

PRINCE EDWARD ISLAND BUDGET 2014

April 9, 2014

On track to balance by 2015/16

Prince Edward Island maintained a return to budget surplus in 2015/16 with the release of their 3-year fiscal plan as part of Budget 2014 yesterday. The government expects to edge out a small surplus of \$0.1 million in that year (initially \$0.6 million) followed by an \$8.9 million balance in 2016/17. The improving fiscal situation reflects the expectation that revenue growth will outpace the rate of spending increases through the projection period. For 2014/15, however, the government now projects that slower revenue growth will result in a slightly larger deficit compared to what it forecasted in Budget 2013, despite showing a greater degree of expenditure restraint. The deficit is projected to come in at \$39.7 million instead of the previous figure of \$34.5 million. In contrast, the government anticipates an improvement to the province's bottom line in 2013/14 (a deficit of \$51.9 million compared to \$58.9 million previously anticipated). While the better-than-expected performance in 2013/14 will not be carried into the upcoming fiscal year, overall, the budget profile shows a \$1.3 million cumulative improvement over the first three years of the fiscal plan (including 2013/14) relative to the plan presented one year ago.

Beneath the province's budget balance for the current fiscal year, there was a marked shift in the composition of revenues and expenditures compared to the budget plan presented last year. A \$39 million federal transfer for HST transitional assistance from the federal government was recorded in its entirety in 2013/14 resulting in a \$25 million unexpected boost to overall revenues. Initially, the payment was recorded over a two-year span with \$25 million allocated to 2012/13; however, under a ruling by the Provincial Auditor, the transfer was allocated entirely in the fiscal year in which the transition to HST occurred, which was 2013/14. This one-time lift was nearly fully offset, however, by the inclusion of a \$20.3 million expenditure charge related to funding the province's pensions. The one-time charge reflects the government's earlier announcement that it will provide additional funding in 2013/14 to help offset lower than expected gains in the portfolios of the province's pension funds. These previously unexpected revenue and expenditure items nearly offset each other and on net, resulted in an overall small improvement in the budget balance for 2013/14.

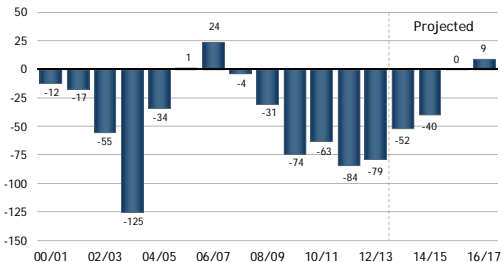
One-time revenue boost slightly offset one-time expenditure charge in 2013/14

The incremental boost to revenues as a result of the HST assistance largely contributed to revenues coming in 1.7% above the Budget 2013 projection for 2013/14. This helped to offset an outright decline in provincial own source revenues, expected to be 0.2% below the budget estimate last year as a result of weaker-than-expected sales tax revenues. Program expenditures were also 1.5% higher than the initial budget estimate as a result of the pension charge providing a boost to Employee Benefits (up 43% to \$67 million). In the absence of the change in HST payment timing, the budget deficit would have shown significant deterioration at \$76.9 million. Alternatively, without the pension charge, the budget deficit would have instead been \$31.6 million. Thus, with the timing of both coinciding in 2013/14, the overall budget deficit showed a slight improvement, declining by \$7 million.

Own-source revenues set to rise in 2014/15

Total revenues are slated to rise 1.6% to reach \$1.6 billion in 2014/15. Strengthening personal income tax revenues (up 4.7% to \$0.33 billion) along with an improvement in sales tax revenues (up 3.0% to \$0.25 billion) are set to lift provin-

Prince Edward Island budget balance
\$ millions



Source: Prince Edward Island Ministry of Finance, RBC Economics Research

Laura Cooper

Economist

(416) 974-8593

laura.cooper@rbc.com

cial own-source revenues by 1.5% to \$0.98 billion. Despite a higher starting point as a result of the \$39 million HST payment in the year prior, federal source revenues are expected to rise further in 2014/15. A \$25 million federal transfer related to the Building Canada Plan along with a \$20 million increase in the province's equalization transfer will more than offset the effect of the non-recurrence of the \$39 million one-time HST transitional transfer in 2013/14. Projected deficits in Finance PEI and PEI Agricultural Insurance Corporation (\$395K and \$100K, respectively) in 2014/15 following a combined surplus of \$11.9 million in the year prior are expected to contribute to a decline in the Net Consolidated Surplus of Crown Corporations component of revenues. Revenues from Capital Assets are also expected to decline to temper the overall revenue gain.

