ALBERTA ECONOMIC OUTLOOK

Q2 2015

Prepared by ATB Financial, Economics & Research

March 31, 2015

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ATB Financial's *Alberta Economic Outlook* is released at the beginning of each quarter of the financial calendar. It's designed to summarize our province's economic landscape and give us an idea of what the next three months look like (April – June, 2015). The *Economic Outlook* provides Albertans with economic commentary that is trusted, meaningful and easy to understand.

Provincial Overview

Since the first quarter *Economic Outlook* the price of crude oil has fallen even further; this has negatively altered the outlook for Alberta's economy for 2015. Still, even with the drag set to weigh on the economy, an outright contraction remains somewhat unlikely.

ATB Financial's Economics and Research team projects real GDP growth of 0.8 per cent in 2015, with gradual recovery in 2016 and beyond.

	Year			
	2014	2015	2016	2017
Real GDP	3.7	0.8	1.7	3.1
Consumer Price Index (annual % change)	2.5	1.1	2.1	2.1
Unemployment Rate	4.7	6.0	5.8	4.9
Employment (% chg.)	2.2	0.0	2.0	2.8
Population (millions)	4.122	4.201	4.277	4.358

KEY RESULTS:

- Alberta's economy will slow significantly in 2015 with real GDP growth of 0.8 per cent.
- Labour markets are being affected by rising unemployment.
- Consistently weak oil and natural gas prices have curtailed investment in the energy sector.
- Housing starts remain stable, but softness in residential real estate suggests construction activity will cool.
- Net interprovincial in-migration will slow but should remain positive.

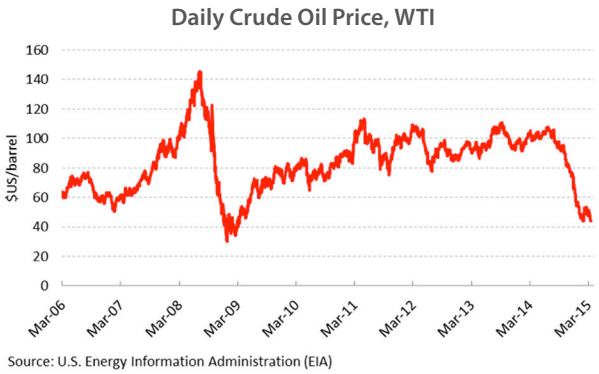
Alberta: Sector Overviews

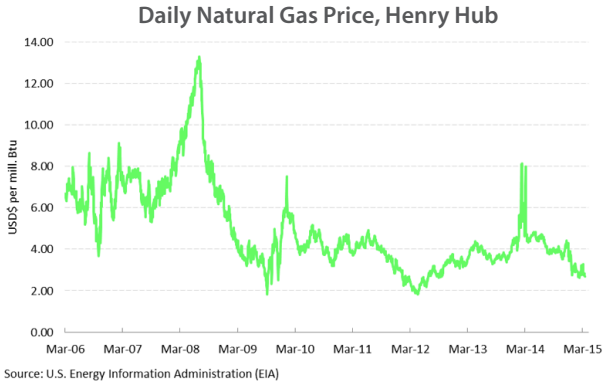
Oil and Gas

North American crude oil price (West Texas Intermediate) fell further in the first three months of 2015 and currently sits close to $US 45 per barrel. OPEC's decision to maintain production combined with reduced global demand from China and other developing nations and ever higher United States crude production has flooded markets.

The glut of oil is beginning to strain crude-storage capacity in the U.S. and abroad. With American crude production at its highest level in more than 80 years, nearly 70 per cent of the nation's storage facilities and tankers are full. With commercial oil and petroleum product inventories inching towards capacity limits, there is a possibility that oil prices could fall further.

In the face of increased supply and limited storage capacity, a lacklustre Canadian dollar has offered some support to our oil producers. The differential between West Texas Intermediate and the Western Canadian Select blend has fallen almost $C 5 since the last *Economic Outlook* (Q1, 2015) and currently hovers slightly below $C 15 per barrel; this has somewhat cushioned the blow of lower prices.





