ATB Financial's Alberta Economic Outlook February 2018

Economics and Research, ATB Financial

Released four times a year, ATB Financial's *Alberta Economic Outlook* summarizes the province's current economic landscape to give us an idea of what the future may hold for our economy.

Overview

Alberta entered 2018 in much better shape than a year ago when the economy was crawling out from under the 2015-16 contraction. With growth returning, it is time for Albertans to shift away from a mentality of recession, to one oriented toward expansion. Still, challenges exist.

North American benchmark oil prices have increased, yet Western Canadian prices have barely budged due to pipeline capacity constraints to US markets. NAFTA negotiations and ongoing opposition to the Trans Mountain Pipeline expansion are creating uncertainty. Household debt levels are high, and interest rates are likely to rise.

Key Findings:

- US oil prices have been stronger this year.
- The price for Alberta's heavy crude has not enjoyed the same increase, which has widened the differential.
- Alberta will continue to see job creation in 2018, but the unemployment rate will come down only gradually.
- Housing prices will improve modestly over the last year; housing starts will be unchanged or slightly lower.
- Net inter-provincial migration should return to positive in 2018.

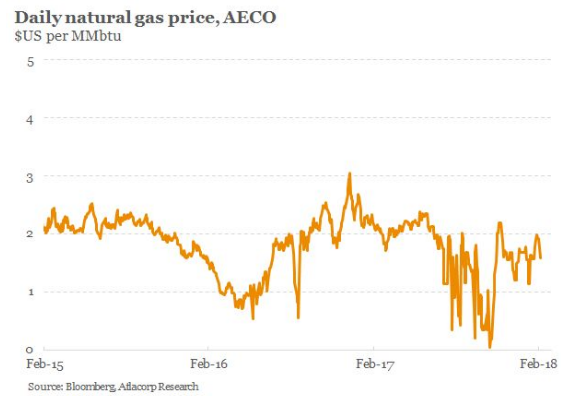
On balance, however, Alberta's economy continues to edge forward. ATB Financial's Economics and Research team is forecasting real GDP growth this year of 2.8 per cent, followed by 2.2 per cent in 2019.

	2017	2018	2019	2020
Real GDP growth (annual (% change)	3.9	2.8	2.2	2.0
Consumer price index (annual % change)	1.6	1.7	1.5	1.6
Unemployment rate (%)	7.9	6.8	6.4	6.1
Employment (annual % change)	1.0	1.0	2.0	1.7
Housing starts (000s)	29.3	28.3	26.9	26.0

Oil and gas

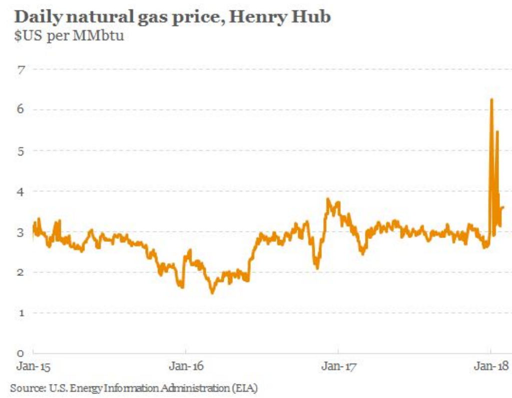
Since the end of last year, US benchmark oil prices have significantly improved. Draws on inventories and a continued rebalancing of supply and demand have lifted the price of West Texas Intermediate (WTI) crude. Since ATB Financial's last Alberta Economic Outlook, WTI has increased from about $US 50 per barrel to around $US 64 per barrel. OPEC's now two-year-old decision to cut its crude oil production by nearly two million barrels per day has helped to drive some of this increase.

Last year, there were concerns that US shale output would counteract the effects of the OPEC cut and keep oil's price pinned lower. This is still a concern. According to the International Energy Agency, the US is on pace to surpass Saudi Arabia and Russia as the world's largest oil producer. If OPEC halts its production cuts and the US continues to produce more oil, there may be another supply glut and prices could slump again.



While the price of WTI has improved, the benchmark price for the heavy oil produced in Alberta -- Western Canadian Select (WCS) -- has not followed the same price path. WCS prices have averaged around $US 37 per barrel so far this year, roughly eight per cent lower than the last three months of 2017. Unfortunately, the WCS price is being held back by transportation bottlenecks into the US market, emphasizing the need for new pipeline capacity and the option to ship more oil to Asian markets. Unfortunately, BC's political opposition to the Trans Mountain Pipeline expansion (which intends to move bitumen from Edmonton to Burnaby) is adding to the cost and uncertainty of the project. Crude-by-rail options could help alleviate some of the transportation bottlenecks, but without solid progress on pipelines this year, the future of investment in the industry is unclear.

