BUDGET ANALYSIS

Quebec: Budget 2024–2025

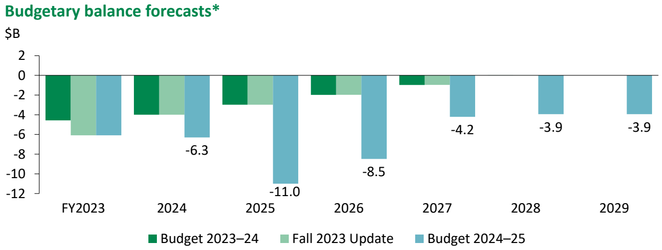
Economic Weakness and Collective Agreement Renewals Make the Path to a Balanced Budget Even More Difficult

By Jimmy Jean, Vice-President, Chief Economist and Strategist, Marc Desormeaux, Principal Economist, and Benoit P. Durocher, Director and Principal Economist

HIGHLIGHTS

- Quebec's financial plan shows a significant deterioration in public finances. Budget 2024–2025 (FY2025) does not include a plan for a return to budget balance and predicts a record deficit next year (graph 1).
- This deterioration reflects weaker-than-expected economic conditions after the 2023 technical recession and the cost of public sector wage increases. The latter effect accounts for approximately two-thirds of the rise in spending compared to what had been predicted in the fiscal update published in November 2023.
- Some other financial indicators are less pessimistic. Quebec's debt-to-GDP ratio is not expected to reach the peak of the early 2010s. This budget also contains an additional $4B in provisions for economic risks in FY2025 to FY2027, which could positively affect the bottom line if it proves unnecessary.

Graph 1
Quebec's budgetary balance



* After deposits in the Generations Fund.
Quebec Ministry of Finance and Desjardins Economic Studies

- The new measures are, for the most part, geared toward the health and education sectors and are mainly aimed at enhancing previous plans.
- Quebec's financing program is now expected to reach $21.5B in FY2024, $36.5B in FY2025 and $32.7B in FY2026, as well as $81B from FY2027 to FY2029.

Desjardins Economic Studies: 514-281-2336 or 1-866-866-7000, ext. 5552336 • desjardins.economics@desjardins.com • desjardins.com/economics

Table 1
Budget Arithmetic

$B (unless otherwise indicated)	2022–23 Actual	2023–24 Update*	2023–24 Budget	2024–25 Update*	2024–25 Budget	2025–26 Update*	2025–26 Budget	2026–27 Update*	2026–27 Budget	2027–28 Update*	2027–28 Budget	2029–29 Budget
Total Revenue	144.3	149.1	146.8	152.0	150.3	157.7	156.6	164.4	163.8	168.2	168.5	172.8
Own-Source Revenue	115.6	117.6	115.5	122.1	120.9	126.2	126.1	131.6	131.9	135.5	136.4	140.8
Federal Transfers	28.7	31.5	31.3	29.8	29.4	31.5	30.4	32.8	31.9	32.7	32.1	32.0
Total Expenses	147.3	150.3	151.0	152.6	157.6	157.3	162.1	162.2	165.6	164.9	170.1	174.6
Program Spending	137.2	140.4	141.3	142.7	147.8	147.3	152.5	151.7	155.5	153.8	159.1	163.0
Debt Service	10.1	9.9	9.7	10.0	9.8	10.0	9.6	10.5	10.1	11.1	11.0	11.6
Contingency Reserve	---	---	---	---	---	---	0.8	---	1.5	---	1.8	2.0
Provisions for economic risks	0.0	0.5	---	0.0	1.5	0.0	1.5	0.5	1.5	0.5	1.5	1.5
Balance	**-3.0**	**-1.7**	**-4.2**	**-0.7**	**-8.8**	**0.4**	**-6.3**	**1.7**	**-1.8**	**2.8**	**-1.4**	**-1.3**
% of GDP	*-0.6*	*-0.3*	*-0.7*	*-0.1*	*-1.5*	*0.1*	*-1.0*	*0.3*	*-0.3*	*0.4*	*-0.2*	*-0.2*
Generations Fund	3.1	2.2	2.1	2.3	2.2	2.4	2.2	2.7	2.4	2.8	2.6	2.7
Budget balance within the meaning of the Act	**-6.1**	**-4.0**	**-6.3**	**-3.0**	**-11.0**	**-2.0**	**-8.5**	**-1.0**	**-4.2**	**0.0**	**-3.9**	**-3.9**
% of GDP	*-1.1*	*-0.7*	*-1.1*	*-0.5*	*-1.9*	*-0.3*	*-1.4*	*-0.2*	*-0.7*	*0.0*	*-0.6*	*-0.6*
Net Debt (% of GDP)	**38.3**	**37.9**	**39.0**	**37.8**	**40.3**	**37.4**	**41.0**	**36.8**	**40.6**	**35.9**	**40.0**	**39.5**
Real GDP (% change)	*2.6*	*0.6*	*0.2*	*0.7*	*0.6*	*1.6*	*1.6*	*1.6*	*1.7*	*1.6*	*1.7*	*1.7*
Nominal GDP (% change)	*9.6*	*4.0*	*3.9*	*3.4*	*4.0*	*3.5*	*3.8*	*3.5*	*3.7*	*3.5*	*3.7*	*3.6*
Financing Program	**---**	**21.9**	**21.5**	**29.0**	**36.5**	**28.7**	**32.7**	**25.3**	**28.1**	**21.9**	**26.5**	**26.5**
Net financial requirements	---	14.5	14.8	15.8	28.5	14.3	22.6	15.2	17.5	13.7	17.4	16.2

