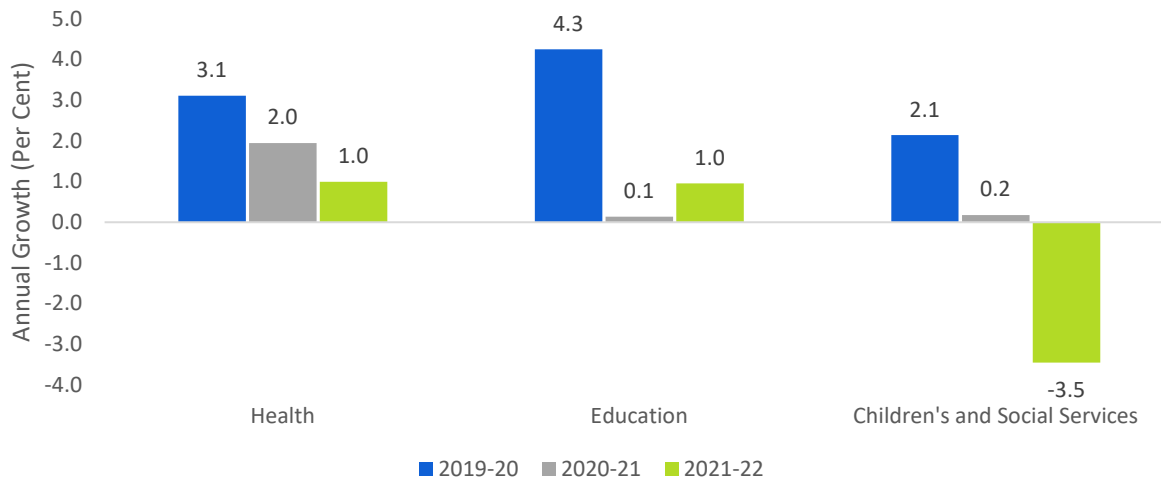
Beyond 2019-20, the Fall Economic Statement increasingly limits spending growth in the three largest sectors.

²⁹ The FAO estimates that program spending excluding new unannounced spending measures would grow by 1.3 per cent over the full five-year outlook.

³⁰ The Fall Economic Statement announced additional changes to the Ontario Autism Program, the Transition Child Benefit, Ontario Works, and Ontario Disability Support. See [2019 Fall Economic Statement](#), page 159 for details.

³¹ Children’s and Social Services sector received \$637 million or 48 per cent of the total new allocated spending in the 2019 Fall Economic Statement.

The Fall Economic Statement increasingly limits spending growth over the outlook



Source: 2019 Ontario Budget, 2019 Ontario Economic Outlook and Fiscal Review and FAO.

To restrain program spending growth over the medium term, the government is implementing a variety of measures, including:

- consolidation of the province's Local Health Integration Networks (LHINs) and other provincial health agencies into Ontario Health,³² integration of supply chains, reforming OHIP+ to cover only children and youth without pre-existing drug plans, and restricting base hospital operating funding growth to less than one per cent annually over the outlook;³³
- increasing class sizes for students in grade 4 through 12 and expanding e-learning for secondary school students; and
- transforming the delivery of children's and social services, including social assistance, developmental services and youth justice services.

Additional cost savings required to achieve spending plan

Over the 2019-20 to 2021-22 period, Ontario's population is expected to increase by over 750,000 people (or 5.3 per cent)³⁴ while the share of seniors in Ontario's total population will also rise, placing additional demands on the health care system. During the same period, consumer prices are projected to increase by a cumulative 6.2 per cent, raising the cost of purchasing goods and services and putting upward pressure on public sector wages.

The FAO's "status quo" projection for program spending reflects these underlying cost drivers and suggests that in the absence of policy changes, program spending would need to increase to \$167.3 billion by 2021-22 in order to maintain the current mix and quality of Ontario's public services.

³² The integration of LHINs and five health agencies will commence on December 2, 2019 while the Trillium Gift of Life Network will integrate later. See Government of Ontario News Release: [Ontario Taking Next Steps to Integrate Health Care System](#), November 2019.

³³ See page 15, [Expenditure Estimates 2019-20: Ministry of Health and Long-Term Care](#), FAO, May 2019.

