

February 29, 2024

Manageable deficit to provide services for surging population

By Daren King, Warren Lovely & Taylor Schleich

Highlights

Thanks to a record population increase, the second strongest of any Canadian province, PEI's economic growth in 2023 was higher than expected, reducing the projected deficit from \$97.6 million in the last budget to \$85.5 million in 2023-24 (0.86% of GDP). Looking ahead, the Government has no plans to return to a balanced budget by 2026-27. However, the deficit should decrease to \$85.0 million in the current 2024-25 fiscal year (0.80% of GDP), before decreasing to \$59.5 million in 2025-26 and to \$30.5 million in 2026-27. The budget outlined record expenses to fund key initiatives most notably for health and housing, while also helping Islanders with the increasing cost of living. Net debt-to-GDP is set to peak in 2025-26 to 29.5%, while PEI's debt burden should be no more painful in 2024-25 vs. the outgoing year and remains below the provincial average. While technically twice the amount of 2023-24, the gross bond requirement of \$400 million for 2024-25 would hardly be out of the line on a relative basis when lined up against the expected provincial average for 2024-25.

- **Economic outlook** – Thanks notably to historic population growth of 3.9%, the second highest among Canadian provinces after Alberta, it is estimated that real GDP in the P.E.I. has expanded by 3.0% in 2023, almost three times the rate seen at national level. As for nominal GDP, which has a greater influence on public finances, we're talking about an estimated rise of 6.5% in 2023, more than double the growth seen in the country as a whole. Remarkably, the PEI labour market is one of the few provinces to have managed to create enough jobs to absorb strong demographic growth. Although rather volatile, the number of jobs rose by 3.0% on average in 2023, the highest job creation rate of all the provinces. As a result, the average unemployment rate in 2023 was only 7.4%, down 0.1% year-on-year. Remarkably, the PEI labour market is one of the few provinces to have succeeded in creating enough jobs to absorb the strong demographic growth. For the future, the Budget 2024 assumes real GDP growth of 4.1% in 2023, then 4.0% in 2025 and 2026, an assumption that seems optimistic given the less buoyant demographic outlook and the growing impact of restrictive monetary policy on the Canadian economy in the current year. More importantly for public finances, the budget forecasts nominal GDP growth of 6.6% in 2024 and 6.0% in 2025 and 2026, which are also rather high figures in the current context.
- **Fiscal outlook (including an update to 2023-24)** – With a month remaining in the 2023-24 fiscal year, Prince Edward Island's budgetary position is shaping up slightly better than expected compared to both Budget 2023 and the fall fiscal update. Indeed, the province is now projecting an \$86 million shortfall (0.9% of GDP) compared to a \$99 million shortfall (1.0% of GDP) signalled back in December. The 2023-24 deficit comes after PEI registered budgetary surpluses in five of the last six years (the one exception being the pandemic-distorted 2020-21 fiscal year). A return to surplus will have to wait some time however, as the province has pencilled in deficits throughout the three-year fiscal plan. 2024-25 is expected to see the budgetary shortfall remain steady at \$85 million (0.9% of GDP), before easing to \$60 million (0.5% of GDP) in 2025-26 and \$31 million (0.3% of GDP) in 2026-27. And while 2023-24 results were better than expected last year, the combined deficit for the next two years (i.e., 2024-25 and 2025-26) is \$55 million larger (0.5% of GDP) than the earlier estimates. Both sides of the income statement are expected to grow at a healthy clip over the next three years, as revenues are seen advancing at a 5.1% annualized pace and spending is set to grow 4.5% per year on average. Overall, PEI is in a better starting position than previously thought and its fiscal plan makes clear progress on shrinking the deficit. However, there's now more red ink that is expected to be accumulated over coming years and there's no clearly communicated path back to balance.
- **Budget initiatives** – Like many provinces, the PEI budget focuses on additional investments for healthcare, housing, and to help with the rising cost of living. In terms of healthcare, the Budget included, among other investments, an additional \$10.5 million to add more patient medical homes, \$9.9 million to support the implementation of a medical school at UPEI, \$6.2 million to recruit additional healthcare professionals, and \$4.5 million to move toward parity for private nursing homes and community care facilities. On the housing front, the Budget is allowing \$10 million to launch the Community Housing Expansion program to create new affordable housing units, \$6.9 million to expand shelter spaces, and \$6.7 million to provide tax rebates for newly constructed multi-unit residential buildings (like the federal government several months ago). Regarding the rising cost of living, the main announcement was the increase in the basic personal amount, i.e., the minimum income to start paying income tax, and the reduction in the tax rate on the first four tax brackets starting in January 2025, representing a shortfall of \$14.6 million for the government.
- **Debt outlook & borrowing requirement** – PEI's net debt rose an estimated \$289 million in 2023-24, positive prior-year adjustments allowing for a lower-than-planned reading in absolute (\$2.74 billion vs. \$2.80 billion plan) and relative terms (27.4% of GDP vs. 28.8% plan). For 2024-25, the province expects to take on an extra \$324 million of net debt, the resulting net debt-to-GDP ratio edging up to 28.8% of GDP. Debt-to-GDP could take one final step higher in 2025-26 (to 29.5%) before edging a touch lower in the final year of the fiscal framework. PEI's 'interest bite' should be no more painful in 2024-25 vs. the outgoing year, interest charges set to consume a relatively manageable 5.3 cents of the province's revenue dollar. When it comes to borrowing, PEI tapped the domestic debt capital market for \$200 million in 2023-24, which was satisfied via a single 10-year benchmark offering this January. For the



