WEEKLY ECONOMIC BULLETIN

ATB Financial®
Senior Economist Todd Hirsch
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November 20, 2009

- **Alberta manufacturers facing challenges**
- **US housing starts falter**
- **Inflation is back… barely**
- **Canadian leading indicators forge ahead**

Alberta's Mix of Manufacturing

When you think of manufacturing, you might think of Michigan, southern Ontario, or (more and more) China. But Alberta? It doesn't seem like a hot bed of manufacturing activity. While it may not have the same heavy industrial sector, typical of the auto-producing regions, Alberta does have its own unique mix of manufacturing.

Earlier this week, Statistics Canada reported that Alberta's manufacturers shipped about $4.496 billion of goods in September, down a hair from the previous month. Overall, 2009 has not been a great year for the value of manufacturing in the province. During the first nine months, total shipments are off by about 23% from the same period in 2008. Much of this has to do with softer prices for these manufactured items, not necessarily a lower volume of goods.

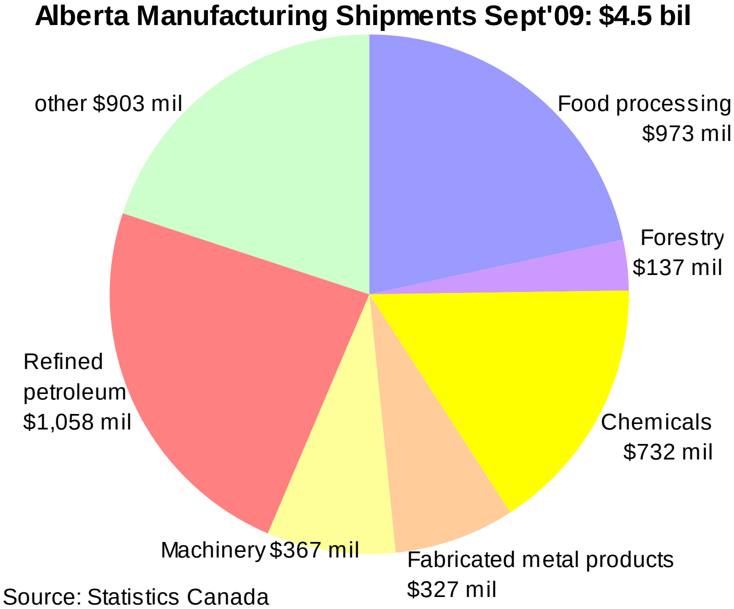
Broken down by sector, manufacturing in Alberta is dominated by a few very large sub-categories.

In September of this year, food processing accounted for about 22% of the value of manufacturing – much of that related to beef and pork processing. Forest products (such as lumber and plywood) account for only 3%, and this figure has been gradually declining due to the tremendous challenges in the forestry sector.

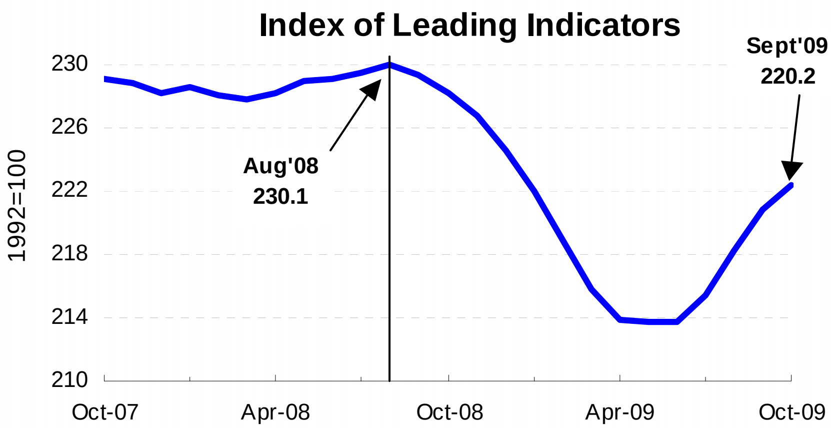
Four sectors combined (chemicals, fabricated metals, machinery, and refined petroleum products) make up over half (55%) of Alberta's manufacturing. What these four sectors have in common is that they are all largely exposed to Alberta's oil and natural gas extraction sector.

