Firing on (Almost) all Cylinders

Alberta's Economic Profile and Forecast

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Canada West Foundation

This report is part of the ongoing work of the Canada West Foundation on the economy of western Canada. The next province-specific report will be on the economy of British Columbia and will be published in July 2005 followed by a reports on Manitoba in October 2005 and Saskatchewan in January 2006. For more information, please contact Canada West Foundation Chief Economist Todd Hirsch (Hirsch@cwf.ca). Cover photo by Robert Roach.

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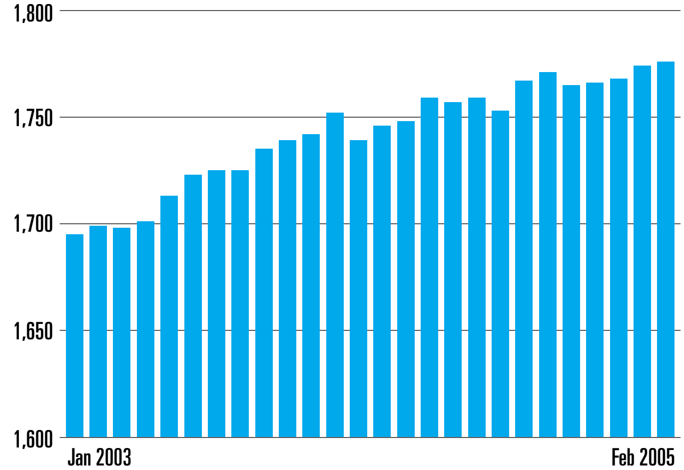
INTRODUCTION

It is difficult to find anything but optimism in Alberta's economy in the spring of 2005. And for all of the areas that are doing extremely well – construction, manufacturing, services, and public finance to name a few – most of the strength can be traced back to one factor: a strong energy sector.

The gains in the energy sector are being sparked by high prices for oil and natural gas. As of the end of March 2005, crude oil hovers above $55 US – record highs in nominal dollar terms. Natural gas, from which the provincial government generates the vast majority of its natural resource royalty income, is also at relatively high levels. Oil and natural gas, including the northern oil sands, are currently the main drivers of total investment, exports, and construction activity in the province.

But other areas of the provincial economy are also doing well. Manufacturing in the province was up nearly 15% in 2004. The housing market also remains very strong – near record levels – driven largely by strong employment gains and in-migration. As shown in *Figure 1,* total employment in the province has seen continued growth since early 2003. Tourism is also on the rebound, and total exports from the province surged to a new record of almost $67 billion. Topping it all off, the province's public finances are marked by a burgeoning surplus and a debt-free status – the only Canadian provincial government in this position.

FIGURE 1: Employment in Alberta
(January 2003-February 2005, in 000s)



SOURCE: Statistics Canada.

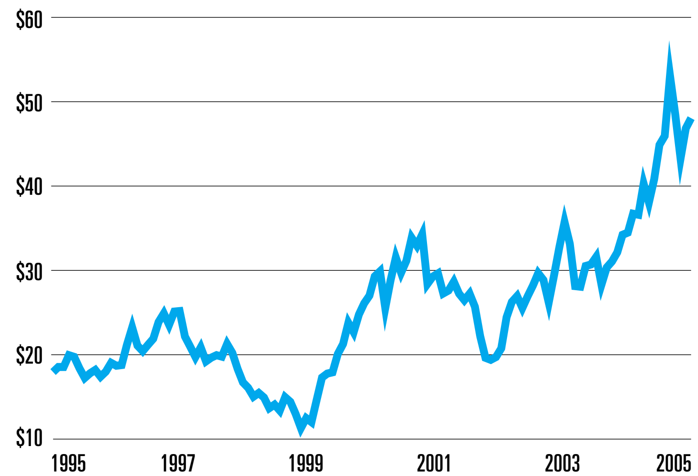
Weak spots in the economy are few and largely externally driven – out of the control of provincial policy-makers. The US border remains closed to live cattle after nearly two years, and there is little optimism that it will open any time soon. The Canadian dollar remains firmly entrenched above $US 0.80, making exports from the province less competitive and reducing the Canadian dollar price received by producers. Housing will remain strong, but mortgage prices are likely to increase by late 2005 or 2006, which will drag total starts down somewhat from their now lofty heights.

Overall, then, Alberta's economy is in very good shape. Real GDP growth in 2005 is forecast to be 3.7% in 2005, moderating only somewhat to 3.3% in 2006. In both years, Alberta will likely lead all provinces in economic growth.

