2023 Quebec Budget

Slow Revenue Growth and Spending Plans to Keep Province in the Red

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Highlights

- In Budget 2023, Quebec's government is pledging several new spending initiatives while also reducing income tax rates on the bottom two brackets. With only mild revenue growth forecast for the next few years, the budget balance (before contributions into the Generations Fund) doesn't turn positive until FY 2025/26 – two years later than what was expected in the December fiscal update.
- For FY 2023/24, the government is projecting a $1.6 billion shortfall (about 0.3% of GDP). This deficit, alongside robust capital spending, will power an uptick in the province's debt-to-GDP ratio in the upcoming fiscal year. Thereafter, it's forecast to decline, while debt servicing charges remain near multi-decade lows.
- Tax cuts and hefty capital spending plans should be growth-supportive heading into an uncertain period of the economy. Indeed, we see downside risks to the government's growth forecast in 2024. While the measures could add a further tailwind to inflationary pressures, this risk is reduced by the fact that they will be implemented over time.

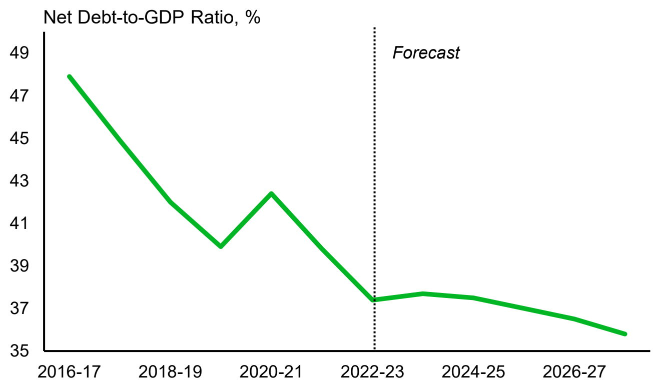
Quebec's Budget 2023 delivers on the government's prior pledge to cut personal income taxes at the lower end of the income spectrum. At the same time, policymakers will ramp up spending in several priority areas like healthcare and education in the upcoming fiscal year, even after an outsized FY 2022/23 gain. These measures will impact the province's bottom line, especially as their timing coincides with what should be an environment of cooling economic and revenue growth. Fortunately, the province is starting from a relatively favourable position. Indeed, Quebec's debt burden was at its lowest point since the mid-2000s in FY 2022/23, as policymakers worked to bring debt levels down for several years before the onset of the pandemic.

FY 2022/23 Deficit Slightly Below December Update

At the time of their December update, the government was forecasting a deficit (before contributions into the Generations Fund) of $2.0 billion in FY 2022/23. In today's budget, the FY 2022/23 shortfall is pegged at $1.7 billion (or 0.3% of GDP), thanks mostly to an upgrade in the revenue outlook. As such, the starting position heading into the upcoming fiscal year is better-than-thought, although not materially so.

For the upcoming fiscal year, the government is forecasting a $1.6 billion deficit, mostly unchanged from the year prior. And, because of spending commitments, tax cuts and soft revenue growth, policymakers now expect the first surplus to arrive in FY 2025/26 – two years after what was expected in the December fiscal update.

Chart 1: Despite Near-term Uptick, Debt-to-GDP Slated to Remain Well Below Historical Levels



Source: Québec Budget 2023, TD Economics.

Québec Economic Assumptions - Baseline Scenario [% change unless otherwise noted]			
	2023 Budget		
Calendar Year	2022	2023	2024
Real GDP	2.8	0.6	1.4
Nominal GDP	9.7	2.7	3.8
Employment Rate (%)	95.7	95.4	95.8
Unemployment Rate (%)	4.3	4.6	4.2
Population (000s)	8,696	8,776	8,843
Housing Starts (000s)	57.1	50.1	46.2
3-month T-bills (%)	2.3	4.4	3.5
10-year Bonds (%)	2.8	3.1	3.0

Source: Québec Budget 2023.

Near-term Economic Growth Assumptions Appear Reasonable, Downside Risk in 2024

This year, the government expects real GDP growth slow to 0.6% from 2.8% in 2022, as higher interest rates and inflation curb activity. Nominal GDP, meanwhile, is forecast to slow to 2.7% this year from 9.7% the year prior.

Over 2022 and 2023, the government's projections for real and nominal GDP growth almost exactly match ours. However, where we differ meaningfully from the government is in our 2024 outlook, where we expect 0.4% GDP growth while the government is forecasting a 1.4% gain. Our view reflects a lagged impact on growth from the Bank of Canada's rate tigtening campaign.

Consistent with significantly softer nominal GDP growth, revenue growth is expected to ease to 1.8% in FY 2023/24, weighed down by weaker own-source revenues. Federal government transfers are also expected to increase at a relatively subdued pace of 1.8%, despite the federal government pledging more healthcare funding for all provinces. While Quebec has included these funds in their projections, the main offset comes through a steep decline in federal transfers to "other programs", owing in part to the end of certain types of assistance.

The marquee measure on the revenue side is the government's pledge to reduce tax rates for the bottom two tax brackets by 1 ppts. Wage earners will start benefitting from the tax reduction as of July 2023. These measures are expected to cost the government $9.2 billion over 5 years and are estimated to return up to $814 in savings this year for an individual living alone. Notably, the measures will apply to income earned up to $98,540, meaning the tax cuts are not only targeted at low-income earners. Even with these cuts, Quebecers still face a relatively high tax burden, so this measure will help reduce the gap with some other provinces. That said, the government estimates that Quebec's personal income tax to GDP ratio will still be the highest in Canada after the measures are implemented.

