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# 2011 QUÉBEC FISCAL UPDATE

## TD Economics



October 25, 2011

## QUÉBEC'S DEFICIT IN 2010-11 IMPROVED, BUT PLAN LARGELY THE SAME

### Highlights

- Québec Finance Minister Raymond Bachand released his government's 2010-11 Public Accounts earlier today. He also released a 2011 Update on the Economic and Financial Situation. No new initiatives or tax measures were announced. Instead, revisions were made to economic and fiscal planning assumptions.
- The provincial deficit for 2010-11 has been inked in the record books at \$3.15 billion (1.0% of GDP), or an improvement of \$1 billion relative to the March budget estimate.
- Contingency reserves were boosted by \$100 million, every year, from 2011-12 to 2013-14. Even with the change, medium-term deficit targets remain identical to those presented in the 2011 budget.
- Return to budgetary balance is on track to be achieved in 2013-14, the original timetable.
- Annual provincial economic growth forecasts have been downgraded relative to budget estimates by 0.3-0.6 percentage points. The revised profile is consistent with TD Economics' views on Québec's near-term economic prospects.

Earlier today, Québec's Finance Minister Raymond Bachand released two publications: the 2010-11 Public Accounts and an Update on the Economic and Financial Situation. The documents reveal that the 2010-11 deficit projection has come in about \$1 billion better than was estimated in the 2011 budget. This outcome marks the second year in a row in which the final shortfall tallies have come in more than \$1 billion better than the target estimate. However, as was the case last year, improvements do not carry forward to later years. In fact, deficit estimates for 2011-12 and 2012-13 are identical to those presented in the March budget. Behind the numbers and to reflect the fragile global economic climate and lower provincial economic growth forecasts, annual contingency reserves have been increased by \$100 million. Even with the slight changes made to the profile, the government reaffirmed its commitment to return to budgetary balance by 2013-14, its original timetable and the one set in provincial legislation.

### Public Accounts offer a better starting point

With the release of the Public Accounts, the 2010-11 fiscal year is now officially in the record books. The deficit for the year was recorded at \$3.15 billion. Relative to the estimate in the 2011 budget, the shortfall was \$1.05 billion better than expected. Revenue improvement came primarily from increased mining royalty revenues and a better financial result for government business enterprises whose books are consolidated with those of the government. A lack of need for the \$300 million contingency reserve also helped out on the expenditure side of the ledger. However, this gain was more than offset by an increase in \$346 million in program spending relative to the budget estimate.

The government notes that its deficit-to-GDP came in at 1.0% of provincial GDP in 2010-11. By comparison, the similar statistic for the federal government is 2.1% of GDP. Ontario also has a higher

reading, with a deficit-to-GDP share of 2.3%. Armed with these inter-jurisdictional comparisons in hand, the fall update states that the Québec government is on a sound financial path and is much better shape than its peers. We would agree with this statement when the deficit is the measure of interest, however, the same cannot be said if provincial debt levels were reviewed – Québec retain its spot as the most indebted provincial government across the country.

### Moderate economic growth in store

Within the fall update, a significant portion of the text pertains to an updated economic outlook for the province. Consistent with our own views, Québec held up quite well during the initial phases of the recovery, namely 2010 and the first half of the 2011. Enhanced business investment, particularly in the mining sector, and a quick return to pre-recessionary employment levels helped support the solid performance. However, the province remains manufacturing heavy and the disappointing economic indicators coming from south of the border have hurt international export numbers. Disappointing news stateside also serves to keep a lid on the overall 2011 economic performance.

QUÉBEC REAL GDP ECONOMIC ASSUMPTIONS				
Calendar Year	2010	2011	2012	2013
Fall 2011 Update	2.9	1.6	1.6	2.0
2011 Budget	3.0	2.0	2.2	2.3
Difference	-0.1	-0.4	-0.6	-0.3

Source: Finances Québec, 2011 Update on Québec's Economic and Financial Situation.

An increase in economic uncertainty, combined with consumer and business confidence on high alert, have led the province to shave off 0.4 percentage points from its 2011 real GDP growth forecast. Real GDP growth is now slated to come in at 1.6% in 2011. Looking ahead, and consistent with our own views, the province expects modest-to-moderate economic growth over the near-term. In number terms, real GDP is poised to come in anywhere from 0.3 to 0.6 percentage points lower in 2012 to 2013.

