Quebec Budget Highlights

BMO Capital Markets
We're here to help.™

Highlights and analysis of Quebec's FY19/20 budget — **March 21, 2019, 4:00 pm**

Delivering the Goods

Robert Kavcic, Senior Economist • robert.kavcic@bmo.com • 416-359-8329

The **Province of Quebec is projecting a sixth consecutive surplus in FY19/20**, while delivering another helping of policy goodies and spending increases. Before transfers to the Generations Fund (for debt reduction), the surplus is pegged at $2.5 billion (0.6% of GDP), down from a larger-than-expected $5.6 billion now estimated for FY18/19. The latter is more than a billion dollars larger than expected in the post-election update, and comes despite a dose of spending getting pushed out the door before the fiscal year ends. Surpluses in the $2.5-to-$4 billion range persist through the forecast horizon. Meantime, net debt continues to decline as a share of GDP, pegged at 38.8% in FY19/20, down from more than 50% six years ago. And, on a relative basis, the move below Ontario (budget pending) has been well documented.

This budget builds on a host of measures introduced in the Fall fiscal update, which included accelerated CCA allowances and an enhanced family allowance (for those with children). There is $2.3 billion worth of new measures outlined for FY19/20—much of that flows through the spending channel, but $271 million will flow back to Quebecers (rising above $400 million the following year).

Summary of Major Policy Measures

- A gradual reduction in **school tax rates** begins in July 2019, with the goal of a single tax rate across the province by 2021 (matching the current low jurisdiction). This will save households anywhere from zero to $500.
- Gradual reduction in the additional **contribution for childcare** begins (to be fully eliminated by 2022).
- Mandatory **registration of properties** listed on digital platforms.
- **Full-day kindergarten** for 4-year olds.
- Enhancing measures to **increase labour force participation among older workers**: Lower age eligibility (to 60 from 61) for the career extension tax credit; higher income ceiling for the credit; small business payroll tax credit up to $1,250 for workers 60-64, and $1,875 for workers above 65.
- **Generations Fund** assets will be used to pay down an additional $2 billion in debt, as previously planned, after $8 billion was used in FY18/19.

Revenue Handoff Strong and Spending Flows

Total consolidated revenue is projected to rise 1.8% to $115.6 billion in FY19/20, with own-source revenue rising 0.6%--tax

Table 1
Fiscal Summary

Quebec (Consolidated. C$ mlns, except where noted)

	Est.	— Forecast —		
	18/19	19/20	20/21	21/22
Revenues	113,557	115,638	119,389	122,984
Expenditures	107,951	113,034	116,605	119,937
Program Spending	99,052	104,038	107,467	110,645
Debt Service	8,899	8,996	9,138	9,292
Contingency Reserve	—	(100)	(100)	(100)
Public Accounts Balance	5,606	2,504	2,684	2,947
Generations Fund	(3,106)	(2,504)	(2,684)	(2,947)
Stabilization reserve use	—	—	—	—
Budgetary Balance [1]	2,500	—	—	—
Gross Debt	200,756	204,169	207,318	211,357
Net Debt	174,095	174,699	175,276	176,498
As a percent of GDP:				
Budget Balance	0.2	0.4	0.6	0.6
Gross Debt	46.1	45.3	44.6	44.1
Net Debt	40.0	38.8	37.7	36.8
As a percent of revenue:				
Federal Transfers	20.6	21.6	21.4	21.1
Debt Service	7.8	7.8	7.7	7.6
Key assumptions:				
Real GDP (% chng)	2.3	1.8	1.5	1.3
Nominal GDP (% chng)	4.3	3.5	3.2	3.0

Source: Provincial Budget ( ) = deficit
[1] for the purposes of the *Balanced Budget Act*
Notes: Totals may not add due to rounding; GDP figures are for calendar year (FY19/20=CY19)

Table 2
Borrowing Requirements

Quebec (C$ mlns)

	19/20	20/21	21/22
General Fund[2]	**482**	6,598	12,380
Financing Fund	**9,400**	9,000	9,000
Financement-Quebec	**1,900**	1,800	2,700
Total Borrowing	**11,782**	17,398	24,080
Incl: Repayments of Borrowings	**11,066**	11,528	14,231

[2] FY19/20 is reduced by $4.2 billion of pre-financing, and by $2 billion with Generations Fund used to repay maturities

reduction measures have lowered overall growth. That said, and despite measures previously announced and those in this budget, total revenues are pegged more than $2 billion higher for FY19/20 than was forecasted this time a year ago. Federal transfers will total $24.9 billion, up 6.5% from the prior year. Higher expected personal income and consumption tax growth also continue to support the top line. Over the next five years, revenues are projected to grow roughly 3.5% per year, reasonable and a bit firmer than nominal GDP growth.

