Economic Trends

December 2022

This month's Economic Trends is taken from the Economic Update of the 2022-23 mid-year Fiscal Update and Economic Statement, released on November 24, 2022.

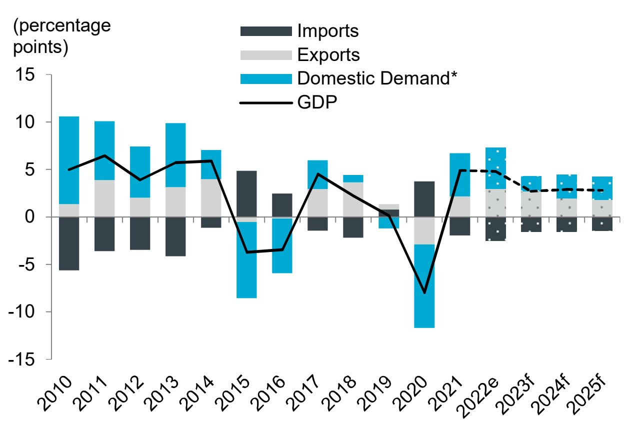
Overview

Alberta economic prospects remain solid, but risks are increasing. Persistently high inflation, aggressive interest rate hikes around the world and ongoing geopolitical uncertainty are slowing the momentum in the global economy. Commodity prices have retreated from elevated levels seen earlier this year amid heightened concerns of a global recession. Even so, Alberta's economy is positioned well to weather the challenges. Oil prices have softened but remain robust, boosting revenues and activity in the energy sector. Exceptional growth in non-energy business output has also bolstered export revenues and corporate profits, while investment intentions continue to be strong. Alberta's housing market is faring much better compared with the rest of the country, buoyed by solid migration and low inventories. The Alberta Activity Index, a measure of provincial economic activity, is up 6% so far this year.

After rebounding 4.8% in 2021, Alberta's real gross domestic product (GDP) is now forecast to grow 4.8% this year (Chart 1). This is down 0.1 of a percentage point and

CHART 1: REAL GDP GROWTH TO MODERATE BUT REMAIN SOLID NEXT YEAR

Contribution to annual change in Alberta real GDP by expenditure



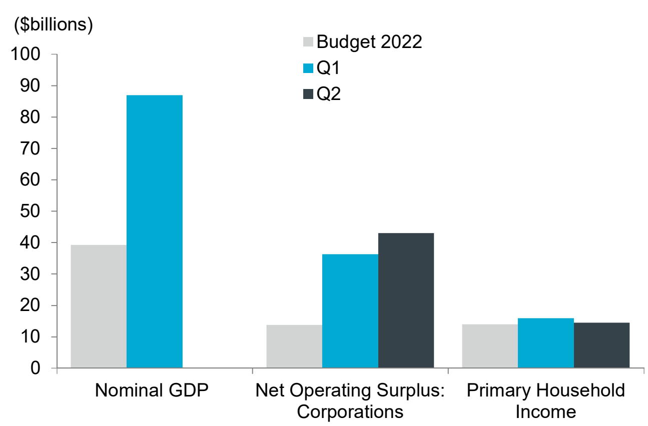
Sources: Statistics Canada and Alberta Treasury Board and Finance; e-estimate, f-forecast

* Includes total household, business, and government spending

0.6 percentage points from the first quarter and budget, respectively. The downgrade reflects weaker sentiment and softer consumer spending as a result of faster interest rate hikes, persistently high inflation and lagging wage growth. Weaker renovation spending and a pullback in resale housing activity are also weighing on residential investment, although housing starts have remained strong. Despite softer growth, real GDP is set to fully recover from the COVID-19 downturn and surpass the 2014 peak this year. At the same time, incomes in the province remain strong and will support provincial government revenues. Nominal GDP – a broad measure of income – is forecast to grow 24% in 2022, buoyed by record high corporate profits and solid household income growth (Chart 2).

