

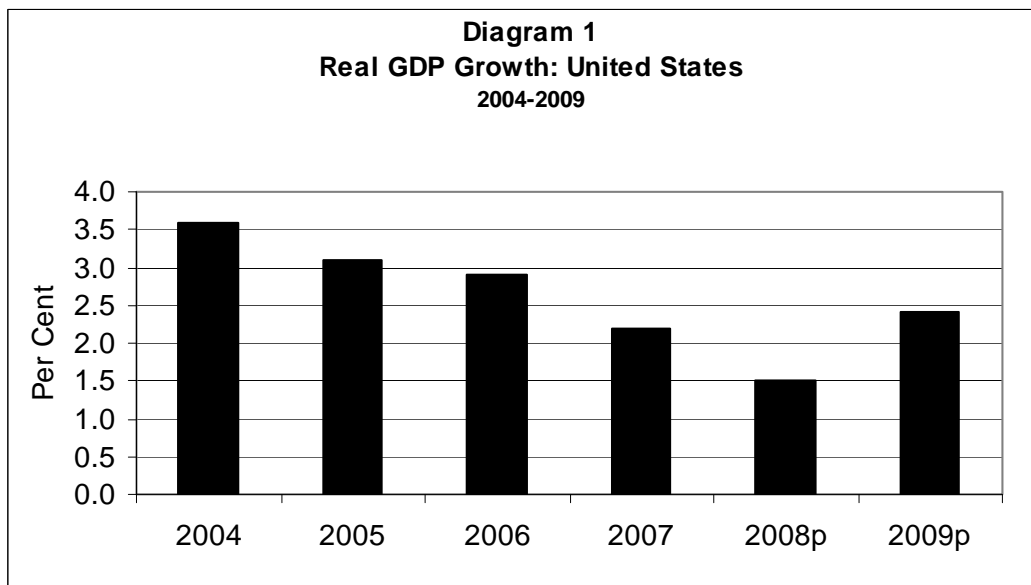
## 2007 Economic Review

### *The International Economy*

The International Monetary Fund (IMF) predicts that the global economy should continue to expand through 2008 and 2009, despite the concerns over the U.S. economy. Real world GDP growth in 2007 was 4.9 per cent, down slightly from the 5.0 per cent growth of 2006 and is expected to grow more slowly in 2008, at a rate of 4.1 per cent<sup>1</sup>. This growth will be driven primarily by emerging economies, notably those in Asia, and should compensate for the slowing of more developed economies through this time period.

### *The American Economy*

There is considerable evidence that the American economy is slowing down. The United States witnessed a fourth quarter growth rate of 0.6 per cent in 2007, and saw a moderate annual GDP growth rate of 2.2 per cent. This is somewhat lower than the 2006 growth rate of 3.1 per cent. As can be seen in Diagram 1, the rate of real GDP growth in the United States has been declining steadily for the last several years, and is expected to slow to 1.5 per cent in 2008, less than half the pace of seen in 2005, before picking up to 2.4 per cent in 2009.



One of the key features of American economy in 2007 was the expansion of the sub-prime mortgage situation into broader financial markets. There was a significant increase in the number of defaults in sub-prime mortgages in the wake of falling housing prices, causing credit standards to become more restrictive, further depressing housing demand, and increasing foreclosures. These events caused investors to re-evaluate their risk, and has resulted in a movement away from asset-backed securities, and the continued fragility of commercial paper. From closing highs in October 2007, most major indices have seen declines in the area of 10 per cent, erasing most of the gains seen through 2007<sup>2</sup>.

<sup>1</sup>Department of Finance, The Budget Plan, 48

<sup>2</sup>Department of Finance, The Budget Plan, 44

Economic growth in the first two quarters of 2008 is expected to be relatively low, before rising in the second half of the year. Decreases in consumer spending, and a softening of the labour market combined with continued financial market instability, a tightening of credit markets, and a deepening of the sub-prime mortgage situation will put further pressure on U.S. economic growth<sup>3</sup>. In response to these indications, the United States Federal Reserve has lowered the target federal funds rate by 300 basis points since September 2007 to 2.25 per cent, and has provided billions in liquidity to the financial system. In addition, the U.S. government introduced an economic stimulus package equivalent to approximately 1 per cent of GDP.

### *The Canadian Economy*

Statistics Canada estimates that the Canadian economy grew by 2.7 per cent in 2007. This matches the growth rate experienced in 2006, and is slightly down from the 2005 rate of 3.1 per cent. The Canadian economy appears to have been less affected by the slowdown in the U.S. economy in 2007. World demand for commodities at record prices and a strong labour market have offset the impact of the rise in the Canadian dollar and the slowdown in the U.S. economy.

Western Canada led the country in economic growth in 2007, and is expected to continue to grow in 2008. This expansion is largely driven by natural resource developments. According to the Conference Board of Canada, Manitoba is expected to post the highest growth rate in 2008 with a second year of expansion at 3.7 per cent. The appreciation of the Canadian dollar and a weaker U.S. export market have dampened economic growth in both Ontario and Quebec, which are both expected to grow at a rate of 2.1 per cent in 2008.