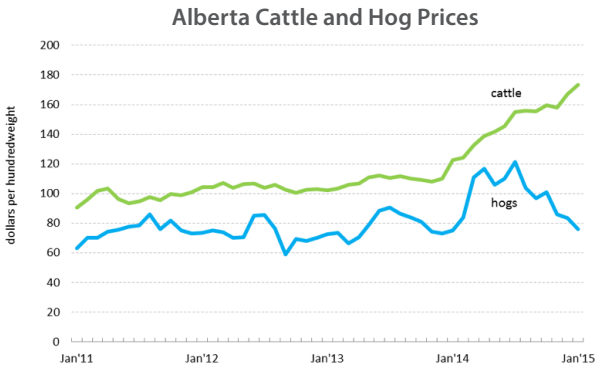
Natural gas prices have slipped back below $US 3 MMbtu range recently. Alberta's natural gas producers continue to struggle against increasing output from the American shale regions. Inventories were low going into the winter heating season and were replaced quickly, but relatively mild winters in both the U.S. and Canada have failed to bring down natural gas inventories and support prices.

Energy transportation and access to markets continue to be a concern for Alberta producers. At the end of February, U.S. President Barack Obama vetoed a bill that would have approved construction of the Keystone XL oil pipeline. In addition, there is still no resolution on the other major pipeline projects (i.e. Northern Gateway, Energy East or TransMountain). But even though significant pipeline development is off the table (for now), rail transportation remains an alternative for transporting Alberta oil.

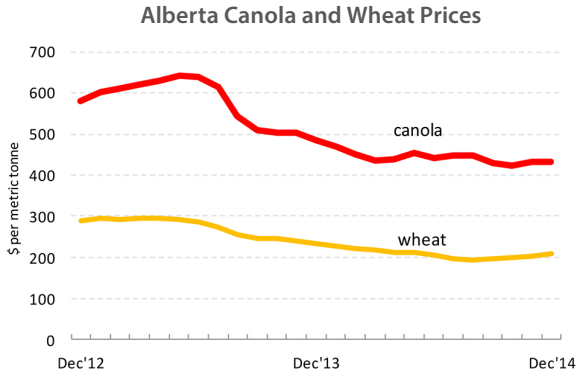
Agriculture and Forestry

Agriculture has been one of the leading sectors in Alberta's economy over the past few years, led by particularly strong cattle prices. These continued to remain high during the first quarter of 2015, suggesting that livestock farmers will see decent cash receipts this year.

Reduced hog supplies prompted by the PEDv virus last year pushed prices higher. Since then, however, hog farmers have increased supply and expanded their farms which has caused prices to fall somewhat. Prices currently sit around $C 1.40/kg, down from $C 1.70 at the start of 2015.



Source: Statistics Canada, CANSIM table 002-0043



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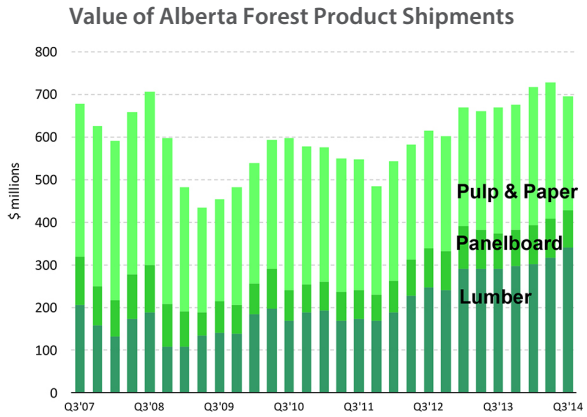


Source: Alberta Forest Products Association, Mar. 6, 2015
Note: includes AFPA member data only

Cattle prices have continued to climb but remain balanced and healthy due to the strong demand for beef. Cattle prices have risen since the end of last year; the most recent data available show that prices currently sit in the $170 per hundredweight range.

Even though hog prices have fallen, the price of cattle will continue to offset the weaker prices for grains and oilseeds. Altogether, the agricultural sector should do reasonably well in 2015.

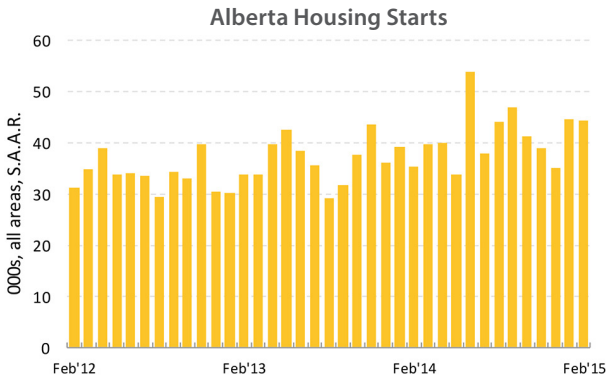
Alberta's forestry sector is expected to perform impressively this year. Increased demand for building materials has been positive for the industry. Over the last couple of years, Alberta's strong housing market has been a significant driver in the growing demand for lumber in our province. But an invigorated housing market in the United States is mostly responsible for the current price increases.

