

ALBERTA ECONOMIC OUTLOOK

August 2017

Prepared by ATB Financial, Economics & Research

ATB Financial's Alberta Economic Outlook

August 2017

Economics and Research, ATB Financial

ATB Financial's *Alberta Economic Outlook* summarizes the province's current economic environment. Released four times a year, *The Outlook* aims to provide Albertans with economic commentary that is clear and meaningful.

Overview

Alberta's economy is gradually gaining momentum. The recession has left deep scars, particularly in the energy sector and across the labour market. These will be slow to heal.

Oil prices have stabilized below \$US 50 per barrel, which is commonly regarded as the break-even point for the industry overall. Natural gas prices have been similarly muted. While employment and drilling has picked up in recent months, the energy sector will not return as a robust growth engine of the economy this year. Other sectors such as agriculture and forestry are stable, yet the latter remains impaired by US tariffs and a stronger Canadian dollar.

At the national level, the Canadian economy continues to show impressive job gains. And while inflation remains muted, the Bank of Canada has now shifted to a tightening bias--interest rates rose in July and could bump up again this fall.

Alberta's job market is improving. Nearly 35,000 net new jobs have been added over the last 12-months (+1.5 per cent), all of them full time positions. However many of them are lower paying jobs and hiring in the private sector has been lagging.

Overall the economy is on the right track. However, Alberta's economy is unlikely to recover to its pre-recession levels this year. ATB Financial's economics and research team is forecasting real GDP growth of 3.2 per cent this year, moderating to 2.1 per cent next year.

Key Results:

- . Alberta emerges from two years of recession with growth of around three per cent
- . Retail, housing surprisingly higher
- . Oil prices have dipped and are expected to average below \$US 50 this year
- . Trade talks with the US still pose a risk to the economy this year and for years to come
- . Tourism, agriculture and agri-food will continue to lead economic growth and economic diversification
- . Net out-migration to other provinces still expected to taper off this year

	2016	2017	2018	2019
Real GDP growth (annual % change)	-3.8	3.2	2.1	2.3
Consumer price index (annual % change)	1.1	0.9	2.2	1.7
Unemployment rate (%)	8.1	7.9	7.7	6.8
Employment (annual % change)	-1.6	1.3	0.8	2.4
Housing starts (000s)	24.6	27.2	25.2	27.5

Oil and gas

Over the first half of 2017, oil prices have been a mixed bag. At the beginning of the year, the price of a barrel of West Texas Intermediate (WTI) began to rebound from last year's levels and hovered around \$US 52 per barrel. Since then, the prices have fallen and have been sitting below \$50 for most of the summer.

As we entered 2017, optimism in the energy sector was mounting. Fresh news of pipeline developments and production cuts by OPEC member states boosted sentiment. Specifically, OPEC's agreements to cut production helped prop up prices, but only for the first couple of months of the year. The brief improvement in price enticed producers in the US and Canada to raise production, which added more oil to the global supply glut and caused the price of oil to slide.

Since April, prices have been range bound between \$US 45 and \$US 48 and don't show any durable signs of increasing (at least not yet). Crude supply numbers from the US Energy Information Administration (EIA) continue to show an oversupply of oil. Although there are early signs that stockpiles may begin to decline in the US, many analysts conclude that the current global supply glut will continue to persist over at least the short-term.

ATB Financial's economics team has revised its projection for the price of oil in 2017. This year, we now anticipate that oil prices will average around \$US 48 per barrel (WTI) and approach \$US 50 next year.

Although we've revised price downward, the story for petroleum producers remains the same. After two years of turmoil, Alberta's energy sector will show modest improvement in 2017. Cash flow is improving in the industry and cost cutting has tapered off. As we head into the autumn months, we can still anticipate conventional drilling to increase by about 10 per cent this year, and improve slightly in following years. Additionally, a few new projects related to non-conventional extraction are set to take shape in Alberta this year which will help boost

Daily crude oil price, West Texas Intermediate (WTI)



Source: US Energy Information Administration (EIA)

Daily crude oil price, Western Canadian Select (WCS)



Source: Bloomberg, Altacorp Research

Daily natural gas price, AECO



Source: Bloomberg, Altacorp Research

output. With that said, the large investments in new oilsands projects are unlikely to materialize in the short-term with oil prices at or below \$US 50 a barrel.

