FAO Financial Accountability Office of Ontario

Economic and Fiscal Outlook

Assessing Ontario's Medium-term Prospects

Fall 2016 Update

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 Fiscal Outlook is released each spring and fall, providing an assessment of the province's medium-term economic performance and fiscal position.

This report was prepared by Nicolas Rhodes, Luan Ngo, Edward Crummey, and Mario Angastiniotis 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.

This report is based on information available to October 7, 2016. Background data used in this report are available upon request.

FAO's Fiscal Projections

The FAO forecasts provincial finances based on projections of existing and announced revenue and spending policies. The forecast represents the FAO's view of the most likely fiscal outcomes given existing policies, without anticipating any new government policy decisions. 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. Beyond the government's published spending projections, the FAO forecasts spending based on the outlook for underlying cost drivers including demographics and price inflation.

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EXECUTIVE SUMMARY

This report provides an updated Economic and Fiscal Outlook for Ontario based on developments since the release of the FAO's spring outlook[1] on May 18, 2016.

Major developments since the FAO's spring report include:

- the release of Ontario's Public Accounts, which reported higher than expected tax revenues in 2015-16, suggesting higher revenues over the outlook;
- proposed new spending commitments, announced in the government's Throne Speech, to provide an HST rebate on electricity bills and expand child care spaces; and
- a more moderate outlook for economic growth, reflecting weaker economic conditions in Canada and globally, which leads to lower tax revenues but also lower interest on debt expense.

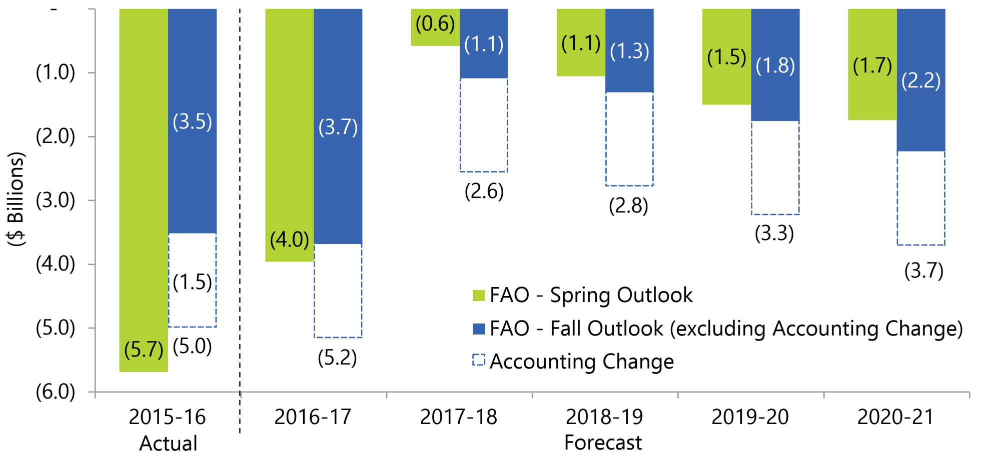
In addition, the government legislated a change in the accounting treatment for jointly sponsored pension plans, which increased program expense by $1.5 billion in 2015-16.[2]

1 'Economic and Fiscal Outlook, Assessing Ontario's Medium Term Prospects, Spring 2016', Financial Accountability Office of Ontario.

2 In the 2015-16 Public Accounts, the Province legislated a change in the accounting treatment of jointly sponsored pension plans, which increased net debt by $9.2 billion and the deficit by $1.5 billion in 2015-16. It is not clear how this accounting change for 2015-16 will impact the Province's finances in the future. For this report, the FAO assumed that program spending is $1.5 billion higher over the outlook, and provided Ontario's fiscal position both excluding and including the accounting change.

Excluding the accounting change, these developments were largely offsetting, resulting in a moderately higher budget deficit over the outlook compared to the FAO's spring report.

Ontario's Budget Balance*



Source: Ontario Public Accounts and FAO

* Budget balance excluding reserve.

Including the accounting change, the FAO is projecting Ontario budget deficits of $5.2 billion in 2016-17 and $2.6 billion in 2017-18.[3] Beginning in 2018-19, the deficit is forecast to steadily deteriorate to $3.7 billion by 2020-21, as growth in revenue is outpaced by increases in program expense and interest on debt.

Ontario's net debt is expected to rise by $64 billion over the next five years to $370 billion by 2020-21, about $20 billion higher than forecast in the FAO's spring outlook. This increase in net debt is the result of cumulative deficits, capital spending and the accounting change. Ontario's net debt-to-GDP ratio is now expected to plateau at about 41 per cent, significantly above the 39.6 per cent peak projected in the FAO's spring report.

The government has reaffirmed its commitment to achieve budget balance in 2017-18 and maintain balance going forward. However, based on the FAO's analysis of the economic outlook and the government's current fiscal position, Ontario's budget would be expected to remain in deficit over the next five years. Achieving and maintaining budget balance will likely require additional measures to raise revenue or reduce expense.

3 In this report, the budget deficit is presented excluding any 'reserve'. In government budget documents, the reported budget deficit typically includes a 'reserve' as a measure of prudence against unexpected outcomes. For example, in the 2016 Budget, the budget deficit for 2016-17 included a $1.0 billion reserve.

2

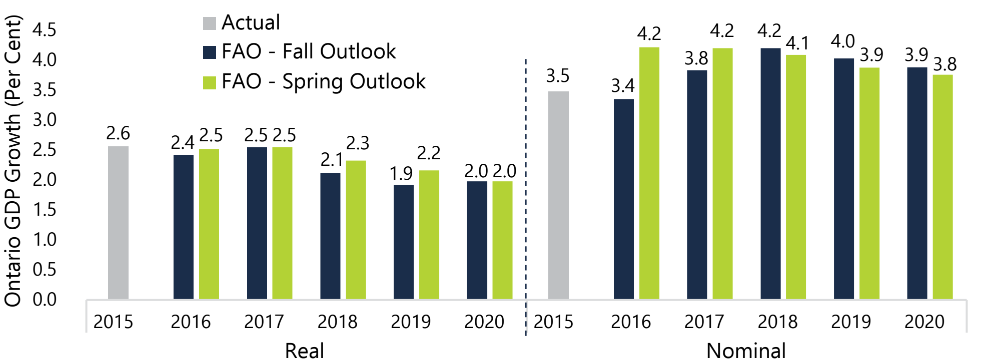
ECONOMIC OUTLOOK

Overview

Ontario Growth Expected to be Lower in 2016 and 2017[1]

Following a solid gain in the first quarter of 2016, economic indicators suggest that the pace of economic activity in Ontario moderated noticeably through the second quarter, reflecting a decline in merchandise exports and slower growth in retail sales. Based on Ontario's economic performance over the first half of 2016, the FAO has revised down its projection for Ontario real and nominal GDP growth compared to the outlook presented in the FAO's spring outlook report.[2] In particular, nominal GDP – the broadest measure of the tax base – is now projected to increase by 3.4 per cent in 2016 and 3.8 per cent in 2017, below the 4.2 per cent projected in the spring.

The FAO's Revised Economic Outlook



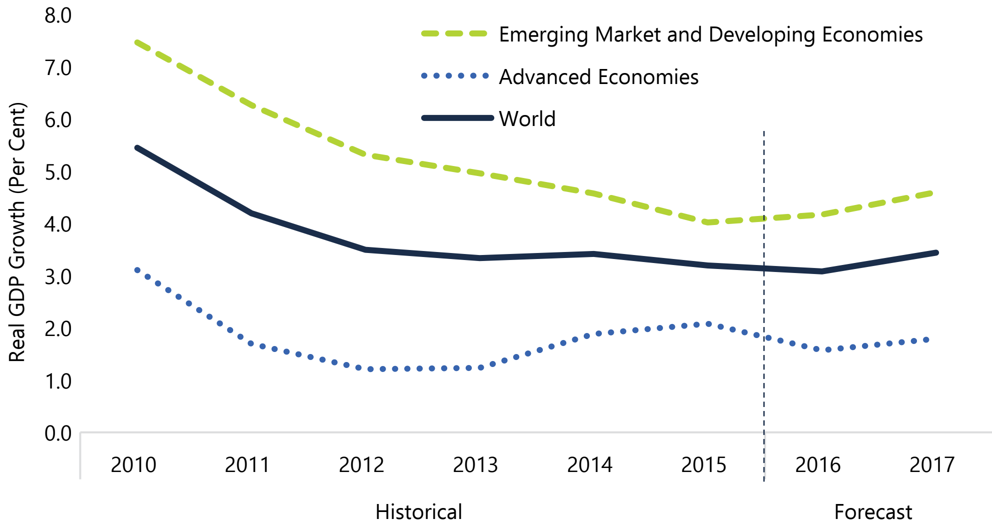
Source: Ontario Economic Accounts and FAO

1 See Appendix for detailed forecast tables.
2 'Economic and Fiscal Outlook, Assessing Ontario's Medium Term Prospects, Spring 2016', Financial Accountability Office of Ontario.

