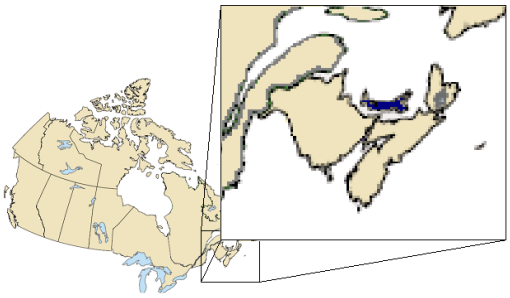
Environmental Scan

Prince Edward Island



2018

KEY HIGHLIGHTS

- Global economic conditions improved in 2017 thanks to higher-than-expected growth in advanced economies. Looking towards 2018 and 2019, global growth is anticipated to remain elevated and stabilize at around 3.5% per year.

- The United States, easily the Atlantic region's most important trading partner, is on course to surpass its longest economic recovery on record. The rise in real GDP growth from 1.9% in 2016 to 2.3% last year was made possible because of a sharp acceleration in the second half of the year. The average pace of monthly job gains have moderated somewhat, but not enough to keep the unemployment rate, currently at 4.1%, from falling further. Otherwise, as rising wage growth leads to higher inflation, the Federal Reserve will respond by raising the fed funds rate even faster in 2018. Against this backdrop, U.S. real GDP growth is expected to slow from 2.6% in 2018 to 2.3% in 2019.

- In Canada, economic growth rebounded considerably in 2017, after being subdued by temporary factors such as raging wildfires in the western provinces in 2016. Indeed, the Bank of Canada estimates that real GDP grew by 3.0% last year, due in large part to a significant rebound in energy exports and stronger growth in household spending. A gradual slowdown in the pace of employment gains combined with a moderation in household income growth is expected to limit economic growth to 2.2% in 2018 and 1.6% in 2019.

- The Prince Edward Island population totalled 152,021 on July 1, 2017, an increase of 1.7% over 2016, the fastest growth amongst provinces. Provincial forecasts indicate that increased immigration will reverse the decline in the working age population beginning in 2017 and beyond.

GENERAL OVERVIEW / ECONOMIC CONTEXT

The Global Economy: *Global economic activity continues to strengthen amidst a more positive outlook for advanced economies*

After strengthening towards the latter half of 2016, global economic conditions gained further momentum throughout most of 2017. For the year as a whole, global real GDP is estimated to have expanded by 3.6% in 2017, up from the 3.0% pace in 2016. Looking ahead, economic growth is expected to stabilize around the 3.5% mark in 2018 and 2019.

The strength in global economic activity has been supported by sustained growth in emerging-market economies and higher-than-expected growth in advanced economies. Improvements among the latter have been broad based, although growth in Europe and, Asia in particular, easily surpassed expectations. Despite political instability in certain member nations, growth in the euro area has been fairly widespread and labour market conditions continue to improve. Negotiations surrounding the United Kingdom's exit from the European Union are ongoing and pose a moderate risk to the economies in the region. Below target inflation across many advanced economies has allowed central banks to keep interest rates near historic lows. As labour market conditions continue to strengthen and exert upward pressure on inflation, central banks will respond by gradually raising interest rates further in the near future.

The U.S. economy, easily the Atlantic region's most important export market, is on course to match its longest recovery period on record. Following a slow start to 2017, economic activity in the U.S. strengthened considerably in the second half, due mainly to a sharp acceleration in household spending that resulted from steady employment gains and elevated consumer confidence. Business investment strengthened for much of the year, reflecting a growing contribution from the energy sector and, more recently, fiscal measures (including tax cuts) and trade policy reforms. Despite rising mortgage rates, housing remains affordable and starts continue climbing towards pre-recession levels. Labour market conditions remain healthy, and the average pace of monthly employment gains remain over 150,000, which is unprecedented given the late-stage of the recovery. The unemployment rate declined further throughout 2017, and currently sits at 4.1%. Despite a labour market that is operating so close to full employment, wage growth has only recently begun to accelerate.

