



September 5, 2012

PARTI QUÉBÉCOIS RETURNS TO POWER, BUT WITH A MINORITY

Highlights

- Québec voters elected a minority Parti Québécois (PQ) government and their first ever female Premier in Pauline Marois. The PQ's platform included new daycare spaces, the cancellation of university tuition fee increases and changes to the personal tax system.
- Ms. Marois has not specifically committed to achieving the previous government's balanced budget target of FY 2013-14. The PQ platform includes modest new annual spending commitments of \$0.9 billion, partially funded by new revenue measures of \$0.3 billion on a net basis. However, in a minority context, it is unclear at this stage which other party could support the PQ's attempts to pass its commitments.
- Today's result does not change our near-term real economic growth forecasts for Québec. Independence from the rest of Canada remains the PQ's ultimate goal, but a referendum during this mandate is unlikely given the new government's minority status.

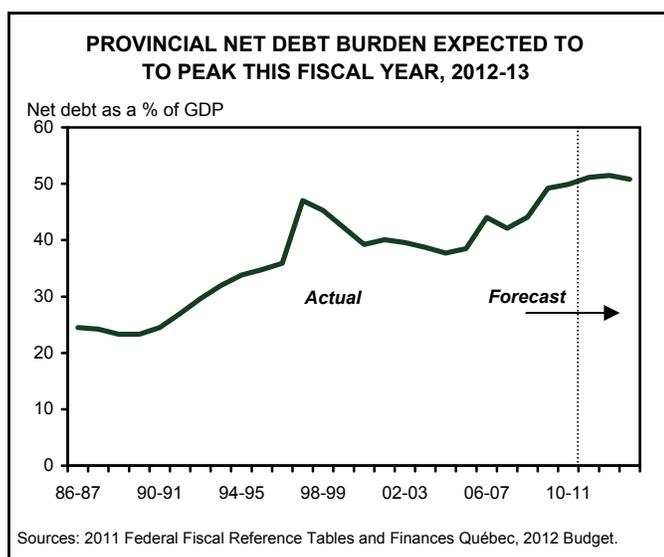
After nine years of Liberal government, Québec voters elected a minority Parti Québécois government and their first ever female Premier in Pauline Marois. With 54 seats, the PQ fell nine short of securing a majority in the province's National Assembly. The incumbent Liberals secured Official Opposition status with 50 seats, and the upstart Coalition Action Québec (CAQ) won 19. Québec solidaire closed the rankings with two seats. A PQ minority government had been anticipated by most opinion polls over the last weeks of the campaign.

The new government will need to get down to the job of implementing its election platform within a challenging fiscal environment. Recall that the former Liberal government had projected a budget deficit in the current fiscal year. While at 0.7% the shortfall relative to the size of the economy is relatively low and below the Canadian provincial average of 1.4% in FY 2011-12, the debt-to-GDP ratio (51%) remains lofty (see chart).

We present a summary of the new governing PQ party's election platform in table 1. The government's minority status suggests that it might need to consider policies of other parties in order to gain enough votes to pass legislation. For that reason, we have also included their policies in the table.

Perhaps most importantly, Ms. Marois has departed from her predecessor and from the leader of the CAQ by not specifically committing to achieving a balanced budget target of FY 2013-14. Instead, she has said that her government "doesn't want to be in deficit and will make all possible efforts" to avoid that outcome.

Compared to the status-quo budget profile, the PQ platform would modestly raise near-term deficits and lower medium-term surpluses. The platform promises new annual spending commitments of \$0.9 bil-



lion by the end of a five-year mandate. These commitments include an additional 15,000 daycare spaces (\$0.18 billion) and the cancellation of the university tuition increase (\$0.15 billion). That increase, proposed by the former government, triggered the student strikes/boycotts of last spring.

In order to partially fund these commitments, the PQ proposes new revenue measures of \$0.3 billion on a net basis. New taxes on the table would yield \$1.3 billion. They include the addition of two brackets to the existing 3-bracket personal income tax system (\$0.6 billion, most of it from high income earners), and new hybrid mining royalties based on production as well as on profits (\$0.4 billion). The revenue generated by the new taxes would be largely offset by the cancellation of the personal portion of the fairly recent health premium (\$1.0 billion).

