ECONOMIC COMMENTARY

Capital Investment in Alberta to Decline Again in 2017

May 18, 2017

Highlights:

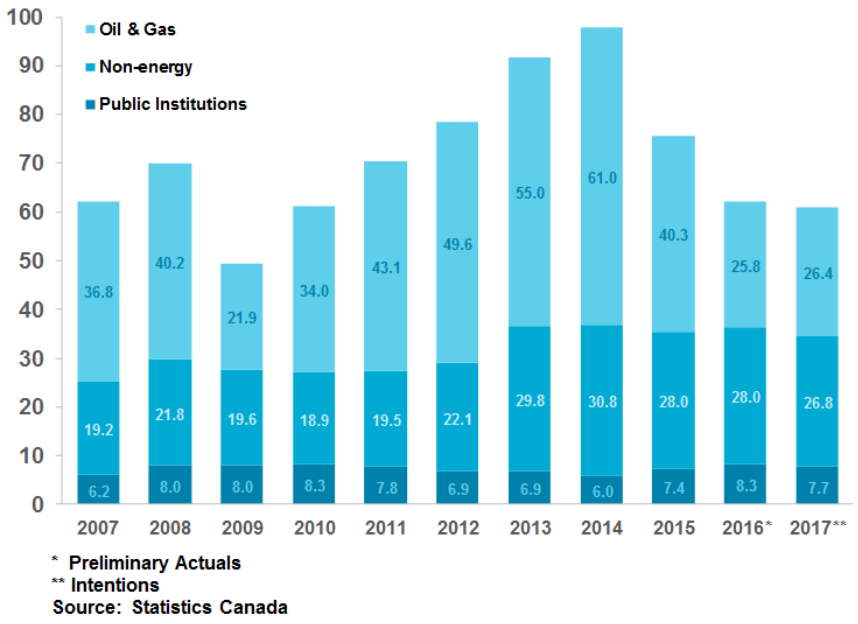
Capital investment was the largest contributor to Alberta's economic growth between the mid-nineties and 2014. However, low oil and gas prices resulted in declining capital investment in Alberta in 2015 and 2016. Although rising oil and gas prices are expected to lead to some improvement for the conventional oil and gas sector, capital investment in most other sectors is expected to remain weak this year.

Alberta Government

Of the three largest components of Alberta's Gross Domestic Product (GDP), household consumption, international exports and gross fixed capital formation (or capital investment), investment has had the largest impact on Alberta's economic performance since the mid-nineties. Whereas in the 1980's and early 1990's international exports drove the Alberta economy, between 1996 and 2008, capital investment accounted for 70% of Alberta's overall GDP growth, and it was also by far the largest contributor to Alberta's large GDP decline in 2009 and to its subsequent recovery. Between 2009 and 2013, capital investment accounted for 81% of Alberta's total GDP growth. However, in 2014 investment made only a small contribution to Alberta's overall GDP growth and it declined sharply in 2015 and 2016 because of the downturn in the oil and gas sector that was driven by lower oil and gas prices.

Statistics Canada has recently released preliminary capital investment estimates for 2016 and investment intentions for 2017 from its Capital and Repair Expenditures Survey. Investment includes capital spending on construction and machinery and equipment reported by private and public organizations, but excludes residential investment.

Chart 1
Non-Residential Investment In Alberta



* Preliminary Actuals
** Intentions
Source: Statistics Canada

After falling 22.6% in 2015, capital investment in Alberta declined a further 17.9% in 2016 to $62.1 billion. Investment spending peaked in 2014 at $97.8 billion. Construction spending, which accounted for 74% of total investment spending in 2016, declined by 20.7% while spending on machinery and equipment fell 8.7%. Following a 26% decrease in 2015, private sector investment was down 22.9% in 2016 to $51.4 billion. Public sector investment rose 16.7% in 2015 and 19.3% in 2016 to $10.7 billion.

The sectors with the highest investment growth in 2016 were:

- Educational services (up 64.1% to $2.8 billion);
- Real estate and rental and leasing (up 39.6% to $2.9 billion);
- Finance and insurance (up 13.2% to $661 million);
- Retail trade (up 11.7% to $1.1 billion); and
- Transportation and warehousing (up 7.4% to $10.0 billion – most of this is pipeline investment).