Global Economic Growth Revised Modestly Lower

Global economic growth remains tentative with current forecasts much weaker than expected a few years ago and well below the pace of growth before the 2008-2009 recession. According to the latest forecast from the International Monetary Fund (IMF)[3], the global outlook for 2016 and 2017 has weakened since the FAO's spring report, largely due to the United Kingdom's decision to withdraw from the European Union (commonly referred to as *Brexit*). The deterioration in the global outlook largely reflects greater political uncertainty across a wide range of institutional and economic arrangements which is negatively affecting business confidence and investment.

Global Growth Remains Weak



Source: International Monetary Fund, World Economic Outlook, October 2016

The IMF is projecting global growth of 3.1 per cent in 2016 and 3.4 per cent in 2017, slightly lower than its outlook last spring. The downward revisions to the IMF's global outlook are concentrated in European economies, with minor changes to the forecasts for the United States and China. The IMF has lowered its forecast for Canadian real GDP growth to 1.2 per cent in 2016 and 1.9 per cent in 2017. Most advanced economies continue to experience weak business investment and poor labour market results, which are contributing to a muted inflation outlook. On average, advanced economies are expected to record growth of just 1.6 per cent in 2016 and 1.8 per cent in 2017.

3 International Monetary Fund, World Economic Outlook, October 2016

In China, economic growth is expected to gradually moderate as the economy continues to rebalance from investment and manufacturing-led growth to a more service-intensive economy. China's real GDP growth is expected to be 6.6 per cent in 2016 and 6.2 per cent in 2017, down substantially from growth rates of over nine per cent following the global recession. The short-term outlook for China has improved modestly compared to the spring outlook, largely as a result of stimulus from both monetary and fiscal policy.

There were only modest changes in the IMF's outlook for the other large emerging market economies since the spring. On average, the IMF is projecting real GDP growth for emerging and developing market economies of 4.2 per cent in 2016, strengthening to 4.6 per cent in 2017.

Significant Risks Remain for the Global Outlook

Economic and political uncertainty remains elevated with a number of significant risks continuing to weigh on global growth prospects.

In Europe, concerns over the stability of a number of major banks raises the risk of a renewed financial crisis which would impact the already weak pace of European growth. As well, the sharp rise in corporate and household debt in China over the past several years has been identified by the IMF as a key risk for the global economy.

Other political developments, including military conflict in the Middle East and the growing popularity of nationalism and protectionist trade policies in developed nations could also impact global economic growth.

U.S. Economic Growth Weaker than Expected in 2016

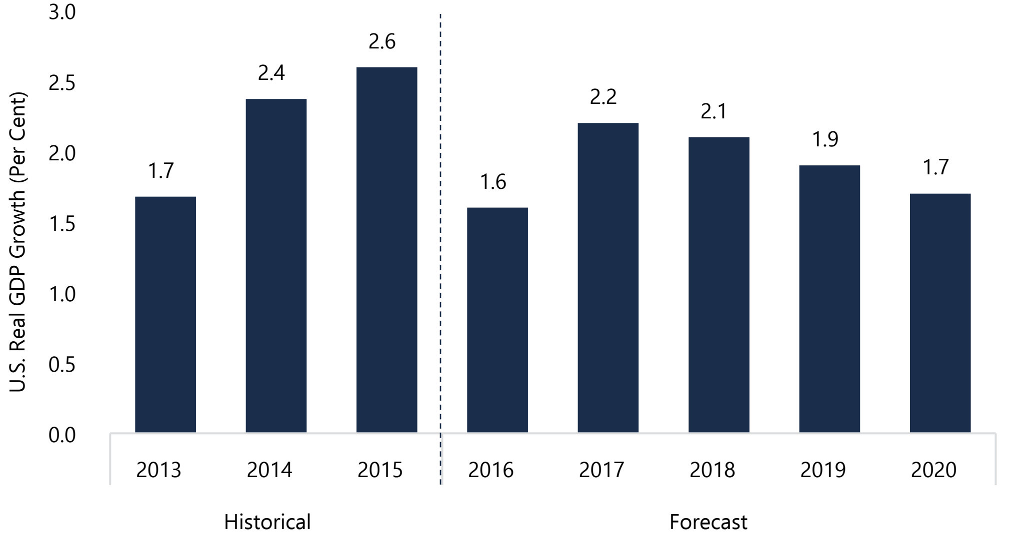
In the United States, economic growth over the first half of 2016 was weaker than expected, contributing to downward revisions of recent economic forecasts. Over the first two quarters of 2016, U.S. real GDP increased by just 1.4 per cent on a year-over-year basis, well below projections last spring for growth of over two per cent.

U.S. employment growth has also moderated in 2016, with average monthly gains of about 180,000 jobs, down from average monthly increases of almost 230,000 jobs in 2015 and 250,000 in 2014.

Despite the weaker than projected growth for 2016, economic forecasters continue to expect the U.S. economy will strengthen over the remainder of 2016 and beyond. In particular, household spending and residential construction are expected to contribute to overall economic growth, supported by continued job creation and rising wages. Forecasters also remain confident that business investment, which has generally disappointed expectations over the past several years, will eventually rebound and help spur overall economic growth.

Based on the latest IMF forecast, U.S. real GDP is expected to grow by 1.6 per cent in 2016 and strengthen to over two per cent growth in 2017 and 2018. Beyond 2018, growth is expected to moderate, remaining close to the pace of growth of potential output.[4] This moderate but steady growth in the U.S. economy should lead to a gradual rise in interest rates.

U.S. Economic Growth Disappoints in 2016



Source: International Monetary Fund, World Economic Outlook, October 2016

4 The maximum sustainable level of output where the economy's resources such as labour are fully utilized.

Canadian Economic Growth Revised Lower

The outlook for the Canadian economy has deteriorated over the past six months. Canadian real GDP is currently projected to grow by 1.2 per cent in 2016, down from a forecast of 1.7 per cent growth at the time of the FAO's spring outlook.[5] The downward revision to the Canadian outlook reflects the impact of the Alberta wildfires, but also weaker than expected non-energy exports and business investment.

After a promising start to 2016, with solid first quarter growth, Canadian real GDP declined at an annualized rate of 1.6 per cent in the second quarter, the weakest quarterly result since the 2008-2009 recession. While the Alberta wildfires were a major contributor to the disappointing outcome, there were also declines in household durable goods spending and business investment. Temporary disruptions in Ontario's auto sector[6] led to a drop in automotive exports, which contributed to an overall decrease in goods exports in the first half of 2016.

The resumption in oil production in Alberta and the end of production slowdowns in the auto sector should contribute to a rebound in Canada's goods exports in the third quarter. This, along with an expected boost to consumer spending from the federal child benefit in the third quarter, will contribute to stronger real GDP growth in the second half of 2016. Further, the rebuilding effort in Alberta should bolster Canadian real GDP growth in 2017.

