

**THE PRINCE EDWARD ISLAND ECONOMY
PROGRESS REPORT 2005**

November 2005

Economics, Statistics and Federal Fiscal Relations
P.E.I. Department of the Provincial Treasury

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INTRODUCTION

This report summarizes the progress of the Prince Edward Island economy in 2005 using available statistical information up to November 10, 2005. The report also references the national and international economic perspectives. Emerging trends in economic indicators such as labour, population, prices, consumer spending, manufacturing, construction and the primary industries are identified and discussed.

The Prince Edward Island economy in 2005 has been showing signs of strength and the national economic performance remains strong. For Prince Edward Island, economic growth is supported by strong employment gains, increased manufacturing activity, export growth, and robust non-residential construction. Growth in retail spending has also been a positive factor. Moderating growth this year is a decline in the level of housing starts and reduced potato production. High energy prices and the continued appreciation of the Canadian dollar are key risk factors to economic growth in 2005, both nationally and provincially.

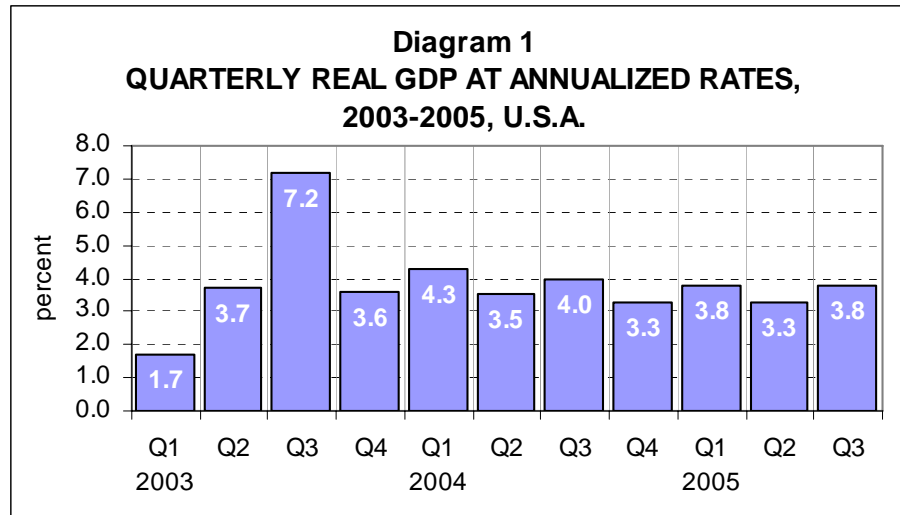
THE GLOBAL ECONOMY

According to the *International Monetary Fund* (IMF), world economic growth is expanding strongly in 2005, albeit at a slower pace than in 2004. The global economy is forecast to increase by 4.3 per cent in 2005, down from 5.1 per cent last year. Higher oil prices have negatively impacted leading economic indicators and business confidence in most countries in 2005.

The IMF expects that growth of the U.S. economy will outperform other advanced economies in 2005, with a forecast of 3.5 per cent. Growth of the Canadian economy ranks second, at 2.9 per cent, and Japan third, at 2.0 per cent. Economic growth in the Euro area is expected to be modest at a forecasted 1.2 per cent due primarily to a slowing of domestic demand.

With respect to emerging markets, strong export activity and increased domestic demand are expected to drive economic growth in China and India in 2005. The IMF forecasts growth of these economies to be in the order of 9.0 per cent and 7.1 per cent, respectively.

THE UNITED STATES ECONOMY



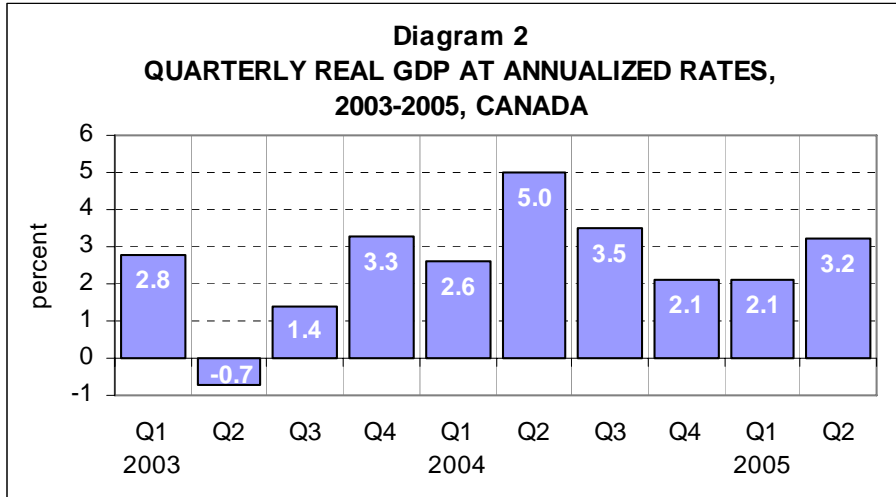
The United States economy continues to perform well in 2005, posting average annualized growth of 3.6 per cent in the first three quarters of the year. Growth over this period is attributed to strong consumer spending, increased exports, and high residential fixed investment. Partially offsetting was a decline in private inventory investment.

