ALBERTA ECONOMIC OUTLOOK

Q3 2016

Prepared by ATB Financial, Economics & Research

Alberta Economic Outlook Q3 2016

ATB Financial's Alberta Economic Outlook is released in each quarter of the financial calendar. It is prepared by ATB's economics and research team and is designed to summarize our province's current economic landscape to give Albertans a clear idea of what the future looks like.

Key results:

- Alberta's economy is set to contract 1.9 per cent this year, following a four per cent contraction in 2015.
- The Fort McMurray fires will weigh on the province's economy this year, while rebuilding will add to GDP in 2017.
- Alberta's energy sector and related industries will continue to shed labour throughout the summer, pushing the unemployment rate above eight per cent.
- Weak economic conditions will continue to affect the retail and housing markets with improvements expected next year.
- A net outflow of interprovincial migrants over the next few quarters is expected, although Alberta's population will continue to increase.

Overview

Alberta's energy sector breathed a brief sigh of relief when oil prices reached the $US 50 mark in late May, a price last seen in October of 2015. Signs of stronger demand and falling production in the United States were two reasons why oil markets rallied back. Political and civil unrest in some OPEC countries such as Nigeria, Venezuela and Libya caused production outages which also contributed to the increase.

Still, instability continues to weigh on financial markets. Even with a moderate correction in oil prices due to falling supply and increased demand, there remains plenty of political uncertainty. Investor nervousness surrounding the Brexit result, instability in Brazil and the Middle East and the haze that looms over the US political environment has caused yo-yo movements across financial markets.

At home, the wildfire in May resulted in tens of millions of barrels in lost production and cost Alberta's economy hundreds of millions of dollars. This, coupled with a drop in investment, sliding retail sales and a weak labour market have pinned our province's economy down for another difficult year.

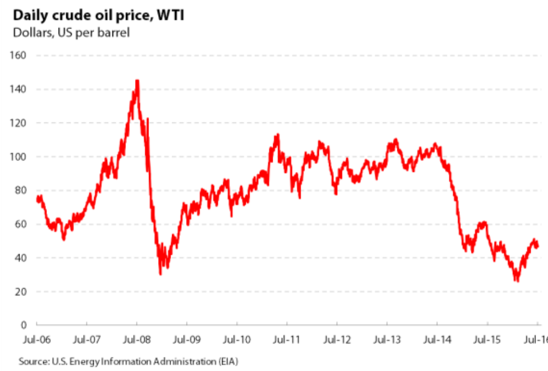
The current projection by ATB's economics and research team calls for a contraction in the real GDP of 1.9 per cent. However, barring a major global economic event later this year, a modest rebound in 2017 is likely. Stability in the energy sector and a lift resulting from the rebuilding efforts in Wood Buffalo should bring growth close to two per cent.

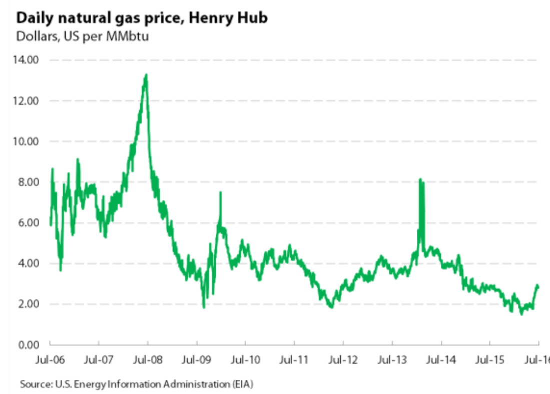
	2015	2016	2017	2018
Real GDP growth (annual % change)	-4.0	-1.9	2.0	2.3
Consumer price index (annual % change)	1.2	1.4	1.6	1.7
Unemployment rate (%)	6.0	7.8	7.6	7.1
Employment (annual % change)	1.2	-2.3	1.5	1.9
Housing starts (000s)	37.5	23.6	27.6	32.1

Oil and gas

Since our Q2 Outlook, the oil market has shown more balance with respect to supply and demand. The price of a barrel of West Texas Intermediate (WTI) broke the psychological barrier of $US 50, prompted by falling rig counts in the US, production outages in Nigeria and Venezuela, the wildfires in Alberta and signs of increased demand in Asia.

