Quebec: 2018–19 Economic and Fiscal Update

SUMMARY

- **The 2018 *Update on Quebec's Economic and Fiscal Situation* (*Update*) unveils a budget surplus of $2.6 bn[1] in fiscal year 2018–19 (FY18), with balance maintained through FY23 (chart 1, p.2).**
- **Robust economic growth plus previously announced changes to financial reporting provide the Government with fiscal room well beyond that projected in the March 27, 2018 Budget (*Budget*).**
- **A significant portion of this windfall is being allotted to business taxation changes to boost competitiveness and pocketbook relief for families and seniors.**
- **The Province is also accelerating its debt reduction plans by front-loading borrowing repayment.**

ECONOMIC CONDITIONS

As a result of more favourable economic conditions, the Quebec government forecasts real GDP growth of 2.5% in calendar year 2018 and a 1.8% expansion next year. Both represent material improvements versus *Budget*, which projected respective advances of 2.1% and 1.7% (chart 2, p.2); outer-year forecasts remain in line with *Budget* estimates. A stronger profile for business investment was attributed to relief from trade-related uncertainty via the USMCA signing as well as capacity constraints. Additional support for growth is expected to come from solid, albeit easing household consumption and the external sector, buoyed by new trade agreements and robust Canadian and US expansions. Home sales activity and residential construction remain healthy in Quebec despite weakness in much of the rest of the country.

The *Update* also identified several risks to the economic outlook. These included escalating trade tensions between major world economies, oil price volatility, uncertainty related to Brexit negotiations, a pronounced Canadian real estate sector slowdown and US steel and aluminum tariffs.

NEW POLICY MEASURES

Following election promises aiming to improve affordability, the Province announced three key measures. In January 2019, the maximum payment allotted under Quebec's family allowance system will increase by $500 for second and third children, for total assistance of up to $1,000 for families with two or more kids. The additional contribution for subsidized childcare will be frozen at the 2018 rate. A new senior assistance amount offers up to $200 per senior or $400 per senior couple in 2018, with benefit amounts indexed as of 2019, and a review of current tax measures for seniors forthcoming. The Government expects the three measures to benefit 423,000 families, over 140,000 families with young children, and more than 570,000 seniors, respectively.

CONTACTS

Marc Desormeaux, Provincial Economist
416.866.4733
Scotiabank Economics
marc.desormeaux@scotiabank.com

Updated Fiscal Forecast
$ millions except where noted

	FY18	FY19	FY20
	Final	Revised	Forecast
Personal Income Tax	29,528	31,196	32,502
Corporate Taxes	8,142	8,521	8,099
Consumption Taxes	20,329	21,040	21,792
Government Enterprises	5,093	4,640	4,565
Other Own-Source Revenue	22,827	23,074	22,790
Total Own-Source Revenue	**85,919**	**88,471**	**89,748**
Federal Transfers	22,485	23,999	25,215
Total Revenue	**108,404**	**112,470**	**114,963**
Health & Social Services	40,176	42,094	43,857
Education & Culture	22,780	23,788	24,603
Economy & Environment	14,459	14,974	15,927
Support for Individuals & Families	9,816	10,225	10,602
Administration & Justice	7,018	7,756	8,154
Total Program Spending	**94,249**	**98,837**	**103,143**
Debt Service	7,468	7,773	8,134
Total Expenditure	**103,489**	**107,969**	**112,364**
Contingency Reserve	—	—	100
Balance Before Transfers	**4,915**	**4,501**	**2,499**
Deposit to Generations Fund	2,293	2,851	2,499
Balance:*Balanced Budget Act*	**2,622**	**1,650**	**—**
Memo Items, %			
Own-Source Revenue / GDP	20.7	20.5	19.9
Program Spending / GDP	22.7	22.9	22.9
Total Expenditure / GDP	24.9	25.0	25.0
Budget Balance / GDP	0.6	0.4	0.0
Debt Service / Revenues	6.9	6.9	7.1
Annual Change, %			
Personal Income Tax	*1.0*	*5.6*	*4.2*
Corporate Taxes	*8.9*	*4.7*	*-5.0*
Consumption Taxes	*5.4*	*3.5*	*3.6*
Government Enterprises	*4.0*	*-8.9*	*-1.6*
Total Own-Source Revenue	***3.6***	***3.0***	***1.4***
Federal Transfers	*11.4*	*6.7*	*5.1*
Total Revenue	***5.2***	***3.8***	***2.2***
Health	*3.7*	*4.8*	*4.2*
Education & Culture	*4.4*	*4.4*	*3.4*
Economy & Environment	*17.0*	*3.6*	*6.4*
Support for Individuals & Families	*2.4*	*4.2*	*3.7*
Administration & Justice	*4.9*	*10.5*	*5.1*
Total Program Spending	*5.7*	*4.9*	*4.4*
Total Expenditure	***4.8***	***4.3***	***4.1***

Sources: Finances Québec; Statistics Canada; nominal GDP forecasts: Scotiabank Economics.

