THE QUÉBEC ECONOMIC PLAN

March 2018

The Generations Fund

BUDGET 2018-2019

Québec Is Repaying Its Debt

Québec

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Budget 2018-2019
The Generations Fund: Québec Is Repaying Its Debt

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HIGHLIGHTS

In 2006, the government established the Generations Fund, thereby adopting an original, bold approach in order to control and then reduce the debt burden on public finances, beyond changes in the economic situation.

— The strategy has been maintained despite the economic and financial crisis of 2008 and the ensuing budgetary deficits.

Just over 10 years later, the strategy is bearing fruit and the strides we have made are impressive.

— As at March 31, 2018, the Generations Fund stood at $13 billion and the debt burden in relation to gross domestic product (GDP) is decreasing.

— These results stem directly from the strategy adopted and the attendant gains.[1]

To give concrete expression to the results already obtained and prepare for the future, the government is entering a new phase.

— Québec will begin in 2018-2019 to repay its debt using part of the amounts accumulated in the Generations Fund.

— The government is simultaneously maintaining a winning strategy by continuing to dedicate revenues to the fund, which will guarantee its future growth.

In *The Québec Economic Plan − March 2018*, the government presents the results obtained and the new policy directions implemented to enable Québec to free itself of debt and benefit from the fruits of its efforts.

The decisions and future policy directions are part of a short- and medium-term economic and fiscal projection.

— The publication of Québec's short- and medium-term economic and financial framework reflects the good practices of budget transparency of the Organisation for Economic Co-operation and Development (OECD).[2]

— It satisfies recommendation 14 of the Auditor General of Québec in his special 2014-2015 report.[3]

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1 See Ministère des Finances du Québec, *The Québec Economic Plan – Budget 201--2018*, *The Generations Fund: A Renewed Commitment to Fostering Intergenerational Equity*, *March 2017*.

2 OECD, *OECD Best Practices for Budget Transparency*, *2002*.

3 Auditor General of Québec, *Rapport spécial du Vérificateur général du Québec à l'Assemblée nationale pour l'année 2014-2015 − Vérification particulière*, *évolution du solde budgétaire du gouvernement pour l'année 2014-2015*.

Québec's medium-term financial and fiscal position and the underlying perspective are presented in the three sections of this document.

— Impressive strides have been made in the restoration of public finances: budgetary balance has been re-established and the reduction of indebtedness is accelerating even as the government continues to provide quality services.

— The results are enabling the government to enter a new phase by beginning to repay its debt while maintaining the Generations Fund, a winning strategy, and growth in the funds accumulated there. By 2022-2023, it will be possible to better fund public services and invest more extensively in infrastructure.

— By 2034-2035,[4] the government is presenting projections that illustrate its perspective of the management of public finances and the debt over a longer period, management that meets the main challenges of the future, whether a possible reversal of economic conditions or the impact of demographic changes.

4 In this document overall, budgetary data until 2022-2023 are forecasts and those for subsequent years are projections.

1. ACCELERATED GROWTH OF THE GENERATIONS FUND AND THE RESTORATION OF FISCAL BALANCE HAVE BEEN ACHIEVED

Since the Generations Fund was established in 2006, considerable effort has been devoted to freeing Québec from its debt.

Such efforts are bearing fruit: growth in the Generations Fund is accelerating and the debt burden in relation to the economy is decreasing rapidly.

1.1 Accelerated growth of the Generations Fund

In 2006, the National Assembly adopted quasi-unanimously legislation to set debt reduction targets and established the Generations Fund.[5]

By tackling the debt, the government wished to foster intergenerational fairness, hence the fund's name, and ensure the continued existence of social programs.

— As the Minister of Finance noted in the 2017-2018 Budget Speech, "the Generations Fund is the most powerful instrument of intergenerational equity ever adopted by a government."[6]

— Each payment to the Generations Fund is made, first and foremost, with young people in mind.

The Act to reduce the debt and establish the Generations Fund
The *Act to reduce the debt and establish the Generations Fund* (CQLR, chapter R-2.2.0.1) was adopted on June 15, 2006. The Act sets the debt-reduction targets and establishes the Generations Fund, which is earmarked exclusively for gross debt repayment. It stipulates the sources of revenue dedicated to the Generations Fund to repay the debt. The Act allows the government to decree that the portion that it sets of any amount be allocated to the Generations Fund that otherwise would be attributed to the General Fund of the Consolidated Revenue Fund. The amounts that make up the Generations Fund are deposited at the Caisse de dépôt et placement du Québec and managed following the investment policy determined by the Minister of Finance in collaboration with the Caisse.

5 Three members of the National Assembly voted against the *Act to reduce the debt and establish the Generations Fund*, adopted on June 15, 2006.

6 *The Québec Economic Plan*, 2017-2018 Budget Speech, March 2017, page 4.

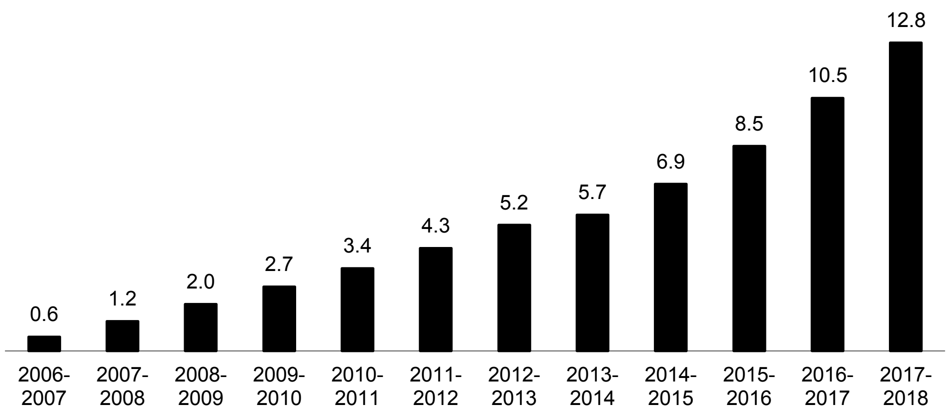
❑ The amounts accumulated in the Generations Fund since 2006

As a result of the mode of operation defined in 2006 and followed since then, the Generations Fund has grown considerably, more rapidly so in recent years.

— In just over 10 years, the capitalization of the Generations Fund has risen from $600 million as at March 31, 2007 to nearly $13 billion as at March 31, 2018.

CHART 1

Change in the book value of the Generations Fund
(billions of dollars)

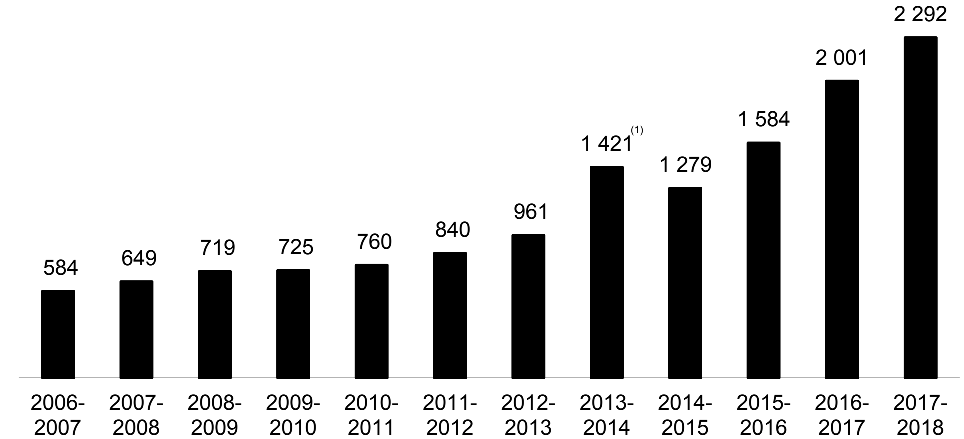


Growth in the Generations Fund has been continuous and has accelerated over the years, especially because of the reinvestment of investment income.

Deposits to the Generations Fund increased from $584 million in 2006-2007 to $2 292 million in 2017-2018.

CHART 2

Change in the amounts earmarked for the Generations Fund
(millions of dollars)



(1) In 2013-2014, a one-off payment of $300 million from the Territorial Information Fund was made to the Generations Fund.

❑ The growing importance of investment income

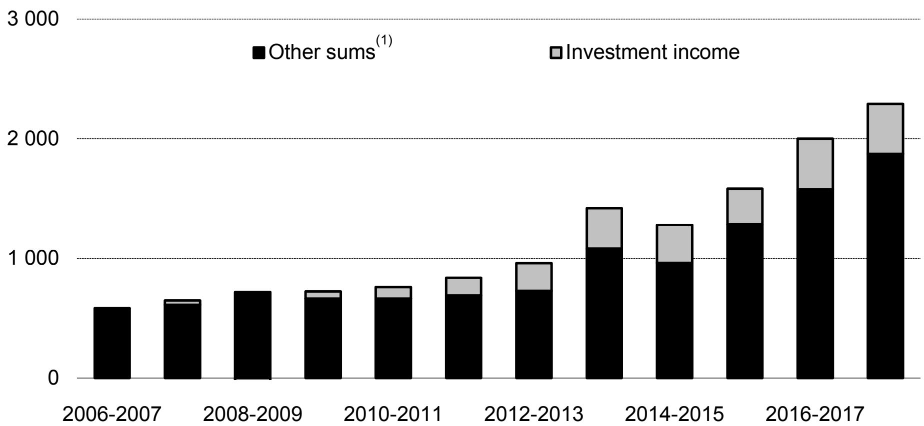
Over the years and because of the fund's operating mechanism, a major change has occurred in the relative importance of the sums allocated to it.

