Central 1™

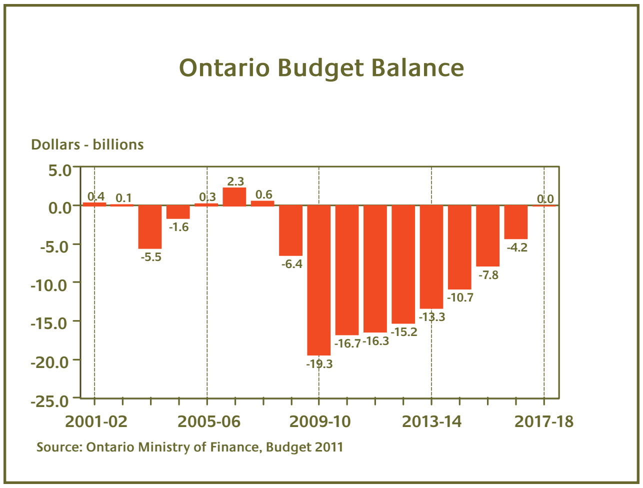
Ontario Budget 2011

Economics — March 2011

Summary: The 2011 Ontario budget contains a gradual deficit reduction plan largely similar to the previous budget. No new tax measures or significant spending initiatives were announced, though various efforts to achieve efficiencies within departmental spending will be undertaken. The government's financial situation generally mirrors the economy and with the economic recovery well in place, stimulus spending will wind down. Also winding down are the HST transition payments. The recent rapid rise in debt slows while reaching new highs and pushing debt servicing costs to rates not seen since 2003. Containing debt will become a more pressing issue since it will consume a growing portion of revenue and reduce funding available for other purposes.

Fiscal Plan: Ontario's government budget deficit is projected at $16.3 billion in the current fiscal year, down slightly from $16.7 billion in fiscal 2010/11. The medium term outlook calls for a gradual reduction in the deficit to $15.2 billion in 2012/13, and to $13.3 billion in 2013/14. In the extended outlook, the deficit is eliminated by 2017/18. A reserve of $0.7 billion is set aside in 2011/12, which rises to $1.0 billion per year thereafter, for unforeseen events affecting revenue or expenses.

The plan has a $1.4 billion buffer in 2011/12 which should cover most negative circumstances. While no contingency funds are budgeted after the current year, practice has included a contingency amount in the current and following fiscal year when a budget is delivered. Unused contingency funds in 2010/11 were $1.3 billion and used to reduce the 2010/11 deficit.



Revenue growth exceeds expenditures throughout the fiscal plan eventually eliminating the deficit. Until a surplus is achieved, debt keeps rising as does the cost to service the debt. Net debt will rise to about $325 billion in 2017/18 with debt charges projected at $16.3 billion or 11.5 cents per revenue dollar. In 2010/11, net debt was $217.3 billion requiring $9.5 billion in debt charges or an interest bite of 9.0 cents.

The path to a balanced budget is long and gradual with a more expeditious march desired by the financial and bond markets. However, there is likely no shortage of buyers for Ontario government bonds and while its yield will rise with all others, the market may begin demanding a premium or wider spread

Medium Term Fiscal Plan and Outlook, ($ Billions)

	Interim	Plan	Outlook	
	2010/11	2011/12	2012/11	2013/14
Revenue	**106.2**	**108.5**	**111.8**	**117.0**
Expense				
Programs	113.3	113.8	114.6	116.7
Interest on Debt	9.5	10.3	11.4	12.6
Total Expense	**122.9**	**124.1**	**126.0**	**129.3**
Reserve	–	0.7	1.0	1.0
Surplus/(Deficit)	**-16.7**	**-16.3**	**-15.2**	**-13.3**
Net Debt	217.3	241.5	264.8	284.8
Accumulated Deficit	147.6	164.0	179.1	192.4

Source: 2011 Ontario Budget.

