NATIONAL BANK OF CANADA
FINANCIAL MARKETS

Québec
2018 Fiscal Update
Economics and Strategy

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Gross debt as % of GDP: On track to reach target five years early

Highlights

- The surplus for the 2017-18 fiscal year, ended last March, is revised up $1.772 billion, from the $850 million estimated in last March's budget to $2.622 billion in today's Fiscal Update. Revenue is revised up $1.2 billion, thanks mainly to a strong economy. Expenditure is revised down $565 million, mainly because of below-budget spending, notably on municipal infrastructure projects.
- The strength of the economy has prompted an upward revision of the budget outlook for the current fiscal year (2018-19) from a balanced budget to a surplus of $1.65 billion, despite new commitments of $229 million included in the Fiscal Update. Projections for subsequent years are a balanced budget in 2019-20 followed by surpluses rising from $150 million in 2020-21 to $650 million in 2022-23.
- The current fiscal year, 2018-19, is expected to end with program spending up 4.9% from the previous year (budget +4.7%) but debt service down 1.2%, for reasons including accelerated debt repayment as noted below, instead of rising as budgeted last March. The upshot is an estimated 4.3% rise of total expenditures (4.5% in the March budget). Growth of own-source revenue is now estimated at 3.0% versus 1.7% in the budget. Growth of federal transfers is now projected at 6.7% (budget 4.4%). Total revenue growth is projected at 3.8% (budget 1.7%).
- In the March budget, draws were projected from the stabilization reserve to balance the books this year and the next two years. In the Fiscal Update these draws are eliminated.
- The Update makes official three new measures for support of families and seniors (increased family allowance, new support for low-income seniors and freeze on the additional contribution for childcare). These measures are budgeted at $164.5 million in the current fiscal year and projected to cost $1.7 billion over five years.
- Measures to stimulate business investment (accelerated depreciation of some capex, new permanent 30% additional capital cost allowance for some capex, extension and broadening of electricity discount programs) are budgeted at $44 million in 2018-19 and projected to cost $1.6 billion over five years. An amount of $20.7 million to encourage acquisition of electric vehicles is budgeted in 2018-19.
- Real GDP, which grew 2.8% in 2017, is projected to grow 2.5% in 2018 and 1.8% in 2019. Nominal GDP, which grew 5.1% in 2017, is projected to grow 4.4% in 2018 and 3.5% in 2019.
- The government confirms its intention to accelerate repayment of its market debt. An amount of $8 billion will be drawn from the Generations Fund for this purpose during the current fiscal year. Note that the Generations Fund will continue to receive revenues dedicated to debt reduction as provided in the Act ($2.8 billion a year, on average, from 2018-19 through 2022-23).
- The government's borrowing program for 2018-19 amounts to $12.3 billion, or $1.1 billion less than budgeted last March. The program for 2019-20 is projected at $13.2 billion.
- Gross debt as at March 31, 2018 was $201.1 billion, amounting to 48.2% of GDP. The government projects that the target ratio of 45% of GDP will be reached in 2020-21, five years ahead of schedule.

Surplus of $2.6 billion in 2017-18

In the Quebec budget of last March, the previous government estimated that the 2017-18 fiscal year would end with a surplus of $850 million.[1] As established in the Public Accounts for 2017-18, the surplus came in $1.772 billion higher, at $2.622 billion.

Revenue was $1.2 billion higher, thanks mainly to a strong economy. Expenditure was $565 million lower, mainly as a result of below-budget spending, notably on municipal infrastructure projects.

Surplus of $1.65 billion projected for current fiscal year

Last spring's budget for the current fiscal year (2018-19) was balanced after a projected draw of $1.587 billion from the stabilization reserve. It is now projected that total revenue will be $2.917 billion higher than budgeted last March. The improvement comes mostly from own-source revenue; only $325 million of it is attributable to federal transfers. Program spending, meanwhile, is projected to come in $661 million below budget and debt service $248 million below budget, of which $40 million attributable to accelerated debt repayment (as discussed below under "Debt management and borrowing requirements.")

These numbers add up to an improvement of no less than $3.826 billion in the budget balance for 2018-19. From this total is subtracted $360 million for higher-than-budgeted investment income of the Generations Fund, which must be reinvested in the Fund and therefore subtracted from the budget balance. That leaves an improvement of $3.466 billion, enough to avoid a draw on the stabilization reserve and still show a budget improvement of $1.879 billion. Deduct the cost of new measures announced in the Update, and we arrive at the surplus of $1.65 billion now projected for 2018-19, with no draw from the stabilization fund.

The revenue improvement and the debt-service cost saving will of course carry over to future years. Despite rising program expenditures and the full-year cost of new measures, together amounting to $1.5 billion a year, the government can expect to balance its budget in 2019-20 and run a $150-million surplus in 2020-21, again without drawing from the stabilization reserve.