CHART 2: INCOMES SURGE HIGHER

Change in Alberta nominal GDP, corporate profits and household income, 2022



Source: Alberta Treasury Board and Finance

Alberta's real GDP growth is forecast to moderate to 2.7% next year but will fare better compared with the rest of the country. The completion of the Trans Mountain Pipeline expansion (TMX) expansion in late 2023 along with solid oil prices are expected to support activity in the energy sector. Non-energy business investment will also be buoyed by large-scale projects in clean technology, renewable power and other emerging sectors. However, growth in consumer spending and residential investment are expected to slow further as higher interest rates work their way through the economy and pent-up demand for services fades. Over the medium term, the Alberta economy is expected to grow at around 2.9%. Solid fundamentals – including a strong population growth, relatively young population, lower cost of living and high wages – will support Alberta's expansion in the coming years.

Global prospects weaken

Ongoing geopolitical uncertainty, persistently high inflation and aggressive interest rate hikes around the world are creating significant headwinds for the global economy. Central banks around the world – including the U.S., Canada and Europe – have increased their policy rates at a rapid pace in order to bring down inflation. The Bank of Canada, in particular, has increased the overnight target rate by 350 basis points since March 2022, the fastest pace in history. The overnight target rate is forecast to rise further to reach 4% by the end of this year, the highest level since 2008. While tighter financial conditions are beginning to slow demand in the Canadian economy, the labour market continues to be resilient. Employment grew in the last two months and the unemployment rate is still hovering at record lows.

The global wave of aggressive monetary tightening has contributed to a sharp deterioration in sentiment and raised concerns about a recession in the global economy. This, in turn, has led to sharp declines in asset and commodity prices in recent months. There are also signs that global economic activity has begun to slow. The global composite PMI output index contracted for the third consecutive month in October, with activity declining in both manufacturing and service sectors.

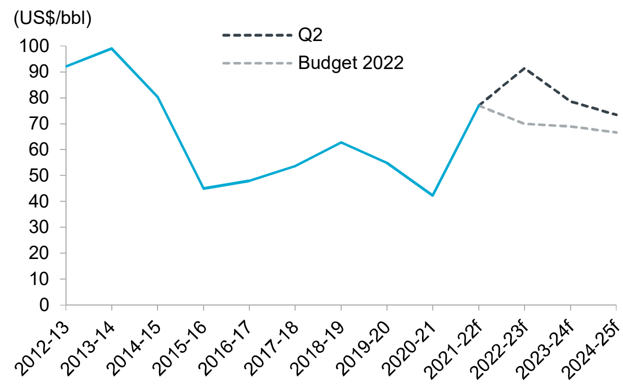
Oil prices strong despite pullback

Oil prices have softened from the record highs seen earlier this year, but tight market conditions are keeping prices at robust levels. Global petroleum demand has weakened due to slowing industrial production, rolling lockdowns in China, as well as lower-than-expected U.S. gasoline consumption throughout the summer this year. The announcement by OPEC+ in October to cut their production target by two million barrels per day (bpd) starting in November led to a partial rebound in West Texas Intermediate (WTI), although rising fears of a global recession continue to weigh on prices. Ongoing geopolitical developments will also continue to keep oil prices volatile in the near term.

WTI is now forecast to average US$91.50/bbl in 2022-23, US$1.00/bbl lower than the first quarter update but still well above budget expectations. The slight downward revision reflects expectations of a slowdown in global growth next year, which is anticipated to dampen petroleum demand and prices. Even so, global oil supply-demand balance will remain tight and provide support to prices. As a result, WTI is forecast to be significantly higher than budget, averaging US$78.50/bbl in 2023-24 and US$73.50/bbl in 2024-25 (Chart 3).

CHART 3: TIGHT GLOBAL OIL MARKET TO BUOY PRICES

West Texas Intermediate



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

Alberta prices under pressure

The discount between WTI and Western Canadian Select (WCS) oil price has widened significantly in recent months. While there is sufficient egress from the province, the combination of planned and unplanned refinery outages in the U.S., the release of heavy oil barrels from the U.S. Strategic Petroleum Reserve (SPR) and rebound in Western Canadian oil production has pushed the light-heavy differential to above US$25/bbl since October. A global glut of high sulphur fuel oil, due in part to increased flows of Russian residual fuel oil to Asia, is also weighing on refinery demand for Alberta's heavy oil in the U.S. Gulf Coast. The differential is now forecast to average US$19.80/bbl for 2022-23, up $0.60/bbl from the first quarter and $5.50/bbl higher than budget.

