NATIONAL BANK OF CANADA
FINANCIAL MARKETS

Québec
2017 Fiscal Update
Economics and Strategy

November 21, 2017

Tax relief for households and anti-poverty funding

Highlights

- The public accounts released today show a surplus of $2.361 billion for the fiscal year ended last March 31, compared to the $250-million surplus estimated in the budget tabled last March. Under the Balanced Budgets Act, that surplus was deposited to the stabilization fund, as was the 2015-16 surplus of $2.191 billion. The two surpluses brought the fund total to $4.552 billion as of last March 31.
- The fiscal update announces new measures budgeted at $1.339 billion for the current fiscal year (cuts in individual income taxes $1.083 billion, health and education $129 million, regional economies $86 million, anti-poverty measures $41 million). Higher-than-budgeted net revenue means that despite these new measures, the operating balance (before payment of revenues dedicated to the Generations Fund) will remain $2.2 billion compared to the $2.488 billion budgeted last spring. However, since $2.45 billion must be paid into the Generations Fund, an amount of $250 million will be drawn from the stabilization fund to maintain a zero budget balance under the Balance Budget Act.
- Thus the stabilization fund will amount to $4.302 billion at the end of the current fiscal year. The fiscal update projects draws totalling $2,502 over the three subsequent fiscal years in order to maintain a balanced budget under the Balanced Budget Act, reducing the stabilization fund to $1.8 billion at the end of the 2020-21 fiscal year. No further draws are projected for the following two years.
- Quebec real economic growth in 2017 is revised up to 2.6% from the 1.7% assumed in last spring's budget. For 2018 it is revised up to 1.8% from 1.6%. Nominal growth is revised up 0.4 points to 3.7% for 2017 and 0.1 points to 3.4% for 2018.
- The tax rate for the lowest individual income tax bracket is reduced to 15% from 16% (cost in 2017-18: $971 million).
- Annual payment to households of $100 per child aged 4 to 16 for school supplies (cost in 2017-18: $112 million).
- The fiscal update presents the financial framework of a third Plan to combat poverty and social exclusion. Spending under the Plan will be only $41 million in 2017-18 but will be $2.5 billion over the subsequent five years.
- Additional spending on health and education will amount to $129 million in 2017-18 and more than $1 billion over six years.
- $667 million over six years will be spent in support of regional economies (cost in 2017-18: $86 million).
- Over five fiscal years beginning next year, investment of $544 million to ensure higher retirement incomes for Quebecers.
- Gross debt as of March 31, 2018 is projected at $207 billion or 50.1% of GDP. Maintenance of balanced budgets in following years is projected to lower the ratio of gross debt to GDP to 46.7% by March 2022.
- The financing program for 2017-18 is projected at $14.8 billion, up $3.5 billion from the forecast of last March. The upward revision is attributable mainly to pre-financing for the following year. For 2018-19 the program is projected at $20.3 billion, of which $8.1 billion for repayment of borrowings.

A second straight surplus in 2016-17

The surplus for fiscal 2016-17 (within the meaning of the Balanced Budgets Act, i.e. net of revenue dedicated to the Generations Fund) — budgeted at $250 million last March — came out as $2.361 billion in the public accounts released today. The difference is attributable to program spending of $1.4 billion less than budgeted, revenue of $418 million more than budgeted, a saving of $160 million in debt service cost, non-use of a $100-million contingency reserve and a downward revision of $41 million in deposits to the Generations Fund.

Under the Balanced Budgets Act, a budget surplus must be paid into the stabilization fund. Following the 2015-16 surplus of $2.191 billion, the 2016-17 surplus brought the stabilization fund to $4.522 billion as of last March 31.