Like oil, the Canadian benchmark for natural gas (AECO spot price) started 2017 on a brighter note. However lately, AECO's spot price has been volatile. In July, it hovered between \$C 1.00 and \$C 2.00/MMBtu. The shaky pricing for AECO happens whenever there is a pipeline outage for western Canadian production or when producers are desperate to gain access to market. Over the first seven months of the year, AECO's price has averaged about \$C 2.70/MMBtu. Meanwhile, the North American benchmark (Henry Hub) has been a little more stable, averaging around \$US 3.20/MMBtu. Currently, Henry Hub sits around \$US 3.30/MMBtu.

Daily natural gas price, Henry Hub
\$US per MMBtu



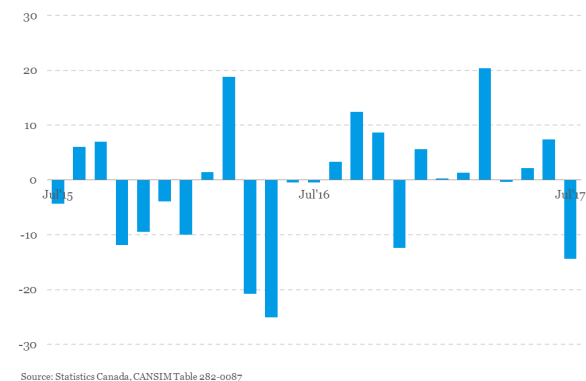
Weather has natural gas prices stuck in its current range. After a relatively mild winter at home and a cooler than normal summer in many parts of the United States, demand for natural gas is lower than the average for this time of year. We anticipate natural gas prices to average around \$C 2.30 (AECO) this year.

Labour market

Job growth was reasonably strong over the first half of the year, with jobs created in five of the first six months. But Alberta's labour market lost some of its momentum in July, shedding 14,400 jobs. It was one of the worst months over the last three years. What's worse, the jobs that were lost were overwhelmingly full-time positions.

Notwithstanding the losses in July, over the past 12 months the labour market has been on the right track, adding nearly 35,000 net new jobs, all of them full-time. The unemployment rate stood at 7.8 per cent in July.

Change in employment, Alberta
Thousands, seasonally adjusted

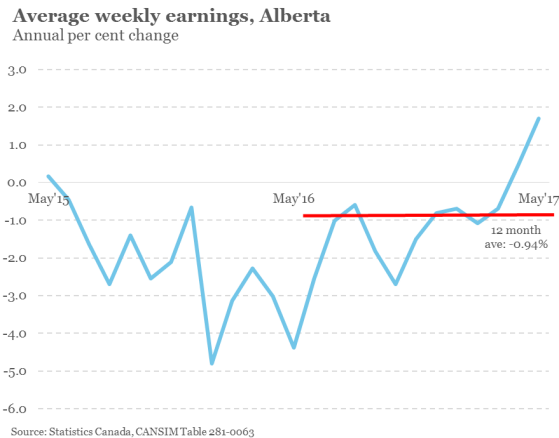


The construction industry continues to be the sector hardest hit by the downturn. Compared to a year ago, construction jobs are down about six per cent. Jobs in the resource sector, on the other hand, appear to be rebounding. They are up more than 13 per cent from a year ago, although they had fallen to a low level in 2015 and 2016.

With growth in the energy sector and with business gaining faith in the economy, the labour market is showing modest yet encouraging progress. Despite July's setback, labour market

conditions are expected to improve throughout the remainder of the year, causing the unemployment rate to drift lower. We are projecting Alberta's unemployment rate will average 7.9 per cent this year, a slight decrease from last year's average of 8.1 per cent.

The earnings of Alberta employees had been trending negatively for nearly two years. Average weekly wages remain below the peak reached in January 2015 (\$1,171). However, in May, the take home pay of workers in the province rose by almost two per cent. Average weekly earnings in Alberta were \$1,120 that month. Statistics Canada noted that the rise in wages was mostly attributable to a rebound from the low point that was reached the previous May (\$1,100). (These figures are adjusted for seasonality and include overtime pay, but excludes taxes.)



Several job categories saw decent boosts to pay and contributed to the rise in average wages across the province in May. Those employed in professional, scientific and technical services saw a four per cent increase to \$1,502 per week. Real estate and rental and leasing (\$1,125), and accommodation and food services (\$438.15) both increased by around three per cent.

May's positive wage report is yet another signal that Alberta is finding its feet. Nonetheless, it's important to remember that wage statistics do not include those who are unemployed and that many Albertans continue to struggle in the wake of the recession.

Employment insurance benefits also continue to signal improvements in the job market. In June, there were 69,740 regular insurance benefit cheques issued in the province, the eighth month in a row of declines. Benefit recipients are now 15 per cent below the year-ago level (yet they remain more than twice as high as pre-recession levels).

