LAURENTIAN BANK

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**Quebec Budget 2024 - Big Deficit Today, Bold Efforts to Eliminate the Structural Deficit Next Year**

The Quebec budget exposes a swift move to a large deficit position of $6.3B in FY 2023-24 and $11B in FY 2024-25. These figures represent a stark contrast with the $4B and $3B shortfalls reported in the mid-year fiscal update of late 2023.

In the near term, the Quebec government continues to prioritize additional funding for the delivery of health care, education, and infrastructure improvements. This public policy choice manifests in overrun expenses and new wage agreements for approximately three-quarters of public sector employees. Total spending is projected to increase by a large 4.4% in FY 2024-25, driven by the $3B higher-than-expected funding for wage increases for public sector employees. On the revenue side, the lower contribution of Hydro-Quebec, challenged by low water levels in reservoirs, stands out from the pack. Additionally, the absence of growth in total revenues in FY 2023-24 matches the quasi-stagnation of Quebec's real GDP growth last year (+0.2%). A soft rebound in total revenues of 2.4% is poised to occur in FY 2024-25, with Quebec's real GDP growth forecast at 0.6% due to the expectation of an improvement in economic conditions during the second half of 2024. This 0.6% forecast is a conservative assumption, considering the impressive resiliency of the U.S. economy. Also, the Quebec government's consideration of restraining the inflow of temporary foreign workers may lead us to revise downward our economic growth forecasts.

The big picture reveals an unusually large gap between revenues, running near 25% of NGDP, and expenses, at almost 27% of NGDP. Quebec is the largest provincial spender, whether based on program spending per capita or relative to NGDP. The Province will be a very active bond issuer in upcoming quarters. Total borrowing requirements are projected at a sizzling $36B in FY 2024-25, a noticeable jump from FY 2023-24 ($21B). This figure would have easily surpassed $40B without a major withdrawal from the Generations Fund (of $4.4B), the growing utilization of T-bills (+$2B), and the end of borrowing for the payment of pension benefits to public sector retirees. More precisely, Quebec will withdraw assets from the very well-capitalized Retirement Plans Sinking Fund (RPSF) to reduce borrowing requirements. Indeed, the book value of the RPSF represents 89% of the actuarial obligations in respect of pension plans. With $36B to borrow in FY 2024-25, financial markets should expect the Quebec government to start issuing very shortly, before the official beginning of FY 2024-25 on April 1st. The average maturity of total outstanding debt is near 11 years. The average interest rate on transactions in FY 2023-24 was 3.99%, with an average maturity of 14 years.

With plenty of significant developments altering the revenue and spending path in such a short period of time, it was the proper decision to wait before proposing a long-term plan to return to a balanced budget. The establishment of a roadmap to a balanced budget in FY 2029-30, two years later than previously planned, will be released in the 2025 budget. The government estimates the size of the structural annual deficit to eliminate at $4B. This structural deficit includes efforts asked of crown corporations to find savings of $1B over 5 years and lower tax breaks for the information-technology sector. During his press conference on budget day, Finance

Minister Éric Girard said he will not increase the provincial sales tax rate as part of the solution to absorb the $4B gap. What we know so far is the eventual conduct by the Treasury Board of a global review of tax and budgetary expenditures and spending in ministries. Particularly, inefficient corporate subsidies are at risk of disappearing. The outcome of this exhaustive review will lead to difficult but necessary public policy choices. It has a fair chance of improving the fiscal outlook beyond FY 2024-25 relative to what the 5-year framework of the 2024 budget reveals. Quebec's fiscal outlook could also improve if the federal government provides additional funding for asylum seekers and compensates Quebec looking to opt out of national pharmacare plan recently announced in Ottawa.

Until then, the net debt-to-NGDP ratio will likely rise in the short run from the trough of 38% reached in March 2022. Currently at 39%, this figure is projected to return to 40% by March 2025 for the first time since March 2020. This financial situation is manageable, and very far from putting Quebec's credit ratings at risk. As a reminder, the Province's net debt-to-NGDP ratio fell from 49% to 43% between 2017 and 2019, and eventually led to credit rating upgrades from S&P in 2017 (to AA-), DBRS in 2019 (to AA low), and JCR in 2022 (to AAA). Despite this short-term deterioration in the net debt-to-NGDP ratio, the Quebec government intends to remain responsible in the long run. First, by keeping intact its interim target of a net debt to GDP ratio of 33% in FY 2032-33 and final target of 30% by FY 2037-38. As an additional sign of fiscal responsibility, the government will continue to make consistent deposits to the Generations Fund going forward, in the tune of $2.2B annually. Nonetheless, the outstanding amount of the Generations Fund will temporarily fall in FY 2024-25 (to $16.7B) due to the withdrawal of $4.4B to repay borrowings in FY 2024-25 and prevent borrowing requirements from going north of $40B. The Generations Fund continues to be an extremely valuable tool, as the rate of investment return of the Fund was 5.2pp above the total cost of new borrowings of the government in 2023.

In summary, Quebec's deficit in the year ahead will inevitably be large. Excluding the $1.5B cushion for unexpected events and the $2.2B contribution to the Generations Fund, the size of Quebec's deficit as a % share of NGDP (1.9%) is a touch lower than what the BC government proposed in its 2024 budget released three weeks ago. At the same time, the FY 2024-25 deficit projection looks materially bigger than deficits recorded in Quebec during the pandemic (1% in FY 2020-21) and in the aftermath of the global financial crisis (1% in FY 2009-10).

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