fiscal year set to commence April 1st, a notably larger funding requirement—including new net borrowing on behalf of Crowns—has PEI signalling \$400 million in gross bond supply. While a noted increase vs. the prior fiscal year or the pre-COVID norm, PEI's relative bond issuance (vs. revenue or in per capita terms) would hardly be out of the line when lined up against the expected provincial average for 2024-25.

- Current long-term credit ratings – S&P: A, Positive | Moody's: Aa2, Stable | DBRS: A, Stable
[Refer to our Provincial Ratings Snapshot for additional colour on specific credit rating drivers/considerations]

Prince Edward Island

	Budget	Forecast	Budget	Plan	
	2023-24	2023-24	2023-24	2025-26	2026-27
\$ Millions					
Gross Consolidated Revenue	2,995.2	3,013.9	3,147.4	3,323.7	3,503.4
Taxes, licenses, fees, permits and sales	1,602.1	1,632.2	1,717.5		
Federal sources	1,215.1	1,190.9	1,250.7	1,313.2	1,372.3
Investment/Sinking fund	38.5	49.5	38.8		
Net consolidated surplus of GBE and agencies	139.5	141.4	140.3		
Gross Consolidated Expenditure	3,092.8	3,099.4	3,232.4	3,383.2	3,533.9
Program expenditures and consolidated agencies	2,809.3	2,817.4	2,933.3		
Debt Servicing	162.7	163.4	168.0	183.8	199.9
Amortization	120.8	118.6	131.2	144.3	151.5
Consolidated Surplus (Deficit)	(97.6)	(85.5)	(85.0)	(59.5)	(30.5)
As a % of GDP	-1.00%	-0.86%	-0.80%	-0.53%	-0.26%
As a % of revenue	-3.26%	-2.84%	-2.70%	-1.79%	-0.87%
Cash Requirements	373.6	391.8	530.8		
Consolidated Surplus (Deficit)	97.6	85.5	85.0	59.5	30.5
Net acquisition of tangible capital assets	308.1	321.1	368.8	352.1	286.3
Amortization of tangible capital assets	(120.8)	(117.2)	(129.8)	(142.9)	(150.1)
Net borrowings on behalf of Crown Corporations	50.0	15.0	130.0		
Sinking Fund Earnings	12.5	12.5	10.5		
Sinking Fund Provisions and Transfers	10.2	10.2	10.2		
Change in pension accrual	(51.7)	(2.9)	(11.1)		
Transfer to Pension Fund	56.6	56.6	56.6		
Maturing debt not financed by Sinking Fund	11.1	11.1	10.5		
Financing sources					
Short-term Financing	123.6	191.8	130.8		
Long-term Financing	250.0	200.0	400.0		
Net debt - Beginning of Year	2,515.4	2,450.9	2,740.2	3,064.3	3,333.0
Deficit (surplus)	97.6	85.5	85.0	59.5	30.5
Acquisition of Tangible Capital Assets	308.1	321.1	368.8	352.1	286.3
Amortization	(120.8)	(117.2)	(129.8)	(142.9)	(150.1)
Net Debt - End of Year	2,800.3	2,740.2	3,064.3	3,333.0	3,499.7
as a % of GDP	28.8%	27.4%	28.8%	29.5%	29.3%
Debt Servicing / Gross Consolidated Revenue	5.4%	5.4%	5.3%	5.5%	5.7%
Federal transfers / Gross Consolidated Revenue	40.6%	39.5%	39.7%	39.5%	39.2%