Amid rising US production, ATB's economics team anticipates that oil prices will average around $US 59 per barrel (WTI) this year and move slightly higher next year. New projects related to non-conventional extraction (i.e., oilsands) are underway and will help boost overall investment in the province. Going forward large investments in new oilsands projects are unlikely to materialize given the current price environment. In this new price regime, the energy sector will continue to evolve towards greater investment in quick, small-scale projects rather than long-term, large-scale projects. As such, overall growth in energy investment will be slower than before the downturn but will remain a backbone of the economy. This year, we expect energy investment to grow by four to seven per cent.



Last year the Alberta benchmark for natural gas (AECO spot price) started on a brighter note; however, the price failed to maintain that momentum. So far in 2018, the price has hovered between $US 1.50 and $US 1.80/MMBtu. Despite the frigid temperatures that tortured the province at the end of last year, soft natural gas prices are the direct result of weaker demand and higher inventories. We anticipate natural gas prices to average slightly below $US 2.00/mmBTU (AECO) this year. Meanwhile, the North American Henry Hub benchmark is expected to average around $US 3.20/MMBtu in 2018.

Labour market

Employment slipped a bit in January (-5,600), but full-time jobs roared ahead month-over-month, offset by a drop in part-time jobs. The decline in total employment in January comes on the heels of three months of job gains at the end of 2017, during which the province gained 38,000 jobs.

The big story in the job market, however, has been the steady improvement in the quality of jobs. Compared to a year ago, full-time jobs are up 88,800 (+4.9 per cent)--the strongest performance of any province in the country. Job gains have been concentrated in manufacturing, natural resources and finance, insurance and real estate.

Both business confidence and overall economic conditions have continued to improve over the course of 2017. The greater degree of optimism has resulted in a better job market that should continue to improve in 2018.

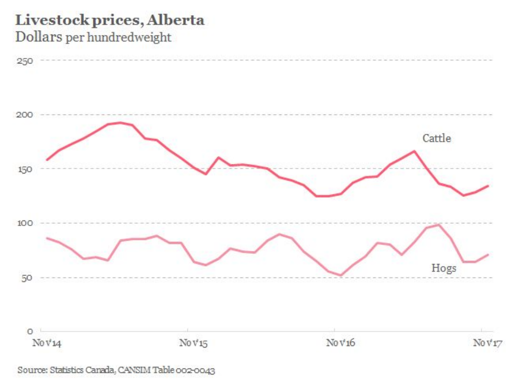
After averaging 7.9 per cent in 2017, Alberta's unemployment rate is expected to average 6.8 per cent this year and fall to 6.4 per cent in 2019.

In one of the clearest signs of Alberta's economic recovery, many working Albertans may be starting to notice some changes to their pay cheques. Compared to the same month last year, wages were 2.5 per cent higher (wage data are before taxes, include overtime pay and are adjusted for seasonality). Improving wages in the coming year will continue to support the province's retail and housing sectors.

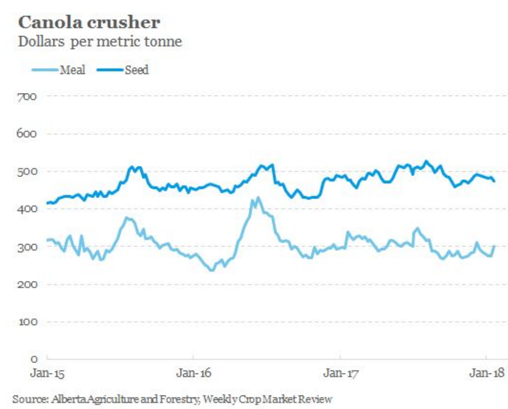
In November, the average weekly wage in Alberta was $1,144 compared to $988 nationally. The average wage in Alberta remains the highest among the provinces. Workers in Alberta's oil and gas extraction sector are still paid the highest among all sectors at $2,219 per week but have seen average wages fall compared to the same time last year by -6.1 per cent.

Agriculture and forestry

The bovine tuberculosis scare that threatened cattle ranchers across the province at the end of 2016 has subsided, and cattle prices are now inching higher again. The data show cattle prices have improved, moving up about seven per cent from 2017's low (October). As of November, prices hovered around $134 per hundredweight. Despite improvement at the end of 2017, cattle prices continue to be well below their record highs reached in 2015 (approximately $190 per hundredweight). The drop in price from 2015 is mainly due to increased herd size.