As illustrated by Diagram 1, the U.S. economy has recorded consistent quarterly rates of growth since its extraordinary posting of 7.2 per cent in the third quarter of 2003. Average annual real Gross Domestic Product (GDP) growth was 4.2 per cent in 2004, and 2.7 per cent in 2003.

The U.S. employment situation in the first nine months of 2005 increased by 1.7 per cent relative to the same period in 2004. This is an improvement over average annual growth of 1.1 per cent in 2004 and a 0.3 per cent decline in 2003. The unemployment rate in the U.S. averaged 5.1 per cent in the first nine months of 2005. This compares to an annual average jobless rate of 5.5 per cent in 2004 and 6.0 per cent in 2003.

In 2005 the U.S. *Federal Open Market Committee* (FOMC) continues on its path to remove monetary stimulus from the U.S. economy. Since June 2004, the FOMC raised the target for the federal funds rate in each of its last 12 rate announcements. The latest rate increase occurred on November 1, 2005, from 3.75 per cent to 4.0 per cent, where it currently stands. The FOMC stated that economic activity will continue to be supported by existing monetary accommodation and underlying productivity growth, notwithstanding elevated energy prices and hurricane-related disruptions to economic activity.

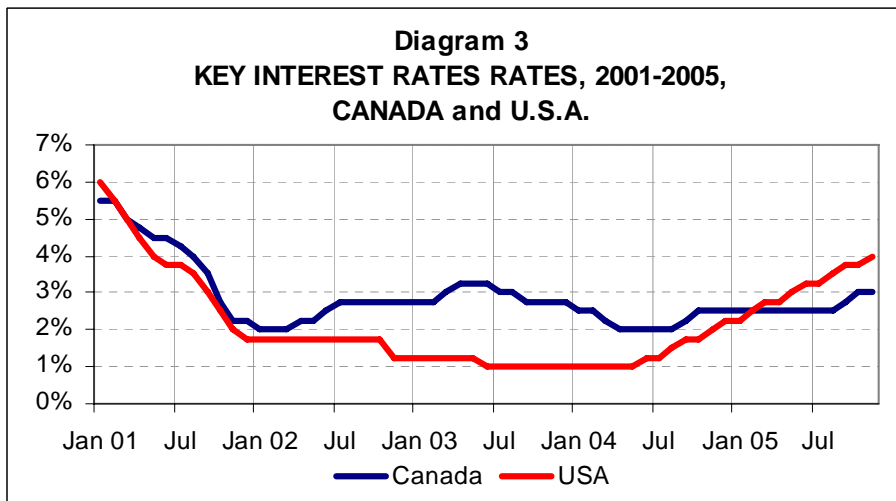
THE CANADIAN ECONOMY



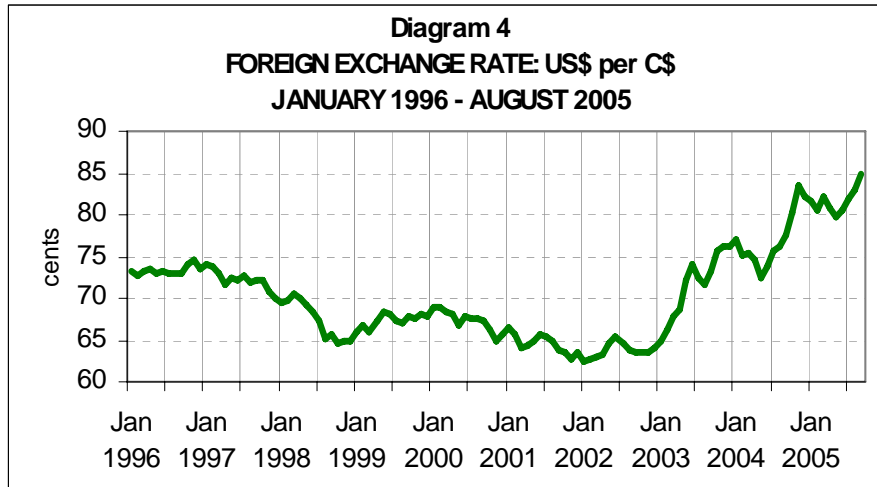
The Canadian economy continues to perform well in 2005. As shown in Diagram 2, the national economy advanced by an annualized rate of 3.2 per cent in the second quarter, a significant improvement from the first quarter. Driving growth was strong consumer spending and private investment, particularly in housing.

