NATIONAL BANK
FINANCIAL MARKETS
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QUEBEC
Fiscal Update

Economics and Strategy

October 25, 2016

Highlights

- After statutory payments to the Generations Fund, the 2015-16 fiscal year ended with a surplus of $2.2 billion. This surplus will constitute a stabilization reserve.
- Balanced budgets are projected for the current and subsequent fiscal years. New commitments will be funded without affecting budget balance, in part by a $250-million reduction of the provision for contingencies in each year through 2020-21.
- In 2016-17, consolidated total revenue is projected to grow 2.2% and consolidated expenditure 3.8%. The difference is a large part of the reason another surplus is not projected. In subsequent years revenue is projected to grow slightly faster than expenditure, but an increase in payments to the Generation Fund will keep the budget in balance.
- Complete abolition of the health care contribution is brought forward to January 1, 2017. New expenditure is announced amounting to $520 million in the first full year (2017-18), including $400 million in additional funding for the Quebec Infrastructure Plan.
- The government is assuming real GDP growth of 1.4% in 2016 and 1.5% in 2017, with nominal GDP growth of 2.6% and 3.3% respectively.
- The total financing program for 2016-17 is projected at $13.5 billion, $450 million less than budgeted last March.

Surplus in 2015-2016

Quebec's public accounts for fiscal 2015-16, tabled today, show a surplus of $2.2 billion after allocation of revenue dedicated to the Generations Fund. This compares with the balanced books estimated for 2015-16 in last spring's 2016-17 budget. This surplus now forms a stabilization reserve for use in maintaining budget balance. In addition, the government may elect to transfer funds from this reserve to the Generations Fund.

The surplus was due mostly to non-recurring factors. Own-source revenue exceeded last spring's estimate for 2015-16 by $891 million, including $612 million from corporate income taxes, as business profits declined less than expected, and $282 million from individual income taxes, a result of higher capital gains and investment income. Federal transfer payments were $188 million lower than estimated, leaving **consolidated total revenue higher by $703 million** or 0.7%. **Consolidated expenditure was $1.161 billion lower** than estimated last spring, a difference that included reductions of $147 million from strike days, mainly at school boards, $220 million in health care expenditure, $288 million in unused budget amounts and $335 million in expenditures of special funds and agencies. **Debt service cost $46 million less than estimated**, and the **contingency provision of $300 million** was not used. Hence a $2.2-billion surplus.

Budget balance in 2016-2017 and subsequent years

The government's consolidated financial framework projects balanced budgets in 2016-17 and subsequent years.

Despite a downward revision of Hydro-Québec export revenues, a strong showing of the economy has resulted in a $40-million upward revision of current-year revenue relative to last spring's budget. Debt services is revised down $359 million. The government has added $288 million of this combined gain to spending under four headings of its Quebec Economic Plan. The remaining $111 million is allocated to partial funding of $361 million negative revisions linked for instance to the abolition of the health care contribution two years ahead of schedule, and to additional infrastructure spending in some agencies. The remainder will be funded by a $250-million reduction of the contingencies provision, which was budgeted last spring at $400 million.

The $250-million reduction of the contingency provision will be maintained in subsequent years in order to keep budgets in balance after inclusion of the new measures.

In the current fiscal year, revenue is projected to grow 2.2% and consolidated expenditure 3.8%. The 2015-16 surplus of $3.6 billion before allocation to the Generations Fund and the provision for contingencies is accordingly reduced to $2.1 billion in 2016-17. In subsequent years, consolidated revenue is projected to grow at an average 2.8%, slightly faster than consolidated expenditure (2.4%), but the resulting increase of the operating surplus will be allocated to the Generations Fund, leaving balanced budgets.

The new measures

Quebecers' tax burden will be somewhat reduced by the abolition of the health care contribution as of January 1, 2017, two years ahead of schedule. This measure, part of the Quebec Economic Plan, will have a full-year cost of $179 million in 2017-18.

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The three other parts of the Quebec Economic Plan where new measures will have a fiscal incidence are: health and social services, $300 million annually beginning in 2017-18; education, including higher education, $110 million annually beginning in 2017-18; and regional economic development, $100 million annually beginning this year and extending through the next three years.

The government has also added $400 million to the 2017-18 budget for infrastructure spending under the Quebec Economic Plan, bringing total infrastructure investment for that year to $10 billion. This increase is non-recurring.

