Economics

PROVINCIAL BUDGET BRIEFS

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Québec budget 2023

The Province of Québec is now projecting a $1.7bn deficit on a public accounts basis for the outgoing fiscal year, which is $1.3bn slimmer than anticipated in Budget 2022 thanks to stronger revenues offsetting higher spending. For the coming fiscal year, the deficit is expected to remain largely unchanged at $1.6bn, with 1% reductions to the bottom two income tax brackets weighing on revenue growth, although the budget projection does include a $1.5bn contingency. On a Balanced Budget Act basis, which is after deposits to the Generations Fund, the province set out a path back to balance by fiscal 2027/28, as a suspension to the Act made during the pandemic was lifted. Borrowing requirements are expected to rise by more than $5bn, to $29.5bn in fiscal 2023/24, even after a $2.5bn drawdown from the Generations Fund, and hold relatively steady at that higher level for the following two years.

Table 1: Summary of fiscal position: (C$billions)

Fiscal measure	2021/22 Actual	2022/23 22 Budget	2022/23 23 Budget	2022/23 Change	2023/24 23 Budget	2024/25 23 Budget	2025/26 23 Budget	2026/27 23 Budget	2027/28 23 Budget
Revenue	138.8	138.5	145.1	6.6	147.7	151.8	157.0	162.9	167.6
Own-source	109.6	109.7	115.9	6.2	118.0	122.1	126.0	130.9	134.4
• % Change	19.4	3.6	5.7	2.1	1.8	3.4	3.3	3.8	2.7
Federal transfers	29.2	28.8	29.2	0.4	29.7	29.7	30.9	32.0	33.2
Expenditure	136.0	139.0	146.8	7.8	147.9	151.4	155.4	159.7	163.2
Portfolio expenditures	127.3	130.1	136.7	6.6	138.4	141.5	145.4	149.1	152.1
• % Change	6.9	4.9	7.4	2.5	1.2	2.2	2.8	2.5	2.0
Public debt interest	8.6	8.8	10.1	1.2	9.5	9.9	10.0	10.5	11.1
Contingency Reserve	0.0	2.5	0.0	-2.5	1.5	1.0	1.0	1.5	1.5
Budget balance (public accounts basis)	2.8	-3.0	-1.7	1.3	-1.6	-0.6	0.5	1.7	2.8
Generations fund deposit	-3.6	-3.4	-3.4	0.1	-2.4	-2.4	-2.5	-2.7	-2.8
Use of the Stabilization Reserve	0.8	-	0.4	0.4	-	-	-	-	-
Budget Balance per Balanced Budget Act	0.0	-6.5	-4.6	1.9	-4.0	-3.0	-2.0	-1.0	0.0

After outpacing Canada during the recovery, Québec is set to slow

After a particularly strong economic recovery in 2021, Québec saw real GDP growth advance a further 2.8% in 2022, a tad below the Canadian average and roughly in line with the prior year budget's forecast. With high inflation and rising interest rates, the Budget plan is based on a sharp slowdown to 0.6% in 2023, before rebounding somewhat to 1.4% the following year, with these assumptions slightly more optimistic than the private sector average. Growth in the coming year will be sustained by household consumption, government spending and exports, while the continuing adjustment in the housing market will act as a drag. Over the medium term, population aging will act to limit potential GDP growth.

In terms of nominal GDP, which more closely aligns with revenues, 2022 registered a 9.7% increase, more than 3 percentage points above last year's budget forecast. The province expects a sharp slowdown to 2.7% in 2023, before climbing back up to 3.8% in 2024. The deceleration this year will reflect both the easing in economic activity and inflation. The forecasts for 2022-2024 are all a few ticks above the private sector average, mostly reflecting the optimism for real GDP growth. However, the Budget plan lays out alternative growth scenarios and their impact on the return to fiscal balance. The province expects that a recession scenario for 2023 would increase the 2023/24 deficit by roughly $2.2bn.

