

Prince Edward Island: 2018–19 Q2 Update

SUMMARY

The Province of Prince Edward Island published its **Second Quarter Forecast Update (Update)** for fiscal year 2018–19 (FY19) on Friday. The *Update* came on the heels of the FY18 final financial results and updated *Capital Budget* estimates for FY20–24 that were released in the preceding weeks.

PEI's FY18 surplus of \$75.2 mn¹ (1.1% of GDP) far surpassed the April 6, 2018 *Budget (Budget)* projection of \$0.6 mn. The fiscal surfeit stemmed from explosive gains in income tax revenues via a 3.5% surge in economic growth in 2017. It was the third consecutive year in which corporate income taxes exceeded *Budget* estimates by more than 25% (chart 1). The wider-than-expected surplus last fiscal year pushed net debt more than \$70 mn lower than the *Budget* forecast.

A surplus of \$4.4 mn (0.1% of GDP) is now forecast for FY19, about \$3 mn higher than anticipated in *Budget*. Further strength in personal and corporate income tax receipts underlies the government's stronger revenue profile. These gains are expected to be partially offset by a \$12.9 mn upward shift in Health PEI costs and net losses for the PEI Agriculture Insurance Corporation due to poor harvest conditions.

The Province expects robust population gains over the next two years to translate into a moderating, but solid expansion. The Island's *Population Action Plan* aims to boost the populace 4.4% higher than current levels by 2022, and PEI's 2% y/y ytd population climb as of June is the fastest of any province this year (chart 2, p.2). Population gains are forecast to contribute 1.5 percentage points to a real GDP jump in the order of 2.5% in 2019. Continued advances across a broad industrial base that includes agriculture, tourism, business services and advanced manufacturing account for the rest.

Integration of newcomers is a pillar of the Island's population plan.

Immigration has thus far eased from last year's record level, but PEI foresees renewed strength via the Provincial Nominee Program (PNP) and *Atlantic Immigration Pilot*. In September, the Province closed the immigrant investor stream of the former program, but intends to increase admission via other PNP streams. Consequently, PEI expects to admit 2,360 newcomers in 2019—more than last year—with a further climb to 2,600 by 2021. The policy change tilts admissions towards labour market immigrants, who are generally viewed as more likely to remain in their province of entry than those in the investor category, and therefore has the potential to increase retention rates.

Buoyed by a better-than-anticipated fiscal result, PEI has scaled up its previously planned capital expenditures to address the needs of a growing population. The *Capital Budget* outlines \$156.6 mn in infrastructure spending for FY20, 44% more than allocated in 2017 (chart 3, p.2). Relative to the previous plan, additional outlays of \$17 mn are meted out across transportation, infrastructure and energy in FY20 as bridge replacements and new plans to improve roads and highways proceed. Other notable investments include \$38 mn

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Updated Fiscal Forecast

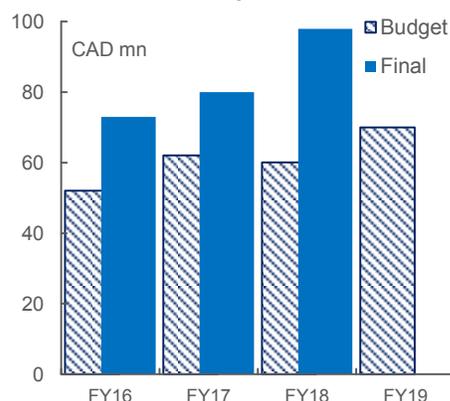
\$ millions except where noted

	FY18		FY19	
	Bud.	Final	Bud.	Update
Own-Source Revenue	1,166.4	1,269.1	1,215.3	1,245.5
Federal Transfers	710.4	718.6	770.1	770.1
Total Revenue	1,876.8	1,987.7	1,985.4	2,015.7
Program Spending	1,750.2	1,786.2	1,856.7	1,885.1
Debt Service*	126.0	125.5	127.3	126.3
Total Expenditures	1,876.2	1,912.5	1,983.9	2,011.3
Surplus	0.6	75.2	1.5	4.4
Net Debt	2,207.6	2,134.9	2,264.1	-**
Memo Items, %				
Own-Source Revenue / GDP	17.5	19.1	17.6	18.0
Program Spending / GDP	26.3	26.9	26.9	27.3
Budget Balance / GDP	0.01	1.13	0.02	0.06
Debt Service* / Revenue	6.7	6.3	6.4	6.3
Net Debt / GDP	33.2	32.1	32.7	-**
Annual Change, %				
Own-Source Revenue	2.2	11.2	4.2	-1.9
Federal Transfers	2.1	3.2	8.4	7.2
Total Revenue	2.1	8.2	5.8	1.4
Program Spending	2.2	4.3	6.1	5.5
Total Expenditures	2.0	4.0	5.7	5.2

* Ex Crown corporations' interest costs. ** Data not available. Figures may not add due to rounding. Source: PEI Finance; Statistics Canada; nom.GDP forecasts: Scotiabank Economics.

