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GLOBAL ECONOMICS

FISCAL PULSE

November 7, 2023

Quebec: 2023–24 Mid-Year Update

BALANCING ACT 2.0: PATH TO BALANCE INTACT AS NEW SPENDING ERODES FINANCIAL BUFFER

- **Budget balance projections: -$4.0 bn (-0.7% of nominal GDP) in FY24, -$3.0 bn (-0.5%) in FY25 (all figures after deposits into Generations Fund)—in line with Budget 2023 projections; deficit projected to be gradually eliminated at a rate of $1 bn per year until the return to balance targeted for FY28 (chart 1).**
- **Net debt forecasts: expected to decline gradually from 38% of nominal output in FY23 to 35.9% by FY28—a hair above the path outlined in Budget 2023 (chart 2).**
- **Economic forecasts: real GDP forecast unchanged at 0.6% for 2023 but reduced from 1.4% to 0.7% for 2024; nominal GDP projection raised to 4.0% for 2023 and nudged down to 3.4% for 2024.**
- **New policy measures: $1.6 bn in FY24, $2.2 mn in FY25, and $3.1 bn in FY26—combined $13 bn over FY24–28 (averaging 0.4% of projected nominal GDP per year over the forecast horizon), two-thirds of which is the indexation of the personal income tax system and social assistance benefits. Other key measures target housing, climate transition and business investment.**
- **Downward adjustments in the contingency reserve by $1 bn per year offset costs of new policy actions, keeping the projected consolidation path intact.**
- **Financing program: estimated at $21.9 bn in FY24—$7.6 bn lower than March 2023 forecast; medium-term borrowing projection remains stable at $29.0 bn in FY25 and $28.7 bn in FY26.**
- **We are encouraged by the government's continued commitment to achieve a balanced book by FY28 but note with caution downside risks from an optimistic growth forecast and the reduction of financial buffer. The indexation of the personal income tax system—another major reform in Quebec's tax system commeasurable with the tax cut delivered in Budget 2023—provides welcomed support to the lower end of the income spectrum but the timing could add immediate inflationary pressures. Other policy measures appear relatively contained and position the province for sustained competitiveness in the future.**

OUR TAKE

Quebec presented its FY24 mid-year amid a year marked by a more pronounced economic slowdown than the national average, persistent inflation, and an outlook clouded by heightened uncertainty. The province found itself in a weaker fiscal position than previously anticipated, with the FY23 deficit, previously projected at -$5.0 bn, rising to -$6.1 bn (before use of the stabilization reserve) based on a weaker revenue outlook and lifted program spending. However, the consolidation path remains similar to the one outlined in Budget 2023, with new policy actions funded by a yearly drawdown of $1 bn from the contingency reserve over the planning horizon. Before Generations Fund deposits, Quebec still expects to balance in FY26.

The updated economic projections are largely in line with private-sector averages in real terms but slightly more optimistic than our current view, leaving the potential for downside risks. Nominal GDP assumptions underpinning the updated fiscal plan are above both the private-sector averages and our projections through 2023 and 2024. Every 1 ppt in nominal GDP growth is linked with $1 bn in own-source revenues—on this basis, the nominal output growth forecast of 4.0% this year—0.9 ppts above the private-sector average—could be expected to subtract -$0.9 bn (0.2% of nominal output) from the

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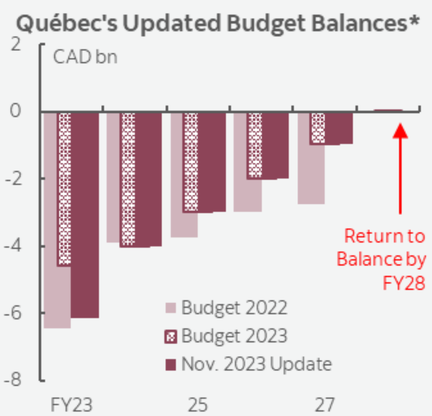
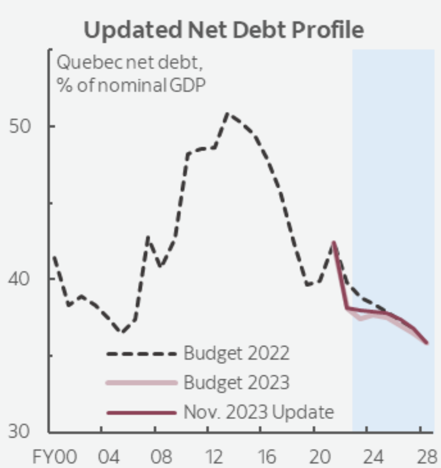
Chart 1



* After deposits into Generations Fund, before use of Stabilization Reserve.
Sources: Scotiabank Economics, Finances Québec.

Chart 2



Sources: Scotiabank Economics, Finance Canada, Finances Québec.

bottom line. The update presented an alternative scenario that forecasts a recession in 2024 with Quebec's economy contracting by -0.8%. The potential fiscal impact of the alternative scenario is estimated at -$127 mn in FY24, -$1.7 bn in FY25, and -$0.8 bn in FY26.

Before accounting for new policy actions, fiscal impact from changes in the economic and budgetary situation since Budget 2023 is minimal. Revenue projection remains largely intact but the composition has changed. The province expects tax revenue to be close to $1 bn lower in the next three years, offset by higher federal transfers and higher miscellaneous revenue from health and education services. Portfolio spending projections were revised higher by around $800 mn per year over FY24–FY26 due to the higher cost of refundable tax credits, combined with higher-than-anticipated activities in health and education expenditures. Debt-service costs saw a $401 mn (4%) uptick in FY24, adding to near-term spending pressure. To sum up, the fiscal impact on the province's bottom line from changes in the economic and budgetary situation is estimated at $104 mn in FY24, -$747 mn in FY25 and $94 mn in FY26.