More optimism exists around hog prices. In November, the price of Alberta hogs was $70.51 per hundredweight, about 37 per cent higher than the same month one year earlier. Many anticipate a stronger demand for Alberta pork this year as the Canada-European Union Comprehensive Economic and Trade Agreement (CETA) comes into effect, opening up new markets for Canada's pork producers.



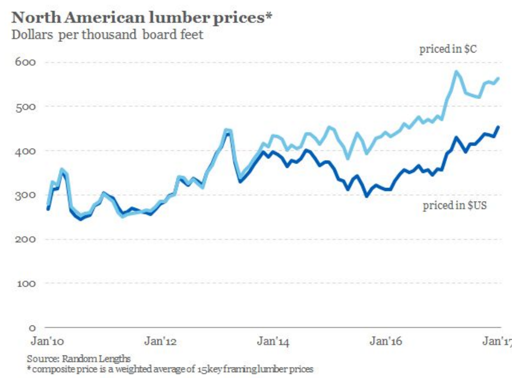
Like cattle prices, canola has also experienced a bit of trouble. At the tail end of 2017, canola crusher prices (the primary input into canola oil) nearly touched the annual high. However, as the new year rolled around, the price fell again. Prices for canola crusher currently sit around where they were last year ($470 per metric tonne). Meanwhile, wheat prices (non-durum) have improved compared to a year ago. Drought conditions in parts of the US have helped boost prices.

Even though Alberta's forestry industry has had to deal with the expiry of the Canada-US Softwood Lumber agreement and steep tariffs on Canadian lumber imports, Alberta's forestry sector is likely performing better than many expected.

As of January, the average benchmark price for North American framing lumber remained strong. At the beginning of this year, the average price was $US 453 per thousand board feet (American industry group, Random Lengths, calculates the price based on the average of 15 key framing lumber prices). January's price was up two per cent from December, but prices are up 27 per cent from the beginning of 2017. The strong prices are likely due to diminished supply from last summer's forest fires in British Columbia, as well as increased demand stemming from robust US home building.

But while pricing is still strong, Canada's forestry sector is facing some trade-related challenges. Domestic producers are dealing with steep tariffs on lumber exports to the US and a new trade agreement on softwood lumber is not expected anytime soon, if at all. The tariffs and uncertainty surrounding a new softwood arrangement—and Canada-US trade concerning the renegotiation of NAFTA—could slow the province's forestry industry going forward.

Despite ongoing price fluctuations and trade battles, the agriculture and forestry sectors have new reasons for optimism. That's because Canada is set to join 10 other countries to form the much-awaited Comprehensive and Progressive Agreement for Trans-Pacific Partnership, or CPTPP (formerly the TPP). For Canada, the benefits of the agreement are focused around the seafood, mining, non-dairy agriculture, forestry and manufacturing industries. It will take some time before the agreement is in effect and for Alberta producers to take advantage of it, but the CPTPP bodes well for the long-term market diversification of Alberta agriculture and forestry.

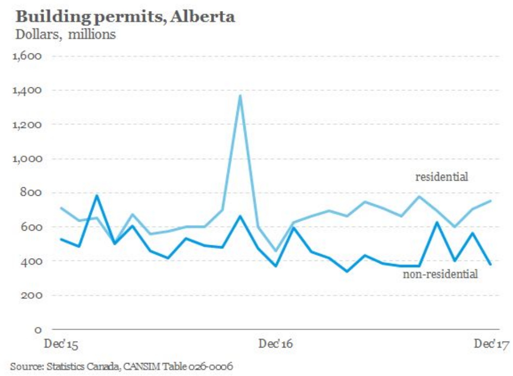


Construction and real estate

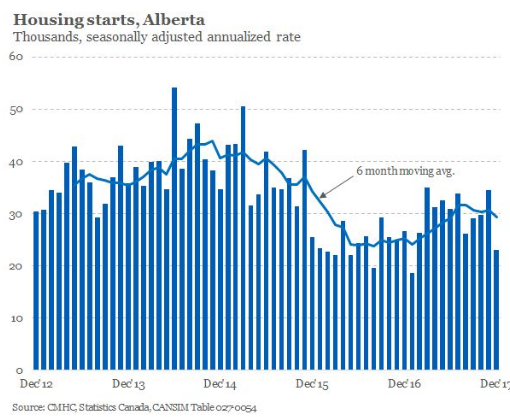
In December, building permits in Alberta slipped to $1.13 billion, down 11 per cent from November. That was due to a 32 per cent month-over-month drop in non-residential permits. Residential permits edged slightly higher than the previous month.

