

The long goodbye: Inflation and interest rates will weigh on Alberta's economy in 2023

As 2022 draws to an end, many countries are edging closer to recession due to tighter monetary policy, slower global growth, geopolitical strife and the lingering pandemic. The Alberta economy can't avoid these headwinds, but it will continue to advance on the back of its natural resource industries and growing population. Our current forecast pegs Alberta's real GDP growth at 5.0% for 2022 (unchanged from our August forecast) and 2.8% in 2023 (down from 3.0% in August).

In addition to the boost being received from the natural resource sector, Alberta's strong GDP numbers in 2022 reflect the fact that it has more catching up to do. Alberta lost more economic ground than any other province in 2020 due to the pandemic and oil price crash. As a result, the province's GDP at the end of 2021 was still 3.6% below the 2019 level compared to a shortfall of just 0.3% for the country as a whole.

The Bank of Canada's trendsetting policy interest rate has risen six times so far this year and has reached the highest level since March 2008. Given October's encouraging job market report and headline inflation still sticky at almost 7% in October, it is widely expected that the Bank of Canada will retain its hawkish stance in the short-term. As a result, we expect economic momentum in Canada to slow in 2023 with Alberta one of the bright spots due to the lift it will continue to receive from softening, but still relatively high, commodity prices and strong agricultural output.

Energy market activity robust in Alberta

Averaging almost 3.9 million barrels per day in September, oil production in Alberta surpassed its previous peak reached in November last year and stood at the highest level in the province's history.

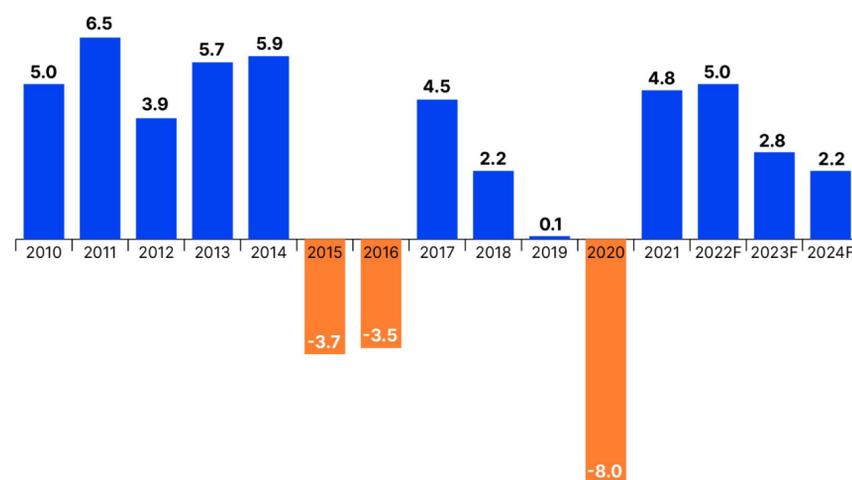
Western Canadian crude prices have also been robust, but not as strong as the WTI benchmark. Recently, the WTI-WCS differential has been hovering close to US\$30/bbl, nearly twice the discount experienced over the first half of the year. Some of the factors that have likely caused the discount to widen include reduced crude exports via the Gulf Coast, refinery outages, and removals from the US strategic petroleum reserves. Even with the outsized differential, oil prices are high enough that companies have increased their capital spending plans.

Looking ahead, the volume of Alberta's oil exports to the US will get a boost from the completion of the Trans Mountain Expansion Project later next year. The pipeline's capacity will go from approximately 300,000 barrels per day to 890,000 barrels per day. This is, however, likely to be the last major increase in crude oil transportation capacity out of Alberta for the foreseeable future.

