ALBERTA ECONOMIC OUTLOOK

Winter 2016/17

Prepared by ATB Financial, Economics & Research

ATB's Economic Outlook
Winter 2016/17

Prepared by ATB Financial's economics and research team.

Released four times a year, ATB's Economic Outlook summarizes Alberta's current economic landscape to give us an idea of what the future may look like. The ATB Economic Outlook aims to provide Albertans with economic commentary that is clear and meaningful.

Overview

Key results:

- Alberta's economy is forecast to contract by 2.6 per cent this year with growth of 2.1 per cent returning next year.
- Oil prices have rebounded somewhat, which should bring stability next year.
- Weak consumer and business sentiment are challenges, yet retail and housing markets remain relatively stable.
- For three consecutive quarters, the province has experienced net interprovincial out-migration.

As the second consecutive year of recession in Alberta draws to a close, many are looking for signals that perhaps we've seen the worst of the downturn and that the economy will improve in 2017.

The situation in the petroleum sector has marginally improved. Prices have climbed to around $US 50 for a barrel of West Texas Intermediate (WTI) and the balance of global supply and demand suggests that the worst of the global price collapse of 2016 is behind us. This should bring stability, but not yet renewed growth, to Alberta's energy sector.

Globally, headwinds remain. With fallout from the Brexit vote still pushing down the pound sterling, and uncertainty surrounding the November 8th election in the United States, investors are nervous and on-edge. On the positive side, China appears to have shaken off the volatility of earlier this year and this has added to the oil price rally. The Bank of Canada remains solidly on the sidelines, and no rate hikes are anticipated until well into 2018.

In Alberta, economic conditions remain difficult. The labour market has seen the largest hit with unemployment rising to close to nine per cent, the highest since the mid-90s. Business sentiment is weak, but there is a sense that things may stabilize and improve in 2017.

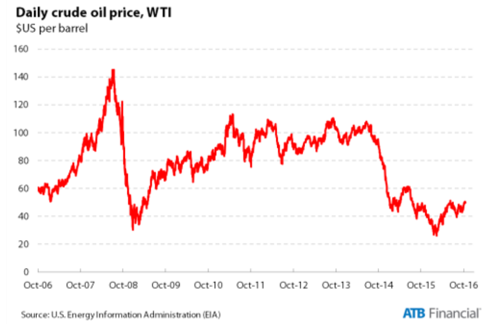
The ATB Financial Economic Outlook for Winter 2016/2017 is forecasting a contraction in Alberta's real GDP of 2.6 per cent this year, with a modest rebound of 2.1 per cent growth in 2017.

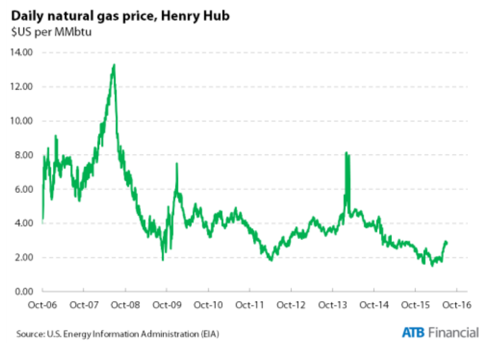
	2015	2016	2017	2018
Real GDP growth (annual % change)	-4.0	-2.6	2.1	2.2
Consumer price index (annual % change)	1.2	1.5	2.1	1.6
Unemployment rate (%)	6.0	8.0	8.1	7.7
Employment (annual % change)	1.2	-1.7	0.6	1.2
Housing starts (000s)	37.5	23.3	22.5	23.6

Oil and gas

After drifting in the $US 45-50 range throughout the summer and early fall, a barrel of WTI once again rose above the $50 mark in mid-October.

It appeared as though oil prices would hover in the mid-$45 range until the Organization of Petroleum Exporting Countries (OPEC) reached an agreement to cut output at the end of September. For the first time since 2008, OPEC agreed to limit its production to a range of 32.5 to 33.0 million barrels per day (bpd). This prompted an advance in oil prices in the aftermath and made some traders and investors optimistic.





Despite the short-term increase in prices, it's still unclear as to when OPEC's agreement will come into effect and how compliance with the cut will be verified (OPEC meets again on November 30, 2016 in Austria). Many are also worried about a strengthening US dollar as well as increasing US crude stockpiles that appear to be dampening the price gains prompted by OPEC's announcement. As we head into 2017, supply and demand fundamentals will continue to seek out equilibrium andprices will continue to feel soft. It's anticipated that oil prices will average around $US 45 this year, and approach $US 50-55 per barrel next year. It will take some time before oil prices return to the $US 70 range.

