Economic Trends

The recovery continues to broaden across Alberta's economy. More balanced job gains are lifting wages and hours worked while net interprovincial migration has turned a corner. Crude oil production is also ramping up to reach record levels and manufacturing sales are getting a boost from higher prices. However, some headwinds remain. Private sector construction spending continues to be weak and transportation bottlenecks have led to a larger discount for Alberta heavy crude oil. This month's inFocus looks at the major factors behind the oil market rebalancing in 2017.

Key Indicators

Seasonally adjusted unless otherwise indicated.

Indicator	Latest Month	Value	Change year-over-year (y/y)
Alberta Activity Index (y/y growth)	November	+3.7%	+4.3 p.p.
Employment (thousands)	December	2,322	+2.4%
Unemployment Rate	December	6.9%	-1.6 p.p.
CPI Inflation (unadjusted)	December	2.0%	+1.0 p.p.
Retail Sales	November	$6.8 B	+7.4%
Housing Starts (annualized)	December	23,104	-12.0%
Rigs Drilling (unadjusted)	December	155	+2.9%
Manufacturing Shipments	November	$6.1 B	+10.4%
Exports (unadjusted)	November	$8.4 B	+7.4%

Source: Alberta Treasury Board and Finance, Statistics Canada, CAODC, CMHC. p.p.= percentage points.

Household Sector

Turnaround in net interprovincial migration

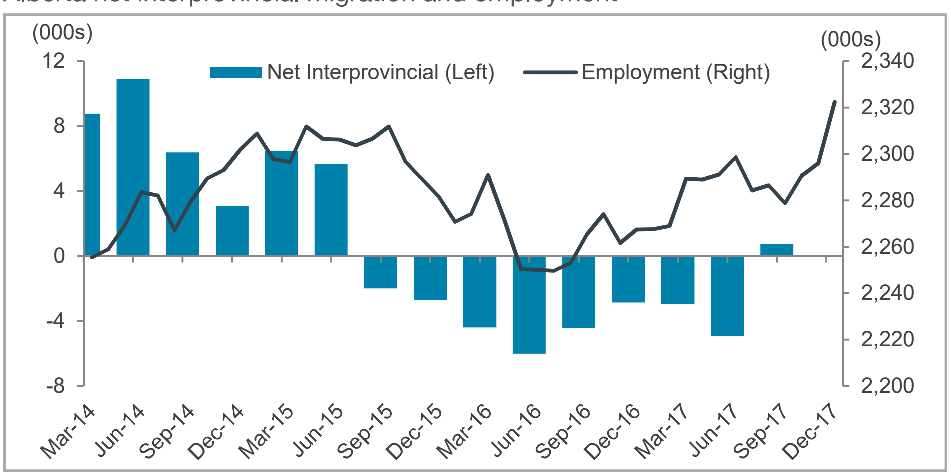
Alberta's year-over-year population growth ticked up for the first time since 2013 as net interprovincial outflows ceased. Population grew by 19,905 in the third quarter to reach 4,306,039 as of October 1, 2017. While the quarterly gain continued to be led by natural increase and international migration, it was also supported by net interprovincial migration, which turned positive for the first time in two years (Chart 1). As a result, Alberta's year-over-year population growth ticked up to 1.3% after slowing consistently since 2013.

Balanced employment growth

Alberta employment regained its footing after stalling in the third quarter. The province added 19,800 jobs in the fourth quarter of 2017, the largest quarterly gain since the third quarter of 2013. This helped pull down the unemployment rate to a two-year low of 6.9% in December. Job gains over 2017 became more balanced across the goods and service sectors, as well as across classes of workers. In particular, recent gains were more concentrated in the private sector following strong growth in self-employment and public sector early in 2017. While overall employment surpassed the pre-recession peak in December, full-time and goods sector employment have yet to recover to pre-recession levels.

Chart 1: Net interprovincial migration turns a corner as job growth picks up

Alberta net interprovincial migration and employment



Source: Statistics Canada

Earnings gaining ground

After remaining directionless for more than a year, average weekly earnings (AWE) have begun to rise. AWE jumped higher in the previous three months to reach $1,144 in November. While both wages and the number of hours worked increased, gains in average hourly wages were particularly strong, rising from $26.11 hour in August 2017 to over $27 in November. Improving wages and hours are partly the result of the growing share of employment in full-time and goods sector positions, which have higher pay rates and more hours.

