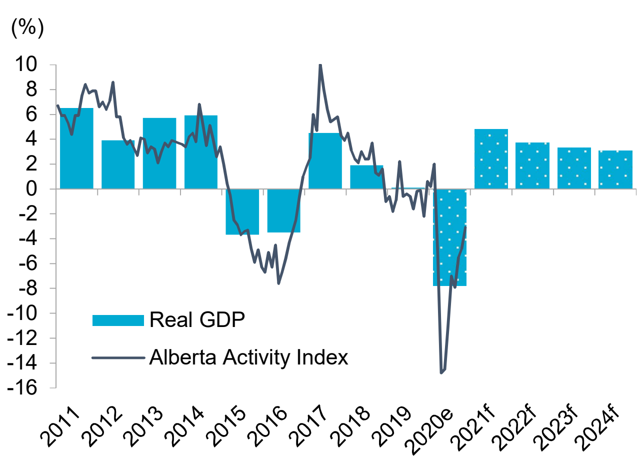
Economic Trends

This month's Economic Trends is taken from the Economic Outlook chapter of *Budget 2021*, released on February 25, 2021.

The global economy is slowly emerging from one of the worst downturns in history, caused by the COVID-19 pandemic. In Alberta, the impact of the health crisis was compounded by the collapse in oil prices last year. The Alberta Activity Index (AAX), an indicator of provincial economic activity, rebounded nearly 10 per cent after hitting a low in May 2020, led by a swift recovery in retail spending, housing and oil production (Chart 1). The arrival of vaccines is expected to pave the way for the Alberta economy to gain momentum in the second half of the year, when vaccinations are expected to become more widely available and the virus is better contained. Real gross domestic product (GDP) is forecast to see a partial rebound of 4.8 per cent this year, following a severe contraction of an estimated 7.8 per cent in 2020. Even with the pickup in activity, some degree of public health measures may remain this year. This will limit the recovery in the services sector, particularly travel and tourism-related industries.

CHART 1: ALBERTA ECONOMY TO PARTIALLY REBOUND THIS YEAR

Real GDP Growth and Alberta Activity Index



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

Growth this year will be led by oil production. Improving oil prices and demand will also support gains in energy investment. However, continued uncertainty around COVID-19 and weakness in commercial building construction will keep a lid on non-energy investment. Meanwhile, low interest rates and COVID-related government income supports will continue to play an important role in supporting consumer spending and housing activity.

Over the medium term, real GDP growth is forecast to moderate to a solid pace of about 3.4 per cent per year through to 2024. As the economy moves from recovery to expansion, rising exports will be accompanied by a pickup in business investment. Expansions in sectors outside of oil and gas will also contribute to growth. As government income supports wind down and the economy reopens, consumer spending and housing activity will become increasingly driven by a strengthening labour market and accelerating population growth.

The Alberta outlook remains highly uncertain. In particular, the recovery in economic activity in the second half of the year is contingent on containing the spread of the virus. Delays in the rollout of vaccine to the general population could lead to another severe wave of infection and necessitate more restrictive public health measures. Households and businesses could also voluntarily curb activity in response to a resurgence in cases. Other factors, such as slower-than-expected vaccine uptake and the impact of new variants of the virus, also pose significant risks to the outlook. For more information on the risks and scenarios, see p. 63–64 of the Fiscal Plan.

Global recovery to strengthen after near-term challenges

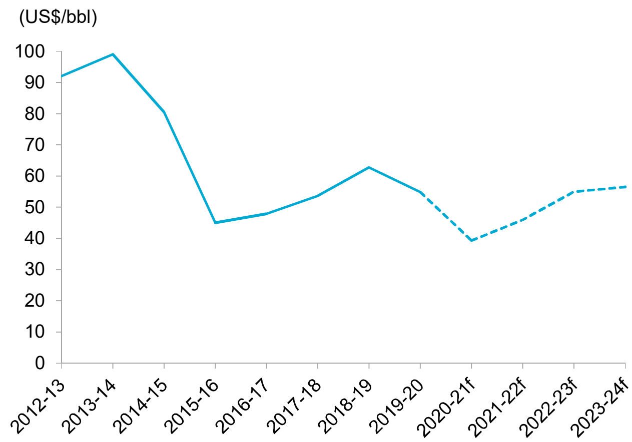
The pandemic pummeled the global economy into its worst recession since the Great Depression of the 1930s. Most countries around the world saw sharp annual declines in output in 2020, with the exception of China, where real GDP grew an estimated 2.3 per cent on the back of a strong rebound in industrial output. China reopened its economy earlier than other countries and saw a swifter recovery in global goods trade and production. The International Monetary Fund is forecasting the global economy to grow 5.5 per cent in 2021 and 4.2 in 2022 amid a rebound in both advanced and emerging economies. The pace of recovery will vary considerably in advanced and emerging economies.

