ALBERTA ECONOMIC OUTLOOK

Q2 2016

Prepared by ATB Financial, Economics & Research

April 2016

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Released quarterly, ATB Financial's Economic Outlook summarizes Alberta's current economic landscape to give us an idea of what the future may look like. The Economic Outlook aims to provide Albertans with economic commentary that is clear and meaningful.

Key Results:

- Alberta's economy contracted by about 1.7 per cent last year; less of a contraction is likely in 2016, with modest growth possible for 2017.
- Oil prices remain in line with first quarter forecast levels and are not expected to recover substantially for some time.
- The petroleum sector and related industries will continue to shed labour, pushing unemployment above seven per cent.
- Weak consumer demand will weigh on residential housing and retail activity.
- Net interprovincial migration will likely be negative for the first time since 2009.

Provincial Overview

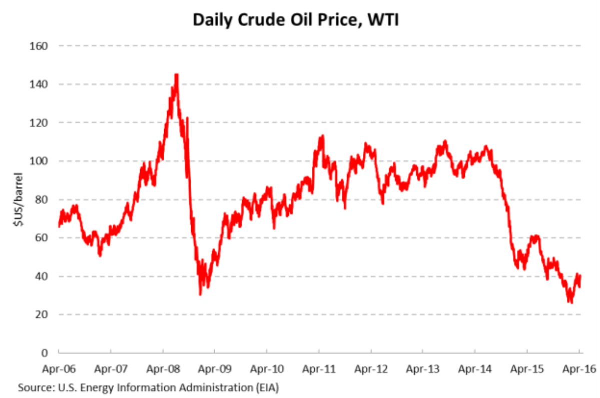
Excess global oil supply, instability in securities markets, as well as tensions in Europe and in the Middle East have kept the price of oil pinned down for some time. West Texas Intermediate (WTI) fell to about $US 27 per barrel to start the year, but has since recovered somewhat. Despite the slight improvement, prices still remain unstable and oil is not expected to recover substantially for a while. This low price environment has discouraged investment and spending and has had a negative effect on Alberta's employment picture and throughout most sectors of our province.

The current projection by ATB's economics and research team is for real GDP to contract again in 2016 (-1.3 per cent), with gradual recovery in the second half of the year and in 2017.

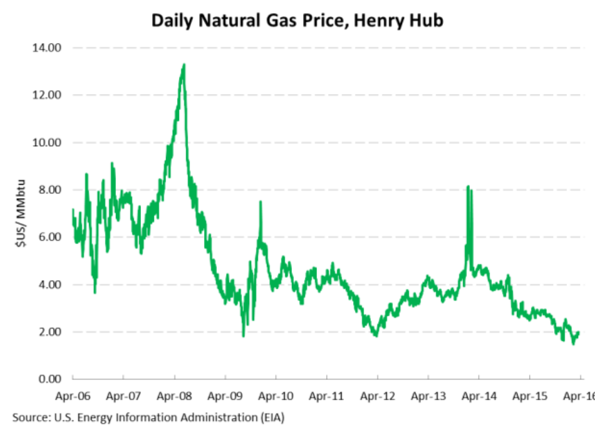
	Forecast by Year			
	2015	**2016**	**2017**	**2018**
Real GDP growth (%)	**-1.7**	**-1.3**	**1.5**	**2.2**
Consumer price index (annual % change)	1.2	1.2	1.5	1.8
Unemployment rate (%)	6.0	7.9	7.5	6.8
Employment (% change)	1.2	-1.9	1.7	1.8
Population (millions)	4.196	4.250	4.311	4.384

Oil and Gas

Alberta continues to joust with low oil prices and their adverse effect on our economy. Even in the face of falling rig counts at home (and abroad) and with numerous rounds of spending cuts from energy companies, the oil market is still far from reaching a balanced state. Furthermore, even if oil production is frozen by members of the Organization of Petroleum Exporting Countries (OPEC), a multitude of potential sources of oil production and other reasons exist that may keep oil's price repressed and unpredictable.



Oil prices continue to fluctuate by a few dollars each day. Prices fell sharply to $US 27 at the start of the year and now sit in the $US 36-39 range. Uncertainty about production and instability in markets are the main drivers of price volatility. Come summer, the price environment may be even more uncertain. Market anxiety may increase due to a potential Brexit or Grexit that would have a negative impact on Alberta because of our tight tie to commodities.