ENERGY

Much of the current strength and optimism in Alberta's economy is directly related to robust activity in the provincial energy sector, particularly the current high world prices for crude oil and, to a lesser extent, natural gas *(Figure 2 and Figure 3).*

FIGURE 2: Crude Oil Prices
(Monthly Average, 1995-2005, WTI Crude, $US/Bbl.)



SOURCE: www.economagic.com.

1. Oil and Gas

Prices for crude oil in 2004 averaged $41.40 US and by mid-March of 2005, prices were trading in the range of $53-$57 US on the NYMEX. These are record high prices in nominal terms. But prices were still higher in the late 1970s and early 1980s in inflation-adjusted terms *(Figure 4).*

The Canadian reference prices for both light sweet and heavy crude loosely track the global prices set on the NYMEX with discounts for transportation, the season of the year, quality of the products, etc. Despite the current strength of the Canadian dollar, the prices received for Canadian crude oil have remained very strong.

Natural gas prices have also been rising lately on the strength of crude oil prices – the two commodities are substitutes in some applications. The *AECO* daily spot price (the widely-tracked benchmark Alberta price) has been moving in the range of $6-$7 ($CDN) in early 2005.

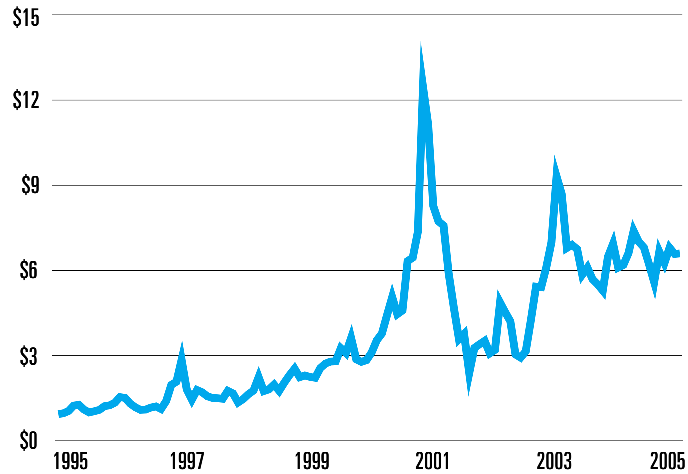
The combined effects of high oil prices and high natural gas prices have created an extremely favourable economic environment in the province. The *Petroleum Services Association of Canada* – the national trade association representing the service, supply and manufacturing sectors within the upstream petroleum industry – is forecasting 18,625 gas and oil wells to be drilled in Alberta this year, a 6% increase from last year and a new record high.

2. Oil Sands

Nowhere in the province have high oil prices been the source of more optimism than in the massive oil sands projects. After dipping slightly in 2004, capital investment in the oil sands is expected to rise sharply in 2005. The *Canadian Association of Petroleum Producers (CAPP)* is forecasting total investment to jump from $5.8 billion in 2004 to $8.5 billion in 2005.

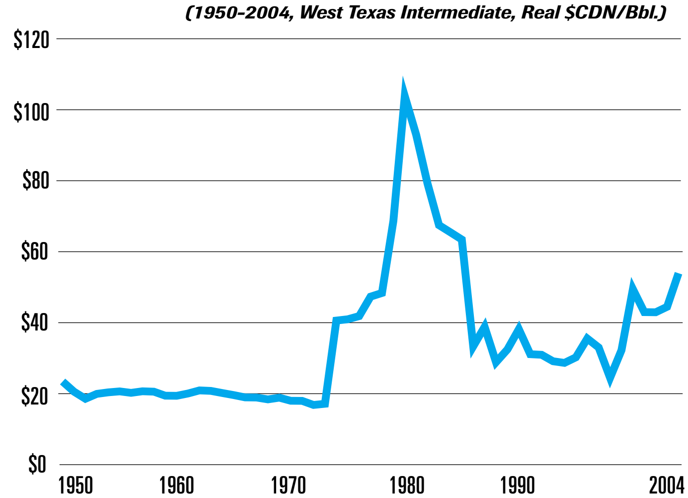
Several projects or expansions have recently been announced. In early February of 2005, *Canadian Natural Resources Ltd (CNRL)* announced it will proceed with the $10.8 billion *Horizon Oil Sands* project, the fourth surface mining operation in the Alberta oil sands. Also, *Suncor* announced in March that it will seek regulatory approval to construct and operate a third oil

FIGURE 3: Natural Gas Prices
(Monthly Average, 1995-2005, Henry Hub, $US/MMBtu)



SOURCE: Canadian Gas Association.

