Economic Trends

February 2023

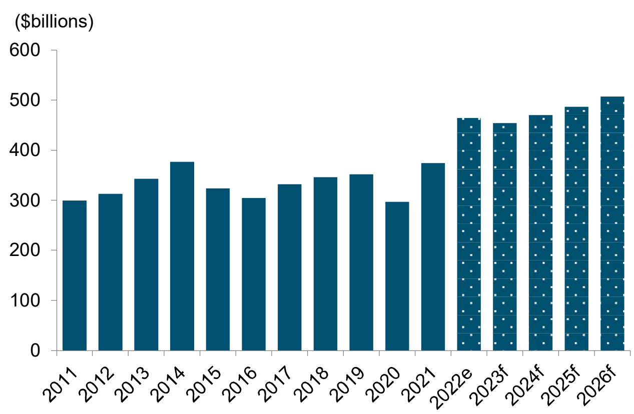
This month's Economic Trends is taken from the Economic Outlook Chapter of *Budget 2023*, released on February 28, 2023.

Overview

Alberta is well-positioned to face the challenges coming from last year's rapid rise in prices, higher interest rates, and slowing global growth. Following two years of robust post-pandemic recovery, Alberta's real gross domestic product (GDP) growth will moderate to a solid clip of 2.8 per cent this year and lead the country. With last year's strong pace of 4.8 per cent, real GDP fully recovered from the COVID-19 downturn and surpassed the 2014 peak. Soaring energy prices and strong economic activity propelled incomes to a record high and boosted provincial government revenues. This is expected to support business and household spending this year, even as incomes pull back from last year's record high (Chart 1).

CHART 1: INCOME GAINS TO SUPPORT ACTIVITY

Nominal GDP, actual and forecast



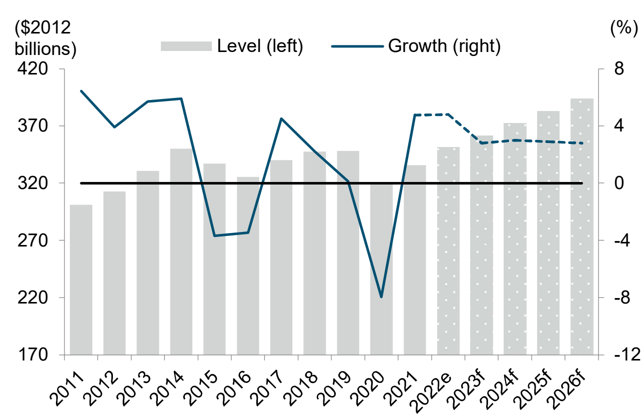
Sources: Statistics Canada, Haver Analytics and Alberta Treasury Board and Finance; e-estimate, f-forecast

Alberta's oil and gas sector is expected to take the lead in 2023. Solid energy prices and strong cash flows from 2022 will support drilling activity, production and investment in the sector. The province's population is expected to rise at its highest pace since 2006, which will provide relief to Alberta's tight labour market and support employment. Residential construction activity will also benefit from rising in-migration and a healthy labour market. However, slowing momentum in the global economy will weigh on non-energy manufacturing and service exports. High interest rates and elevated prices will continue to keep a lid on household spending. Rising borrowing costs, slower export demand and higher construction costs may also limit expansion and investment plans by some companies outside the oil and gas sector.

Alberta's economic growth will become more broad-based over the medium term. Real GDP is forecast to rise to 3.0 per cent in 2024 and average 2.9 per cent between 2025 and 2026 (Chart 2). Business investment is set to accelerate and grow around 10 per cent per year in nominal terms. It will be underpinned by rising investment in the energy sector and large-scale investments in clean technology, manufacturing and other emerging sectors. Alberta's competitive taxes, regulatory environment, and access to abundant and low-cost natural resources will continue to encourage investment in the province. Construction activity will also get a boost from higher capital spending by the provincial government. Consumer spending and residential construction activity are expected to gain traction as inflation subsides further and interest rates come down. A pickup in global growth should fuel gains in manufacturing and services exports. Solid fundamentals – including strong population growth, a relatively young population, lower cost of living, and high wages – will support Alberta's continued expansion.

CHART 2: REAL GDP TO GROW AT A SOLID PACE

Real GDP, level and growth



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

With business investment and consumer spending gathering momentum, Alberta's growth will become increasingly driven by domestic demand. This marks a shift in the composition of Alberta's real GDP compared with the years prior to the pandemic. From 2016 to 2019, exports accounted for nearly all of Alberta's real GDP growth. This was driven by a period of exceptional growth in oil production as several large oil sands projects ramped up. More modest gains in oil production means the contribution of real exports to GDP growth will decline from around 85 per cent in 2023 to 57 per cent by 2026.