Key indicators	2021	ATB forecast		
		2022	2023	2024
Real GDP (annual % change)	4.8	5.0	2.8	2.2
Employment (annual % change)	5.1	5.2	1.8	2.0
Unemployment rate (annual average %)	8.7	5.8	5.9	5.8
Retail sales (annual % change)	11.5	6.7	5.3	5.0
Annual housing starts (000s)	31.9	36.5	32.4	30.6
Consumer Price Index (annual % change)	3.2	6.3	3.9	2.3

Annual % change in Alberta's real GDP

Chained (2012) dollars

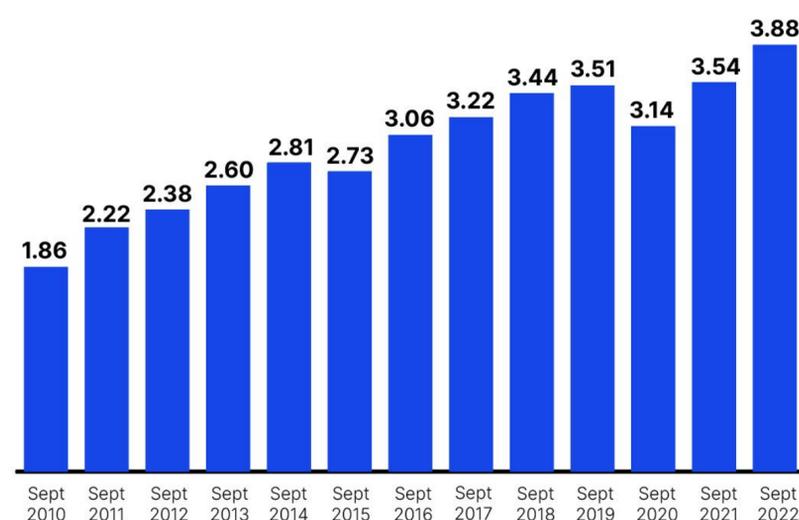


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Source: Statistics Canada Table 36-10-0222-01 and ATB Economics

Oil production in Alberta

Average daily production in September of each year, million barrels per day



Source: Alberta Energy Regulator and ATB Economics

Inflation at an inflection point

The rising cost of living is affecting Canadians across the board, from students to retirees. Soaring rent, food, transit and utility prices amidst rising borrowing costs are pushing day-to-day expenses up to levels not witnessed in decades. While the pain is very real, there are signs that price growth is slowing and will return to the vicinity of the 2% target by 2024. The Canadian headline inflation rate in October was still elevated at 6.9%, but down from the 8.1% peak reached in June. Core inflation – i.e., excluding food and energy – ticked down from 5.4% in September to 5.3% in October, partially driven by lower home prices.

It remains to be seen what the Bank of Canada will do in terms of future interest rate hikes, but our assumption is that the policy rate will top out at either 4.25% or 4.5% by early next year as long as inflation continues its slow march back toward the 2% target.

Strong influx of people cushioning the blow

As of July 1, 2022, Alberta's population grew by 2.2% from the same time in 2021. Despite a healthy jump in natural increase (births less deaths), most of the growth came from people arriving from outside Canada. On a net basis, the province added nearly 60,000 people from other countries in 2022, the highest number on record. Aided by the relatively favourable economic conditions in the province, Alberta also attracted the largest number of interprovincial migrants of any other province between Q2 2021 and Q2 2022.

Population growth plays a key role in boosting activity in residential markets. Housing starts (seasonally adjusted at an annual rate) in Alberta spiked to a seven-year high in October and were averaging over 38,000 units on a year-to-date basis. This was 22.3% above the same 10-month period in 2021 and stands in stark contrast to the 4.3% drop at the national level. A similar trend can be seen in the number of residential building permits issued so far this year. Given these strong gains, we now expect housing starts to average around 36,500 in 2022 and moderate toward 32,400 next year as the economy slows under tighter monetary policy measures.

