



Still Strong

Alberta Economic Profile and Forecast

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WESTERN CANADA'S ECONOMY

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1. Overview

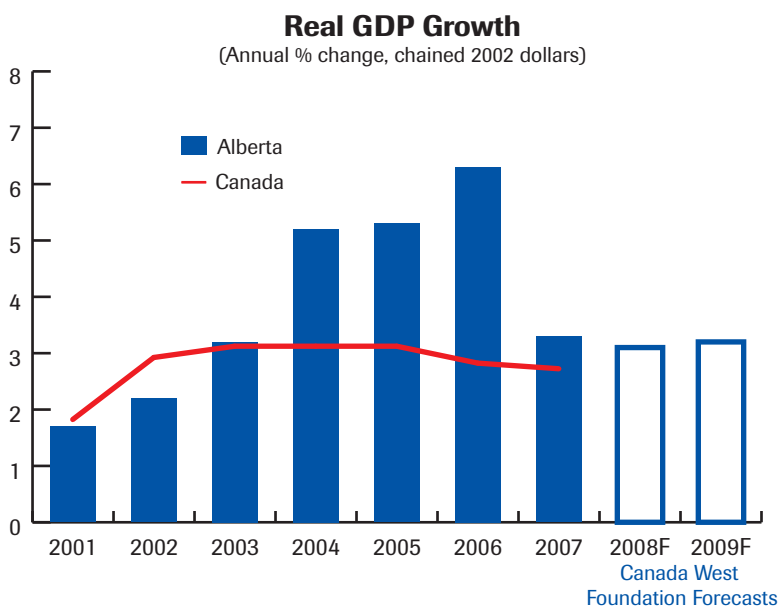
After spending a few years in the fast lane, Alberta's economy changed lanes last year and recorded a slower rate of economic growth. There has been a considerable gap in recent years between Alberta's economic performance and that of the national economy. In 2004 and 2005, Alberta's real economic growth was above 5%—more than two percentage points higher than national figures. The gap turned into a chasm in 2006, when Alberta's real economic growth hit 6.6%. This was roughly *three times higher* than the rest of Canada—the nation with Alberta factored out.

Growth slowed last year, but the provincial economy did not take its foot off the gas and slam on the brake. Real GDP expanded by 3.3% in 2007, on par with the average rate of growth for Alberta since the early 1980s, and above last year's national average. Without a doubt, some aspects of the economy have cooled off. The rate of growth of retail sales has definitely moderated over the past 12 months, but Albertans continue to spend money. The rate of increase in housing prices slowed considerably and housing starts are down, but the floor has not fallen out of the market. Employment growth has slowed, but it certainly hasn't stalled—far from it. The most recent figures show that Alberta continues to lead the country in job creation.

Some segments of the economy—notably the important conventional oil and gas sector—slowed down more than others. The high price of crude oil and massive development in the oil sands contrasts with a marked decline in natural gas drilling activity. Until recently, the price of natural gas was depressed. Furthermore, the industry has struggled with high costs, the strong dollar, and uncertainty surrounding the Alberta government's royalty review. Fortunately, the conventional oil and gas sector is not as pessimistic as we approach the summer of 2008 as it was in late 2007 and early 2008. Some within the industry have regained some optimism, however cautious.

The Canada West Foundation expects Alberta to outperform the national economy this year and next. Alberta, however, will not be the top performing province in 2008. And in a time of national and global economic uncertainties, there is no shortage of downside risks to the forecast for the province. The US—the biggest market for Alberta's exports by far—is currently facing tough times. Slower global economic growth has the potential to bring oil prices down. Natural gas prices are currently favourable, but there is no guarantee they will stay that way given their volatility. Labour shortages and cost pressures—perennial concerns in Alberta—have the potential to reduce economic growth.

Figure 1



Notwithstanding the downside risks, the Alberta economy, by and large, remains on stable footing. The Canada West Foundation is forecasting real GDP growth of 3.1% for 2008 and 3.2% for 2009.

