

# Economic Trends

## A dimmer outlook for the Alberta economy

This edition of *Economic Trends* is taken from the *Third Quarter Fiscal Update and Economic Statement*, released on February 24, 2016. This month's *inFocus* provides an overview of industrial production and manufacturing in the United States.

Economic conditions and the outlook for oil prices have weakened since *Budget 2015* was released. Oil prices continued their downward trend and fell to the lowest level in over a decade at the beginning of 2016. Tempered expectations about global growth and rising oil supplies are weighing on equity and commodity markets and increasing volatility.

The steep decline in oil prices means that the downturn in Alberta's economy will be deeper and longer than forecast at *Budget*. Following an estimated decline in real GDP of 1.5% in 2015, Alberta's economy is expected to contract again in 2016 by 1.1%. Weaker economic conditions continue to weigh on incomes, including wages and salaries, corporate profits, and Government of Alberta revenue. Nominal GDP declined by over 11% in 2015, and is forecast to fall again by about 4% in 2016.

With additional cuts to capital spending by oil and gas companies, the slowdown in the energy sector is feeding through other sectors in the economy. Momentum that supported activity in the province in 2015 has faded, prompting a pullback in non-energy construction and spending. Households will feel the effects, as employment and average weekly earnings are expected to decline in 2016.

Though the outlook for 2016 has deteriorated, there are some factors that remain supportive of growth. Oil sands output will continue to expand, driving exports. As costs moderate, a lower Canadian dollar will support non-energy exports and boost revenue. Increased public capital spending will help offset some of the declines in private sector investment.

### Alberta Business Sector

#### Oil prices searching for a bottom

Following the release of *Budget 2015* in late October, the price of WTI fell over 30% to below US\$30 per barrel. Demand growth has been outpaced by rising

production from OPEC and non-OPEC sources, and global inventories of crude oil have swelled. This has postponed an eventual recovery in prices and weakened market sentiment. Reflecting the worsening outlook, the oil price forecast for 2015-16 has been lowered to US\$45 per barrel, from US\$50 per barrel at *Budget* (Chart 1).

The light-heavy (WTI-WCS) differential has been relatively steady and is expected to average US\$13.50 per barrel in 2015-16, slightly lower than at *Budget*. With the decline in WTI, though, WCS prices have fallen sharply. The Alberta heavy oil benchmark fell below US\$20 per barrel in January 2016 to the lowest level since trading began in 2004. These prices have hurt producers' netbacks and squeezed corporate profits, not only for oil and gas companies, but for those supplying the industry as well. Net corporate operating surplus, a measure of corporate profits, is expected to decline around 17% in 2016.

#### Canadian dollar tumbles

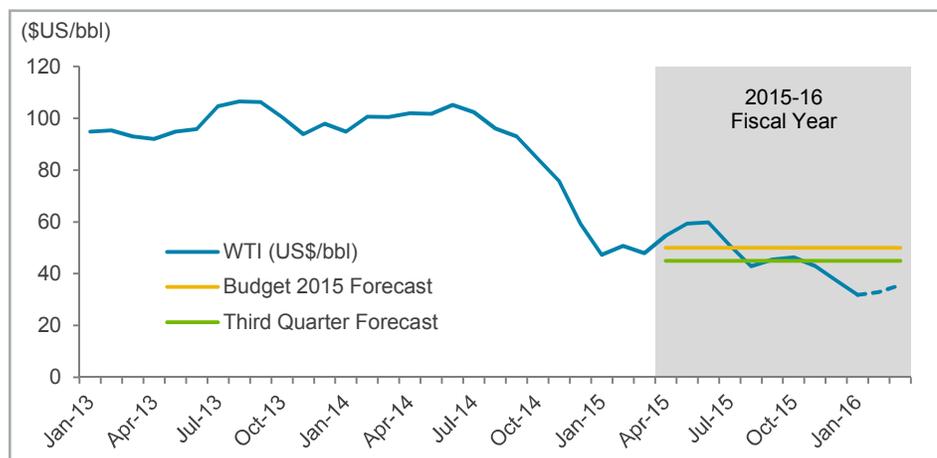
Since *Budget 2015* was released, the Canadian dollar has lost over 5 cents against the US dollar. In January, it fell to the lowest level in twelve years. A combination of US dollar strength, weak commodity prices, and a weaker outlook for the Canadian economy have been responsible for the decline. Reflecting this weakness, the dollar is expected to average 72.5US¢/Cdn\$ in the last quarter of the fiscal year. The exchange rate forecast for 2015/16 has been lowered by two cents to 76.0US¢/Cdn\$. A weaker dollar bolsters exports and resource revenue.

