A Rough Patch

Alberta Economic Profile and Forecast

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Canada West FOUNDATION

WESTERN CANADA'S ECONOMY

Monitoring economic activity in the four western provinces is a priority for Canada West Foundation. One provincial economic profile and forecast report is produced each year for British Columbia, Alberta, Saskatchewan and Manitoba. These reports are supplemented by extensive media commentary and presentations on the western Canadian economy.

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1. Overview

Alberta's economic outlook for 2009 points to further decline before a recovery takes place. Oil and gas prices have apparently hit a floor and recovered to a certain degree in May (especially oil), but the US and world economies have not exhibited the same resilience – economic news is still more negative than positive.

Forecasters agree that Canada's economy will shrink in 2009, and while recessions are not the best time for forecasts, there is a consensus that Alberta's economy will do worse than the Canadian average this year. In fact, so far in 2009, economic indicators such as employment and investment are consistent with a scenario that will see Alberta as one of the hardest hit provinces this year. As to 2010, the expected return to growth in the US, although no one knows how dynamic that growth will be, should help Alberta gain back some of the lost ground.

Readers must keep in mind that there are risks associated to this forecast. Among them, there are the unknowns regarding the implementation of a new US energy policy. However, many signs point to a rebound in energy prices. Canada West Foundation is forecasting that Alberta's real GDP will decline by 2.4% in 2009 and grow by 1.9% in 2010.

Alberta's current downturn is not like previous slowdowns. In the past, disruption in the oil and gas sector caused several major downturns in Alberta while things were going pretty much as usual elsewhere in Canada. In other times, energy resources have acted as a buffer for Alberta's economy, allowing it to keep growing while the rest of the country faced dire straits (witness the years 1991-92, over which Canada's GDP declined by 1.2% while Alberta's grew 1.4%).

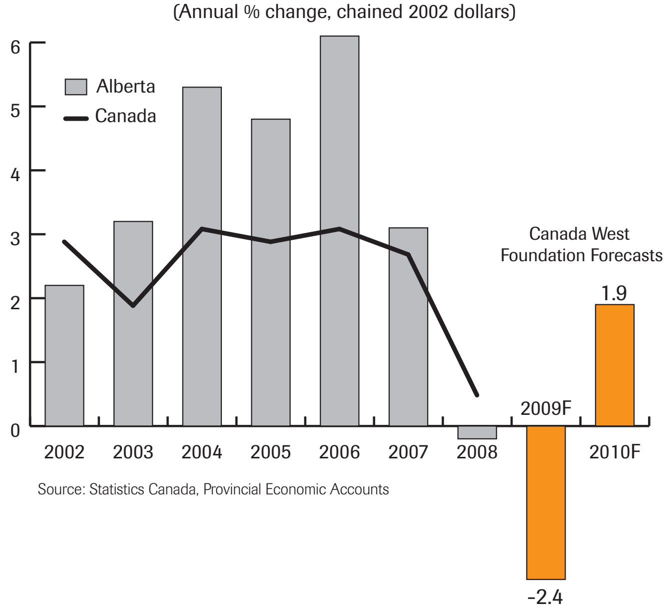
When Canada West Foundation reviewed Alberta's economy in the spring of 2008, it mentioned that "without a doubt, some aspects of the economy have cooled off." Following four boom years during which Alberta's economy grew twice as fast as the rest of the country, 2007 felt like a bit of a letdown, with the province posting real growth of 3.1%, just above the 2.7% Canadian average. Little did analysts know that the less stellar results of 2007 would look quite acceptable compared to the 0.2% economic *decline* the province experienced in 2008. This first annual contraction since 1986 came as a bit of a shock for a whole generation of Albertans. While many provinces faced more severe losses than Alberta in 2008, a few did better and, as a result, Canada's economy edged up 0.5% as a whole.