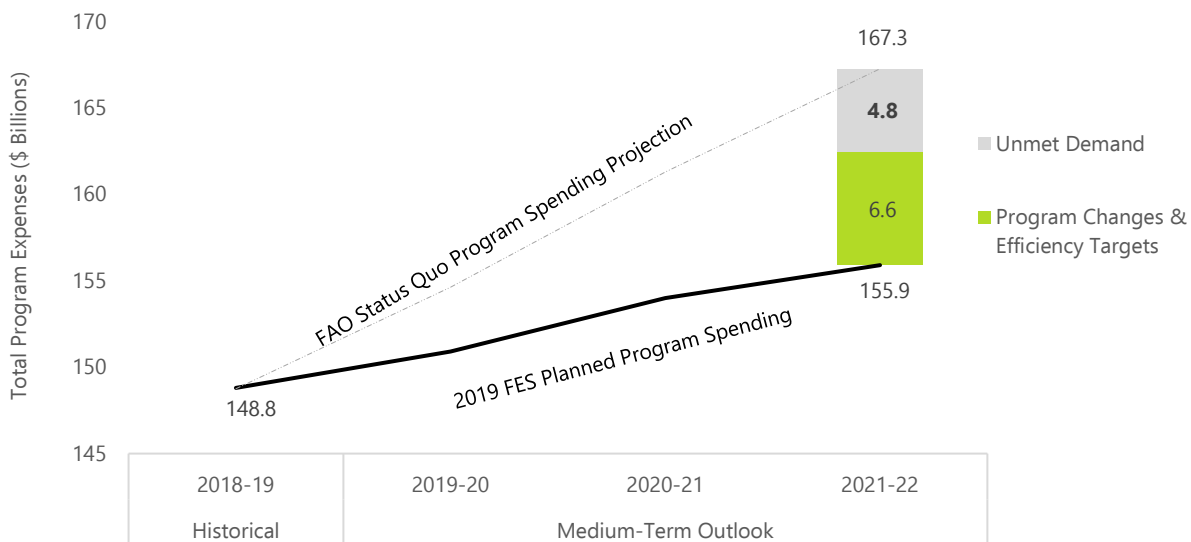
³⁴ See [Table 1 of Ontario Population Projections](#), 2018-2046, Ministry of Finance.

In contrast, based on the Fall Economic Statement, the government plans to increase program spending to \$155.9 billion by 2021-22, or \$11.4 billion less than the FAO's status quo projection.

Over the past 18 months, the Ontario government has announced a broad range of program changes and efficiency targets intended to achieve cost savings that lower program spending.³⁵ In addition, the government recently passed Bill 124,³⁶ which limits public sector compensation growth to an average annual increase of 1.0 per cent, providing further cost savings.³⁷

In total, the government's policy changes and wage restraint could amount to \$6.6 billion of potential cost savings if successfully implemented. This suggests that the demand for public services will exceed the government's planned program spending by approximately \$4.8 billion by 2021-22, after accounting for the government's cost-saving measures.³⁸

Demand for public services exceeds the government's planned spending by \$4.8 billion in 2021-22



Source: FAO analysis of data from Treasury Board Secretariat.

In the absence of \$5 billion in higher spending to fund the expected demand for public services, the government could:

- announce additional program changes that would reduce costs;
- identify and achieve further efficiency gains in the delivery of public services; or
- restrict access or underfund current programs, which could affect the quality of existing public services.

³⁵ Program changes include adjustments to program entitlements, reductions or elimination of existing programs, and changes to the way existing public services are delivered (e.g., larger class sizes). Efficiency targets include measures that aim to improve the delivery of public services without impacting service access or quality. The FAO estimates that these measures could produce \$5.0 billion in cost savings by 2021-22. See page 19 of the [2019 Spring Economic and Budget Outlook](#), FAO, May 2019 for details on program changes and efficiency measures announced in the 2019 Ontario Budget.

³⁶ See [Bill 124, Protecting a Sustainable Public Sector for Future Generations Act, 2019](#).