FIGURE 4: Crude Oil Prices in Real 2004 $CDN
(1950-2004, West Texas Intermediate, Real $CDN/Bbl.)



SOURCE: www.economagic.com.

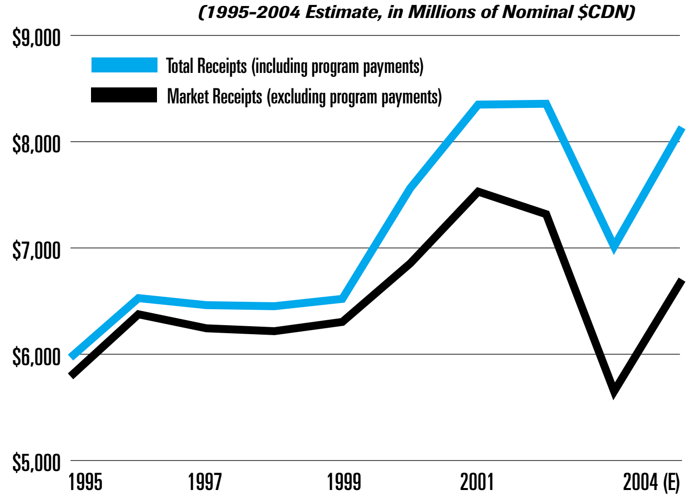
sands upgrader. The $10 billion *Voyageur* upgrader project is designed to increase the production capacity of Suncor's oil sands facility to more than half a million barrels of oil per day. Both of these projects reflect strong optimism in the oil market generally, and in Alberta's oil sands in particular.

Of constant concern to these enormous projects is the availability of skilled labour, particularly trades people. Over the past few years, cost over-runs on some projects have added billions of dollars onto capital costs. The shortages of labour have led to timeline delays and, in some cases, spiraling wage costs. The industry cites labour availability as one of the most significant barriers to their construction and expansion programs.

3. Coal

Another important segment of Alberta's energy economy is coal. Most of the coal mined in Alberta is thermal (or seam) coal. This coal is mined and used directly by electricity generation companies, although some is also used for manufacturing cement. Less common in Alberta but much more valuable currently is metallurgical coal, which is mined predominantly in the Grand Cache and Hinton region of western Alberta. This type of coal has experienced very high prices, driven by strong demand in India, China and South Korea. Metallurgical coal is used in the coking process for making steel. Prices and demand in 2005 and 2006 are expected to remain robust and extra production capacity is being planned for some Alberta mines.

FIGURE 5: Farm Receipts in Alberta
(1995-2004 Estimate, in Millions of Nominal $CDN)



SOURCE: Statistics Canada.

AGRICULTURE

Farm cash receipts in Alberta rebounded in 2004 to just over $8.1 billion, largely due to better crop conditions in that year and higher than average crop yields *(Figure 5).* Total market receipts – the amount received for farm products excluding program payments from governments – was still quite low in 2004 at $6.7 billion. A record $1.4 billion was paid out to farmers in direct program payments, largely reflecting aid to ranchers suffering from the closed US border to cattle exports.

1. Livestock

The number one issue affecting agriculture in the province has clearly been the impact of the BSE crisis and the continued US border closure to live cattle. Since the export prohibition was imposed in the spring of 2003, the Canadian beef industry has lost some $7 billion in economic activity, much of this in Alberta.

If there is an upside to the border being closed to live cattle and calves, it is the fact that meat packing and processing in Alberta has surged in 2004 and 2005. The US border was partially opened to cuts of fresh and frozen beef in 2004. As a result, cattle slaughter houses and meat packing facilities have been extremely active. *Figure 6* shows how dramatically the exports of fresh and frozen beef products have risen in 2004. *Figure 7* shows how at the same time exports of live cattle have ceased completely.

While the border was expected to be re-opened to live cattle exports on March 7, 2005, a last minute injunction by a US federal court managed to keep the border closed. It is impossible to predict when the border will re-open, and Canadian producers are now exploring other ways to keep the cattle and beef sector viable. One possible solution is to drastically increase the slaughter and packing plant capacity in Canada. However, the type of large-scale facility that would be required to meet the supply of Canadian cattle would cost millions and take up to two years to construct. Even if this option is pursued, there will be no easy or immediate solution to Alberta's cattle crisis.

