Quebec: 2020–21 Economic and Fiscal Update

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COVID-19 TURNS BLACK INK RED

SUMMARY

- **Quebec's updated *Economic and Fiscal Situation* (*Update*) reports that the COVID-19 pandemic will result in a record $14.9 bn accounting deficit in fiscal year 2020–21 (FY21).**
- **That shortfall is expected to be covered using Quebec's stabilization reserve fund; as such, the Province is set to balance its budget under the parameters of its *Balanced Budget Act**.**
- **No fiscal details were announced beyond FY21, but the document notes the government's desire to return to balance within five years.**
- **FY21 debt levels and borrowing plans shifted higher, mirroring the projected budget balances.**
- **The Province outlined significant policy efforts to support the health care system and bolster the economic recovery; over the longer-run, it hopes to establish conditions consistent with annual GDP growth of 2%.**

OUR TAKE

As was the case with other provincial updates released last week—and is likely to be case around the world—COVID-19 has put Quebec on a more challenging fiscal path than it faced pre-pandemic. The secure surpluses it had targeted in March for the next several years are no longer expected after the unprecedented hit to provincial finances this year. Like other jurisdictions, the Province will eventually have to consider the appropriate timing of stimulus withdrawal as it weighs the need to support the recovery with longer-run fiscal sustainability considerations.

Nevertheless, the benefits of pre-virus consolidation efforts are apparent in the *Update*. Success with respect to debt reduction over the last several fiscal years is set to keep Quebec's net debt burden well below the rates above 50% of GDP witnessed in the aftermath of the 2008–09 recession. Moreover, interest costs are expected to remain near historic lows as a share of revenues, leaving more spending room should conditions dictate. On that front, the $4 bn set aside as contingency appears prudent, acknowledging the significant downside risk vis-a-vis a second virus wave and more potential growth-sapping containment efforts.

ECONOMIC OUTLOOK

The considerable economic fallout of the COVID-19 pandemic is expected to bring Quebec's recent string of robust output gains to an end. From 2016 to 2019, real provincial GDP climbed by 8.2%—2.7% per year—to complete the strongest three-year expansion since 2000–02. Unfortunately, this year, the economy is forecast to contract by 6.5% in real terms (chart 1, p.2)—the steepest

Table 1

Updated Fiscal Forecast
$ millions except where noted

	FY20		FY21	
	Bud.	June	Bud.	June
Own-Source Revenue	88,153	87,831	90,789	82,338
Government Enterprises	4,693	4,555	4,814	3,316
Federal Transfers	25,097	25,158	25,692	29,781
Total Revenue	**117,943**	**117,544**	**121,295**	**115,435**
Program Spending	**104,962**	**103,724**	**110,300**	**115,504**
Debt Service	7,845	7,648	8,266	8,304
Total Expenditure	**112,807**	**111,372**	**118,566**	**123,808**
Contingency Reserve	603	603	—	—
Provision for Risk & Recovery	—	—	—	4,000
Balance Before Transfers	**4,533**	**5,569**	**2,729**	**-12,373**
Deposit to Generations Fund	2,633	2,606	2,729	2,567
Use of Stabilization Reserve	—	–2,963	—	14,940
Balance:*Balanced Budget Act*	**1,900**	**—**	**—**	**—**
Net Debt	**171,658**	**170,621**	**172,625**	**189,588**
Memo Items, %				
Own-Source Revenue / GDP	20.2	0.0	20.0	0.0
Program Spending / GDP	22.8	22.6	23.0	26.2
Total Expenditure / GDP	24.5	24.3	24.8	28.1
Budget Balance / GDP	0.4	0.0	0.0	0.0
Net Debt / GDP	37.3	37.2	36.1	43.0
Debt Service / Revenues	6.7	6.5	6.8	7.2
Annual Change, %				
Own-Source Revenue	2.4	2.0	3.0	-6.3
Government Enterprises	*-7.5*	*-10.2*	*2.6*	*-27.2*
Federal Transfers	*7.2*	*7.5*	*2.4*	*18.4*
Total Revenue	***3.9***	***3.5***	***2.8***	***-1.8***
Program Spending	*6.0*	*4.7*	*5.1*	*11.4*
Total Expenditure	***4.5***	***3.2***	***5.1***	***11.2***

Sources: Scotiabank Economics, Finances Québec.

