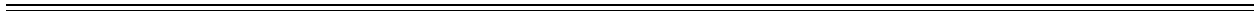




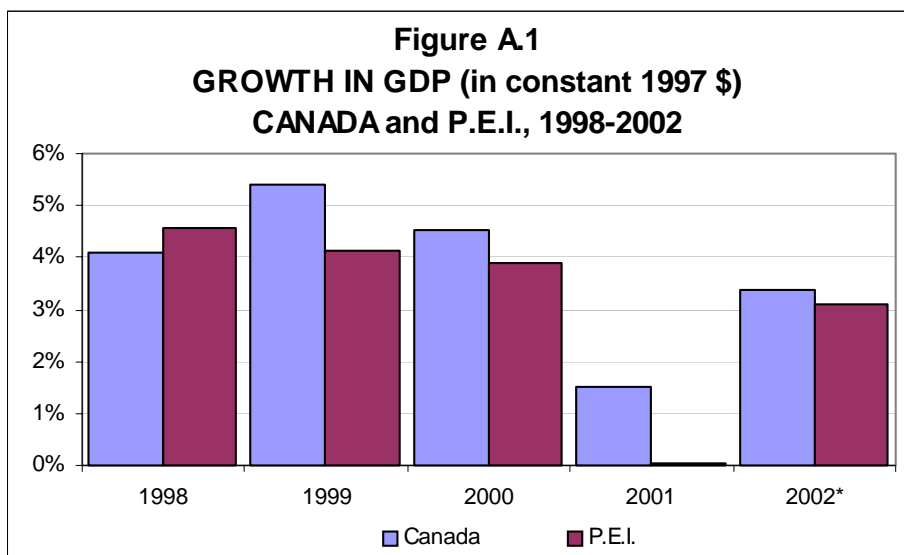
BUDGET PAPER A:
BACKGROUND NOTES ON THE ECONOMY



BUDGET PAPER A: BACKGROUND NOTES ON THE ECONOMY

Introduction

In 2002 the Canadian economy outperformed all industrialized countries, posting a 3.4 per cent growth in real Gross Domestic Product (GDP). This was significantly better than had been anticipated a year ago, when growth of only 1.5 per cent was expected. Canada's resilience in the face of global uncertainties is attributed to strong domestic demand and effective monetary and fiscal measures. Prince Edward Island also performed better than expected in 2002.



Source: Statistics Canada, *Canadian Economic Observer*.

* Provincial Treasury forecast.

Island's GDP at market prices for 2002 is estimated to be \$3,692 million. Growth in 2002 was highlighted by the recovery in potato production, growth in manufacturing, a buoyant residential construction sector and rising employment.

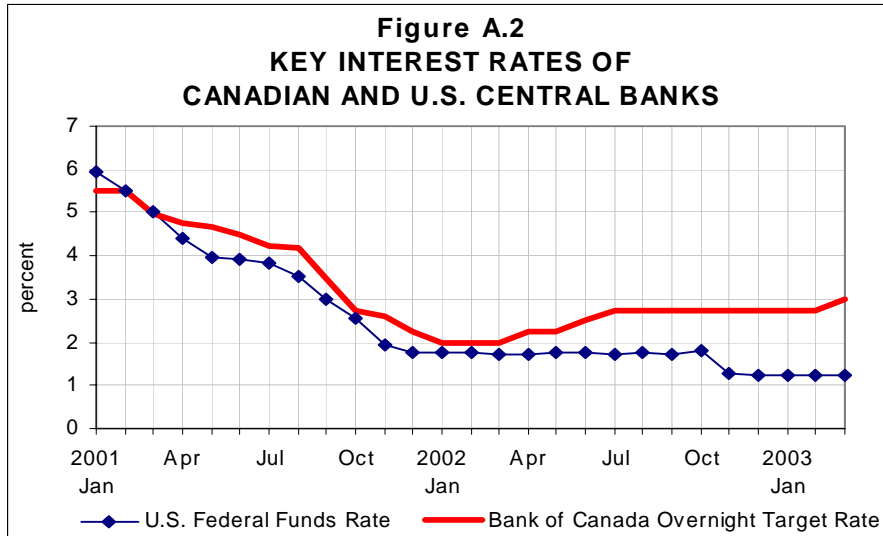
The provincial economy is estimated to have grown by 3.3 per cent in 2002, compared to the anticipated 1.2 per cent growth presented in the *2002 Budget Address*. Figure A.1 shows percentage gains in Canadian and provincial GDP since 1998. Statistics Canada estimates that P.E.I.'s economy experienced no growth in 2001, as a result of the impact of the drought on the potato harvest. The value of Prince Edward

National and International Review

After contracting for three consecutive quarters in 2001, the U.S. economy showed signs of a slow recovery from the fourth quarter of 2001 through 2002. Estimates released by the *U.S. Bureau of Economic Analysis* indicate that the U.S. economy increased by 1.4 per cent in the fourth quarter of 2002 for an annual growth of 2.4 per cent, an improvement over the 0.3 per cent annual growth in 2001.