A softened export sector and a reduction in manufacturing activity moderated growth. The national economy expanded in 2004 by 2.9 per cent, in constant dollar terms, and in 2003, a moderate gain of 2.0 per cent was experienced.

The *Bank of Canada* projects growth of the national economy to be in the order of 2.8 per cent for 2005. In its October 2005 *Monetary Policy Report*, the Bank identified strong growth in final domestic demand, particularly in business investment, as an important factor contributing to overall growth in 2005. A reduction in net exports, due to the high value of the Canadian dollar relative to the U.S. dollar, is expected to be a drag on economic growth.



The Bank raised its key interest rate by 25 basis points in September and again in October to 3.0 per cent, where it currently stands. This follows a period when rates were maintained at 2.5 per cent since October 2004. As illustrated by Diagram 3, the U.S. federal funds rate has exceeded Canada's target rate since March



2005.

The Canadian dollar continued to appreciate against the U.S. dollar in 2005. The Canada / U.S. exchange rate, as measured by the noon spot rate, averaged 84.92 cents in September 2005, a gain of 4.1 per cent relative to the average level reported in January. The exchange rate in September was the

highest monthly average since January 1992.

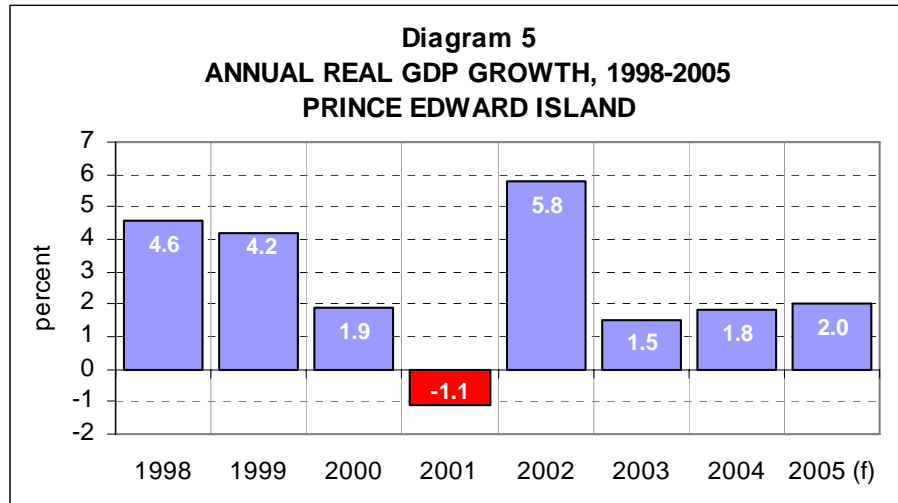
Diagram 4 shows the monthly trend of the Canadian dollar relative to its U.S. counterpart since 1996, and the appreciation that occurred since early 2003.

The Canadian labour market in 2005 remains positive with modest year-to-date employment gains. From January to October 2005, employment increased by 1.4 per cent relative to the same period in 2004, to average 16.1 million persons. This compares to average annual employment growth of 1.8 per cent in 2004 and 2.3 per cent in 2003.

Average employment levels in the service-producing industries rose by 1.6 per cent on a year-to-date basis in 2005 largely due to increased employment gains in retail trade, education services, and finance and real estate services. Employment losses occurred in transportation services and in health and social services. With respect to the goods-producing sector, employment gains were weak during the first ten months of 2005, with average growth of 0.7 per cent on a year-to-date basis. Employment losses in the manufacturing sector were offset by increased employment in construction and agriculture.

Canada's unemployment rate averaged 6.8 per cent over the January to October 2005 period, an improvement from 7.2 per cent over the same period in 2004. The national rate of unemployment in October, at 6.6 per cent, was at its lowest point in three decades, according to the Honourable Ralph Goodale in *The Economic and Fiscal Update*, November 2005. Unemployment in 2004 averaged 7.2 per cent and in 2003, 7.6 per cent.