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Ontario's Recovery Plan, ($ Billions)								
	Interim	Plan	Medium-Term Outlook		Extended Outlook			
	11-Oct	11–12	12–13	13–14	14–15	15–16	16–17	17–18
Revenue	**106.2**	**108.5**	**111.8**	**117.0**	**122.8**	**129.0**	**135.4**	**142.2**
Expense								
Programs	113.3	113.8	114.6	116.7	118.8	121.0	122.9	124.9
Interest on Debt	9.5	10.3	11.4	12.6	13.7	14.8	15.7	16.3
Total Expense	**122.9**	**124.1**	**126.0**	**129.3**	**132.6**	**135.8**	**138.6**	**141.2**
Reserve	–	0.7	1.0	1.0	1.0	1.0	1.0	1.0
Surplus/ (Deficit)	**-16.7**	**-16.3**	**-15.2**	**-13.3**	**-10.7**	**-7.8**	**-4.2**	**0.0**

Source: 2011 Ontario Budget.

over Canada bonds in the later years of the extended outlook. Bond rating agencies may also adjust their ratings. The performance of the economy and the government's fiscal plan will determine how markets and bond rating agencies react.

Economic Forecast: The budget forecast uses a moderate growth profile through to 2014 with slightly lower growth in 2011 than in 2010. Real GDP growth forecasts are slightly lower than the private-sector average in 2011 to 2014. Higher interest rates are expected along with a slightly lower exchange rate at 98.1 US cents in 2014 while oil prices edge down to about $US 100 in 2014.

The Budget's economic forecasts are generally 'in the ball park' and likely add a small buffer to any downside surprises. Central 1's forecasts are slightly higher for nominal or current dollar GDP and corporate profits though slightly lower for labour income. Long government bond yields are considered on the low side from 2012 onwards with Central's forecast incorporating higher inflation and a more robust bond market response.

Revenue: Total revenue is projected to rise 2.2%, 3.0% and 4.6% in the next three years, respectively, in the medium term outlook and about 5% annually in the extended outlook. In 2011/12, total revenue increases by a small amount on less federal transfers for HST transition payment and less infrastructure spending. Taxation revenue led by personal income and sales tax growth are the mainstays of total revenue growth. Any fallback into recession or a period of economic underperformance jeopardizes the revenue stream for government. No recession is expected

The government's revenue is increasingly dependent on federal government transfers. Not withstanding

Ontario Economy 2009 to 2014						
	Actual		Projection			
	2009	2010	2011	2012	2013	2014
Real Gross Domestic Product	-3.6	2.8e	2.4	2.7	2.7	2.6
Nominal Gross Domestic Product	-1.1	6.1e	4.6	5.1	4.8	4.6
Labour income	-1.0	4.0e	4.3	4.7	4.8	4.6
Corporate Profits	-13.6	15.1e	12.2	9.2	5.9	5.2
Employment	-2.5	1.7	1.7	1.8	1.8	1.7
Consumer Price Index	0.4	2.5	2.3	2.1	2.0	2.0
Crude Oil ($ US per Barrel)	61.8	79.4	99.7	102.2	100.6	100.1
U.S. Real Gross Domestic Product	-2.6	2.8	3.1	3.3	3.2	3.1
Canadian Dollar (Cents US)	87.6	97.1	100.0	99.7	99.3	98.1
3-month Treasury Bill Rate	0.3	0.6	1.4	2.6	3.7	4.2
10-year Government Bond Rate	3.3	3.2	3.5	4.1	4.7	4.9

Source: 2011 Ontario Budget. Per cent change except where indicated. e = estimate ( ) negative