#### Energy investment to decline again

Oil and gas investment is expected to contract by over 20% in 2016, sharper than the 4.2% decline expected at *Budget*. The continued slump in oil prices has caused energy companies to cut spending further. Conventional oil and gas investment has slowed considerably, with the number of rigs drilling falling to multi-decade lows. Spending in the oil sands will be limited to maintenance of

Chart 1: Oil prices have fallen since *Budget 2015*

West Texas Intermediate



Sources: Alberta Energy

existing facilities and the completion of projects that were under construction prior to the price decline. Firms will continue to seek ways of cutting costs by bargaining aggressively with suppliers and containing labour costs. Some consolidation within the industry is likely, as firms with healthy balance sheets acquire those under financial stress.

**Public spending boosts construction**

Non-residential building construction was bolstered by strong momentum heading into 2015 and a large increase in institutional and governmental construction. However, the pace of declines in the industrial and commercial sectors accelerated through 2015. Although public spending will continue to provide a boost in 2016, non-energy investment is expected to fall. This reflects lower activity in the province and the winding down of current projects. Construction activity will get some support from easing cost pressures, as non-residential building construction price indices have fallen across most sectors.

**Positive trade gains**

Exports will continue to provide a lift to the Alberta economy, despite the plunge in oil prices and lower investment. New oil sands projects ramping up in 2015 led to strong gains in crude production. Gains will continue as major oil sands projects under

construction come on-line. Exports from other industries including agriculture, food manufacturing, and services are also expected to expand, partially offsetting the declines in energy-related manufacturing. Overall, export-oriented industries will benefit from easing cost pressures, the lower Canadian dollar, and a solid US economy.

In addition, the lower level of activity in the province has led to a pullback in imports. International imports fell by almost 9% in 2015 and are forecast to decline further in 2016. Rising exports and declining imports are improving Alberta's trade balance, which adds to real GDP growth (Chart 2).

**Household Sector**

**Employment expected to decline**

Employment remained resilient for much of 2015, even as the unemployment rate was rising as more people searched for work. Although annual employment grew by 1.2%, job losses started to accumulate in the fourth quarter. The weak start to 2016 and the worsening outlook for oil prices and economic activity suggest employment will fall further in 2016, with the largest declines in the first half of the year. Annual employment is forecast to decline 1.5%, compared with the 0.5% growth forecast at *Budget*. The unemployment rate is expected to remain elevated, averaging 7.4% in 2016 (Chart 3).

