Alberta Economic Outlook
Q1 2015

Prepared by ATB Financial, Economics and Research
January 5th, 2015

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ATB Financial's Economic Outlook is released at the beginning of each quarter of the financial calendar. It's designed to summarize Alberta's economic landscape and give us an idea of what the future looks like. The Economic Outlook provides Albertans with economic commentary that is trusted, meaningful and easy to understand.

A precipitous drop in the price of crude oil has negatively altered the outlook for Alberta's economy in 2015. But even with the expected slowdown, an outright recession is highly unlikely.

The most current projection by the ATB Financial Economics and Research team is for real GDP growth of 3.9 per cent in 2014, with the rate of growth falling by nearly half to 2.0 per cent in 2015.

KEY RESULTS:

- Alberta's economy is set to slow significantly in 2015 with growth at half the rate seen last year.
- Labour markets are currently balanced, but a slightly higher level of unemployment is anticipated.
- Weak oil and natural gas prices have curtailed investment in the energy sector.
- Housing starts are stable, but will likely show some modest decrease this year.
- In-migration will continue to be positive but will slow significantly from 2014.

	Year			
	2014	**2015**	**2016**	**2017**
Real GDP	**3.9**	**2.0**	**2.2**	**3.1**
Consumer Price Index (annual % change)	2.6*	1.8*	2.0	2.1
Unemployment Rate	4.7	5.4	5.0	4.7
Employment (% change)	3.1	1.3	1.9	2.1
Population (millions)	4.133	4.230	4.325	4.417

Global Overview

Geopolitical tensions remain a destabilizing factor for the global economy.

U.S. airstrikes against the Islamic State (ISIS) rebels continue in 2015 and have significantly increased global concern about the stability of the region. It remains unclear at this point if the situation is moving towards ground combat war. That result could have worrying impacts on financial and economic markets.

The collapse of the Russian ruble and the recession gripping that country this year also raises troubling prospects for the global economy. Trade sanctions against Russia in response to aggressions in Crimea and eastern Ukraine punish not only Russia, but also Germany and other European economies with trade links to Russia.

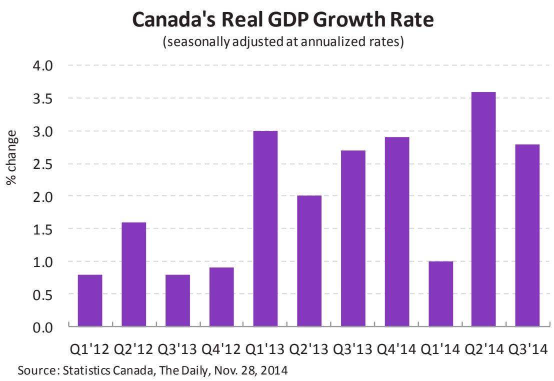
* these numbers have been corrected from a previous version of this report

President Putin has placed the blame for his country's recession and plunging currency squarely on the allied Western nations. Inflamed attitudes towards the West could prompt further aggressions in 2015, all of which would create even more economic disruption in the region.

Asia's economy has slowed, with Japan once again in contraction; its program of enormous monetary stimulus continues. China's economy has also slowed, but remains stable.

The U.S. economy continues to perform quite well going into 2015. The real GDP expanded by 4.6 per cent in the second quarter of last year, and an estimated 5.0 per cent in the third quarter—some of the strongest quarterly growth rates since the end of the 2009 recession. The unemployment rate has dipped below 6 per cent and confidence continues to strengthen.

Canada's economy staged an impressive come-back in the second quarter of last year. The value of goods and services grew at an annualized rate of 3.6 per cent, more than three times the pace set in the first three months of the year. Growth continued with an expansion of 2.8 per cent in Q3. Better results on exports have helped lift Canadian output. Despite the better economic results, the Canadian dollar softened significantly throughout the second half of last year. It enters the first quarter of 2015 at roughly $US 0.86 to one Canadian dollar—a decrease of about 10 per cent from year-ago levels.