Main new measures in the Fiscal Update

The Fiscal Update announced three new initatives benefiting families and seniors. The Family Allowance, a refundable income tax credit intended to help taxpayers meet the needs of their minor children, consists at present of $2,472 for the first child and half that for the second and third. The new measure adds $500 to the amounts for the second and third child, at a full-year cost of $250 million.

The second measure is a $200 refundable income tax credit for people 70 and older, effective in 2018. The credit will be reduced at a rate of 5% starting at a household income of $22,500 for single seniors and $36,600 for couples when one spouse is 70 or older. Full-year cost: $102 million.

The third measure is a freeze of the additional contribution for subsidized childcare. The cost is $11.4 million over the current fiscal year and five subsequent years.

In the wake of measures announced by the federal government, the Update announces:

- an increase to 100% of the depreciation rate applicable as of the first year for computer hardware, manufacturing and processing equipment, clean energy generation equipment and intellectual property;
- introduction of an enhanced depreciation in the year of acquisition for all other types of investment;
- introduction of a permanent additional capital cost allowance of 30% for computer hardware, manufacturing and processing equipment, clean energy generation equipment and intellectual property.

These measures are projected to cost $448 million in 2019-20.

The government also announces an extension and broadening of electricity discount programs, a measure that has no direct effect on the budget.

Finally, the government announces $20.7 million in additional funding for rebates on the acquisition of electric vehicles between now and next March 31.

Debt management and borrowing requirements

The government confirms its intention to accelerate repayment of market debt. To this end, $8 billion will be drawn from the Generations Fund during the current fiscal year and $2 billion early in 2019-20. These repayments are in addition to a $2-billion repayment made early in the 2018-19 year. A total of $10 billion in market debt will thus have been repaid by next spring. The finance minister forecasts a saving of $1.4 billion in debt-service cost over five years as a result of these repayments. The contribution of the Generations Fund to repayment of market debt will crystallize investment gains and reduce exposure to market risk in a mature phase of the economic cycle. The Generations Fund will continue to receive

[1] Unless otherwise indicated, the budget balance is as defined by the Balance Budget Act, i.e. after deduction of payments to the Generations Fund.

revenues dedicated to debt reduction as provided by the Act (an average of almost $3 billion a year over five years).

Generations Fund
(millions of dollars)

	2017-2018	2018-2019	2019-2020	2020-2021	2021-2022	2022-2023
Book value, beginning of year	**10 523**	**12 816**	**7 667**	**8 166**	**10 853**	**13 806**
Dedicated revenues						
Water-power royalties						
Hydro-Québec	695	694	713	738	752	773
Private producers	102	100	102	104	107	108
Subtotal	**797**	**794**	**815**	**842**	**859**	**881**
Indexation of the price of heritage electricity	218	242	305	395	485	580
Additional contribution from Hydro-Québec	215	215	215	215	215	215
Mining revenues	145	230	245	295	325	358
Specific tax on alcoholic beverages	500	500	500	500	500	500
Unclaimed property	6	15	15	15	15	15
Investment income(1)	412	855	404	425	554	696
Total dedicated revenues	**2 293**	**2 851**	**2 499**	**2 687**	**2 953**	**3 245**
Use of the Generations Fund to repay borrowings	—	−8 000	−2 000	—	—	—
BOOK VALUE, END OF YEAR	**12 816**	**7 667**	**8 166**	**10 853**	**13 806**	**17 051**

(1) The investment income of the Generations Fund corresponds to realized investment income (interest income, dividends, gains on the disposal of assets, etc.). Therefore, the forecast may be adjusted upward or downward according to the timing of realized gains or losses. The increase in investment income in 2018-2019 can be explained, in particular, by the materialization of a portion of the investment gains resulting from the $8-billion Generations Fund withdrawal.

The maintenance of balanced budgeting and of payment of dedicated revenue to the Generations Fund, together with favourable conditions, will help reduce the debt load. The government projects that the objective of reducing the gross-debt-to-GDP ratio to 45% will be reached in 2020-21, five years ahead of schedule.[2]

As of March 31, 2018, gross debt was $201.1 billion or 48.2% of GDP. As of March 31, 2023 the ratio will be 42.0%. Gross debt will increase $6.5 billion in absolute terms over those five years, mainly as a result of investment in fixed assets ($14.5 billion). Investments, loans and advances will add a further $9.7 billion over the five years, while payments to the Generations Funds will subtract $14.2 billion. Debt will be further reduced by $2.9 billion in budget surpluses and $611 million from other factors.

The government's financing program for 2018-19 calls for borrowing of $12.3 billion, or $1.1 billion less than budgeted in March. For 2019-20 the borrowing requirement is projected at $13.2 billion. For the subsequent three fiscal years it will average $20.4 billion, including an average $13.5 billion in loan repayments.

