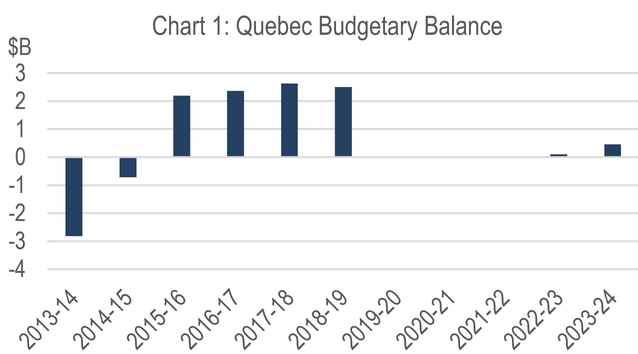
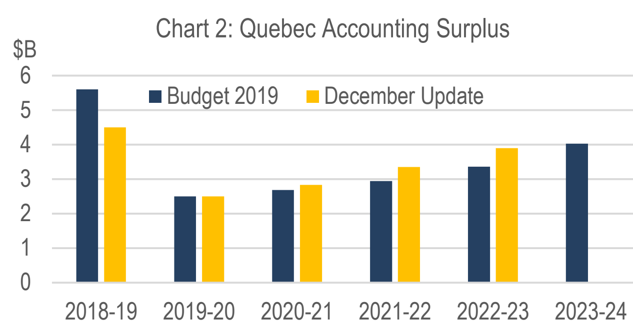
The 2019 Quebec Budget – Sowing the Seeds for Improving the Economic Potential of the Province

Finance Minister Éric Girard delivered today the first CAQ budget proposing an improvement in public finances during the next five years and measures to improve the economic potential of the Province of Quebec.

A fourth consecutive surplus of $2.5B (0.6% of GDP) was registered in FY 2018-19, up from an estimated $1.7B surplus in the December Update. The $0.8B improvement comes from stronger-than-expected own-source and crown corporation revenues and lower-than-expected expenditures despite the addition of new non-recurrent spending initiatives. This $2.5B surplus will be allocated to the stabilization reserve. Thus, the reserve will stand at a record-high $9.7B (8.6% of revenues), a cushion probably large enough to preserve a balanced budget for a number of years in the eventuality of a global recession.



Note: After transfers to the Generations Fund.
Source: Government of Quebec.



Note: Before transfers to the Generations Fund.
Source: Government of Quebec.

Without surprise, the five-year financial framework includes balanced budgets after large annual transfers to the Generations Fund (GF) (chart 1). The *accounting surpluses* (revenues minus expenditures before transfers to the GF) are mostly unchanged in 2019 and 2020 and slightly lower between 2021 and 2023 (chart 2). The stronger-than-expected revenue windfall of $2.6B in FY 2018-19 allows for the introduction of fiscal measures of an equivalent amount. The government decided to announce a few targeted tax reductions, but mostly preferred to introduce measures to enhance Quebec's economic potential:

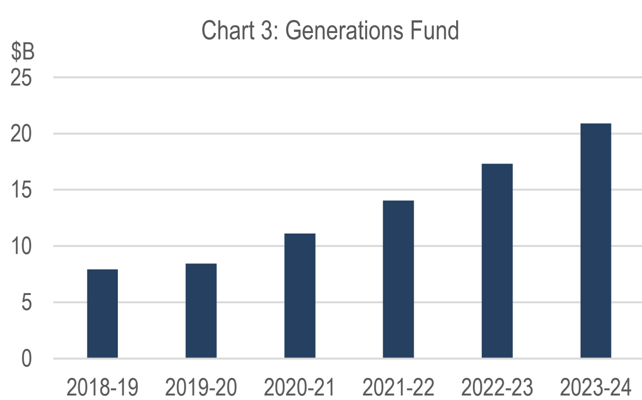
- A more generous tax credit to encourage experienced workers to stay longer in the workforce and encourage businesses to retain those workers ($892M over five years);
- Funding for K-4 education ($1.0B over five years);
- Additional resources to facilitate the integration of immigrants into the workforce ($730M over five years);
- *Investissement Québec* will also receive a $1B increase in its capital stock (from $4B to $5B) in order support business creation and development;

- A $15B increase in the 10-year infrastructure program, now totalling $115B. For instance, we view favourably the $20.3B portion allocated to educational infrastructures given the longstanding investment gap, estimated at $3.3B.

Overall, program spending growth will accelerate to 5.0% in FY 2019-20, higher than the 4.5% annual average registered since 2000. Then, the government intends to keep a lid on program spending at 3.0% on average until FY 2023-24. This is below the historical average and in line with fiscal revenues and nominal GDP growth.

The Generations Fund resumes its upward trend after a large withdrawal

FY 2018-19 is the only year where more money is withdrawn from the GF than the new contributions going into the fund: A large $8B withdrawal from the GF was used to reduce the Province's outstanding market debt in FY 2018-19; at the same time, the government was able to allocate $3.1B to the GF thanks to higher-than expected revenues. A remaining $2.0B is likely to be used in the early stages of FY 2019-20 to further reduce the outstanding market debt of the Province. Also, the projected transfers to the GF remain unchanged relative to the 2018 Budget, averaging $3.0B per year over the 5-year fiscal horizon (2.4% of revenues). Since there is no other withdrawal planned in the medium-term to reduce the Province's outstanding market debt, the GF's book value is projected to reach $21B at the end of FY 2023-24 (representing a sizeable 4.1% of GDP, chart 3). All in all, this budget is not a game changer for bond holders since the debt reduction effort remains the same as the one announced last December.



Source: Government of Quebec.

The public debt remains elevated

The net debt-to-GDP ratio is expected to fall to 40% at the end of FY 2018-19, a remarkable decline considering the 50.9% peak of FY 2012-13. However, the still-elevated debt level is responsible for generating the second highest debt-service ratio (DSR) in Canada this year at 8.5%. The good news is that this number has been falling from a multi-year high of 11.7% in 2013-14. Assuming that economic developments unfold as expected, Quebec's DSR could reach 7.4% in 2023-24.

No major change to the debt management program

- The FY 2018-19 is almost wrapped up with $15.6B in borrowing, including $4.2B in pre-financing for next year.

- The government forecasts gross borrowings at $11.7B in FY 2019-20 and $17.4B in FY 2020-21. The, borrowing requirements will increase to $24.0B, $23.0B and $22.0B in FY 2021-22, 2022-23 and 2023-24, respectively. This expected increase reflects the higher amount of debt coming to maturity and higher financial needs for dedicated government funds relative to last year.
- There is no major change in sight for FY 2019-20 relative to the local/foreign composition of the debt and its fixed/floating structure.
- The budget document mentions that the Province will be a regular issuer of Green Bonds ($2.3B was issued since the program was launched) in coming years.

Finally, in terms of risks, monitoring global turbulences will remain crucial as the fiscal outlook does not include a major economic slowdown. Also, investors will need to monitor upcoming negotiations between public sector unions and the government as the current wage contracts end this year. A new settlement could imply a faster or slower path of spending relative to the unknown hypothesis used by the government; 60% of spending goes to public sector wages currently.

Sébastien Lavoie | Chief Economist
514 350-2931 | lavoies@vmbl.ca

Dominique Lapointe | Economist
514 350-2924 | lapointed@vmbl.ca