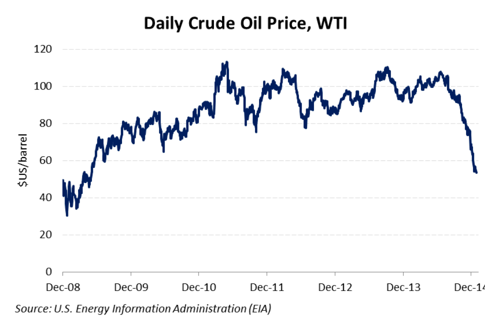


The Bank of Canada continues with a neutral position on interest rates, but is monitoring very closely the output gap in the broader economy. Inflation did tick somewhat higher last fall, but the impacts of lower gasoline and heating prices will likely bring rates back down in coming months. At its most recent fixed announcement date, the Bank indicated that the balance of risk remains within the zone for which the current stance of monetary policy is appropriate.

Alberta: Sector Overviews

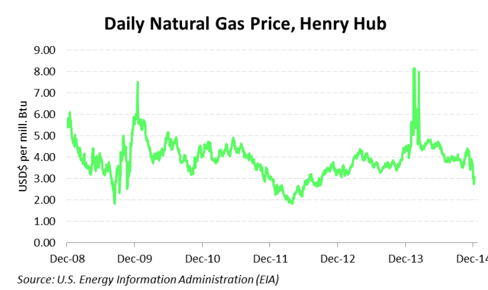
Oil and Gas

North American crude oil prices (West Texas Intermediate) plunged in the final four months of last year and are currently close to $US 53 per barrel—down by nearly 50 per cent from last summer. An OPEC refusal to cut production and a somewhat slower global economy has led to the glut of oil on the market.



Offering some modest offset to lower prices has been the much softer Canadian dollar. The differential between West Texas Intermediate and the Western Canadian select blend benchmark is currently hovering slightly below $C 20 per barrel.

Henry Hub natural gas prices have slipped back below the $US 3.20 per MMbtu range recently. Producers in Alberta continue to struggle against plenty of supply from American shale regions. To date, the mild winter weather in most of the U.S. has failed to significantly draw down inventories in the U.S., so prices have experienced little lift.



Energy transportation and access to markets will remain a key concern for producers in 2015. As of the beginning of the year, there is still no resolution on any of the major pipeline projects (i.e. Northern Gateway, Keystone XL, Energy East or TransMountain). There is some optimism that the Republican controlled congress in the U.S. will approve the Keystone XL project, but a Presidential veto is still possible, meaning the pipeline remains uncertain.

Risk Scenarios for Global Energy Prices and Implications for Alberta

The sudden and rapid drop in oil prices is having a significant impact on Alberta's economy. Almost every oil producing company in the province has cut planned capital spending programs for 2015, and some layoffs have been announced (particularly among oilfield service providers and contract companies).

Outlined below are three scenarios for average oil prices in 2015, as well as what each could imply for Alberta's economy.

SCENARIO ONE: World economic growth slows further; OPEC sticks with its production levels (i.e. refusing cuts).

WTI = $US 40-55/barrel
PROBABILITY: Somewhat likely

- High cost oil producers (i.e. U.S. Bakken, Russia, Venezuela, Alberta, etc.) reduce output in the first half of 2015, providing a floor to WTI price of $US 40.
- Several Alberta oilsands projects are deferred or cancelled; conventional drilling scaled back 20 per cent.
- Layoffs are announced, especially by smaller energy producers without the deep cash reserves.
- Indirect activity (drilling contractors, personal and business services, engineering, etc.) is affected and suppliers start to scale back labour.
- Costs for Alberta producers also ratchet downward, restoring some cost-benefit balance within the sector.
- Alberta unemployment rises to 6 per cent to 7 per cent by end of 2015.
- Provincial real GDP growth slows to 0.5 per cent to 1.5 per cent.

SCENARIO TWO: World growth stabilizes, OPEC members are not able to maintain production levels; prices stabilize and rebound somewhat in second half of the year.

