Economic Trends

August 2023

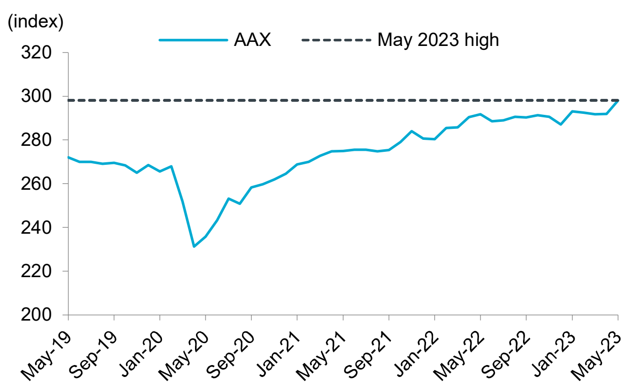
This month's Economic Trends is taken from the [Economic Update] of the 2023-24 First Quarter Fiscal Update and Economic Statement, released on August 31, 2023.

Overview

Alberta's economic expansion remains on track this year despite headwinds from rising interest rates and persistently high consumer prices. The Alberta Activity Index, a measure of provincial economic activity, climbed to a record high in May (Chart 1) and was up 2.4% year-to-date (YTD). The exceptional pace of migration into the province is supporting the labour market and consumer spending, although rising interest rates have been a drag on residential investment. Business sector activity and investment intentions remain solid, while lower commodity prices are helping to moderate cost pressures among businesses and consumers. Alberta's real gross domestic product (GDP) is now expected to rise 3.0% in 2023, up 0.2 percentage points from Budget 2023 (Chart 2). The expansion builds on estimated growth of 5.1% last year, when the Alberta economy fully recovered from the COVID-19 pandemic and 2015-16 recession.

CHART 1: ECONOMIC ACTIVITY PICKING UP

Alberta Activity Index (January 1981=100)

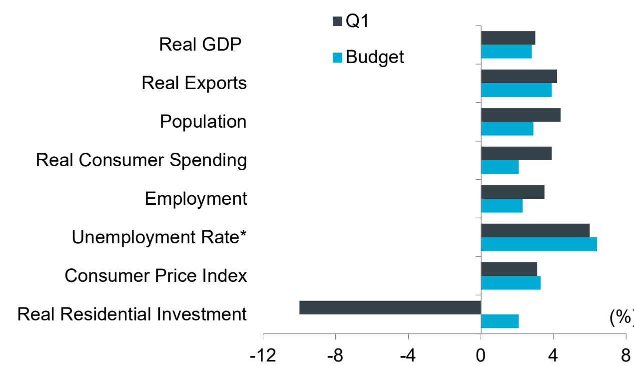


Source: Alberta Treasury Board and Finance

In contrast to real GDP, nominal GDP is forecast to decline 4.6% this year. Corporate profits are expected to pull back after last year's exceptional growth due to lower commodity prices and ongoing cost pressures. Stronger-than-expected job gains will boost labour and primary household income growth, offsetting some of the decline in corporate profits.

CHART 2: STRONGER POPULATION AND EMPLOYMENT GROWTH LIFT OUTLOOK

Year-over-year growth in selected economic indicators, 2023



Source: Alberta Treasury Board and Finance; *Unemployment rate is forecast level

In 2024, real GDP growth is forecast to remain solid at 2.9%. The completion of Trans Mountain Pipeline Expansion (TMX) in early 2024 will boost egress in the province. This, along with solid oil prices, will support energy sector activity next year. Several companies have announced projects since budget, which will add to business investment outside oil and gas extraction. However, higher for longer interest rates will weigh on consumer spending.

