Economic Trends

February 2022

This month's Economic Trends is taken from the Economic Outlook Chapter of *Budget 2022*, released on February 24, 2022.

Overview

Alberta's economic recovery from the global pandemic and the oil price crisis far exceeded expectations last year. Following a 7.9 per cent contraction in 2020, real gross domestic product (GDP) grew an estimated 5.8 per cent in 2021, with nearly all sectors of the economy rebounding.

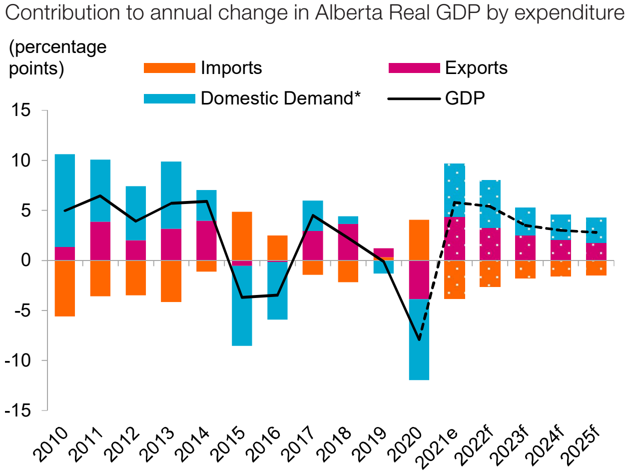
Prospects for the Alberta economy are solid, although supply chain disruptions, elevated inflation and COVID-related disruptions remain headwinds. Oil prices have surged, boosting cash flows and activity in the oil and gas sector. Further expansion of the province's export pipeline capacity will accommodate growing oil production and exports in the coming years. At the same time, recent investment announcements point to growing momentum in sectors such as petrochemicals, technology, finance and other emerging industries. Alberta's relatively low cost of living, a more affordable housing market, higher earnings, and lower taxes are attracting people into the province.

With strong momentum heading into the new year, Alberta's real GDP is forecast to grow at a solid clip of 5.4 per cent in 2022 (Chart 1). Oil production will expand at a slower pace, and as the economy moves closer to full recovery, real GDP growth will be increasingly driven by domestic demand. Business investment is accelerating this year, underpinned by strong energy prices, improving business confidence and Alberta's competitive tax regime. A pick-up in population growth and a strengthening labour market will also buoy consumer spending and housing activity. Real GDP growth is forecast to moderate to 3.5 per cent next year as the economy moves into the expansion phase. Alberta's strong fundamentals – including an attractive tax regime and an educated and relatively young population – will continue to support real GDP growth of 2.9 per cent on average in 2024 and 2025.

Real GDP is expected to return to the 2014 level this year (Chart 2). The recovery from the 2015-16 recession marks the most prolonged recovery in Alberta in modern history. Alberta's economic recovery faced multiple setbacks over the past several years, including market access challenges in late 2018 and 2019, followed by the dual shock of the oil price collapse and COVID-19 pandemic in 2020.

CHART 1: ALBERTA ECONOMY TO GROW AT A SOLID PACE

Contribution to annual change in Alberta Real GDP by expenditure

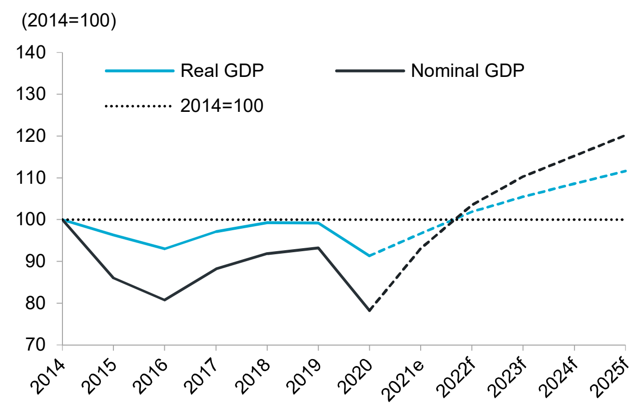


Sources: Statistics Canada, Haver Analytics and Alberta Treasury Board and Finance; e-estimate, f-forecast