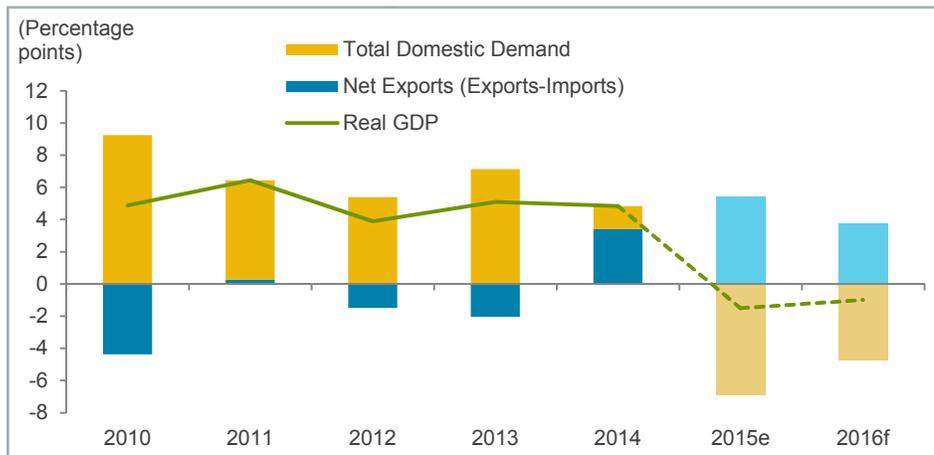
**Labour earnings slump**

Businesses responded to the economic slowdown by trimming labour costs in 2015, including reducing hours and employment, especially in the high-paying goods sector (which includes oil and gas, manufacturing, and construction). This resulted in average weekly earnings (AWE) declining by an estimated 0.4% in 2015, much weaker than the *Budget* forecast of 0.7% growth. As the labour market continues to soften in 2016, AWE is forecast to fall an additional 0.8%. Combined with declines in employment and weaker investment income, primary household income is expected to decline by 1.0% in 2016.

**Population growth moderates**

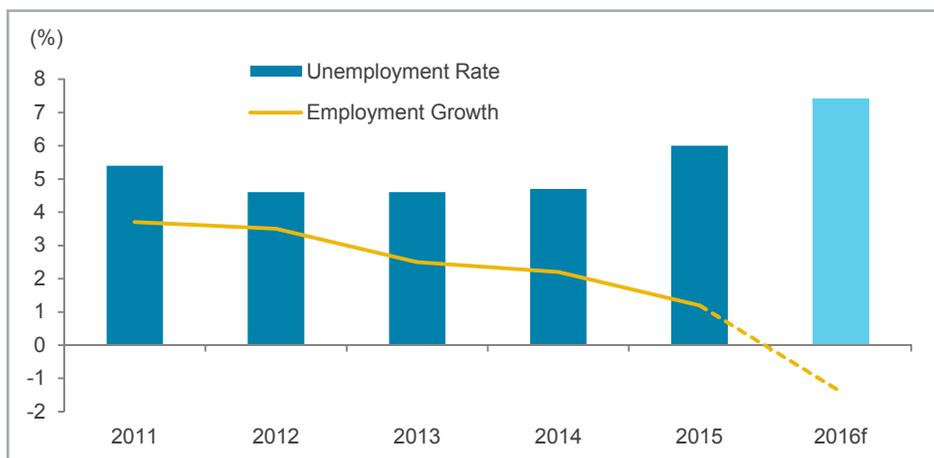
Alberta's population growth is expected to moderate to 1.2% in 2016, dragged down by declining net interprovincial migration (Chart 4). Net interprovincial migration slowed dramatically in the

**Chart 2: Trade is supporting growth**  
Contribution to Alberta real GDP growth



Sources: Statistics Canada and Alberta Treasury Board and Finance

**Chart 3: Labour market to worsen in 2016**  
Alberta labour market indicators



Source: Statistics Canada and Treasury Board and Finance

third quarter of 2015. In 2016, weakening economic conditions in the province are forecast to spur the net outflow of around 6,000 people to other parts of Canada. This would be the first decline since 2010. Net international migration will continue to support population growth, but record levels of immigration will be tempered by continued outflows of non-permanent residents. As overall migration levels fall, most of the expected population growth in 2016 will be due to natural increase.

**Housing momentum fades**

Alberta’s housing market held up relatively well in 2015, despite a sharp decline in resale activity. Low inventories and strong momentum from 2014 boosted housing starts, particularly for multi-unit construction. This strength faded in the second half of 2015 as the labour market softened and consumer confidence waned. Starts fell to 23,500 (annualized) in January 2016. With weaker momentum and slowing population growth, housing starts are expected to fall to 22,300 in 2016.

