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Substantial deficits requiring reduction

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Highlights

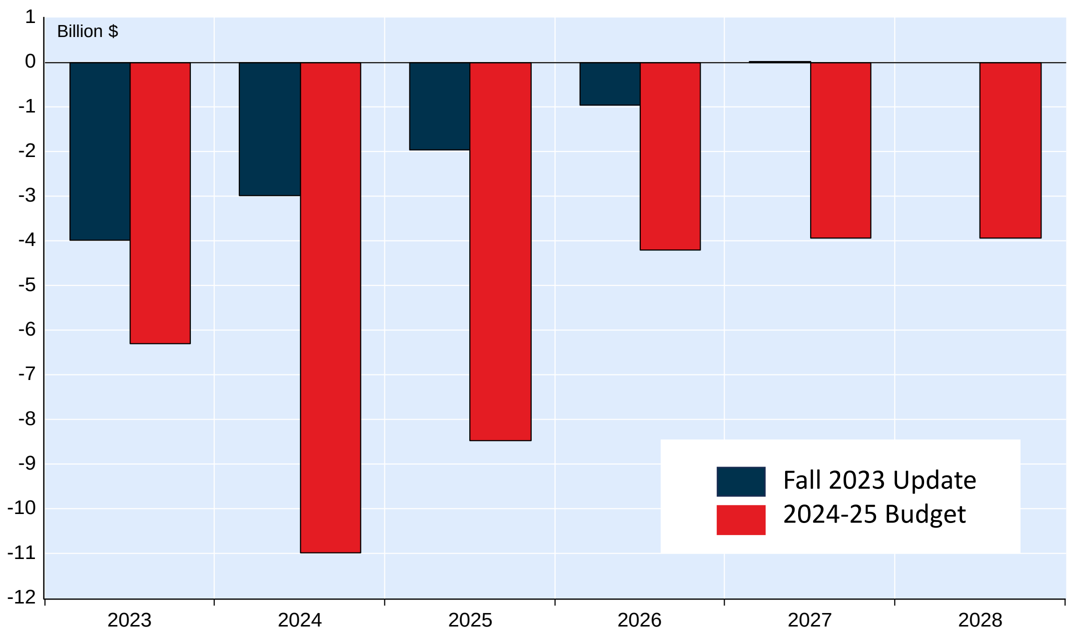
The Quebec government has provided an update on the state of public finances as part of its 2024-2025 Budget, and as telegraphed, the picture has deteriorated substantially since last fall's update. From a projected deficit of $3 billion a few months ago, the government now expects a shortfall of $11 billion (1.9% of GDP). The main reasons for these changes are higher-than-expected wage increases for government employees and weaker-than-expected revenue growth, as the Quebec economy has been in the doldrums in recent months. Spending is expected to reach 26.7% of GDP in the coming year, up from 25.0% before the pandemic. Revenues, meanwhile, are forecasted at 25.5% of GDP in 2024-2025. While a return to a balanced budget was anticipated for the 2027-2028 financial year just a few months ago, the government is no longer expecting that to happen over its forecast horizon, forecasting what it considers to be a structural deficit of $4 billion in 2028-2029 ($6 billion including a gap of $2 billion yet to be identified). According to the public accounts published at the end of 2023, the deficit for 2022-2023 exceeded the payment to the Generations Fund. Under the new version of the Balanced Budget Act, the government must present a plan for returning to balance over a 5-year period in the next or subsequent budget. The government has chosen to do this next year and will therefore have to announce measures to transform a $6 billion deficit in 2028-2029 into a balanced budget no later than the following year (2029-2030). It should be noted that the government has a contingency reserve of $1.5 billion per year between now and then. This prudence seems necessary to us insofar as the economic context anticipated in the Budget is somewhat optimistic with the unemployment rate below 5% beyond 2025. On current projections, net debt would have fallen from 40.9% to 39.5% between 2019-2020 and 2027-2028 (over 9 years), a reduction of only 1.4 percentage points (pp). This means that a substantial reduction of 9.5 pp will have to be achieved in the following 9 years to meet the target of 30% in 2037-2038 set by the Act to reduce the debt and establish the Generations Fund. Fortunately, next year the government will have to make more progress in the short term to comply with the Balanced Budget Act. To this end, it has announced a complete review of its programs to identify additional savings. This should reduce the fiscal effort required after 2029-2030, when health spending will come under significant pressure in the context of an aging population. To return to a balanced budget, the government must increase the gap between revenue and expenditure, which is currently forecasted to average 3.3% and 2.9% until 2028-2029. This is a major challenge, as the gap between the expected growth rates, which is currently 0.4 pp, needs to reach 1.1 pp by 2028-2029 in order to absorb the structural deficit, according to the Ministry of Finance. Overall, this budget is more of a statement on the state of the Quebec government's public finances after a sharp increase in spending without an increase in revenues (as a % of GDP). The government will have to draw up a plan over the coming year to improve public finances so that Quebec can continue to reduce its debt, which remains well above the national average. In an environment where interest rates should be higher than in the past, investors are likely to be more discriminating toward governments based on their financial health. Fiscal discipline is therefore the order of the day, as demographic changes and the asset maintenance deficit pose a challenge to Quebec's public finances in the coming years. Below are the details of the 2024-2025 budget.