Surge in housing resale activity

Activity in Alberta's resale housing market surged at the end of 2017. Seasonally adjusted home sales spiked in December to reach the highest level in three years. This is mainly the result of motivated buyers completing sales ahead of the mortgage rule changes in January and anticipated hikes in interest rate this year. Home sales rebounded sharply in 2017, with activity gaining ground earlier in the year and stabilizing throughout the summer.

Alberta Business Sector

Crude oil production set for record highs

Alberta's crude oil production continues to advance. Bitumen production is ramping up with the completion of several oil sands projects in the last quarter of 2017. It reached a new high of over 1.8 million barrels per day (Mbpd) in November. At the same time, synthetic crude output is benefitting from debottlenecking and expansion at existing facilities and is poised to surpass the record set in November 2016. These developments propelled Alberta's overall crude production to a record high of 3.4 Mbpd in November, in addition to propping up energy exports over the course of last year.

Light-heavy differential under pressure

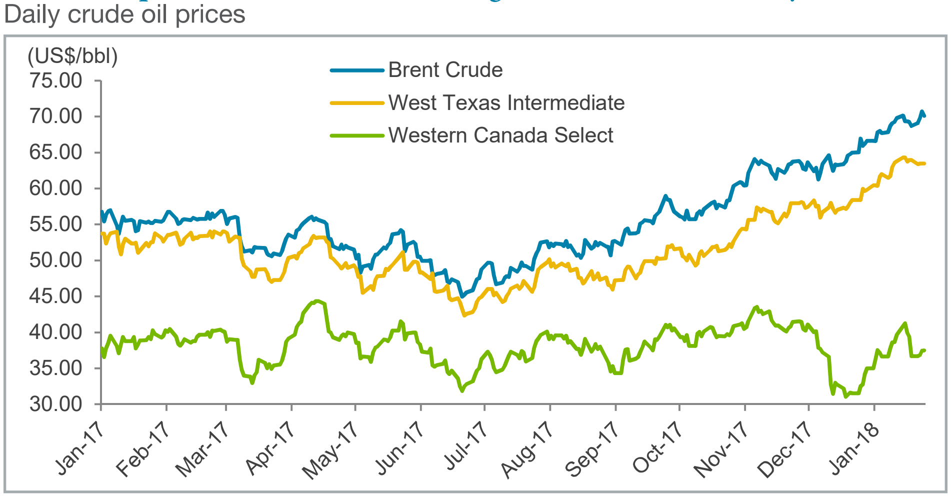
The light-heavy (WTI-WCS) differential has widened in recent months after remaining in a narrow range through most of 2017. The differential increased from an average of US$15/bbl in November to around US$26/bbl by the end of January (Chart 2). The differential came under pressure after a spill in Keystone pipeline in late November resulted in reduced operations, further exacerbating already tight pipeline capacity. This, combined with railway capacity constraints and record production of crude oil, has led to a build-up in domestic inventories in the province, which has dragged down WCS prices. A wider differential means that Alberta crude oil prices are not improving in lockstep with international oil prices (Brent and West Texas Intermediate), which are currently hovering around three-year highs (Chart 2).

Higher prices boosting manufacturing shipments

Alberta's manufacturing activity is getting a boost from the improvement in prices. Alberta refiners are capitalizing on higher world oil prices and producing record amount of refined petroleum products. This has bolstered the value of petroleum and coal shipments, which rose more than 20% in the past four months to their highest level in three years. Chemical prices have also rebounded from a 2017 low and subsequently lifted chemical sales from a 19-month low in October. Meanwhile, wood shipments continued to hover near an all-time high, bolstered by higher lumber prices driven by supply disruptions and heighten building activity in southern US.

