Market View
Economics and Strategy

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Not to be outdone, Quebec's monthly finances looking tres bien

By Warren Lovely

In an apparent game of fiscal one-upmanship, Ontario's knockout public accounts (released Friday and analyzed here) were followed closely by Quebec's latest *Monthly Report on Financial Transactions*. Cue this brief *Market View Addendum*.

For Quebec, the reporting period in question is the first three months of the current 2021-22 fiscal year (i.e., April to June 2021). Let's see... Quebec own-source revenue is up a dazzling 36.7% year-on-year. That works out to an additional C$6.8 billion compared to the corresponding prior-year period. It's obvious that comparisons to April-June 2020 are heavily distorted, that earlier period feeling the full brunt of the pandemic storm. Moreover, some of the extraordinary government support programs that were put in place to protect Canadian households and businesses from COVID damage have clearly done the trick, inflating personal and corporate income growth. More generally, and as we've glimpsed elsewhere, the unfolding economic recovery is paying fiscal dividends in the form of resurgent revenue growth. In Quebec's case, any number of major own-source revenue streams are flying high: PIT +24%; health service contributions +30%; CIT +107%; consumption taxes +39%; duties/permits +61%; miscellaneous revenue +22%. It's an encouraging fiscal picture (Chart 1).

Adding to the buoyant own-source revenue performance is a major improvement in GBE results (+C$587 million or +158% year-over-year). Here again, a big-time gain captures (in part) favourable comparisons to distorted prior-year results at Loto-Québec and Hydro-Québec. Investment returns have been another nice story of late. As for federal transfers, there's more modest but still positive growth vs. the prior-year period (+3.1%), as Ottawa funneled more health care dollars and virus-related relief to the provinces.

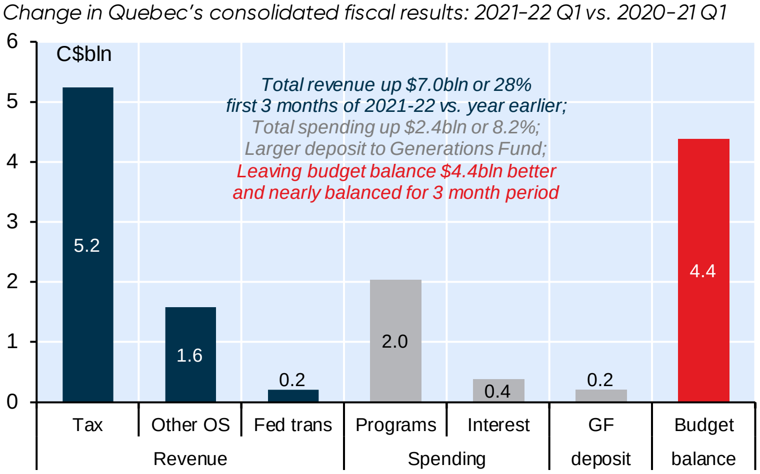
Against the backdrop of burgeoning revenue, total spending was up 8.2% through the first three months of 2021-22 (vs. the prior year period). Not surprisingly, health and social services saw the fastest rate of increase. Higher interest rates have resulted in some extra debt service, although interest on debt consumed just 6.8% of consolidated revenue in the first quarter of the fiscal year—a clearly manageable interest bite. Moreover, Quebec has effectively managed its interest rate reset risk via longer-term debt issuance, a hallmark of prudent debt management across the broader provincial sector.

All told, Quebec's revenue gains outstrip extra spending by a ratio of 2.9:1, allowing for nice progress on the budget deficit. After accounting for deposits to the Generations Fund, Quebec ran a three-month budget deficit of just C$359 million or barely 1% of total revenue. That's a marked improvement relative to the C$4.7 billion budgetary shortfall (~19% of revenue) that was chalked up from April-June 2020.

The monthly report does not update full-year fiscal guidance, with the 2021 budget (set down in March) having originally planned for a C$12.3 billion deficit for 2021-22 (after Generations Fund deposits). Simply put, we see Quebec improving on this number by a *wide* margin. We don't yet have Quebec's official public accounts, but the province has signaled a significant improvement in the unofficial 2020-21 budget balance vs. an interim estimate (Chart 2). That implies a positive prior-year base effect, which combined with today's reported momentum in current year revenue sets the stage for a serious upgrade to the 2021-22 budget balance in Quebec. If you've been following along, this is becoming something of a common theme, with this year's slate of provincial fiscal updates some of the most impressive this author can recall.

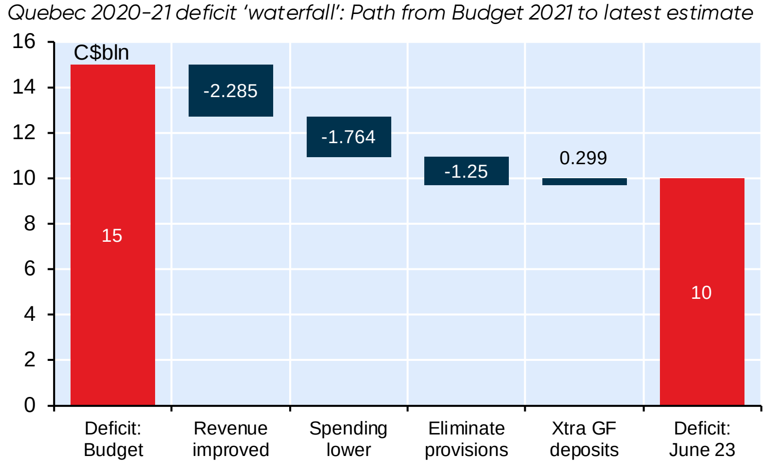
Without minimizing the current public health crisis, the other DELTA that provincial bond investors may wish to focus on is the year-over-year improvement in provincial finances and the commensurate step down in borrowing needs. On the subject of borrowing, Quebec's official and as-yet-unrevised requirement calls for C$28.5 billion in long-term bond issuance in 2021-22. Against that requirement, C$14.9 billion has been completed, implying a funded status of ~52%. But as with Ontario, will be looking for financing needs to get chopped and funded status to automatically vault ahead once a fall fiscal update arrives.

Chart 1: Stellar first three months of 2021-22 revenue wise
Change in Quebec's consolidated fiscal results: 2021-22 Q1 vs. 2020-21 Q1



Source: NBF, Quebec

Chart 2: And don't forget impressive hand-off from 2020-21
Quebec 2020-21 deficit 'waterfall': Path from Budget 2021 to latest estimate



Source: NBF, Quebec | Note: Blue bars denote change to deficit vs. Budget 2021; C$10bln deficit for 2020-21 was telegraphed in June; refer to related analysis here

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