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Ontario First Quarter Finances – Fiscal Impact Of The Enhanced Action Plan

The government of Ontario showed proactivity by introducing an initial $17B response plan to Covid-19 in its March 2020 Update. However, the pandemic continues to cause health and economic hardship, requiring additional spending. According to the *First Quarter Finances* released today, the Ontario government wants to make sure resources are available by adding $13B to its pandemic response plan in FY 2020-21. Close to two thirds ($18.7B) of this $30B enhanced Action Plan comes in direct support to health care workers, individuals and businesses, impacting the fiscal framework. The remainder ($11.3B) mostly consists of tax deferrals and cash flow measures that would be recouped by the government at some point. It is too early to tell if the $30B allocation will end up being adequate or not since it will significantly depend on the course of Covid-19.

In any case, this enhanced response plan proposed today results in an 8% increase in program expenditures relative to March, now expected to reach $174B in FY 2020-21. This update notably includes additional support to municipalities and public transit, resulting in a $2.4B fiscal cost. Of note, about three-quarters ($9.6B) of the projected increase in program expenditures consist of additional contingencies for health and economic measures. Altogether, after accounting for $3.6B in drawdowns, the level of these contingencies amount to $10.3B in FY 2020-21, the equivalent of 6% of total planned spending. In addition, the revised 2020-21 outlook continues to include a $2.5B reserve, the largest on record. As a result, the fiscal framework proposed today will be resilient in case of a more adverse Covid-19 scenario. On the contrary, a more optimistic outcome regarding the pandemic and the economic recovery would result in unused contingencies dedicated to lower the Province's $397.2B net debt position.

Total revenue declines by $5.7B (-3.6%) relative to the March Update, mainly due to a $10.8B downward revision (-10%) to taxation revenue. The pandemic has a particularly profound impact on companies: corporation tax revenues were revised down by about one-third (-$5.2B, -34.5%) relative to March. The downward revision to personal income taxes is smaller (-$0.5B, -1.2%) due to CERB payments supporting household income. Also, this revenue forecast errs on the side of caution. Indeed, the Ministry of Finance takes into account the fact that taxation revenue is more sensitive to a downward revision to nominal GDP (-7.3 ppts in this update) in a recession than in normal times. The federal government offsets half of the revenue shock as Ottawa's transfers to Ontario increase by $6.2B relative to March, driven by the Safe Restart Agreement providing $5.1B to the Province in FY 2020-21.[1] Clearly, the federal government takes the biggest hit from the Covid-19 pandemic.

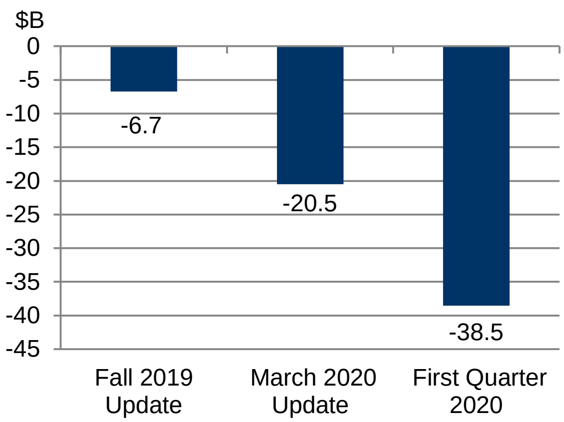
[1] Including in-kind federal spending such as support to municipalities and transit, the agreement provides $7B in total to Ontario.

With information up to June 30, the *First Quarter Finances* offers a more complete assessment of the impact of Covid-19 on the province's coffers than it was possible to deliver in March. The deficit amounts to $38.5B (4.6% of GDP), almost doubling from a $20.5B earlier estimate (chart 1). This shortfall is the highest on record both in dollar terms and relative to the size of the economy. In addition, the combination of a lower nominal GDP and a higher public debt burden will lead to a 5.4 ppts increase in the net debt-to-GDP ratio relative to March, now projected to reach 47.1% in FY 2020-21 (chart 2).

Long-term borrowing requirements are revised up from $43.6B to $52.1B, of which $23.6B (45%) has been filled. 76% of the program has been conducted in Canadian dollars, in line with recent years' average and the province's 70-80% target range. While the province took advantage of very low interest rates to extend the average term of it debt by issuing with maturities over 10 years, it also benefited from the Bank of Canada Provincial Money Market Program by borrowing an additional $5B in short-term debt earlier this Spring.

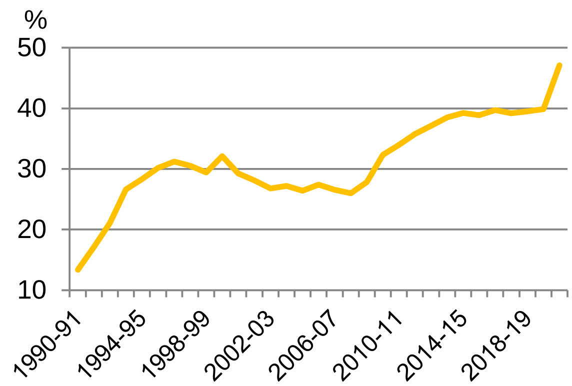
Finally, the government will release its Fall Update no later than November 15. The latter will include a multi-year outlook, providing investors with a fiscal plan beyond the pandemic.

Chart 1: Ontario Budgetary Balance Forecast FY 2020-21



Source: Ontario Government.

Chart 2: Ontario Net Debt-to-GDP



Source: Ontario Government, Government of Canada Fiscal Reference Tables and LBS Econ. Res. and Strategy.