* Includes total household, business, and government spending

CHART 2: INCOMES TO OUTPACE REAL ACTIVITY OVER THE MEDIUM TERM

Alberta's nominal and real GDP, indexed to 2014 level



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

Nominal GDP, a broad measure of income, is expected to rise further after fully recovering to pre-pandemic levels in 2021. This year, it is forecast to increase over 11 per cent and exceed its 2014 peak. The swift recovery in incomes has boosted provincial government revenues. Over the medium term, nominal GDP growth is forecast to slow to an average of about 5.0 per cent as growth in commodity prices moderate.

Uncertainty around global oil prices and the long term effects of the COVID 19 pandemic remain risks to Alberta's economic outlook. Scenarios were developed in *Budget 2022* to illustrate the impact of low and high oil prices on Alberta's economy and revenue. For more information on the risks and scenarios, see p. 88–89 of the Fiscal Plan.

Global economy

Global recovery still on track

The recovery in the global economy remains intact, despite several challenges to growth. Lingering supply chain disruptions – which weighed on industrial production and global trade in 2021 – have become more broad-based and are expected to remain a drag on growth this year. However, these are anticipated to slowly dissipate as the pandemic subsides, supply chains adjust, and demand rotates away from goods to services. After a strong rebound of an estimated 5.9 per cent last year, the International Monetary Fund is forecasting global growth to moderate to 4.4 per cent in 2022 and 3.8 per cent in 2023. Growth will moderate as activity stabilizes and monetary and fiscal support measures – which bolstered housing activity and consumer spending last year – unwind. China, which recovered from the pandemic-induced recession more quickly than the rest of the world, is also anticipated to see decelerating growth.

Omicron-driven wave temporarily weighs on activity

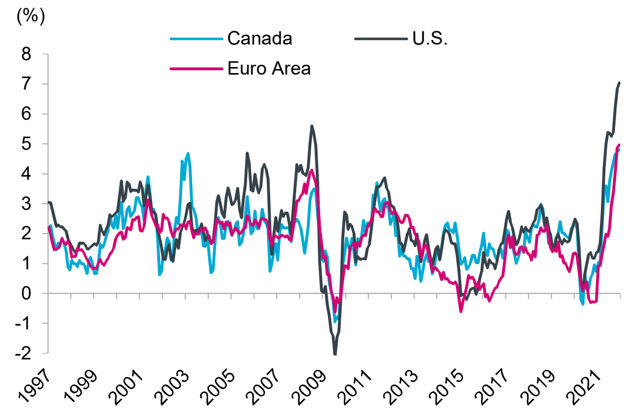
The emergence of the Omicron variant has been a drag to global growth. Many countries re-introduced travel restrictions and targeted public health measures in an effort to curb transmission. In some countries such as the U.S. and United Kingdom, where restrictions have not been tightened as aggressively, consumer activity is slowing but not to the same extent as previous waves. Nonetheless, the economic drag from the Omicron-driven wave is expected to be short-lived. The impact of the pandemic will continue to diminish over time with subsequent waves of the virus as households and businesses adapt further.

Global inflationary pressures elevated

Inflation is expected to remain elevated in the near term before gradually moderating as supply chain disruptions ease, consumers shift their spending from goods to services, and rising interest rates dampen demand. Inflation rose rapidly around the world in the second half of last year (Chart 3), fuelled by soaring commodity prices, persistent supply bottlenecks and robust demand for consumer goods. Higher inflation and tight labour markets are also feeding into rising wage pressures. In the U.S., wages are accelerating at their fastest pace in many years, particularly in close-contact industries which are struggling to fill job openings. In Canada, labour shortages are also pushing wages higher and contributing to broader price pressures.