For many Alberta oil producers, it looks like the worst will be left behind in 2016. Production interrupted by May's forest fires has come back online, drilling may begin to pick up and some deferred projects may begin to trickle back into sight. Conventional oil and gas investment is anticipated to increase by about five to ten per cent next year, but that is starting from a greatly-reduced base. Non-conventional investment will see very little change.

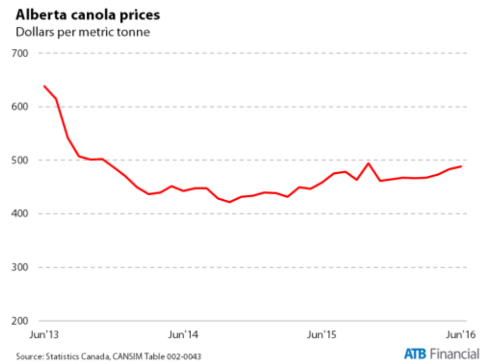
Even though there will be fewer cuts to investment in 2017, Alberta's energy producers will still face challenges with the price for oil. Layoffs in the energy sector should taper off, but rehiring is unlikely to commence, at least for a year or more. Other industries that are related to the energy sector (transportation, manufacturing, construction, etc.) are also unlikely to begin significant rehiring in 2017.

There is an air of cautious optimism swirling around the topic of pipelines and energy transportation. At the end of September, the federal government approved a major natural gas project for northern BC. This made some energy companies slightly more confident that Ottawa would give the go ahead to the TransMountain pipeline. Still, the federal government must take into account the 157 conditions the National Energy Board (NEB) put forth in May and make a decision by mid-December. There has been little to no movement with respect to Keystone XL, Northern Gateway and Energy East.

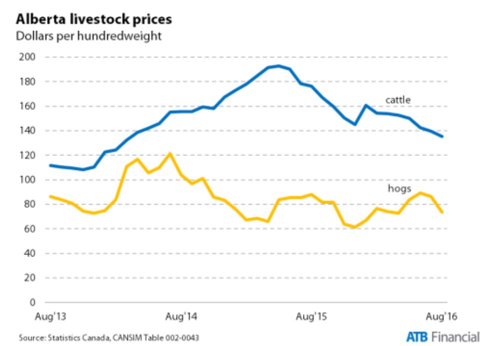
After a disastrous May for the Canadian benchmark for natural gas (AECO spot price), prices have recovered somewhat. Over the last couple of months, the AECO spot price has pushed toward $C

3.00/MMBtu and has averaged $C 2.40/MMBtu. The North American benchmark (Henry Hub) has averaged $US 2.80/MMBtu over the same timeframe and currently sits above $US 3.00. We anticipate natural gas prices to recover as we head into the new year, pushing close to around $US 3.20.

Agriculture and forestry

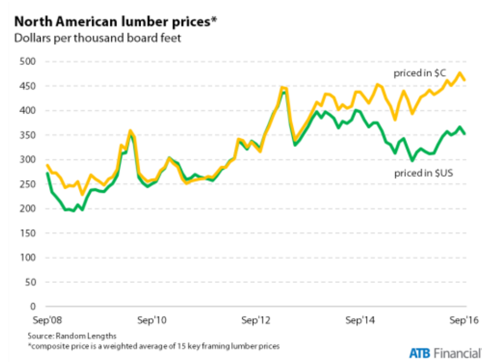


The latest assessment of crop development data from Statistics Canada shows that average yields for Alberta's major crops should be quite good. All three major crops in the province are on track to exceed the average yield over the last 20 years. Barley is predicted to yield about 4,000 kilograms per hectare this year, compared to its 20-year average of just under 3,300 kilograms. Wheat is forecast to yield 3,600 kilograms per hectare (average is 2,900) and canola, 2,300 kilograms per hectare (average is 1,800).



The latest data show that canola was priced around $490 per metric tonne in June, the highest price since October 2015 and about $30 higher than during the same month last year. Future pricing for canola also looks promising. Wheat prices, however, have slid steadily over the summer and fall and are now at 10 year lows. That will cut into farm income, regardless of yield or quality.

