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Quick Hit – Québec: Canada's fiscal boy scout

By Warren Lovely

Any former Boy Scouts out there, or once proud Girl Guides? If so, you're probably familiar with the motto: be prepared. Words to live by. As it happens, this maxim can be applied to public sector finances. For a government, being prepared means getting/keeping your fiscal house in order when the weather is reasonably good so that you have an ability to respond when economic storm clouds roll in, when you find yourself on wholly unfamiliar geopolitical terrain, when you stumble into a demographic hornets nest, or when you get attacked by a raging bear market (to cite a few adverse examples).

Over the years, Canada has had its share of fiscal leaders (and laggards). But by many objective standards, Québec qualifies as something of a fiscal boy scout. Based on the province's fresh 2019 budget, membership in this club—that comes with some perks, in the form of higher credit ratings and/or lower borrowing costs—clearly survived a transition in political leadership following last year's election. We joke, but in addition to the oath of allegiance, it's almost like Premier Legault and Finance Minister Girard swore the same fiscal pledge that has guided Québec's fiscal management for years:

On my honor I will do my best to do my duty to Government and to Quebecers and to obey the Budget Law; to balance the books at all times; to keep the provincial economy strong, the Generations Fund intact, and the debt burden declining.

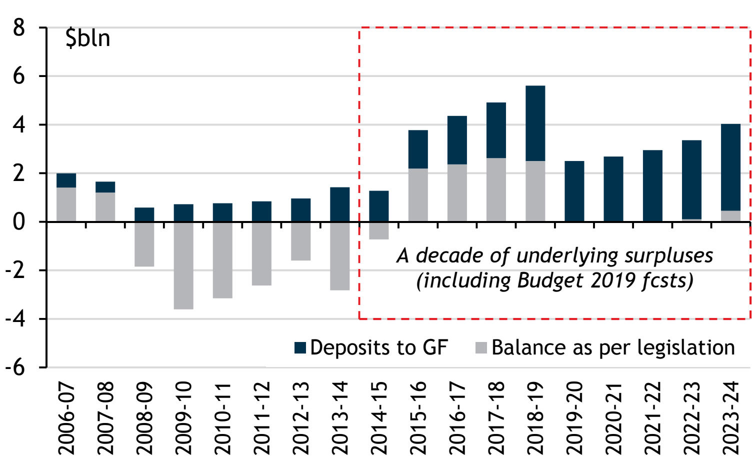
What qualifies Québec for membership in the fiscal boy scouts of Canada? We'd refer you to our detailed budget analysis, but in terms of some ultra-high-level takeaways we'd cite the following: (a) ongoing adherence to balanced budget legislation; (b) continuation of significant legislated deposits to the Generations Fund (which is solely dedicated to debt reduction and really means Québec runs a structural budget surplus); (c) funding of political commitments from surpluses, as opposed to deficit-financed tax relief/investments; (d) prudent planning assumptions and non-trivial contingencies, including a large/growing stabilization reserve; (e) likely attainment of debt targets (notably a 45% gross debt-to-GDP ratio) well ahead of plan; (f) structural measures to bolster labour force participation (which could dull demographic-related fiscal pressures down the road); (g) negligible net bond requirements, but an ongoing/prudent use of pre-funding to take advantage of favourable market conditions when/where they exist. That's a good number of merit badges.

Before we get too carried away, note that Québec's debt burden remains high. The population is slower growing, and older, than in Canada as a whole. Tax rates, despite having come down, remain more elevated here. There's also a larger assist from federal transfers, certainly relative to the so-called "have" provinces that don't qualify for Equalization cash. Moreover, Québec is hardly the sole province with fiscal credentials to their name. Triple-A rated British Columbia (running surpluses in a budget packed with layers of prudence) is a proud member of the fiscal boy scout troop. Bondholders could likewise take comfort in the fiscal performance/direction recently outlined in Manitoba, New Brunswick, Nova Scotia and Saskatchewan. Really then, all six provincial budgets we've digested so far this year have contained distinct credit positive elements, even if generalized and idiosyncratic risks remain (Table, page 2).

Now, we've not heard from some of the more structurally challenged jurisdictions, including Ontario (budget April 11th). But by all outward appearances, Ontario's PC government looks poised to attack the deficit. As for Alberta, an election has been called for April 16th. Polls suggest change could be in the air, which would presumably have material bearing on taxes, energy policy and fiscal posture for this large borrower. While we'll hardly be starved for provincial bonds in the fiscal year ahead, recent fiscal fundamentals (on their own) are supportive for sub-sovereign credits, assuming we could ever get clear of the growth fears embedded in today's inverted yield curve.

