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Ontario Budget 2023 – Big Positive Leap, Fiscal Resiliency to Face Global Uncertainty

Budget 2023 unveils a major near-term improvement in public finances underpinned by solid revenues. The medium-term outlook proposes further progress under the baseline scenario and shows fiscal resiliency under the alternative downside economic scenario.

First, Ontario was able to shrink down its FY 2022-23 deficit significantly over a very short period. The tiny $2.2B shortfall marks a bold $4.4B upgrade over the 3rd quarter update released not long ago, in mid-February. Personal income tax revenue was the most striking positive surprise recently, thanks to solid momentum in labour market conditions. Soaring corporate income tax revenue stood out from the pack in the early stages of FY 2022-23, allowing total revenues to reach $200B for the entire year. Altogether, debt burden measures improved across the board: the net debt-to-GDP ratio fell by 2pp to 37.8% vs FY 2021-22; the net debt-to-revenues ratio plunged below 200%; interest on debt expressed as a % of revenues edged down by 0.2pp to 6.7%.

With such near-term progress, the Ontario government was able to revisit debt burden targets in upcoming years. These targets are more ambitious (net debt-to-GDP ratio to stay under 40%; net debt-to-revenues ratio under 200%; interest on debt-to-revenue under 7.5%). Those are realistic, based on the revamped economic and fiscal outlook. The government notably projects a small $1.3B deficit in FY 2023-24 and essentially a balanced budget ($0.2B surplus) in FY 2024-25, both stunning gaps relative to the $12B and $8B deficits predicted a year ago. The world, plagued with uncertainties, contributed to bring fiscal prudence to the forefront: total expenses are projected to increase by only 1% in FY 2023-24, a stark contrast with the 11% surge of FY 2022-23.

Total revenues are projected to grow by only 2%. Household spending is notably expected to stay in the slow lane, as the adjustment to higher interest rates continue. If the domestic economy barely outperforms and the small $1B reserve (0.5% of revenues) is not required, Ontario could easily balance the books soon, according to the alternative optimistic scenario provided. Notably, the 0.2% Ontario real GDP 2023 growth assumption looks conservative relative to what we've seen so far from other provincial budgets. Of course, the big concern these days, relates to the adverse economic impact in the aftermath of the U.S. and European banking turmoil. The magnitude and persistency of possible tighter financial conditions from lenders is uncertain. For instance, if we consider the alternative downside scenario of a mild recession (0.7% real GDP contraction in 2023), the deficit estimate stands at $5B and the net debt-to-GDP ratio rises to 38.8% without compromising the target of staying below 40%.

The progress in public finances underpins lower-than-usual long-term borrowing requirements. The FY 2023-24 long-term borrowing program of $27B is forecast to be the lowest since FY 2016-17, thanks in part to $14.5B in pre-borrowing. Long-term bond issuance for FY 2023-24 increases modestly to $31B under the alternative pessimistic economic scenario. Beyond FY 2023-24, long-term borrowing requirements are poised to softly rise because of additional financing required for capital infrastructures. The 10-year capital spending program of $184B will support several initiatives. Almost 40% will be dedicated to public transport infrastructure, a natural fit for Ontario's Green Bond Program. In terms of proceeds, the bulk of $15B allocated so far under the Green Bond Program goes to eight major, clean transportation projects; the remaining is dedicated to energy efficiency and conservation as well as climate adaptation and resilience. In addition, the narrower deficit allows the province to taper off, somewhat, the uptrend in annual debt servicing triggered by higher interest rates. Ontario has appropriately managed its interest rate risk by extending its debt average term to 11.1 years in FY 2022-23, compared to 10.7-10.9 since the mid-2010s decade. The plan is to keep Ontario's average debt term to at least 10.7 years, going forward. Since the mid-March banking stress events, liquidity has taken back center stage. Ontario counts on almost $36B in liquid reserves, below the level observed during the pandemic and above levels observed prior to COVID-19.

In summary, Queen's Park brings plenty of positive fiscal news to begin the Spring season. Investors should give a thumbs up to the recent improvement in debt metrics as well as the possible rapid return to balanced budgets. Given the high degree of economic uncertainty, spending restraint is, logically, back. And, considering the most recent episode of financial stress globally, it is comforting to find, in the valuable alternative downside scenario, that the sensitivity of Ontario's public finances is not extravagantly negative, but rather shows signs of fiscal resiliency. Our last words go to the flagship tax policy of Budget 2023: the new "Ontario Made Manufacturing Investment Tax Credit". This measure will provide a 10% corporate income tax refund to local manufacturers.

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