QUEBEC BUDGET 2013-2014

November 20, 2012

Robert Hogue
Senior Economist
(416) 974-6192
robert.hogue@rbc.com

New government, same priority: balanced budget

The political circumstances were such that, instead of providing the usual mid-year update on the economy and fiscal situation, new Quebec Finance Minister Nicolas Marceau today opted to present a full-blown budget: Budget 2013-2014. The September 4 provincial elections, that saw the Parti Québécois win a minority government after nine years of Liberal party ruling, gave Minister Marceau an opportunity to signal a shift in priority in the province. While there were some changes to a number of policies, the key priority of balancing the budget in 2013-2014 was maintained. The new government remains fully committed to achieving zero deficit next fiscal year. Furthermore, it remains fully committed to eliminating this year's official projected $1.5 billion shortfall primarily through ambitious spending restraint.

The task ahead became harder this year because the Quebec economy has been unwilling to cooperate. Growth in the provincial economy has been notably slower so far this year than projected in the March 2012 budget. The government is, consequently, revising its 2012 real GDP forecast lower (to 0.9% from 1.5% in March), as well as its forecasts for the next two years (to 1.5% in 2013 from 1.9% previously, and to 2.0% in 2014 from 2.1%). There were roughly similarly-sized downward revisions to nominal GDP forecasts. Such weaker expected economic underpinnings to the budget projections undermined the revenue outlook to the tune of nearly $200 million in 2012-2013, more than $600 million in 2013-2014 and almost $290 million in 2014-2015.

Nonetheless, the Quebec government will compensate these pressures by introducing both additional revenue measures (including higher taxes on tobacco, alcoholic beverages and financial institutions) and expenditure measures (including greater program spending restraints and higher efficiency gains from government corporations).

Relative to the 2013-2014 projections in the March budget, consolidated revenues in 2013-2014 are revised lower by 0.2% but consolidated program revenues are revised marginally higher by 0.1%. Balance is maintained in 2013-2014 thanks to a 2.6% downward revision to debt service costs (presumably resulting from lower projected interest rates).

Relative to the 2012-2013 projections updated today, consolidated revenues are projected to rise by 5.0% to $72.4 billion in 2013-2014 and consolidated program spending by 1.8% to $63.8 billion. Total spending is projected to increase by 2.6% (to $72.4 billion) due to a significant 7.7% jump in debt service costs (to $8.6 billion). The 1.8% rise in consolidated program spending will follow a similarly restraining 1.9% increase in 2012-2013 and will be less than half the 3.9% average in the past 10 years.

Longer term projections maintain a zero deficit in the province through fiscal year 2017-2018.

With respect to other policies, the change with the biggest fiscal impact will be the closure of the Gentilly-2 nuclear power plant, costing $1.8 billion in 2012-2013. Interestingly, this fiscal hit is excluded from the official accounting of the provincial government's bottom line on the basis that this loss is extraordinary. This exclusion will require a change in the current legislation, however. Including the $1.8 billion loss into the regular accounting framework would more than double the deficit projected in 2012-2013 to $3.3 billion. This would be the largest deficit since 1995-1996 (the earlier estimated $3.3 billion deficit for 2011-2012 was revised to $2.6 billion with today's concurrent publication of the provincial accounts for that year).

Along with the closure of the Gentilly-2 nuclear power plant, the majority of the new measures introduced today that were not in the March budget had been announced previously in the weeks following the swearing in of the new government. For instance, this budget replaces the flat $200 per taxpayer health tax with a "progressive" version of the tax as of 2013 (which will now rise to $1000 for individuals with income greater than $150,000). As well, this budget creates a new top tax bracket at a rate of 25.75% for taxable income exceeding $100,000 (representing an increase of 1.75 percentage points). The Quebec government cancels the 1 ¢/KWh electricity rate increase over a five year period that was scheduled to begin in 2014. Instead, the budget proposes to index electricity rates to inflation. And, the university tuition hike announced by the previous government – and which led to massive student protests earlier this year – is cancelled.

In terms of new measures in this budget, Minister Marceau announced today the creation of the Banque de développement économique du Québec, which will be endowed with an annual budget of $500 million to "help Quebec businesses obtain flexible financial and technical support tailored to their needs". It also announced a tax holiday for investments, applying on projects of $300 million or more in targeted ("strategic") industrial sectors (manufacturing, valued-added distribution centres, and data processing and hosting). This measure will provide a 10-year holiday from corporate income tax and contributions to the Health Services Fund. The government also extended the tax credit for investments for two years until the end of 2017, even raising the rate of credit by 5 percentage points in certain "resource" regions.

