BUDGET ANALYSIS

Quebec: Mid-Year Fiscal Update 2023

Targeted New Supports as Economic Backdrop Weakens

By Marc Desormeaux, Principal Economist and Marc-Antoine Dumont, Economist

HIGHLIGHTS

- Quebec's 2023 mid-year fiscal and economic update maintains plans to balance the books in fiscal year 2027–28 (FY2028) after deposits into the Generations Fund, and by FY2026 before those deposits. Its net debt-to-GDP ratio is set to decline from 38% in FY2024 to 36% in FY2028. Table 1 below summarizes key fiscal indicators.
- The province forecasts total borrowing requirements of $21.9B in FY2024, $29B in FY2025, and then total $75.9B from FY2026 to FY2028.
- The largest single new policy measure was the indexation of the personal income tax system and social assistance benefits, which is not expected to hold back the planned return to balance. New spending was limited, and other measures concentrated on increasing the supply of new housing. These largely followed a series of recommendations published last month by Desjardins Economic Studies.
- Amid heightened economic uncertainty, we like the province's decision to limit new expenditures and build on success in reducing its debt load. The key risks to the plan going forward are weaker-than-expected expansion in line with our most recent projections and the possibility that population continues to outpace historical norms.

TABLE 1
Budget Arithmetic

	2022–23	2023–24		2024–25		2025–26		2026–27		2027–28	
IN $B (UNLESS OTHERWISE INDICATED)	ACTUAL	Budget	Q2 FY2024	Budget	Q2 FY2024	Budget	Q2 FY2024	Budget	Q2 FY2024	Budget	Q2 FY2024
Total Revenue	144.3	147.7	149.1	151.8	152.0	157.0	157.7	162.9	164.4	167.6	168.2
Own-Source Revenue	115.6	118.0	117.6	122.1	122.1	126.0	126.2	130.9	131.6	134.4	135.5
Federal Transfers	28.7	29.7	31.5	29.7	29.8	30.9	31.5	32.0	32.8	33.2	32.7
Total Expenses	147.4	147.9	150.3	151.4	152.6	155.4	157.3	159.7	162.2	163.2	164.9
Program Spending	137.3	138.4	140.4	141.5	142.7	145.4	147.3	149.1	151.7	152.1	153.8
Debt Service	10.1	9.5	9.9	9.9	10.0	10.0	10.0	10.5	10.5	11.1	11.1
Contingency Reserve	0.0	1.5	0.5	1.0	0.0	1.0	0.0	1.5	0.5	1.5	0.5
Balance	**-3.1**	**-1.6**	**-1.7**	**-0.6**	**-0.7**	**0.5**	**0.4**	**1.7**	**1.7**	**2.8**	**2.8**
% of GDP	*-0.6*	*-0.3*	*-0.3*	*-0.1*	*-0.1*	*0.1*	*0.1*	*0.3*	*0.3*	*0.4*	*0.4*
Generations Fund	3.1	2.4	2.2	2.4	2.3	2.5	2.4	2.7	2.7	2.8	2.8
Budget balance within the meaning of the Act	**-6.2**	**-4.0**	**-4.0**	**-3.0**	**-3.0**	**-2.0**	**-2.0**	**-1.0**	**-1.0**	**0.009**	**0.004**
% of GDP	*-1.1*	*-0.7*	*-0.7*	*-0.5*	*-0.5*	*-0.3*	*-0.3*	*-0.2*	*-0.2*	*0.0*	*0.0*
Net Debt (% of GDP)	***38.0***	***37.7***	***37.9***	***37.5***	***37.8***	***37.0***	***37.4***	***36.5***	***36.8***	***35.8***	***35.9***
Nominal GDP (% change)	*2.6*	*0.6*	*0.6*	*1.4*	*0.7*	*1.6*	*1.6*	*1.5*	*1.6*	*1.4*	*1.6*
Real GDP (% change)	*9.6*	*2.7*	*4.0*	*3.8*	*3.4*	*3.7*	*3.5*	*3.3*	*3.5*	*3.3*	*3.5*

Sources: Quebec Ministry of Finance and Desjardins Economic Studies

Desjardins Economic Studies: 514-281-2336 or 1-866-866-7000, ext. 5552336 • desjardins.economics@desjardins.com • desjardins.com/economics

Our Take

Like many provinces, Quebec came into this update seeking to show progress on its plans to return to balance, while also grappling with longer-run affordability issues and slowing economic growth. Against that backdrop, we think that it was wise to hold off on offering more support for households or significant new spending. New policy looks appropriately targeted and is unlikely to add significantly to the deficit on its own.