- During its first years of existence, most of the amounts transferred to the Generations Fund came from dedicated revenues excluding investment income.
- In 2017-2018, the investment income from the Generations Fund represented 18.2% of the amounts devoted to the fund.

For 2017-2018 alone, the amounts paid into the Generations Fund stand at nearly $2.3 billion, including over $400 million from investment income.

CHART 3

Amounts allocated to the Generations Fund
(millions of dollars)



(1) The amounts include revenues (excluding investment income) dedicated to the Generations Fund and certain ad hoc payments.

The Generations Fund: the gain obtained by not directly repaying the debt

The establishment of the Generations Fund has afforded Québec taxpayers overall a considerable gain in relation to the option that would have consisted in directly earmarking the dedicated revenues to debt repayment.

− By entrusting to the Caisse de dépôt et placement the amounts dedicated to the Generations Fund, they have benefited from a rate of return higher than the cost of the borrowings that the funds could have repaid.

From 2007 to 2017, the average return was 5.6%, while the average cost of new borrowings was 3.5%, which represents a difference of 2.1-percentage points.

− Over the past nine years, from 2009 to 2017, so as to exclude the global financial crisis of 2008, the average return was 9.3%, while the average cost of new borrowings was 3.2% for this period, which represents a difference of 6.1-percentage points.

Comparison of the annual return of the Generations Fund and the Québec government's borrowing cost
(as a percentage, based on a calendar year)

	Return of the Generations Fund	**Cost of new borrowings** [1]	**Difference** (in percentage points)
2007	5.6	4.7	0.9
2008	–22.4	4.5	–26.9
2009	11.3	4.4	6.9
2010	12.3	4.1	8.2
2011	4.0	3.7	0.3
2012	8.4	3.0	5.4
2013	12.0	3.3	8.7
2014	11.7	3.2	8.5
2015	8.1	2.4	5.7
2016	7.3	2.2	5.1
2017	8.5	2.5	6.0

(1) The government's borrowing costs correspond to the yield on 10-year maturity Québec bonds.
Source: PC-Bond for the rate of return on Québec 10-year bonds.

❑ Change in the debt burden in relation to GDP

As a result of the Generations Fund and the restoration of fiscal balance, the gross debt burden in relation to GDP will stand at 49.6% as at March 31, 2018, compared to 54.3% as at March 31, 2015.

The debt representing accumulated deficits, or "bad debt," will represent 27.9% of GDP as at March 31, 2018, compared to 32.3% as at March 31, 2015.

In 2015-2016, the return to budgetary balance meant that the gross-debt-to-GDP ratio decreased for the first time since 2008-2009.

— Gross debt has even declined in absolute value, for the first time since the late 1950s.

CHART 4

Gross debt as at March 31

(as a percentage of GDP)

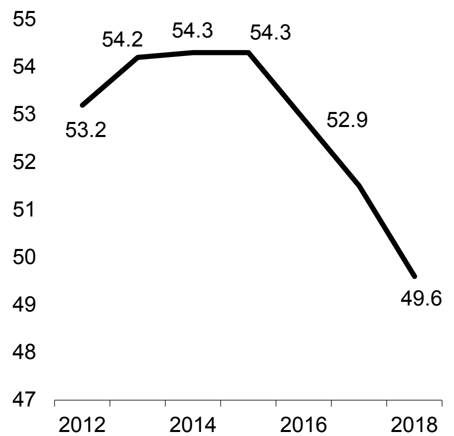
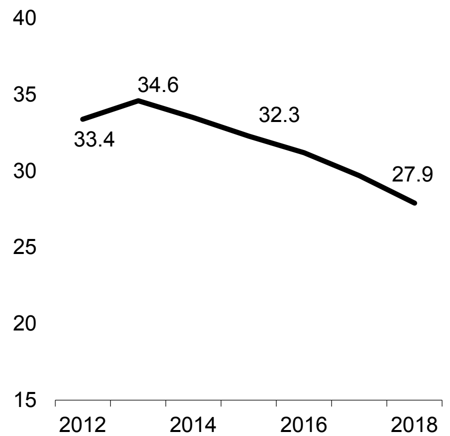


CHART 5

Debt representing accumulated deficits as at March 31

(as a percentage of GDP)



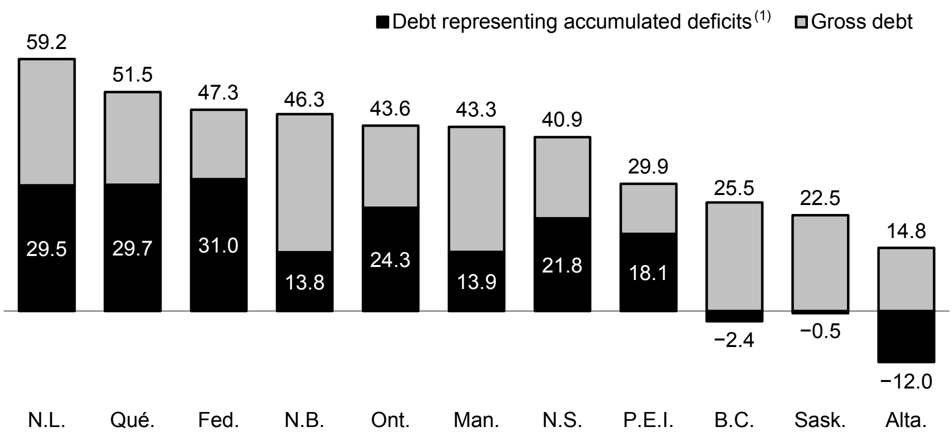
❑ Québec is no longer Canada's most indebted province

Based on gross debt and as a percentage of GDP, Québec is the second most indebted province after Newfoundland and Labrador.

As at March 31, 2017, the federal government's ratio of debt representing accumulated deficits to GDP was higher than that of each of the provinces.

CHART 6

Gross debt and debt representing accumulated deficits as at March 31, 2017
(as a percentage of GDP)



(1) A negative entry means that the government has an accumulated surplus.
Sources: Public Accounts and Statistics Canada.

"Bad debt" and "good debt"

"Bad debt"

"Bad debt" corresponds to accumulated budgetary deficits and is described thus since the government has resorted to indebtedness to fund current spending, which in fact consists in passing on the payment of such spending to the detriment of future generations.

"Good debt"

"Good debt" corresponds to infrastructure funding. In this instance, recourse to indebtedness is warranted since it facilitates funding of investments that engender benefits spread over several years.

Capital outlays in government enterprises used to fund productive investments also justify indebtedness and for this reason are included in "good debt." This is true of Hydro-Québec dams, which are contributing to economic development and thus benefit society as a whole for the future.

1.2 The restoration of fiscal balance

Two years after the inception of the Generations Fund, the 2008-2009 recession dragged Québec into six consecutive years of deficit, between 2009-2010 and 2014-2015.

- The deficits were necessary to maintain the level of public services and support economic activity.
- The budgetary deficits for the period 2009-2015 totalled nearly $15 billion, which further exacerbated the weight of “bad debt”.

The 2008-2009 recession also led the government to invest heavily in infrastructure in order to support economic recovery.

- From 2009-2010 to 2014-2015, gross debt thus increased by $26 billion to fund infrastructure investments.

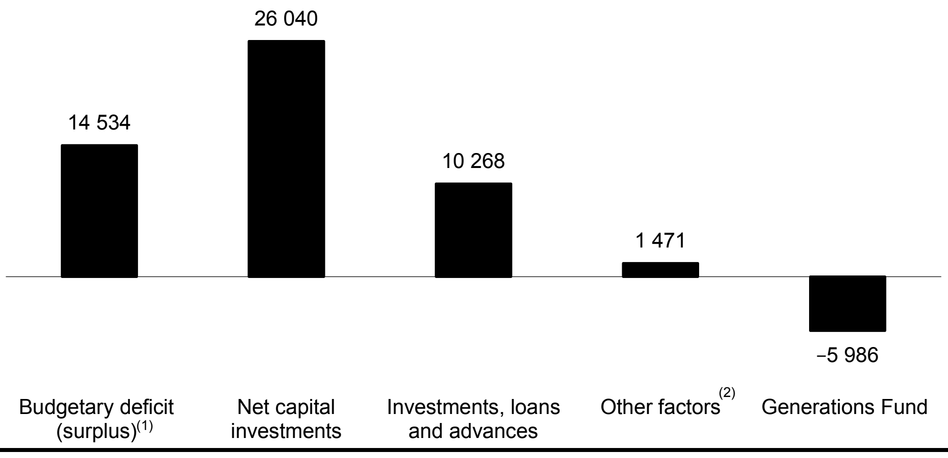
All told, between 2009-2010 and 2014-2015, gross debt increased by $46.3 billion. Accordingly, debt’s share of GDP rose from 50.1% as at March 31, 2009 to 54.3% as at March 31, 2015.