Continued growth and new developments in the energy and mining sectors have spurred growth in the Atlantic region in 2007. These new developments will allow the region to experience continued growth in 2008. 2007 saw a stellar rate of growth in Newfoundland and Labrador, at 7.3 per cent, the highest growth rate of any Canadian province. Growth is expected to slow in 2008, to 1.5 per cent, due to the winding down of several offshore oil and gas construction projects. Nova Scotia and New Brunswick recorded positive growth in 2007 at 1.8 per cent and 2.2 per cent respectively. Both of these provinces are expected to benefit from several new energy-related projects coming online in 2008. As a result, Nova Scotia should see a rate of growth of 2.6 per cent, while New Brunswick should see a growth rate of 2.2 per cent in 2008, according to the Conference Board of Canada estimates.

Canadian labour markets remained tight in 2007 with more than 400 000 new jobs created since the end of 2006. This job creation has benefitted all areas of the country<sup>4</sup> with the majority of job growth occurring in the service sector, and the majority of job losses occurring in manufacturing and construction<sup>5</sup>. Unemployment in Canada continued to fall, with the Jan-Dec 2007 unemployment rate at 6.0 per cent, down from the previous year's rate of 6.3 per cent, reducing the unemployment rate to its lowest level in 33 years<sup>6</sup>. Labour income grew 6.1% in 2007, down very slightly from its

---

<sup>3</sup> U.S. Bureau of Economic Analysis, online at <http://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm> , 20/03/08

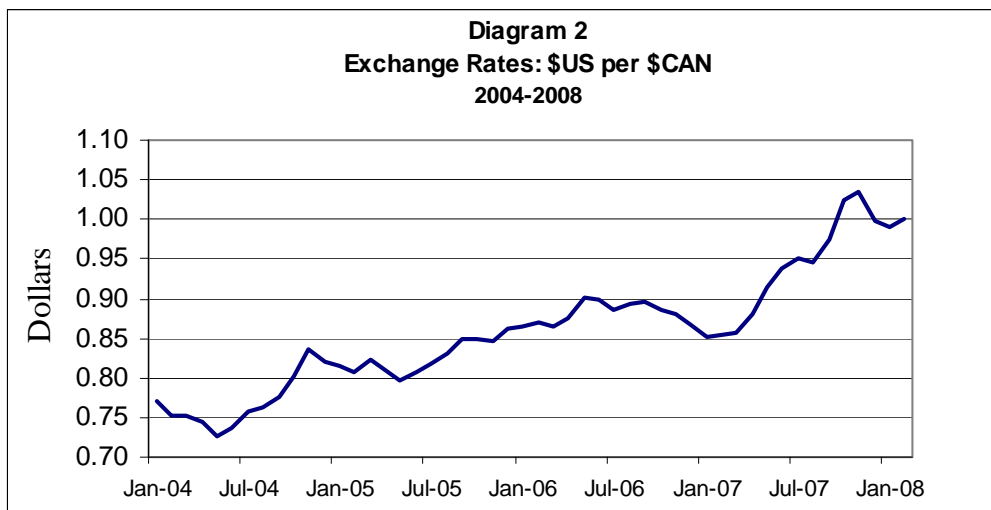
<sup>4</sup> Department of Finance, The Budget Plan, 31

<sup>5</sup> Ibid, 31

<sup>6</sup> APEC, Atlantic Report, 42 (4): 9

growth rate of 6.2 per cent in 2006<sup>7</sup>. Strong labour markets and rising incomes have helped consumers. The number of housing starts increased by 0.4 per cent in 2007 to total 228,343 and the value of retail sales increased by 5.8 per cent.

The Canadian exchange rate with respect to the U.S. dollar continued its ascent in 2007, witnessing the Canadian dollar trading above par with the U.S. dollar for the first time since 1976. In 2007 the Canadian dollar reached its all time high against the U.S. dollar since the currency was allowed to float beginning in 1950, peaking at 1.06cents U.S. on November 6, 2007. As can be seen in the diagram 2 below, the Canadian dollar appreciated sharply over the course of 2007, reaching an average monthly high of 1.03 cents U.S. in November 2007. Recently, the value of the dollar has fallen back slightly trading just under parity with the U.S. dollar.



With the United States being Canada’s largest trading partner, the appreciating dollar has had a detrimental impact on exports, particularly in sectors such as manufacturing and forestry which are also being affected by the lower demand for housing in the United States. 2007 saw very low export growth in the first three quarters, with substantial negative growth experienced in the fourth quarter (-2.2 per cent)<sup>8</sup>. However, the Canadian dollar has not appreciated as quickly with respect to other international currencies such as the Euro, and consequently, Canada has been able to make inroads into European, Asian and South American markets<sup>9</sup>.