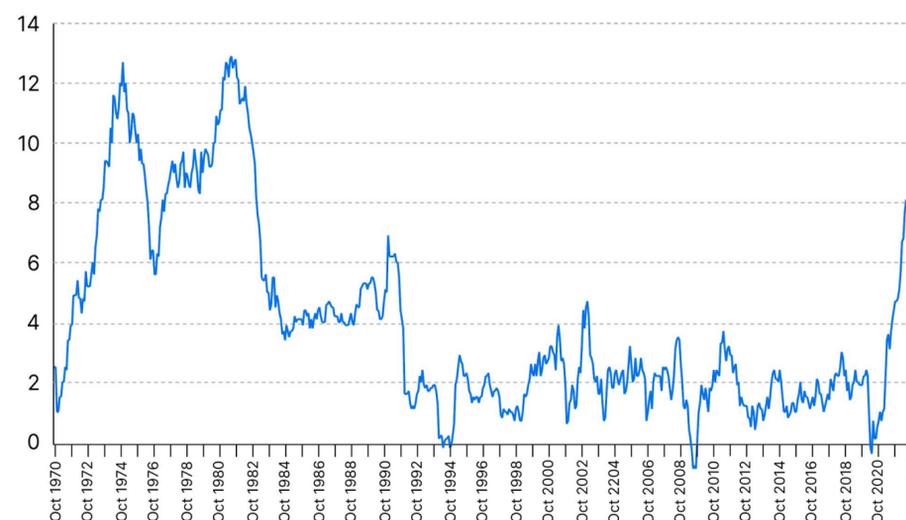
Strong migration levels are also expected to benefit Alberta's labour market, which has been grappling with staffing challenges. Many sectors, such as manufacturing and agriculture, where employment is still below pre-pandemic levels, have finally seen some improvements over the fall. Overall, we expect our unemployment rate to average 5.8% this year and remain around this level in 2023 and 2024.

Momentum slowing going into the new year

Business activity, especially outside the energy sector, has started to slow down in recent months despite averaging higher on a year-to-date basis. Non-energy export revenues hit a record peak in July, but have been lackluster ever since. Factory sales have also eased every month since June. This is in part due to the tempering of commodity prices with easing global supply chain pressures.

National inflation rate

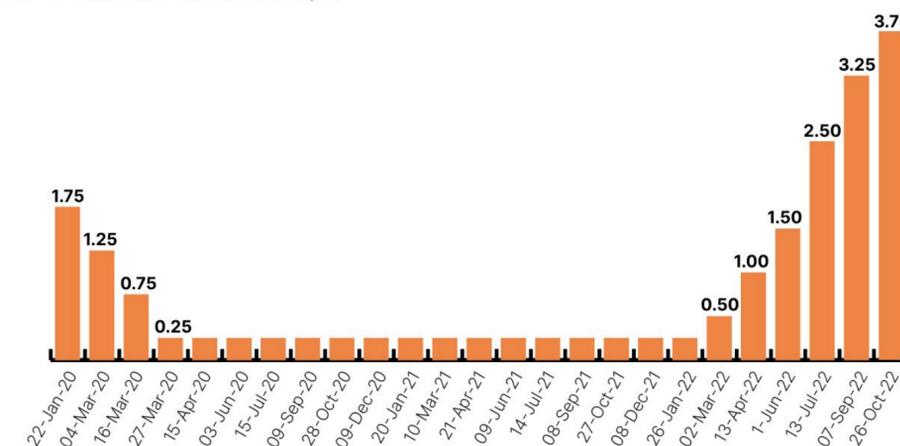
Year-over-year % change in the monthly Consumer Price Index



