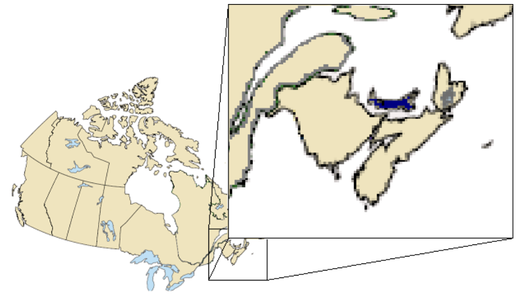
Environmental Scan

Prince Edward Island

2017



KEY HIGHLIGHTS

- After a slow start to 2016, global economic growth strengthened in the second half of the year, and is expected to see further improvements in 2017 and 2018.

- The United States has seen healthy job gains and a pickup in wage growth, helping lift consumer optimism and demand for housing. Economic growth is expected to further strengthen amid the high uncertainty over potential bold measures on tax reform, fiscal policy and trade agreements.

- Economic growth in Canada rebounded strongly in the second half of 2016, following weak performance earlier in the year. The Bank of Canada anticipates real GDP growth in Canada will accelerate in 2017 and 2018, although this outlook is subject to policy uncertainty at the global level.

- With over $1.8 billion in projected spending, and continued growth in the population over the coming decades, the outlook for economic growth on Prince Edward Island is better than it had been in recent times. Exports and Tourism related activities are expected to continue to benefit directly from a lower Canadian dollar, with Tourism attracting both international and domestic visitors to the Island.

- The consensus outlook among major independent forecasters suggests the Island economy will advance by about 1.4% and 1.3% in 2017 and 2018 respectively, to lead economic growth in the Atlantic Region. After three consecutive years of less than stellar performances, labour market conditions on P.E.I. are expected to slowly improve during this period, including a modest turnaround in job creation, and a gradual reduction in the unemployment rate.

- One of the key challenges facing the Atlantic Region is the aging of the population. The Region is aging more rapidly than the rest of Canada. Coupled with out-migration, population aging is expected to negatively impact the labour market and public finances in the years ahead. This phenomenon presents a real challenge for employers in the province, especially in the rural areas of the Island.

GENERAL OVERVIEW / ECONOMIC CONTEXT

The Global Economy: *Global economic activity remains subdued, and recovery is expected to be uneven and modest in advanced economies*

Global economic conditions appear to have strengthened in the second half of 2016, following a slow start to the year where economic activity fell short of expectations. Growth in real GDP is now anticipated to come in just shy of 3% for 2016, which would be slightly weaker than what it was in 2015. The mid-year turnaround is partly due to a recovery in manufacturing output and a more general pickup in growth in advanced economies. The euro area, meanwhile, seems to have avoided any dramatic economic consequences following the United Kingdom's vote to exit the European Union. Nonetheless, growth prospects across much of Europe lie below historic rates and remain tempered by lingering concerns over further instability associated with rising protectionism and high debt levels.

The United States economy rebounded after a weak first half in 2016. The recent surge in consumer and business confidence is encouraging moving forward. Meanwhile, investors are showing increased optimism, particularly since the conclusion of the U.S. election and a promise of additional fiscal measures (including tax cuts) and trade policy reforms on the part of the new U.S. administration. The labour market continues its steady rebound, with the unemployment rate now sitting below 5% and wage growth beginning to accelerate. More money in the hands of consumers has helped boost retail sales and demand for new housing. Despite a rise in mortgage rates since the last U.S. elections, housing starts in the last quarter of 2016 reached their highest level since the onset of the 2008 global economic recession. Mounting inflationary pressures suggest further U.S. interest rate increases in 2017, which could exert further downward pressure on the Canadian dollar. This should be partly offset by a higher price for oil, however, which is expected to remain fairly stable around $55 per barrel – well off from the $100 per barrel seen in 2014.

