Economic Trends

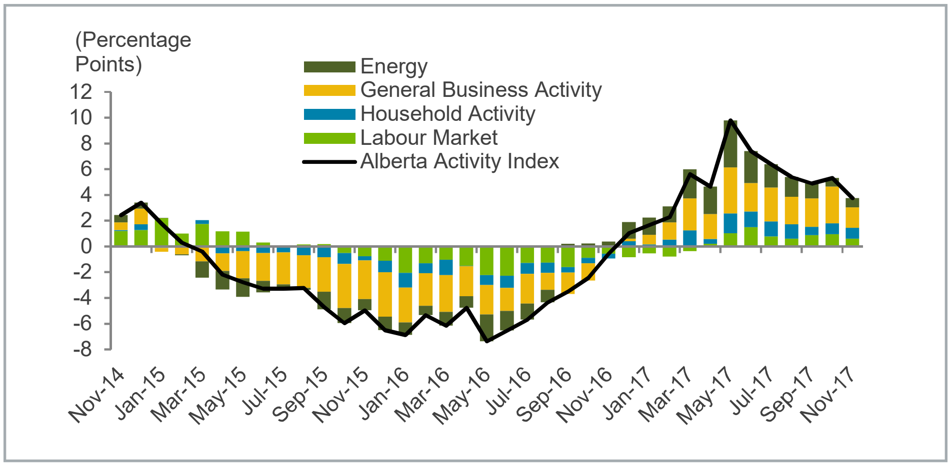
This edition of Economic Trends is taken from the [Third Quarter Fiscal Update and Economic Statement](), released on February 28, 2018.

Alberta saw a broad-based resurgence in economic activity in 2017 following a deep recession. An improvement in oil prices, growing exports, and a strong rebound in consumer spending pulled up all components of the Alberta Activity Index, Treasury Board and Finance's measure of economic activity (Chart 1). GDP is estimated to have grown 4.5%, almost two percentage points higher than expected at *Budget*.

Following the surge in 2017, GDP growth is forecast to moderate to 2.8% in 2018, an upward revision from 2.2% forecast at *Budget*. A return to positive interprovincial migration, solid employment growth, and higher earnings will support residential investment and consumption. Continued growth in oil production and manufacturing will drive exports and boost economic activity (Chart 2).

Chart 1. Broad-based recovery across all sectors

Contribution to year-over-year change in the Alberta Activity Index



Source: Alberta Treasury Board and Finance

Chart 2. Higher business output driving economic growth

Alberta manufacturing shipments and merchandise exports

Source: Statistics Canada

Alberta Business Sector

Benchmark oil prices moving up

The global oil market is rebalancing primarily on the strength of solid global demand growth, global oil inventory declines, and reaffirmation of OPEC supply commitments. West Texas Intermediate (WTI) rose above US$60/bbl for the first time in two and a half years in 2018. However, responsive US shale production is likely to keep prices contained moving forward. WTI is forecast to average US$54/bbl for 2017-18, close to the *Budget* forecast of US$55/bbl.

For Alberta oil sands producers, the appreciation in WTI coincided with a TransCanada Keystone pipeline disruption in late November, rail capacity constraints and growing production. With the Enbridge Mainline pipeline system at capacity and inventories building up in Alberta, heavy oil benchmark Western Canadian Select (WCS) prices remain suppressed (see *inFocus*). The WTI-WCS differential is now forecast to average US$14.50/bbl for 2017-18.

Oil sector expanding

Alberta's oil sector saw a resurgence in 2017. Conventional investment, with its nimble responsiveness, increased almost 60% as prices appreciated. This outweighed declining non-conventional investment as oil sands producers remained focused on containing costs and wrapping up construction on several large projects. Total oil production peaked at a record 3.5 million barrels per day (bpd) in December. Overall, in 2017, bitumen and synthetic production expanded over 10% as projects initiated prior to the downturn came online. Conventional output grew by 3.6%. Another 300,000 bpd of crude is forecast to come online in 2018 as recently completed oil sands projects continue to ramp up. This will lift overall real exports by almost 5% following an estimated 6.0% increase in 2017.