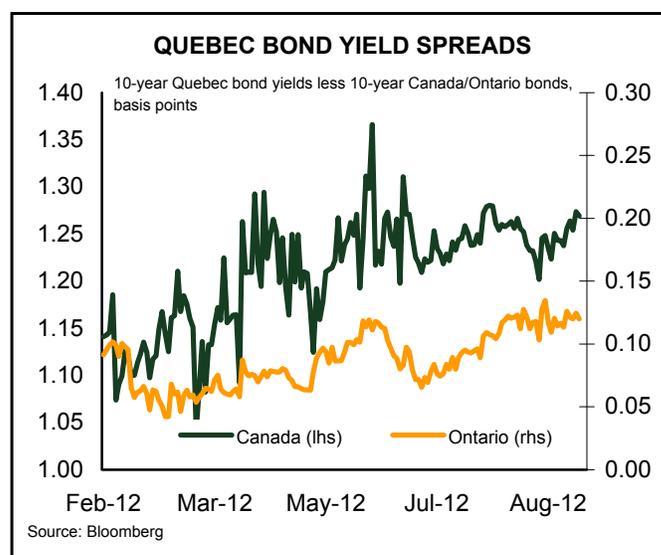
In its platform, the PQ used the economic and fiscal assumptions included in the Province's March 2012 budget as a starting point. On the plus side, these projections still look reasonable. Notably, the March budget prudently assumed real economic growth of 1.5% and 1.9% in 2012 and 2013, respectively, which is similar to our current forecast.

It is unclear at this stage where the PQ might find support to pass its commitments. The Québec solidaire pro-sovereignty party supports tax increases to fund social spending, but does not have enough seats to secure a majority for the PQ. Other key parties did not build in significant tax increases in their platforms. In fact, the CAQ's package is tilted towards tax cuts, while its promises are funded largely through \$2.1 billion in cost savings over five years. There is

a strong likelihood that some of the PQ commitments will not see the light of day or get scaled back in order to reach a compromise and gain support.

In light of today's result, we are not inclined to change our near-term real economic growth forecasts for Québec. The proposed spending commitments and tax increases laid out by the PQ and the other two parties are not insignificant, but nor are they a near-term game changer in light of a \$320 billion economy. We don't rule out some impact on demand and spending in the province due to uncertainty surrounding policy changes as well as the re-emergence of a sovereignist party in government. But despite the fact that independence from the rest of Canada remains the PQ's ultimate goal, the new government is based on a minority, which makes it unlikely that a referendum will be held during this mandate. Opinion polls over the past few years show support for sovereignty at or below 40%. Perhaps more concerning to some observers would be the potential longer-term impacts on skills and investment from the proposed personal income tax changes (among the provinces, Québec already has the highest personal tax burden for income earners at the upper end of the range) as well as policies meant to limit foreign investment in Québec companies.

Lastly, no major reaction has been observed in markets following the election. Some of the risks attached to a new minority PQ government appear to have already been factored in, as evidenced by a widening spread between Québec and federal government bonds last week when poll results started showing the PQ within reach of power. But the increase in differential was only modest (less than 10 basis





points – see chart) and the Canadian dollar has remained well bid. The market does not appear to be anticipating any major shift in the deficit and/or new funding requirements in the bond market. Nor is it building in a significant risk of a referendum over the foreseeable future.

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Table 1. Québec General Election – Platform Highlights of the Leading Parties

	Parti Québécois (PQ)	Liberal Party of Québec (PLQ)	Coalition Avenir Québec (CAQ)
Public finances	<p>Balance Commitment to avoiding deficits, but with no specific date.</p> <p>Spending Commitments add up to \$945m per year by the end of the mandate (1.2% of current annual spending) and include:</p> <ul style="list-style-type: none"> \$177m for daycare spots \$150m to cancel tuition fee increases \$119m for home care for the elderly <p>Revenue Net commitments add up to \$341m per year by the end of the mandate (0.4% of current annual revenue) and include:</p> <ul style="list-style-type: none"> \$610m by switching from 3 to 5 personal income tax brackets to make higher earners pay more. \$388m from new mining royalties. -\$1,005 by eliminating the personal health premium. 	<p>Balance Still targeting a return to balance in FY 2013-14.</p> <p>Spending Commitments add up to \$778m per year by the end of the mandate (1.0% of current annual spending) and include:</p> <ul style="list-style-type: none"> \$58m for children's dental care \$47m for high users of health system \$376m in "upcoming announcements" <p>Revenue Commitments add up to -\$296m per year by the end of the mandate (-0.4% of current annual revenue) and include:</p> <ul style="list-style-type: none"> -\$120m to keep older workers in labour force 	<p>Balance Assumes government's fiscal plan but uses up most of upcoming surpluses.</p> <p>Spending Net commitments amount to a reduction of \$241m per year by the end of the mandate (0.3% of current annual spending) and include:</p> <ul style="list-style-type: none"> -\$2,100m in cost savings \$500m for new doctors \$410m for teacher pay \$290m for longer school day <p>Revenue Net commitments amount to a reduction of \$1,061m per year by the end of the mandate (1.3% of current annual revenue) and include:</p> <ul style="list-style-type: none"> -\$1,804m in middle-class personal tax cuts and elimination of the personal health premium. \$416m from lower deduction limit for capital gains.
Public debt	Liquidate the Generations Fund to pay back some of the debt (\$0.4b of \$179b net). In the long term, "avoid excessive debt growth."	Allocate 100% of resource royalties to debt reduction.	"Debt reduction is a priority", but so are the tax cuts mentioned above. Allocate 100% of resource royalties to debt reduction.
Job creation plans	No job creation target. Streamline government support to businesses. Instruct the Caisse de Dépôt to create an arms-length fund which would limit job outsourcing via strategic investment.	The PLQ expects to create 250,000 jobs and bring the unemployment rate down to 6% by 2017, mainly as a result of "Plan Nord".	No job creation target. The CAQ has often mentioned that what Québec needs is more high-paying jobs, not just more jobs.
Demographics / labour force	"Repatriate" Employment Insurance (EI) responsibility from the federal government and use it as a policy tool to keep older workers in labour force.	Modify tax system to keep older workers in labour force.	No commitment.

