Economic Trends

This edition of Trends is taken from the Second Quarter Fiscal Update and Economic Statement, released on November 28, 2017.

The recovery in the province is firmly underway, with nearly every sector of the economy strengthening. Alberta is widely expected to lead all provinces in growth this year, with real GDP growth revised up to 4.0% from 2.6% at *Budget* on the back of first-half strength. Oil production is boosting exports and an improving labour market, with over 70,000 full-time jobs added since mid-2016, has fueled retail sales and demand for housing. Economic activity, as measured by the Alberta Activity Index (AAX), is up 5.4% so far this year, boosted by rapid growth in the first half (Chart 1).

Growth is expected to moderate to 2.5% in 2018 as the economy shifts gears and the recovery becomes entrenched. Several economic indicators have eased in recent months from the torrid pace set in the first half of 2017. In addition, some indicators such as average weekly earnings and non-residential construction continue to lag. This highlights the impact that the oil price shock continues to have on the economy and government revenue.

Alberta Business Sector

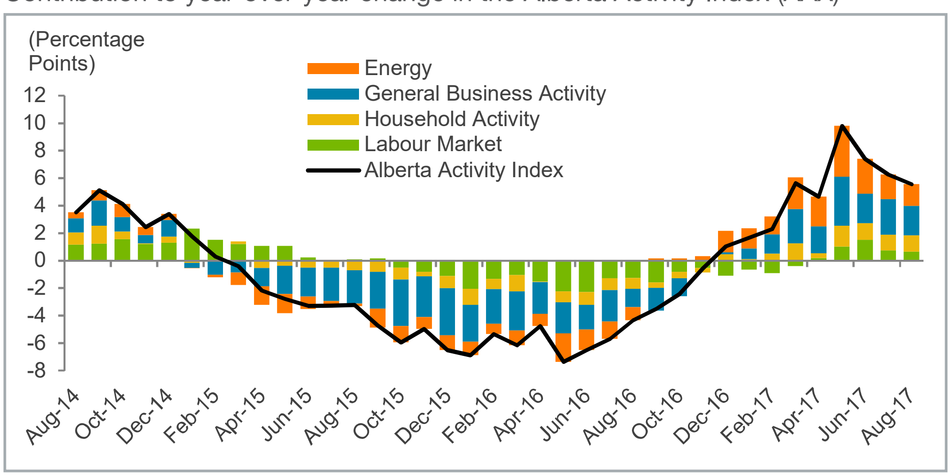
Oil prices below *Budget* forecast

Oil prices have improved in the last three months. The recovery has been driven by ongoing rebalancing in the oil market, OPEC production cuts, a geopolitical risk premium in the Middle East and stronger demand, especially in advanced economies. However, oil prices in the first two quarters of 2017-18 were much lower than expected at *Budget*, and responsive US production is likely to keep a lid on prices. As a result, WTI, the North American light crude oil benchmark price is forecast to average US$49/bbl for the fiscal year, US$6/bbl lower than the *Budget* forecast.

Heavy oil producers in Alberta have benefited from a narrower light-heavy (WTI-WCS) differential, as heavy supply reductions from OPEC production cuts and declining heavy production in Venezuela have supported heavy oil prices. Despite the differential widening recently due to unexpected refinery outages and robust growth in oil sands production, it is forecast to average US$12.10/bbl in 2017-18, US$3.90/bbl narrower than forecast at *Budget*.

Chart 1: First half strength springboards economic recovery this year

Contribution to year-over-year change in the Alberta Activity Index (AAX)



Source: Alberta Treasury Board and Finance

Stronger oil and gas activity

The recovery in oil and gas activity is one of the principal factors driving Alberta's recovery in 2017. Conventional investment is forecast to grow by 40% in 2017, up from 22% at *Budget*. Drilling activity for much of 2017 has been double 2016 levels and increased interest in liquids-rich conventional development has boosted Crown land sales. Non-conventional investment, on the other hand, is expected to fall in 2017 as construction wraps up on the last of the large oilsands projects that began before prices declined. As these projects move into the operation phase, oil production is expected to increase by 311,000 barrels per day in 2017-18. The ramp up in production highlights the need for additional pipeline capacity to diversify markets and improve returns for Canadian crude oil.