[1] Figures reported in Canadian dollars unless otherwise stated.

Tax changes that mirror recent Federal policy will also be enacted to foster a more competitive business environment and encourage new investment. Full depreciation expensing will apply to eligible computer hardware, manufacturing and processing equipment, clean energy generation equipment and intellectual property outlays until 2024. A new permanent additional capital cost allowance of 30% will also be introduced for such investments, with a further enhanced capital cost allowance for all other types of capital expenditure. The Province anticipates that 90,000 businesses will benefit from these changes annually.

Business taxation measures will be complemented by an extension and expansion of electricity rebate programs. Application deadlines for existing electricity discount programs for select consumers and greenhouse development, which the Government cites as drivers of past investment projects, will be extended one year to December 31, 2019. The Province also intends to establish new discounts for large firms served by Hydro-Québec's off-grid systems.

The Province also committed to fighting climate change and tax evasion. For the former, the new administration indicated its intent to fund rebate programs encouraging the purchase of new electric vehicles and support efforts by businesses to lower their GHG emissions. This builds on the existing Quebec cap-and-trade system. The Government cited continued implementation of the previously announced *Tax Fairness Action Plan* as a means to tackle less-than-above board tax planning practices.

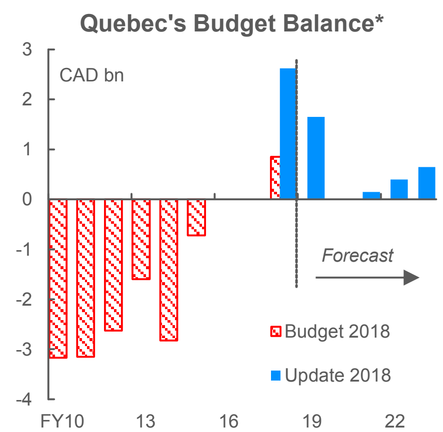
FISCAL PROJECTIONS

New measures announced in the *Update* are expected to come with a hefty price tag of $3.3 bn during FY19–23. Foregone revenues via affordability-related policies ramp up steadily over that period to reduce the Government's bottom line by a combined $1.7 bn over the five years. Nearly two-thirds of the hit is attributable to family allowance expansion. Business taxation changes are forecast to eat up nearly $1.6 bn in Government receipts through FY23. The most significant costs are slated for FY20, when accelerated depreciation is expected to lower revenues by $443 mn.

The good news is that the *Update* reveals new fiscal room. Revisions to revenue forecasting methodology and accounting of expenditures outlined in the August *Pre-Election Report on the State of Québec's Public Finances* improve the balance relative to *Budget* by $950 mn per year over FY19–21. Nearly $1.8 bn is added to the final FY18 balance as well. Additional income tax receipts stemming from stronger-than-anticipated economic growth trajectory pad government coffers by $1.5 bn in FY19 and $1.6 bn in both FY20 and FY21. Higher carbon market auction, government business enterprise and Generations Fund investment income plus transfer adjustments related to phase 2 of the federal infrastructure plan are expected to further buoy revenues during that time. With weaker forecast interest costs, these gains far outweigh upward revisions to program expenditures totaling $1.4 bn over FY20–21.

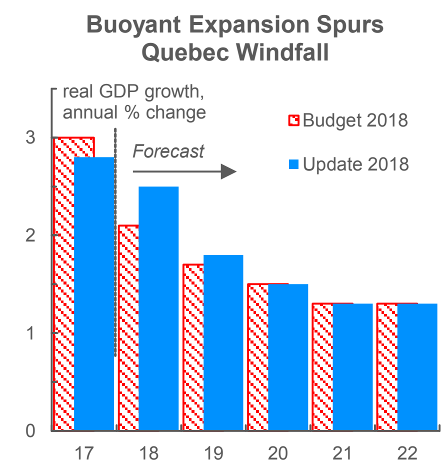
In light of the improved financial situation, stabilization reserve withdrawals planned for FY19–21 by the previous administration are being cancelled. This erodes the revenue gains above by $3 bn over the next three fiscal years, but relative to *Budget* still leaves funding of $1.9 bn in FY19, $806 mn in FY20 and $879 mn FY21 for new initiatives (table, p.3). The Government intends to introduce a new framework for stabilization reserve allocations in the 2019 Budget.

