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## Ontario Budget

### Analysis of Ontario's 2007 Budget

#### A Balanced and Relatively Modest Budget



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## Highlights

Ontario's Minister of Finance Greg Sorbara tabled the 4<sup>th</sup> budget of the McGuinty government today, the last one before the elections on October 10, 2007. This budget proposes several measures that involve children and families, the property tax system, education, health, the environment, infrastructures and businesses. However, no significant tax cuts have been put forward as the government simply cannot afford it. In addition, despite a wide range of new measures, the financial impact of these announcements is all in all rather limited. The budget anticipates a second consecutive budget surplus in 2006-2007 and the Ministry's forecasts are counting on slight budgetary surpluses (excluding the reserve) for the next two fiscal years.

- Own-source revenues should increase by only 0.6% in 2007-2008, even though the average growth in the past three years was 8.6%. Clearly, the Ministry of Finance's projections seem particularly conservative in this aspect. Revenues from federal transfers will increase by 13.6% in 2007-2008 due to the recent changes announced by Ottawa.
- Program spending will grow by only 2.5% in 2007-2008, a pace that seems particularly sluggish

compared with what was observed in the previous fiscal years (average growth of 7.6% since 2004-2005). In other words, the financial impact of the new initiatives is rather limited. Interest rates on the debt could increase by 3.2% in 2007-2008, but these projections also seem conservative as the pace of increases could, in the short term, move slower. On the one hand, the debt that represents the accumulated deficits could decline rather than grow if the reserve is not used and on the other hand, interest rate levels risk remaining relatively low.

- The Ontario government maintains a contingency reserve of \$0.8B for 2007-2008, \$1.0B for 2008-2009 and \$1.3B for 2009-2010. So, the budgetary balance including these reserves is of -\$0.4B, \$0.3B and \$0.4B respectively. It goes without saying that these balances could be higher if the reserve is not used.
- Moreover the budget proposes a reform of the support for children and families with the introduction of the Ontario Child Benefit (OCB). This new measure will help close to 1.3 million children every

**Tableau 1**

### Summary of budgetary transactions

In millions of \$	2003-2004	2004-2005	2005-2006	2006-2007	2007-2008p	2008-2009p	2009-2010p
. Own-source revenues	58,507	65,959	70,974	74,965	75,397	78,900	81,900
- Ann. var. in %	-2.5	12.7	7.6	5.6	0.6	4.6	3.8
. Federal transfers	9,893	11,882	13,251	14,178	16,106	15,800	15,900
- Ann. var. in %	11.2	20.1	11.5	7.0	13.6	-1.9	0.6
. Total revenues	68,400	77,841	84,225	89,143	91,503	94,700	97,800
- Ann. var. in %	-0.7	13.8	8.2	5.8	2.6	3.5	3.3
. Program expenses	64,279	70,028	74,908	79,992	82,030	84,200	86,800
- Ann. var. in %	8.8	8.9	7.0	6.8	2.5	2.6	3.1
. Interest on debt	9,604	9,368	9,019	8,841	9,123	9,200	9,400
- Ann. var. in %	-0.9	-2.5	-3.7	-2.0	3.2	0.8	2.2
. Total expenses	73,883	79,396	83,927	88,833	91,153	93,400	96,200
- Ann. var. in %	7.4	7.5	5.7	5.8	2.6	2.5	3.0
. Reserves	---	---	---	---	750	1,000	1,300
. Surplus/(deficit)	-5,483	-1,555	298	310	-400	300	400
. Surplus/(deficit) excluding the reserve	-5,483	-1,555	298	310	350	1,300	1,600
. Net debt	138,816	140,921	141,928	143,025	145,314	147,000	149,200
. Accumulated deficit	124,188	125,743	109,155	108,845	109,245	108,900	108,600
. Nominal GDP	493,219	517,608	537,657	553,197	570,346	597,200	625,200
- Ann. var. in %	3.2	4.9	3.9	2.9	3.1	4.7	4.7
. Total expenses as a % of GDP	15.0	15.3	15.6	16.1	16.0	15.6	15.4
. Surplus/(deficit) as a % of GDP	-1.1	-0.3	0.1	0.1	-0.1	0.1	0.1
. Net debt as a % of GDP	28.1	27.2	26.4	25.9	25.5	24.6	23.9
. Accumulated deficit as a % of GDP	25.2	24.3	20.3	19.7	19.2	18.2	17.4

Sources: Ministry of Finance of Ontario and Desjardins, Economic Studies

year, compared with 467,000 children with the current programs.