Global economy

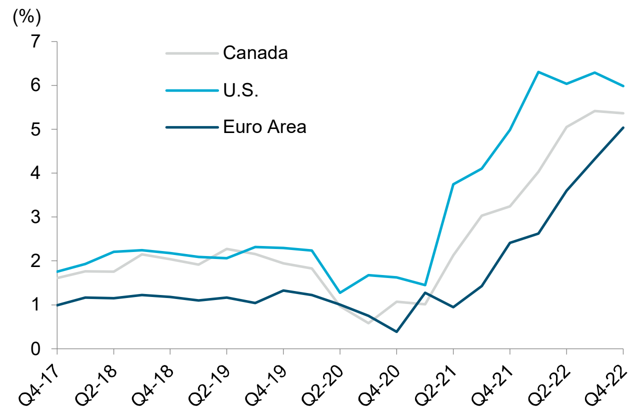
Inflation abating but still elevated

Consumer prices appear to be levelling off in most advanced economies following sharp increases over the past year. In Canada and the U.S., headline inflation – measured as the year-over-year percentage change in the consumer price index – has cooled significantly after hitting 40-year highs in mid2022. Inflation in the euro area and the U.K. has also moderated in recent months. Goods inflation, which was a significant driver of inflation last year, has retreated amid a steep pullback in energy prices, easing supply chain disruptions and shifting demand from goods to services. This trend is expected to continue in 2023 as consumer demand for goods weakens further.

While pressures are easing, inflation and consumer prices remain high in most advanced economies. Core inflation, which excludes the volatile components of food and energy, has yet to show signs of peaking (Chart 3). Shelter costs continue to increase, particularly in Canada, as higher interest rates add to owned accommodation costs. Tight labour market conditions and rising wages have also pushed up core inflation. As a result, headline inflation is expected to decline gradually over the next two years in advanced economies.

CHART 3: CORE INFLATION REMAINS ELEVATED IN ADVANCED ECONOMIES

Annual rate of core inflation, selected countries



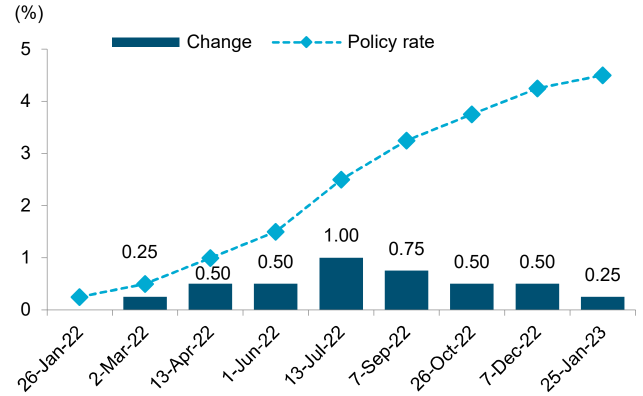
Sources: Statistics Canada, Bureau of Labor Statistics, Statistical Office of the European Communities and Haver Analytics

Monetary policy shifting gears

With headline inflation turning a corner, some central banks have begun to slow the pace of rate increases. The Bank of Canada (BoC) raised its overnight target rate by a quarter of percentage point in January – the smallest rate hike since March 2022 – and indicated that it is taking a conditional pause to assess the full impact of cumulative rate hikes on the economy (Chart 4). The Bank of England implemented a half of a percentage point hike in early February, but signaled that further tightening will depend on whether price pressures remain persistent. The U.S. Federal Reserve lifted its key policy rate in February by a quarter-point after aggressive hikes through 2022. The Fed anticipates more increases are needed to bring inflation back to target, albeit at a slower pace than last year. In contrast, the European Central Bank, which began to raise interest rates later than other central banks, is expected to continue with aggressive increases given ongoing elevated inflation in Europe. While the pace of monetary tightening is slowing in some countries, interest rates will stay high until inflation falls to levels targeted by central banks. The BoC is not expected to begin cutting interest rates until early 2024, when inflation returns to its mid-point target of 2 per cent and the economy improves.

CHART 4: BANK OF CANADA'S MONETARY TIGHTENING IS DOWNSHIFTING

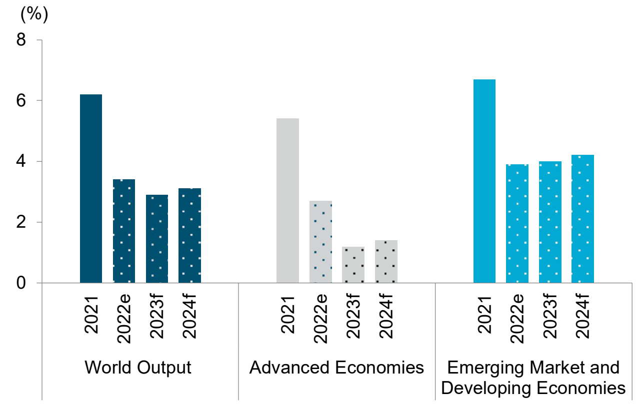
Policy rate and change by BoC meeting date



Sources: Bank of Canada and Haver Analytics

CHART 5: GROWTH TO SLOW IN ADVANCED ECONOMIES THIS YEAR

Actual and IMF forecast for real GDP growth



Source: IMF World Economic Outlook, January 2023 Update; e-estimate, f-forecast

Global growth to slow in the near term

Global economic activity is forecast to pull back considerably this year before improving in 2024 and over the medium term. Central banks' efforts are helping to quell inflation. However, the lagged effects of higher interest rates and increasing borrowing costs for businesses and consumers are expected to cool demand further this year. In addition, persistently high prices and ongoing geopolitical tensions will continue to weigh on global growth. After advancing an estimated 3.4 per cent in 2022, the International Monetary Fund (IMF) is projecting global growth to decelerate to 2.9 per cent in 2023.