Agriculture and forestry

Lower cattle prices earlier in the year were a result of the bovine tuberculosis scare in southeastern Alberta at the end of 2016. But the smaller herd sizes prompted by that epidemic restricted supply; coupled with higher demand, cattle prices have rebounded somewhat in recent months.

Even though cattle prices remain above last year's levels, they are still well below the record highs reached in 2015 (\$US 190 per hundredweight). Future contracts for feeder cattle have hovered



around \$US 140 per hundredweight so far this year. Meanwhile, live cattle prices have fallen to around \$US 110 per hundredweight. It's expected that both cattle prices should remain in this range for the rest of 2017.

Drought conditions on the US plains have brought wheat prices up recently. Feed wheat bids around Alberta were \$C 30 to \$C 60 higher in July than at the beginning of the year. The latest data also show that canola prices have performed well throughout the first seven months of the year. The price for canola crusher (the main input to canola oil) recently averaged \$520 per metric tonne, about 6.4 per cent higher than last year's average price. If current prices for wheat and canola continue their upward trend and the weather cooperates, grain and oilseed farmers could see decent returns this year.

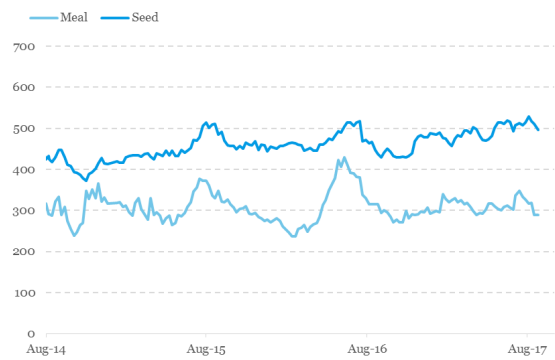
Alberta's forestry sector is showing mixed results. Since April, the average benchmark price for North American framing lumber has remained strong. As of July, the average price was \$US 415 per thousand board feet (the price is calculated by Random Lengths, an American industry group, and is based on the average of 15 key framing lumber prices.) That is up by about four per cent from the previous month and 17 per cent higher than the same month a year earlier. In Canadian dollars, the benchmark price was closer to \$C 530. Part of the price increase is due to the summer forest fires in British Columbia, which has restricted supply.

Yet all is not well in Canada's forestry sector. In April, the US imposed steep tariffs on Canadian softwood lumber imports and a new trade agreement in softwood lumber is not expected anytime soon. This puts Alberta exporters at a disadvantage to US producers. The tariffs and uncertainty surrounding a new softwood arrangement and Canada-US trade relations in general are expected to slow the province's forestry industry for the remainder of this year.

Construction and real estate

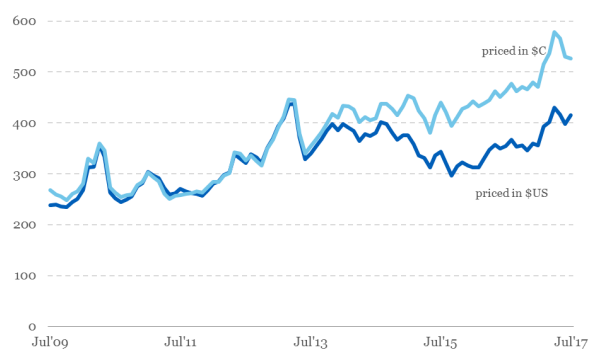
Even though construction activity in the province showed signs of slowing last year, building activity has stabilized and is beginning to pick up again. Total building permits in Alberta grew to \$1.2 billion in May, adjusted for seasonality. That's the highest level since January and is up 18 per cent from April. Compared to the same month a year earlier, permits have grown 16 per cent.

Canola crusher
Dollars per metric tonne



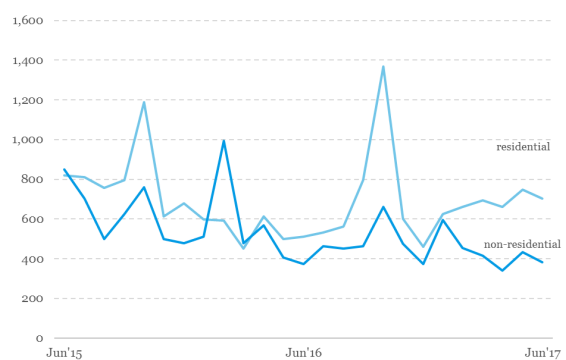
Source: Alberta Agriculture and Forestry, Weekly Crop Market Review

North American lumber prices*
Dollars per thousand board feet



Source: Random Lengths
*composite price is a weighted average of 15 key framing lumber prices

