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Quebec Pre-election Report – Large short-term fiscal improvement, medium-term outlook subject to global economic conditions

As required by law, the Quebec government released this morning an update on public finances before the general elections of October 3rd. The Pre-election Report has been verified by the Auditor General of Quebec.

The FY 2022-23 $6.5B deficit projected last March shrinks to a meagre $0.7B, a major $5.8B improvement. The positive revision for the remaining four years of the 5-year financial framework is relatively modest, slightly north of $2B pe year. The annual deficit projection ranges from a small $1.3B in FY 2023-24 and $1.9B in FY 2026-27.

The large improvement in public finances during FY 2022-23 relates to the positive landscape surrounding total revenues, up $6.1B relative to the 2022 budget. First, own-source revenue surged by 19% in FY 2021-22 due to the unusual boom of post-pandemic economic activity, offering a higher base for FY 2022-23. In FY 2022-23, moderate own-source revenue growth will come in below nominal GDP growth as consumers and companies return to normal spending and income patterns. Federal transfers were revised up slightly in FY 2022-23 while the medium-term path remains similar for outer years.

Total expenses in FY 2022-23 are slightly revised up by $1.7B, to $138B. The fundamental spending upward trend is unambiguously steep. Portfolio expenditures excluding COVID spending will jump by 8.4% in FY 2022-23 on the heels of a 11.4% bounce the previous year. Including COVID spending expected to drop by more than two-thirds this year, total spending growth will come in at only 2.4%. Also, a $0.9B will be withdrawn from the stabilization reserve to ultimately come up with a deficit forecast of only $0.7B in FY 2022-23.

Debt servicing costs in FY 2022-23 were revised up by an unusually large amount of $1.4B, to $10.1B, due to higher interest rates. The transparent Pre-election Report stipulates a one-time negative return on investment coming from the Retirement Plans Sinking Fund (RPSF) reflecting the fall in equities and increase in interest rates. Debt servicing costs will fall back slightly below $10B afterwards. Surprisingly, in contrast to the RPSF, investment income of the Generations Fund is projected to remain positive at $0.9B. Combined with $3.4B of revenues dedicated to the Generations Fund, the book value is expected to increase boldly from $15.8B as of March 2022 to $19.3B one year later.

In summary, Quebec is home of short-term fiscal resiliency. The FY 2022-23 deficit shrinks. The 5-year outlook rests on a soft-landing scenario including 3.4% real GDP growth this year and 1.7% next year. The province counts on a small provision of $2.2B in FY 2022-23 and $2.4B per year afterwards, less than 2% of own-sources revenues. If provisions are not used, Quebec could register a surplus. But if the global economy goes south, the financial situation will worsen. During this press conference, Finance Minister Eric Girard says previous recessions cut real GDP growth by about 4% and revenues by $8B, almost four time the annual provision. Finance Minister Eric Girard also mentions during his press conference the current government intends to cut personal income tax rates at some point in time, without providing details on the timing and magnitude.

Similarly, time will tell if the proposed net debt-to-GDP figure will revise substantially or not. The net debt-to-GDP ratio is expected to fall from 38% as of March 2022, to 35.3% in March 2023 and stabilize near 33% in the medium-term. In a nutshell, the increasing Generations Fund and shrinking deficits are poised to weigh more in the balance of the debt burden than the sizeable net public capital investments.

There was no update or information relative to borrowing requirements in the Pre-election Report. Shrinking deficits suggest possible downward revisions to bond supply at first glance but the uncertain economic outlook and possible tax changes could lead to a different trend.

Despite the uncertain global economic outlook, investors will find positive support in the Fiscal Sustainability Report released by the Office of the Parliamentary Budget Officer (PBO) in July. The PBO assesses Quebec is the province with the most sustainable path for its current fiscal policy.

Lastly, the Quebec government published earlier this month the Annual Green Bond Report containing valuable information on the history of green bonds issuance, the use of proceeds in specific projects and estimates of GHG reductions and positive social benefits.

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