However, most other sectors had lower investment spending in 2016 than in 2015, led by a drop of $13.3 billion or 35.0% in the oil and gas extraction sector due to much lower oil and gas prices. The sectors with the largest investment declines in 2016 were:

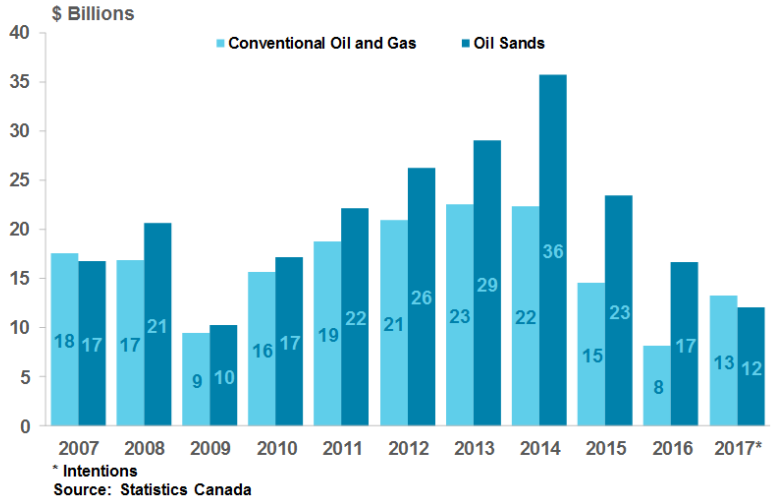
- Oil and gas services (down 54.8% to $978 million);
- Oil and gas extraction (down 35.0% to $24.7 billion);
- Accommodation and food services (down 34.7% to $712 million);
- Manufacturing (down 20.6% to $2.1 billion – about one-half of this goes into the refineries and chemicals sub-sectors); and
- Health care and social assistance (down 15.2% to $1.0 billion).

Investment spending in the manufacturing sector fell 20.6% as all manufacturing sectors, with the exception of electronic products, reduced investment. The largest decreases were noted for the machinery, primary metals, refinery products, food and beverages and non-metallic minerals sub-sectors.

The oil and gas sector extraction sector's investment spending was estimated to have decreased by 35.0% in 2016, accounting for 40% of total capital investment in Alberta. In 2014 it still accounted for 59% of total investment. This sector is an important contributor to capital investment in Alberta and oil and gas prices play a critical role in the investment in this sector.

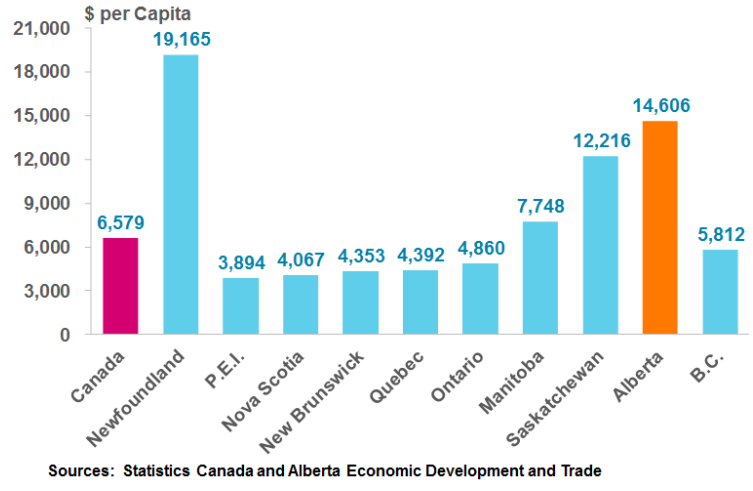
During Alberta's first investment boom, which lasted from 1996 to 2008, the value of all capital investment in the province spending quadrupled while oil and gas investment more than quadrupled. Oil and gas prices rose strongly over that period which led to surging investment in the energy sector, especially in the oil sands. Oil sands investment was also impacted by technological breakthroughs, such as the Steam-Assisted Gravity Drainage process. The wealth effects of higher energy prices also spilled over onto other sectors, such as transportation (especially pipelines), manufacturing (especially fabricated metals and machinery) and public institutions (especially provincial government, education and healthcare).

Chart 2
Oil and Gas Capital Investment in Alberta



Within the oil and gas sector, investment in conventional oil and gas projects more than doubled between 1996 and 2008 to $16.8 billion while oil sands investment reached $20.6 billion in 2008 (Chart 2), twenty times as high as in 1996. During the global recession of 2009, total investment spending fell by 29.2%, and oil and gas investment by 47.4% as many previously announced large projects were put on hold. Investment bounced back strongly after 2009 and by 2014 investment spending had reached new highs, as oil and gas investment nearly tripled during those five years. However, total mining and oil and gas investment fell sharply by 33.9% in 2015 and by a further 36.0% in 2016 because of that sector's downturn which was caused by sharply lower oil and gas prices. Oil sands investment was estimated to have dropped by 29.1% in 2016 to $16.6 billion, while conventional oil and gas investment fell 44.4% to $8.1 billion and investment spending by oil and gas service companies declined 54.8% to $978 million.

