Economic Trends

December 2021

This month's Economic Trends is taken from the Economic Update of the *2021-22 Mid-year Fiscal Update and Economic Statement*, released on November 30, 2021.

Overview

The recovery in the Alberta economy is firmly underway. The Alberta Activity Index, a measure of provincial economic activity, is up 9.4% through September, reflecting the sharp rebound in the first half of the year. High energy prices are boosting drilling activity and oil production, while business output remains solid. Housing activity continues to be robust, while private sector construction spending is picking up. There have been a number of large investment projects announced recently, including Amazon Web Services' $4.3 billion cloud computing hub in Calgary and Northern Petrochemical Corp.'s $2.5 billion petrochemical facility in Grand Prairie.

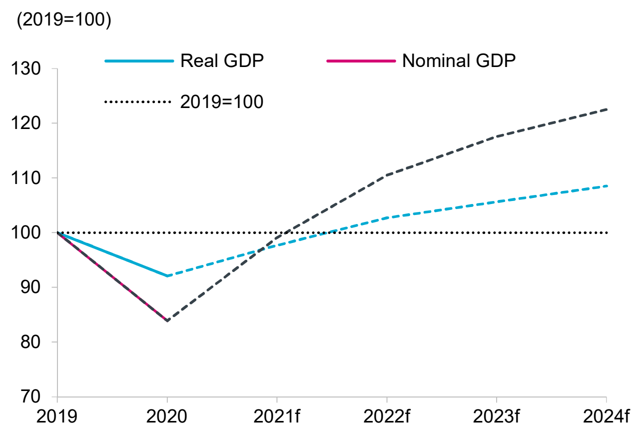
The economy continues to feel the effects of COVID-19, but the impacts are fading. With the economy reopening in the summer and consumer confidence at pre-pandemic levels, there were signs of a broader recovery in services, such as restaurant sales and hotel occupancy rates. The Delta-driven fourth wave and tighter public health measures dampened activity in the Fall, particularly in tourism-related services, but the impacts are expected to be far less than in previous waves.

After contracting 7.9% last year, Alberta's real gross domestic product (GDP) is now forecast to grow 6.1% in 2021. While this is lower than the *First Quarter* forecast of 6.7%, it continues to far exceed *Budget* expectations. Rising input costs, supply side bottlenecks and labour shortages in some industries are expected to restrain job gains in the near term. As a result, employment is now forecast to grow 5.1%, slightly lower than in the *First Quarter*, while the unemployment rate is forecast to average 8.8%.

Income gains in the province are expected to outpace real activity. Growth in nominal GDP, a broad measure of income, has been revised up to 18.1% this year compared to 15.7% in the *First Quarter*. The swift recovery in incomes relative to output (Chart 1) will boost provincial government revenues this year.

CHART 1: INCOMES RECOVERING FASTER THAN REAL OUTPUT

Alberta's nominal and real GDP, indexed to pre-pandemic level



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

Next year, real GDP is forecast to expand 5.1% and return to 2014 levels as the pandemic subsides further and the recovery in the services gathers momentum. Growth in business investment is expected to accelerate, underpinned by solid oil prices, improving confidence and Alberta's competitive tax regime. Alberta's strong fundamentals, including a young working age population, will support real GDP growth of about 2.8% on average in 2023 and 2024.

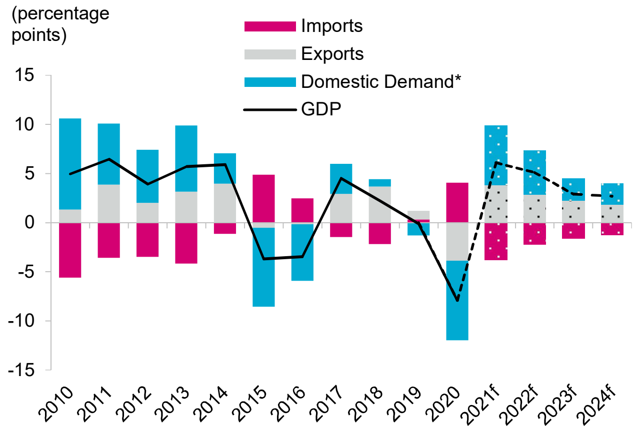
Energy leads output recovery

The recovery in business output this year is largely being driven by the energy sector. Strong oil prices and demand are boosting oil production, which reached 3.5 million barrels per day (bpd) in September, up more than 9% year-to-date. Manufacturing shipments of petroleum and petrochemicals have also rebounded strongly. On the non-energy side, food manufacturing shipments were at record highs in September on the back of robust growth in global demand and prices. However, exports of forestry products have come down amid a sharp pullback in lumber prices and moderating residential construction activity. Tight crop inventories, along with drought conditions in the summer, have also weighed on primary agricultural production and exports.