CHART 3: CONSUMER INFLATION HAS RISEN SHARPLY

CPI inflation in select advanced economies



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

Monetary stimulus unwinds

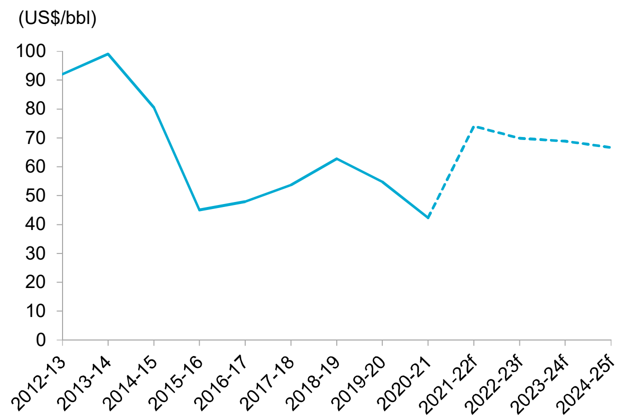
In response to rising inflationary and wage pressures, central banks around the world are beginning to tighten monetary policy. The Bank of England increased its policy rate twice since mid-December 2021, making it the first major central bank to raise interest rates since the pandemic started. The U.S. Federal Reserve has announced that it will taper off its asset purchases at a faster pace and is about to embark on hiking rates. In contrast, the European Central Bank has reiterated its commitment to keep its key interest rates at current levels this year but expects to gradually start reducing its balance sheet in March 2022. Meanwhile, the Bank of Canada (BoC) started scaling back its quantitative easing program in October 2021 and recently raised interest rates. While there is some uncertainty regarding the pace of increases, the BoC is expected to hike rates three times this year, bring its key policy rate to 1.75 per cent over the medium term and begin quantitative tightening thereafter. While tighter monetary policy is expected to moderate growth in the Canadian economy this year, it will remain supportive to investment and consumer spending as interest rates will remain low by historical standards.

Global oil prices to moderate

A gradual increase in global petroleum supply and fading geopolitical risks are expected to bring oil prices down from recent highs (Chart 4). Rising geopolitical tensions and operational challenges in some oil-producing regions have pushed oil prices higher. In addition, expectations of a cold winter around the world and power generators switching temporarily to oil products from expensive natural gas further lifted petroleum demand. Oil prices are anticipated to retreat from current elevated levels as these interim factors dissipate and supply increases. WTI is forecast to average US$70.00 per barrel (/bbl) in 2022-23, down from US$74.00/bbl in 2021-22. The global oil market is expected to become more balanced as OPEC continues to wind down its output cuts and U.S. companies increase spending, resulting in rising production. Over the medium term, continued rebalancing in the global oil market will limit price gains, with WTI settling around US$66.50/bbl by 2024-25, in line with private sector forecasts.

CHART 4: OIL PRICES TO MODERATE

West Texas Intermediate



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

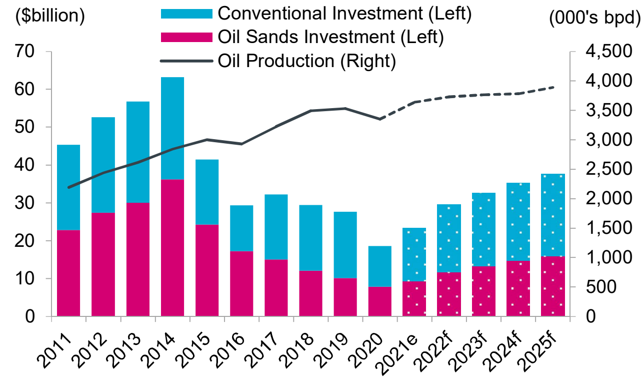
Alberta Economy

Investment growing in Alberta's energy sector

Surging oil prices are bolstering cash positions of oil and gas companies. This, combined with robust demand for energy products around the world, is reinforcing investment in Alberta's oil and gas sector. After a solid comeback in 2021, upstream oil and gas investment is forecast to increase by over $6.0 billion (or nearly 27 per cent) and surpass the pre-pandemic (2019) level this year (Chart 5).