The strategy adopted in 2006 with the establishment of the Generations Fund did, however, limit growth in indebtedness and prepare a reduction in such debt for the future.

- During the entire budget deficit period, the Generations Fund continued to receive the funds dedicated to it, including investment income from already accumulated sums.

CHART 7

Factors responsible for the change in the gross debt over five year – 2009-2010 to 2014-2015
(millions of dollars)



(1) Budgetary balance within the meaning of the *Balanced Budget Act*.
(2) Other factors include, in particular, the change in other accounts, such as accounts receivable and accounts payable.

Starting with the March 2010 Budget, the government set new debt reduction targets to be reached by 2025-2026.

- The targets were stipulated in the *Act to reduce the debt and establish the Generations Fund*.
- For fiscal year 2025-2026:
  - gross debt may not exceed 45% of GDP;
  - the debt representing accumulated deficits may not exceed 17% of GDP.

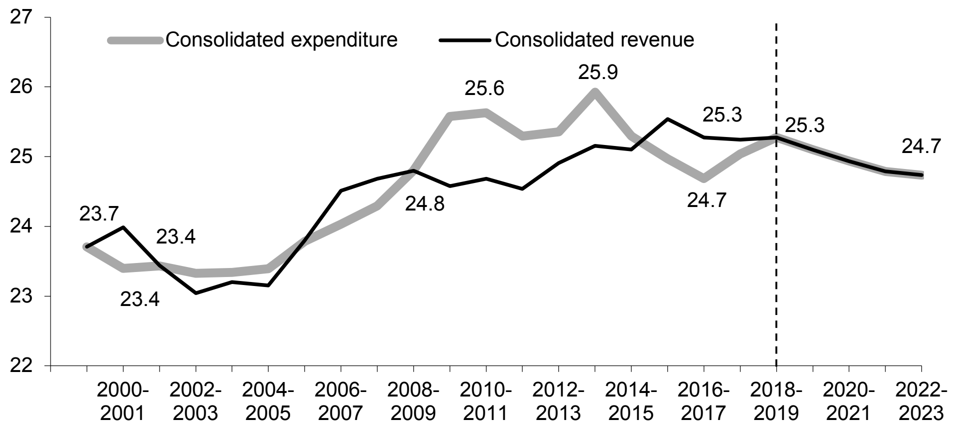
❑ A return to fiscal balance starting in 2015-2016

In recent years, the restoration of fiscal balance has halted growth in “bad debt” while the Generations Fund affords the possibility of maintaining a high level of investment.

- Sound management of public finances and the economy restored fiscal balance in 2015-2016 and has maintained it since then.
  - To achieve fiscal balance, the growth rate target for consolidated expenditure target was set at a rate below that for revenue.
    - Accordingly, for 2014-2015 and 2015-2016, average annual growth in consolidated expenditure stood at 0.8% while that in revenue stood, on average, at 3.6%.
  - The government has also adopted the means to better control its overall spending through:
    - expenditure control and management measures established in government departments and bodies;
    - tightening of tax expenditures.
- A return to fiscal balance halts any increase in the debt stemming from deficits.
- The government has made fiscal balance a top priority.

CHART 8

Change in the share of consolidated revenue[1] and consolidated expenditure in the economy – 1999-2000 to 2022-2023
(as a percentage of GDP)



(1) Revenue takes into account the use of the stabilization reserve and excludes revenues dedicated to the Generations Fund and the contingency reserve.

2. QUÉBEC IS ENTERING A NEW PHASE: DEBT REPAYMENT

Accelerated growth in the Generations Fund is enabling Québec to enter a new phase by using part of the sums accumulated to initiate the actual repayment of a portion of its debt.

— The actual repayment of a portion of the debt will give concrete expression to the efforts made since 2006 to reduce Québec's indebtedness.

— The repayment will provide leeway to better fund public services as a result of interest savings on the debt.

— Moreover, the maintenance of deposits to the Generations Fund will allow for infrastructure investments without increasing gross debt in relation to GDP.

2.1 Repayment of $10 billion of debt over the next five years

In 2018-2019, the government is initiating the actual repayment of the debt, thereby entering a new phase in the management of public finances.

— Starting in 2018-2019, the government will repay each year $2 billion of the debt on the financial markets, drawn from the amounts accumulated in the Generations Fund.

TABLE 1

Use of the Generations Fund for debt repayment
(millions of dollars)

	2017-2018	2018-2019	2019-2020	2020-2021	2021-2022	2022-2023	Total
Book value, beginning of year	**10 523**	**12 815**	**13 306**	**14 013**	**15 004**	**16 269**	
Revenues dedicated to the Generations Fund	2 292	2 491	2 707	2 991	3 265	3 502	
Use of the Generations Fund to repay maturing borrowings	—	–2 000	–2 000	–2 000	–2 000	–2 000	**–10 000**
BOOK VALUE AT YEAR-END	**12 815**	**13 306**	**14 013**	**15 004**	**16 269**	**17 771**	

❑ Debt reduction objectives are being met

The pace of repayment will conform to the objectives set by law for fiscal year 2025-2026.

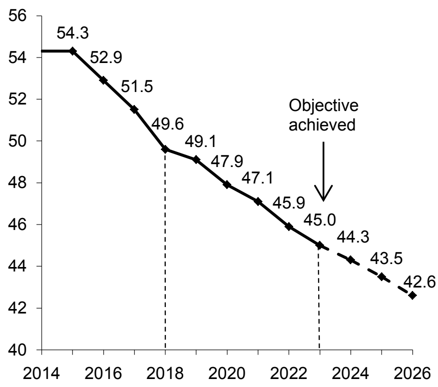
— Gross debt will represent 45.0% of GDP in 2022-2023 and 42.6% of GDP in 2025-2026.

— The debt representing accumulated deficits will reach 16.8% of GDP in 2025-2026.

CHART 9

Gross debt as at March 31

(as a percentage of GDP)

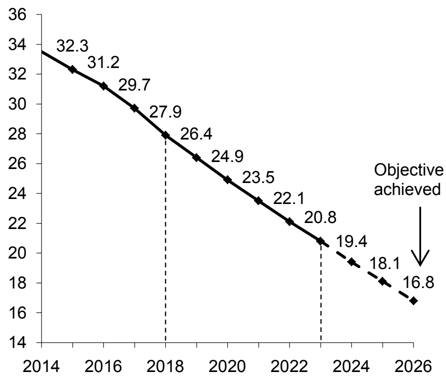


Note: Forecasts until 2023 and projections thereafter.

CHART 10

Debt representing accumulated deficits as at March 31

(as a percentage of GDP)



Note: Forecasts until 2023 and projections thereafter.

2.2 Leeway to better fund public services

Debt repayment will provide leeway to fund public services.

— It will contribute to reducing debt service as a proportion of revenue.

— The government is thus creating fiscal space to bolster funding of public services in relation to the situation where no repayment occurred.

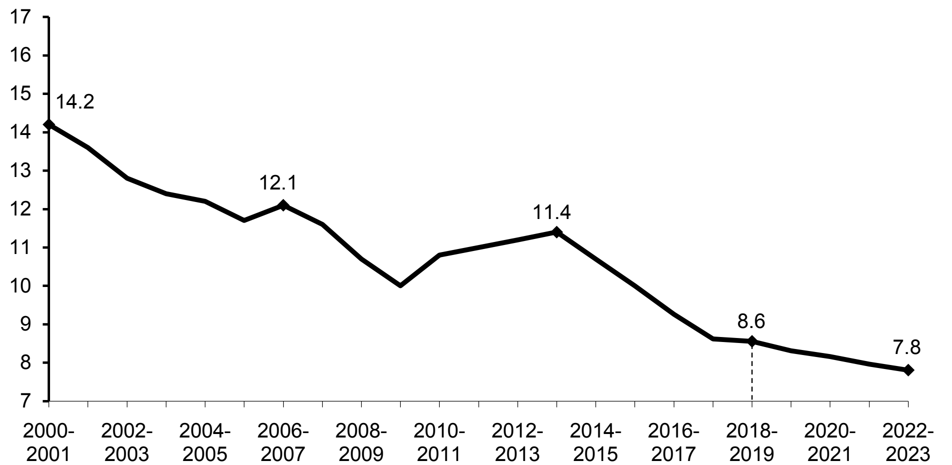
The leeway will grow gradually as the government repays the debt.

— The share of government revenue devoted to debt service will decrease from 8.6% in 2018-2019 to 7.8% in 2022-2023.

— It has been declining for several years and will continue to do so in the coming years.

CHART 11

Debt service
(as a percentage of consolidated revenue)



❑ $1.1 billion in interest savings on the debt over five years

For the period 2018-2023, the leeway freed up stands at $1.1 billion.