The slowdown in growth will be led by advanced economies (Chart 5). It will be most notable in the euro area, where aggressive monetary tightening and the ongoing impact of the energy shock exacerbated by Russia's invasion of Ukraine will remain a drag on activity. The U.S. economy is expected to see muted growth this year as the impact of rising interest rates and high consumer prices restrain household spending. A strong labour market and healthy balance sheets will cushion the impact. In China, growth is set to pick up this year after posting its weakest expansion in four decades in 2022 due to COVID-19 lockdowns. As the impact of monetary tightening fades, global economic growth is forecast to rise slightly to 3.1 per cent in 2024, although it will remain weak by historical standards.

Momentum slowing in the Canadian economy

The Canadian economy will face similar headwinds as other advanced economies in 2023. Momentum slowed considerably at the end of last year as consumer spending, residential investment, and the housing market weakened. As a result, Canada's real GDP growth in the fourth quarter fell to an estimated annualized rate of 1.6 per cent. The weakness will carry through into this year and restrict GDP growth to 0.6 per cent before it improves in 2024. Lower energy prices will reduce the value of Canada's energy exports and be a drag on incomes this year. Following extremely tight conditions last year, the labour market is projected to become more balanced in 2023 and 2024 as demand cools and immigration normalizes.

The Canadian dollar is forecast to strengthen over the forecast horizon. It persistently underperformed the U.S. dollar in 2022, as global economic uncertainties and actions by the U.S. Federal Reserve led to a surge in demand for safe-haven U.S. dollar. This is expected to reverse gradually in 2023, with the Loonie projected to rise to an average US¢76.20/Cdn$ in 2023-24 and US¢78.20/Cdn$ in 2024-25.

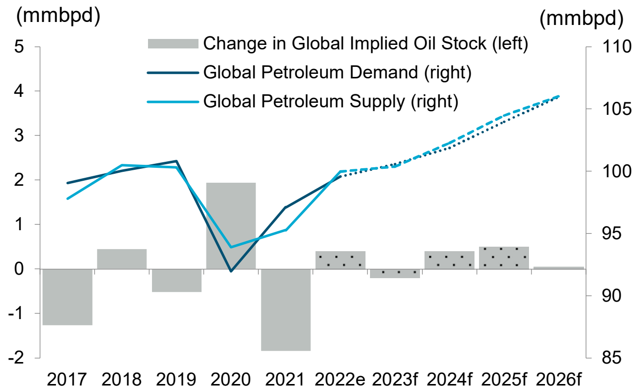
Global oil prices to moderate

The backdrop of slower world economic growth and a tight oil market is creating a lot of uncertainty and price volatility. West Texas Intermediate (WTI) tumbled in early December after the G7 and its allies imposed sanctions and a price cap on Russian oil supplies. Fears of a looming global recession and a surge in COVID-19 cases in China further depressed prices heading into the new year. WTI dipped to a low of US$71 per barrel (/bbl) in early December before bouncing back to around US$80/bbl more recently. Against this backdrop, global oil prices are forecast to soften this year but remain at solid levels. Slower global growth is expected to dampen petroleum demand, although a tight supply-demand balance will continue to buoy oil prices (Chart 6). WTI is forecast to average US$79.00/bbl in 2023-24, down from US$90.50/bbl in 2022-23. Price volatility is expected to persist this year amid ongoing geopolitical tensions.

The medium-term outlook for oil prices is higher compared with previous budget expectations following Russia's invasion

CHART 6: TIGHT GLOBAL OIL MARKET TO SUPPORT PRICES

Global oil supply and demand, actual and forecast



Sources: U.S. EIA, Haver Analytics and Alberta Treasury Board and Finance calculations; e-estimate and f-forecast

of Ukraine last year. Petroleum demand is expected to improve alongside a pick up in global growth, while restrained investment in the oil and gas sector worldwide will limit supply increases. This will keep prices above US$70/bbl over the forecast period.

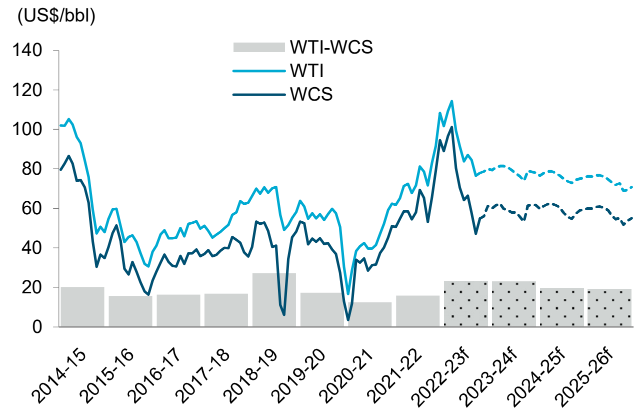
Alberta Economy

Increased export capacity to buoy Alberta energy prices

The spread between WTI and Western Canadian Select (WCS) oil prices is expected to narrow as factors that weighed on the differential in late 2022 dissipate and additional pipeline capacity comes online later this year. Higher processing costs at the U.S. Gulf Coast (USGC) due to spiking natural gas prices and a heavy refinery maintenance season in the U.S. reduced demand for Alberta's heavy oil last year. The release of heavy oil barrels from the U.S. Strategic Petroleum Reserve (SPR) also weighed on prices. The full restart of the Keystone pipeline in late December, along with improving U.S. refinery demand, have already led to an improvement in the differential so far this year. With natural gas prices coming down, heavy oil should become more economic to refine at the USGC. Additional support to prices will also come from U.S. government's decision to begin rebuilding its strategic reserves by purchasing crude off the market. After widening to a monthly average of $29.00/bbl in December, the WTI-WCS differential is forecast to average US$19.50/bbl in 2023-24 (Chart 7).