**Consumers rein in spending**

Falling earnings and economic uncertainty weighed on household spending in 2015. Retail sales declined in most major categories, and the pace of the declines picked up through the year (Chart 5). Consumers postponed large purchases, with sales

from motor vehicle dealers falling over 6%. By the end of the year, the pullback in spending broadened beyond more discretionary purchases. With labour conditions expected to weaken further in 2016, household consumption is forecast to fall 0.5%. Consumer price inflation is expected to rise to 1.6% in 2016, boosted by a lower dollar, which increases the cost of imported goods.

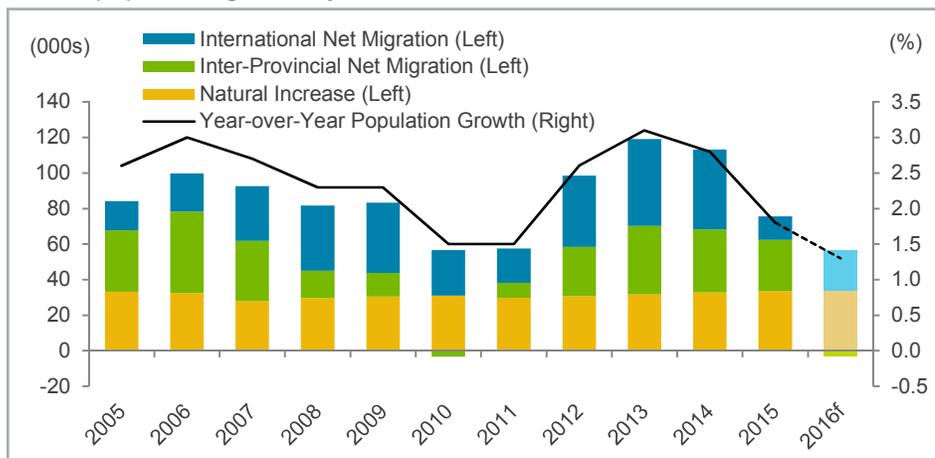
**External Risks**

While the US economy appears on solid footing, the outlook for several other countries, including China, has softened. The moderating outlook for oil prices has also subdued near-term growth expectations for the Canadian economy. Heightened uncertainty about global economic growth and Alberta’s high reliance on trade and commodities subject the outlook to a number of external risks:

- ◆ There has been increased volatility in financial markets partly due to uncertainty about global growth and emerging markets. This may limit the recovery in commodity prices, hurting Alberta’s growth prospects.
- ◆ Despite the pullback in investment, global oil production has continued to outperform expectations. If production continues to exceed expectations, for example from Iran, prices will remain lower for longer. A prolonged period of low oil prices would further weaken Alberta’s outlook.
- ◆ Larger-than-expected outflows of interprovincial migrants poses downside risk to housing and consumer-related activity.
- ◆ On the upside, oil prices and Alberta’s growth outlook could be lifted by an acceleration in the decline of non-OPEC oil production (for example US shale) or fiscal stress on OPEC countries, leading to lower production quotas.