- In 2022-2023, such leeway will reach nearly $400 million.
- The leeway will be earmarked for funding public services.

TABLE 2

Interest savings on the debt stemming from debt repayment
(millions of dollars)

	2018-2019	2019-2020	2020-2021	2021-2022	2022-2023	Total
Interest savings on the debt	61	130	209	295	383	**1 078**

2.3 Deposits to the Generations Fund, a winning strategy, will be maintained

The actual repayment of the debt is accompanied by the maintenance of the strategy successfully followed since 2006.

- More than ever, the Generations Fund is an essential tool in efforts to reduce indebtedness.
- The Generations Fund will continue to receive the funds now dedicated to it.
- Such revenue will always include accumulated investment income, which will be reinvested in the Generations Fund.

The dedicated revenues will exceed withdrawals to repay the debt.

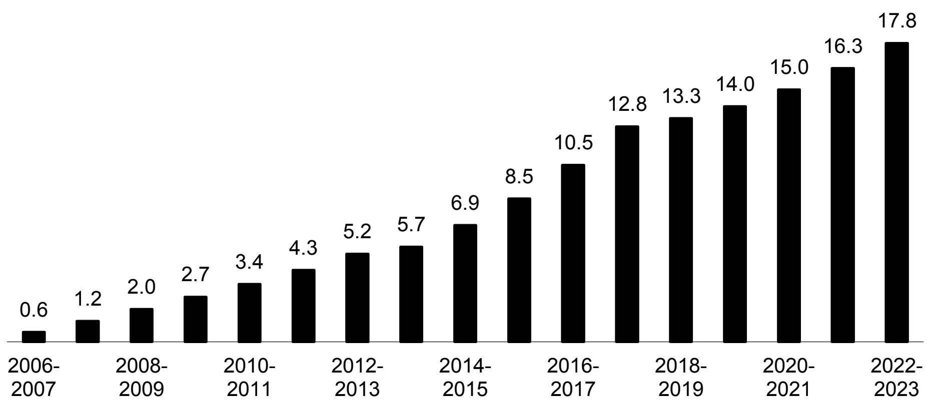
- In the coming years, the balance of the Generations Fund will remain at high levels even after the debt repayment withdrawals.
- In 2021-2022, investment income will stand at $869 million, equivalent to 26.6% of the revenue dedicated to the Generations Fund. Such income will be the main source of revenue devoted to it.

Furthermore, the Generations Fund will be used solely to repay the debt.

- The Act will continue to exclude any other use of the amounts accumulated in the fund.

CHART 12

Change in the book value of the Generations Fund
(billions of dollars)



In the coming years, the Generations Fund will continue to grow gradually, even after a portion of it is allocated to debt payment.

As at March 31, 2023, the Generations Fund will stand at $17.8 billion. The sums come mainly from:

- the water-power royalties that Hydro-Québec and private power producers pay;
- revenue stemming from the indexation of the price of heritage electricity;
- mining revenues;
- an amount from the specific tax on alcoholic beverages;
- the investment income accumulating in the fund, which is accelerating debt reduction.

TABLE 3

The Generations Fund
(millions of dollars)

	2017-2018	2018-2019	2019-2020	2020-2021	2021-2022	2022-2023
Book value, beginning of year	**10 523**	**12 815**	**13 306**	**14 013**	**15 004**	**16 269**
Dedicated revenues						
Water-power royalties						
Hydro-Québec	700	687	703	727	734	761
Private producers	102	100	102	104	106	108
Subtotal	**802**	**787**	**805**	**831**	**840**	**869**
Indexation of the price of heritage electricity	218	245	300	385	470	565
Additional contribution from Hydro-Québec	215	215	215	215	215	215
Mining revenues	133	230	272	324	356	388
Specific tax on alcoholic beverages	500	500	500	500	500	500
Unclaimed property	6	15	15	15	15	15
Investment income(1)	418	499	600	721	869	950
Total dedicated revenues	**2 292**	**2 491**	**2 707**	**2 991**	**3 265**	**3 502**
Use of the Generations Fund to repay maturing borrowings	—	–2 000	–2 000	–2 000	–2 000	–2 000
BOOK VALUE AT YEAR-END	**12 815**	**13 306**	**14 013**	**15 004**	**16 269**	**17 771**

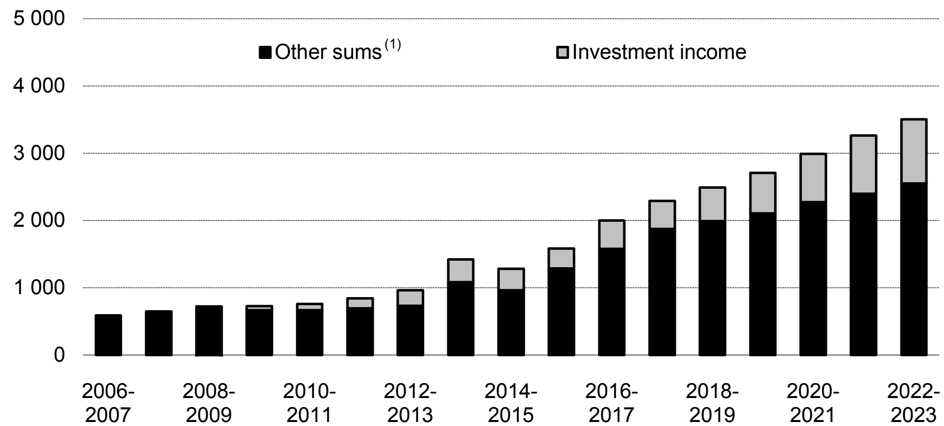
(1) The interest income of the Generations Fund corresponds to such income that is realized (interest, dividends, gains on disposal of assets, and so on). The forecast can thus be adjusted upward or downward depending on the time at which the gains or losses are actually realized.

The leverage effect that ensures the rapid growth of the fund will continue.

— The share of investment income in the amounts paid to the Generations Fund will increase from 18.2% in 2017-2018 to 27.1% in 2022-2023.

CHART 13

Amounts allocated to the Generations Fund
(millions of dollars)



(1) The amounts include revenues (excluding investment income) dedicated to the Generations Fund and certain ad hoc payments.

A winning strategy: the objectives pursued with the establishment of the Generations Fund

It was at once bold and original to establish the Generations Fund instead of directly repaying the debt. The establishment of the Generations Fund and its mode of operation targeted two objectives.

Dedicate secured revenues to debt repayment

First, the Generations Fund's objective was to dedicate to debt repayment secured revenues whose collection did not hamper economic growth.

The allocation to the Generations Fund of secured revenues meant constantly reducing the debt burden despite variations in the availability of funds.

- The Generations Fund had dedicated revenues from its inception.
- The government thus wished to ensure that the fund benefits from guaranteed, stable revenues, regardless of the budgetary situation.

What is more, the government felt it was essential that the collection of the revenue dedicated to the Generations Fund have little impact on the competitiveness of the Québec economy.

- The revenues allocated to the fund should not increase the tax burden on individuals and businesses.
- In this way, the first significant revenue dedicated to the Generations Fund came from water-power royalties collected from Hydro-Québec and private hydroelectricity producers. The water-power royalties that Hydro-Québec pays to the Québec government do not affect the electricity rates that consumers pay.

Starting in 2010, new sources of revenue whose collection had the least detrimental impact on the Québec economy were dedicated to the Generations Fund.

- In this way, the government dedicated to the fund payments from the specific tax on alcoholic beverages and the indexation of the price of heritage electricity, all mining revenue and, more recently, an additional contribution from Hydro-Québec.
- Other amounts have been paid from time to time to the Generations Fund.

Rely on the "leverage effect"

Second, the government opted to rely on the gain to be achieved by not directly repaying the debt and putting to work the accumulated revenues.

The government was confident of obtaining a higher return than the saving it would have obtained on debt service by directly repaying the debt. The management of the amounts accumulated in the Generations Fund was entrusted to the Caisse de dépôt et placement du Québec.

By necessarily reinvesting in the fund all of the return, the government sought to enable the fund to benefit from a powerful leverage effect stemming from the ongoing increase in the amounts accumulated in the fund and the corresponding growth in investment income.

- The investment income reinvested in the fund did not represent a tax bite and it was thus possible to reduce the debt burden without slowing down Québec's economic growth.

2.4 A space to invest more extensively in infrastructure

Since the return to a balanced budget, gross debt has increased mainly because of capital investments[7] but its weight as a share of the economy continues to decline.

The government's infrastructure investments are, by and large, funded by debt in order to reconcile the latter with the useful life of the assets.

— The investments are essential to satisfy Québec's needs for quality infrastructure and to support economic growth.