However, the appreciation of the Canadian dollar has not been all negative. Canadian consumers have benefitted from increased purchasing power, while the rise in price of products produced in Canada, such as oil and other mined materials, have bettered Canada’s terms of trade. The continued appreciation of the dollar has also meant that there has been significant investments made in machinery and equipment in 2007 by Canadian business due to lower import prices. This should lead to increases in future productivity.

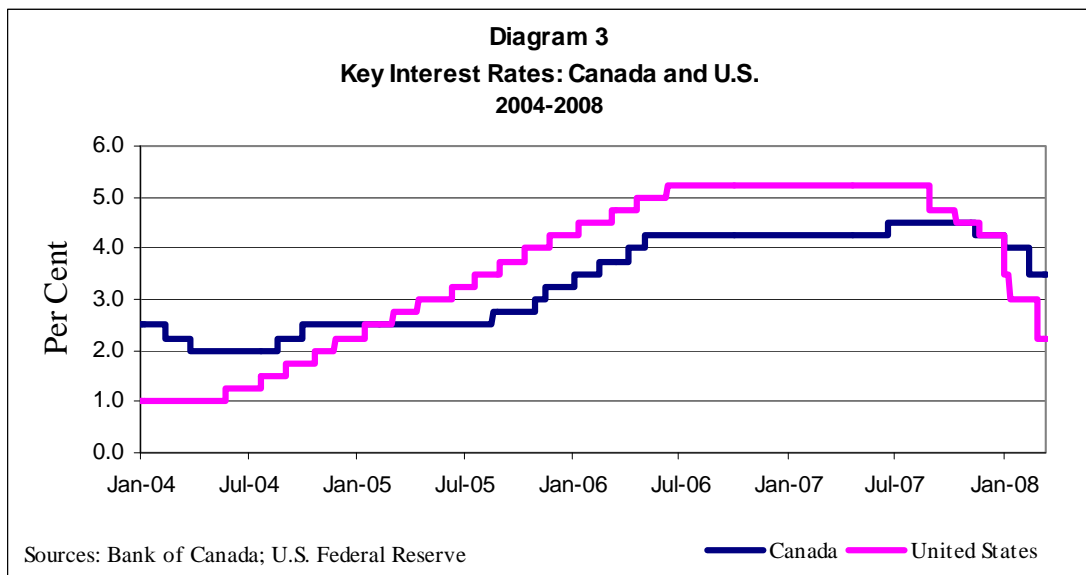
<sup>7</sup> The Daily, Statistics Canada, March 3, 2008 online at <http://www.statcan.ca/english/nea-cen/> accessed 20/03/08

<sup>8</sup> Statistics Canada

<sup>9</sup> Conference Board of Canada, Provincial Outlook Executive Summary, 2

The Bank of Canada was presented with a series of challenges with respect to conducting monetary policy. These include strong domestic demand, high energy prices, the sharp appreciation of the Canadian dollar versus the U.S. dollar, and the fallout in the wake of the U.S. sub-prime mortgage crisis<sup>10</sup>. Despite these challenges, the central bank was able to keep inflation within the 1 to 3 per cent control range to average 2.2 per cent in 2007.

The key overnight rate set by the Bank of Canada held steady through the end of 2006 and most of 2007 at 4.25 per cent. July 2007 saw an increase in the overnight rate by 25 basis points, which stayed constant until the overnight rate was reduced in December back to 4.25 per cent. This rate was further lowered to 4.0 per cent in January of 2008, and lowered again in March 2008 to 3.5 per cent where it continues to hold. The Bank has indicated that future monetary stimulus is likely to be required in the near term, signaling the potential for future rate cuts. As can be seen in diagram 3 below, rates in both Canada and the United States were quite steady through the first half of 2007, with the American interest rate 75 basis points above the Canadian rate.



However throughout the second half of 2007 and the beginning of 2008 interest rates in Canada and the United States both began to trend downward, with the United States cutting their rate dramatically and Canada first increasing, then decreasing the overnight rate at a more gradual pace.

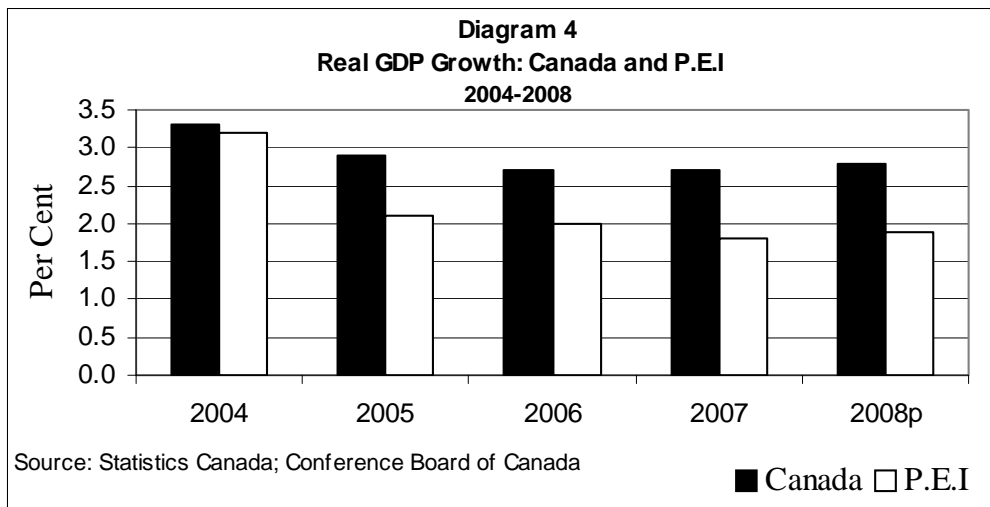
<sup>10</sup> Bank of Canada, Annual Report 2007: Monetary Policy, 15