* See box on p.4 for details.

drop since data were first recorded in 1981—amid province-wide lockdowns to contain the virus' spread. Non-residential business investment is expected to see the most severe percentage-wise decline of any sector of the economy—though households and the external sector will not be spared. By industry, air transportation, retail trade and accommodation and food services have been hit the hardest thus far.

The good news is that a solid recovery is expected in 2021. Real GDP is forecast to jump 6% next year, with a significant pickup in growth anticipated in the second half of FY21. Those gains are likely to be driven by the easing of COVID-19 containment measures, and buttressed by the continuing impacts of policy support from the federal and provincial government. In 2022, 2.4% gains are expected.

We highlight a number of potential forecast risks. The first is a softer annual rate of decline than our own forecast, which suggests a stronger post-reopening rebound than our own, though that projection mirrors a (relatively) upbeat national-level outlook for 2020. Another is the assumed rate of population growth—at 0.7% in both 2020 and 2021, it is below more recent gains above 1% that assisted the province's recent expansion. The third is the 4% decline in nominal GDP projected for this year—more muted than the forecast drop in real GDP. That reflects a terms of trade boost via weaker oil import prices—and the impact of flat wage growth plus diminished hours worked in Quebec's large public sector. This has important implications for economy-wide revenue growth going forward.

NEW POLICY MEASURES

***Update* incorporates more than $6.3bn in policy supports in FY21.** Efforts since the start of the pandemic are estimated to have injected more than $28 bn—6.2% of GDP—into Quebec's economy.

Measures to bolster Quebec's response to the public health challenge created by COVID-19 are forecast to amount to $3.5 bn this fiscal year. About two-thirds of that figure is attributable to the purchase of health care equipment. Over $800 mn will go to further compensation and training for health care workers.

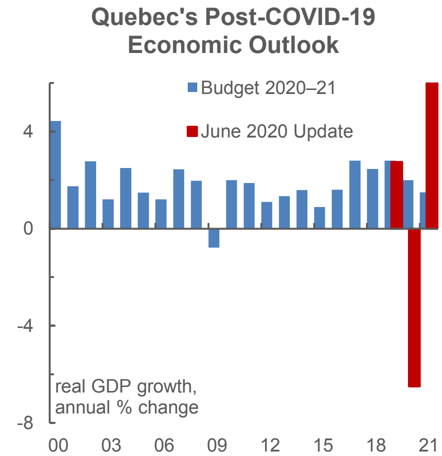
New supports for workers and individuals are expected to total more than $900 mn in FY21. These include acceleration of the planned school tax harmonization, lower mandatory minimum withdrawals from registered retirement income funds for seniors, and an incentive program providing financial support to essential workers.

The Province also allocated $1.9 bn this fiscal year to bolster economic growth. Accelerated FY21 capital outlays under the Quebec Infrastructure Plan will assist projects in the health, education, higher education, road transport, and public transit sectors, and are forecast to add 0.3 ppts to Quebec's real GDP gains. Various tax and fee deferrals and liquidity supports—including the previously announced Concerted Temporary Action Program for Businesses (PACTE)—will add $1.2 bn to the Province's deficit. Federal ventures such as the Canada Emergency Commercial Rent Assistance (CECRA) and Canada Emergency Response Benefit (CERB) programs allow for cost sharing.