Economic growth in the U.S. is anticipated to remain elevated in the near-term, as a depreciation in the trade-weighted currency supports further contributions from net trade. Economic activity will receive a small boost from recent tax measures, including cuts to personal and corporate income taxes. The added strain on the fiscal deficit might prompt investors to eventually require higher yields on U.S. debt, however, exerting upward pressure on long-term interest rates. The extent to which these stimulus measures impact inflation will determine how fast the Federal Reserve will be required to raise interest rates. The bottom line is that interest rates will inevitably rise over the outlook period, which will trigger a gradual slowdown in business and consumer spending. Against this backdrop, after strengthening to around 2.6% in 2018, real GDP growth in the U.S. will slow to around 2.3% in 2019.

Table 1: Projection for global economic growth

	Projected growth (%)		
	2017	2018	2019
United States	2.3 (2.2)	2.6 (2.2)	2.3 (2.0)
Rest of the World	1.4 (1.4)	2.0 (2.2)	2.5 (2.8)
China	6.8 (6.8)	6.4 (6.4)	6.3 (6.3)
Oil-importing (Emerging Markets Economies)	4.3 (4.0)	4.2 (4.0)	4.2 (4.2)
Euro Area	2.5 (2.3)	2.2 (1.8)	1.6 (1.6)
World	3.6 (3.4)	3.6 (3.4)	3.5 (3.5)

Sources: Bank of Canada, *Monetary Policy Report, January 2018*
Numbers in parenthesis are projections used in the Bank of Canada's previous Monetary Policy Report (October 2017)

Global economic growth is projected to remain more stable, with real GDP expanding by 3.6% in 2018 and 3.5% in 2019. After being a key contributor to global growth, the Chinese economy will contribute only slightly to global growth, as its rate of expansion slows from 6.8% in 2017 to 6.4% in 2018 and 6.3% in 2019. Among developed economies, growth will be stronger in the U.S., but diminish in the euro area, as domestic demand softens. In particular, some of these economies are approaching full employment, which suggests that employment growth will diminish, and weigh on consumer spending. At the same time, rising inflation will prompt central banks to raise interest rates. Otherwise, some uncertainty surrounds the outlook, much of which revolves around geopolitical developments and trade policies, such as the rising protectionism, and the impacts it will have on business investment and trade. Structural challenges such as aging demographics and weak productivity growth represent a source of risk over the longer-term.

Canada: *Economic activity rebounds in 2017, though uncertainty regarding international trade could impact future growth*

Economic growth rebounded sharply in 2017, following limited gains in 2016. Growth was more pronounced during the first half of the year, however, moderating over the final two quarters. The Bank of Canada estimates that real GDP grew by 3.0% in 2017 thanks to a strong contribution from consumption, but limited to some extent by net exports, which is estimated to have subtracted from growth. A gradual slowdown in the pace of employment gains, coupled with a moderation in household income growth, is expected to limit economic growth to 2.2% in 2018 and 1.6% in 2019.

Both the goods-producing and services-producing sectors contributed to growth in 2017. Having been the main driver of growth for a number of years, the services-producing sector is expected to be the more sustainable source of growth over the medium-term. Still, after having been battered by low commodity prices over the past two years, the goods-producing sector underwent a considerable expansion, with a significant contribution from mining, quarrying, and oil and gas extraction. The value of the Canadian dollar remains relatively low, and this should continue to provide some support to exporters in the near term.

The primary contributor to growth in 2017 was household expenditures, supported by steady employment gains and rising wage growth. Despite policy measures aimed at cooling overvalued housing markets in some of the larger urban centers, starts reached nearly 220,000 in 2017, marking the highest level of activity in a

decade. While financial conditions remained accommodative throughout the year, future interest rate hikes from the Bank of Canada will begin to weigh not only on housing, but consumption also, particularly rate-sensitive durable goods. Elevated levels of household debt and tighter mortgage lending guidelines will amplify the impacts of higher interest rates on consumption.

Business investment received a strong contribution from public infrastructure spending in 2017. At an aggregate level, the economy is operating at close to full capacity, which means that many firms will require additional investment to meet growing external demand. One notable exception is the energy sector, which continues to operate below capacity, leaving little incentive for investment despite rising energy prices. Significant cuts to corporate and personal income tax rates in the U.S. also risk weighing on business investment, leaving many Canadian businesses at a competitive disadvantage.