Alberta faces difficulties not seen in many years as a result of the double and simultaneous hits it took from plunging energy prices and a global economic slowdown. Within six months, the unemployment rate nearly doubled, international exports were almost cut in half, and the provincial government announced it would be facing its first deficit in a decade. How can those dramatic headline-grabbing items be related to the modest 0.2% annual decline mentioned earlier, a mere pause in statistical terms? Answer: the impact of the left-right blows of low energy prices and the world downturn were felt in the second half of 2008 only. In fact, the January to June period in Alberta featured growth which, while not spectacular, was still somewhat in line with the province's 2007 performance. Then in July oil and gas prices began a sustained decline just as US economic exhaustion started to be felt around the world.

Figure 1

Real GDP Growth

(Annual % change, chained 2002 dollars)



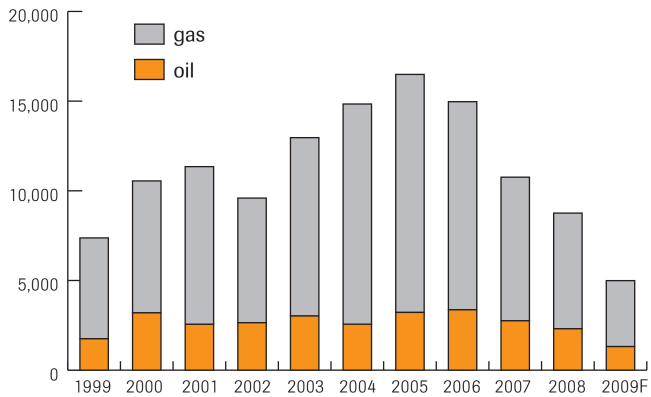
Source: Statistics Canada, Provincial Economic Accounts

2. Oil and Gas Sector

Without a doubt, the rise and fall of energy prices defined Alberta's economic year in 2008. From January to June, the price of both oil and natural gas climbed steadily, peaked in July and declined from then on. July's peak for oil was at $150 (all price figures $US) and represented an all-time high, whereas $13.60 for gas was just below records set in late 2005. After falling, oil hit a floor at $40 near the end of 2008 and was back around $60 as of May 2009. Gas prices seem to have stabilized around $3.75, a sign that their descent could be over, although surpluses in the US represent a downside risk.

Figure 2

Oil and Gas Drilling Activity, 1999-2009
(number of wells)



NOTE: 2009 levels based on Petroleum Services Association of Canada growth forecast.
Source: Canadian Association of Petroleum Producers, Statistical Handbook, May 2009.

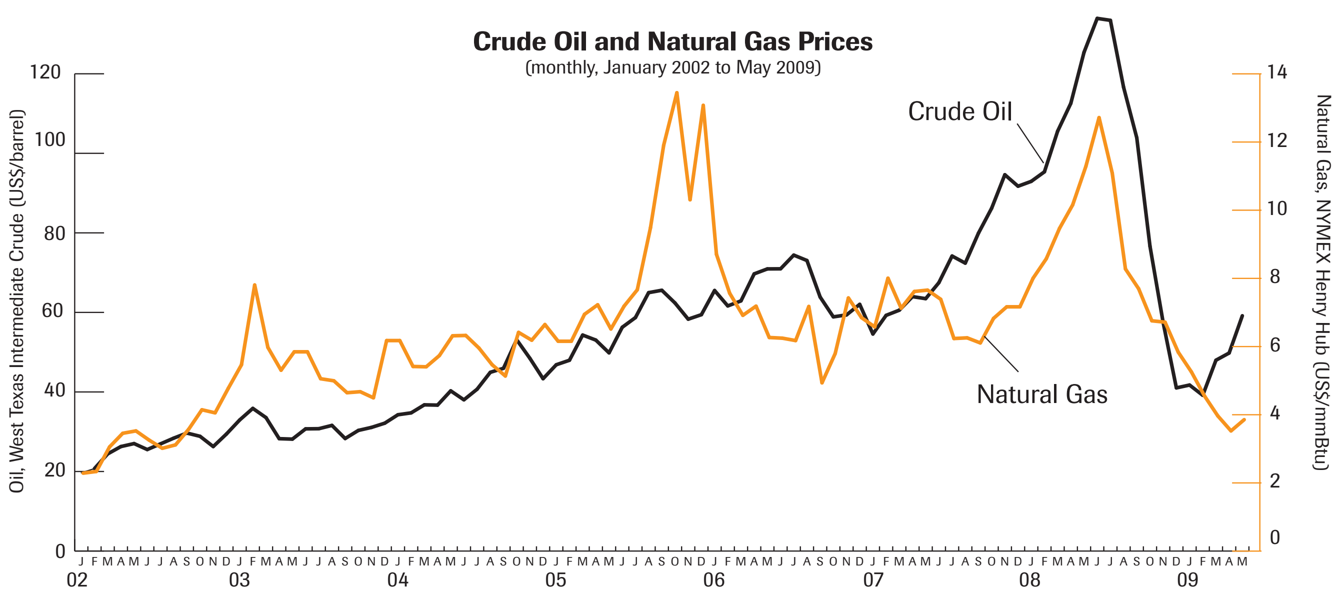
Alberta's oil and gas industry is comprised of diverse sectors but its reaction was the same once the lower prices became entrenched: firms operating in conventional extraction, oilfield services and the oil sands all put aside new development projects, cut down on existing ones and laid off some workers. Well drilling, which was forecast earlier to reach 9,575 wells in 2008, was reduced to 8,757 (a decline of nearly 20%), with an even lower number (6,620) expected for 2009.

