

# Budget

## EXPRESS

November 4, 2008

### QUÉBEC: ECONOMIC AND FINANCIAL UPDATE

- **Tax Measures**

A few measures conditional  
on federal agreement

- **Budget Analysis**

The Québec government  
is living on its reserves!

*No deficit unless the economy  
deteriorates even more*



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*Today, Ministre des Finances Monique Jérôme-Forget tabled an update on Québec's current economic and financial situation. Several tax measures were announced, but before we implement some of these changes, we will have to wait until federal government taxation policy is harmonized with these proposals.*

## MEASURES AFFECTING DESJARDINS - CORPORATE

### **Age limit for converting RRSPs, DPSPs and RPPs raised from 71 to 73.**

The Government of Québec is proposing, that, as of 2009, the age limit for converting registered retirement savings plans (RRSPs) deferred profit-sharing plan (DPSP) and registered pension plans (RPPs) be raised from 71 to 73, thereby enabling 72 and 73 year olds to continue earning tax-sheltered retirement income.

It is important to note that taxation of registered plans currently falls under federal jurisdiction. As such, federal government policy must be harmonized with this proposal before it can go into effect.

### **One year carry-over for repayments to the Home Buyers Plan (HBP)**

Individuals have fifteen years to repay amounts withdrawn from RRSPs for an HBP. Should they fail to reimburse the amount prescribed for a given year, they must include it in earnings of that same year. Moreover, the repayment period begins the second year following the one during which the withdrawals were made. This means individuals have a maximum period of two years before they are required to begin repayment.

In order to boost the cash assets of individuals, the Québec Government is proposing to carry over into subsequent remaining years reimbursement of the HBP that was due in 2009. This measure would help tax

payers deal with the consequences of the current financial crisis.

Once again, since Québec does not have jurisdiction over tax laws governing the HBP, the federal government must act upon the Québec proposal before this measure can go into effect.

### **Impact of the current situation on retirement plans**

The Government is concerned about the impact the current crisis may have on the financial status of the retirement plans of Québec citizens.

It has therefore announced measures designed to shore up this sector:

- the formation of working groups made up of management, union and municipal representatives in addition to representatives from the Québec Pension Board and other concerned groups;
- introducing specific standards for pension plans facing major financial difficulties;
- adopting additional powers to assist plans facing major financial difficulties;
- Government commitment concerning the new actuarial standards for the Canadian Institute of Actuaries.

The ministre de l'Emploi et de la Solidarité sociale will soon be unveiling additional information about these measures.

## MEASURES AFFECTING INDIVIDUALS

### Retirement income tax credit increased from \$1,500 to \$2,000 in 2009

The government announced that the maximum amount of pension income eligible for a retirement income tax credit would be increased from \$1,500 to \$2,000 in 2009. This amount would also be indexed at the personal income tax indexing factor as of 2010.

Please note that in its March budget the Government announced that the maximum amount of eligible retirement income would be increased from \$1,500 in 2008 to \$1,750 in 2009, and to \$2,000 in 2010.

### Personal income tax indexing factor set at 2.36% for 2009

In order to soften the blow a higher cost of living will have on the purchasing power of its citizens, the Government will fully index personal income tax, as of January 1 each year, according to the rate of inflation in Québec. This indexing applies to taxable income thresholds in the tax table and to most tax credits.

For the 2009 tax year, due to higher consumer prices, the indexing factor will be set at 2.36%.

### Full indexing for last-resort assistance for 2009

The Government announced that social welfare payments made to employable households will be fully indexed on the basis of the increased cost of living. This measure will go into effect on January 1, 2009 and will apply to subsequent years. For 2009, this indexing factor will be set at 2.36%.

Full indexing of social welfare payments will also serve to increase amounts paid out under for child support and *Prime au travail* programs, since these two programs are defined in conjunction with last-resort assistance programs.

## MEASURES AFFECTING BUSINESS

### Additional funding for SMEs

In order to assist businesses, primarily SMEs, in need of short-term cash, the Government will introduce a financial assistance program for funding successful businesses experiencing financial difficulties as a direct result of the current situation.

This program will provide up to \$1B in additional cash to Québec companies between now and the end of 2010. Information about this program will be unveiled soon by the *ministre du Développement économique, de l'Innovation et de l'Exportation*.