* Fall 2023 Economic and Financial Update.
Quebec Ministry of Finance and Desjardins Economic Studies

Main Developments

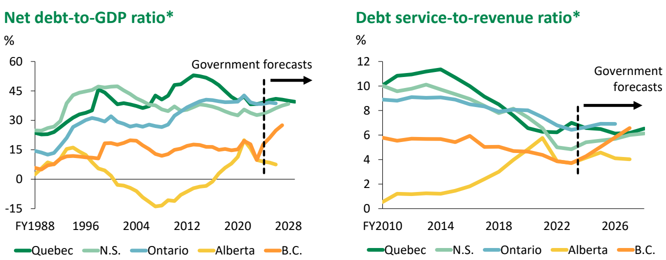
Quebec's 2024–25 budget shows a significant deterioration in its fiscal position. The government increased its forecast deficits by at least $3B for each fiscal year from FY2024 onwards and will only present a plan for a return to budgetary balance in next year's budget. Moreover, the $11B deficit predicted for FY2025 will be the largest ever recorded in Quebec.

Two factors are behind the deterioration in Quebec's public finances. The first is a weaker-than-expected economic outlook that follows a technical recession in 2023. That contributed to a downward revision of more than $5B to tax revenue forecasts for FY2024, FY2025 and FY2026 combined. The other key factor is the cost of wage increases in the public sector stemming from the renewal of collective agreements.

Some financial indicators are less pessimistic. Despite a deterioration in the budgetary outlook, the debt-to-GDP ratio in Quebec should not reach its peak of more than 50% from the 2010s. In fact, the baseline scenario peak of 41% is consistent with that of the two fiscal years preceding the pandemic. This ratio is an important measure of financial sustainability, followed by a number of organizations such as Canada's Parliamentary Budget Office. Over the longer term, Quebec's debt service ratio is anticipated to be lower than Ontario's and British Columbia's (graph 2). Moreover, this budget increased provisions for economic risks by a combined $4B for FY2025 to FY2027. That could positively affect the budgetary balance if it proves unnecessary.