- **Economic outlook**: After a solid economic recovery in 2022 following the pandemic, real GDP growth in Quebec in 2023 disappointed, coming in at just 0.2%. Weighed down by a number of temporary factors, such as forest fires, low water levels in the basins of Hydro-Québec's dams and strikes in the public sector, but also by the growing impact of restrictive monetary policy, economic growth in the province is among the weakest seen in the federation. More importantly for public finances, nominal GDP grew by 3.9% in 2023, higher than the 2.7% seen in the country as a whole. The labour market continued to be particularly tight, but still managed to grow by 2.3% in 2023, similar to the national average. However, the unemployment rate in Quebec rose from 4.0% in February 2023 to 4.7% in February 2024 without any job losses, as the labour market was unable to absorb the large number of new arrivals. Looking ahead, the 2024-25 Budget forecasts real GDP growth of 0.6% in 2024, which is slightly more optimistic than the average private sector forecast of 0.4%. After this modest increase, economic growth should then rise to 1.6% in 2025, helped in particular by lower interest rates, and then to 1.7% from 2026 to 2028 (these forecasts are broadly in line with the private sector average). As for nominal GDP, the Budget is based on growth of 4.0% in 2024, compared with 3.0% expected by the private sector average. Thereafter, GDP should evolve more in line with the consensus, with growth of 3.8% in 2025, 3.7% in 2026 and 2027 and 3.6% in 2028. As for the labour market, the unemployment rate in Quebec should rise from an average of 4.5% in 2023 to 5.2% in 2024 as a result of the economic slowdown we are experiencing. However, it should start to fall again in 2025, to 4.9%. It will then continue to fall, reaching 4.1% by 2028, against a backdrop of an ageing population, according to the Ministry of Finance.
- **Budget balance for the year ending (2023-2024):** A deficit of $6.3 billion is estimated for 2023-2024 after payments to the Generations Fund, which is $2.3 billion higher than anticipated in last spring's budget and $2.307 billion estimated in November's budget update. Put in perspective, the deficit represents 4.3% of revenues or 1.1% of GDP. Before payment to the Generations Fund, the deficit stood at $4.2 billion, an increase of $2.596 billion compared with the last budget. This significant difference from the previous budget is due in particular to a shortfall of $898 million in own-source revenue, a $1.6 billion drop in revenue from government enterprises (mainly Hydro-Québec) and $1.7 billion in higher spending, which more than offset the $1.5 billion increase

in federal transfers. Revenues totalled $146.8 billion, which was $2.275 billion less than forecast in November and $955 million less than forecast in the 2023-2024 Budget. Expenditure totalled $151.0 billion, $692 million more than in the November update and $3.141 billion more than forecast in the last budget.