**Chart 4: Population slows on weak economic activity**

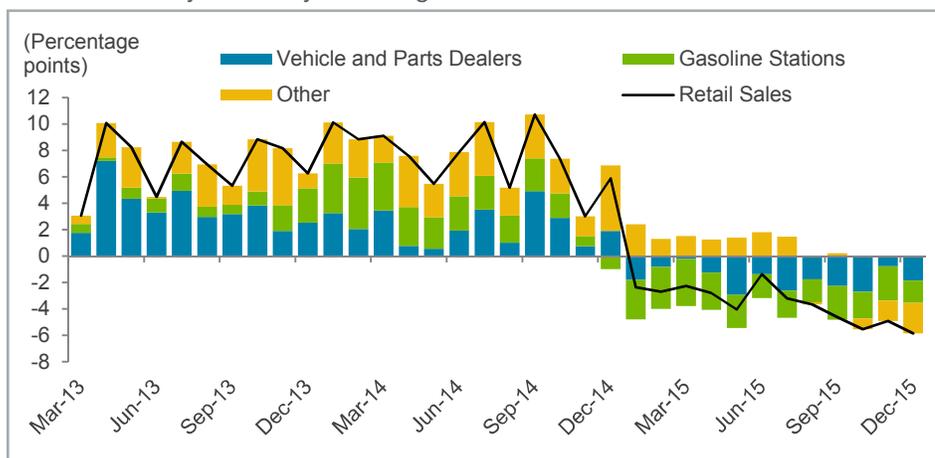
Alberta population growth by source



Source: Statistics Canada and Alberta Treasury Board and Finance

**Chart 5: Consumers are pulling back on spending**

Contribution to year-over-year change in Alberta retail sales



Source: Statistics Canada and Alberta Treasury Board and Finance

**Contact**

[Kailer Mullet](#)

780.427.7391

# inFocus

## US industrial sector looking for its stride

Strong consumer spending supported the US economy in 2015, which grew by 2.4%. Despite solid overall growth, US industrial sectors faced several challenges including low commodity prices, softer global demand, and a strong US dollar. As a result, lower investment, industrial production, and exports weighed on real GDP growth, which slowed through 2015 and slipped below 2% in the fourth quarter.

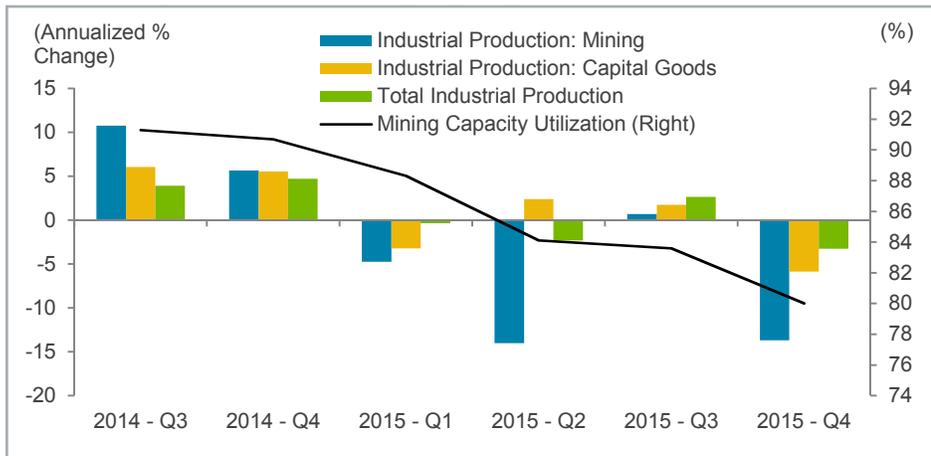
### Low oil prices drag on industrial production

Industrial production in the US, which encompasses the mining, utilities and manufacturing industries, fell through most of 2015. It declined in nine out of twelve months and ended the year down 1.73 percentage points (Chart 1). The

main contributor to the slowdown was cutbacks in the energy sector spurred by the plunge in oil prices. Following several years of strong industrial production from the rapid growth in US tight oil, mining production fell by 12 percentage points in 2015. The drop in rig drilling activity was even starker, down 60% over the past year to 532 rigs by February 2016 (Chart 2). Other resource extracting industries also struggled, especially base metals and minerals. Although industrial production improved at the start of 2016, it remained 1 percentage point below December 2014 levels.