Chart 3
Per Capita Investment in 2016



Sources: Statistics Canada and Alberta Economic Development and Trade

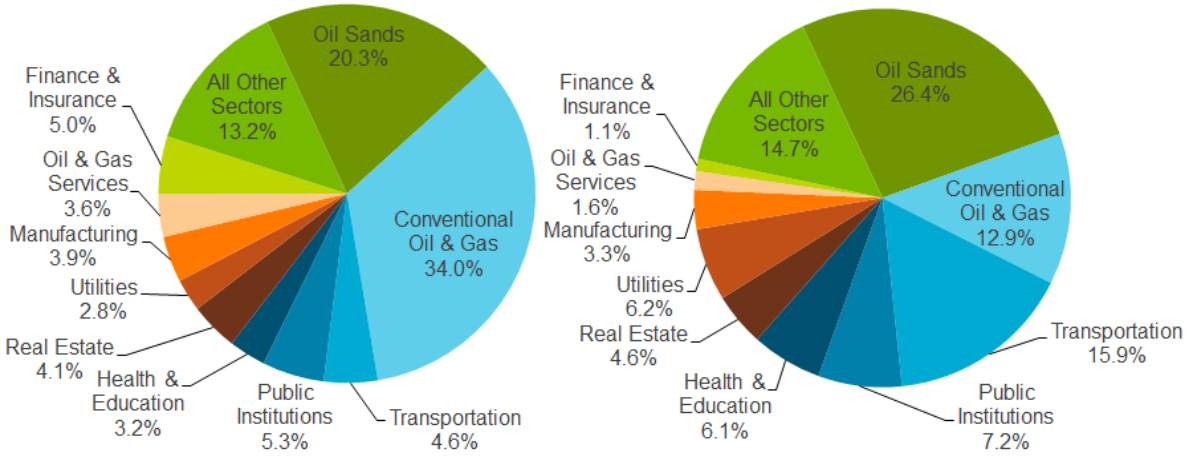
In 2016, Alberta's per capita capital spending was the second highest of all provinces at $14,606, more than twice the Canadian average of $6,579 per capita and second only to Newfoundland and Labrador's $19,165. Alberta accounted for 26% of total capital investment in Canada in 2016.

There have been major shifts in investment by the various sectors between 2006 and 2016 (see Chart 4). Even with the recent investment declines the oil sands sector has increased its share from 20.3% in 2006 to 26.4% in 2016. However, the conventional oil and gas saw its share drop sharply from 34% in 2006 to 12.9% in 2016. The transportation sector (mainly pipelines) saw its share rise sharply from 4.6% to 15.9% and now accounts for a larger share of investment than conventional oil and gas. Other sectors that saw their shares increase sharply during the 10-year period are health and education (from 3.2% to 6.1%), utilities (from 2.8% to 6.2%) and public administration (from 5.3% to 7.2%).

Chart 4

Percentage Distribution of Non-Residential Capital Investment in 2006 and 2016

Total Investment: $57.1 Billion in 2006; $62.1 Billion in 2016



Source: Statistics Canada

In 2017, the sharp drop in oil and gas prices in 2015 and 2016 continues to affect many Alberta industries and non-residential capital spending in Alberta is anticipated to drop by 1.9% from 2016 to $60.9 billion. Construction spending is forecast to increase 1.1% and machinery and equipment spending is expected to fall 10.4%. Private investment is expected to decline by 1.8% and public investment by 2.5%.

Capital expenditures by conventional oil and gas companies are expected to increase sharply by 63.4% to $13.2 billion in 2017 and expenditures by oil sands companies are expected to decline by 27.4% to an eight-year low of $12.0 billion. Investment by companies providing support services to mining and oil and gas extraction industries, such as rigging and drilling, is anticipated to drop by 2.3% in 2017 to $955 million.

Most other sectors are anticipating decreases in capital spending with the largest declines registered in these sectors: arts, entertainment and recreation (down 24.1%); real estate and rental leasing (down 23.1%); education (down 21.0% - after large increases in the previous two years); and manufacturing (down 14.4% - very large declines for refinery products and non-metallic mineral products).

Sectors which anticipate high growth in 2017: utilities (up 25.3%); professional, scientific and technical services (up 16.5%); and accommodation and food services (up 9.6%).

It is probable that the final estimates for 2017 will come in stronger than Statistics Canada's Capital and Repair Expenditures Survey suggest. The survey was conducted between November 2016 and February 2017 and may not fully reflect the recent improvement in the Alberta economy and in crude oil prices.

In summary, capital investment spending in Alberta declined sharply in 2015 and 2016 as oil and gas extraction companies slashed investment spending because of low oil and gas prices. Investment is forecast to decline slightly in 2017 as a large jump in spending by the conventional oil and gas sector is expected to be more than offset by continued weakness in most other sectors. Even with last year's decline Alberta's per capita investment spending still far exceeded the Canadian average in 2016.