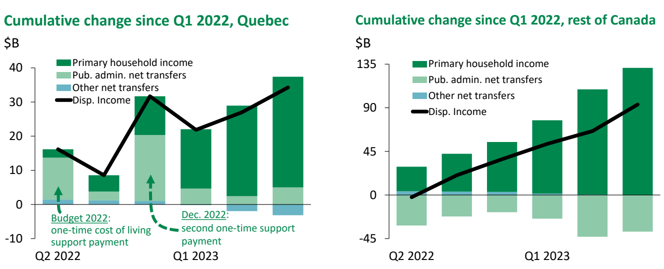
With respect to new measures, the government opted for restraint. Since inflation began picking up, Quebec has been the most generous province in terms of cost of living support. The effects of a series of tax cuts and household transfers are clear in the data: reductions in household transfers to governments have meaningfully increased Quebecers' disposable income and savings (graph 3). This gives households a cushion that should help them navigate the challenging economic environment ahead.

Graph 2
Debt burden of Quebec and the other provinces



* Ontario figures based on FY2024 mid-year update forecasts.
Provincial budget documents and Desjardins Economic Studies

Graph 3
Support measures have boosted Quebec household incomes



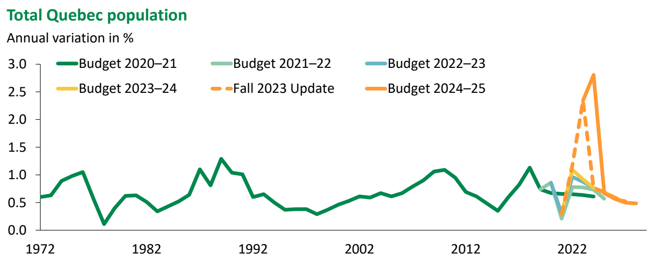
Statistics Canada, Institut de la Statistique du Québec and Desjardins Economic Studies

Population growth continues to be a risk to watch. Although population growth forecasts for this year were revised higher following the recent surge, Quebec has yet to alter its projections for later years (graph 4). Stronger-than-expected headcount gains would have mixed effects on the province's public finances. On the one hand, faster-than-expected demographic growth could help address labour shortages, which continue to plague many businesses in Quebec, and boost economic activity and government revenues by extension. On the other hand, if the population continues to advance this much faster than the historical average, it could also put persistent upward pressure on government spending, even beyond FY2025.

A Weaker Economy Hurts the Bottom Line

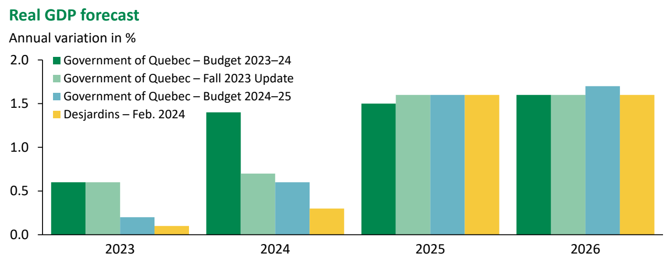
In line with the downturn observed at the end of 2023, the government now expects a more modest expansion over the next two years. Budget tax revenue losses amount to over $5B for FY2024 and FY2025 compared to the plan published in November, mainly due to a more unfavourable economic and financial climate. The data presented in table 2 primarily reflect this effect, while unexpected gains in the "other income" category roughly offset Hydro-Québec's lower net income. The good news is that the government anticipates a recovery in economic activity as we progress through 2024, in line with our projections published in February (graph 5).

Graph 4
Population growth more persistent than before



Statistics Canada, Quebec Ministry of Finance and Desjardins Economic Studies

Graph 5
More pessimistic economic forecasts



Quebec Ministry of Finance and Desjardins Economic Studies

Table 2
Adjustments to the Financial Framework Since November 2023

$M (unless otherwise indicated)	2023–24	2024–25	2025–26
Budget Balance – November 2023*	-3,995	-2,982	-1,975
New Revenues	-2,275	-1,753	-1,478
New Spending	375	2,994	2,845
Reduction in Deposits in the Generations Fund	160	82	224
Total – adjustments	-2,490	-4,666	-4,100
Health and social services, education, and higher education	188	1,058	925
Supporting Quebecers and communities	129	438	486
Economic priorities	---	441	596
New Initiatives	317	1,937	2,007
Optimizing government action	---	86	345
Reduction of the Contingency Reserve	---	---	750
Change in contingency reserves	-500	1,500	1,500
Budget Balance – March 2024*	**-6,302**	**-10,998**	**-9,986**