Canada's lower dollar has made our resources more attractive to foreign buyers, too, which will help boost the value of exports to the U.S.

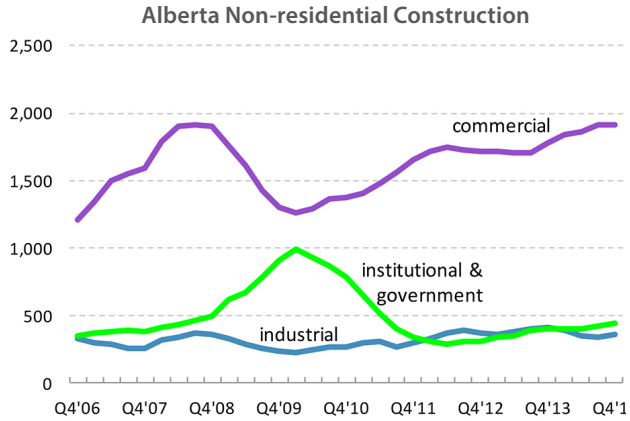
Construction and Real Estate

Housing starts have yet to register any downturn that might be associated with lower oil prices or weaker consumer demand. In February, builders began construction on over 44,000 homes (seasonally adjusted annualized rates or S.A.A.R.). That is above the 12-month average.

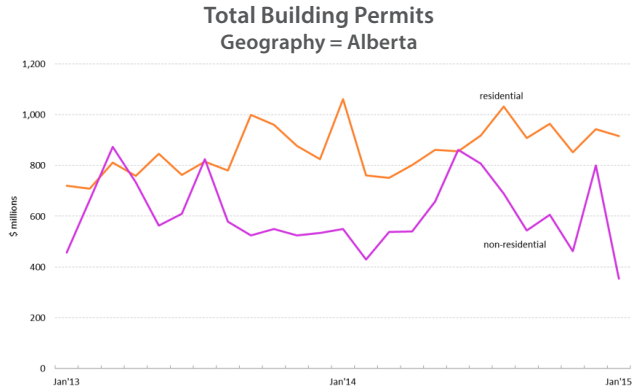
However, new home construction is expected to dip in the coming months. Other real estate metrics such as MLS sales and prices have shown the strain of a broader economic slowdown and home builders are certain to respond with less activity in the second and third quarters of 2015. New construction is likely to slow to the range of 25,000-30,000 per month (annualized rates).



Source: CMHC, Mar. 9, 2015 and Statistics Canada CANSIM table 027-0054



Source: Statistics Canada, The Daily, Jan. 16, 2015 and CANSIM table 026-0016



Source: Statistics Canada, CANSIM table 026-0006

Non-residential construction activity has also yet to respond to the slower economy—at least in the most recent data, which are for the final quarter of 2014. During those three months, total activity edged slightly higher to $2.7 billion (seasonally adjusted). Most of this was commercial real estate projects, particularly office buildings in both Calgary and Edmonton.

Industrial and institutional/government construction was also steady in the fourth quarter.

However, as with the residential building sector, non-residential activity is certain to slow as 2015 progresses. Building permits—an excellent leading indicator of future construction activity—dipped sharply in January to $353 million. That was the lowest level of new building permits in three years. But while building permits have slowed, and are likely to slow further, this is not unexpected. With a large amount of commercial office real estate soon to come onto the market (particularly in Calgary), it would be surprising if new projects are not delayed or postponed until 2016 or beyond.

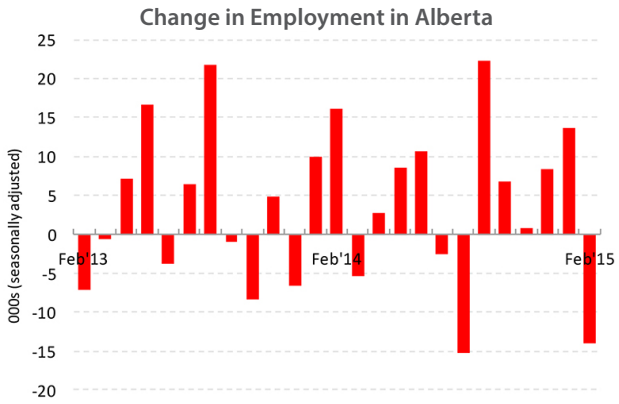
Labour Market

The economic slowdown appears to be taking a toll on jobs in Alberta. While there has been much anecdotal evidence of job losses over the last several months, February provides the first statistical evidence of a deteriorating labour market.