**Chart 1: Waning industrial output has left capacity sitting idle**

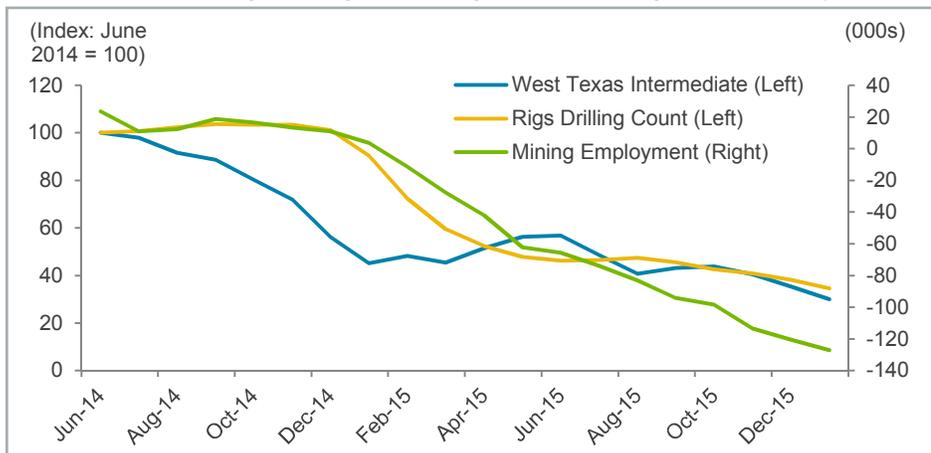
US industrial production and mining capacity utilization rate



Source: US Federal Reserve Board

**Chart 2: Oil price shock leads to cuts in rigs activity and mining employment**

WTI spot price, US rigs drilling and changes in US mining sector employment



Source: IMF, US Bureau of Labor Statistics and Baker Hughes

### Cuts to non-residential investment

Low energy prices also led to deep cuts in capital spending in 2015. Investment in non-residential structures contracted by 1.6% in 2015. This was mainly due to a large decline in mining structures, which plummeted 39% after contracting for four straight quarters. Mining investment as a proportion of overall non-residential structures investment fell from 27% at the beginning of 2014 to 13% by the end of 2015. Weakness was also seen in other categories, including transportation and other equipment. In addition to low energy prices, the strong US dollar and uncertainty about global growth weighed on investment in 2015.

### Strong US dollar hits exports

In addition to low energy prices, industrial production has been hurt by the over 20% appreciation of the US dollar (USD) since mid-2014. The strong USD has reduced the competitiveness of US made products in international markets (Chart 3). The moderating global economy has also suppressed the level of international trade and pushed down global export and import volumes. US goods exports were down in three of the past four quarters. They shrank 0.3% in 2015, compared with 4.4% growth in 2014, and detracted from real GDP growth. Exports of industrial supplies were especially weak, falling 15% in 2015 compared with 2014. As of January

2016, industrial exports were down 16% y/y. Service exports continued to increase, but at a slowing pace.

### Manufacturing on the wane

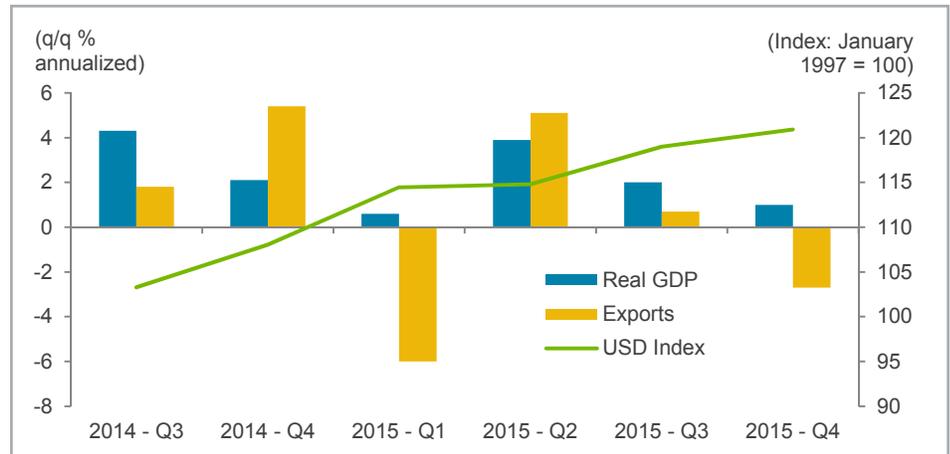
The energy sector slowdown, lower prices for energy and other products, a strong USD and weaker global demand dragged down manufacturing in 2015. US manufacturing shipments fell 4.3%, mainly due to a large decline in non-durables. Petroleum and coal product shipments fell over 30%; sales of food products (-1.6%) and paper (-0.9%) also dropped. In addition, sales fell in oil and gas field machinery (-36%), primary metals (-10.3%) and chemicals (-2.3%). Despite lower sales, real manufacturing output remained positive, but year-over-year growth slowed from almost 5% at the beginning of 2015 to around 1% by January 2016.

