Economic Trends

November 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 November 30, 2023.

Overview

The Alberta economy continues to be resilient; however, interest rate increases, high prices and slower global economic growth are creating headwinds. Growth is being led by the oil and gas sector, where solid energy prices and the anticipated increase in Alberta's takeaway capacity next year are driving spending and production. Business investment intentions are on track and employment prospects remain positive in the province. Homebuilding activity took off in the third quarter, suggesting some relief is coming for Alberta's tight housing market. However, the impact of higher interest rates and elevated prices is working its way through the economy. Consumer confidence has pulled back sharply, leading households to curtail spending. Consumers and businesses also continue to grapple with rising costs. Slower global demand is dampening non-energy exports and contributing to the volatility in oil prices. Alberta's real gross domestic product (GDP) is forecast to grow 2.8% this year, a moderation from last year's exceptionally strong pace of 5.0%. This is in line with budget expectations but slightly lower than the first quarter.

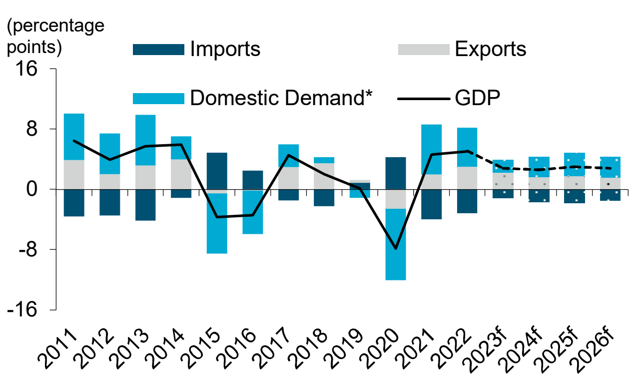
Real GDP growth is set to slow further next year to 2.6% (Chart 1). The slowdown is mainly due to higher for longer interest rates and more persistent inflation, which will be a drag on consumer spending. The completion of Trans Mountain pipeline expansion (TMX) in the second half of 2024 is expected to support energy sector activity, although slower global growth will continue to dampen non-energy output and exports. Strong momentum in residential construction in the second half of this year will support a modest rebound in residential investment in 2024.

Over the medium term, the Alberta economy is expected to rebound to around 2.9% as consumer spending recovers. Solid fundamentals – including a strong population growth, relatively young population, lower cost of living and high wages – will support Alberta's expansion. While real GDP is forecast to expand, it will lag behind Alberta's strong population growth in 2023 and 2024. As a result, real GDP per capita is expected to decline during these years before rebounding in 2025.

Nominal GDP, a broad measure of income, is forecast to retreat in 2023 before rebounding in 2024. This reflects the pullback in corporate profits this year due to lower commodity prices with last year's elevated levels and rising costs. Even with the decline, corporate profits are forecast to exceed the 2014 high throughout the forecast period (Chart 2). In contrast, strong job gains and accelerating wage growth are expected to lift labour and primary household incomes this year and over the forecast period. Growth in labour and primary household incomes are projected to be higher compared with budget and the first quarter.

CHART 1: REAL GDP GROWTH TO MODERATE NEXT YEAR

Contribution to annual change in Alberta real GDP by expenditure

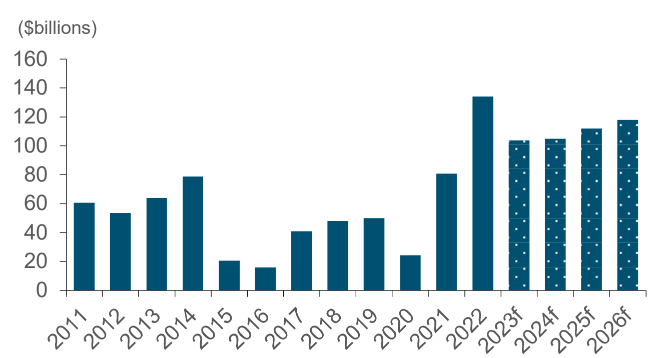


Sources: Statistics Canada, Haver Analytics and Alberta Treasury Board and Finance; e-estimate, f-forecast

