Laurentian Bank Securities
ECONOMIC RESEARCH AND STRATEGY

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The 2020 Ontario Budget – Transitioning Toward A Post-Covid Recovery

Ontario Minister of Finance Rod Phillips presented the 2020 Budget today. Built on three pillars, the budget proposes $15B in new support for: 1- protection; 2- financial aid taking the form of targeted tax deferrals and cash-flow relief for individuals and companies; 3- recovery efforts reducing the cost of doing business. In total, $45B in COVID-19 related spending over three years is put on the table instead of the $30B included into the March Action Plan and the *First Quarter Finances* from last August. This reinforced but necessary response unambiguously leaves a footprint on public finances. Under the base case scenario proposed today, the deficit shrinks modestly over time, the net debt-to-GDP ratio increases to nearly 50% by FY 2022-23 and borrowing requirements stay elevated compared to historical standards.

Unchanged outlook for FY 2020-21, due to the federal government

The FY 2020-21 deficit of $38.5B (-4.5% of GDP) is unchanged from the First Quarter Finances. Total revenues of $151.1B, down $5B relative to the previous year, were nonetheless revised up by $462M. Federal transfers were revised up by $771M, mainly reflecting Ontario's share of the federal's Safe Return to Class Fund. Lower-than-expected own-source revenues are driven by limited activities in casinos, leading up to a $386M downward revision to Government business enterprises' revenue. On a brighter note, the large $420M upward revision to land transfer tax revenue reflects the V-shaped recovery observed in resale housing activity.

On the spending side, debt servicing costs of $12.5B for FY 2020-21 are unchanged thanks to lower borrowing rates, more than 2 full ppts lower relative to Budget 2019. It fully compensates the effect of increased marketable debt. This is a silver lining considering the bigger picture showing record spending in dollar terms ($187B) and as a percentage of GDP (22.1%). Relative to the First Quarter Finances, Budget 2020 proposes a $391M increase in total expenses. The lion's share of additional funding for health and economic support introduced since August will be funded by the contingency funds put in place in March. These time-limited contingency funds stand at $13.3B for FY 2020-21. After accounting for past drawdowns and new measures announced today, the balance in the contingency funds stands at $2.7B. In case the second wave of COVID-19 does not get worse, those balances should prove sufficient for the remainder of FY 2020-21.

Base Case Scenario: small progress relative to deficits

Under the base case scenario laid out today, the deficit shrinks modestly to $33.1B (3.5% of GDP) and $28.2B (2.7% of GDP) in FY 2021-22 and FY 2022-23, respectively (chart 1). Most of the improvement is driven by the economic rebound. Total revenue goes back to pre-crisis levels in FY 2022-23, after the level of economic activity reaches pre-coronavirus levels toward the end of FY 2021-22. In contrast to own-sources revenues, extraordinary COVID-19 support from the federal government provided in FY 2020-21 is expected to recede by $6.3B in FY 2021-22.

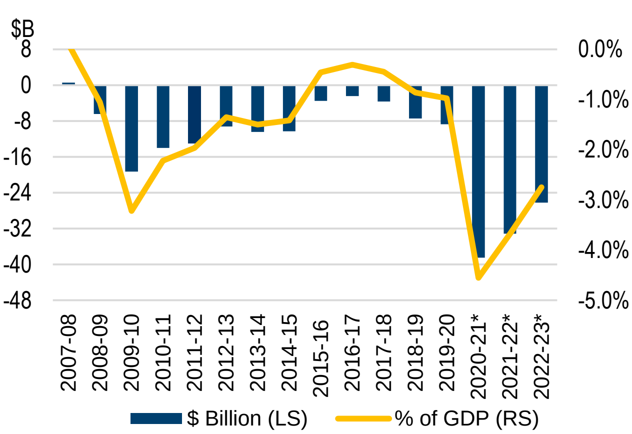
Total spending only edges down over time due to the non-recurring nature of coronavirus expenses. Hence, contingency funds are reduced to $5.0B and $2.8B in FY 2021-22 and FY 2022-23, respectively, compared to $13.3B this year. The pandemic will lead the government to permanently inject recurrent large sums for hospitals, vaccine stocks and blood products. As a result, projected at $68.5B in FY 2022-23, once the pandemic will likely be over, health care funding could stand $2.3B above Budget 2019 initial forecasts. Meanwhile, the breakdown proposes fiscal discipline in other large departments such as education and justice.

Alternative COVID-19 scenarios and possible fiscal trajectories

Under the base case scenario, the real GDP annual growth forecast of -6.5% in 2020 is 0.4 ppt lower than the private sector average. The 5.0% 2021 rebound is 0.1ppt lower than private forecasters. This layer of prudence is further reinforced by a lower trajectory for fiscal revenue relative to GDP over the three-year horizon.

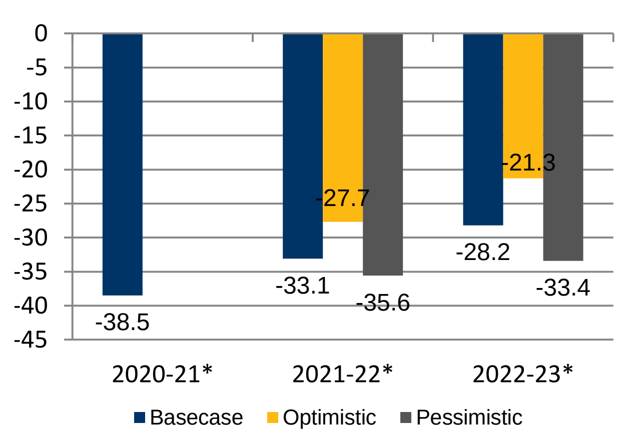
Building up fiscal prudence in the outlook is imperative given the elevated degree of uncertainty. For instance, a few regions in the Province are poised to benefit from eased restrictions starting this weekend, but it is difficult to say for how long this can last. Accordingly, the government proposed alternative optimistic and pessimistic economic and fiscal scenarios. These incorporate changes in fiscal revenues only, driven by variation in GDP projections. Relative to the base case scenario projecting $100B worth of deficits over three years, the optimistic scenario lowers combined deficits and borrowing requirements by $12B. Under the pessimistic scenario, deficits and borrowing requirements turn out to be $8B higher (chart 2).

Chart 1: Ontario Budgetary Balance Projections (historical and basecase scenario)



Source: Ontario Government and LBS Economic Research and Strategy.

Chart 2: Ontario Budgetary Balance Projections Under Various Scenarios



Source: Ontario Budget 2020.

To Watch: COVID-19 Monitoring, BoC Support, Budget 2021

All in all, Budget 2020 remains focused on the pandemic. It proposes a necessary bold response to COVID-19 and a challenging fiscal map in a post-pandemic world.

Similar to other provinces, borrowing requirements will remain elevated for quite some time relative to pre-pandemic standards. Fortunately, the BoC has been active with its Provincial Bond Purchase Program (PBPP) since last Spring, particularly in the last two weeks. Terms and conditions of the PBPP leave plenty of room to support efficiency in the Provincial bond market going forward.

Finally, given the multiple pandemic paths possible, the government decided to wait until Budget 2021 next March before proposing a multi-year plan to return to balance. Hopefully, the impact of the pandemic will have receded and vaccines will have started being distributed.

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