ECONOMIC RESEARCH AND STRATEGY

LAURENTIAN BANK SECURITIES

Sébastien Lavoie,
Chief Economist
LavoieS@vmbl.ca
514 350-2931

Dominique Lapointe, CFA,
Senior Economist
LapointeD@vmbl.ca
514 350-2924

November 5, 2021

Ontario 2021 Economic Outlook and Fiscal Review - Significant Fiscal Improvement

Ontario delivered today its mid-year update built around the theme of reinvesting to foster a solid economic recovery. Better-than-expected revenue results in FY 2020-21 and a solid economic recovery allow the province to present a significantly improved medium-term fiscal outlook.

Solid momentum heading into 2022

The second half of 2021 bodes well for the Ontario economy. We expect real GDP to strongly rebound after the 2021Q2 contraction caused by supply chain disruptions in the auto sector and the third wave of infections. Recent developments have been positive. High vaccination rates and a sound management of the reopening process led to sizeable job gains over the past four months. Moreover, the level of employment reached its pre-COVID level in September 2021. From 4.3% in 2021, the Ministry of Finance forecasts real GDP growth to accelerate slightly, to 4.5% in 2022, consistent with our own estimates. Solid household consumption growth, excluding housing, is the main pillar of the bright economic outlook. The most striking feature of the outlook in our view relates to the flat growth projection for average home prices for both 2022 and 2023.

In the context of acute labour shortages, particularly in the high contact sectors such as food and accommodation services, the government raises the minimum wage to 15$/hour. This 4.5% increase, starting January 1st, 2022, could fuel CPI inflation, already running at 4.4% y/y. The update also includes additional funding for training and helping individuals to find jobs.

Chart 1: Ontario Budgetary Balance

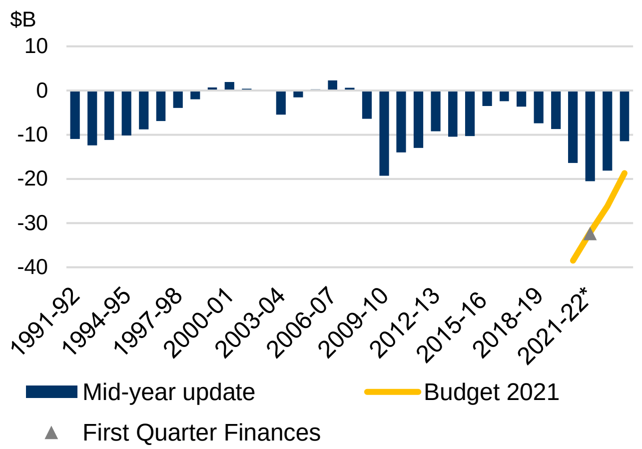
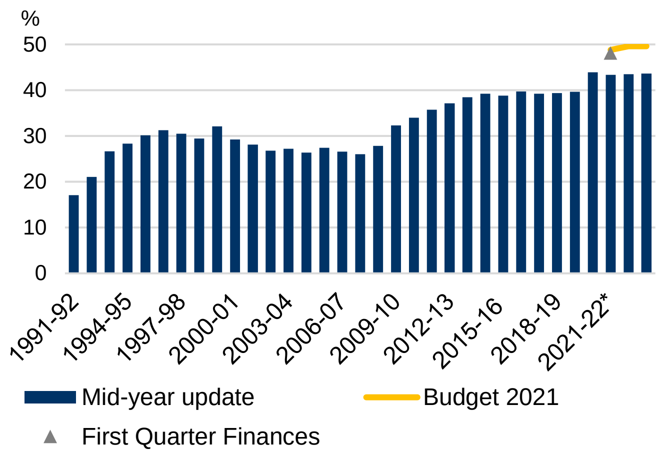


Chart 2: Ontario Net Debt-to-GDP



Source: Ontario Government.

