QUEBEC BUDGET 2019

March 22, 2019

Making full use of the fiscal dividend bounty

- In its first budget ever, the Coalition Avenir Québec government projects to balance its books for the next five years and expects a $2.5 billion surplus in 2018-2019.
- There's little risk of slippage: the fiscal plan is well protected by a $9.7 billion stabilization reserve (built by the previous administration) as well as an annual contingency reserve of $100 million.
- Thanks to a strong starting point and an upwardly revised revenue profile Budget 2019 offers $16.2 billion in additional spending and tax cuts over five years. This includes $5.2 billion that the government is “putting back into the pocket of Quebecers”.
- As announced in the fall economic and fiscal update, the earlier objective to reduce the gross debt burden to 45% of GDP by 2025-2026 will be achieved by 2020-2021.
- Quebec's net debt-to-GDP ratio (40.0% at March 31, 2019) remains on a downward track and is now edging marginally lower than Ontario's ratio (40.4%).

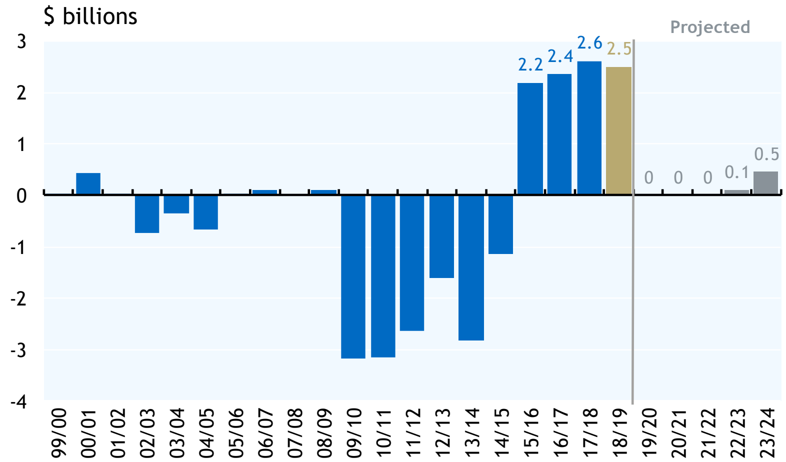
New government eager to move its agenda forward

The CAQ government elected just five months ago wasted no time in delivering on its ambitious campaign promises. Budget 2019 checked pretty much every item on the list (at least partly)—giving more money for education, health and senior care, and helping out families by reducing daycare fees and school tax rates in many areas. In all, there are $16.2 billion in additional spending and tax cuts over four years including $2.3 billion slated for 2019-2020. Oh yes, and the budget will be balanced over the entire five-year fiscal plan.

Unusually strong fiscal position for a first budget

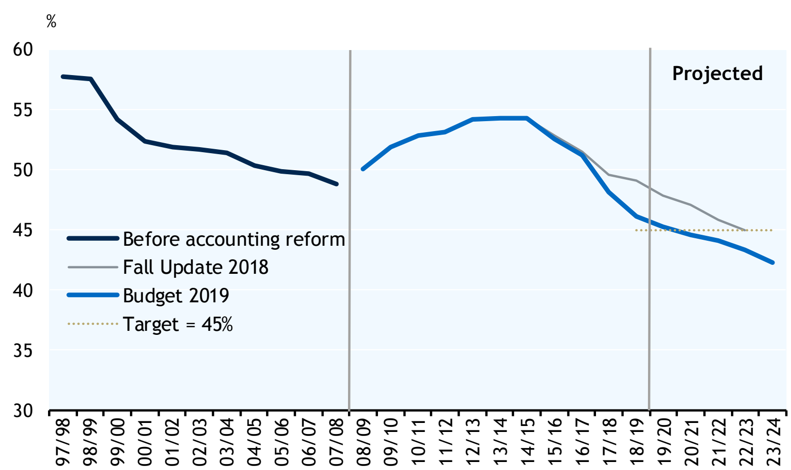
It must be said that Quebec Finance Minister Éric Girard is in a very unique position of having inherited substantial fiscal room to maneuver from the previous government. If we include the $2.5 billion surplus now expected for 2018-2019 (revised up from zero in Budget 2018), the previous Liberal administration ran substantial surpluses for four straight years—building a large $9.7 billion stabilization reserve in the process