THE PRINCE EDWARD ISLAND ECONOMY

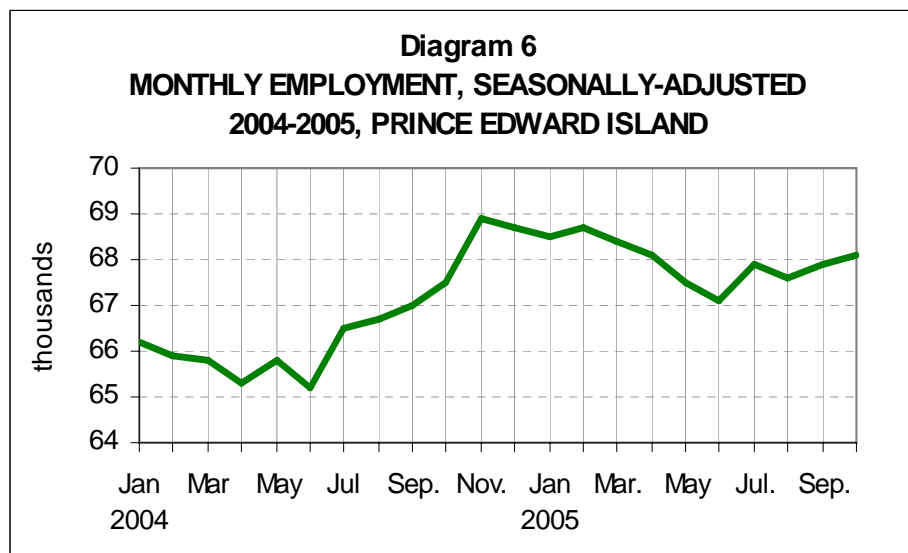


Growth of the Island economy in recent years has been modest, as shown in Diagram 5. According to *Statistics Canada*, the provincial economy expanded by 1.8 per cent in 2004 and 1.5 per cent in 2003 in constant dollar terms. For 2005, the province is expected to maintain its moderate pace of economic expansion. The *P.E.I. Department of the Provincial Treasury* forecasts growth

of the provincial economy to be in the order of 2.0 per cent for 2005, revised upward from the 1.8 per cent forecast published in the 2005 Provincial Budget.

The improved outlook for the province’s economic forecast is supported by better than expected growth in employment and retail spending. Growth prospects for manufacturing activity, construction, and agriculture were in line with Budget expectations.

THE LABOUR MARKET



Island employment has improved in 2005. Average employment for the first ten months of 2005 increased by 1,800 persons, or 2.7 per cent, compared to the same period in 2004. That year, employment rose by an average annual rate of 0.9 per cent. Diagram 6 displays seasonally-adjusted monthly levels of employment from

January 2004 to October 2005.

Employment gains in the first ten months of 2005 occurred in the *manufacturing, educational service* and *accommodation and food service* sectors. Partly offsetting were employment losses experienced in the *agricultural* and *retail and wholesale trade* sectors. Employment stood at 68,100 in October 2005, slightly lower than the all-time high of 68,900 reached in November 2004.

Improved employment in 2005 has resulted in a reduced unemployment rate for the province. The seasonally-adjusted unemployment rate averaged 10.9 per cent between January and October 2005, down from 11.5 per cent over the same period in 2004. That year, the annual rate of unemployment was 11.3 per cent.

PERSONAL INCOME

According to *Statistics Canada* total labour income on Prince Edward Island was valued \$1,082.2 million from January to June 2005, an increase of 4.1 per cent relative to the same period in 2004. This is the same rate of growth experienced in 2004, but down from 5.5 per cent growth in 2003. Nationally, total labour income during the first six months of 2005 was 4.7 per cent higher relative to the same period in 2004. This compares to annual growth of 4.2 per cent in 2004.

Total labour income growth on the Island in the first half of 2005 was driven by increased wages and salaries in federal government public administration, education services, finance, real estate and company management. Strong employment growth over this period was a major factor behind the continued strength in labour income on Prince Edward Island.

POPULATION

Statistics Canada's estimates show that there were 138,113 persons living on Prince Edward Island on July 1, 2005. This represents a yearly increase of 252 persons, or 0.2 per cent growth, since July 1, 2004. This was the highest growth rate in Atlantic Canada, but well below the national average of 0.9 per cent. Population growth was flat for Nova Scotia, and small declines were experienced in Newfoundland and New Brunswick.

Between July 1, 2004 and June 30, 2005 the Island saw a net interprovincial outflow of 222 persons. This loss was more than offset by net international migration of 271 persons (312 immigrants minus 41 emigrants). The primary source of P.E.I.'s interprovincial in-migrants between July 1, 2004 and June 30, 2005 was Ontario followed by Nova Scotia, New Brunswick and Alberta. These four provinces were also the four main destinations of out-migrants from Prince Edward Island.

The province gained 150 people by natural increase (births minus deaths). It had 1,409 births and 1,259 deaths during this period. There were also 53 non-permanent residents living on the Island.

CONSUMER PRICES

The *All-Items Consumer Price Index* (CPI) for Prince Edward Island from January to September 2005 is 3.2 per cent higher relative to the same period in 2004. That year, inflation was 2.1 per cent. Nationally, consumer prices rose by 2.2 per cent during the first nine months of 2005 and compares to annual inflation of 1.9 per cent in 2004.

The major inflationary factors in 2005 in order of importance were: higher prices for fuel oil and other fuels; gasoline; and expenses related to owned accommodation. The category *Owned Accommodation* carries the largest weight in the province’s *All-Items Consumer Price Index*. Expenses related to *owned accommodation* for the period January to September rose, on average, by 3.1 per cent relative to the same period in 2004.