Non-residential investment to stabilize

Investment outside of the energy sector, particularly in commercial construction, has lagged behind improving economic conditions elsewhere in the province. As the province moves into a second year of sustained economic growth in 2018, non-residential investment is expected to stabilize and begin to recover. This is similar to the 2008-2009 recession, when non-residential investment did not begin recovery until late 2011.

Expanding manufacturing base

Alberta's manufacturing industries have seen a solid improvement this year. Manufacturing sales, while still below their pre-recession peak, have posted substantial gains since early 2016. Higher oil prices have boosted prices for petroleum and petrochemical products. The forestry sector has been bolstered by higher lumber prices, in part due to market disruptions caused by hurricanes Harvey and Irma and wildfires in western North America. Manufacturing volumes are also expected to be higher this year as a result of capacity expansions at two chemical processing facilities and the reopening of a beef packing plant in Balzac earlier this year. Alberta's manufacturing base will be further expanded in 2018 with production starting at the Sturgeon Refinery. These factors, combined with stronger oil production, are expected to support real export growth of 5.7% in 2017 and 3.4% in 2018.

Alberta Household Sector

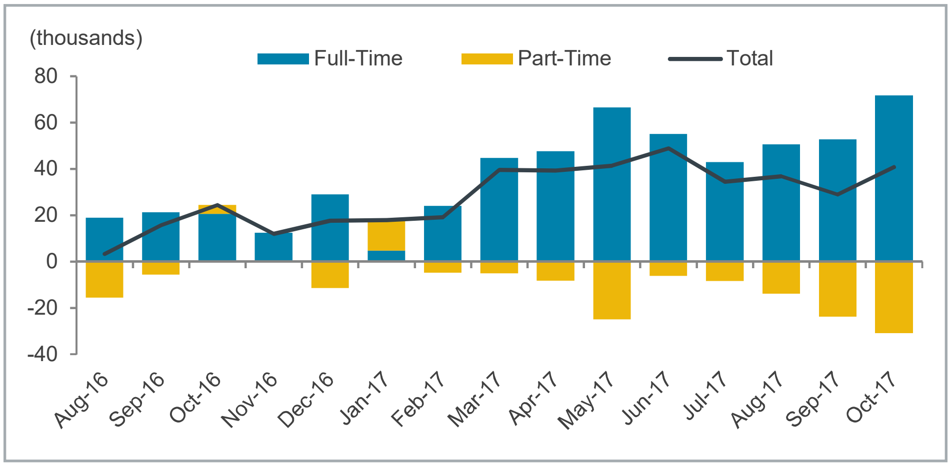
Labour market gaining strength

Alberta's labour market continues to recover. As of October 2017, the provincial economy has regained 41,000 of the 62,000 jobs lost during the recession. This has been led by a more than 70,000 increase in full-time positions which offset part-time losses (Chart 2). The economy is projected to see employment growth of 1.0% in 2017 and 1.5% in 2018, closely in line with the *Budget* forecast.

The *Budget* forecast for the unemployment rate is also closely tracking actuals and so is unchanged for 2017 at about 8.0%. As the economy improves and employment growth accelerates, the unemployment rate is anticipated to decline to 7.6% in 2018. Average weekly earnings (AWE) have finally started to recover, though at a weaker pace than what was expected at *Budget*. AWE is expected to grow by a modest 0.8% in 2017 before growth rises to 1.4% in 2018.

Chart 2: Full-time jobs leading the employment recovery

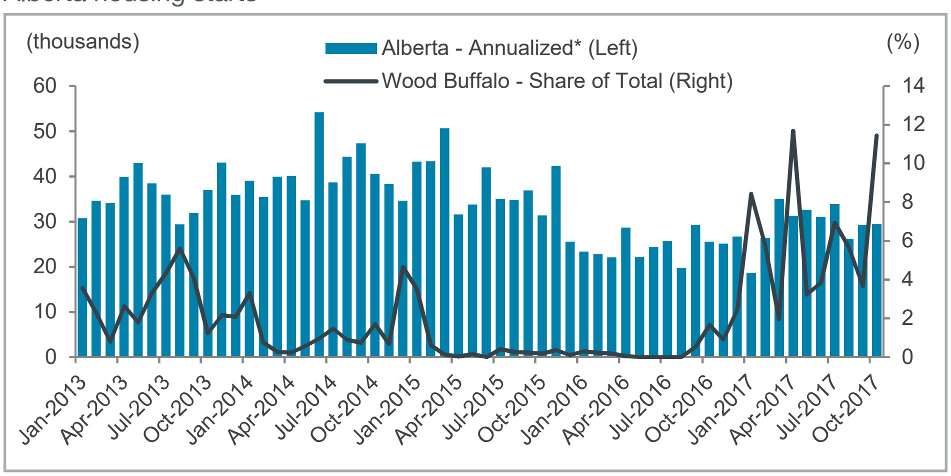
Cumulative change in Alberta employment since July 2016