Medium-Term Revenue Outlook, ($ Billions)				
Revenue	Interim	Plan	Outlook	
	2010/11	2011/12	2012/13	2013/14
Taxation Revenue	**71.3**	**75.3**	**78.3**	**81.7**
Personal Income Tax	23.8	25.5	26.9	28.5
Sales Tax	19.0	20.1	21.1	22.2
Corporations Tax	8.3	8.9	9.1	9.4
Education Property Tax	3.0	3.1	3.2	3.4
Ontario Health Premium	5.8	5.7	5.7	5.6
All Other Taxes	11.5	12.0	12.2	12.6
Government of Canada	23.0	21.7	21.8	23.1
Income from Government Business Enterprises	4.4	4.5	4.8	5.2
Other Non-Tax Revenue	7.5	6.9	6.9	7.0
Total Revenue	**106.2**	**108.5**	**111.8**	**117.0**

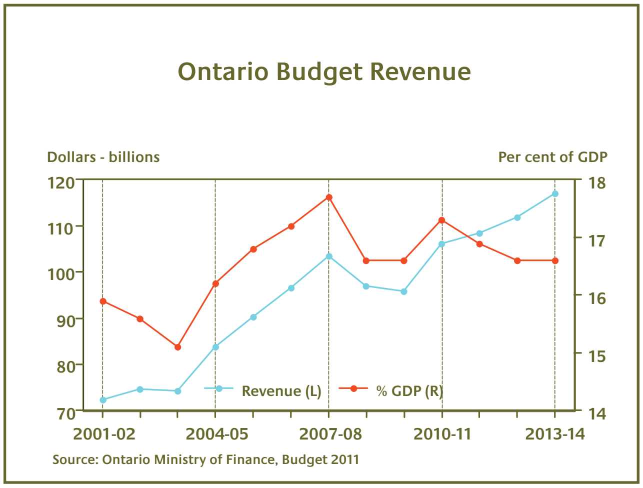
Source: 2011 Ontario Budget.

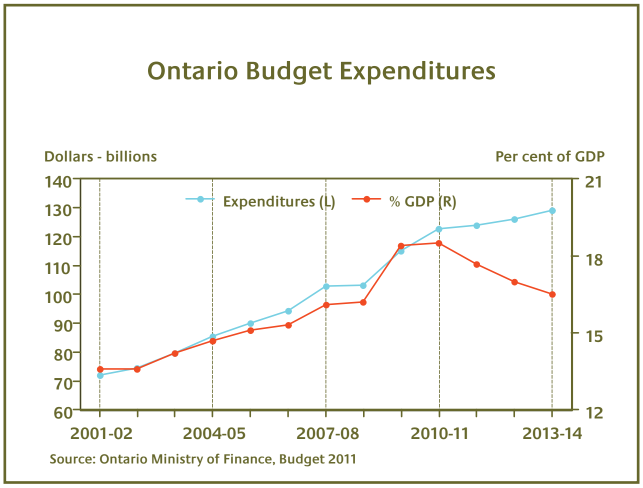
the HST and recession driven increases between 2009/10 and 2011/12, the trend is clearly upward and reaches a projected 19.7% in 2013/14 compared to 17.1% in 2008/09. In dollar terms, federal cash transfers rise to $23.1 billion from $16.6 billion in the same period. Budget 2011 devoted an entire section to the need for federal support in a number of areas most of which involve monies.

Expenditures: Interest on the debt is the fastest rising component behind total spending. Debt charges rise between 8 to 10% per year in the medium term outlook mainly on higher. In 2011/12, program spending increases only 0.4% due to the influence of lower HST transitional support payments and less infrastructure spending. Excluding these items, program expenses would increase about 2.5% and total spending about 2.9% in 2011/12. A similar situation plays out in 2012/13 but in 2013/14 these impacts disappear at which time below-normal health and education spending increases keeps total and program spending from rising above 2.6% and 1.8%, respectively.

The budget seeks savings of $1.5 billion over three years through operational efficiencies and consolidation; streamlining programs; and further efficiencies in the health care system.