In contrast to the United States, the Canadian economy recovered strongly from the weak conditions in 2001, especially in the first half, when GDP increased by 5.1 per cent. Statistics Canada indicates that the national economy expanded by 3.4 per cent in 2002, up from the 1.5 per cent growth of 2001. Employment growth remained strong with 560,000 new jobs created. Low interest rates, together with sustained growth in labour income, resulted in strong consumer demand.

The *Organization for Economic Cooperation and Development* (OECD) estimates an average 1.5 per cent GDP growth among its members in 2002, while economic expansion in the *European Union* was limited to just 0.2 per cent in the last quarter of 2002, for an annual increase of 0.8 per cent.



Source: Bank of Canada and United States Federal Reserve.

Figure A.2 shows the key interest rates in Canada and the United States, from January 2001 to the present. Concern over a weak economy in the United States and declining stock market values caused the *U.S. Federal Reserve Bank* to progressively lower the federal funds rate through 2001 and again in November 2002, when it was lowered to 1.25 per cent. The Federal Reserve Bank

left interest rates unchanged in March 2003, in light of global uncertainties.

By contrast, the Bank of Canada raised its target for the overnight lending rate in a series of steps: from 2 per cent in January 2002 to 2.25 per cent in April, 2.50 per cent in June, and 2.75 per cent in July 2002. The most recent increase in the Bank Rate, from 2.75 per cent to 3 per cent on March 4, 2003, signified the Bank's concern over inflationary pressures and an overheated economy.

The relatively low interest rates through 2002 reduced mortgage rates and the cost of consumer credit, which spurred new home construction. New automobile sales were also stimulated by attractive rebates and other incentives offered by manufacturers.

The number of new motor vehicles sold in Canada in 2002 increased by 8.5 per cent resulting in a record year for car sales. Housing starts in Canada rose to 205,034 units in 2002, up 26 per cent from 2001. However, non-residential investment fell from \$48.1 billion in 2001 to \$45.1 billion in 2002, a decline of 6.4 per cent. Overall government and business investment increased from \$209 billion in 2001 to \$214 billion in 2002, up by 2.5 per cent, compared to an increase of 1.7 per cent the previous year.

The Canadian exchange rate with the U.S. dollar hit a record low of 62.5 cents in January 2002, but by March 2003 the rate had climbed to 68 cents U.S.

Employment in Canada expanded by an average of 2.2 per cent during 2002 compared to 1.1 per cent a year earlier. The unemployment rate increased by a half percentage point to average 7.7 per cent.

Looking towards 2003, David Dodge, Governor of the Bank of Canada, stated on March 12, 2003:

“While we continue to foresee growth somewhat below potential in the first half of this year, we expect increased demand in the second half of 2003 and into 2004, as global uncertainties diminish. But with an appropriate reduction in the amount of monetary stimulus, we see the level of output remaining close to capacity [3 per cent] during this year and into 2004.”