Despite all of this, exports are projected to rebound moderately, due to stable demand among trading partners in developed economies. A growing trend towards increasingly protectionist trade policies - particularly in the U.S. - introduces a significant degree of uncertainty to the Canadian outlook. The U.S. has already begun levying duties on aircraft, softwood lumber products and newsprint.

Ongoing North American Free Trade Agreement (NAFTA) negotiations certainly add another layer of uncertainty going forward, in part because there are so many variables and unknowns. Regardless, the U.S. accounts for nearly 80% of Canada's exports and changes to NAFTA, or even a complete withdrawal from the agreement, will have a noticeable impact on overall economic activity. A complete termination of NAFTA means that trade between the two countries will likely be operated under World Trade Organization (WTO) rules, which would bring the return of long-abandoned tariffs in several industries.

Prince Edward Island: *Growth expected to moderate in the short term as Island businesses begin to feel the effects of rising interest rates and a strengthening Canadian currency*

The Island's economy maintained its moderate momentum in 2017, slightly outmatching its 2016 growth. According to private-sector estimates, real GDP grew by 2.0 per cent in 2017, 0.4 of a percentage point below its growth rate in 2016. The provincial economy benefited from strong performances in tourism and retail, as well as in manufacturing and exports. A rebounding construction industry also contributed to growth this past year. Contributions from P.E.I.'s primary sectors of fishing and farming were subdued in 2017.

Tourism built on its record performance in 2016, in part due to the celebration of Canada 150th anniversary and, to a lesser extent, from increased international visits. Free passes to national parks, Green Gables and Island's heritage sites saw increased visitation to the Island. Similarly, cruise ship visits were up 18.2 per cent by August, translating into higher numbers of overnight stays in accommodations and at campgrounds. As a result, tourists spending at restaurants and drinking places improved 2.5 per cent by August of 2017, compared to the same period in 2016.

Retail experienced another year of impressive gains, after a strong performance in 2016. On a year-to-date basis, retail sales were at record levels through August in 2017, up 8.4 per cent. In addition to stronger tourism figures, growth in retail was supported by healthy population growth and strong income gains. The Island saw significant job creation last year, which increased incomes and encouraged consumer spending on items like

gasoline, motor vehicle and parts, and building materials and garden equipment. Population growth remained on an upward path as international migration rose 12.4 per cent by August of 2017, on a year-to-date basis.

P.E.I's manufacturing industry picked up some momentum in 2017, performing much better than in 2016. The industry benefited from strong demand for Island exports, particularly from the United States where economic conditions remained solid. A weaker Canadian dollar also made manufacturing exports more attractive in international markets, particularly for major export items like frozen food products, aerospace products and parts, and engine and turbine equipment.

The construction industry on the Island experienced significant gains in 2017. Growth in residential building was supported in part by increased international migration to the Island and diminished provincial out-migration, which elevated demand for housing. On a year-to-date basis, total building permits rose 23.8 per cent, on average, in the first three quarters of 2017, compared to the same period in 2016. Over the same period, home sales increased by 2.2 per cent. The low supply of housing also helped residential performance; vacancy rates declined to 1.2 per cent in 2017 as Charlottetown and Summerside experienced robust demands. Elsewhere, non-residential construction also saw improved investment, growing 36.2 per cent for much of 2017.

The non-commercial sector (such as public administration, educational services, health care and social assistance) contributed modestly to GDP growth in 2017 as the provincial government restrained spending to lower its deficit. More generally, the government has made significant progress in improving its fiscal position in the past two years. The increase in HST to 15 cents on every dollar in 2016 helped reduce the deficit from $13.1 million in fiscal year (FY) 2015-16 to just $1.3 million in FY 2016-17. This FY 2017-18, the government forecasts a budget surplus of $600,000. With an improved fiscal position, there is scope for the government to loosen its restraint on expenditures going forward, which could add to the overall economic performance of the Island.