Health sector spending growth slows to 3.4% in 2012/13 and 2.8% in 2013/14, which is below recent growth rates and a potential source of risk to the fiscal plan. Those efficiencies in the health care system are incorporated into the spending estimates. In any case, health spending has been rising between 5 to 8% annually in the past few years.





Medium-Term Expense Outlook, ($ Billions)				
	Interim	Plan	Outlook	
	2010/11	2011/12	2012/13	2013/14
Programs				
Health Sector	45.6	47.6	49.2	50.6
Education Sector	22.2	23.2	24.0	24.3
Postsecondary and Training Sector	7.6	7.1	7.1	7.4
Children's and Social Services Sector	13.1	13.7	14.0	14.4
Justice Sector	4.4	4.7	4.6	4.2
Other Programs	20.3	17.4	15.7	15.9
Total Programs	**113.3**	**113.8**	**114.6**	**116.7**
Interest on Debt	9.5	10.3	11.4	12.6
Total Expense	**122.9**	**124.1**	**126.0**	**129.3**

Source: 2011 Ontario Budget.

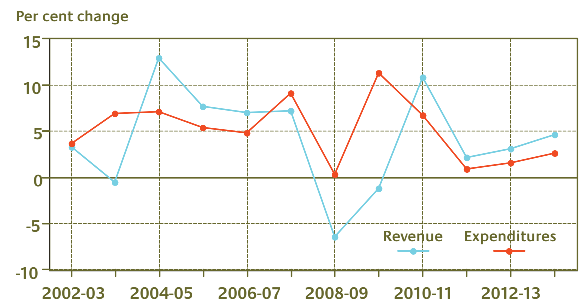
Capital Spending: Government spending on infrastructure holds steady at $12.1 billion in 2011/12 and 2010/11. These figures are net of federal government transfers and other partner funding. Actual spending reached a high in 2010/11 at $14.9 billion with 2011/12 spending at $13.4 billion. The economic impact of capital spending tracks these numbers and will become a lesser growth driver in the medium term.

Provincial Debt: Total debt, which represents all borrowing without offsetting financial assets, is projected to be $236.3 billion at the end of 2010/11, compared to $212.1 billion in 2009/10. Total debt rises each year on the medium term outlook to $303.0 billion in 2013/14. Net debt, the difference between total liabilities and total financial assets, is projected at $241.5 billion in 2011/12, up 11.1% from 2010/11. The net debt-to-GDP ratio increases in tandem with the projected deficits and reaches a peak at 40.6% in 2014/15 according to the extended outlook.

Net debt is estimated by Central 1 to reach about $325 billion in 2017/18. Recent double-digit annual percentage increases in net debt are projected to end in 2011/12 with 2012/13 coming in at a close 9.7%. With the deficit slated to decline every year and to disappear in 2017/18, net debt increases by less than 2% in the last year of the extended outlook.

The cost of servicing debt rises in tandem with debt and the expected increase in financing costs. Based on the projection of interest on debt in the extended outlook, the interest bite or cost per revenue dollar rises to 11.5 cents in 2017/18 from 9.0 cents in 2010/11. In dollar terms, debt charges climb to $16.3 billion from $9.5 billion in the same period. The debt situation was more costly in 2001/02 when the interest bite was 14.3 cents and took 14.4% of total spending since financing costs were almost twice as high while debt was about 50% lower.

Annual Growth in Ontario Budget Revenue and Expenditures



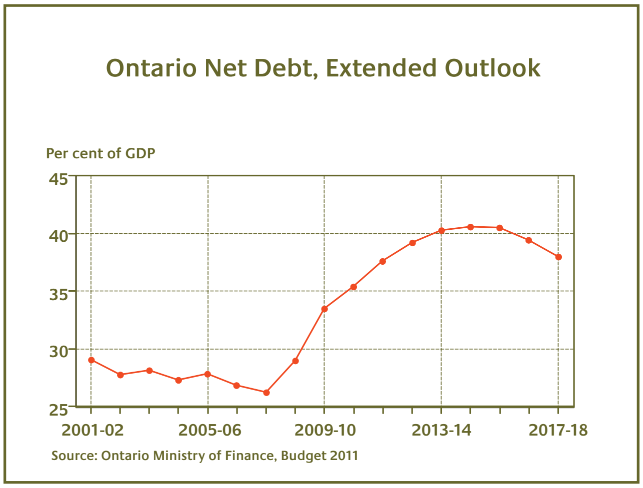
Source: Ontario Ministry of Finance, Budget 2011