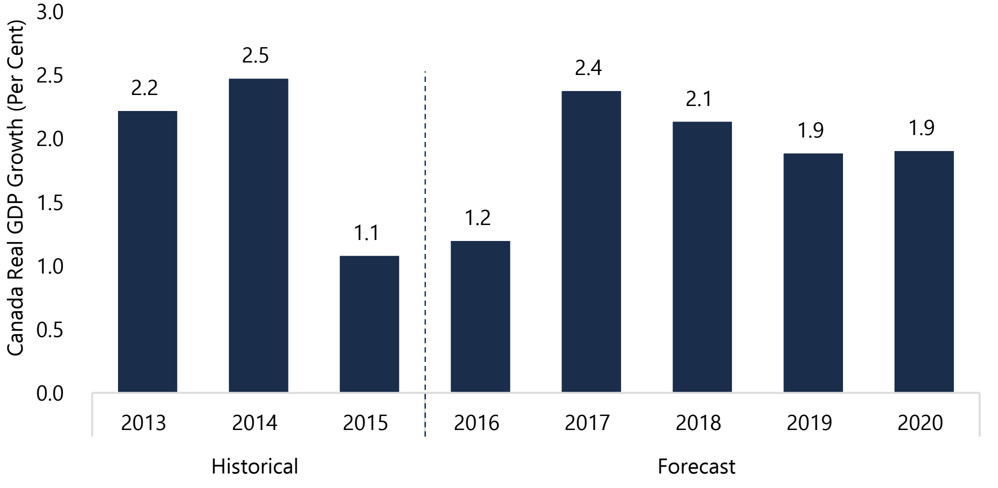
Beyond the temporary factors which buffeted the economy in 2016, the Canadian economy continues to adjust to the longer-term structural impact of lower energy prices. While weakness in the energy sector continues, growth in the rest of the Canadian economy has not significantly improved, leading to slower growth overall than previously expected. In 2015 and 2016, Canadian real GDP is expected to grow by just over one per cent on average, well below the 2.5 per cent average rate recorded from 2010 to 2014.

However, forecasters generally expect the Canadian economy to strengthen in 2017, recording growth of 2.4 per cent, as steady gains in non-energy exports, and a rebound in business investment help offset continued slow growth in the oil and gas sector.

5 Based on the FAO consensus forecast which includes the Centre for Spatial Economics, the University of Toronto and the Conference Board of Canada.

6 General Motors shut four of its North American assembly plants, including the Oshawa plant for 2 weeks in April 2016. This was due to a parts shortage, caused by the earthquakes that struck Japan. 'GM's Oshawa plant halts production for two weeks', The Toronto Star, April 22, 2016.

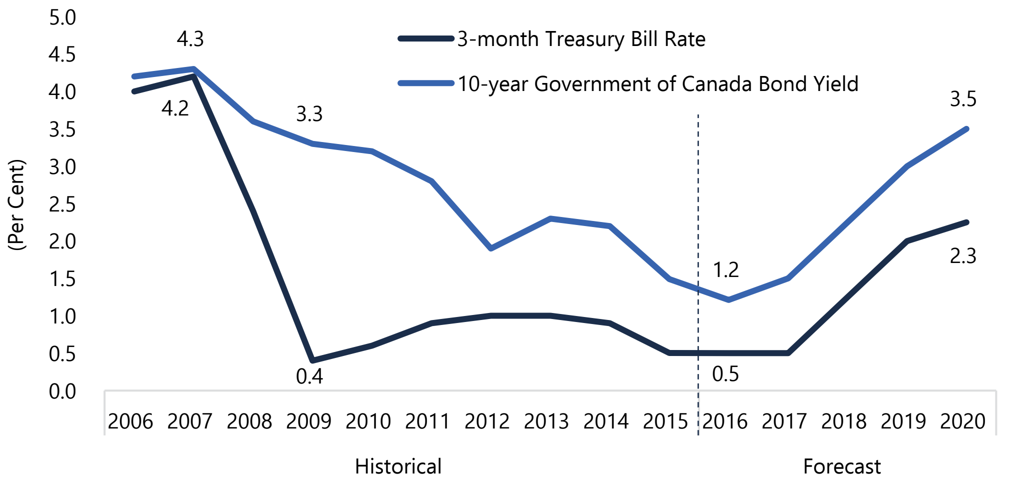
Canada GDP Growth Expected to Rebound in 2017



Source: Statistics Canada and FAO Consensus

Given the relatively slow growth of the Canadian economy, the Bank of Canada appears unlikely to raise its key policy interest rate before 2018. As a result, the FAO has revised down its interest rate outlook from its spring forecast. The current outlook assumes short-term rates remain near current levels until 2018. Beyond 2018, interest rates are expected to gradually normalize with the 10-year Government of Canada bond yield rising to 3.5 per cent by 2020 – a full percentage point below the FAO's spring projection of 4.5 per cent in 2020.

Canadian Interest Rates to Rise Gradually



Source: Statistics Canada and FAO

The Canadian dollar is expected to gradually appreciate over the next five years, rising from an average of about 76 cents U.S. in 2016 to about 84 cents U.S. by 2020, supported by steady economic growth and a gradual increase in oil prices.

Ontario Economic Outlook

Outlook for Real GDP Growth Remains Solid

The Ontario economy posted strong real GDP growth over the second half of 2015 and into the first quarter of 2016. However, merchandise exports, retail trade and employment growth slowed noticeably in the second quarter of 2016, contributing to a slowdown in overall economic growth.

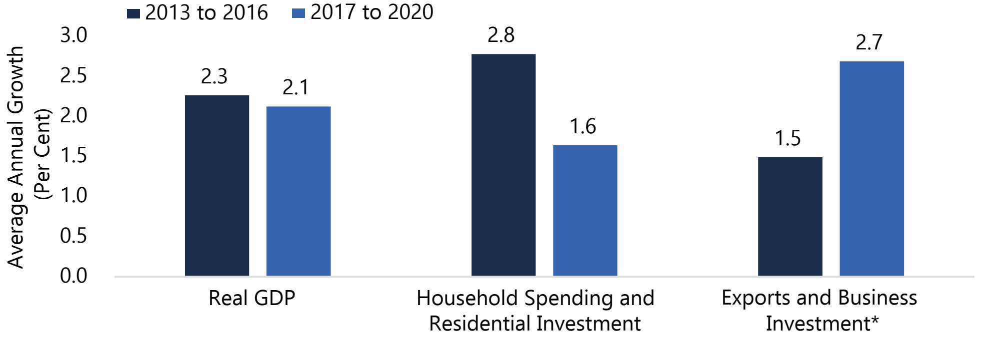
The slower pace of growth in the second quarter was partly the result of the temporary shutdown of some auto production facilities in the province. However, the return to normal production levels should boost third quarter growth. In addition, the introduction of the new federal child benefit in the third quarter is expected to provide a lift to household spending over the second half of 2016. In 2017, new spending initiatives announced in the Ontario government's September Throne Speech should also provide some additional support to household and government spending.[7]

On an annual basis, the FAO is forecasting real GDP growth of 2.4 per cent in 2016 and 2.5 per cent in 2017, slightly below the projection last spring. Beginning in 2018, real GDP growth is expected to gradually moderate, with average annual gains of 2.0 per cent.

The FAO forecast is broadly consistent with the consensus view among economists that stronger international exports and business investment will be key drivers of Ontario's overall growth over the next several years. At the same time, household spending and residential investment are expected to grow more modestly as households begin to reduce borrowing and residential construction activity slows.

7 This includes the announced expansion of child care spaces in Ontario and the rebate of the provincial portion of the HST on electricity bills.

Exports and Business Investment Expected to Drive Growth



* Business Investment includes both Non-Residential Investment and Machinery & Equipment Investment
Source: Ontario Economic Accounts, Statistics Canada and FAO

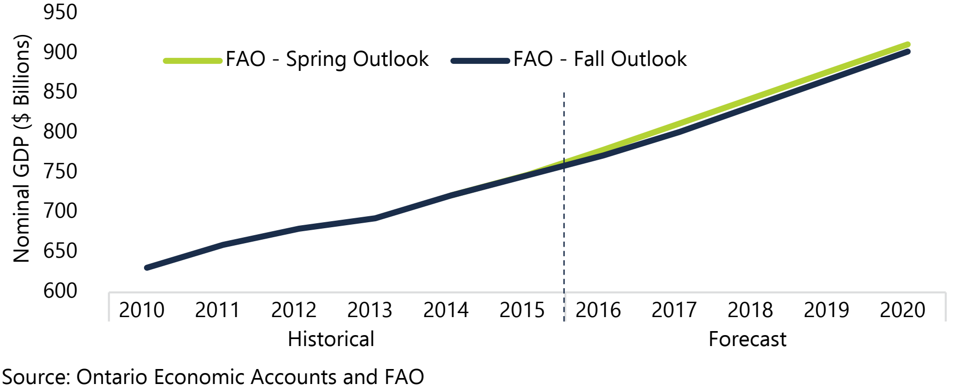
Weaker Profit Gains Contribute to Lower Nominal GDP Growth in 2016

The FAO forecast for nominal GDP over the short-term is largely based on its projections for labour income and net operating surplus of corporations (corporate profits), which together account for about 66 per cent of total GDP.