The recovery in the global economy is expected to be supported by monetary and fiscal stimulus. Countries around the world have responded swiftly and aggressively with coordinated policy actions since the pandemic began, with massive quantitative easing and record low interest rates. In addition, governments have provided unprecedented amounts of fiscal support to individuals and businesses. Key policy rates in major advanced economies are expected to remain near historic lows at least through 2022.

The recovery in the Canadian economy will continue to be driven by consumer spending and the housing sector, buoyed by low interest rates and high household savings. The Bank of Canada is not anticipated to raise interest rates until early 2023. At the same time, federal and provincial fiscal stimulus will continue to support the economy, particularly contact-intensive industries. As vaccination rollout gains traction and the economy reopens, fiscal stimulus is expected to slowly unwind and contribute less to growth.

CHART 2: MODERATE OUTLOOK FOR OIL PRICES

West Texas Intermediate



Sources: Reuters and Alberta Treasury Board and Finance, f-forecast

Oil prices to improve

The uneven recovery across advanced and emerging economies, along with the uncertainty about the path of COVID, particularly in the first half of this year, are expected to keep energy markets volatile in 2021. Oil prices have strengthened since December, supported by ongoing production restraint by OPEC (Organization of Petroleum Exporting Countries) and its allies, followed by a surprise announcement by Saudi Arabia to undertake additional production cuts. Positive news on vaccination and new fiscal support in the U.S. have raised optimism about the outlook for oil demand, adding further momentum in prices. These developments sent West Texas Intermediate (WTI) above US$55 per barrel (bbl) in recent weeks. However, it is expected that WTI will retreat from currently high levels in the near term as demand fundamentals remain weak amid renewed lockdowns and ongoing challenges with production and distribution of vaccines. WTI is forecast to average US$46/bbl in 2021-22, up from US$39.30/bbl in 2020-21 (Chart 2). WTI is forecast to average US$55/bbl in 2022-23, when global petroleum demand is expected to surpass its 2019 level. The recovery in oil demand is expected to be driven by emerging markets, in contrast to advanced economies, where the accelerated adoption of energy efficiency technologies and renewable energy will temper petroleum demand growth. Ample supply from OPEC countries will keep a lid on prices. WTI is expected to rise to US$56.50/bbl by 2023-24.

Cautious optimism in the energy sector

Improving global growth and a sustained upturn in U.S. and global oil demand and prices are expected to pave the way for a turnaround in Alberta's oil and gas sector. Energy investment is anticipated to turn a corner in 2021 on the back of rising oil production and prices, coupled with growing domestic demand for natural gas and natural gas liquids (NGLs). After plunging an estimated 30 per cent in 2020, energy investment is forecast to increase by over $1.9 billion (or 10.9 per cent) in 2021. Investment is expected to accelerate in 2022 by another 13.1 per cent, followed by a solid gain of 11.3 per cent per year in 2023 and 2024. While oil and gas investment is expected to pick up, it is not expected to return to 2019 levels until 2024.

Oil producers are expected to maintain capital discipline and gradually increase production to meet growing demand. The improvement in activity will be led by the oil sands sector. Meanwhile, conventional oil producers are expected to gradually ramp up spending, but at a slower pace than non-conventional investment. Natural gas investment is also expected to be a source of growth, driven by domestic demand for natural gas and NGLs.