* Includes total household, business, and government spending

CHART 2: CORPORATE PROFITS TO EASE BUT REMAIN ROBUST

Net operating surplus, actuals and forecast



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

Oil price volatility continues

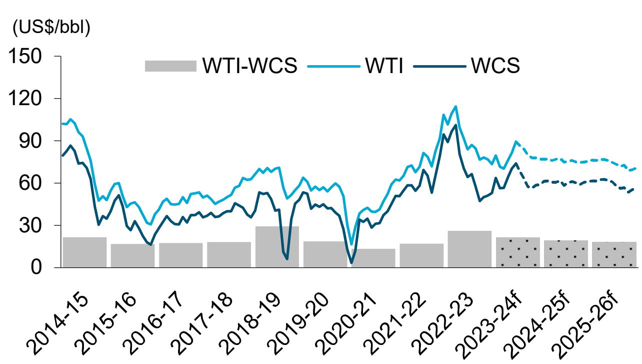
Global oil prices have gained ground after falling below $70/bbl in the summer. The extension of voluntary output cuts by Saudi Arabia and Russia until the end of the year, along with lower crude oil stocks in the U.S., lifted West Texas Intermediate (WTI) oil price above US$89/bbl in September. Supply concerns intensified following the onset of the Israel-Hamas conflict in October, but these have since eased as fears over slowing demand have grown recently. These factors have all contributed to more volatility in prices. The outlook for WTI has improved modestly in recent months, in-line with budget projections. It is forecast to average US$79.00/bbl in 2023-24 before easing to US$76.00/bbl in 2024-25. The global oil market is expected to shift into modest surplus next year amid slower growth in petroleum demand and additional supply coming online. While demand is expected to rise in the coming years, restrained investment in the oil and gas sector worldwide will limit supply growth and keep prices at or above US$70/bbl over the medium term.

TMX to boost Alberta oil prices

Additional pipeline capacity to move oil out of the province next year is expected to support Alberta oil prices and narrow the discount between WTI and the Western Canadian Select (WCS). The completion of TMX in the second half of 2024 will help bring the differential to around US$14-15/bbl in the next two fiscal years (Chart 3). TMX is scheduled to begin line fill in the second quarter of 2024, which will require about 4.5 million barrels, before coming into full service in the third quarter. This comes on the heels of steeper discounts for WCS in recent months. The WTI-WCS differential has stayed above US$25/bbl since September due to a heavy refinery turnaround season in the U.S., which temporarily reduces demand for Alberta's crude oil. This has coincided with a ramp up in oil sands production following larger-than-normal maintenance activities. The differential is expected to recede from current levels in the near term as U.S. refineries come back online and average US$17.00/bbl for 2023-24, $2.00 wider than the first quarter, but down $2.50/bbl from budget.

CHART 3: WTI-WCS DIFFERENTIAL TO IMPROVE WITH TMX COMPLETION

Oil Prices



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

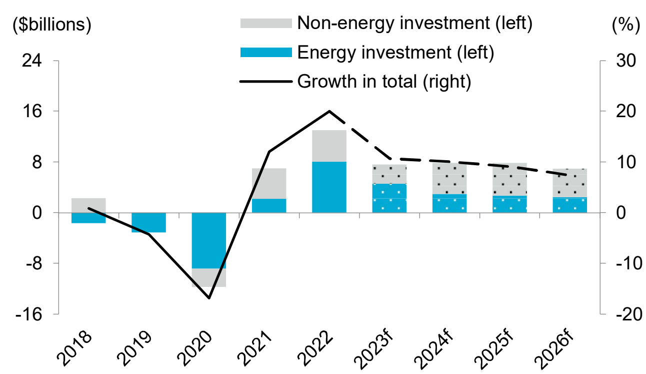
Despite the wider differential, a lower Canadian dollar is expected to bolster Alberta heavy oil prices. With the U.S. economy exceeding expectations this year alongside a slowing Canadian economy, the Loonie has lost ground to the U.S. dollar. It is now forecast to average US¢74.10/Cdn$ in 2023-24, lower than expected in the first quarter and budget, before slowly rising to US¢78.60/Cdn$ by 2025-26. This will lift WCS price to C$84.00/bbl in 2023-24 before moderating to C$75.10/bbl by 2025-26.