Chart 1



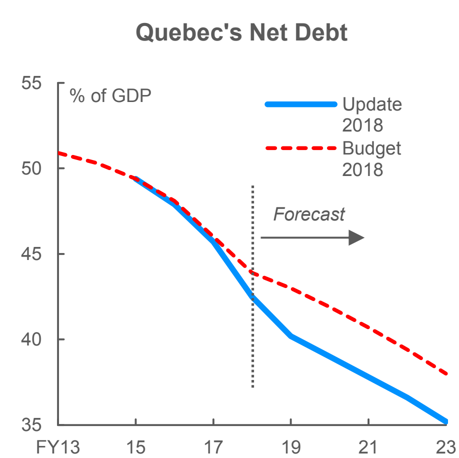
*Under the *Balanced Budget Act*. Source: Finances Québec.

Chart 2



Source: Finances Québec.

Chart 3



Source: Finances Québec.

With respect to the *Quebec Infrastructure Plan* (QIP), funding of $100.4 bn is allocated to 2019–29. This is equal to the level of capital expenditures scheduled for 2018–28 in the previous QIP. The Province intends to improve the implementation rate for QIP outlays, which was 76.8% in 2016–17, for more impactful public investment.

DEBT AND BORROWING

Quebec is also using its fiscal windfall to accelerate debt repayment. The new administration will front-load $8 bn in Generations Fund reserves to repay borrowings in FY19, rather than the previous government's plan to apportion $10 bn evenly over the next five fiscal years. The move is forecast to create interest savings exceeding $300 mn from FY19 to FY23 and allow for an additional $1.4 bn to fund public services. It is also expected to help Quebec achieve its objective of reducing gross debt to 45% of GDP in FY21—two years ahead of the March plan—and contribute to a weaker net debt profile than outlined in *Budget* (chart 3, p.2).

With repayment of mature borrowings stepped up, the Province's financing program is estimated to come in at $12.3 bn in FY19, $1.1 bn lower than projected in *Budget*. Financing of $13.2 bn is anticipated in FY20—in line with the March forecast—before averaging $20.4 bn per annum during the three ensuing fiscal years—$1.7 bn higher than in the previous plan. Some $416 mn of pre-financing had been completed as of November 21st, 2018. To date in FY19, 21.4% of Quebec's borrowings have been contracted in foreign currency—in line with the annual average during the last decade.

OUR TAKE

We support the new policy initiatives and fiscal planning direction. Quebec's productivity has long lagged that of both Ontario and of Canada as a whole and targeted measures to boost it are encouraging. Pocketbook relief is also constructive with Quebec's wages continuing to lag those in Ontario, Alberta and BC and recent real estate activity putting upward pressure on home prices. Accelerating the debt repayment schedule is also prudent and may help the Province make the case for further credit rating upgrades in the future. Broadly speaking, we view the measures announced in the *Update* as highly appropriate uses of Quebec's fiscal surplus.

Perhaps our greatest concern going forward is how Quebec will proceed with respect to immigration. A reduction in newcomer admissions from current levels was a signature election promise, and would be counterproductive to economic growth or financial sustainability. The Province's job vacancy rate has hovered near record highs in recent months and skills shortages increasingly threatens to also limit businesses' ability to hire and expand, especially as the population ages and with Quebec's net population outflow to other provinces widening. The Government has been more circumspect of late and we continue to monitor the situation.

Net Fiscal Impacts of Developments Since Budget 2018
$ millions except where noted

	FY18	FY19	FY20	FY21
Budgetary Balance*—March 2018 Budget	850	—	—	—
Improvements presented in the pre-election report	1,453	950	950	950
Improvements since the publication of the pre-election report	319	2,516	792	408
Elimination of the use of the stabilization reserve	—	-1,587	-936	-479
Total	**1,772**	**1,879**	**806**	**879**
December 2018 policy initiatives	—	-229	-806	-729
Budgetary Balance*—December 2018 Update	**2,622**	**1,650**	**—**	**150**

*Under the *Balanced Budget Act*. Source: Finances Québec.