Quebec: 2018–19 Budget

REVISITING CURRENT AND CAPITAL EXPENDITURES

- The projected deficit for fiscal 2017–18 (FY18) of $850 million is less than the monthly data suggest as the Province further expands the *Québec Economic Plan* with multiple spending initiatives and targeted tax relief. Nevertheless, cumulative black ink of $5.4 billion from FY16 to FY18 establishes a healthy $5.4 billion Stabilization Reserve balance to support balanced books over the next three years if necessary.
- The Couillard government is ending its first term projecting a drop in Quebec's gross debt from the March 2015 peak of 54.9% of GDP to 42½%of GDP by March 2026.
- **Financing for FY18** is $6.6 billion above *Budget* at $17.9 billion. For FY19, pre-borrowing of $9.3 billion trims requirements to $13.4 billion and borrowing needs over the next four years average $18.7 billion annually.

OVERVIEW

In the shadow of an election this Fall, with recent robust financial results and an upswing in economic growth, this *Budget,* after a $2.2 billion surge in the *Québec Economic Plan* during FY18, details *Plan* increases of $3.7 billion in FY19, $4.7 billion in FY20 and $5.2 billion in FY21.

To sustain balanced books, planned withdrawals from the Reserve are $1.6 billion in FY19, $0.9 billion in FY20 and $0.5 billion in FY21. The remaining Reserve balance of $2.4 billion by March 2021 is deemed sufficient for the future. For FY20 to FY23, relatively modest annual contingency reserves of $1.0 billion are incorporated.

Supporting the *Budget's* ambitious plan is the upswing in Quebec's economic expansion with real GDP growth accelerating from 1.6% in calendar 2016 to the government's revised assumption of 3.0% in 2017, the strongest gain since 2000. While Quebec's output increases are assumed to ease to 2.1% in 2018 and 1.7% in 2019, this is higher than previously forecast and full-time employment gains have provided an income boost (bottom chart, p.2)

Quebec's plan to withdraw $2 billion annually from its Generations Fund from FY19 to FY23 to retire maturing debt is discussed here.

PROJECTED REVENUES AND PLANNED EXPENDITURES

Projected FY19 revenue growth slips to 2.2% from an estimated 4.2% in FY18. In part this is due to the substantial tax relief introduced in the *Fall Update.* Reducing the lowest personal income bracket rate from 16% to 15% trims FY19 receipts by a hefty $0.96 billion and reform of the school tax system subtracts a further $0.5 billion. Combined, the measures added in this *Budget* and the *Update* decrease receipts by $1.64 billion.

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Quebec's Budget Balances

Under the *Balanced Budget Act*

Fiscal 2016–17 (FY17)
Final: +$2.4bn (+0.6% of GDP)

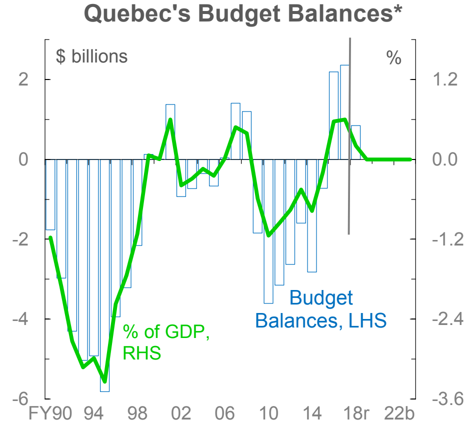
FY18
Budget: $0mn
Revised: $850mn (+0.2% of GDP)

Budgets FY19 to FY23:
Balanced books each fiscal year.

Borrowing Requirements

FY18 Budget:	$11.3bn	**Rev.:**	**$17.9bn**
FY19b	**$13.4bn**	**FY20b**	**$18.6bn**
FY21b	**$18.1bn**	**FY22b**	**$19.7bn**
FY23b	**$18.4bn**		

Source: Finances Québec; Statistics Canada; nominal GDP forecasts: Scotiabank Economics.



*Under the *Balanced Budget* Act. Sources: Finances Québec; Statistics Canada; nominal GDP forecast: Scotiabank Economics.

Among this *Budget's* business initiatives, assistance to small- and mid-sized businesses offers $229 million of tax relief this year. In addition to scaling back their Health Services Fund contribution, for SMBs in the construction and service industries, Quebec's small business corporate income tax rate will be gradually cut from 8.0% to 4.0%.

