Economic Trends

This edition of Economic Trends is taken from the [Second Quarter Fiscal Update and Economic Statement](), released on November 30, 2018.

The Alberta economy is on track to post solid growth in its second year of recovery. The province added more than 42,000 jobs since October 2017. However, transportation bottlenecks, if left unchecked, will continue to cripple Alberta oil prices and create economic headwinds. Alberta's recovery following the 2015-16 recession has been a driver of the Canadian economy. A lack of progress from Ottawa on pipelines has resulted in a slowdown in economic activity heading into 2019 and lost income to the country.

Through three quarters of 2018, Alberta's economy expanded largely in line with *Budget 2018* expectations. The Alberta Activity Index (AAX) is tracking 3.0% above the 2017 level through August, hovering near pre-recession peak. Heading into the fourth quarter of 2018, with Alberta crudes currently trading at record discounts to global benchmarks, sentiments and conditions have deteriorated markedly. Producers are slowing production and restraining capital spending. In addition, household spending and residential construction activity have softened more than expected. As a result, after nation-leading growth of an estimated 4.5% in 2017, real GDP growth is expected to be 2.5% in 2018, down from 2.7% at *Budget*.

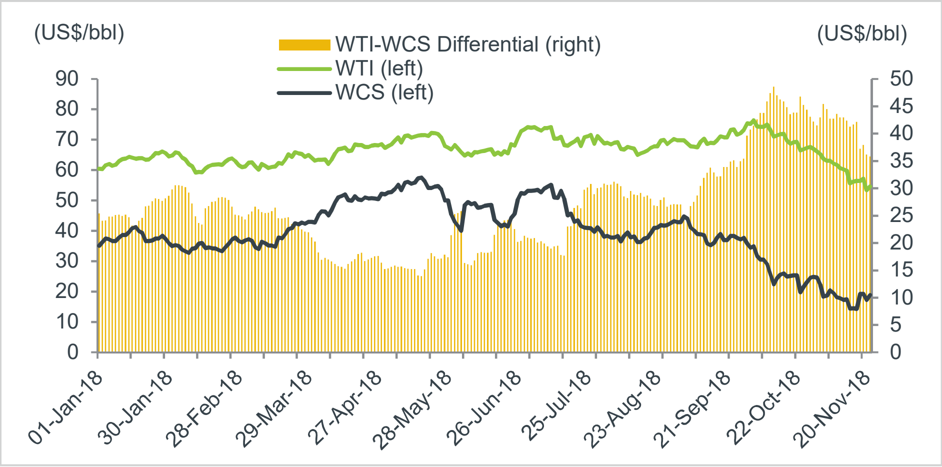
With market access issues persisting in 2019, weaker corporate profits and slower oil production growth will dampen the investment and export outlook next year. Based on recent developments, growth is forecast to slow to 2.0% next year, down from 2.5% at *Budget*.

Alberta oil prices tumble

Alberta oil producers are grappling with weaker global oil prices and severe discounts for their crude. West Texas Intermediate (WTI), the benchmark North American crude, has fallen below US$55/bbl in recent weeks, a decline of more than 30% from a four-year high reached in early October. Global prices have come under pressure as concerns over a supply glut have intensified. At the same time, persistent transportation bottlenecks and rising inventories have caused severe discounts for Alberta crudes. The differential between WTI and Alberta's Western Canadian Select (WCS) widened to a record high in October (Figure 1). Other Alberta crudes are also trading at large discounts. The WTI-WCS differential is forecast to remain volatile and elevated in 2019 until rail capacity increases and Enbridge's Line 3 pipeline expansion comes online. As a result, the WTI-WCS differential is expected to average US$29.25/bbl in 2018-19, up from US$22.40/bbl at *Budget*, while WTI is forecast to average US$64/bbl.

Chart 1: WTI-WCS differential widens dramatically

Daily oil prices



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

Corporate profits aided by weaker Loonie

A lower Canadian dollar is cushioning the blow of weaker oil prices on corporate profits for Alberta oil producers and other exporters. After a brief uplift in early October from the conclusion of the US-Mexico-Canada trade negotiations, the Loonie has since slipped to around 76 US¢/Cdn$. The 2018-19 exchange rate is now forecast at 77.5 US¢/Cdn$, two and a half cents lower than *Budget*.

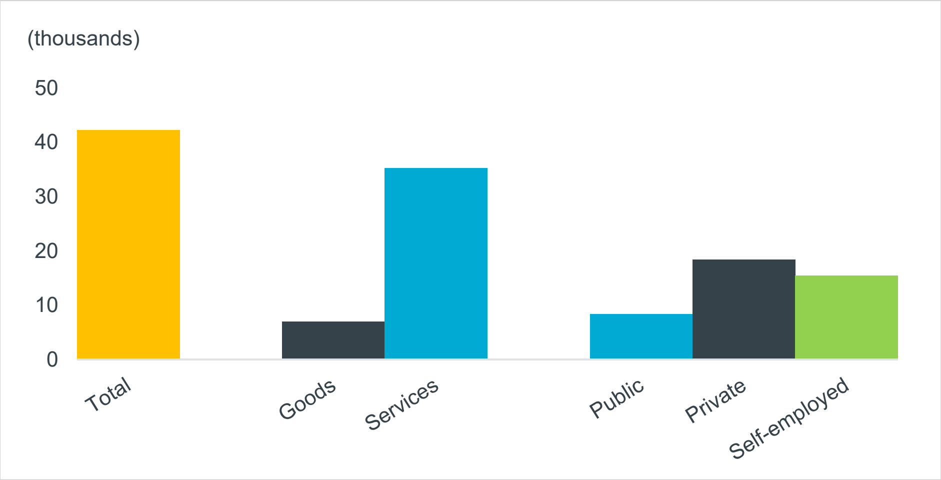
Pipeline constraints lower investment

The run-up in oil prices earlier in the year brought the prospect of continued improvement in oil and gas investment in 2018. However, the collapse in WCS prices is hitting corporate profits and weighing on investor sentiment. Efforts to curb costs and reduce production have weakened the energy investment outlook. Oil sands investment in 2019 is forecast to remain weak after four years of decline, while growth in conventional investment is forecast to slow.