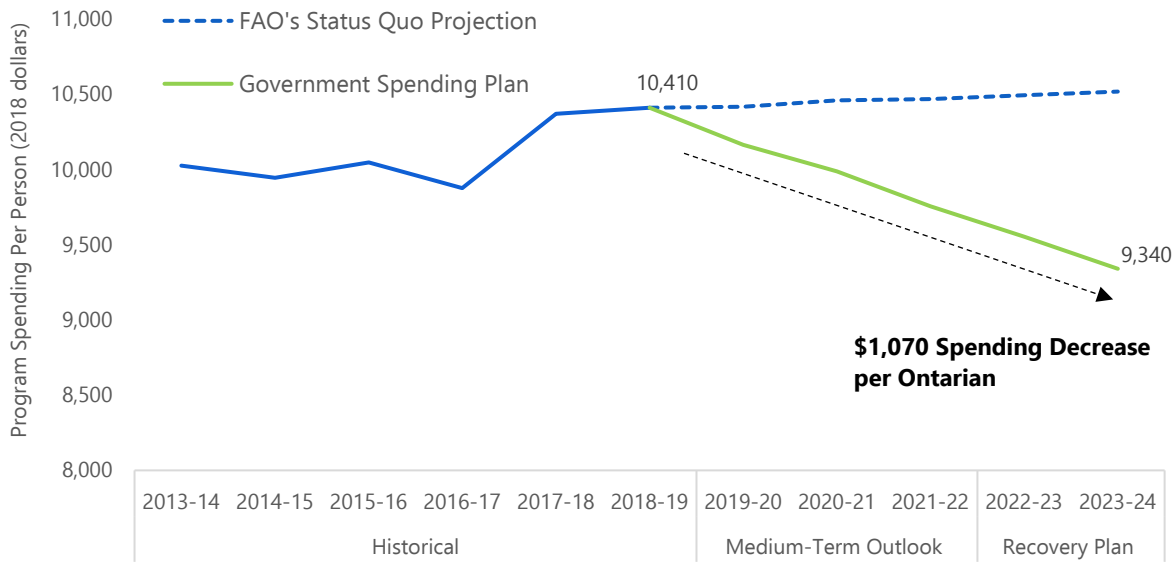
³⁷ The FAO estimates that Bill 124 could result in additional cost savings of \$1.6 billion by 2021-22.

³⁸ This estimated unmet demand is smaller than the \$5.9 billion the FAO estimated in the 2019 spring outlook, primarily due to the introduction of Bill 124.

It is unclear to what extent the Province will rely on these various options to achieve its spending targets, or if the existing program changes and efficiency measures will produce the cost savings anticipated in the government's fiscal plan.

However, if the government achieves its spending plan, program spending per person would be reduced by \$1,070 (approximately 10 per cent) by 2023-24, compared to 2018-19.

The government plans to reduce spending per person by \$1,070 over five years



Note: Estimates for program spending in 2022-23 and 2023-24 are based on program spending growth rates from the 2019 Ontario Budget.

Source: Ontario Public Accounts, 2019 Ontario Budget, 2019 Ontario Economic Outlook and Fiscal Review and FAO.

The government's budget plan comes with risks

The Fall Economic Statement reaffirmed the government's commitment to balance the budget by 2023-24 in order to put Ontario's finances "... on a path towards fiscal sustainability."³⁹ The government's plan to balance the budget relies primarily on spending restraint, while also incorporating measures that reduce the growth of existing tax revenue sources. The extent to which the government's fiscal plan will deliver a sustainable improvement to Ontario's finances depends on the success of the government's transformational changes to public services, particularly in the areas of health and education.