WTI = $US 55–70/barrel
PROBABILITY: MOST LIKELY

- Some higher cost oil comes off the market, including OPEC members (other than Saudi Arabia).
- Prices possibly drop further at the beginning of 2015, but stabilize by the spring; prices start to rebound above $60 by summer.
- Some oilsands projects are delayed or scaled back, conventional drilling reduced by 10 per cent.
- Layoffs in Alberta's energy sector and by energy service providers are modest.
- Alberta unemployment rate rises to 5 per cent to 6 per cent by end of 2015.
- Provincial real GDP growth slows to around 2.0 per cent in 2015.

SCENARIO THREE: Global growth accelerates, OPEC loses the "game of chicken" and blinks first and oil production falls

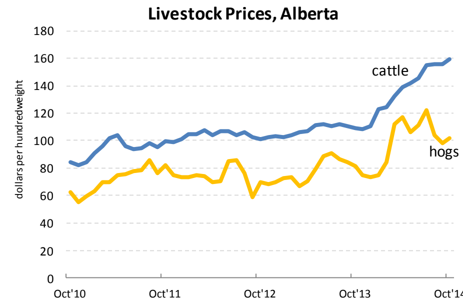
WTI = $US 70-90/barrel
PROBABILITY: LEAST LIKELY

- Higher cost OPEC producers fail to maintain production and even Saudi Arabia's government feels the fiscal strain; the cartel loses effectiveness and output falls.
- Global oil prices rise to a level closer to supply and demand fundamentals.
- Only modest curtailment in Alberta's oilsands; conventional drilling stabilizes in second half of the year.
- Modest layoffs in Alberta; unemployment rate remains close to balanced 5 per cent.
- wwProvincial real GDP growth remains above 2.5 per cent.

NOTES to the Risk Scenarios:

- *In all three scenarios, Alberta experiences the slowest rate of GDP growth it has seen since the recession of 2009.*
- *In all three scenarios—including the worst-case scenario, number one—Alberta's unemployment rate remains at or below the national average.*
- *In all three scenarios, Alberta's bitumen sector experiences some retrenchment.*
- *The best-case scenario for Alberta (number three) sees WTI prices recovering at most to $US 90/barrel, and the provincial unemployment rate remains unchanged at its current level (4.5 per cent). This is the least likely case.*
- *In no scenario does Alberta experience a recession. Other non-energy related sectors (agriculture, forestry, tourism) continue to do well and are bolstered by low energy prices.*
- *These forecasts and scenarios are best guesses only, especially the probabilities attached to each. Estimates for unemployment and real GDP growth are unscientific and offered only as a credible range.*

Agriculture and Forestry

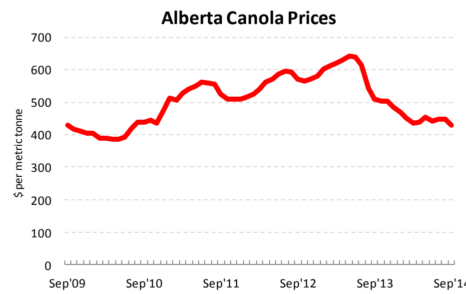


Source: Statistics Canada The Daily, Dec. 5, 2014 and CANSIM tables 002-0043

Partially offsetting the negative shocks in the energy sector, livestock prices continued to rise steadily in the third and fourth quarters of 2014, suggesting that cattle and hog farmers are in for decent cash receipts.

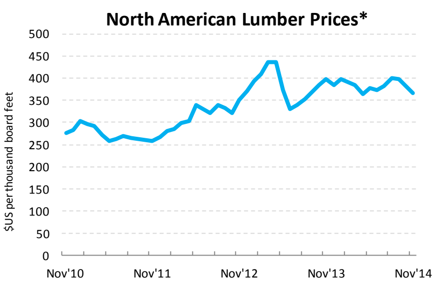
Hog prices soared in the first half of 2014, prompted by the outbreak of the PEDv virus in the U.S. which has significantly reduced hog supply in North America. Prices stabilized over the summer, and finished the year around $C 1.75/Kg, up from below $1.50 at the start of the year.