In fact, the situation appeared dramatic enough to prompt the provincial government to step in and support the sector. In November 2008 the government decided to ease the January 1, 2009 transition to its new resource royalty policy by making the rules more flexible with regard to new wells.

The government also went on a media blitz to counter the environmental bad boy image the oilsands were acquiring, especially in the US. The death of 1,600 waterfowl in an unfortunate incident at a Syncrude tailings pond and the ensuing bad press (highlighted by a pictorial in National Geographic) triggered this effort. While the new US administration has used moderate and sometimes positive words about the oilsands and their potential position in its future energy policy, Alberta's oilsands face an uphill battle in the media.

However, there was some good news in the sector over the last 12 months. The March acquisition by Suncor of Petro-Canada created a new, healthy $43 billion giant, which is virtually guaranteed to remain Canadian due to Petro-Canada's 20% Canadian ownership rule. In April, AIMCo, the investment agency for provincial heritage funds, took a 15% stake in Precision Drilling to help it restructure its heavy debt load. Then in May, Imperial Oil marked the beginning of the next energy cycle as it announced an investment of more than $8 billion in its stalled Kearl oilsands project. Sign of the times: the announcement included a mention of greenhouse gas emission targets and was realistic about the technology upgrades required to meet them. The next cycle of oilsands development should be quite different from the previous one.

Figure 3



Source: Federal Reserve Bank of St. Louis.

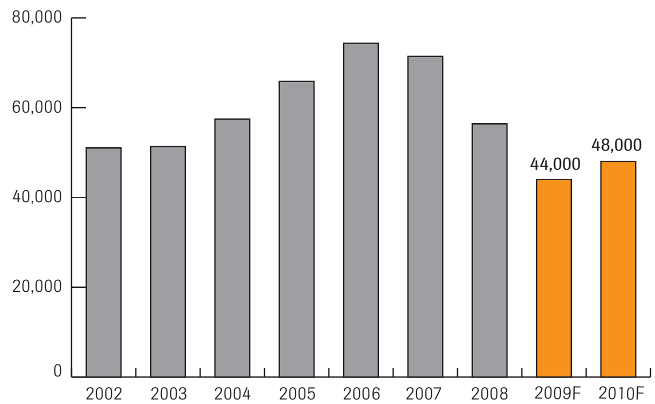
3. Construction and Investment

The difficulties of the oil and gas sector were felt all over the Alberta housing market, although there were already signs as early as 2007 that the mid-decade heydays were already over. After pausing in 2007 at 48,000 units (-1.3%), Alberta housing starts dropped 39.7% to 29,000 units in 2008. In its forecast, the Canada Mortgage and Housing Corporation calls for a further and steeper decline to 13,700 units (-53%) in 2009. For both years the declines were the sharpest in the country. While a partial recovery is expected in 2010, housing starts will at this point amount to only one third of their 2006-2007 peak. The capped, uncompleted condominium projects now dotting some of Alberta's urban centres could remain like this for a while. Home resales will follow a pattern similar to new home construction. Down 4% and 21% in 2007 and 2008 respectively, they will drop 22% in 2009 before bouncing back (+9%) in 2010, according to CMHC.