Chart 2: Pipeline bottlenecks lead to larger discount for AB heavy crude oil

Daily crude oil prices



Sources: Kent Group Limited/Haver Analytics, Financial Times

Ongoing slump in private sector construction

Alberta's non-residential sector continues to weigh on overall construction activity. In the fourth quarter of 2017, investment in non-residential building construction dipped to its lowest level in four years. The ongoing decline reflects sustained weakness in private construction spending which has been partly countered by strong institutional and governmental investment. In particular, elevated office vacancy rates in Calgary and Edmonton continue to dampen construction activity in the commercial sector.

Outside Alberta

Brighter global growth prospects

The global economy continues to gain momentum. The International Monetary Fund (IMF) estimates that global economic growth rose by half a percentage point to 3.7% last year in the broadest synchronized global growth since 2010. With considerable momentum heading into 2018 along with the anticipated impact of US tax reforms, the IMF forecasts global growth to accelerate to 3.9% in 2018 and 2019. However, uncertainties around the key trade negotiations of NAFTA and Brexit remain key risks to the outlook.

Central banks tighten policy

In light of growing economic momentum, central banks around the globe are shifting their monetary policy stance. The US Federal Reserve, Bank of Canada, Bank of England, and the European Central Bank have all moved toward tighter policies by engaging in measures such as: signalling optimism with forward guidance, winding down quantitative easing programmes, and raising key interest rates. While continued economic growth suggests further tightening, central banks continue to communicate uncertainty around the timing of these measures. Meanwhile, plagued by excessively weak inflation, the Bank of Japan is bucking the trend by maintaining accommodative policies.

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inFocus

Crude oil market rebalancing in 2017

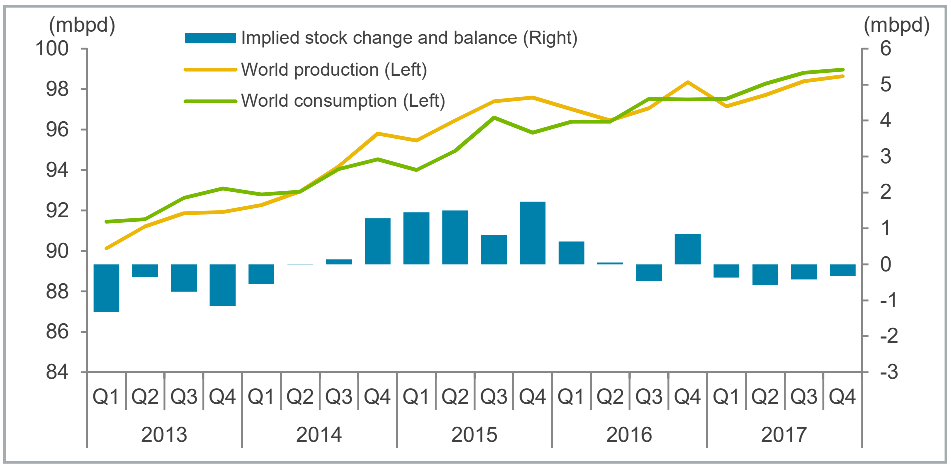
Following the oil price collapse in late 2014 and depressed prices through much of 2015 and 2016, world crude oil markets moved towards rebalancing in 2017. Supply and demand adjustments have resulted in a drawdown in global stocks. This inFocus looks at the major factors driving the oil market rebalancing in 2017.

Supply outpacing demand

The US shale oil revolution completely reshaped global oil markets. After nearly 30 years of continuous decline, US oil production increased 63% between 2010 and 2014. In the context of strong US production, growth in world supply began to outstrip demand growth by mid-2014. With rising global inventories, the Organization of Petroleum Exporting Countries (OPEC) decided to maintain production in November 2014, putting further downward pressure on the oil market. Consequently, oil prices fell precipitously. The West Texas Intermediate (WTI) spot price hit a 12-year low in February 2016, 71% lower than the price in mid-2014.The crude oil market did not begin to rebalance until early 2017 (Chart 1).

