

Prince Edward Island: 2019–20 Budget

STAYING THE COURSE, WITH A FEW ELECTORAL GOODIES SPRINKLED IN

- Prince Edward Island's (PEI) budget for fiscal year 2019–20 (*Budget*; FY20) outlined slim balances through FY22 (chart 1), with net debt as a share of GDP set to progress on a modestly improved downward path.
- New policy initiatives included tax relief promised during the provincial election campaign, increased health and education spending, and measures to improve housing affordability.
- *Budget* is unlikely to alter market perception of the Province's credit; it largely continues the prior Government's plans, which we still assess to be fiscally prudent and supportive of economic growth.

ECONOMIC CONDITIONS

PEI's near-term economic outlook has improved considerably since the release of last year's fiscal plan. The Province now projects average annual nominal GDP growth of 4.6% over FY19–21 versus a prior estimate of just 3.0% (table, p.3). Key contributors include further gains across the Island's diversified industrial base and greater immigration and population growth—the populace is forecast to advance by 1.5% per annum over the medium-term rather Budget 2018–19's 1.3% per year.

Stepped-up public-sector capital expenditures are also expected to power the Island's continued expansion. Recall that the prior administration announced its intent to significantly escalate infrastructure spending to meet the needs of its rapidly rising population; in FY20, an increase of more than 40% relative to the previous blueprint was planned. Those outlays, concentrated in bridge replacements and road improvements this fiscal year, will go ahead under the new government, with additional funding support from the federal government.

NEW POLICY MEASURES

Budget's key tax measures were signaled during the 2019 provincial election. In 2020, the basic personal income tax amount will rise to \$10k¹ from its current level of \$9,160, with additional expansions to the amounts for spouses and equivalents. On January 1st of next year, the low-income tax threshold will be raised from \$17k to \$18k, while the small business tax rate will fall from 3.5% to 3.0%. All three measures were somewhat less generous than implied in the current administration's election platform.

Planned spending increases were concentrated in health care and education. Health spending included funding for additional family physicians, new long-term care beds, assistance for mental health, and expanded drug coverage. The Province also allotted \$19.2 mn to hire new K-12 teachers and educational assistants and increase wages for early childhood educators, and will study the implementation of a pre-school program for four year-olds.

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Current Year Projections

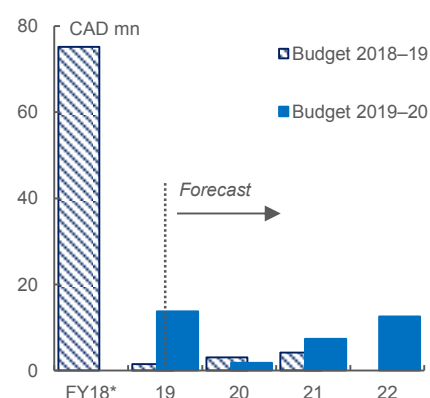
\$ millions except where noted

	FY19		FY20
	Bud.	Update	Bud.
Own-Source Revenue	1,215.3	1,279.1	1,341.1
Federal Transfers	770.1	765.6	859.9
Total Revenue	1,985.4	2,044.7	2,201.0
Program Spending	1,856.7	1,904.5	2,071.2
Debt Service*	127.3	126.4	128.0
Total Expenditure	1,983.9	2,030.9	2,199.2
Surplus	1.5	13.8	1.8
Net Debt	2,264.1	2,175.2	2,244.2
Memo Items, % of GDP			
Own-Source Revenue	17.6	18.5	18.8
Program Spending	26.9	27.6	29.0
Budget Balance	0.02	0.20	0.03
Debt Service*/ Revenue	6.4	6.2	5.8
Net Debt	33.0	31.3	30.7
Annual Change, %			
Own-Source Revenue	4.2	0.8	4.8
Federal Transfers	8.4	6.5	12.3
Total Revenue	5.8	2.9	7.6
Program Spending	6.1	6.6	8.8
Total Expenditure	5.7	6.2	8.3

* Ex Crown corporations' interest costs. Figures may not add due to rounding. Sources: PEI Finance; Statistics Canada.

Chart 1

PEI's Budget Balance



* Final result. Sources: Scotiabank Economics, PEI Finance.

¹ Figures reported in Canadian dollars unless otherwise stated.

To address well-documented housing affordability challenges on the Island, the Province earmarked \$2.2 mn in supplements for renters and \$4.4 mn for additional construction of affordable housing units beyond the prior government's plan.

With respect to climate change policy, the Government reiterated its commitment to the previously released *PEI Climate Action Plan*, and pledged to complete a long-discussed \$60 mn wind farm project by next year.

REVENUE AND EXPENDITURE DETAILS

Budget forecasts that stronger tax receipts will dominate foregone revenues vis-à-vis pocketbook relief measures. Total revenue is expected to outstrip the previous estimate by more than \$330 mn (2.2% of nominal GDP) during FY20–21. Those gains reflect both the more robust-than-previously-anticipated economic growth profile and an upward revision of nearly \$150 mn to federal transfer payments over the two fiscal years.