Investments in non-residential construction and machinery and equipment are expected to decline by 6.6% in Canada in 2009. More than half of this drop is taking place in Alberta, where private and public investment intentions for 2009 are down 15.3% compared to 2008 actual spending. The Alberta decline, the steepest among Canadian provinces, is nearly all taking place in the oil and gas industry as a direct result of low prices. While in theory the expected profitability of an oil or gas investment should be based on a range of possible future prices, not just the current one, only a few energy majors have the financial muscle allowing them to follow this practice *(The Economist, May 21, 2009)*.

Figure 5

Residential Resales, 2002-2010

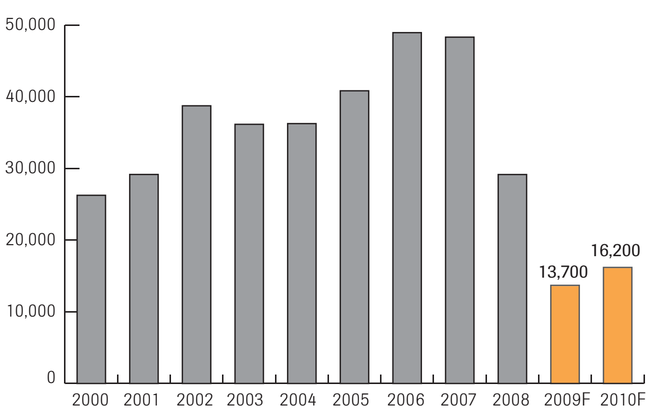


NOTE: 2009 and 2010 figures are CMHC forecasts.
Source, Canada Mortgage and Housing Corporation, *Housing Market Outlook: Canada Edition,* Second Quarter 2009.

However, the Alberta drop in investment has two hidden positive benefits. The first one is that it frees up part of the province's construction industry to work on other construction projects such as completing Calgary's ring road, and at lower wages to boot. The other positive outcome was well described by Ali al-Naimi, Saudi Arabia's oil minister, at an OPEC meeting, when he mentioned that "a low oil price always sowed the seeds of a future price rise, since it led to underinvestment [in extraction capacity]" *(The Economist, ibid)*.

Figure 4

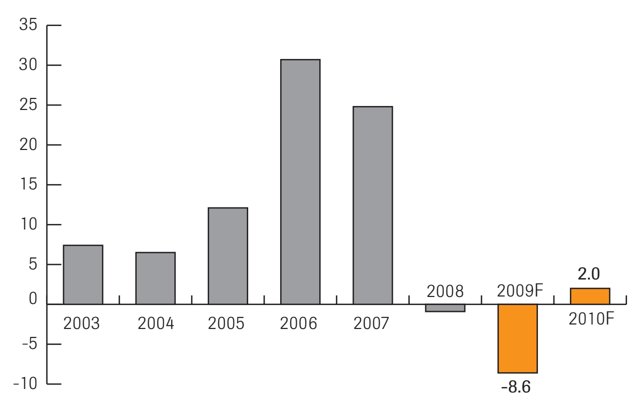
Housing Starts, 2000-2010



NOTE: 2009 and 2010 figures are CMHC forecasts.
Source, Canada Mortgage and Housing Corporation, *Housing Market Outlook: Canada Edition,* Second Quarter 2009.

