Quebec: 2020–21 Budget

SUMMARY

- **The Province of Quebec's budget for fiscal year 2020–21 (*Budget*, FY21) projects continued budgetary surpluses over the planning horizon (chart 1, p.2).**
- **Strong economic growth has translated into robust revenue receipts that have delivered a higher-than-anticipated surplus of $4.5 bn for FY20, with a windfall $2.6 mn redirected to the Generations Fund.**
- **A signature deliverable is a $6.2 bn allocation over five years towards a new 'green plan' to address climate change with a comprehensive policy framework to be unveiled shortly.**
- **Otherwise, another $5.9 bn in new expenditures over the *Budget* horizon focus on education, business productivity, regional development, and another tax cut for households.**
- **These developments continue to drive down Quebec's debt as a share of the economy substantially over the medium-term from 37.3% in FY20 to 34.2% in FY24.**
- **With debt reduction targets achieved well ahead of schedule, the Government plans to define new policy directions on debt reduction in the future.**

OUR TAKE

***Budget* offers a stay-the-course fiscal plan that is largely calibrated to the economic cycle.** With the economy operating above potential for about three years now, running surplus balances in the order of 1% of GDP is appropriate. This has enabled substantial improvements to the Province's debt profile that should continue to embolden market confidence. With growth set to slow, this also preserves capacity to respond to a more serious downturn in the economic outlook if necessary.

New investments continue to build on the productive capacity of the Province for the most part. The priority afforded to education and business productivity in particular should continue to raise Quebec's longer-term growth potential. Labour market investments are critical in this regard, but will likely only partially offset the erosion of potential owing to a pullback in population inflows through reduced immigration levels. Meanwhile, a substantial down-payment towards greening the economy lends credibility to the Province's emissions targets and positions it well to capitalize on future market opportunities.

The Province is in a solid position to respond to downside risks on the horizon. In particular, the COVID-19 represents a serious economic (and health) risk across the country with Quebec particularly exposed through trade channels. It has the capacity to provide fiscal support should these risks shows signs of materializing.

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Updated Fiscal Forecast
$ millions except where noted

	FY20	FY21
Personal Income Tax	33,502	35,435
Corporate Taxes	8,712	8,530
Consumption Taxes	22,118	22,961
Government Enterprises	4,693	4,814
Other Own-Source Revenue	23,821	23,863
Total Own-Source Revenue	**92,846**	**95,603**
Federal Transfers	25,097	25,692
Total Revenue	**117,943**	**121,295**
Health & Social Services	44,124	46,562
Education & Culture	25,517	26,989
Economy & Environment	16,205	16,683
Support for Individuals & Families	10,899	11,413
Administration & Justice	8,217	8,653
Total Program Spending	**104,962**	**110,300**
Debt Service	7,845	8,266
Total Expenditure	**112,807**	**118,566**
Contingency Reserve	603	—
Balance Before Transfers	**4,533**	**2,729**
Deposit to Generations Fund	2,633	2,729
Balance:*Balanced Budget Act*	**1,900**	**—**
Memo Items, %		
Own-Source Revenue / GDP	19.4	19.3
Program Spending / GDP	21.9	22.3
Total Expenditure / GDP	23.6	24.0
Budget Balance / GDP	0.4	0.0
Debt Service / Revenues	6.7	6.8
Annual Change, %		
Personal Income Tax	*7.2*	*13.4*
Corporate Taxes	*-3.6*	*-5.6*
Consumption Taxes	*4.6*	*8.6*
Government Enterprises	*-7.5*	*-5.1*
Total Own-Source Revenue	***3.0***	***6.1***
Federal Transfers	*7.2*	*9.7*
Total Revenue	***3.9***	***6.8***
Health	*5.1*	*10.9*
Education & Culture	*7.6*	*13.8*
Economy & Environment	*2.5*	*5.5*
Support for Individuals & Families	*6.9*	*11.9*
Administration & Justice	*11.6*	*17.6*
Total Program Spending	***6.0***	***11.4***
Total Expenditure	***4.5***	***9.8***

Sources: Scotiabank Economics, Finances Québec.