Improving market access to support Alberta oil prices

The large discounts that Alberta crudes have faced due to transportation bottlenecks have diminished. Without sufficient pipeline capacity in recent years, the price discount between WTI and Alberta's heavy oil benchmark, Western Canadian Select (WCS), widened to levels that reflected the higher cost of transporting crude by rail. However, government-mandated production limits in 2019, followed by voluntary production shut-ins due to weaker prices and demand from COVID-19 last year, alleviated pipeline constraints. The differential is expected to average US$11/bbl in 2020-21 and US$14-15/bbl in the next three years. Sufficient export pipeline capacity will keep it less volatile than in previous years, reflecting the lower cost of transportation by pipeline. A narrow differential, along with a moderate improvement in WTI, will help lift WCS prices to US$40/bbl by 2022-23.

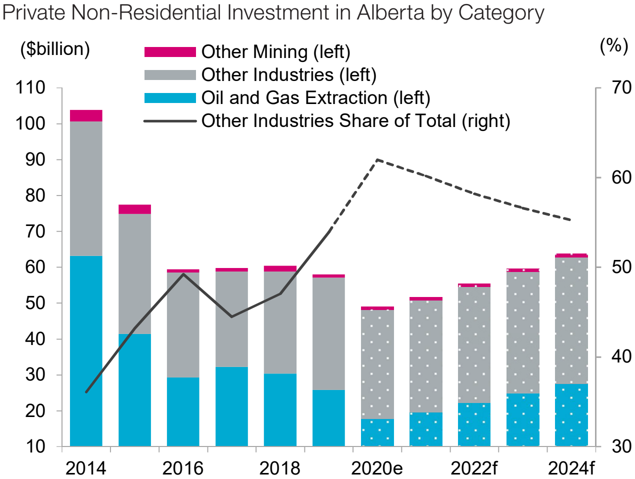
The completion of the U.S. portion of Enbridge's Line 3 replacement later this year, followed by the TransMountain Expansion (TMX) by the end of 2022, will add more than 800,000 bpd of pipeline capacity. Both the Line 3 and TMX pipelines have passed major regulatory hurdles and are under construction; however, continued legal and regulatory challenges could hamper progress. Under a scenario of no additional pipeline access, foregone resource revenues are estimated to be $4.9 billion between 2021-22 and 2023-24.

Other industries a source of strength

While investment in the non-energy sector pulled back last year, the decline was far more modest compared to the energy sector. This year and over the medium term, non-energy investment is expected to exceed that of the energy sector (Chart 3). It is forecast to rise by over $700 million, or 2.4 per cent, in 2021. Weakness in commercial building construction will remain a drag on investment, but prospects for industrial construction are expected to remain positive, as the sector benefits from expansions in petrochemical and food manufacturing, transportation, renewable energy and agricultural infrastructure.

CHART 3: NON-ENERGY INVESTMENT TO ACCELERATE OVER MEDIUM TERM

Private Non-Residential Investment in Alberta by Category



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

Growth in non-energy investment is forecast to accelerate to an average of $1.4 billion (or 4.2 per cent) per year from 2022 to 2024. As government infrastructure spending eases, construction spending will become increasingly driven by the private sector. Non-energy investment in the province is expected to account for more than 55 per cent of overall business investment in 2024, up significantly from under 40 per cent in 2014.

The recovery in investment outside oil and gas extraction over the medium term will continue to be led by the transportation sector, as several projects begin or ramp up construction: TC Energy's expansion of its NGTL system and Pembina's Peace Pipeline expansion.

Alberta is seeing a growing number of companies investing in renewable energy projects, particularly solar and wind. Projects that support more natural gas consumption in the province and renewable energy will also help fuel expansion in investment outside of oil and gas extraction.

Alberta's petrochemical manufacturing will also contribute to non-energy investment (Inter Pipeline's Heartland Petrochemical Complex).