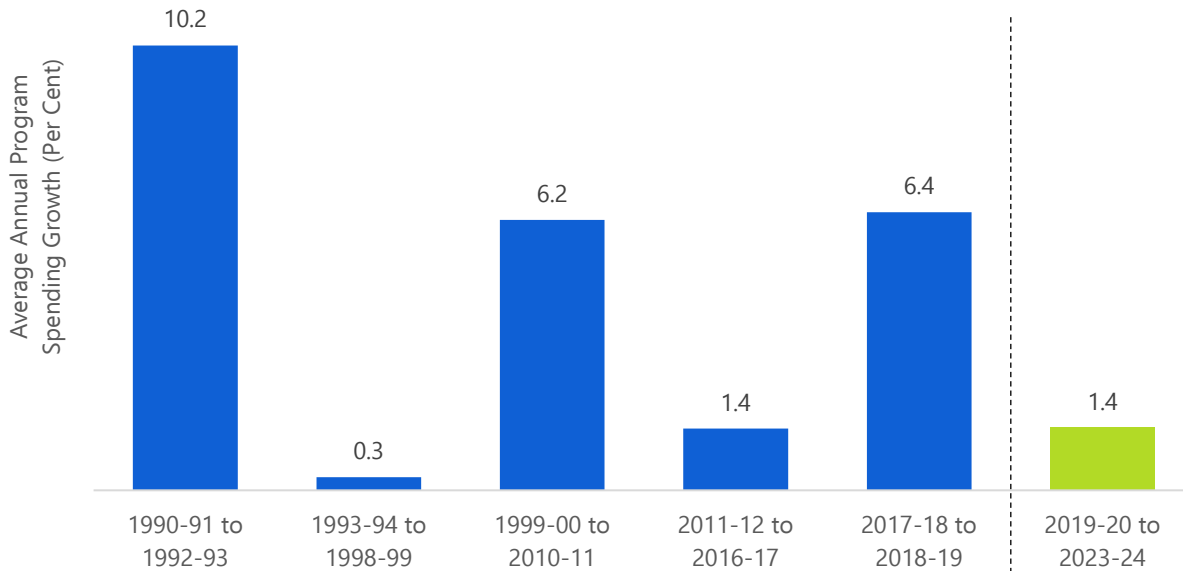
Transformational changes to public services that lead to permanent efficiency gains are possible but have generally been difficult to achieve.⁴⁰ Furthermore, while the reduction or elimination of government programs is also an option, this has proven challenging to implement and sustain.

As a result, governments have often relied on temporary measures to manage and restrain public spending. However, temporary measures can result in a "catch-up" period where additional spending is used to address built-up budgetary pressures.

³⁹ 2019 Fall Economic Statement, p. 5.

⁴⁰ See the Ontario Auditor General's review of eHealth, the Province's effort to digitize health records, or the Auditor General of Canada's report on the Federal government's attempt to centralize pay services.

Historically, periods of spending restraint were followed by “catch-up” periods



Note: Pre-2009 data is from Statistics Canada table 385-0001.

Source: Statistics Canada, 2019 Ontario Budget, 2019 Ontario Economic Outlook and Fiscal Review and FAO.

Avoiding a period of “catch-up” spending beyond the medium-term outlook will depend on how the current government achieves cost reductions, and the extent to which transformational changes to public services permanently improve efficiency.⁴¹

Impact of Implementing Unannounced Measures

In the FAO’s baseline projection, unannounced measures incorporated in the Fall Economic Statement and 2019 budget are excluded because they are not reflected in current legislation and have not been formally proposed by the government. On this basis, the FAO projects that the Ontario budget would reach a large \$8.7 billion surplus by 2023-24, achieved primarily through spending restraint.

If the government were to implement the unannounced measures, the FAO estimates that the budget balance would deteriorate by \$3.0 billion in 2021-22, \$4.9 billion in 2022-23 and \$5.6 billion in 2023-24.

⁴¹ The FAO’s upcoming Long-Term Budget Outlook will assess the implications of this question.

Impact of the unannounced measures, \$ billions

	2019-20	2020-21	2021-22	2022-23	2023-24
Budget Balance - FAO Baseline (Excluding unannounced measures)	-8.5	-5.5	-0.6	3.7	8.7
Impact of implementing unannounced measures*		-0.1	-3.0	-4.9	-5.6
Budget Balance including unannounced measures	-8.5	-5.5	-3.6	-1.1	3.2
Budget Balance - 2019 Fall Economic Statement	-8.0	-5.7	-4.4		
Net debt - FAO Baseline (Excluding unannounced measures)	354.3	366.1	372.2	372.8	368.9
Net debt to GDP (Per Cent)	39.9	39.8	39.0	37.8	36.1
Impact of implementing unannounced measures*		0.1	3.1	7.9	13.5
Net debt including unannounced measures	354.3	366.2	375.3	380.7	382.4
Net debt to GDP (Per Cent)	39.9	39.8	39.4	38.6	37.4
Net debt - 2019 Fall Economic Statement	353.7	365.8	375.7		
Net debt to GDP (Per Cent)	40.0	40.1	39.8		