Manufacturing comeback

Manufacturing is playing a significant role in Alberta's recovery, benefiting from both the oil recovery and a global economic upswing in 2017. Strong lumber prices helped the forestry and wood products sectors, while agri-foods production improved following resumption of activity at a beef packing plant in Balzac. In the petrochemical sector, output rose with startup of the Joffre polyethelene plant expansion. Total real manufacturing exports are estimated to have risen over 7% in 2017, an improvement of more than three percentage points over *Budget*. Growth should remain strong in 2018 at 3.8%, led by the ramp up of the Sturgeon Refinery, Canada's first new refinery in more than 30 years.

Business investment lagging

Investment outside the conventional energy sector, particularly in commercial construction, is lagging behind the rest of the recovery. The lingering effects of elevated commercial real estate vacancies and the pullback in oil sands investment continue to push down total business investment. The manufacturing sector is expected to provide support in 2018 as construction ramps up on two petrochemical facilities and Cavendish Farms works towards a 2019 completion of its potato processing facility in Lethbridge. However, total real business investment is forecast to edge down 1.9% this year following an increase of almost 1% in 2017.

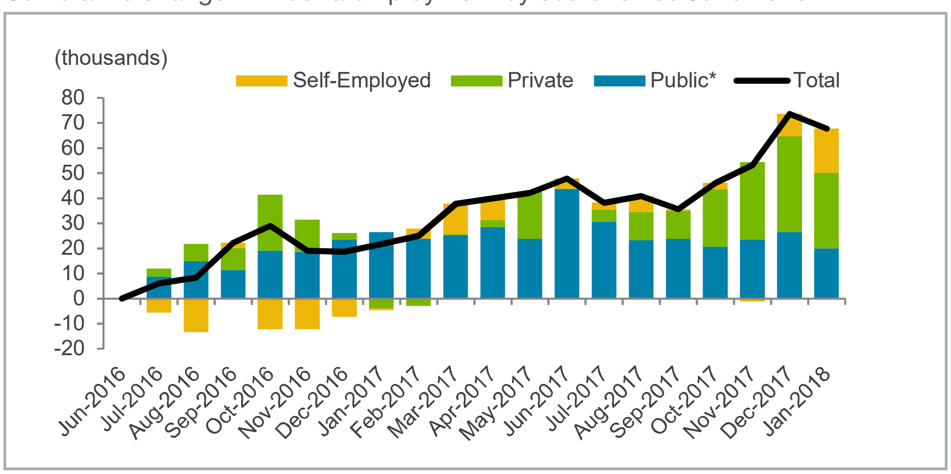
Alberta Household Sector

Labour market renewal

Alberta's labour market picked up some momentum in the second half of 2017. On the back of strong gains in the last quarter, the number of employed people in the province reached 2.3 million in December, marking a full recovery of jobs lost during the recession. In line with *Budget* expectations, employment rose 1.0% in 2017 as full-time employment (+1.3%) more than offset part-time declines (-0.1%). Labour market strength is expected to continue in 2018 as private sector gains seen since mid-2017 are extended (Chart 3). Employment is forecast to rise 2.0% in 2018, pushing the unemployment rate down to 6.8%. After two consecutive years of decline, earnings also edged higher in 2017. Average weekly earnings (AWE) grew an estimated 1.0% and remained the highest in the country. The recovery is expected to quicken in 2018, with AWE forecast to climb 2.4%.

Chart 3. Private sector gains lift employment

Cumulative change in Alberta employment by sector since June 2016



Source: Statistics Canada

*Public sector employment encompasses all levels of government, agencies, Crown corporations, and government funded institutions, like schools and hospitals

Population growth picking up

The third quarter of 2017 brought net interprovincial inflows for the first time in two years as economic conditions and labour prospects continued to improve. Following net losses in 2016 and 2017, the province is forecast to gain 2,000 interprovincial migrants in 2018. These inflows, along with sizable immigration and natural increase, will push population growth to 1.4% this year, up from 1.2% in 2017.