Table 1: Projection for global economic growth

	Projected growth (%)		
	2016	**2017**	**2018**
United States	1.6 (1.5)	2.2 (2.1)	2.3 (2.0)
Rest of the World	1.6 (1.6)	1.3 (1.3)	1.5 (1.5)
China	6.6 (6.5)	6.3 (6.4)	6.4 (6.3)
Oil-importing (Emerging Markets Economies)	3.3 (3.4)	3.6 (3.8)	4.4 (4.3)
Euro Area	1.0 (0.9)	2.1 (1.9)	3.0 (3.0)
World	2.9 (2.8)	3.2 (3.2)	3.6 (3.5)

Sources: Bank of Canada, *Monetary Policy Report, January 2017*
Numbers in parenthesis are projections used in the Bank of Canada's previous Monetary Policy Report (October 2016)

According to the Bank of Canada's January 2017 Monetary Policy Report, growth in real GDP in the U.S. is expected to be better in 2017 (+2.2%) and 2018 (+2.3%), after a disappointing year in 2016 (+1.6%). The global economy is also expected to see stronger economic growth over the next two years. Some caution is required however, as most major forecasters express considerable uncertainty in their outlook, largely related to the unknown policy actions of the new U.S. administration and how it could impact international relations and trade flows.

Canada: *Economic activity rebounding slowly*

Following a weak performance in the first half of 2016, which was partly a reflection of the disruption caused by the Alberta wildfires, economic growth rebounded significantly in the second half of the year. The Bank of Canada anticipates real GDP growth in Canada will strengthen from 1.3% in 2016, to 2.1% in both 2017 and 2018.

Activity in the service sector has been relatively healthy and is expected to remain the main source of growth in the medium term. Nevertheless, the goods sector, which has been battered by the slump in commodity prices and competitiveness challenges, has begun to grow again following two years of near-steady declines.

Modest expansion of exports and investment will be supported by increased foreign demand, but uncertainty remains due to the new U.S. administration's position on important trade agreements, including NAFTA. Even though Canada does not seem to be the primary focus of the reopening of the agreement, the country could experience collateral damage from new trade restrictions. While stronger economic growth south of the border is supportive, the dollar's recent appreciation versus the U.S. currency will limit net trade's contribution to overall growth.

Household expenditures, with the support of steady but moderate employment gains and low interest rates are projected to be the primary contributor to growth in 2017. Elevated levels of household debt, however, could eventually begin to weigh on consumption, particularly if borrowing costs rise faster than anticipated. As it stands, however, the Bank of Canada is expected to keep interest rates at current levels until the spring of 2018. Otherwise, government stimulus spending should provide some support to economic growth in 2017 and 2018. As commodity prices rebound gradually, the persistent drag from business investment should diminish significantly in 2017, with positive contributions anticipated in 2018. The possibility of significant corporate and personal income tax cuts in the United States, however, could result in the deterioration in Canadian competitiveness and incite businesses to invest in the United States, rather than in Canada.

Prince Edward Island: *A modest but steady pace of economic growth is expected on the Island in the years ahead*

The PEI economy is not significantly exposed to potential shocks such as swings in energy prices. Nonetheless, the Island had budget deficits in 12 of the last 14 years, and fiscal policy has been restraining economic performance in the province in recent times. As part of efforts to eliminate those deficits, the 2016 budget increased the province's Harmonized Sales Tax (HST) rate to a combined 15%, bringing it in line with the rates in the other Atlantic Provinces. Following a $17.9 million deficit in the previous year, the provincial government recently announced a projected surplus of $600,000 for the 2017/2018 fiscal year. Government revenues are expected to increase by almost $80 million, with the bulk of the growth coming from personal income taxes, HST revenues and federal transfers.

Construction activity in the province is stabilizing following three consecutive years of declines in the dollar value of building permits. The value of construction permits on the Island totalled $219 million in 2016, which is up from $196 million in the previous year. Nonetheless, this is still down considerably from an average of $261 million in building permits between 2010 and 2012. The number of urban and rural housing starts in P.E.I. totalled 556 units in 2016, virtually unchanged from 2015 levels. While the number of housing starts appears to be stabilising, it is significantly less than the 880 units constructed, on average, between 2010 and 2012.

There are no mega projects in the horizon for P.E.I in the near future. According to the Atlantic Provinces Economic Council Major projects inventory, investment in major projects in P.E.I. (-21%) will fall back to more traditional levels as a majority of the work on the transmission line to New Brunswick wraps up.