Budget update

The new measures tabled today total $1.339 billion for the current fiscal year. However, the budget operating balance (before payment of dedicated revenue to the Generations Fund) is reduced only $288 million, from $2.488 billion to $2.2 billion. In other words, much of the new spending is to be funded by an excess of net revenue over that budgeted last spring (notably a $764-million excess of federal transfers). Given required payments of $2.45 billion to the Generations Fund, the government will draw $250 million from the stabilization fund to balance the budget within the meaning of the Balanced Budgets Act.

The picture for 2018-19 is similar. Today's new measures result in a projected operating surplus of $1.305 billion, $1.529 billion less than budgeted in March. After a $2.712-billion payment to the Generations Fund, the government will need to draw $1.407 billion from the stabilization fund.

The government's projections show stabilization-fund draws totalling $1.095 billion in the following two fiscal years. The fund will thus be reduced to $1.8 billion by March 2021, after which the government projects no further draws out to its forecast horizon.

Consolidated revenue is now projected to grow 3.5% this year, 2.0% in 2018-19 and 3.5% in 2019-20. Program spending is projected to grow 6.3% this year, 3.1% in 2018-19 and 2.7% in 2019-20.

A contingency reserve of $100 million is projected for each year. That may seem skimpy, but there is little need for more when the government has a stabilization fund to draw on if necessary to balance its budget.

Economic outlook

Quebec real economic growth in 2017 is revised up to 2.6% from 1.7% in the spring budget. For 2018 it is revised up to 1.8% from 1.6%. These forecasts are slightly below the private-sector consensus, as are the average forecasts out to 2021.

The growth rates projected for 2017 and 2018 are exceptional. Employment has recently surged spectacularly. The five-year scenario realistically forecasts a cooling of GDP growth over the subsequent three years. This reflects not an expectation of weakness but a return towards growth consistent with growth of potential output. Shrinking of the main labour pool — the population aged 15 to 64 — caps potential GDP growth.

The substantial upward revision of 2017 GDP expansion can be laid to spectacular employment growth over the year to date. Today's update projects an addition of 85,000 jobs in 2017, more than double the projection of the spring budget. The unemployment rate has fallen to historic lows, slightly more than 6%, and is expected to stay in that neighbourhood in 2018.

Nominal GDP growth, meanwhile, has been revised up 0.4 points to 3.7% in 2017 and 0.1 points to 3.4% for 2018.

New measures

The rate for the lowest individual income tax bracket — the first $42,705 of taxable income — has until now been 16%. Effective for the 2017 taxation year, it is reduced to 15%, the lowest in 30 years. After reduction of the rate for personal tax credits for consistency with this reduction, the total cost of the measure is $971.4 million for the 2017-18 fiscal year.

Today's update introduces an annual benefit of $100 per child aged 4 to 16 as of September 30 for school supplies, with the first payment to come this January for the school year that began last September and subsequent payments in July of each year for the school year beginning in September. For fiscal 2017-18 this measure is budgeted at $111.2 million. It will benefit almost 700,000 households with school-age children.

The update presents the financial framework for a third Plan to combat poverty and social exclusion together with tax measures providing incentive to work. The goal is to lift 100,000 people out of poverty by 2023.

This third Plan is organized around two objectives. The first is to increase the disposable income of poor people by increasing benefits under the last-resort financial assistance and "Objectif emploi" programs and by strengthening the incentive to work. The second is to facilitate the social inclusion of people with low incomes.

Through these measures, the lowest-income Quebecers will benefit from additional investments of $700 million by the end of the Plan in 2022-23.

Additional funding of $1.1 billion over six years will support school success and promote health. It will include $337 million for childcare and early schooling, $107 million for higher education and $630 million for health and social services.

The government has tabled a bill to increase Quebec Pension Plan contributions effective January 1, 2019. As at present, employee QPP contributions will be deductible from taxable income. The deductions for the increase in employee contributions will cost $440 million over five years. The increase in the employer share of QPP contributions, also deductible from the employer income, will cost $104 million over five years.

Other new measures will affect the economies of Quebec's regions. Over the current and the next five fiscal years, they will amount to $367 million to support digital infrastructure and $300 million to support economic development in all regions.