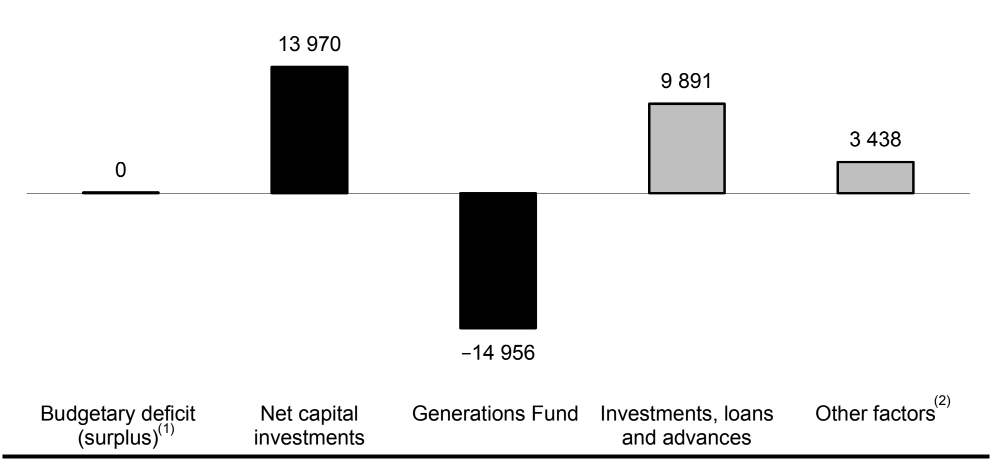
Growth in the Generations Fund allows for more extensive infrastructure investments without increasing the gross debt.

— By 2022-2023, growth in the Generations Fund will free up a space of nearly $15 billion, which will fund additional public infrastructure investments.

— The gross debt will increase in absolute terms but the increase in the debt will be less rapid than economic growth.

CHART 14

Factors responsible for the change in the gross debt over five years – 2018-2019 to 2022-2023
(millions of dollars)



(1) The budgetary balance indicated is that after the use of the stabilization reserve
(2) The other factors include, in particular, the change in other accounts, such as accounts receivable and accounts payable.

7 Gross debt is also increasing because of the government's investments, loans and advances. For example, each year Hydro-Québec pays the government a dividend that corresponds to 75% of its net earnings. Hydro-Québec uses the portion (25%) that is not paid to the government to finance its investments, in particular hydropower dams. For the government, it is an investment in Hydro-Québec that creates a financial requirement, thus an increase in the gross debt.

❑ The increase in the stock of public capital in the economy

The stock of public capital is a key determinant in productivity and economic growth.

The stock of public capital increased from 22.5% of real GDP in 2000 to 27.6% of real GDP in 2018, in particular as a result of a significant increase in the Québec government's investments.

— The growth is equivalent to the level observed in the early 1980s.

CHART 15

Québec government annual public investment in capital assets
(as a percentage of GDP)

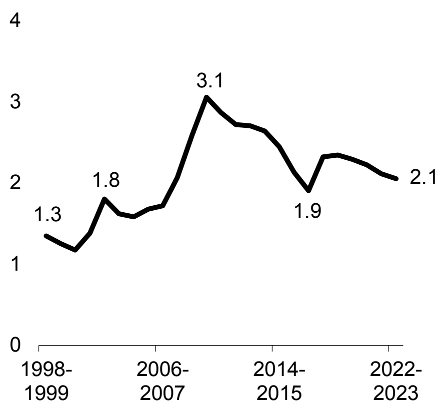
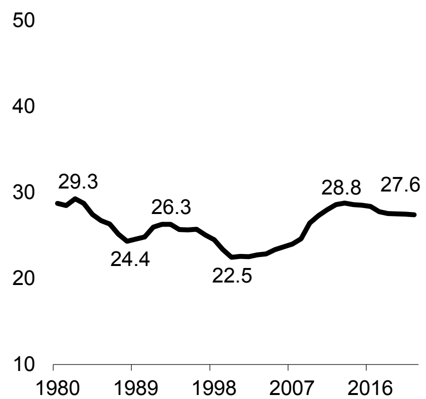


CHART 16

Change in Québec's stock of public capital
(as a percentage of GDP, in real terms)



2.5 Maintaining fiscal balance is a top priority

In 2018-2019, consolidated revenue will stand at $109.6 billion, up 2.2%, while consolidated expenditure will reach $108.7 billion, a 4.5% increase.

In 2019-2020, growth in consolidated revenue will stand at 3.4% and that in expenditure, 2.6%.

By 2022-2023, the pace of growth of expenditure will be compatible with that of revenue, which will make it possible to maintain fiscal balance over the financial framework's time horizon.[8]

TABLE 4

Financial framework – *The Québec Economic Plan* – March 2018
(millions of dollars)

	2017-2018	2018-2019	2019-2020	2020-2021	2021-2022	2022-2023
Consolidated revenue	**107 196**	**109 597**	**113 359**	**116 840**	**120 237**	**123 746**
% change	*4.2*	*2.2*	*3.4*	*3.1*	*2.9*	*2.9*
Mission expenditures	–94 817	–99 313	–102 066	–104 696	–107 294	–110 480
Debt service	–9 237	–9 380	–9 422	–9 532	–9 578	–9 664
Consolidated expenditure	**–104 054**	**–108 693**	**–111 488**	**–114 228**	**–116 872**	**–120 144**
% change	*5.6*	*4.5*	*2.6*	*2.5*	*2.3*	*2.8*
Contingency reserve	—	—	–100	–100	–100	–100
SURPLUS	**3 142**	**904**	**1 771**	**2 512**	**3 265**	**3 502**
BALANCED BUDGET ACT						
Deposits of dedicated revenues in the Generations Fund	–2 292	–2 491	–2 707	–2 991	–3 265	–3 502
Use of the stabilization reserve	—	1 587	936	479	—	—
BUDGETARY BALANCE(1)	**850**	**—**	**—**	**—**	**—**	**—**

(1) Budgetary balance within the meaning of the Balanced Budget Act, after use of the stabilization reserve.

8 Section A of *The Québec Economic Plan – March 2018* presents details of the five-year financial framework.

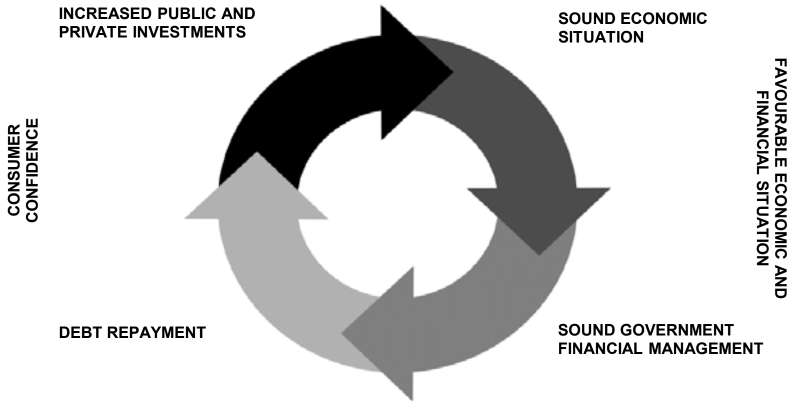
2.6 The initiation of a “virtuous circle” of getting out of debt

The restoration of fiscal balance, the reduction in the debt burden and infrastructure funding have enabled Québec to initiate a genuine “virtuous circle” of getting out of debt.

- The sound management of public finances and debt control have had repercussions on economic growth, which affords the government the means to pursue debt reduction.
  - The reduction of the debt burden is contributing to economic growth by creating a climate of confidence conducive to investment and higher productivity.
- The actual repayment of the debt and the maintenance of the Generations Fund will further bolster this “virtuous circle.”

CHART 17

The virtuous circle of getting out of debt



❑ The restoration of fiscal balance and debt control have had a positive impact on Québec's credit rating

Generally speaking, the less indebted a government is, the higher the credit rating granted by the credit rating agencies.

Two positive changes occurred in June 2016.

— The credit rating agency Standard & Poor's raised the outlook linked to Québec's credit rating, from "stable" to "positive."

— The credit rating agency Fitch raised the outlook linked to Québec's credit rating from "negative" to "stable" because of the return to budgetary balance.[9]

In June 2017, Standard & Poor's raised Québec's credit rating, in particular because of the government's debt control.

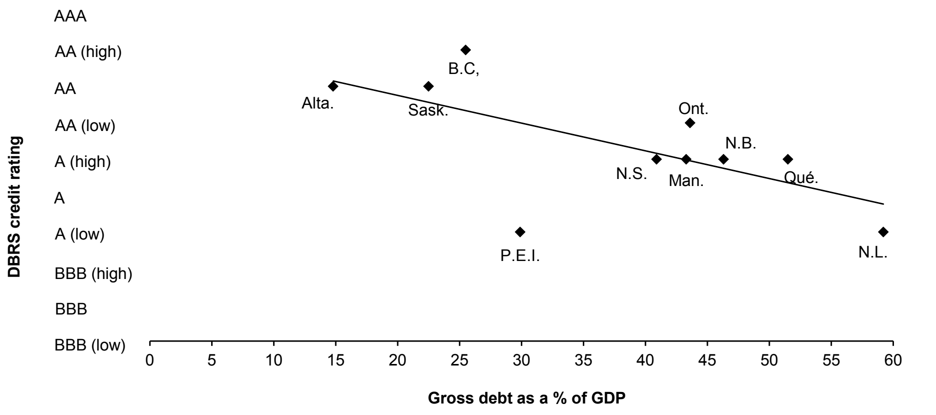
A higher credit rating means:

— access to a broader pool of investors;

— advantageous borrowing costs.