- **Medium-term budget outlook (2024-2025 and beyond)**: For the fiscal year 2024-2025, which will begin shortly, the Budget forecasts a deficit of $11.0 billion (1.9% of GDP) after payment to the Generations Fund. This includes a provision of $1.5 billion for economic risks. The financial framework no longer envisages a return to balanced budgets in 2027-2028 (or in 2028-2029 for that matter). Between now and then, the size of the deficit should continue to fall, from $8.5 billion in 2025-2026 (1.4% of GDP) to $3.9 billion in 2028-2029 (0.6% of GDP). It should be noted that, excluding the payment to the Generations Fund, the Budget is not balanced either. Payments to the Generations Fund should gradually rise from $2.2 billion in 2024-2025 to $2.7 billion in 2028-2029.

Québec: Outlook for the budget balance
Budgetary balance after payment to the Generations Fund



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- **Revenue Outlook:** For 2024-2025, revenues should grow by 2.4% to reach $150.3 billion. This increase is the result of growth in own-source revenue excluding government business enterprise revenue (+4.7%) and government business enterprise revenue (+4.3%), while federal transfers will decline (-6.0%). For 2025-2026, revenues should grow by 4.2%, thanks to a 3.8% increase in own-source revenues excluding those of government business enterprises and a 15.5% increase in revenues of government business enterprises. Federal transfers are expected to rebound by 3.5%. In subsequent years, revenues should grow by 4.6% in 2026-27, 2.9% in 2027-28 and 2.6% in 2028-29.

- **Spending Outlook**: For 2024-2025, expenditure will rise by 4.4% to $157.6 billion. This increase is mainly due to a 4.6% rise in portfolio expenditure, while debt servicing is expected to rise by 1.2%. For 2025-26, expenditure should increase by 2.9% to $162.1 billion, due to a 3.2% rise in portfolio expenditure and a 1.8% fall in debt servicing. In subsequent years, spending is expected to increase by 2.2% in 2026-27, 2.7% in 2027-2028 and 2.6% in 2028-2029.

- **New measures:** The 2024-2025 Budget provides for additional initiatives totalling $8.8 billion between now and 2028-2029, including $317 million already incurred during the 2023-2024 budget year and $1.9 billion to be incurred this year, as well as savings of $2.9 billion over 5 years through the optimization of government actions, which will partly offset the additional expenditure.

  Called "Priorities: Health and Education", the Budget includes $4.9 billion in new initiatives over 5 years for these two pillars of government, including $1.1 billion for 2024-2025. For health initiatives, the Budget allocates an additional $3.7 billion over 5 years to improve access to care and increase hospital fluidity ($1.8 billion to accelerate the digital transformation, maintain and develop alternative measures to hospitalization, add beds and deploy the Primary Care Access Point), ensure the maintenance and quality of care and services for seniors ($1. 1 billion for home support, private residences for the elderly, seniors' homes and CHSLDs) and consolidating social services for young people and vulnerable people ($738 million). In education, the Budget includes an additional $818.7 million over 5 years to promote the educational success of young people. To this end, the government is investing to support student success ($544 million for school transport, support for students in difficulty and the transformation of school governance), ensure the attraction and retention of school staff ($114 million), support education partner organizations ($61 million) and accelerate the maintenance of school buildings ($100 million). Finally, to promote success in higher education, the government will invest $420.5 million over 5 years to promote the success and retention of university students ($370 million), support training in priority areas and digital transformation ($43 million) and increase the number of student housing units and maintain the building stock ($8 million).

Secondly, the Budget plans to invest $2.0 billion over 5 years to support Quebecers and their communities. To this end, the government is announcing the elimination of the reduction in retirement pensions for disabled seniors aged 65 or over. In addition, the Budget aims to consolidate support for Quebecers ($1.3 billion for access to housing, supporting young people and families, helping the most disadvantaged and fostering social inclusion), support communities ($441 million for sports and recreation, public safety intervention capacity and legal support), enhance culture and promote the French language ($187 million) and protect the environment and adapt to climate change ($128 million). This also includes a review of the Roulez Vert program for electric vehicles with a view to ending the program in January 2027).