Over the medium term, the WTI-WCS differential is forecast to narrow to US$18.10/bbl in 2023-24 as some of the transient factors fade. Export capacity additions from the completion of TMX in late 2023 should lead to further improvement to US$16.10/bbl in 2024-25. Despite the normalization, stronger oil production, and thus pipeline throughput, is expected to push the differential above levels forecast at budget.

Despite a wider differential, strong global oil prices and a lower Canadian dollar are expected to buoy WCS prices. WCS is forecast to average C$94.70/bbl in 2022-23, surpassing the 2013-14 peak, before moderating to C$73.30/bbl by 2024-25. With the recent weakness in the Loonie, the Canadian dollar is now forecast to average US¢75.20/Cdn$ in 2022-23, down from expectations in first quarter and budget, before slowly rising to US¢78.20/Cdn$ by 2024-25.

The price of western Canadian natural gas has also displayed increased volatility in recent months due to pipeline restrictions and robust production levels. Maintenance on both the Nova Gas Transmission Line (NGTL) and West Coast pipelines have temporarily restricted export flows from the province, resulting in wide swings in the AECO price. In contrast, natural gas prices in the U.S. have been comparatively steady and elevated, which is pushing up the cost of processing high sulphur crude such as Alberta's heavy oil. The Alberta Reference Price (ARP) is expected to average C$5.40/GJ in 2022-23, down slightly from first quarter but still well above budget. Natural gas prices are expected to remain above pre-pandemic levels on the back of rising demand, with ARP averaging C$4.40/GJ in 2023-24 and $3.80/GJ in 2024-25.

Non-energy exports remain high

Non-energy business output has grown at an exceptionally strong pace so far this year, although it is expected to ease in 2023 in line with a slowdown in the global economy. While manufacturing sales have retreated from recent peaks on the back of declines in petroleum & coal products and durable goods manufacturing, they are still up more than 30% year-to-date. The value of non-energy goods exports has also moderated, weighed down by lower exports of basic & industrial chemicals, as well as forestry and building products. These have been partly offset by a rebound in farm, fishing and intermediate food products, which has surged in recent months due to higher export volumes of wheat. The bounce back comes after depleted inventories and last year's dry weather conditions weighed on crop exports in the first half of this year. Despite the recent pullback, the value of non-energy exports is still up nearly 14% so far this year.

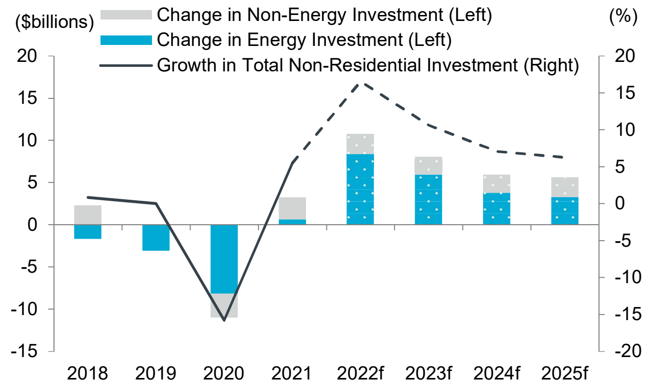
With the slowdown in the global economy, growth in manufacturing and service exports is expected to decelerate and dampen non-energy exports in 2023, although this will be partly cushioned by a weaker Canadian dollar. Overall, real exports are forecast to grow around 4% next year before moderating to 3% over the medium term.

