Ontario
Budget 2025

Tariffs Cause Short-Term Strain; Long-Term Sustainability Remains Strong

Softer-than-Usual Economic Conditions to Improve Over Time

Tariff-related uncertainty will continue to weigh on Ontario's fiscal performance over the next two years to an unpredictable degree. Budget 2025 assumes real GDP growth of 0.8% in 2025 and 1.0% in 2026. This is reasonable in our view and significantly lower than the 10-year average of 2.2%. These 2025–26 real GDP growth projections have been halved compared to those in Budget 2024.

According to Laurentian Bank Securities April Budget Season Q & A report, Ontario's economic slowdown is partially driven by excess motor vehicle inventory in North America. Another major factor hampering growth is the decline in immigration. Ontario's net international net inflow fell by more than half between 2023 and 2024. This trend is expected to continue, contributing to weaker housing conditions in parts of the province compared to the rest of Canada.

Budget 2025 reflects this softness, forecasting 74,000 housing starts—the lowest since 2019—and a modest 1.2% drop in average resale home prices. However, a slight increase in land transfer tax revenue is expected, driven by a rebound in home sales later in the year.

These economic challenges have also affected labour market conditions. Ontario's unemployment rate rose by 0.5 percentage points to 7.8% in April, but some of this weakness is likely temporary, with improvement anticipated as auto production shutdowns come to an end.

Enhanced Fiscal Prudence: A Prudent Approach

Amid ongoing trade uncertainty, the Ontario government is taking a proactive approach. To support Canadian-controlled private manufacturers, it is introducing a refundable corporate income tax credit designed to encourage capital investment.

In response to the economic risks posed by trade disruptions—similar to its actions during the 2008–09 Global Financial Crisis and the pandemic—the government has strengthened its fiscal prudence. The first layer of this approach is the $3 billion Contingency Fund. The second layer is a $2 billion annual reserve, which has been increased by $1 billion in the first year of the three-year outlook and by $500 million in the second year, compared to Budget 2024. Combined, the Contingency Fund and annual reserve represent 2.3% of total revenues in FY 2025-26, offering Ontario a solid financial cushion—on par with buffers used in Quebec and Newfoundland & Labrador in their respective budgets.

Manageable Short-Term Deficits, Balanced Budget Still in Sight

Ontario's fiscal revenues are expected to decline by less than 1% in FY 2025–26 under the base case scenario, which incorporates tariff-related uncertainty. At the same time, total spending is projected to rise by a modest 2.1% compared to the previous year. This small increase is made possible due to the absence of growth in several sectors (except health and education), aligning with Fitch's rating agency's assessment of strong expenditure adjustability.

The combination of a slight revenue dip and controlled spending growth results in a short-term deterioration in Ontario's fiscal position. After a $6 billion shortfall in FY 2024–25, deficits are expected to be $14.6 billion in FY 2025–26 and $7.8 billion in FY 2026–27, both manageable.

Market participants will be reassured to know that Ontario remains committed to returning to a balanced budget by FY 2027–28, maintaining fiscal sustainability despite near-term challenges.

Annual Bond Issuance: Perspectives

Ontario has historically maintained a steady flow of annual bond issuance, deviating from this trend only during the 2008–09 financial crisis and the pandemic. However, U.S. President Trump's inefficient tariff policies and Ontario's significant exposure to tariffs are introducing a new period of instability.

Despite this new challenge, the province's bond borrowing program—set at $42.8 billion for FY 2025–26 and $41.1 billion for FY 2026–27—is in line with the seven-year average of $42 billion, or $39 billion when excluding the pandemic year (FY 2020–21). A below-average issuance of $33 billion is expected in FY 2027–28, partly due to reduced capital investments.

Key Strengths of Ontario's Borrowing Strategy

1. Long-term borrowing would have been higher if not for an increase in short-term borrowing, projected at $5 billion in FY 2025–26 and $2.5 billion in FY 2026–27. Additionally, Ontario will utilize $12 billion in cash and cash equivalents in FY 2025–26, bringing its liquidity reserve closer to pre-pandemic levels ($32 billion), down from a very elevated $41.9 billion at the end of FY 2024–25. The province's liquidity position remains robust, a strength previously highlighted by both Fitch and S&P credit agencies.

2. The $42.8 billion borrowing figure represents a 14% increase relative to last year's $37.5 billion (excluding $12 billion in pre-financing, totaling $49.5 billion). This increase is relatively modest, especially when compared to the Government of Canada's bond issuance, which is expected to rise at approximately twice the rate, reaching over $300 billion in FY 2025–26. The exact federal borrowing figure remains uncertain due to the postponed 2025 budget announcement (to be made next fall).

3. The Ontario government intends to be more active in foreign markets, setting a target range of 70%–85% for domestic borrowing in FY 2025–26, slightly lower than the 75%–90% range in FY 2024–25. Issuing up to 30% internationally is not an unrealistic goal; Ontario has previously borrowed more extensively outside Canada during challenging economic periods, including 35% in FY 2020–21, 51% in FY 2009–10, and 41% in FY 2010–11. The foreign bond market has been highly receptive lately, as evidenced by Quebec's recent €3 billion, 10-year European issuance—the largest ever by a Canadian issuer. Market participants should expect Ontario to take advantage of favorable market conditions in Europe, the U.S., and Australia throughout the year. Fitch's latest rating review noted that "robust access to global capital markets supports liquidity and provides flexibility for operations", reinforcing Ontario's strategy for FY 2025–26.

4. Sensitivities provided in Budget 2025 suggest that the trade conflict will have limited impact on bond issuance. In a higher economic growth scenario, long-term borrowing in FY 2025–26 would decline by $2.3 billion to $40.5 billion. Conversely, under a slower growth scenario, incorporating prolonged 25% U.S. tariffs, borrowing requirements would increase modestly by $2.5 billion to $45.3 billion.

Bottom Line—Strong Long-Term Debt Sustainability Despite Short-Term Challenges

Ontario's economy faces near-term pressures due to reduced immigration targets at the federal level and elevated exposure to the ongoing trade conflict. However, while these factors will lead to a temporary and manageable deterioration in public finances compared to what was envisioned before the Trump 2.0 era, the province's long-term fiscal picture remains solid.

The projected $14.6 billion deficit and $42.8 billion in borrowing for FY 2025–26 are lower than pandemic-era figures ($16.3 billion deficit and $47.2 billion borrowing in FY 2020–21). Furthermore, Ontario is approaching this tariff-related uncertainty from a strong financial position, supported by sound fiscal management, which led to an S&P credit upgrade in 2024 (to 'AA-' from 'A+').Ontario's net debt-to-GDP ratio also fell to a 13-year low of 36.3% in FY 2024–25, providing flexibility to absorb the current upward pressure without surpassing the below the intended target of 40% or lower.

Other key debt sustainability metrics projected in Budget 2025 also reinforce long-term fiscal sustainability:

- Net debt-to-operating revenue is projected to rise to 211% in FY 2025–26, slightly exceeding the government's 200% target but manageable compared to 195% in FY 2024–25.

- Net interest-to-operating revenue remains historically low, rising modestly from 5.6% in FY 2024–25—the lowest since the 1980s—but staying well below the 7.5% target.

Ontario's commitment to returning to a balanced budget by the end of the three-year outlook (FY 2027–28) also reinforces long-term fiscal sustainability, a factor likely to be well-received by market participants.