2. Housing Market, Construction, and Capital Investment

Total housing starts in Alberta leveled off last year, declining 1.3% in 2007 after increases of 12.6% and 19.9% in 2005 and 2006. The Canada Mortgage and Housing Corporation (CMHC) forecasts that total housing starts—single detached and multiple units—will drop considerably this year and next, 22.9% in 2008 and 11.4% in 2009 (see Figure 2).

Source: Statistics Canada, *Provincial and Territorial Economic Accounts Review*, Vol. 4, no. 1, Catalogue no. 13-016-XIE.

While lower than 2006 and 2007 levels, the expected number of housing starts for 2008 is just above the 10-year average.

The softening of the Alberta housing market is reflected in the rate of price growth, which has come back down to single digits from the unsustainable price increases that characterized much of 2006 and the first few months of 2007 (see Figure 3). Similarly, growth in average prices of sales of existing homes has fallen from recent highs (see Figure 4). CMHC has stated that sales of existing homes in Alberta is in “contraction mode” and forecasts a 14.3% drop in residential resales in 2008 followed by a marginal increase in 2009 (Canada Mortgage and Housing Corporation 2008).

Figure 2

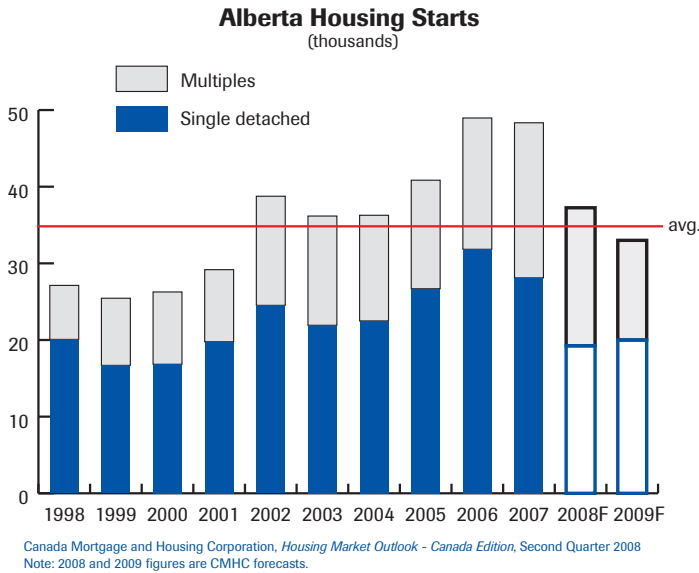


Figure 3

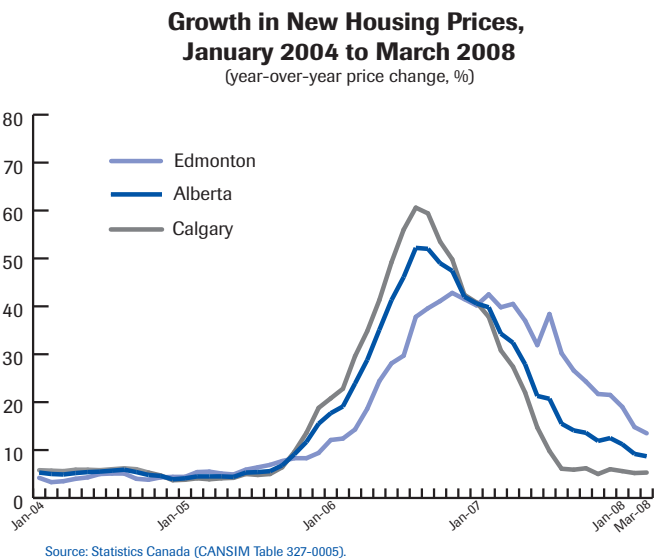
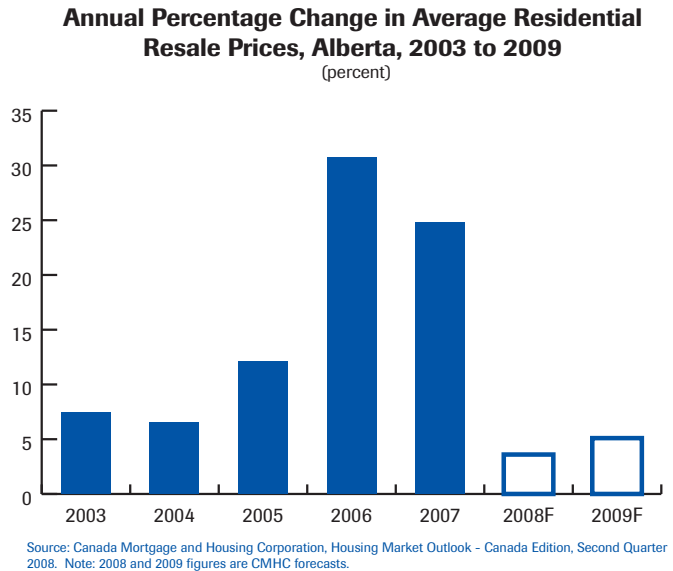