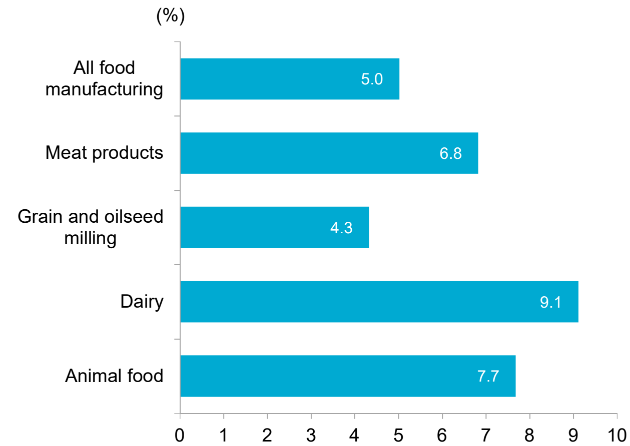
The province's agri-food sector saw the attraction and expansion of 14 value-added processing companies in 2019 and 2020, engaged in vegetable processing, food services, plant-based food production, natural health products and agri-technology. Moreover, the Government of Alberta, along with Canada Infrastructure Bank and eight irrigation districts, have partnered on an historical $815 million investment in irrigation infrastructure to support economic recovery in the province.

Non-energy exports to gain ground

Non-energy exports will benefit from manufacturing expansions and solid activity in the agri-foods sector. Capacity expansions in the petrochemical sector, along with improving industrial activity, will support gains in durable and non-durable manufacturing shipments. At the same time, growing global population and improving demand will drive growth in agri-food exports. Last year, robust consumer demand and households shifting their spending towards groceries and food stores during the pandemic fueled a strong rebound in the sales of food and beverage manufacturing products (Chart 4). These will propel real manufacturing exports to grow by about 4 per cent this year and 3.5 per cent over the medium term. Prospects for Alberta's crop and livestock sector are also expected to remain positive in 2021. Solid activity in the North American housing market also bodes well for lumber prices and exports of forestry products.

CHART 4: FOOD MANUFACTURING SECTOR A BRIGHT SPOT

Change in Food Manufacturing Shipments, Jan-Nov 2020 vs Jan-Nov 2019

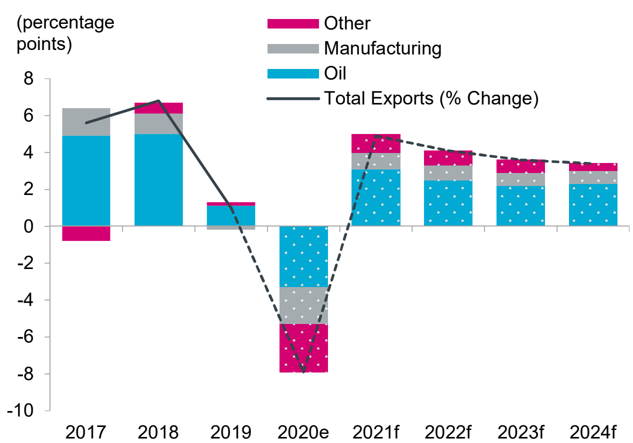


Sources: Statistics Canada and Alberta Agriculture and Forestry

With the pick-up in non-energy exports, overall real exports are forecast to grow by nearly five per cent this year before expanding at an average of 3.7 per cent per year from 2022 to 2024 (Chart 5).

CHART 5: SOLID REBOUND IN EXPORTS

Contribution to Change in Real Exports by Component



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

Slower recovery in the services sector

The services sector is expected to face a slower recovery than the goods sector as ongoing public health measures continue to hold back growth in contact-intensive industries. Services, which are typically resilient and have acted as a buffer to the economy in prior recessions, have been hit particularly hard during the pandemic. Continued travel restrictions, social distancing and restrictions on large gatherings have negatively affected food and accommodation, entertainment and recreation, and air travel sectors.

One bright spot during the pandemic is Alberta's burgeoning technology sector. The sector has benefitted from accelerated adoption in digitization among companies, including those in the oil and gas sector. Last year, Calgary and Edmonton both broke records for venture capital investments. Several companies have also moved their headquarters to downtown Calgary.

Real service exports are expected to see a strong rebound this year, but are not expected to return to 2019 levels until 2023. Growth is forecast to moderate to around four per cent by 2024.