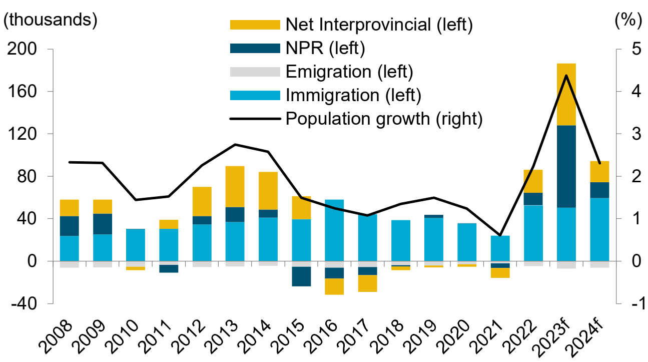
Although the outlook for Alberta's economy is positive, downside risks remain elevated. More persistent inflation in Canada could lead to further interest rate hikes, which could dampen business investment, consumer spending and residential investment in Alberta. A sharper slowdown in the global economy from additional monetary tightening in other major economies or weaker-than-expected growth in China would also weigh on global oil prices.

Outsized population growth

The majority of the uplift in the outlook for this year is being driven by recent population trends. Alberta's population is growing at an exceptionally strong pace. More than 46,000 people have moved into the province from the rest of the country so far in the 2023 census year. They have been drawn by Alberta's robust economic conditions, relatively favourable housing affordability and lower cost of living. This exceeds the previous high set in the 2006 census year and has outpaced other provinces. Net international migration is also on track to reach a record high, bolstered by unprecedented net inflows of non-permanent residents (NPRs). The NPR category includes temporary foreign workers, international students and refugee claimants, along with their family members. NPRs are expected to account for more than 60% of total international migration this census year (Chart 3). This is driven in part by the arrival of more than 37,000 migrants since June 2022 fleeing the conflict in Ukraine. Alberta's population is now forecast to grow 4.4% in the 2023 census year, up from the budget forecast of 2.9%. This will be the fastest annual population growth since 1981.

CHART 3: SURGE IN NPRS ACCELERATING POPULATION GROWTH

Annual change in the Alberta population by migration component



Sources: Statistics Canada, Haver Analytics, and Alberta Treasury Board and Finance; e-estimate, f- forecast

Population growth is forecast to decelerate to a solid pace of 2.3% in the 2024 census year. Interprovincial and international migration are both expected to retreat from this year's elevated levels as job vacancies ease and employment growth moderates. The end of the Canada-Ukraine Authorization for Emergency Travel (CUAET) program will also result in a pullback in NPRs next year.

Employment exceeds expectations

Robust migration flows into the province are helping to fill job vacancies and boost employment. The province has added more than 60,000 jobs since December 2022, led by full-time and private sector hiring. Employment is now forecast to rise 3.5% this year, up 1.2 percentage points from budget. The influx of people is providing some relief to Alberta's tight labour market. Although job vacancies remain above pre-COVID levels, they have eased compared to a year ago. As positions continue to be filled, the pace of job gains are set to slow in the second half of the year. This is expected to carry into next year, with employment growth moderating to 2.7%.

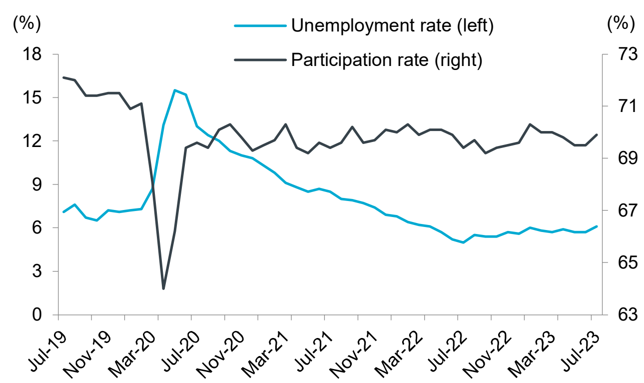
Primary household income is forecast to grow 6.8% this year, up 0.9 percentage point from budget, on the back of stronger labour market conditions. In 2024, it is expected to moderate to 6.1%.