The fiscal plan for FY21 also includes $4 bn in contingency funding (chart 2)**, in the event that additional needs arise.**

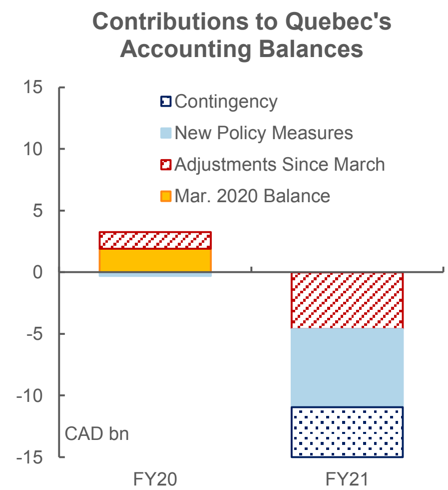
Longer-run policy plans are expected to be unveiled in a further update this fall. The Province wishes to return provincial output to December 2019 levels by the end

Chart 1



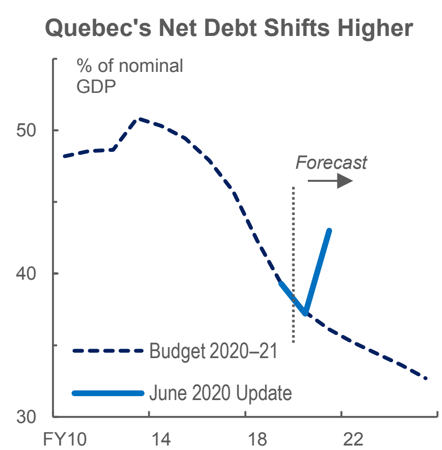
Sources: Scotiabank Economics, Statistics Canada, Finances Québec.

Chart 2



Sources: Scotiabank Economics, Finances Québec.

Chart 3



Sources: Scotiabank Economics, Finance Canada, Finances Québec.

of 2021, re-establish conditions consistent with long-term GDP growth of 2%, balance the books within five years, and remains committed to building a green economy.

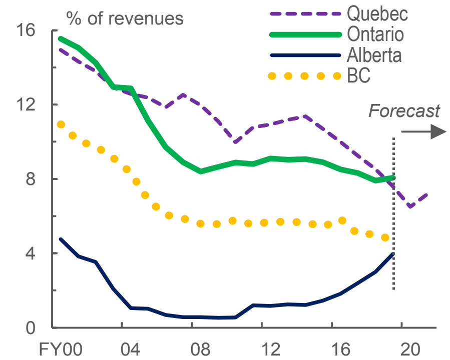
FISCAL PLAN HIGHLIGHTS

For FY20, now complete, the government anticipates an improvement in budgetary conditions. A stronger-than-anticipated $3 bn surplus (0.6% of GDP) is expected, largely the result of an undershoot in program spending.

Facing much weaker economic outlook this year, Quebec's own-source revenues are forecast to fall 6.3% versus FY20—in stark contrast to the 3% gain anticipated in March and the worst annual decline since at least FY87. Of that plunge—which amounts to a $9.6 bn downward adjustment to the last fiscal plan—more than three-quarters stems from weaker tax revenues. Expected to provide a partial offset is the $4.1 bn boost to federal transfers, which reflects Quebec's portion of Ottawa's $14 bn support package for the Provinces and Territories.

Chart 4

Quebec's Debt Servicing Costs to Rise, but Remain Historically Low



Sources: Scotiabank Economics, Finance Canada, Finances Québec.

Total expenditures are now forecast to rise more than 11% in the coming fiscal year—the largest increase since FY98. The increase primarily reflects the host of new COVID-19 policy supports. Debt servicing costs are roughly in line with the March forecast, with a larger debt load expected to be offset by lower interest rates.

Generations Fund deposits for FY21 are estimated at $2.6 bn. That is $162 mn less than assumed in the March 2020 budget.

Given substantially softer revenues, a jump in expenditures, and a sizeable contingency, Quebec is set to run an accounting deficit (i.e. the amount by which expenditures exceed revenues) of $14.9 bn in FY21. At 3.4% of nominal GDP, that amounts to the largest shortfall as a share of provincial output since at least FY87—slightly higher than the 3.3% in FY95.

