BUDGET ANALYSIS

Quebec: Budget 2022

Inflation Influences Budget Choices

HIGHLIGHTS

- Strong economic growth and the acceleration of inflation have led to a significant revenue increase for the Quebec government.
- The government will put a substantial portion of these additional amounts back into the Quebec economy through considerably higher spending.
- The new measures announced in today's budget total $22B over the next five years.
- After deficits of around $6B in 2021–2022 and 2022–2023, the gradual return to a balanced budget is still forecast by 2027–2028.
- Stronger-than-expected economic growth has resulted in a sharp reduction in the debt burden. As a percentage of GDP, gross debt fell from 46.8% in 2020–2021 to 43.1% in 2021–2022.
- The financing program is expected to amount to $27.6B in 2022–2023 and to increase over the two subsequent fiscal years, reaching $33.8B in 2024–2025. Meanwhile, $19.1B in maturities will have to be refinanced.

A Sharp Rise in Revenue Makes Higher Spending Possible

With the gradual return to normal of the pandemic situation, economic conditions are much more favourable for the Quebec government. On one hand, the reopening of many sectors drove up real GDP, estimated by the Ministère des Finances at 6.3% in 2021. On the other hand, sharp price increases are causing an even greater expansion in nominal GDP, which could grow by 11.3% in 2021. Nominal GDP growth is expected to be 6.4% in 2022, very high from a historical standpoint. The unemployment rate also decreased significantly, dropping back to its historic low of 4.5% in February.

This obviously helped boost the Quebec government's tax revenue, through personal income tax, corporate tax and various sales taxes. Quebec's own-source revenue should therefore climb by 15.3% during the 2021–2022 fiscal year and by 3.6% during the next fiscal year. This will largely offset the slight decline in federal transfers anticipated for the 2021–2022 and 2022–2023 fiscal years as a result of a return to normal after the additional one-time payment in 2020–2021 to counter the effects of the pandemic.

However, the government will reinject a substantial portion of its additional revenue into the Quebec economy, with support measures for individuals and businesses, as well as additional spending. Program spending should rise 14.8% in 2021–2022 and 4.9% in 2022–2023. Debt service should also increase faster in the short term, due to higher outstanding debt during the pandemic and rising interest rates.

Ultimately, the Quebec government is projecting a $6.1B deficit for the fiscal year ending March 31, after accounting for the amounts paid into the Generations Fund. The 2022–2023 fiscal year could end with a similar deficit of $6.5B. In both cases, this is a slight deterioration compared to the projections made in the fall, which called for deficits of $5.6B (2021–2022) and $5.5B (2022–2023). A slight improvement is expected afterwards, however, and the Quebec government is on course for a return to balance by 2027–2028. That said, considering the low residual deficits foreseen as of 2023–2024, balance might be reached sooner. Not considering the amounts paid into the Generations Fund, the Quebec government could achieve balance by the 2023–2024 fiscal year. This is a much more advantageous financial position than in many other provinces.

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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.