Labour market resilient

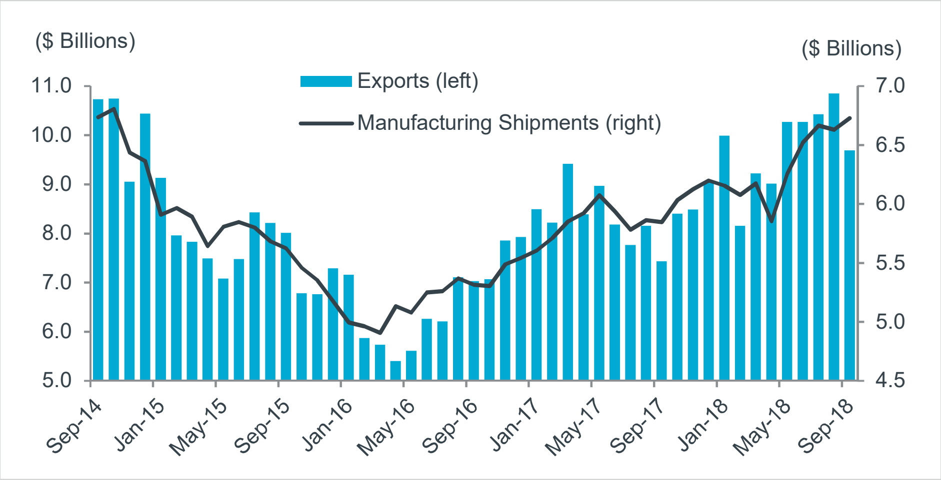
Employment gains have been moderating compared to last year's strong pace, but still remain solid. The province has added over 42,000 jobs since October 2017, reflecting broad-based gains (Figure 2). Employment is forecast to grow 1.9% this year, in-line with *Budget* expectations. In 2019, weaker energy investment and related activity will slow employment growth to 1.4%.

Chart 2: Broad-based gains in employment
Change in employment from October 2017



Source: Statistics Canada

Chart 3: Solid business activity driving growth
Value of Alberta merchandise exports and manufacturing shipments



Source: Statistics Canada

A stronger economy has drawn people back into workforce, lifting the participation rate to a 10-month high. This, along with a pick-up in population growth, pushed the unemployment rate to 7.3% in October. The unemployment rate has averaged 6.7% year-to-date, in line with *Budget* expectations. It is expected to decline to 6.3% in 2019.

Exports aid growth

Despite recent difficulties, solid business activity has been the linchpin of Alberta's economic growth so far this year. Manufacturing sales are at a four-year high and are up 8.5% through the first three quarters of 2018 (Figure 3). Energy exports have also risen by more than 19% over the same period, bolstered by the improvement in prices and strong growth in oil production prior to the recent slide in WCS prices. Given the year-to-date strength, exports are expected to grow by 7.4% this year. However, oil producers have already started to slow production in response to the wider differential. This is expected to carry into 2019, dragging down exports and overall real GDP growth in 2019.

Non-energy investment shift

There are some positive signs for investment outside the energy sector. The decline in private sector construction spending over the past three years looks to have abated, led by a recovery in industrial construction, which climbed to a two-year high in the third quarter of 2018. The decline in real non-energy business investment is expected to moderate to 2.9% this year before turning to modest growth in 2019.

Housing market slows

Tighter mortgage regulations, rising interest rates and elevated housing inventories are weighing on residential housing activity. Resale activity across most regions of the province has slowed markedly in recent months, with the number of units sold falling below last year's levels and prices softening. On the construction side, housing starts are expected to slow from around 29,500 units in 2017 to 26,500 in 2018 due to weakness in the fourth quarter. In 2019, starts are forecast to average 27,300 units reflecting a pick-up in the last half of the year.

Households cautious

Rising costs and weaker sentiment are slowing the pace of consumer spending in Alberta. While retail sales remain at record levels, they are being propped up by higher consumer prices. Inflation remains elevated on higher gasoline and electricity prices, along with a weakening Canadian dollar. Inflation has been revised to 2.5% in 2018, up 0.4 ppt from *Budget*. On an inflation-adjusted basis, growth in consumer spending in 2018 is now forecast to rise 2.2% compared with 2.9% at Budget. In 2019, growth is forecast to increase slightly, buoyed by a growing population and employment gains.

Risks to the Outlook

- An easing of trade tensions and protectionist policies would improve growth prospects and boost global growth.
- Growing global oil supply or slowing demand could put downward pressure on oil prices.
- As oil production is now outstripping pipeline capacity in the province, more prolonged and wider-than-expected discounts for Alberta crudes would further hit corporate profits and investment.

Contact: Catherine Rothrock 780.427.2758