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QUEBEC BUDGET 2017

March 29, 2017

Prudent initiatives in a post-deficit era

- Budget balance is projected in FY17/18 and the following four years.
- A small $250 million surplus is now expected in FY16/17.
- Quebec taxpayers get additional tax cuts worth $500 million next year.
- Additional program expenditures of $977 million (1.3% boost) focus on high-priority items (health care, education and regional economic development).
- The weight of provincial debt, although still high, remains on a downward course and on track to hit long-term targets.

Not breaking from recent tradition

With some fiscal flexibility in hand, Quebec Finance Minister Carlos Leitao yesterday presented a budget that gave both more money for high-priority government programs and more tax cuts to individuals in the province. Still, this budget hardly broke from recent tradition, and remained cautious and focused on keeping the provincial fiscal situation on a sustained path. New measures introduced on both sides of the ledger in Budget 2017 were fairly modest and within the government's means. As was the case in the previous two budgets, revenues and expenditures are projected to be in balance not only in the coming fiscal year but over the entire five-year plan.

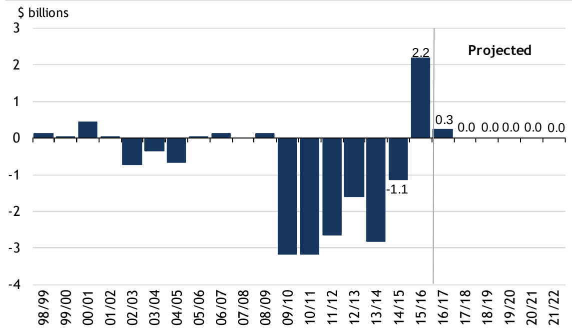
Underestimating the size of the 2016-2017 surplus?

Prudence clearly was still on Minister Leitao's mind as he designed this budget judging by the conservative economic assumptions on which it is based and the maintenance of contingency reserves that range between $100 million and $900 million. Perhaps a more compelling sign of prudence, however, is the fact that the budget expects only a small surplus in the fiscal year ending in a few days despite the latest monthly report on the government's financial transactions showing a much more substantial $2.3 billion surplus during the first nine months of the year. In fact, this tracking is even stronger than what was shown at the same date last year, in a year that ultimately saw a record $2.2 billion surplus. Some of the new measures announced in yesterday's budget will temper the FY16/17 surplus; however, we suspect that the $250 million projection will prove to be an underestimate.

Tax cuts that add up

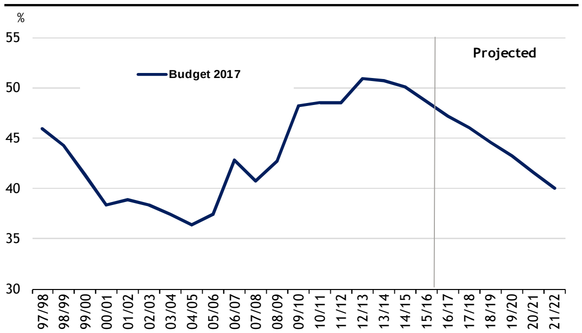
Budget 2017 gives Quebec taxpayers some relief that will come on top of previously announced tax cuts. First, Finance Minister Carlos Leitao took the complete elimination of the health contribution announced in last October's Economic Plan Update to the next level and made it retroactive to January 2016 for 97% Quebecers (those earning an annual income of less than

Quebec budget balance



Source: Ministère des Finances du Québec, RBC Economics Research

Net Debt as % of GDP



Source: Ministère des Finances du Québec, RBC Economics Research

Economic growth assumptions

	2016	2017	2018	2019	2020	2021
Real GDP growth (%)						
Budget 2017	1.7	1.7	1.6	1.5	1.4	1.2
RBC	1.8	1.8	1.6	-	-	-
Nominal GDP growth (%)						
Budget 2017	3.0	3.3	3.3	3.3	3.1	2.9
RBC	2.9	3.6	3.4	-	-	-

Source: Ministère des Finances du Québec, RBC Economics Research

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$134,000) who will receive a refund for 2016. This measure will cost the government $441 million in FY16/17 and a further $32 million in FY17/18. The acceleration of the elimination of the health contribution (two years ahead of original schedule) announced last fall will return $179 million into taxpayers' pockets in FY17/18. Second, the government increased the basic personal amount exempted from personal income tax from $11,635 to $14,890 starting in the 2017 taxation year, costing the government $295 million in lost revenues in FY17/18 (and representing average tax cut of $55 per taxpayer in the province). Together, new tax measures announced in this budget and the fall update amount to $506 million in FY17/18. The government further estimates that, including the cuts from the initial phases of the health contribution elimination in Budgets 2015 and 2016, these measures represent a permanent tax reduction of more than $1 billion for Quebec taxpayers.

Modest, targeted expenditure increases

Improved fiscal flexibility also enabled the Quebec government to 'invest' more money on programs to address identified needs. It has opted to do so cautiously in Budget 2017 by focusing on high-priority 'mission expenditures' only. The budget includes net new program spending of $977 million (a boost of 1.3%) in FY17/18 relative to previous baseline, almost all of which is being directed toward health care ($742 million), education ($333 million) and regional economic development ($245 million). The increase in these high-priority mission expenditures in fact total $1.3 billion; however, the government is reallocating some money from other programs to fund the difference.