The province's finances remain sustainable. Quebec's net debt-to-GDP ratio is high relative to that of most provinces but is still set to decline steadily over time and reach a level in FY2028 not seen since the late 1990s. And even in an environment of sharply higher interest rates, debt servicing costs should remain near historical lows as a share of total revenues.

Still, Quebec faces risks like those in other provinces. We anticipate a more significant and longer-lasting economic slowdown over the next year than the government does. To the extent that our projections come to fruition, there is downside potential for revenues for the next two years, and a risk of a more prolonged period of deficits. A $5B reduction in contingency reserves over the next five years reduces the province's margin for error. And if decades-high population growth persists, it could support economic activity but also put additional upward pressure on spending. Whether these risks materialize, and how Quebec's fiscal position might adjust in response to them may only become clear in the coming quarters or indeed years. But in this update, the province likely positioned its finances as best it could to weather the coming period of economic uncertainty.

Little Change to Revenue Outlook Despite Slow Start to 2023

In line with Budget 2023 projections, Quebec continues to anticipate real GDP growth of 0.6% this year. It revised its forecast for the nominal output expansion more than 1 percentage point higher to 4.0%. Both figures are higher than our most recent projections. We assume that economic conditions will remain challenging over the next few quarters as the restrictive effects of high interest rates increasingly take a toll on consumption and the labour market. In 2024, the government lowered its real and nominal GDP forecasts by 0.7 and 0.5 percentage points, respectively. Budget 2023 linked every 1% difference in the nominal GDP growth rate with $1B in own-source revenue. A recessionary scenario presented by the province would see the bottom line erode by nearly $3B over the next three fiscal years. The return to balance (after deposits into the Generations Fund) would be delayed by at least one year.

Budget balance projections were not altered significantly from those laid out in the March 2023 fiscal plan, but there were significant changes in some of the underlying details (table 2). The government expects tax revenues to come in almost $3B lower than previously forecast over the next three fiscal years, a development it attributes to lower economic growth. But an increase in federal transfers—coupled with the Housing Accelerator Fund—will help offset this effect. Moreover, the impact of a slight increase in program spending will be mitigated by a reduction in the contingency provision of $1.0 billion per year throughout the remainder of the forecast horizon.

TABLE 2
Adjustments to the Financial Framework Since March 2023

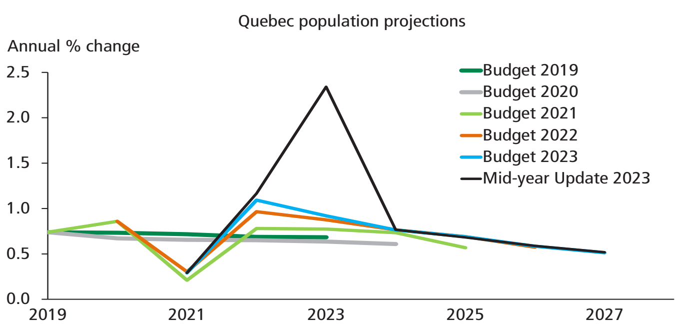
IN $M (UNLESS OTHERWISE INDICATED)	2023–24	2024–25	2025–26
Budget Balance – March 2023*	-3,998	-2,984	-1,980
New Revenues	1,316	109	692
New Spending	1,344	939	679
Reduction in Deposits in the Generations Fund	132	83	81
Total – adjustments	104	-747	94
Providing better access to housing	219	15	853
Combatting homelessness and enhancing food aid	39	26	27
Supporting training in specific fields	199	130	0
Sustaining the climate transition and communities	649	101	77
Fostering business investment	-5	-21	133
New Initiatives	1,101	251	1,089
Reduction of the Contingency Reserve	1,000	1,000	1,000
Budget Balance – November 2023*	**-3,995**	**-2,982**	**-1,975**

* After deposits into the Generations Fund
Sources: Quebec Ministry of Finance and Desjardins Economic Studies

Long-Run Demographic Growth Forecasts Largely Unchanged

Following a surge in population growth over the last year Quebec has revised its near-term demographic projections higher. However, unlike Ontario and BC, it has not made significant changes to forecasts for the later years of the fiscal plan (graph 1). That is a double-edged sword for the province's

