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Quick Hit — Just what is Québec doing with its Generations Fund cash?

Québec's new CAQ government presented a much anticipated economic and fiscal update on Monday. A summary from our *Economics* colleagues can be accessed here. Those of us in close proximity to provincial trading desks were keen to see what the new government's plans were for the vaunted Generations Fund (GF). That's our focus here.

In 2018-19 (the current fiscal year ending March 31), $8 billion is being used from the GF to "repay borrowings on financial markets". A further $2 billion will be drawn down in 2019-20. By accelerating debt repayment, the province expects to see future-year relief on interest charges, equivalent to some $332 million over five years. First things first, Québec is NOT doing away with the Generations Fund. That's a key point, since the GF locks in an underlying budget surplus and has, without exaggeration, been a linchpin of Québec's debt containment strategy and credit rating/spread improvement in recent years. The GF's dedicated revenue streams—averaging $2.85 billion/year through 2022-23 (Chart 1)—and the associated legislation remain firmly in place. Indeed, after the two-year $10 billion withdrawal, the book value of the Fund is expected to be rapidly rebuilt, topping $17 billion by 2022-23 (Chart 2).

Essentially, what Québec is doing is withdrawing a large amount of money from the Fund—which was always dedicated to debt reduction, managed at arm's length and invested in a diversified portfolio—to repay debt, thus significantly lowering future funding requirements. To help illustrate, we key on *changes* in the 2018-19 financing program line items relative to March's budget. In addition to the larger/accelerated withdrawal from the Generations Fund (now $8 billion this fiscal year vs $2 billion in budget), a stronger-than-expected fiscal position means lighter net requirements/more cash on hand. Armed with this stronger underlying balance and the extra GF proceeds, Québec has more actively paid down debt in 2018-19. All told, there's now an incremental $3 billion of debt repayments being conducted this fiscal year compared with the prior government's budget plan, leaving less "repayments of borrowings" to go when 2019-20 rolls around. More on next year's program in a moment.

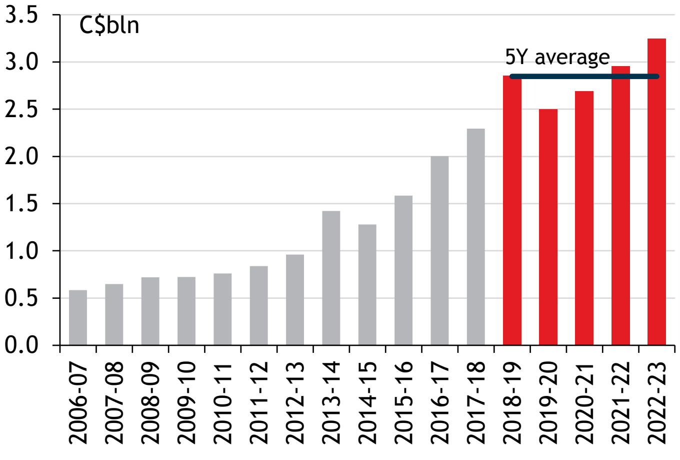
Note that there's $1 billion earmarked for each of Québec's unfunded pension liability (via a dedicated sinking fund) and other sinking funds, with the latter providing marginal scope to absorb additional maturities. While technically "optional", neither of those allocations are particularly unusual, having been conducted in prior years too. However, since they weren't included in the budget plan they constitute a partial use of this year's exceptional cash. There are also larger requirements for the Financing Fund vs budget.

When it comes to the bond market, 2018-19's *underlying* long-term requirement (that is, before pre-funding) has been cut ~$1.5 billion vs budget to less than $12 billion. As of today, Québec has issued $12.34 billion of term debt in 2018-19 (including just over $1 billion via savings products and from immigrant investors), putting the province $416 million pre-funded towards 2019-20 (and counting). Any incremental term funding between now and March 31 will only add to that pre-funding tally, producing a commensurate drop in next fiscal year's long-term program, *all else equal*. And that's where the rubber really hits the road (Chart 3). Having accelerated repayments of debt, and having already started to chip away at future year needs via pre-funding, the 2019-20 long-term bond requirement has been slashed to $13.2 billion. That's down from the $18.6 billion telegraphed back in Budget 2018 and again, could head lower still as pre-funding mounts. Adding it up, over the two-year period covering 2018-19 and 2019-20, some $6½ billion of long-term funding needs have evaporated courtesy of the Generations Fund withdrawal and the stronger fiscal backdrop (Chart 4). These lighter needs suggest that the province could be less active internationally, since defending liquidity in core domestic (C$) benchmark bonds is an obvious priority.