Sources: Statistics Canada

Chart 3: Fort McMurray rebuilding supports residential construction activity

Alberta housing starts



Sources: Canada Mortgage and Housing Corporation and Treasury Board and Finance
* Seasonally Adjusted at Annual Rates

Consumer confidence improves

An improving economy has consumers returning to the tills. Retail sales have returned to pre-recession levels and year-to-date are up 8.0%. As a result the forecast for real household consumption growth has been revised up to 2.4% for both 2017 and 2018. The increased demand from consumers has yet to translate into significantly higher prices, with CPI inflation in Alberta well below 2%.

Housing market on the rebound

Rebuilding in Fort McMurray (Chart 3) and robust demand for single-unit dwellings are fueling residential investment. House prices and the number of sales have been growing this year and rebuilding efforts in Fort McMurray are ahead of schedule. Consequently, the forecast for housing starts in 2017 has increased from 24,500 at *Budget* to 28,700 and the forecast for residential investment has been revised up from 1.7% to 14%. In 2018, starts are forecast to hold steady at 29,000.

Risks to the Outlook

- If global oil inventories unwind faster than expected, higher oil prices could lead to a stronger-than-expected recovery in Alberta.
- Geopolitical risks, including uncertainty over NAFTA negotiations and softwood lumber, could weigh on investment and exports.
- A sudden increase in interest rates could slow housing activity and consumer spending.

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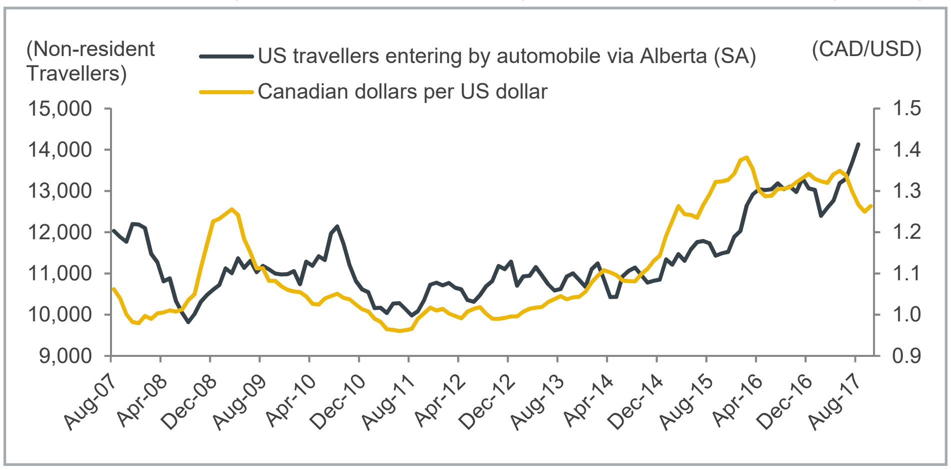
inFocus
Alberta continues to attract visitors

The tourism sector remained robust during the downturn as people from outside Alberta continued to visit the province and Albertans vacationed closer to home. Lower business activity led to a drop-off in business travelers and associated retail activity. This inFocus looks at Alberta's tourism and related industries and how they fared through the economic downturn and into the recovery.