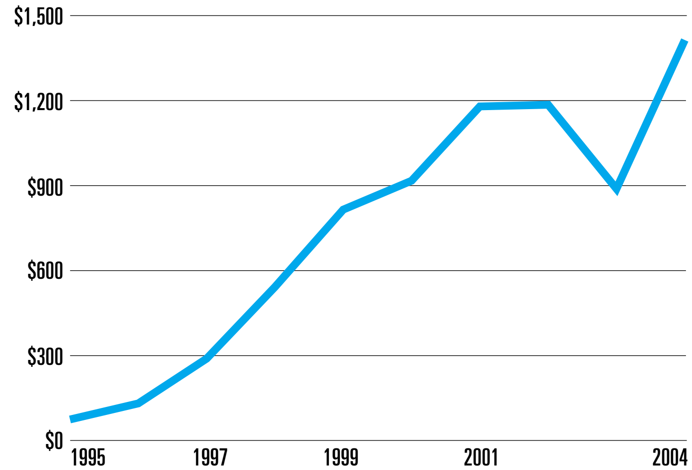
Hog farming receipts in Alberta were very strong in 2004, up 26% during the first 9 months of the year compared to 2003. Strong demand for pork in North America – driven to some degree by higher US beef prices resulting from the closed border to Canadian cattle – has been supporting hog prices. While price levels have been relatively flat in early 2005, prices are expected to rebound in the second quarter of the year.

2. Grains and Oilseeds

Wheat prices enjoyed a fairly strong run-up in 2004 based on tight global supplies *(Figure 8)*. Crop conditions in Alberta were mixed, but generally more favourable than they were in Saskatchewan, where early frost caused considerable damage. Cash receipts for wheat totaled $794 million, up 75% in 2004 over the previous year when drought severely limited production. *TD Economics* is forecasting wheat prices to remain steady in 2005 and 2006.

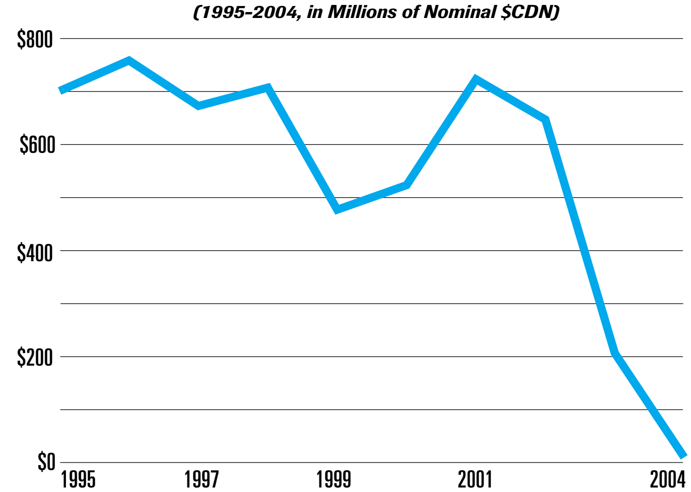
Canola cash receipts were also up in 2004 to $819 million, a gain of 44% from the previous year. Canola prices – which closely track the price of soybeans in the US – are expected to remain flat in 2005 as global production of soybeans, especially in Brazil, is forecast to increase. Some price increase is forecast for 2006.

FIGURE 6: Exports of Fresh/Frozen Beef from Alberta
(1995-2004, in Millions of Nominal $CDN)



SOURCE: Statistics Canada.

FIGURE 7: Exports of Live Cattle from Alberta
(1995-2004, in Millions of Nominal $CDN)



SOURCE: Statistics Canada.

Production for Alberta grain and oilseed farmers will depend largely on moisture, summer growing conditions, and a dry harvest – none of which can be predicted with much accuracy. However, *Agriculture and Agrifood Canada's* most recent assessment of moisture conditions (as of March 31, 2005) indicate fairly good moisture in central and northern Alberta, with drier conditions in the south. If moisture conditions continue to improve throughout the spring and summer, 2005 could see average to good crop production.