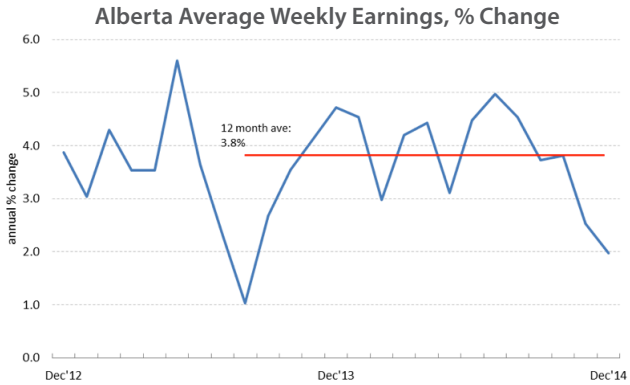
In February, net employment fell by 14,000—one of the largest monthly decreases in some time. The unemployment rate rose to 5.3 per cent, up from a very low 4.5 per cent in January.

Most of the job losses in February were concentrated in predictable industries. Resource extraction sectors lost 7,000. A category of jobs labelled "professional, scientific and technical services"—which would be largely occupations such as engineers, geologists and other positions central to oil and gas extraction—shed 6,900. Retail trade jobs also showed a drop of more than 10,000.

Still, there were some sectors that gained ground. Construction employment rose by 7,000 month-over-month and jobs in health care and social assistance advanced by 5,900.



Source: Statistics Canada, The Daily, Mar. 13, 2015 and CANSIM table 282-0087



Source: Statistics Canada, The Daily, February 26, 2015, CANSIM table 281-0063

Average weekly earnings in Alberta rose to $1,163 in December (seasonally adjusted), matching the record high set two months previous. But while earnings remained elevated, the year-over-year rate of increase dipped to just below two per cent. The Survey of Employment, Payroll and Hours (SEPH) captures earnings of employees but does not include workers who have recently lost their jobs. As such, it may exaggerate how well workers in Alberta were doing in December.

The loss of employment and general weakening of the labour market in our province is unfortunate, but expected. While many employers appeared to be keeping workers as long as they could, by February, the cost pressures forced some layoffs. With oil prices remaining low going into the second quarter of the year, we can anticipate a few more unpleasant job reports in the short term.

Retail, Wholesale and Manufacturing

Retail sales in Alberta have reacted quickly and sharply to the economic slowdown. Total sales at retail outlets dropped to $6.26 billion in January (seasonally adjusted), down 6.5 per cent from the record high set only four months prior in September 2014. It was the fourth consecutive month of declines for retailers and the rate of decline appears to have picked up speed. It appears the anxiety of job security has started to weigh on Alberta consumers.

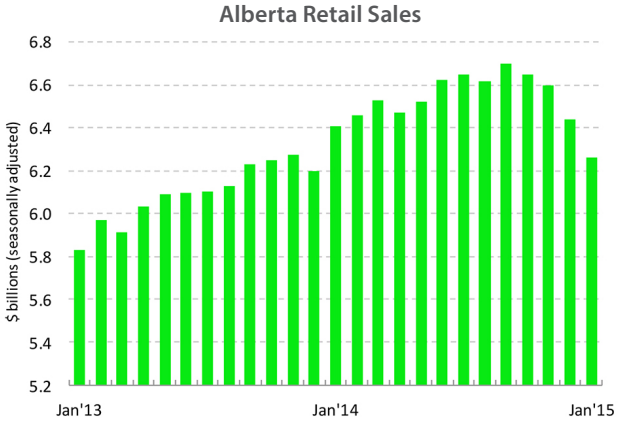
But as with other indicators that have shown some strain in the face of the economic slowdown (e.g. employment), the drop in retail activity should come as no surprise. Even without the slowing of the economy, some pullback in retails sales was expected as consumer fatigue set in. New record highs month-after-month cannot be maintained indefinitely.

Wholesalers were able to maintain a consistent level of activity in January with sales of $7.1 billion. Over the last 12 months, total wholesale trade is up 7.5 per cent compared to the previous 12-month period. However, this too is expected to show some degree of decline in the coming months as retail activity eases back.