Increased international tourism

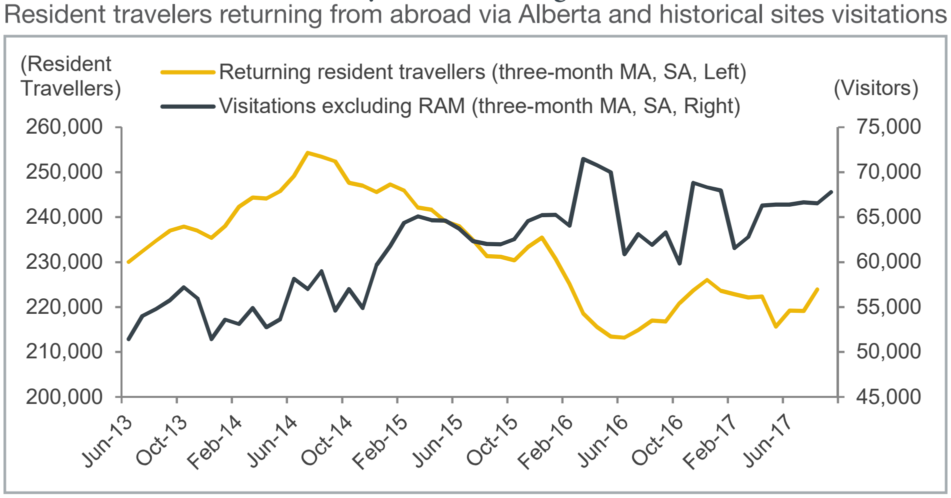
A lower Canadian dollar and improved economic conditions, especially in the US have made Alberta an appealing vacation destination for international visitors.

Chart 1: Increased US cross-border visits and shopping
US travelers entering Alberta and US exchange rate (three-month moving average)



Source: Statistics Canada, Bank of Canada

Chart 2: Albertans favour "staycations" during downturn
Resident travelers returning from abroad via Alberta and historical sites visitations



Source: Statistics Canada, Alberta Culture and Tourism

From June 2014 to January 2016, the Loonie depreciated 15% relative to all foreign currencies. Beginning in 2016, the province saw strong increases in the number of US travellers clearing customs in Alberta. The number of international travellers entering Canada through Alberta in September 2017 was 12.7% higher than at the end of 2014. International travel to Alberta via automobile was especially sensitive to the increased retail buying power from a stronger US dollar (Chart 1). In the province's resort communities, hotel occupancy rates climbed 4.0 percentage points between 2014 and 2016. This trend has carried into 2017, with occupancy rates through September up 1.8 percentage points from the same period of 2016.

Albertans staying closer to home

The depreciation of the Loonie reduced Albertans' spending power abroad. This, coupled with employment uncertainty and lower incomes in 2015 and 2016, led Albertans to favour "staycations."

What is Tourism?

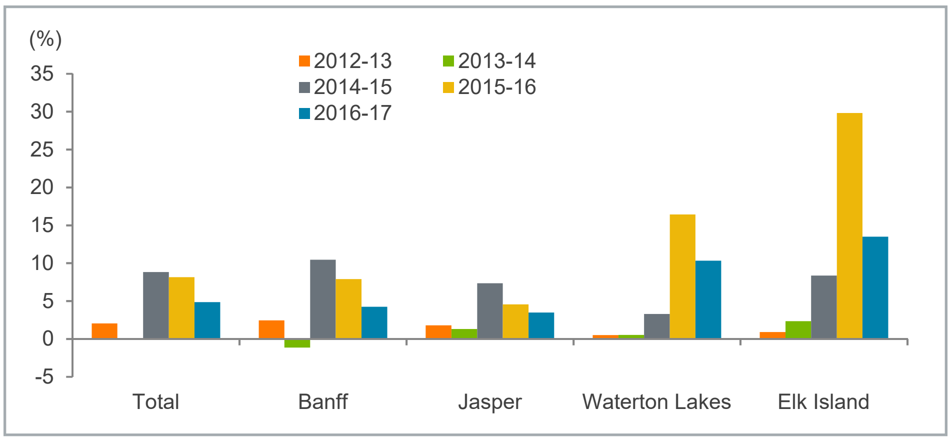
Tourism is an industry of industries incorporating activity from many sectors. Tourists can be from other provinces or countries, or even from Alberta, so long as they are travelling outside their usual environment and not being remunerated from within the area they are travelling to. Consequently tourists and travellers are not the same. Due to this difference and the amount of time and effort to disentangle one from the other, the official provincial Tourism statistics from Statistics Canada are provided on a two-year lag. The data presented in this inFocus pertaining to 2016 and 2017 are tourism-related indicators and not official provincial tourism data. The official provincial 2016 Statistics Canada tourism data will be released in 2018.