TABLE 1
Budgetary situation

IN $B (EXCEPT IF INDICATED)	ACTUAL 2020–2021	PROJECTIONS 2021–2022	2022–2023	2023–2024	2024–2025	2025–2026	2026–2027
Own-source revenue	91.9	105.9	109.7	112.8	117.0	121.1	125.2
Variation (%)	*0.1*	*15.3*	*3.6*	*2.8*	*3.8*	*3.5*	*3.4*
Federal transfers	30.7	29.5	28.8	29.7	29.1	31.0	31.4
Variation (%)	*21.8*	*-3.8*	*-2.6*	*3.3*	*-2.1*	*6.4*	*1.5*
Total budget revenues	122.6	135.5	138.5	142.5	146.2	152.1	156.6
Variation (%)	*4.8*	*10.5*	*2.2*	*2.9*	*2.6*	*4.0*	*3.0*
Program spending	-106.1	-121.9	-127.8	-131.8	-135.2	-140.3	-144.1
Variation (%)	*-1.0*	*14.8*	*4.9*	*3.1*	*2.6*	*3.8*	*2.6*
Debt service	-7.7	-8.4	-8.8	-8.7	-8.8	-8.6	-8.8
Variation (%)	*0.2*	*9.8*	*4.8*	*-1.3*	*0.8*	*-2.3*	*2.8*
Support and recovery measures	-13.0	-9.0	-2.4	-0.5	0.0	---	---
Provision for economic risks	---	---	-2.5	-1.5	-1.5	-1.5	-1.5
Balance	-4.2	-3.9	-3.0	0.0	0.6	1.6	2.2
Generations Fund	-3.3	-3.5	-3.4	-3.9	-4.4	-4.6	-5.0
Balance before stabilization reserve	-7.5	-7.4	-6.5	-3.9	-3.8	-3.0	-2.8
Accounting changes	-3.2	---	---	---	---	---	---
Use of the stabilization reserve	10.8	1.2	---	---	---	---	---
Balance in the meaning of the Act	0.0	-6.1	-6.5	-3.9	-3.8	-3.0	-2.8
Gross debt	210.1	215.3	228.3	234.9	240.8	246.6	251.0
Variation (%)	*5.7*	*2.5*	*6.1*	*2.9*	*2.5*	*2.4*	*1.8*
In % of GDP	*46.8*	*43.1*	*42.9*	*42.7*	*42.3*	*41.9*	*41.2*
Debt representing accumulated deficits	108.7	112.6	115.6	115.6	115.0	113.3	111.1
Variation (%)	*0.9*	*3.6*	*2.7*	*0.0*	*-0.5*	*-1.4*	*-1.9*
In % of GDP	*24.2*	*22.5*	*21.7*	*21.0*	*20.2*	*19.2*	*18.3*

Source: Ministère des Finances du Québec

Toward Swift Debt Reduction

Stronger-than-expected economic growth has resulted in a sharp reduction in the debt burden. As a percentage of GDP, gross debt fell from 46.8% in 2020–2021 to 43.1% in 2021–2022. Not only will the gross debt burden be slightly lower than its pre-pandemic level, but it will also fall back down below the 45% threshold established in the Act to reduce the debt and establish the Generations Fund.

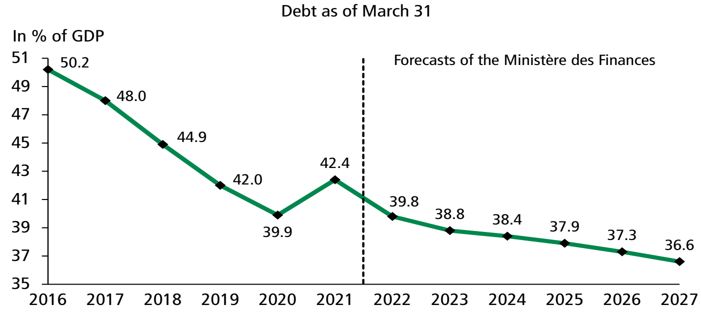
The government also plans to propose amendments to this act in the 2023–2024 budget in order to set a new debt target that would cover a potential horizon of 10 or 15 years. While the objective of the initial 2006 legislation was for Quebec's debt burden to reach the Canadian average, the government has indicated that the new target would take into account the realities of the coming years, including population aging, the fight against climate change and infrastructure needs.

In all likelihood, the revision of the Act will also include a change in the definition of debt, moving from the concept of gross debt to that of net debt, which is gross debt less financial assets.[1]

[1] Net of certain other liabilities such as accounts payable.

One of the main advantages of this adjustment is that it will facilitate interprovincial comparison, since most of the provinces use this concept. The government forecasts that, as for gross debt, net debt as a percentage of GDP will fall slightly below its pre-pandemic level, to 39.8% in 2021–2022, and will maintain a downward trajectory to stand at 37.3% in 2025–2026. This represents a decline of 6.1 percentage points over the projections of the March 2021 budget, once again the result

GRAPH
The debt burden has rapidly fallen below its pre-pandemic level



Sources: Ministère des Finances du Québec and Desjardins, Economic Studies of stronger-than-anticipated economic growth. Despite the government's announcement of a $7.5B increase in infrastructure investments over ten years, the fact that deficits are lower than were projected in last year's budget should mean that in 2026 the level of net debt will be almost $18.8B lower than was predicted at that time.