Cattle prices have also been rising on strong demand and reduced herds over the last few years. Prices peaked in November at over $170 per hundredweight before easing back to closer to $165 by the end of the year.



Source: Statistics Canada, The Daily, Dec. 5, 2014, and CANSIM table 002-0043

But the higher livestock prices are being offset by weaker prices for grains and oilseeds. Overall, agriculture should enjoy a decent year in 2015, led primarily by solid livestock prices.

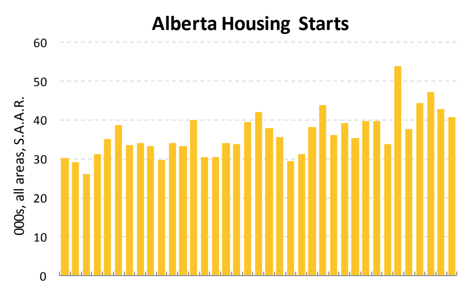


Source: Random Lengths
* - composite price is a weighted average of 15 key framing lumber prices

Alberta forest product producers have enjoyed one of the best years in a decade. Prices for lumber have been lifted by the strong recovery in the U.S. housing market and by the much softer Canadian dollar.

The total value of lumber, pulp and paper and panelboard manufactured by Alberta Forest Products Association (AFPA) members totaled approximately $728 million for the second quarter of 2014, up $67 million (or 10 per cent) from the same period last year.

Construction and Real Estate

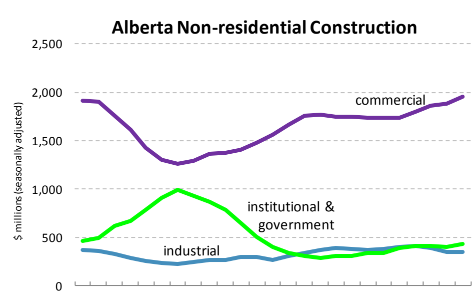


Source: CMHC, Dec. 10, 2014 and Statistics Canada CANSIM table 027-0054

As of November 2014, the downturn in the energy sector did not seem to be having a negative impact on the residential housing market.

Housing starts continued at healthy levels in 2014, with the average monthly starts at just over 40,000 (January to November average, seasonally adjusted at annualized rates). Builders are still reporting generally good, steady demand for new homes, although there is an increasing sense of caution in the industry as in-migration from other provinces is set to slow in 2015.

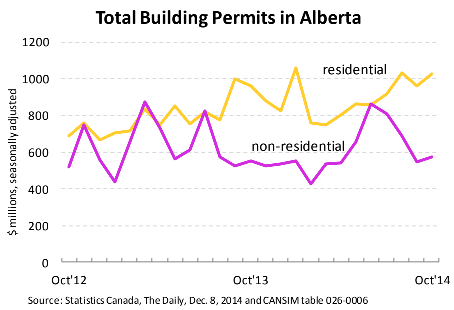
Mortgage lending rates have continued to support new purchases. With very little concern about the prospect of interest rates rising within the next six months, there should be little worry about higher rates destroying demand any time in the immediate future.



Source: Statistics Canada, The Daily, Oct. 17, 2014 and CANSIM table 026-0016

Spending on non-residential construction was higher during the third quarter of 2014 at $2.73 billion. Over the last twelve months (ending September 2014), total non-residential construction spending in Alberta was up 8 per cent compared to the previous twelve month period. Commercial construction projects—led by a furious pace in both downtown Edmonton and Calgary—remain the strongest segment of overall non-residential construction.

Residential building permits in October increased to just slightly over $1 billion (seasonally adjusted)—close to the all-time record. Non-residential permits remained at close to their two-year average.

