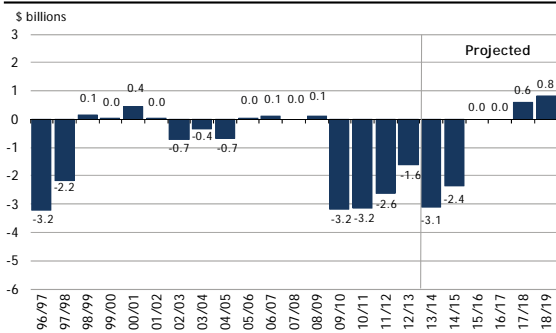


QUEBEC BUDGET 2014

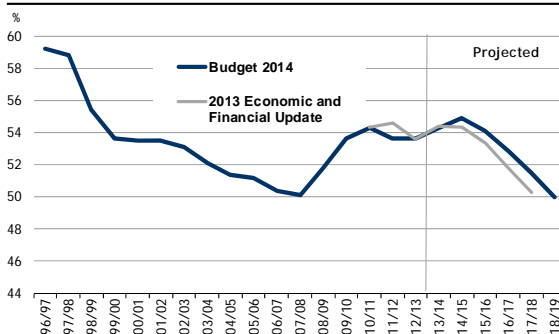
June 4, 2014

Quebec budget balance



Source : Ministère des Finances du Québec, RBC Economics Research

Gross Debt as % of GDP



Source : Ministère des Finances du Québec, RBC Economics Research

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A transition budget

Just six weeks into the job, new Quebec Finance Minister Carlos Leitao presented a 'transition' budget today that 1) gave an updated assessment of the Province's fiscal situation (grim) and 2) set the stage for a more comprehensive plan of attack on the deficit that likely will be spelled out in more details in the next budget.

Grim assessment

Minister Leitao offered a rather grim assessment of Quebec's fiscal situation with the deficit for 2013/14 now estimated to have ballooned to \$3.1 billion—from \$2.5 billion in the February budget and zero in the 2013 budget. If nothing was done to turn around the fiscal situation, Quebec would be headed for record-high deficits of \$5.9 billion in 2014/15 and \$7.6 billion in 2015/16. Yesterday, Quebec's interim auditor general largely corroborated this assessment saying that after scrutinizing the books that the Province was running \$4 billion off the track set out by the previous government for 2014/15.

Still committed to balancing the books by 2015/16...

Budget 2014 contains a series of measures—90% of which are on the expenditure side—designed to reverse the fiscal deterioration. Although Minister Leitao expects these measures to help his government lower the deficit relative to 2013/14, he nonetheless now projects a higher shortfall (\$2.4 billion) in 2014/15 than was projected by the previous government (\$1.75 billion). Despite the more sombre near-term fiscal picture being painted in Budget 2014, the new Quebec government remains committed to balancing the books by 2015/16.

...and reducing the debt over the longer term

The short-term deterioration in the budget balance necessarily has adverse repercussions for Quebec's elevated debt. Gross debt is now projected to be \$2 billion higher (to \$212 billion) by the end of 2015/16 than it was previously projected. As a share of GDP, gross debt now shows a higher medium-term profile starting in 2014/15, although it is still expected to peak that year (at 54.9%) and ease gradually thereafter. Minister Leitao and his government remain committed to lowering Quebec's debt to the long-standing targets of 45% for the gross debt-to-GDP ratio and 17% for the debt representing accumulated deficits-to-GDP ratio by 2025/26 (the latter ratio stood at 33.0% at March 2013 and is projected peak at 33.1% in 2015).

Deeper hole in 2013/14 posed serious challenges for 2014/15

The deeper than expected budget hole in 2013/14 no doubt posed the biggest challenge for the 2014/15 plan. Weaker than expected revenue growth (2.9% versus 3.3% in the November 2013 fiscal update) and, especially, stronger program expenditure growth (3.6% versus 2.5% in November) last year set

very poor baselines from which to build Budget 2014. The budget document stated that the lower revenue base from 2013/14 caused a \$916 million downward revision to 2014/15 revenues (with some offset coming from upwardly revised federal transfers to the tune of \$193 million). On the other side of the ledger, the government says that last year's higher expenditure base threatened to produce a \$2.6 billion expenditure over-run in 2014/15 relative to the previous target. Including downward revisions to the contribution of consolidated entities, Quebec was on path to miss the previous budget's deficit target of \$1.75 billion by \$4.2 billion this year.