Energy sector driving investment

Prospects for the energy sector remain positive, underpinned by solid energy prices and the anticipated increase in Alberta's takeaway capacity. A strong increase in drilling activity, along with a rising number of wells coming online, have boosted conventional oil production. The latter reached a five-year high in September and was up 6% year-to-date. Meanwhile, non-conventional oil production fully recovered in the summer following an abnormally large maintenance period. Both natural gas output and exports have also risen at a strong pace so far this year despite the impact of wildfires in the spring. Investment in the oil and gas extraction sector is forecast to grow 18% (or more than $4.5 billion) in 2023, unchanged from budget. It is the major driver of business investment this year (Chart 4).

CHART 4: OIL AND GAS LEADS GROWTH IN INVESTMENT THIS YEAR

Change in Alberta non-residential investment by component



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

Oil and gas investment is forecast to rise over the medium term, growing at a more moderate pace of $3.0 billion (or 10%) in 2024 and $2.7 billion (or 8.2%) in 2025. Energy prices are anticipated to remain supportive of activity. Producers are also expected to continue drilling at a solid pace ahead of TMX coming online in the second half of 2024. Increased takeaway capacity will help propel Alberta's crude oil production from nearly 3.8 million barrels per day (bpd) in 2023 to over four million barrels bpd by 2026. Producers, however, are still expected to maintain capital discipline in expanding production and continue to invest in emissions reduction initiatives.

Business investment still on track

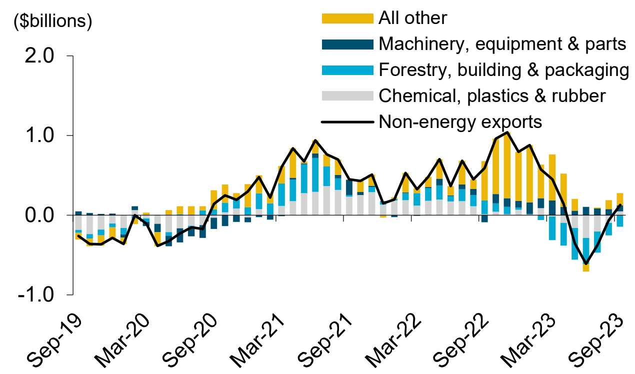
With many new projects announced in the province over the past year, industries outside oil and gas extraction will become an increasingly important driver of business investment over the medium term. Investment in non-residential building construction is finally gaining momentum despite higher borrowing and input costs. Investment increased for the third month in a row in August, led by gains in commercial and industrial buildings. Non-residential building permits in the private sector remain up nearly 14% year-to-date, despite pulling back from recent highs. Indicators of business spending on machinery and equipment, such as imports and wholesale trade, have grown at a robust pace so far this year, partly reflecting solid activity in the energy sector. Business investment outside oil and gas extraction is forecast to grow around 9% this year. In real terms, however, non-energy investment is forecast to rise by a modest 3%. Over the medium term, investment is forecast to accelerate as the impact from higher interest rates fades and demand improves. Capacity additions in the petrochemical and agri-food sectors, as well as ongoing efforts to reduce emissions and increase capacity in renewable energy in the province, will contribute to growth. Real non-energy investment is forecast to expand 8-9% annually between 2024 and 2026.