Nonetheless, real exports are forecast to rise 6.7% this year (Chart 2). Oil exports will lead the gains, accounting for more than half of the growth in overall exports this year. With the pick-up in tourism-related services, real exports are forecast to grow 5.2% in 2022 before expanding at an average of 3.6% in 2023 and 2024.

CHART 2: EXPORTS A KEY DRIVER OF GROWTH THIS YEAR

Contribution to change in Alberta real GDP by expenditure



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

* Includes household, business and government spending

Stronger energy prices

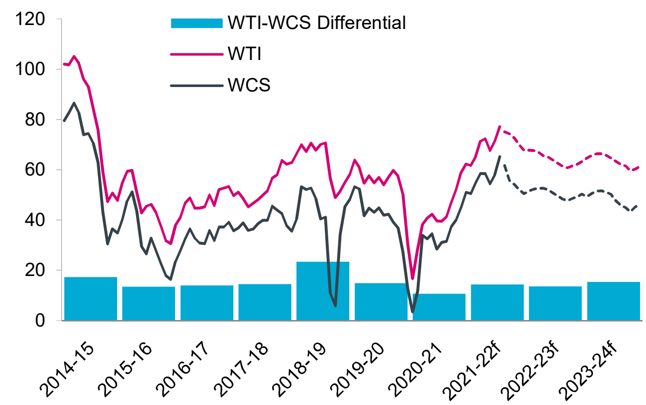
Natural gas prices have strengthened this year. A solid rebound in the global economy and an accelerated transition away from emissions-intensive energy sources like coal have boosted demand for natural gas globally. Moreover, concerns about short-term supply constraints and low storage levels heading into the 2022 heating season have caused price spikes in Europe and Asia. This has led to moderate price gains in North America, with the price surge in Alberta less drastic than in the U.S. While prices are expected to moderate following the winter heating season, strong demand fundamentals will continue to support prices. The Alberta Reference Price (ARP) is expected to average $3.30/GJ in 2021-22, a robust increase from $1.40/GJ in 2019-20, before moderating to an average of $2.90/GJ over the next two fiscal years.

The recovery in oil prices has far exceeded *Budget* expectations. Global petroleum demand has outstripped supply, underpinned by a solid pickup in the global economy and ongoing output restraint by OPEC+. Oil prices are also getting support from the natural gas crunch in Asia and Europe. The surge in natural gas prices is expected to boost oil demand from jurisdictions that are switching to oil to meet winter fuel needs. This switch will be temporary, and natural gas prices are anticipated to normalize next year. As these transitory factors fade, oil prices are expected to retreat from currently elevated levels. West Texas Intermediate (WTI) is forecast to average US$70.50/bbl in 2021-22, US$5/bbl higher than in the *First Quarter*.

Over the medium term, a gradual rebalancing in the global oil market will lead to moderation in oil prices, with WTI averaging US$64.00/bbl in 2022-23 and US$63.50/bbl in 2023-24 (Chart 3). This is still above *Budget* expectations, when WTI was expected to average US$56.50/bbl in 2023-24. The Mid-year oil price forecast is prudent, below the average of private sector forecasters (see page 20).

CHART 3: OIL PRICES TO MODERATE AFTER SHORT-TERM SURGE

Oil prices



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

Light-heavy differential supports netback prices

The differential between WTI and Western Canadian Select (WCS) is expected to remain in line with pipeline transportation costs as export pipeline capacity is anticipated to meet growing oil production. Enbridge's Line 3 replacement pipeline is now in operation and expected to reach its nameplate capacity in the next few months. Trans Mountain Pipeline Expansion (TMX) will add more export pipeline capacity in early 2023. However, transient periods of volatility are likely. For example, the recent increase in natural gas prices has caused the differential to widen as U.S. refineries cut back on using high sulphur Alberta crudes that require more natural gas for processing. As a result, the differential is expected to remain under pressure for the rest of this fiscal year and average at US$14.40/bbl, an increase from US$13.30/bbl in the *First Quarter*. Once the impact of temporary factors dissipate, the differential is forecast to narrow to US$13.60/bbl in 2022-23.