* After deposits into the Generations Fund.
Quebec Ministry of Finance and Desjardins Economic Studies

An alternative, more pessimistic scenario in which real GDP falls by 0.5% this year would add about $2.5B to deficit for FY2025 and FY2026 combined. In each fiscal year from FY2025 to FY2029, it would add 0.4 to 1.0 percentage points to the net debt-to-GDP ratio. Fortunately, contingencies baked into the fiscal plan would be enough to absorb these costs.

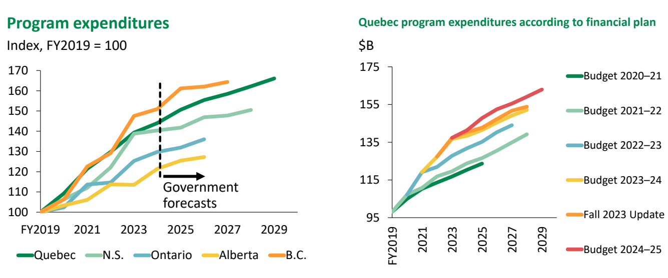
Details of Spending and New Measures

Public sector wage increases account for the bulk of new spending plans. This had been signalled by the provincial government after collective agreement negotiations wrapped up earlier in 2024. According to the budget, "the financial framework includes an annual adjustment of over $3 billion to portfolio expenditures since the *Update on Québec's Economic and Financial Situation – Fall 2023*, essentially to reflect the agreements reached and the negotiations to come." This suggests that payroll costs account for about two-thirds of the increase in spending projections from FY2025 to FY2028 versus November 2023. Changes in the timing of infrastructure projects and higher projected demographic growth contributed as well.

Aside from wage increases, new measures announced in the budget were largely incremental. They build on initiatives announced in previous blueprints and fall into three categories. The first amounts to $4.9B (0.15% of nominal GDP) over the next five fiscal years and includes funding to help accelerate the digital shift in the healthcare system and for enhancing home-support services. The second category of new measures, called "Supporting Quebecers and Communities," includes efforts to promote access to housing and improve social inclusion among vulnerable populations. Its cost is estimated at $2B (0.06% of nominal GDP) from FY2025 to FY2029. Measures under the "Acting on Economic Priorities" umbrella total $1.9B (0.06%) from FY2025 to FY2029, and offer funds to encourage new technologies, support the forestry sector following last year's forest fires and boost mobility and vitality in the regions.

In all, new measures put Quebec in second place among the provinces with respect to program spending growth since the start of the pandemic, just behind British Columbia (graph 6).

Graph 6
Quebec's program expenditures compared to other provinces

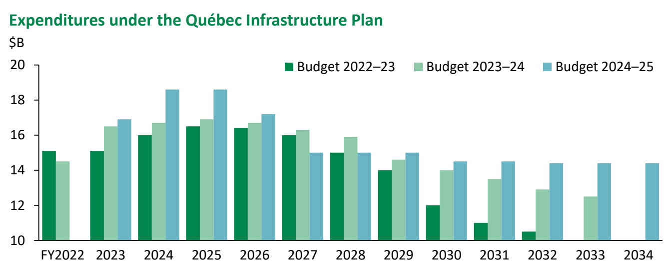


* Ontario figures based on FY2024 mid-year update forecasts.
Statistics Canada, provincial budget documents and Desjardins Economic Studies

Achieving deficit targets will depend on the success of two long-term objectives. First, the government highlighted a $6B gap that will need to be bridged from FY2026 to FY2029 if it is to achieve fiscal balance in its operations. Accordingly, the province will begin reviewing its spending in the spring, and also affirmed its commitment to boosting Quebec's potential growth and increase the wealth of Quebecers over time. The government will also attempt to optimize its operations, which it estimates could help it recover $2.9B in revenues over five years.