At the same time, there are a number of possible scenarios that would see oil nudge higher. Stronger economic growth in China and other emerging market economies, tied with some pullback in Middle East oil production due to a spike in violence could push oil back up past $US 70.

Unfortunately, prices could also drop. A severe pullback in China or other emerging nations coupled with increases in the oil supply could cause oil to fall to $US 20 per barrel. The best estimate at this point is that oil prices will remain volatile and weak into summer and edge up above $US 45 per barrel by the end of the year.

For many of Alberta's producers this price scenario is still problematic. Investment in both conventional and non-conventional crude oil production is expected to fall again. This will continue to weigh on employment in Alberta and run through other sectors in our province as well. The unpredictability of markets will continue to affect the price of oil and remain a key concern for our province's oil producers and peripheral sectors.

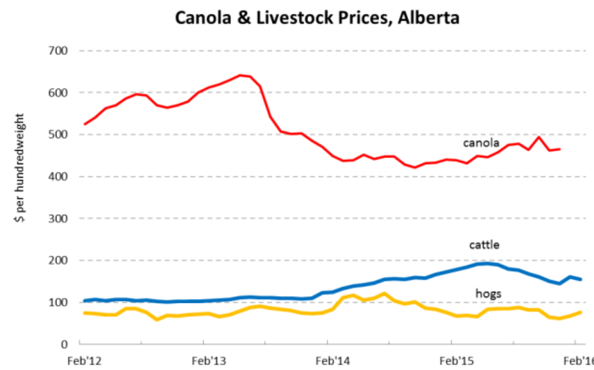
Energy transportation remains another significant challenge and a contentious issue facing the energy industry. Last November, President Obama formally denied the Keystone XL pipeline proposal. There are still no resolutions or further signs that any of the other major pipeline projects (Northern Gateway, Energy East or TransMountain) will be moving Alberta oil to tidewater anytime soon.

Natural gas prices remained subdued to start the year, ranging around $US 2.0 to 2.2 MMBtu. The average for this year so far is $US 2.00 MMBtu. Additionally, warmer winter conditions across North America failed to draw on natural gas inventories, thus keeping the price in a low territory. Gas prices are unlikely to climb higher this year.

Agriculture and Forestry

Even though Alberta's oil and gas sector is set to battle economic headwinds again this year, Alberta's agriculture industry is well-positioned to fend off potential financial troubles and give our economy a boost.

Grain and oilseed prices have remained stable and at decent levels for Alberta farmers to start the year. If Alberta farmers experience decent growing conditions throughout the spring and summer, agriculture may be in for a fruitful 2016.



Source: Statistics Canada, CANSIM table 002-0043

Cattle prices have come off from their record highs—but still remain strong—held up by solid foreign and domestic demand for Alberta beef. The most recent data available show that cattle prices currently sit in the $155 per hundredweight range. Hog prices also remain stable and have gained some ground since the end of last year. It's no surprise that with higher meat prices, Alberta's animal producers are seeing their revenue and income grow more significantly than all other farm types.

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

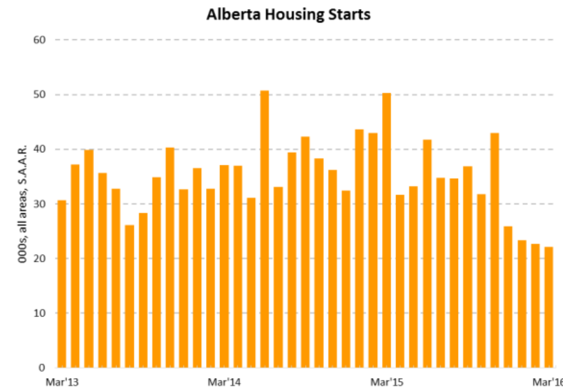
The star of the show throughout 2016 will remain Alberta's forestry sector. Even though North American lumber prices have dampened somewhat, demand from US home builders will remain strong this year. The benchmark lumber price is just above $US 300 per thousand board feet, very close to the 10 year average.