Consumer spending rising

Employment and wage gains encouraged Albertans to open their wallets in 2017. Retail sales surged as spending at both motor vehicle and parts dealers and electronics and appliance stores rose at the fastest rate since 2006. Sales growth at gasoline stations was higher as oil prices climbed. Overall, real consumption rose an estimated 3.1%, more than two percentage points higher than the *Budget* forecast. Housing starts climbed 20% to 29,500, which included a record 1,625 starts in Wood Buffalo as part of rebuilding efforts following the 2016 wildfire. This was 5,000 more than anticipated at *Budget*. With the Wood Buffalo rebuild winding down, starts in 2018 are forecast to hold fairly steady at 30,200. Continued labour market strengthening is forecast to keep consumer spending strong at almost 3% in 2018.

Risks to the Outlook

- Ongoing oil market access issues could affect provincial exports and revenue.
- A resurgence in US shale oil output or less compliance to supply cuts from OPEC could temper oil prices.
- NAFTA negotiations and softwood lumber uncertainty could weigh on investment and exports.

Contact

Catherine Rothrock 780.427.2758

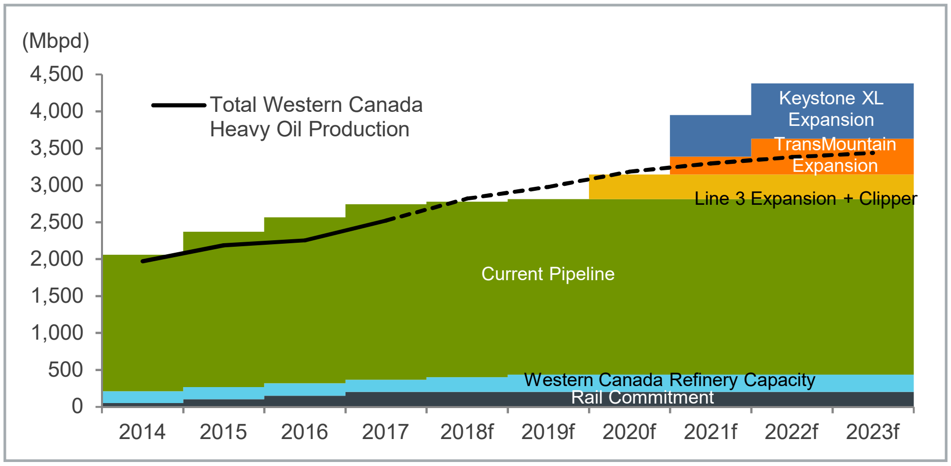
inFocus

Pipeline bottlenecks hit Canadian oil producers

The Alberta economy is on its strongest footing since 2014. However, just as the effects of the oil price collapse have started to fade, in part because of an improvement in oil prices, the challenges of market access have moved to the fore. Alberta heavy oil prices are once again trading at a large discount to global benchmarks. The problem became acute towards the end of 2017 as temporary reductions in pipeline capacity, continued oil sands production growth, and the inability of rail to fill the gap led to a dramatic widening of the oil price differential.

Chart 1: Pipeline access needed for oil sands production

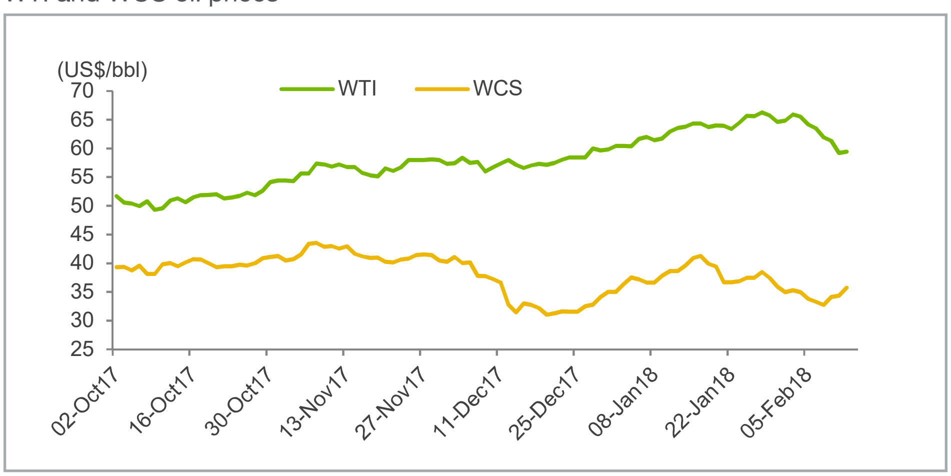
Pipeline and Refinery Capacity and Western Canada Heavy Oil Production