In the short term, private sector forecasters project economic growth for P.E.I. will moderate to 1.5 per cent in 2018 and 1.2 per cent in 2019. A gradual strengthening in the Canadian dollar, which is expected to exchange at around 80 cents U.S. this year, suggests both exports and tourist visitation to the Island will see more limited gains this year. Nonetheless, compared to past standards, these two components of the economy are expected to yield relatively solid performances over the same forecast horizon. Growth in consumer spending, particularly on durable items, is also expected to diminish slightly, as interest rates continue to rise. A faster than expected increase in rates may also trigger a reversal in residential building construction as well as business investment, as raising new capital becomes more expensive.

LABOUR MARKET

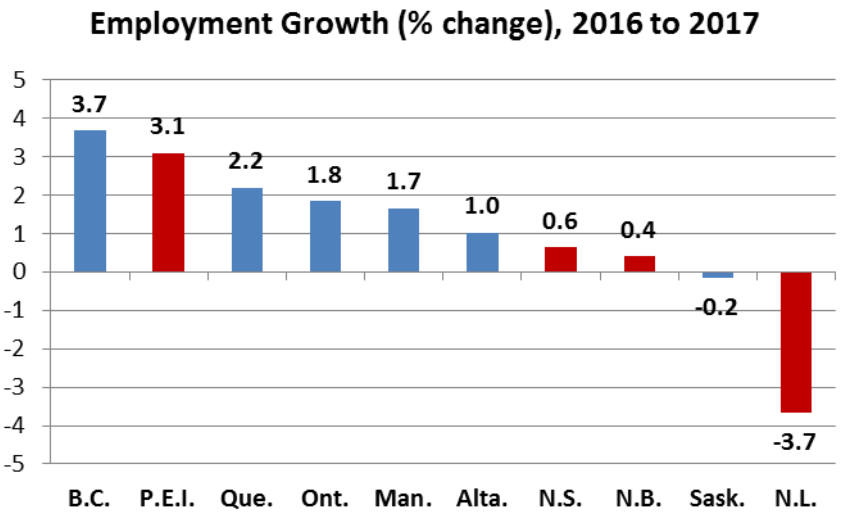
Canada: L*abour market expands at fastest pace since pre-recession*

The Canadian labour market showed some improvements in 2017. The majority of the near 400,000 increase in employment was concentrated in full-time and high-paying jobs. With the exception of P.E.I., employment

growth was strongest in the three largest provinces in the country (B.C., Que., and Ont.). Otherwise, only Newfoundland and Labrador registered a meaningful decline.

The unemployment rate fell from 7.0% in 2016 to 6.3% last year, as the pace employment gains outpaced the rise in the labour force. Despite the small increase in the participation rate, it remains nearly two full percentage points below its pre-recession level and is projected to fall further over the outlook period.

The number of older workers (aged 55 and over) grew by 3.8% in 2017 while the unemployment rate among this cohort settled at 5.6%. Workers in this age group are accounting for a growing share of the overall employment base. This is both a reflection of the rise in the number of people in this age category and their rate of participation in the labour force, which has grown by nearly five percentage points in the past decade alone.



Source: Statistics Canada, Labour Force Survey

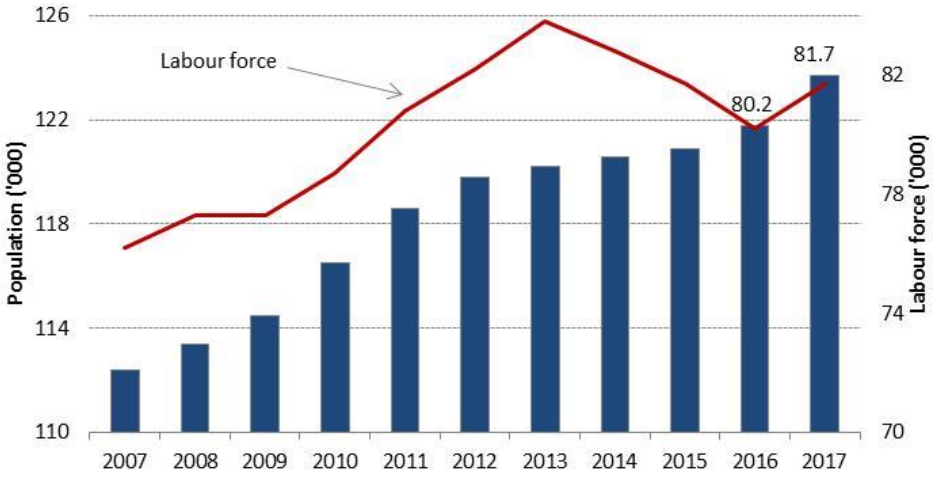
The youth (15 to 24 years) unemployment rate continued to trend downward in 2017, settling at a record-low of 10.1% for the year as a whole. Among prime-age workers, employment grew by 1.4%, lowering the unemployment rate to 5.4%.