## QUÉBEC: ECONOMIC AND FINANCIAL UPDATE

The Québec government is living on its reserves!  
No deficit unless the economy deteriorates even more

### HIGHLIGHTS

- The budget balance is maintained for 2008-2009 and 2009-2010.
- However, it will be necessary to go through the \$2.3B accumulated in the budget reserve to do so.
- The Québec economy's anticipated growth was significantly revised downwards. In addition, risks keep pointing downward.
- The Québec government has no more leeway. The possibility of a deficit cannot be ignored for 2009-2010 and 2010-2011, should economic conditions deteriorate even more.
- The ministère des Finances is proposing some new measures totalling \$413M over two years to minimize the effects of the economic slowdown and the financial crisis on households and businesses.

**Table 1**  
**Summary of adjusted budgetary transactions – Fall 2008<sup>P</sup>**

	2007-2008	2008-2009	2009-2010
In \$M			
<b>Budgetary revenue</b>	<b>63,093</b>	<b>63,376</b>	<b>64,716</b>
% change	4.0	0.4	2.1
<b>Budgetary expenditure</b>	<b>-61,847</b>	<b>-63,953</b>	<b>-65,830</b>
% change	5.2	3.4	2.9
<b>Net results of consolidated entities</b>	<b>404</b>	<b>365</b>	<b>839</b>
<b>Contingency reserve</b>	<b>---</b>	<b>-200</b>	<b>---</b>
<b>Surplus (deficit) for the purposes of the public accounts</b>	<b>1,650</b>	<b>-412</b>	<b>-275</b>
Payments of revenue dedicated to the Generations Fund	-449	-660	-822
<b>Budgetary balance before use of budgetary reserve</b>	<b>1,201</b>	<b>-1,072</b>	<b>-1,097</b>
Payments to the Generations Fund from the budgetary reserve	-200	-132	---
<b>Use of the budgetary reserve<sup>(1)</sup></b>	<b>-1,001</b>	<b>1,204</b>	<b>1,097</b>
<b>Budgetary balance for the purposes of the balanced budget act</b>	<b>0</b>	<b>0</b>	<b>0</b>

<sup>P</sup> Last results for 2007-2008 and forecasts for subsequent years.

<sup>(1)</sup> A negative amount indicates an allocation to the reserve and a positive amount, a use of the reserve.

Source: Ministère des Finances du Québec

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**NOTE TO READERS:** The letters **k**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.

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### MAINTAINING A BALANCED BUDGET

As the ministre des Finances already mentioned, the Québec government will likely be maintaining a balanced budget despite the deteriorating economy and the worsening financial crisis. This situation is different than that of the Ontario government as it anticipates a \$500M deficit for 2008-2009. Even the federal government does not seem to be ignoring the possibility of a slight deficit. More will be known when the economic statement expected in the coming weeks will be published.

The Québec government owes this tour de force to prudent management through the establishment of a budgetary reserve. This reserve, made up of \$1.3B in budgetary surpluses in 2006-2007 and \$1B in 2007-2008, will be used for the next two fiscal years to maintain a balanced budget. Without this reserve, the Québec government would have posted a \$1.1B deficit in 2008-2009 and in 2009-2010. Bear in mind that the ministère des Finances will pay close to \$1.6B to the Generations Fund during 2008-2009 and 2009-2010. Taking into account these payments, which are in fact budget surpluses allocated to possible debt repayment, the Québec government's financial picture is somewhat improved. In addition, the ministre des Finances anticipated a \$200M contingency reserve for 2008-2009. It will provide some leeway should there be unexpected expenses or harsher economic conditions.

Budget revenues are revised upwards by \$396M in 2008-2009 and downwards by \$486M in 2009-2010. As well, additional earnings of \$300M from Hydro-Québec are expected for the current year. In 2009-2010, forecasts on personal income tax, consumption taxes and corporate income tax were brought down by \$532M. Program expenditures were revised upwards in comparison to last March's budget projections (+289M in 2008-2009 and +416M in 2009-2010). The new measures announced today

for individuals and businesses represent additional expenses of \$166M over two years while the harmonization of the accounting method on capital property in the health and education networks results in an increase of \$100M per year.