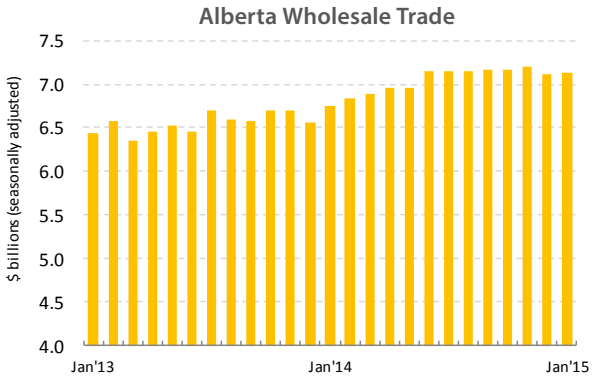
Like retail sales, manufacturing in Alberta has shown clear signs of pull-back over the last few months. In January, shipments from manufacturers totalled just under $5.9 billion—the lowest level since August 2012.

While most manufacturers of inputs into oil and gas extraction have been affected by the downturn, much of the present slide in manufacturing is a result of lower prices for refined petroleum products (e.g. gasoline).

Some of Alberta's manufacturers, particularly those in forestry and food products, continue to do well and provide some offset to the downturn in the energy sector.



Source: Statistics Canada, The Daily, Mar. 20, 2015 and CANSIM table 080-0020

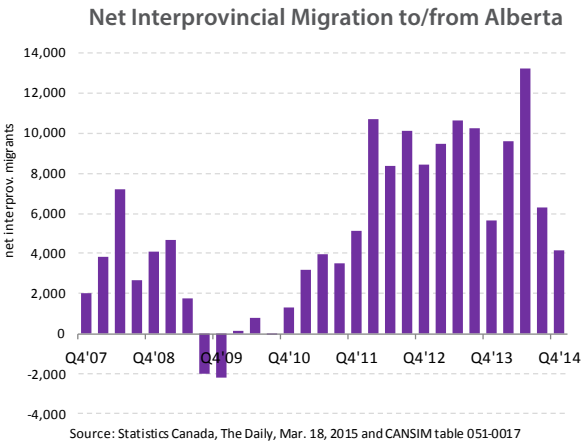


Source: Statistics Canada, The Daily, Mar. 18, 20145and CANSIM table 081-0011

Source: Statistics Canada, The Daily, Mar. 17, 2015, and CANSIM table 304-0015

Interprovincial Migration

Alberta experienced strong interprovincial in-migration last year, although it has since slowed. In the fourth quarter of 2014, the province saw a net gain of 4,178—the slowest rate of growth since 2011. Over the entire calendar year in 2014, Alberta was the destination of a net 33,283 Canadians from other provinces (that is, new entrants to Alberta minus those who left the province).

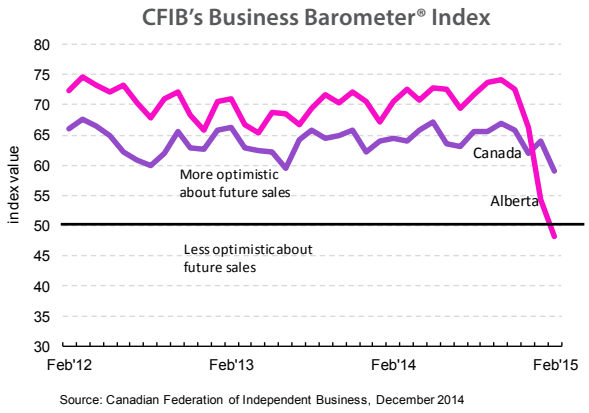


In-migration from other provinces is being accompanied by strong international inflow as well. Alberta's annual net international migration position has been increasing from the 20,000-25,000 range a few years ago to over 35,000 today. These factors have been a driving force for the residential real estate market and retail sales in the province.

But in-migration to Alberta is likely to continue to slow—both from other parts of the country and internationally. The energy sector slowdown will result in fewer new job openings. As well, better economic results in Ontario and Quebec in 2015 will discourage as much migration from those provinces to the Prairies. Total net in-migration is likely to fall from over 75,000 in 2014 to closer to 40,000 in 2015, with the most significant drop coming from fewer interprovincial migrants.