But the longer-term perspective is less dismal. For the year overall, the value of permits in 2017 rose by a third over 2016. Most of that was residential permits, which grew 63 per cent from the previous year. Non-residential permits were unchanged.

Given the large volume of commercial real estate on the market in Alberta's major cities, a significant pull-back in non-residential building permits is expected in 2018. That will be partially offset by stable or slightly higher permits for government and institutional building projects (such as schools, hospitals, post-secondary, etc.). More details on this will be available with the federal and provincial budgets due later this spring.



In contrast to the slow down in non-residential building, residential home builders in Alberta had a relatively good year in 2017, especially considering the economy was only starting to crawl out of recession. A nice rebound in housing starts marked the first half of the year, but as 2017 drew to a close, home builders pulled back. In December, construction began on 23,104 new homes, including both single detached and multi-unit homes. (This figure is adjusted for seasonality and expressed at annualized rates, meaning the number of new homes that would be built in a full year if the same pace were to continue for 12 months.) That was one-third lower than in November.



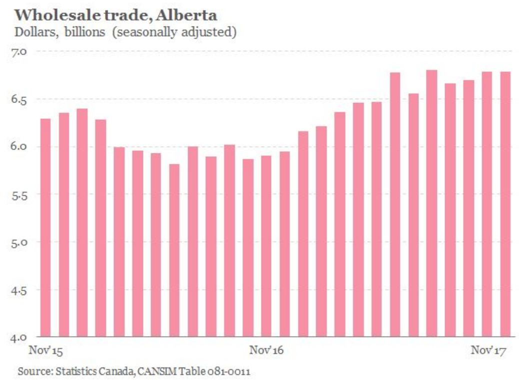
Even though Alberta's economy is growing and the recession is behind us, the residential construction industry may not pick up much speed in 2018. Demand for new homes will be limited by tighter rules on mortgage lending that came into effect January 1, as well as higher interest rates. There are also indications of an overbuild of new homes in the province, suggesting that activity this year will only match or dip from last year.

Home prices started the year predictably and in line with expectations. In Calgary, the average price of a detached home was $545,834 in January, unchanged from the same month last year. The median sale price in October was $474,000, down 2.3 per cent from January 2017. In Edmonton, the average price of a house in December was $475, 720, a little more than a three per cent increase from last year. The median price in October also advanced 1.2 per cent to $415,000.

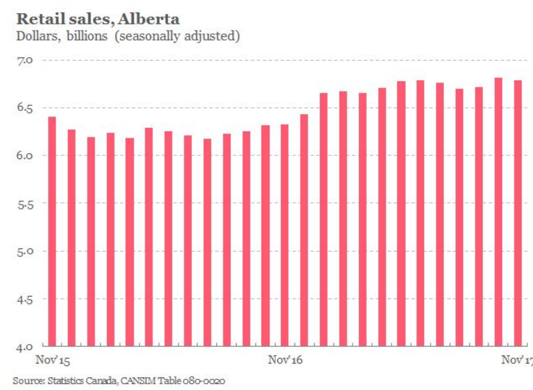
Total MLS sales are up in both cities by about two per cent and signal that housing prices will continue to improve modestly this year.

Wholesale, retail and manufacturing

The latest wholesale trade numbers confirm that Alberta businesses continue to gain confidence in the province's economic recovery. In November of last year, total wholesale activity in the province reached $6.8 billion. Sales were unmoved from October, but compared to the same month a year earlier, sales were up significantly (+14.2 per cent). Although the latest numbers show that wholesale activity paused from the previous month, growth in sales activity in the majority of wholesale’s sub-sectors compared to last year continues to point to an improving economy.

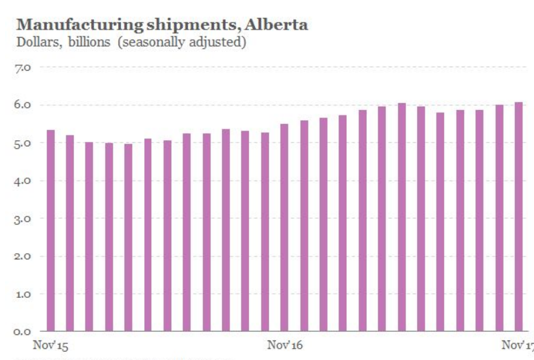


Wholesale’s strong end to the year is certainly helped by the average Alberta consumer. Total retail sales rang in at $6.79 billion in November, down only slightly from the record high in October. Comparing the total over the last 12 months to the same 12 months before that, sales are higher by 7.5 per cent.



