Economic Trends

This edition of Trends is taken from the First Quarter Fiscal Update and Economic Statement, released on August 23, 2017.

The Alberta economy exceeded expectations in the first half of 2017. Nearly every sector of the economy is rebounding, which has revived exports and manufacturing shipments and boosted employment by almost 17,000 so far this year. The Alberta Activity Index (AAX)[1], a composite indicator of economic activity in the province, is up 4.9% year-to-date (Chart 1). Reflecting first half strength, real GDP is now expected to grow 3.1% in 2017, up from the 2.6% forecast in *Budget 2017*.The forecast for 2018 is mostly unchanged at 2.3%, as the pace of growth is expected to moderate heading into next year.

Despite the improved outlook, the lingering effects of the two-year downturn continue to dampen corporate profits, household incomes and Government of Alberta revenues. The contraction in 2016 was deeper than expected with nominal GDP, a broad measure of income, falling an estimated 6.0%. Even with a strong rebound in 2017, corporate profits are expected to be well below 2014 levels. Moreover, an improving labour market has yet to translate into higher average weekly earnings.

Energy prices lower

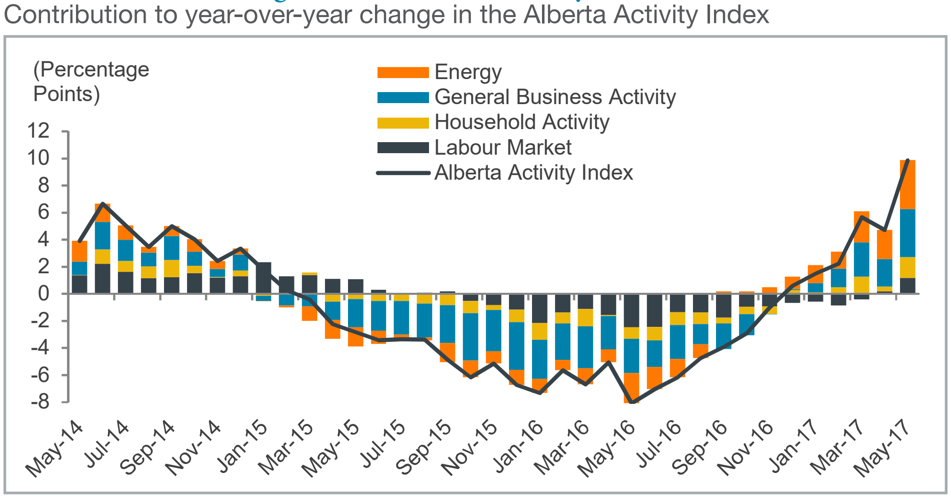
Oil prices have not met *Budget* expectations. Elevated global inventories and higher-than-expected oil production in the US, Libya and Nigeria have kept a ceiling on oil prices despite a renewed commitment from OPEC and 11 other countries to extend production cuts into the first quarter of 2018. This has led to a revision in the 2017-18 forecast for WTI to US$49/bbl, down US$6/bbl from the *Budget* forecast.

Alberta's heavy oil exporters have benefited the most from the OPEC cuts, which have focused on heavier crude types. This, combined with supply outages in the oil sands, has boosted the price of the Alberta heavy oil benchmark (WCS) relative to WTI. However, pipeline capacity is expected to become limited towards the end of 2017 as rising oil sands production causes the differential to widen. Reflecting these developments, the forecast for the WTI-WCS differential in 2017-18 has been revised down $3.80/bbl from *Budget* to $12.20/bbl.

1 More information about the Alberta Activity Index can be found at http://www.finance.alberta.ca/aboutalberta/archive-alberta-activity-index.html

Chart 1: Broad-based gains in economic activity

Contribution to year-over-year change in the Alberta Activity Index



Source: Alberta Treasury Board and Finance

Lower prices weigh on profits

The increase in economic activity in the province will help corporate profits rebound in 2017 after a dramatic decline in 2015 and 2016. However, the rebound is more muted than expected at *Budget* due to the weaker outlook for oil prices. Also impacting profits and export revenues is the recent appreciation of the Canadian dollar, mainly due to the recent interest rate increase by the Bank of Canada and broad-based weakness in the US dollar. The Canadian dollar is now expected to average 77 US¢/Cdn$ in 2017-18, up a full cent from *Budget*.

Oil and gas sector fuels recovery

Drilling activity has been strong so far in 2017. Both the rig count and the number of metres drilled have doubled from last year's levels. As a result, conventional oil and gas investment is projected to rise 40% in 2017. This is partly offset by a larger-than-expected contraction in non-conventional investment, which is now forecast to decline by nearly 14%. With many large oil sands projects moving from construction to production, oil production is expected to grow by over 300,000 barrels per day (bpd) in 2017-18.