Labour income growth remained relatively robust over the first half of 2016, rising by 3.9 per cent compared to the same period in 2015. However, overall corporate profits declined in the first half of 2016, on a year-over-year basis, reflecting lower profits in the manufacturing and the banking sectors.[8]

Based on the FAO's updated outlook, Ontario nominal GDP is expected to be about 1.0 per cent lower by 2020 than originally projected in the spring forecast. The lower level of nominal GDP over the outlook is largely due to the downward revisions to growth for 2016 and 2017.

Ontario Nominal GDP Below FAO's Spring Forecast



Source: Ontario Economic Accounts and FAO

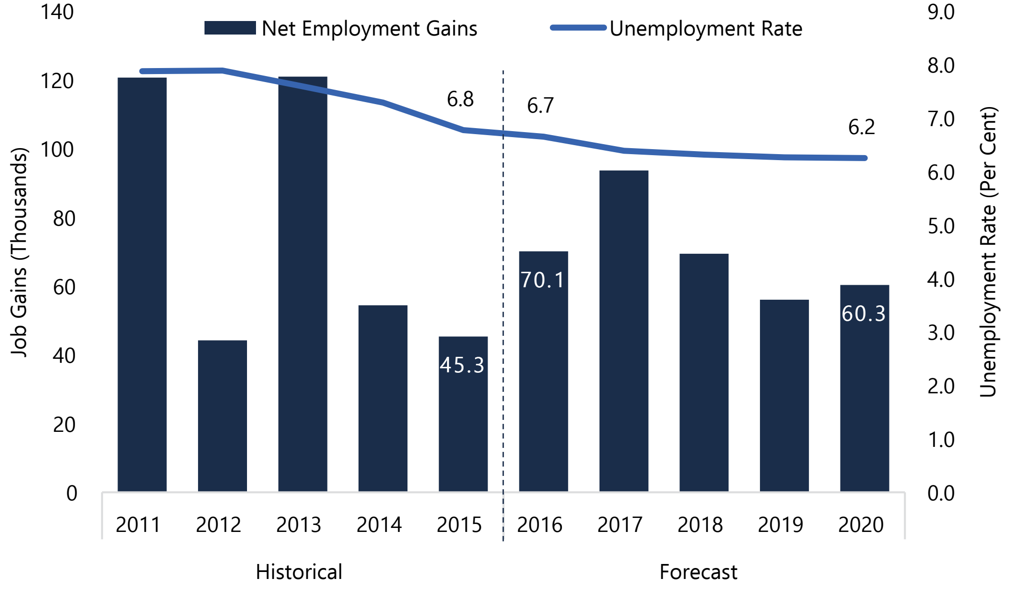
8 'Quarterly Financial Statistics for Enterprises', Second Quarter 2016, Statistics Canada.

Steady Employment Gains Result in Gradual Decline in Unemployment Rate

Ontario employment is expected to grow moderately over the outlook, reflecting the outlook for steady economic growth. The FAO is projecting solid job growth of 1.0 per cent (+70,000 net job gains) in 2016, following a more modest gain of 0.7 per cent (+45,000 net jobs) in 2015. The majority of the net new jobs are projected to be in full-time, private sector employment. Furthermore, manufacturing sector employment is expected to post a moderate gain in 2016, the first annual increase in four years.

Over the five-year forecast, the FAO is projecting Ontario employment growth to average 1.0 per cent per year, down from an average pace of 1.2 per cent over the past five years. Even so, the steady projected gains in employment, combined with more moderate labour force growth, will result in a gradual decline in Ontario's unemployment rate from 6.8 per cent in 2015 to 6.2 per cent by 2020.

Steady Employment Gains and Gradual Decline in Unemployment Rate



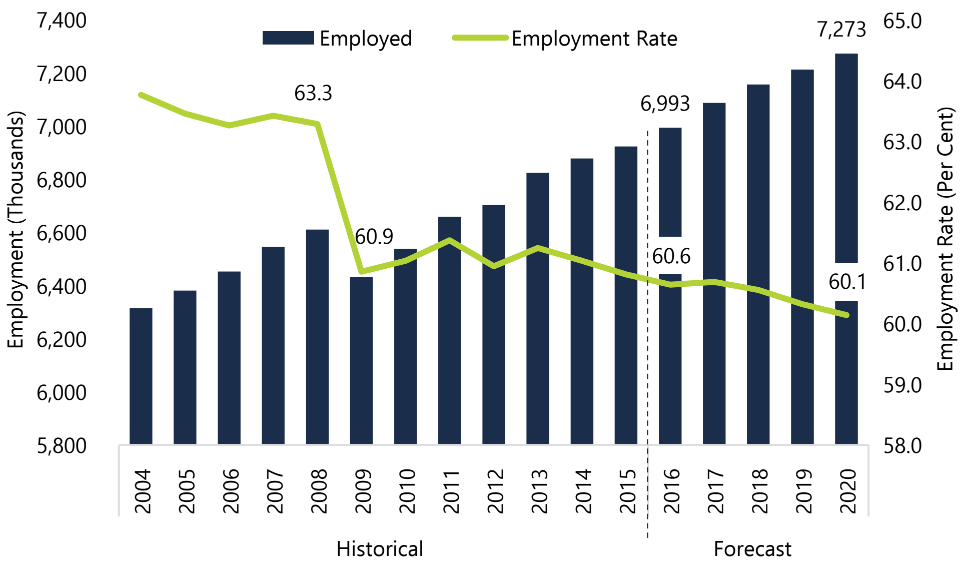
Source: Statistics Canada and FAO

Change Continues for Ontario's Labour Market

While steady job gains and a gradual improvement in the unemployment rate are expected to continue, significant structural changes are also occurring in Ontario's labour market.

Ontario's employment rate – the share of the working age population with a job – currently remains well below the pre-recession rate of over 63 per cent. The employment rate improved somewhat in the years following the recession, but has resumed its downward trend in the past three years. Over the next five years, the FAO projects a continued decline in the employment rate to about 60 per cent by 2020, as the rate of growth in employment continues to be lower than overall population growth.

Employment Rate to Trend Lower



Source: Statistics Canada and FAO

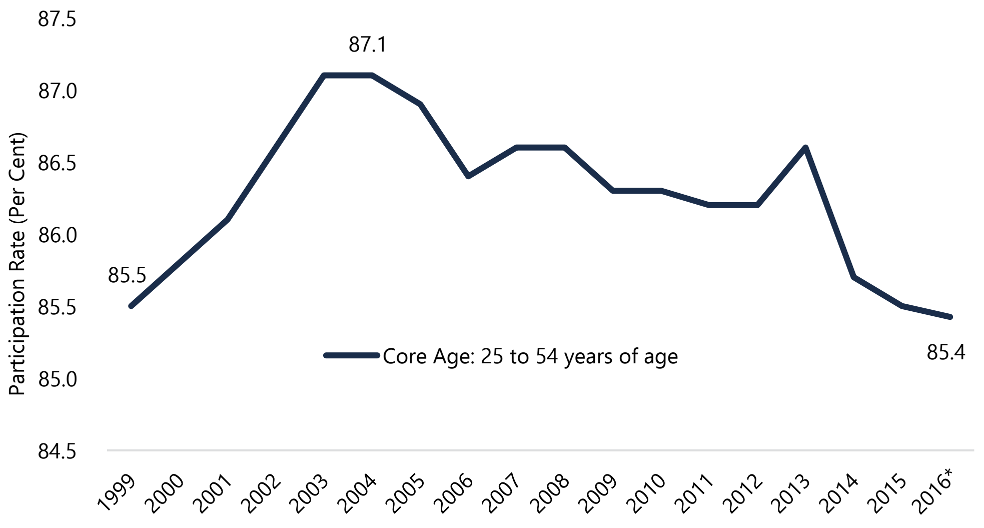
The nature of unemployment in Ontario has also changed since the 2008-2009 recession. Both the long-term unemployment rate (the share of those unemployed for longer than six months) and the average duration of unemployment (the length of time it takes to find a new job) continue to be worse than pre-recession levels.[9] The slow pace of improvement in these other measures of unemployment suggests

9 The long-term unemployment rate – the percentage of those unemployed who have been without a job for longer than six months – increased from 13 per cent in 2007 to 25 per cent in 2010. Since 2010, the long-term unemployment rate has improved moderately, decreasing to 20 per cent in 2015. The average duration of unemployment increased from around 15 weeks in 2007 to almost 22 weeks in 2010. Since 2010 the average time spent unemployed has decreased to 20 weeks in 2015, but remains well above pre-recession levels.

that despite overall job growth, many workers continue to face a challenging labour market.