The forestry sector will continue to gain from strong job applications—a side-effect of weak oil prices and layoffs in the petroleum sector. Still, challenges lie ahead in 2016 for this sector. The Softwood Lumber Agreement with the United States expired last October. Now both countries are in a one year "standstill period" during which both sides are prohibited from imposing duties or tariffs. Achieving a new agreement this year is critical for the future of Alberta's and Canada's forestry industry.

Canada's sunken loonie didn't have much of an impact last year. However, this year, the benefits of a weaker loonie should kick into gear and really benefit our farmers, ranchers and forestry operators. As a result, both agriculture and forest product manufacturing are again expected to be two leading industries in our province this year.

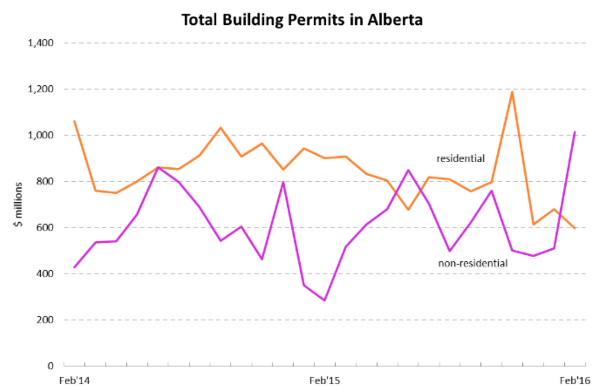
Construction and Real Estate

There are obvious signs that construction activity in Alberta is set to slacken further. Construction of new housing, for example, fell to 19,853 (seasonally adjusted at annualized rates) in March, a 58 per cent reduction from a year earlier and the lowest monthly total since April 2011.



Source: CMHC, Statistics Canada CANSIM Table 027-0054

As 2016 moves on, it's likely that new housing construction will shrink considerably. Oil prices aren't expected to gain in any material fashion and interprovincial in-migration is also set to turn negative for the first time since 2009. This, coupled with competition from existing home sales, could leave many new houses vacant, which will drive construction activity down. For 2016, ATB Financial projects about a 35 per cent reduction in the amount of new housing starts compared to last year.



Source: Statistics Canada, CANSIM table 026-0006

Non-residential construction spending will see some pullback in 2016 and 2017 due to the large amount of commercial office space soon coming onto the market in both major cities. However, this will be partially offset by an increase in government and institutional spending. Bolstered by announcements in both the recent federal and provincial budgets, infrastructure spending is expected to ramp up over the next few years.

Recent building permit data also reveal a weaker construction sector. Even though there was a 40 per cent year-over-year increase in the value of building permits in February, Edmonton alone was responsible for this increase.

Alberta's capital city accounted for nearly 70 per cent ($1.1 billion) of the total building permits issued in February. Given economic sentiment at the moment, it is interesting to see that the majority ($656 million) of the permits issued were for commercial projects within the city.

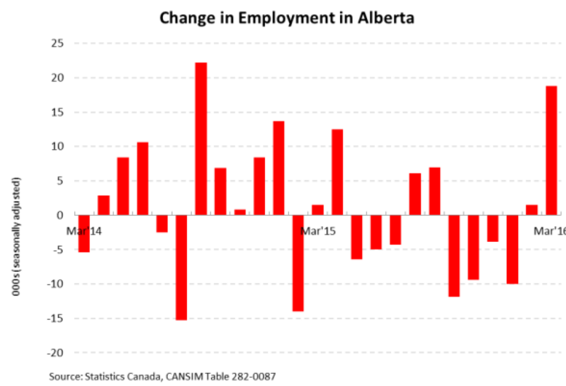
But while construction is likely to continue in Edmonton, Alberta's building permits as a whole are weak. It's important to remember that many towns and cities in Alberta will continue to ride out the effects of the energy slowdown which will translate into slower construction and real estate activity.

Lastly, average home prices have been relatively stable. In Calgary, prices are down one per cent year-over-year. In Edmonton, prices have actually appreciated by about two per cent. As consumer sentiment stays wary, and as some Albertans look for economic opportunities in other provinces, home prices may tick lower.

