

Alberta Economic Outlook

Q4 2014

Prepared by ATB Financial Economics and Research Group
October 2, 2014

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Despite growing political tensions around the world, Alberta’s economy is expected to continue to post healthy, balanced rates of growth entering the fourth quarter of the year.

The most current projection by the ATB Financial Economics and Research group is unchanged from the last Economic Outlook. The expectation for real GDP growth in 2014 is 3.7 per cent, slightly higher than the previous forecast rate of 3.6 per cent.

KEY RESULTS:

- Alberta continues to post healthy economic growth, forecast at 3.7% this year
- Labour market remaining balanced with 4.7% unemployment
- Stronger oil and natural gas prices will support continued investment in energy
- Housing starts are stable and residential market appears to be balanced
- In-migration will continue to lead to population growth

	Year			
	2013	2014	2015	2016
Real GDP	3.9	3.7	3.6	3.4
Consumer Price Index (annual % change)	1.4	2.6	2.6	2.3
Unemployment Rate	4.6	4.7	4.4	4.3
Employment (% chg.)	2.9	3.0	2.8	2.6
Population (millions)	4.025	4.149	4.251	4.364

Global Overview

Geopolitical tensions have heightened around the world through the summer and fall of the year. So far the violence and uncertainty has not yet had a major impact on world economic or financial markets, but that remains a potential risk.

U.S. airstrikes against the Islamic State (ISIS) rebels have significantly increased global concern about the stability of the region. Other nations around the world (including Canada) have pledged support for the mission, but it remains unclear at this point if the situation is moving towards ground combat war. That result could have very worrying impacts on financial and economic markets.

Tensions between Russia and Ukraine have subsided somewhat (at least with respect to media attention), which has helped ease concerns in Europe. Still, economic sanctions against Russia by Europe and other G7 countries remain in place and could intensify in the second half of the year if progress is not made in resolving the conflicts. Germany has the most at risk as it is Europe's largest trading partner with Russia. If increased aggressions lead to more sanctions, Germany's already fragile economy could face challenges.

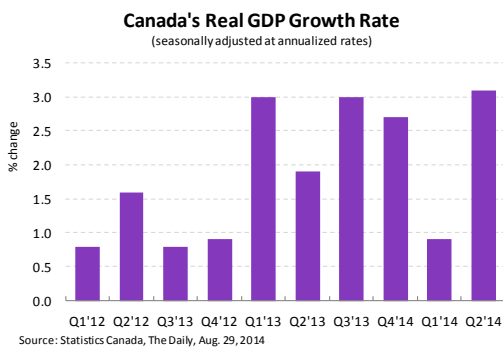
After suffering a sharp 2.1 per cent contraction in the first quarter of the year, the U.S. economy came roaring back to life with an annual growth rate of 4.6% in the second quarter. Federal Reserve Chair Janet Yellen has continued to steadily curtail the program of asset purchases and has raised the prospect of interest rates rising sooner than previously expected. Many market watchers are now expecting a U.S. rate increase in the first quarter of 2015.

Equity markets in both Canada and the United States have pulled back in recent weeks from the all-time high levels reached in the summer.

Canada's economy also staged an impressive come-back in the second quarter of the year. Growth clocked in at an annualized rate of 3.1 per cent, more than three times the pace set in the first three months of the year. Better results on exports helped lift Canadian output.

The Bank of Canada continues with a "neutral" position on interest rates, but is monitoring very closely the output gap in the broader economy. Overall inflation remains weak at 2.1 per cent in August, but the bank's "core" rate has risen steadily from 1.4 per cent to 2.1 per cent in the most recent price survey.

Given the somewhat stronger growth rates in the U.S., the Bank of Canada is almost certain to lag the Fed in raising rates in



2015. That could translate into a bit more weakness on the Canadian dollar exchange rate.

Alberta: Sector Overviews

Oil and Gas

North American crude oil prices (West Texas Intermediate) have softened in recent weeks to the range of \$US 92-94 per barrel. Slower economies in Europe, China and the emerging markets have reduced global oil demand. Helping keep prices from falling even further are the tensions in the Middle East.

The differential between the U.S. dollar benchmark WTI and the Western Canadian Select Blend (WCSB) price has narrowed sharply in September. The gap, which traditionally is between \$C 20-25 per barrel, is currently close to \$C 15. That has helped bolster investment and revenues for producers, despite the somewhat softer WTI prices.

Looking into Q4, both WTI prices and the differential are likely to continue with the usual level of volatility. However, prices should remain at levels supportive of continued investments in oilsands, along with both conventional and unconventional oil.

