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GLOBAL ECONOMICS

FISCAL PULSE

March 21, 2023

Contributors

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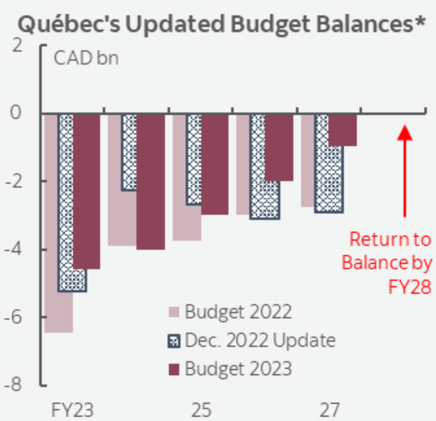
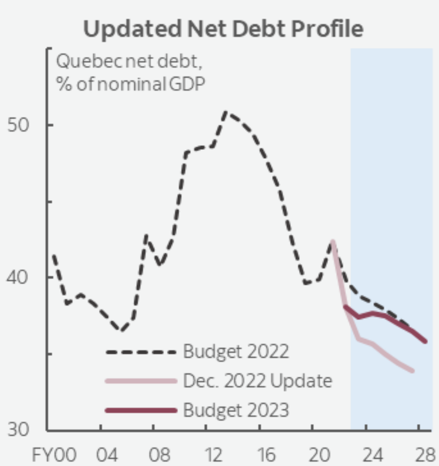
Chart 1



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

Chart 2



Sources: Scotiabank Economics, Finance Canada, Finances Québec.

Quebec: 2023–24 Budget

A BALANCING ACT

- **Budget balances: -$4.6 bn (-0.8% of nominal GDP) in FY23, -$4.0 bn (-0.7%) in FY24, -$3.0 bn (-0.5%) in FY25—a slight improvement in FY23, but FY24 and FY25 deficits are now deeper by $1.7 bn and $0.3 bn when compared to the December 2022 update (all figures after Generations Fund deposits); narrower deficits projected from FY26–27 and the return to balance targeted for FY28 (chart 1).**

- **Net debt: raised to 37.4% of nominal output for FY23—up by two percentage points from the December 2022 update—and is expected to reach 37.7% in FY24 before declining gradually to 35.8% by FY28 (chart 2). Debt reduction target of 30% net debt-to-GDP delayed by five years from FY33 to FY38 due to reduced payments towards the Generations Fund.**

- **GDP expectations: 0.6% real growth and 2.7% nominal growth this calendar year—a hair below prior projections of 0.7% and 2.8%, respectively. The budget expects real and nominal growth to pick up again next year to 1.4% and 3.8%.**

- **New policy: $1.1 bn in FY23, $4.3 bn in FY24, $4.9 bn in FY25, combined $24.5 bn over FY23–28 accounts for 0.8% GDP per year—half of which is related to the one percentage-point income tax cut in the first two brackets, with the remainder dedicated to health system improvements and education.**

- **Infrastructure spending: increased by a combined $11.5 bn during FY22–32 versus the mid-year update, capital outlays under the Quebec Infrastructure Plan (QIP) now expected to jump by 13.8% in FY23, then remain elevated in FY24 and FY25.**

- **Financing program: expected to reach $24.2 bn in FY23, $29.5 bn in FY24, $28.6 bn in FY25, and average $25.6 bn during FY26–28; projected FY23–27 total is about $9.6 bn lower than forecast in the December 2022 update.**

- **Quebec's Budget 2023 strikes a balance between fiscal sustainability and strategic investments in key sectors of the province's economy while delivering on a major election platform. By reducing payments to the Generations Fund, the government has created more flexibility and taken important steps towards eliminating structural deficits, even though this approach impedes progress in reducing net debt burden. Despite the introduction of significant new policy measures, Quebec still enjoys a decent fiscal standing as a result of its debt reduction effort since the early 2010s, which keeps net debt as a share of output below pre-pandemic levels.**

OUR TAKE

Quebec's Budget 2023 features significant changes and outlined a more aggressive consolidation path over the medium term. The province plans to reduce revenues dedicated to the Generations Fund by an average of $2 bn per year between FY24 to FY27, stepping up near-term spending and gradually eliminating structural deficits by ensuring that expenditure growth remains within the bounds of revenue growth. Deeper near-term deficits and reduced payments to the Generations Fund offset the substantial improvement in net debt-to-GDP ratio anticipated in the December update, but the ratio remains well below pre-pandemic levels and is expected to trend lower through FY28.