As detailed in this week's *Economically Speaking* (see page 5), manufacturing activity in the province has declined in recent months. Much of that decline can be traced back to challenges in conventional oil and gas drilling, as well as softer petroleum prices.

Alberta Manufacturing Shipments Sept'09: $4.5 bil



Source: Statistics Canada



Source: Statistics Canada The Daily, Nov. 19, 2009

Canadian Leading Indicators Harbinger of Optimism

The index of Canada's leading economic indicators continued on its upward path in October, advancing 0.7% during the month. October's gain marked the fourth straight monthly advance for the forward-looking collection of indicators, although after experiencing gains of over 1% month-over-month in August and September, the pace is probably beginning to decelerate. Eight of the ten sub-indices advanced in October, with the housing indicator providing the largest contribution to the upside. The US indicator continued to provide moderate support while the stock market and money supply variables both rose by 1%.

The category providing downside pressure was the new orders for durable goods indictor, which fell 4.4% over the month, as Canadian exporters continued to suffer from the high dollar and weak demand from south of the border. Considering that the leading index only posts huge gains, such as those of the past three months, at the beginning of an economic recovery, the torrid advance can probably be expected to moderate going forward.

US Consumers Cautiously Open Their Wallets

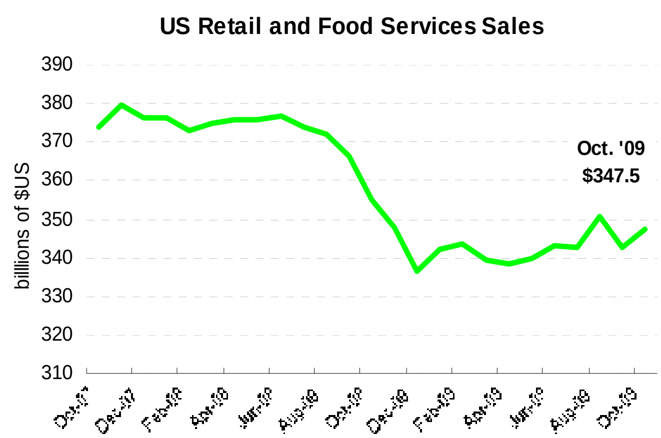
US retail sales experienced a healthy rebound in October 2009, rising 1.4% month-over-month — well ahead of a consensus of economists' forecasts who were predicting a 0.9% gain. October's figures were welcome relief after September's dismal reading, which suffered due to the end of various US economic stimulus programs, such as cash-for-clunkers and the first-time homebuyer credit.

Higher automobile sales were the primary driver of the overall recovery in US retail activity, as sales excluding autos were limited to an increase of 0.2%. Despite this, sales did improve at clothing, department, and health and personal care stores, along with internet retailers and restaurants. But these gains were mitigated by losses in the furniture, electronic and building supply store categories. Looking ahead to the all-important Christmas retail season, some major chains have already announced price cuts in an attempt to buoy volumes.

Developers See Construction Costs Moderate

The cost of building an apartment complex continued to fall in Alberta's two large metropolitan areas. In Calgary, apartment construction costs fell by 2% during the third quarter of 2009, while in Edmonton they were down 0.4%. Year-over-year apartment construction costs were 12.9% lower in Calgary and 15.7% lower in Edmonton as materials like steel and concrete fell in price.

Nationally, the cost of building an apartment was 9.6% lower than a year previous as material costs declined but also competition for

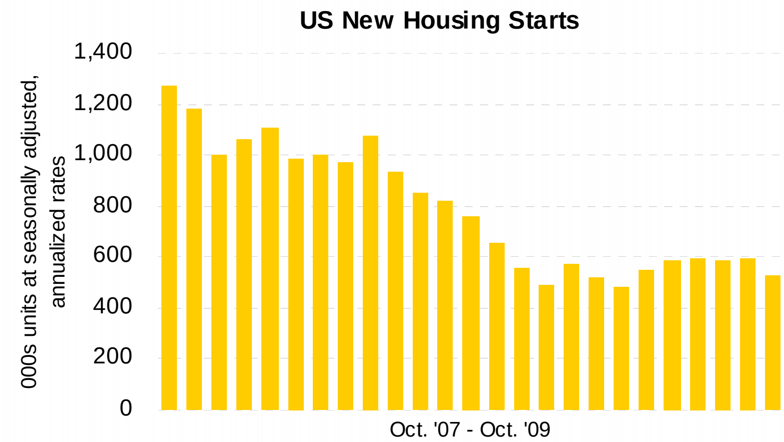


Source: US Department of Commerce, Nov. 16, 2009 projects heated up, as there were fewer contracts to bid for. Halifax (+0.1%) and Montreal (+1.5%) were the only cities included in the survey in which apartment construction costs were actually higher year-over-year.

