

# BUDGET ANALYSIS



## Quebec: Economic and Fiscal Update

### The New Government Inherits an Enviably Financial Situation

#### HIGHLIGHTS

- ▶ The Quebec government's financial situation has improved significantly owing to good economic conditions.
- ▶ The budgetary surplus for the current fiscal year (2018–2019) has been revised upwards considerably. The projections for subsequent fiscal years are also slightly more positive.
- ▶ The Quebec government took advantage of its financial leeway to introduce a few new measures for families and seniors. Initiatives are also proposed to promote business investment, thus following up on the measures recently announced by the federal government.
- ▶ Debt repayment using available sums from the Generations Fund has increased.

#### Plenty of leeway

Quebec's new government has been in power for just a few weeks and, as expected, has inherited an enviable financial situation. The projected balance before the deposit into the Generations Fund is now \$4.501B for the current fiscal year (2018–2019). This is a substantial increase from the \$904M forecast in the last budget. While program expenditure growth is in line with projections at around 4.9%, the change in budgetary revenues has far exceeded expectations with an increase that has now been revised to 3.8% (from 2.2% in the last budget).

The reason behind this difference is stronger federal transfer and own source revenue growth. The increase in transfers is due mainly to the \$456M gain from other programs in connection with phase 2 of the federal government's infrastructure plan. Higher growth in own source revenues is, without question, a reflection of the good economic conditions currently observed in Quebec. Not only is Quebec's real GDP growth expected to exceed the national average in 2018, but employment and wages are also growing at a sustained pace, which reflects favourably in government revenues.

Taking into account deposits into the Generations Fund (\$2.851B), fiscal 2018–2019 could therefore end with a \$1.65B surplus. This sum will boost the stabilization reserve, which will

reach \$8.824B by March 31<sup>st</sup>, 2019. This is a significant amount that gives the Quebec government room to deal with potential economic or financial contingencies. In the next budget, the government should also review its direction as to the optimal stabilization reserve level to maintain in the future.

For fiscal 2019–2020 to 2022–2023, the government's new financial projections are, on the whole, fairly similar to those established in the March budget. Broadly speaking, however, the budgetary balances before the deposit into the Generations Fund could be slightly higher than projected in the last budget.

With a book value of \$12.816B as at March 31<sup>st</sup>, 2018, the Generations Fund has grown considerably over the years. This fund has given the Quebec government leverage in recent years owing to a higher rate of return than the average rate of new loans. That said, returns from the Generations Fund have always experienced major fluctuations. Yet, after almost a decade of relatively high rates of return, the risk of poor performance increases with time. To reduce this risk exposure, the new Quebec government will step up the withdrawals taken from the Generations Fund by the previous government. Generations Fund withdrawals would therefore total \$8.0B by March 31<sup>st</sup>, 2019, followed by an additional \$2.0B by March 31<sup>st</sup>, 2020. These amounts will be dedicated entirely to debt repayment.

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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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**TABLE 1**  
**Summary of transactions**

IN \$M (EXCEPT IF INDICATED)	ACTUAL	PROJECTIONS				
	2017–2018	2018–2019	2019–2020	2020–2021	2021–2022	2022–2023
Own-source revenue	85,919	88,471	89,748	92,707	95,850	99,182
Variation (%)	3.9	3.0	1.4	3.3	3.4	3.5
Federal transfers	22,485	23,999	25,215	25,514	25,562	26,212
Variation (%)	11.4	6.7	5.1	1.2	0.2	2.5
Total budget revenues	108,404	112,470	114,963	118,221	121,412	125,394
Variation (%)	5.3	3.8	2.2	2.8	2.7	3.3
Program spending	-94,249	-98,837	-103,143	-105,789	-108,286	-111,418
Variation (%)	5.9	4.9	4.4	2.6	2.4	2.9
Debt service	-9,240	-9,132	-9,221	-9,495	-9,673	-9,981
Variation (%)	-3.0	-1.2	1.0	3.0	1.9	3.2
Contingency reserves	---	---	-100	-100	-100	-100
Balance	4,915	4,501	2,499	2,837	3,353	3,895
Generations Fund	-2,293	-2,851	-2,499	-2,687	-2,953	-3,245
Balance in the meaning of the Act	2,622	1,650	0	150	400	650
Gross debt	203,490	204,533	209,418	211,120	214,151	215,076
Variation (%)	0.0	0.5	2.4	0.8	1.4	0.4
In % of GDP	51.5	49.6	49.1	47.9	47.1	45.9
Debt representing combined deficits	117,401	115,109	112,618	109,911	106,920	103,655
Variation (%)	0.0	-2.0	-2.2	-2.4	-2.7	-3.1
In % of GDP	29.7	27.9	26.4	24.9	23.5	22.1