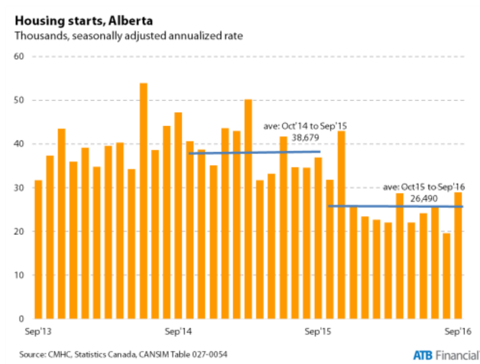
As with wheat, cattle prices in Alberta also slid throughout the summer, dropping to just over $135 per hundredweight in August. That is down sharply from the record high back in early 2015 when prices approached the $200 mark. Despite the decline, prices remain above the 10-year average of $106 per hundredweight. In August, prices for hogs were stuck at $73.51 per hundredweight, close to the 10-year average price of $71.28.

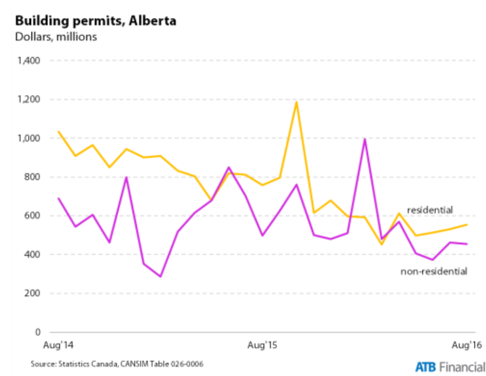


Alberta's forestry industry continues to be a bright spot in the province's economy. Much of the success of this industry has hinged on strong prices for lumber, pulp and paper and panelboard. Even though homebuilders are using less lumber domestically, the strong housing market in the United States has been a key determinant in the success of Alberta's forestry industry. Alberta's lumber producers and other forestry-related businesses are reaping the benefits of a lower Canadian dollar. In September, the North American benchmark price for lumber (based on an average of 15 key framing lumber prices) was $US 353. In Canadian dollars, this translates to around $463, which is near the record high.

However, forestry is facing a major challenge that could prove difficult for the industry. The softwood lumber trade agreement with the United States expired more than a year ago and finding a resolution is proving to be a challenge. Much uncertainty prevails, particularly given the current flux of the American political situation.

Construction and real estate





After stumbling badly in August, housing starts perked up again in September to just under 29,000 units (seasonally adjusted at annualized rates). Still, over the last 12 months, new housing construction has fallen 31 per cent compared to the previous 12-month period.

The two main causes for the pull back in housing construction are fewer buyers and a weak labour market. Net migration to other provinces has picked up pace and reduced the demand for new homes. A weaker labour market has resulted in consumer hesitancy and caused more potential homebuyers to put off buying a new home. As a result, homebuilders have had to scale back new builds.

For the remainder of 2016, it's likely that new housing starts will stay in their current range (20,000 to 25,000) and average around 23,300. Despite the rebuilding effort in Fort McMurray, migration patterns and consumer hesitancy are likely to force a continued reduction in the amount of new housing starts next year as well. In 2017, it's anticipated that new housing starts will fall to around 22,400.

Average house prices in Edmonton have been relatively stable over the course of this downturn. In September, the average sale price was $430,461, virtually unchanged from the same month last year (-0.24 per cent). The median sale price that same month was $397,250, almost a percentage point less than the previous September. In Calgary, September home prices fell almost seven per cent from last year and sat at $458,265. The median price slid a more modest two per cent from a year ago.

With both new housing construction and home prices hanging in the balance, it's no surprise that building intentions are at lower levels as well. According to the latest Statistics Canada data on building permits, a total of $1.0 billion worth of permits (adjusted for seasonality) were issued in August, a 1.2 per cent increase from July but a 20 per cent drop from last year.

As a whole, the value of non-residential permits shrunk 1.9 per cent in August, not bad considering business sentiment in the province. Most surprising was a 27 per cent increase in the value of commercial-type permits. The advance in commercial permit activity most likely stems from renovating and retrofitting old buildings instead of permits to build new office towers.

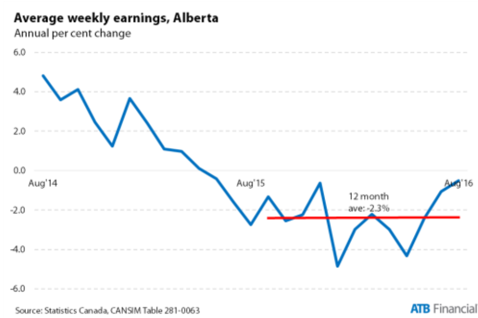
Residential permits picked up in August, too (+4.0 per cent); however, the value of residential permits is 27 per cent lower than it was at this point last year, and 46 per cent lower than the same point in

2014. Even though it's expected that Alberta will return to modest growth next year, the construction and real estate sectors may feel particularly slow.