American Residential Construction Disappoints

Data released this week by the US Department of Commerce indicated that the residential construction sector continued down a rocky road to recovery. American contractors and developers broke ground on 529,000 homes (seasonally adjusted and annualized) in October 2009, far below expectations for 600,000 and the previous month level of 592,000. Building permits, an indication of housing starts to come, were also lower than expected.

The dramatic drop in residential construction has been mostly attributed to the end of the first-time homebuyer credit. Fortunately, subsequent to the credit's expiry it has been re-instated and expanded by US authorities, which should put some of the pep back into America's housing markets going forward. The fact that housing starts fell by nearly 12% in one month because the credit expired shows how the US economy is still very reliant on government stimulus programs.



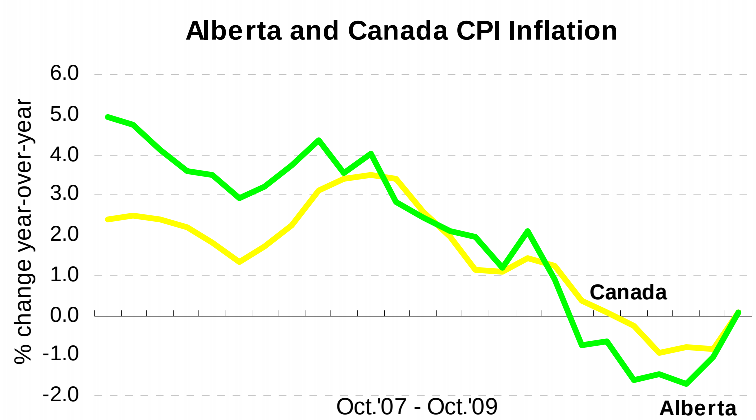
Source: US Department of Commerce, Nov. 18, 2009

Deflation Breathes its Last Breath

After several months of deflation, prices for Alberta consumers popped back into positive territory in October. But despite overall price increases last month, inflation remains a timid threat to the economy. Alberta's Consumer Price Index rose 0.1% in October compared to the same month last year. That's a strong rebound from September when year-over-year prices were falling by 1.1% (see graph). This marks the first time since March 2009 when overall prices in Alberta were rising.

A similar trend was noted at the national level; Canada's total CPI also posted a gain of 0.1% in October. The core rate of inflation (a measure used by the Bank of Canada which sets aside eight of the most volatile items in the basket of goods and services) was 1.8% in October – still below the target rate of 2%.

In Alberta, falling year-over-year prices for electricity (-24.7%) and gasoline (-18.0%) continue to keep overall inflation very weak. Home maintenance costs (+10.1%) and auto insurance premiums (+11.7%) helped pull prices higher.



Source: Statistics Canada, The Daily, Nov. 18, 2009

TECHNICALLY SPEAKING

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by Will Van't Veld

Jobless Recovery

There are about 83 thousand more unemployed individuals in Alberta today than a year ago. It's even worse in Ontario, where the unemployment rate is hovering just under 10%. The human cost of recessions is what motivates politicians to spend billions in stimulus, but a return to economic growth is unlikely to be followed quickly by lower unemployment.

A lag between economic recovery and increased hiring is normal. Employers will want to be sure a recovery is underway before re-staffing, but historically this delay was measured in months. This ended with the recession of 1990 when hiring didn't begin to increase until over a year after the recovery officially began. The lag was even longer in the 2001 recession and the term 'jobless recovery' was coined to describe this new tendency.