Source: Statistics Canada Table 18-10-0004-01

Bank of Canada Policy Interest Rate

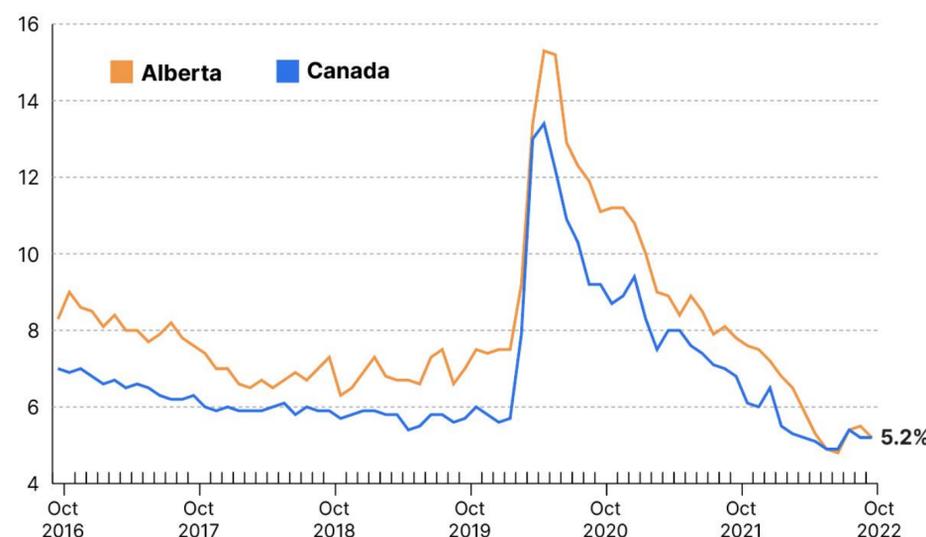
As of announcement dates, %



Source: Bank of Canada

Unemployment rate

%, monthly, seasonally adjusted



Source: Statistics Canada Table 14-10-0287-01

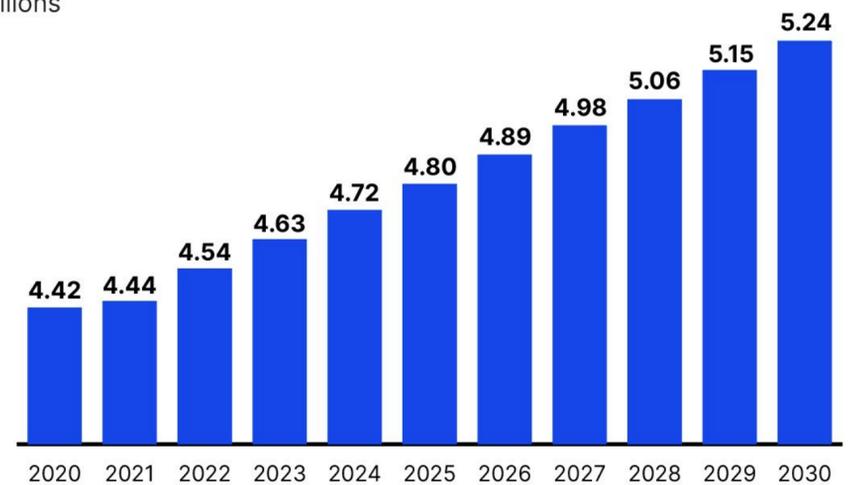
The weakness is more apparent if we examine consumer spending levels in the province. Inflation-adjusted retail activity in Alberta was down 2.5% over the first nine months of 2022 relative to where things stood back in 2021. We expect this trend to get worse as higher prices and borrowing costs continue to cut into the disposable incomes of regular Albertans. Unadjusted revenues, however, are still upbeat and we expect a modest 6.7% jump in nominal retail sales this year, beating the inflation rate by a small margin.

As the impact of the interest rate hikes work their way through the economy and add to the ongoing headwinds generated by still-elevated inflation, the war in Ukraine and the pandemic (witness the dampening economic effects of recent public health measures in China), economic growth in Alberta will slow and this will be felt by households and businesses alike. However, with growth of 2.8%, Alberta will buck the trend in most provinces and avoid the recessionary or near-recessionary conditions that will prevail in the country as a whole. The unemployment rate in both Alberta and Canada is expected to stay low with labour shortages rather than rising job losses the main theme going forward.

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Projected population of Alberta

Millions



Source: ATB Economics Forecast