Slower demand weighing on exports

Outside oil and gas, business output has trended lower since peaking in 2022. There have been declines in exports of many categories, most notably metal ores & non-metallic minerals, forestry products & building & package materials, and basic & industrial chemical products (Chart 5). While lower commodity prices have played a significant role, slowing demand has also been a factor. These declines are being partly offset by strength in exports of agriculture products and machinery and equipment, which have both seen exceptional growth so far this year. Given the broad-based weakness, growth in real manufacturing and services and other exports have been revised down this year before picking up slightly next year. This will dampen overall real exports, which are forecast to grow 3.5% this year. Meanwhile, crop exports are expected to pull back in 2024 due to this year's drought conditions. This will weigh on real exports, which are forecast to rise just 2.6% next year.

CHART 5: SLOWER DEMAND WEIGHING ON NON-ENERGY EXPORTS

Year-over-year change in Alberta's non-energy merchandise exports



Sources: Statistics Canada and Haver Analytics

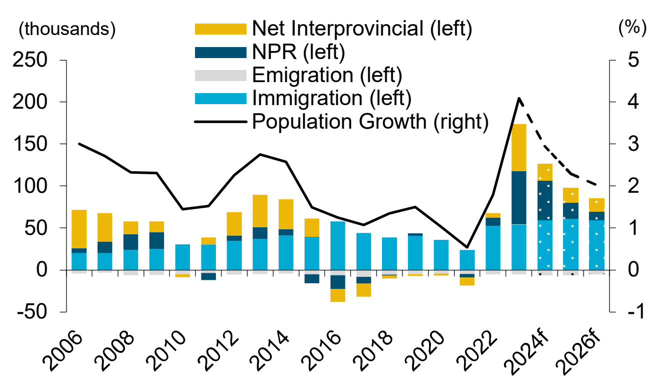
Population growth to moderate

Alberta's population growth is expected to moderate from last year's exceptionally strong pace but nevertheless remain robust. Strong momentum in the second quarter of the year propelled Alberta's population to expand by 184,000 or 4.1% in the 2023 census year, the fastest annual growth rate since 1981.

Alberta's population is projected to rise 2.9% in the 2024 census year, an upward revision from 2.2% at budget. Net international migration is expected to remain at elevated levels, buoyed by higher national immigration targets set by the federal government and strong inflows of non-permanent residents. The latter will be largely driven by the arrival of Ukrainian migrants under the Canada-Ukraine Authorization for Emergency Travel (CUAET) program. Over 36,000 CUAET visa holders have settled in Alberta since the program began in 2022, and about 30,000 more are expected in the 2024

CHART 6: STRONG INFLOWS OF NON-PERMANENT RESIDENTS WILL SUPPORT POPULATION GROWTH

Annual change in the Alberta population by migration component



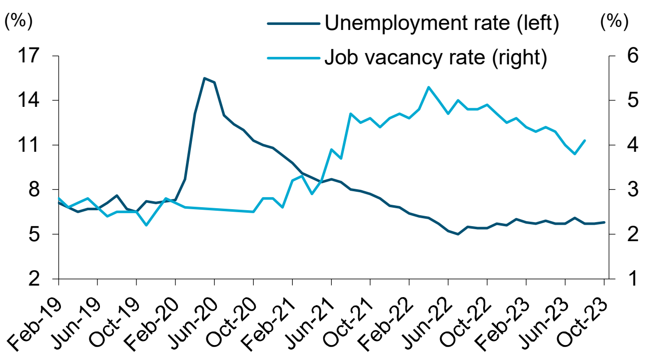
Sources: Statistics Canada, Haver Analytics and Alberta Treasury Board and Finance; e-estimate, f-forecast census year. Meanwhile, net interprovincial migration will slow following exceptional gains in 2023 (Chart 6). Nonetheless, it is still expected to remain strong, supported by Alberta's relatively strong economic and labour market conditions, favourable housing affordability and a lower cost of living. Population growth is forecast to moderate over the medium term to 2.0% by 2026.

