Economic Trends

This edition of Economic Trends is taken from the First Quarter Fiscal Update and Economic Statement, released on August 31, 2018.

Alberta's economic recovery remains on pace through the first half of 2018. The Alberta Activity Index (AAX) is tracking 3.0% higher than 2017 through May (Chart 1) and has moved above its pre-recession peak. Stronger-than-expected oil prices and solid business activity have lifted the forecast for nominal GDP, a broad measure of income, up from 4.7% at *Budget* to 5.8%. However, household spending growth has been weaker than expected compared with *Budget*, which is offsetting gains in other sectors. As a result, the forecast for 2018 real GDP remains unchanged from *Budget* at 2.7%. In 2019, ongoing strength in exports, a modest improvement in investment and continued population and earnings growth are expected to support real GDP growth of 2.7%, slightly stronger than the 2.5% forecast at *Budget*.

Despite the solid outlook for Alberta's economy, heightened uncertainty about US trade policies and the impact they may have on growth and investment is creating headwinds. While Alberta's exposure to recently announced trade tariffs is smaller than a number of provinces, an escalation of trade actions poses some downside risk to the economic outlook.

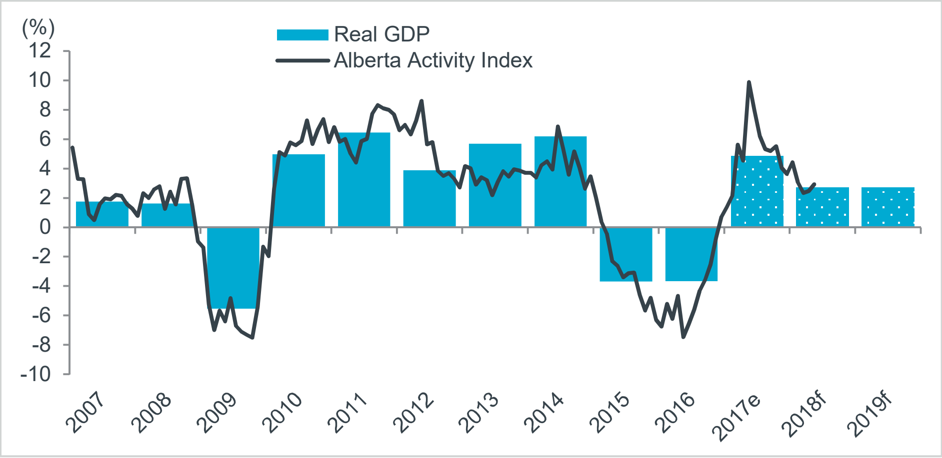
Oil prices strengthen

Rising global demand and tightening supply due to heightened geopolitical risks have driven oil prices higher since Budget. So far this fiscal year, North American benchmark West Texas Intermediate (WTI) crude has averaged around US$68/bbl. Market expectations are that WTI prices will be higher this fiscal year compared with Budget.

Alberta's Western Canadian Select (WCS) has shared in the price appreciation, averaging just under US$50/bbl in the first quarter. However, ongoing pipeline constraints and increased oil sands production have widened the light-heavy (L/H) price differential. Additionally, WCS prices have displayed more volatility than WTI, with daily price changes ranging across a 30-percentage-point-wide spectrum since the end of 2017-18, versus 10 percentage points (ppts) for WTI. With oil sands production continuing to expand, the L/H differential is expected to remain under pressure.

Chart 1: Alberta economic recovery remains on pace

Year-over-year % change in Alberta Activity Index and Alberta real GDP



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

Exports driving recovery

Growing exports are leading Alberta's economic recovery in 2018 (Chart 2). Through the first six months of the year, international merchandise exports are up 11% compared to the same period in 2017. Oil prices have played a significant role but non-energy exports are also near all-time highs, with volumes up roughly 8% over the first half of 2017. Strong growth in shipments of food and beverage, forestry and machinery and equipment products, especially, is helping offset a downward revision to oil production due to the power outage at Syncrude. Real exports are forecast to grow 4.9% in 2018 and 3.7% in 2019.

