ECONOMIC RESEARCH AND STRATEGY

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Ontario First Quarter Update – Fiscal Resiliency in a Gloomy, Uncertain Economic World

The Province of Ontario released the *First Quarter Update* on Tuesday. Most forecasters have been revising down global economic projections since the release of the 2022 budget last March, including the IMF gloomy outlook released in July.

Positive domestic developments prevent a major downgrade to Ontario's real GDP 2022 growth forecast, shaved by only 0.2pp since the budget release from 3.7% to 3.5%. Among encouraging news, we note the solid recovery in services-oriented activities following COVID shutdowns and the rebound in auto assembly. For instance, the value of manufacturing shipments rose 20% year-to-date. Ontario will also benefit soon from the construction phase of large EV battery investments coming into the province. Vic Fedeli, Minister of Economic Development, Job Creation and Trade, recently said Ontario has attracted $16B in EV investments in the last 20 months, an impressive amount almost matching the government's public infrastructure capital spending of $20B for this year. Furthermore, media reported earlier this week Tesla disclosed efforts to set up a new factory in Ontario.

The 2022 budget CPI inflation forecast of 4.7% in 2022 has been revised up significantly due to the diffusion of inflation and global commodity supply shock caused by the war in Ukraine, allowing the nominal GDP 2022 growth forecast – key for the tax base – to be revised up markedly from 6.7% to 9.0%. The stronger nominal GDP profile contributes to a small $1.2B, or 0.6%, upward revision in total taxation revenues. Personal income tax revenues saw a relatively larger $0.9B upside revision due to wage inflation acceleration and better-than-expected job growth (+6.3% year-to-date versus the 2022 budget forecast of +3.9%). High CPI inflation contributed to a $0.6B increase in sales tax. Without surprise, the 36% drop in resale housing transactions and 13% decline in average home resale prices observed between February and June contributed to a $0.5B downward revision in land transfer tax. The softening in housing conditions reflects the end of the hype seen during the pandemic, as well as a temporary reassessment of potential first-time buyers suddenly dealing with the fastest tightening in financial conditions in ages. Chronic undersupply in Ontario poised to deteriorate further according to a recent CMHC report, higher labour and material costs and double-digit rent increases in several cities will prevent a long, severe decline in home prices.

The government now projects a deficit of $18.8B in FY 2022-23, a modest $1.1B improvement relative to the budget. Total expenses are virtually intact relative to budget. A large cost overrun is very unlikely since spending totaling nearly $200B in FY 2022-23 represents a large 6% increase over the previous year. Interest debt servicing is revised up by only $0.1B, to $13.6B. Ontario plans to allocate 7.5% of revenues to debt servicing this year.

Long-term borrowing requirements were revised down by the same amount than the deficit, from $41.5B to $40.4B. One-third of the program has been completed so far, with 72% done through domestic issuance in Canadian dollars. Ontario is considering updating its Green Bond Framework to have a better alignment with Green Bond Principles. The province is open to issue multiple Green Bonds in FY 2022-23.

In summary, the *First Quarter Update* reveals fiscal resiliency. The $18.8B deficit projected for FY 2022-23 represents 1.8% of nominal GDP, which we interpret as a manageable financial situation. The same can be said about the 40% net debt-to-GDP ratio similar to pre-pandemic levels and the net debt-to-revenues ratio of 236%. Time will tell but Ontario could end up FY 2022-23 with a lower deficit, depending on how the pandemic situation and the economic outlook, evolve. In case the global economy goes south, Ontario can count on various unallocated fiscal buffers totaling 5% of revenues, a comfortable cushion very few provinces have. These include $4.1B in unallocated funding for COVID, the usual $1.0B reserve and the $4.1B Contingency Fund. Finally, as we noted in our 2022 Ontario budget write-up, the Province benefits from prudential liquidity reserves of about $47B versus $32B prior to the pandemic.

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