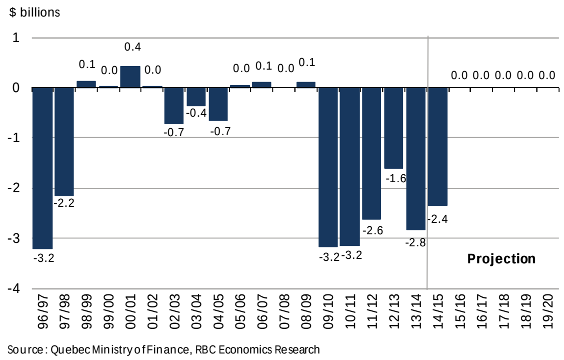
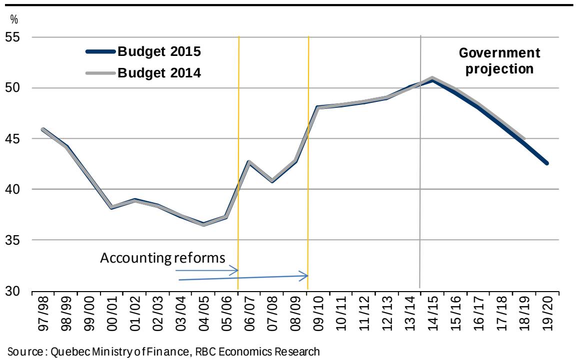
QUEBEC BUDGET 2015

March 26, 2015

Quebec budget balance



Net debt as % of GDP



Budget assumptions

	2014	2015	2016
Real GDP growth (%)			
Budget 2015	1.5	2.0	2.0
Private sector average*	1.6	2.0	2.0
RBC	1.5	2.0	1.9
Nominal GDP growth (%)			
Budget 2015	3.5	3.8	3.4
Private sector average*	3.4	3.5	3.8
RBC	3.5	4.3	3.4

* As of March 20, 2015

Source: Quebec Ministry of Finance, RBC Economics Research

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Balanced budget mission to be accomplished in FY15/16

Since the end of the post-recession fiscal stimulus period in 2010, Quebec finance ministers have been handed two key missions: 1) eliminate the budget deficit in the short to medium term and 2) substantially reduce the weight of the provincial debt over the longer term. Today, current Finance Minister Carlos Leitao announced that his government will accomplish the first mission. He presented a balanced budget for FY15/16—the first since FY08/09—while leaving the deficit for FY14/15 at $2.35 billion (unchanged from the projection in last year's June budget and the most recent Fall Financial Update published in December 2014).

'Right sizing' expenditures

As was pledged in last year's budget (June 2014 version), the government's efforts to eliminate the deficit primarily focus on the expenditure side. Last year, the government said that it faced a $7.3 billion budget shortfall in FY15/16 if nothing was done. In Budget 2014, it identified $3.6 billion worth of measures to bridge that gap, $3.1 billion of which coming from various departmental spending control initiatives. In the Fall Financial Update published in December 2014, the government announced a further $2.5 billion in expenditure savings—including $1.1 billion in public sector cost reductions and $738 million in program review measures. Today's budget identifies the remaining $1.2 billion and, again, nearly the entire amount ($1.0 billion) comes from savings in departments and budget-funded bodies. Altogether, the initiatives that have been identified by the government are expected to rein in program spending growth to its slowest rate (1.2%) in 17 years. Even healthcare (where spending is slated to grow by only 1.4%) and education (by even less, 0.2%) contribute to the slowing. On a consolidated basis, total expenditures are expected to grow by 1.5%, or substantially less than the 2.3% rate in FY14/15.

A little help from the economy

The government will get a little help from the economy on the revenue side. The budget expects real GDP growth to accelerate modestly from 1.5% in 2014 to 2.0% in both 2015 and 2016—in nominal terms GDP is forecasted to quicken from 3.5% to 3.8% in 2015 before easing to 3.4% in 2016, which we believe is a reasonable basis for the budget, if somewhat conservative for 2015. The government expects, as we do, that the sharp drop in oil prices will have net positive effects for the Quebec economy in 2015. With faster growth in the economy providing some tailwind, own-source revenues are projected to increase by a solid 4.4% (on a consolidated basis) in FY15/16, up from 3.5% in FY14/15. Measures announced in previous budgets as well as in the Fall Financial Update are estimated to contribute an extra $1.9 billion in revenues in FY15/16, thereby boosting total revenue growth by 0.5

percentage points. It is important to note that initiatives announced in Budget 2015 will add virtually nothing in terms of net new revenues in the coming year. Minister Leitao stressed that today's budget contains no tax increases.

Economic Plan

Budget 2015 still contained several announcements, which generally aimed at 1) solidifying the platform for the fiscal plan over the medium term and 2) promoting economic growth and efficiency. Minister Leitao presented an Economic Plan that includes a lower tax burden on individuals and businesses (e.g., gradual elimination of the health contribution, enhanced tax credit for experienced workers, reduction of the tax rate for small businesses in certain sectors), measures to stimulate investment (e.g., tax holiday for major investment projects, investments to accelerate the maritime infrastructure strategy), and initiatives to promote labour market performance and participation (e.g., increased spending on training, tax shield reducing disincentives to work for individuals receiving various tax benefits). That being said, the majority of new announcements in today's budget will be implemented in future years.