Job gains to moderate

Job prospects remain strong in the province even as momentum in the labour market is slowing. Looking past the recent volatility, employment in the province has expanded 78,000 through ten months of the year. Employment is now forecast to grow 3.3% this year, up one percentage point from budget but down slightly from the first quarter update. The province will continue to add jobs, albeit at a more moderate pace of 2.5% in 2024. Job vacancies remain elevated in the province, despite the downward trend this year (Chart 7). Rising investment and higher migration will help employers fill vacant positions and should help bring down vacancies further. Employment is forecast to rise around 2.4% in 2025 and 2026.

CHART 7: JOB VACANCIES REMAIN HIGH AMID TIGHT LABOUR MARKET

Unemployment rate and job vacancy rate in Alberta



Sources: Statistics Canada and Haver Analytics

Labour market still tight

Strong job gains and a declining labour force participation rate have contributed to tight labour market conditions in the province. Although Alberta's labour force expanded by over 108,000 (or 4.3%) over the past year, its proportion to the working-age population – as measured by the labour force participation rate (or part rate) – has fallen since January 2023. The recent weakness has been most pronounced among youth and older workers, with the youth part rate pulling back sharply to historically low levels. An ageing population also continues to exert downward pressure on the overall part rate. Given the weakness year-to-date, the labour force participation rate has been revised down from budget and is expected to average 69.6% this year. This is below the annual rates seen in the previous two years. A weaker participation rate is expected to lower Alberta's unemployment rate, which is now forecast to average 5.9% in 2023. This is down 0.5 and 0.1 percentage points from budget and the first quarter, respectively.

The labour market is anticipated to gradually become more balanced in the coming years as labour demand moderates. Higher levels of migration into the province are also expected to boost supply. The unemployment rate is expected to rise to 6.2% in 2024 before declining gradually to 5.9% by 2026.

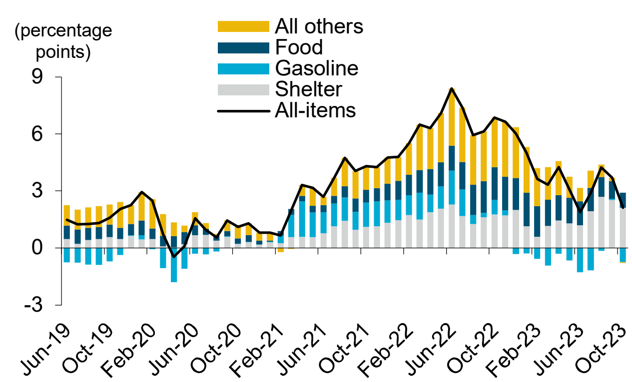
Consistent with a tight labour market, wage growth in the province has accelerated and is now catching up to the national pace. This, along with strong job gains, will help boost labour and primary household incomes. The latter is expected to rise 7.0% this year, up 1.1 percentage points from budget, before moderating to 6.0% in 2024. Wages will continue to grow at a robust pace of between 3.6% to 3.8% over the next few years.

Food and shelter propping up inflation

While headline inflation has moderated significantly this year, prices for shelter and food remain elevated. Prices for durable and semi-durable goods have fallen and are lower than year-ago levels. In contrast, shelter inflation has accelerated since February and is now close to a 15-year high, driven by rising mortgage rates, surging rent and electricity prices (Chart 8). Notably, electricity prices reached a record high in September due to the removal of provincial affordability measures and robust demand. Alberta's tight rental market has also contributed to an 9.9% year-over-year increase in rents, marking the fastest growth since December 1982. Although food inflation is moderating, prices remain considerably higher than a year ago.

CHART 8: SHELTER COMPONENT A KEY DRIVER OF INFLATION

Contribution to inflation by category



Source: Statistics Canada

According to the Bank of Canada, underlying inflation is proving to be more persistent. Data from the Canadian Survey on Business Conditions for the third quarter of 2023 show that rising inflation and higher input costs are the two most commonly expected obstacles faced by businesses over the next three months. Consequently, more than a fifth of businesses expect to raise their selling prices over the next three months, a marginal decrease from the second quarter.