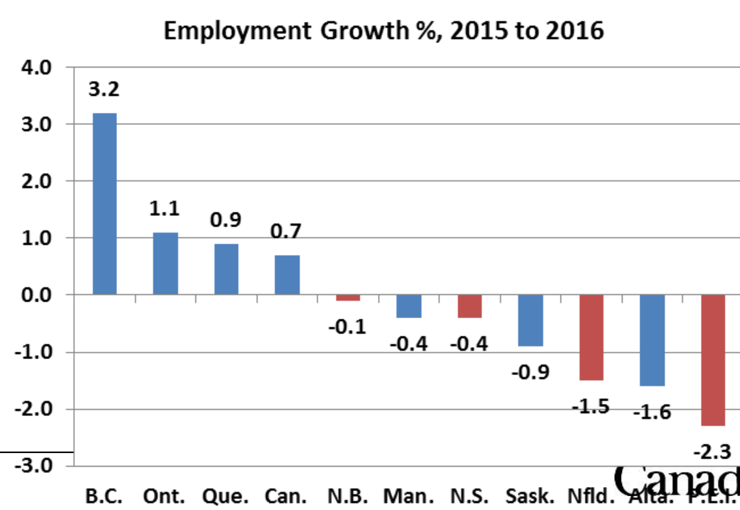
The Manufacturing industry is expected to keep on making gains over the next two years as demand for the Island's food products continues to grow in Asia and other parts of the world. Exports and Tourism related activities are expected to continue to benefit directly from a lower Canadian dollar, with Tourism attracting both international and domestic visitors to the Island. With a boost in the provincial government's projected spending (of over $1.8 billion) and continued growth in the population over the coming decades, the outlook for economic growth on the Island is better than it had been in recent times.

Looking forward, the consensus outlook from independent forecasters suggest the Island economy will advance steadily by about 1.4% and 1.3% in 2017 and 2018 respectively, to lead economic growth in the Atlantic Region. Against this backdrop, the prospects for job creation on the Island are better for 2017 and 2018, compared to the last three years. While overall economic conditions in the province are expected to improve, growth in the labour force is expected to outpace job creation over the next two years.

LABOUR MARKET

Canada: *The labour market has been resilient despite weakness in the economy*

Labour market conditions deteriorated somewhat in 2016, thanks in part to slumping commodity prices. Although the economy added around 130,000 jobs last year, more than 80,000 were in part-time employment. The increasing shift towards part-time gains intensified during the final months of the year. More generally, the average pace of job gains over the past two years is down sharply from the typical gains seen prior to the recession. In 2016, job losses were concentrated in provinces that faced the greatest exposure to the slump in

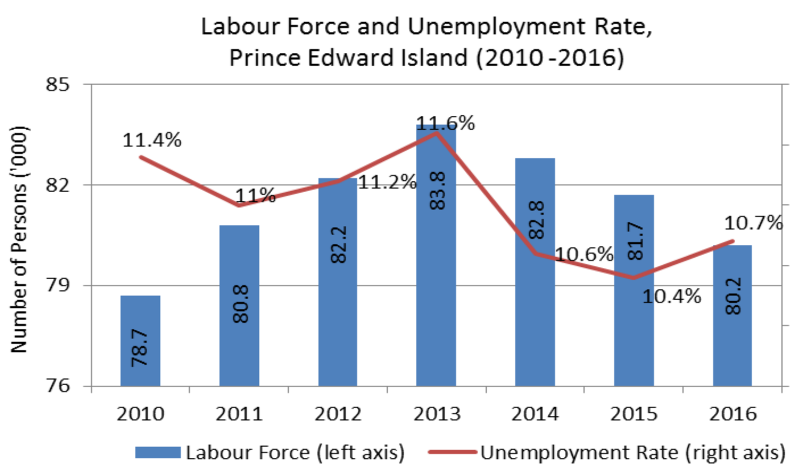


Source: Statistics Canada, Labour Force Survey commodity prices earlier in the year, such as Alberta, Newfoundland and Saskatchewan. Otherwise, with the exception of British Columbia, job gains were relatively weak across the board in the other provinces. The unemployment rate, which has been stuck at around 7% for the past four years, was broadly unchanged in 2016 thanks to a bigger rise in the labour force. The participation rate, however, edged down in 2016 and has been on a well-established downward trend since the onset of the recession. Indeed, since 2008, the latter has fallen from 67.5% to 65.7% and is expected to fall further over the outlook period.