Material revenue boost leads to smaller deficits

Ontario revises down its deficit forecast for FY 2021-22 from $32.4B in the First Quarter Finances to $21.5B in the FES (2.2% of GDP). On the revenue side, a stronger-than-expected tax base coming off FY 2020-21 combined to an upward revision to compensation of employees for 2021 lead total revenues to hit $168.6B, a material 7.5%increase relative to the First Quarter Finances. The lion's share of the boost to taxation revenue comes from PIT and the sales tax, adding an additional $8.4B. In contrast to taxation revenues, receipts from crown corporations are still running below pre-pandemic levels. No major changes occurred to federal transfers, pegged at $29.7B in the mid-year update. The Ministry of Finance forecasts nominal GDP growth at 9.0% in 2021, 2.5ppts below our internal estimate and the average private sector forecast of 10.4%. This large discrepancy in nominal GDP forecasts can be linked to inflation uncertainty, particularly how quickly global supply disruptions will be resolved. Given Ontario's fiscal sensitivities, the prudence built up in the Province's nominal GDP projections presents a potential $1.0-$2.0B upside risk to revenue in the forthcoming Third Quarter Update. The government forecasts own-source revenue (including government business enterprises) to grow by 3.7% on average annually, somewhat slower than what the 5.6% average annual nominal GDP growth forecast would suggest.

No major change to expenses: focus on health and infrastructure spending

Ontario increases total spending by a small $0.8B, to $165.5B, relative to the First Quarter Finances. The previously announced extension of the Temporary Wage Enhancement for Personal Support Workers (+$0.9B) and the top-up to the Time-Limited COVID-19 Fund (+$0.5B) are partly offset by a drawdown of contingency funds and accommodation under the existing fiscal framework. Additional support for municipal transit (+$345M) and community infrastructure (+$200M) is jointly funded with the federal government. Also, all of the $10.7B contingencies in FY 2021-22 related to COVID-19 and the recovery has been allocated, with a small $2.2B left to be spent in the second half of this fiscal year. In our opinion, baring any major adverse epidemic development such as the apparition of a vaccine-resistant variant, these contingencies combine to the $1.0B reserve should be enough to meet the economic and health requirements related to the pandemic in FY 2021-22. Over the next two years, base expenditures continue to increase, albeit a moderate annual average pace of 3.0%. This implies a tight fiscal management. Indeed, since the inflation rate could average close to this level in 2022 and 2023, real growth in program expenditure is closer to, but above, zero.

A lower projected deficit offsets higher-than-expected interest rates in Canada as interest on debt projections comes in $0.1B lower than in the First Quarter Finances. Interest on Debt as Per Cent of Revenue stands at 7.7%, a low level relative to history. In the Update, the 10-year government of Canada bond yield forecast was revised up to average 1.3%, 1.8% and 2.2% in 2021, 2022 and 2023, respectively. This poses a small upside risk to debt servicing relative to our average 2021 forecast of 1.5% and 1.9% for 2022.

Lower deficits to shrink bond supply and improve long-term fiscal path

The fiscal framework embeds a lower, but steady, debt burden forecast. Net debt-to-GDP is revised down by almost 5 percentage points in FY 2021-22, from 48.1% to 43.4% (chart 2). Long-term borrowing requirements falls from $53B, to $42B in FY 2021-22. It includes the Province's intention to pre-borrow $6B for FY 2022-23. As of October 19th, 69% of this year's program had been completed. Approximately 76% has been issued domestically, near the upper end of the 65%-80% target range. Ontario also plans to issue Green Bonds many times each fiscal year. The Update provides valuable colours on debt term extension, with an additional $7.5B in long bonds so far this year. Thus, the weighted-average term of borrowings jumps from 12 years in FY 2020-21 to 14.5 years in FY 2021-22, providing refinancing protection. Borrowing requirements for FY 2022-23 and FY 2023-24 were revised down significantly, to $59B and $55B. Finally, we see positive long-term implication from this Update. Lower projected deficits put the Province three years ahead of its decade-long plan to balance the budget by FY 2029-30 (chart 1). The government plans to provide an updated recovery plan and debt reduction strategy in the 2022 Budget.

Sébastien Lavoie | Chief Economist
514 350-2931 | lavoies@vmbl.ca

Dominique Lapointe, CFA | Senior Economist
514 350-2924 | lapointed@vmbl.ca