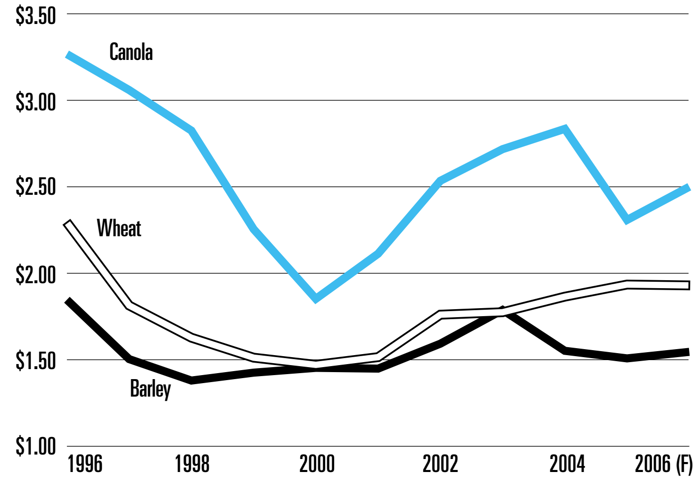
TOURISM

Tourism in the province has experienced a few difficult years of flat growth and even declines following the 9/11 terrorism attacks and the resulting slump in global travel *(Figure 9).* Alberta was also hit hard by the outbreak of SARS in 2003, which – although Alberta was unaffected by SARS itself – resulted in an international advisory against travel to Canada.

The year 2004 saw an encouraging turn-around for Alberta tourism operators. Total receipts are expected to be $4.7 billion, an increase of about 7% from the previous year. Barring other unforeseen events that would restrict tourism (e.g., another terrorist attack, SARS, forest fires, etc.), tourism should continue to strengthen in Alberta this year and next. One of the largest threats to tourism could come in the form of high gasoline and jet fuel prices, both of which will add to the cost of travel. This could hurt the "rubber tire" traffic from the US. On the up-side of this factor, more close-by residents in Alberta and neighbouring provinces may opt to spend holiday time in Alberta rather than in more distant destinations.

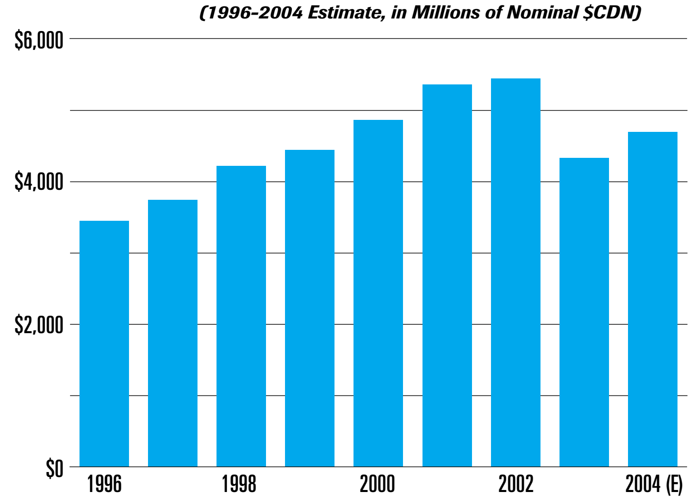
This spring, the provincial government introduced legislation to reduce the hotel room tax from 5% to 4% (and to rename it the tourism levy). This will save visitors to the province an estimated $11 million annually. But more importantly than the cost savings for guests are the measures taken to promote tourism in the province. The legislation will direct the proceeds from the tourism levy – estimated at $42 million – to tourism marketing and development. This is an increase of 75% in the annual funding for marketing Alberta, and it should have a noticeable effect on tourism. The provincial tourism industry is expecting increases in the range of 3-4% in 2005 and 2006.

FIGURE 8: Crop Prices
(1996-2006 Forecast, in Nominal $US/Tonne)



SOURCE: Wheat: Canadian Wheat Board (historic). Barley and Canola: Canadian Grain Commission (historic). Pricing Units for Wheat: Can., St. Lawr., CWRS, 13.5%, $US/tonne. Pricing Units for Canola: WCE cash, 1 Can. Vancouver, $US/tonne. Pricing Units for Barley: Malting, CWB, Spec. Select 6R, Thunder Bay, $US/tonne. Years 2005 and 2006 are *TD Economics* forecasts.

FIGURE 9: Tourism Receipts in Alberta
(1996-2004 Estimate, in Millions of Nominal $CDN)



SOURCE: Alberta Economic Development. 2004 is preliminary estimate.

MANUFACTURING

Total manufacturing rose strongly in Alberta in 2004 to a value of $52.6 billion, up 14.6% from 2003 *(Figure 10)*. Three areas account for the majority of the province's manufacturing shipments: refined petroleum products, chemicals, and agri-food products.