The government's financing program, 2019-2020 to 2022-2023
(millions of dollars)

	2019-2020	2020-2021	2021-2022	2022-2023
GENERAL FUND				
Net financial requirements(1)	527	1 879	1 966	2 190
Repayments of borrowings	3 506	6 153	10 152	7 882
Use of the Generations Fund to repay borrowings	−2 000	—	—	—
Change in cash position(2)	−416	—	—	—
GENERAL FUND	**1 617**	**8 032**	**12 118**	**10 072**
FINANCING FUND	**9 800**	**9 200**	**8 800**	**8 600**
FINANCEMENT-QUÉBEC	**1 800**	**1 700**	**1 500**	**1 100**
TOTAL	**13 217**	**18 932**	**22 418**	**19 772**
Including: repayments of borrowings	11 154	11 641	15 398	13 448

Note: A negative entry indicates a source of financing and a positive entry, a financial requirement.
(1) These amounts exclude the net financial requirements of consolidated entities funded through the Financing Fund. They are adjusted to take into account, in particular, the non-receipt of revenues of the RPSF and of funds dedicated to other employee future benefits.
(2) The change in cash position corresponds to pre-financing carried out the previous year.

Conclusion

The government acknowledges that the upbeat revisions of the financial framework out to the planning horizon result largely from strengthening of the economy. The government's contribution is to reduce debt service costs by accelerating debt repayment. Overall, the improvement has been such that, contrary to the projection of last March, no draw from the stabilization reserve will be needed to balance the budget for this year and the next two years.

Moreover, the 2017-18 surplus was higher than expected and a surplus is now expected for 2018-19. If the latter materializes, the stabilization reserve (consisting of cumulative surpluses since the 2015-16 fiscal year) will reach $8.8 billion at the end of the current fiscal year. In the event of a recession, the Balanced Budget Act authorizes the government to run deficits up to a total not exceeding the stabilization reserve.

The attainment five years early of the target gross-debt-to-GDP ratio is an important development for the Quebec economy. It increases the government's options to meet coming challenges, such as that of productivity.

Today's projections, of course, take into account only the measures announced in the Fiscal Update, and not all of the government's campaign promises. Further measures to meet those promises would be incorporated in budgets to come.

Marc Pinsonneault / Paul-André Pinsonnault

[2] Gross debt is the sum of debt issued on financial markets, plus net liabilities for pensions and other future benefits of public-service and parapublic employees, minus the balance of the Generations Fund.

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Consolidated financial framework, 2017-2018 to 2022-2023
(millions of dollars)

	2017-2018	2018-2019	2019-2020	2020-2021	2021-2022	2022-2023
Consolidated revenue						
Personal income tax	29 528	31 196	32 502	33 809	35 203	36 567
Contributions for health services	6 221	6 171	6 333	6 481	6 619	6 763
Corporate taxes	8 142	8 521	8 099	8 335	8 530	8 742
School property tax	2 243	1 860	1 738	1 811	1 892	1 976
Consumption taxes	20 329	21 040	21 792	22 230	22 717	23 359
Duties and permits	3 965	4 192	4 060	4 203	4 310	4 415
Miscellaneous revenue	10 398	10 851	10 659	11 010	11 470	11 888
Government enterprises	5 093	4 640	4 565	4 828	5 109	5 472
Own-source revenue	**85 919**	**88 471**	**89 748**	**92 707**	**95 850**	**99 182**
% change	***3.6***	***3.0***	***1.4***	***3.3***	***3.4***	***3.5***
Federal transfers	22 485	23 999	25 215	25 514	25 562	26 212
% change	*11.4*	*6.7*	*5.1*	*1.2*	*0.2*	*2.5*
Total consolidated revenue	**108 404**	**112 470**	**114 963**	**118 221**	**121 412**	**125 394**
% change	***5.2***	***3.8***	***2.2***	***2.8***	***2.7***	***3.3***
Consolidated expenditure						
Mission expenditures	–94 249	–98 837	–103 143	–105 789	–108 286	–111 418
% change	*5.7*	*4.9*	*4.4*	*2.6*	*2.4*	*2.9*
Debt service	–9 240	–9 132	–9 221	–9 495	–9 673	–9 981
% change	*–3.0*	*–1.2*	*1.0*	*3.0*	*1.9*	*3.2*
Total consolidated expenditure	**–103 489**	**–107 969**	**–112 364**	**–115 284**	**–117 959**	**–121 399**
% change	***4.8***	***4.3***	***4.1***	***2.6***	***2.3***	***2.9***
Contingency reserve	—	—	–100	–100	–100	–100
SURPLUS	**4 915**	**4 501**	**2 499**	**2 837**	**3 353**	**3 895**
BALANCED BUDGET ACT						
Deposits of dedicated revenues in the Generations Fund	–2 293	–2 851	–2 499	–2 687	–2 953	–3 245
BUDGETARY BALANCE[1]	**2 622**	**1 650**	**—**	**150**	**400**	**650**

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

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