- The government proposes to continue increasing the minimum wage, which has already been raised some 17% since 2003. The minimum hourly wage could move up from the current \$8.00/hour to \$10.25 by 2010 with three annual increases of \$0.75 starting in March 2008.
- The Ministry of Finance announces measures designed to increase the fairness and predictability of the property tax system. More specifically, a cut in the high level of the business education property tax, a change in the property assessment system and an improvement of the fairness and efficiency of the assessment system are suggested.
- This budget supports the government's investments in infrastructures by adding \$5.9B in 2007-2008. In addition, minister Sorbara is introducing many measures aimed at driving innovation, training a high-quality labour force, increasing the competitiveness of Ontario businesses and facilitating their adjustments to international competition and a higher dollar.

### A Realistic Economic Scenario

We feel that the economic assumptions used in developing Budget 2007 are very realistic, since they are on the whole similar to our most recent forecasts. This is in contrast with the relatively pessimistic assumptions, and so more conservative, used in the two last budgets of the McGuinty government.

Today, Ontario's economy is experiencing serious difficulties, and the Ministry of Finance believes that 2006 ended with a mere 1.3% increase of real GDP. The restructuring of the automobile industry in North

America and a weaker demand for American cars are adversely affecting Ontario in a great way. The difficulties in the forest industry, which provides approximately 25,000 jobs in the north of the province, also contribute to the sluggish economic performance. Bear in mind however that the mining industry is benefiting from high metal prices and is currently growing steadily.

Growth should remain tenuous in 2007, at 1.6%, as global economic conditions, especially south of the border, will keep holding back export growth in the province. The anticipated housing construction decline will also slow down the economy over the next quarters. However, the situation will improve next year due especially to the anticipated recovery of economic activity in the United States. The growth of Ontario's real GDP could then reach 2.8% according to the Ministry of Finance.

It should be emphasized however that we anticipate a more pronounced rise of the Canadian dollar than the one indicated in the budgetary assumptions. A stronger dollar could delay the recovery of Ontario's economy somewhat. Just as we do, the Ontario government anticipates that interest rates will remain stable in 2007 before increasing moderately in 2008.

### Ontario Returns to Budgetary Surpluses

The McGuinty government obviously made drastic changes to the province's finances over recent years. With an important deficit at the beginning of the government's mandate, the budgetary balance improved gradually and the fiscal years 2005-2006 and 2006-2007 even ended with a small surplus. Yet, the Ministry of Finance did not anticipate, until recently, a return to a balanced budget before 2007-2008. By the way, if the contingency reserve is not used (the opposite would be surprising given that the reserve has not been needed in the past two fiscal years), the government's balance sheet could keep improving over the coming years.

The return to balanced budgets, indeed slight surpluses, helps to stabilize the debt that represents the accumulated deficits. However, the province's net debt should keep growing over the coming years, as financing fixed assets and infrastructure will require additional financial resources. Even so, the growth of the net debt will likely be slower than that of economic growth, so that the debt-to-GDP ratio will go down even more