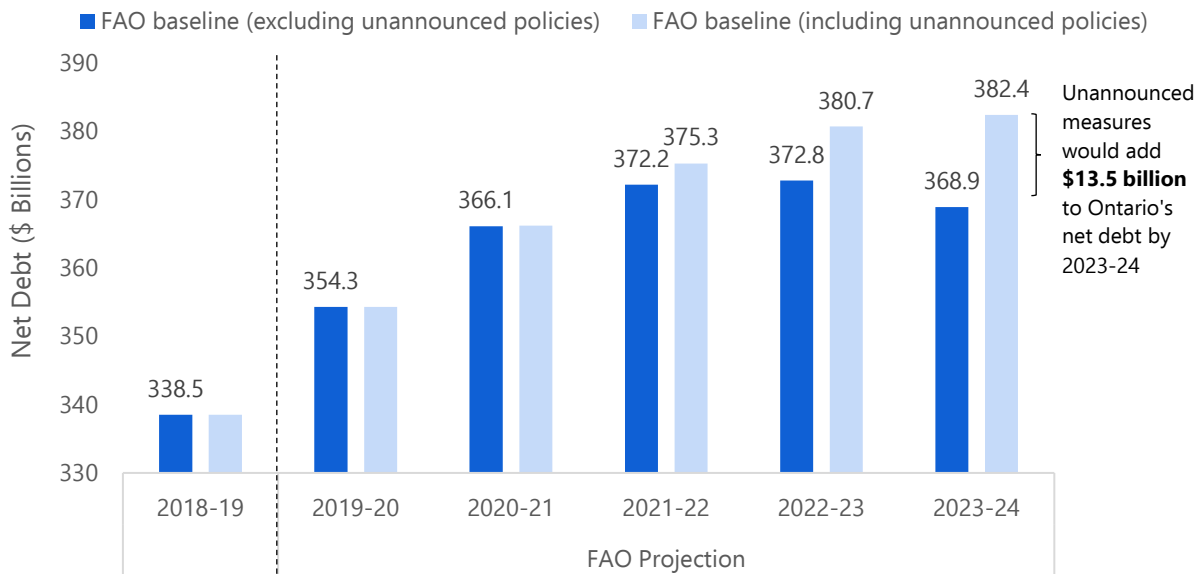
Source: 2019 Ontario Economic Outlook and Fiscal Review, 2019 Ontario Budget and FAO.

Note: Budget balance is presented before the reserve.

* Values include the impact to interest on debt payments.

Based on the FAO's projections, if the government achieves its plan of significantly restraining program spending, it would create enough fiscal capacity to allow the government to introduce the unannounced tax and spending measures and still achieve a balanced budget by 2023-24. The FAO estimates that implementing the government's unannounced measures would result in a gradual decline in the deficit over the outlook, and a surplus of \$3.2 billion by 2023-24. Implementing the unannounced measures would also result in an additional \$13.5 billion in net debt by 2023-24.

Unannounced measures would add \$13.5 billion to Ontario's net debt by 2023-24



Source: 2019 Ontario Economic Outlook and Fiscal Review and FAO.

Budget Sensitivities

Changes in Ontario's current revenue or expense policies, as well as external factors, can have a significant impact on Ontario's budget balance. In the table below, the FAO provides estimates of the sensitivity of Ontario's fiscal position to potential changes across several key policy areas, including tax policy, federal transfers, expenditure policy and economic risks. For example:

- For tax policy, if the government were to permanently increase personal income tax (PIT) revenue by 10 per cent or around \$500 per tax filer, starting in 2019-20, the budget deficit would fall by \$3.7 billion in the first year and by \$5.2 billion in 2023-24.
- For expenditure policy, if the government were to decrease the growth rate of program spending by 0.5 percentage point for each year, or \$2.3 billion on average over the projection, the budget deficit would decrease by \$4.4 billion by 2023-24.
- If Ontario's effective interest rate on its borrowing were to decrease by 1 percentage point, beginning in 2019-20, the deficit would decline by \$0.5 billion in 2019-20 and \$1.7 billion in 2023-24.