Figure 6

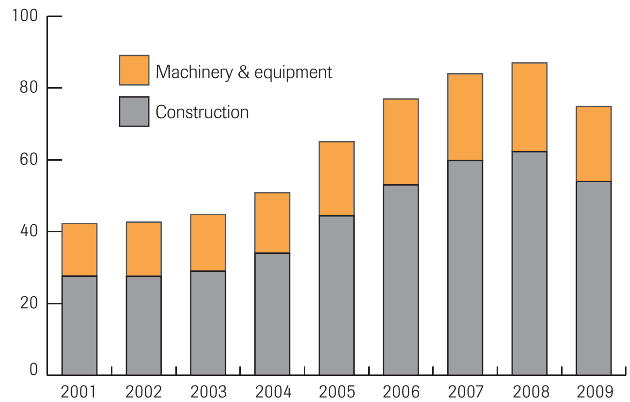
Annual Percentage Change in Average Residential Resale Prices, 2003 to 2010 (%)



NOTE: 2009 and 2010 figures are CMHC forecasts.
Source, Canada Mortgage and Housing Corporation, *Housing Market Outlook: Canada Edition,* Second Quarter 2009.

Figure 7

Private and Public Investment, 2001 to 2009
($ billions)



NOTE: The value for 2008 is preliminary actual and the value for 2009 is intentions.
Source: Statistics Canada CANSIM Table 029-0024.

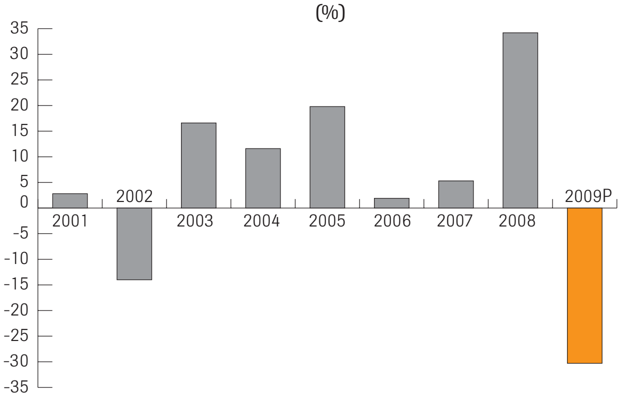
4. Exports

Over the first three months of 2009, Alberta's exports are down 30% from the same period in 2008, the sharpest drop among provinces. In dollar terms, Alberta's export loss of $7.7 billion was only second to Ontario's ($8.9 billion). Part of the decline in the value of Alberta's energy exports is attributable to lower prices, but volumes were down as well.

Of all the provinces, Alberta is now the one which depends the most on the US as an export market. The US absorbs nearly 90% of the province's merchandise exports, and three quarters of those exports are either oil or natural gas. As the US economy slowed down, Alberta was hit the hardest.

Figure 8

International Merchandise Exports, 2001 to 2009, change from previous year
(%)



NOTE: 2009 preliminary based on first three months of the year.
Source: Statistics Canada, CANSIM series V847737.

However, the drop in Alberta exports to the US so far in 2009 (-32%) pales compared to that of exports to Alberta's distant second-largest export market, China (-50%). Alberta's exports to China of ethylene glycol, an organic chemical used to make polyester, dropped 80% during that period as China's garment industry was hit hard by lower global demand.

5. New Industries and Research

Alberta's economy is more than just natural resources, and research and development is taking place in a number of industries, some with little to do with oil and gas.

Nanotechnology, an emerging industry cluster in Edmonton, refers to the manipulation of atoms and molecules in order to create new materials (such as corrosion-resistant metals) or to build small-scale machines (such as bacteria-resistant medical devices). Edmonton's nanotechnology industry is anchored by the National Institute for Nanotechnology, a joint partnership between the National Research Council of Canada and the University of Alberta. NINT opened in 2001 and is expected to create 100 companies and 15,000 new jobs by 2012. In addition, the Alberta Centre for Advanced Microsystems and Nanotechnology opened last year in Edmonton and will support the commercialization of nanotechnology products.

During the past two decades the growth of Calgary's wireless and telecommunications sector has been impressive. It all started with a partnership between the energy industry and government leaders that led to the creation of the University of Calgary's GPS/Geomatics Engineering Department and of NovAtel Communications Ltd. Before its wireless operations were sold and moved to San Diego in 1998, NovAtel acted as a telecom pioneer when it built the first North American cellular telephone network in Calgary in 1983. Today, Calgary's wireless and telecommunications community is supported by WiTec Alberta, a non-profit industry association which assists local companies and organizations to market their technologies locally and around the world.

