BUDGET ANALYSIS

Ontario: Fall Economic Statement 2024

Some Treats for Ontarians Just in Time for Halloween

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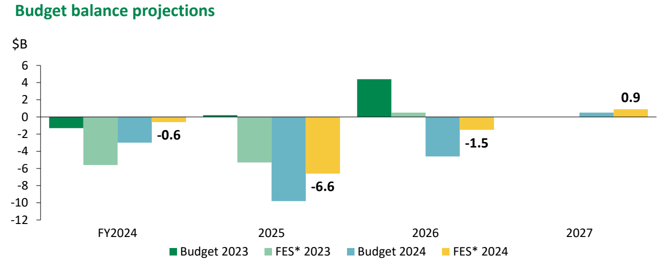
HIGHLIGHTS

- The province of Ontario's 2024 Fall Economic Statement (FES) again forecasts a return to budget surplus in fiscal year 2026–27 (FY2027), albeit with a smaller deficit profile in each year of the outlook and a larger surplus at the end than in Budget 2024 (graph 1). Table 1 on page 2 summarizes updated economic and financial projections.
- An increase in the projections for personal and corporate income tax revenues helped to shore up Ontario's fiscal outlook, thanks in large part to the federal government's proposed changes to the capital gains inclusion rate. This bump in revenues more than offset the proposed six-month extension of the reduction to the gas tax this year by a wide margin.

Graph 1
Across the Board Improvement in Ontario's Budget Balance Outlook



** Fall Economic Statement*
Ontario Ministry of Finance and Desjardins Economic Studies

- Higher revenues opened the door to new spending, which was largely concentrated in the current fiscal year. The biggest ticket items were the $200 cheques to every eligible Ontarian, to the tune of $3.0B this year, and another $1.6B in additional compensation costs for health and public sector employees.
- But total new program spending this year ($4.8B) was more than offset by higher revenues ($6.9B) and lower interest on debt ($1.2B). Hence the swing from a projected deficit of $9.8B for FY2025 projected in Budget 2024 to $6.6B today. This positive fiscal momentum is expected to continue, reducing borrowing requirements and putting downward pressure on the debt-to-GDP and debt service-to-total revenue ratios. Borrowing requirements are now expected to total $37.5B in FY2025, $35.0B in FY2026, and $32.6B in FY2027. Over the three-year outlook period, total long-term borrowing is projected to be $3.6B lower than forecast in Budget 2024.
- Risks to the outlook are tilted to the downside of the baseline economic projection. These include the recently announced planned reduction in permanent resident admissions, possible slower consumption growth as households renew their mortgages at higher rates in 2025 and 2026, and the potential of a second Trump presidency. But the Government of Ontario's downside scenario seems too bearish in the near term. As such, we expect the actual economic performance to be somewhere in between.

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Main Takeaways

Against a more optimistic economic backdrop than projected in Budget 2024 and the federal government's proposed changes to the capital gains inclusion rate, provincial revenues have come in stronger than anticipated. That trend is expected to continue over the medium term. This allowed the Government of Ontario to increase spending in the current fiscal year, albeit keeping spending in check in the outer years of the forecast. Lower interest payments on debt also helped to reduce deficits over the outlook, capping in off with a larger-than-projected surplus in FY2027. Consequently, borrowing requirements were reduced, putting downward pressure on the debt-to-GDP and debt service-to-total revenue ratios.

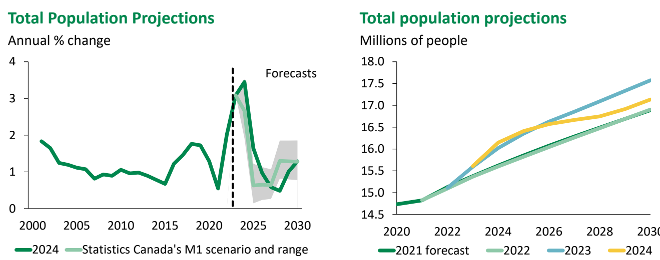
Economic Outlook Revisions Are Broadly Positive

Recent economic conditions have largely been positive in Ontario. Real GDP growth in 2023 bested the expectations of the provincial government in Budget 2024, leading to higher nominal GDP—the broadest measure of the tax base. Another upside surprise is anticipated for 2024 (table 1). The same is true for employment growth, supporting higher compensation of employees.