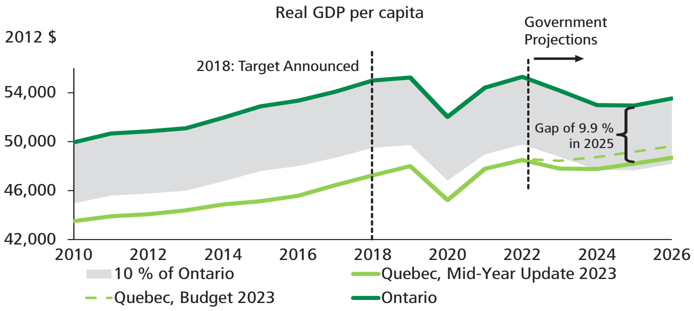
GRAPH 1
Quebec Expects Population Growth to Return to Its Long-Run Trend



Sources: Quebec Ministry of Finance and Desjardins Economic Studies finances. On the one hand, faster-than-expected population growth could help address labour shortages and stimulate economic activity and government revenues. On the other hand, if headcount gains so much stronger than the historical average persist that could also put pressure on the government to boost spending.

Despite higher-than-previously-anticipated population growth and some downward revisions to the economic expansion, Quebec's per-capita real GDP is still on track to come within 10% of Ontario's by the middle of this decade. Recall that this "objective of collective wealth" was put in place in 2018. However, that upbeat projection comes with two caveats. The first is the upside risk to Quebec's population growth, which presents downside risk to GDP per person. Note that following Ontario's boost to its own demographic forecasts, it now expects GDP per person to decline next year. The second is that while Quebec's forecast GDP per capita is on track to narrow the gap with Ontario over time, it's lower than it was just eight months ago (graph 2).

GRAPH 2
Quebec Should Attain Its "Objective of Collective Wealth" as Ontario's GDP per Capita Weakens



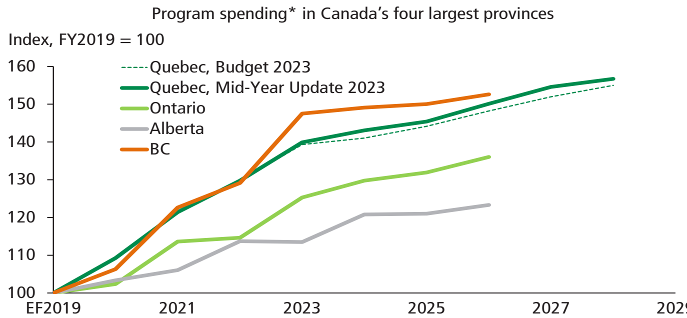
Sources: Statistics Canada, Quebec Minsitry of Finance, Ontario Ministry of Finance and Desjardins Economic Studies

Spending Similar to Prior Projections

Quebec opted to keep its spending targets largely in line with those laid out in Budget 2023. So far, it has increased expenditures more than Ontario and Alberta have since the pandemic but not quite as much as BC has. According to the latest forecasts, those rankings will not change (graph 3). Spending increases were primarily attributed to higher costs for refundable tax credits, including one that aims to stimulate business investment and support research and development in Quebec. A stronger-than-expected post-pandemic rebound in activities in the health and social services and education networks also contributed.

Given plans to balance and the ongoing uncertainty about the course of economic growth, we like the government's cautious approach on spending. The risk of re-stimulating inflation remains, and prudence with respect to expenditures can help to keep the province's debt burden on an easing path, leaving more room to offer support should more difficult economic conditions arise.

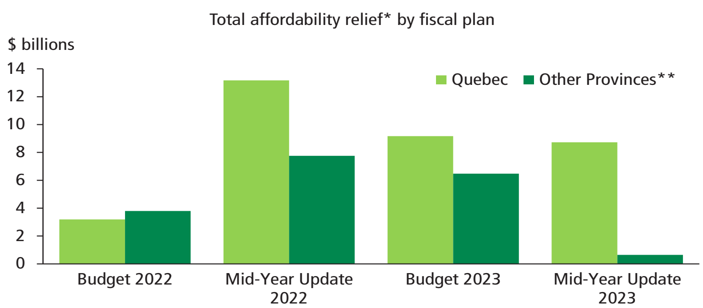
GRAPH 3
Little Change to Quebec's Spending Profile



* Including COVID-19 response measures
Sources: Provincial budget documents, Statistics Canada and Desjardins Economic Studies

The update continued the trend in prior plans by offering meaningful cost-of-living relief measures (graph 4). The largest single item was the indexation of the personal income tax system and social assistance benefits as of January 1, 2024. This came with an estimated cost of $8.7B (0.3% of nominal GDP) over five years to provincial coffers. It's a considerable sum, but not one that is expected to have a negative impact on the budget, particularly after non-tax own-source revenue projections were revised significantly higher. It should also offer support for low-income households most affected by inflation. Other than indexation, the province did not implement significant direct supports for households. As with spending plans, this is a tacit acknowledgment of the risks of exacerbating easing but still elevated price pressures. It also helps the government show progress on its plans to return to black ink amid an uncertain economic backdrop.