Henry Hub natural gas prices have slipped back below the \$US 4.00 per MMBtu range recently. Producers in Alberta continue to struggle with plenty of supply from American shale regions. The peak summer demand for electricity for air conditioning failed to significantly draw down inventories in the U.S., so prices have not experienced much lift.

Overall, Alberta's energy sector remains in good shape. Oilsands development have not slowed in any material way, and activity in the Fort McMurray region continues to drive much of the provinces overall industrial investment.

Energy transportation remains an issue. As of the beginning of the fourth quarter, there is still no resolution on any of the major pipeline projects (i.e, Northern Gateway, Keystone XL, Energy East or TransMountain). The election of Premier Jim Prentice as leader of the governing PC party could help remove some of the loggerheads, but access to markets will remain a key concern for producers in 2015.

Daily Crude Oil Price, WTI



Source: U.S. Energy Information Administration (EIA)

Daily Natural Gas Price, Henry Hub



Source: U.S. Energy Information Administration (EIA)

Agriculture

Livestock prices continued to rise steadily in the third quarter, suggesting that cattle and hog farmers are in for decent cash receipts in 2014.

Hog prices have 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. In early September, Alberta hog farmers were receiving around \$2.00/kilogram—up from about \$1.40/k at the beginning of the year.

Cattle prices have also been rising on strong demand and reduced herds over the last few years.

But the higher livestock prices are being offset by weaker prices for grains and oilseeds. Canola prices have eased back from their extreme highs in the early summer. Prices in September have softened even further as soybean yields in the U.S. rose on good crops this summer.

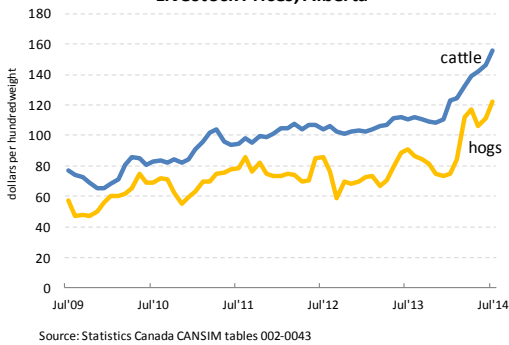
An ill-timed September snow storm in southern Alberta has lowered crop expectations. The cold and moisture resulted in broken stalks and distressed roots, which will reduce much of the grain and oilseed quality to feed grade. Throughout central Alberta, warm and dry conditions mid-September has helped bring harvested acres back to average yields and qualities. Regions in northern Alberta received too little moisture this summer so yields are below normal.

Construction and Real Estate

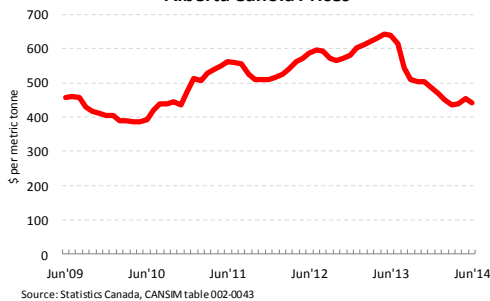
Housing starts have continued at healthy levels in 2014, with the average monthly starts at 39,700 for the first eight months of the year (seasonally adjusted at annualized rates). Builders are reporting generally good, steady demand for new homes. Continued in-migration, high average earnings and solid employment prospects have all kept demand for new dwellings in balance with the supply.

As well, the still-favourable mortgage lending rates have supported new purchases. With very little concern about the prospect of interest rates rising within the next six months, there

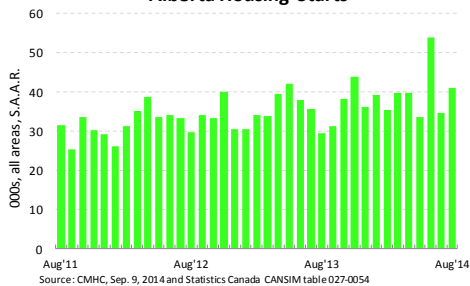
Livestock Prices, Alberta

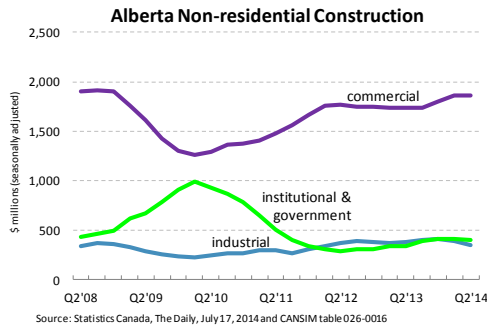


Alberta Canola Prices



Alberta Housing Starts

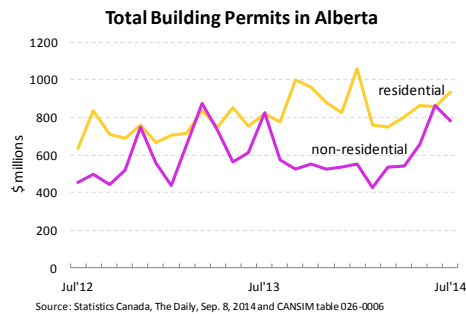




should be little worry about higher rates destroying demand any time in the immediate future.