Over the medium term, rising oil production and higher pipeline throughput will put upward pressure on the differential to US$15.40/bbl by 2023-24.

Despite a wider differential, stronger global oil prices will lift the WCS price to around US$56/bbl in 2021-22 and average at US$49.00/bbl over the next two years, the highest annual averages since oil prices collapsed in 2014. This will be tempered by a higher Canadian dollar, which is now forecast to average 80.1 US¢/Cdn$ in 2021-22 before easing to 79.7 US¢/Cdn$ in 2023-24.

Strong rebound in incomes

Robust energy prices and a pick up in economic activity are boosting incomes in the province. After declining 63% in 2020, corporate incomes are forecast to surge more than 70% this year. At the same time, the recovery in employment, along with hours worked, are expected to bolster primary household income by 6.2% this year. Household disposable incomes are also getting a lift from federal government income support programs, which started to wind down in the Fall. While growth in incomes is expected to moderate next year, it will remain solid, supported by the ongoing economic expansion.

Oil and gas investment recovering

With higher corporate profits, there are growing investment opportunities in Alberta's oil and gas sector. Stronger cash flows and financial positions among energy producers have allowed some operators to exceed their debt reduction targets. Drilling activity is picking up after a slow start to the year, with rig counts exceeding pre-pandemic 2019 levels every month since June. Non-conventional production has also risen 11% year-to-date through September amid a quick rebound in bitumen output. After plunging an estimated 37% in 2020, total oil and gas investment is forecast to grow nearly $4.3 billion (or 26%) this year.

Investment will gain further momentum in 2022, adding another $5.4 billion (or 26%) to reach almost $26 billion and return to 2019 levels. With the ramp up in activity, conventional investment is forecast to lead growth in total oil and gas investment. Meanwhile, rising bitumen production will lift sustaining capital in the oil sands. Although energy producers are likely to maintain capital discipline in expanding production, they are expected to ramp-up financing of ESG-related initiatives in the medium term.

Non-energy investment looking up

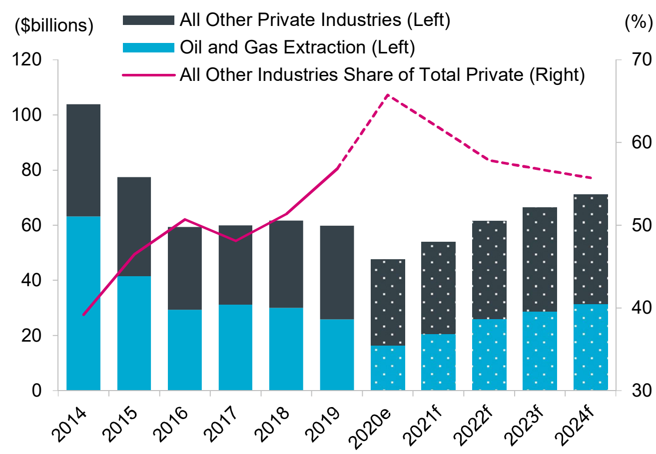
With pandemic-related uncertainty gradually dissipating, investment outside oil and gas is anticipated to see a full recovery this year. Investment is getting a boost from Alberta's competitive tax environment, lower office and industrial rents, and a young and skilled workforce. Commercial building investment has risen steadily since bottoming out earlier in the year on the back of strong growth in trade and services, as well as continued demand for distribution and warehouse spaces due to growing e-commerce and better availability in the industrial space. This is partly offsetting the weakness in the commercial real estate, where office space continue to grapple with high vacancy rates.

Investment in petrochemical manufacturing, transportation, renewable energy and agricultural infrastructure is boosting investment in the industrial sector. Adoption of cleaner and emission-reduction technologies is also helping to grow emerging sectors and diversify the economy.

