Laurentian Bank Securities
ECONOMIC RESEARCH AND STRATEGY

The 2020 Quebec Budget

A year ago, the CAQ government released its first budget under the theme of labour market participation and business investment. The goal was ultimately to improve the Province's economic potential. The 2020 Budget also focusses on longer term issues, but in a different way. The environment is front and center. An unprecedented amount of $6.7B is allocated over six years to fight climate change. The government is providing funding to public transit projects in six cities and regions, promote the decarbonisation of the industrial sector and introduces policies that encourage renewable energy consumption for individuals. Ultimately, the goal is to reduce GHG emissions by 37.5% below their 1990 level in 2030. About two-thirds of the $6.7B sum is part of the capital spending program called Quebec Infrastructure Plan (QIP), a natural fit for future green bonds issuance.

Coronavirus risks

Because of the coronavirus outbreak, the world is in uncharted territory. This is an unusual challenge for governments preparing budgets. The government forecasts 2.0% and 1.5% real GDP growth in 2020 and 2021, respectively. Critically, those forecasts were developed before the important increase in the number of infections outside of China. Based on a constructive base case scenario in which global economic activity contracts this March and engages into a recovery later this Spring, Quebec's economy could grow closer to 1.7%-1.8% instead of 2.0% in 2020. This would not be enough to threaten Quebec's solid public finances.

Increased spending to preserve the economic momentum

The government decided to use the $100M annual contingency reserve included into previous budgets, a small amount relative to the $119B expenditure program. To support the economy, the government accelerates program expenditure in FY 2020-21 relative to what was forecast in the Fall Fiscal Update. Portfolio expenditures are projected to increase by 5.1% in FY 2020-21, up from a 2.9% forecast in the Fall 2019 Fiscal Update. This also follows a 7.4% jump in FY 2019-20. Part of the new funding announced today will occur this month, another way to offset the viral-led slowdown. Lower-than-expected interest rates and a lower value for the Canadian dollar could very well lead to lower expenditure and higher nominal income, respectively.

The Quebec Infrastructure Plan is another tool to support the ongoing economic momentum and offset the negative impact of the coronavirus outbreak. It is now pegged at $131B between 2020 and 2030, a $15.1B increase relative the 2019-2029 Plan.

Solid foundations to preserve a budgetary balance

Fortunately, Quebec's economic foundations were very solid before Covid-19. The unemployment rate has been hovering below 5% for most of 2019. A stunning 2.8% real GDP growth performance generated a $1.5B boost to tax revenues in FY 2019-20. Debt service costs were also revised down by $1.2B. Those developments offset the $0.6B estimated loss on the CSeries investment. Altogether, the surplus is estimated at $4.5B for FY 2019-20 ($2.5B forecast in the 2019 budget). After the $2.6B transfers to the Generation Funds, the surplus was $1.9B. For FY 2020-21, a balanced budget is projected after the $2.7B deposit to the Generations Fund.

The negotiations for new collective agreements between the public sector members and the government are ongoing. The current union contracts run out on March 31st. The 5-year financial framework assumes a 9% payroll increase for government employees over 5 years. The total cost is estimated to be $3.7B annually when fully implemented. The offer was made by the Treasury department (Conseil du Trésor) to public and parapublic union representatives last December.

Quebec achieves debt reduction target ahead of schedule

On average, surpluses of $2.8B were registered over the last five years, bringing down Quebec's debt burden lower than where it stood prior to the 2008-09 recession. A major highlight is that a debt reduction objective has been met several years ahead of schedule: the gross debt-to-GDP ratio fell below 45%, at 43% in FY 2019-2020, five years ahead of schedule. The accumulated deficits-to-GDP ratio is forecast to decline to 17% in FY 2022-23, three years ahead of schedule. The government intends to define both a new debt reduction target and the rate at which it should be met.

With a few weeks left in March, the borrowing program for FY 2019-20 is pegged at $19.2B, including $6.3B in pre-financing. A higher share of borrowing was done abroad (36% in FY 2019-20, compared to an average of 21% over the past 10 years). Borrowing requirements will fall to $13.9B in FY 2020-21 but could turn out to be higher depending on pre-financing activity. Higher repayments of borrowing in FY 2021-22 will lead to higher borrowing requirements ($27.1B). As of note, five green bonds totaling $2.8B have been issued since 2017, including $0.5B last February. The government intends to continue regularly issuing green bonds.

In summary, the 2020 Budget focuses on the transition to a low-carbon economy and boosts spending in the near term. Budget 2020 is not tilted towards individual tax relief, likely reflecting the various tax cuts announced in previous years and the already strong growth in household disposable income. Also, there is nothing new to report relative to the housing market in this budget. It appears that the government does not have an appetite for a foreign buyer tax or a vacancy tax. This view is supported by the small share of real estate transactions involving foreign buyers (2.6% in 2019, lower than the 3.4% figure of 2018). Finally, companies will be able to benefit from a new investment and innovation tax credit called C3i to buy manufacturing, hardware and software equipment.

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