The budget also raised infrastructure spending projections compared to last year's plan. The Quebec Infrastructure Plan should total $153B between FY2025 and FY2034. The biggest increases over last year's forecast will take place in FY2024 and FY2025 (graph 7), with an increase of more than $7B compared to the Budget 2023 forecasts for the FY2024 to FY2034 period. Infrastructure spending plans remain focused on healthcare, education and public transit.

Graph 7
More long-term infrastructure spending



Quebec Ministry of Finance and Desjardins Economic Studies

Borrowing Program and Financial Markets

Quebec's financing program is now expected to reach $21.5B in FY2024, $36.5B in FY2025 and $32.7B in FY2026, as well as $81B from FY2027 to FY2029. The figures for FY2025 and FY2026 represent respective increases of $7.4B and $4.1B compared to the November 2023 update. Refinancing represents 45% and 52% of the total for fiscal years 2025 and 2026, respectively. Nearly the entire program for FY2024 was completed on February 23, 2024. In FY2024, before the contribution of swaps, 77% of Quebec's debt is expected to be denominated in Canadian dollars, with shares of 10% for euros and 10% for US dollars. For FY2025, the government expects the share of its debt subject to an interest rate change to be only 16%. According to the Ministry of Finance, the average maturity of borrowings for fiscal year 2024 is 14 years. Given the high demand for Quebec's Green Bonds, the government pledged to continue to issue the bonds regularly.

Quebec's long-term bond spreads widened immediately after the budget's publication. Investors seem to have been surprised by the extent of the deterioration in the province's financial situation and by the increase in the borrowing program, despite government communications.

Over the next few months, we expect Quebec's bond spreads to evolve in line with risk sentiment in global markets. In the longer term, the expanded borrowing program could deepen bond spreads. However, if the province manages to reduce the deficits and debt burden it targeted in today's financial plan, it should be well received by investors and could support reductions in borrowing costs over time.

Final Thoughts: Deeper Reflection Will Eventually Be Needed

It's never easy for a government to table a budget when the needs of its population are still great, but resources are limited. It was a particularly difficult exercise for Minister Girard this year. Renewal of collective agreements, inflation-induced rises in government costs, increased debt costs driven by higher interest rates and weaker economic growth were just some of the challenges with which Minister Girard had to contend. And the effects of these forces were significant, as evidenced by much wider budgetary deficits and a delay in the planned return to black ink.

Budget 2024 is a reminder of the harsh reality facing many governments around the world and also shows what little leeway the Quebec government has to manage its finances going forward. Of course, the budgetary situation should improve with economic conditions, but the government will nonetheless need to think seriously about its long-term priorities in the coming years. Pressures from population growth and aging will only increase in the coming decades. As such, funding of the healthcare system and education sector, maintenance and development of public infrastructure—particularly the road network—efforts to support the energy transition, and provision of affordable housing will all be of vital importance. All of this is occurring against a backdrop in which the Quebec government has few levers to meaningfully increase its revenues, as Quebecers are already some of the most heavily taxed not only in North America, but among industrialized countries. In short, to deliver on public spending in priority areas, Quebecers will undoubtedly have to resolve to reduce other public services. Planned optimization of government operations announced in today's budget is a step in the right direction, but further analysis will almost certainly be needed in the coming years.

The consolidation of public finances before the pandemic undoubtedly helped reduce Quebec's debt burden, but following the deterioration detailed in this plan, the province's financial situation remains fragile. And with high debt levels, potentially higher-for-longer interest rates present outsized risk. Accordingly, it's crucial for the Quebec government's longer-term planning to include a credible path to balance the books, as well as aim to lower the debt burden as a share of GDP. For now, the projections in today's budget don't fully address those concerns.