Sensitivity of Ontario's Budget Balance to Select Factors

Change Beginning in 2019-20	Change in Budget Balance in:	
	2019-20	2023-24
Tax Policy		
A sustained 10 per cent increase in Personal Income Tax revenues (\$500 per tax filer in 2019-20) over the projection	+\$3.7 billion	+\$5.2 billion
A sustained 1 percentage point increase in the general Corporations Tax rate over the projection	+\$1.1 billion	+\$1.6 billion
A sustained 1 percentage point increase in the HST rate over the projection	+\$3.6 billion	+\$4.7 billion
Federal Transfers		
A sustained 1 percentage point increase in the annual growth of the Canada Health Transfer over the projection	+\$0.2 billion	+\$1.0 billion
A sustained 1 percentage point increase in the annual growth of the Canada Social Transfer over the projection	+\$0.1 billion	+\$0.4 billion
Expenditure Policy		
A sustained 0.5 percentage point decrease in the growth rate of total program spending over the projection	+\$0.8 billion	+\$4.4 billion
A sustained 1 percentage point decrease in the growth rate of health spending over the projection	+\$0.6 billion	+\$3.9 billion
A sustained 1 percentage point decrease in the growth rate of social assistance over the projection	+\$0.1 billion	+\$0.6 billion
Borrowing Costs		
A sustained 1 percentage point decrease in Ontario's effective borrowing rate over the projection	+\$0.5 billion	+\$1.7 billion

Note: These estimates include the associated impact to interest on debt, but do not incorporate any economic feedback effects.
Source: FAO.

4 | Appendices

Forecast Tables

Table 1: FAO Outlook for Key Revenue Drivers

(Per Cent Growth)	2017a	2018a	2019f	2020f	2021f	2022f	2023f	Average*
Nominal GDP								
FAO - Fall 2019	4.6	3.7	3.6	3.5	3.6	3.6	3.6	3.6
2019 Ontario FES	-	-	3.4	3.3	3.3	3.6	-	3.4
Consensus**	-	-	3.7	3.7	3.7	3.9	3.9	3.8
Labour Income								
FAO - Fall 2019	4.6	5.5	4.2	4.0	3.8	3.8	3.8	3.9
2019 Ontario FES	-	-	4.3	4.0	3.7	3.8	-	4.0
Corporate Profits								
FAO - Fall 2019	2.7	-0.9	1.7	2.7	3.4	3.5	3.5	3.0
2019 Ontario FES	-	-	0.6	0.6	2.7	3.9	-	2.0
Household Consumption								
FAO - Fall 2019	5.2	4.4	3.7	3.7	3.7	3.7	3.7	3.7
2019 Ontario FES	-	-	-	-	-	-	-	-

a = Actual f = Forecast

* Average is calculated from 2019 to 2023.

** See 2019 Ontario FES, page 139 for list of consensus forecasters. Forecasts as of November 8, 2019.

Source: Statistics Canada, 2019 Ontario FES and FAO.

Table 2: FAO Outlook for Ontario Real GDP and Components

(Per Cent Growth)	2017a	2018a	2019f	2020f	2021f	2022f	2023f	Average*
Real GDP								
FAO - Fall 2019	2.9	2.2	1.7	1.7	1.7	1.7	1.7	1.7
2019 Ontario FES	-	-	1.4	1.5	1.5	1.9	-	1.6
Consensus**	-	-	1.6	1.7	1.7	1.9	1.8	1.7
Real GDP Components								
Household Consumption	4.1	2.5	1.9	1.9	1.9	1.9	1.9	1.9
Residential Investment	0.6	-3.3	-5.3	2.8	2.4	2.3	2.3	0.9
Business Investment***	8.4	6.3	-2.6	0.9	2.8	2.5	2.5	1.2
Government (Consumption and Investment)	2.8	4.0	1.6	0.4	0.4	0.4	0.3	0.6
Exports	0.4	0.9	2.6	2.0	2.0	2.0	2.0	2.1
Imports	3.1	1.6	1.2	1.5	1.8	1.9	1.9	1.7

a = Actual f = Forecast

* Average is calculated from 2019 to 2023.