Looking ahead, the federal government's planned reduction in permanent resident and non-permanent resident (NPR) admissions should slow the pace of population growth relative to prior projections (graph 2). This is likely to weigh on overall economic activity, pulling down real GDP growth. Employment gains should be more modest as well.

However, the proposed population changes look to have a minimal impact on Government of Ontario's economic forecast, with little to no impact on nominal GDP growth. This suggests some possible downside to the province's economic outlook for planning purposes. Other risks include possible slower consumption growth as households renew their mortgages at higher rates in 2025 and 2026, as well as the potential economic impacts of a second Trump presidency. But the Government of Ontario's downside scenario seems too bearish in the near term. As such, we expect the actual economic performance to be somewhere in between.

Graph 2
Ontario Does Not Buy StatCan's Gloomy Population Forecast



Note: The dotted line refers to the beginning of the population projections. Grey area represents range of Statistics Canada scenarios
Statistics Canada, Ontario Ministry of Finance and Desjardins Economic Studies

TABLE 1
Updated Ontario Fiscal and Economic Forecasts

IN $B (UNLESS OTHERWISE INDICATED)	2023–24		2024–25		2025–26		2026–27	
	Bud. 2024	Actual	Bud. 2024	FES* 2024	Bud. 2024	FES* 2024	Bud. 2024	FES* 2024
Total Revenues	204.3	205.9	205.7	212.6	217.4	220.8	226.6	230.7
% change	*5.9*	*6.7*	*0.7*	*3.3*	*5.7*	*3.9*	*2.6*	*4.5*
Own-Source Revenues	169.6	171.6	169.4	176.3	179.9	183.2	187.9	192.0
% change	*4.9*	*6.2*	*-0.1*	*2.7*	*6.2*	*3.9*	*2.6*	*4.8*
Federal Transfers	34.8	34.3	36.3	36.3	37.5	37.6	38.7	38.7
Total Spending	207.3	206.6	214.5	218.3	220.6	220.8	224.1	227.8
% change	*4.3*	*3.9*	*3.5*	*5.7*	*2.8*	*1.1*	*1.5*	*3.2*
Program Spending**	194.5	195.2	200.6	205.6	205.9	206.8	208.9	213.3
% change	*4.3*	*4.7*	*3.1*	*5.3*	*2.6*	*0.6*	*1.0*	*3.1*
Debt Servicing	12.8	11.4	13.9	12.7	14.7	14.0	15.2	14.5
% of revenues	*6.3*	*5.5*	*6.8*	*6.0*	*6.8*	*6.3*	*6.7*	*6.3*
Reserve	0.0	0.0	1.0	1.0	1.5	1.5	2.0	2.0
Budget Balance	**-3.0**	**-0.6**	**-9.8**	**-6.6**	**-4.6**	**-1.5**	**0.5**	**0.9**
% of GDP	*-0.3*	*-0.1*	*-0.9*	*-0.6*	*-0.4*	*-0.1*	*0.0*	*0.1*
Net Debt (% of GDP)	*38.0*	*37.3*	*39.2*	*37.8*	*39.5*	*37.9*	*39.1*	*37.5*
Nominal GDP (% change)	*4.1*	*4.3*	*2.7*	*3.8*	*3.9*	*3.9*	*4.3*	*4.4*
Real GDP (% change)	*1.2*	*1.4*	*0.3*	*0.9*	*1.9*	*1.7*	*2.2*	*2.3*
Infrastructure Spending	20.9	23.6	26.2	26.3	29.5	30.3	26.7	27.0

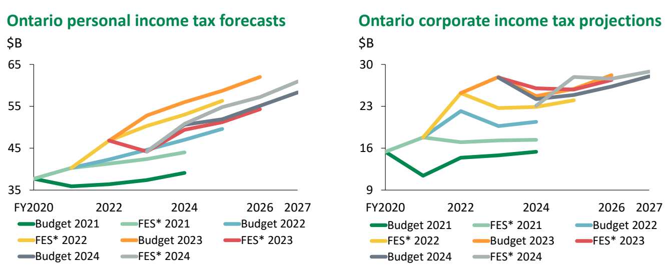
* *Fall Economic Statement*
** Includes COVID-19 funding and one-time expenses
Ontario Ministry of Finance and Desjardins Economic Studies