Currently, the provincial government is in the process of restructuring its research-supporting policy. The new approach will be focused on three industries (bio-industries, health, energy and environment) and one targeted outcome: increasing the rate of commercialization for Alberta based research.

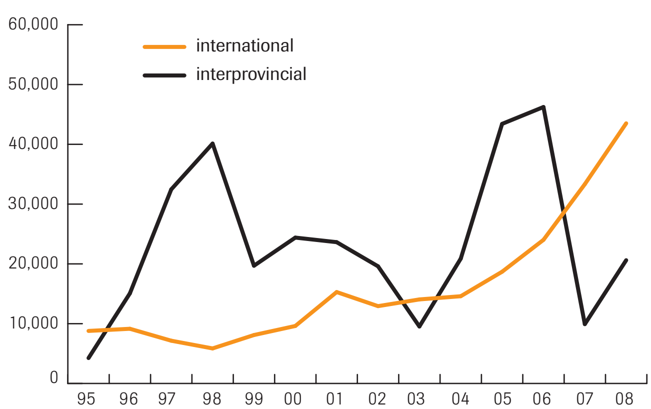
6. Population

Alberta's economic success earlier in the decade made it the Canadian destination of choice for international and interprovincial migration. For more than 10 years, net migration has been the main source of Alberta's population growth. In 2007, there were hints that Alberta had lost its attraction to newcomers, especially interprovincial ones. This turned out to be a simple pause and reflected, in part, the attraction of Saskatchewan's good economic conditions for Albertans who were originally from that province.

While Alberta's net interprovincial migration of 20,600 in 2008 was well below the record-breaking levels of 2005 and 2006 (43,400 and 46,200 net migrants), the international numbers did set new marks, up 30% from the previous year to a level of 43,500 net migrants. Apparently, the good news about Alberta reached other countries with a delay of a few years compared to other provinces. No matter their origin, these new Albertans now face challenges as some of the opportunities they envisioned have dried up for a while.

Figure 9

Net Migration into Alberta,1995 to 2008



Source: Statistics Canada (Cansim Tables 051-0017 and 051-00377).

7. Labour Market

Long considered Canada's source of unlimited new jobs, Alberta went through an abrupt return to normal in 2008. The global recession put an end to the many years of questioning on what to do with a labour market so tight that some fast-food restaurants flaunted their benefit packages to attract staff. The "help wanted" signs have largely vanished.

From October 2008 to April 2009, one Albertan out of 48 lost his or her job, a loss of 42,000 jobs in total. This is not as dramatic as in Ontario, where one worker out of 36 received a pink slip, but much worse than Quebec, where one worker out of 125 was let go *(Picher 2009)*.

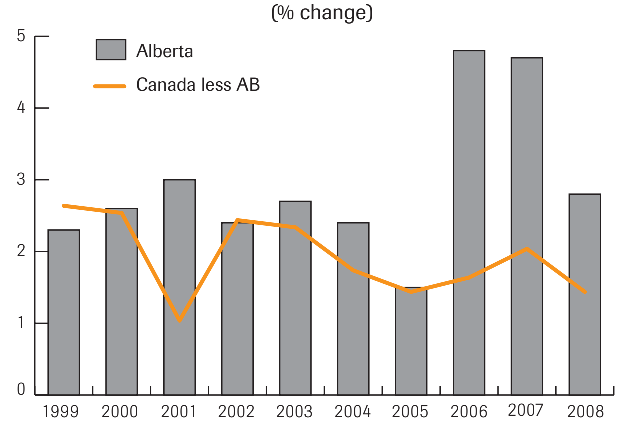
Over those infamous six months, Alberta's unemployment rate jumped from 3.7% to 6.0%. However, this rate remains quite low compared to the national one (8.0%). Only Saskatchewan (5.0%) and Manitoba (4.6%) had a lower unemployment rate than Alberta as of May.