While this may seem like good news, the fact remains that Quebec is still the third most indebted province in Canada, with net debt as a percentage of GDP being 6.8 percentage points higher than the average of all provinces. Low interest rates in recent years have nevertheless greatly contributed to reduce the cost of servicing the debt. In 2022–2023, debt service will amount to only 6.4% of revenue. This is based on an assumption that interest rates will be lower than in our last forecast. For example, we forecast a rate of 2.40% for Canadian 10-year bonds at the end of 2022, as compared with the 2.20% rate included in the budget. However, the sensitivity analysis shows that even in the event of a 100-basis-point rise in interest rates, the effect would be to take the debt service ratio to just 6.8%, and not until 2026–2027. This ratio would remain lower than in 2018–2019, and less than half its 2000–2001 level.

Although some voices have called for the Generations Fund to be partially used to pay down the debt, the 2021–2022 results argue in favour of a commitment to continue building up the Fund to foster intergenerational fairness. In 2021, the Fund posted its best annual performance since 2014, with a gain of 11.4%. The 9.5-percentage-point difference compared to the cost of new borrowings is the highest since its creation in 2007. In 2022–2023, $3.4B of revenue will be devoted to the Generations Fund, an amount similar to 2021–2022. The Fund's book value should reach $19.1B in 2022–2023 and climb to $37B by 2026–2027.

As for the financing program, it should amount to $27.6B in 2022–2023. This takes into account $5.9B of pre-financing contracted in 2021–2022 (as of March 7). In 2021–2022, the program should stand at $22.9B, $5.6B less than was projected in March 2021. Moreover, net financial requirements were $9B lower than projected, partly due to the improvement in the budgetary balance (before use of the stabilization reserve), but also thanks to the disposition of $3.1B in temporary investments acquired in 2020–2021.

The financing program should nevertheless increase over the next two fiscal years, rising to as much as $33.8B in 2024–2025, as maturities of $19.1B will have to be refinanced. It is worth noting that foreign demand for Quebec bonds shows no signs of letting up. As at March 7, 2022, 37% of borrowings had been contracted in foreign markets, substantially above the 24% average over the last ten years.

Measures That Largely Address the Main Issues

The budget tabled today contains additional measures totalling $22B over the next five years. Generally, these measures are aimed at coping with the rising cost of living, restoring the health care system, stimulating economic growth, investing in education, continuing efforts related to the environment and strengthening communities. These actions largely address the challenges that we identified in a recent *Economic Viewpoint* on government finance.

Without going into the details of these measures, certain initiatives require comment. First, the government's intention to help Quebecers cope with the sharp rise in prices is laudable. But the distribution of a one-time payment of $500 to every adult with an annual income of up to $100,000 is questionable. In our opinion, this measure is not sufficiently progressive. The effects of the sharp rise in prices, particularly for food and housing, are being felt much more acutely by low-income households. Moreover, these households have not benefited from increased savings and wealth to the same extent as higher-earning individuals. Financial assistance focusing more on lower-income households would therefore have been preferable. This would also have had the effect of minimizing distortions. The danger is that this additional $500 will encourage many Quebecers to increase their spending. The ensuing upswing in demand, in a context where supply is restricted by transportation problems and by the labour shortage, could intensify current imbalances and foster further price increases, running counter to the initial objective.

Second, the government could have directed more effort toward measures to accelerate the long-term growth of the Quebec economy. The slow increase in the working-age population will reduce the growth potential of Quebec's real GDP in the coming years. To offset these effects, considerable efforts will be needed to increase investment and productivity, improve worker training and facilitate the integration of newcomers. Initiatives to help solve businesses' supply-chain problems and transportation difficulties would also have been welcome in the current context. Although some initiatives have been put forward, we believe that more assertive steps could have been taken to boost the economy's long-term growth potential.