** See 2019 Ontario FES, page 139 for list of consensus forecasters. Forecasts as of November 8, 2019.

*** Business Investment is Non-residential Investment and Machinery & Equipment.

Source: Statistics Canada, 2019 Ontario FES and FAO.

Table 3: FAO Outlook for Selected Economic Indicators

	2017a	2018a	2019f	2020f	2021f	2022f	2023f
Employment (Per Cent Growth)							
FAO - Fall 2019	1.8	1.6	2.8	1.0	0.9	0.9	0.9
2019 Ontario FES	1.8	1.6	2.6	1.2	1.0	1.1	-
Unemployment Rate (Per Cent)							
FAO - Fall 2019	6.0	5.6	5.6	5.7	5.8	5.9	6.0
2019 Ontario FES	6.0	5.6	5.6	5.5	5.5	5.5	-
Labour Force (Per Cent Growth)							
FAO - Fall 2019	1.2	1.2	2.7	1.1	1.0	1.0	0.9
2019 Ontario FES	-	-	-	-	-	-	-
Population Growth (Per Cent)							
FAO - Fall 2019	1.4	1.7	1.8	1.8	1.6	1.5	1.4
2019 Ontario FES	-	-	-	-	-	-	-
CPI Inflation (Per Cent Growth)							
FAO - Fall 2019	1.7	2.4	1.9	2.0	2.0	2.0	2.0
2019 Ontario FES	1.7	2.4	2.0	2.0	1.9	1.9	-
Canada Real GDP (Per Cent Growth)							
FAO - Fall 2019	3.2	2.0	1.5	1.8	1.9	1.9	1.9
2019 Ontario FES	-	-	-	-	-	-	-
U.S. Real GDP (Per Cent Growth)							
FAO - Fall 2019	2.4	2.9	2.3	1.9	1.9	1.9	1.9
2019 Ontario FES	2.4	2.9	2.3	1.7	1.8	1.9	-
Canadian Dollar (Cents US)							
FAO - Fall 2019	77.1	77.2	76.0	76.5	76.7	76.9	77.1
2019 Ontario FES	77.1	77.2	75.4	76.3	77.0	77.9	-
Three-month Treasury Bill Rate (Per Cent)							
FAO - Fall 2019	0.7	1.4	1.7	1.5	1.7	1.9	2.1
2019 Ontario FES	0.7	1.4	1.6	1.5	1.5	1.8	-
10-year Government Bond Rate (Per Cent)							
FAO - Fall 2019	1.8	2.3	1.6	1.9	2.2	2.5	2.7
2019 Ontario FES	1.8	2.3	1.5	1.6	2.1	2.5	-

a = Actual f = Forecast

Source: Statistics Canada, US Bureau of Economic Analysis, 2019 Ontario FES, Bank of Canada and FAO.

Table 4: Expenses by Ministry

(\$ Millions)	2018-19 Actual (\$)	2019-20 FES (\$)	Y/Y Change (\$)	Y/Y Growth (Per Cent)
Ministry				
Health and Long-Term Care	61,904	63,831	1,927	3.1
Education*	30,425	31,702	1,277	4.2
Treasury Board Secretariat (Base)	1,346	1,640	294	21.8
Contingency Fund (Total)	0	549	549	-
Transportation	4,718	5,126	408	8.6
Children, Community and Social Services	16,862	17,223	361	2.1
Infrastructure	513	550	37	7.1
Francophone Affairs	6	6	-0	-3.3
Executive Offices	38	38	-1	-1.3
Seniors and Accessibility	52	51	-1	-2.3
Labour, Training and Skills Development	307	293	-14	-4.6
Natural Resources and Forestry	716	699	-17	-2.4
Solicitor General	2,681	2,645	-36	-1.4
Heritage, Sport, Tourism and Culture Industries	1,562	1,512	-51	-3.2
Government and Consumer Services	1,757	1,687	-70	-4.0
Environment, Conservation and Parks	682	606	-76	-11.1
Board of Internal Economy	371	288	-84	-22.5
Attorney General	1,714	1,604	-110	-6.4
Economic Development, Job Creation and Trade	922	773	-149	-16.1
Agriculture, Food and Rural Affairs	1,066	880	-186	-17.5
Finance	1,637	1,450	-187	-11.4
Indigenous Affairs	290	72	-218	-75.1
Municipal Affairs and Housing	1,479	1,112	-368	-24.8
Energy, Northern Development and Mines	5,721	5,179	-543	-9.5
Colleges and Universities	11,984	11,369	-615	-5.1
Interest on Debt	12,384	12,905	521	4.2
Total Expense	161,135	163,785	2,650	1.6