Source: Alberta Energy, f-forecast

Chart 2. Higher oil prices have not helped Alberta heavy producers

WTI and WCS oil prices



Source: Alberta Energy

Pipelines at capacity

The need for more market access has been evident for the last several years. Increased use of rail and optimization of the existing pipeline network helped to quell the differential for a while, but as in 2011-2013, the rise in oil sands production is once again bumping up against capacity constraints (Chart 1). Since 2014, oil sands production has increased by over 500,000 barrels per day (bpd) and a further 350,000 bpd are expected by the end of this year. Long forecasted pipeline bottlenecks and an increasing reliance on rail are increasing transportation costs for Alberta heavy oil and widening the differential.

Outage reveals vulnerability

In addition to higher transportation costs, recent pipeline outages highlight that without enough capacity to provide a buffer, unplanned outages increase market volatility and depress prices. The TransCanada Keystone pipeline, with a capacity of 600,000 barrels per day, transports heavy crude from Hardisty Alberta to refining markets in the US Midwest and Gulf Coast. On November 17, 2017, the pipeline was shut down for two weeks and continues to operate at reduced pressure. With the Enbridge Mainline system full, inventories began to pile up in Alberta and shippers had to scramble to find alternate means of transport. Rail was not nimble enough to fill the gap, so the differential increased from an average of US$14/bbl in November to around US$28/bbl more recently. This has prevented Alberta from realizing the gains from the recent rise in global oil prices (Chart 2). Alberta heavy oil producers are currently foregoing an estimated $30-$40 million per day in revenue as result. The wider differential has also subtracted an estimated $500 million from bitumen royalties in 2017-18 compared with the Second Quarter.

Lucrative markets to access

Increased market access allows for low cost transportation to markets where heavy oil is fetching the highest price. At many places around North America, heavy crude oil pricing is favourable. OPEC has reduced heavy oil supplies and oil production has been contracting in Venezuela and Mexico, Alberta's major heavy oil competitors. Figure 1 shows the prices Alberta producers could have received with market access. The TransMountain expansion would allow Alberta to sell into the Pacific market, where in January heavy oil sold for US$65/bbl, compared to US$43/bbl in Alberta. Keystone XL would increase access to the Gulf Coast, where in January heavy oil sold for US$59/bbl.