Solid oil and gas investment

Energy sector revenues and activity remain strong despite the volatility in prices. Oil and gas producers are drilling wells at a pace not seen since 2014, although ongoing labour and material shortages are restraining activity Strong drilling activity has lifted conventional oil production by 12% year-to-date, while natural gas output is up 4% .Oil sands production has also rebounded to near all-time highs following maintenance-related disruptions in the spring. While producers are spending significantly more compared to last year, they are reinvesting a much smaller share of their cash flow into expanding production. They continue to focus on paying down debt to improve their balance sheets and increasing shareholder returns after many years of struggling with weak prices and market access constraints. Oil and gas investment is forecast to grow 35% (or more than $8 billion) this year, led by the conventional sector (Chart 4). The increase in spending also reflects higher input costs.

CHART 4: BUSINESS INVESTMENT CONTINUES TO ADVANCE

Change in Alberta non-residential investment by component



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

Energy investment is forecast to rise over the medium term, growing $5.9 billion (or 18%) in 2023 and $3.8 billion (or 9.9%) in 2024. While oil prices are anticipated to moderate from this year's elevated levels, they will remain supportive of activity. Producers are expected to ramp up drilling and production ahead of TMX coming online in late 2023. Even so, they are expected to maintain capital discipline in expanding production and continue to invest in emissions reduction initiatives.

Non-energy investment to gain momentum

Outside of oil and gas extraction, construction projects are proceeding despite higher costs. A strong expansion in the warehousing sector has propelled spending in commercial building construction this year, while ongoing projects in renewable energy, utilities and pipeline transportation are boosting investment in machinery & equipment and engineering construction. Non-energy investment is forecast to grow $2.9 billion (or around 10%) in 2022, reflecting increased activity and soaring construction costs.

Non-energy investment is anticipated to grow further by around 9% in 2023 and around 7% over the medium term. Cost pressures are expected to ease in the next few years. Activity will be boosted by spending on clean technology, which is poised to gain traction on the back of Alberta's competitive taxes, stable regulatory environment, and access to abundant, resilient and low-cost natural resources. Air Products is set to build a $1.6-billion new net-zero hydrogen energy complex in Alberta's Industrial Heartland. This landmark hydrogen production and liquefaction facility is expected to create 2,500 construction jobs and 30 permanent jobs once it becomes operational in 2024. A number of large-scale investment projects that will use hydrogen for industrial processes and power generation were also announced over the past year, providing significant potential upside to investment. These include Dow Chemicals $10 billion net-zero emissions ethylene and derivatives facility and Northern Petrochemical Corporation's $2.5 billion carbon-neutral ammonia and methanol production facility.

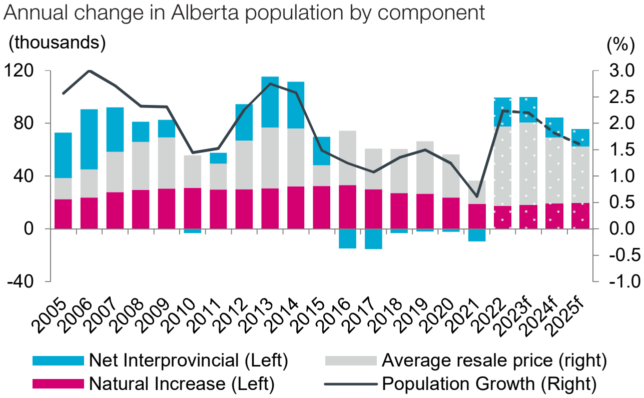
Strong migration lifts population growth

After gaining momentum in the last year, Alberta's population growth is expected to remain robust with higher levels of net migration. Alberta's population grew 2.2% in the 2022 census year, a dramatic turnaround from 0.6% growth in 2021 and the highest rate since 2014. Population growth started picking up in the second quarter, propelled by net international migration which saw its strongest quarterly level on record. Alberta also welcomed nearly 22,000 people from other provinces on a net basis in 2022, the highest level since 2014 and the largest among provinces.

Alberta's population is forecast to rise 2.2% in the 2023 census year (Chart 5). Immigration will get a boost from higher national targets set by the federal government, while strong levels of temporary foreign workers coming into the province will continue to buoy non-permanent residents. With activity slowing more sharply in the rest of the country, Alberta is also expected to see robust inflows of interprovincial migrants given its relatively strong economic conditions, favourable housing affordability and lower cost of living. Population growth is forecast to moderate over the medium term to 1.6% by 2025.