The slowdown in manufacturing was also evident from the drop in the Institute of Supply Management (ISM) index. The ISM index has fallen from a peak of 57.5 in November 2014 to 49.5 in February 2016, remaining in contractionary territory. New manufacturing orders have also dropped. Producers serving the energy sector have seen their new orders fall as producers cut costs, while other manufacturers have been hurt by the strong USD and resultant drop in exports. As a result, new manufacturing orders contracted in eight out of twelve months in 2015 and were down by 3.7% (y/y) in December.

### Capacity increasingly underutilized

Slowing industrial production has resulted in increasing idle capacity in the US. The capacity utilization rate for overall industry declined by 2.3 percentage points in 2015, before picking up slightly at the start of 2016. Capacity underutilization has been most pronounced in the mining industry. From a peak of 91.7% in December of 2014, the utilization rate dropped 13.3 percentage points to a low of 78.4% in December 2015 (see Chart 1). Mining capacity utilization is at its lowest level since mid-1987, though it picked up slightly to 78.8% in January 2016.

**Chart 3: The Greenback's appreciation weighs on exports**  
US dollar, real GDP and exports



**Source:** US Bureau of Economic Analysis and US Bureau of Labor Statistics

Utilization rates for manufacturing were relatively stable in 2015, supported by motor vehicle and parts as well as food products. However, the utilization rate for durable goods manufacturers was down 1.1 percentage points by December. The decline coincided with slowing capital goods production as the energy and export sectors held off on buying new equipment and machinery.

### Industry resorts to job cuts

Despite impressive employment growth through 2015, the slowdown in US industrial production put a damper on labour markets. Overall manufacturing employment improved in 2015, but durable goods producing industries cut 20,000 jobs. Employment in the mining sector was especially hard hit. Over the past eighteen months, the mining industry has lost a whopping 138,000 jobs (see Chart 2).

### Many sectors maintained growth

Outside of industrial sectors, the US economy remained solid in 2015. Consumers and some business sectors benefited from the low cost of energy and fuel. Consumer spending also helped key sectors serving the US domestic market. Industries that strengthened included manufacturers of electronic equipment (26%), transportation equipment (6.9%) and furniture makers (6.3%). Residential investment (8.7%) and the housing market fared well, supporting the construction industry and suppliers of construction machinery (+16.1%).

### Gains limited for Alberta

The United States was the destination for 87% of Alberta's exports in 2015, and solid US economic growth and a low Canadian dollar generally benefit Alberta exporters. However, in 2015, the energy sector slowdown and lacklustre performance of America's industrial sector weighed on demand for Alberta's manufactured goods. US producers cut their imports of industrial supplies by 27%. Alberta's US-bound exports of industrial equipment and machinery exports were down 32% y/y by December 2015. The oil price shock also lowered the value of Alberta's US bound crude exports, but not the volume. The result was a 27% drop in the value of Alberta's US bound exports in 2015.

### Contact

[Nachum Gabler](#)

780.638.3238