The third pillar of the 2024-2025 Budget allocates $1.9 billion over 5 years to address economic priorities. Additional amounts are therefore earmarked to support strategic sectors and economic growth ($443 million to set up industrial laboratories in innovation zones, growth in the aerospace sector, development of the aluminium sector, adoption of new technologies and research, and support for entrepreneurship), increase the available workforce and productivity in the construction industry ($126 million to continue the construction training offensive and encourage innovation and productivity in the construction industry), contribute to the prosperity of the regions ($889 million for the forestry sector, regional mobility and dynamism, development of the bio-food sector, the tourism sector and partnerships with First Nations) and promote the economic and social integration of immigrants ($400 million).

Finally, the Budget provides for additional savings/revenues of $2.9 billion over 5 years by optimizing government actions. Notable changes include the abolition of the business tax credit for the retention of experienced workers ($252 million), a review of tax credits supporting jobs in the IT sector ($875 million), optimization efforts for government businesses ($1 billion, i.e. $100 million from 2025-2026) and an increase in the tax on cigarette cartons.

Financial impact of the measures of Budget 2024-2025
(millions of dollars)

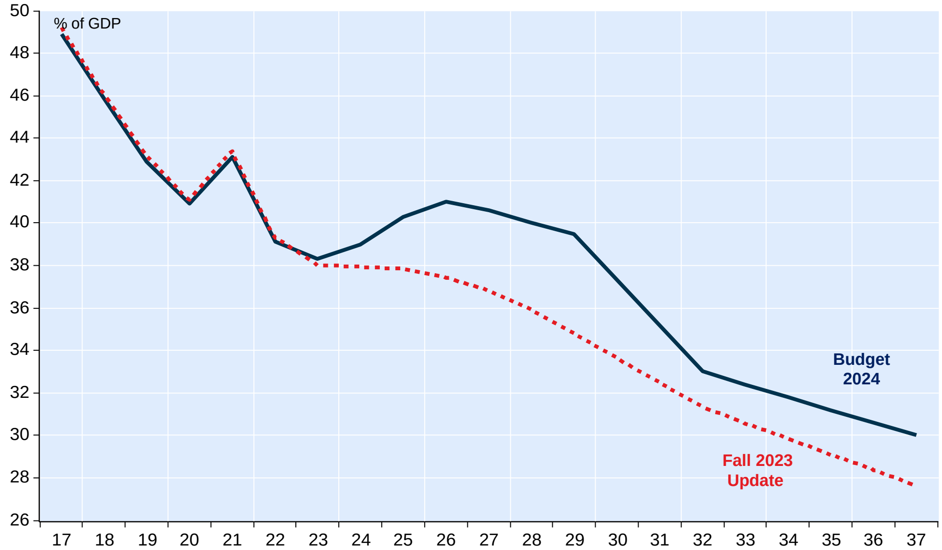
	2023-2024	2024-2025	2025-2026	2026-2027	2027-2028	2028-2029	Total
Funding health and social services, education and higher education	−188	−1 058	−925	−935	−907	−903	−4 916
Supporting Quebecers and communities	−129	−438	−486	−411	−282	−282	−2 028
Acting on economic priorities	—	−441	−596	−285	−265	−271	−1 858
Subtotal	**−317**	**−1 937**	**−2 007**	**−1 631**	**−1 454**	**−1 456**	**−8 801**
Optimizing government action	—	86	345	607	847	1 017	2 903
TOTAL	**−317**	**−1 851**	**−1 662**	**−1 023**	**−607**	**−439**	**−5 898**

Note: Totals may not add due to rounding.

- **Debt Burden:** As a reminder, since last year the Quebec government has been targeting the net debt-to-GDP ratio as part of its Act to reduce the debt and establish the Generations Fund, instead of the gross debt or the debt representing accumulated deficits. Net debt represents all the government's liabilities minus its financial assets. This measure allows better comparison between provinces and internationally. The government's new target is to gradually reduce the net debt to GDP ratio to 30%, which is close to the average for Canadian provinces.