## *The Prince Edward Island Economy*

### **Highlights of the Provincial Economy, 2007**

- The P.E.I. economy grew at 1.8 per cent in 2007, and is expected to grow at 1.9 per cent in 2008.
- Employment on P.E.I. grew by 1.0 per cent during 2007 to average 69,300 people.
- The unemployment rate averaged 10.3 per cent for 2007, a 29 year low.
- In March 2008, employment on P.E.I. reached 71,000 people, an all-time high.
- Labour income was 5.2 per cent higher relative to the same period in 2006.
- The value of retail spending was up 8.2 per cent in 2007 to total \$1,603 million.
- Total public and private capital investment in P.E.I. reached \$943.7 million in 2007, up 14.1 per cent from 2006 levels.
- The housing sector on P.E.I. had 1.6 per cent more starts in 2007 than in 2006.

P.E.I. experienced a growth rate of 1.8 per cent in 2007, and is expected to continue to experience stable economic growth at a rate of 1.9 per cent in 2008, as can be seen in Diagram 4.



## Employment

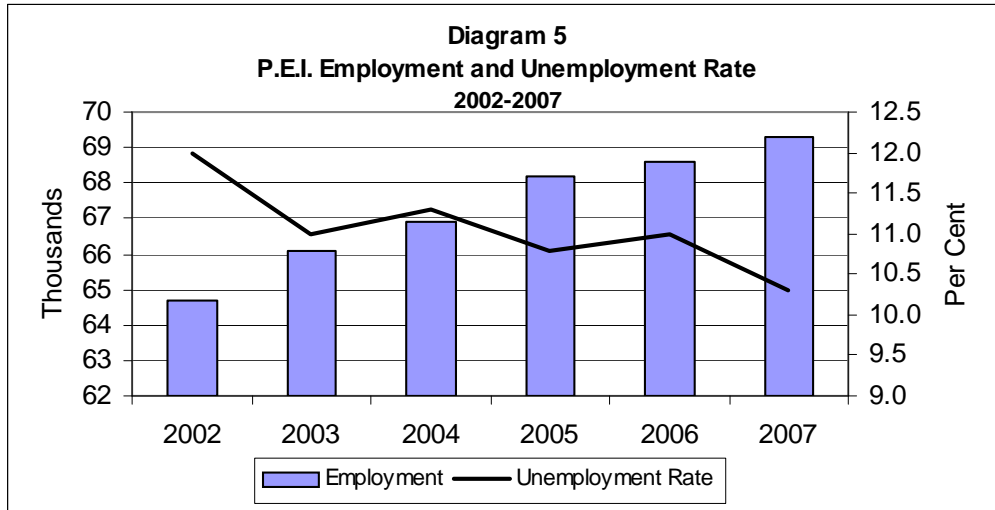
Employment on Prince Edward Island grew by 1.0 per cent during 2007 to average 69,300. This was almost twice the rate of 0.6 per cent growth experienced in 2006, and marked the tenth consecutive year of employment growth on P.E.I. Most of the gains in employment were made in the service producing sectors, which grew at a rate of 3.4 per cent in 2007 to employ 51,400 people. This growth offset losses in the goods producing sector, which declined 5.3 per cent in 2007. Table 1 shows the average employment levels by industry. As can be seen below, the biggest losses in 2007 occurred in agriculture, construction and professional service, while the largest gains occurred in trade, finance, insurance and real estate, and accommodation and social services. In March 2008, employment on P.E.I. reached a new high of 71,000.

**Table 1**  
**Prince Edward Island**  
**Employment By Industry, 2006 - 2007**

<b>in thousands, not adjusted</b>	<b>2006</b>	<b>2007</b>	<b>% Change</b>
<b>Employment All Industries</b>	<b>68.6</b>	<b>69.3</b>	<b>1.0</b>
<b>Goods-producing sector:</b>	<b>18.9</b>	<b>17.9</b>	<b>-5.3</b>
Agriculture	3.9	3.6	-7.7
Forestry, Fishing, & Mining	2.4	2.4	0.0
Utilities	0.3	0.3	0.0
Manufacturing	6.6	6.7	1.5
Construction	5.7	5.0	-12.3
<b>Service-producing Sector:</b>	<b>49.7</b>	<b>51.4</b>	<b>3.4</b>
Trade	9.9	10.5	6.1
Transportation & Warehousing	2.2	2.3	4.5
Finance, Insurance, Real Est.	2.1	2.7	28.6
Professional services	2.8	2.2	-21.4
Management & Admin. services	2.8	2.8	0.0
Educational services	4.6	4.7	2.2
Health Care & Social services	7.9	8.3	5.1
Public Administration	6.3	6.6	4.8
Information, Culture & Recreation	2.6	2.7	3.8
Accommodation & Food services	5.6	5.9	5.4
Other services	2.9	2.8	-3.4