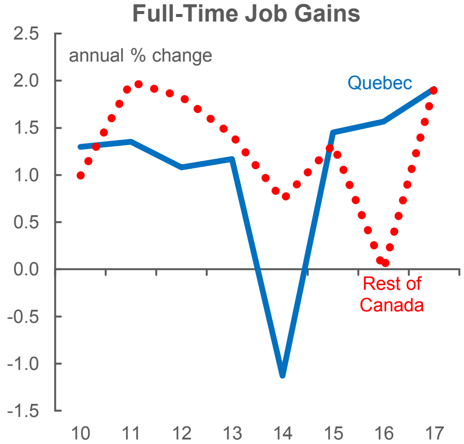
The Compensation Tax on financial institutions will now have a ceiling on the wages subject to the tax and the rate will fall from the current 4.48% to 4.29% on April 1, with further declines each April to a 2.80% rate by April 2024. For digital platform projects, the tax holiday is broadened and to ensure that the Quebec Sales Tax is collected on the digital economy, a mandatory registration system will be introduced for suppliers with no physical or significant presence in the province.

Boosting revenues is the Equalization Adjustment payment, with a positive $576 million impact for FY19 and $1.1 billion for FY20. In FY20, however, reduced transfers under Phase 1 of the federal infrastructure program are expected to emerge as a dampening factor.

Though revenue growth in FY20 picks up to 3.4%, for the following years it averages just 3.0%. Own-source receipts are still forecast to advance at a buoyant 3.3% pace but increases in federal transfers are expected to slow to 1.6%.

Program spending growth picks up to an estimated 6.5% in FY18 with measures added in-year such as the supplement per child for school supplies. With respect to the annual Health and Education spending targets of 4.0% and 3.5% set from FY18 to FY21, outlays for Health are expected to surge by 4.6% in FY19, while Education posts gains of 5.4% in FY18 abd 5.0% the following year. As programs are being expanded, a second review cycle is announced that will include innovation initiatives to enhance the quality of government services.

Quebec's Buoyant Full-Time Job Gains



Source: Statistics Canada.

Quebec's Budget Arithmetic

$ millions except where noted

	FY18 Budget	FY18 Revised	FY19 Budget
Personal Income Tax	30,569	29,115	30,549
Corporate Taxes	7,227	7,900	8,028
Consumption Taxes	19,681	20,299	20,921
Government Enterprises	4,480	4,735	4,332
Other Own-Source Revenue	22,322	22,478	22,093
Total Own-Source Revenue	**84,279**	**84,527**	**85,923**
Federal Transfers	22,029	22,669	23,674
Total Revenue	**106,308**	**107,196**	**109,597**
Health & Social Services	40,223	40,240	42,062
Education & Culture	22,662	22,572	23,781
Economy & Environment	12,965	13,833	14,374
Support for Individuals & Families	9,935	10,113	10,372
Administration & Justice	8,067	8,059	8,724
Total Program Spending	**93,852**	**94,817**	**99,313**
Debt Service*	9,868	9,237	9,380
Total Expenditure	**103,720**	**104,054**	**108,693**
Contingency Reserve	100	0	0
Balance Before Transfers	**2,488**	**3,142**	**904**
Deposit to Generations Fund	-2,488	-2,292	-2,491
Stabilization Reserve	0	0	1,587
Balance:*Balanced Budget Act*	**0**	**850**	**0**
Financing Program	**11,264**	**17,910**	**13,422**
For: General Fund	3,064	9,810	1,922
Financing Fund	7,000	7,200	10,100
Financement-Québec	1,200	900	1,400
*Of Which: Total Refinancing***	*10,992*	*11,300*	*16,559*
Memo Items, %			
Own-Source Revenue / GDP	20.5	20.5	20.1
Program Spending / GDP	22.8	23.0	23.2
Total Expenditure / GDP	25.2	25.3	25.4
Debt Service* / Revenues	9.3	8.6	8.6
Annual Change, %			
Personal Income Tax	*4.6*	*-0.4*	*4.9*
Corporate Taxes	*-3.4*	*5.6*	*1.6*
Consumption Taxes	*2.0*	*5.2*	*3.1*
Government Enterprises	*-8.6*	*-3.3*	*-8.5*
Total Own-Source Revenue	***1.9***	***2.2***	***1.7***
Federal Transfers	*9.2*	*12.3*	*4.4*
Total Revenue	***3.3***	***4.2***	***2.2***
Health	*3.8*	*3.9*	*4.5*
Education & Culture	*4.7*	*4.3*	*5.4*
Economy & Environment	*5.1*	*12.1*	*3.9*
Support for Individuals & Families	*3.7*	*5.5*	*2.6*
Administration & Justice	*20.2*	*20.1*	*8.3*
Total Program Spending	***5.4***	***6.5***	***4.7***
Total Expenditure	***5.3***	***5.6***	***4.5***