While revenue projections are largely in line with previous projections, the near-term spending profile has been lifted further, building on the previous upgrade in the

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December update (chart 3). Revenue growth is expected to decelerate to 1.8% in FY24 due to weaker economic growth, slightly offset by an uptick in health transfers, before recovering to an average annual pace of 3.2% through FY28. Program spending has been lifted in FY23 and FY24 and is projected to grow by 7.4% in FY23 and 1.2% in FY24. New expenditures focus on healthcare, education and the environment, which are expected to see respective growth of 7.7%, 6.4% and 10.7% over FY23 to FY25.

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

	FY23	FY24	FY25
December 2022 Balance Projection*	-5.2	-2.3	-2.7
Changes to Economic & Fiscal Outlook	0.4	0.5	-0.7
Deposits of dedicated revenues in the Generations Fund	-0.1	1.6	2.2
Updated Balance	-5.0	-0.2	-1.2
Growing Québec's wealth	-0.5	-2.1	-2.3
Developing the potential of youth	–0	-0.3	-0.5
Making the health care system more effective & humane	—	-1.0	-1.1
Supporting Quebecers	-0.5	-0.7	-0.8
Diversifying and consolidating environmental measures	0.0	-0.1	-0.2
New Policy	-1.1	-4.3	-4.9
New Contingencies	1	0.5	1.0
Provincial Balance*	**-5.0**	**-4.0**	**-5.1**
% of GDP	*-0.9*	*-0.7*	*-0.9*

* After Generations Fund deposits, before Stabilization Reserve use.

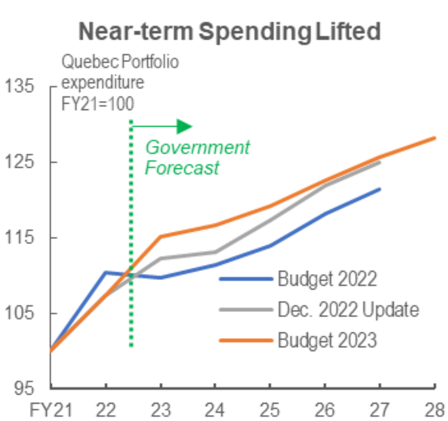
Sources: Scotiabank Economics, Finances Québec.

New policy initiatives amount to $24.5 bn over six years—or about 0.8% of GDP per year, evenly split over FY24–28. Big-ticket items in the Budget include an income tax cut of one percentage point in the first two income brackets at a cost of $1.7 bn per year, funded by reduced payments towards the Generations Fund—delaying the province's debt reduction target by five years from FY33 to FY38. The tax cut provides some relief to lower-income households, but may have limited impact on stimulating long-term economic growth since higher-income earners tend to save more. The timing of the tax cut amid elevated inflation could undermine the Bank of Canada's counter-inflation effort. The budget also dedicates $5.6 bn through FY28 to improve the healthcare system—higher than the $4.7 bn additional funding provided by the federal government over the same period. Increased outlays allocated to education and the tax holiday for large investment projects are also favourable for the province's long-term growth.

The forecasting assumptions underpinning the updated fiscal plan is largely unchanged from the December update, suggesting confidence in the economy's ability to weather the impact of aggressive monetary policy tightening. The projected real growth rate is 0.6% in 2023, with an expected increase to 1.4% in the following year. Nonetheless, the inclusion of alternative scenarios indicates a recognition of the heightened uncertainty and considerable downside risks. To ensure preparedness for further deterioration in the economic situation, the current planning also includes a contingency reserve of $1.5 bn in FY24 and $1 bn each year in FY25 and FY26.