Another indicator pointing to a structural shift in Ontario's labour market is the decline in the proportion of adults, aged 25 to 54, who are currently employed or looking for work – the 'core age participation rate'. Since 2004, the core participation rate decreased from about 87 per cent to just over 85 per cent in 2016 (the lowest rate since the late 1990s).

Core Age Participation Rate at Lowest Level Since 1999



Source: Statistics Canada and FAO

* 2016 is August year-to-date value.

As Ontario's population ages, the overall labour force participation rate (for all Ontarians) will decline since people work less as they move into their senior years. This will lead to slower growth in Ontario's workforce and contribute to a slower pace of economic growth. However, the declining participation rate for adult-aged workers is a key concern, since it exacerbates the effects of an aging workforce on economic growth.

An increase in the core age participation rate back to 87 per cent would represent about 90 thousand additional workers for Ontario's labour force.

Key Risks for Ontario’s Economic Outlook

The FAO’s current economic projection represents a prudent outlook for the Ontario economy and an appropriate foundation for fiscal planning. However, a number of key risks could lead to weaker than expected economic growth for Ontario.

The sharp rise in housing prices, particularly in the Greater Toronto Area, continues to represent a key risk for the overall economy. A significant correction in housing prices, exacerbated by elevated levels of household debt, would negatively affect household spending and residential construction activity and could lead to broader, economy-wide impacts on growth and employment.

Ontario’s export sector is expected to be a key driver of economic growth over the next five years, as Ontario increases sales to the key U.S. market. A necessary ingredient of Ontario’s export led growth will be a rebound in business investment to allow for the expansion in export volumes. However, growth in business investment has been disappointing over the past four years. If business investment continues to underperform, export gains would be more limited than expected, holding back overall economic growth.

3

FISCAL OUTLOOK

Overview

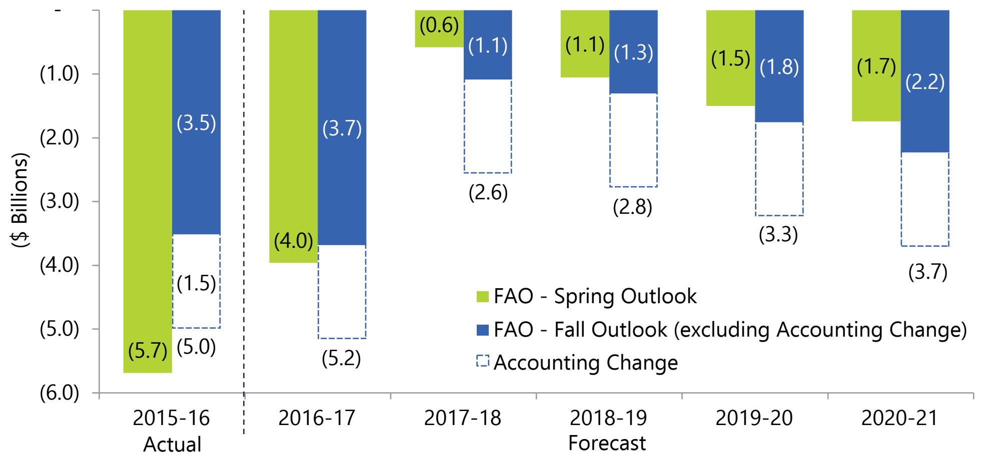
Outlook for Budget Deficit Has Deteriorated Moderately

Based on the revised economic outlook and new fiscal developments, the FAO is projecting Ontario budget deficits of $5.2 billion in 2016-17 and $2.6 billion in 2017-18.[1] Beginning in 2018-19, the deficit is expected to gradually increase as growth in revenue is outpaced by increases in program spending and interest on debt expense.

This fiscal projection reflects the legislated change in the accounting treatment of jointly sponsored pension plans in 2015-16, which the FAO assumes will remain in place over the outlook.[2] Excluding this accounting change, the deficit would be $3.7 billion in 2016-17 and $1.1 billion in 2017-18. This represents a slight improvement in the deficit in 2016-17, but a moderate deterioration over the last four years of the outlook, compared to FAO's spring report.

1 Budget balance projections are presented without the reserve.
2 In the 2015-16 Public Accounts, the Province legislated a change in the accounting treatment of jointly sponsored pension plans for 2015-16, based on the position of the Auditor General of Ontario. This accounting change increased net debt by $9.2 billion and the deficit by $1.5 billion in 2015-16. However, it is unclear how this accounting change for 2015-16 will impact the Province's finances going forward. The government has announced it will form an independent expert panel to provide recommendations on the appropriate accounting treatment of Ontario's pension assets. This report provides Ontario's fiscal position both excluding the accounting change (to allow for comparisons to the FAO's spring outlook) and including the accounting change which the FAO assumes will result in a $1.5 billion increase in program spending over the outlook.

Ontario's Budget Balance*



Source: Ontario Public Accounts and FAO

* Budget balance excluding reserve.

The outlook for the budget balance (excluding the accounting change) has deteriorated moderately since the FAO's spring report due to a number of factors that had significant but partially offsetting impacts on Ontario's fiscal position. These include:

- higher than expected tax revenues in 2015-16, as reported in the Public Accounts, which partially carry forward over the outlook;
- proposed new spending commitments, announced in the September 12, 2016 Speech from the Throne, to expand child care spaces and provide a rebate equal to the provincial portion of the HST paid on the electricity bills of households, farms and small businesses;
- lower economic growth in 2016 and 2017 which moderately dampens the expected growth in tax revenues; and
- lower interest on debt expense, reflecting a more gradual expected increase in interest rates over the outlook.

Change in the Budget Balance since the FAO's Spring Outlook

($ Billions)	2016-17	2017-18	2018-19	2019-20	2020-21
2016 Spring Outlook Budget Balance	**-4.0**	**-0.6**	**-1.1**	**-1.5**	**-1.7**
2015-16 Public Accounts[1]	0.4	0.6	0.7	0.7	0.7
Throne Speech Announcements	-0.3	-1.4	-1.8	-1.8	-1.8
Updated economic and demographic data	-0.4	-0.8	-0.6	-0.6	-0.8
Interest on Debt[2]	0.4	0.8	0.9	0.9	0.9
Other[3]	0.2	0.3	0.4	0.5	0.5
Total	**0.3**	**-0.5**	**-0.2**	**-0.3**	**-0.5**
Updated Budget Balance	**-3.7**	**-1.1**	**-1.3**	**-1.8**	**-2.2**
Accounting Change	-1.5	-1.5	-1.5	-1.5	-1.5
Updated Budget Balance with Accounting Change	**-5.2**	**-2.6**	**-2.8**	**-3.3**	**-3.7**

1 Excludes $1.5 billion impact of the change in the accounting treatment of jointly sponsored pension plans.
2 Captures impact of lower interest rates as well as changes in borrowing.
3. Reflects a change in the forecasting methodology for income from government business enterprises, which is now based on the 2016 Budget projection to 2018-19.

