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Provincial Budget Briefs

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PRINCE EDWARD ISLAND BUDGET 2018

After showing a materially lower deficit than expected for fiscal 2016/17 compared to last year's budget, PEI is confirming that the province returned to balance in 2017/18. Economic strength was a key contributor to the success, and will be important in maintaining surpluses moving forward. Additional spending was added in key areas, such as education and healthcare services. Looking ahead, additional spending will still allow for further growth in surpluses, but gains will be modest. PEI's net debt/GDP is projected to decline gradually over the three-year forecast horizon from the current level of around 33%. This is predicated on economic growth outpacing modest debt accumulation. PEI's cash requirements are about $81mn in 2018/19, inclusive of about $58mn for net tangible capital asset acquisitions and the $10mn HST repayment to the federal government. There are no public debt maturities in the current fiscal year. The province has no plans to tap the term debt markets, instead choosing to fund through short-term borrowing and Federal grants.

Table 1

$Millions	2016/17 Actual	2017/18 17 Budget	2017/18 18 Budget	2017/18 Change	2018/19 18 Budget	2019/20 18 Budget	2020/21 18 Budget
Revenue	**1,837**	**1,877**	**1,899**	**22**	**1,985**	**2,036**	**2,089**
Provincial Sources	1,141	1,166	1,191	24	1,215	1,251	1,288
% change		*2.2*	*4.3*	2	*2.1*	*2.9*	*3.0*
Federal Source	696	710	708	-2	770	786	801
Expenditures	**1,839**	**1,876**	**1,897**	**21**	**1,984**	**2,033**	**2,085**
Programs	1,640	1,628	1,655	27	1,740	1,828	1,877
% change		*-0.7*	*1.0*	2	*5.1*	*5.0*	*2.7*
Public Debt Interest	125	126	124	-2	127	130	132
Depreciation Expense	74	72	74	2	76	76	76
Consolidated Budget Balance	**-1.3**	**0.6**	**1.2**	**0.6**	**1.5**	**3.1**	**4.2**

Economy Benefitting From Strong Fundamentals

The PEI economy continued to press ahead in 2017, supported by solid fundamentals. The population grew 1.7% last year, the fastest among all provinces. At the same time, the median age of the demographic actually became younger, in contrast to what's happened in many other parts of Canada, and a factor that leaves PEI with a more sustainable workforce.

Employment gained a healthy 3.1%, seeing the unemployment rate fall to its lowest level since 1978. Strong population and employment growth combined to create a positive environment for both retail sales and housing starts, with the former pacing the region and the latter posting the fastest growth rate amongst all provinces.

Tourism, of course, remains critical to the economic health of PEI, and was again a boon for growth in 2017. Total overnight stays on the Island were up 6.5%, and exceeded 1 million stays for the first time. Exports of agriculture and fisheries products were also supportive of the economy last year, something that should continue given the stronger US economy and weaker Canadian dollar. That said, while growth was buoyed by work on the PEI-New Brunswick Submarine Cable Project in 2017, that project is now complete.

The relatively broad-based growth combined with positive trends in the labour force and favourable conditions for PEI's exports suggest that the province should see another healthy year in 2018. However, without the boost from that major capital project, the growth rate is likely to decelerate at least somewhat this year. Over the projection horizon, the province is forecasting nominal growth of roughly 3%.

Balance Achieved and Expected to be Maintained

After coming in well below the deficit estimate for 2016/17 contained in last year's budget, the province is on track to achieve balance in 2017/18 for the first time in a decade. Revenue growth in 2017/18 is expected to have been driven by provincial sources on the back of a stronger economy. Fiscal 2018/19 will see further progress on that front, but will also benefit from a notable increase in Federal transfers. Thereafter, revenues will rise from a combination of growth in both Federal and Provincial sources.

Spending is expected to have increased in 2017/18 almost commensurate with revenues, and higher program spending in 2018/19 will see total expenditures leave only a modest budget surplus again. Additional spending has been allocated to important areas including education and early learning, in addition to support for post-secondary students. Spending will also be increased to enhance healthcare services and support senior citizens on the Island.

Looking ahead, PEI has charted a course to continue growing fiscal surpluses in the coming years. The economy is well positioned to keep those plans on track and an expected increase in Federal transfers will help too. But the margin for error is relatively narrow given that projected expenditures will track revenues closely, leaving modest surpluses growing at an only gradual pace.

Again This Year, No Plans for Long-Term Borrowing

PEI, balanced for the first time in 10 years in 2017/18, is projecting small surpluses and a declining debt/GDP going forward. As such, today's budget is modestly positive from a credit perspective.

We highlight though that PEI is Canada's smallest province by both population and GDP. Its debt burden is considered high in the context of its narrow-scope economy. PEI's reliance on Federal transfers is the highest among the Canadian provinces, representing around 38% of total revenues.

Although PEI's economy tends to grow more slowly, it has shown to be reasonably resilient. Its primary industries are agriculture, notably potato farming, as well as fishing.

PEI has run deficits for several years causing its debt burden to rise. Debt-funded special contributions to provincial pension plans have also been a contributing factor. However, getting back to balance and debt stabilization has been a major priority and was behind the government's decision to increase the Harmonized Sales Tax (HST) by one percentage point to 15% in October 2016.

Table 2	**Financing Plan**		
$Millions	**2016/17E**	**2017/18F**	**2018/19F**
Borrowing Requirements			
Consolidated (Surplus)/Deficit	1	-1	-1
Capital Adjustments	7	37	58
Sinking Funds Earnings/Provisions	20	21	21
Pension Transfers/Accruals	-5	-24	-17
Change in Cash & ST Pay/Rec	-7	-52	10
Borrowing On Behalf of Crown Corp	-40	-1	10
Net Financial Requirement	**-23**	**-20**	**81**
Maturities & Calls	0	0	0
Total	**-23**	**-20**	**81**
Sources of Funding			
Short-term Paper	23	-20	81
Bonds and MTNs	0	0	0
Sinking Fund Withdrawls[1]	0	0	0
Total	**23**	**-20**	**81**
Net New Issues			
Bonds & MTNs	0	0	0

PEI's cash requirements are about $81mn in the 2018/19 fiscal year, inclusive of about $58mn for net tangible capital asset acquisitions and the $10mn HST repayment to the Federal government (i.e. second installment of $10mn – i.e. one-third of the $30mn over three years). PEI has no public debt maturities in the current fiscal year. The province is not planning to tap the term debt markets, instead choosing to fund through short-term borrowing. Under the Investing in Canada Plan pursuant to the Federal 2016 Budget, the province is tapping into Federal grants worth about $56mn over several years under an Infrastructure Bi-lateral agreement for clean water, wastewater, public transit, and other infrastructure.

PEI projects that net debt will increase to about $2.3bn at the end 2018/19, up from $2.2bn. Net Debt is forecasted to grow by about $100mn over the Three-Year Plan. Meanwhile, net debt/GDP is estimated to have peaked at 33.1% in 2017/18. It is then forecasted to gradually fall to 31.6% in three years.

PEI's Five-Year Capital Plan (2018/2019 to 2022/2023) projects cumulative capital expenditures of $494.4mn, with $133.9mn for 2018/19. Thereafter, amounts fall modestly year after year. The Capital Plan covers a range of projects/initiatives in social programs such as health and education, along with transportation, infrastructure, and energy to agriculture, fisheries and tourism.

Credit Ratings: DBRS A(low), Moody's Aa2, S&P A (all outlooks stable)