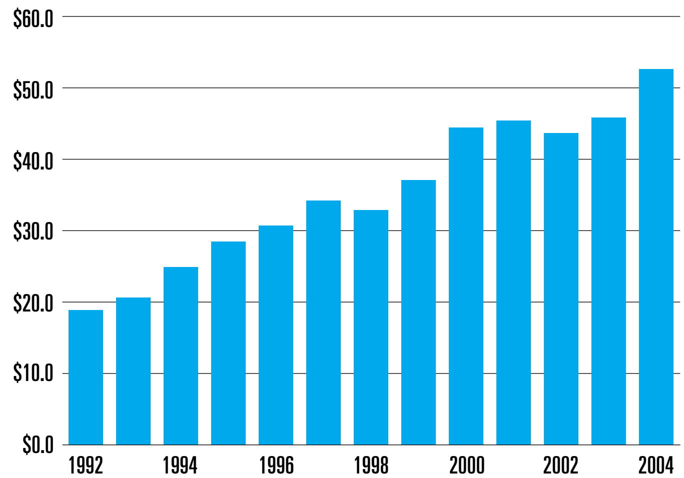
Refined petroleum, coal and other value-added petroleum products jumped 21% last year largely on expanded refinery capacity, high commodity prices, and strong demand in the US. Food and beverage manufacturing also increased 14% in 2004. Chemical products, particularly ethylene and linear low-density polyethylene (i.e., plastic in pellet form sold to manufacturers of plastic bags, bottles, etc.) rose by 16% in 2004. Polyethylene manufacturing in Alberta has been increasing as a result of plant expansions at the NOVA Joffrey facility in the early 2000s, as well as the new Dow Chemical ethylene cracker at Fort Saskatchewan. These recently completed projects and expansions have increased Alberta's ethylene and derivatives capacity by over 40%.

While wood products account for a smaller component of manufacturing in Alberta (7% of the total), it was the fastest growing segment with a year-over-year increase of nearly 27%. This sharp run-up in shipments was driven almost entirely by value, although volume was up slightly as well. Global commodity prices for forest products, particularly for lumber, were very strong in 2004. In Alberta, the wood products manufacturing sector is largely lumber (47%) followed by pulp and paper product (30%) panel board, plywood and OSB (19%), and secondary manufacturing such as wooden boxes and palettes (5%).

Looking forward to 2005 and 2006, manufacturing in Alberta should continue to expand, albeit at perhaps a somewhat slower pace. Continued strong demand from the US and China, a healthy domestic market, and strong commodity prices are likely to support both the volume and value of Alberta's industrial manufactured items (plastics, jet and automotive fuels, panel board, and oriented strand board). Agri-food items such as packaged beef and pork will continue to do well as exports to the US, particularly with the border remaining closed to live cattle exports.

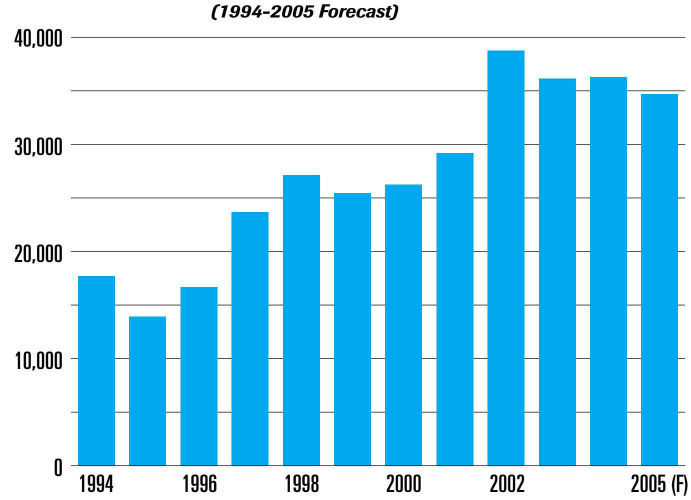
Alberta's wood products manufacturing sector has invested heavily in efficiency improvements, driven primarily by the softwood lumber trade dispute with the US. This will bode well for the industry in 2005 and 2006, although increases in shipments will again depend on global prices remaining firm.

FIGURE 10: Manufacturing Shipments From Alberta
(1992-2004)



SOURCE: Statistics Canada.