CHART 7: LIGHT-HEAVY DIFFERENTIAL TO IMPROVE OVER THE MEDIUM TERM

Oil prices



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

The completion of Trans Mountain Expansion (TMX) in late 2023 will boost the province's takeaway capacity by 590,000 barrels per day. This will help reduce the light-heavy differential to around US$16-17/bbl in the next three fiscal years, in line with pipeline transportation costs. A narrower differential, along with solid global oil prices, will keep WCS above C$70/bbl over the medium term.

Strong fundamentals are expected to support natural gas prices in Western Canada. North American natural gas prices have retreated from elevated 2022 levels, with prices at Henry Hub trading below US$4.00/MMBtu since late December. Mild winter weather in the U.S. and Europe, strong U.S. gas production and the delayed restart of the Freeport LNG export facility all contributed to weaker exports and rising inventories. However, some of these temporary factors are expected to fade and should translate to an improvement in the price of Western Canadian natural gas. The Alberta Reference Price (ARP) is forecast to average C$4.10/GJ in 2023-24 before moderating to C$3.80/GJ in 2025-26. Even so, ARP is expected to remain above pre-pandemic levels. Growing oil sands production along with increasing demand from coal-to-gas power plant conversions and new gas-fired power plants will continue to buoy demand and price for natural gas in the province.

Solid prospects for oil and gas extraction

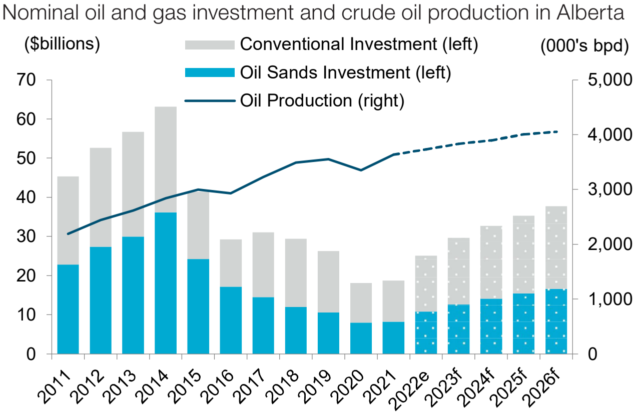
Oil and gas producers are poised to increase spending, supported by healthy cash flows and balance sheets. Drilling activity in the province ramped up to an eight-year high last year in response to elevated energy prices and strong demand. This, coupled with escalating input costs, propelled investment in the conventional oil and gas extraction sector to rise by more than 36 per cent to an estimated $14.3 billion in

2022. With strong momentum expected to carry through this year, investment is forecast to increase at a solid pace amid favourable oil prices. Conventional investment is forecast to grow 19 per cent (or $2.7 billion) in 2023 before moderating to an average of about 7 per cent in the next three years (Chart 8). Rising costs will also continue to drive spending higher for oil and gas producers this year, although the pace of increase will be slower compared to 2022.

Rising bitumen production and moderate growth in costs are also expected to lift oil sands investment higher this year. After increasing by an estimated 31 per cent in 2022, non-conventional investment is forecast to grow nearly 17 per cent (or $2.7 billion) in 2023 before rising at an average of about 9 per cent over the medium term. However, without any greenfield projects on the horizon, oil sands producers will continue to focus spending on clean energy projects, debottlenecking, and optimizing existing infrastructure. In particular, the Pathways Alliance – a group of Canada's largest oil sands producers – announced plans to collectively invest $16.5 billion by 2030 to build carbon capture, utilization and storage (CCUS) facilities. Detailed engineering evaluation and regulatory work on the project will be underway this year.

CHART 8: INVESTMENT AND PRODUCTION SET TO RISE IN 2023

Nominal oil and gas investment and crude oil production in Alberta



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

Oil exports to grow moderately over the medium term

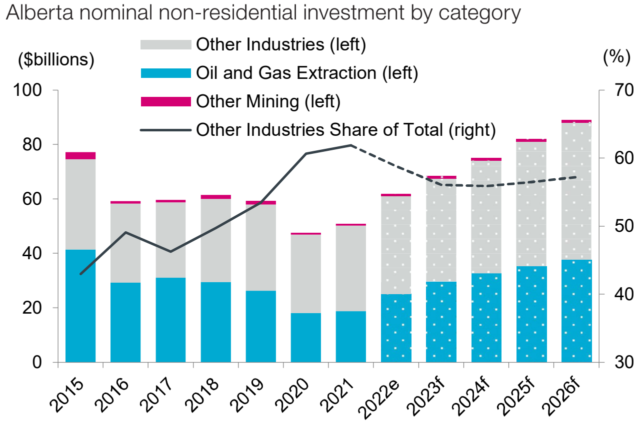
While investment is set to gain momentum over the next few years, growth in exports is anticipated to slow on the back of more modest gains in oil production. After reaching an all-time high of 3.7 million barrels per day (bpd) in 2022, Alberta's oil production is forecast to grow 100,000 bpd (or 2.7 per cent) this year and 220,000 bpd between 2023 and 2026. This represents annual average growth of 1.9 per cent, a more moderate pace compared to the last decade when oil production rose at an annual rate of 4.0 per cent. As a result, real exports are forecast to slow from 3.9 per cent in 2023 to 2.6 per cent in 2026. With production reaching almost 4.1 million bpd by the end of the forecast period, however, oil exports will continue to be an important driver of incomes in the province and maintain Alberta's position as one of the largest oil-producing jurisdictions globally. The completion of TMX in late 2023 will pave the way for further expansion in oil production in the coming years. Natural gas will continue to be a source of growth for exports, supported by robust demand and expanding export pipeline capacity.