Energy prices have been on the rise in recent years and have been subject to periods of significant volatility. In October 2005 oil prices averaged US\$62.62 per barrel (based on West Texas Intermediate crude oil prices) up by 33.5 per cent from the average price recorded in January. On Prince Edward Island average energy prices between January and September 2005 were 14.5 per cent higher relative to the same period in 2004. That year energy prices rose by 8.7 per cent compared to an increase of 11.2 per cent in 2003.

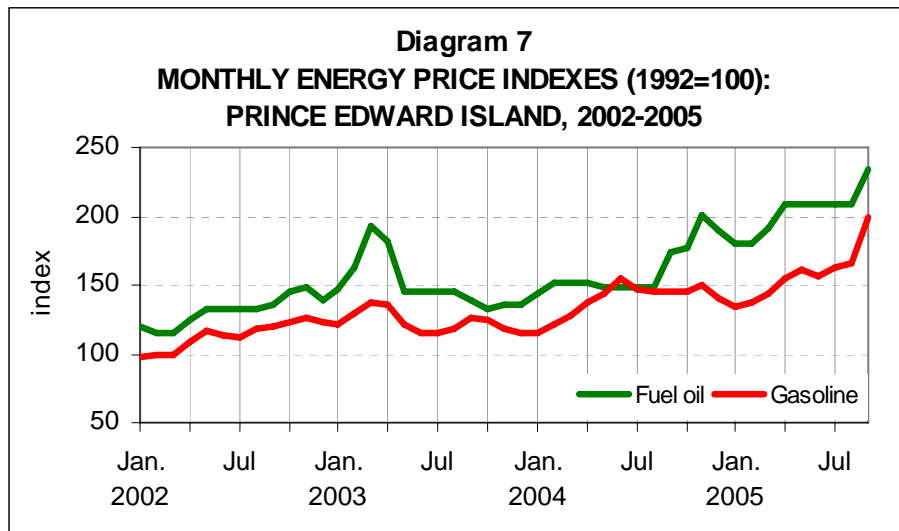


Diagram 7 shows trends in monthly fuel oil and gasoline prices from 2002 to 2005. A brief spike in oil prices was experienced in the first quarter of 2003, resulting from concerns surrounding the U.S.-led war on Iraq. More recently, the devastating impact of Hurricane Katrina on oil production and refining facilities along the Gulf of Mexico coast of the United States resulted in an

extraordinary increase in gasoline and heating oil prices in September 2005.

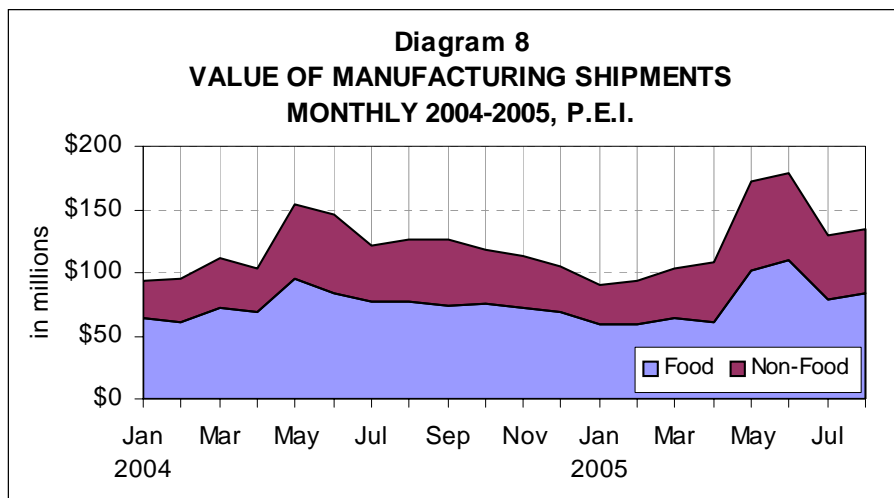
According to the *Island Regulatory and Appeals Commission (IRAC)*, in 2005 the average price of a litre of regular gasoline at self-serve stations rose from 100.2 cents in August to an all-time high of 135.0 cents in September. By November the average price of gasoline fell to 96.1 cents per litre for regular unleaded grade, up by 18.8 per cent from 80.9 cents per litre reported on January 1, 2005.

RETAIL SALES

The retail sector on Prince Edward Island strengthened in 2005. From January to August, seasonally-adjusted retail sales were valued at \$956.4 million, up by 3.8 per cent relative to the same period in 2004. This compares to virtually no growth experienced in 2004 and just 1.0 per cent growth in 2003. Nationally, the value of retail sales between January and August 2005 is 7.1 per cent higher relative to the same period in 2004. Growth in the value of retail spending in 2005 year-to-date is largely attributed to strong motor vehicle sales.