Source: Prince Edward Island Budget documents.

Economics and Strategy

Montreal Office

514-879-2529

Stéfane Marion

Chief Economist and Strategist
stefane.marion@nbc.ca

Kyle Dahms

Economist
kyle.dahms@nbc.ca

Alexandra Ducharme

Economist
alexandra.ducharme@nbc.ca

Matthieu Arseneau

Deputy Chief Economist
matthieu.arseneau@nbc.ca

Daren King, CFA

Economist
daren.king@nbc.ca

Angelo Katsoras

Geopolitical Analyst
angelo.katsoras@nbc.ca

Jocelyn Paquet

Economist
jocelyn.paquet@nbc.ca

Toronto Office

416-869-8598

Warren Lovely

Chief Rates and Public Sector Strategist
warren.lovely@nbc.ca

Taylor Schleich

Rates Strategist
taylor.schleich@nbc.ca

General

This Report was prepared by National Bank Financial, Inc. (NBF), (a Canadian investment dealer, member of IIROC), an indirect wholly owned subsidiary of National Bank of Canada. National Bank of Canada is a public company listed on the Toronto Stock Exchange.

The particulars contained herein were obtained from sources which we believe to be reliable but are not guaranteed by us and may be incomplete and may be subject to change without notice. The information is current as of the date of this document. Neither the author nor NBF assumes any obligation to update the information or advise on further developments relating to the topics or securities discussed. The opinions expressed are based upon the author(s) analysis and interpretation of these particulars and are not to be construed as a solicitation or offer to buy or sell the securities mentioned herein, and nothing in this Report constitutes a representation that any investment strategy or recommendation contained herein is suitable or appropriate to a recipient's individual circumstances. In all cases, investors should conduct their own investigation and analysis of such information before taking or omitting to take any action in relation to securities or markets that are analyzed in this Report. The Report alone is not intended to form the basis for an investment decision, or to replace any due diligence or analytical work required by you in making an investment decision.

This Report is for distribution only under such circumstances as may be permitted by applicable law. This Report is not directed at you if NBF or any affiliate distributing this Report is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you. You should satisfy yourself before reading it that NBF is permitted to provide this Report to you under relevant legislation and regulations.

National Bank of Canada Financial Markets is a trade name used by National Bank Financial and National Bank of Canada Financial Inc.

Canadian Residents

NBF or its affiliates may engage in any trading strategies described herein for their own account or on a discretionary basis on behalf of certain clients and as market conditions change, may amend or change investment strategy including full and complete divestment. The trading interests of NBF and its affiliates may also be contrary to any opinions expressed in this Report.

NBF or its affiliates often act as financial advisor, agent or underwriter for certain issuers mentioned herein and may receive remuneration for its services. As well NBF and its affiliates and/or their officers, directors, representatives, associates, may have a position in the securities mentioned herein and may make purchases and/or sales of these securities from time to time in the open market or otherwise. NBF and its affiliates may make a market in securities mentioned in this Report. This Report may not be independent of the proprietary interests of NBF and its affiliates.

This Report is not considered a research product under Canadian law and regulation, and consequently is not governed by Canadian rules applicable to the publication and distribution of research Reports, including relevant restrictions or disclosures required to be included in research Reports.