Note: Numbers may not add due to rounding. Ministries are ranked by their year over year change in funding.

* Education includes the Teachers' Pension Plan.

Source: 2019 Ontario Economic Outlook and Fiscal Review.

Table 5: FAO Baseline Fiscal Outlook

(\$ Billions)	2016a	2017a	2018a	2019f	2020f	2021f	2022f	2023f
Revenue								
Personal Income Tax	30.7	32.9	35.4	36.8	38.5	40.3	42.2	44.1
Sales Tax	24.8	25.9	27.8	27.9	29.0	30.0	31.1	32.2
Corporations Tax	14.9	15.6	16.6	15.8	16.5	17.2	17.9	18.8
All Other Taxes	24.1	25.3	25.7	26.4	27.3	28.1	28.8	29.5
Total Taxation Revenue	94.3	99.7	105.5	106.9	111.3	115.7	119.9	124.6
Transfers from Government of Canada	24.5	24.9	25.1	25.5	26.6	27.2	28.0	28.8
Income from Government Business Enterprise	5.6	6.2	5.5	5.8	6.3	6.9	7.1	7.4
Other Non-Tax Revenue	16.3	19.9	17.6	16.7	17.1	17.6	18.1	18.6
Total Revenue	140.7	150.6	153.7	154.9	161.3	167.3	173.2	179.3
Expense								
Health Sector	56.2	59.1	61.9	63.8	65.1	65.7	66.7	68.4
Education Sector	26.6	27.3	28.7	30.0	30.0	30.3	30.3	30.4
Children's and Social Services Sector	15.7	16.3	16.9	17.2	17.3	16.7	16.3	16.2
Other*	33.0	39.7	41.2	39.9	41.7	42.6	43.6	43.4
Total Program Expense	131.5	142.4	148.8	150.9	154.1	155.3	156.9	158.4
Interest on Debt	11.7	11.9	12.4	12.6	12.7	12.7	12.5	12.2
Total Expense	143.2	154.3	161.1	163.5	166.8	167.9	169.4	170.6
Budget Balance**	-2.4	-3.7	-7.4	-8.5	-5.5	-0.6	3.7	8.7

a = Actual f = Forecast

* Includes Teachers' Pension Plan.

** Budget Balance is presented without reserve.

Note: Years represent fiscal years starting in the number presented (i.e., 2018 is fiscal year 2018-19). Numbers may not add due to rounding.

Source: Statistics Canada, 2019 Ontario Economic Outlook and Fiscal Review, Ontario Public Accounts and FAO.

Table 6: FAO Baseline Debt Outlook

(\$ Billions)	2016a	2017a	2018a	2019f	2020f	2021f	2022f	2023f
Budget Balance	-2.4	-3.7	-7.4	-8.5	-5.5	-0.6	3.7	8.7
Accumulated Deficit	205.9	209.0	216.6	225.2	230.6	231.2	227.5	218.7
Net Debt	314.1	323.8	338.5	354.3	366.1	372.2	372.8	368.9
Net Debt to GDP (Per Cent)	39.6	39.2	39.6	39.9	39.8	39.0	37.8	36.1

a = Actual f = Forecast

* Budget Balance is presented without reserve.

Note: Years represent fiscal years starting in the number presented (i.e., 2018 is fiscal year 2018-19). Numbers may not add due to rounding.

Source: Statistics Canada, 2019 Ontario Economic Outlook and Fiscal Review, Ontario Public Accounts and FAO.



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