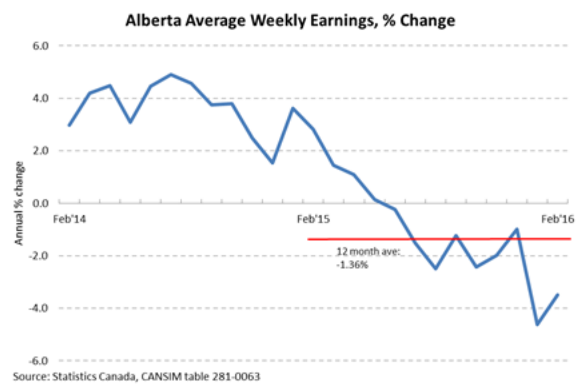
Labour Market

Over the first three months of the year, Alberta's job market seems to be showing some encouraging signs of improvement. After five months of decline, our province added jobs in February (+1,500). Despite this, the unemployment rate actually jumped higher by half a percentage point to 7.9 per cent, the highest in over 20 years. The reason for the jump in the jobless rate (even as jobs were added) is the labour force increased by an even greater amount, rising by 14,100 as more job-seekers entered the labour market.

Additionally, the latest Labour Force Survey showed that a whopping 19,000 jobs were added in March—the highest monthly advance in employment in over two years. Of the new jobs gained, the vast majority of them (14,500) were full-time positions. The sector that had been losing thousands of positions—the resource sector—actually eked out a small gain in total employment for the month. The only sector that continued to suffer major job losses was manufacturing (-7,900). With the gain in employment, the province's unemployment rate dropped from 7.9 per cent in February down to 7.1 per cent in March—matching the national average for the month.



For the remainder of 2016, it's possible that Alberta could experience a few more months of lay-offs. However, with some improvement in oil prices, the labour market could stabilize by the second half of the year. ATB is projecting that the unemployment rate will average 7.7 per cent in 2016.

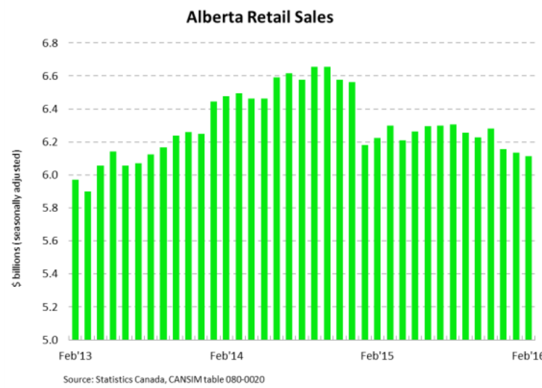


The latest average weekly earnings figures from February showed that wages in Alberta were $1,118.48. This is actually up from $1,114.88 in January but down from $1,158.87 in February 2015. Compared to a year ago, earnings in the province are off by 3.5 per cent. Falling average earnings in Alberta are a clear indication of a softer economy, particularly as fewer overtime hours are requested by employers. This trend will likely continue over the next couple of months.

The fact that wages continue to fall shows that wage costs are still trying to correct the cost imbalance that has afflicted Alberta's economy, especially in the oil and gas sector. Unfortunately, it still imposes a painful adjustment on households and will spill-over into other sectors throughout the year.

Retail, Wholesale and Manufacturing

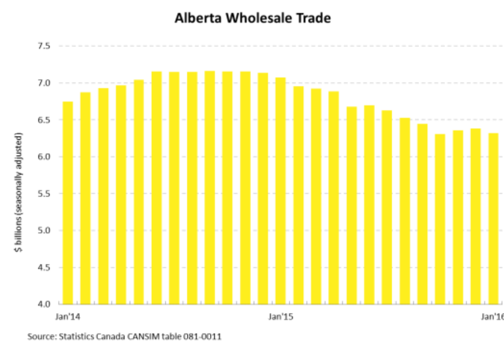
Albertans sat on their wallets during the kick off to 2016. In January, retail sales fell by 0.2 per cent compared to December to $6.13 billion dollars (seasonally adjusted) This was the lowest monthly total for retail activity since August 2013. The latest numbers show that consumer spending also dipped again in February ($6.11 billion).



But, given the severity of the economic situation and the plunge in other measures of consumer sentiment, the fact that sales are down by just over four per cent over the past twelve months is surprisng. Comparing February's figure with the all-time record high for retail sales set in October 2014, sales are down eight per cent.