Inflation is now forecast to average 3.5% this year, up 0.2 percentage points from budget. Inflation projections have also been revised up by 0.3 percentage points from budget to 2.5% in 2024, before returning to around 2% over the medium term.

Consumer spending softening

Consumers are curtailing their spending in response to interest rate increases over the past year, elevated prices, and waning sentiment. Consumer confidence remains subdued despite the improvement in September. Declining sentiment toward major purchases has translated to weaker spending on big-ticket items such as motor vehicles and housing-related categories, where sales have slowed considerably compared to a year ago. On an inflation-adjusted basis, spending on food and beverage stores has also stagnated so far this year. Despite these headwinds, staggering population growth is supporting overall consumption, and real consumer spending is now forecast to rise 3.4% in 2023, up 1.3 percentage points from budget. On a per capita basis, however, real consumer spending is set to decline this year, reflecting the impact of rising borrowing costs and high inflation on goods spending. Services spending, on the other hand, is expected to rise in line with strong population growth.

With inflation slower to return to target, the Bank of Canada is not expected to begin cutting rates until the third quarter of 2024. This means that households are expected to increasingly feel the impact of higher for longer interest rates next year, which will lead to slower consumer spending. Real consumer spending is forecast to slow to 2.5% next year before bouncing back in 2025 and boosting overall real GDP growth.

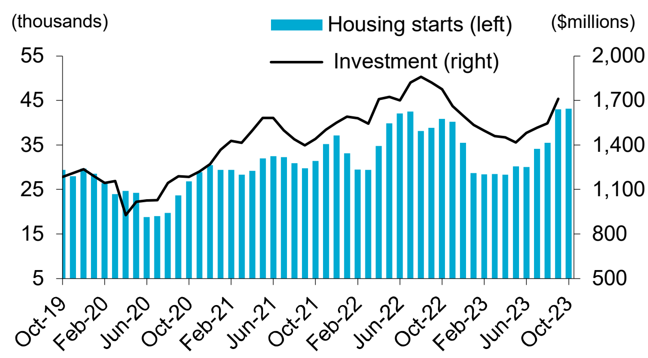
Homebuilding activity gains momentum

Residential construction is finally responding to low inventories after being weighed down by higher interest rates, labour shortages and elevated costs in the construction sector. Housing starts posted a significant turnaround, averaging at a annualized pace of over 42,000 units in the last four months to October. While the robust growth has primarily been driven by a surge in apartment starts, single-family dwellings have also picked up. Residential building investment have also trended higher in recent months (Chart 9). With the recent pickup in activity and construction intentions, housing starts in the province are now expected to average 34,000 units this year. This is higher than the first quarter forecast of 31,000 but still lower than 38,000 at budget.

Housing construction in the province has not kept up with the pace of recent population growth during the 2023 census year. Between July 1, 2022 and 2023, there were 33,300 units that started construction in the province even as population grew more than 184,000 people. This translated to 5.5 people per housing start, exceeding the approximate 2.5 people per dwelling each census has record since 2001. The catch-up in supply will buoy housing starts in the next few years. Housing starts are expected to gradually rise to 35,200 in 2024, 36,000 in 2025 and 36,800 in 2025, buoyed by faster population growth and declining interest rates. Despite the upswing, real residential investment is expected to decline about 10% this year. This reflects subdued renovation activity and weakness in new housing construction in the first half of 2023, in addition to the shifting composition of housing starts towards lower-priced, multi-family dwellings. However, strong momentum in residential construction during the second half of this year is expected to carry over into the next, resulting in a projected 4% rebound in real residential investment in 2024.

CHART 9: RESIDENTIAL CONSTRUCTION TURNING A CORNER

Residential construction investment and 3-month MA* housing starts



Sources: Statistics Canada and Haver Analytics; * Moving average

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