Laurentian Bank Securities
ECONOMIC RESEARCH AND STRATEGY

Update on Quebec's Economic and Financial Situation: Fast Tracking Public Debt Relief

The CAQ government released its first fiscal document today. Very robust economic growth led to an upward revision of $1.5B in tax revenue for the current fiscal year 2018-19. Thus, a $1.7B surplus is now expected. It marks an improvement relative to the Pre-Electoral Report released last August in which a $0.6B withdrawal from the stabilization reserve was required to balance the books. The stabilization reserve is projected at $8.8B in March 2019 (representing 8% of total fiscal revenues), a large financial cushion in case an economic downturn comes unexpectedly. Balanced budgets are also projected beyond FY 2018-19 in today's fiscal update.

This being said, the biggest news for bond holders is that more money will be pulled out from the Generations Fund than money added to the Fund in the short-term. First, significant deposits to the Generations Fund for FY 2018-19 ($2.9B) and FY 2019-20 ($2.5B) are maintained. Second, as we discussed in a note published mid-October, the fiscal update confirms the accelerated repayment of public debt. An unprecedented $6B will be withdrawn from the Generations Fund before the end of FY 2018-19. This sum will principally repay maturing borrowings on financial markets and reduce the net liability of the Retirement Plans Sinking Fund by $1B ($22B net liability as of last March). A $2B debt reduction has already been made so far in FY 2018-19. Another $2B debt repayment will occur at the beginning of FY 2019-20 starting in April, for a combined $10B withdrawal from the Generations Fund between the Spring of 2018 and the Spring of 2019.

Altogether, the accelerated repayment of debt will save $332M in interest costs over five years. Borrowing requirements are also revised down from $13.4B to $12.3B in FY 2018-19 and from $18.6B to $13.2B in FY 2019-20. Accordingly, the Province of Quebec is on track to reach a gross debt-to-GDP ratio of 45% in FY 2020-21, five years earlier than previously planned.

The CAQ government also took the opportunity to move forward with its commitment to improve household disposable income. The allowance for families with two or more children will increase in January 2019. Also, low-income seniors will be able to claim a new refundable tax credit taking effect in 2018 when they file their income tax return in the Spring of 2019. These two measures will cost close to $350M annually for the provincial government. Companies get a different kind of fiscal incentive. Similar to the federal government's announcement of two weeks ago, the CAQ government announced measures allowing business to write-off capital investments faster. These fiscal incentives to boost investment, effective immediately, will also cost close to $350M annually for the government during the next two years.

In summary, the CAQ government shows strong fiscal discipline at the beginning of its four-year term. The new tax measures announced today for individuals and businesses only reduce the surplus by $0.2B in FY 2018-19 and $0.8B in FY 2019-20 below what it otherwise would have been. More importantly, the accelerated repayment of the debt crystallizes previous investment gains, a point recently highlighted by the DBRS credit rating agency. Paying down the debt faster also reduces the risk associated with what will remain in the Generations Fund. We project the market value of the Fund to reach about $10B in March 2019 compared to $15.1B in March 2018.

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