Corporate earnings improve

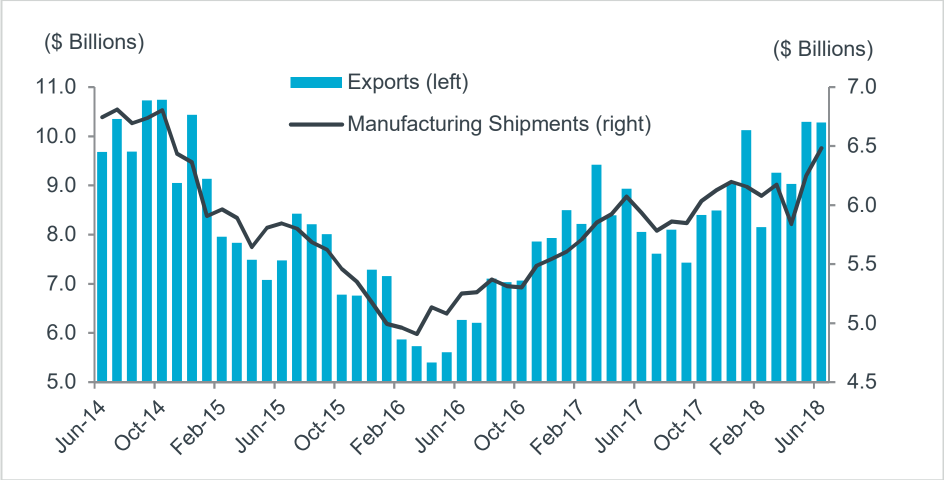
With oil prices higher than anticipated and economic momentum spreading, Alberta producers are seeing higher returns than estimated at *Budget*. Corporate earnings are now forecast to rise 31%, up 12 ppts from *Budget*. Exporters are additionally benefiting from a weaker than expected Canadian dollar.

Consequently, the Loonie has averaged $0.77 USD/CAD through the first four months of the fiscal year, nearly three cents lower than the *Budget* forecast. The 2018 exchange rate forecast has been lowered to $0.78 USD/CAD.

Energy investment looking up

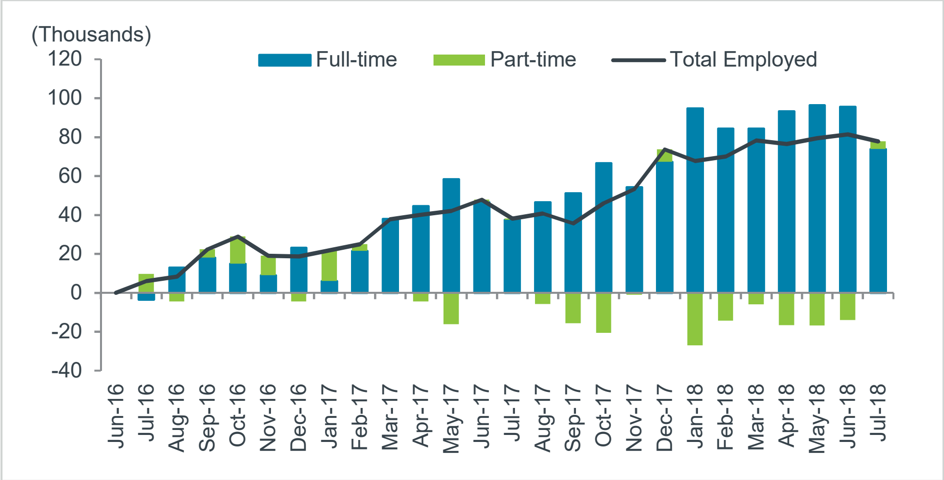
With improving corporate profits, energy investment prospects are beginning to shift. Rigs drilling jumped 20% in July compared with last year and are averaging almost 7% higher year-to-date. As a result, conventional investment is expected to rise approximately 9% in 2018, almost entirely offsetting the decline in non-conventional investment. Next year is also anticipated to bring modest growth to oilsands investment, the first year of growth since 2014. Along with a continued increase in conventional investment, oil and gas investment growth is anticipated to lead overall business investment 3.2% higher in 2019.