UK Residents

This Report is a marketing document. This Report has not been prepared in accordance with EU legal requirements designed to promote the independence of investment research and it is not subject to any prohibition on dealing ahead of the dissemination of investment research. In respect of the distribution of this Report to UK residents, NBF has approved the contents (including, where necessary, for the purposes of Section 21(1) of the Financial Services and Markets Act 2000). This Report is for information purposes only and does not constitute a personal recommendation, or investment, legal or tax advice. NBF and/or its parent and/or any companies within or affiliates of the National Bank of Canada group and/or any of their directors, officers and employees may have or may have had interests or long or short positions in, and may at any time make purchases and/or sales as principal or agent, or may act or may have acted as market maker in the relevant investments or related investments discussed in this Report, or may act or have acted as investment and/or commercial banker with respect hereto. The value of investments, and the income derived from them, can go down as well as up and you may not get back the amount invested. Past performance is not a guide to future performance. If an investment is denominated in a foreign currency, rates of exchange may have an adverse effect on the value of the investment. Investments which are illiquid may be difficult to sell or realise; it may also be difficult to obtain reliable information about their value or the extent of the risks to which they are exposed. Certain transactions, including those involving futures, swaps, and other derivatives, give rise to substantial risk and are not suitable for all investors. The investments contained in this Report are not available to retail customers and this Report is not for distribution to retail clients (within the meaning of the rules of the Financial Conduct Authority). Persons who are retail clients should not act or rely upon the information in this Report. This Report does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for the securities described herein nor shall it or any part of it form the basis of or be relied on in connection with any contract or commitment whatsoever.

This information is only for distribution to Eligible Counterparties and Professional Clients in the United Kingdom within the meaning of the rules of the Financial Conduct Authority. NBF is authorised and regulated by the Financial Conduct Authority and has its registered office at 70 St. Mary Axe, London, EC3A 8BE.

NBF is not authorised by the Prudential Regulation Authority and the Financial Conduct Authority to accept deposits in the United Kingdom.

U.S. Residents

With respect to the distribution of this report in the United States of America, National Bank of Canada Financial Inc. ("NBCFI") which is regulated by the Financial Industry Regulatory Authority (FINRA) and a member of the Securities Investor Protection Corporation (SIPC), an affiliate of NBF, accepts responsibility for its contents, subject to any terms set out above. To make further inquiry related to this report, or to effect any transaction, United States residents should contact their NBCFI registered representative.

This report is not a research report and is intended for Major U.S. Institutional Investors only.

This report is not subject to U.S. independence and disclosure standards applicable to research reports.

HK Residents

With respect to the distribution of this report in Hong Kong by NBC Financial Markets Asia Limited ("NBCFMA") which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 (dealing in securities) and Type 3 (leveraged foreign exchange trading) regulated activities, the contents of this report are solely for informational purposes. It has not been approved by, reviewed by, verified by or filed with any regulator in Hong Kong. Nothing herein is a recommendation, advice, offer or solicitation to buy or sell a product or service, nor an official confirmation of any transaction. None of the products issuers, NBCFMA or its affiliates or other persons or entities named herein are obliged to notify you of changes to any information and none of the foregoing assume any loss suffered by you in reliance of such information.

The content of this report may contain information about investment products which are not authorized by SFC for offering to the public in Hong Kong and such information will only be available to, those persons who are Professional Investors (as defined in the Securities and Futures Ordinance of Hong Kong ("SFO")). If you are in any doubt as to your status you should consult a financial adviser or contact us. This material is not meant to be marketing materials and is not intended for public distribution. Please note that neither this material nor the product referred to is authorized for sale by SFC. Please refer to product prospectus for full details.

There may be conflicts of interest relating to NBCFMA or its affiliates' businesses. These activities and interests include potential multiple advisory, transactional and financial and other interests in securities and instruments that may be purchased or sold by NBCFMA or its affiliates, or in other investment vehicles which are managed by NBCFMA or its affiliates that may purchase or sell such securities and instruments.

No other entity within the National Bank of Canada group, including National Bank of Canada and National Bank Financial Inc, is licensed or registered with the SFC. Accordingly, such entities and their employees are not permitted and do not intend to: (i) carry on a business in any regulated activity in Hong Kong; (ii) hold themselves out as carrying on a business in any regulated activity in Hong Kong; or (iii) actively market their services to the Hong Kong public.

Copyright

This Report may not be reproduced in whole or in part, or further distributed or published or referred to in any manner whatsoever, nor may the information, opinions or conclusions contained in it be referred to without in each case the prior express written consent of NBF.