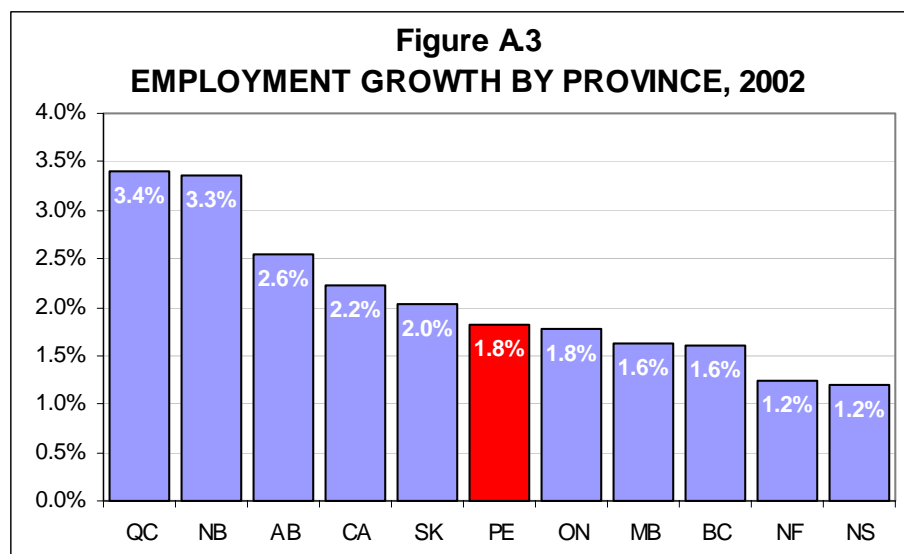
Provincial Highlights 2002

- Based on available statistics for Prince Edward Island in 2002, the P.E.I. Department of the Provincial Treasury estimates that the economy grew by 3.3 per cent, as measured by constant dollar Gross Domestic Product. This compares with a national growth rate of 3.4 per cent. It is estimated that growth of 2 per cent will occur in 2003 on the assumption that international economic conditions do not deteriorate as a result of global unrest.
- Employment on Prince Edward Island expanded by 1.8 per cent in 2002 to average 67,100 persons. This is a slightly lower growth rate than in 2001, when Island employment increased by 2.2 per cent.
- Total labour income grew by 6.3 per cent to value \$1,946 million in 2002, compared with national growth of 4.6 per cent.
- The value of international exports of goods was \$679.1 million in 2002, an increase of 1.9 per cent from a year ago. International exports of frozen food products fell by 2.3 per cent, but this decrease was more than offset by a 20.1 per cent increase in the value of processed fish products and 57.2 per cent in the value of exports of raw potatoes.
- After a modest increase of 1.5 per cent in 2001, manufacturing shipments on Prince Edward Island bounced back strongly in 2002 with an increase of 9.5 per cent, to value \$1,315.9 million. This was slightly lower than the average annual growth rate of 12 per cent that has been occurring since 1996.
- Total farm cash receipts recorded in 2002 improved by 9.5 per cent, to reach an all-time high of \$369.6 million.

- Favourable weather conditions during the summer of 2002, following the disastrous 2001 season, resulted in a 57 per cent increase in the harvested potato crop with a volume estimated at 28,890,000 cwts. The estimated value of \$194 million in potato receipts recorded in 2002 set a new record for Prince Edward Island.
- Higher landings and strong prices increased the value of the 2002 lobster catch to an estimated all-time high of \$105.5 million. However, preliminary estimates indicate that the value of all fish landings fell by 1.2 per cent in 2002 to value \$162.9 million.
- According to the P.E.I. Department of Tourism, 413,559 parties visited Prince Edward Island in 2002, an increase of 1.5 per cent from 2001. They spent an estimated \$353 million, an all-time high for Prince Edward Island.

The Prince Edward Island Economy

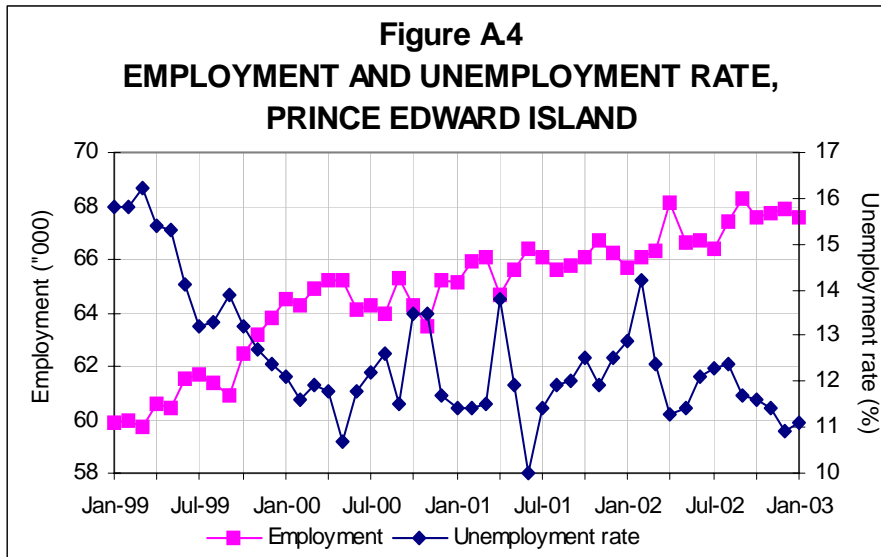
Employment



Source: Statistics Canada, *Labour Force Survey*.

Employment on P.E.I. rose to 67,100 in 2002, an increase of 1,200 from a year earlier. Figure A.3 shows employment growth in Canada and the provinces in 2002. One can see that P.E.I. had the second highest employment growth in the Atlantic region, at 1.8 per cent.

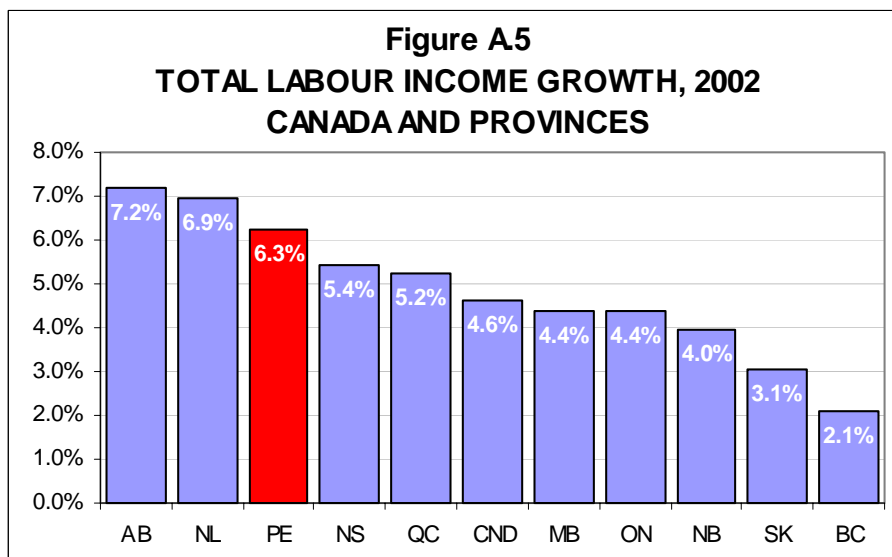
The unemployment rate averaged 12.1 per cent in 2002, slightly higher than the 11.9 per cent recorded a year earlier. This occurred largely because the labour force participation rate rose from 67.6 per cent in 2001 to 68.2 per cent in 2002. Figure A.4 illustrates monthly trends in unemployment and employment. It shows that the monthly unemployment rate on Prince Edward Island has been trending down since August 2002.