Note: Positive values indicate improvement in budget balance (i.e. lower deficit). Numbers may not add due to rounding.
Source: FAO

Revenue Outlook

From 2015-16 to 2020-21, the FAO projects total revenues to increase at an average annual rate of 3.0 per cent, slightly below the 3.3 per cent forecast in the FAO's spring outlook. This incorporates the proceeds from the government's planned asset sales, new revenues from cap and trade, and new federal transfers as assumed in the 2016 Ontario Budget.

Tax Revenue

Consistent with the FAO's current economic projection, tax revenue is expected to rise by 3.0 per cent over the outlook, slightly weaker than the 3.2 per cent forecast in the spring.

There were two significant changes to the tax revenue outlook since the spring.

- The 2015-16 Public Accounts reported higher than expected tax revenues. This raised the starting point for the projection, pushing up tax revenues over the outlook.
- At the same time, a somewhat weaker economic forecast, particularly for corporate profits, slowed the growth of tax revenues over the outlook.

2015-16 Public Accounts

The incorporation of the 2015-16 Public Accounts led to somewhat higher tax revenues over the forecast, compared to the spring outlook. Specifically, the Public Accounts reported a strong 11.6 per cent increase in 2015-16 tax revenues. Excluding the impact of the sale of Hydro One shares, tax revenues grew by 8.3 per cent, much stronger than the growth in economic drivers would suggest.

In particular, personal income tax (PIT) revenue grew by 6.2 per cent in 2015-16, well above the 3.9 per cent growth in labour income.[3] This unusually large increase in PIT revenues was not anticipated in the 2016 Budget projections nor by the FAO in the spring outlook, and reflects stronger than expected tax assessments from personal income tax returns for 2015.

The strong increase in PIT revenues is partly due to the federal government's introduction of a 33 per cent tax rate on taxable income over $200,000 in 2016, which led some high income earners to shift earnings from the future into the 2015 tax year to avoid the tax increase.[4] The FAO has adjusted the PIT forecast to account for the effect of income-shifting[5].

Impact of Revised Economic Outlook on Tax Revenues

A moderately weaker economic forecast dampened the tax revenue outlook, partially offsetting some of the positive impact of the 2015-16 Public Accounts.

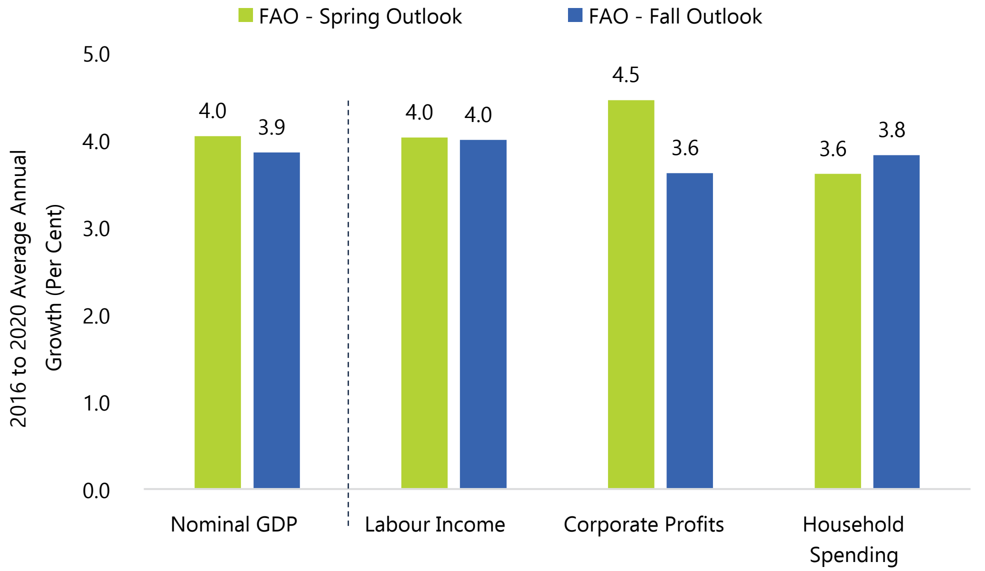
While the FAO outlook for labour income and household spending remains fairly strong, the forecast for nominal GDP has declined since the spring outlook, largely due to weaker corporate profits growth.

3 Household disposable income, which includes net property income and net government transfers increased by 3.8 per cent in 2015.

4 The federal government's 2015-16 Annual Financial Report indicated that stronger 2015 federal PIT returns partly reflect "...tax planning by high-income individuals to recognize income in the 2015 tax year before the new 33 per cent tax rate came into effect in 2016" (see: http://www.fin.gc.ca/afr-rfa/2016/report-rapport-eng.asp#_Toc463249478). Finance Canada estimates that this increased 2015 Federal PIT by $3.3 billion.

5 The FAO estimates that roughly $600 million of Ontario's 2015 PIT revenue was due to taxpayers shifting income to 2015 from future tax years.

Growth in Key Tax Drivers, 2016 – 2020*



* "Labour income", "corporate profits" and "household spending" are defined by Statistics Canada as "compensation of employees", "net operating surplus: corporations", and "household consumption" respectively.
Source: Ontario Economic Accounts and FAO

The forecast for corporate profits was revised lower, largely reflecting weak growth over the first half of 2016. As a result, corporate tax revenue is currently projected to average $0.5 billion lower over the outlook than was anticipated in the spring report.

Non-Tax Revenue

Revenues from federal transfers are expected to rise from $22.9 billion in 2015-16 to $27.0 billion by 2020-21. This includes the Province's anticipated $1.3 billion in new federal transfers by 2017-18 as outlined in the 2016 Budget. The current outlook for federal transfers has been revised down modestly from the FAO's spring outlook, reflecting $0.3 billion in lower Equalization receipts by 2020-21 due to a relatively weaker economic outlook for the rest of Canada.

In April 2016, non-tax revenues were boosted by the Province's sale of a further 14 per cent of Hydro One, generating approximately $0.6 billion in one-time revenue gains. Consequently, the Province's net income from Hydro One is reduced by a further 14 per cent (roughly $100 million) beginning in 2016-17.

The 2015-16 Public Accounts reported that revenue from government business enterprises (GBEs) was $560 million higher in 2015-16 than forecast in the 2016 Budget, largely reflecting higher net income from the electricity sector.

The FAO forecast adopts the 2016 Budget forecast for GBE income, and projects 2019-20 and 2020-21 based on economic growth.

The FAO revenue outlook continues to assume that the Province will collect $1.9 billion in proceeds from the cap and trade program, as reported in the 2016 Budget. However, it remains unclear the extent to which this revenue will be spent on new initiatives to reduce greenhouse gas emissions, or on programs already included in the government's fiscal plan.[6]

Spending Outlook

Program Spending

From 2015-16 to 2018-19, the FAO projects program spending to grow at an average annual rate of 2.2 per cent. Beyond the government's published fiscal projections to 2018-19, program spending is expected to increase by an average of 3.4 per cent in 2019-20 and 2020-21, in-line with population growth, aging and inflation.

The FAO's program spending projections adopt the 2016 Budget forecast with adjustments to incorporate the new spending commitments announced in the September 12, 2016 Speech from the Throne.

According to the Throne Speech, the government proposes to:

- Provide a rebate equal to the provincial portion of the HST on the electricity bills of residential homes, farms and small businesses, beginning January 1, 2017.[7] This measure is expected to result in new government spending of $1 billion annually.[8]

- Create 100,000 new child care spaces over five years starting in 2017. This program is expected to result in new capital spending between $1 billion and $3 billion over five years, and between $600 million and $750 million in new annual operating costs, when fully implemented.[9]

Given the limited details, the FAO has incorporated reasonable assumptions about the total cost and roll-out of both measures into its program spending projections. These measures are assumed to be new expenditures on top of the program spending projections published in the 2016 Budget.