### ECONOMIC FORECASTS REVISED DOWNWARDS

The 2008-2009 budget tabled last spring anticipated 1.5% growth in the Québec economy in 2008 and 2.0% in 2009. However, the economic outlook has deteriorated significantly since. In the U.S., falling real estate prices, the increase in gas prices observed earlier in the year, tightening credit conditions and the recent worsening financial crisis will have led the economy into recession. As a result, U.S. GDP fell by 0.3% in the third quarter and everything leads us to believe that another decline in production will be seen at the end of 2008. The decrease in U.S. real GDP has global ramifications and a recession will likely happen in the euro zone, the U.K. and Japan. In Canada, risks of a recession are estimated at around 50%. However, some regions are more exposed to current difficulties. This is the case in Ontario, where a decline in real GDP is expected in the coming quarters.

Québec cannot obviously avoid this deterioration. Foreign trade is suffering not only from the effects of the stronger loonie in the past, but also from the recent slowdown of U.S. and Ontario demand. Domestic demand, the underpinning of economic growth over recent years, has recently been showing signs of weaker growth. In October, the confidence of Québec households has gone down to its lowest level in 12 years and retail sales expressed in real terms are rising at a slower pace. It is difficult these days to say if Québec will avoid a recession or not. However, the labour market has been standing firm up to now, real estate prices are not falling as is the case in some other regions in Canada and especially in the U.S., Canadian financial institutions are better capitalized, there is a better quality of mortgages in Canada and tightening credit conditions for households are less

**Table 2**  
**Use of the budgetary reserve<sup>(1) (2)</sup>**

In \$M	2006-2007	2007-2008 <sup>P</sup>	2008-2009 <sup>P</sup>	2009-2010 <sup>P</sup>
2008-2009 Budget	1,300	517 <sup>(3)</sup>	-1,370	-447
Changes	---	484	166 <sup>(4)</sup>	-650
<b>Fall 2008</b>	<b>1,300</b>	<b>1,001</b>	<b>-1,204</b>	<b>-1,097</b>
<b>Balance of the reserve at year-end</b>	<b>1,300</b>	<b>2,301</b>	<b>1,097</b>	<b>0</b>

<sup>P</sup> Last results for 2007-2008 and forecasts for subsequent years.

<sup>(1)</sup> In accordance with the Act to establish a budgetary surplus reserve fund, the transactions in the budgetary reserve shown in this document will be incorporated in the next budget.

<sup>(2)</sup> With the exception of the balance of the budgetary reserve, a positive amount indicates an allocation to the reserve and a negative amount, a use of the reserve.

<sup>(3)</sup> Including \$200 million paid into the Generations Fund from the budgetary reserve.

<sup>(4)</sup> Including \$132 million to be paid into the Generations Fund from the budgetary reserve arising from the sale of assets by the Société immobilière du Québec.

Source : Ministère des Finances du Québec

**Table 3**  
**Economic outlook for Québec**

	2007	2008f	2009f
% change (except if indicated)			
<b>Real gross domestic product</b>			
Ministère des Finances forecasts	2.4	0.8	0.6
Desjardins forecasts	2.4	0.6	0.8
2008-2009 Budget	2.4	1.5	2.0
<b>Gross domestic product</b>			
Ministère des Finances forecasts	5.5	2.9	2.3
Desjardins forecasts	5.5	3.0	2.6
2008-2009 Budget	5.9	3.2	3.5
<b>Housing starts (in thousands of units)</b>			
Ministère des Finances forecasts	48.6	45.6	38.5
Desjardins forecasts	48.6	46.0	43.0
2008-2009 Budget	48.6	44.6	38.5
<b>Consumer prices</b>			
Ministère des Finances forecasts	1.6	2.3	1.4
Desjardins forecasts	1.6	2.3	1.5
2008-2009 Budget	1.6	1.4	1.8
<b>Job creation (in thousands of units)</b>			
Ministère des Finances forecasts	86.3	28.3	18.4
Desjardins forecasts	86.3	30.0	20.0
2008-2009 Budget	86.3	45.0	34.2
<b>Unemployment rate (in %)</b>			
Ministère des Finances forecasts	7.2	7.4	7.6
Desjardins forecasts	7.2	7.4	7.7
2008-2009 Budget	7.2	7.0	6.9

f: forecasts

Sources: Ministère des Finances du Québec and Desjardins, Economic Studies

important here. Furthermore, an important investment program in public infrastructures and energy development is taking place. According to the ministère des Finances, all the actions taken by the Québec government will have generated 1.4% in real GDP additional growth in 2008 and 0.4% in 2009.