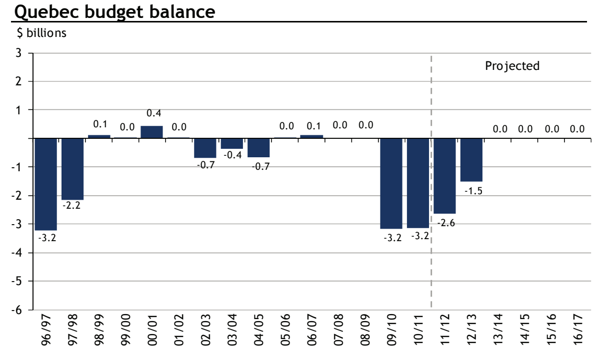
Other measures of note included an increase in the research and development tax credit for large biopharmaceutical companies from 17.5% to 27.5% and the funding 28,000 new $7/day daycare spots,

Perhaps as noteworthy were the measures proposed during the election campaign that did not make it into Budget 2013-14. Chief among them was the absence of changes to mining royalties, with the Minister indicating that his government will "consult the industry and the stakeholders concerned". Also, the Generations Fund is not being abolished and, in fact, will see additional revenue sources in coming years (including all mining royalties and the revenues from the electricity price indexation), although the Fund will be drawn down by $1 billion in 2013-14 to reduce the provincial debt.

Sticking to generally prudent assumptions

The economic assumptions appear to be reasonably conservative. The government's real GDP forecasts for the province are slightly lower

Quebec budget balance



Source: Ministère des Finances du Québec, RBC Economics Research than our own (1.0% in 2012 and 1.7% in 2013). Prudence was also in evidence in the boosting of contingency reserves (from the previous $200 million to $400 million in 2013-2014, and from zero to $500 million in the subsequent years).

Cap on capital spending

The Quebec government today announced that it will limit its capital spending investments to an average of $9.5 billion per year over the next five years, representing a $1.5 billion per year reduction relative to the March infrastructure plan. On an annual basis, this will result in such spending declining from $12.5 billion in 2012-2013 to $10.5 billion in 2013-2014 and $10.1 billion in 2014-2015.

Still committed to long-term debt reduction targets

The new Quebec government remains committed to achieving the previous government's long-term debt reduction targets: gross debt to GDP ratio of 45% and debt representing accumulated deficits of 17% by 2026. Today's budget expects gross debt (debt contracted on financial markets and the net liability for the retirement plans and for employee future benefits of public and parapublic sector employees, minus the balance of the Generations Fund) to increase by nearly $10 billion at March 31, 2013, to $193 billion, pushing the debt-to-GDP ratio higher to 55.7% from 54.6% a year earlier. Gross debt-to-GDP ratio is expected to decline after this, reaching 49.8% by March 2018. The government projects the debt representing accumulated deficits (gross debt less financial and non-financial assets) to rise by $3.6 billion to $177.8 billion by March 31, 2013. As a ratio to GDP, this will represent 33.9%, which would be down marginally from 34.0% at March 31, 2012. This ratio is projected to continue declining slowly in the coming years, reaching 26.8% by March 2018. The profile of both measures of debt relative to GDP is slightly lower in the short term than it was in the March budget, although the profile of debt representing accumulated deficit is now a touch higher in the out years of the plan.

Financing requirements to decrease modestly next year

The budget documents indicated that, as of November 13, 2012, the government had contracted borrowings totalling $9.4 billion in 2012-2013 (entirely in the Canadian market) with $8.0 billion still to be carried out. For 2013-2014, the financing program is scheduled to decline modestly to $15.0 billion but increase again to $17.3 billion in 2014-2015.

Will this budget survive?

Overall, the 2013-2014 budget presented today by Minister Marceau was the usual balancing act of a minority government. We are heartened by the fact that, in it all, the priority of eliminating the deficit has prevailed and that this government remains committed to reduce the provincial debt. The real test for this budget will come in the next few weeks, however. All opposition parties have indicated that they will vote against it.

Quebec's consolidated fiscal plan

($ millions)	Actual		Forecast			Projections		
	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
Total revenues	62,650	65,515	68,897	72,360	74,472	76,832	79,378	81,760
Total expenditures	67,062	68,851	70,559	72,392	74,085	76,386	78,743	81,215
Program spending	59,978	61,503	62,642	63,791	65,350	67,434	69,594	71,806
Interest on public debt	7,084	7,348	7,917	8,601	8,735	8,952	9,149	9,409
Net results of consolidated entities	2,022	1,548	1,241	1,471	1,069	1,508	1,563	2,141
Contingency reserve			200	400	500	500	500	500
Measures to be identified					430	430	430	430
Surplus/(Deficit)	(2,390)	(1,788)	(621)	1,039	1,386	1,884	2,128	2,616
Payments to the Generations Fund	(760)	(840)	(879)	(1,039)	(1,386)	(1,884)	(2,128)	(2,616)
Budgetary balance for the purposes of the Balanced Budget Act	(3,150)	(2,628)	(1,500)	–	–	–	–	–
Extraordinary loss - Closure of Gentilly-2	–		(1,805)	–	–	–	–	–

Source: Ministère des Finances du Québec, RBC Economics Research