Laurentian Bank Securities

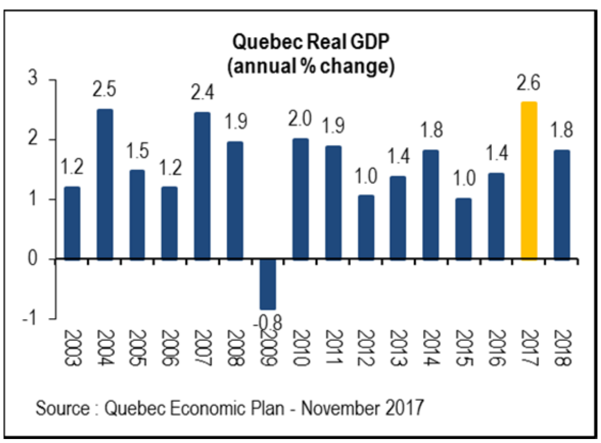
ECONOMIC RESEARCH AND STRATEGY

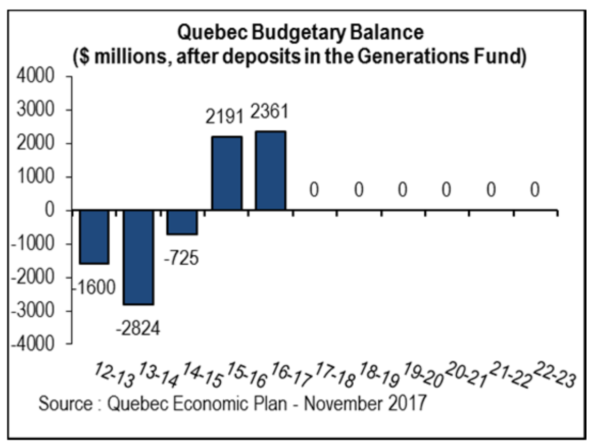
Quebec Fiscal Update: Additional tax relief for individuals without compromising debt reduction

The fiscal update unveiled in Quebec City on November 21th could be appropriately dubbed a responsible mini-budget.

First, the fiscal update confirms that the Quebec government registered its largest surplus ever in FY 2016-17: $4.4B or $2.4B after the $2.0B contribution to the Generations Fund. Principally driven by higher corporate income taxes, higher consumption taxes and delays in the implementation of federal-related infrastructure spending initiatives, this $2.4B surplus (0.6% of NGDP) is significantly above the $250M estimate included in the 2017 budget.

Second, the economic momentum accelerated further this year: Business and consumer confidence are at multi-year high; the unemployment rate is at an all-time low; 2017 turned out to be the best year in terms of economic growth since 2004; and real GDP growth is on track to reach 2.6%, above the 1.7% assumption included in the 2017 budget. As such, better-than-expected economic conditions improved the budgetary balance by $1.3B in FY 2017-18 (and by $1.7B for FY 2018-19 and FY 2019-20).