New motor vehicle sales on Prince Edward Island was valued at \$90.2 million between January and August 2005, up by 6.2 per cent compared to the same period in 2004. Major discounting and buyer incentives by the major car manufacturers contributed to the increase. Sales of new motor vehicles declined in previous years, by 2.1 per cent in 2004 and by 2.8 per cent in 2003. Nationally, the value of new motor vehicle sales on a year-to-date basis is 8.2 per cent higher relative to the same period in 2004.

MANUFACTURING



Between January and August 2005 the Island’s manufacturing industry shipped goods with a total value of \$1,007.3 million. On a year-to-date basis, this was 5.8 per cent higher compared to the same period in 2004. In terms of value, the major contributors to manufacturing growth this year are chemical production and miscellaneous manufacturing.

Diagram 8 shows the relative importance of both food and non-food manufacturing shipments, by value. Total food production, which makes up sixty-one per cent of all shipments, was valued at \$615 million during the first eight months of 2005, an increase of 3.3 per cent year-to-date.

During that period fish products totaled \$195.5 million, up by 12.4 per cent from the same period in 2004. This is an improvement from 2003 and 2004 when the value of fish manufacturing declined by a cumulative 30.0 per cent. Other food products (excluding fish) fell by 0.5 per cent to total \$419.7 million between January and August 2005.

Transportation equipment manufacturing shipments were valued at \$126.8 million between January and August 2005, a decrease of 1.1 per cent relative to the first eight months of 2004. This category includes *aerospace products and parts manufacturing* and *shipbuilding and repair manufacturing*.

INTERNATIONAL TRADE

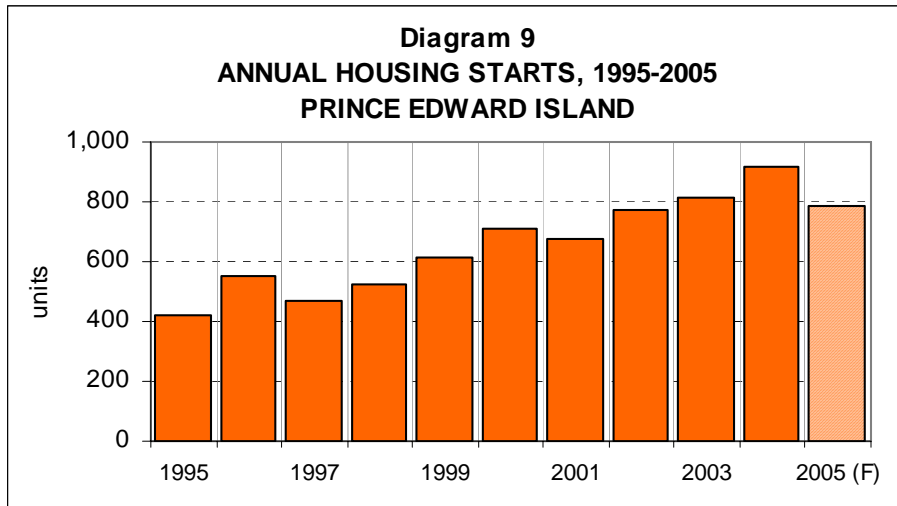
According to *Industry Canada*, between January and August 2005 international exports of goods from Prince Edward Island totaled \$518.4 million, an increase of \$82.2 million, or 18.8 per cent, compared to the same period in 2004. The bulk of these exports consisted of food products, both frozen and fresh. The largest component, by value, is frozen food manufacturing and is predominantly made up of french fries and lobster. Fresh food products include seafood and table stock potatoes.

Between January and August 2005 the value of frozen food products rose by 2.4 per cent to \$186.2 million, while fresh food exports were up by 6.7 per cent to total \$34.1 million. Increased export values of machinery and equipment and paperboard exports also contributed to year-to-date growth in 2005. Partially offsetting were reduced export values for industrial machinery and forestry products.

CONSTRUCTION AND HOUSING

A robust non-residential construction sector on Prince Edward Island in 2005 is expected to offset the impact of fewer housing starts. Based on Statistics Canada's *2005 Private and Public Investment Intentions*, total capital expenditures are estimated to be \$771.4 million, up by 10.5 per cent from 2004. Non-residential capital expenditures on the Island are valued at \$542.5 million for 2005, an increase of 20.3 per cent from a year earlier. This represents the highest growth rate in Canada. Capital construction expenditures are valued at \$218.1 million, up by 36.7 per cent, while machinery and equipment expenditures are estimated at \$324.4 million, up by 11.4 per cent.

Major projects on Prince Edward Island in 2005 include the construction of the new Government of Canada building; U.P.E.I. construction projects such as the National Research Centre, the Atlantic Veterinary College expansion project, and the new student residence; and the new Maritime Electric Power Plant.