Chart 1: World oil market has started to rebalance

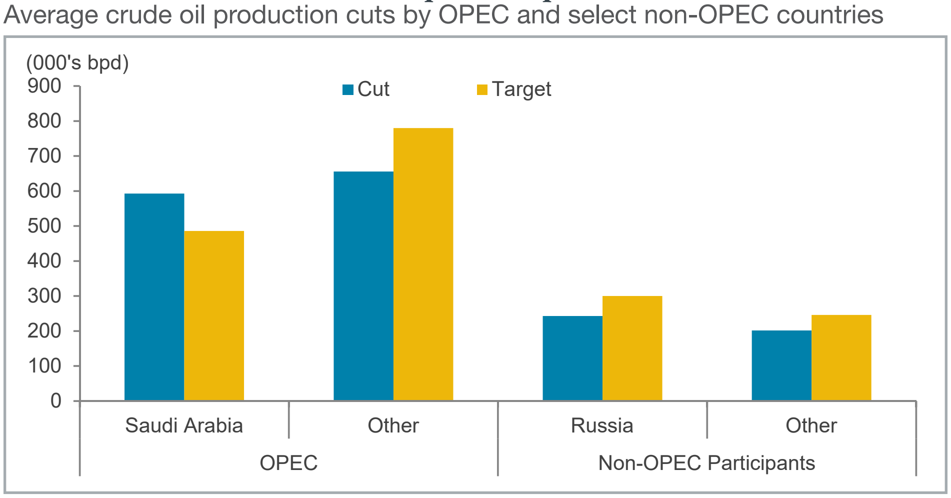
World fuels production and consumption balance



Source: US Energy Information Administration

Chart 2: Saudi Arabia and Russia spearhead production cuts in 2017

Average crude oil production cuts by OPEC and select non-OPEC countries



Source: Bloomberg

Supply cuts drive rebalancing

Lower prices and increased uncertainty in the market caused global oil investment to contract, which helped to limit supply growth. Between 2015 and 2016, a sharp decline in US drilling activity in response to lower prices led to declines in US oil production. However, this was more than offset by rising OPEC production, especially from Saudi Arabia, Iraq and Iran. The failure of the market to self-correct prompted action by OPEC in late 2016. OPEC and some non-OPEC countries, led by Saudi Arabia and Russia, targeted supply cuts of 1.7 million barrels per day (mbpd) beginning in 2017. Cuts made by Saudi Arabia and Russia accounted for almost half of the targeted cuts (Chart 2). Nevertheless, total actual production cuts came in slightly less than target, as there was less than full compliance, especially by non-OPEC nations.

Pick-up in global growth

Oil market rebalancing also occurred in the context of a pick-up in global growth. Increases in industrial production in some of the world's largest economies boosted global demand for commodities. In 2017, the rise in production in the US and Europe (specifically Germany) translated to increases in petroleum consumption. Also, China's imports of crude oil grew through much of 2017, reaching near-record highs in September.

Alberta Government

January 2018
Treasury Board and Finance
Economics and Revenue Forecasting

Inventories decline from historical highs

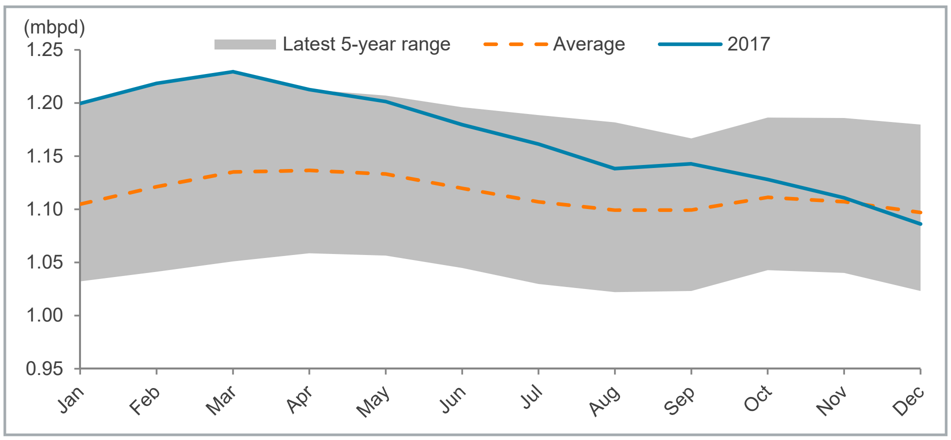
Between 2014 and mid-2016, there was a significant build-up in Organisation for Economic Co-operation and Development (OECD) inventories. Over this period, OECD petroleum inventories increased by almost 500 million barrels, mainly due to the significant build in US petroleum stocks, which peaked in July 2016. After OPEC took steps to rebalance the market by cutting production in 2017, US crude oil stocks declined rapidly and by the end of the year werelower than the latest 5-year average (Chart 3). Also, European petroleum inventories were affected as they declined rapidly (-5.6%) between April and October 2017 to the lowest levels since July 2015.

