Laurentian Bank Securities
ECONOMIC RESEARCH AND STRATEGY

Ontario March 2020 Fiscal Update: A First Response to Covid-19

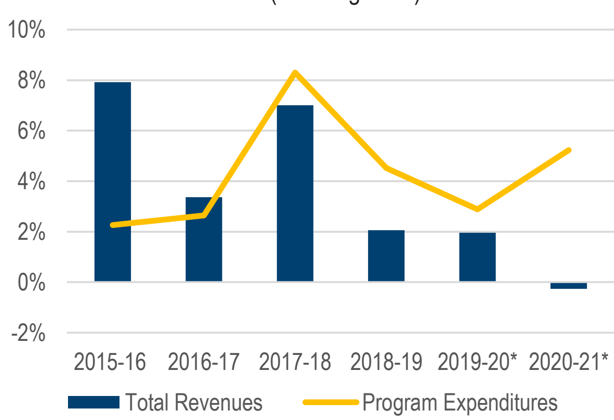
The Ontario government delivered a one-year fiscal outlook due to the Covid-19 outbreak instead of a regular budget with a medium-term outlook. The Covid-19 plan includes a $17B response divided into three components:

1. Additional support to health care delivery worth $3.3B relative to Budget 2019;
2. Various forms of direct financial support and tax relief measures for individuals estimated at $3.7B;
3. Several tax and fees deferrals to mitigate cash-flow pressures for businesses estimated at $10B;

Projection: fiscal revenue stable, expenses on the rise

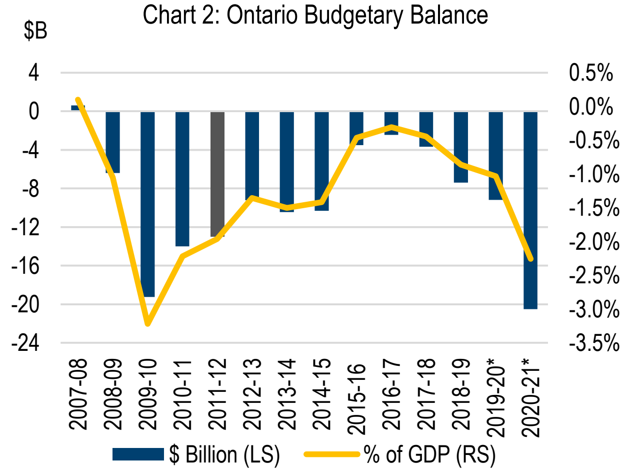
The combination of the above-mentioned measures and the deteriorating economic outlook will yield a quasi-stagnation in total revenue in FY 2020-21 relative to FY 2019-20 (-0.3%, chart 1). The fiscal update incorporates a $5.8B negative impact on revenues as a result of the virus outbreak (3.7% of revenue; 0.7% of GDP), partially offset by the $2.6B upward revision to revenues in FY 2019-20. PIT and CIT revenue are projected to edge down in light of slow growth in household compensation (2.7% in 2020 vs 4.1% in 2019), a net income loss for corporations and the tax relief measures announced. Program expenses for FY 2020-21 are forecast to increase by $7.1B relative to the Fall 2019 Fiscal Update, a 5.2% growth rate relative to FY 2019-20. Altogether, the deficit for FY 2020-21 is pegged at $20.5B (2.3% of GDP). In comparison, the largest deficit registered during the financial crisis was $19.2B in FY 2008-09, representing 3.2% of GDP (chart 2).

Chart 1: Ontario Fiscal Framework (annual growth)



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

Chart 2: Ontario Budgetary Balance



Source: Ontario Government and LBS Economic Research and Strategy.

Several layers of prudence to meet fiscal metrics

A positive aspect relates to the several layers of prudence built into this new fiscal forecast protecting against unexpected developments to revenue and spending:

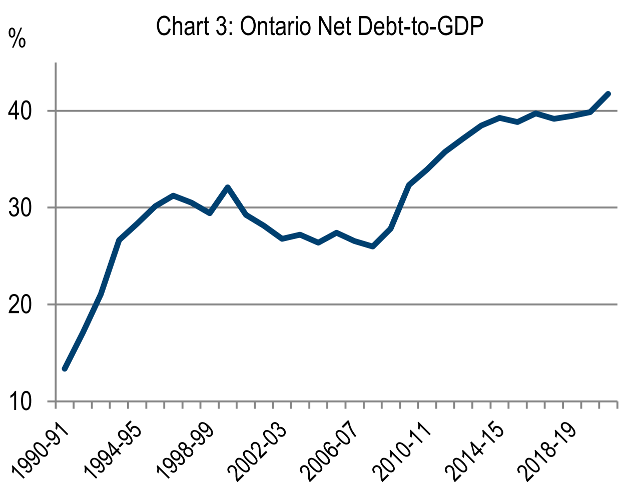
- The 0.4% projected decline in revenues was deliberately pegged lower than the 2020 nominal GDP growth forecast of +2.0%;
- A $1.0B contingency fund to face additional costs in the health care sector;

- Other contingencies for unexpected emergency spending totalling $1.3B;
- A record-high $2.5B reserve, instead of the usual $1.0B cushion;

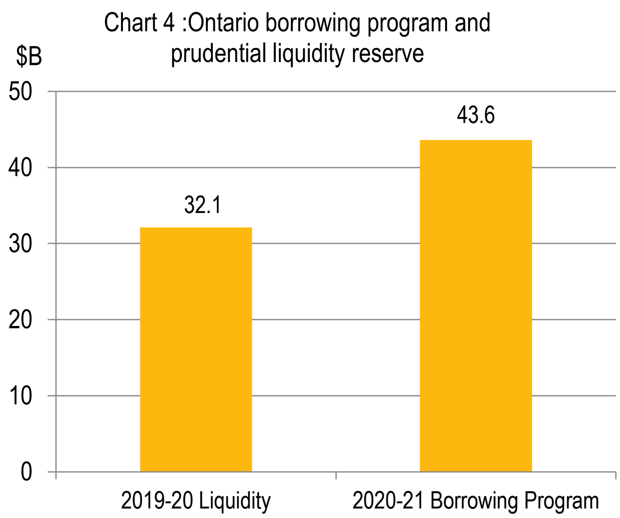
Altogether, these layers of prudence reinforce the odds of meeting the deficit, borrowing requirements and debt figures proposed for FY 2020-21.

Public debt and borrowing requirements on the rise, strong prudential liquidity reserve

Ontario's public debt burden has been stable for six consecutive years. But the Covid-19 crisis is forcing the Ontario government to project a record high net debt-to-GDP ratio of 41.7% in FY 2020-21, up from 39.9% in FY 2019-20 (chart 3). Borrowing requirements are expected to increase to finance the deficit and capital spending. Long-term borrowing needs for FY 2020-21 are estimated at $43.6B, $7.6B higher than last year. 61% of this year's program is for refinancing purposes. The province maintains its 70-80% range target for Canadian dollar borrowings but could also show some flexibility due to the current unusual market conditions. Also, the government's plan remains to extend the term of the Province's debt (averaging 10.8 years) due to the low interest rates environment, subject to investor demand. Finally, heightened market volatility and diminished liquidity caused by Covid-19 have hindered provincial financing operations in the primary bond market. Under the unlikely scenario that financial markets are extremely illiquid, the Province's sizeable prudential liquidity reserve above $30B would assure uninterrupted government operations (chart 4).



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



Source: Ontario March 2020 Fiscal Update.

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