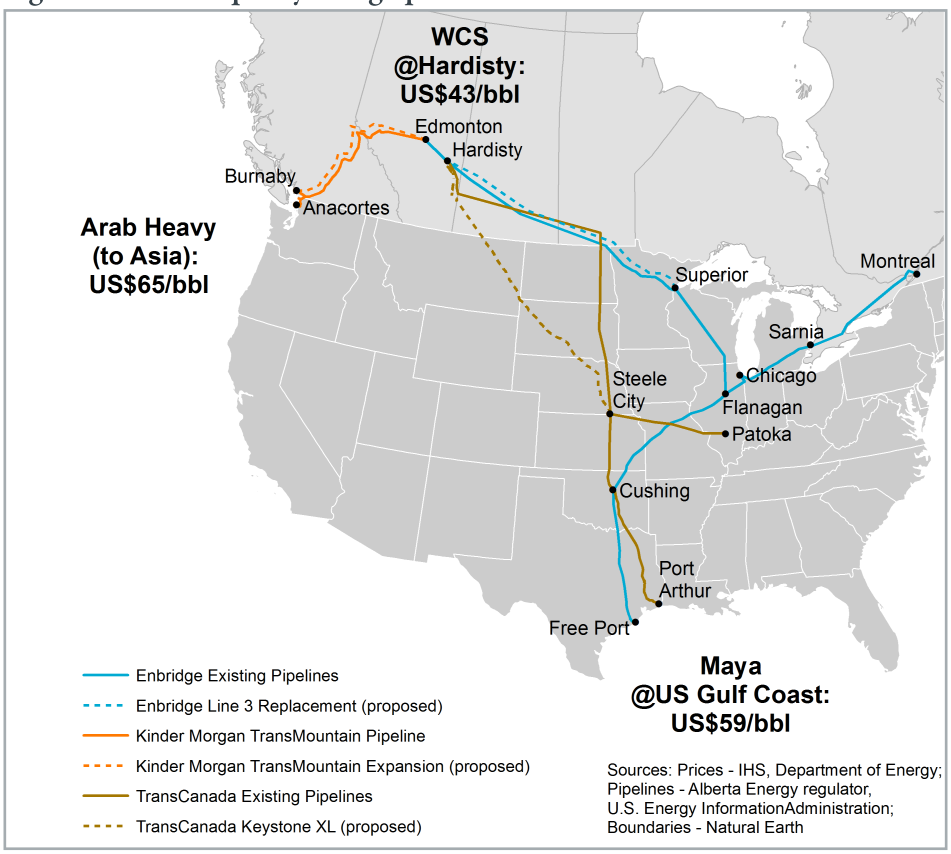
Benefits of market access

Based on analysis done for *Budget 2017*, gaining market access would reduce market volatility and allow Alberta producers to earn up to US$7 more per barrel on average. Higher expected revenues and more certainty about transportation infrastructure would incentivize investment, with an estimated $10 billion more in capital spending added between 2018-22. Over that same span, higher production and prices could boost royalty payments by up to $9 billion.

The rest of Canada also benefits

The benefits to market access do not stop at the Alberta border. The province's oil and gas industry has deep ties to the rest of Canada. This was on display in 2017 when Canada led advanced economies in real GDP growth, thanks in part to the rebound in Alberta's economy. Energy exports account for 20% of Canada's goods exports, the bulk of which come from Alberta. In addition, Alberta is the destination for almost one-third of Canada's non-residential investment and $75 billion annually in goods and services from other provinces, second only to Ontario. Saskatchewan and BC depend on Alberta to develop their own oil and gas sector and, in turn, Western Canadian production is a key input into Eastern Canadian petroleum manufacturing. Many out of province residents earn a living in Alberta. As of 2014, the last year estimates are available for, 157,000 residents of other provinces worked in Alberta, earning a combined income of over $8 billion. The oil and gas industry creates fiscal benefits for the federal government. In 2016, Albertans paid $21.8 billion more in taxes to the federal government than they received in federal spending. Alberta accounts for 17% of federal tax revenues despite having just 11% of the population.

Figure 1. Added capacity to high price markets



Notes: These are average prices for January 2018. Though all three benchmarks are for heavy oil, there are some quality differences between the different heavy blends.

Proposed Pipelines

There are three potential pipeline projects that would provide relief to the pipeline bottlenecks. All three projects still need to clear legal and regulatory hurdles.

- The Keystone XL pipeline is the largest of the three projects. It would carry 830,000 bpd of Alberta oil between Hardisty and Steele City, Nebraska where it would gain access to both the US Midwest and Gulf Coast.
- The TransMountain Expansion (TMX) project would add 590,000 barrels of transportation capacity from Edmonton to Burnaby, BC and increase access to the West Coast and Pacific markets.
- The Enbridge Line 3 replacement project would add 370,000 bpd of capacity to the existing pipeline that runs from Hardisty, Alberta to Superior, Wisconsin. Construction has already begun on the Canadian portion of the pipeline, but the project is awaiting approval from the Minnesota Public Utilities Commission.

Contact

Kailer Mullet 780.427.7391