Source: Statistics Canada, *Labour Force Survey*.

Figure A.4 also shows the upward trend in employment since January 1999. Employment gains in 2002 were centred in the service-providing sector, accounting for 1,400 new jobs, with the business services and public administration sectors registering the largest increases. Employment in the goods-producing sector fell by 200 jobs in 2002, mainly in the primary and construction sectors. The reduced level of employment in construction is related to the completion of several large projects in 2002, such as the Atlantic Technology Centre.

Personal Income



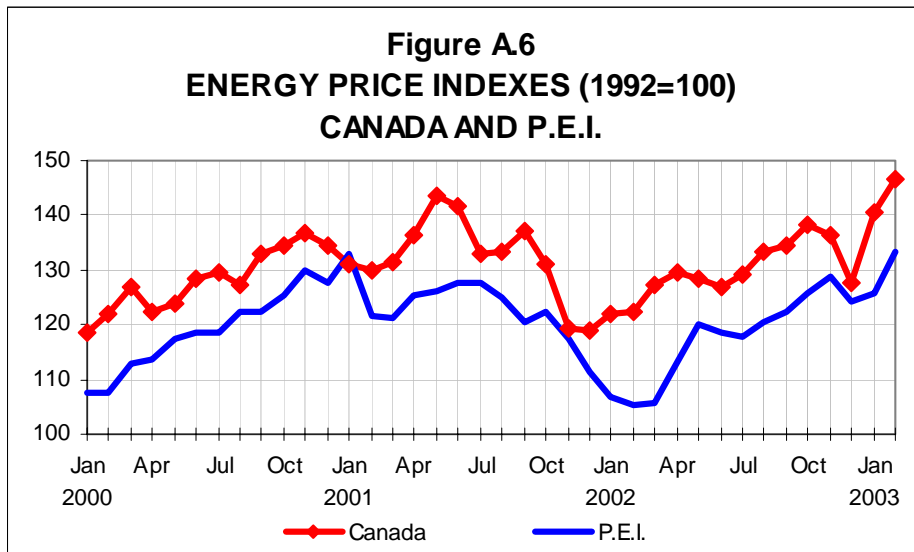
Source: Statistics Canada, *Estimates of Labour Income*.

The P.E.I. Department of the Provincial Treasury estimates that personal income of Islanders rose from \$3,141 million in 2001 to \$3,299 million in 2002, an increase of 5 per cent. The major contributors to this growth were labour income and federal government transfers to persons. Total labour income improved by 6.3 per cent in 2002 as a result of employment gains and wage settlements and compares to a national growth rate of 4.6 per cent. Figure A.5 shows total labour income growth for Canada and the provinces in 2002. For the second year in a row, Prince Edward Island placed near the top with growth of 6.3%. This was led by manufacturing which expanded by 7 per cent.

Federal government transfer payments to persons are estimated to be 5.1 per cent higher in 2002 due to increases in Canada Child Tax Benefits (CCTB), Canada Pension Plan (CPP) benefits and Employment Insurance (EI) benefits. EI benefits paid on Prince Edward Island in 2002 totalled \$196.7 million, an increase of 4.2 per cent from 2001. This increase is mainly attributed to a 15.5 per cent rise in the value of fishing benefits.

Negatively impacting growth in personal income in 2002 was interest, dividends and other investment income, which is estimated to have decreased by 7 per cent from 2001 as a result of poor financial market conditions. This was counteracted to some degree by net farm income, which is expected to increase significantly as a result of the recovery in the potato sector in 2002.

Consumer Prices



Source: Statistics Canada, *Consumer Price Index*.

The All-Items Consumer Price Index for Prince Edward Island rose by 2.7 per cent in 2002, compared to 2.2 per cent nationally. Energy prices were on average 4.8 per cent lower in 2002. Figure A.6 shows the national and provincial energy price indexes from January 2000 to February 2003. Falling energy prices through 2001 reversed in 2002.

