

BUDGET ANALYSIS

Quebec: Budget 2020

A Continuity Budget in an Uncertain Environment

HIGHLIGHTS

- ▶ Another budget surplus of \$1.9B has been posted for the 2019–2020 fiscal year. For the past five years, budget surpluses totalling \$13.9B have been posted to make up a stabilization reserve fund under the *Balanced Budget Act*. The Government of Quebec forecasts a balanced budget for the 2020–2021 to 2024–2025 fiscal years.
- ▶ However, global economic and financial conditions have significantly deteriorated since work began on preparing the budget due to the spread of the COVID-19 epidemic outside of China. As a result, we cannot rule out the possibility that the next fiscal year may end with a slight deficit.
- ▶ Budget 2020–2021 includes new initiatives totalling just over \$15.5B in investments by 2025–2026 in three major areas: the environment, the growth potential of Quebec's economy and wealth creation, and Quebecers' needs.
- ▶ The ratio of the Quebec government's gross debt will continue to trend downwards. It should decrease from 45.3% at March 31, 2019, to 39.5% at March 31, 2025.

TABLE 1
Summary of transactions

IN \$M (EXCEPT IF INDICATED)	ACTUAL	PROJECTIONS					
	2018–2019	2019–2020	2020–2021	2021–2022	2022–2023	2023–2024	2024–2025
Own-source revenue	91,626	92,846	95,603	98,859	102,094	105,623	109,061
Variation (%)	6.6	1.3	3.0	3.4	3.3	3.5	3.3
Federal transfers	23,120	25,097	25,692	26,293	26,529	26,598	26,808
Variation (%)	2.8	8.6	2.4	2.3	0.9	0.3	0.8
Total budget revenues	114,746	117,943	121,295	125,152	128,623	132,221	135,869
Variation (%)	5.9	2.8	2.8	3.2	2.8	2.8	2.8
Program spending	-97,744	-104,962	-110,300	-113,617	-116,837	-120,375	-123,664
Variation (%)	3.7	7.4	5.1	3.0	2.8	3.0	2.7
Debt service	-8,722	-7,845	-8,266	-8,630	-8,683	-8,420	-8,460
Variation (%)	-5.4	-10.1	5.4	4.4	0.6	-3.0	0.5
Estimated losses on the Cseries investment	---	-603	---	---	---	---	---
Shortfall to be offset	---	---	---	125	250	250	250
Balance	8,280	4,533	2,729	3,030	3,353	3,676	3,995
Generations Fund	-3,477	-2,633	-2,729	-3,030	-3,353	-3,676	-3,995
Balance in the meaning of the Act	4,803	1,900	0	0	0	0	0
Gross debt	199,098	197,685	202,185	206,517	209,983	213,639	215,026
Variation (%)	-1.0	-0.7	2.3	2.1	1.7	1.7	0.6
In % of GDP	45.3	43.0	42.2	41.7	41.1	40.5	39.5
Debt representing combined deficits	100,448	95,915	93,186	90,156	86,803	83,127	79,132
Variation (%)	-6.5	-4.5	-2.8	-3.3	-3.7	-4.2	-4.8
In % of GDP	22.9	20.9	19.5	18.2	17.0	15.8	14.5

Source: Ministère des Finances du Québec

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NOTE TO READERS: The letters k, M and B are used in texts and tables to refer to thousands, millions and billions respectively.

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Towards Less Robust Economic Growth

Overall, the Government of Quebec's financial situation remains excellent. For a fifth consecutive year, the fiscal year ending March 31 will close with a \$1.9B budget surplus. This amount will boost the stabilization reserve fund to \$13.9B. This reserve fund provides budgetary leeway, which could allow the Quebec government to post future budget deficits without derogating from the *Balanced Budget Act*. It should be noted that this reserve fund is not comprised of additional liquidity, since the budget surpluses of recent years have been used to reduce the provincial debt.

The government anticipates a return to a balanced budget over the coming fiscal years while continuing to contribute dedicated revenues to the Generations Fund. Program spending growth will continue to increase rapidly while several new initiatives were announced in today's budget. Revenue growth has been exceptional recently, but a return to a more modest increase is forecast over the coming fiscal years as a result of slower economic growth.