GRAPH 4
New Affordability Relief



* Includes current and future fiscal year estimates
** To date
Sources: Provincial budget documents and Desjardins Economic Studies

Housing Supply Measures Will Help Over Time

As signalled in the leadup to this update, the government is making further efforts to boost the housing supply in order to improve affordability, in line with the recommendations we made last month. The most significant measure, with an estimated cost of more than $1.7 billion over the next five years for Quebec, is a commitment to build 8,000 new units for low- and modest-income households. This will be financed via funds from the province and the federal government under the Housing Accelerator Fund. The Fund provides financial support for construction projects that increase the supply of affordable housing. In addition, the province will provide funding for 4,000 new units to become eligible for the Rent Supplement Program, which aims to assist the low-income households most vulnerable to rent increases. While the benefits of these measures will take time to translate into available new housing stock, they also are not costly in the short run from a fiscal perspective.

Borrowing Program

Quebec's financing program is now forecast to reach $21.9B in FY2024 and $29B in FY2025, then total $75.9B from FY2026 to FY2028 (table 3). Debt refinancing accounts for 62% and 58% of the totals in FY2024 and FY2025, respectively. To date in FY2024, 61% of Quebec's debt has been denominated in Canadian dollars, with 36% in US dollars, and 3% in Swiss francs. The province stated that the average maturity of borrowing conducted to date in FY2024 was 13 years. This tilt towards long-dated issuance protects the province's financial position from taking a hit due to higher interest rates.

Bond Market Response

Quebec's long-term bond spreads were largely unchanged immediately after the budget was released. This likely reflects relatively little change versus Budget 2023 projections, some of which investors may have already priced in.

Over the next few months, we expect Quebec's bond spreads to move in line with global risk appetite, but that yields will remain lower than in most other provinces. This reflects the benefits of a large, liquid and diversified borrowing program as well as positive response to the achievement of debt reduction efforts in recent years. Moreover, Ontario now expects its issuance to outpace that of Quebec over the next several years, in contrast to forecasts from the two jurisdictions' last fiscal plans. The return to more historically typical borrowing program sizes may contribute to some compression of Quebec's spreads versus those of Canada's largest province over the coming weeks.

TABLE 3
Quebec's Borrowing Program

	2023–24		2024–25		2025–26		2026–27		2027–28	
IN $B (UNLESS OTHERWISE INDICATED)	Budget	Q2 FY2024	Budget	Q2 FY2024	Budget	Q2 FY2024	Budget	Q2 FY2024	Budget	Q2 FY2024
Net Financial Requirements	18,647	14,500	15,671	15,843	14,899	14,337	14,101	15,212	15,227	13,701
Repayments of Borrowings	13,396	13,647	16,477	16,687	16,630	16,819	13,666	13,637	12,915	12,741
Use of the Generations Fund to Repay Borrowings	-2,500	-2,500	-2,500	-2,500	—	—	—	—	—	—
Retirement Plans Sinking Fund Withdrawals	—	—	-1,000	-1,000	-2,500	-2,500	-3,500	-3,500	-4,500	-4,500
Withdrawal from the Accumulated Sick Leave Fund	—	-160	—	—	—	—	—	—	—	—
Use of Pre-Financing	—	-2,233	—	—	—	—	—	—	—	—
Change in Cash Position	—	0	—	—	—	—	—	—	—	—
Transactions Under the Credit Policy	—	665	—	—	—	—	—	—	—	—
Pre-Financing	—	0	—	—	—	—	—	—	—	—
Increase in the Outstanding Amount of Québec Treasury Bills	—	-2,000	—	—	—	—	—	—	—	—
Total	**29,543**	**21,919**	**28,648**	**29,030**	**29,029**	**28,656**	**24,267**	**25,349**	**23,642**	**21,942**

Sources: Quebec Ministry of Finance and Desjardins Economic Studies