### HST transition payment booked into plan

Lower economic growth forecasts, described in the previous section, trickle down into the revenue intake profile. The government estimates the hit to be \$850 million over three years, which is fairly consistent with our sensitivity analysis. Federal transfers, primarily through Equaliza-

QUÉBEC GOVERNMENT FISCAL POSITION						
[C\$ millions unless otherwise noted]						
	Actual	2011 Update on Québec's Economic and Financial				
Fiscal Year	10-11	11-12	12-13	13-14	14-15	15-16
<b>REVENUES</b>	<b>62,650</b>	<b>65,404</b>	<b>69,354</b>	<b>73,164</b>	<b>74,315</b>	<b>76,990</b>
% change	-0.8	4.4	6.0	5.5	1.6	3.6
Own-source	47,225	50,257	53,597	56,225	58,269	60,218
% change	-1.6	6.4	6.6	4.9	3.6	3.3
Federal transfers	15,425	15,147	15,757	16,939	16,046	16,772
% change	1.7	-1.8	4.0	7.5	-5.3	4.5
<b>EXPENDITURES</b>	<b>67,149</b>	<b>69,007</b>	<b>70,776</b>	<b>72,661</b>	<b>74,584</b>	<b>77,036</b>
% change	-0.8	2.8	2.6	2.7	2.6	3.3
Program expenditures	60,165	61,284	62,255	63,467	65,348	67,614
% change	-2.3	1.9	1.6	1.9	3.0	3.5
% of GDP	19.0	18.5	18.1	17.8	17.5	17.5
Debt charges	6,984	7,723	8,521	9,194	9,236	9,422
as % of revenues	11.1	11.8	12.3	12.6	12.4	12.2
Generations Fund deposits	0	929	1,047	1,108	1,560	2,008
Budgetary Reserve	0	-400	-200	-100	0	0
Net results Gov. Corp.	1,349	203	122	-403	-706	-929
Shortfall to be offset					975	975
Total OTHER	1,349	732	969	605	854	1,079
<b>BALANCE</b>	<b>-3,150</b>	<b>-2,871</b>	<b>-453</b>	<b>1,108</b>	<b>1,560</b>	<b>2,008</b>
% of GDP	-1.0	-0.9	-0.1	0.3	0.4	0.5
Payments dedicated to the Generations Fund	-760.0	-929	-1,047	-1,108	-1,560	-2,008
<b>BALANCE after payments</b>	<b>-3,150</b>	<b>-3,800</b>	<b>-1,500</b>	<b>0</b>	<b>0</b>	<b>0</b>
% of GDP	-1.0	-1.1	-0.4	0.0	0.0	0.0
<b>NET DEBT</b>	<b>158,995</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>	<b>NA</b>
% of GDP	50.1	--	--	--	--	--

Source: Finances Québec, 2011 Update on Québec's Economic and Financial Situation.

tion payments, are also expected to decline in 2012-13 and 2013-14 to the tune of \$444 million over two years. In these latter projections, the government argues that its Equalization entitlements are set to decrease on the heels of a better performance by the Québec economy relative to where other provinces stood at the time of the 2011 budget.

While federal fiscal arrangements are set to decrease over the medium-term, revenues derived from the federal government, as a whole, are up thanks in large part to the recent signing of the Canada-Québec Harmonized Sales Tax (HST) on September 29, 2011. With a formal deal now in place, the Québec government will receive \$2.2 billion in compensation in two installments: \$733 million in 2012-13 and \$1,467 million in 2013-14. These amounts have now made their way into the province's fiscal plan.

#### Return to budgetary balance unchanged at 2013-14

Upon first glance, it is surprising that such a large revenue windfall would not translate into significant improvements in Québec's fiscal position. However, this is exactly what we see upon inspection – the government's deficit tallies in 2012-13 and 2013-14 are identical to that presented in the 2011 budget when transition payment funding was not secured. What's more, the original deficit timetable of 2013-14 remains firmly in place and on track. The lack of change to the overall bottom line has to do with \$1.3 billion in 'measures to be identified' which were included in the budget profile as part of the government's expenditure restraint efforts. Such measures appear to be shelved or

QUÉBEC ECONOMIC ASSUMPTIONS			
[ % change unless otherwise noted ]			
Calendar Year	2010	2011	2012
<b>Nominal GDP</b>	5.0	4.4	3.7
<b>Real GDP</b>	2.9	1.6	1.6
<b>Housing starts ('000s)</b>	51.4	45.1	41.0
<b>Employment ('000s)</b>	66.7	54.1	35.4
<b>Unemployment rate (%)</b>	8.0	7.6	7.6

Source: Finances Québec, 2011 Update on Québec's Economic and Financial Situation.

perhaps punted to later on down the road. Increases to the contingency reserve also erode some of the HST transition money. On the net debt front, revised numbers were not included in today's update, but with the deficit profile virtually unchanged, no significant updates since the March budget are expected.

The government's return to surplus is stipulated by current legislation. It must also comply with annual deficit reduction targets and maintain fiscal balance in 2013-14 and thereafter. With such a timetable, the province is set to return to budgetary balance one year earlier than the federal government (2014-15) and four years before Ontario (2017-18). If realized, the better fiscal position should give Québec a competitive advantage. However, as we argued in our March 2011 budgetary commentary, there are many downside risks to the medium- to long-term fiscal plan. Examples include ageing demographics, intensifying age-related spending like health care, and the upcoming renewal of federal-provincial fiscal arrangements. With such a long list, challenges remain front and centre for policymakers.

*Sonya Gulati*  
Economist - Regional and Government Finances  
416-982-8063

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