New spending announcements translate into an expected rise of more than \$330 mn in total expenditures relative to last year's baseline. An 8.3% jump in total spending is penciled in for FY20, a rise that would represent the sharpest annual increase since FY08. By department, Transportation, Infrastructure and Energy is set to see the largest increase this fiscal year: the planned \$87 mn bump in funding over FY19 levels would account for more than half the annual climb in program spending.

With matching revenue and spending plan increases, PEI is set to maintain a modest surplus of about 0.1% of nominal GDP over the next three fiscal years.

DEBT AND BORROWING

As a result of a stronger-than-expected \$75.2 mn surplus reported in PEI's final FY18 results, the Province's net debt is on a fundamentally lower trajectory. In FY19, net debt fell in FY18 (chart 2) and is now forecast to come in \$88.9 mn below the previous estimate.

In subsequent fiscal years, increased infrastructure spending appears set to push tangible capital asset acquisition higher than outlined in *Budget 2018–19* and put more upward pressure on net debt. However, planned increases in amortization of those assets should keep level debt rises roughly in line with previous estimates; with stronger economic growth, PEI's net debt as share of GDP is expected to fall steadily from 30.7% in FY20 (previous projection: 32.3%) to 29.1% in FY22 (29.9%).

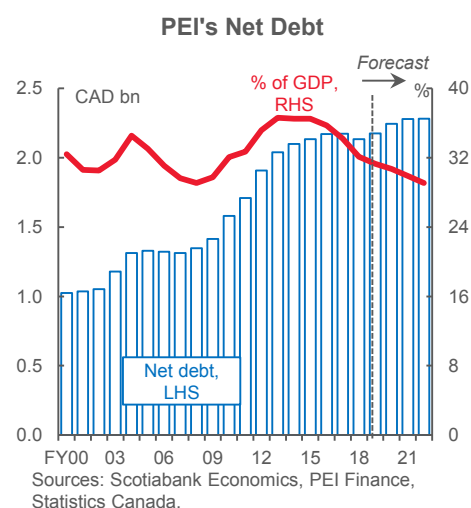
Some \$201.8 mn in cash requirements for FY20 are scheduled to be split roughly evenly between short- and long-term borrowing. This contrasts with FY19 borrowing, which was financed entirely with short-term debt instruments as outlined last year.

OUR TAKE

This was precisely the fiscal plan we had anticipated, and it is unlikely to change market views of PEI's finances. The unexpectedly large FY18 surplus and a range of healthy economic indicators released since its publication strongly suggested that the Province would find itself on a more favourable debt trajectory come budget time. Nevertheless, commitment to more accelerated debt repayment over the longer-run—combined with cautious tax relief—was a wise first step for this Government in its maiden budget.

We have previously written in support of the Province's long-term fiscal objectives, and we remain supportive. New spending puts some upward pressure on debt and borrowing levels. But there is no doubt as to the outsized role that immigration and population gains have played in PEI's remarkable recent expansion, and improved infrastructure and core services will be crucial if the Island is to continue to harness the economic opportunity presented by increased admissions of skilled newcomers.

Chart 2



That said, the viability of the current financial plan does depend fundamentally on whether infrastructure outlays translate into economic growth. While the assumptions used for fiscal planning look reasonable at this time, the forecast expansion is towards the more optimistic end of the current range of consensus projections. The Province could perhaps build additional prudence into its plans with a contingency reserve similar to that used at the federal level and in some other provinces. A fiscal buffer would further guard against downside revenue scenarios with the North American economy in an advanced stage of its expansion and heightened world trade risks emerging as PEI becomes an increasingly global player.

Revenue, Expenditure, and Net Debt							
\$ millions except where noted							
	FY19		FY20		FY21		FY22
	Bud. '19	Bud. '20	Bud. '19	Bud. '20	Bud. '19	Bud. '20	Bud. '20
Nominal GDP	6,868	6,950	7,110	7,322	7,297	7,622	7,836
% change	2.9	4.5	3.5	5.4	2.6	4.1	2.8
Total Revenue	1,985.4	2,044.7	2,036.1	2,201.0	2,089.3	2,258.3	2,317.3
% change	4.6	7.7	2.6	8.1	2.6	2.6	2.6
Total Expenditure	1,983.9	2,030.9	2,033.0	2,199.2	2,085.1	2,250.9	2,304.7
% change	4.6	7.0	2.5	8.2	2.6	2.4	2.4
Budget Balance	1.5	13.8	3.1	1.8	4.2	7.4	12.6
% of GDP	0.0	0.2	0.0	0.0	0.1	0.1	0.2
Net Debt	2,264.1	2,175.2	2,293.9	2,244.4	2,308.6	2,279.5	2,280.9
% of GDP	33.0	31.3	32.3	30.7	31.6	29.9	29.1
Sources: Scotiabank Economics, PEI Finance.							

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