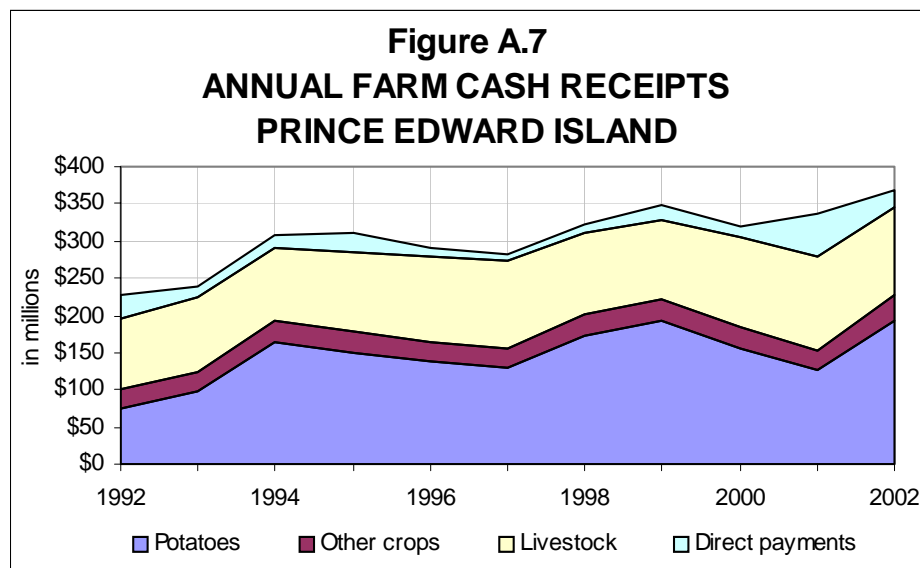
Particularly noteworthy is the period March to November 2002, when energy prices rose by 22 per cent on Prince Edward Island compared to a 7 per cent increase nationally. Highest price increases for Islanders in 2002 were for motor vehicle insurance premiums, up 39 per cent, and cigarette prices, up 29 per cent.

Final Domestic Demand

It is estimated that real final domestic demand expanded by 4.3 per cent in 2002. The main contributors to this growth were the strong recovery in potato production, the surging residential construction sector, and growth in retail sales, especially motor vehicle sales. Preliminary estimates show that exports increased by only 3.8 per cent in 2002, while import buying rose by 6.4 per cent, explaining the 3.3 per cent growth in real GDP, by contrast with a 4.3 per cent growth in final domestic demand.

Detailed Industry Analysis

Agriculture



Source: Statistics Canada, *Farm Cash Receipts*.

Total farm cash receipts for Prince Edward Island reached an all-time high of \$369.6 million in 2002, an increase of 9.5 per cent from a year ago. Figure A.7 shows the major components that make up total farm cash receipts 1992 to 2002. The dominance of potatoes increased in this time, rising from 32 per cent of total farm cash receipts in 1992 to 53 per cent by 2002.

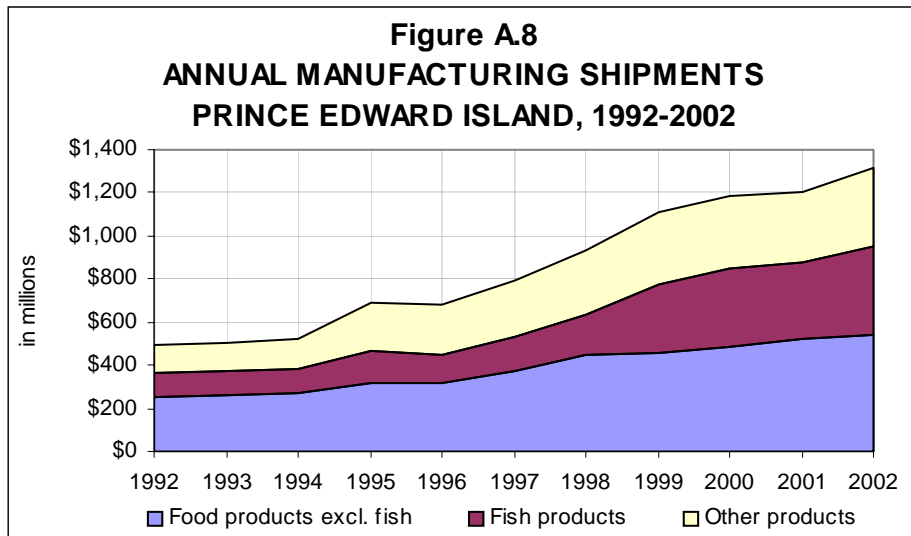
Table A.2 shows the recent trends in farm cash receipts by major commodity from 1997 to 2002. The increased potato production in 2002 is valued at \$194.2 million, an increase of 54.1 per cent from 2001. However, total livestock receipts fell by 5.4 per cent in 2002 as hog and cattle receipts declined. Government support payments to farm operators declined by 60 per cent from 2001, when compensation payments relating to the potato diversion program and increased crop insurance payouts were at an all-time high.