Spending on non-residential construction was unchanged in the second quarter of 2014 at \$2.6 billion. Over the last twelve months, total non-residential construction spending in Alberta is up 6.5 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.



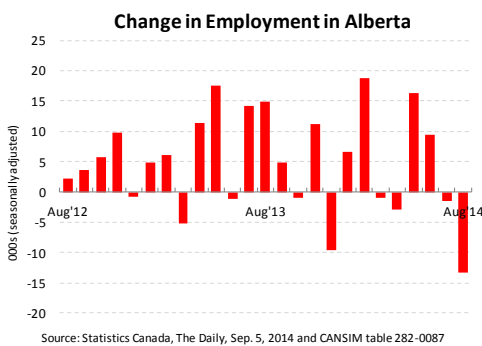
Judging by the continued strength in the pace of building permits issued over the summer, the fourth quarter of 2014 should remain very active. Residential permits in July increased to \$933 million (seasonally adjusted), while non-residential permits dipped a small amount to \$780 million. Combined, total building permits over the last twelve months in Alberta are 5.9 per cent higher than the previous twelve-month period.

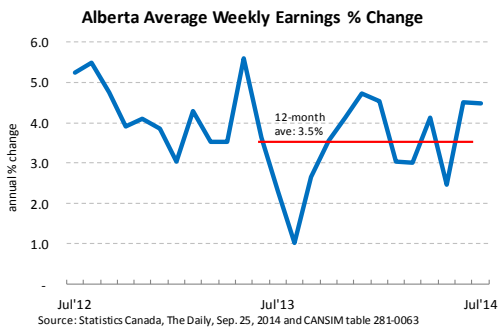
Labour Market

Alberta's job market shed some 13,400 jobs in August, one of the steepest months for lost jobs on record. Most of the losses were concentrated in retail trade, food and accommodation, health care and social assistance, and public administration. These were partially offset by increases in generally higher paying jobs. Employment was up in transportation and warehousing; professional, scientific and technical jobs; and manufacturing.

The longer-term trend for employment in the province remains positive. Over the last twelve months, Alberta has added 37,800 jobs, a year-over-year increase of 1.7 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 (0.5 per cent).

Stronger employment growth should return in September and the final quarter of the year. ATB Financial is forecasting overall employment to expand close to 3 per cent again in 2014.

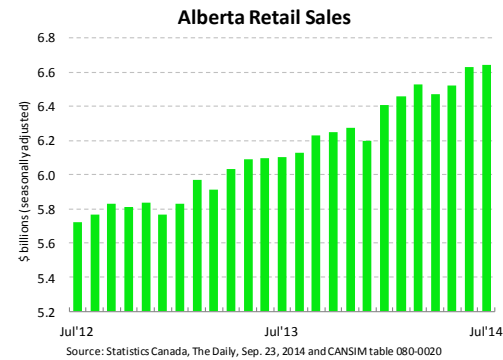




The unemployment rate in August stood at 4.9 per cent, close to the middle point of a balanced job market. The ATB Financial forecast is for an unemployment rate of 4.7 per cent this year.

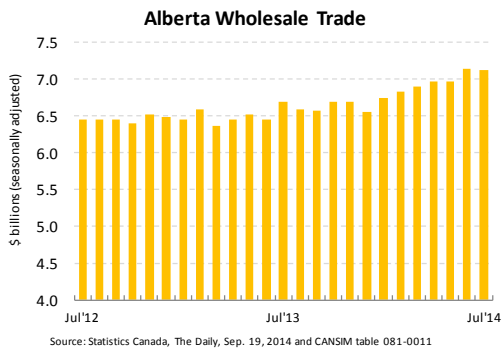
Paycheques of Alberta employees rose to another record high in July as companies and businesses feel the pressure of labour shortages. The average weekly earnings of employees in the province rose to \$1,153.81 in July (seasonally adjusted), up 4.5 per cent from a year ago. That figure includes overtime pay and is calculated before taxes and other deductions.

Nationally, average weekly earnings rose to \$940.43 in July, an annual increase of 3.3 per cent.