CHART 5: STRONG POPULATION GROWTH TO CONTINUE IN 2023

Annual change in Alberta population by component



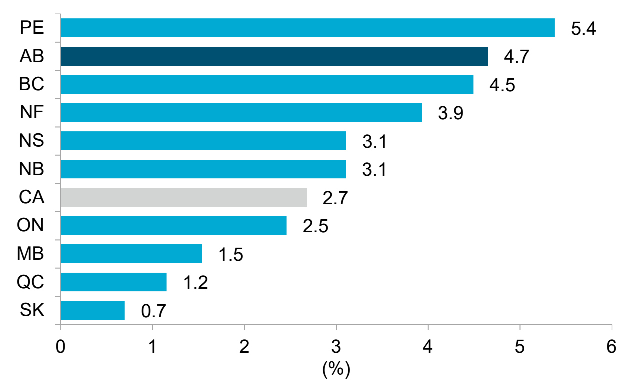
Sources: Statistics Canada, Haver Analytics and Alberta Treasury Board and Finance; e-estimate, f-forecast

Employment to expand

Employment in the province has regained some momentum after stalling in the summer. It has been buoyed by renewed strength in some sectors such as construction and retail & wholesale trade, as well as ongoing gains in professional, scientific and technical services. Employment has expanded by more than 79,000 since December 2021, with services sector leading the way. Tourism-related industries such as food & accommodation continue to make headway despite difficulties finding workers. Goods sector employment has also improved in recent months, but still lags behind other industries. Even so, Alberta's overall employment recovery from the pandemic outpaced that of most provinces (Chart 6). Employment is now forecast to grow 5.2% this year, down slightly from the first quarter.

CHART 6: ALBERTA'S EMPLOYMENT RECOVERY OUTPACES MOST PROVINCES

Percentage change in seasonally adjusted employment since February 2020



Sources: Statistics Canada and Haver Analytics

The province is expected to continue adding jobs next year, but at a more moderate pace of 2.4%, driven by rising investment and solid population growth. While small business sentiment has pulled back from recent highs, firms remain optimistic that their performance will be stronger over the next year. With continued inward migration, many employers will be able to fill vacant positions, particularly for those industries where shortages remain acute. Employment growth is expected to accelerate to 2.6% in 2024 as interest rates fall and global growth picks up, before moderating to around 2.3% in 2025.

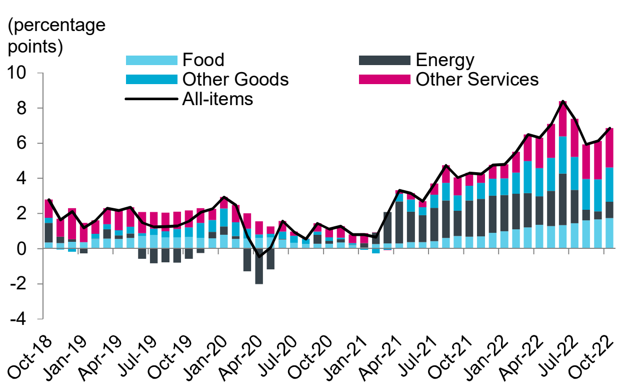
As hiring pressures ease off, the unemployment rate is forecast to tick up slightly in 2023. The labour force is anticipated to expand significantly with a surge in population and a rebound in the participation rate. After remaining steady in 2022, the participation rate is expected to improve 0.2 percentage points to 69.4% in 2023. The unemployment rate is forecast to increase to 6% next year before declining gradually to 5.5% by 2025. After remaining subdued this year, growth in average weekly earnings is expected to pick up in the next few years as compositional factors fade and wages catch up with inflation. It is forecast to accelerate from 2.3% this year to 3.9% by 2025.