**Table A.2.
Annual Farm Cash Receipts, (\$ Millions)**

Year	Total Crop	Potato	Total Livestock	Cattle	Hog	Dairy	Direct Payments	Total Receipts
1997	155.7	128.8	116.9	29.8	29.2	47.1	8	280.6
1998	201.7	173.3	109.5	28.8	20.6	49.5	11.1	322.3
1999	222.2	192.2	106.1	24.8	21.9	49	18.7	347
2000	185.1	154.5	118.6	26.8	29.5	51	17	320.7
2001	153.6	126	125.2	27.3	33.5	52.5	58.5	337.4
2002	227.7	194.2	118.4	25.8	27.6	53.3	23.4	369.6
Per Cent Change								
2002/2001	48.3%	54.1%	-5.4%	-5.8%	-17.5%	1.6%	-60.0%	9.5%

Source: Statistics Canada, *Farm Cash Receipts*. cat no. 21-603-XPB

Manufacturing



Source: Statistics Canada, *Monthly Survey of Manufacturers*.

In 2002 the value of total manufacturing shipments was \$1,316 million, an increase of 9.6 per cent from 2001. Food shipments, excluding fish products, rose by 2.5 per cent to \$539 million. Processed fish products, totalling \$413.5 million, expanded by 16.2 per cent in value in 2002, while the value of all other manufacturing on Prince Edward Island

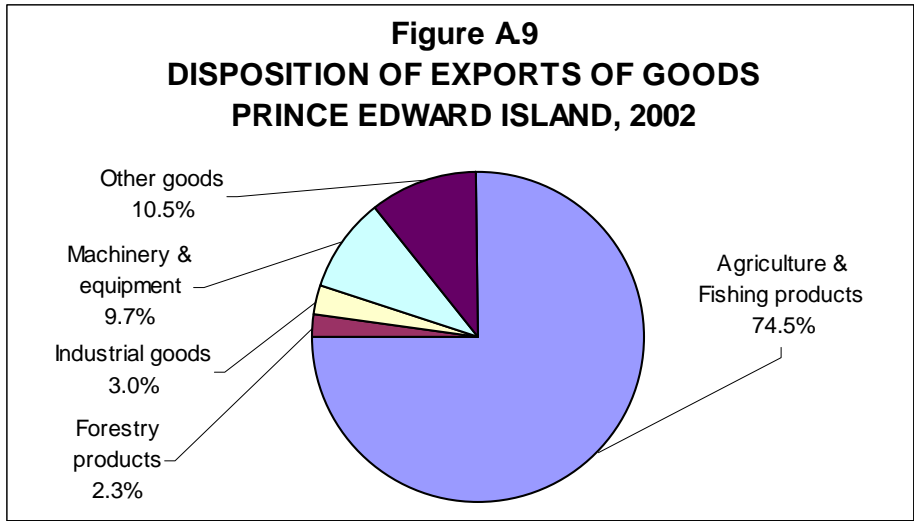
increased by 14 per cent to reach \$363.5 million. Figure A.8 shows the annual value of provincial manufacturing shipments between 1992 and 2002. Fish products have played an increasingly important role in Island manufacturing, expanding from \$131.1 million in 1996 to \$413.5 million in 2002. In comparison, the value of other food products increased by \$223 million during that period, and the value of non-food manufactures rose by \$132 million.

Fishing and Forestry

The P.E.I. Department of Fisheries, Aquaculture and Environment estimates that the total value of all fish landings on Prince Edward Island in 2002 was \$163 million, a decrease of 1.2 per cent from a year ago. Preliminary estimates also indicate that lobster landings in 2002 reached a seven-year high of 19.9 million pounds, and that, combined with strong prices during the spring and fall seasons, the value of lobster landings reached a record-breaking \$105.4 million that year. Snowcrab and bluefin tuna quotas increased in 2002, but herring landings declined by 21 per cent to 34 million lbs. due to quota reductions.

The P.E.I. Department of Agriculture and Forestry indicates that in 2002 most Island forest product sectors experienced slight production increases over 2001. Island lumber production is up 10 per cent and demand for fuel wood has been increasing in light of rising oil prices. The total volume of wood harvested on Prince Edward Island in 2002 is expected to increase slightly from the 2001 harvest. The Canada-U.S. softwood lumber dispute has not directly affected Island production, since Prince Edward Island is exempt from the countervailing duty imposed on the four major lumber-producing provinces - British Columbia, Alberta, Ontario and Quebec, where softwood is primarily harvested on Crown lands. Most Island softwood is harvested on private land with prices determined by market demand.