Chart 2: Exports leading Alberta's economic recovery
Alberta business indicators



Source: Statistics Canada

Chart 3: Job recovery concentrated in full-time positions
Cumulative change in Alberta employment since trough (June 2016)



Source: Statistics Canada

Non-energy investment lags

The completion of several major projects and elevated commercial vacancies continue to weigh on commercial and industrial construction. In addition, tariffs and higher wood prices are raising input costs and construction prices. As forecast at *Budget*, non-energy investment is expected to fall about half a percentage point in 2018 and trail overall business investment in 2019.

Labour market advancing

Alberta's labour market continues to improve (Chart 3). While employment growth has moderated, earnings have picked up. With year-to-date employment growth slowing from 2.0% at the beginning of the year to 1.7% through July, employment growth for 2018 has been revised from 2.0% at *Budget* to 1.9%. The unemployment rate is forecast slightly lower at 6.7% due in part to slower growth in the number of people joining the labour force.

Household earnings are forecast to be stronger than at *Budget*, with the majority of year-to-date employment growth coming from the higher-earning goods sector and full-time employment (Chart 4). Average weekly earnings growth for 2018 is now forecast at 2.7%, up from 2.4% at *Budget*. This strength is anticipated to carry into 2019, with primary household income climbing 4.7%.

Consumer prices climb

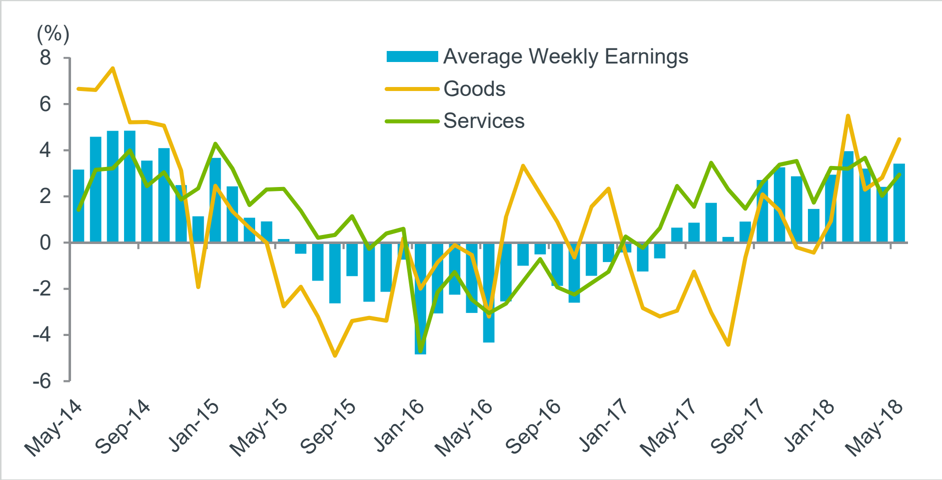
A lower Canadian dollar and rising energy prices are driving up consumer prices across Canada. In Alberta, rising gas and electricity prices have lifted Alberta's consumer price index (CPI). This has led to a revised forecast for 2018 inflation, up 0.2 ppts to 2.3%. As the impact of these temporary factors dissipates, inflation is expected to ease to 1.9% in 2019.

Pace of household spending eases

Rising costs, tighter mortgage regulations implemented early in the year and climbing interest rates are weighing on household spending. Through July, there has been an average of 1,100 fewer (annualized) housing starts than 2017, leading to a small downward adjustment to 2018 starts forecast. While retail sales are at a record high, growth in consumer spending has been slower than anticipated, especially on durable goods such as motor vehicles. This is expected to pickup in 2019 as housing activity rises and employment and wages continue to climb higher.

Chart 4: Goods sector boosts average weekly earnings

Year-over-year change in Alberta average weekly earnings



Source: Statistics Canada

Risks to the Outlook

- Monetary policy in advanced economies could tighten faster than anticipated, putting pressure on heavily indebted emerging economies. This would be a drag on global growth.
- Growing oil supplies or slowing demand globally could put downward pressure on oil prices.
- As oil production is expected to outstrip pipeline capacity starting this year, prolonged market access issues could widen the differential, impacting incomes and investment.
- The threat of protectionist trade policies pose direct risks to the trade outlook and indirect risks related to lower global growth.

Contact: Catherine Rothrock 780.427.2758