However, the estimated accounting deficit matches exactly the amount accrued in the stabilization reserve over the last several years. With the use of that fund, the Province will balance its budget within the meaning of the *Balanced Budget Act*. Given the multi-year recovery anticipated, the Province may need to run a technical deficit next year.

DEBT AND BORROWING

Quebec's gross debt and net debt are both expected to shift higher than projected in March's budget. Gross debt is set to climb above 50% of nominal GDP in FY21—versus prior plans of just 42.2%—while net debt's corresponding share is forecast to reach 43%—almost 7 ppts higher than outlined in March (chart 3, p.2). That would bring to an end a remarkable streak of seven consecutive annual decreases. Of the nearly $23 bn y/y increase in gross debt penciled in for FY21, $14.9 bn is attributable to the accounting deficit, with a further $6.6 bn due to new capital outlays. Consistent with pre-virus plans, no withdrawals will be made from the Generations Fund to pay down debt.

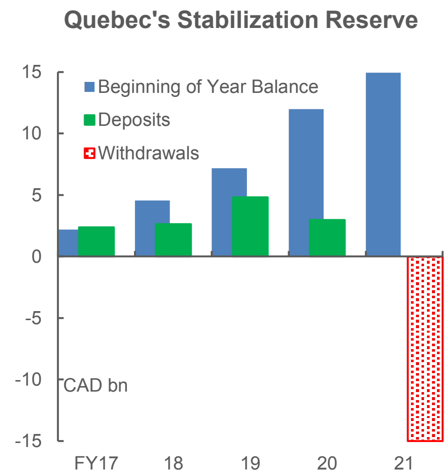
Despite the heavier debt burdens anticipated this fiscal year, debt servicing costs are expected to remain historically low. As a portion of consolidated revenues, Provincial interest payments are projected to reach 7.2% in FY21. That would represent the second-lowest ratio since at least FY87, trailing only the 6.5% in FY20 after considerable improvements over the last several years (chart 4).

Quebec's financing program is now expected to total $32.1 bn this fiscal year—$18.2 bn more than outlined in March. FY20 borrowing activity is expected to have risen $0.8 bn higher than anticipated in the March budget. To date this fiscal year, the government has borrowed $12.3 bn. Of that amount, almost 37% has been contracted on foreign markets—more than the 21% mean over the last 10 years—but the Province's debt is not exposed to fluctuations in foreign exchange rates. About two-thirds of borrowings conducted to date have a maturity of 10 years or more, and almost 20% have a maturity of 30 years or more. The Province maintains a stable outlook according to the six agencies that rate its credit, and noted that the Bank of Canada`s provincial programs remain in place to support bond market liquidity.

PRIMER: QUEBEC'S FINANCIAL FRAMEWORK

Quebec's financial framework contains a number of unique features—intended to support long-run fiscal sustainability—that are important to understanding the coming year's balances.

Quebec's *Balanced Budget Act* requires that a balanced budget be tabled each fiscal year; to achieve that objective, it established the stabilization reserve fund. This fund is used to cover accounting deficits (i.e. amounts by which expenditures exceed revenues), with any annual accounting surpluses deposited into the reserve so that funds are available to cover future shortfalls. Stabilization reserve funds stood at a hefty $14.9 bn prior to FY21 (left chart), significantly bolstered during Quebec's sizeable recent surpluses and period of above-trend economic growth. The reserve is an accounting artefact, not a pool of readily available cash; as such, its use corresponds to additional borrowing and debt accumulation, even if the budget is balanced within the parameters of the *Act*.



Sources: Scotiabank Economics, Finances Québec.

The Province also maintains a large sinking fund called the *Generations Fund*. Established in 2006, it set two targets for end-FY26: a 45% gross debt-to-GDP ratio—achieved well ahead of schedule in FY20—and accumulated deficits representing a 17% share of output. Allocations to the *Fund* impact Quebec's annual accounting balance, and are sourced from mining revenues, royalties paid by Hydro-Québec, and various provincial taxes. Withdrawals are used to pay down debt.