Source: Ministère des Finances du Québec

### Measures for families, seniors and investments

Today's update includes a few new measures that will add up to \$3.3B by the 2022–2023 fiscal year. These new initiatives will mainly be funded out of the government's financial leeway. The measures announced in the update are:

- ▶ The government will give close to \$1.7B back to families and seniors over five years as follows:
  - Family allowance payments will be raised. As of January 1<sup>st</sup>, 2019, the maximum amounts for the second and third children will be increased by \$500. The allowance will go from \$1,235 to \$1,735 and will continue to be indexed thereafter. For example, a couple with three children and a family income of up to \$148,194 will receive a larger allowance; based on this income, this family will receive an overall amount of \$1,976.
  - There will be a freeze on the additional contribution for subsidized childcare starting in 2019. The minimum amount of the additional contribution will stay at \$0.70, and the maximum will remain \$13.90.
  - There will be a new refundable tax credit of \$200 for low-income seniors age 70 and older.

- ▶ The government has also introduced initiatives worth close to \$1.6B to encourage businesses to invest in increasing their productivity:

- To encourage businesses to invest more, the government has announced that they will be able to immediately write off the total costs of computer hardware, manufacturing and processing equipment, clean energy generation equipment and intellectual property; this comes on the heels of the federal government's similar announcement in its update last month.
- To further reduce the cost of business investments for Quebec enterprises, the government is introducing an additional permanent capital cost allowance of 30% for investments in computer hardware, manufacturing and processing equipment, clean energy generation equipment and intellectual property. Coupled with the 100% write-off, this new, additional deduction will allow businesses to deduct 130% of the value of their eligible investments from their taxable income.
- Electricity discount programs will be extended for consumers in the "rate L" category and for greenhouses; the programs will be broadened to include large businesses served by Hydro-Québec's off-grid systems.

**TABLE 2**  
**Economic outlook**

VARIATION IN % (EXCEPT IF INDICATED)	2018f	2019f	2020f
<b>Real GDP<sup>1</sup></b>			
Ministère des Finances forecasts	2.5	1.8	1.5
Desjardins forecasts	2.6	2.0	1.5
<b>Nominal GDP</b>			
Ministère des Finances forecasts	4.4	3.5	3.2
Desjardins forecasts	4.5	3.7	3.2
<b>GDP deflator<sup>1</sup></b>			
Ministère des Finances forecasts	1.8	1.7	1.7
Desjardins forecasts	1.9	1.7	1.7
<b>Housing starts (annual rate in thousands of units)</b>			
Ministère des Finances forecasts	47.9	43.6	n/a
Desjardins forecasts	47.0	43.0	38.0
<b>Consumer prices</b>			
Ministère des Finances forecasts	2.0	2.0	n/a
Desjardins forecasts	1.7	1.7	1.5
<b>Job creation (annual average in thousands)</b>			
Ministère des Finances forecasts	43.7	40.2	25.1
Desjardins forecasts	35.0	40.0	20.0
<b>Unemployment rate (annual average in %)</b>			
Ministère des Finances forecasts	5.5	5.4	5.3
Desjardins forecasts	5.4	5.1	5.0
<b>Treasury bills—3-month (annual average in %)</b>			
Ministère des Finances forecasts	1.4	2.2	2.7
Desjardins forecasts	1.4	2.2	2.4
<b>Federal bonds—10-year (annual average in %)</b>			
Ministère des Finances forecasts	2.3	2.8	3.2
Desjardins forecasts	2.3	2.9	2.9
<b>Exchange rate (annual average in US\$)</b>			
Ministère des Finances forecasts	0.78	0.78	0.80
Desjardins forecasts	0.77	0.77	0.79

f: forecasts; n/a: not available; <sup>1</sup> 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

- The government is also announcing additional funding of \$20.7M to cover rebates for the purchase of electric vehicles until March 31<sup>st</sup>, 2019.

### Stay tuned for the 2019 budget

Even though the new government has taken advantage of the update to introduce a few new measures, today's announcements are still quite modest. The Legault government, having only been in power for a few weeks, has obviously decided to take its time before going ahead in a new budget direction for the province. We will expect to see more when the next budget is tabled, especially on the topic of harmonizing school taxes.