Compared to the previous year, employment in the services-producing sector grew by nearly 294,000 in 2017, easily surpassing the 43,000 gain in the goods-producing sector. The 64,000 employment gain in Wholesale and retail trade was highest among all industries in 2017. Significant gains were also registered in Professional, scientific and technical services (+55,000) and Health care and social assistance (+44,000).

Prince Edward Island: The labour market showed greater strength in the past year

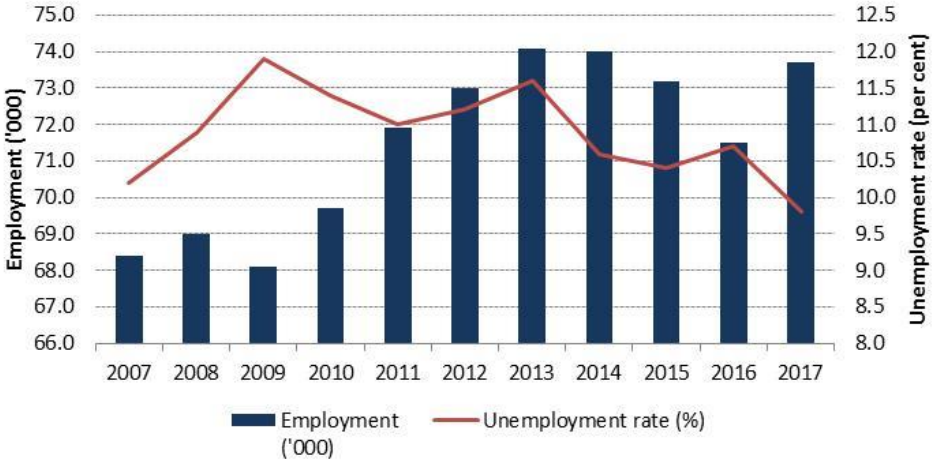
Mirroring the overall strength in P.E.I.'s economy, the latest labour market figures suggest improved labour market conditions in 2017, following a weak performance in 2016. In general, people demonstrated a greater attachment to the labour market in 2017. After sustaining three years of decline beginning in 2013, the labour force grew by a net 1,500 in 2017, representing a 2.0 per cent increase from 2016. Men made up nearly three quarters of the gain in the labour force. Youth (aged 15-24), however, continued to detach from the labour market as more chose to exit than join the labour force in 2017. Notably, the labour force participation for individuals aged 55 and over rose by 3.6 percent in 2017.

Working-age Population and Labour Force Trends



The level of employment expanded by 2,300 (or 3.1 per cent) in 2017, essentially returning to 2012-2015 levels (Chart 2). Full-time employment gains of 2,600 (or 4.4 per cent) easily offset a modest decline in part-time employment (-300). The rise in employment in 2017 was most pronounced among men (+1,500), although 800 more women were working in 2017. Although the rate of participation among women has improved significantly over the years, it still lags that of men. This could explain, in part, the disproportionate gains in employment between men and women. Broken down by age, employment gains were highest among those aged 55 and over (+1,100). The level of employment among youths, however, remained broadly unchanged at around 10,500 in 2017.

Employment and Unemployment Rate



The unemployment rate on the Island averaged 9.8 per cent in 2017, down 1.7 percentage points from 2016 and also a ten-year low. The faster pace of employment gains relative to that of the labour force helped lower the unemployment rate.

On an industrial basis, employment gains were evenly divided between the services-producing and goods-producing sectors. A breakdown of the service-producing sector reveals that the majority of job gains were in wholesale and retail trade (+800), followed by health and social assistance (+400) and transportation and warehousing (+300). Gains in the goods-producing sector were strongest in construction (+600) and manufacturing (+500). Employment was stronger in construction primarily because more people were needed to meet the stronger demand for housing.