Some of the improvement in retail sales is due to pent-up consumer demand. As well, there is a worry that some shoppers may be relying far too much on credit. With debt ratios at record highs, we know that at least some of this retail spending is done by borrowing. So while retail sales performed well in 2017 (+8 per cent), the pace of growth is likely to slow in 2018.

In November, manufacturing shipments reached the highest level seen in 2017. Total manufacturing grew 1.2 per cent from October, reaching $6.1 billion. Compared to a year earlier, shipments were up more than 10 per cent.



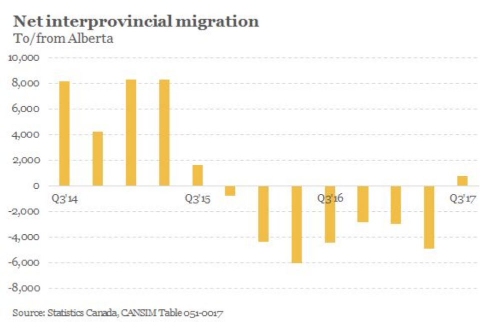
Over the course of the month, increases were recorded in about half of the manufacturing sub-sectors, but shipments of transportation equipment led the charge, growing close to nine per cent. Other big movers included chemical manufacturing (+7.6 per cent), plastics and rubber manufacturing (+4.3 per cent) and paper manufacturing (+3.9 per cent).

Many of the key manufacturing sub-sectors to Alberta's energy industry were down from October to November; however, sales from these industries are significantly higher from where they were at the same time last year. This is a sign that Alberta's energy sector is gaining strength after the recession.

As Alberta begins 2018, manufacturing is starting the new year on solid footing. Virtually every single sub-sector of manufacturing is above where it was a year ago. As economic conditions improve, manufacturing is likely to grow.

Population growth

After several consecutive quarters of net out-migration to other parts of Canada, Alberta received some welcome news: more people from the rest of the country are again choosing to move to Alberta than those choosing to leave. Most recently, the province experienced a net gain of 743 residents over July, August and September. This gain is well below pre-recession levels but is a sign that things are moving in the right direction.



We won't have the numbers for all of last year from Statistics Canada until March, but we are estimating a net loss of around 7,000 people in 2017. In 2018, we project a net inflow of people coming to Alberta from other provinces of approximately 2,000 people. The average net annual inflow in the five years before the 2015-2016 recession was about 24,000.

Overall population growth in the province will be slower than before the recession but will remain positive. Alberta has the youngest population in the country and, in turn, the highest rate of natural increase (births less deaths). International immigration is also expected to continue to add to Alberta's population with the federal government's announcement last autumn to increase international migration. Strong immigration numbers, a high birth rate and the return to (albeit modest) net positive inter-provincial migration are good news for Alberta's retail and housing sectors.

Summary

Albertans will remember the recession of 2015 and 2016. It will be the recession against which all future downturns in this province will be compared--much like how earlier generations of Albertans reference the 1980s.

But as measured by almost every economic indicator, the pit of the recession occurred in July of 2016--about 19 months ago. Last year we saw growth return to the province, and all signs point to growth in 2018. It is time for Albertans to intentionally re-orient our language and mentality away from the recession; instead, it is time to purposefully re-focus on growth.

This is not to say everything in Alberta's economy is easy. Many businesses continue to struggle. The unemployment rate is still too high. And threats beyond our control--such as NAFTA negotiations and opposition to pipeline expansion--continue to add layers of uncertainty to our economy. Household debt levels are at record levels, and borrowing costs are rising.

And indeed, the global economy may be shifting into another period of financial and market volatility. In the days leading up to the time of the writing of this report, stock markets and commodity prices have been unsettled. Increased volatility could rattle nerves and derail the economic optimism that marked 2017.

Higher North American oil prices, as measured by West Texas Intermediate, are much improved from two years ago. However, our heavy oil producers have not enjoyed the same lift in price, due mostly to pipeline bottlenecks and constraints. In the current price environment, Alberta's energy sector is positioned for only modest expansion in capital spending programs. This highlights the shifting role of the energy sector from growth engine (circa 2010-14) to the backbone.

New sectors of the economy offer promise, particularly in agriculture, agri-foods, tourism and technology. These may take some time to germinate and grow, but they do point towards a growth in economic diversity. New jobs in new sectors will follow.

ATB Financial's Economics and Research team is forecasting real GDP growth of 2.8 per cent this year, followed by 2.2 per cent in 2019.