Quebec budget balance*



* After deposits into the Generations Fund.
Source: Ministère des Finances du Québec, RBC Economics Research

Gross Debt as % of GDP



Source: Ministère des Finances du Québec, RBC Economics Research

Robert Hogue | Senior Economist | 416-974-6192 | robert.hogue@rbc.com

that provides ample protection against all but the most severe adverse events.

Understating the 2018-2019 surplus?

In fact, we suspect the $2.5 billion surplus for the fiscal year ending this month may be understated (like all preliminary surplus estimates in the prior three years). Monthly budget tracking shows a surplus of $5.6 billion for the first nine months, almost double the figure over the same period a year earlier which ended in a $2.6 billion annual surplus. The government's conservative forecast for 2018-2019 incorporates a larger deposit into the Generations Fund, an extra $1.4 billion in non-recurring expenditures (to "improve public services and increase the potential of the economy") and expects revenue growth to slow over the last three months of the fiscal year—all together slicing $3.1 billion from the surplus.

Economic growth assumptions

	2018	2019	2020	2021	2022	2023
Real GDP growth (%)						
Budget 2019	**2.3**	**1.8**	**1.5**	**1.3**	**1.3**	**1.3**
Fall update 2018	**2.5**	**1.8**	**1.5**	**1.3**	**1.3**	
RBC	2.2	1.6	1.6	-	-	-
Nominal GDP growth (%)						
Budget 2019	**4.3**	**3.5**	**3.2**	**3.0**	**3.0**	**3.1**
Fall update 2018	**4.4**	**3.5**	**3.2**	**3.0**	**3.0**	
RBC	4.2	2.9	3.4	-	-	-

Source: Ministère des Finances du Québec, RBC Economics Research

Higher revenue baseline opens up more fiscal room...

The stronger results in 2018-2019 primarily reflect higher-than-expected revenues (from virtually all sources) thanks to Quebec's solid economy. Those results also set a better starting point for the coming years, providing $3.1 billion in 2019-2020 and $3.7 billion in 2020-2021 in extra fiscal room—even as the government expects economic growth to slow (its forecast is marginally stronger than ours for 2019).

...that Budget 2019 uses up fully

This was more than enough for Minister Girard to give the green light to a long list of election promises. His government is gradually eliminating the additional daycare fees that some parents pay ($680 million over five years) and moving toward a single school tax rate across the province ($1.2 billion). These and other measures will "put back" $5.2 billion in the pockets of Quebecers by 2023-2024. The government is also rolling out 4-year-old kindergarten across the province ($1.7 billion); improving home care services to seniors and adding more beds in residential and long-term care centres ($2.6 billion); increasing caregiving staff ($1.1 billion); implementing various measures targeting older workers and immigrants to boost labour force participation ($1.7 billion); and extending the Green Program and supporting businesses to reduce greenhouse gases ($1.1 billion). In all, Budget 2019 contains $16.2 billion worth of new measures including $2.3 billion in 2019-2020. This is definitely a big budget that uses up all the fiscal room available.

Quebec's consolidated fiscal plan

($ millions)			Forecast			
	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Consolidated Revenue	113,557	115,638	119,389	122,984	127,032	131,146
Own-source revenue	90,146	90,714	93,789	97,034	100,443	103,895
Government enterprises	5,073	4,778	5,067	5,299	5,777	6,191
Federal transfers	23,411	24,924	25,600	25,950	26,589	27,251
Consolidated expenditure	107,951	113,034	116,605	119,937	123,572	127,014
Portfolio expenditure	99,052	104,038	107,467	110,645	113,911	117,287
Debt service	8,899	8,996	9,138	9,292	9,661	9,727
Contingency reserve	-	100	100	100	100	100
Surplus/(Deficit)	5,606	2,504	2,684	2,947	3,360	4,032
Payments to the Generations Fund	(3,106)	(2,504)	(2,684)	(2,947)	(3,260)	(3,582)
Budgetary balance for the purposes of the Balanced Budget Act	**2,500**	**-**	**-**	**-**	**100**	**450**