On the one hand, after accelerating significantly recently due to increased employment and productivity rates (table 2), the growth potential of Quebec's economy should return to a more modest level in the coming years. Our most recent forecasts indicate that the economy's growth potential should converge toward 1.5% in the coming years according to the core scenario.¹

TABLE 2
Contribution of economic growth factors

AVERAGE ANNUAL VARIATION IN % AND CONTRIBUTION IN % POINTS	QUEBEC		ONTARIO	
	2009–2018	2019	2009–2018	2019
Real GDP	1.5	2.8	1.7	1.7
Potential labour pool ¹	0.2	0.2	0.8	1.5
Employment rate ²	0.7	1.6	0.1	1.4
Productivity ³	0.5	1.0	0.8	-1.2
Standard of living⁴	0.7	1.6	0.6	0.0

NOTE: Totals may not add due to rounding.

¹ Population aged 15-64; ² Corresponds to the total number of workers out of the population aged 15-64; ³ Represents real GDP per worker; ⁴ As measured by real GDP per capita.

Sources: Institut de la statistique du Québec, Statistics Canada, Conference Board of Canada, Ontario Ministry of Finance and Ministère des Finances du Québec

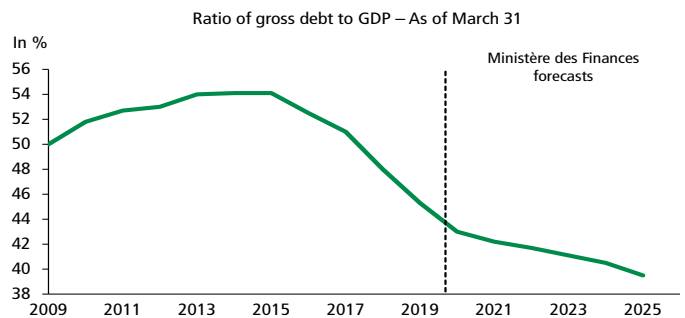
On the other hand, it is clear that the global economic conditions have worsened considerably in recent weeks. Between the time that work on preparing the budget began and its tabling at the National Assembly today, the global economic and financial situation deteriorated significantly. The coronavirus epidemic has spread outside of China, and the financial markets are in turmoil. Moreover, the Bank of Canada and the Federal Reserve lowered

their key interest rates last week, which was not expected at the time the Ministère des Finances du Québec was preparing the budget. Given these conditions, the economic growth forecast in Canada and the United States was revised downwards. This will inevitably affect the growth of the Quebec economy.

Following an estimated increase of 2.8% in 2019, our forecasts indicate that Quebec's real GDP growth could slow to 1.5% in 2020 (table 3 on page 3). This is a less favourable prognosis than the assumptions used to prepare the budget, which counted on an increase of 2.0%. This gap should result in a lower increase in budgetary revenues than forecast. That said, interest rates on the financial markets fell sharply in recent days due to the significant and unexpected negative shock. As a result, the outlook on interest rates has dropped sharply recently. Consequently, the interest rates used to prepare the budget seem too high. This should support a lower debt service than anticipated, which will, in part, offset the effects of slower growth in budgetary revenues. All in all, the budgetary balance could decrease slightly in 2020–2021. Therefore, the 2020–2021 fiscal year may end with a slight deficit. It is also clear that risks will remain on the downside.

With regards to the Quebec government's debt, gross debt will continue to increase over the coming fiscal years primarily as a result of financing infrastructure spending. However, the growth in debt should remain lower than that of the economy, such that the ratio of gross debt compared to GDP will continue to decrease in the years to come, decreasing from 45.3% at March 31, 2019, to 39.5% at March 31, 2025. It goes without saying that this decrease could take slightly longer if the next fiscal year ends with a slight deficit.

GRAPH
The relative size of debt will continue to trend downwards



Sources: Ministère des Finances du Québec and Desjardins, Economic Studies

¹ *Is Quebec's Potential Economic Growth Still Around 1.5%?*

Desjardins, Economic Studies, *Economic Viewpoint*, March 9, 2020, 7 p.