Source: Statistics Canada, CANSIM Table 282-0008

The unemployment rate averaged 10.3 per cent for 2007, a 29 year low, and a marked improvement from 11.0 per cent recorded in 2006. In October 2007, the unemployment rate fell to 8.8 per cent, the lowest monthly rate since January 1977. Diagram 5 shows P.E.I.'s average annual employment levels and unemployment rates for the most recent six years. As can be seen, a steady gain in employment has resulted in a decline in the unemployment rate.

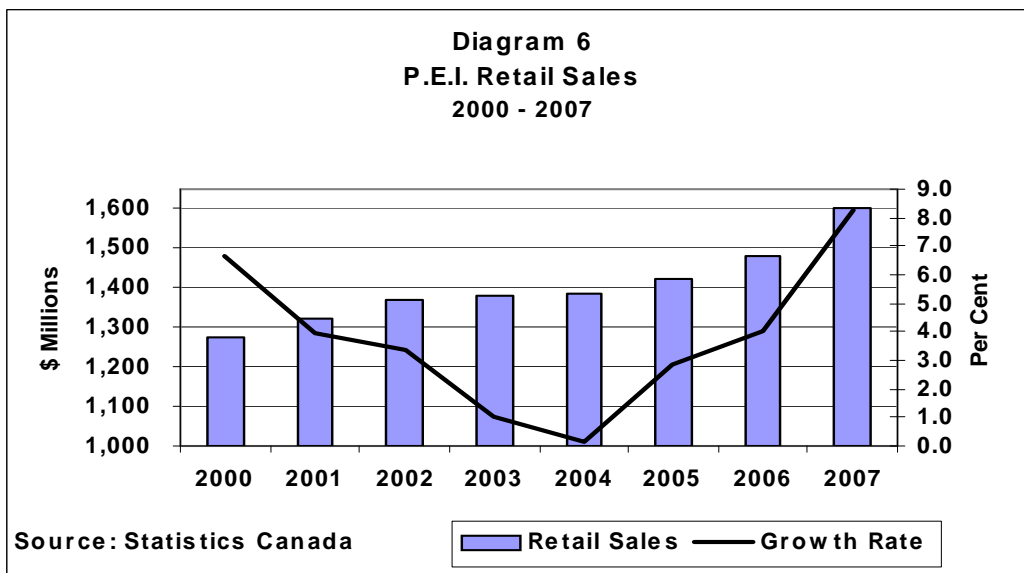


***Labour Income***

The value of total labour income on P.E.I. grew by 5.2 per cent in 2007, almost twice the rate seen in 2006. Income growth in 2007 was generally widespread across industries, but with notable gains in professional services, health care and social assistance, and federal government public administration.

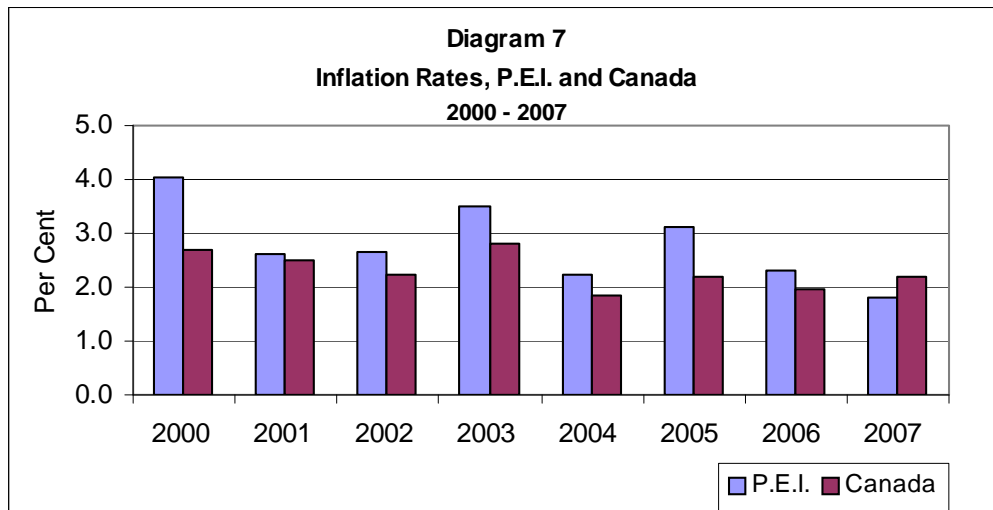
***Retail sales***

The value of retail spending in Prince Edward Island totaled \$1,603 million in 2007, up by 8.2 per cent over 2006. Rising employment and incomes on P.E.I. helped retail sales advance at their fastest pace since 1999. This was driven largely by increased sales at new and used car dealerships and gasoline stations. Growth in the value of retail sales has accelerated since 2004. Diagram 6 shows annual retail sales and growth rates since 2000.



