Ontario

Economic Fall Statement

Ontario Fall Economic Statement—Material Improvement

Small Changes in Long-Term Borrowing Reflect Good Debt Management Strategy

The 2024 Ontario Budget, released last spring, originally proposed a $10B deficit and $38.2B in long-term bond issuance during the fiscal year (FY) 2024–25. Fast-forward to Wednesday, October 30th, the Fall Economic Statement (FES) reduces the deficit to $6.6B, while keeping long-term borrowing at $37.5B, unchanged relative to Q1 fiscal update and a notch down relative to the budget.

Significantly reducing borrowings would have almost exhausted the remaining FY 2024–25 issuance. Instead, Ontario made the smart move to moderately increase its cash reserve (rather than lower it, as proposed in Budget 2024). This approach allows for improved liquidity given potential global catalysts in the short- and medium-term. Still, there is only $6.1B left for the remaining five months of FY 2024–25 (assuming no pre-financing activity). 84% of this year's program is complete.

Also, as highlighted in our Provincial Issuers Update, released last September, Ontario issued more long-term bonds on the domestic market (81%) relative to other provinces. This figure is within Ontario's target range of 75% - 90%. Notably, domestic issuance activity year-to-date featured $2.3B in two Green Bonds, including the recent, first ever 30-year Green Bond by a Canadian province. The latter will fund four large public transit projects.

Altogether, shrinking deficits imply long-term bond borrowings will be used primarily to refinance maturing debt and make investments in capital assets. It is a sound advantage very few provinces benefit from.

Short-Term Outlook: Better Real GDP Performance Feeds Fiscal Revenues

In 2024, real GDP growth is on track to fall within the base case scenario and the upside faster growth scenario originally forecasted in Budget 2024. The FES estimates annual real GDP growth this year at 0.9% (exceeding the Budget 2024 projection of 0.3%). Stronger-than-expected compensation of employees and household spending growth near 5%, are the other main factors lifting nominal GDP beyond Budget 2024 expectations, with growth projected at 3.8% instead of 2.7%.

FY 2024–25 revenues are projected to significantly exceed Budget 2024 (by almost $7B). An unusually large revision is coming from personal income and corporate income taxes. The top driver of this outcome is improved economic performance. The second driver is the anticipated change relative to the federal government's announced increase to the capital gains inclusion rate (Budget 2024 was released before this announcement). Additional sales tax is another factor boosting government revenues. These upward revisions significantly outweigh the minimal decrease in revenues ($0.3B) related to the extension of the 6-month gasoline tax reduction, to remain in place until June 2025.

It is also worth mentioning that the ongoing reduction in international student study permits, which is negatively impacting revenues for Broader Public Sector Colleges, was already included in Budget 2024.

Expenses: One-time $200 Taxpayer Rebate in Early 2025

Total expenses in FY2024–25 are revised up to a lesser extent than revenues (+$3.8B versus Budget 2024). Approximately three quarters of this increase relates to the Ontario Taxpayer Rebate: the Ontario government will disburse one-time payments of $200 to 15M Ontarians at a cost of $3B. This one-time payment represents a 0.5% boost to annual nominal household disposable income.

Other noteworthy changes to expenses include a revision to health care spending (revised up by $1B) and materially lower interest debt charges (-$1.2B).

Medium-Term Outlook Reveals Solid Financial Ratios

Improved fiscal performance in FY2024–25; slight increases in projected annual nominal GDP growth over time, and delayed positive impact of the higher inclusion rate on capital gains translate into an improved fiscal path for the following two years.

The FES projects a small deficit of $1.5B in FY2025-2026 (vs. $4.6B in Budget 2024) and a small surplus of $0.9B in FY 2026–27 (vs. $0.5B in Budget 2024). Accordingly, long-term borrowings in FY2025–26 are revised down by $2.7B relative to Budget 2024 (to $35B) and will remain intact the following year, at $32.6B. This amount is at the low end of the $32B–$43B steady range of the annual bond supply recorded during the last eight years, excluding the pandemic shock ($60B).

Furthermore, the FES shows material improvement in the medium-term outlook of sustainability ratios. The net debt-to-GDP figure is projected to remain closer to 38% than 39%, between now and FY2026–27. Such a low a figure has not been recorded since the early 2010s. Also, interest on debt, as a percentage of revenue, is projected to peak soon at 6.3% (up from 5.5% in FY2023–24).

Finally, the net debt-to-revenue ratio has been revised down, closer to 200% than the 210% previously projected. In our view, these ratios raise the odds of a credit upgrade (Moody's and S&P's both have positive rating outlooks).

Takeaway: Moving Closer to a Credit Rating Upgrade

Ontario's real GDP growth continues to moderately outpace the rest of Canada. This is a key driver behind the material improvement in public finances unveiled in the FES. A balanced budget is within reach as early as next year. Sustainability ratios are very solid. The long-term bond borrowing program, in particular, aims to ensure stability in funding activity over time while prioritizing larger liquidity reserves. Furthermore, the revised fiscal outlook incorporates prudence with the annual reserve of $1B in FY2024–25 and the top-up of $0.9B to the Contingency Fund projected at a balance of $1.7B. The $200 taxpayer rebate, announced before Wednesday's FES, increased speculation about the possibility of an election in the first half of 2025, one year before the officially scheduled date of June 2026. Other potential targeted electoral measures could be financed with these reserves.