The *Canada Mortgage and Housing Corporation* (CMHC) estimates that housing starts in 2005 will reach 785 units. Last year there were a total of 919 housing starts, the highest annual level since 1988. Data for the first six months of 2005 show 400 new housing starts on Prince Edward Island. This is 13.8 per cent lower than the number of starts recorded during the

same period in 2004. As illustrated by Diagram 9, residential construction activity has been on the rise since 1995.

AGRICULTURE

Increased support payments and improved farm commodity prices resulted in higher farm cash receipts in the first half of 2005. From January to June, receipts totaled \$180.7 million, up by 7.2 per cent relative to the same period in 2004. Annual farm cash receipts in 2004 totaled \$348.3 million, which is a decrease of 1.8 per cent from 2003. Table 1 (see next page) shows quarterly farm cash receipts since 2004.

Potato receipts for the first two quarters of 2005 were valued at \$80.7 million, an increase of 4.3 per cent compared to the same period in 2004. That year annual potato receipts totaled \$152.3 million, down by 17.8 per cent from 2003 due to low potato prices. The improvement in the value of potato receipts in 2005 is reflected in stronger potato prices. According to Statistics Canada’s *Farm Product Price Index* (FPPI), average potato prices over the first half of 2005 were 8.1 per cent higher relative to the same period in 2004.

Based on data by the *P.E.I. Potato Board* average potato prices in October 2005 were in the order of \$1.80 per 10 pound bag of potatoes sold in the Toronto market. This compares to an average of \$1.00 per pound received around the same period in 2004.

TABLE 1
FARM CASH RECEIPTS PRINCE EDWARD ISLAND
(\$ Millions)

Year/ Quarter	Crops			Livestock					Direct	Total
	Potatoes	Other	Total	Cattle	Hogs	Dairy	Other	Total	Payments	Receipts
2004/1	38.4	5.8	44.2	3.5	7.4	14.4	4.7	29.9	6.8	81.0
2004/2	39.0	5.0	44.0	4.1	8.9	15.1	3.4	31.5	12.0	87.5
2004/3	39.3	14.3	53.6	3.4	9.2	15.0	3.4	30.9	4.6	89.1
2004/4	35.5	8.8	44.4	3.6	8.4	15.2	3.2	30.4	15.9	90.7
2005/1	39.4	4.9	44.3	4.4	7.5	15.7	4.3	31.8	13.2	89.4
2005/2	41.3	4.8	46.1	5.1	7.1	15.3	3.1	30.7	14.5	91.3
2004 YTD	77.4	10.8	88.2	7.5	16.3	29.5	8.1	61.4	18.8	168.5
2005 YTD	80.7	9.7	90.4	9.5	14.6	31.1	7.4	62.5	27.7	180.7
% Change	4.3	-10.2	2.5	26.7	-10.4	5.4	-8.6	1.8	47.3	7.2

Source: Statistics Canada

Based on preliminary estimates by *Statistics Canada*, a total of 95,500 acres of potatoes were planted on the Island in 2005, a decline from 106,000 acres planted in 2004. This compares to an all-time high of 113,000 acres in 1999. Farmers reduced planted acreage in 2005 as a means to strengthen potato prices. Nationally, the area planted with potatoes declined by 8.9 per cent in 2005 marking the second consecutive year of reduced potato production in Canada. As the largest potato producer in Canada, Prince Edward Island produced about 25 per cent of national production in 2004.

Total livestock receipts in the first six months of 2005 were valued at \$62.5 million, an increase of 1.8 per cent relative to the same period in 2004. The largest component of livestock by value is dairy, followed by hogs and cattle. Dairy receipts totaled \$31.1 million in the first half of 2005, up by 5.4 per cent compared to the same period in 2004, mainly due to an increase in the producer price of milk. Lower hog prices in the first six months of 2005 resulted in a 10.4 per cent decline in receipts, which totaled \$14.6 million in the first half of 2005. On a year-to-date basis, cattle receipts are significantly higher in 2005. From January to June cattle receipts valued \$9.5 million, an increase of 26.7 per cent compared to the same period in 2004. According to the FPPI, cattle prices were 10.0 per cent higher in the first six months of 2005 relative to the first six months of 2004. This reflects improved market conditions in the beef industry.

FISHING

According to the *P.E.I. Department of Agriculture, Fisheries and Aquaculture* overall lobster landings on Prince Edward Island in 2005 were down from the previous year, while prices increased. Landings totaled 18.5 million pounds in 2005, down by 1.4 million pounds from 2004. The Department indicated that unfavourable weather conditions was a factor attributing to fewer lobster landings in 2005. The landed value of lobster is estimated to be higher in 2005, at about \$103 million, up from \$100 million reported in 2004, due to higher prices.