Figure 4



The total value of building permits was relatively flat from 1998 to 2004 compared to the past three years, when they more than doubled (see Figure 5). Roughly half of the increase from 2004 to 2007 was due to residential construction. However, the value of building permits started to retreat in the middle of 2007. In the first quarter of 2008, total building permits declined for the third consecutive quarter, largely due to the residential side. Residential building permits dropped 18.7% in the closing quarter of 2007 and 8.0% in the first quarter of this year (see Figure 6).

After increasing sharply from 2003 to 2006, private and public capital investment grew at a more modest pace of 4.9% in 2007.

Figure 5

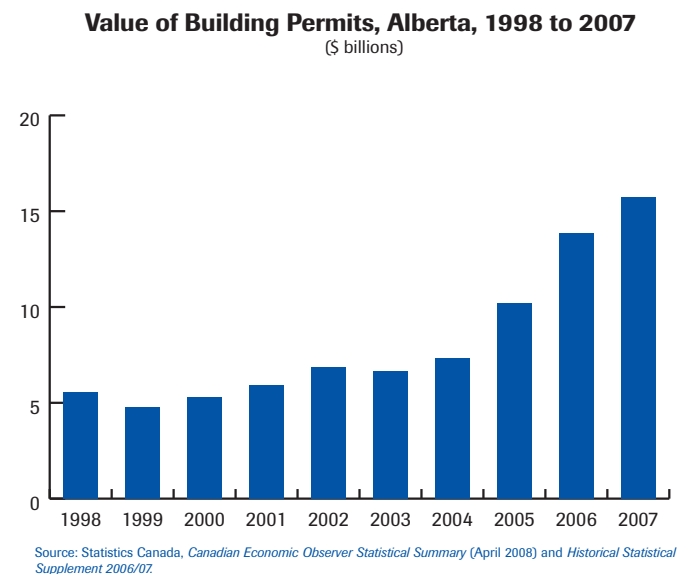
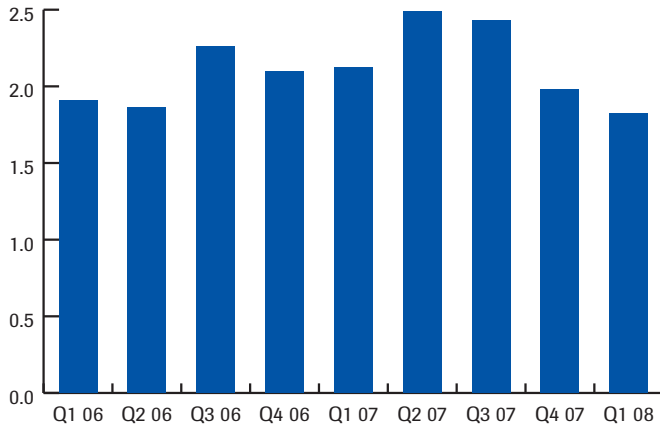


Figure 6

Value of Residential Building Permits, Alberta, Quarterly, Q1 2006 to Q1 2008
(\$ billions)



Source: Statistics Canada (CANSIM Table 026-0006).