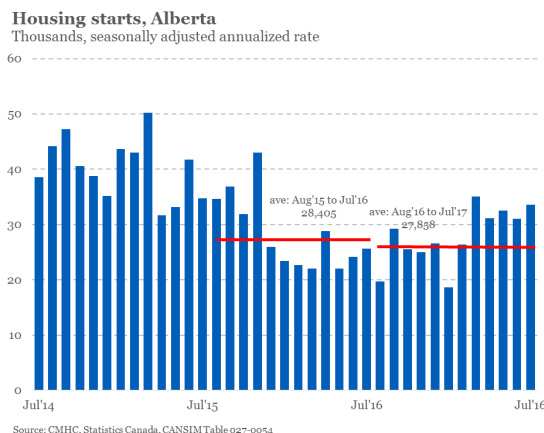
Building permits, Alberta
Dollars, millions



Source: Statistics Canada, CANSIM Table 026-0006

Notwithstanding the stabilization in permits, projections for construction activity in 2017 still remain quiet compared to pre-recession levels. Both Calgary and Edmonton have a significant amount of commercial and residential real estate coming online in their downtown cores over the next couple of years. This will keep future building activity muted over the short- and medium-terms.

In July, builders started construction on 33,535 homes in the province, including multi-family units. The figure is adjusted for seasonality and is expressed as an annualized rate (that is, the number of units that would be built in one year if the pace in June continued for 12 months). It was the fifth month in a row in which housing starts were above the 30,000 mark.



It's likely that this pace will slow. Stubbornly high unemployment, slow or negative interprovincial migration and muted consumer sentiment may keep demand for new housing muted. On top of this, new home construction may be affected by an increase in borrowing costs. The Bank of Canada increased its overnight rate in July and it's expected to raise interest rates again before the end of the year. This would nudge mortgage rates up by a similar amount and discourage some new home buyers.

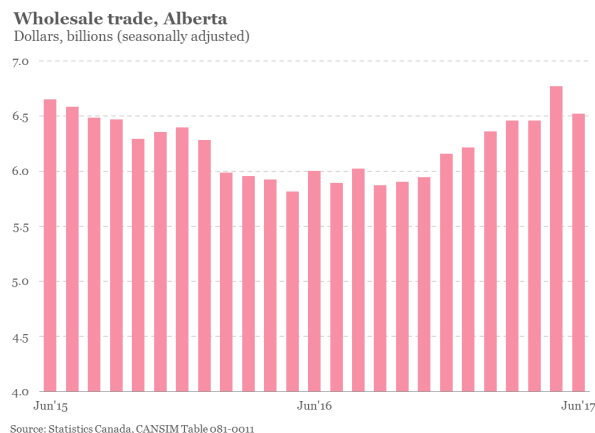
Home prices in Edmonton have struggled to show momentum over the first half of the year. In July, the average price of a single-detached home was \$446,892. That price was half a percentage point lower than the same month last year. The median sale price in July was \$410,000, up 1.2 per cent from July of 2016.

In Calgary, house prices are showing some decent advances. As of July, the average price of a house in Calgary was \$554, 544, almost a four per cent increase from last year. The median price in July showed similar advances (+4.2 per cent) and sat at \$496,000.

Even though Calgary is seeing some decent price gains, house prices across Alberta are not expected to make any material advances this year. Instead, average prices will continue to show stability.

Wholesale, retail and manufacturing

After decent momentum over the winter and spring of 2017, wholesale activity in the province slowed in June. Sales fell for the first time in nine months, falling 3.7 per cent to \$6.5 billion. Sales declined in all but one subsector. The machinery, equipment and supplies subsector contributed the most to the decline as sales decreased 8.0 per cent to \$2.0 billion in June.



June's loss offset most of the gains made in this subsector in May.

Other significant losses occurred in farm products (-7.1 per cent), personal and household goods (-6.0 per cent) and motor vehicles and parts. The building material and supplies subsector was the only sector to register sales advances in June (+0.33 per cent).

Although June's total shows that wholesale activity paused, total activity as a whole is up nearly eight per cent from where it was last year and confirms that Alberta's economy is indeed on track to recovery.