International Export Performance

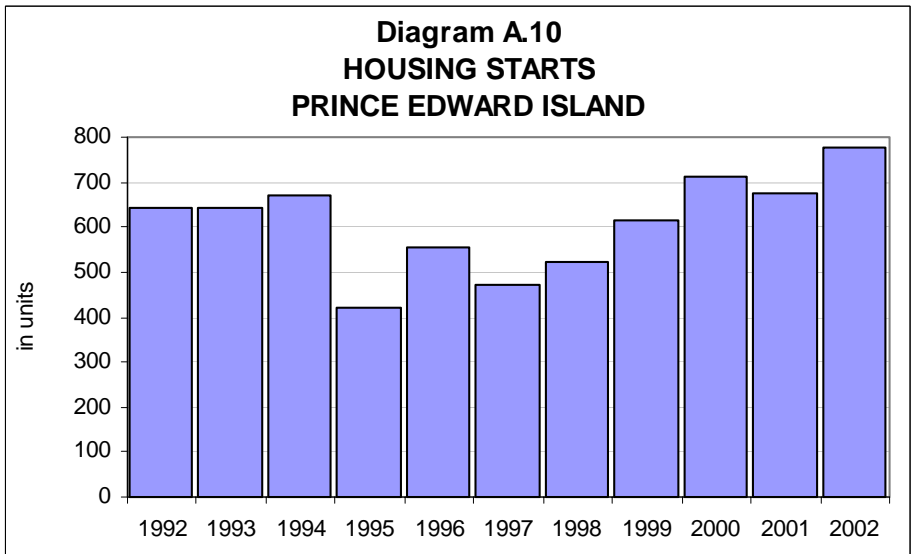


Source: Statistics Canada, *International Exports*.

After a 2.4 per cent decline in 2001, Prince Edward Island's export performance of goods in 2002 improved by 1.9 per cent and was valued at \$679 million. Fresh and processed food products represent about 75 per cent of the province's value of international exports in 2002, as illustrated in Figure A.9. While the value of internationally exported

frozen food products fell by 2.3 per cent in 2002, the value of fish and raw potato exports increased by 28.4 per cent.

Construction and Investment

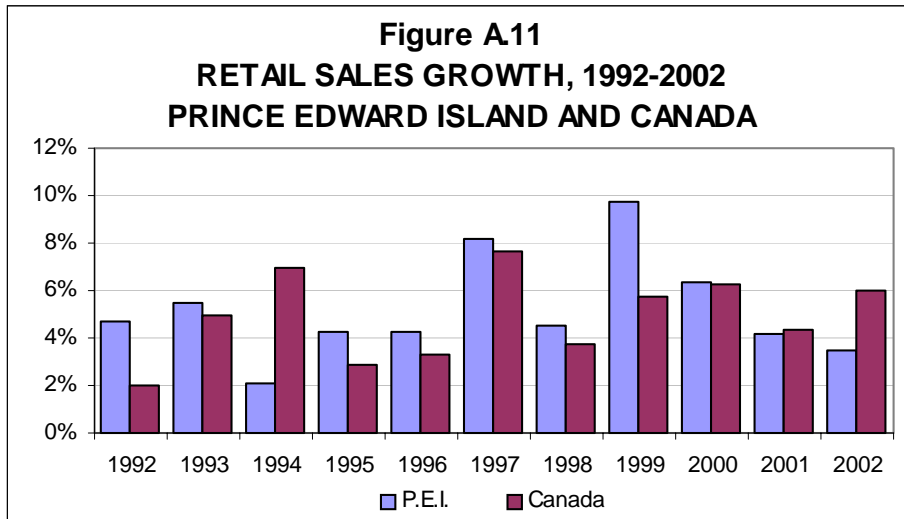


Source: Canada Mortgage and Housing Corporation.

Figure A.10 shows the total number of housing starts on Prince Edward Island between 1992 and 2002. As one can see, the province experienced strong growth in residential construction in 2002, when housing starts reached a thirteen-year high of 775 units, an increase of 15 per cent from 2001. In contrast, non-residential building permits in 2002 were valued at \$47 million, 70 per cent below the

record-breaking high of \$152.9 million recorded in 2001.

Statistics Canada estimates the value of private and public investment for Prince Edward Island in 2003 to be \$626.6 million, a decrease of 4 per cent compared to 2002. The value of construction is expected to fall by 7.6 per cent, while the value of investment in machinery and equipment is expected to increase by 1.5 per cent.



Source: Statistics Canada, Retail Sales.

per cent, respectively. Total retail sales on Prince Edward Island were valued at \$1,325 million in 2002.

Retail Trade

Figure A.11 illustrates growth in retail sales on Prince Edward Island and in Canada from 1992 to 2002. In only three years did the nation's growth rate exceed that of P.E.I. Provincial retail sales expanded by 4.2 per cent in 2001 and 3.4 per cent in 2002. This compares to a national growth rate of 4.4 and 6 per cent, respectively.

The number of new motor vehicles sold on Prince Edward Island totalled 4,996 in 2002, an increase of 7.8 per cent from 2001 compared to a 5.4 per cent decline in 2001. This represents a value of \$131.2 million, up 8.7 per cent from 2001.

Tourism

The P.E.I. Department of Tourism estimates that 387,154 pleasure parties came to Prince Edward Island in 2002, about 2 per cent more than in 2001. The number of business parties fell from 27,481 in 2001 to 26,405 in 2002, a decline of 3.9 per cent. In 2002, the number of pleasure parties from the United States increased by 4 per cent from 2001, while 1.5 per cent more Canadian pleasure parties came to the province. Total spending by all visitors between May and October 2002 is estimated at \$353 million.

Government

Government services include public administration, education, health and social services and account for almost 30 per cent of Prince Edward Island's economic activity. The government service sector in total employs more Islanders than any other sector in the province.