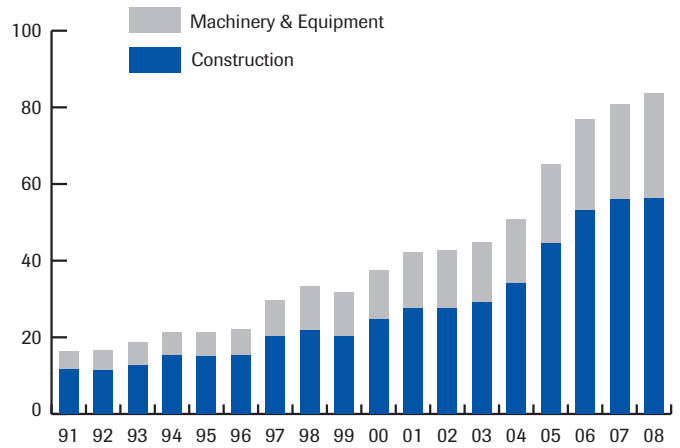
This moderating trend is expected to continue in 2008. Capital investment in Alberta is expected to grow 3.8% in 2008, slightly lower than the national rate of 5.2%. Private and public sector investment—construction and investment in machinery and equipment—are expected to reach nearly \$84 billion in 2008 (see Figure 7). The construction portion, which accounts for just over two-thirds of the total, will remain more or less flat in 2008.

Although the rate of increase in capital investment has slowed, Alberta accounts for a disproportionate share of total investment in Canada. Approximately one-quarter of total capital investment in Canada takes place in Alberta. Driving this is the oil and gas sector, particularly the oil sands. Alberta’s oil and gas sector accounted for 44.1% of all capital expenditures last year. Capital construction in the oil and gas sector is expected to fall 10.7% in 2008, while expenditures on machinery and equipment are expected to increase 26.4%.

The Alberta government’s Inventory of Major Alberta Projects provides another perspective on activity in the province. This inventory includes proposed and recently completed projects but does not breakdown expenditures by year. The cost of a project is the expected value of expenditures over all phases of construction, which may span over multiple years. As of March 2008, there were 1,076 major projects (valued at \$5 million each or greater) planned, underway, or recently completed in Alberta (Alberta Finance and Enterprise 2008). These projects are estimated to be worth more than \$250 billion in total. Roughly

Figure 7

Private and Public Investment, Alberta, 1991 to 2008
(\$ billions)



Source: Statistics Canada, CANSIM Table 029-0024.

Note: The value for 2007 is preliminary actual and the value for 2008 is intentions.

one-quarter of the total number of projects are infrastructure projects.

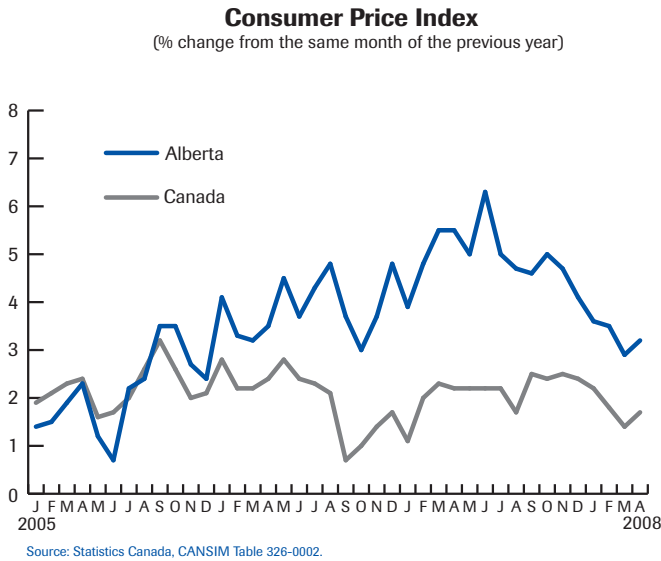
While oil sands projects account for only 4.8% of the total number of projects, they are valued at over \$160 billion, nearly two-thirds of the total value of all Alberta projects. These tend to be multi-year projects, many with proposed completion dates ranging from 2010 to 2015.

3. Inflation

In June of last year, the rate of inflation in Alberta was running more than 2.5 times higher than the national level, primarily because of large increases in the cost of housing. As the rate of increase in the price of housing and shelter slowed down in second half of last year, Alberta’s inflation rate lowered and the gap between the provincial and national inflation rates lessened (see Figure 8).