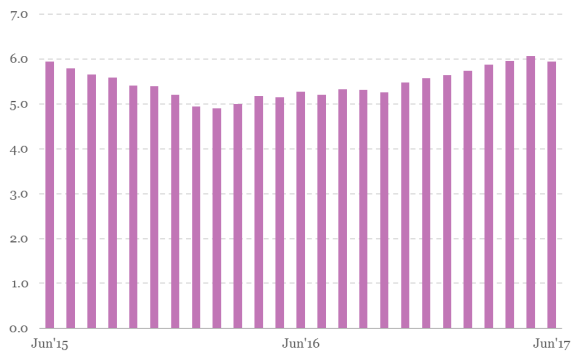
Retailers in the province flexed their muscles and rang in nearly \$6.9 billion in sales in June (adjusted for seasonality), surpassing the previous record of \$6.7 billion set in October 2014. Compared to a year ago, sales are up 11 per cent. Even though a new record high has been set, retailers have a way to go before feeling like things are back to normal. Alberta's labour market will likely experience a few more bumps along the road to recovery and wages are also trending lower. These two things may slow retail activity in the last half of 2017.

Retail sales, Alberta
Dollars, billions (seasonally adjusted)



Source: Statistics Canada, CANSIM Table 080-0020

Manufacturing shipments, Alberta
Dollars, billions (seasonally adjusted)



Source: Statistics Canada, CANSIM Table 304-0015

After reaching \$6 billion in May, the total value of manufacturing shipments in Alberta took a pause in in June, falling to \$5.95. Despite the small pullback, manufacturing activity in Alberta remains on an upward trend. Over the last 12 months, its total value is up by more than six per cent compared to the previous 12 month period.

The drop in June was driven by lower shipments of refined petroleum products, which fell from over \$1.3 billion to \$1.2 billion due to lower prices as well as some temporary refinery outages. Refined petroleum products are one of the largest contributors to Alberta's manufacturing sector.

Moving in the opposite direction, food and beverage processing jumped in June to nearly \$1.3 billion, surpassing refined petroleum in terms of value. Alberta's agri-food industries were a leading growth sector throughout last year's recession and continue to diversify and strengthen the economy in 2017.

Chemical production slipped in June, but that was offset by gains in plastics, wood products and fabricated metal products—all of which gained ground month-over-month and are now solidly above their levels of a year ago.

Despite the slight setback in June, manufacturing is still making a comeback after a rough couple of years. Optimism remains in agri-food, food processing and especially beverage manufacturing. With the stabilization in energy prices and a still-lower Canadian dollar, Alberta's manufacturing should continue to perform well for the remainder of the year.

Population

During the first three months of this year, nearly 18,200 people left Alberta for other provinces. At the same time, some 15,800 arrived in the province. That left a net loss of about 2,400 and was the sixth consecutive quarter of net out-migration.

The latest statistics suggest that the worst of the recession may be behind the province and show the net outflow of people from Alberta is now falling. The largest loss of people came last summer when nearly 3,900 more people packed up and left than arrived.



This year, it's expected that Alberta will continue to experience a net outflow of provincial migrants, but only for the first half of the year. As the economy improves over the second half of 2017, Alberta could see the number of people leaving and coming equal each other, or show a slow trickle in. Altogether, 2017 is likely to be another year of interprovincial out-migration, with a net loss of between 5,000 and 8,000 people.

Alberta's total population is expected to grow, offsetting the interprovincial losses. The increase will be supported by international migration as well as natural population growth (births-minus-deaths).

Conclusion

There is little question that Alberta's economy has rounded the corner and the worst recession in three decades is now squarely in the rear-view mirror. It has been a turning point that many Albertans have been anxiously awaiting.

Still, it is not surprising that the general economic mood around the province, while improved, is muted. Alberta has not returned to its pre-recession booming economy, even if things are moving in the right direction. Attitudes and sentiment remain cautious.

The major challenge remains the energy sector and the stubbornness with which the benchmark price of oil remains below \$US 50 per barrel. At those levels, Alberta's energy sector struggles. Drilling activity and hiring has picked up modestly, but the oil and gas sector remains tenuous. At best it is stable, but not an engine of growth in 2017.

Other sectors are contributing to the modest economic expansion this year: agriculture, food processing, tourism, retail and manufacturing are all experiencing decent growth.

The labour market is adding jobs--some 35,000 over the last 12 months (+1.5 per cent). However, positions have tended to be lower paying and in the service sector. Most of the high-paying professional jobs in the energy sector have been slow to return. And the private sector overall has lagged the public sector in job creation.

Alberta's economy is recovering, but it is not returning to what it looked like in 2014. Instead, the economy is evolving into one that is more diversified, and more typical of other Canadian provinces. It is a slow process and it may be a few more years before we see a full economic recovery.

ATB Financial's economics and research team is forecasting real GDP growth of 3.2 per cent this year, followed by a more modest expansion of 2.1 per cent in 2018.