Higher Revenues Are Expected Now and Later

Since the release of the *2024–25 First Quarter Finances*, the Government of Ontario sees revenues coming in $6.9B higher than planned in the current fiscal year. The bulk of that comes from greater personal and corporate income tax revenues, thanks, in large part, to the federal government's proposed changes to the capital gains inclusion rate. Better-than-expected revenues from the processing of prior tax returns and stronger growth in compensation of employees didn't hurt either. Sales tax revenues were also notably higher, more than offsetting lower revenues resulting from the proposed six-month extension of the reduction to the gas tax.

The Government of Ontario expects the recent tailwind to revenues to persist over the outlook. Specifically, personal and corporate income tax revenues are projected to be higher than in Budget 2024 (graph 3). This despite slower-than-expected population growth weighing on economic and labour market activity.

Graph 3
Ontario Upgrades Its Revenue Forecast



* *Fall Economic Statement*
Ontario Ministry of Finance and Desjardins Economic Studies

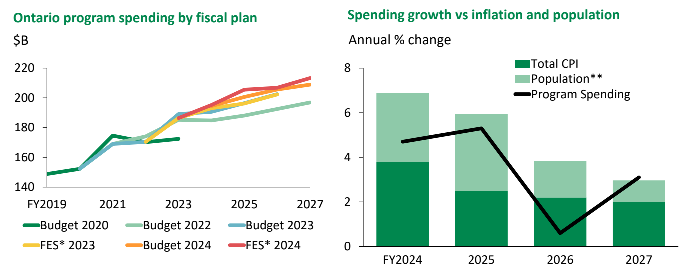
Going forward, we will also be watching non-tax revenues closely. In the *Public Accounts of Ontario* for FY2024, these revenues came in much higher than anticipated in Budget 2024 "mainly due to higher third-party revenue from colleges driven by higher revenue from international student tuition and private partnerships." We noted in our analysis of Budget 2024 that federal caps on international student permits prompted Ontario to lower forecasts for the "other tax revenue" category throughout the forecast horizon. And while fewer international students didn't earn a mention in the FES 2024, they pose another potential downside risk to the revenue outlook.

Some New Goodies Thanks to Higher Revenues

The Government of Ontario plans to return some, but not all, of the newfound revenues in FY2025 to taxpayers. Specifically, a proposed one-time $200 rebate to each eligible adult Ontario tax filer and each eligible child under the age of 18 will add up to $3.0B in the current fiscal year. Add to that $1.6B for additional compensation costs related to the health sector and Ontario Public sector, as well as other more minor costs, and the increase in program spending this fiscal year since the *2024–25 First Quarter Finances* should reach $4.8B. However, this will be offset by a $730 million drawdown of the Contingency Fund and $1.2B saving in interest on debt, knocking the net increase in total expenses down to $3.8B this year.

Further out the forecast, the province of Ontario plans to keep its spending broadly in line with, albeit ever so slightly higher than, the trajectory laid out in Budget 2024 (graph 4). But it is projected to remain below the growth in population plus inflation over most of the outlook, meaning program spending will be declining on a real per capita basis. As we have observed previously, this leaves Ontario well positioned from a spending perspective relative to the other big provinces, having exercised notable prudence in recent years.

Graph 4
Spending Expected to Increase but Remain Contained



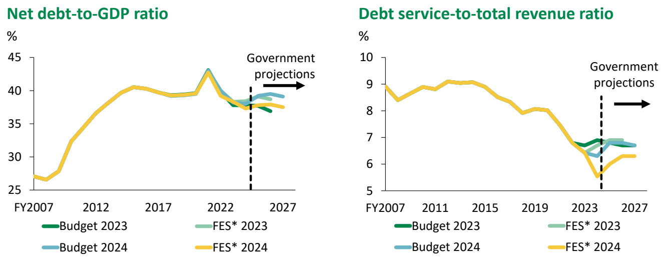
* *Fall Economic Statement*. ** Outer-year population growth numbers based on 2024 Ontario demographic projections
Statistics Canada, Ontario Ministry of Finance and Desjardins Economic Studies

Expect Debt to Be Lower, Given Smaller Deficits

With planned revenues revised higher and program expenses remaining broadly unchanged, it's inevitable that the Government of Ontario's outlook for its primary surplus has improved. And when combined with expected lower interest on debt, the deficit forecast for the province has improved across the board (see graph 1 on page 1).