No deficits projected for the next five years!

Minister Leitao did not stop at balancing the books in FY15/16 and expects this to become the new norm. Today's plan shows zero deficits every year to FY19/20. For this, he will continue to focus on strict expenditure discipline, limiting annual program spending growth to an average of 2.6% per year during the latter four years of the plan (which represents practically no growth on an inflation-adjusted, per capita basis). Total medium-term (consolidated) expenditures are projected to grow even more slowly by 2.2% on average thanks in part to an anticipated decline in debt service. This is a slower rate than the 2.6% expected growth in total (consolidated) revenues.

Medium-term plan will be challenging

To be sure, delivering on the medium-term plan presented today will be no easy task. Among other things, Quebec's rapidly aging population is likely to exert pressures on both the revenue and expenditure sides in the coming years. Revenues will be challenged by generally slowing economic growth due to the decline of working age population in the province. An older population no doubt will intensify demands on the provincial healthcare system, which could possibly clash with the government's objective to strictly contain growth in program spending. In this context, the government no doubt will look further down the list of recommendations from the two commissions it created in the last budget (Quebec Taxation Review Committee and Program Review Committee)—and from which it drew in the Fall Financial Update and in Budget 2015 to find savings—for ways to reform the tax system, assess the effectiveness of government programs and find efficiencies in the public sector. Standing still is unlikely to be an option in the years ahead.

Next mission: reducing the debt load…

While eliminating the deficit is a significant achievement, the more important mission remains the reduction of the provincial debt's weight —most certainly a long-term endeavour. Quebec has among the highest levels of indebtedness of the provinces with a gross debt-to-GDP ratio of 54.3%, a net debt-to-GDP ratio of 50.0% and a debt representing the accumulated deficits-to-GDP ratio of 33.0% (as at March 31, 2014). The government's objective is to lower the first ratio to 45.0% and the third ratio to 17.0% by 2026 (there is no specific target for the net debt-to-GDP ratio). Thus, much progress needs to be made during this and future fiscal plans.

…and this budget shows that progress is on the way

In this fiscal plan, the Quebec government expects gross debt (defined as debt contracted on financial markets and the net liability for the retirement plans for employee future benefits of public and parapublic sector employees, minus the balance of the Generations Fund) to peak at 54.9% of GDP in 2015 and gradually decline to 49.5% by 2020. The peak is slightly lower than the 55.1% ratio previously projected for the same year. Similar improving patterns are expected for the net debt and debt representing accumulated deficits ratios, cresting at 50.7% and 33.2%, respectively, in 2015 and easing to 42.6% and 25.1% by 2020. This will reflect a significant break from rapid debt accumulation by the Province in the past several years. For instance, net debt is projected to decline by 0.5% in the next five years, thereby contrasting sharply with a surge of 26% in the past five years.

Lower anticipated financing program for FY15/16 due to pre-financing

The Province now expects its financing program for FY14/15 to reach $21.9 billion (up from $12.9 billion anticipated in Budget 2014), although this amount includes $9.0 billion in pre-financing. The financing program for FY15/16 is expected to be $12.2 billion, and the programs for the following two years are preliminarily set at $19.9 billion for FY16/17 and $16.3 billion for FY17/18.

Joining the Balanced Budget Club

The task of eliminating deficits is rarely easy and Quebec's ticket to join the Balanced Budget Club next fiscal year (which is likely to consist of only two members among the provinces, Quebec and British Columbia) was obtained by making difficult choices. Minister Leitao and his government are on their way to accomplish Mission 1—which is no small feat—and the same determination and resolve will need to be applied to ensure that Mission 2 (reducing the debt load) also meets a successful outcome in the coming years. Quebec still has a long way to go to restore fully its fiscal flexibility (hampered by the accumulation of debt over decades); however, it is encouraging to see that progress is being made.

Quebec's consolidated fiscal plan

($ millions)	Actual		Forecast					
	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
General Fund - total budgetary revenues	67,566	69,770	71,171	74,458	76,956	79,104	81,072	83,154
Own-source revenue	51,859	53,242	54,339	57,136	58,955	60,551	62,114	63,609
Federal transfers	15,707	16,528	16,832	17,322	18,001	18,553	18,958	19,545
General Fund - total budgetary expenditures	70,013	72,756	73,868	74,791	76,504	78,354	80,117	82,016
Program spending	62,247	64,322	65,704	66,460	67,889	69,788	71,722	73,722
Interest on public debt	7,766	8,434	8,164	8,331	8,615	8,566	8,395	8,294
Net results of consolidated entities	1,808	1,283	1,600	1,919	2,184	2,415	2,530	2,708
Contingency reserve	-	-	-		400	400	400	400
Measures to be identified		-	-					
Surplus/(Deficit)	(639)	(1,703)	(1,097)	1,586	2,236	2,765	3,085	3,446
Payments to the Generations Fund	(961)	(1,121)	(1,253)	(1,586)	(2,236)	(2,765)	(3,085)	(3,446)
Budgetary balance for the purposes of the Balanced Budget Act	**(1,600)**	**(2,824)**	**(2,350)**	**-**	**-**	**-**	**-**	**-**
Extraordinary loss - Closure of Gentilly-2	**(1,876)**	**-**	**-**	**-**	**-**	**-**	**-**	**-**

Source: Quebec Ministry of Finance, RBC Economics Research