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## Quebec's fall financial update Larger - though still manageable - deficits

The significant upward revision to Ontario's deficit last week sent shockwaves not only for what it reveals about the financial situation of Canada's largest province but also for what it might signal about other provinces that had presented their budgets many months ago in the spring. Quebec being next in line to provide an economic and financial update, concerns had accordingly risen that the \$3.9 billion deficit projected for 2009-10 in the March provincial budget would be marked up substantially.

Today, Quebec Finance Minister Raymond Bachand did indeed confirm that the financial picture had deteriorated but, overall, not quite as much as feared. The deficit for 2009-10 is now expected at \$4.7 billion, an increase of \$749 million or 19% relative to the March budget. The Quebec government also raised its projection for 2010-11 from \$3.8 billion to \$4.7 billion, a 24% bump up. While these are meaningful revisions, they are much less dramatic than the roughly 80% ballooning deficit reported in Ontario – and, for that matter, the 66% surge in this year's federal deficit since the federal budget in January. A significant factor in the deterioration in Ontario, and federally, was large financial aid to the auto sector, which has been absent in Quebec.

In contrast to Ontario, which is now facing its highest deficits on record, the upwardly revised budget shortfalls in Quebec remain smaller than those posted during the first half of the 1990s. Relative to GDP the deficits in Quebec measure 1.6% and 1.5% in 2009-10 and 2010-11, respectively, or less than half of the 3.4% achieved in 1994-95 and the modern-day high of 3.9% in 1984-85.

The higher projected deficit this fiscal year equally reflects downward revisions to revenues and higher expected expenses. Total revenues (\$62.0 billion) are now projected to be \$187 million (or 0.3%) lower than forecast in the March budget (and down 1.4% compared to 2008-09). This stems from lower-than-expected receipts from both personal income taxes (\$450 million) and corporate income taxes (\$125-million). However, expected revenues from the province's value-added consumption tax have been bumped up by \$100 million relative to the March budget due to stronger-than-expected housing sector activity, while federal transfers are projected \$315 million higher due to recent agreements signed between the Quebec and the federal government (mainly the Canada-Quebec Base Fund Agreement (Building Canada) and the Canada-Quebec Labour Market Agreement).

Total expenditures, now at \$66.3 billion, represent a \$200 million (or 0.3%) increase from the March budget primarily as result of a boost in funding to the province's Renfort program, "which has been more successful than expected and in helping support the economy and employment". The Renfort program, which provides loan guarantees and other support to businesses, is a key element of the Quebec government's plan to jumpstart the economy. A rise in the debt service charge of \$50 million accounts for the remainder of the rise in total expenditures.

Finally, the Quebec government has introduced a \$300 million provision for revenue shortfalls in 2009-10, a prudence factor that was absent in the March budget.

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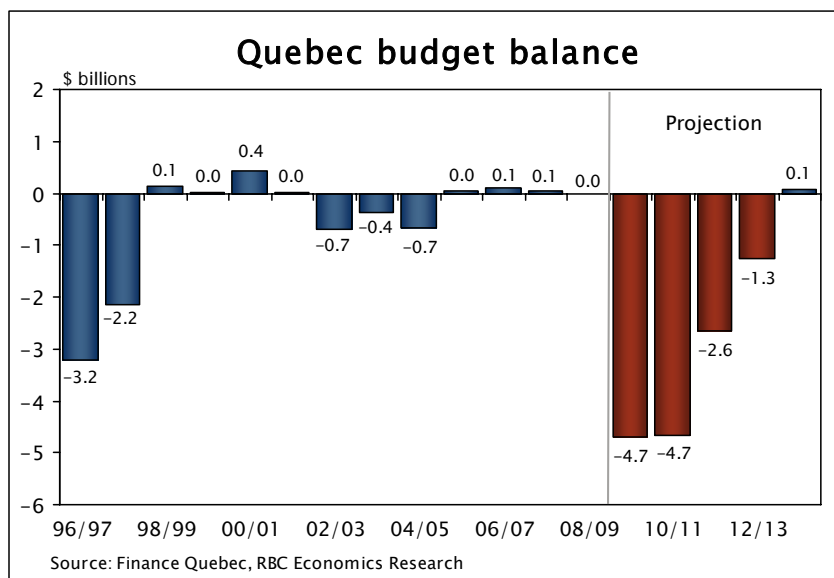
For 2010-11, the deficit revision again reflects changes to revenues and expenditures of approximately equal magnitude. On the revenue side, the projection for personal income tax revenues has been reduced by \$500 million (less rapid growth in employment and wages) and a \$300-million drop in Hydro-Quebec's profits has been budgeted amid weaker-than-expected outlook for selling prices on the export market. These declines, however, are partially offset by upward revisions to consumption taxes (\$200 million) and corporate income taxes (\$75 million). In balance, total revenues next fiscal year are now projected to be \$432 million (0.7%) lower than forecast in the March budget.

On the expenditure side, both program spending and debt service expenses have been revised higher by \$170 million and \$118 million, respectively.

Interestingly, the provincial government has not set aside any provision for revenue shortfalls or other contingencies for 2010-11.

As was the case in Ontario, this deterioration in the financial picture of the Quebec government stems only partly from weaker-than-expected economic performance. The Ministry of Finance now forecasts real GDP growth at -1.5% in 2009 and 1.7% in 2010, down modestly from -1.2% and 1.9%, respectively, in the March budget. This compares with RBC's forecast of -1.9% this year and 2.2% next year (as of our September *Provincial Outlook*).

Longer-term, the Quebec government remains committed to balancing its books by 2013-14. However, with the cumulative deficit over the next five years now projected to be \$1.7 billion higher at \$13.2 billion, that task will be even more daunting – especially considering that the budget reserve will be exhausted by the end of this fiscal year and that no provision for contingencies has been set aside past 2009-10. As the government itself stated, the return to balance will imply “difficult choices”.



## Quebec's fiscal plan

(\$ millions)	Actual		March Budget		October Update	
	2007/08	2008/09	2009/10	2010/11	2009/10	2010/11
<b>Total revenues</b>	63,093	62,916	62,212	64,017	62,025	63,585
<b>Total expenditures</b>	61,847	65,054	66,093	68,525	66,293	68,813
Program spending	54,826	58,550	59,989	61,879	60,139	62,049
Interest on public debt	7,021	6,504	6,104	6,646	6,154	6,764
<b>Net results of consolidated entities</b>	404	880	355	563	155	369
<b>Provision for revenue shortfall</b>					(300)	
<b>Plan to return to balanced budgets</b>				1,065		1,065
<b>Surplus/(Deficit)</b>	1,650	(1,258)	(3,526)	(2,880)	(4,413)	(3,794)
<b>Deposit of dedicated revenues in the Generations Fund</b>	649	587	715	880	715	881
<b>Stabilization reserve</b>	(1,001)	1,845	295	-	433	-
<b>Budgetary balance for the purposes of the Balanced Budget Act</b>	<b>0.0</b>	<b>0.0</b>	<b>(3,946)</b>	<b>(3,760)</b>	<b>(4,695)</b>	<b>(4,675)</b>
<b>as % of GDP</b>	0.0	0.0	(1.3)	(1.2)	(1.6)	(1.5)

Source: Finances Quebec, RBC Economics Research