Business investment looking up

Investment outside oil and gas extraction is expected to moderate this year before gaining momentum over the medium term. Non-energy investment rose by an estimated 14 per cent (or $4.4 billion) last year on the back of soaring construction costs and progress on large-scale industrial projects in renewable energy, transportation, petrochemicals and telecommunications. As some of these projects wind down and cost pressures ease further, growth in non-energy investment is forecast to moderate at 5.6 per cent (or $2 billion) this year. Higher borrowing costs may also limit expansion plans in some sectors. Over the medium term, however, growth is anticipated to accelerate to 9.4 per cent (or $3.6 billion in 2024) and about 10 per cent on average in 2025 and 2026. The share of non-energy to total business investment is expected to remain above its 10-year historical average of about 47 per cent (Chart 9).

CHART 9: BUSINESS INVESTMENT CONTINUES TO DIVERSIFY

Alberta nominal non-residential investment by category



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

Clean Technology

Alberta's positive investment climate and abundant natural resources are paving the way for strong investment intentions in clean technology. In addition to the Pathways Alliance, a wave of CCUS projects have been proposed over the past year. A total of 25 projects have been selected by the Alberta government for further evaluation in the development of storage hubs. Among these is the Atlas Carbon Sequestration Hub that builds on the success of the Quest Carbon Capture and Storage project, which has now stored seven million tonnes of CO2 since late 2015. The first phase of the project will capture and store 750,000 tonnes of carbon from Shell's Scotford refinery and chemical plant.

In addition, a number of industrial projects will rely on CCUS to lower emissions. Capital Power is adding carbon capture to its existing Genesee power plant station. Construction is already underway on Air Products $1.6-billion new net-zero hydrogen energy complex, which is expected to come on stream in 2024. Once completed, the facility will be supplying low-carbon hydrogen to Imperial Oil's recently announced renewable diesel production facility, the largest of its kind in Canada. The $720-million facility is expected to become operational in 2025 and will produce a billion litres of diesel using biofeedstock and hydrogen. In addition to providing 600 construction jobs over the next two years, this project is anticipated to create spinoffs for other industries. A number of investment projects announced over last two years may also provide significant potential upside to investment, including Dow Chemicals $10 billion net-zero emissions ethylene and derivatives facility.

Technology and aviation sectors

Alberta's economy is diversifying with investments in emerging industries such as tech and aviation. De Havilland is set to build a new aircraft manufacturing facility near Calgary, with construction to commence in late 2023. Dura-line, a U.S. based tech firm that specializes in developing Internet connection systems, is investing in a new state-of-the-art manufacturing facility in the province that will come online in spring 2023. While Alberta has not been immune to the global layoffs in the tech sector, some companies in the province are choosing to expand their workforce. Garmin Canada is planning to double its staffing size and grow operations in its Cochrane headquarters, while Amazon Web Services is slated to open a cloud computing hub in Calgary in late 2023 or early 2024. Meanwhile, TELUS announced last year that it is investing $17.0 billion in network infrastructure and operations across Alberta over the next four years.

Commercial building construction

The industrial real estate market is expected to lend support to Alberta's non-residential construction sector. Construction activity for warehousing, distribution and other industrial spaces in both Edmonton and Calgary is anticipated to remain strong, as vacancy rates in this segment are at multi-year lows following last year's record-setting positive net absorption. According to CBRE Canada, Edmonton and Calgary were among the cities leading activity in Canada at the end of 2022, with positive net absorption at 2.9 million square feet and one million square feet, respectively. Alberta's higher levels of available space and lower average market rents compared to other provinces will continue to boost demand. Industrial activity will help to offset ongoing challenges in the office market segment, where elevated vacancies in Edmonton and Calgary continue to persist.

Food processing sector

The agri-food sector continues to be a source of strength for the province. Several investment projects announced over the past year are expected to boost Alberta's value-added agricultural processing capacity. PIP International successfully commissioned its $20 million pilot plant and commercial testing facility in Lethbridge. The company also announced plans to build a second, larger $150 million yellow pea protein facility, which will handle 126,000 tonnes of yellow peas annually from local and regional growers. The new Alberta Agri-processing Investment Tax Credit is expected to spur additional, large-scale investment projects that will help grow the province's value-added agriculture sector and make the province a preferred destination for these types of investments.