To be clear, markets weren't shocked with Québec's update, where a relatively enviable fiscal position is well understood and the accelerated withdrawal from the GF had been telegraphed. Nor did it stop Québec spreads from moving out Tuesday on a broader erosion in risk sentiment. Nonetheless, the GF-induced drop-off in long-term borrowing needs is clearly supportive for the credit.

Chart 1: Dedicated revenue sources intact

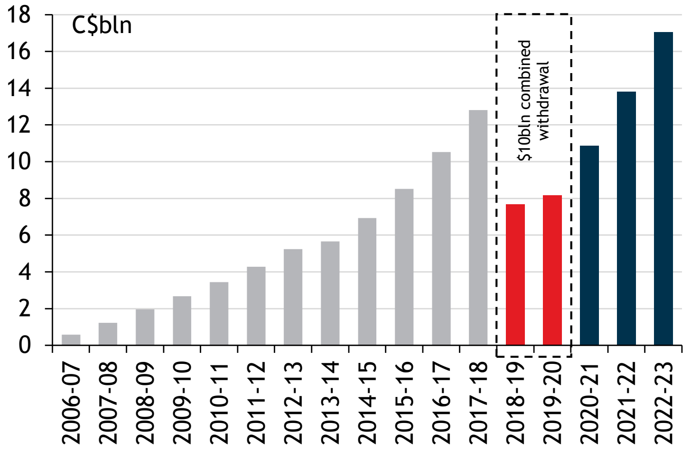
Revenues dedicated to the Generations Fund



Source: NBF, Québec

Chart 2: After withdrawal, GF looks to be rebuilt

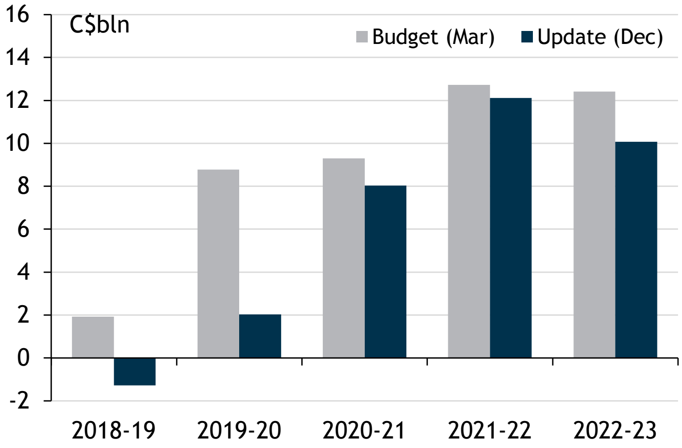
Book value of Generations Fund (end of year)



Source: NBF, Québec

Chart 3: Core funding needs now lower

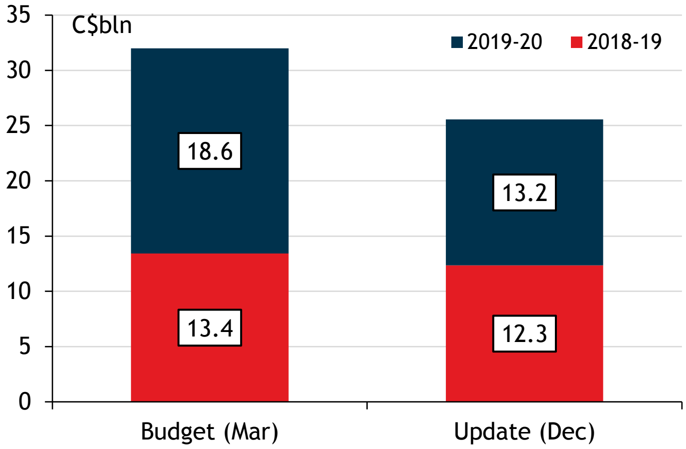
Gross requirements for Québec's General Fund: Update vs Budget



Source: NBF, Québec | Note: 2018-19/2019-20 adjusted to control for pre-funding completed to date ($416mln); General Fund requirements do not include the Financing Fund or Financement-Québec needs

Chart 4: Long-term requirement steps down

Québec's long-term funding requirements: 2018-19 & 2019-20



Source: NBF, Québec | Note: Figures for "Update (Dec)" include $416 mln of pre-funding already completed in 2018-19, with pre-funding having been netted from requirements for 2019-20; the $12.3bln updated figure for 2018-19 represents borrowings contracted in fiscal year-to-date, inclusive of savings products and immigrant investor proceeds jointly totaling ~$1bln

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