In March 2008, Alberta’s inflation rate slipped below 3% for the first time since December 2005. Despite this trend, Alberta still had the highest inflation rate of all Canadian provinces for the first four months of this year, narrowly edging out its neighbour directly to the east.

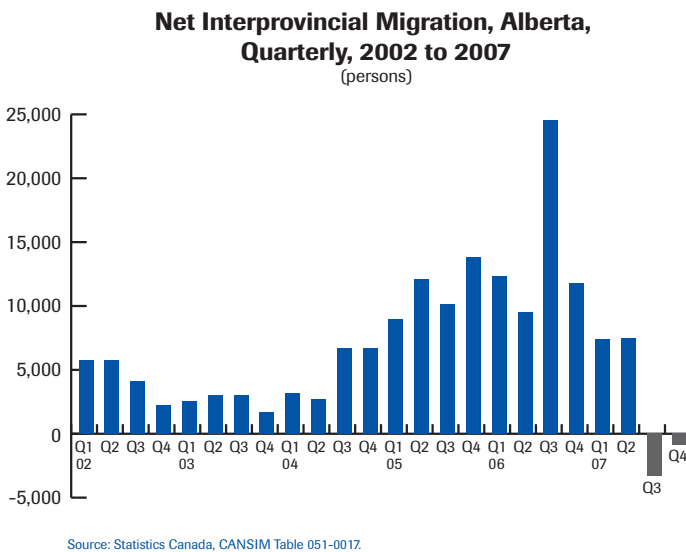
Figure 8



4. Population Growth

Population growth in Alberta has slowed, largely due to a recent change in interprovincial migration in and out of the province. Alberta's strong economy and robust job market attracted thousands of people from other provinces in recent years, resulting in record gains in 2006. From 2005 to the middle of 2007, the province gained 118,000 people from other parts of Canada. By the second half of 2007, the situation changed completely and Alberta lost people to interprovincial migration (see Figure 9). This has not happened since 1994 and is due to a sharp increase in out-migration.

Figure 9



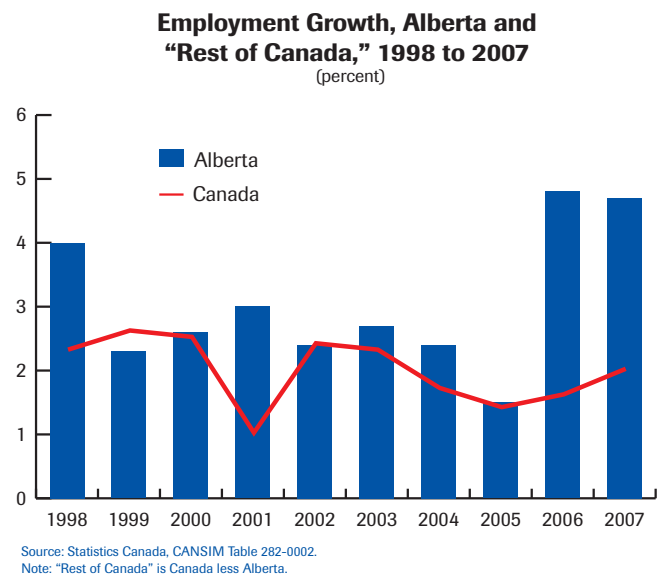
It is important to keep these figures in perspective. Interprovincial in-migration remains strong and Alberta's total population continues to grow faster than the national average, due to the province's relatively high natural population growth and strong international migration. Furthermore, the province lost 4,200 people in the second half of last year, which pales in comparison to the mid-1980s when Alberta lost an average of almost 23,000 people annually for five years.

5. Alberta's Workforce

Alberta has been the perennial leader in terms of employment growth, consistently outperforming the rest of the country (see Figure 10). While it is true that economic growth has moderated and the number of people leaving the province for other parts of Canada has shot upwards, Alberta continues to hold the top spot on employment growth. From May 2007 to April 2008, Alberta was responsible for 19.3% of Canada's total growth in employment. Year-over-year employment growth over this period was 3.3% in Alberta, the highest of any province and well above the national rate of 2.0%. The unemployment rate for the first four months of 2008 was 3.4%, a shade lower than the 2007 rate of 3.5%.