Capacity expansions to support non-energy exports

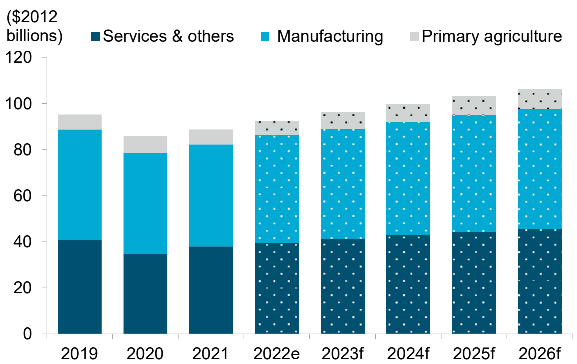
Export growth outside of oil and gas is expected to pick up following a near-term slowdown. Alberta's real manufacturing exports are forecast to decelerate from an estimated 5.2 per cent in 2022 to 2.6 per cent in 2023. Continued weakness in residential construction activity in North America will weigh on wood manufacturing sales, while a slowdown in global industrial activity will dampen export demand for durable goods manufacturing in the near term. Demand for machinery and equipment, however, is expected to hold up better as it benefits from solid drilling activity in the U.S. and across Canada. Services exports are also forecast to slow, from an estimated 5 per cent in 2022 to 3.5 per cent in 2023 before easing further to 2.9 per cent by 2026. Travel and tourism-related services should continue recovering following last year's post-pandemic rebound, although growth will likely be constrained as high interest rates continue to dampen consumer demand. In addition, staffing shortages in the U.S. airline industry, which hampered the recovery in air capacity from the U.S. to Canada last year, could linger in the short term.

Alberta

Recent and upcoming capacity expansions in petrochemicals and other emerging sectors should support manufacturing exports as global demand improves (Chart 10). Inter Pipeline's Heartland Polymers – Canada's first integrated propane dehydrogenation and polypropylene facility – began commercial production in the third quarter of last year. It is expected to produce 525,000 tonnes of polypropylene annually. Real manufacturing exports are expected to accelerate to around 3 per cent between 2024 and 2026. Meanwhile, growing service exports will be supported by enhanced air capacity and connectivity in Alberta's major airports, which should bolster domestic and international visits to and from the province. Demand for Alberta's engineering and technical services are also expected to benefit from rising business investment. Employment in professional, scientific, and technical services rose steadily to record highs last year and led the recovery in job gains.

CHART 10: NON-ENERGY EXPORTS TO ADVANCE

Alberta real non-energy exports by component



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

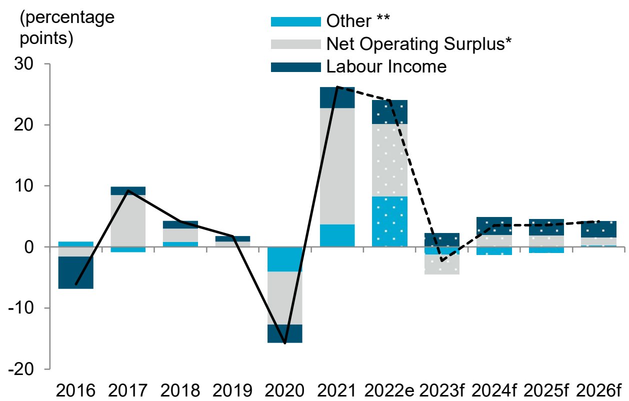
Alberta's agri-food sector will be a bright spot this year. Better growing and harvesting conditions contributed to above-average yields and higher crop production in 2022. Although crop prices have moderated from the record highs of last spring, historically strong prices continue for most crops. Domestic and export crop demand remains solid, and despite high crop input costs, the crop sector is expected to experience another year of high net returns. Live cattle exports are also expected to benefit from robust prices and tighter supply in the U.S. Meanwhile, prospects for Alberta's food manufacturing sector remain positive, buoyed by a growing global population and improving demand.

Corporate profits slide from elevated levels

Corporate profits are expected to decline after reaching a record high last year. Alberta's net corporate operating surplus – a measure of corporate profits and driver of corporate income tax revenues – is forecast to fall nearly 14 per cent to $101 billion this year amid softer energy prices and moderating economic growth (Chart 11). Costs are also expected to rise, albeit at a more moderate pace than last year, which will also weigh on profits. Despite the pullback, net operating surplus will remain elevated by historical standards. It is forecast to resume growth in 2024 as economic activity picks up and cost pressures ease further.

CHART 11: LOWER CORPORATE PROFITS WEIGHING ON INCOME THIS YEAR

Contribution to change in Alberta's nominal GDP by income



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

* Includes net operating surplus of corporations and net mixed income

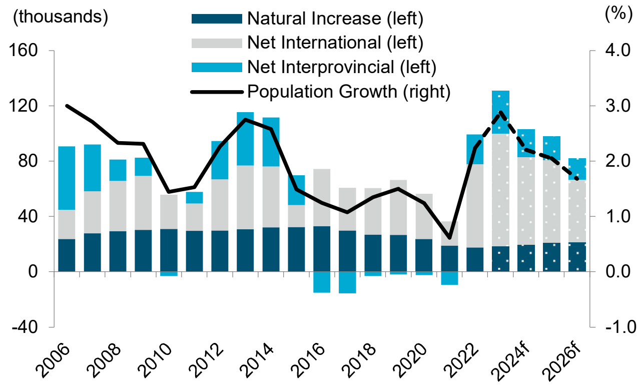
** Includes consumption of fixed capital and taxes less subsidies

Strong migration to bolster population growth

Alberta's population is poised to surge this year, driven mainly by net migration. Immigration will get a boost from higher national targets set by the federal government, while strong levels of temporary foreign workers and international students coming into the province will continue to buoy non-permanent residents in combination with refugee claimants due to Russia's invasion of Ukraine. With activity slowing more sharply in the rest of the country, Alberta is also expected to see robust inflows of interprovincial migrants given its relatively strong economic conditions, favorable housing affordability, and lower cost of living. Alberta's population growth rate is forecast to rise to 2.9 per cent before moderating to 1.6 per cent by 2026 (Chart 12).