KEY CHALLENGES AFFECTING PRINCE EDWARD ISLAND'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 put pressure on the labour market, public finances and health care. 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, as will meeting the growing demand for health care services.

According to the PEI Statistics Bureau, the size of the population under age 45 has increased by just 1.5 per cent over the past decade, dwarfed by nearly 22% growth in the 45 and over population.[1] The baby boom generation started reaching the age of 65 in 2011 which will continue for the next couple of decades. The Island's median age in 2017 was 43.5, a decline of 0.2 over 2016, the first time the median age for PEI has declined since 1967.

Trade Uncertainty

International exports represent an important source of revenue for Island businesses. A number of industries in the province have managed to benefit in recent years from favourable export conditions, namely a lower Canadian dollar and growing demand from key trading partners. Exports of manufactured food products and aerospace-related products in particular, have experienced considerable growth over the past year.

In addition to uncertainty surrounding currency movements and economic conditions of the province's trading partners, recent geopolitical events and growing protectionist sentiment have heightened concerns around trade stability. Important trade agreements such as NAFTA face uncertain futures, and certain industries could see the return of long-abandoned tariffs, particularly under a NAFTA termination. The United States is PEI's largest trading partner, accounting for 70% of total export sales.

These risk factors inevitably impact business investment and hiring decisions. The uncertainty could pose a higher risk to smaller communities in Prince Edward Island considering a greater portion of workers in these areas are employed in export-oriented industries (e.g., agriculture, manufacturing) compared to larger urban centres.

[1] *Prince Edward Island Population Report 2017*, February 15, 2018

Rural-Urban Divide

Prince Edward Island is the only province in Canada whose rural share (53%) of the population exceeds its urban share (however, the rural proportion has been shrinking consistently over the years). Challenges that affect rural communities include the high incidence of seasonal employment (associated with farming, fishing and tourism), high unemployment, and out-migration of young workers (affecting the composition of the labour force in rural areas and exerts further pressures on the pool of available labour).

From a population perspective: "While the overall story of our population growth has been a positive one, most of these new residents have settled in our largest municipalities."[2] A priority of the provincial government is to better balance the population and workforce among rural and urban areas, with particular effort toward settling residents in rural regions. Investments in community infrastructure and facilities (i.e. accessibility of high-speed internet services for residents and businesses), as well as supports for newcomers settling in rural areas, have been identified as key focus areas to promote economic development in rural Prince Edward Island.

Fiscal Challenges

The Government of Prince Edward Island forecasts its second consecutive balanced budget for 2018-19 and has earmarked more spending on physicians, hospitals and long-term care. A reduced pace of growth is projected for the PEI economy over the next two years which could limit tax revenues and affect spending plans.

The aging population and its impact on future health care demands translates into higher health care expenditures (currently, about 41 cents per dollar of program spending is allocated to health care). As the aging population dynamic continues to unfold, there will be growing reliance on pension income in the province resulting in lower tax revenues (as pensions are typically taxed less and at a lower rate). Further, the aging dynamic will cause health care requirements and related costs to expand with most of the burden supported by slow growing or stagnant (and shrinking) labour force.

Another challenge is that PEI has among the highest corporate and personal income taxes which can make it difficult for employers 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.

[2] *Recruit, Retain, and Repatriate: A Population Action Plan for Prince Edward Island* (https://www.mighty-princeedwardisland.com/population-action-plan)

Note: *In preparing this document, the authors have taken care to provide clients with labour market information that is timely and accurate at the time of publication. Since labour market conditions are dynamic, some of the information presented here may have changed since this document was published. Users are encouraged to also refer to other sources for additional information on the local economy and labour market. Information contained in this document does not necessarily reflect official policies of Employment and Social Development Canada.*

Prepared by*: Labour Market Analysis Directorate, Service Canada, Nova Scotia*
For further information*, please contact Labour Market Analysis Directorate at:*
NC-LMI-IMT-GD@hrsdc-rhdcc.gc.ca