  At 31 March 2024, net debt is expected to be $221.13 billion, or 39% of GDP, up from 38.3% in 2023. According to the forecasts included in the budget, the 30% target should be reached by 2037-2038, while an intermediate target of 33% has been set for 2032-2033. For the 2024-25 financial year, net debt as a proportion of GDP should rise to 40.3% and to 41.0% in subsequent years. Thereafter, the ratio is expected to fall gradually, reaching 39.5% in 2028-29. According to this forecast, a fall of only 1.4 p.p. would have occurred compared with the pre-pandemic level (over 9 years) and a fall of 9.5 percentage points would have to be achieved in the 9 subsequent years to meet the target.

Québec: Net debt trajectory
Net debt as of March 31st as a percentage of GDP



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- For 2023-24, debt servicing stood at $9.65 billion, down 4.1% on the previous year. Debt servicing should then rise by 1.2% in 2024-25, fall by 1.8% in 2025-26 and rise by 5.6% in 2026-27. As a proportion of revenue, debt servicing is forecasted at 6.4% in 2024-25. Over the coming years, it should rise to 6.5% in 2024-25, then fall to 6.1% in 2025-2026, before rising again to 6.2% in 2026-2027, 6.5% in 2027-28 and 6.7% in 2028-2029.

- **Borrowing Requirement**: Borrowing activity in the outgoing year (2023-24) will be $21.5 billion, $8.1 billion lower than forecasted in the March 2023 budget. As the government explains, "the decrease is mainly due to a reduction in net financial requirements, use of pre-financing and an increase in the outstanding amount of Québec Treasury bills". To date, 34% of borrowings have been carried out on foreign financial markets, compared with 19% last year, which is higher than the average of 27% over the last 10 years. The government uses a range of financial instruments to limit the risks associated with fluctuations in exchange rates and interest rates. After taking swaps into account, the debt is entirely denominated in Canadian dollars. For 2024-2025, the government's financing program provides for borrowings of $36.5 billion. For subsequent years, borrowing requirements will average $28.4 billion a year.

GOVERNMENT'S FINANCING PROGRAM, 2023-2024 TO 2028-2029
(millions of dollars)

	2023-2024	2024-2025	2025-2026	2026-2027	2027-2028	2028-2029
Net financial requirements(1)	14 767	28 472	22 591	17 540	17 409	16 208
Repayment of borrowings	13 663	16 904	17 155	14 025	13 086	14 254
Use of pre-financing	−2 233	—	—	—	—	—
Use of the Generations Fund to repay borrowings	−2 500	−4 400	−2 500	—	—	—
Withdrawal from the Accumulated Sick Leave Fund	−160	—	—	—	—	—
Change in cash position	295	—	—	—	—	—
Transactions under the credit policy(2)	−372	—	—	—	—	—
Withdrawal from the Retirement Plans Sinking Fund	—	−2 500	−2 500	−3 500	−4 000	−4 000
Increase in the outstanding amount of Québec Treasury bills	−2 000	−2 000	−2 000	—	—	—
TOTAL	**21 460**	**36 476**	**32 746**	**28 065**	**26 495**	**26 462**

Note: A negative entry indicates a source of financing and a positive entry, a financial requirement.
(1) The high level of net financial requirements in 2024-2025 is mainly due to the outflow of funds in 2024-2025 for expenditures tied to the renewal of collective agreements in 2023-2024, as well as to the budgetary deficit and higher net capital investments than in subsequent years.
(2) Under the credit policy, which is designed to limit financial risk with respect to counterparties, the government disburses or receives amounts following, in particular, movements in exchange rates. The amounts transacted have no effect on the debt.