According to Statistics Canada's *Survey of Employment, Earnings and Hours* (SEPH), employment in public administration (federal, provincial and municipal) decreased by 2.6 per cent in 2002, which translates into a loss of 168 positions. The survey shows that education services experienced job growth of 2.7 per cent in 2002, while the health and social services sector including private services, experienced virtually no job growth.

Provincial tax revenues increased to \$459.7 million in FY 2001/02 which is a 4.1 per cent improvement from FY 2000/01. Federal transfers to Prince Edward Island (Equalization and Canada Health and Social Transfer (CHST) payments) contributed 37 per cent to the province's total revenue. Equalization payments increased by 4.4 per cent from 2001, to value \$282.3 million, while CHST payments advanced 15.9 per cent to total \$88.9 million.

Total provincial government spending rose to \$1.03 billion in FY 2001/02, an increase of 3.7 per cent from FY 2000/01. The budget of the Department of Health and Social Services was 9.3 per cent higher in FY 2001/02, while the Department of Education experienced a budgetary increase of 4.5 per cent.

Summary and Outlook for 2003

The Bank of Canada, in its *Monetary Policy Report Update: January 2003*, estimates that economic growth for Canada in 2003 will be close to its potential of 3 per cent. This is slightly below the rate indicated in its October Report, largely as a result of the slower growth prospects for the U.S. and overseas economies. Nonetheless, the Bank anticipates increased demand pressures in the second half of 2003 and into 2004, following growth at slightly below potential in the first half.

The Bank of Canada may notch interest rates up again in the coming months, according to the Governor of the Bank of Canada. However, major uncertainty over the Iraq situation makes economic forecasts at the present difficult.

The P.E.I. Department of the Provincial Treasury estimates that the value of Gross Domestic Product on Prince Edward Island was \$3,692 million in 2002, an increase of 3.3 per cent in constant dollars. The pace of economic expansion in 2002, after no growth in 2001, was at par with the average annual rate of expansion per cent since 1997. Economic growth in 2002 was led by record-breaking potato receipts, a buoyant residential construction sector, strong manufacturing and employment gains in the service-providing sector.

The Provincial Treasury estimates that the Prince Edward Island economy will expand in the order of 2 per cent in 2003. The goods-producing sector is expected to grow by 1.4 per cent, while the service-providing sector is forecast to increase by 2.1 per cent.

**SUMMARY STATISTICS
PRINCE EDWARD ISLAND ECONOMY**

	1996	1997	1998	1999	2000	2001	2002
Population on 1 July (in '000s)	136.2	136.9	136.9	137.8*	138.3*	138.9*	139.9
Personal Income per capita (\$)	18,926	19,197	19,861	20,667*	21,971*	22,597*	23,578 ¹
<i>As % of Canadian Personal Income</i>	81.7	80.5	80.3	80.4	80.6	80.5	82.2 ¹
Employment (in '000s)	58.9	59.2	60.4	61.3	64.5	65.9	67.1
Unemployment rate (%)	14.7	15.4	13.8	14.4	12.0	11.9	12.1
<i>Unemployment Rate - Canada</i>	9.6	9.1	8.3	7.6	6.8	7.2	7.7
CPI - annual change P.E.I. (%)	1.8	1.2	-0.5	1.2	4.1	2.6	2.7
<i>CPI - annual change (%) Canada</i>	1.6	1.6	0.9	1.7	2.7	2.6	2.2
Retail trade (\$ millions)	931.7	1,007.9	1,053.7	1,156.6	1,230.1	1,281.3*	1,324.8
New Motor Vehicle Sales (units)	4,120	4,717	4,556	4,802	4,902	4,635	4,996
Farm Cash Receipts (\$ millions)	291.3	280.6	322.3	347.0	320.7*	337.4*	369.6
Potato Receipts (\$millions)	137.5	128.8	173.3	192.2	154.5*	126.0	194.2
Lobster Landings (\$ millions) *	61.3	73.2	80.6	88.9	87.8	104.8	105.4
<i>Lobster Landings (lbs - millions) *</i>	17.9	17.8	18.9	18.5	19.1	19.4	19.9
Housing Starts (units)	554	470	524	616	710	675	775
Investment (\$ millions)	482.0	467.8	481.3	547.5	549.3	597.4*	652.4
Manufact. shipments (\$ millions)	678.8	788.8	937.6	1,109.0	1,183.1	1,201.3*	1,315.9
Tourist expenditures (\$ millions) ²	160.1	245.9	274.4	283.4	280.0	310.0	331.8
International exports (\$ millions)	353.7	435.2	466.0	566.5	682.9	666.4*	679.1
GDP at market prices (\$ millions) *	2,823	2,800	2,981	3,173	3,394	3,480	3,692 ¹

* revised data

Note 1: Provincial Treasury estimate

Note 2: Expenditures do not include business travel

Sources: Statistics Canada; CMHC; Provincial Department of Fisheries, Aquaculture and Environment; Tourism P.E.I.