6 Funding existing initiatives would improve its budget balance, while funding new initiatives would not impact the budget balance.
7 Government of Ontario News Release, Ontario Introducing Measures to Reduce Electricity Costs, September 15, 2016
8 QP Briefing, Throne Speech 2016: Premier Wynne pledges hydro bill relief, more child care spaces, September 12, 2016
9 QP Briefing, Throne Speech 2016: 100,000 new licensed child care spaces to cost up to $3.75B, September 12, 2016

FAO's Assumptions for Newly Announced Programs

($ Millions)	2016-17	2017-18	2018-19	2019-20	2020-21
Total Operating	**250**	**1,375**	**1,750**	**1,750**	**1,750**
Child Care Spaces Expansion		375	750	750	750
HST Rebate on Electricity Bills	250	1,000	1,000	1,000	1,000
Total Capital	**-**	**800**	**600**	**300**	**300**
Child Care Spaces Expansion	-	800	600	300	300

Note: Since the rebate is effective January 1, 2017, the HST rebate expense is assumed to be one quarter of the annual cost for 2016-17. Given the need to design and implement the new program, spending on the expansion of child care spaces is assumed to be one-half the estimated total cost in 2017-18. Capital spending for the day care expansion is assumed to be $2 billion (the mid-point of the announced range), front-loaded in the first two years, and conducted by the government rather than transferred to outside agencies.
Source: FAO

In addition, the Province legislated a change to the accounting treatment of jointly sponsored pension plans as reported in the 2015-16 Public Accounts. This resulted in an increase of $1.5 billion in program spending for 2015-16, which the FAO assumes will extend over the outlook.

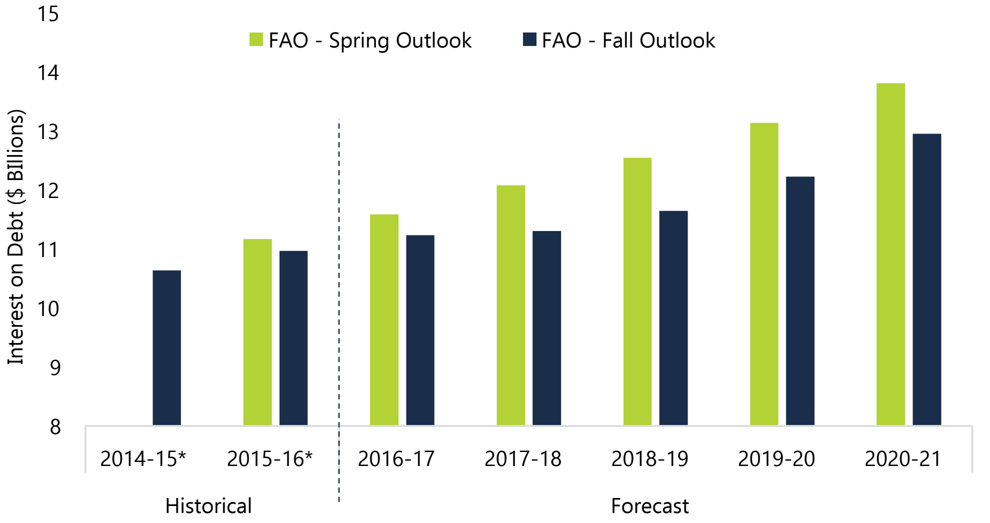
Interest on Debt

The 2015-16 Public Accounts reported that interest on debt expense (IOD) grew 3.1 per cent in 2015-16 to $11.0 billion, $0.2 billion below the FAO's spring outlook projection.

From 2015-16 to 2018-19, the FAO projects IOD will increase at an average rate of 2.0 per cent, reaching $11.6 billion by 2018-19. Over the final two years of the projection, IOD will increase more sharply rising 5.5 per cent per year on average.

The current IOD projection is $0.8 billion lower each year on average, compared to the FAO's spring outlook, primarily due to a lower forecast for interest rates over the outlook.

Interest on Debt Outlook



* 2014-15 and 2015-16 FAO – Fall Outlook values are actuals.
Source: Ontario Public Accounts and FAO

Debt Outlook

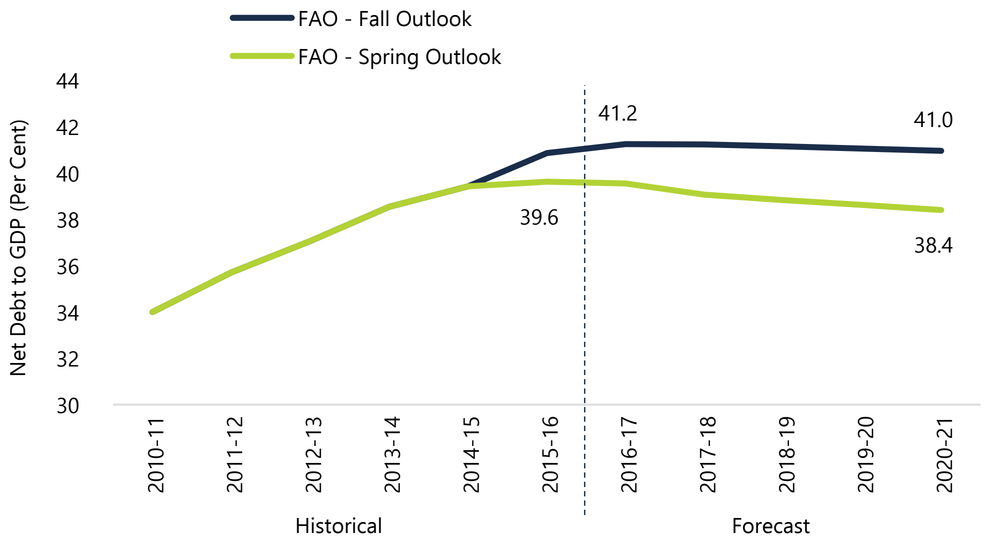
The Public Accounts reported that Ontario's net debt[10] rose 7.3 per cent to $305.2 billion in 2015-16, $8.9 billion higher than projected in the FAO's spring outlook. The increase in net debt in 2015-16 includes a one-time increase of $10.7 billion as a result of the legislated change in the accounting treatment of jointly sponsored pension plans.[11]

The FAO projects Ontario's net debt to rise by $64 billion over the next five years to $370 billion by 2020-21. This reflects cumulative deficits, capital spending for infrastructure and the accounting change.

The increase in net debt, coupled with slightly lower growth in nominal GDP, results in a significantly higher net debt-to-GDP ratio relative to the FAO's spring outlook. Ontario's net debt-to-GDP ratio is now expected to plateau at about 41 per cent, significantly above the 39.6 per cent peak projected in the FAO's spring report.

10 Net debt is defined as gross debt and other liabilities less financial assets.
11 2015-16 Public Accounts of Ontario, page 10.

Ontario's Net Debt to GDP Ratio



Source: Ontario Public Accounts and FAO

The Province's borrowing requirement is expected to edge down slightly to $29.3 billion in 2016-17 from $32.1 billion in 2015-16, and average $29 billion per year over the outlook, largely unchanged from the FAO's spring outlook. The change in the accounting treatment of jointly sponsored pension plans does not affect the Province's borrowing requirement or gross debt.

Risks to the Fiscal Plan and Policy Options

There are material risks that could impact Ontario's fiscal position.

- Actual growth in the economy could be weaker than projected, lowering tax revenues. Growth in nominal GDP over the first half of 2016 is currently tracking below forecasts published earlier in 2016. If actual growth continues to underperform forecasts, tax revenues would be lower.
- The FAO forecast adopts the government's outlook for program spending, adjusted for new fiscal developments. This assumes that program spending can be restrained below the growth in demographic factors and inflation. If program spending grows faster than projected, the fiscal balance would deteriorate. Notably, the government has increased planned spending for 2017-18 in each of the last three budgets.

At the same time, the government has a broad range of policy options that could improve the fiscal position, including the sale of additional public assets beyond announced targets, or applying new revenues (from cap and trade or new federal transfers) to existing program spending commitments.