Provincial economic measures lend support during pandemic

Last year, the provincial government introduced numerous measures that significantly reduced the impact of the pandemic on the economy. In 2020-21, the government allocated $5.8 billion in expense and $700 million in capital investment to COVID-19 response, economic stimulus and Recovery Plan initiatives. This was in addition to accelerating the reduction in the corporate income tax (CIT) rate and waivers and payment deferrals to businesses and individuals. These measures are estimated to have lifted Alberta's real GDP by about $8.2 billion (or 2.6 per cent) and employment by about 32,200 in 2020, compared to a scenario without provincial economic measures.

Employment to fully recover as economy reopens

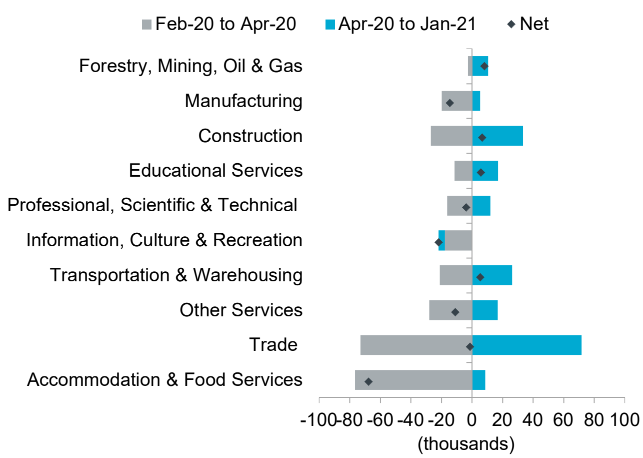
The recovery in employment stalled as the province tightened public health measures to curb the spread of COVID-19 in November 2020. This came on the heels of a strong bounce back in jobs following the reopening of the economy in Spring 2020. As of January, the province has recovered nearly 74 per cent of the 337,000 jobs lost between February and April 2020.

While employment is expected to improve further, the recovery will be uneven across industries. Last year, employment in the services sector, which was hit hard in the spring, rebounded strongly after the economy reopened.

In contrast, goods sector employment lagged behind, due to ongoing weakness in business investment (Chart 6). This year, both goods and service sector employment are forecast to advance. In the goods sector, employment in construction and manufacturing will benefit from a pickup in business investment, solid residential construction activity and improving export demand. Meanwhile, progress on vaccinations will pave the way for restrictions to be eased gradually in the second half of this year. However, until a significant proportion of the population is inoculated, some public health measures are assumed to remain in place. This will limit the employment recovery in some service industries this year, such as food and accommodation and personal services. Overall employment is forecast to bounce back 4.2 per cent this year after posting a record decline of 6.6 per cent in 2020. Employment is anticipated to see a full recovery in 2022, followed by a 2.5 per cent growth in the next two years.

CHART 6: UNEVEN RECOVERY IN EMPLOYMENT ACROSS INDUSTRIES

Change in employment



Sources: Statistics Canada and Haver Analytics

Immigration to drive population growth

Alberta's population growth is projected to pick up after slowing this year. Travel restrictions, provincial immigration policy changes and other pandemic-related disruptions will continue to limit international migration in the 2021 census year (June 30, 2020 to July 1, 2021). Meanwhile, weaker economic conditions in Alberta relative to the rest of Canada are expected to result in net outflows of interprovincial migrants, although limited mobility due to the pandemic will temper the outflows. Population growth in the 2021 census year is forecast to be 0.6 per cent, down significantly from 1.4 per cent growth in 2020. With net migration slowing dramatically, natural increase will account for the lion's share of the province's population growth this year.

Over the medium term, Alberta's population growth is projected to recover as higher federal targets combined with easing travel restrictions will result in more immigrants coming into the province. An improving migration outlook, coupled with continued strong natural increase, will lift population growth to 1.0 per cent in 2022 and 1.4 per cent over the medium term.