The expansion in Alberta's technology sector is also gaining momentum. The province has already exceeded last year's record for venture capital investment this year. Several tech companies have also announced that they are relocating or setting up operations in the province. More recently, Amazon Web Services announced plans to invest $4.3 billion in the next two years to create a cloud computing hub in Calgary. Overall, non-energy investment is forecast to grow 6.6% this year. Growth is expected to accelerate to 7% in 2022 before moderating to an average of 5.6% thereafter. Non-energy investment is expected to exceed investment in oil and gas extraction over the forecast horizon (Chart 4).

CHART 4: BUSINESS INVESTMENT TO ACCELERATE OVER THE MEDIUM TERM

Alberta nominal non-residential investment by category



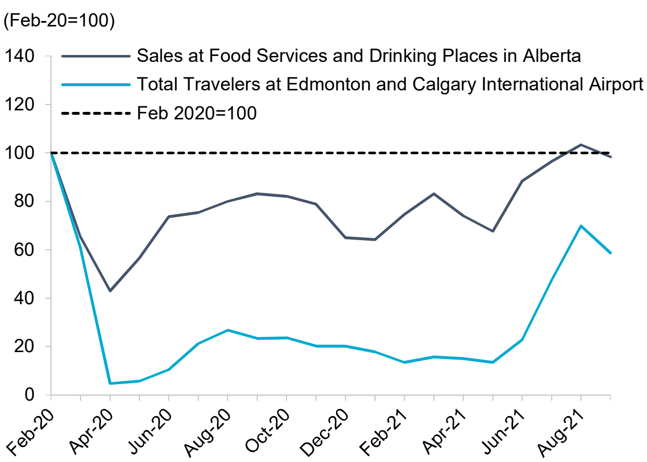
Sources: Statistics Canada and Alberta Treasury Board and Finance; e-estimate, f-forecast

Pandemic weighs on services

The services sector was gaining momentum in the summer (Chart 5). However, the fourth wave of the pandemic and subsequent tightening of public health measures introduced in the Fall are expected to slow the recovery in services, albeit by a lesser extent that in previous waves. With the province lifting most public health measures in July, restaurant sales bounced back strongly and exceeded pre-pandemic February 2020 level as of August. Hotel occupancy rates and air travel in and out of the province have also picked up in the summer, although they are still well below 2019 levels, largely reflecting the impact of ongoing federal travel restrictions and pandemic concerns. The recovery is expected to be slower than anticipated, particularly in tourism-related industries such as food and accommodation, entertainment and recreation. However, the impact of COVID-19 on these industries is far less than in previous waves and will continue to fade as businesses and consumers further adapt to the pandemic and public health measures become more targeted. In particular, Alberta's Restrictions Exemption Program is lending support and enabling participating businesses to operate without most public health restrictions. Next year, activity in these industries is anticipated to pick up strongly as the pandemic abates further and travel restrictions continue easing. The rebound is lifting overall GDP growth in 2022.

CHART 5: TOURISM-RELATED ACTIVITY RAMPS UP IN THE SUMMER

Alberta restaurant sales and air travel, indexed to Feb 2020 level



Sources: Statistics Canada, Haver Analytics, Alberta Jobs, Economy and Innovation; *Total Travelers is all Air Passengers, arrivals and departures

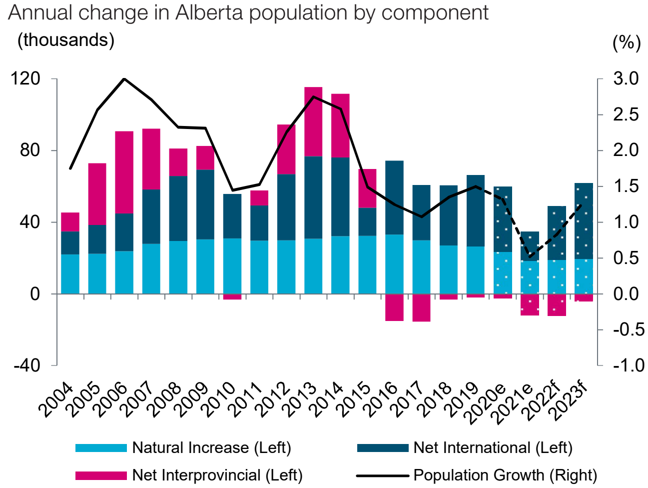
Immigration to drive population growth

The impact of the pandemic continues to dampen Alberta's population growth, although there are signs that this is easing. Immigration into the province is recovering from last year's pandemic lows as travel restrictions are lifting and application processing is ramping up. In contrast, net interprovincial outflows have picked up, likely reflecting the impact of elevated unemployment in Alberta relative to other provinces.