### ***Consumer Prices***

In 2007, the all-items consumer price index, as measured by Statistics Canada, averaged 1.8 per cent higher relative to 2006. This compares to the Canadian inflation rate in 2007 of 2.2 per cent. Inflation increased for volatile commodities, such as food (3.4 per cent), shelter (2.8 per cent), and energy (2.7 per cent). The increase in energy prices in 2007 was more moderate than the 4.9 per cent increase in 2006. Energy prices rose during late 2007 and into 2008. Home heating oil reached 103.5 cents per liter in March 2008, compared to 72.9 cents per liter in March 2007. Lower prices were seen in prescribed medicines (-1.0 per cent) and medicinal and pharmaceutical products (-0.7 per cent). Nationally, inflation has been mitigated by the rising Canadian dollar, and more recently by the reduction in the GST.



### ***Primary Industries***

The Island's primary industries in 2007 did not keep pace with their record setting performance in 2006. As can be seen in Table 2, total farm cash receipts in 2007 declined by 3.4 per cent. Crop receipts declined by 7.6 per cent. A 7.9 per cent decline in the volume of the 2007 potato crop along with reduced potato prices caused receipts to decline by 11 per cent for the year. Improving wheat prices and barley production helped to increase receipts for other crops by 13.5 per cent per cent. A 3.4 per cent increase in livestock receipts was led by an 8.1 per cent increase in dairy receipts.

Continued low prices for hogs have depressed hog receipts on P.E.I. for the fourth consecutive year. Cattle receipts improved by 4.5 per cent. Direct payments to farmers increased by 4.3 per cent in 2007 to total \$22.2 million. This however remains well below the \$45.9 million in government supports recorded 2005.

**Table 2**  
**P.E.I. Farm Cash Receipts**  
**2003 - 2007**

<b>in '000s</b>								
<b>Year:</b>	Potatoes	Total Crops	Cattle	Hogs	Dairy	Total Livestock	Direct Payments	Total Farm Receipts
<b>2003</b>	\$185,266	<b>\$219,098</b>	\$18,186	\$26,562	\$55,023	<b>\$113,382</b>	<b>\$22,750</b>	<b>\$355,230</b>
	-2.4%	-0.6%	-28.2%	-4.1%	3.2%	-4.9%	-6.6%	-2.4%
<b>2004</b>	\$151,250	<b>\$185,582</b>	\$14,550	\$33,955	\$59,717	<b>\$122,989</b>	<b>\$40,226</b>	<b>\$348,797</b>
	-18.4%	-15.3%	-20.0%	27.8%	8.5%	8.5%	76.8%	-1.8%
<b>2005</b>	\$165,325	<b>\$195,812</b>	\$21,592	\$27,538	\$61,612	<b>\$125,272</b>	<b>\$45,874</b>	<b>\$366,958</b>
	9.3%	5.5%	48.4%	-18.9%	3.2%	1.9%	14.0%	5.2%
<b>2006</b>	\$202,905	<b>\$234,488</b>	\$20,966	\$23,882	\$63,087	<b>\$121,822</b>	<b>\$21,343</b>	<b>\$377,653</b>
	22.7%	19.8%	-2.9%	-13.3%	2.4%	-2.8%	-53.5%	2.9%
<b>2007</b>	\$180,647	<b>\$216,585</b>	\$21,918	\$20,961	\$68,177	<b>\$126,022</b>	<b>\$22,253</b>	<b>\$364,860</b>
	-11.0%	-7.6%	4.5%	-12.2%	8.1%	3.4%	4.3%	-3.4%

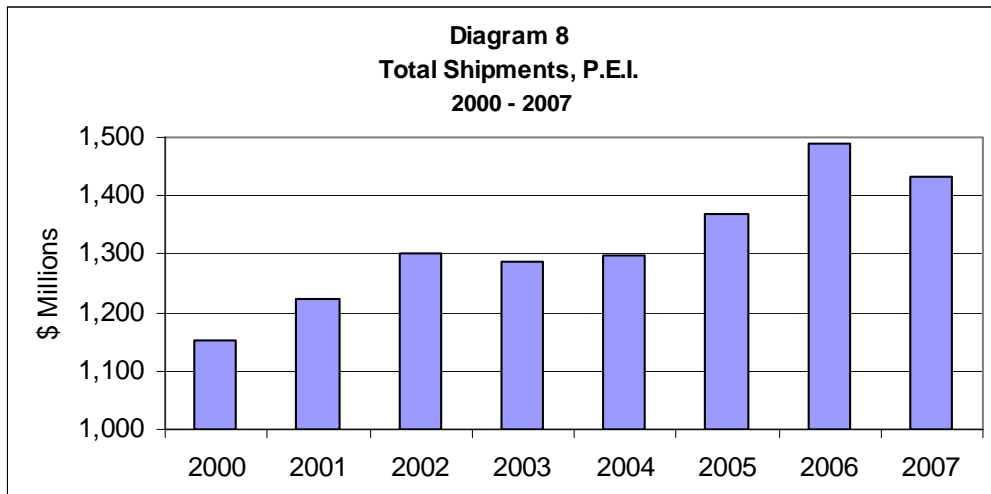
Source: Statistics Canada, CANSIM Table 002-0001