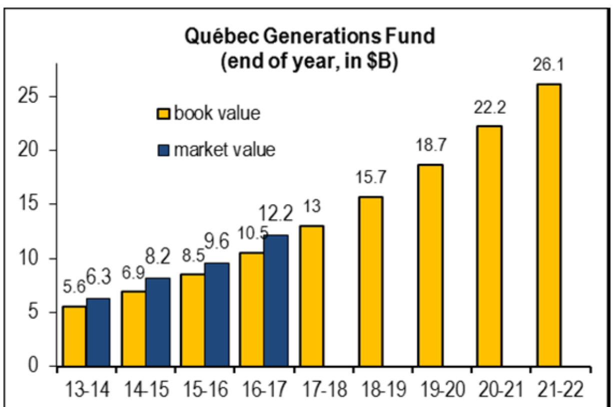


Most of this new fiscal room, combined with the $4.6B stabilization reserve built up from the surpluses registered in the previous two years, is principally used to lower the tax burden of individuals. The main measure included in this fiscal update is the reduction, from 16% to 15%, of the personal income tax rate applicable to the first $42 705 of taxable income. Effective for the 2017 taxation year, this measure will cost about $1.0B annually in foregone revenues (taxpayers will receive a refund after filling their tax return in the Spring of 2018). Another smaller measure is dedicated to families: a $100 cheque per child per year for the purchase of school supplies. This measure, also applicable in 2017, will cost about $100M in foregone revenues. Combined with tax cuts initiatives provided recently, such as the elimination of the health contribution, the tax burden for individuals falls by about $2.3B per year starting in 2017. This is significantly larger than the $950M tax relief of 2008 (which turned out to help mitigate the economic downturn in the Province during the 2008-09 global financial crisis). We expect this tax relief to contribute to maintain the pace of growth in household disposable income (+4.5% year-to-date) above the pace of growth in household nominal expenditures (+4.0% year-to-date), a positive trend in Quebec which is not observed in Ontario.

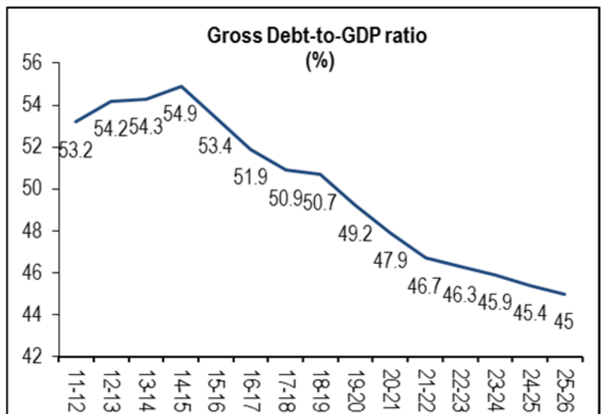
In addition to easing the tax burden on individuals by an additional $1.1B, the Quebec government will spend a few hundred millions more in health care and education services as well as on initiatives to reduce poverty and reduce social exclusion.

Altogether, the five-year fiscal outlook presented in this fall's update continues to project balanced budgets in FY 2017-18 and beyond. Bond investors will be pleased that the $1.1B tax cut does not compromise the long term financial objective of reducing the gross debt-to-NGDP ratio to 45% by 2026. Almost one-third of this objective has been achieved already, as the ratio fell quickly during the last two years from 54.9% to 51.9%. In order to fully reach this long-term objective (in about 8 years from now), the government will count on the same annual contributions to the Generation Funds that were identified in the 2017 budget ($2.5B in FY 2017-18, $2.7B in FY 2018-19, $3.0B in FY 2019-10). Also, in case of unexpected events, there are two financial cushions at the government's disposal: 1- the stabilization reserve projected at $1.8B in FY 2020-21; and 2- a $100M contingency reserve each year.

Finally, borrowing requirements stand at $14.789B in FY 2017-18, above the 2017 budget estimate of $11.264B due principally to $4.450B in pre-financing for FY 2018-19. The average in pre-financing activity for the past 10 years is $5.9B per year.



Source : Québec Economic Plan - November 2017



Source : Quebec Economic Plan - November 2017

Summary: No fiscal risk taking despite good economic times

After putting back the fiscal house in order in 2014 and 2015, the Province of Quebec is now on track to register a third consecutive balanced budget in FY 2017-18. In this fiscal update, bond investors will find out that the Quebec government's fiscal strategy is balanced. First, the government's continued commitment to debt reduction efforts through the Generations Fund remains intact; a key factor leading the S&P credit agency to upgrade the Province's credit rating from A+ to AA- last June. Second, the economy is on a roll and the Province's personal income tax rates are still among the highest in North America, a solid economic rationale for tax relief.

Lastly, let us point out a detail mentioned in the 314-pages document regarding the housing market. The Quebec government intends to "*make the legislative amendments needed to monitor the purchase and sale of property by foreign investors in Quebec*." While no specific date is mentioned, the new legislation will eventually oblige housing transaction contracts to include the residence of the buyer. Thus, we will be able to learn to which extent foreigners are involved in the housing markets of Montreal and the rest of the Province. For the moment, the Quebec government does not intend to raise a tax on foreign home buyers like in B.C. and Ontario.

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