CHART 5: OIL AND GAS INVESTMENT TO SURPASS 2019 LEVEL THIS YEAR

Alberta Nominal Oil and Gas Investment and Crude Oil Production



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

Conventional oil and gas investment will gain momentum in 2022. This builds on the improvement in the second half of last year when drilling activity surpassed 2019 levels. Higher oil prices are boosting drilling while strong demand for natural gas and natural gas liquids (NGLs) will also support higher spending. While prices are expected to moderate following the winter heating season, strong demand fundamentals will continue to support natural gas prices and activity.

Oil sands producers will also contribute to investment growth, with rising bitumen production lifting sustaining oil sands investment. Although oil sands producers are likely to maintain capital discipline in expanding production capacity, they are expected to ramp up investment into new technologies that target emissions reduction, reduce the environmental impact of tailing ponds and improve water use.

Light-heavy differential to support Alberta oil prices

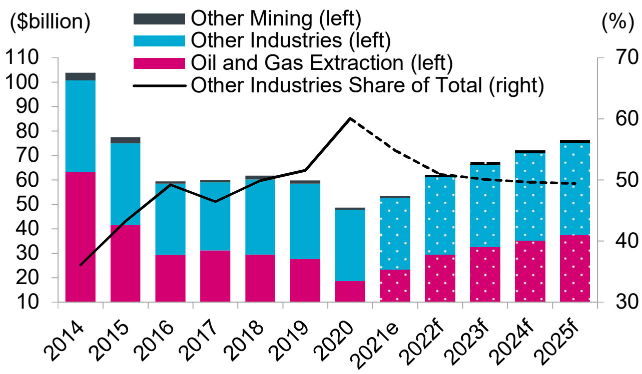
The differential between WTI and Western Canadian Select (WSC) is expected to widen but remain in line with pipeline transportation costs. Growing volumes of Alberta crude oil transported by pipelines, along with more supply of heavier sour grades to the global market, are expected to lift the differential. The differential is forecast to widen from an average of US$13.60/bbl in 2021-22 to US$14.30/bbl in 2022-23. Oil export capacity is also set to improve further with the Trans Mountain Expansion (TMX) coming online in 2023, which will add more than 800,000 bpd of pipeline capacity. This comes on the heels of last year's completion of Enbridge's Line 93 (previously Line 3 replacement project) and the Gibson/USD Group's diluent recovery unit in Hardisty in 2021 increased export capacity. Sufficient export pipeline capacity will also keep the differential less volatile than previous years. The differential is forecast to average US$14.70/bbl by 2024-25.

Investment continues to diversify in the province

Investment outside oil and gas extraction is anticipated to gain momentum this year as business confidence continues to improve, thanks to Alberta's competitive tax and cost environment, lower cost of living, and a young and skilled workforce. There were a number of large investment projects that were announced last year, which will buoy investment in the coming years. After staying flat last year, non-energy investment is forecast to rise $2.2 billion (or 7.5 per cent) in 2022. Growth is forecast to moderate to around 6.2 per cent per year (about $2.1 billion) from 2023 to 2025. It is expected to exceed oil and gas investment in level terms throughout the forecast period (Chart 6).

CHART 6: NON-ENERGY INVESTMENT TO ACCELERATE IN THE COMING YEARS

Private Non-Residential Investment* in Alberta by Category



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

* Includes plant & equipment and intellectual property

Petrochemical manufacturing will remain a large contributor to investment over the medium term, with projects such as Inter Pipeline's Heartland Petrochemical Complex and Northern Petrochemical Corp. plans to build a carbon-neutral plant in Grande Prairie. Projects that support more natural gas consumption in the province and renewable energy will also remain a bright spot for the province. There are also several large scale projects currently underway in the transportation and warehousing sector, namely TC Energy's $1.5 billion expansion of its NGTL system and Pembina Pipeline construction of a few phases of its Peace Pipeline System expansions. Alberta's technology and finance sectors are also expanding, with several companies announcing that they are relocating or setting up operations in the province. Additionally, TELUS will invest $14.5 billion in infrastructure and operations in the next three years, including a broader deployment of its 5G network across the province.

