ECONOMICS | **RESEARCH**

PRINCE EDWARD ISLAND BUDGET 2016

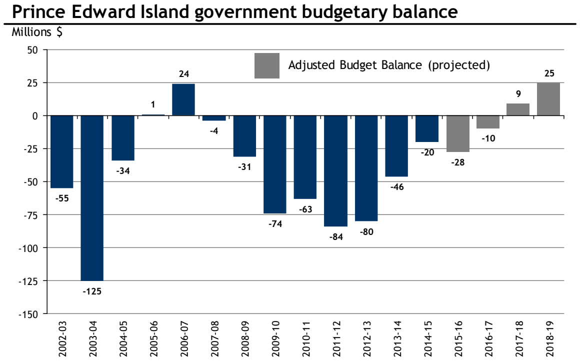
April 20, 2016

New taxes and another year of deficits

Overview

The two big questions leading up to the Prince Edward Island budget, released yesterday, were will the government balance the budget and will they need to raise the HST to do it? As it turns out, deteriorating tax revenues and unforeseen costs required both a hike to the HST and another year's delay in the return to budget balance. Now targeting 2017-18 for a surplus, the province remains on track for a gradual reduction in their net debt-to-gdp ratio while forestalling any cuts to services. Budget 2016 projects a deficit of just under $10 million for 2016-17 before a return to surplus in 2017-18 after a decade of deficits.

Prince Edward Island government budgetary balance



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

Fiscal balance

Overly rosy forecasts of economic growth coupled with unforeseen health care costs led Prince Edward Island to revise last year's deficit to $28 million (from $20 million) and to forestall a return to surplus for another year. Thanks in part to new tax measures, forecast revenues are expected to rise relative to last year's budget plan however expenditures are to rise by more. Compared with last years' budget plan, the 3-year cumulative deterioration in the budget balance totals $64 million.

Table 1: Economic Assumptions

Year-over-year % change	Projection	
	2016	2017
2016 Budget		
Real GDP growth	1.4	1.4
Nominal GDP growth*	3.2	3.4
RBC Economics		
Real GDP growth	1.2	0.9
Nominal GDP growth	2.8	2.9

*Fiscal year basis

Source: RBC Economics, Prince Edward Island Department of Finance

New tax measures to fund increased spending

The delay in returning the budget to balance is owed in part to the government's insistence that "a balanced budget should not come at the expense of essential services". In order to fund a health care-driven 2.5% increase in program spending this year, the government is raising the HST by 1 percentage point to 15%, effective in October 2016, which is expected to raise $11 million this year and a further $22 million in 2017-18. In addition a host of fees are being increased which the government expects will boost revenues by $1 million per year. Partially offsetting these revenues are modifications made to income taxes. The Basic Personal Amount will be raised to $8,000, and the refundable PEI Sales Tax Credit and the Low Income Tax Reduction Program will be increased. Together these measures will cost the government $3.9 million annually. Increased revenues are being directed toward shoring up core services. New spending includes $18 million for health and wellness, $7 million for education and youth, $3 million to support the needy and $7 million to encourage economic growth especially in exports and tourism.

Capital spending

Prince Edward Island's capital plan, released in November 2015, outlined an initial rise in spending this year, followed by a declining trajectory over the remaining years in the forecast. In 2016-17 capital expenditures are slated to increase by $9 million to $78 million led by increased investment in long-term care facilities by Health PEI. Thereafter spending is projected to decline reaching a nadir of $55 million in 2019-20 as spending is reduced by all major departments. A declining profile of government infrastructure spending comes amid province-wide weakness in construction activity and will represent a drag on economic activity in the coming years.

Gerard Walsh
Economist
416-974-6525
Gerard.walsh@rbc.com

Net debt and borrowing plan

Projections of a relatively modest deficit this year followed by narrow surpluses going forward will keep Prince Edward Island's debt in check. The province's net debt is expected to peak at $2.2 billion this year before remaining broadly unchanged through 2018-19. Despite a flat outlook for net debt, a growing economy will help push down the net debt-to-gdp ratio which is expected to fall to 32% in 2018-19 from 35% this year. After issuing $125 million in long-term debt last year to fund operations and maturing debentures, the government is planning on borrowing $43 million this year on a short-term basis.

Commentary

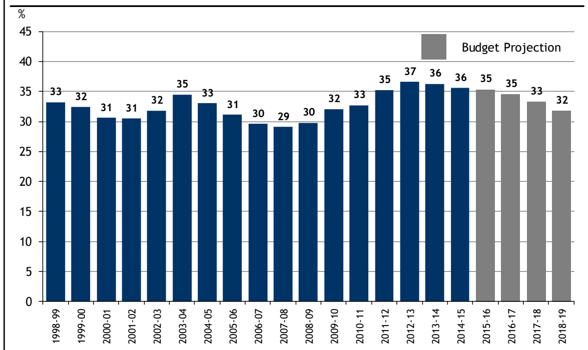
The government missed their target of a small surplus this year because of unexpected cost increases and lower tax revenues. In the 2016 budget speech, Minister Roach expressed the government's preference for delaying a return to surplus in order to avoid cuts to key services. This entailed new revenues, no cuts in spending, and another year of deficit. While the Province is once again aiming for a small budget surplus next year, we see the balance of risks as tilted to the downside given our somewhat less optimistic outlook for GDP and revenue growth.

Table 2: Budget Summary (millions of dollars)

	Forecast	Estimate	Plan	
	2015-16	2016-17	2017-18	2018-19
Total Revenues	**1,655**	**1,710**	**1,767**	**1,820**
Program Expenses	1,488	1,525	1,560	1,598
Interest	128	127	129	130
Amortization	67	69	69	69
Total Expenses	**1,682**	**1,720**	**1,758**	**1,796**
Adjusted Budgetary Balance	**-28**	**-10**	**9**	**25**
Net Debt	2,183	2,202	2,196	2,168
Net Debt to GDP Ratio	35%	35%	33%	32%

Source: Prince Edward Island Department of Finance

Prince Edward Island net debt-to-GDP ratio



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