Labour market

In September, Alberta's labour market gained 13,300 new jobs (seasonally adjusted)—one of the largest monthly gains in several years and the second month in a row of positive employment growth. Still, despite the growth, the latest job report exposes certain weaknesses. The jobs that were added were heavily skewed toward part-time (+9,300); only 4,000 full-time positions were gained in September. It's true that Alberta welcomes any employment growth, but a ratio of more than two-to-one in favour of part-time job growth reveals a lack of confidence in the trajectory of Alberta's economy.

Alberta's unemployment rate ticked a tenth of a per cent higher in September as well. More people entered the labour force and were looking for work, pushing the unemployment rate up to 8.5 per cent.



Over the course of the downturn, construction and professional, scientific and technical services positions have been some of the hardest hit industries. Yet in September, they both added jobs. Construction jobs rose by 5,300, and professional, scientific and technical services gained 5,200. Even the resource sector added 1,000 jobs. While good news, the gains may be part-time or contract positions.

Calgary continues to see the worst of the downturn. Its unemployment rate (three-month moving average) rose from 9 to 9.5 per cent while Edmonton's dropped from 8 to 7.7 per cent.

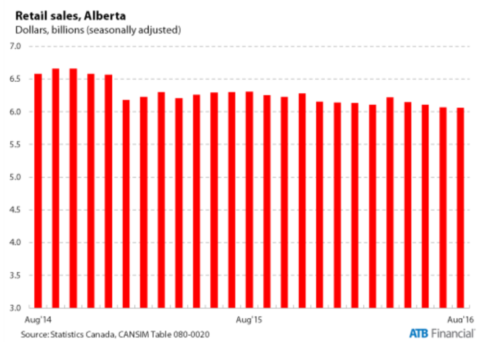
Overall, we are projecting that Alberta's unemployment rate will average around eight per cent this year. Next, year the unemployment rate could average slightly higher. Even though economic conditions will improve, more people will start to enter the labour force to look for work and, in turn, increase the unemployment rate.

Average weekly earnings picked up in Alberta between June and July and sat around $1,123(before taxes and includes overtime). Still, earnings are lower than they were last year by about 0.5 per cent.

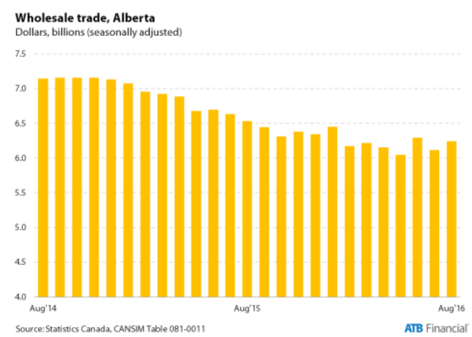
The reason for lower paycheques is due to less overtime hours being worked, workers taking jobs that pay less and staff taking pay cuts. Next year, the take home pay for workers in the province is likely to still be less than a few years ago when average weekly earnings were around $1,160.

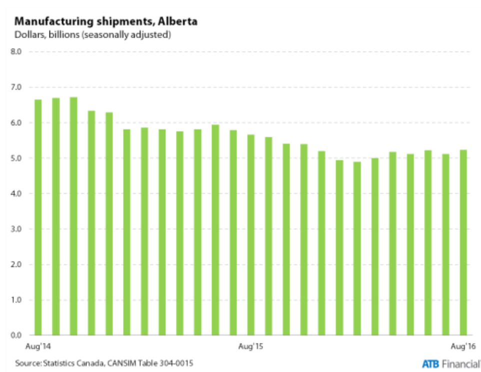
Retail, wholesale and manufacturing

Taking into account the negative sentiment in the province, it's a bit of a surprise to see retail sales so stable. Over the last 12 months, total sales are down by only 3.8 per cent and are still ahead of the levels reached in 2012 and 2013, which were boom years for the province. In August, retailers racked up $6.06 billion in sales (adjusted for seasonality). There's no question that spending has been curtailed, but retail spending has not collapsed. As we roll into 2017, we can anticipate a slight bump up in retail sales. Part of this is due to the rebuilding effort in Fort McMurray, but improving retail conditions will be largely due to the slight upturn in general economic conditions.