ECONOMIC OUTLOOK

Quebec's economy has been firing on all cylinders. Growth is expected to run above potential for three years now averaging 2.7% annually (chart 2). Estimates for 2019 have once again been revised upward by 0.4 ppts to 2.8%. A combination of solid population growth, residential investment, and business activity has supported a growth path for Quebec that exceeds its counterparts across the country. Sustained growth in business investment since late-2018 tax measures in Quebec (through Q32019) bucks Canada-wide trends of high volatility (chart 3). These factors, along with a supportive policy environment, have lifted Quebec long-term growth potential.

Growth will face headwinds in 2020. Population growth is expected to moderate while business investment is likely to return to trend as capacity pressures ease with economic growth forecast to moderate to 2.0%. The COVID-19 outbreak is another risk on the near-term horizon, with a substantial deterioration in the global outlook since *Budget* was finalized three weeks earlier. While lower global oil prices will provide some offset to the Quebec economy, its trade exposure will likely erode some growth as global demand retrenches.

FISCAL PATH

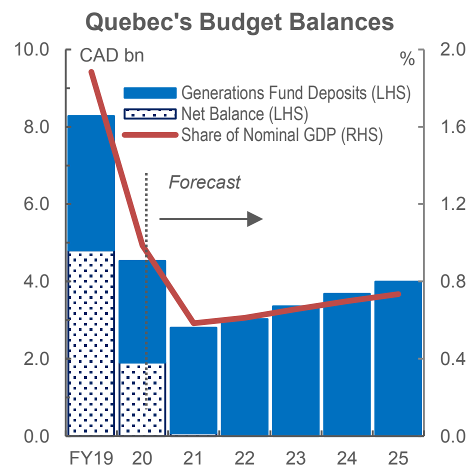
Robust economic growth continues to drive substantial improvements to the Province's bottom-line. Budget expects a $1.9 bn surplus for FY20 (after a $2.6 bn deposit to the Generations Fund), reflecting a $500 mn improvement over forecasts in November's Fall Statement. In particular, own-source revenues drive the windfall with stellar growth in personal income tax receipts at 5.8% y/y and consumption taxes at 3.8% y/y in FY21 (which, combined, represent about 60% of own-source revenues). A pullback in corporate tax receipts of around 2% y/y in FY21 is expected, following last year's 5% dip owing in part to the earlier accelerated depreciation allowances.

Outer-year budgetary surpluses—before Generations Funds deposits—are set to grow by almost 15% annually. This fiscal balance is expected to reach almost $4 bn by FY25 (or 0.8% of GDP). The Government now plans to deposit *all* surplus balances to the Generations Fund in outer years relative to its most recent fiscal path that netted out all but $100 mn annually (chart).

Overall, favourable economic and budgetary developments have contributed to positive adjustments to the balance totaling over $10 bn between FY20 and FY22 since last year's budget. This budget reallocates almost $8 bn of this windfall over the same time horizon. Sustained economic growth, along with accelerated debt repayment and/or asset accumulation through the Generations Fund, have resulted in the fastest pace of debt consolidation across the country (chart 4). Not surprisingly, it also has the highest own-sourced revenues as a share of GDP across provinces, which underpins exceptional revenue growth at the peak of its economic cycle.

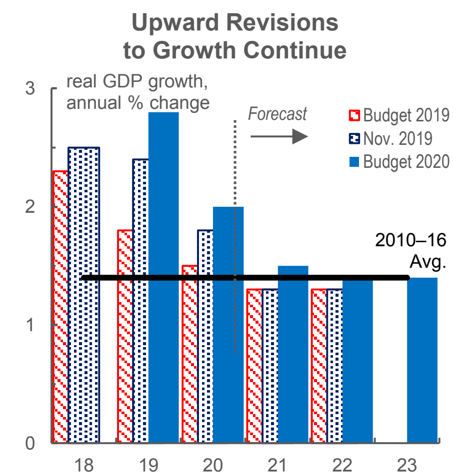
These developments should continue to further strengthen the Province's positive credit outlook.