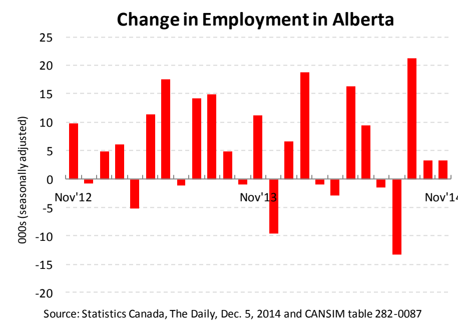


Combined, total building permits over the last 12 months in Alberta are 4.3 per cent higher than the previous twelve-month period.

But in spite of the strong level of building permits as of October, both the residential and non-residential sectors are set to moderate in 2015. Slower population growth, more cautious developers and home buyers, higher levels of investor nervousness, and a softer job and wage market will take a toll on the construction sector.

Overall, investments in housing and non-residential projects will be flat to slightly lower in 2015.

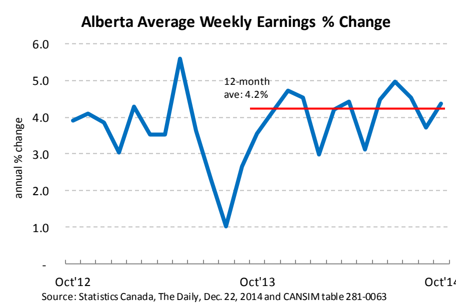
Labour Market



Alberta's job market recovered from a big one-month loss in August with a huge gain in September, and two smaller increases in October and November.

Over the last twelve months ending in November, Alberta has added 50,500 jobs, a year-over-year increase of 2.2 per cent. That pace of new job creation is decidedly slower than the pace of a year ago when employment was growing by more than 3 per cent annually. Still, even this more moderate pace is still three times the national employment growth rate.

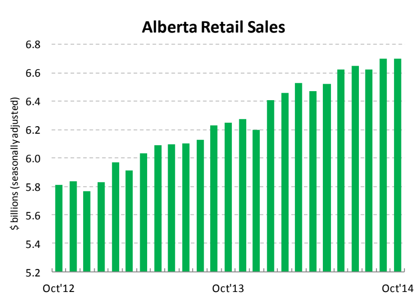
But while the number of jobs increased in November, there may still be some cracks starting to show in the energy sector. Employment in professional, scientific and technical services took a big hit—a loss of 11,000 jobs. Occupations in this category include geologists, engineers, accountants, lawyers and technicians—the kinds of services acquired by oil and gas producers. Even though they didn't lay off any of their own workers, energy producers may be starting to pull back on contracts with external service providers.



As with most indicators in the autmun of 2014, it appears that wages in Alberta have yet to experience the effects of declining oil prices. The paycheques of Alberta employees rose to another record high in July as companies and businesses continued to feel the pressure of labour shortages. The average weekly earnings of employees in the province rose to $1,172 in October (seasonally adjusted), up 4.4 per cent from a year ago. That figure includes overtime pay and is calculated before taxes and other deductions.

Softer job creation, tighter spending controls by companies and weaker overall conditions should act to contain wage growth in 2015.

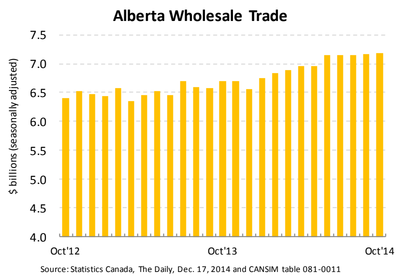
Retail, Wholesale and Manufacturing



Alberta retailers saw an extremely strong year in 2014. Record sales were recorded in September and October where total receipts exceeded $6.7 billion (seasonally adjusted). The trend has been exceptionally strong over the last several years, lifted by strong population growth and healthy wages.

December retail sales are not yet available, but anecdotally information collected from retailers indicate that the Christmas shopping season was strong—once again suggesting that any energy-related downturn in the broader economy has so far yet to damage consumer confidence.

Wholesale activity in the province peaked at a record high in October of $7.18 billion, a level at which it has hovered for most of the summer and fall. Over the last twelve months, wholesale trade is up 6.5 per cent over the previous 12-month period.