The reason most often cited for the increased time lag between economic growth and employment is that recent recessions are more structural than cyclical in nature. Cyclical unemployment relates to fluctuations in aggregate demand as it relates to the business cycle. Those laid off due to temporary low demand expect to be rehired once demand picks up again. Structural unemployment relates to industrial transformations, where jobs are permanently lost. If unemployment is due mostly to structural unemployment, then those affected need to be retrained and firms need time to recognize new opportunities.

Why might structural unemployment be more prominent in recent recessions? According to a 2003 paper by the Federal Reserve of New York "Has Structural Change Contributed to a Jobless Recovery?" there are three possible explanations: bouts of over-expansion in certain industries; monetary and fiscal policy controls cyclical booms/busts far better; and new management techniques that has very little excess labour at any point in time.

The most interesting of the three is the first, where the over-investment explanation was made in reference to the dot.com bubble of the late 90s. If an industry over invested in one sector prior to a recession, then even upon recovery those resources would continue to need to be reallocated. Whether or not government mandarins were really able to tame cyclical swings in the business cycle, and whether corporate America really became so lean and efficient as to have substantially reduced cyclical unemployment, might be more debatable.

A more recent look at the question of why structural unemployment might be so prominent, especially in the United States, would relate to changes in the pattern of trade. Federal Reserve Chairman Ben Bernanke has made comments to this effect. The American trade deficit mostly results in Asian countries sending their manufactured goods to the US in exchange for American IOUs. This has put increased and sustained pressure on US manufacturing.

Productivity improvements also play a role. The amount of economic output produced by an economy, given a certain level of technology, depends on the amount of labour and capital employed. If output is growing, notwithstanding stagnant job growth and low capital formations, then an explanation could be that those inputs are being more efficiently used.

Will this be a jobless recovery in Canada? This might depend on where you live. Manufacturing in Ontario has been decimated, with employment down 14% in the sector year-over-year. Alberta has also seen manufacturing pummeled, down 23.5%, albeit from a smaller base. The difference, however, is that even manufacturing in Alberta is largely tied to the energy sector, whereas Ontario's manufacturing is largely tied to the auto sector.

As the recovery takes hold, employment in Alberta will likely pick up quicker than in Ontario. Even the most optimist auto sector analyst doesn't expect auto production in Ontario to regain its previous strength. This is by definition a structural shift, meaning those workers will need to be retrained. There was no similar structural shift for the energy sector, notwithstanding shale gas becoming economically viable. Unemployment might remain relatively high in Alberta, however, as individuals begin moving here in search of work, but relatively speaking, it could be better than in central Canada.

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Manufacturing in Alberta Tied to Energy

November 20, 2009

Who knew Alberta was such a manufacturing super star?

The value of manufacturing from the province totals some $4.5 billion, and accounts for nearly 11% of Canada's total manufacturing activity. That's roughly in line with Alberta's share of the country's population.

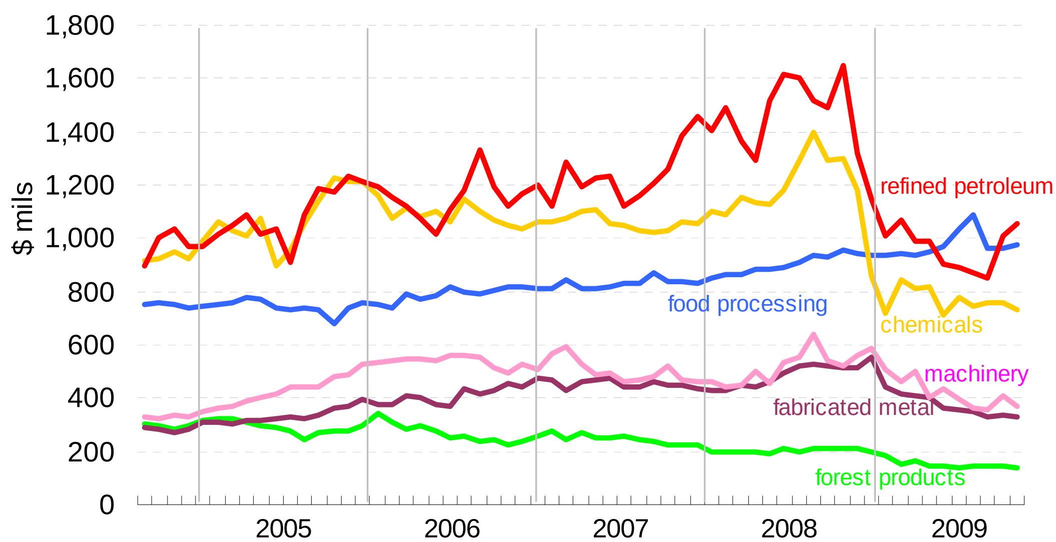
Doesn't this show that Alberta's economy is nicely diversified after all? With all of this manufacturing, maybe the province isn't as dependent on natural resources as people think!