Province to Beef Up Near-term Healthcare, Education Spending

After jumping by 7.4% in FY 2021/22, program spending growth is set to cool to 1.2% in the upcoming fiscal year. This modest spending projection can be put down to the non-recurrence of one-time inflation relief payments. Healthcare and education spending, meanwhile, are expected to record healthy gains of 8% and 6%, respectively. After this fiscal year, spending is projected to average a modest 2.4% gain over the next four fiscal years.

Digging into the details, the government plans on spending $12.4 billion over the next 5 years on developing the potential of youth, making the healthcare system more effective and humane, supporting Quebecers, and diversifying and consolidating environmental measures. Notable examples include expenditures meant to improve student retention and success, sustain the new approach for vaccination and testing developed during the pandemic, improve seniors care, enhance housing affordability through building new units and enhancing the housing component of the refundable solidarity tax credit, and protect water resources.

Capital Spending, Deficits to Prop Up FY 2023/24 Debt Burden

Quebec's debt-to-GDP ratio is forecast to edge higher in the upcoming fiscal year (to 37.7% from 37.4%) as the province remains in deficit and capital spending is robust. On the latter point, the government is planning an increase of $7.5 billion over 10 years under the Quebec Infrastructure Plan, bringing its total to $150 billion. Note that Statistics Canada's recent investment intentions survey points to a 17% gain in government capital spending in 2023.

After the upcoming fiscal year, an improving fiscal position and stronger economic growth is forecast to re-position Quebec's debt burden on a downward track. By FY 2027/28, the ratio is forecast at 35.8%, down 1.6 ppts from FY 2022/23. Notably, the government is introducing a new net debt target of 27.5 – 32.5% of GDP by FY 2037/38.

By FY 2024/25, Quebec's debt-to-GDP ratio is projected to be 37.5%. In comparison, Ontario forecasted its ratio to be 38.3% during the same time in its fall fiscal update. There is a possibility that Ontario could show an improved path once their budget is released this Thursday, but that's still a gap between the two provinces.

Debt servicing charges are expected to drop in FY 2023/24, even with the level of interest rates forecast to be higher, (on average) this year than 2022. The government attributes this to the assumed non-recurrence of losses in the Sinking Fund for Government Borrowing that were sustained in FY 2022/23 due to the rapid increase in interest rates during that fiscal year. Typically, income gained through this fund is used to reduce debt servicing costs.

After FY 2023/24, debt servicing charges are expected to increase modestly through the projection horizon. Still, by FY 2027/28, only 6.6% of revenues are expected to be taken up by debt servicing, near a multi-decade low. Borrowing requirements are expected to total $29.5 billion in FY 2023/24, up from $24.2 billion in FY 2022/23.

Bottom Line

Even with some modest near-term deterioration in its fiscal position anticipated, Quebec's fiscal house remains in decent shape heading into a period of elevated economic uncertainty. The tax cuts combined with hefty near-term capital spending plans could add some tailwind to inflation in a province where price pressures have generally remained relatively sticky. However, the impulse should be spread out over time and could ultimately provide some support if the economy suffers a larger-than-expected slowdown.

The tax cuts do come at a relatively steep price tag (both in terms of absolute and opportunity costs). Having said that, the reduction will help to narrow the existing gap in rates between Quebec and other provinces, and in that vein could be growth enhancing.

Québec Government Fiscal Position [Billions CAD unless otherwise noted]						
Fiscal Year	2023 Budget					
	22-23	23-24	24-25	25-26	26-27	27-28
Revenues	**145.1**	**147.7**	**151.8**	**157.0**	**162.9**	**167.6**
% Change	4.5	1.8	2.8	3.4	3.8	2.9
Own-Source	115.9	118.0	122.1	126.0	130.9	134.4
Federal Transfers	29.2	29.7	29.7	30.9	32.0	33.2
Expenditures	**146.8**	**147.9**	**151.4**	**155.4**	**159.7**	**163.2**
% Change	7.9	0.7	2.4	2.7	2.7	2.2
Program Expenditures	136.7	138.4	141.5	145.4	149.1	152.1
Debt Charges	10.1	9.5	9.9	10.0	10.5	11.1
Total Consolidated Entities	**-1.7**	**-0.1**	**0.4**	**1.5**	**3.2**	**4.3**
Contingency Reserves	-	1.5	1.0	1.0	1.5	1.5
Surplus (Deficit)	**-1.7**	**-1.6**	**-0.6**	**0.5**	**1.7**	**2.8**
% Of GDP	-0.3	-0.3	-0.1	0.1	0.3	0.5
Generations Fund Deposits	-3.5	-3.4	-3.9	-4.4	-4.6	-5.0
Budgetary Balance*	**-5.0**	**-4.0**	**-3.0**	**-2.0**	**-1.0**	**0.0**
% Of GDP	-0.9	-0.7	-0.5	-0.3	-0.2	0.0
Net Debt	**206.8**	**214.4**	**221.1**	**226.5**	**230.6**	**223.5**
% Of GDP	37.4	37.7	37.5	37.0	36.5	35.8
Gross Debt	**222.6**	**235.6**	**244.6**	**252.0**	**258.1**	**265.2**
% Of GDP	40.2	41.5	41.5	41.2	40.8	40.6
Accumulated Deficits	**113.3**	**114.9**	**115.5**	**114.9**	**113.3**	**110.4**
% Of GDP	20.5	20.2	19.6	18.8	17.9	16.9

*Budgetary balance within the meaning of the *Balanced Budget Act* , after contributions towards the Generations Fund.
Source: Quebec 2023 budget.