After slowing to a multi-decade low of 0.5% in the 2021 census year, Alberta's population growth is expected to improve to 0.8% next year (Chart 6). Over the medium term, population growth is anticipated to trend up to pre-pandemic levels, reaching 1.4% by 2024. Immigration will remain a key driver. It is projected to surpass 2019 levels in the 2023 census year, buoyed by increased federal immigration targets as Canada tries to compensate for limited landings throughout the pandemic. Meanwhile, net outflows of interprovincial migrants will moderate as economic activity picks up and the labour market strengthens. Natural increase will continue to underpin growth.

CHART 6: POPULATION GROWTH TO PICK UP AFTER NEAR-TERM SLOWDOWN

Annual change in Alberta population by component



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

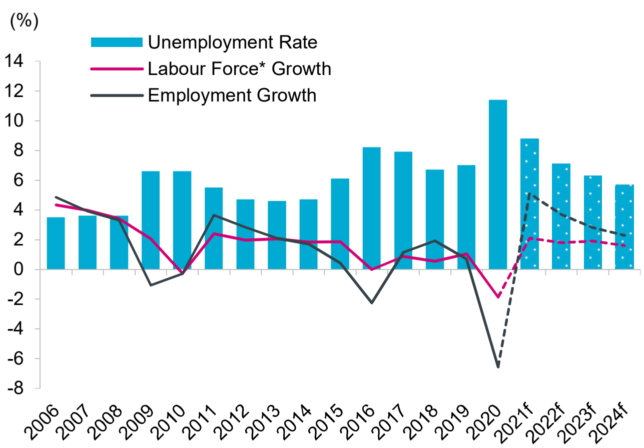
Economic reopening lifts employment

Alberta's labour market has made significant progress, but the recovery continues to be uneven. With the strong employment gains throughout the summer and into the fall, the province has regained nearly all of the jobs lost during the pandemic, mostly in full-time positions. Services sector employment is now above its pre-COVID level, led by finance, insurance and real estate, as well as wholesale and retail trade. In contrast, contact-intensive and tourism-related industries continue to lag behind. Goods sector employment has also been much slower to recover, despite the strong rebound in business output and residential construction investment this year. In particular, employment in agriculture and some manufacturing industries – such as fabricated metals and machinery equipment – remains subdued.

Rising input costs, supply side bottlenecks and labour shortages in some industries have intensified in recent months and are posing challenges for many businesses. These factors are expected to restrain job gains in the near term. Employment is now forecast to grow 5.1% this year (Chart 7), down slightly from the *First Quarter*. As public health measures ease and pandemic-related challenges dissipate, services sector employment is forecast to gather momentum next year. Goods sector employment is also expected to benefit from a robust pick-up in business investment. Overall employment is forecast to advance 3.7% in 2022 before growing at a solid clip of 2.6% over the medium term.

CHART 7: LABOUR MARKET TO STRENGTHEN AS SERVICES SECTOR RECOVERS

Labour market indicators



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

* The number of people working or looking for work

Unemployment rate declining

With the employment recovery well underway, the unemployment rate has receded, but remains elevated. It is now forecast to improve to an average of 8.8% this year, down from 11.4% in 2020 and more than a percentage point below *Budget* expectations. While labour underutilization has improved, considerable slack in the labour market remains. Despite the economic reopening in the summer, labour market participation has been slow to recover in some groups, particularly among youth, older workers and women aged 35-44 years old. Lingering concerns over the virus, government income support programs, and other pandemic-related factors may be holding back some people from returning to the workforce. Moreover, growth in the working-age population remains muted, as ongoing travel restrictions and higher unemployment in the province continue to weigh on migration.