In 2007, the largest gains in the number of people employed occurred in construction (20,507); mining, oil and gas extraction (11,263); and management, administration and other support (12,256) (Alberta Employment and Immigration 2008a).

Figure 10



Percentage increases in these industries were 11.9%, 8.3% and 18.0% respectively.

As reported by the Canada West Foundation for a few years now, labour shortages continue to be one of the most serious challenges facing Alberta employers, and the economy more broadly. Alberta's hunger for workers persists and shows no signs of abating. The province could face a shortfall of 111,000 workers by 2017 (Alberta Employment and Immigration 2008b). The shortage of labour will continue to be an issue of concern as more and more people move toward retirement. The aging of the workforce will have wide ranging implications on the economy, the labour market, employers, and workers of all ages.

Despite employers' seemingly insatiable demand for labour, many immigrants to Alberta experience relatively poor labour market outcomes. In 2007, the unemployment rate for Canadian-born Albertans aged 25 to 54 was 2.6%. This compares to an unemployment rate of 7.0% for recent immigrants, those who have been in Canada for less than five years (Statistics Canada 2008a). According to the most recent Census, the median salary of Canadian-born Albertans with a university degree was \$54,950 in 2005, two times that of recent immigrants (\$27,430) (Statistics Canada 2008b).

The combination of strong labour demand, low unemployment and the rising cost of living have put upward pressure on labour costs. No province has had larger percentage increases in average weekly earnings than Alberta over the past few years. Average weekly earnings have increased 4.9% per year on average in the past three years compared to 3.1% nationally (Statistics Canada 2008c). The labour income component of Alberta GDP (wages, salaries and supplementary labour income) has increased 10.5% on average over the past five years (Statistics Canada 2008d). Further, Alberta has the highest average weekly earnings of all provinces—8.4% higher than the national average (Statistics Canada 2008c).

However, adjusted for inflation, average weekly earnings have remained flat, increasing only 0.4% on average over the past five years. The Canada West Foundation recently reported that more than half of Albertans feel they are better off financially today than five years ago. On the flip side, a large minority said they are not better off, with 28% saying they have remained about the same and 15% saying they are worse off financially than five years ago (Berdahl 2008). Clearly, Alberta's prosperity

has been a good thing for many. But, it is important to recognize that the benefits of economic growth have not accrued to all Albertans.

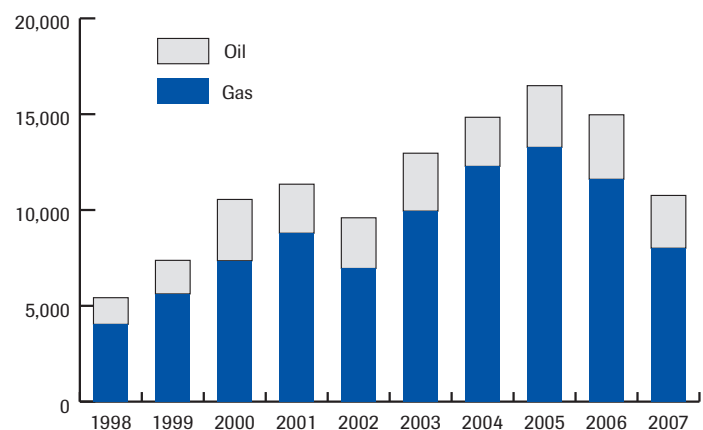
6. Oil and Gas Sector

The oil and gas sector, the primary driver of the Alberta economy, is often viewed—incorrectly so—as one homogeneous entity. Recent conditions in the conventional (mainly natural gas) and non-conventional (led by the oil sands) aspects of the oil and gas sector underscore the underlying differences. While activity in the oil sands continued to steam ahead, there was a slowdown in the natural gas sector in 2007. Oil and gas drilling activity was down 28.1% in 2007, with gas responsible for 85% of the decline (see Figure 11). While the price of oil climbed upwards in 2007, natural gas prices, in comparison, were subdued (see Figure 12).