CHART 18

Relationship between the indebtedness of the provinces and credit rating in 2017
(as a percentage)



Sources : DBRS and Ministère des Finances du Québec.

9 Fitch lowered the outlook in December 2013 following the postponement to 2015-2016 of budgetary balance announced in November 2013.

The improvement of Québec's credit rating is enabling Québec to continue to benefit from advantageous borrowing costs.

- Each year, the Québec government must borrow significant amounts to:
  - repay maturing borrowings;
  - fund significant capital investments.
- Over the next five years, the government's long-term annual financing program will, on average, be more than $17 billion.[10]

Debt control is contributing to more extensive private investments by creating a climate of confidence conducive to investment.

Higher private investments and financing of fixed capital stock are sustaining growth, which is increasing the government's revenue and thereby contributing to reducing the debt burden.

- In this way, the "virtuous circle" has been set in motion.

[10] See section G of *The Québec Economic Plan – March 2018* for additional information.

Debt reduction: a strategy that the credit rating agencies recognize

The government's pursuit of its debt reduction strategy is a key factor for credit rating agencies.

For example, in June 2017, the credit rating agency Fitch indicated that the stable outlook attributed to Québec's credit rating hinged on the hypothesis that the debt burden would dwindle in the coming years:

> The Stable Outlook at the current rating level assumes the Province retains its focus on lowering the burden of debt. The resumption of significant borrowing to support operating deficits would result in a downgrade.[1]

The credit rating agency Moody's noted that the stable outlook attributed to Québec's credit rating hinged on the hypothesis that Québec would succeed in maintaining budgetary balance in the medium term, thereby facilitating the gradual reduction of the debt burden:

> The rating outlook is stable reflecting the assumption that the province will succeed in recording balanced budgets across the medium term, allowing for a gradual decrease in the debt burden.[2]

The Generations Fund is a key element of the strategy

The credit rating agencies and investors regard with considerable favour the Generations Fund, which represents a concrete commitment by the government to reduce the debt.

In 2006, when the Generations Fund was established, DBRS indicated that the initiative demonstrated the province's determination to contain rising debt.

Standard & Poor's had noted that Québec's credit rating was sustained, in particular, by the province's intention to reduce its debt burden through payments to the Generations Fund.

By contributing positively to the quality of Québec's credit, the Generations Fund is ensuring that Québec's access is maintained to a broad pool of investors on financial markets in Canada and abroad.

1 Fitch, June 13, 2017 press release.
2 Moody's, *Credit Opinion*, June 21, 2017.

3. LOOKING AHEAD TO 2034-2035: MANAGEMENT THAT TACKLES FUTURE CHALLENGES

3.1 Economic outlook

Economic growth can be broken down into three fundamental determinants:

- demographic trends, in particular changes in the 15 to 64 age group, which represents the potential labour pool;
- changes in the employment rate, that is, the total number of workers in relation to the population between 15 and 64 years of age;
- productivity developments, that is, output (real GDP) per worker.

In the coming years, Québec's real GDP growth should undergo marked changes in the contribution of factors of production.

- Between 2018 and 2030, the demographic factor, expressed by growth in the labour pool, will no longer support real GDP growth. Consequently, productivity gains and a higher employment rate will more extensively support Québec's economic growth.

TABLE 5

Québec's economic growth outlook and factors of production of real GDP
(percentage change and contribution in percentage points)

			Outlook			
	1982-2010	**2011-2017**	**2018-2022**	**2023-2026**	**2027-2030**	**2031-2035**
Nominal GDP (% change)	*4.9*	*3.3*	*3.2*	*3.1*	*3.3*	*3.3*
Real GDP (% change)	*2.0*	*1.6*	*1.6*	*1.3*	*1.4*	*1.5*
Factors of production (contribution)						
– Labour pool (1)	0.6	0.1	−0.2	−0.2	−0.1	0.3
– Employment rate (2)	0.6	0.9	0.9	0.5	0.5	0.1
– Output per employee (3)	0.8	0.6	0.8	1.0	1.0	1.0
Nominal GDP per capita (%)	*4.2*	*2.5*	*2.4*	*2.4*	*2.7*	*2.8*
Real GDP per capita (%)	*1.3*	*0.8*	*0.8*	*0.7*	*0.9*	*1.1*

Note: Totals may not add due to rounding.
(1) Population between 15 and 64 years of age.
(2) The employment rate corresponds to the total number of workers over the population between 15 and 64 years of age.
(3) Productivity represents real GDP per job.
Sources : Institut de la statistique du Québec, Statistics Canada and Ministère des Finances du Québec.

The structural impact of demographic changes

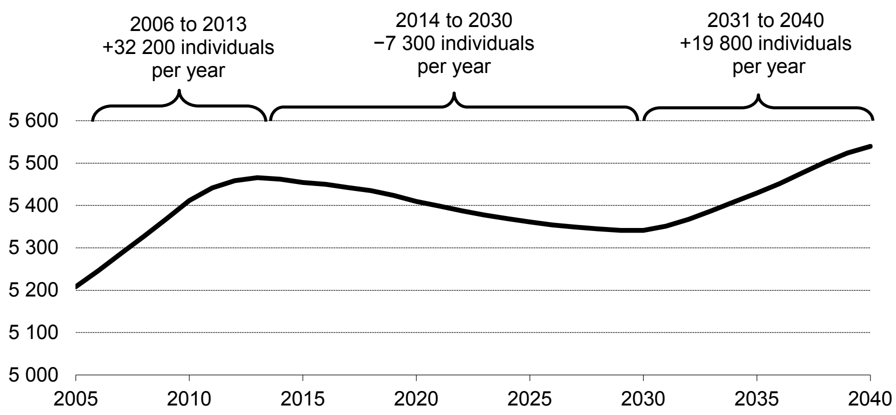
The aging of Québec's population

The aging of Québec's population means that in the medium term the number of individuals 15 to 64 years of age, who make up the main potential labour pool, is declining.

- The 15 to 64 age group should fall by 7 300 per year between 2014 and 2030, an average annual decrease of 0.1%.
- On the other hand, the population 65 years of age or over should increase, on average, by 3.2% per year during the same period.

Accordingly, in the coming years, Québec's key economic challenge linked to the aging of the population will be to satisfy manpower needs.

Change in Québec's population between 15 and 64 years of age
(in thousands)



Sources : Institut de la statistique du Québec, Statistics Canada and Ministère des Finances du Québec.

To meet the challenge of economic growth, Québec must rely on broader labour force participation.

— In this context, broader labour market participation by the population overall, especially experienced workers and immigrants, will be necessary.

Moreover, increased productivity will be important to support economic growth and enhance Quebecers' standard of living.

In this respect, the reduction in the debt burden will contribute to economic growth by creating a climate of confidence conducive to investment and higher productivity.

3.2 The reduction of the debt burden

❑ The projection of the weight of the debt and the balance of the Generations Fund

Once the debt reduction targets have been achieved, the debt burden should continue to decline as a result of the maintenance of budgetary balance and payments to the Generations Fund.

— As is the case for forecasts for 2018-2019 to 2022-2023, the projection of the debt burden until 2034-2035 considers the use of $2 billion per year from the Generations Fund to repay the debt.

— In its medium-term projections, the government has used conservative hypotheses concerning changes in the debt in order to take into account, in particular, the risk of a reversal in economic conditions.

The Generations Fund will continue to grow over the years. As at March 31, 2035, the balance should stand at $59.7 billion.

TABLE 6

Projection of the debt burden and the balance of the Generations Fund as at March 31
(in millions of dollars and as a percentage of GDP)

	Gross-debt-to GDP ratio	Ratio of the debt representing accumulated deficits to GDP	Balance of the Generations Fund
2019	49.1 %	26.4 %	13 306
2020	47.9 %	24.9 %	14 013
2021	47.1 %	23.5 %	15 004
2022	45.9 %	22.1 %	16 269
2023	45.0 %	20.8 %	17 771
2024	44.3 %	19.4 %	19 525
2025	43.5 %	18.1 %	21 549
2026	42.6 %	16.8 %	23 855
2027	41.7 %	15.4 %	26 433
2028	40.7 %	14.1 %	29 308
2029	39.8 %	12.8 %	32 498
2030	39.0 %	11.5 %	36 030
2031	38.2 %	10.2 %	39 926
2032	37.3 %	8.9 %	44 214
2033	36.4 %	7.6 %	48 912
2034	35.5 %	6.4 %	54 059
2035	34.6 %	5.1 %	59 678

Note: Forecasts until 2023 and projections thereafter.