While job cuts in oilfield services (especially drilling) often made the headlines, this sector was not hit as hard as other, albeit related, industries. Compared to 12 months earlier, Alberta's total employment was down 0.9% in April 2009, with heavy losses in manufacturing (-11.6%), wholesale trade (-22.4%) and construction (-9.6%). The job decline in mining and oil and gas was less severe (-1.3%). In other areas of the economy, some industries posted solid job creation results, including information, culture and recreation (+19.1%) and accommodation and food services (+10.7%).

One peculiar aspect of Alberta's troubled employment situation is that the labour force is no longer growing. This is usually a

Figure 10

Employment Growth Alberta and Rest of Canada 1999 to 2008
(% change)



Source: Statistics Canada, CANSIM Table 282-0002.

sign that workers are have stopped looking for jobs because they don't expect to find any. However, it could also mean that Alberta's youth, who recently led Canadians in school drop-out rates (nothing to boast about) realizes that the source of high-paying jobs with low academic requirements has run out and that it's time to head back to school. Maybe the recession achieved what advertising campaigns could not.

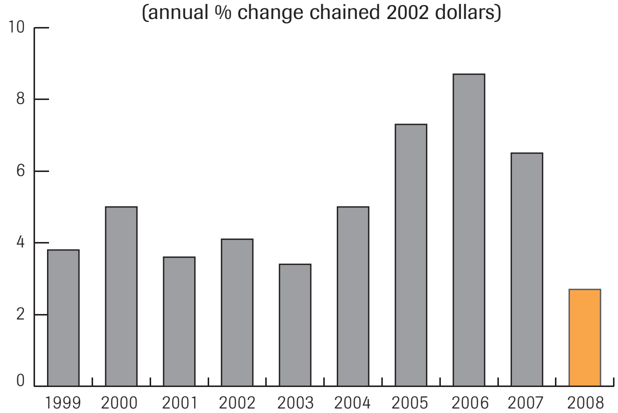
8. Consumer Spending and Prices

Alberta's labour income (the sum of wages, salaries and supplementary labour income) grew 8.4% in 2008, the slowest since 2003. While Alberta wage rates remain nearly 20% higher than the Canadian average, their growth was less spectacular in 2008. This obviously made Albertans cautious: personal expenditures (in real terms) grew only 2.7% in 2008. Spending on durable goods (such as cars, furniture and household appliances) went nearly flat (+0.4%) after three years of double-digit growth. As a result the personal saving rate jumped to 14.3%, the highest in more than two decades.

After averaging 5.0% in 2007, CPI inflation was more subdued in Alberta in 2008, ebbing down from 3.6% to 2.0% in the course of the year, and then down to 0.9% in April, below the Canadian average (1.2%). Over three of the last 12 months, Alberta inflation was lower than the national rate. The last time this occurred was in 2005. The main moderating factors for Alberta consumer prices were lower prices for natural gas, electricity and gasoline.

Figure 11

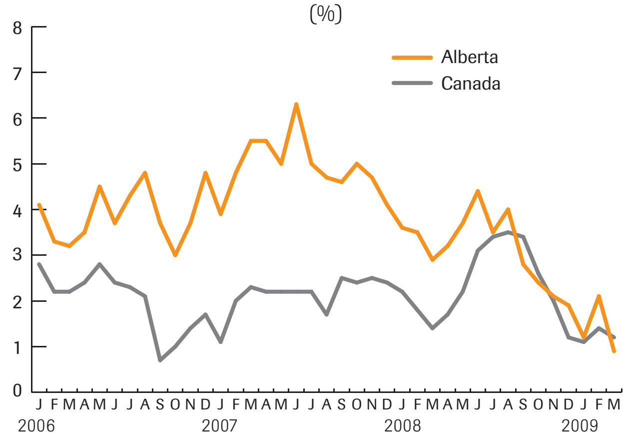
Personal Expenditure 1999-2008
(annual % change chained 2002 dollars)



Source: Statistics Canada, CANSIM series V15855887.

Figure 12

Consumer Price Index Inflation 2006-2009
(%)



Statistics Canada, CANSIM series V41692327, V41690973.