The majority of job gains in 2016 were concentrated among older workers (aged 55 plus), a trend which has been firmly in place since the recovery began in 2009. The increasing share of jobs going to those in the older age cohort, which might have a higher propensity to work fewer hours, could explain the shift towards part-time work. In comparison, employment among the core working-age (25-54 years) group was up only slightly by 0.2% or 26,700 jobs, while younger workers (15-24 years) experienced a slight decline (-0.2% or - 5,100 jobs). Compared to the previous year, the Services-producing sector generated more than 295,000 jobs in 2015, while the Goods-producing sector experienced job losses largely due to a 5.7% (or 17,700 jobs) decline in the Mining, quarrying, and oil and gas extraction industry.

PEI: *Labour market conditions on the Island are expected to gradually improve over the next two years.*

Labour market conditions in PEI have been weak in recent years. After reaching all-time highs in 2013, both the labour force and employment levels have steadily declined. As shown in Chart 2, about 3,600 people exited the Island's labour force between 2013 and 2016. The majority have been people in the core working-age group, and women. During this period, employment also declined by 2,600 and close to two-thirds of the job losses were in full-time work. All age groups experienced declines in employment, and as it was with the labour force, the core working-age group accounted for the majority of the job losses in the last three years.



The unemployment rate averaged 10.7% in 2016, slightly higher than what it was in the previous year. Despite the small increase, the province's unemployment rate is almost a full percentage point lower than what it was in 2013. It is worth noting, however, that the improvement seen in the unemployment rate is a result of more people leaving the labour force altogether, which helped to reduce the effects of the job losses experienced during this period. While the youth and those in the core working-age group have experienced improvements in their unemployment rates, older workers have seen their rates go up in recent years.

The participation rate, which can provide an indication of labour market optimism, has been dwindling on the Island since 2013. In 2016, at 65.8%, the participation rate was the lowest on the Island in more than a decade, meaning that Islanders have been less optimistic about the prospects of finding work. Despite the decline, the province's participation still ranks highest in the Atlantic Region and continues to rank among the highest in the country. At 69.3%, the participation rate for younger workers in P.E.I. was the highest in the country, while females in the core working-age group on the Island had the second highest participation rate in Canada in 2016.

The trends at an industry level can help shed more light on where the changes have been occurring in the labour market. Both the **Goods-producing** and **Services-producing sectors** have experienced job losses in the last three years. In the Goods-producing sector, there were notable declines in employment levels in **Construction** and **Agriculture**, while there were strong gains in **Manufacturing** employment (1,000 jobs) which helped to partially offset the job losses in this sector. The number of jobs in the manufacturing industry has been increasing over the past three years aided by a weaker Canadian dollar and a stronger U.S. economy. Despite the reductions experienced in recent times, the services-producing sector remains the key provider of jobs in the province, accounting for 77% of total employment on the Island in 2016. This share is unchanged from what it was in 2013. The largest job losses in this sector during this period occurred in **Retail Trade** (-900) and **Public administration** (-800). There were notable job gains in **Finance and insurance** (500), and **Professional, scientific and technical industries** (600).

Looking forward, labour market conditions on P.E.I. are expected to gradually improve in the next two years. After three consecutive years of less than stellar performances, employment in the province rose for the third straight month in February 2017, backed by gains in full-time positions. According to the consensus of private sector forecasts, the Island is expected to lead the Atlantic Region in real GDP growth over the next two years. This is expected to translate into better labour market performances over this period, including a modest turnaround in job creation, and a gradual reduction in the unemployment rate in the province.

KEY CHALLENGES AFFECTING THE ATLANTIC REGION'S LABOUR MARKET

Demographic Challenge

The Atlantic Region is aging more rapidly than the rest of Canada. Coupled with out-migration, population aging is expected to negatively impact the labour market and public finances. As all members of the baby-boom cohort reach age 65, the aging phenomenon will accelerate in Atlantic Canada in the coming decades. Managing pensions and overall public finances will become more challenging with fewer workers and more retirees. In the Atlantic Region, the percentage of seniors living with low-incomes was 6% in 1996. Since then, the proportion has more than tripled to 21% in 2014. If this trend continues, as a higher percentage of the population move into the 65 years + age group, it could lead to higher spending commitments on the Old Age Security (OAS) and the Guaranteed Income Supplement (GIS).