Chart 1



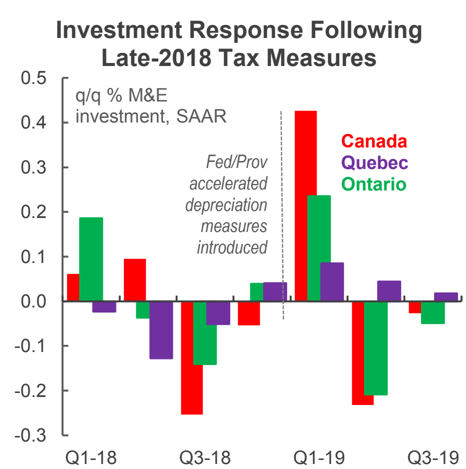
Sources: Scotiabank Economics, Finances Québec.

Chart 2



Sources: Scotiabank Economics, Finances Québec.

Chart 3



Sources: Scotiabank Economics, Statistics Canada, OMoF, ISQ.

POLICY MEASURES

As expected, Budget is positioned as a 'green budget'. It announces $6.2 bn over the next five years towards a financial framework in support of the soon-to-be unveiled *Electrification and Climate Change Plan.* The *Plan* will set out the broader policy framework for greening the Quebec economy over the next decade to achieve its 2030 greenhouse gas (GHG) emission reduction target, while *Budget* funding effectively doubles annual allocations towards these goals. A substantial portion of financing will be dedicated to emissions reductions in transportation (electric vehicles, public transit) and industrial activity, along with adaptation and environment measures (chart 5). Today's Budget allocation lends credibility to the Province's emissions reduction targets.

Enhancing long-term growth potential is a second key theme with a set of measures expected to total $5.9 bn over FY20–25. Education initiatives account for $1.5 bn of the total. These funds are concentrated in policies that aim to improve educational attainment among youth, as well as financial support for students who pursue graduate and professional studies in high-demand fields such as artificial intelligence, computer science, and engineering. New measures to stimulate productivity and competitiveness are forecast to total $1 bn during FY20–25, and feature a tax credit for firms employing digital technologies or facilitating automation in the manufacturing sector. Other initiatives include regional economic development supports in infrastructure and the tourism sector.

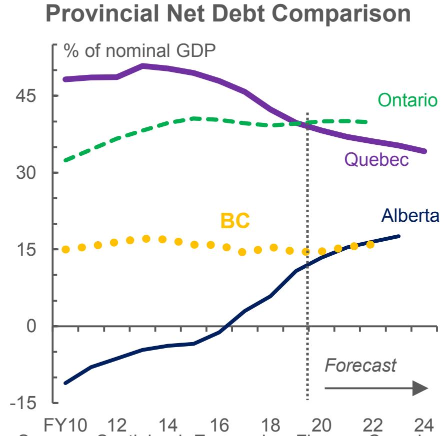
Targeted social spending constitutes the third policy plank of the fiscal blueprint, and is expected to run nearly $3.5 bn from FY20 to FY25. The bulk of this funding will be allocated to improving access to health and social services, notably in specialized medicine, primary care staffing, and new treatment methods. Expected savings vis-à-vis the Province's memorandum of understanding with the *Fédération des médecins spécialistes du Québec* provides a partial offset to these costs. Dedicated initiatives including supports for caregivers, new subsidized childcare services, and housing assistance are forecast to reduce the Province's bottom line by another $1.8 bn through FY25. Another $219 mn is allocated to Indigenous communities during that time frame.

***Budget* also offers modest pocketbook relief to households via another reduction in school taxes.** This measure will forego $1.2 bn in revenues over the horizon or about $240 mn annually.