Cost pressures rising for businesses

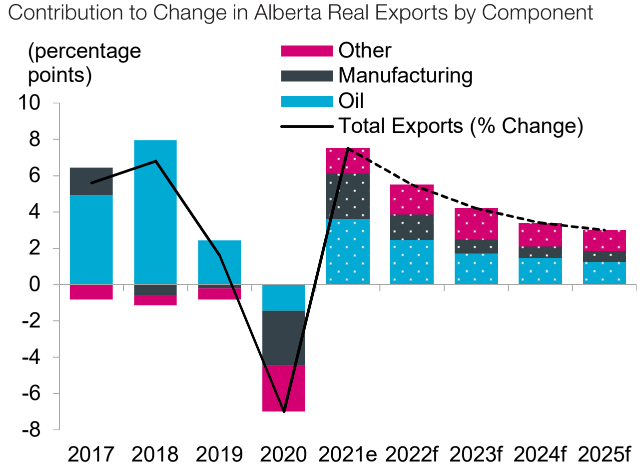
Businesses will continue to face higher costs this year. Input costs are expected to remain elevated after surging last year, while labour costs are anticipated to rise. Agriculture producers are grappling with high energy, fertilizer and feed prices. Residential and non-residential construction costs grew as prices rose across a broad range of inputs, ranging from plastic resin (which is used in various building construction materials) to concrete and metal fabrication products. The resurgence in lumber prices in late 2021 has also put additional upward pressure on costs. Growth in construction costs will moderate over the medium term, although persistent supply chain disruptions and elevated transportation costs will drive up prices of imported goods this year.

Pickup in services boost exports

Exports will continue to be a growth driver in Alberta's economy after a strong recovery last year. They are forecast to grow 5.5 per cent this year and 3.5 per cent on average over the medium term (Chart 7) on the back of solid gains in services and manufacturing. Services exports are set to gain momentum as pandemic-related travel restrictions ease and tourism-related activities pick up. Alberta's real manufacturing exports are also expected to advance. Robust export demand and capacity expansions will boost shipments of petrochemical products. Demand for machinery and equipment should improve with drilling activity gaining momentum in North America. Solid residential construction activity will also continue to support wood manufacturing sales.

CHART 7: SOLID REBOUND IN EXPORTS

Contribution to Change in Alberta Real Exports by Component



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

Rising oil production will continue to be a key driver of overall exports. After rebounding strongly to a new record high last year, oil production is forecast to rise at a more modest pace. Even so, oil exports will account for over 40 per cent of the annual growth in real exports over the forecast period. Recent changes to North American infrastructure, including the reversed Capline pipeline in the U. S., will further facilitate delivery of Alberta's oil products to markets. Natural gas will also be a source of growth for exports in the coming years, supported by robust demand and expanding export pipeline capacity.

The province's agri-food sector will continue to feel the lingering effects of last year's challenges. Primary agricultural exports will be weighed down by lower available crop supplies resulting from last summer's extremely dry conditions, although farm incomes will be buffered by strong crop prices. The livestock production sector is facing challenges from high feed prices, but beef exports and other value-added products are expected to again significantly support exports this year. A growing global population and improving demand will remain supportive of agri-food exports. However, high energy and input costs, supply bottlenecks and other pandemic-related disruptions will remain headwinds to the agri-food industry in 2022.