Lobster landings in the Spring 2005 season, which ran from May 1 to June 30, totaled 16.1 million pounds, down by 1.7 million pounds or 9.1 per cent compared to landings in the Spring of 2004. The average price for market-sized lobsters in the Spring 2005 was \$6.11 per pound, up by 11.8 per cent compared to the previous year. Lobster landings in the Fall season of 2005, which ran from August 10 to October 10, totaled 2.3 million pounds, an increase of 5.9 per cent from 2004. That year, landings fell by 10.0 per cent. Fall lobster prices also improved in 2005 averaging \$6.00 per pound for market lobsters, an increase of 6.4 per cent relative to prices in the Fall of 2004.

The *Department of Agriculture, Fisheries and Aquaculture* recognized that changes made to existing conservation measures by the *Department of Fisheries and Oceans* was a contributing factor to the increase in Fall lobster landings on P.E.I..

TOURISM

Data published by the *P.E.I. Tourism Advisory Council (TAC)* suggests a modest improvement in tourist visitation in 2005. From January to August, Confederation Bridge traffic (non-resident vehicles) increased by 1.0 per cent compared to the same period in 2004 and air traffic improved by 3.0 per cent year-to-date. Partially offsetting was a decline in ferry traffic, by 6.0 per cent. Overall traffic volume is estimated to have increased by nearly 1.0 per cent on a year-to-date basis. The TAC reported that occupancy rates for all fixed roof accommodation during the peak tourism months of July and August were 65.7 per cent and 60.5 per cent, respectively.

With respect to other performance indicators, tourist visitation at information centres rose by 3.0 per cent during the first eight months of 2005 compared to the same period in 2004, and visitation to provincial parks increased by 5.0 per cent year-to-date. On the down side, visitation to historic sites on the Island fell by 6.0 per cent, and according to the Department of Tourism, there were fewer paid rounds of golf in 2005, a decline of 4.0 per cent compared to total paid rounds in 2004.

PROVINCIAL GOVERNMENT

Government Finances

The Honourable Mitchell Murphy presented his second Budget Address on April 7, 2005. The Budget theme was *A Plan to Protect the Priorities of Islanders*. Budget 2005 presented a consolidated deficit in 2004-05 of \$39.5 million. For 2005-06, Government estimated an improved deficit position, at \$22.0 million. Gross provincial revenue was forecast to increase to \$1.109 billion in 2005-06, an increase of 3.3 per cent over the 2004-05 Forecast, and operating expenditures were forecast to increase by a lower rate, at 2.6 per cent. Health and education budgets both increased in 2005-06.

Highlights of the 2005 Budget include a Government focus on sustainability; the introduction of the Workforce Renewal Program; a new progressive tax rebate program; and a reduction in the corporate income tax rate.

Renewable Energy

In June 2004, the *P.E.I. Department of Environment, Energy and Forestry* released the *Prince Edward Island Energy Framework and Renewable Energy Strategy*, which commits the province to a renewable portfolio standard (RPS) of at least 15 per cent by 2010. RPS refers to the percentage of energy that will be accessed by the province from renewable resources. The province is aiming at yielding an RPS of 100 per cent by 2015.

Investment in wind energy is the cornerstone of the province's renewable energy strategy. The Atlantic Wind Test Site, located at North Cape, P.E.I., currently generates 13.6 megawatts of electricity from wind power, meeting 5.0 per cent of the electricity needs of the province. Some highlights of the renewable energy program include: the planned construction of a \$55.0 million 30-megawatt wind farm at the eastern end of the Island; the *Canadian Wind Energy Institute*, which is to support the development of wind power generation in Canada, is expected to open in North Cape in 2006; and Canada's first wind-hydrogen village demonstration, the P.E.I. Wind-Hydrogen Village, will be developed in the North Cape area.

SUMMARY

Growth prospects for both the Canadian and Prince Edward Island economies remain favorable for 2005. The Island economy is projected to expand at a moderate pace, while the outlook nationally is more robust. Risk factors to growth include the high value of the Canadian dollar, which makes Canadian exports less competitive in world markets, and high oil prices, which are currently poised as a major risk factor globally.

Growth of the Prince Edward Island economy in 2005 is buoyed by a booming non-residential construction sector with a combined capital project value unparalleled since the construction of the Confederation Bridge. The province is also benefitting from a solid manufacturing sector, employment growth in the service producing sector, and stronger retail sales activity. The economic expansion is somewhat moderated by a reduction in potato production, a slowdown in housing construction and a lackluster tourist season. Overall, the outlook for the Prince Edward Island economy remains balanced, at 2.0 per cent.

*Inquiries can be directed to Jamie Dooks at Economics, Statistics, and
Federal Fiscal Relations (902) 368-4032*