**Tableau 2**  
Economic and financial forecasts

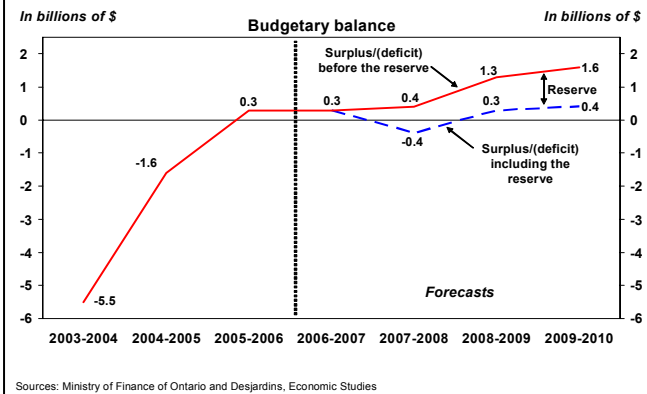
	2006	2007 Budget	Desjardins Group	2008 Budget	Desjardins Group
. Ontario nominal GDP (%)	2,9e	3.10	3.10	4.70	4.80
. Ontario real GDP (%)	1,3e	1.60	1.60	2.80	2.70
. Inflation rate ( % )	1.80	1.30	1.60	1.90	2.50
. Employment (in % )	1.50	1.10	1.40	1.40	1.70
. Unemployment rate ( % )	6.30	6.30	6.40	6.20	6.20
. Canadian Treasury bills (%)					
- 3 months	4.00	4.10	4.15	4.30	4.35
. Canadian bonds (%)					
- 10 years	4.20	4.20	4.15	4.70	4.80
. Canadian dollar (US\$/CAN\$)	88.20	86.00	85.40	87.50	91.50

\* Consumer price index.

Sources: Ministry of Finance of Ontario and Desjardins Economic Studies

e: estimate

### Ontario: Budgetary surpluses should continue



reaching 25% in 2007-2008, 23.9% in 2009-2010, compared with 30.4% in 1998-1999. In Quebec, the same ratio should hover around 36.4% in 2007-2008, i.e. close to ten percentage points higher than Ontario. This clearly demonstrates the difference in the debt situation between the two provinces.

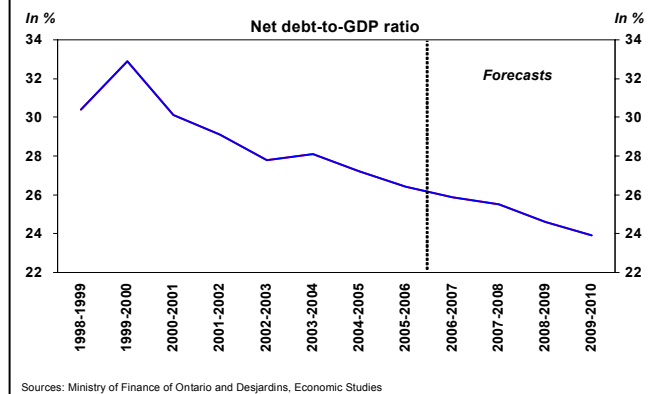
Maintaining consistent balanced budgets and reducing the weight of the debt should satisfy financial markets. As in the last few months, the gaps between Ontario's bonds and those of the federal government should close somewhat.

### Conclusion: Waiting for the October Elections

The first point to remember in the 4<sup>th</sup> budget of the McGuinty government is that budgetary deficits now seem a thing of the past in Ontario. Following the small surplus recorded during fiscal 2005-2006, many feared that the Ontario government would fall back into deficits. Fortunately, that is not the case and small surpluses are now anticipated for the next fiscal years. This is delightful news.

With less than seven months before the next elections, some election measures were expected in Ontario's budget. So, the most important new element announced in this budget is the introduction of the Ontario Child Benefit. This reform of the support for low-income families involves some very interesting ideas. In particular, the fact that the children of low-income workers will not be put to a disadvantage in comparison with those under social assistance could help some on social assistance return to the labour market. However, it seems strange that this new program comes with a lump-sum payment that can reach \$250 per child on the eve of the elections. We also feel that the relatively

### Ontario: The weight of the debt is decreasing



sudden hike in the minimum wage is pandering to electors and could lead to some economic consequences. The increase of approximately 50% in the minimum wage in Ontario between 2003 and 2010 is in sharp contrast with what has been observed in the past and with the changes in Quebec.

If the government had a greater leeway, making more efforts to counter the slow-down of Ontario's economy might have been desirable. The budget includes few new elements for Ontario businesses: basically a more rapid elimination of the capital tax and a gradual cut in the education tax. In addition, tax cuts would have definitely boosted the confidence of Ontario consumers. But in the current situation, the government could not have easily done more without falling back into deficits.