Corporate profits move higher

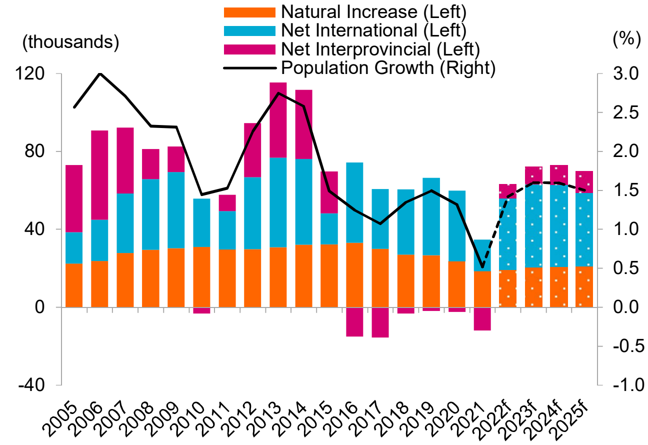
Corporate profits are set to rise further, underpinned by solid energy and other commodity prices and strengthening economic activity. Net corporate operating surplus – a measure of corporate profits and driver of corporate income tax revenues – is forecast to jump nearly 31 per cent to over $58 billion this year, the highest level since the 2015-16 recession. Over the medium term, growth in net operating surplus is forecast to slow in line with moderating oil prices and economic growth.

Population growth rebounding

Alberta's population growth is expected to gain traction due to increasing levels of net migration (Chart 8). It is forecast to accelerate from 0.5 per cent in the 2021 census year to 1.4 per cent this year. While the pandemic severely impacted international migration, Canada adapted by increasing immigration targets and focusing on transitioning temporary residents to permanent residency, which has helped bolster immigration to pre-pandemic levels. Economic conditions in the province have substantially improved, and Alberta's lower cost of living, more affordable housing, relatively higher earnings and lowest overall taxes have been a major draw for people moving from other provinces. Over the medium term, Alberta's population growth is expected to remain robust at around 1.5 per cent, supported by gradual increases in the federal immigration targets and a steady improvement in interprovincial migration. Meanwhile, natural increase (births minus deaths) is expected to normalize into its long-term trend as births and deaths return to pre-pandemic patterns.

CHART 8: POPULATION GROWTH TO PICK UP

Annual change in the Alberta population by component



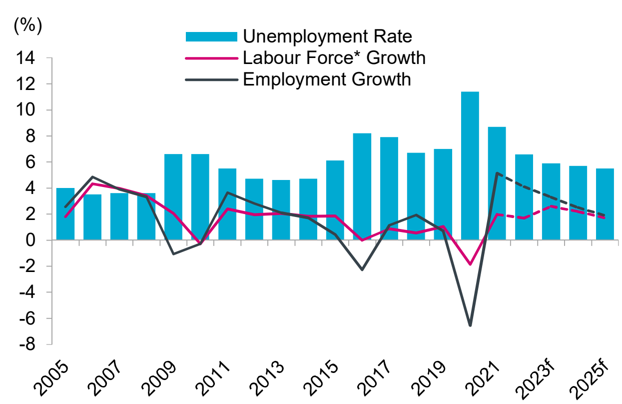
Sources: Statistics Canada, Haver Analytics and Alberta Treasury Board and Finance; e-estimate, f-forecast

Solid expansion in employment

Building on the strong momentum in the second half of last year, employment is expected to expand further. It is forecast to advance 4.1 per cent this year (Chart 9). Employment in contact-intensive and tourism-related services – which lagged behind the recovery last year – is expected to regain momentum. Goods sector employment is also poised to strengthen after failing to make much headway last year. A solid pick-up in business investment and robust export demand is expected to underpin the improvement, led by the energy and construction sectors. Over the medium term, employment growth is forecast to moderate to 3.3 per cent next year before continuing at a solid clip of 2.2 per cent thereafter.

CHART 9: UNEMPLOYMENT RATE TO RECEDE ON RISING EMPLOYMENT

Labour market indicators



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

*The number of people working or looking for work.

Unemployment rate recovering

With the solid expansion in employment, the unemployment rate is expected to decline further this year to an average of 6.6 per cent. Last year, muted growth in the working-age population, coupled with the slow return of people into the workforce, held back labour supply as the economy reopened and demand in some sectors bounced back quickly. These supply side constraints, along with skills mismatches between job seekers and employers, contributed to high job vacancies and labour shortages despite elevated unemployment in the province. Some of these factors are temporary and should dissipate.