Business Confidence

Business confidence here in Alberta is the lowest in the country according to a recent survey of small- and medium-sized businesses in our province. With an index in February of 48.2, Alberta is only a dozen or so points above its previous recessionary lows from early 2009. Likewise, hiring plans have also weakened, with only 20 per cent of owners expecting to add full-time staff, versus 17 per cent who plan to cut back—conditions we have not seen since 2010. Still, 47 per cent of owners say their businesses are in good shape—remaining above the national average.



Q2 Update of Risk Scenarios for Global Energy Prices and Implications for Alberta

Outlined below are three updated scenarios for average oil prices in 2015. Each scenario lists implications for Alberta's economy.

SCENARIO ONE

Global economic growth slows further; OPEC continues to refuse curtailing current production levels.
WTI= $US 40-50/bbl

PROBABILITY: SOMEWHAT LIKELY

- High cost oil producers (i.e. Bakken, Russia, Venezuela, Alberta, etc.) continue to reduce investment in new projects, creating a price floor for WTI of around $US 40/bbl.
- Oil continues to be stored in the hope that both demand and prices will pick up in the future. Storage space reaches capacity and drives prices down again.
- Several more oilsands projects in Alberta are deferred or cancelled; conventional drilling continues to be scaled back.
- More layoffs are announced, especially by smaller energy producers with less cash reserves.
- Oil-related occupations (drilling contractors, geologists, engineers and other technical services) continue to be scaled back.
- Lower oil prices continue to chip away at the costs for Alberta's producers, which helps restore some cost-benefit balance in the sector.
- Alberta's unemployment rate rises to 7.5 to 8.0 per cent by the end of 2015.
- Provincial real GDP growth slows to 0 to -1.0 per cent.

SCENARIO TWO

Global economic growth stabilizes; OPEC members unable to maintain current production levels indefinitely and prices start to rebound by summer or early fall.
WTI = $US 50-60

PROBABILITY: MOST LIKELY

- Some high-cost producers come off the market, including some OPEC members (e.g. Venezuela, Nigeria).
- Restocking continues and storage space for oil remains available (albeit near capacity).
- Prices continue to drop, but start to stabilize at $US 45 before rebounding above $US 55 in the summer, ultimately testing $US 60/bbl by year's end.
- More oilsands projects in Alberta are delayed or scaled back, conventional drilling is reduced.
- Layoffs in Alberta's energy sector and energy service providers, contractors, etc. continue.
- Alberta's unemployment rate rises to 6.0 to 6.5 per cent by the end of 2015.
- Provincial real GDP growth slows to around 0.5 to 1.0 per cent.

SCENARIO THREE

Global economic growth accelerates, OPEC blinks and oil production falls.
WTI = $US 60-75

PROBABILITY: LEAST LIKELY

- OPEC producers fail to maintain production levels; the cartel loses its effectiveness and oil output falls.
- Global demand for oil ramps up; oil prices rise to a level closer to supply and demand fundamentals.
- Fewer oilsands projects in Alberta are delayed or scaled back, conventional drilling stabilizes in the summer and picks up in the fall.
- Layoffs in Alberta are relatively modest and the province's unemployment rate remains balanced in the 5.5 to 6.5 per cent range.
- Provincial real GDP growth for 2015 moves to 1.5 per cent.

Summary

Alberta's economy enjoyed a solid year of growth in 2014 and continued to outperform the rest of Canada. But with oil prices falling—and consumer and business optimism sliding—the provincial economy is facing a challenging 2015.

The energy sector has just started to absorb the impact of oil prices that have dropped nearly 60 per cent from a year ago. Despite the low Canadian dollar and a reasonably narrow differential, Alberta producers are suffering restricted cash flow. Capital expenditure plans have been scaled back and employment has started to fall. This is an unpleasant but entirely normal pattern for a labour market that has faced energy price shocks numerous times in the past. The job market is almost certain to show further stress in the second quarter of the year.

Of the three oil price scenarios presented in this report, the second scenario is most probable—that is, WTI prices will average within a range of $US 50-60 per barrel. Oil prices could fall further in the second quarter of the year, and the current price volatility suggests that the bottom of the market has not yet been tested. However, prices should stabilize by the summer or early autumn with some gradual price improvement towards the end of the year.

Despite the severe challenges in the energy sector, many other industries in the province face much brighter prospects in 2015. Agriculture, forestry and tourism all benefit from lower fuel prices. The lower Canadian dollar will also help commodity exporters and tourism operators.

The ATB Financial Economics and Research team projects real GDP growth of 0.8 per cent in 2015, with modest recovery in 2016 and 2017.