Real GDP is projected to grow 1.8% in 2019 and 1.5% in 2020, which is not far off our call of 1.6% and 1.5%, respectively. Recall that Quebec posted its strongest growth rate (2.8%) in 15 years in 2017, and momentum has been gradually fading toward potential, which we would judge to be around 1.3%-to-1.5% (the long-term budget forecast agrees with this). Still, the jobless rate is now consistently below the national average, demographic flows are uncharacteristically solid in the province, and the housing market is expanding despite meaningful corrections elsewhere in the country. So, despite softer headline growth numbers, the relative fundamentals still look quite good in Quebec.

Total consolidated spending is projected to jump 4.7% to $113 billion in FY19/20, with health care and education getting hefty increases (these areas were under heavy restraint until recently). This follows 4.3% growth in FY18/19, and is a clear sign that spending is still flowing more freely in the province after a few years of stiffer restraint (as you'd expect given election promises). To put it in perspective, program spending for FY19/20 is estimated to be $5 billion higher than projected (for the same year) two years ago. Beyond this coming fiscal year, program spending growth will slow down to 3% per year, or in-line with nominal GDP growth and slightly positive in real per-capita terms.

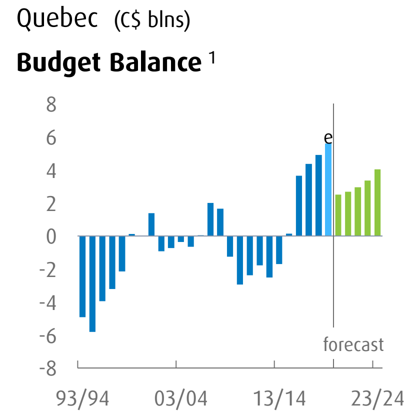
Paying Down More Debt

The fiscal outlook builds in transfers to the Generations Fund for debt reduction of $2.5 billion this fiscal year, rising to $3.5 billion by FY23/24, as has been the norm. The Province is also following through on its plan to use $10 billion of prior **Generations Fund savings to pay down debt** ($8 billion in FY18/19 and $2 billion in FY19/20). While this technically hasn't lowered 'net debt', it has reduced the Province's borrowing requirement, and has arguably helped keep spreads tight given the lower issuance. It is also estimated to save about $400 million per year in interest costs from the operating budget by FY22/23.

As such, total **borrowing requirements**, including the gross financial requirements of the general fund along with the Financing Fund and Financement-Québec**,** are pegged at $11.8 billion in FY19/20, including $11.1 billion in maturities—the Province pre-borrowed $4.2 billion in FY18/19, which lowers this year's requirement from $15.6 billion in FY18/19. Borrowing then rises above $17 billion in FY20/21 and to $24 billion in FY21/22. **Net debt** will total $175 billion by fiscal year-end, or 38.8% of GDP, down from a high of 50.9% in FY12/13. The ratio has been falling by about 2 ppts per year over the past five years.

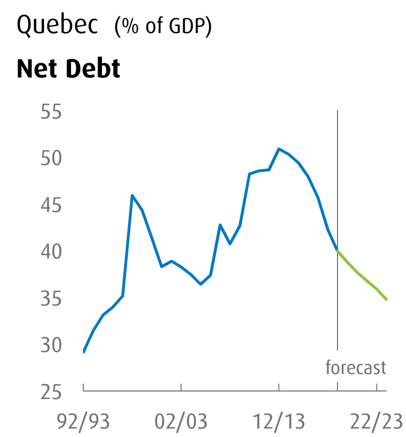
The Bottom Line: This budget doesn't change the very positive fiscal story in Quebec, as a strong economy has allowed election promises to flow without denting the bottom line.

Chart 1
Surpluses Continue



[1] before transfers to the Generations Fund
Source: Provincial Budget e = estimate

Chart 2
Net Debt Declining



Source: Provincial Budget