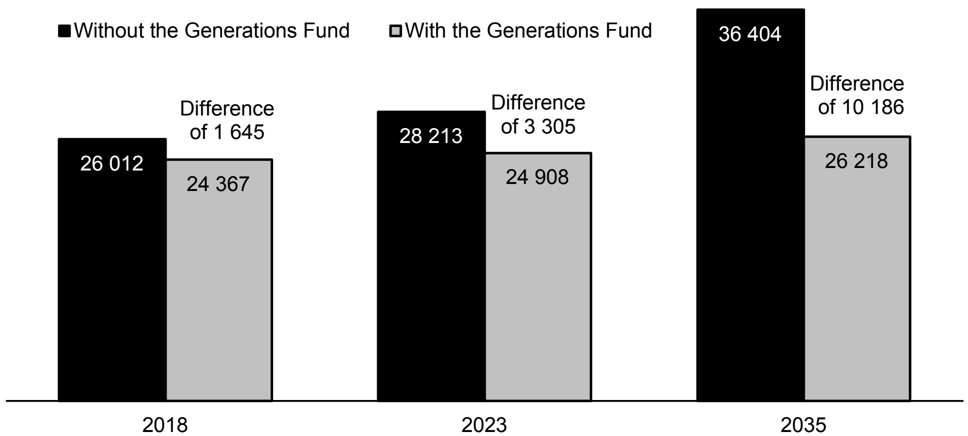
❑ The importance of the Generations Fund

Without the payments to the Generations Fund, the anticipated gross debt at March 31, 2035 would be $94.7 billion higher.[11] On a per capita basis, this represents $10 186.

- At March 31, 2035, per capita gross debt will stand at $26 218.
- Without the Generations Fund, it would have reached $36 404 per capita.

CHART 19

Gross debt as at March 31
(dollars per capita)



[11] The $94.7-billion difference is $35 billion higher than the balance of the Generations Fund at March 31, 2035 ($59.7 billion) because of the use of $35 billion from the Generations Fund to repay maturing borrowings ($1 billion in 2013-2014 and $34 billion from 2018-2019 to 2034-2035).

❑ Québec is gradually drawing closer to the average for the Canadian provinces

Québec is more indebted than the average for the Canadian provinces but the gap is gradually narrowing.

From March 31, 2014 to March 31, 2017, Québec's gross-debt-to-GDP ratio fell from 54.3% to 51.5%, while the average for the Canadian provinces overall rose from 35.7% to 37.7%.[12] The difference in relation to the average for the 10 provinces thus decreased from 18.6 to 13.8 percentage points in three years.

The same is true of the weight of the debt representing accumulated deficits. The difference declined from 19.5 to 14.9 percentage points between 2014 and 2017.

CHART 20

Comparison of Québec's gross debt with the provincial average as at March 31

(as a percentage of GDP and in percentage points)

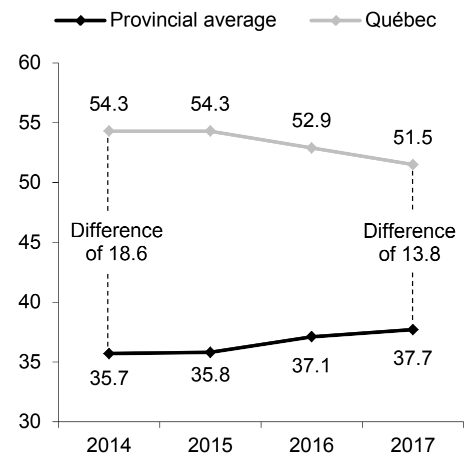
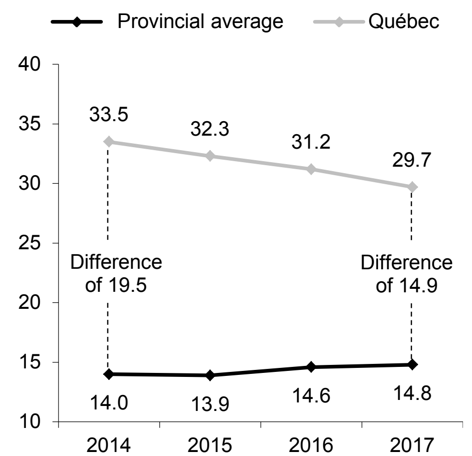


CHART 21

Comparison of Québec's debt representing accumulated deficits with the provincial average as at March 31

(as a percentage of GDP and in percentage points)



12 A weighted average is used.

The government will virtually eliminate the “bad debt” by 2034-2035.

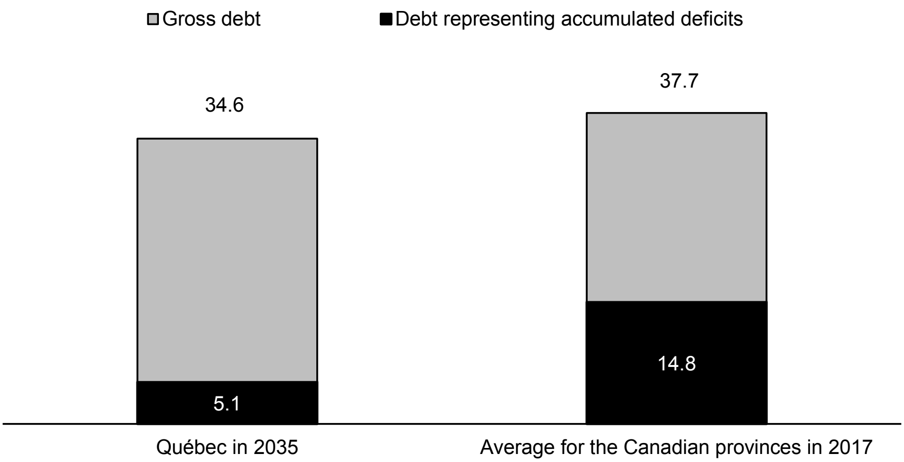
- The weight of the debt representing accumulated deficits should stand at 5.1% of GDP as at March 31, 2035.
- In the longer term, the government’s objective should be to completely eliminate the debt representing accumulated deficits, that is, the debt that does not correspond to any asset, commonly called the “grocery debt.”
- The gradual elimination of the debt representing accumulated deficits is in close keeping with the search for greater intergenerational equity. Once this objective has been attained, the gross debt will only correspond to assets, especially investments in public infrastructure, which benefit the taxpayers who assume such debt.

According to the projection, the gross debt will represent nearly 35% of GDP in 2034-2035.

- As at March 31, 2035, the gross debt burden should reach 34.6% of GDP, which falls below the average for the Canadian provinces of 37.7% of GDP as at March 31, 2017.

CHART 22

Gross debt and debt representing accumulated deficits
(as a percentage of GDP)



3.3 $10 billion per year for infrastructure over the next 10 years

The government's objective is to maintain the stock of public capital in the economy at 26% of real GDP.

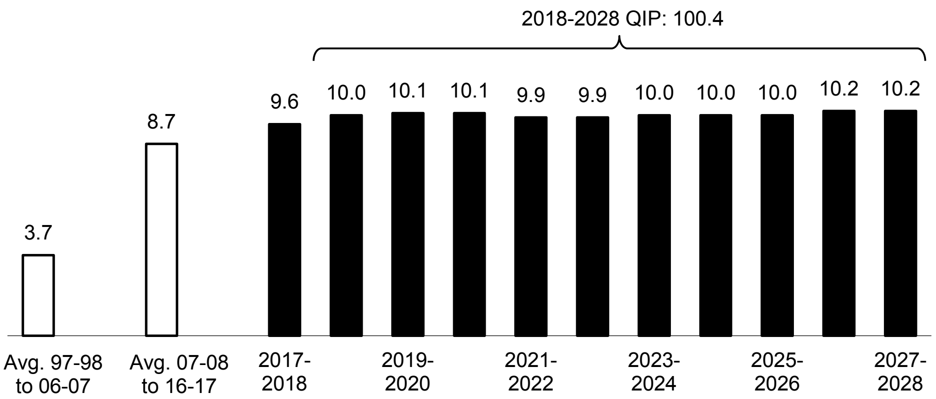
Annual investments of $10 billion are planned over the next 10 years.

The government is announcing that the planned investments in the *2018-2028 Québec Infrastructures Plan* (QIP) will stand at $100.4 billion, a $9.3-billion increase in relation to what was announced in the 2017-2027 QIP.

The increase brings to $10 billion per year over 10 years what the government will invest in Québec infrastructure to satisfy infrastructure needs, in particular in the education and health and social services sectors, the road network and public transit in order to enhance Quebecers' quality of life.

CHART 23

Investments under the *2018-2028 Québec Infrastructures Plan*
(billions of dollars)



❑ Maintenance of public capital assets – 2034-2035

Over the next 10 years, the Québec government's level of annual investment will reach roughly $10 billion, considerably higher than prior to 2008.

Such investments reached 2.3% of GDP in 2017-2018 and the ratio should be maintained in the coming years.

Investments under the *Québec Infrastructures Plan* are contributing directly to the increase in the stock of public capital in the economy.

Starting in 2028-2029, the ratio of the stock of public capital as a proportion of GDP is maintained at 26.0%.

— To maintain this ratio constant, the annual level of investments under the *Québec Infrastructures Plan* should ultimately reach $15 billion.