Total spending by Alberta residents abroad in 2016 fell 6.6% from 2014, while the number of Albertans returning from abroad fell 16% between July 2014 and July 2016 (Chart 2). Vacationing closer to home, became more appealing during the downturn as visitors became more thrifty. Visits to provincial historic sites and museums in 2015 increased 10%. Though visitations dropped in 2016, this was mostly due to the closure of the Royal Alberta Museum (RAM) at the end of 2015 for a two-year move. Excluding the RAM visits to historic sites and museums rose 1.4% in 2016.

Tourism and Canada 150

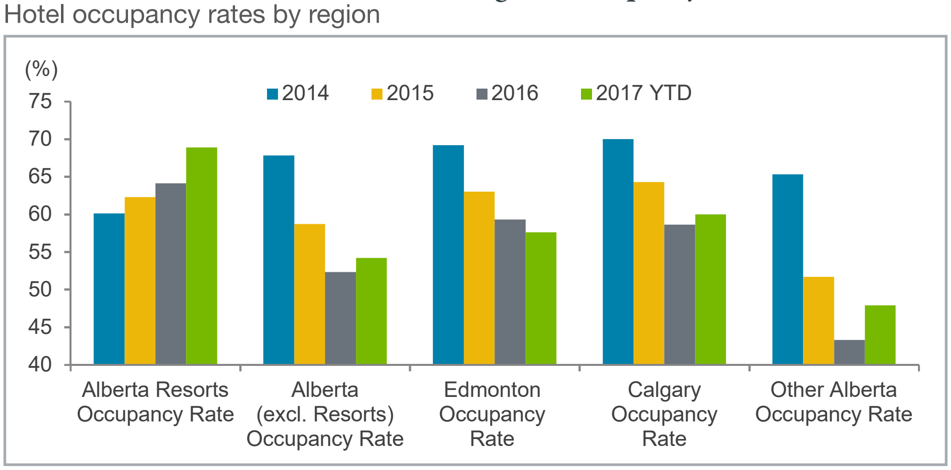
International visitation to Alberta's resort areas - Jasper, Banff, Lake Louise, Kananaskis and Canmore - has been buoyed by increased levels of international travellers. This has been buoyed by free national park access to celebrate Canada's 150th anniversary in 2017. These celebrations also attracted more interest in the province's national parks from Albertans and other Canadians. Through September, occupancy rates in Alberta's resort communities climbed, rising 1.8 percentage points YTD, while the average daily room rate rose 10% YTD. Some of the strongest gains were in the lower profile parks of Elk Island and Waterton Lakes (Chart 3), despite the closure of Waterton Lakes due to wildfires in September. Park attendance benefited from the free passes and Albertans' preference for staying closer to home. Visitations at Alberta's historic sites were up 5.4% YTD through September.

Chart 3: Strong growth in lesser known Alberta National Parks
Fiscal-year growth in visitors to Alberta National Parks, excluding Wood Buffalo



Source: Parks Canada

Chart 4: Business travel continues to weigh on occupancy
Hotel occupancy rates by region



Source: CBRE, Alberta Culture and Tourism

Business travel down

Travel for business suffered during the recession in 2015 and 2016. In 2015 alone, domestic person visits to Alberta primarily for business fell by 3%, with corresponding expenditures decreasing 9%. Fewer workers in the energy sector traveling back and forth from home and job sites meant less money flowing into rural Alberta. Meanwhile, hotels in the major cities saw fewer overnight stays by business travellers and rising room inventories. This drove hotel occupancy rates outside of the mountain resort areas from 68% in 2014 down to 52% in 2016 (Chart 4), while the average room rate fell 8.0%. Job losses and falling disposable income weighed on food and drinking places. Although sales growth at these establishments continued during the downturn, the pace of growth slowed nearly five percentage points in 2015 and fell to a seven-year low of 1.0% in 2016.

Some recovery in 2017

The uplift in oil prices since early 2016 lows and the economic recovery have helped tourism-related industries across most of Alberta. Hotel occupancy rates outside of the cities and resort areas have started to creep higher, boosted by increased conventional oil and gas drilling activity. However, occupancy rates in Edmonton and Calgary continue to be hampered by weak business conditions and increased inventory. Business travellers' accommodation prices remain below pre-recession levels in the province even as leisure travellers' prices have fully recovered. In Calgary occupancy rates were down modestly through September, despite the 2017 Calgary Stampede bringing in 1.2 million visitors, a multi-year high that was up 10% over 2016. In Edmonton occupancy rates were even lower, down 2.7 percentage points.

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