Inflation cooling gradually

Consumer inflation has cooled down from its peak, although it has been more persistent than expected since first quarter and price pressures remain broad-based. While growth in energy prices has declined sharply due to lower gasoline prices and the impact of the provincial government's affordability measures, prices for other components such as food and services have accelerated, keeping inflation stubbornly high (Chart 7). In particular, growth in food prices rose to the highest rate since 1981 in October, as higher input prices such as fertilizers and natural gas, unfavourable weather and ongoing geopolitical instability stemming from the war in Ukraine contributed to the increase. Core inflation (all items except food and energy) also rose, with growth in prices for services jumping to a new 14-year high. Headline inflation is now forecast to average 6.3% this year, up 0.2 percentage points from first quarter.

CHART 7: FOOD PRICES CONTRIBUTING MORE TO HEADLINE INFLATION

Contribution to Alberta's headline consumer inflation



Sources: Statistics Canada and Alberta Treasury Board and Finance calculations

* Energy includes gasoline, natural gas and electricity

The impact of unprecedented interest rate hikes by the Bank of Canada will be felt more next year as demand slows further. This, coupled with moderating energy prices and smaller base year effects, should help bring inflation further down to an average of 3.3% for 2023 before returning back to around 2% over the medium term.

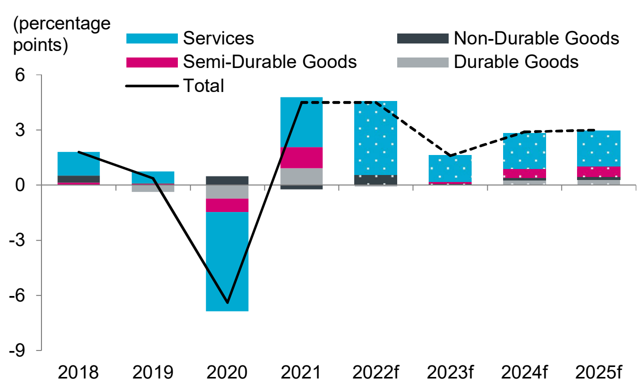
Households restrain spending

Household finances and consumer spending will remain under pressure in the near term until inflation eases significantly and wage growth accelerates. The combination of persistently high inflation and rising interest rates this year has dampened consumer sentiment and eroded household spending power. Growth in retail spending has moderated significantly as a result, particularly for discretionary and big-ticket items such as motor vehicles and renovation-related building materials. The slowdown in goods spending has been somewhat offset by pent-up demand for discretionary services such as restaurant sales and hotel occupancy rates, which have rebounded strongly so far this year. Real consumer spending is now expected to rise 4.5% this year, 0.8 percentage points lower than first quarter.

Higher interest rates are expected to work their way through the economy and will further slow growth in real consumer spending to 1.6% in 2023 (Chart 8). As inflation eases and rising wages begin to catch up, growth in real consumer spending is set to accelerate and outpace population growth again at 2.9% in 2024.

CHART 8: CONSUMER SPENDING ON GOODS TO STALL NEXT YEAR

Contribution to annual change in real consumer spending by component



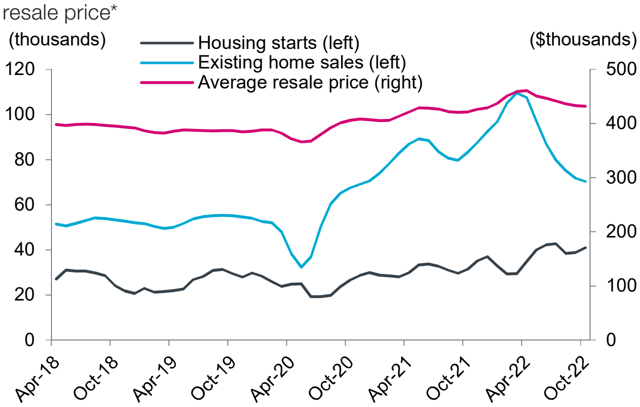
Sources: Statistics Canada, Haver Analytics, and Alberta Treasury Board and Finance; f-forecast

Housing market resilient

Alberta's housing market is faring better compared to the rest of the country despite the rapid rise in interest rates. Although resale activity has pulled back from the exceptionally high levels seen earlier in the year, it is still up 4% year-to-date and higher than pre-pandemic levels. Housing starts jumped above 48,000 units in October to the highest level since early 2015, and are up 22% so far this year (Chart 9). This is in contrast to the national level, where unit sales and housing starts have fallen 23% and 4.3% year-to-date, respectively. While Alberta's housing activity surged following the onset of the pandemic, the market never became overheated and the run-up in home prices was far more muted compared to other provinces.