- **Current long-term credit ratings** - S&P: AA-, Stable | Moody's: Aa2, Stable | DBRS: AA(Low), Stable | Fitch: AA-, Stable
[See our Provincial Ratings Snapshot *publication for additional information on specific credit rating factors/considerations.]*

Multi-year financial framework
(millions of dollars, unless otherwise indicated)

	2022-2023	2023-2024	2024-2025	2025-2026	2026-2027	2027-2028	2028-2029
Revenue							
Personal income tax	42 251	42 389	44 952	46 746	48 592	50 577	52 537
Contributions for health services	7 914	8 298	8 670	8 991	9 248	9 526	9 778
Corporate taxes	13 243	11 399	12 116	12 729	13 369	13 795	14 409
School property tax	1 113	1 137	1 310	1 436	1 531	1 553	1 615
Consumption taxes	26 597	27 118	27 991	28 994	29 888	30 859	31 889
Duties and permits	5 741	5 832	5 940	6 274	6 615	6 812	7 099
Miscellaneous revenue	12 083	14 116	14 507	14 703	15 106	15 704	16 238
Government enterprises	6 620	5 197	5 418	6 257	7 588	7 565	7 274
Own-source revenue	**115 562**	**115 486**	**120 904**	**126 130**	**131 937**	**136 391**	**140 839**
% change	***5.4***	***−0.1***	***4.7***	***4.3***	***4.6***	***3.4***	***3.3***
Federal transfers	28 737	31 290	29 397	30 428	31 883	32 112	32 006
% change[(1)]	*−1.5*	*8.9*	*−6.0*	*3.5*	*4.8*	*0.7*	*−0.3*
Total revenue	**144 299**	**146 776**	**150 301**	**156 558**	**163 820**	**168 503**	**172 845**
% change	***3.9***	***1.7***	***2.4***	***4.2***	***4.6***	***2.9***	***2.6***
Expenditure							
Portfolio expenditures	-137 243	−141 347	−147 815	−152 492	−155 493	−159 140	−162 972
% change	*7.6*	*3.0*	*4.6*	*3.2*	*2.0*	*2.3*	*2.4*
Debt service	−10 058	−9 650	−9 762	−9 583	−10 117	−11 003	−11 642
% change[(2)]	*16.4*	*−4.1*	*1.2*	*−1.8*	*5.6*	*8.8*	*5.8*
Total expenditure	**-147 301**	**−150 997**	**−157 577**	**−162 075**	**−165 610**	**−170 143**	**−174 614**
% change	***8.1***	***2.5***	***4.4***	***2.9***	***2.2***	***2.7***	***2.6***
Gap to be bridged for achieving fiscal balance in operations	—	—	—	750	1 500	1 750	2 000
SURPLUS (DEFICIT) FROM OPERATIONS BEFORE CONTINGENCY RESERVE	**−3 002**	**−4 221**	**−7 276**	**−4 767**	**−290**	**110**	**231**
Contingency reserve	—	—	−1 500	−1 500	−1 500	−1 500	−1 500
SURPLUS (DEFICIT) FROM OPERATIONS	**−3 002**	**−4 221**	**−8 776**	**−6 267**	**−1 790**	**−1 390**	**−1 269**
BALANCED BUDGET ACT							
Deposits of dedicated revenues in the Generations Fund	−3 082	−2 081	−2 222	−2 219	−2 419	−2 554	−2 671
BUDGETARY BALANCE WITHIN THE MEANING OF THE *BALANCED BUDGET ACT*[(3)]	**−6 084**	**−6 302**	**−10 998**	**−8 486**	**−4 209**	**−3 944**	**−3 940**

Note: Totals may not add due to rounding.

(1) The significant increase in federal transfers in 2023-2024 is due, in particular, to the additional amounts for health care announced by the federal government in February 2023 (nearly $1.1 billion more in 2023-2024, including a non-recurring amount of $447 million), the change in the value of the special Québec abatement ($310 million), and the housing agreement ($900 million over four years, including $225 million in 2023-2024). The decrease in 2024-2025 is due, among other things, to a decline in equalization resulting from changes made by the federal government to the program in its 2023 budget.

(2) The −4.1% change in debt service in 2023-2024 is due, in particular, to the non-recurrence of losses on the disposal of assets as part of the activities of the Sinking Fund for Government Borrowing in 2022-2023.

(3) Budgetary balance within the meaning of the Balanced Budget Act, before use of the stabilization reserve. In accordance with the Balanced Budget Act, the stabilization reserve is abolished as of 2023-2024.

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