After a slight decline in July, total wholesale activity in Alberta picked back up again in August. The latest report showed that wholesale sales reached $6.2 billion and grew by $128 million or 2.1 per cent from July (this figure is adjusted to account for seasonal variation). Surprisingly, sales grew in every type of wholesale category. The value of goods sold from Alberta's largest wholesale supplier, machinery, equipment and supplies merchants grew by 15.2 per cent in August from July. The value of goods sold by building material and supplies improved nine per cent, while sales from food and beverage wholesalers rose about two per cent from July. August's numbers now show that half of all wholesale subsectors are above last year's levels and may also suggest that retailers are beginning to grow more optimistic about general economic conditions. That said, total wholesale trade is still below where it was at the same point last year (-4.7 per cent).





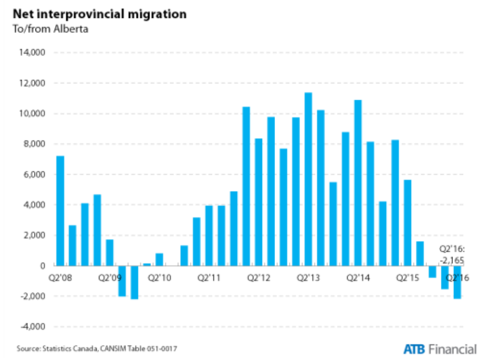
Like wholesale, manufacturing has continued to struggle throughout the year. But, August's data show that shipments totalled $5.2 billion, up two per cent from July and the largest total registered in 10 months.

Despite August's marginal growth, manufacturing has struggled over the course of the year. These struggles are the direct result of lower energy prices and have translated to lower sales in petroleum manufacturing (-15.2 per cent), transportation equipment (-16.9 per cent), fabricated metal products (-18.2 per cent) and machinery (-33.6 per cent) over the year. But, while a large share of manufacturing subsectors depend on the energy sector, there are a few that don't. During the course of this economic downturn, miscellaneous (sporting goods, toys, etc., +5.3 per cent), chemical manufacturing (+7.0 per cent) and manufactured wood products (+13.2 per cent) have managed to find some traction compared to a year ago.

Unfortunately, manufacturing as a whole is expected to stay suppressed through the remainder of the year. In 2017, as energy prices start to recover and Alberta's energy companies start to emerge, manufacturing should begin to stabilize and slowly pick up.

Interprovincial migration

Alberta's weak economy and labour market in 2016 accelerated the net outflow of interprovincial migrants from the province. In the second quarter of this year, a total of 21, 837 people arrived in Alberta from other provinces. At the same time, 24,002 packed up and headed to other parts of Canada. This left a net loss of 2,165.



For three consecutive quarters, Alberta has seen a net outflow of people from the province. After losing about 800 residents at the end of last year, 1,500 people in the first quarter of this year and close to 2,200 in the second quarter, Alberta has now seen more people leave on a net basis than during the recession in 2009. However, these losses are still relatively modest when you consider that Alberta gained over 75,000 people on a net basis over the last three years.

Over the second half of the year, the net flow of people from Alberta could increase. The energy sector will continue to battle economic headwinds, albeit lighter than last year. Other industries and sectors will be squeezed too. Unfortunately, this weakness will continue to run through the veins of Alberta's business community and will keep the labour market muted. As a result, there will be fewer job openings—this will not only discourage migration to Alberta from other provinces but will force many Albertans to try to find jobs elsewhere.

While international migration and natural population growth (births-minus-deaths) will keep Alberta's population growth positive, we expect a net interprovincial loss of close to 10,000 people this year. Next year, it's probable that the battered labour market will keep interprovincial migration negative for a second year running.

Summary

Despite some glimmers of optimism brought on by higher oil prices, Alberta's economy remains challenged as 2016 draws to a close. This has understandably weighed down consumer and business confidence; the prevailing mood in the province is, unfortunately, discouraging.

The positive news is that the worst of the 2015/16 oil price downturn is now behind us. We are unlikely to test the lows set earlier this year, and prices should continue to rally (though modestly) in 2017. That will bring stability to Alberta' petroleum sector, but not growth. Hiring and resumption of investment will be weak in 2017.

Other sectors continue to fare better. Agriculture has been hit with some recent downturns in cattle and wheat prices, yet overall conditions going into next year remain decent. Forestry continues to do well, although the unresolved softwood lumber agreement with the US could irritate the industry.

Tourism could see another record year in 2017. Rebuilding in Fort McMurray will also contribute to activity in construction and building services.

As well, new enterprises in agri-foods and high-tech will find attractive labour and office space, which could help encourage greater economic diversity.

ATB Financial's economics and research team is forecasting another contraction of 2.6 per cent this year, with modest growth of 2.1 per cent in 2017. Despite a rebound in GDP growth, unemployment will remain high.