Growth in employment is forecast to outpace labour force growth over the medium term. This will help pull the unemployment rate lower to 5.5 per cent by the end of the forecast period. The labour force participation rate is expected to improve but not return to pre-pandemic levels due to an aging population. Lingering concerns over the virus and healthy balance sheets – owing to strong equity markets – may have also prompted some older workers to retire early and leave the workforce permanently, limiting the recovery in the participation rate.

Faster wage growth lifts household incomes

Along with rising employment, faster wage growth is expected to buoy earnings and household incomes. Wages began to pick up in the fourth quarter of 2021 amid strong job vacancies and labour shortages. With the labour market tightening, employers are anticipated to continue raising wages in 2022 in an effort to compete and attract workers. At the same time, expectations of high inflation among workers are expected to put additional upward pressure on wages. Growth in average weekly earnings is forecast to accelerate from 2.0 per cent last year to 3.4 per cent in 2022 before averaging 3.9 per cent thereafter. This will boost growth in primary household income – a key driver of personal income tax revenues – to rise 6.7 per cent this year before moderating to a solid pace of 5.8 per cent by 2025.

Inflation to stay elevated in the short run

Factors that led to higher consumer prices last year are expected to keep inflation elevated in the near term before moderating. Headline inflation spiked to a nearly 15-year high in December 2021 amid ongoing supply chain disruptions, which were exacerbated by the floods in British Columbia and the rapid spread of the Omicron variant, plus sharp rises in energy and food prices and escalating construction costs. Inflation is set to moderate from this level as base-year effects fade, COVID-19 infections recede and supply chain disruptions dissipate. Rising interest rates, along with the further reopening of the services sector, are also expected to dampen demand and prices for some consumer goods.

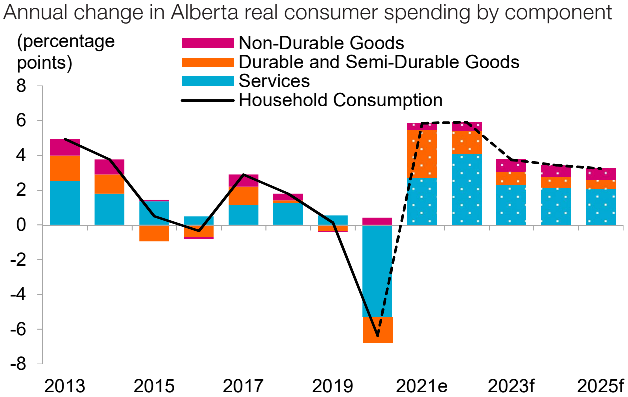
However, faster wage growth and rising food prices will keep inflation above pre-pandemic rates in the short term. Inflation is forecast to average 3.2 per cent in 2022, the same as last year's rate, before declining gradually to around 2.2 per cent by the end of the forecast period.

Services spending gathers momentum

With the strong recovery in services, real consumer spending is anticipated to surpass pre-pandemic levels this year (Chart 10). Consumers are expected to shift more of their spending towards services as public health measures ease. High household savings, improving consumer confidence and pent-up demand for some consumer goods related to the reopening will also buoy spending. Growth in real consumer spending is forecast at 5.9 per cent this year before moderating to 3.2 per cent by 2025.

CHART 10: SERVICES TO BUOY GROWTH IN REAL CONSUMER SPENDING THIS YEAR

Annual change in Alberta real consumer spending by component



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

Solid housing market activity

The strength in Alberta's housing market is expected to continue this year. With the strong resale activity, home unit sales reached a record high in the fourth quarter of last year while housing starts accelerated to the fastest pace since 2015. Tight inventories, a pickup in migration and strengthening employment and wages are expected buoy activity this year. Housing starts are forecast to average around 32,000 units, close to the 2021 level. Interest rates are expected to rise this year but will remain accommodative for homebuyers. Over the medium term, housing starts are forecast to increase to an annual pace of about 35,000 units by 2025. While interest rates are anticipated to rise further, faster population growth and a strengthening labour market will support activity.

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