The P.E.I. Department of Fisheries, Aquaculture and Rural Development estimates that fish landings totaled \$166.8 million in 2007, a decline of 2.8 per cent from the all-time-high set in 2006. Following a 15 year high set in 2006, Lobster landings declined by 6.3 per cent to 20.1 million pounds with an estimated value of \$108.6 million

### ***Manufacturing Shipments and Exports***

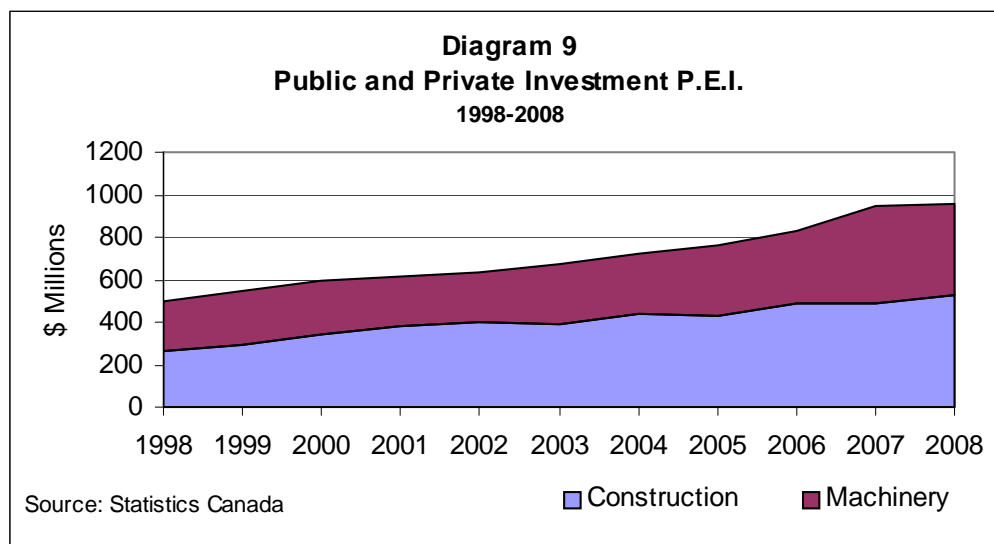
Increased manufacturing and exports were seen in processed fish products ( up 3.3 per cent) and chemicals ( up 30.8 per cent) in 2007. However, these gains were offset in part by a decrease in fabricated metal manufacturing shipments, down 67.4 per cent from 2006 levels. Consequently, the value of 2007 manufacturing shipments decreased by 4 per cent relative to 2006 figures, to a value of \$1,430.7 million.

Provincial exports destined for international markets valued \$767 million in 2007, a decrease of 2.5 per cent compared to 2006. There were decreases in most areas of production, notably agriculture and fishing, forestry products and industrial goods. However, there were positive gains made in machinery and equipment, parts and consumer goods, though these gains were not enough to offset losses in other areas.



### ***Capital Expenditures***

Total public and private capital investment in P.E.I. reached \$943.7 million in 2007, up 14.1 per cent from 2006 levels. This was achieved largely through increases in machinery and equipment purchases. The value of construction on Prince Edward Island declined slightly in 2007 from performance in 2006 as major construction projects on the Island wrapped up, but remains high by historical standards. Capital investment has increased steadily since 1998, and increased by 1.7 per cent in 2008, as seen in Diagram 9. This increased growth will be the result of both increases in construction and machinery investment. Continued strong performance in private and public investment in P.E.I. both in 2007 and into 2008 can be attributed to a robust housing sector, public investment in new hospital infrastructure, the construction of several new buildings in the Charlottetown and Summerside areas, and investments in new wind energy projects and electricity transmission lines. The Government of Prince Edward Island recently committed to developing 500MW of wind energy on P.E.I. in the next five years.



The housing sector in P.E.I. the final three quarters of 2007 to end the year with 1.6 per cent more housing starts as compared to 2006. This marks the first increase in housing starts since 2004. Though the Canadian Housing and Mortgage Corporation (CMHC) predicts that new housing starts will decline by 6.7 per cent in 2008, Statistics Canada predicts that the value of new housing construction is expected to remain constant at \$249 million, largely due to the construction of more expensive homes.