Maybe. But breaking down manufacturing by sector, it' s glaringly apparent that the energy patch is still the muscle that powers the provincial economy.

The single largest manufacturing sector in Alberta is refined petroleum and coal, which contributed close to $1 billion (22%) in September of this year. But that refining activity is, of course, directly related to the value of crude oil and its derivative products: gasoline, diesel fuel, jet fuel, etc. Those products – led by the rollercoaster that is called oil prices – have gyrated wildly over the past couple of years. And it has only been recently that the value of refined petroleum products has clawed its way back up. Even still, with the recent price gains in oil and gasoline, the value of refined petroleum is only back to where it was in 2004 and 2005 (see graph).

Chemical production is the third largest contributor to industrial manufacturing, and this is concentrated in a few very large facilities. Here again, on the surface it seems to support to the notion of economic diversity. But feedstocks into the production of chemicals in Alberta are drawn primarily from

Manufacturing in Alberta by Major Sector



Source: Statistics Canada, CANSIM Table 304-00151, 2 natural gas liquids – and that, in turn, depends on natural gas extraction. When that activity is disrupted by low natural gas prices, it greatly affects input availability.

Machinery and equipment places fourth in Alberta's manufacturing ranking. But it's not the same mix of industrial and technical manufacturing taking place in southern Ontario, Michigan, or China. By and large, machines produced in Alberta are specialized pieces used in either conventional drilling, or increasingly, in oilsands extraction. Think specialized boilers, pumps, drill bits, and heating coils. Without demand from oil and gas drillers, machinery and equipment manufacturing in Alberta is in a funk. From it's peak in July 2008, total value in the province is down 43%.

Fifth on the list of Alberta manufacturing is fabricated metal products, and the story is the same as with machinery and equipment: most of it feeds into the energy sector. Specialized rolled steel products and steel pipe used for drilling and casing make up a good deal of these metal products. And like machinery and equipment, they've taken a hit. Their overall value is off by more than 40%.

Those four sectors alone – refined petroleum, chemical, machinery & equipment, and fabricated metals – accounted for 55% of Alberta's total $4.5 billion in manufacturing in September of 2009. And the troubles in the energy patch are without doubt being felt. The attached graph shows how each of these four industrial sectors has been pummeled in 2009.

However, it's not all doom and gloom. Food processing has scrambled to #2 spot among the major manufacturing sectors, and it has been on an upward trend. Most of the action in Alberta's food processing takes place at a handful of cattle and hog slaughtering factories, and the associated beef and pork packaging. But it also includes poultry and egg production, bakeries, beverage brewing and bottling, and a series of other smaller food processors. All in, they account for nearly $1 billion sales, up about 25% in the past five years.

Forest product manufacturer, on the other hand, are not enjoying the same growth. In fact, the total value of lumber, plywood, pulp and paper has gradually fallen over the past few years, weighed down by low prices, poor demand from the US, and a punishingly high Canadian dollar.

But with over half of the province's manufacturers being heavily exposed to the energy patch, it's hard to see much upside without a strong recovery in conventional drilling. That, unfortunately, is not particularly likely given the stubbornly soft prices for natural gas. The irony is that the current downturn in the energy sector will probably result in Alberta's economy becoming more diversified after all.

Oh… *that* kind of manufacturing!