* Includes imputed interest on retirement benefits. ** Before $2 billion debt repayment from the Generations Fund. Sources: Finances Québec; Statistics Canada; nominal GDP forecasts: Scotiabank Economics.

After FY19, program spending growth is expected to cool to an average 2.7% annually through FY23. For the same period, annual increases in the debt service are forecast to average a modest 0.7%, in part due to the $2 billion annual retirement of maturing market debt now planned.

CAPITAL SPENDING, DEBT AND BORROWING

Quebec is stepping up its 2018–28 *Infrastructure Plan* to a cumulative $100 billion, an increase of $9 billion from last year's plan. In FY19, over 37½% of the planned $10 billion investment is directed to roads, public transit, marine, rail and other transportation and even over the decade, transportation's share remains close to one-third. As further details of its *Sustainable Mobility Policy* are released, three major transit projects are proceeding—Montreal's Metropolitan Express Rail Network and its Blue Line extension and Quebec City's "structuring project". In FY19, government enterprises, notably Hydro-Québec, add $3.8 billion of investment.

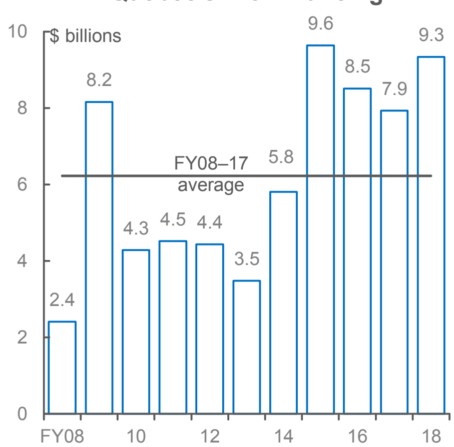
While the book value of the Generations Fund is still expected to rise from an estimated $13.3 billion as of March 2019 to $16 .3 billion by March 2022, the latter forecast is $9.8 billion less than the government's projections last fall (bottom right chart). Interest savings from the planned debt retirement over the next half decade are expected to total $1.1 billion.

OUTLOOK

After significant post-recession austerity, Quebec is replenishing spending and making substantive investments in its economy to broaden and raise the province's underlying growth. With the *Québec Economic Plan* expansion and the current synchronized upswing in global growth, Quebec's economic performance near-term may be stronger than the government has assumed, lifting provincial revenues and downsizing the planned drawdowns from the Stabilization Reserve.

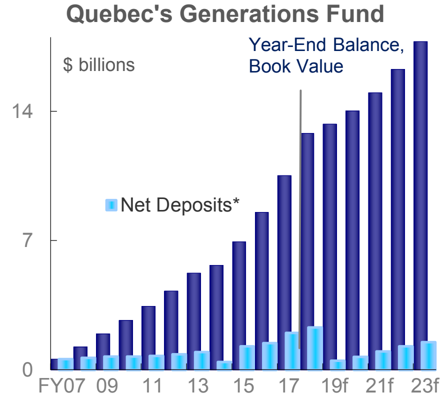
Risks, however, persist, particularly with respect to potential US trade actions and the NAFTA negotiations. With US tax reform, Canada has lost is prior significant corporate tax advantage versus the US. The Province acknowledges that even with its progress in decreasing its debt reduction burden, its liabilities are still above the average of the other Provinces'. As the Province assumes more program responsibilities and implements greater tax relief, Quebec's debt reduction strategy gains importance.

Quebec's Pre-Financing



Source: Finances Québec.

Quebec's Generations Fund



* Dedicated revenues & investment income; in FY14, $1 bn debt repayment. Source: Finances Québec.