The government is pledging several new policy initiatives, totalling $12.9 bn (0.4% of nominal GDP), with $1.6 bn added to this fiscal year and $2–3 bn per year over FY25–FY28. New policy initiatives target cost of living, housing, homelessness, adaptation to climate change and business investment. The lion's share of the new measures is the $2 bn per year in indexation of the personal income tax system and social assistance benefits. The modernization of the tax system provides more relief to low- and medium-income households—known to be the most impacted by price inflation—but could also add some tailwind to inflation. Other targeted actions are dominated by the $1.8 bn housing investment over five years, aiming to build 8,000 social and affordable housing units in the province. The update also dedicates $649 mn in FY24 in response to the forest fires and to support climate change adaptation, as well as public transit. To boost business investment, the province is renewing the investment and innovation tax credit (C3i), with gradually escalating costs reaching $590 mn by FY28. Other than the tax changes, policy actions look appropriately targeted but unlikely to generate a significant boost to near-term economic growth.

The annual drawdown of $1 bn from the contingency reserve enables the province to keep its consolidation path, albeit at the cost of diminishing its capacity to buffer against downside risks. The updated plan retains a $500 mn contingency reserve in FY24, leaving no provision over FY25–FY26. Hence, we could anticipate further downward revisions to the medium-term bottom line, particularly in light of heightened uncertainties surrounding the economic and inflation outlook.

Changes to Quebec's Fiscal Outlook
$ billions except where noted

	FY24	FY25	FY26
Budget 2023 Balance Projection*	**-4.0**	**-3.0**	**-2.0**
Tax revenue	-0.7	-1.0	-1.2
Other own-source revenue	1.1	1.2	1.3
Government enterprises	-0.8	-0.2	0.0
Federal transfers	1.8	0.1	0.6
Subtotal – Revenue	**1.3**	**0.1**	**0.7**
Subtotal – Expenditure	**-1.3**	**-0.9**	**-0.7**
Deposits of dedicated revenues in the Generations Fund	0.1	0.1	0.1
Updated Balance	**-3.9**	**-3.7**	**-1.9**
Providing better access to housing	-0.2	0.0	-0.9
Combatting homelessness and enhancing food aid	0.0	0.0	0.0
Supporting training in specific fields	-0.2	-0.1	—
Sustaining the climate transition and communities	-0.6	-0.1	-0.1
Fostering business investment	0.0	0.0	-0.1
New Policy	**-1.1**	**-0.3**	**-1.1**
Contingency reserve	1.0	1.0	1.0
Provincial Balance*	**-4.0**	**-3.0**	**-2.0**
% of GDP	*-0.7*	*-0.5*	*-0.3*

* After Generations Fund deposits, before Stabilization Reserve use.

Sources: Scotiabank Economics, Finances Québec.

Long-Run Fiscal Forecast
$ billions except where noted

	FY23	FY24	FY25	FY26	FY27	FY28
Total Revenue	144.3	149.1	152.0	157.7	164.4	168.2
% change		*3.3*	*2.0*	*3.8*	*4.2*	*2.3*
Total Expenditure	147.4	150.3	152.6	157.3	162.2	164.9
% change		*2.0*	*1.6*	*3.0*	*3.2*	*1.7*
Net	-3.1	-1.3	-0.7	0.5	2.2	3.3
Reserve	—	0.5	—	—	0.5	0.5
Surplus/Deficit	-3.1	-1.8	-0.7	0.5	1.7	2.8
Generations Fund Deposits	3.1	2.2	2.3	2.4	2.7	2.8
Balance Before Stabilization Reserve	**-6.1**	**-4.0**	**-3.0**	**-2.0**	**-1.0**	**0.0**
Stabilization Reserve Withdrawal	0.4	—	—	—	—	—
Provincial Balance	**-5.7**	**-4.0**	**-3.0**	**-2.0**	**-1.0**	**0.0**

Sources: Scotiabank Economics, Finances Québec.

In line with the largely unchanged deficit profile, the province's net debt-to-GDP ratio remains on a similar downward path as the one outlined in Budget 2023. Quebec's debt as a share of output came in higher in FY23 at 38% instead of the 37.4% anticipated at budget time, and is expected to remain largely flat till FY25 before gradually declining to 35.9% in FY28. A recession could lead to a temporary uptick in the province's net debt-to-GDP ratio in FY25 at 38.7%—0.9 ppts higher than in the baseline scenario. The government has a long-term debt reduction strategy, which aims to reduce net debt to 30% of nominal output by FY38 (with a ±2.5% interval) and a median-term target of 33% of GDP by FY33.

The province's financing program scaled back by $7.6 bn for FY24 with outer years projections largely stable relative to Budget 2023. The province now expects to borrow $21.9 bn in FY24, $29.0 bn in FY25, $28.7 bn in FY26, $25.3 bn in FY27, and $21.9 bn in FY28. The $7.6 bn reduction in FY24 financing needs is the combination of lower net financial requirements ($4.1 bn), the use of pre-financing ($2.2 bn), and an increase in the amount of Quebec Treasury bills outstanding ($2 bn). Among the $18.6 bn borrowing completed to date in FY24, 39% of borrowing had been conducted on foreign markets—higher than the 27% average in the prior 10 years. The province also issued a $600 mn green bond this fiscal year under its Green Bond program, for a total of nine issues totalling $5.7 bn since the program was launched.