FIGURE 11: Housing Starts in Alberta
(1994-2005 Forecast)



SOURCE: Canada Mortgage and Housing Corporation (CMHC). 2005 is a forecast based on data for January and February of 2005.

CONSTRUCTION

Housing starts in Alberta in 2004 were maintained at fairly high levels with total starts (all areas) at 36,270 – up slightly from 2003 but down from the recent-record year in 2002 *(Figure 11).* Recent data for 2005 show that housing starts are continuing to slow somewhat. For the period January-February 2005, starts in all areas of the province are down 8.5% from the same period in 2004. However, some of this may be weather-related as January of 2005 was particularly cold.

According to *Statistics Canada's Investment Intentions for 2005,* Alberta housing construction activity in 2005 will be approximately $7.959 billion – down about 2% from 2004. But total construction activity in the province (residential, commercial, industrial, and institutional) is expected to rise to $35.194 billion in 2005. This is a gain of about $3.1 billion over 2004 (9.8%). Almost all of this $3.1 billion gain is due to an increase in oil and gas extraction, and most of this is oil sands related.

Construction in the public sector is expected to increase by $2.255 billion (18.5%) in 2005. Major transportation infrastructure projects in Calgary and Edmonton, as well as major institutional projects (mostly health care related), will boost total public investment over the next few years *(Figure 12).*

FIGURE 12: Major Infrastructure and Institutional Projects
(Ongoing and Planned Projects, 1998 to 2011)

PROJECT	TIMING	COST
Stoney Trail-Deerfoot Extension (Calgary)	2005-2007	$250 Million
Highway Twinning (Alberta-Wide)	1998-2011	$1,400 Million
Anthony Henday Drive (Edmonton)	2005-2007	$493 Million
Airport Improvements (Calgary)	1998-2007	$800 Million
Glenmore-Elbow Interchange (Calgary)	2005-2007	$99 Million
Pine Creek Wastewater Treatment Plant (Calgary)	2005-2007	$245 Million
Alberta Children's Hospital (Calgary)	2003-2006	$220 Million
South Hospital (Calgary)	2006-2009	$500 Million
Alberta Heart Institute (Edmonton)	2004-2006	$142 Million
Courthouse Centre (Calgary)	2004-2007	$300 Million
UofC Health Research Innovation Centre (Calgary)	2003-2005	$220 Million
UofA Health Research Innovation Facility (Edmonton)	2003-2006	$165 Million

SOURCE: Alberta Economic Development, Inventory of Major Alberta Projects.

EXPORTS

The value of exports from Alberta has nearly tripled over the past ten years, and in 2004 it reached a record level of $66.7 billion *(Figure 13).* This represents about 40% of the total provincial economy.

As with other growth stories in Alberta, the surge in exports is almost entirely related to high energy prices and increased volumes and values of oil and natural gas. Together, oil and natural gas account for two-thirds of all exports from the province. Adding in other petroleum-related products – such as chemicals, refined petroleum products, and coal – the percentage is higher yet.

Two export items stand out in terms of growth over the past decade. Exports of frozen or fresh cuts of beef have shot up from $80 million in 1995 to over $1.4 billion in 2004. Much of this can

FIGURE 13: Exports From Alberta
(1994-2004, in Millions of Nominal $CDN)

	Crude Oil	Natural Gas	Plastics	Fresh/Frozen Beef	Live Cattle	Total
1995	$7,056	$5,135	$91	$80	$691	$27,780
1996	$8,193	$6,867	$3	$137	$748	$32,081
1997	$8,501	$7,862	$15	$294	$662	$33,686
1998	$6,714	$7,946	$7	$546	$697	$31,216
1999	$7,679	$9,665	$40	$818	$467	$34,966
2000	$14,903	$17,136	$39	$919	$513	$55,880
2001	$12,629	$21,684	$150	$1,181	$713	$57,536
2002	$12,666	$15,741	$579	$1,186	$637	$49,312
2003	$15,879	$22,148	$854	$891	$196	$57,211
2004	$20,392	$23,393	$1,234	$1,414	$0	$66,721

SOURCE: Statistics Canada.

be attributed to greater slaughter and packing facilities in the province over the past decade, and also to the US border being closed to live cattle, but open to some cuts of beef.

Exports of plastics have also increased dramatically over the same period. This has been driven by increased capacity (at both the *Dow Chemical* ethylene cracker at Fort Saskatchewan and the expansion of the *Dow/NOVA* facility at Joffrey). Exports of polymers of ethylene (i.e., plastic in the form of pellets) increased from $91 million in 1995 to over $1.2 billion in 2004.