Financial Data

Interest Rates	20-Nov-09	13-Nov-09
Note: Data is as of 10 a.m. MST		
Call Loan	0.20	0.20
CAD Prime Rate	2.25	2.25
Fed Funds (effective)	0.120	0.130
USD Prime Rate (base rate)	3.75	3.75
1 month schedule I Bank B.A. (bid)	0.35	0.34
3 month schedule I Bank B.A. (bid)	0.36	0.36
1 year CAD T-Bill (bid)	0.47	0.54
2 year CAD Bond (bid)	1.240	1.403
5 year CAD Bond (bid)	2.551	2.737
2 year CAD Swap	1.2690	1.4100
5 year CAD Swap	2.5860	2.8150
Implied 2 year CAD Swap in 1 Year	2.4527	2.7332
Implied 5 year CAD Swap in 1 Year	3.2914	3.5524
Exchange Rates	**20-Nov-09**	**13-Nov-09**
Canada/U.S.	1.0702	1.0722
Canada/Euro	1.5894	1.5937
Canada/GBP	1.7672	1.7757
Yen/Canada	83.14	83.91

Equity Markets	20-Nov-09	13-Nov-09	
S&P TSX Composite	11,528.86	11,104.65	
Dow Jones Industrial Average	10,324.36	9,940.82	
NASDAQ	2,143.45	2,090.06	
Commodity Prices	**20-Nov-09**	**13-Nov-09**	
NYMEX MMBTU(USD)	4.356	5.139	
Crude Oil (WTI in USD)	76.50	79.20	
Gold (London A.M. in USD)	1139.80	1042.90	
Prices $/tonne*	**19-Nov-09**	**12-Nov-09**	**1 year ago**
**Average elevator bids, Edmonton, unless otherwise noted*			
Canola (crusher FOB)	379.26	367.47	404.9
Feed Barley	121.78	121.95	146.7
Oats (Red Deer)	122.5	120.09	154.4
Feed Wheat	137.69	138.05	103.6
Alberta direct cattle sales $/cwt			
Steers	77.5	77.5	95.00
Heifers	n/a	n/a	n/a
Western Hog Exchange (WHE) base cash price			
Index 100 hogs ($/kg)	0.997	1.043	1.168

`Data as of Thursday, Nov. 19, 2009

Compass Portfolio Fund Name	1 week % change	30 day % change	YTD % change	Incep (as of Sept. 30)	
Compass Balanced Growth Portfolio	0.93	0.72	17.92	4.77	(12/02)
Compass Balanced Portfolio	0.89	1.00	16.41	4.89	(12/02)
Compass Conservative Balanced Portfolio	0.87	1.30	16.32	5.08	(12/02)
Compass Conservative Portfolio	0.58	0.93	13.08	4.17	(12/02)
Compass Growth Portfolio	1.02	0.58	18.29	4.25	(12/02)
Compass Maximum Growth Portfolio	1.04	0.64	19.47	3.50	(12/02)

Compass Portfolio Fund Name	Current yield %
ATB Money Market Series A	0.12
ATB Money Market Series I	0.23

Economic Data

Wholesale merchants' sales Seasonally adjusted	Sept 08	Aug 2009	Sept 09	Aug to Sept 2009	Sept 2008 to Sept 2009
	$ millions			% change	
Total, wholesale sales	45,787	40,929	41,019	0.2	-10.4
Farm products	473	452	440	-2.6	-6.8
Food, beverages and tobacco products	7,990	8,087	8,167	1.0	2.2
Personal and household goods	6,794	6,935	6,928	-0.1	2.0
Automotive products	7,263	6,583	6,457	-1.9	-11.1
Building materials	6,531	5,367	5,408	0.8	-17.2
Machinery and electronic equipment	10,195	8,502	8,605	1.2	-15.6
Alberta sales	5,985	4,708	4,703	-0.1	-21.4

Source: Statistics Canada, The Daily, Nov.19, 2009

Consumer Price Index	Oct-08	Oct-09	Oct. '08 to Oct. '09
Alberta - all-items	121.5	121.6	0.1%
Canada - all-items	114.5	114.6	0.1%
Canada - Goods	108.9	107.0	-1.7%
Canada- Services	120.0	122.1	1.8%
Canada- Energy	147.5	128.8	-12.7%
All items excluding food and energy	110.6	112.0	1.3%
Core CPI	112.2	114.2	1.8%

Data is available in Statistics Canada, The Daily, Nov. 18, 2009

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Where there's a way