In late 2007 and early 2008, the conventional side of the oil and gas industry was decidedly pessimistic, largely due to weak natural gas prices and the Alberta government's new royalty regime. Producers, industry associations, and energy industry analysts were talking about layoffs and reduced investment and expenditures in Alberta. There were warnings a "major slowdown" (Petroleum Services Association of Canada 2008a)

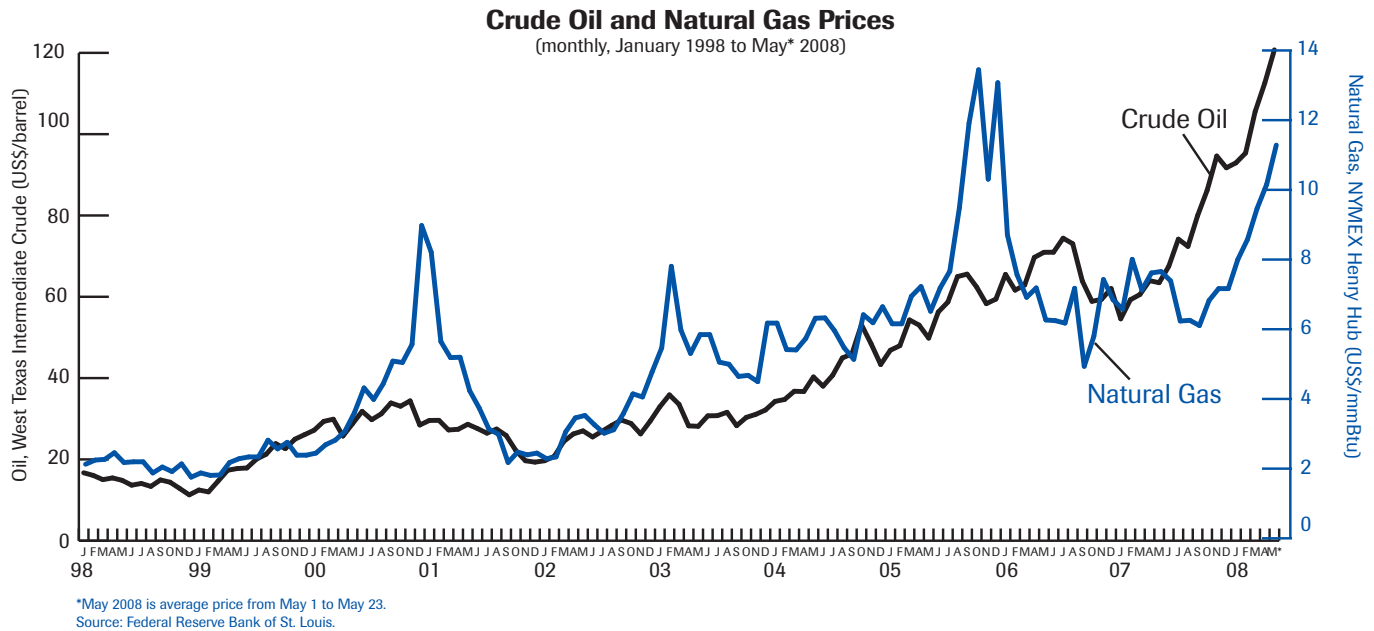
Figure 11

Oil and Gas Drilling Activity, Alberta, 1998-2007 (number of wells)



Source: Canadian Association of Petroleum Producers, *Statistical Handbook*, May 2008.

Figure 9



and a “conventional oil and gas recession in 2008” (Ziff Energy Group 2008).

However, increases in the price of natural gas, and record high crude oil prices, have improved the outlook for Alberta’s conventional oil and gas industry. Recent forecasts for drilling activity in 2008 have been revised upwards (Petroleum Services Association of Canada 2008b; Canadian Association of Oilwell Drilling Contractors 2008). Nonetheless, drilling activity in 2008 is still expected to come in below 2007.

Despite the slowdown in the US economy, strong demand for oil in emerging economies and supply constraints have helped push the price of crude oil above US\$130 in May 2008, double the price 12 months earlier. Sky-high oil prices are certainly good news for the oil sands industry, which is now responsible for roughly half of western Canada’s total output of crude oil.