Unemployment rate contained

The unemployment rate has been lower-than-expected so far this year. It is now forecast to average 6.0% in 2023, down 0.4 percentage point from budget, but still higher than last year's annual rate of 5.8%. The decline is due to both strong job gains and lagging participation in the labour force. The participation rate has drifted lower since hitting a recent high in January, despite record migration into the province (Chart 4). This is partly because landed immigrants, who are becoming a larger portion of the labour force, face more barriers in joining the workforce and tend to participate less than their Canadian-born counterparts. While the overall participation rate is expected to improve slightly next year, Alberta's ongoing ageing population will limit the gains. This will dampen the unemployment rate in 2024, which is now forecast to average 6.0%, 0.3 percentage points lower than budget.

CHART 4: MUTED PART RATE KEEPING A LID ON THE UNEMPLOYMENT RATE

Unemployment rate and labour force participation rate



Sources: Statistics Canada and Haver Analytics

Consumer spending resilient

Strong migration and a robust labour market are boosting household spending. However, the rapid rise in prices and interest rates over the past two years is expected to take a bite out of consumption next year. Spending on services is anticipated to rise in line with population growth, as strong migration boosts demand for housing, transportation, and finance, insurance, real estate and leasing services. Discretionary services such as restaurant sales and hotel accommodation are also expected to increase. While sales of housing and renovation-related categories have declined from a year ago, spending on other discretionary items such as motor vehicles and clothing and accessories have held up. Retail sales rose 6.8% YTD through June, and on an inflation-adjusted basis they were up 4.1%. Given the YTD strength, real consumer spending is now forecast to rise 3.9% in 2023, 1.8 percentage points higher than budget.

Despite the upward revision, per capita real goods spending is forecast to decline this year, reflecting the drag from high inflation and rising borrowing costs. Since budget, the Bank of Canada (BoC) has raised its key policy rate by another 50 basis points to 5.0% – the highest since early 2001. With the BoC not expected to begin cutting interest rates until the second half of 2024, interest rates will be higher for longer. A growing number of highly indebted Albertans are already feeling the strain of rising interest rates. Consumer insolvencies in the province have climbed steadily over the past year and are now above pre-COVID levels, largely driven by record high consumer proposals. Rising debt servicing costs and moderating population growth should dampen real consumer spending next year, which is forecast to grow at a slower pace of 2.8%.

Weakness in residential investment

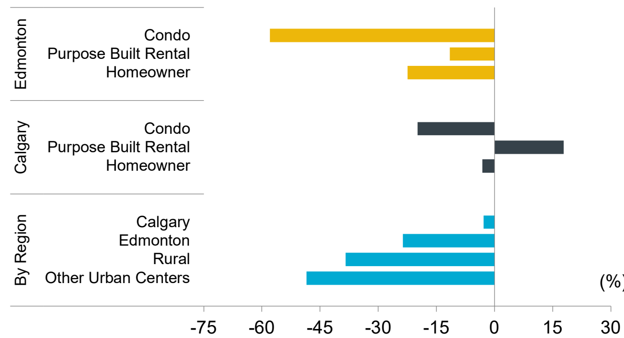
Housing construction activity has failed to gain ground this year. Homebuilders have been slow to respond despite Alberta's booming population, with activity hampered by rising interest rates and labour shortages in the construction sector. In addition, there has been pronounced weakness in renovation spending. Both are weighing on overall residential investment.

Construction of purpose-built rental apartments rose at a solid pace in the first half of the year. This is likely driven by demand from international migrants, which more often rent when arriving in Canada. The trend has been pronounced in Calgary (Chart 5), which appears to be the biggest beneficiary of Alberta's surging population growth. In contrast, construction of homeowner-occupied dwellings and condominiums has declined across the province, with the weakness most pronounced in Edmonton. As a result, housing starts in the province are now forecast to average 31,000 units in 2023, down from about 38,000 at budget and lower than last year's annual pace of 36,500. A recent surge in residential building permits in Edmonton bodes well for a modest pickup in housing starts in the second half of the year. Next year, housing starts are forecast to increase slightly to 32,500 units as construction begins to catch up with demand.