New measures to bridge part of the gap

To bridge part of the gap that his government was facing, Minister Leitaó recently announced a series of measures focusing on restraining expenditure growth and these were supplemented by a few more today. In April, he asked all ministries to achieve a 2% productivity gain (based on wages) and reduced their operating budgets by 3%. He also cut subsidies back to various organizations. Today, he asked crown corporations and various government organizations and funds to generate \$438 million in savings in 2014/15 and \$172 million in 2015/16. In total, Budget 2014 expects more than \$2.7 billion in savings to come from ministries and government organizations. A public service hiring freeze and other spending measures will help save a further \$538 million this year. Reductions in tax credits and other 'fiscal spending' will generate \$254 million in 2014/15 (rising to \$1 billion in 2015/16). All included, expenditure measures are expected to save \$3.5 billion this year.

No generalized tax increases

On the revenue side, the main new initiative in today's budget is a stronger effort to fight tax evasion that is expected to generate \$111 million higher revenue this year. An increase in the cigarette tax (adding \$90 million) was also announced. In total, revenue measures are projected to bring in an extra \$291 million in 2014/15. There are no 'generalized' tax increases include in the budget.

A still incomplete plan for 2015/16

Budget 2014 also identifies about half the \$7.6 billion worth of savings measures that will be required to balance the budget by 2015/16. Once again, most of these identified measures will be on the expenditure side (\$3.4 billion) with the remainder coming from the revenue side (\$365 million). The Finance Minister expects that two commissions tasked to review government programs and Quebec's fiscal position will help identify a further \$3.3 billion and \$650 million worth of savings in expenditures and revenues, respectively, next year. A more complete plan detailing how the deficit will be eliminated thus awaits us next year.

Financing requirements to decrease next year

The government expects its financing program to total \$15.0 billion in 2014/15 (excluding \$5.6 billion in pre-financing made during 2013/14), \$17.9 billion in 2015/16 and \$18.9 billion in 2016/17. In 2013/14, the government estimates its financing program at \$19.6 billion, which includes the \$5.6 billion pre-financing.

Little room to manoeuvre

In the six weeks since he's been on the job Quebec's new Finance Minister put together the first steps of his government's plan to balance the budget. Last year's poor results underscore how vulnerable budget projections can become when the economy fails to cooperate and expense management loosens. Even though Budget 2014 rests on reasonable economic assumptions (the Ministry of Finance forecasts real GDP growth of 1.8% in 2014 and 2.0% in 2015, both close to our own 1.9% and 1.8% forecasts respectively), it should be noted that the budget removed the contingency reserve in both 2014/15 and 2015/16. This leaves less room to manoeuvre in the event of unexpected developments.

Quebec's consolidated fiscal plan

(\$ millions)	Actual		Forecast					
	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Total budgetary revenues	65,515	67,566	69,506	71,373	73,799	76,318	78,845	81,141
Total expenditures	68,851	70,013	72,961	74,287	74,818	76,544	78,476	80,463
Program spending	61,503	62,247	64,518	65,704	66,141	67,631	69,530	71,465
Interest on public debt	7,348	7,766	8,443	8,583	8,677	8,913	8,946	8,998
Net results of consolidated entities	1,548	1,808	1,476	1,865	1,952	2,230	2,771	2,998
Contingency reserve		-	-	-		400	400	400
Measures to be identified			-	-	650	650	650	650
Surplus/(Deficit)	(1,788)	(639)	(1,979)	(1,049)	1,583	2,254	3,390	3,926
Payments to the Generations Fund	(840)	(961)	(1,121)	(1,301)	(1,583)	(2,254)	(2,790)	(3,126)
Budgetary balance for the purposes of the Balanced Budget Act	(2,628)	(1,600)	(3,100)	(2,350)	0	0	600	800
Extraordinary loss - Closure of Gentilly-2	-	(1,876)	-	-	-	-	-	-

Source: Ministère des Finances du Québec, RBC Economics Research

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