Table 2: Key assumptions (Y/Y % chg)

Economic assumptions	2022	2023	2024	2025-27
Real GDP	2.8	0.6	1.4	1.5
• Private sector average	2.7	0.3	1.1	1.7
Nominal GDP	9.7	2.7	3.8	3.4
• Private sector average	9.3	2.4	3.2	3.7
Employment (K)	130	63	25	22
Jobless rate (%)	4.3	4.6	4.2	4.1
Household consumption	4.9	1.6	1.5	1.6
Housing starts (k)	57.1	50.1	46.2	43.0
Household income	9.2	3.0	3.4	3.1
Corporate net operating surplus	1.5	-4.9	5.3	3.7
CPI	6.7	3.5	2.2	2.0

Table 3: Key financial assumptions

Financial assumptions (fiscal yr)	2022	2023	2024	2025-27
3-month T-Bills (%)	2.3	4.4	3.5	-
10-year GoC Bonds (%)	2.8	3.1	3.0	-
Exchange rate (US¢/C$)	76.6	75.0	76.8	-

Note: 2025-27 is three-year average

Still a deficit, but a shrinking one

Like many other provinces, Québec saw stronger nominal GDP growth than anticipated, which boosted tax receipts and improved the fiscal situation. On a public accounts basis, which excludes deposits to the Generations Fund and the use of stabilization reserves, 2022/23 saw a deficit of $1.7bn, much smaller than the $3.0bn that was projected at the time of the March 2022 budget. On a Balanced Budget act basis, Québec records the outgoing year as having a $4.6bn budgetary deficit, with that including a payment of $3.4bn to the Generations Fund and a $450mn withdrawal from stabilization reserves.

The 2022/23 results would have looked even better without the additional $6.6bn allocated to new initiatives since last year's budget, including $5.1bn in cost-of-living support announced in 2022. Debt service costs are also expected to be $1.2bn higher in fiscal 2022/23 than originally budgeted for, due to rising interest rates and a downward adjustment of the expected return on the Retirement Plans Sinking Fund (RPSF).

Looking ahead, revenues are set to increase by 1.8% in fiscal year 2023/24, despite a tax cut of 1 percentage point for each of the bottom two income tax brackets and a projected slowdown in nominal GDP growth. The tax cut is estimated to ease the household tax burden by $1.7bn per year starting in 2023/24. While portfolio spending growth is projected to be a modest 1.2% in the coming fiscal year, that comes off a high base as fiscal 2022/23 spending included cost-of-living payments to households. Spending on key areas such as health (+7.7%) and education (+6.0%) will see increases that outpace the expected rise in nominal GDP in fiscal 2023/24.

The projections for fiscal 2023/24 also include a contingency of $1.5bn in case of unforeseen negative impacts on revenue. Including the contingency, the deficit is expected to be $1.6bn on a public accounts basis, which would represent a $4.0bn shortfall as per the Balanced Budget Act following a $2.4bn deposit to the Generations Fund. Note that the Generations Fund deposit for fiscal 2023/24 is $1.5bn lower than in Budget 2022, with the province noting that a proportion of these funds are being allocated to the financing of the 1 percentage-point reduction in the first two tax brackets. Deposits to the Generations Fund are budgeted to remain on a lower track until fiscal 2027/28, before rising more noticeably to nearly $5bn a year by fiscal 2037/38.

During the pandemic, certain elements of the Balanced Budget Act were suspended, meaning that the province could table a budget deficit without having to immediately implement offsetting measures during that uncertain time. This suspension is now lifted, and as a result today's budget included a path back to balance as per the Balanced Budget Act (after payments to the Generations Fund and use of Stabilisation) by fiscal 2027/28. On a public accounts basis, balance is reached earlier, by fiscal 2025/26, although this is two years later than was anticipated in last year's budget.

Net financial requirements are increasing next year

When the budget was tabled last year, the financing program for this current fiscal year was estimated to be $27.6bn. However, due to changes in net financial requirements (-$6.4bn), higher repayment of borrowings ($4.6bn), improvement in the public accounts for 2021/22 resulting in more pre-funding (-$1.2bn), as well as an increase of $2.0bn in short-term funding, the financing program is finishing slightly lower at $24.2bn.