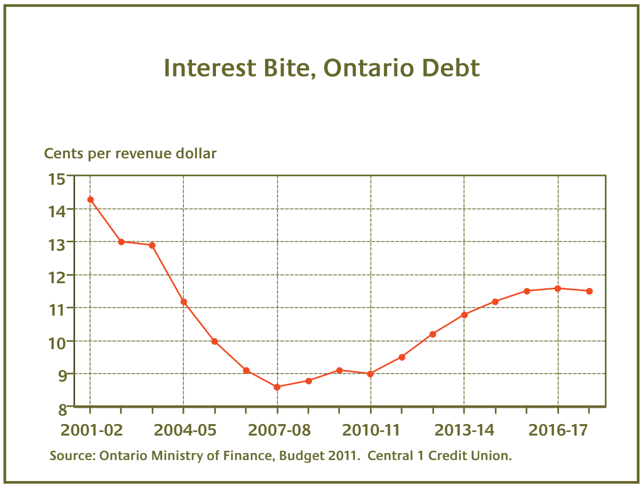
Ontario Net Debt

Source: Ontario Ministry of Finance, Budget 2011

Medium-Term Outlook Net Debt and Accumulated Deficit, ($ Billions)				
	Interim	Plan		
	2010/11	2011/12	2012/13	2013/14
Total Debt	**236.3**	**257.9**	**282.3**	**303.0**
Cash and Temporary Investments	-19.2	-14.6	-14.6	-14.6
Total Debt Net of Cash and Temporary Investments	217.1	243.3	267.7	288.4
Other Net (Assets)/Liabilities	-13.3	-16.0	-17.1	-18.5
Broader Public Sector (BPS) Net Debt	13.5	14.2	14.2	15.0
Net Debt	217.3	241.5	264.8	284.8
Non-Financial Assets	**-69.7**	**-77.5**	**-85.7**	**-92.4**
Accumulated Deficit	**147.6**	**164.0**	**179.1**	**192.4**
Net Debt as a per cent of GDP	**35.4**	**37.6**	**39.2**	**40.3**
Accumulated Deficit as a per cent of GDP	**24.1**	**25.5**	**26.5**	**27.2**

Source: 2011 Ontario Budget.





Non-Tax Measures: A handful of new measures were announced mainly increasing the number of spaces at post-secondary education institutions 60,000 over the next three years and some spending for basic training, summer jobs, literacy, mental health, and breast cancer screening.

The government is also looking for savings by examining the current ServiceOntario delivery model; by permanently reducing funding for executive offices of specific transfer payment recipients by 10 per cent over two years for major government agencies; reducing the size of the Ontario Public Service (OPS) by an additional 1,500 positions, between April 2012 and March 2014; closing underutilized prisons in Owen Sound, Walkerton and Sarnia, and the partial closure of Toronto West Detention Centre; and cancelling the construction of the Toronto West Courthouse, resulting in savings of $181 million over the next three years; and establishing a Commission on Broader Public Sector Reform.

Financial Services: The government plans to further limit abuse and fraud in auto insurance. A review of the remaining major parts of the Ontario Insurance Act — such as life insurance and accident and sickness insurance — as well as other insurance-related legislation will commence. In addition, regulatory effectiveness will be enhanced by considering additional enforcement tools for the regulator, such as administrative monetary penalties.

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