Chart 1: Québec locks in structural surpluses

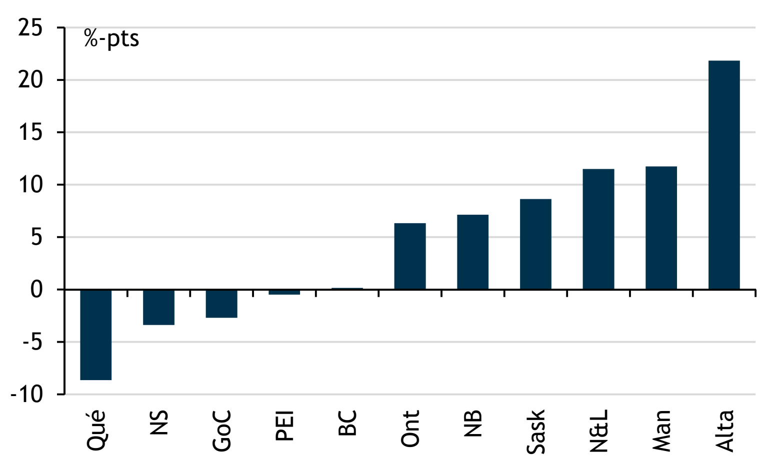
Québec budget balance: As per legislation plus Generations Fund deposits



Source: NBF, Québec | Note: Budgetary balance pursuant to law is after GF deposits

Chart 2: Taming Québec's high debt burden

10-year change in net debt-to-GDP ratio as at 2019-20



Source: NBF, federal-provincial gov'ts | Note: Based on latest estimates for 2019-20

Table: Notwithstanding risks/concerns, rating agencies generally like what they see in 2019 budgets

Preliminary rating agency commentary (from Moody's & DBRS) following 2019 provincial budgets (presented in chronological order)

