Quebec's Debt Reduction, FY19 to FY22

FURTHER MEASURES TO ASSURE A MORE SUSTAINABLE DEBT BURDEN

- Quebec announces the achievement of its longstanding goal to reduce its gross debt from a peak of 54.9% of GDP in March 2015 to 45% by March 2023, three years ahead of schedule.

Quebec's substantive debt reduction mirrors a $4½ billion cumulative surplus during fiscal 2015–16 (FY16) to FY17, more black ink in FY18, and the discipline of substantial annual deposits to its Generations Fund since its inception in 2006 (chart 1). Monthly data for FY18 indicate a cumulative surplus to date ahead of a year earlier and the planned $250 million drawdown from the Province's Stabilization Reserve will not be needed.

The book value of the Generations Fund, the lynchpin of the Province's debt reduction strategy, as of last November was is expected to approach $13 billion (chart 2) by March 31, 2018. The Fund's market value by year-end is expected to climb to the $15 billion range. A growing component of the projected $2.45 billion FY18 annual deposit is investment income, expected to reach $0.5 billion in FY18 (components of the Generations Fund annual deposit, table 1, p.2).

In the next phase of Quebec's debt reduction plan, over the five years to FY22, $2 billion will be withdrawn annually from the Generations Fund to repay maturing market debt. This will directly reduce the Province's annual interest costs, in contrast to the current practice of netting all the Fund's investment income from the gross debt service to benefit from any investment return over the cost of borrowing (chart 2).

Quebec already is credited with a robust debt reduction strategy. Now, the partial shift to direct debt repayment, adds some prudence. Quebec's current practice of capitalizing on investment returns from the Generations Fund exceeding the cost of new borrowing has benefitted from historically low borrowing rates during the post-recession recovery and the returns possible as economies strengthened around the world, in North America and also in Quebec (chart 3). But the post-recession recovery is currently in an advanced stage, borrowing rates are forecast to rise and over the next few years, and the return on equities, that accounted for 45½% of the Fund's benchmark portfolio as of January 2017 (table 2, p.2) may stumble. In calendar 2008, the Generations Fund experienced a 22.4% loss, and the Fund's market value subsequently lagged behind its book value until FY11. The proposed direct debt repayment moderates this risk.

In addition, a rising Generations Fund balance might tempt legislative amendments to divert some of the balance that presently is dedicated solely to decreasing provincial debt. Last Fall, the government's *Update* forecast that the Fund's book value would top $26 billion by March 2022 (chart 1), an amount sufficiently large to spur alternate proposals as pressures, such as the health needs of an expanding Seniors' cohort, intensify.

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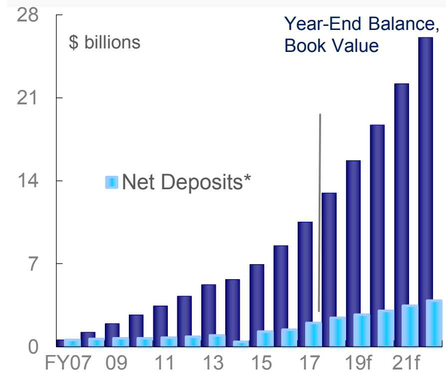
Chart 1

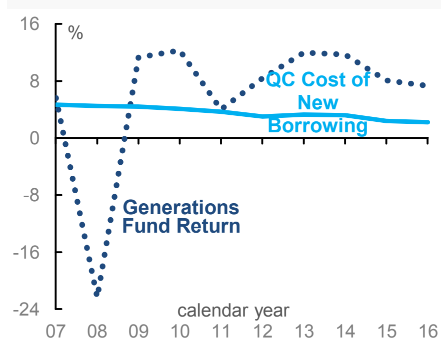
Quebec's Generation Fund, Fall 2017 Update Forecast



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

Chart 2

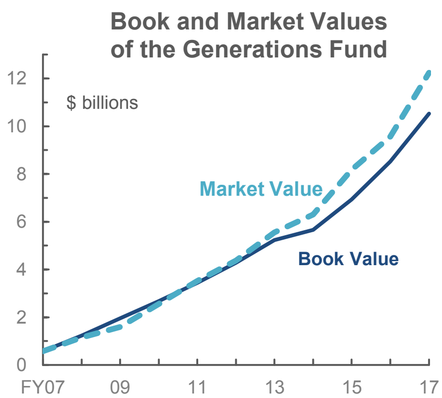
Annual Rate of Return vs Quebec's Cost of Borrowing



Source: Finances Québec.

Under the debt repayment plan, the book value of the Generations Fund should continue to climb, albeit at a slightly slower pace. The projected FY19 deposit as of November was $2.7 billion, more than offsetting the annual withdrawal. The annual deposits have imposed a fiscal discipline, and the annual structural surpluses should continue to align Quebec's outlays to its underlying revenue trends. As the economic backdrop shifts, insurance is always a sound strategy.

Chart 3



Source: Finances Québec.

Projected Generations Fund Growth

November 2017 Update, $ millions except where noted

	FY17	FY18r	FY19f	FY22f
Book Value, Start of Fiscal Year	**8,522**	**10,523**	**12,973**	**22,181**
Hydro-Québec	678	688	687	739
Private Producers	104	98	98	105
Total Water-Power Royalties	**782**	**786**	**785**	**844**
Heritage Power Prices: Indexation	164	215	245	465
Hydro-Québec Gentilly 2 Contribution	0	215	215	215
Mining Revenues	80	175	231	368
Alcohol Beverage Tax	500	500	500	500
Unclaimed Property	53	30	30	30
Projected Investment Income	422	529	706	1,485
Total Dedicated Revenues	**2,001**	**2,450**	**2,712**	**3,907**
Book Value, End of Fiscal Year	**10,523**	**12,973**	**15,685**	**26,088**
annual % change	*23.5*	*23.3*	*20.9*	*17.6*

Source: Finances Québec.

Investment Policies, January 1, 2017

% share of benchmark portfolios

	Retirement Plans Sinking Fund	Generations Fund
Fixed Income Securities	33.5	38.5
Inflation-Sensitive Securities	18.0	16.0
Equities	48.5	45.5
Total Portfolio	**100.0**	**100.0**

Source: Finances Quebec.