For this upcoming year, net financial requirements are $18.6bn, while repayment of borrowings are $13.4bn for a total of $32.0bn. However, the province is using $2.5bn from the Generations Fund to repay borrowings, bringing the overall financing program down to $29.5bn. When compared to this outgoing year, net financial requirements are up by $5.9bn, while repayment of borrowings are down $5.6bn. One of the key differences from the prior years is the province did not pre-fund for the upcoming year, whereas usually they averaged around $5-7bn.

Looking further ahead, borrowing requirements are forecasted to stay around this level in 2024/25. That is due to another $2.5bn withdrawal from the Generations Funds, as well as $1.0bn withdrawal from the Retirement Plans Sinking Fund (RPSF). Starting in 2024/25, the government will begin withdrawing funds from that RPSF to provide payment of pension benefits to government employees. The budget stated that the government expects that the amounts accumulated in the RPSF will exceed the government's pension liabilities in future years. Overall, these withdrawals will increase each year and help decrease the financing program, reaching $4.5bn in reduction by 2027/28.

Table 4: Borrowing requirements (C$billions)

Borrowing requirements	2022/23E	2023/24F	2024/25F	2025/26F	2026/27F	2027/28F
Net financial requirements	12.7	18.6	15.7	14.9	14.1	15.2
Repayments of borrowings	19.0	13.4	16.5	16.6	13.7	12.9
Withdrawal from sick leave fund	-0.2	-	-	-	-	-
Use of pre-financing	-7.1	-	-	-	-	-
Change in cash positions	0.7	-	-	-	-	-
Transactions under credit policy[1]	1.0	-	-	-	-	-
Increase in ST debt	-2.0	-	-	-	-	-
Use of Generations Fund	-	-2.5	-2.5	-	-	-
Retirement Plans Sinking Fund withdrawals	-	-	-1.0	-2.5	-3.5	-4.5
Total	24.2	29.5	28.6	29.0	24.3	23.6

Net debt-to-GDP decreasing throughout the forecast horizon

As a result of the budgetary deficit and net capital investments, less the amount deposited into the generations fund, net debt is increasing by $7.1bn to $207bn at March 31, 2023. Despite the increase in net debt, higher GDP sees the net debt-to-GDP ratio dropping to 37.4%, down from 38.1% in 2021/22. Compared to last year's budget estimate for this outgoing year, it is an improvement from the 38.8% forecasted. That improvement too was a result of higher GDP than initially projected, as net debt is almost identical to that prior forecast.

As for this upcoming year, net debt is projected to increase by $7.6bn to $214bn, due to the same factors as mentioned above. Slower growth in GDP relative to the increase in net debt sees that ratio increasing to 37.7% in 2023/24.

The budget also provides a forecast horizon which shows declining increases in net debt, reaching $233.5bn by March 31, 2028. Those projections for net debt show a steady decline in the GDP ratio, falling to 35.8% by the end of the horizon. The province had been steadily decreasing this ratio over the years, down from 50.2% in 2016 to 40.0% before the pandemic. However, due to the health crisis, that ratio increased to a recent high of 42.2% as at March 31, 2021.

In the budget, the government set new net debt-to-GDP reduction objectives. Their goal is to reduce that ratio to 33% by 2032/33, then further reduce to 30% by fiscal year 2037/38. The province stated that based on this target, their net debt burden will gradually move toward the current average net debt of the provinces (31% of GDP as at March 31, 2022).

[1] Payments to / (from) counterparties to reduce exposure.

Capital spending increasing over 10 years

Québec's 10-year capital spending program, referred to as the Québec Infrastructure Plan (QIP) calls for $150.0bn in cumulative investments ($15bn/year avg), up from $142.5bn last year. Over the past five years, the QIP has been increased each year, up from $100.4bn in March 2018. The province states that the financial impact of the increase in the QIP is estimated at $1.0bn over five years from 2023/24 to 2027/28, which includes the impact on portfolio expenditures and on debt service.

The QIP allocates considerable sums to health and social services ($24.2bn), education and higher education ($30.0bn), public transit ($15.4bn) and its road network ($31.5bn). Of that total amount in the QIP, $82.5bn (55%) is planned over the next five years.

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