As goes the deficit, generally so goes the debt. Smaller deficits over the outlook are expected to support an improved projection for net debt, leading to a lower net debt-to-GDP ratio profile in the coming years (graph 5 on page 4). The debt-to-GDP ratio is now the lowest it's been in over a decade. When combined with upwardly revised revenues over the fiscal forecast, smaller planned deficits have helped pull down the outlook for the debt service-to-total revenue ratio dramatically. Indeed, this ratio is now at its lowest level since the 1980s. That is very positive news from a fiscal sustainability perspective, and should make rating agencies very happy.

Graph 5
Lower Debt-to-GDP and Debt-Service-Cost Ratios Expected for Ontario



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Importantly, the provincial government also layered its typical multipronged prudence on top of the already more positive projection. First, it assumed a lower forecast for real GDP growth than the private sector average. Second, the Government of Ontario maintained its reserve of $1.0B this year, $1.5B next year and $2.0B the year after that. And last but not least, after a top-up of $900 million for FY2025, the Contingency Fund has a projected balance of $1.7B before being drawn down to further reduce this year's deficit.

Borrowing and Financial Market Developments

Ontario's long-term borrowing requirement for FY2025 is now forecast to be $37.5B (table 2), down from $38.2B in Budget 2024 thanks to a better deficit position and corresponding decrease in funding requirements. FY2026 and FY2027 total long-term borrowing have also been revised lower to $35.0B and $32.6B, respectively. Over the three-year outlook period, total long-term borrowing is projected to be $3.6B lower than forecast in Budget 2024. Of note, starting in FY2025, pre-borrowing will be reflected as part of the increase in year-end cash and cash equivalents, as opposed to being broken out in a separate line as was the case previously.

To date, approximately 80 percent of 2024–25 long-term borrowing was completed in Canadian dollars, through 24 syndicated issues, and two Green Bonds. The remaining 20 percent was completed in foreign currencies in U.S. dollars and Australian dollars. Ontario's target range for domestic borrowing remains unchanged at 75 to 90 percent of borrowing completed for the 2024–25 fiscal year. The weighted average borrowing term for outstanding debt in FY2025 was estimated at 15.7 years as of September 20, 2024, up from an estimated 15.2 years in FY2024. That's long enough to help mitigate risks related to refinancing at higher interest rates. Ontario once again committed to "monitor the market and adjust the debt term strategy in response to further changes to interest rates and the yield curve."

Spreads on 30-year Government of Ontario bonds to Government of Canada bonds narrowed slightly relative to the pre-FES read on the news of smaller deficits and reduced borrowing requirements. Spreads to other provincial government bonds remained more stable.

TABLE 2
Updated Ontario Borrowing Program

	2024–25		2025–26		2026–27	
IN $B (UNLESS OTHERWISE INDICATED)	**Bud. 2024**	**FES* 2024**	**Bud. 2024**	**FES* 2024**	**Bud. 2024**	**FES* 2024**
Deficit/(Surplus)	9.8	6.6	4.6	1.5	(0.5)	(0.9)
Investment in Capital Assets	17.7	17.7	20.2	20.9	20.4	20.6
Non-Cash and Cash Timing Adjustments	(11.0)	(11.0)	(12.0)	(12.0)	(13.9)	(13.9)
Net Loans and Investments	(0.3)	0.8	0.1	(0.2)	—	—
Debt Maturities/Redemptions	28.0	28.0	33.1	33.1	26.9	26.9
Total Funding Requirement	44.2	42.2	46.0	43.3	32.8	32.6
Decrease/(Increase) in Short-Term Borrowing	(5.0)	(5.0)	—	—	—	—
Increase/(Decrease) in Cash and Cash Equivalents	(1.0)	0.3	(8.3)	(8.3)	—	—
Total Long-Term Borrowing	**38.2**	**37.5**	**37.7**	**35.0**	**32.8**	**32.6**

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