Ontario Election Aftermath:
The Stakes and the Rub

By Paul Borean, June 11, 2018

Following last year's positive upswing in GDP growth and the associated windfall to government finances in Canada, many of the nation's provincial governments have come face to face with some moderation in the economic outlook, and have launched into a phase of late-cycle fiscal stimulus. Ontario had signaled a shift in this direction, with the previous Liberal government having planned to push the province's books into recurring deficits for upcoming fiscal years. The government figures showed the deficit exceeding $6 billion for the next three years, with no plans to balance the books until the 2024/2025 fiscal year, before any adjustments to the province's accounting for the Ontario Fair Hydro Plan.

Much of the concern around this fiscal shift played out in credit markets earlier this year, with Ontario spreads underperforming relative to other provincial issuers (Exhibit 1). On a standalone basis, however, the underperformance of Ontario relative to Canadian government bonds over the same timeframe has been partially a function of the softer tone in global credit markets. In consideration of these movements, the province's standing as the largest provincial issuer should not be ignored, as this makes Ontario a key benchmark for Canadian government credit spreads.

Exhibit 1: Ontario credit spread performance relative to other Canadian provinces.
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After the polls closed on June 7, the PC party emerged with the largest portion of legislative seats, with the NDP forming the official opposition. Initial market reaction to the election results was almost non-existent, with Ontario spreads to Canadian bonds little changed.

While some differences may ultimately surface between the new government’s budgetary plans and the presented pre-election platforms, the destination appears unambiguous. A heavily indebted Ontario consumer has the opportunity to shift a portion of their debt-servicing burden onto the provincial government, as items such as lower income and gasoline taxes will require greater government deficits initially unless offsetting budget cuts are made elsewhere or a significantly improved growth outlook is realized. In turn, additional red ink will likely be spilled in the next provincial budget, and with it, more bond supply will likely surface for markets to take down.

Perhaps less appreciated by markets are any effects that the new government’s plans may have on the competitiveness of Canadian businesses on the world stage. The PC arrival comes following a government with a contrasting agenda on this front, and at a time when the key NAFTA trade relationship is being renegotiated. Ontario exports to the U.S. represent a sizeable 36% of total Canadian goods exports.

Such considerations are not lost on monetary policymakers at the Bank of Canada, though fiscal policy changes are only incorporated into their outlook once legislation is passed. From this perspective, having Canada’s largest province put forward some business-friendly policy prescriptions should help reassure the central bank that its outlook for GDP growth – one dependent on contributions from net exports and business investment – and, in addition, their projections for the output gap and for future inflation, remain on track. As such, the Bank of Canada can likely scratch one possible concern from its list of potential impediments to further monetary policy tightening this year.
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