All in all, ministère des Finances projections anticipate 0.8% growth of real GDP in 2008 and 0.6% the following year. Employment expansion should continue although at a slower pace. In 2009, some 18,400 jobs should be created compared to 86,300 in 2007 and 28,300 in 2008. The unemployment rate could rise slightly and reach 7.6% on average next year. After higher than expected growth in 2008 due to the increase in gas prices noted earlier in the year, inflation should increase moderately in 2009 (+1.4%).

In general, these forecasts appear to be realistic and are similar to our scenario. The risks associated with these projections keep pointing downwards. Should the current economic conditions intensify or persist, the Québec government's budget balance could be threatened. Not only

would the \$200M contingency provision not be available in 2009-2010, but the ministère des Finances is planning to use all its budget reserve. If economic growth is even weaker, the absence of leeway could then force the Québec government to declare a deficit in 2009-2010 and 2010-2011.

#### FINANCIAL IMPACT

The publication of today's budget update does not seem to have affected financial markets. This is not surprising, since for a few months, changing provincial bond rates and spreads in relation to Canadian government securities are basically mirroring the financial turmoil and investor feeling. The record premium required on provincial securities, including Québec securities, in comparison to Canadian bonds comes in fact from the growing financial crisis that has been growing since mid September and not from the erosion of provincial public finances.

The update also brings only very few new elements. It basically confirms to investors that Québec's financial situation is being affected by the economic slowdown and the financial crisis, but that for the time being, the impact is

### **Modest budget initiatives**

The Québec government today announced additional measures aimed at softening the impact of the current financial crisis on the economy and supporting the purchasing power of Quebecers. With extremely limited manoeuvring room, the government decided to opt for modest, targeted initiatives that will represent total additional expenditures of only \$81M in 2008-2009 and \$331M in 2009-2010. Moreover, approximately 50% of the cost of these measures will be borne by the indexing of certain budget parameters as a result of increased inflation, and do not therefore represent any real increase for taxpayers. Fortunately, these limited measures are in addition to more far-reaching initiatives previously announced by various government levels.

### **Measures affecting individuals**

- The age limit for redeeming registered pension plans and registered retirement savings plans has been raised from 71 to 73. This change, which requires federal participation, is aimed at providing affected investors with additional time to profit from the recovery of the financial markets.
- A one year carry-over for repayments to a Home Buyers Plan (HBP). This initiative is designed to increase the cash assets of individuals and the purchasing power of young families and to support the housing market. It too requires federal participation.
- Retirement income tax credit increased from \$1,500 to \$2,000 in 2009.
- Personal income tax indexing factor increased from 1.58% to 2.36% for 2009. This higher indexing factor is the result of rapidly spiralling consumer prices attributable mainly to the higher cost of oil.
- Full indexing of 2.36 % for last-resort assistance in 2009, including assistance to employable households.

### **Measures for businesses**

- A special loan program and loan guarantees that will provide businesses with access to additional financing of \$1B. This program, aimed at assisting companies facing possible credit tightening, will be administered by Investissement Québec.
- The government also plans to announce, at a future date, measures aimed at limiting the financial impact of the current crisis on private pension plans.

not disastrous. The risk of the provincial government defaulting remains very low and in a normal situation, it would not justify the spreads that are currently seen.

### **DEFICITS COVERED BY A “BUDGET RESERVE”**

Balancing the budget for this and next year is to be commended. In addition, the \$200M contingency reserve has not been used, which leaves additional room to manoeuvre. But keep in mind that this balance is due to a budget reserve accumulated over previous years, i.e. in 2006-2007 and in 2007-2008, as a provision for deteriorating economic conditions. In fact, there is an implicit deficit. All the same, it can be stated that the set of reserves are signs of good management in the sense that in leaner times, deficits are accepted and in wealthier periods, losses are recovered. As the reserve will be completely spent in fiscal 2009-2010,

it will be necessary to replenish it afterwards. To do so, economic growth will need to be there in 2010, which is not yet assured.

As for the measures announced in this update, they will not be enough to make a real difference in the economic activity. They are facilitation measures rather than an injection of funds in the economy. In addition, some measures will only come into effect in 2009. In the circumstances, this prudence can be justified. In fact, the Québec economy's weakness is basically related to foreign trade on which the government has little influence. Domestic demand keeps moving forward and the public infrastructure plan and the tax cuts carried out early on in the year are already working to maintain economic activity afloat. But the risks are definitely pointing downwards.