7. Exports

Energy products account for close to 70% of Alberta’s international exports (see Figure 13), with crude oil and natural gas accounting for 34.0% and 29.8% of total exports in 2007 respectively. In the past few years, the value of natural gas exports has declined while the value of exports of crude oil has increased (see Figure 14). In 2006, the total value of crude oil

exports surpassed natural gas, owing to rising oil prices and increased output from the oil sands.

Although countries such as China and India have become much bigger players on the world economic stage, the US is by far Alberta’s most important export market. In 2007, over 85% of Alberta’s merchandise exports went to the US. The proportion of Alberta’s merchandise exports going to the US is about 10 percentage points higher today than it was 15 years ago. Alberta’s trade is the least diversified of the western provinces in terms of the destination of exports.

Figure 13

International Merchandise Exports from Alberta, 1998 to 2007
(\$ billions)

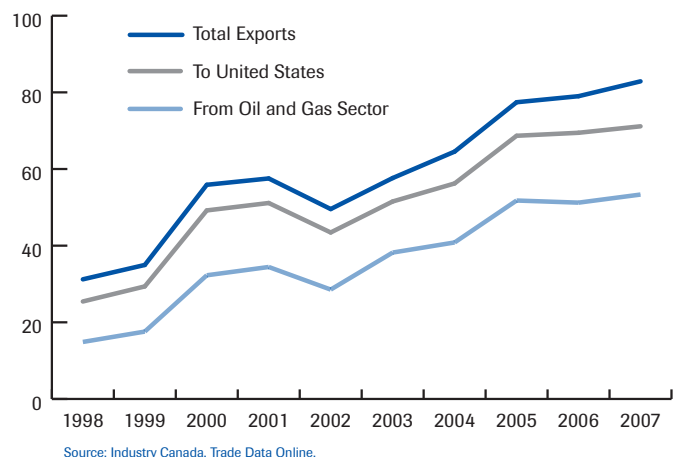
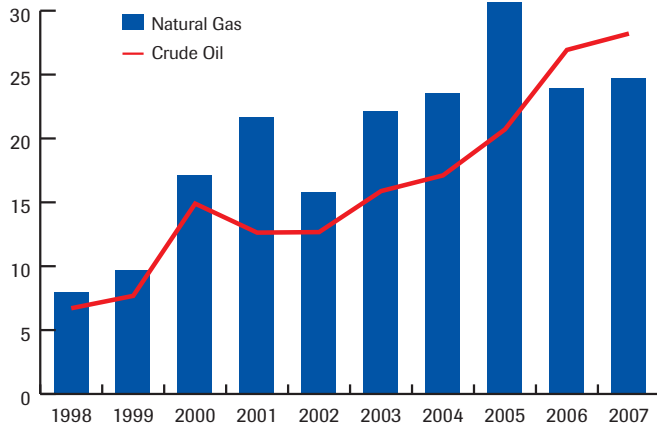


Figure 14

Exports of Natural Gas and Crude Oil from Alberta, 1998 to 2007 (\$ billions)



Source: Industry Canada, Trade Data Online.

8. Conclusions

Alberta's economy slowed down in 2007, particularly in the latter half of the year, after a prolonged boom that was unsustainable. Rapidly rising housing prices helped put an end to record levels of net interprovincial migration. The housing market has since cooled and inflationary pressures have lessened. Yet, Alberta continues to be a leader among provinces in terms of employment growth. While activity in the conventional oil and gas sector is down considerably compared to 2005 and 2006, business investment related to the oil sands will continue to be an important driver of the provincial economy. With oil climbing above US\$130 per barrel and natural gas looking better than it has in the past two years, energy prices so far in 2008 are certainly supportive of continued economic growth.

The Canada West Foundation is forecasting real GDP growth of 3.1% for Alberta in 2008 and 3.2% for 2009. Although the downside risks to this forecast are more pronounced than in past years, Alberta is in a good position to retain its status as one of Canada's top performing provincial economies. ■

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A dynamic and prosperous West in a strong Canada.

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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, the Canada West Foundation was created under letters patent on December 31, 1970. Since that time, the 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.

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