CHART 12: STRONG POPULATION GROWTH TO CONTINUE IN 2023

Annual change in Alberta's population by component



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

Momentum to support job gains

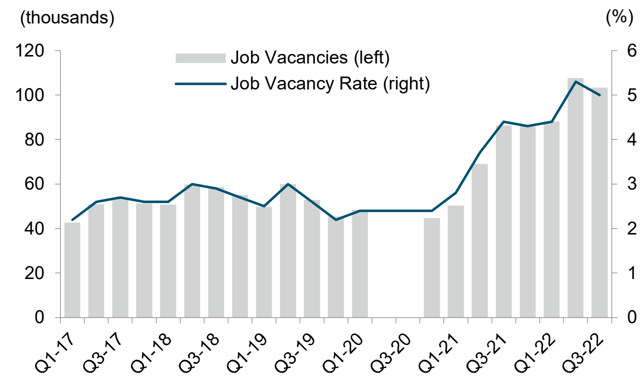
Employment in the province is expected to grow at a solid pace this year. 2023 started on a positive note as the province added more than 20,000 jobs in January, bolstered by hiring in the private sector and full-time positions. With more people moving into the province and looking for work, employers are now having an easier time filling vacant positions (Chart 13). This is in contrast to last year, when hiring in industries such as accommodation and food services, construction, and health care was limited by labour shortages. Many businesses remain optimistic about their outlook over the next year, while some may be keen to hold onto existing workers following labour shortages and the challenges with high rates of illness-related workplace absences over the past year. This should help buoy employment growth at 2.3 per cent this year. Over the medium term, employment growth is expected to rise to an average of 2.5 per cent as interest rates fall, business investment in the province gains momentum, and global economic growth picks up.

Labour market adjusting

The province is expected to see more balanced labour market conditions this year as job gains are matched by more people looking for work. Alberta's labour force is forecast to expand by 3.0 per cent (over 74,000 people) this year – the fastest pace since 2008 – amid a surge in the working-age population and improving labour force participation. After remaining subdued in 2022, the labour force participation rate is forecast to increase 0.1 percentage point to 69.9 per cent in 2023 (Chart 14). This will lift the unemployment rate up from 5.8 per cent in 2022 to 6.4 per cent this year. Despite the uptick, the unemployment rate is expected to remain below the annual levels seen in 2016-2021.

CHART 13: JOB VACANCIES REMAIN HIGH

Alberta's job vacancies and vacancy rate, quarterly



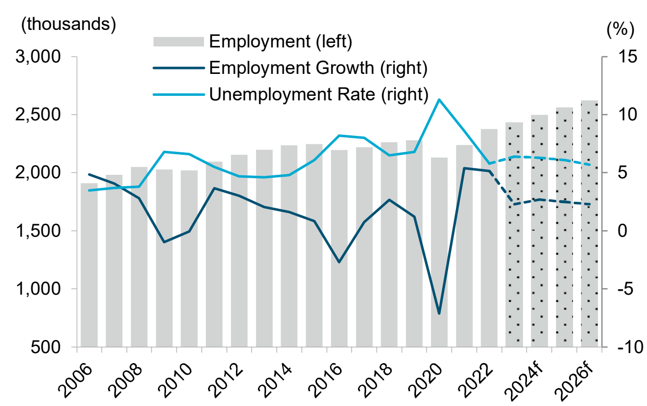
Sources: Statistics Canada and Haver Analytics

The participation rate is expected to improve slightly in the coming years, although population ageing will limit the gains. It is forecast to remain below pre-pandemic (2019) levels throughout the forecast period, reaching 70.0 per cent by 2026. The share of people aged 65 and over is projected to rise to 16 per cent by 2026, up from 12 per cent in 2016. With the slow improvement in the participation rate, employment growth is expected to outpace the expansion in the labour force. This should lead to a gradual decline in the unemployment rate, which is forecast to reach 5.7 per cent by 2026.

After remaining muted last year, growth in average weekly earnings is expected to accelerate to 3.3 per cent in 2023, and around 3.6 per cent thereafter. Increases in wage and employment growth are anticipated to lift growth in primary household income from 5.9 per cent in 2023 to an average of 6.4 per cent over the medium term.

CHART 14: UNEMPLOYMENT RATE TO TICK UP THIS YEAR

Labour market indicators



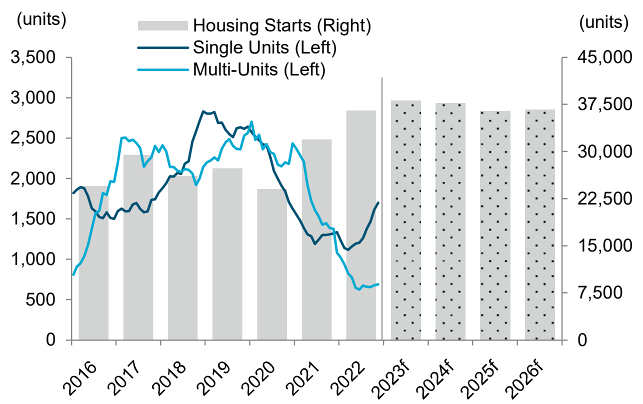
Sources: Statistics Canada, Haver Analytics and Alberta Treasury Board and Finance; f-forecast