TABLE 3
Economic outlook

VARIATION IN % (EXCEPT IF INDICATED)	2019	2020f	2021f
Real GDP¹			
Ministère des Finances forecasts	2.8	2.0	1.5
Desjardins forecasts	2.8	1.5	2.0
Nominal GDP			
Ministère des Finances forecasts	4.7	4.1	3.4
Desjardins forecasts	4.6	3.6	4.0
GDP deflator¹			
Ministère des Finances forecasts	1.8	2.1	1.9
Desjardins forecasts	1.8	2.1	2.0
Housing starts (annual rate in thousands of units)			
Ministère des Finances forecasts	48.0	47.6	45.2
Desjardins forecasts	48.0	45.0	40.0
Consumer prices			
Ministère des Finances forecasts	2.1	2.2	2.2
Desjardins forecasts	2.1	1.9	2.0
Job creation (annual average in thousands)			
Ministère des Finances forecasts	77.7	37.2	25.8
Desjardins forecasts	77.7	35.0	45.0
Unemployment rate (annual average in %)			
Ministère des Finances forecasts	5.1	5.0	4.9
Desjardins forecasts	5.1	4.9	4.5
Treasury bills—3-month (annual average in %)			
Ministère des Finances forecasts	1.7	1.7	1.9
Desjardins forecasts	1.7	0.9	1.0
Federal bonds—10-year (annual average in %)			
Ministère des Finances forecasts	1.6	1.7	2.0
Desjardins forecasts	1.6	0.9	1.2
Exchange rate (annual average in US\$)			
Ministère des Finances forecasts	0.76	0.77	0.78
Desjardins forecasts	0.76	0.75	0.77

f: forecasts; ¹ Due to rounding, the sum of the real GDP and GDP deflator does not correspond exactly to nominal GDP.
Sources: Ministère des Finances du Québec and Desjardins, Economic Studies

A Multitude of New Measures

The Government of Quebec is capitalizing on its solid financial situation to open its coffers and introduce an array of new measures in its 2020 budget. The government's new budgetary framework thus comprises initiatives totalling a little over \$15.5B by 2025–2026, including \$1.7B in 2020–2021. These new expenditures can be divided into three categories:

- ▶ A number of measures, totalling \$6.7B by 2025–2026, are being put forward to fight climate change. The government therefore presented its first plan for the implementation of the electrification and climate change framework policy, which is supported by \$6.2B in investments (public transit, electrification of transportation, decarbonization of the industrial sector, etc.). The budget also includes additional sums of \$472.7M to implement other environmental protection measures.

- ▶ 2020 budget also includes initiatives totalling close to \$5.9B² by 2024–2025 to increase the potential of the Quebec economy and create wealth. Moreover, the Quebec government intends to introduce additional investments of \$1.5B in education, further reduce the school tax rates in order to ease the tax burden on Quebecers by \$1.2B and invest \$456.9M to promote Quebec's cultural distinctiveness. A series of initiatives totalling \$2.7B is also proposed to enhance business productivity and competitiveness in order to develop the regions and promote workers' integration and retention in the labour market.

² This sum includes initiatives totalling \$531.6M to reduce greenhouse gas emissions, which are already included in the \$6.7B put forward to fight climate change.

- ▶ Measures totalling \$3.5B by 2024–2025 to improve health services, take care of people in vulnerable situations or with special needs and support Indigenous communities are also introduced in the 2020 budget.
- ▶ In addition to the increase in program spending, the 2020 budget includes a \$15.1B increase under the 2020–2030 *Québec Infrastructure Plan*. This will bring the 10-year infrastructure investment program to \$130.5B for 2020–2030, funded through the provincial government's borrowings.

Quebec's Public Finances Will Be Put to the Test

After several good years, public finances will undergo an important test in the coming months. The combination of a significant increase in public expenditures and decidedly tougher economic and financial conditions will put a strain on the Quebec government's budgetary balance. The balanced budgets currently forecast by the Ministère des Finances du Québec may therefore actually become slight deficits, particularly for the 2020–2021 fiscal year. This would not be dramatic given the financial leeway that the Quebec government has created for itself over the past few years. It should also be remembered that Quebec has a highly diversified economy, especially in the manufacturing sector, which will help it face the challenges ahead.³ Unlike other provinces, Quebec also does not rely heavily on oil and gas production and will therefore be less affected by the recent drop in energy prices.

Lastly, while there is much uncertainty, the 2020 budget released today by the Government of Quebec is in line with expectations. The measures put forward are consistent with the caquiste government's top priorities while falling within the budgetary framework.

³ [The Structural Transformation of Quebec and Other Provincial Economies in the Last 60 Years](#), Desjardins, Economic Studies, *Economic Viewpoint*, February 6, 2020, 14 p.