4

APPENDIX: DATA TABLES

Table 1a: Outlook for Ontario Nominal GDP and Key Revenue Drivers

(Per Cent Growth)	2015a	2016f	2017f	2018f	2019f	2020f	Average
Nominal GDP							
FAO - Fall Outlook	3.5	3.4	3.8	4.2	4.0	3.9	**3.9**
FAO - Spring Outlook *	3.6	4.2	4.2	4.1	3.9	3.8	**4.0**
Current FAO Consensus **	3.5	4.2	4.4	4.4	4.0	3.9	**4.2**
Labour Income							
FAO - Fall Outlook	3.9	4.0	3.8	4.1	4.2	3.9	**4.0**
FAO - Spring Outlook *	3.7	4.0	3.9	4.1	4.2	3.9	**4.0**
Corporate Profits							
FAO - Fall Outlook	0.9	0.3	2.9	6.6	4.2	4.1	**3.6**
FAO - Spring Outlook *	3.1	3.4	6.9	5.3	3.2	3.5	**4.5**
Household Consumption							
FAO - Fall Outlook	4.2	4.4	4.2	3.7	3.5	3.4	**3.8**
FAO - Spring Outlook *	4.3	4.2	3.8	3.4	3.4	3.4	**3.6**

a = Actual f = Forecast
* 2015 FAO - Spring Outlook values reflect the FAO's forecast, as actuals were not available at the time of the publication of the Spring Outlook.
** FAO consensus includes forecasts from the Centre for Spatial Economics, University of Toronto, and the Conference Board of Canada.
Source: Statistics Canada, Ontario Economic Accounts, FAO Consensus and FAO

Table 1b: Outlook for Ontario Real GDP and Components

(Per Cent Growth)	2015a	2016f	2017f	2018f	2019f	2020f	Average
Real GDP							
FAO - Fall Outlook	2.6	2.4	2.5	2.1	1.9	2.0	**2.2**
FAO - Spring Outlook *	2.6	2.5	2.5	2.3	2.2	2.0	**2.3**
Current FAO Consensus **	2.6	2.6	2.5	2.1	1.9	2.0	**2.2**
Real GDP Components, FAO - Fall Outlook							
Consumption (Households and Non-Profit)	3.2	3.1	2.3	1.8	1.5	1.6	**2.1**
Investment (Business and Non-Profit)	5.9	2.2	1.0	2.7	3.4	2.7	**2.4**
Government (Current and Capital Spending)	1.6	1.4	2.2	1.4	1.1	1.2	**1.5**
Exports	1.5	2.2	2.4	2.7	2.5	2.3	**2.4**
Imports	1.6	2.1	2.3	2.3	2.0	1.7	**2.1**

a = Actual f = Forecast
* 2015 FAO - Spring Outlook values reflect the FAO's forecast, as actuals were not available at the time of the publication of the Spring Outlook.
** FAO consensus includes forecasts from the Centre for Spatial Economics, University of Toronto, and the Conference Board of Canada.
Source: Statistics Canada, Ontario Economic Accounts, FAO Consensus and FAO

Table 2: Outlook for Selected Economic Indicators

	2015a	2016f	2017f	2018f	2019f	2020f
Key Economic Indicators						
Employment (Per Cent Growth)						
FAO - Fall Outlook	0.7	1.0	1.3	1.0	0.8	0.8
FAO - Spring Outlook	0.7	1.2	1.4	1.1	1.1	0.9
Unemployment Rate (Per Cent)						
FAO - Fall Outlook	6.8	6.7	6.4	6.3	6.3	6.2
FAO - Spring Outlook	6.8	6.7	6.5	6.3	6.1	6.0
Labour Force (Per Cent Growth)						
FAO - Fall Outlook	0.1	0.9	1.1	0.9	0.7	0.8
FAO - Spring Outlook	0.1	1.1	1.2	1.0	0.9	0.8
Population (Per Cent Growth)						
FAO - Fall Outlook	0.8	1.2	1.2	1.2	1.2	1.1
FAO - Spring Outlook	0.8	1.0	1.0	1.0	1.0	1.0
CPI Inflation (Per Cent Growth)						
FAO - Fall Outlook	1.1	1.7	2.2	2.2	2.1	2.0
FAO - Spring Outlook *	1.2	1.5	2.0	2.0	2.0	1.9
Canada Real GDP (Per Cent Growth)						
FAO - Fall Outlook	1.1	1.2	2.4	2.1	1.9	1.9
FAO - Spring Outlook *	1.2	1.7	2.4	2.3	2.1	2.0
U.S. Real GDP (Per Cent Growth)						
FAO - Fall Outlook	2.6	1.6	2.2	2.1	1.9	1.7
FAO - Spring Outlook *	2.4	2.2	2.1	2.0	-	-
Canadian Dollar (Cents US)						
FAO - Fall Outlook	78	76	77	79	82	84
FAO - Spring Outlook	78	74	75	79	81	81
WTI Crude Oil (US$)						
FAO - Fall Outlook	48.7	41.9	50.6	54.6	69.5	78.6
FAO - Spring Outlook	48.7	36.5	44.2	50.8	55.4	59.3
Three-month Treasury Bill Rate (Per Cent)						
FAO - Fall Outlook	0.5	0.5	0.5	1.3	2.0	2.3
FAO - Spring Outlook	0.5	0.5	1.2	2.2	2.9	3.3
10-year Government Bond Rate (Per Cent)						
FAO - Fall Outlook	1.5	1.2	1.5	2.3	3.0	3.5
FAO - Spring Outlook	1.5	1.4	2.3	3.3	4.1	4.5

a = Actual f = Forecast
* 2015 FAO - Spring Outlook values reflect the FAO's forecast, as actuals were not available at the time of the publication of the Spring Outlook.
Source: Bank of Canada, Energy Information Administration, International Monetary Fund, Statistics Canada, FAO Consensus and FAO

Table 3: FAO Fiscal Outlook

($ Billions)	2015-16a	2016-17f	2017-18f	2018-19f	2019-20f	2020-21f
Revenue						
Personal Income Tax	31.1	32.0	33.7	35.9	37.8	39.6
Sales Tax	23.5	24.0	24.8	25.5	26.4	27.2
Corporations Tax	11.4	11.5	11.8	12.3	12.6	13.0
All Other Taxes	25.8	23.6	24.2	25.0	25.6	26.4
Total Taxation Revenue	91.8	91.1	94.5	98.7	102.4	106.3
Transfers from Government of Canada	22.9	24.7	25.5	25.9	26.5	27.0
Income from Government Business Enterprise	4.9	5.0	5.3	5.7	5.9	6.2
Other Non-Tax Revenue	8.8	9.1	10.6	9.4	9.4	9.6
Total Revenue	128.4	129.9	135.9	139.7	144.2	149.1
Expense						
Health Sector	51.1	51.8	52.8	53.7	55.5	57.4
Education Sector	25.1	25.6	26.2	26.7	27.7	28.9
Postsecondary and Training Sector	7.6	7.9	7.9	8.0	8.1	8.3
Children's and Social Services Sector	15.6	15.8	16.1	16.3	16.9	17.4
Justice Sector	4.5	4.5	4.5	4.6	4.8	5.0
Other Programs*	18.6	18.3	19.7	21.6	22.2	22.9
Total Program Expense	122.4	123.9	127.2	130.9	135.3	139.9
Interest on Debt	11.0	11.2	11.3	11.6	12.2	12.9
Total Expense	133.4	135.1	138.5	142.5	147.5	152.8
Budget Balance*	-5.0	-5.2	-2.6	-2.8	-3.3	-3.7
Accounting Change	1.5	1.5	1.5	1.5	1.5	1.5
Budget Balance Excluding Accounting Change	-3.5	-3.7	-1.1	-1.3	-1.8	-2.2

a = Actual f = Forecast
* Includes $1.5 billion accounting change beginning in 2015-16.
Note: Budget balance is presented without reserve.
Source: Statistics Canada, Ontario Economic Accounts, FAO Consensus, Ontario Public Accounts and FAO

Table 4: FAO Debt Outlook

($ Billions)	2015-16a	2016-17f	2017-18f	2018-19f	2019-20f	2020-21f
Budget Balance*	-5.0	-5.2	-2.6	-2.8	-3.3	-3.7
Accumulated Deficit	202.7	207.9	210.5	213.3	216.6	220.3
Net Debt	305.2	318.5	330.5	343.8	356.8	369.7
Change in Net Debt	*20.7*	*13.2*	*12.0*	*13.3*	*13.0*	*13.0*
Net Debt to GDP (Per Cent)	*40.9*	*41.2*	*41.2*	*41.2*	*41.1*	*41.0*

a = Actual f = Forecast
Note: All values include $1.5 billion accounting change beginning in 2015-16.
* Budget Balance is presented without reserve.
Source: 2016 Ontario Budget, Ontario Public Accounts and FAO