Unlike the new housing market, supply continues to lag behind demand in the resale market. Unit home sales have bounced back since March and are now above last year's levels. With the pickup in home sales outpacing new listings, inventories remain at historically low levels. Alberta's strong labour market and accessibility to mortgage relief options

CHART 5: CALGARY PURPOSE BUILT RENTALS BUCK THE TREND

Year-to-date growth in Alberta Housing Starts, July 2023



Sources: Statistics Canada, Canadian Mortgage and Housing Corporation, and Haver Analytics

(such as amortization extensions) for some borrowers have kept distressed home sales and mortgage arrears low despite rising borrowing costs. Moreover, high mortgage rates are likely discouraging homeowners from moving up, further contributing to the lack of supply in the resale market.

Prospects positive for business investment

Notwithstanding residential construction, business investment outside oil and gas extraction is expected to see modest growth this year despite higher borrowing and construction costs. A few major projects were announced since budget which will add to investment in the province in the short term. McCain Foods will proceed with the $600 million expansion of its potato processing facility in southern Alberta. Heidelberg Materials also completed a Memorandum of Understanding with the federal government in support of its $1.4 billion Carbon Capture Utilization and Storage facility in Edmonton – the world's first net zero cement plant. The facility recently commenced operations of its pilot carbon capture system this month. These projects will provide an additional lift to non-energy investment, which is now forecast to rise 8% in 2023 and 12% in 2024. With rising construction costs, however, real investment is expected to grow a modest 3% this year before accelerating to 8% next year.

Energy prices soften

Global oil prices have been volatile so far in 2023. After falling sharply in the second quarter due to global demand concerns, the West Texas Intermediate (WTI) oil price rebounded to around US$80/bbl in the last month. The bounce back came as Saudi Arabia extended its output cut until September and OPEC+ maintained its existing production plan. With rising demand expected to outpace supply, oil markets should tighten in the second half of the year and support prices. However, downside risks remain elevated. Several major central banks including the U.S.

Federal Reserve have resumed interest rate hikes or signaled additional tightening in response to persistent inflation, raising concerns of a much sharper slowdown in the global economy. Momentum in China's economy also appears to be slowing following the surge from the economic reopening, while manufacturing activity in the euro area is contracting at a faster pace. Given the weakness YTD, WTI is now forecast to average US$75.00/bbl in 2023-24, US$4.00/bbl lower than budget.

North American natural gas prices have also been weaker since budget. A mild winter in the Northern Hemisphere led to overall lower demand and above-average inventories. This, along with U.S. LNG export terminal outages and robust domestic production, have all weighed on the Henry Hub price. Similarly, the AECO price has been subdued due to above-average storage inventories and robust production. The Alberta Reference Price (ARP) is now expected to average $2.50/GJ in 2023-24, down from $4.10/GJ at budget and lower than the annual levels seen in the last two fiscal years.

Cost pressures moderating

The pullback in commodity prices is starting to work its way into the supply chain and dampen input costs. Prices for raw materials and industrial products in Canada have come down significantly from their mid-2022 peak, led by declines in lumber, energy and primary metals. This has contributed to a much slower pace of growth for construction costs, particularly in the residential building sector, where year-over-year growth fell to 2% in the second quarter. This was the slowest pace in three years. Despite the moderation, construction costs will continue to rise this year and remain significantly higher compared to pre-COVID levels.