For Alberta, the slumping retail figures are another discouraging sign of a struggling economy. In the coming months, as wages are scaled back and consumer confidence stays muted, retail sales as a whole are expected to dip further.

Wholesale activity has also lagged over the last 12 months. Total sales reached $6.3 billion (seasonally adjusted) in January, down 11 per cent from a year previous.



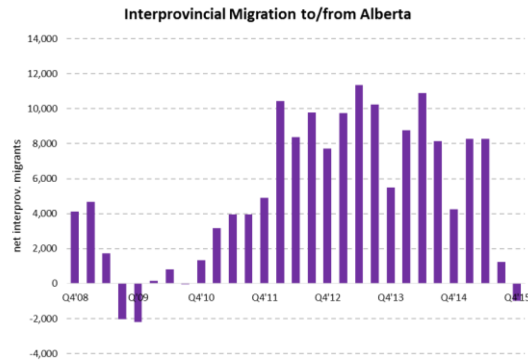
There is potential for wholesale activity to continue its decline throughout 2016. Wholesalers will feel the effects of a slower retail sector which will inevitably weigh on wholesale activity as a whole.

For the sixth time in seven months, manufacturing shipments in Alberta slipped at the beginning of 2016. Manufacturing shipments totalled $5.1 billion, a four per cent drop from December of last year and a 13 per cent drop from one year earlier. Activity was at the lowest point in the province since July 2010. Not surprisingly, the drop in total sales was largely the result of lower sales of petroleum and coal products and fabricated metal products.

Difficulties in the energy sector have caused ongoing declines in refined petroleum product prices. Petroleum was Alberta's largest manufacturing industry from January 2009 to September 2015 in terms of sales. It has since fallen behind both food and chemical manufacturing to become Alberta's third largest manufacturing industry.

There's no doubt that Alberta's manufacturers are struggling with low energy prices. But, even though the petroleum industry is hurting, there appears to be some organic diversity taking place within the sector. Electrical equipment, appliance and component, miscellaneous (medical equipment and supplies, jewellery, sporting goods, toys and office supplies, etc.), and paper manufacturing are making strong gains and may help offset some of the hurt energy prices have dished out on our manufacturing industry as a whole. Like agriculture and forestry, a lower Canadian dollar will likely liven manufacturing activity this year.

Interprovincial Migration



Source: Statistics Canada, CANSIM Table 051-00117

Alberta experienced strong net interprovincial in-migration over the first two quarters of 2015. Migration remained positive in the third quarter, however, the amount of people making our province home declined dramatically. As of the fourth quarter, Alberta actually saw a net loss of about 1,000 people to other provinces.

In 2016, it's likely that we could see a net outflow of people persist, especially over the first two quarters. The energy sector is expected to remain in a delicate state and there is likely to be fewer new job openings. Better economic outlooks for other provinces such as Ontario and British Columbia this year will discourage migration (from other provinces) to Alberta as well.

Total net in-migration (international and interprovincial) is likely to fall from about 36,000 in 2015 to about half (approximately 19,000) in 2016.

Summary

ATB Financial's revised Economic Outlook holds little promise of a quick economic rebound for Alberta. Excess global supply from OPEC producers, together with greater uncertainty in Europe, China and the Middle East, continues to affect oil prices daily and will likely persist throughout the course of the year. As expected, this will continue to cause Alberta energy producers pain and is the sole reason for why our forecast has been downgraded.

As our energy producers continue to wrestle prices in the oil patch, some of the hurt is still expected to spill over into other industries peripheral to petroleum extraction, particularly manufacturing and construction. This will effectively keep consumer sentiment subdued and has potential to mute Alberta's housing market further. All of this has and will result in a weaker job market this year.

However, it's not all negative news. Agriculture, forestry, tourism and Alberta's entertainment industries are expected to have another good year. Even though the Canadian dollar has inched higher in recent weeks, prospects for 2016 are still positive for commodity exporters and tourism operators.

The economics and research team at ATB Financial is projecting a contraction of 1.3 per cent in 2016, with a return to moderate growth in 2017. Most of the stress on the economy and labour market are expected to continue until autumn, when oil prices are expected to move into the $US 45 range.