Greater expenditure restraint planned

On the expenditure side of the ledger, total expenditures are projected to rise by 0.8% to \$1.66 billion in 2014/15. Despite planned increases across nearly all departments in 2014/15, total program expenditures are slated to decline by 0.4% to \$1.46 billion. This is the result of a base effect from higher expenditures in 2013/14 stemming from the pension charge. In the absence of this one-time charge, program expenditures would rise by 1% in the coming fiscal year. Composing 40% of program expenditures, Health PEI is slated to rise \$8 million (1.4%) to \$581 million and is expected to partially offset a \$20 million drop in Employee Benefits, falling to \$47 million. Interest charges on debt are set to jump 14% to \$129 million largely on account of a 72% rise in costs (to \$17.6 million) associated with promissory notes provided to the pension funds.

Despite a focus on expenditure restraint, the budget plan did include a handful of initiatives:

- \$400k for the purchase of insulin pumps and supplies for children with Type 1 diabetes
- 'Eye See, Eye Learn' program for eligible kindergarten children to receive free eye exams
- \$2.3 million for extension of Island Community Fund to 2014/15
- \$1.2 million to support investments in Mental Health and Addictions

Revenue growth to outpace expenditure gains through the fiscal plan

The improvement in the overall budget balance through the projection period reflects a degree of restraint in the province's planned expenditures. Total expenditures are projected to rise on average by 0.9% annually through to 2015/16, which is lower than the 1.3% expenditure growth profile presented in last year's budget for the same time period. While spending related to Health PEI is expected to rise, a decline in other department expenditures in both 2014/15 and 2015/16 is contributing to the greater degree of restraint. (Over the next two years, other department spending is projected to decline by 1.3%, on average, annually compared to a 0.7% decline planned in Budget 2013). A rebound in this component will help to lift total expenditures by 2.4% to \$1.7 billion in the final year of the fiscal plan.

Offsetting part of the savings as a result of lower expenditure growth comes from softer projected revenue gains than those set out in Budget 2013. Compared to the 3.1% annual average increase planned for in Budget 2013, total revenues are now expected to grow on average by 2.5% through to 2015/16. This solely reflects lower revenue growth in 2014/15 (1.5% versus 2.8% initially). Beyond 2014/15, revenues are set to rise by 3.5% and 2.9% in 2015/16 and 2016/17, respectively, on account of increases across total provincial revenues (3.4% and 2.7% in each year) and federal source revenues (3.7% and 3.3%).

Capital plan

The capital budget, released in November 2013, outlined the government's plan to reduce the net capital expenditure in the province by \$17.8 million to \$73.7 million in 2014/15. The largest decline is expected in Health PEI with capital expenditures falling by \$11.4 million (-43%) to \$15.4 million. Investment in transportation and infrastructure is also set to fall by \$9.4 million (22%) to \$32.3 million, although at 44%, this component will still account for the largest share of capital spending. Planned increases in Education and Early Childhood Development (12%) and Finance, Energy and Municipal Affairs (21%) together provide a partial offset to the overall pullback.

Economic forecast

The government forecasts real GDP growth of 1.5% in 2014 in line with RBC's forecast for 1.4% growth. Tourism, manufacturing and export industries are expected to be bright spots for the Island's economy this year and will help to offset the impact of intensifying challenges in the domestic side of the economy.

Net Debt to peak in 2014/15

Net debt in the province is projected to reach \$2.17 billion at March 31, 2015, a 2.2% increase from an estimated \$2.12 billion at the same date in 2014. This is expected to mark a peak for the measure before declining to \$2.16 billion and \$2.15 billion in the outer years of the fiscal plan.

Prince Edward Island fiscal plan

\$ millions	Actual	Estimate	Forecast	Projection		
	<u>2012-13</u>	<u>2013-14</u>	<u>2013-14</u>	<u>2014-15</u>	<u>2015-16</u>	<u>2016-17</u>
Revenue	1,597	1,566	1,592	1,617	1,674	1,723
Expense	1,676	1,625	1,644	1,657	1,674	1,714
Surplus/ (deficit)	-79	-59	-52	-40	0	9

Source: Prince Edward Island Ministry of Finance, RBC Economics Research

The material contained in this report is the property of Royal Bank of Canada and may not be reproduced in any way, in whole or in part, without express authorization of the copyright holder in writing. The statements and statistics contained herein have been prepared by RBC Economics Research based on information from sources considered to be reliable. We make no representation or warranty, express or implied, as to its accuracy or completeness. This publication is for the information of investors and business persons and does not constitute an offer to sell or a solicitation to buy securities.