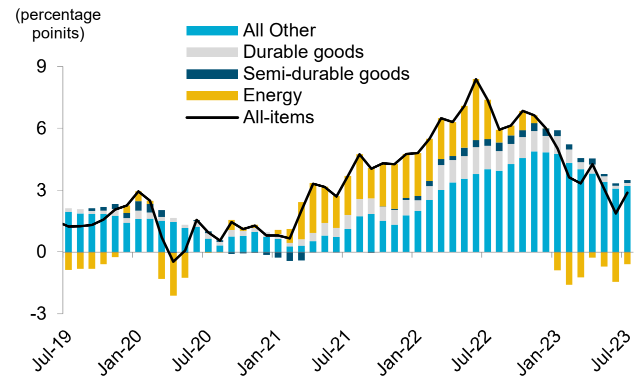
With lower commodity prices and rising labour and other input costs, corporate profits are expected to retreat from last year's record high. Net operating surplus for corporations – a driver of corporate income tax revenues – is now forecast to decline 17.5% in 2023, compared to a 13.9% decline forecast at budget. Despite the downward revision, corporate profits are expected to remain historically elevated and will exceed the 2014 high.

Inflation gradually subsiding

Consumer prices are growing at a much slower pace. Energy prices – which were a major source of inflation in 2022 – have retreated sharply from last year's peak (Chart 6). The province's affordability measures have also helped restrain price increases, with Alberta's inflation staying below the national average since July 2022. At the same time, improving supply chains and moderating input costs have helped cool inflation for durable and semi-durable goods. Consumer inflation is now forecast to average 3.1% in 2023, 0.2 percentage points lower than budget. With the prices for some goods and services – such as food and mortgage interest costs – continuing to grow at a rapid pace, inflation is not expected to return closer to around 2% until next year.

CHART 6: INFLATION MODERATING WITH LOWER PRICES FOR ENERGY AND GOODS

Contribution to inflation by category



Source: Statistics Canada

Lower differential supports netback prices

Heavy oil producers are benefitting from stronger heavy oil prices, which have helped to offset some of the weakness in WTI. Reduced supply due to a larger-than-normal seasonal maintenance by oil sands facilities, alongside a seasonal pick up in U.S. refinery demand, helped narrow the differential between WTI and Alberta's heavy oil benchmark Western Canadian Select (WCS). It fell to a low of around US$11-14/bbl in June and July before starting to widen in recent weeks. As oil sands production continues to come back online, the differential is expected to remain in line with pipeline transportation costs. The completion of TMX in the first quarter of 2024 will boost egress in the province. Strong demand for Alberta's heavy oil is also expected to support prices. The light-heavy differential is forecast to average US$15.00/bbl in 2023-24, US$4.50/bbl lower than budget.

With the narrower differential offsetting a weaker WTI, producer netbacks are expected to remain solid. WCS price is now forecast to average Cdn$79.60/bbl this fiscal year, Cdn$1.60/bbl higher than budget. A weaker Canadian dollar will also provide some additional lift, which is now forecast to be slightly lower at 75.5 US¢/Cdn$ in 2023-24, down from 76.2 US¢/Cdn$ at budget.

Energy investment strong

Healthy cash flows and balance sheets are supporting robust spending in the oil and gas sector this year. Rigs drilling in the province has held close to the five-year high in recent months despite being impacted by wildfires and floods in the spring. With TMX coming into service in early 2024, drilling activity is expected to ramp up in the short term. Conventional oil and gas investment is forecast to increase 19% in 2023 and 9% in 2024, unchanged from budget. Increased drilling in the most prolific and economic resource plays will boost conventional oil production in the province to average 507,000 bpd this year, higher than the budget forecast. However, natural gas production has been revised down due to wildfire-related shut-ins. Meanwhile, rising bitumen output will support higher non-conventional investment, which is expected to rise 18% this year and 12% next year. Oil sands producers will continue to focus spending on clean energy projects, as well as streamlining and optimizing existing infrastructure. Higher costs will also continue to put upward pressure on spending, albeit at a more moderate pace compared to 2022.

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