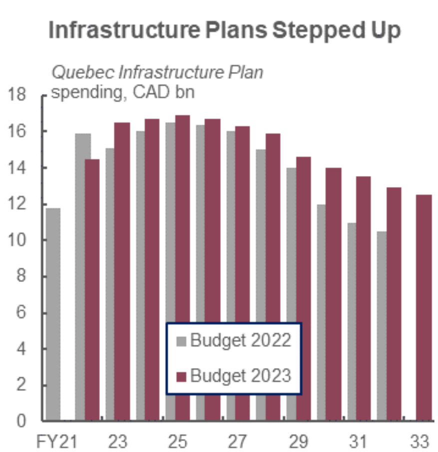
In line with the province's significant public infrastructure needs, the Quebec Infrastructure Plan has been boosted by an additional $11.5 bn over FY22–32 versus the mid-year update, averaging $15 bn over the following 10 years (chart 4). Robust capital investment are expected to take place in various sectors, including $24.2 bn for health and social services, $30.0 bn for education and higher education, $15.4 bn for public transit and $31.5 bn for the road network.

Chart 3



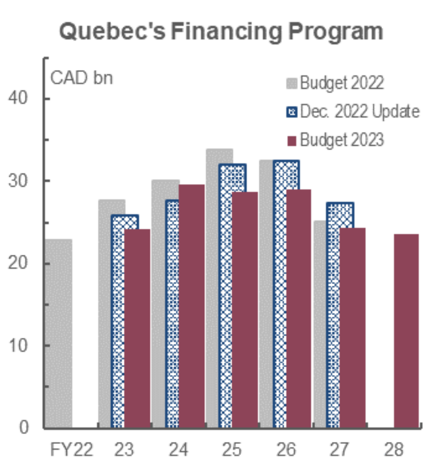
Sources: Scotiabank Economics, Finance Canada, Finances Québec.

Chart 4



Sources: Scotiabank Economics, Finances Québec.

Chart 5



Sources: Scotiabank Economics, Finances Québec.

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Quebec's Budget 2023 revised its debt reduction strategy in response to changing economic conditions and the province's investment needs. The government aims to reduce net debt to a range of 27.5% to 32.5% of nominal output by FY38, with a median target of 30%. Quebec's transfer payments to the Generations Fund for debt reduction have been scaled back, and the province will draw $2.5 bn from the fund in FY24 and FY25 to pay down debt. Despite this, Quebec's financing program will still increase to around $29 bn over FY24 to FY26 (chart 5).

In the short-term, exogenous market sentiment is driving broad-based movements in Canadian provincial bond markets. The recent turmoil in the global banking system and subsequent deterioration of bond market liquidity have triggered a widening in provincial spreads against the backdrop of mounting recession fear but remain far tighter than crisis periods. As policymakers offer liquidity supports—combined with the central banks' ongoing efforts to combat inflation—global factors will dominate market risk appetite, but over the long run, the consolidation efforts outlined in this budget should keep Quebec on a sustainable fiscal path. Quebec should continue to benefit from a deeper market, a long-dated debt structure, and implicit federal backing with its debt remaining attractive to investors.

Long-Run Fiscal Forecast
$ billions except where noted

	FY23	FY24	FY25	FY26	FY27	FY28
Total Revenue	145.1	147.7	151.8	157.0	162.9	167.6
Total Expenditure	146.8	147.9	151.4	155.4	159.7	163.2
Net	-1.7	-0.1	0.4	1.5	3.2	4.3
Reserve	—	1.5	1.0	1.0	1.5	1.5
Surplus/Deficit	-1.7	-1.6	-0.6	0.5	1.7	2.8
Generations Fund Deposits	3.4	2.4	2.4	2.5	2.7	2.8
Balance Before Stabilization Reserve	**-5.0**	**-4.0**	**-3.0**	**-2.0**	**-1.0**	**0.0**
Stabilization Reserve Withdrawal	0	—	—	—	—	—
Provincial Balance	**-4.6**	**-4.0**	**-3.0**	**-2.0**	**-1.0**	**0.0**

Sources: Scotiabank Economics, Finances Québec.