With fertility rates remaining low and continued losses with respect to interprovincial migration, projected international migratory increase would be the main driver of population growth in the Region. Immigration to Atlantic Canada has risen in recent times due to the expanded use of Provincial Nominee Programs and this trend is expected to continue in the years ahead. The Atlantic Provinces Economic Council (APEC) estimates that the total number of provincial nominees in Atlantic Canada could reach 10,600 annually, if the provinces fully use their existing federal allotments.

Trade Uncertainty

International exports represent an important source of revenue to the Atlantic Region, valued at nearly $28 billion in 2015. A number of industries in the region have managed to benefit in recent years from favourable export conditions, namely a lower Canadian dollar and the strengthening economies of key trading partners. Despite this, the Region has seen a 25% drop in the value of international exports in the past two years, primarily due to a large, prolonged decline in commodity prices and reduced production in natural resource and energy industries. The impact on the Region has been most severe in Newfoundland and Labrador and New Brunswick. Furthermore, recent geopolitical events and a growing protectionist sentiment have heightened concerns around international relations and trade stability. Important trade agreements for Canada and the Atlantic Region, such as NAFTA, APTA and the Softwood Lumber Agreement, face uncertain futures, and many Canadian industries stand poised for possible trade barriers (tariffs) to enter the U.S. market. These risk factors, along with a weak outlook for commodity prices, are inevitably impacting businesses as they make investment and hiring decisions.

The implications for the labour market are potentially large, considering roughly 1 in 6 jobs across the country are tied to exports, either directly and indirectly. This issue could pose a higher risk to small communities in Atlantic Canada considering a greater portion of workers, at roughly twice the incidence compared to urban centres, are employed in export-oriented industries (e.g., agriculture, manufacturing). Employers adversely affected by dramatic changes to terms of trade could be forced to adjust their workforce and operations.

Rural-Urban Divide

Atlantic Canada has one of the most rural populations in the industrialized world, and the Region's weaker economic and labour market outcomes compared to the rest of Canada, are largely due to the poorer performances seen in the rural areas. Employment in the core population centres in Atlantic Canada expanded by 41,200 jobs between 2011 and 2016. In comparison, employment in the small population centres and rural areas declined by a similar amount (41,300 jobs) over the same period. While there are no significant gaps in performances between Atlantic Canada population centres and the rest of the country, there exists a wider prosperity gap between rural Atlantic Canada and rural areas in the rest of the country. For example, in 2016, the unemployment rate in rural Atlantic Canada was 14.4% compared to 7.6% for rural areas in the rest of the country. These diverging trends reflect the concentration of export-oriented primary and resource-related manufacturing job losses in rural communities. Furthermore, chronic out-migration of the younger segments of the population is changing the composition of the labour force in rural Atlantic Canada and exerting further pressures on the pool of available labour in these areas. Recent suggestions by the Economic Advisory Council points to demographic groups such as indigenous people, lower income earners, women with young children and Canadians aged 55 to 69 years old as untapped resources that could augment the pool of available labour should the government find ways to get more of them into the job market.

Fiscal Challenges

Rising provincial government debt levels continue to pose a range of challenges to the Atlantic Region. In 2015/16, the net debt-to-GDP ratio across the Atlantic Provinces was 39.8%, which was up significantly from 30.7% in 2011/12. This means that rising shares of provincial government revenues are going towards servicing the debt, potentially at the expense of programs and services. With the exception of Newfoundland and Labrador, provincial governments across the region have made some progress towards lowering their respective deficits and returning to balance. The result of these lower deficits, however, is that households and businesses across the region are now carrying a higher tax burden. In addition to having the highest sales tax rate in the country, the Atlantic Provinces also have the highest corporate and personal income taxes. Personal income taxes across the region are most strikingly high in New Brunswick and Nova Scotia. More generally, the labour market implications of higher income taxes are that it is increasingly difficult for employers in the region to attract and retain workers. This makes addressing certain labour shortages challenging, particularly in some higher-skill and better paid occupations. High corporate income taxes relative to the rest of the country also makes it challenging to attract investment and employment in the region.

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