Chart 1

Corporate Income Tax Receipts Exceed Expectations



Sources: Scotiabank Economics, PEI Finance.

¹ Figures reported in Canadian dollars unless otherwise stated.

for the construction of a new high school in Stratford and \$100 mn over five years—\$40 mn more than allotted as of 2017—for new mental health facilities.

The Province is also disbursing some of its FY18 windfall in the form of new personal and business tax relief. *Budget* announced plans to increase the Basic Personal Amount (BPA) by \$500 to \$8,660; in November, the Island indicated that it would raise the BPA a further \$500 to \$9,160. The change will be made retroactively to January 1, 2018 and is expected to benefit more than half the provincial population. An additional 0.5% reduction of the tax on small business and the new capital investment grant will take effect in 2019; these changes are forecast to generate savings for 2,600 small businesses across the Island.

The Update also offered details on other policy developments since Budget. The PEI cannabis regime is expected to yield tax revenues of \$623K in the first year of legalization. For carbon pricing, fuel charges will apply to purchases of carbon-based fuels at the prescribed federal rates, with the exception of heating fuel and propane. Farmers, fishers and aquaculturists will be exempt and parties currently subject to tax exemptions will only be charged on incremental amounts exceeding the current PEI gasoline and diesel taxes. PEI's *Housing Action Plan* that aims to improve affordability and availability is proceeding against a backdrop of hefty population gains, tight rental market conditions, healthy building activity and rising home prices (chart 4).

OUR TAKE

Broadly speaking, we are supportive of PEI's policy direction and the new announcements. Stepped-up capital expenditures to improve infrastructure and core services appear a prudent use of the surplus as immigration and population continue to register strong gains. Attention to fees and housing affordability is also constructive for a province that is grappling with rapid home price appreciation but still has the lowest average weekly wages in Canada.

Retention of newcomers remains critical for economic growth and fiscal sustainability. PEI's retention rate for immigrants has improved and should be lifted by PNP changes and the *Atlantic Immigration Pilot*, but it still lags that of the other provinces. The emergence of skills shortages—reflected in an elevated PEI job vacancy rate of 4.7% in Q2-2018—highlights a pressing need for newcomer integration, especially as a recovery persists in Western Canada and improves the region's draw.

We await a spring 2019 Budget for more detail on debt and sources of financing, but FY18 final results imply some shifting of the government's borrowing profile. Steady economic growth and the wider projected surplus in FY19 could result in net debt below the \$2.3 bn planned in *Budget* for FY19 and a sharper reduction of the Province's debt-to-GDP ratio. We feel that it would be wise to apportion some of the planned surplus to debt management, but recognize the need to balance this objective with infrastructure program borrowing requirements. As of *Budget*, FY19 borrowing was scheduled to be financed entirely with short-term debt instruments.

Chart 2

Population Growth by Province

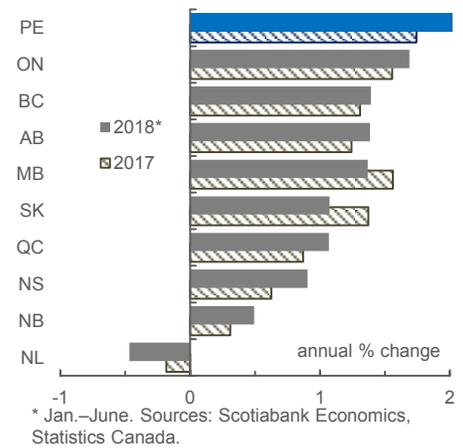


Chart 3

PEI's Capital Budget Shifts Higher

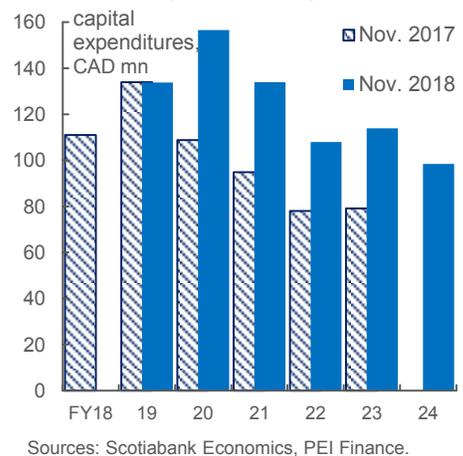
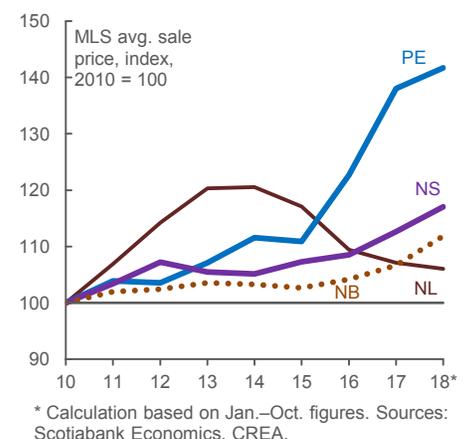


Chart 4

Home Prices Have Climbed on the Island



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