CHART 24

Québec governement annual public capital investments
(as a percentage of GDP)

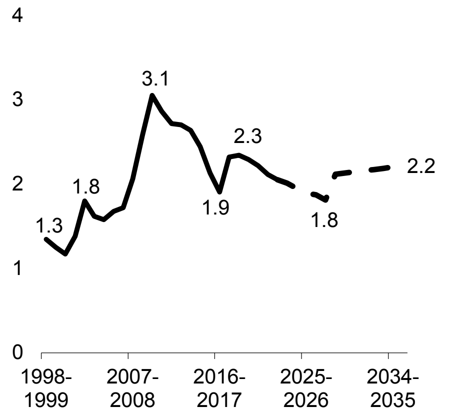
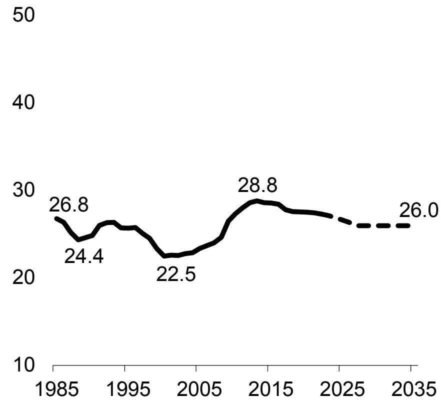


CHART 25

Change in Québec's stock of public capital
(as a percentage of GDP, in real terms)



3.4 The financial framework: maintaining fiscal balance

The projected financial framework by 2034-2035 is based, for a start, on the maintenance of budgetary balance.

- The responsible management of public finances will enable Québec to maintain budgetary balance with comparable growth in revenue and expenditure.

Revenue projections hinge on certain hypotheses to properly reflect growth in each source of revenue.

- They change, in particular, according to economic growth. They are thus based on certain economic and financial assumptions, including growth in wages and salaries, household consumption, inflation and net operating surplus of corporations.
- Lastly, the projections take into account the impact of the aging of the population on government revenue and consider the specific characteristics of each source of revenue, the tax rules in force and those announced in this *Québec Economic Plan*.

Generally speaking, the projected growth in mission expenditures is attributable to:

- changes in the clienteles that benefit from services, which are affected by demography;
- price fluctuations in public service delivery, attributable, in particular, to higher goods prices and pay increments;
- the enhancement and improvement of public services stemming from the reduction in debt service.

Debt service changes according to the size of the debt and interest rates on financial markets.

At the conclusion of the projection, from 2031-2032 to 2034-2035:

— average annual consolidated revenue will stand at $175.7 billion, with average annual growth of 3.3%;

— average annual consolidated expenditure will reach $168.7 billion, with average annual growth of 3.1%;

— the average annual payment of revenues dedicated to the Generations Fund will stand at $6.9 billion.

TABLE 7

Projection of the key components of the financial framework
(billions of dollars)

		Outlook			
	2012-2018	**2019-2023**	**2024-2027**	**2028-2031**	**2032-2035**
Consolidated revenue	**96.2**	**116.8**	**134.6**	**153.9**	**175.7**
Change (%)(1)	*3.8*	*2.9*	*3.4*	*3.4*	*3.3*
Mission expenditures	–85.6	−104.8	−119.9	−136.4	−155.5
Debt service	–9.8	−9.5	−10.6	−12.1	−13.3
Consolidated expenditure	**–95.5**	**−114.3**	**−130.4**	**−148.6**	**−168.7**
Change (%)(1)	*2.9*	*2.9*	*3.3*	*3.3*	*3.1*
Contingency reserve	—	–0.1	—	—	—
SURPLUS	**0.8**	**2.4**	**4.2**	**5.4**	**6.9**
BALANCED BUDGET ACT					
Payments of revenues dedicated to the Generations Fund	–1.4	−3.0	−4.2	−5.4	−6.9
Use of the stabilization reserve	—	0.6	—	—	—
Accounting changes	0.3	—	—	—	—
BUDGETARY BALANCE(2)	**–0.3**	**—**	**—**	**—**	**—**

Note: Data are averages for the period indicated..
Fiscal-year data. For presentation purposes, only the last years of the fiscal years are indicated. For example, 2019-2023 represents the period from 2018-2019 to 2022-2023.
Since figures are rounded, they may not add up to the total shown.
(1) Average annual growth rate.
(2) Budgetary balance within the meaning of the Balanced Budget Act, after use of the stabilization reserve.

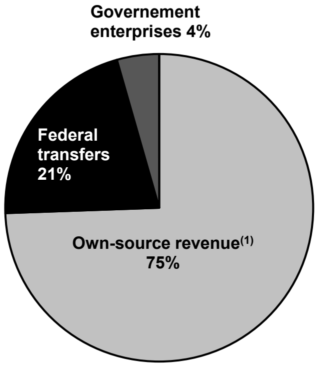
The government's revenue is made up of own-source revenue, including revenue from government enterprises and federal transfer revenue.

- The share of revenue from government enterprises will increase from 4% to 5% between 2017-2018 and 2034-2035, while the share of federal transfers will decrease from 21% to 20% over the same period.

- The share of own-source revenue will remain stable and account for 75% of total revenue.

CHART 26

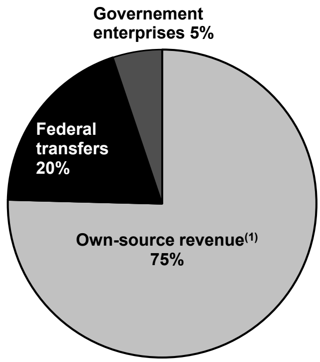
Revenue distribution in 2017-2018
(as a percentage)



(1) Own-source revenue excludes that of government enterprises

CHART 27

Revenue distribution in 2034-2035
(as a percentage)



(1) Own-source revenue excludes that of government enterprises

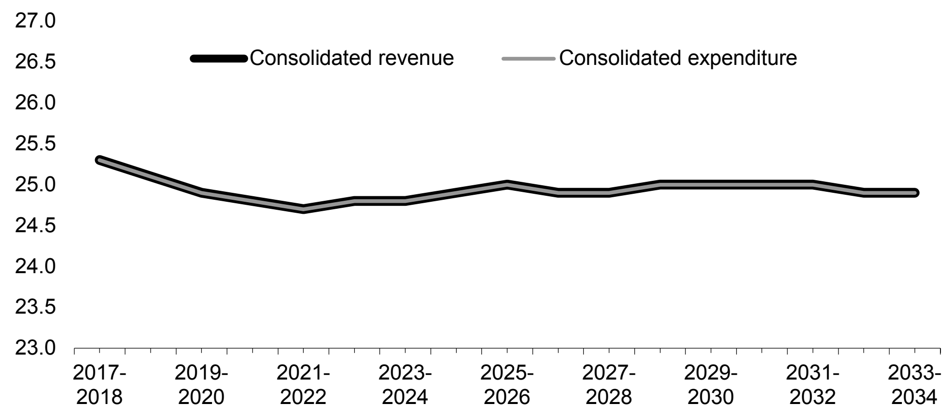
Consolidated revenue and expenditure will remain constant in relation to GDP.

Budgetary balance will be maintained throughout the entire projection horizon. On the whole, growth in spending will thus be maintained at a pace compatible with growth in revenues, excluding revenues dedicated to the Generations Fund.

- The weight in the economy of consolidated revenue and expenditure will remain constant at roughly 25% of GDP.

CHART 28

Change in the share of consolidated revenue(1) and expenditure in the economy
(as a percentage of GDP)



(1) Revenue takes into account the use of the stabilization reserve and excludes revenues dedicated to the Generations Fund and the contingency reserve.

❑ A larger share of spending devoted to public services

Even though debt service will increase, especially due to anticipated interest rate increases and capital investments, by 2034-2035 it will monopolize a smaller share of government spending.

The share of debt service in total spending will decrease from 8.9% in 2017-2018 to 7.8% in 2034-2035.

Over the same time frame, the share of mission expenditures in total spending will increase from 91.1% to 92.2% in 2034-2035.

Regular debt repayment, through the Generations Fund, will contribute to reducing the share of debt service in total spending.

— The repayment will achieve interest savings on the debt of $12.5 billion by 2035.

— Such savings will allow for broader investment in public services.

CHART 29

Share of debt service in consolidated expenditure
(as a percentage)

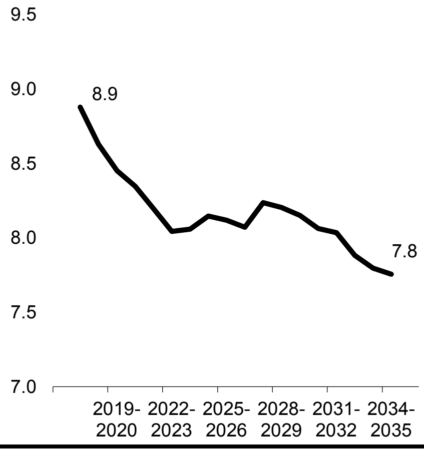


CHART 30

Share mission expenditures in consolidated expenditure
(as a percentage)