Housing market to stay resilient

Strong fundamentals will keep the province's housing market on solid footing. With Alberta's healthy labour market and strong population growth, housing starts are expected to remain strong. They are forecast to average 38,000 units this year, up slightly from 36,500 units in 2022 (Chart 15). A strong bounce back in residential building permits in late 2022 bodes well for activity in the near term. Falling rental vacancy rates and low inventories in the new housing market should continue to support construction activity particularly in the multi-family segment. At the same time, strong housing starts in the latter half of 2022 will boost investment in new housing construction throughout 2023. This will be somewhat offset by muted renovation spending and resale activity, both of which will continue to feel the impact of higher interest rates. Over the medium term, housing starts are forecast to be around 36,900 units annually by 2026, in line with household formations.

CHART 15: HOUSING STARTS STRONG AMID LOW INVENTORIES

Alberta housing starts and completed & unabsorbed units in Edmonton & Calgary



Sources: Canada Mortgage and Housing Corporation and Alberta Treasury Board and Finance; f-forecast

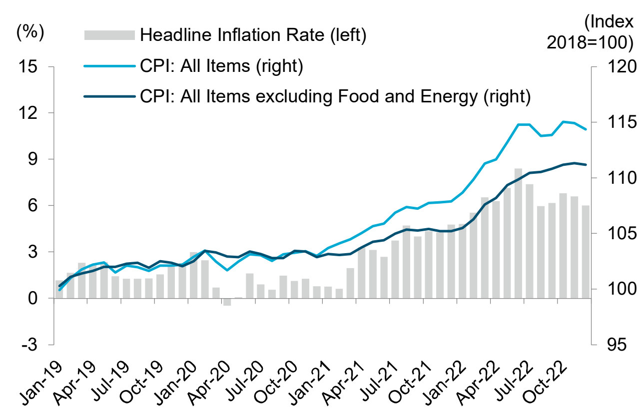
Inflation to subside gradually

Consumer inflation will continue to abate this year but will be slow to return to pre-pandemic levels. Headline inflation cooled to 6.0 per cent year-over-year in December 2022 after peaking at over 8.0 per cent last June. The moderation was largely due to goods inflation, which retreated sharply in the second half of last year due to a slowdown in energy prices. Alberta's affordability measures, such as the fuel tax relief and electricity rebate program, also contributed to the decline. Easing supply chain disruptions, declining shipping costs, and slowing consumer demand are helping to cool inflation for durable goods such as furniture, household appliances, and vehicles. Although food prices are still elevated compared to last year, they fell in December for the first time since July 2021. In contrast, services inflation remains stubbornly high as soaring interest rates have driven up mortgage interest cost and homeowners' replacement cost. This has kept core inflation near its 14-year high.

Despite softer growth, consumer prices remain high (Chart 16). Aggressive interest rate hikes by the Bank of Canada over the past year are expected to further decelerate consumer spending and put downward pressure on prices this year. This, coupled with moderating energy prices and smaller base year effects, should help bring inflation down to an average of 3.3 per cent in 2023. Inflation is not expected to return to pre-pandemic levels until 2024, when it returns to about 2.0 per cent.

CHART 16: CONSUMER PRICES REMAIN HIGH EVEN AS INFLATION EASES

Alberta's inflation rate, CPI and core CPI indexed to 2018



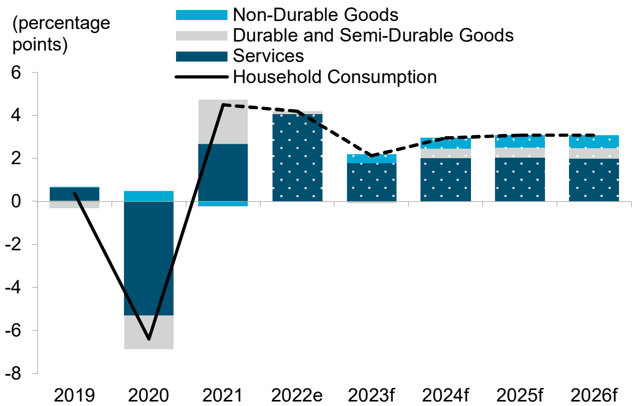
Sources: Statistics Canada and Haver Analytics

Consumers to remain cautious

Higher interest rates and inflationary pressures will continue to keep a lid on consumer spending in the near term. The weakness will be more pronounced on discretionary items such as durables and semi-durable goods. After pulling back sharply in 2022, spending on durable goods is expected to fall again in 2023 although the pace of decline will be smaller. There are tentative signs that new vehicle sales are bottoming out after being hampered by chip shortages through most of 2022. Spending on semi-durable goods is also anticipated to remain muted following last year's post-pandemic rebound. Growth in services spending is expected to slow further after surpassing pre-pandemic levels last year, although this will benefit from rising population growth. Overall, growth in real consumer spending is forecast to be 2.1 per cent in 2023 (Chart 17), down from an estimated 4.2 per cent last year. As inflation eases further, interest rates decline and wage growth picks up, real consumer spending is set to accelerate. It is forecast to expand around 3 per cent in the coming years and outpace population growth.

CHART 17: HOUSEHOLD SPENDING SUBDUED IN 2023

Annual change in Alberta real consumer spending by component



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

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