Provincial government	Budget date	Selected post-budget rating agency commentary	
		Moody's	DBRS
British Columbia	21-Feb	• Balanced 2019/20 budget is credit positive, but capital spending will add to debt burden • Continued strong economic growth and consolidated surpluses until 2022 • Contingencies, together with forecast allowances for revenue fluctuations… provide a sizeable cushion against adverse fiscal changes • Borrowing to finance its ambitious capital program will add to an already elevated debt burden relative to peers • Strong debt affordability, with interest expenses at around 5% of revenue over the next three years	• Credit profile is broadly stable and remains strongly placed in the AA (high) rating category • Responsible fiscal policy remains a priority. Spending increases are being funded by rising revenue, to maintain a thin track of modest surpluses through the three-year outlook • Total expense has risen quickly • The budget incorporates significant contingencies in each year of the plan • DBRS-adjusted debt is likely to remain stable
Manitoba	7-Mar	• 2019/20 budget maintains path towards balance despite slower revenue growth • The projected deficit is 23% lower than the revised CAD470 deficit expected for 2018/19. This strong improvement is credit positive for the province, as it should reduce its borrowing requirements to support operations • If Manitoba is able to execute its budgetary plan, it will have managed to reduce the budgetary deficit by an average of 18% annually between 2017 and 2020 • The impact of improving fiscal deficits partially offset by slowing revenue growth and continued borrowing to support the province's sizable capital plan • China's move to cancel a canola export permit of a Manitoban company, underscore the potential for the province to experience increased volatility in international export markets	• The government has sought to balance its competing policy objectives of deficit reduction, tax reduction and improved program outcomes • Outlook for deficit reduction has continued to improve with the Province reporting better-than-expected results in each of the last three years, though the targets for future years are little changed from what was presented in last year's budget. • The multi-year outlook continues to envision a return to balance toward the end of the next government's mandate (around 2022–23 or 2023–24) • Commitment to deficit reduction appears genuine and credible. However, the protracted time frame to balance the budget remains a risk • The long-standing commitment to reduce the provincial sales tax (PST) will be met July 1, 2019 • DBRS-adjusted debt is likely to remain stable • The credit profile remains firmly anchored in the A (high) rating category
New Brunswick	19-Mar	• Sustained return to surplus is credit positive for the province as it should reduce the amount the province needs to borrow in order to finance its capital plan • The province projects slow annual revenue growth, and its ability to generate fiscal surpluses is highly dependent on aggressive expenditure management • Debt burden to stabilize… over the budget forecast period • Track record of keeping spending growth below that of revenue • Plan to limit spending growth to an average of 1.4% annually is ambitious • Very little room to miss its expenditure targets and still meet its goal of balanced budgets • Together with improving operating surpluses, [lower infrastructure spending] should reduce the amount of external financing the government requires to finance its capital plan and help stabilize the provincial debt burden	• This budget appears to be the initial step in what may be a significant, multi-year effort to address the Province's fiscal and economic outlook • The budget outlook has improved significantly from the time of DBRS's last review. The Province balanced the budget in 2018–19, and the outlook for debt growth is now meaningfully lower that what DBRS had expected • Small budget surpluses over the four-year forecast horizon • Supported by an improved fiscal outlook and reduced capital program, DBRS-adjusted debt is expected to trend downward • The government acknowledges the significant fiscal and economic challenges faced by the Province, including the impact of an aging population and the need to gradually reduce the tax burden to promote economic growth. The budget does not pose any meaningful measures to address these challenges • The government is committed to not increasing taxes
Saskatchewan	20-Mar	• The return to balance in 2019/20 is in line with the province's previous targets and is credit positive, but surpluses are thin and leave a limited buffer to absorb even relatively small fiscal shocks • The budget is based on generally positive medium-term projections for Saskatchewan's economy • Improving resource prices and production activity support the province's fiscal profile, although volatility in oil prices remains a credit risk • The province expects annual infrastructure spending will decline under the plan over the next four years, limiting the amount of new debt financing • Debt levels remain in line with our previous projections	• Saskatchewan has fulfilled its three-year commitment to balance the provincial budget • Saskatchewan's commitment to prudent fiscal policy, along with the pace of fiscal consolidation, stands out among provinces • While not without its challenges, the budget outlook is much improved, and the credit profile has stabilized • [Budget] reiterates the Saskatchewan Party's longstanding commitment to a pro-growth agenda, a low and competitive tax regime, balanced budgets and low debt • The Province projects modest surpluses over the forecast horizon and reduced capital requirements, which translates into improving credit metrics
Québec	21-Mar	• Budget surpluses through to the end of its five-year budget horizon in 2023/24 • Québec's ability to forecast budget surpluses while undertaking efforts to address fiscal constraints on both revenue and spending is credit positive • While marginal at present, efforts to lower Québec's higher than average tax burden will restore some flexibility should it be required in the future and are credit positive • Higher level of spending will alleviate some credit pressures on institutions in the key public sectors such as hospitals and universities • Future economic growth is likely to face headwinds from labour shortages due to Québec's ageing population and the economy's recent strong job creation which has reduced the potential pool of unemployed workers • Given operating surplus forecasts, new debt requirements will be largely limited to funding capital	• The budget is the first to be tabled by the Coalition Avenir Québec (CAQ). The fundamental direction of fiscal policy is unchanged. The Province remains committed to a pro-growth agenda, sustainable public finances and meaningful debt reduction. • The Province is in an enviable position, as past efforts to address to budget imbalances, strong growth in federal transfers and solid economic activity now provide ample flexibility to pursue a range of new policy measures without jeopardizing long-term fiscal policy goals • The Province projects surpluses (before contributions to the Generations Fund for debt reduction) ranging between $2.5 billion and $4.0 billion through the forecast horizon and that debt-to-gross domestic product (GDP) ratios will continue to decline steadily • The pace of debt reduction continues to exceed DBRS's expectations. Further declines in the debt-to-GDP ratio and ongoing fiscal discipline could have positive rating implications if sustained
Nova Scotia	26-Mar	• Forecasting a fourth consecutive balanced budget. Improving results are expected across the budget horizon to 2022/23. The budget is credit neutral given thin surpluses are consistent with our prior forecasts • Year-on-year dynamics suggest the budget plan will face challenges. Should Nova Scotia fail to control spending growth, thin surplus forecasts will be at risk. Nonetheless, the province has successfully met its budget targets in prior years • Debt service is expected to fall… with the value of the savings helping to offset nearly two-thirds of the increase in departmental spending • Nova Scotia's borrowing requirements are expected to reach CAD1.5 billion in 2019/20 or CAD222.7 million lower than previous forecasts. However, borrowing requirements across 2018/19-2021/22 are roughly the same as previously forecasted as the province now expects higher than previously planned borrowing in the latter years of its plan	• Nova Scotia's 2019–20 budget follows the plan established when the Liberal government was re-elected in 2017. The budget highlights three themes: (1) maintaining fiscal balance; (2) spending on priority areas; and (3) fostering economic growth • Despite rising capital spending and a subdued economic growth outlook, modest budget surpluses should keep the debt burden on a declining trend • Overall, the plan is supportive of the Province's credit risk profile, leaving its ratings with flexibility to withstand a deterioration in operating results and debt accumulation in the event of an economic downturn • In recent years, the Province has often exceeded budgetary targets modestly • Over the medium term, the debt-to-GDP ratio is projected to fall • Borrowing requirements are estimated at $1.5 billion for 2019–20 and largely comprise refinancing needs

Source: NBF, Moody's, DBRS | Note: The above table comprises selected excerpts from Moody's/DBRS post-budget commentary. Refer to these rating agencies for complete text. It is important to note that these "comments" and/or "preliminary assessments" are not to be interpreted as formal rating actions/affirmations, with more in-depth credit opinions/rating reports due to follow

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