Commercial construction lagging

Non-residential investment outside of the oil and gas sector has continued to decrease. Many construction projects underway prior to the oil price drop continue to wind down, pushing commercial investment to the lowest level in over six years. Higher institutional and governmental building is partially offsetting the private sector declines. Weakness is likely to persist into 2018 as the value of non-residential building permits has drifted lower in 2017.

Business output rebounds

Exports and manufacturing sales have surged since bottoming out in late 2016. Both have recovered over half of the value lost during the downturn (Chart 2). Stronger oil prices helped to springboard the recovery by boosting the value of energy exports and petroleum and petrochemical manufacturing. Petrochemicals production further benefited from expanded capacity. Strong sales in food and wood products manufacturing helped to sustain the recovery in the first half of 2017. Real exports are expected to grow by 5.8% in 2017 and 4.2% in 2018.

Labour market improves

As with the improvement in business activity, the recovery in employment has been stronger than expected at *Budget*. Since hitting bottom in July 2016, the Alberta economy has added 34,500 jobs; half were added in 2017. At the same time, there has been a shift from part-time to full-time employment, another indication that underlying labour market conditions are improving. Employment is forecast to grow by 1.3% in 2017 and 1.6% in 2018 (Chart 3), up from the *Budget* forecast of 0.9% and 1.4%, respectively. The unemployment rate has fallen 1.2 percentage points since reaching a 20-year high in November 2016, aided by stronger employment growth. Reflecting the improvement, the unemployment rate forecast has been lowered to 7.8% in 2017 and 7.3% in 2018.

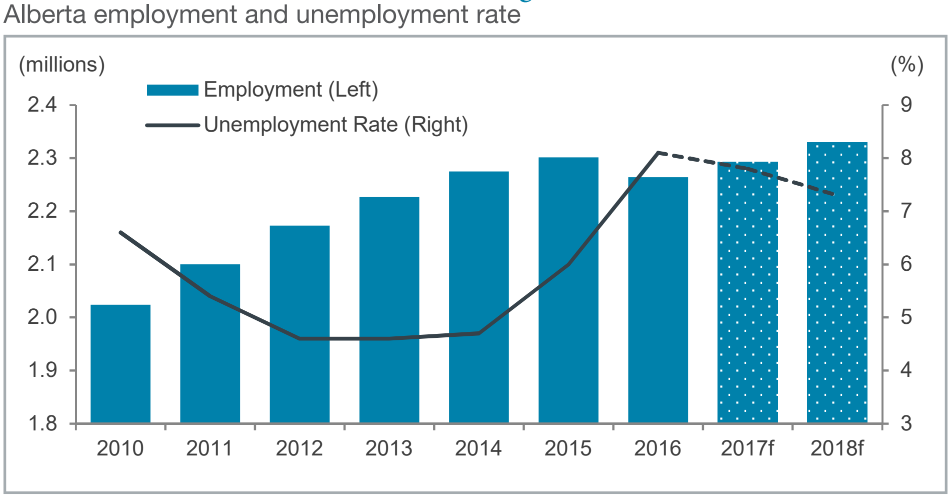
Chart 2: Business output on the rise

Alberta manufacturing sales and international merchandise exports

Source: Statistics Canada

Chart 3: Labour market continues to strengthen

Alberta employment and unemployment rate



Sources: Statistics Canada & Alberta Treasury Board and Finance

Slower earnings recovery

A recovering labour market has not yet translated into a significant improvement in average weekly earnings (AWE), which have essentially remained at 2016 levels. The loss of high paying jobs during the recession, as well as reduced weekly hours worked, are a continuing source of weakness. Because of the trend to date, the forecast for AWE growth in 2017 has been revised 0.4 percentage points lower to 1.0%. The 2018 forecast is unchanged from *Budget 2017* at 2.0%.

Housing market strengthens

Residential investment has improved in the province, despite inventories of new and unsold homes remaining high. Single-unit housing starts have picked up and multi-unit construction has stabilized. In addition, rebuilding in Fort McMurray has proceeded faster than expected at *Budget*. Consequently, the forecast for housing starts has been increased from 24,500 to 27,100 for 2017. The forecast for housing starts in 2018 is now 28,500.

Risks to the Outlook

- If OPEC production cuts are not sustained or US production continues to rise, oil prices could remain weaker for longer.
- Ongoing appreciation of the Canadian dollar could be a drag on exports and revenue.
- Canadian and Alberta households remain exposed to rising interest rates. Rising debt-servicing costs could have a negative impact on consumption and overall growth.

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