CHART 9: HOUSING STARTS RESILIENT DESPITE RISING INTEREST RATES

Annualized Alberta housing starts, existing home sales and average resale price*



Sources: Canada Real Estate Association, Canada Mortgage & Housing Corporation and Haver Analytics

*3-month moving average

With the strength so far this year, housing starts are forecast to average around 38,000 units in 2022. Homebuilding activity in Alberta is being buoyed by elevated commodity prices, favourable affordability and strong migration into the province which is also boosting construction of multi-family rental units. Tight inventories of new and existing homes are also supporting activity, with the number of completed and unabsorbed units near levels seen prior to the 2015-16 recession.

The pace of housing starts is expected to ease in the next two years, averaging between 34,000 and 35,000 units. The slowdown reflects the lagged impact of higher interest rates and more moderate rise in input prices. However, Alberta's strong demand fundamentals – such as robust population growth and healthy labour market – will keep the annual pace of housing starts higher than 2015-2021 levels. While a decline in renovation spending and slower resale activity will be a drag next year, new housing construction in the second half of 2022 is expected to carry through and buoy residential investment in the early part of 2023.

Risks to Outlook

Alberta's economy cannot be insulated from the impacts of geopolitical uncertainty, global economic slowdown and tighter financial conditions. The current economic environment is highly uncertain.

To support the understanding of these risks, two scenarios are considered. The low scenario assumes oil prices remain well below the base forecast starting in early 2023. Weak economic growth in China and contraction in the U.S. and Europe in the first two quarters of 2023 result in sharply weaker global energy demand next year. Global economic growth is expected to be lower than the base case forecast in 2024 and 2025 before normalizing in 2026, but at an overall lower level of economic activity and oil demand than the base forecast. This leads to significantly less investment in the oil and gas sector and lower oil production in Alberta, which results in a weaker Alberta economy. The combined effects of the oil price shock and a weak global economy in the first half of 2023 are lower Canadian interest rates, a weaker Canadian Dollar, and lower consumption, lower employment, lower investment, and a lower rate of population growth in Alberta. A weaker economy has commensurately negative impacts on Alberta's corporate and personal tax revenue, and the low oil prices severely negatively affect Alberta's natural resource revenue.

The alternative high scenario assumes oil prices rise well above the base forecast starting in early 2022, driven by continued strong global demand growth and the effects of global underinvestment in recent years limiting oil production growth. High oil prices gradually drive higher energy sector investment and oil production growth in Alberta, though companies remain disciplined in their capital allocation decisions and disproportionately invest in conventional oil and gas production to see a faster return on investment than in the oil sands. Oil prices slowly retreat over several years towards the base forecast, but oil and gas production, investment, and corporate revenues remain higher than the base forecast. The improving energy sector outlook leads to moderate increases in Canadian interest rates and the Canadian Dollar, although these only provide a modest drag on Alberta's economic growth. This stronger economic performance in the province leads to significantly higher net interprovincial migration, as Canadian residents from other provinces move to Alberta for the economic opportunities the province's strong economy affords. All together, this results in stronger household consumption growth, higher wage growth, higher employment growth, and an unemployment rate declining more than in the base forecast. This economic strength translates into substantial increases in Alberta's corporate and personal tax revenue, and higher energy prices result in even faster growth in Alberta's natural resource revenue.

Neither scenario includes additional fiscal policy responses from the federal or provincial governments beyond what is included in the base forecast that would buffer the downside to the economy in the low scenario nor that would temper the upside to the economy in the high scenario.

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