Meanwhile investments to address chronic labour shortage are more modest. Efforts to promote workforce integration and retention amount to $212 mn over five years. Strong economic growth has amplified labour constraints in Quebec—just as immigration targets are being rolled back—leaving businesses scrambling for labour. Wages are estimated to have appreciated by almost 6% y/y in 2019. Budget investments should help alleviate some of these constraints, but challenges will likely persist.

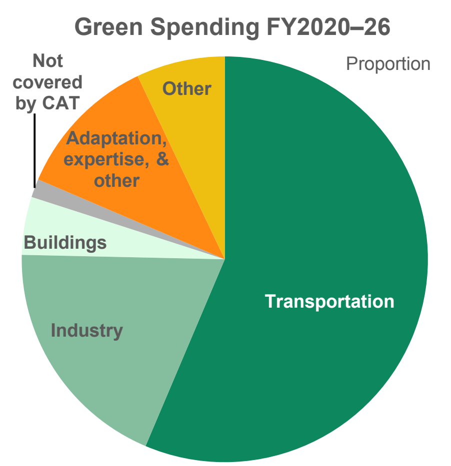
The 2020–30 *Québec Infrastructure Plan* is expected to total $130.5 bn, a $15.1 bn increase versus the 2019–29 *Plan*. Public transit is a focus of the new blueprint, with a range of projects ongoing or under consideration across large and mid-sized cities. Sectors that demonstrate high potential for greenhouse gas emissions are the other target of capital outlays, in line with the Province's climate change plan.

Chart 4



Sources: Scotiabank Economics, Finance Canada, Finances Québec, Ontario Finance, Alberta Treasury Board & Finance, BC Finance.

Chart 5



Sources: Scotiabank Economics, Quebec 2020–2021 budget.

DEBT AND BORROWING

Consistent with Budget's wider anticipated surpluses, Quebec projects a further improvement in its debt trajectory. Net debt is expected to fall from 37.3% of nominal GDP in FY20 to rate just under 33% in by FY25; that contrasts with a previous starting point of 38.2% as of November 2019, and the Province is projected to beat its previous targets in each ensuing fiscal year.

Quebec maintains the third-highest debt burden of any Canadian jurisdiction, but its improvement has since FY13—when net debt approached 51% of GDP—has contributed to two credit rating upgrades since 2017. Having achieved prior debt reduction targets ahead of schedule, the Province stated its intent to continue reducing its debt burden, with plans for deposits of nearly $17 bn into the Generations Fund planned for FY21–25.

Quebec's financing program is expected to amount to $19.2 bn in FY20, before dipping to $13.9 bn in FY21 and averaging about $27 bn over the following four fiscal years (table)**.** Changes to FY20–21 borrowing plans almost entirely reflect some 6.3 bn in pre-financing for future years, which was pulled forward into this fiscal year. Outer-year net financial requirement and borrowing repayment plans remain largely intact.

For Green Bonds, the Province notes that five issues with a total value of $2.8 bn have been made since the program's inception. That figure includes a $500 mn issue in February 2020. Quebec anticipated that it will be a regular Green Bond issuer going forward given the healthy demand observed for its Green Bonds to date and the government's commitment to the environment.

The structure of Quebec's debt continues to be dominated by Canadian dollars and fixed interest rates. By end-FY20, the Province anticipates that domestic currency will make up almost 80% of its gross debt, with a further 12.8% denominated in US dollars before swaps are taken into account. Quebec expects a 91% share of gross debt at fixed interest rates this fiscal year.

Quebec's Financing Program
(millions of dollars)

	FY21	FY22	FY23	FY24	FY25
Net Financial Req.`s	9,843	10,377	10,238	11,382	9,632
Repmt.of Borrowings	10,364	16,880	14,433	16,057	18,968
Pre-Financing	-6,299	—	—	—	—
Generations Fund Use	—	—	—	—	—
Total	**13,908**	**27,257**	**24,671**	**27,439**	**28,600**