Québec General Election – Platform Highlights of the Leading Parties (continued)

	Parti Québécois (PQ)	Liberal Party of Québec (PLQ)	Coalition Avenir Québec (CAQ)
Health	Ensure that by 2016 every Quebecer has a family doctor.	Add family medicine nurses to the health system.	Start pilot projects allowing doctors to work in both the private and public sector. Eliminate some administrative layers in the system. Modify family doctor compensation to increase the patient/doctor ratio.
Education	Reduce classroom sizes.	Target of 80% high school completion by 2020 (currently is 72%). Reduce school board costs by \$300m.	Target of 80% high school completion by 2020 (currently is 72%). Add 1 hour to high school day. Add pay-per-performance to teacher salaries. Abolish school boards.
University tuition	Cancel the recent fee increase. Organize “summit” on university financing, which would examine fee indexation.	Maintain the fee increase of \$254/yr over 7 years. Total increase: \$1778.	Increase fees by \$200/yr over 5 years instead of the current schedule. Total increase: \$1000.
Daycare fees	Freeze the \$7 daily fee.	Index the \$7 daily fee to inflation.	Index the \$7 daily fee to inflation.
Plan Nord	Maintain “Plan Nord” but add more environmental regulatory safeguards.	Maintain the “Plan Nord” northern resource development strategy. This is expected to generate \$60B investment over 25 years and create 20k jobs per year.	Maintain “Plan Nord” but add on an investment fund run by the Caisse de Dépôt so that Quebecers can participate financially.
Oil & gas	Immediately stop shale gas exploration and production until further environmental impact studies yield satisfactory results.	Auction out exploration rights and increase drilling permit fees.	Immediately stop shale gas exploration and production, except for a few highly monitored pilot projects. Accelerate offshore exploration.
Mining royalties	Amend mining royalties so they are based both on production and profits, which would lift the total amount collected.	Maintain the January 2012 reform, which lifted the royalty rate to 16% of profits.	Maintain the royalty system in place.
Electric power generation	Nationalize all new renewable energy capacity. Shut down Gentilly-2 nuclear power plant.	Develop additional capacity of 3,500 MW (hydro), 300 MW (wind) and 200 MW (other renewable).	Set up a feed-in tariff (FIT) for renewable energy.
Infrastructure	Build a high-speed train between Montreal and Quebec City. Invest in east-end Montreal public transit. “Make transportation more electricity-based.”	Find permanent funding solution to transportation infrastructure maintenance costs.	Streamline government agencies in charge of public transportation in Montreal.

Québec General Election – Platform Highlights of the Leading Parties (continued)

	Parti Québécois (PQ)	Liberal Party of Québec (PLQ)	Coalition Avenir Québec (CAQ)
Language and culture	<p>Make French compulsory in businesses of 10+ employees (currently 50+). Block admission to English-language colleges (cégeps) for Francophones and Allophones*. Adopt legislation to define the Québec identity, including secularism of public institutions.</p>	<p>Provide support to employers so they can provide a French-speaking work environment.</p>	<p>Adopt legislation about the secularism of public institutions.</p>
Political status of the province	<p>The PQ's main objective is to make Québec a sovereign state, but no referendum is expected over a first mandate.</p>	<p>The PLQ's view is that Québec can progress within a united Canada if federal-provincial jurisdiction boundaries are respected.</p>	<p>The CAQ is a coalition of federalists and sovereigntists who want to put that debate aside and focus on more pressing matters. As such, they are committed to holding no referendum on sovereignty over the next 10 years.</p>

* Allophones: Québec residents whose mother tongue is neither English or French.