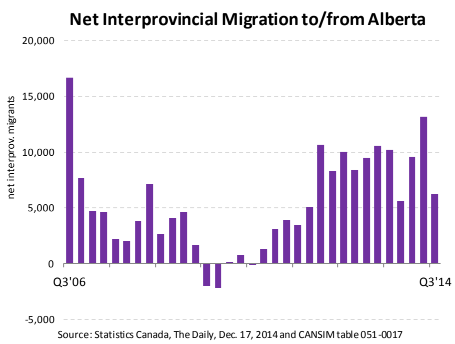


Shipments from Alberta manufacturers have leveled off after reaching a record in June of 2014. Total shipments in October were at a record $6.83 billion.

Falling petroleum prices in November and December will certainly show up in softer overall manufacturing values in data coming in 2015.

Interprovincial In-migration

Alberta experienced strong interprovincial in-migration last year, although it appears that it could be slowing. In the third quarter of 2014, the province saw a net gain of 6,320—one of the slowed rates of growth in a few years. Over the last complete four quarters (Q4'13 to the end of Q3'14) Alberta was the destination of a net 34,768 Canadians from other provinces.



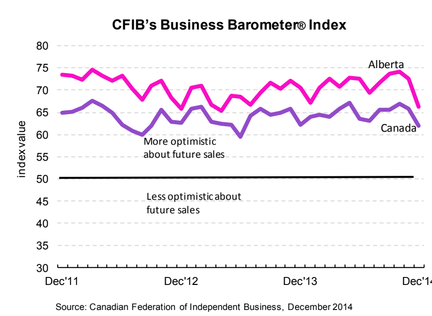
The interprovincial in-migration is being accompanied by very strong international in-migration as well. Every year Alberta's net international migration position increases. In recent years immigration has gone from the 20,000-25,000 range a few years ago to over 35,000 today. These factors have been a driving force for residential real estate market and retail sales in the province.

But in-migration to Alberta is certain 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 60,000 in 2015, with the most significant drop coming from fewer interprovincial migrants.

Business Optimism

While still above the national average, the mood of small- and medium-sized business operators dropped sharply in December of last year. The most recent survey from the Canadian Federation of Independent Business shows the index at 66.2, down from levels close to 75 only a few months ago (Figures above 50 suggest there is, on balance, more optimism among business owners about future sales).



Given the exposure that many independent businesses have to the effects of oil prices—including many small manufacturers and services providers that feed into oil extraction—it is not surprising that optimism levels took a downturn in December. The survey includes responses received up to December 15, 2014, a point at which WTI was already trading well below $US 60 a barrel.

However, not too much should be read into the survey results. While optimism did fall sharply, it remains above the Canadian average—and optimistic business owners still outnumber the pessimistic ones by a margin of two to one. The current index remains within a range that prevailed for most of 2013—a year that was a strong growth year.

Moving into January and beyond, however, optimism levels could dip further. That will depend on how much further oil prices may fall, or how quickly those prices will stabilize and start to climb.

Summary

Alberta's economy enjoyed a solid year of growth in 2014 and continued to outperform the rest of Canada. But with oil prices and optimism sliding rapidly in the second half of the year, change is certain to come in 2015.

The energy sector has just started to absorb the impact of oil prices that have been cut in half. Despite the low Canadian dollar and a reasonably narrow differential, Alberta producers are facing restricted cash flow. Capital expenditure plans have been scaled back and some degree of layoffs are inevitable.

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 55-70 per barrel. Oil prices could fall further in the first half of the year, but will likely recover in the second half. In any case, it will be a challenging year for producers.

There are, however, many non-energy related sectors in the province that will likely do well in 2015. Agriculture, forestry, and tourism all benefit from lower energy (i.e. fuel) prices. The lower Canadian dollar will also help commodity exporters and tourism operators.

The most current projection by the ATB Financial Economics and Research group is for real GDP growth of 2.0 per cent in 2015.