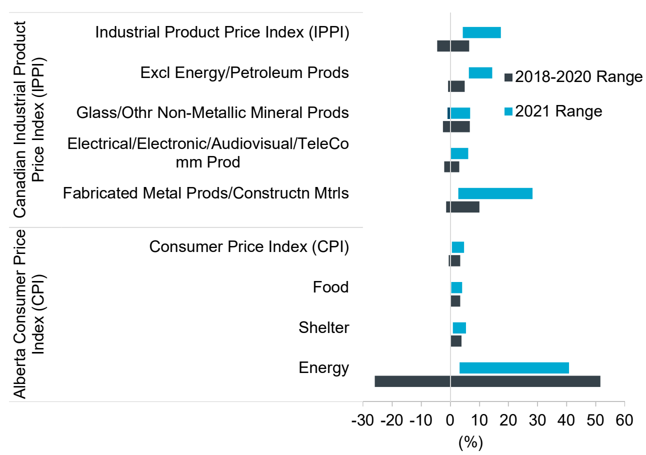
These supply-side constraints, along with mismatches between the skills that job seekers have and what employers are looking for, are contributing to high job vacancies and shortages in some industries, despite elevated unemployment in the province. It is expected to take some time for the labour market to adjust. With the more broad-based recovery in employment and economic activity, the unemployment rate is forecast to fall to an average of 7.1% next year before declining gradually to reach 5.7% by 2024.

Cost pressures elevated

Businesses and consumers are grappling with rising costs and prices. While growth in costs for both residential and non-residential construction have eased, they remain elevated. A sharp pullback in lumber prices has been offset by rising prices for other inputs, such as concrete and fabricated metal products (Chart 8). Persistent supply chain bottlenecks continue to be a major driver, although a sharp increase in energy prices is also putting pressure on costs.

CHART 8: RISING INPUT COSTS PUT UPWARD PRESSURE ON CONSUMER PRICES

Various price indices, year-over-year growth



Sources: Statistics Canada and Haver Analytics

These factors are translating to higher consumer prices. Consumer inflation moved above 4% in the third quarter. Energy prices surged to multi-year peaks in the summer, while pandemic-related disruptions have pushed food prices even higher. Core inflation – excluding food and energy – has also picked up. Robust demand for goods, coupled with ongoing supply chain bottlenecks, are boosting prices for consumer durables such as motor vehicles, household appliances and furniture. Elevated construction costs are also propping up shelter costs. Services inflation continues to lag after stagnating in 2020 and early 2021, but prices are starting to rise, also contributing to consumer inflation.

Headline consumer inflation is now forecast to accelerate to 3.1% this year, the fastest annual pace since 2007. This is 1.7 and 0.2 percentage points higher compared to *Budget* and *First Quarter*, respectively. With the rising inflation, the Bank of Canada is expected to begin raising interest rates in mid-2022, sooner than expected in *Budget*. As supply bottlenecks dissipate in the second half of next year, consumer inflation is forecast to recede gradually to 2.6% in 2022 before returning to 2% by 2024.

Strong recovery in goods spending

Consumer spending has rebounded strongly this year, underpinned by improving consumer confidence and household incomes. While retail sales have moderated from the exceptionally strong gains in the first half of the year, they remain up 15% through October. The summer reopening likely prompted some consumers to shift their spending from goods to services, while supply chain disruptions and higher prices are also weighing on demand for some consumer goods, such as motor vehicles and other housing-related items. This, coupled with rising consumer prices, is likely to restrain goods spending in the near term. However, the overall rebound in goods spending has lifted imports into the province, which are forecast to rise 8% this year.

With the weaker recovery in services, real consumer spending is now expected to rise 7.7% this year, down from the *First Quarter* forecast of 8.6%. Next year, real consumer spending is forecast to grow 6.1% and exceed pre-pandemic 2019 levels by 2022, supported by high levels of household savings and pent-up demand for certain goods and services during the pandemic. Growth is forecast to moderate to around 3.3% over the medium term as consumption patterns normalize and interest rates rise.