9. Public Finances

A few sections in this profile have a "that was then, this is now" theme. Our analysis of Alberta's provincial public finances is no exception. In the middle of 2008, the one significant issue in this area was the introduction of a new royalty regime on natural resources. Following a study it commissioned, the government decided to hike the royalty rates to provide Albertans with a "fair share" of the exploitation of their natural resources. The industry viewed this initiative as a job and investment killer. With hindsight about energy prices, the government's timing could have been better, but who knew then? In any case, the global recession turned out to be the industry's biggest foe, not necessarily the new royalty regime.

As the government brought down its budget in April, royalties were no longer the number one issue: the much-publicized deficit was. It turned out that in 2008-09, Alberta operated with a $1.4 billion deficit, the first in 15 years, and anticipated another deficit of $4.7 billion in 2009-10. Deficits had been made illegal by the Klein government. However, a revised *Fiscal Responsibility Act* now allows the government to run deficits as long as they are offset by sufficient savings in its Sustainability Fund. This is why, as part of this budget, it transferred almost $7 billion from the capital account to the Sustainability Fund.

The act also allowed the until-then-debt-free government to borrow for a few specified purposes, including capital investment in government-owned assets. A few months later the government announced a new savings bond issue, the first

Figure 13

Provincial Revenue ($ millions)

	2007-08 Actual	2008-09 Forecast	2009-10 Estimate	Change from 2008-09 to 2009-10
Non-renewable resource revenue	11,024	12,289	5,903	-6,386
Tax revenue	16,539	16,013	14,752	-1,261
Investment income	2,414	-1,872	1,799	3,671
Other revenue	8,192	9,197	9,207	10
Total Revenue	**38,169**	**35,627**	**31,661**	**-3,966**

Source: Alberta Budget 2009, Fiscal Overview, page 13.

one in more than a decade, expecting to invest $23.2 billion of the raised money into infrastructure projects over three years.

Total revenue for 2009-10 is estimated to be $31.7 billion, about $4 billion lower than in the previous year. More than $6 billion of the revenue decline will be the result of lower resource royalty revenue, while $1 billion can be attributed in part to the elimination of health care insurance premiums. The royalty revenue estimate for 2009-10 was based on an oil price of $56.

On the expenditure side, total spending for 2009-10 will reach $36.4 billion, slightly less than in the previous year. No spectacular new initiatives were announced, which was not a surprise given the combined revenue shortcomings.

10. Conclusion

As they face the first economic recession in almost 20 years, Albertans have their eyes turned toward their provincial government, wondering what will come out of its policy toolbox. “To govern is to choose.” The government faces difficult choices in a number of areas, including its savings (should it tap into them?), deficits (are they acceptable for a few more years?) and the natural resources dilemma (how can one combine energy extraction with “green” imperatives?). Some of these issues were partly addressed over the last 12 months or so but it is not clear whether short term answers to pressing problems were meant to become lasting policy.

Things are not so great in Canada’s energy hotbed these days, but they’re not so bad either. The fantastic reserves of the oilsands are not going anywhere, the province’s financial situation remains the best across the country, and the Stelmach government still has plenty of time to leverage a strong electoral mandate into forward-looking policy that will benefit all the province’s residents.

After firing on (almost) all cylinders for a few years, Alberta will be facing a rough patch for a while and will perform less well than the rest of Canada in 2009. The following year is another story, and so are the ones after that. Energy prices and the global economy combined to slow down Alberta for now, but they could soon help lift it out of its doldrums and make it the Canadian growth champion again.

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A leading source of strategic insight, conducting and communicating non-partisan economic and public policy research of importance to the four western provinces and all Canadians.

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In 1970, the One Prairie Province Conference was held in Lethbridge, Alberta. Sponsored by the University of Lethbridge and the Lethbridge Herald, the conference received considerable attention from concerned citizens and community leaders. The consensus at the time was that research on the West (including BC and the Canadian North) should be expanded by a new organization. To fill this need, Canada West Foundation was created under letters patent on December 31, 1970. Since that time, Canada West Foundation has established itself as one of Canada's premier research institutes. Non-partisan, accessible research and active citizen engagement are hallmarks of the Foundation's past, present and future endeavours. These efforts are rooted in the belief that a strong West makes for a strong Canada.

More information can be found at www.cwf.ca.

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