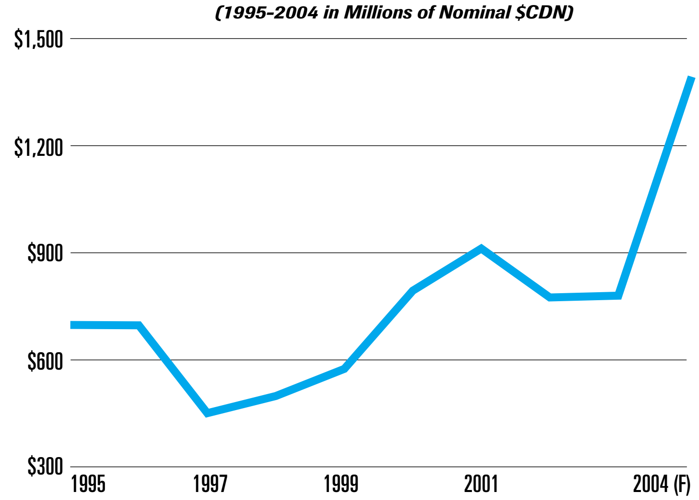
China has grown in importance as a market for Alberta exports, surging from only $683 million in 1995 to nearly $1.4 billion in 2004 *(Figure 14).* The huge Chinese economy has been expanding at a very rapid pace over the last decade, and with it has grown its consumption demand for Alberta exports such as wheat, chemical products, and pulp. China is expected to continue to grow as an export market for Alberta.

The Alberta government announced in March of 2005 a new $30-million Beef Market Development and Retention Fund to help the beef industry find more export markets and increase sales in existing ones. An additional $7 million will go towards creating commercial uses for discarded specified risk material (SRM). This is in response to the difficulties the industry has had in diversifying the export market for cuts of beef beyond the US. It is hoped that, through this initiative, Alberta beef processors will be able to increase its presence is new foreign markets, increase market share in existing markets (especially the US), and to position the industry well for entering other markets when they re-open to Canadian beef.

PROVINCIAL FINANCES

The government of Alberta is in an enviable position with respect to its finances. In 2004, the government announced that as of March 31, 2005 the province will have paid off the remaining debt and the province will then be officially debt free. This comes after decades through the 1970s and 1980s when deficits mounted, leaving the province with some $23 billion in debt. The debt elimination – years ahead of the government's original schedule – is due largely to high energy prices and the windfall of natural gas and oil royalties that have poured in as a result.

FIGURE 14: Total Exports From Alberta to China
(1995-2004 in Millions of Nominal $CDN)



SOURCE: Statistics Canada.

In its Third Quarter update to the 2004/05 provincial budget, the government estimated that natural resource revenues will total $9.628 billion – more than double what was forecast in the original budget. Investment income (primarily from the Alberta Heritage Savings Trust Fund) is forecast to be higher by $505 million and transfers from the federal government (largely for agricultural disaster relief) is forecast to be higher by $178 million.

The province will bring down the 2005/06 budget on April 13, 2005. It is expected that another large surplus will be announced as a result of continued high prices for oil and natural gas. There may be incremental reductions to taxes and increased spending for programs, especially health and education. The remainder of the surplus is likely to be directed into the *Alberta Heritage Savings Trust Fund.*

CONCLUSION

Alberta's economy is in excellent shape. High resource prices, strong employment growth, robust manufacturing activity, and solid business and personal services make this province the economic jewel of the country at the moment.

For decades, Alberta has struggled to diversify its economy away from a heavy reliance on oil and natural gas. And while the province's economy has enjoyed very strong growth in its non-energy sectors, the growth experienced in natural gas, oil, and oil sands has overshadowed the good news stories in these other sectors. In 2005, Alberta's economy is arguably less diversified than at any other point in recent history. This is especially true when one considers that much of the manufacturing and services sector gains have been in industries directly related to – and reliant on – the energy sector.

Aside from the diversification issue, trouble spots on Alberta's rosy economy are few. Agriculture will continue to struggle, particularly cattle ranching. The strong Canadian dollar is not likely to reverse its ascent, putting pressure on exporters. And rising interest rates are imminent over the next two years, which will dampen consumer spending and possibly housing starts.

Overall, however, as Alberta enters its 100th year in Confederation, it is enjoying an enviable economic expansion and leading the country in growth. ■

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