Budget balance to be sustained while stashing more money into the Generations Fund

Consolidated revenues are projected to increase by 3.7% to $106.3 billion in FY17/18 and consolidated expenditures are forecasted to rise by 3.6% to $103.7 billion (health care will see an increase of 4.3% to $40.2 billion and education, a 4.0% boost to $22.7 billion). Please note that these line-by-line consolidated numbers differ from the non-consolidated revenue and expenditure figures shown in the table next page, where results from consolidated entities appear on a net basis as a separate line item. A $2.4 billion deposit to the Generations Fund brings the 2017 budget into balance. Over the remaining four years of the fiscal plan, growth in consolidated revenues is expected to average of 2.9% annually and growth in consolidated expenditures by 2.5%. Deposits to the Generations Funds are projected to climb steadily to $4.0 billion by FY21/22. These deposits, as well as investment returns, will grow the Generations Fund from $10.6 billion at the beginning of FY17/18 to $26.7 billion at the end of FY21/22.

Infrastructure plan gets a boost

The 10-year Quebec Infrastructure Plan (QIP) gets a $2.4 billion boost to $91.1 billion. The plan earmarks $9.6 billion in FY17/18, an increase of $700 million from FY16/17. Capital investments are scheduled to peak at $10.0 billion in FY18/19 and the following two years before moderating to $8.6 billion annually thereafter. The road network will see the largest increase in spending in FY17/18 (up 22.4%) to $2.2 billion, followed by health and social services (up 14.4%) to $1.4 billion. Importantly, the updated QIP confirms the government's support for three major public transit projects, including the $6-billion Réseau électrique métropolitain (light rail transit) in the Montreal area spearheaded by the Caisse de dépôt et placement du Québec. The provincial government's commitment to the project totals $1.2 billion, which is expected to be matched by the federal government—most of the remainder will be financed by the Caisse.

More progress on reducing the debt burden

Wrestling the deficit down in FY15/16 was a turning point not only for the government's commitment to put its finances on a sustainable track but also for addressing Quebec's high debt level. The unexpectedly large budget surplus of $2.2 billion recorded last year provided significant help in tackling the issue as it was used to lower the province's debt—the government was able to reduce its gross debt in absolute terms for the time since 1959. With a small surplus expected in FY16/17 and successive balanced budgets projected during the remainder of the fiscal plan to FY21/22, the government will be in a good position to further reduce the weight of its debt in the years ahead and achieve its long-term targets. Net debt is projected to fall as a share of GDP from 48.6% at March 31, 2016, to 47.2% in March 2017 and 46.0% in March 2018, which likely would still be the highest ratio among the provinces. It is projected to decline further to 40.0% by the end of the fiscal plan in 2022, however. The government expects it gross debt-to-GDP ratio to fall from 53.4% in March 2016 to 47.1% by 2022. This would be within striking distance of the government long-standing target of 45% by 2026.

Financing program expected to drop significantly

The government expects its financing program to be $11.2 billion in FY17/18, down substantially from $22.8 billion now estimated for FY16/17, although the latter included $5.4 billion in pre-financing. The financing program if projected to rebound to $20.6 billion in FY18/19.

Pressures of a different kind in the future

A lot of hard work and sacrifices went into bringing Quebec's fiscal situation back onto a sustainable path and restoring some fiscal flexibility in recent year. The road ahead is unlikely to get much easier unfortunately, although future budget challenges may be of a different nature—they will be less about making painful decisions to restrain spending and more about managing expectations in allocating any 'fiscal dividend'. The government no doubt will face increasing pressure both to open its purse strings and ease the tax burden. We believe that the balanced, cautious approach taken in Budget 2017 is the right one and must be maintained in the years ahead. Bringing the weight of the (still-elevated) provincial debt down should continue to be a priority if future generations of Quebecers are to count on fiscal policy tools to address the issues of the day. Moreover, targeting any new spending toward priority areas such as economic development is a sensible strategy to address one of Quebec's biggest challenges—slow potential growth rate in its economy resulting from the aging of its labour force (a phenomenon that is more pronounced in Quebec than most other jurisdictions). Measures designed to bolster skills and employability of those Quebecers currently not participating in the labour force, and boost productivity should continue to be a focus.

Quebec's consolidated fiscal plan

($ millions)	Actual	Forecast					
	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
General Fund - total budgetary revenues	74,036	77,768	80,302	82,542	85,130	87,852	91,037
Own-source revenue	57,401	54,595	56,199	58,241	60,066	61,991	64,046
Federal transfers	17,035	18,584	20,053	20,359	21,022	21,780	22,862
General Fund - total budgetary expenditures	73,586	77,354	80,367	82,583	84,864	87,145	89,444
Program spending	65,631	69,752	72,591	75,016	77,239	79,411	81,631
Interest on public debt	7,955	7,602	7,776	7,567	7,625	7,734	7,813
Net results of consolidated entities	2,794	1,978	2,653	2,975	3,050	3,320	3,296
Contingency reserve	-	100	100	100	100	400	900
Surplus/(Deficit)	3,644	2,292	2,488	2,834	3,216	3,627	3,989
Payments to the Generations Fund	(1,435)	(2,042)	(2,488)	(2,834)	(3,216)	(3,627)	(3,989)
Budgetary balance for the purposes of the Balanced Budget Act	**2,191**	**250**	-	-	-	-	-

Source: Quebec Ministry of Finance, RBC Economics Research