Economic growth assumptions

Following estimated real GDP growth of 1.1% in 2015, the government is assuming 1.4% this year and 1.5% in 2017. For 2016 at least, its projection is comforted by the release this morning of the GDP report for July, which shows not only a monthly jump of 0.7% over June but an upward revision of growth in Q2. And according to Statistics Canada's Labour Force Survey, Quebec's recent labor market performance compares favourably with that of other provinces.

For nominal GDP growth, the projections are 2.6% in 2016 and 3.3% in 2017, implying inflation of 1.2% in 2016 and 1.8% in 2017. These assumptions seem reasonable.

From 2018 through 2020 the government projects average annual real GDP growth of 1.5%, which is consistent with private-sector forecasts. Inflation is projected at 1.7%, compared to 1.8% for the private-sector consensus.

Debt and financing requirements

Gross debt (market debt plus net liabilities of pension plans and other future government employee benefits, less the Generations Fund) shrank $600 million over the 2015-16 fiscal year, the first decrease since the late 1950s. As a ratio of GDP it declined to 53.8% from 55.1%. By this ratio Quebec is now the second most heavily indebted province, after Newfoundland and Labrador. Gross debt is projected to fall to 48.6% of GDP in 2021, putting the government well on the way to its target of 45% by 2026.

Net debt (gross debt minus items including financial assets) declined by $660 million over the 2015-16 year, to 49.0% of GDP from 50.2%.

Net debt minus nonfinancial assets plus the stabilization reserve yields "debt representing accumulated deficits." The 2026 target for this debt is 17% of GDP, via a reduction to 24% in 2021 from 31.8% in 2016.

The total financing program for 2016-17 is now projected at $13.5 billion, $450 million less than budgeted last March. Repayment of borrowings will be higher than that, mainly because of advance borrowing in 2015-16.

In subsequent years the financing program is projected at $15.3 billion in 2017-18, $18.6 billion in 2018-19, $16.6 billion in 2019-20 and $15.5 billion in 2020-21.

Marc Pinsonneault

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Consolidated financial framework, 2015-2016 to 2020-2021
(millions of dollars)

	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020	2020-2021
Consolidated revenue						
Personal income tax	28 753	29 757	30 911	32 147	33 300	34 512
Contributions for health services	6 614	6 452	6 065	6 133	6 288	6 434
Corporate taxes	7 016	6 743	7 017	7 252	7 336	7 441
School property tax	2 090	2 122	2 208	2 293	2 366	2 443
Consumption taxes	18 517	19 043	19 548	19 927	20 209	20 551
Duties and permits	3 828	3 435	3 600	3 702	3 822	3 893
Miscellaneous revenue	9 391	9 948	10 324	10 714	11 195	11 735
Government enterprises	5 013	4 570	4 598	4 632	4 810	4 998
Own-source revenue	**81 222**	**82 070**	**84 271**	**86 800**	**89 326**	**92 007**
% change	***4.9***	***1.0***	***2.7***	***3.0***	***2.9***	***3.0***
Federal transfers	18 901	20 264	20 828	21 448	21 669	22 231
% change	*2.0*	*7.2*	*2.8*	*3.0*	*1.0*	*2.6*
Total consolidated revenue	**100 123**	**102 334**	**105 099**	**108 248**	**110 995**	**114 238**
% change	***4.4***	***2.2***	***2.7***	***3.0***	***2.5***	***2.9***
Consolidated expenditure						
Mission expenditures	–86 470	–90 138	–92 346	–94 904	–96 984	–99 380
% change	*1.1*	*4.2*	*2.4*	*2.8*	*2.2*	*2.5*
Debt service	–10 009	–10 047	–10 149	–10 376	–10 639	–10 989
% change	*–2.5*	*0.4*	*1.0*	*2.2*	*2.5*	*3.3*
Total consolidated expenditure	**–96 479**	**–100 185**	**–102 495**	**–105 280**	**–107 623**	**–110 369**
% change	***0.7***	***3.8***	***2.3***	***2.7***	***2.2***	***2.6***
Contingency reserve	—	–150	–150	–150	–150	–250
SURPLUS (DEFICIT)	**3 644**	**1 999**	**2 454**	**2 818**	**3 222**	**3 619**
BALANCED BUDGET ACT						
Deposits of dedicated revenues in the Generations Fund	–1 453	–1 999	–2 454	–2 818	–3 222	–3 619
BUDGETARY BALANCE[1]	**2 191**	—	—	—	—	—

(1) Budgetary balance within the meaning of the *Balanced Budget Act*.

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