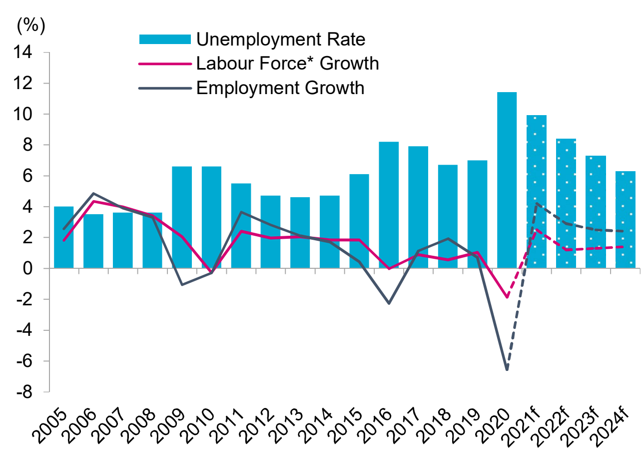
Gradual decline in unemployment rate

The unemployment rate in the province is expected to fall gradually. With employment stalling in late 2020, unemployment in the province remains elevated across all age groups but is most pronounced among young workers (15-24 age group). Youth unemployment has been elevated since mid-2019 amid subdued activity in the energy and construction sectors and exacerbated by pandemic-related disruptions in lower-paid service industries. The labour force underutilization rate, which includes people who left the workforce as well as those who are still employed but not working or working less hours, remains extremely high.

The unemployment rate is forecast to decline this year, although some of the improvement will be dampened by rising labour force participation. More people are expected to return to the labour force as the economy gradually reopens. The unemployment rate is forecast to average 9.9 per cent in 2021, down from 11.4 percent in 2020, but still higher than the annual rate in 2019 and 2016-17. Given the depth of the contraction and protracted recovery in employment, the unemployment rate is not expected to fall below the 2019 level until 2024, when it averages 6.3 per cent (Chart 7).

CHART 7: UNEMPLOYMENT RATE TO DECLINE AMID SOLID JOB GROWTH

Labour Market Indicators



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

* The number of people working or looking for work.

Household income to lead recovery

Nominal GDP, a broad measure of income, is expected to resume growth this year following a sharp decline in 2020. It is forecast to rebound 8.8 per cent in 2021 before growing at an average of about 7 per cent over the medium term.

The recovery in nominal GDP will be led by primary household income, which is set to fully recover this year on the back of an improving labour market. Household incomes were hit hard by the pandemic last year, although government income support cushioned the blow. This helped support the improvement in retail spending and boosted household savings rates. Household incomes will continue to grow over the medium term as the labour market strengthens and wage growth picks up. However, on a per capita basis, household incomes are not expected to return to their 2015 high during the forecast period.

Companies are also expected to see earnings improve over the medium term as economic activity picks up, oil prices move higher and businesses continue to manage costs. This should contribute to higher business investment and employment in the coming years.

Broadening recovery in consumer spending

The recovery in consumer spending is expected to become more broad-based as pandemic-related impacts dissipate and will be a major driver of growth in 2021. After declining an estimated 6.7 per cent in 2020, real consumer spending is forecast to bounce back 6 per cent this year. While tighter public health measures are weighing on spending, some businesses and consumers are adjusting to the pandemic as they shift to online shopping, curbside pick-up and delivery. As public health measures are eased, the recovery will accelerate and broaden in the second half of the year. Pent-up demand and accumulated household savings will also provide some lift to consumer spending. Real consumer spending is forecast to grow 4.3 per cent and return to 2019 levels in 2022, when the economy is expected to fully reopen and services see a stronger recovery.

Housing market a source of growth

After staging a remarkable recovery in the second half of 2020, Alberta's housing market is poised to see another solid year in 2021. The recovery in the housing market defied expectations last year, buoyed by historically low mortgage rates, pent-up demand and an improvement in consumer confidence. These same factors are expected to drive activity in Alberta's housing market this year. Against a backdrop of tight inventories in both the resale and new housing market, housing starts are forecast to increase from an annual pace of just over 24,000 units in 2020 to around 26,000 units in 2021. Residential construction investment is also expected to benefit from continued strength in renovation activity and homebuyers' preference towards bigger spaces. With the Bank of Canada expected to keep interest rates unchanged until early 2023, low mortgage rates will continue to support housing demand, along with a pickup in net migration and earnings growth. Housing starts will reach around 34,000 units annually by 2024.

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