US oil exports facilitate US inventory drawdown

The rapid decline in US crude oil inventories in the latter half of 2017 coincided with record levels of crude oil exports, especially to China. In 2017, US crude oil exports almost doubled the previous year's levels in 2017 to 1.1 mbpd. This was made possible by the lifting of the 40-year ban on almost all crude oil exports in late 2015. If the ban were still in place, the US would not have been able to participate in the global rebalancing to the same extent, nor would the US have been able to cope as well with refinery outages following hurricanes Irma and Harvey.

Chart 3: US crude stocks below the latest 5-year average

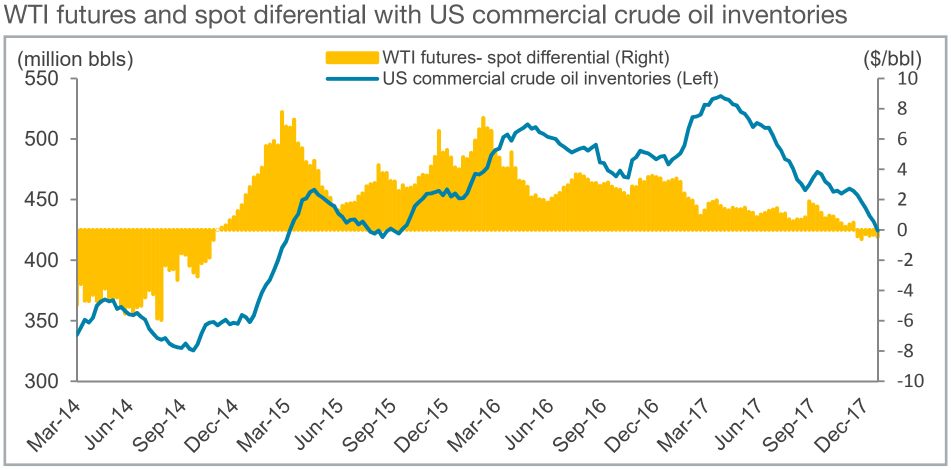
US crude oil inventories including strategic petroleum reserves



Source: US Energy Information Administration

Chart 4: WTI futures switch to backwardation as US stocks decline

WTI futures and spot diferential with US commercial crude oil inventories



Source: US Energy Information Administration, Wall Street Journal

Prices incentivising less storage

Supply cuts made by OPEC and some non-OPEC producers in early 2017 drove up the spot price of crude relative to the futures price. The difference between the futures price and the spot price narrowed significantly and in November the WTI spot price exceeded the futures price for the first time in three years (Chart 4). The higher spot price incentivized oil sales on the spot market rather than storing oil to sell at the futures price later. This facilitated a further drawdown on inventories.

US as swing producer

US oil production is very responsive to price increases. Towards the end of 2016, when prices began to slowly rise, oil production increased. In the Bakken region, for example, production returned close to its 2015 peak by the end of 2017. There is more potential for production increases as the number of drilled but uncompleted wells rose sharply over the year. These drilled and uncompleted wells can be brought online easily with improved market conditions. Shale production in 2017 pushed national oil production to a record high of 9.8 mbpd in December.

Supply cuts increase heavy oil prices

OPEC's decision to cut crude oil production was more focused on heavier crude types. In addition, a further reduction in heavy oil supply from Venezuela was facilitated by the country's political and financial turmoil. This lifted global heavy oil prices. As such, there was a narrowing of the WTI-WCS differential over the first two quarters of 2017. However, transportation bottlenecks due to tighter pipeline capacity, shutdown of the Keystone pipeline and railway capacity constraints caused the differential to widen towards the end of the year (see Economic Trends Page 2).

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