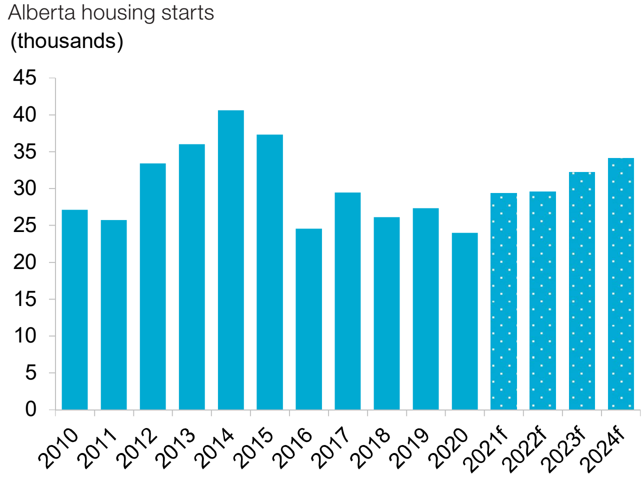
Housing activity solid but moderating

Housing activity is receding from the torrid pace earlier in the year, but remains strong in the province. Activity is being propped up by record low mortgages rates, robust consumer confidence, and elevated household savings. Home sales in the resale market have pulled back after hitting record highs earlier in the year, while renovation spending has slowed sharply from last year's elevated levels, Single-detached housing starts have also moderated in recent months, although this has been partly offset by recent strength in the multi-family segment. These are helping to create more balanced conditions in the housing market and cool down growth in home prices. While house prices in Edmonton and Calgary have risen over the past year, they remain among the most affordable in the country, especially when compared to other urban centres, such as Vancouver and Toronto.

With activity easing in the short-term, housing starts are forecast to average around 29,000 units this year and next year. This comes after years of subdued activity in the province prior to the pandemic (Chart 9). Despite expectations for rising interest rates next year, they will remain very accommodative for homebuyers. Tight inventories, relatively low mortgage rates and strengthening labour market are expected to support activity. Over the medium term, a pick-up in net migration and wage growth should help lift housing starts to around 34,000 units by 2024.

CHART 9: HOUSING STARTS TO RISE GRADUALLY

Alberta housing starts



Sources: Canada Mortgage and Housing Corporation, Haver Analytics, Alberta Treasury Board and Finance; f-forecast

Risks to Outlook

The uncertainty surrounding global oil prices and the long-term effects of the Covid-19 pandemic on households and business investment create a number of risks to the Alberta economy. Oil prices are consistently volatile, and a significantly higher or lower oil price could have a notable impact on the provincial economy and revenues. In the short-term, the B.C. floods have caused severe disruption to the flows of goods. While transportation companies are looking for alternative routes, the disruptions pose a risk to imports and exports and could put upward pressure on prices over the next few months.

The low scenario assumes a persistent decline in oil prices from the base case forecast beginning in 2022. Given the uneven access to vaccines around the world, a resurgence in COVID-19 cases would result in weaker than anticipated demand. Sufficient OPEC+ production capacity is also assumed to balance the market at lower price levels. The weakness in oil prices leads to significantly less oil and gas investment and oil production, which spills over into the broader economy in both Canada and Alberta. The low scenario also assumes a permanent shift in household preferences resulting from the pandemic, with persistently more spending on goods relative to services, more household savings, and reduced labour supply. The combined effect of these shocks is a weaker Canadian dollar, lower consumption, lower employment, lower investment, and a lower rate of population growth. Alberta collects less corporate and personal tax revenues as a result of a weaker economy. Additionally, lower oil prices reduce Alberta's natural resource revenues.

The high scenario assumes a sustained higher path for WTI starting at the end of 2021, driven by continued growth in global demand, combined with lower petroleum production, a consequence of global underinvestment in recent years. At the same time, the light-heavy differential is assumed to stay at levels observed earlier in the Fall, prior to the recent widening. These factors would lead to higher energy sector investment and oil production in Alberta. This, in turn, drives increases in Canadian interest rates and the Canadian dollar, but exert a minor drag on Alberta's corporate profits, business investment, and exports. The strong recovery also bolsters household consumption growth, driven by higher wages and employment, as well as a decline in the unemployment rate relative to the base case. This broad-based economic strength translates into significant increases in corporate and personal tax revenue, and higher energy prices lead to 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 case that would buffer the downside risks to the economy in the low scenario or temper the upside in the economy in the high scenario.

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