Retail, Wholesale and Manufacturing

Alberta retailers are experiencing another very strong year so far in 2014. Record sales were recorded in June and again in July where total receipts exceeded \$6.44 billion (seasonally adjusted). The trend has been exceptionally strong over the last several years, lifted by strong population growth and healthy wages. However, retail sales are rising at a rate well in excess of population plus inflation. Over the last twelve months, total sales are up 8.0 per cent over the previous period.

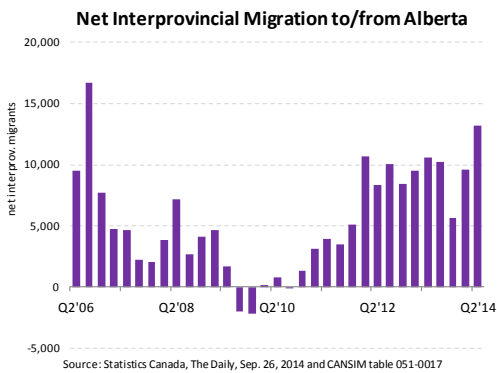


Wholesale activity in the province has also been trending higher in 2014. Sales peaked at a record high in June of \$7.14 billion, to be followed in July by only a very small pull-back to \$7.13 billion. Over the last twelve months, wholesale trade is up 5.1 per cent over the previous twelve-month period.



Shipments from Alberta manufacturers have gained ground in recent months. In June of this year they peaked at a record \$6.95 billion, which (like wholesale trade) was followed by only a slight decline in July.

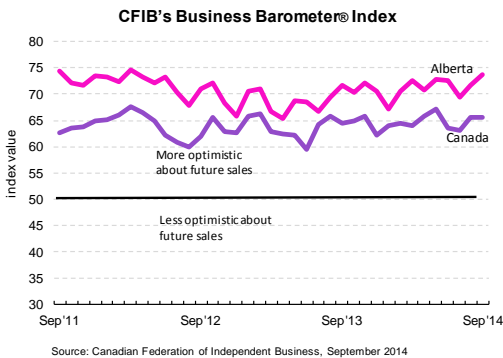
Improved manufacturing results could be the result of higher prices for refined petroleum products (i.e., gasoline) as well as stronger demand from energy producers for pipe, machinery, drilling equipment, etc.



Interprovincial In-Migration

Alberta is once again experiencing a strong period of interprovincial in-migration. In the second quarter of 2014, the province saw a net gain of 13,204. That was the highest quarterly increase since 2006. Over the last complete four quarters (Q3'13 to the end of Q2'14) Alberta was the destination of a net 38,717 Canadians from other provinces.

This high level of 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.



Business Optimism

Alberta is second behind only Newfoundland and Labrador in small- and medium-sized business confidence. The most recent survey from the Canadian Federation of Independent Business shows the index at 73.8. (Figures above 50 suggest there is, on balance, more optimism among business owners about future sales).

Business confidence in the province has remained stable at an elevated level for more than three years.

As reported by the CFIB in its recent report: “Alberta’s Business Barometer registered another gain in September, reaching 73.8—its highest point in a year-and-a-half of strong monthly performances relative to the rest of the country. Short-term hiring plans remain very strong, with 34 per cent of respondents planning to add to their full-time staff and only 6 per cent expecting to cut back. Fifty-one per cent of owners report that their businesses are in good shape, while only 5 per cent report they are in bad shape—among the most positive environments in the country.”

Summary

Alberta's economy is once again enjoying a solid year and continues to outperform the rest of Canada. It is difficult to find too many areas of weakness or pessimism anywhere in the province.

As always, the energy sector will remain the primary driver of fundamental economic activity in the province. Producers will continue to see acceptable price ranges for crude oil—particularly with a narrowing of the WTI/WCS differential in recent months. Investments in both conventional and non-conventional energy plays are expected to remain stable and relatively strong.

The highest influx of interprovincial migrants since 2006 underscores one of the most significant contributors to Alberta's economic growth. Housing demand, retail sales and personal service businesses are all enjoying healthy gains as more people flow into the province.

Agriculture remains in good shape although 2014 is now certain to be a pull-back in cash receipts from the record set last year. Livestock prices remain very strong, but grain and oilseed prices are much weaker. As well, the crop conditions at the end of September suggest yields far below the bumper crops in 2013.

The most current projection by the ATB Financial Economics and Research group is a slight upward revision from the last Economic Outlook. The expectation for real GDP growth in 2014 is 3.7 per cent, followed by growth of 3.6 per cent and 3.4 per cent in the next two years respectively.