### ***Tourism***

Tourism indicators were positive in 2007. The Department of Tourism estimates total expenditures by non-resident tourists reached \$293.9 million during 2007, an increase of 4.4 per cent from the previous year. The number of tourists coming to P.E.I. increased by an estimated 1.1 per cent to reach 1.375 million. Air passenger traffic was up 12 per cent, bridge traffic was up 1 per cent and the number of rooms nights sold increased by 3.5 per cent. These gains were made despite the negative impact that high gasoline prices, a rising Canadian dollar and passport restrictions had on the industry.

### ***Outlook for 2008***

There is variation among forecasts as to the magnitude of Canada's economic growth in 2008. The economic analysis released by the Federal Department of Finance predicts that economic growth will slow to 1.7 per cent in 2008 and increase to 2.4 per cent in 2009. Meanwhile, contingent on the stabilization of the exchange rate and a recovering U.S. economy, the Conference Board of Canada is forecasting a growth rate of 2.2 per cent for 2008, and 3.0 per cent for 2009.

Some private sector, and government, forecasts predicted a pessimistic outlook for the beginning of 2008, recently released economic data suggests a brighter picture. Economic growth increased 0.6 per cent in January, bouncing back from the 0.7 per cent decline observed in December 2007. The growth in GDP, was broadly based, and largely driven by manufacturing and wholesale trade, reversing the decline seen in the fourth quarter of 2007.

Employment growth continues to increase with 104,300 new jobs created during the first quarter of 2008. Retail sales figures continue to be strong, increasing 1.5 per cent in January, the sixth consecutive month of growth. Domestic demand remains strong in Canada due to real income growth and despite the problems in the housing sector being experienced south of the border.

The Conference Board of Canada estimates that the P.E.I. economy grew by 1.8 per cent in 2007 and projects growth of 1.9 per cent in 2008. Employment is forecast to increase by 0.7 per cent resulting in the unemployment rate to decline to average 10.1 per cent for the year. An increase in food production, manufacturing and construction will lead growth in the goods producing sector on P.E.I. in 2008.

**SUMMARY STATISTICS  
PRINCE EDWARD ISLAND ECONOMY**

	2000	2001	2002	2003	2004	2005	2006	2007
Population on 1 July (in '000s) *	136.5	136.7	136.9	137.3	137.9	138.2	138.0	138.6
Personal income per capita *	\$22,382	\$22,679	\$23,810	\$24,292	\$25,326	\$26,065	\$26,920	n.a.
<i>As % of Canadian personal income</i>	81.7%	80.3%	83.1%	82.5%	82.8%	81.9%	80.7%	n.a.
Employment (in '000s) *	62.7	63.6	64.7	66.1	66.9	68.2	68.6	69.3
Unemployment rate P.E.I. (%) *	12.1%	11.9%	12.0%	11.0%	11.3%	10.8%	11.0%	10.3%
<i>Unemployment rate Canada (%) *</i>	6.8%	7.2%	7.7%	7.6%	7.2%	6.8%	6.3%	6.0%
CPI annual change - P.E.I.	4.1%	2.6%	2.7%	3.5%	2.2%	3.1%	2.3%	1.8%
<i>CPI annual change - Canada</i>	2.7%	2.5%	2.2%	2.8%	1.8%	2.2%	2.0%	2.2%
Retail trade (\$ millions) *	\$1,273.9	\$1,324.6	\$1,369.0	\$1,382.6	\$1,384.7	\$1,423.9	\$1,481.3	\$1,602.6
New motor vehicle sales (units) *	4,902	4,635	4,996	4,731	4,696	4,847	4,933	5,303
Farm cash receipts (\$ millions) *	\$323.1	\$336.2	\$364.1	\$355.2	\$348.8	\$367.0	\$377.7	\$364.9
Potato receipts (\$ millions) *	\$154.5	\$123.9	\$189.9	\$185.3	\$151.3	\$165.3	\$202.9	\$180.6
Lobster landings (\$ millions) *	\$87.8	\$103.9	\$105.4	\$108.3	\$100.1	\$103.2	\$113.4	\$108.6
<i>Lobster landings (lbs - millions)</i>	19.1	19.3	19.9	20.0	19.9	18.5	21.5	20.1
Housing starts (units)	710	675	775	814	919	862	738	750
Investment (\$ millions)	\$596.4	\$616.4	\$639.1	\$677.0	\$723.6	\$758.8	\$827.3	\$943.7
Manufacturing shipments (\$ millions) *	\$1,150.6	\$1,222.0	\$1,300.3	\$1,287.4	\$1,297.6	\$1,369.1	\$1,490.0	\$1,430.7
International export of goods (\$ millions) *	\$682.9	\$666.4	\$683.0	\$637.6	\$644.4	\$772.8	\$786.6	\$767.0
GDP at market prices (\$ millions) *	\$3,366	\$3,431	\$3,701	\$3,798	\$3,994	\$4,118	\$4,304	n.a.

n.a.: data not available

Notes:

\*: revised data

1: estimate

Sources: Statistics Canada; P.E.I. Department of Fisheries and Aquaculture.