Source: Quebec Ministry of Finance, RBC Economics Research

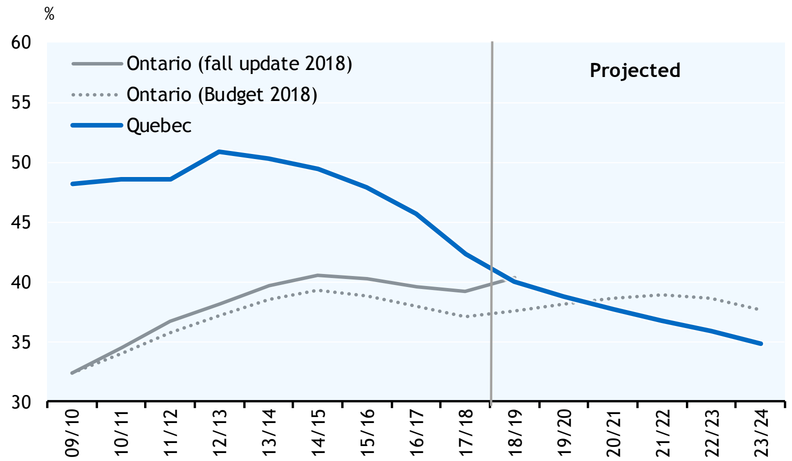
Defending Quebec Inc.

Budget 2019 laid the groundwork on another plank of the CAQ's election platform: actively foster the development of 'strategic' Quebec-based businesses and fight the departure of head offices. To this end, the government will boost funding to Investissement Québec (the province's investment arm) to $5 billion and setting aside $1 billion specifically to "assist the development of strategic businesses" and protect head offices. Details on the program and as to what constitute a 'strategic business' will be announced at a later date.

More progress on righting Quebec's debt situation

The series of budget surpluses recorded in the past four years and regular contributions to the Generations Fund (Quebec's version of a sovereign wealth fund) helped lower the province's high indebtedness. Budget 2019 shows further progress on that front. Gross debt is projected to fall further relative to GDP, dipping below the mandated target of 45% by 2020-2021—five years ahead of schedule. Net debt-to-GDP also is firmly on a downward track. That ratio is projected to reach 40.0% at the end of this month—marginally lower the than the 40.4% currently expected in Ontario—and ease to 38.8% in 2020 and 34.8% by 2024. As announced in the fall economic and fiscal update, the government will use $10 billion from the Generations Fund to repay financial market debt in 2018-2019 and 2019-2020. It is encouraging to see the new government maintaining debt reduction as priority given that Quebec remains among the most indebted province. The Generations Fund is projected to total $8.4 billion at March 2020 and rising to $20.9 billion by 2024.

Net Debt as % of GDP



Source: Ministère des Finances du Québec, Ontario Ministry of Finance, RBC Economics Research

The government expects its financing program to total $11.8 billion for 2019-2020, sharply lower than the $15.6 billion figure in 2018-2019 (which includes $4.2 billion in pre-financing). The program is set to increase materially over the remainder of the fiscal plan, averaging $21.6 billion per year.

Special thanks to the previous liberal government

Finance Minister Girard owes a great deal to his predecessor, Carlos Leitao. Without the tough medicine he administered early in his own mandate, it would not be possible for the CAQ government to get going on such a hefty budget without jeopardizing the health of the province's finances. Let's be clear, though, Quebec's debt is still high and its weight has to come down further to restore long-term fiscal flexibility more fully. The province's rapidly aging demographics is just one of many factors that will exert intensifying spending pressure in the future. So the CAQ government's commitment to lower Quebec's indebtedness is reassuring. Also comforting is its efforts to boost the province's "economic potential", which include measures to increase labour force participation. Any success in reversing the slowdown in the potential growth rate in the economy will enhance the government's longer-term revenue outlook.