Debt management and borrowing requirements

Gross debt as of March 31, 2018 is projected at $207 billion, or 50.9% of GDP. The ratio of gross debt to GDP will thus continue to decline from 2015 and will do so faster than was projected in the spring budget (52.0% next March). Assuming maintenance of balanced budgets in subsequent years, the gross-debt-to-GDP ratio would continue trending down, reaching 46.7% in March 2022. Without payments to the Generations Fund the projected ratio would be 5.8 percentage points higher at 52.5%, a difference of $27.1 billion.

The book value of the Generations Fund was $10.5 billion in 2016-17. Its investment income in 2017-18 is projected at $529 million, or 21.6% of revenue dedicated to the Fund. The $2.45 billion of revenue dedicated to the Fund will take its book value to $13.0 billion next March 31. By March 2022 the book value is projected at $26.1 billion. The average return of the Fund from 2007 through 2016 was 5.3%, versus an average cost of 3.5% for the government's borrowing. At March 31, 2017, the estimated cumulative net gain resulting from the spread between the return of the Fund and the government's borrowing costs was $594 million.

The financing program for 2017-18 is now projected to total $14.8 billion, up $3.5 billion from the forecast of last spring's budget. The increase is attributable mainly to pre-financing for the next fiscal year. For 2018-19 the financing program is projected at $20.3 billion, of which $8.1 billion for repayment of borrowings. For the following three years the respective projections are $20.0 billion, $18.8 billion and $21.3 billion.

Conclusion

Economic growth well in excess of potential combined with budgetary rigour in recent years has allowed the government to reduce household tax burdens and intensify measures to combat poverty. Tax relief for businesses, it seems, will have to wait for the next budget.

Paul-André Pinsonnault / Marc Pinsonneault

Consolidated summary financial framework – November 2017 update
(millions of dollars)

	2017-2018	2018-2019	2019-2020
Own-source revenue	83 677	86 255	89 189
% change	*1.1*	*3.1*	*3.4*
Federal transfers	22 793	22 391	23 220
% change	*13.0*	*−1.8*	*3.7*
Consolidated revenue	**106 470**	**108 646**	**112 409**
% change	***3.5***	***2.0***	***3.5***
Mission expenditures	−94 662	−97 628	−100 276
% change	*6.3*	*3.1*	*2.7*
Debt service	−9 508	−9 613	−9 753
% change	*−0.2*	*1.1*	*1.5*
Consolidated expenditure	**−104 170**	**−107 241**	**−110 029**
% change	***5.7***	***2.9***	***2.6***
Contingency reserve	−100	−100	−100
SURPLUS	**2 200**	**1 305**	**2 280**
BALANCED BUDGET ACT			
Deposits of dedicated revenues in the Generations Fund	−2 450	−2 712	−3 031
Use of the stabilization reserve	250	1 407	751
BUDGETARY BALANCE(1)	—	—	—

(1) Budgetary balance within the meaning of the *Balanced Budget Act* after use of the stabilization reserve.

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Economics and Strategy

Montreal Office
514-879-2529

Stéfane Marion
Chief Economist and Strategist
stefane.marion@nbc.ca

Marc Pinsonneault
Senior Economist
marc.pinsonneault@nbc.ca

Kyle Dahms
Economist
kyle.dahms@nbc.ca

Paul-André Pinsonnault
Senior Fixed Income Economist
paulandre.pinsonnault@nbc.ca

Matthieu Arseneau
Senior Economist
matthieu.arseneau@nbc.ca

Jocelyn Paquet
Economist
jocelyn.paquet@nbc.ca

Krishen Rangasamy
Senior Economist
krishen.rangasamy@nbc.ca

Angelo Katsoras
Geopolitical Analyst
angelo.katsoras@nbc.ca

Toronto Office
416-869-8598

Warren Lovely
MD, Public Sector Research and Strategy
warren.lovely@nbc.ca