Despite the price improvements, some analysts think prices have increased too soon. There remains uncertainty about production and demand levels as well as insecurities across all financial markets. As a result, prices are likely to remain volatile throughout the summer and early fall. Oil prices should hover in the $US 45-50 range, edging slightly higher to end out the year. Prices should average $US 48 this year, approaching an average of $US 50 or higher next year.





Conventional and non-conventional investment in Alberta will continue to deteriorate in 2016. Investment in conventional methods of production could fall by another 12 to 15 per cent, while conventional investment is expected to decline by an additional 20 per cent.

That means Alberta's energy producers will continue to be challenged this summer. Even with oil between $US 45-50, continued rounds of layoffs and reductions to investment are to be expected. The pain will spill over into sectors peripheral to the petroleum industry, such as manufacturing, construction and transportation.

Fort McMurray update:

On May 3, 2016, a wildfire swept through the regional municipality of Wood Buffalo. Approximately 2,400 structures within the urban area of Fort McMurray were destroyed, marking the largest wildfire evacuation in Alberta's history. The Insurance Bureau of Canada (IBC) reports that the wildfire is by far the costliest insured natural disaster in Canadian history, estimating the insured property damage at $3.58 billion.

A month later, many residents returned to their Fort McMurray homes—some houses intact, others just debris. Unfortunately many citizens have still been unable to return. Those who have gone back have had to deal with property damage and a difficult clean up.

Many businesses inside and outside of Fort McMurray were also affected. Nearby oilsands facilities had to be evacuated and shut down over the course of the month while the fire was controlled and small businesses were forced to close at least temporarily.

It's anticipated that the month-long shut down has resulted in about 30 million barrels of foregone oil production. This has cost the industry approximately $1.6 billion in lost revenue.

Adding all the costs together amounts to the costliest Canadian disaster ever. In response, ATB Financial has lowered its projection for real GDP projection for 2016 to a contraction of 1.9 per cent.

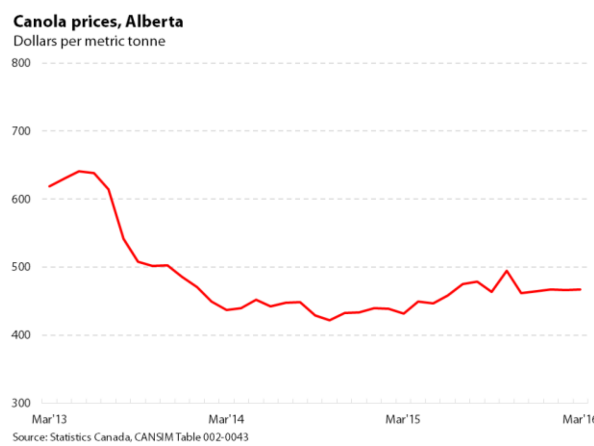
Securing energy pipelines remains a major issue and concern for the sector. However, recent developments show that progress is happening. In May, the National Energy Board (NEB) recommended that Ottawa approve the TransMountain extension project, subject to a significant number of conditions. Keystone XL has re-entered the conversation again too, despite being blocked by the US government back in November. Other major pipeline projects such as the Northern Gateway and Energy East are still in various stages of planning, although opposition remains strong.

In early May, the Canadian benchmark for natural gas fell to what may be the lowest level ever recorded, falling to around $0.80/MMBtu (AECO spot price). Much of this was prompted by the abrupt collapse of demand from oilsands producers, which are major consumers of natural gas. The stoppage of bitumen production due to the wildfires led to a sudden but temporary drop in natural gas demand.

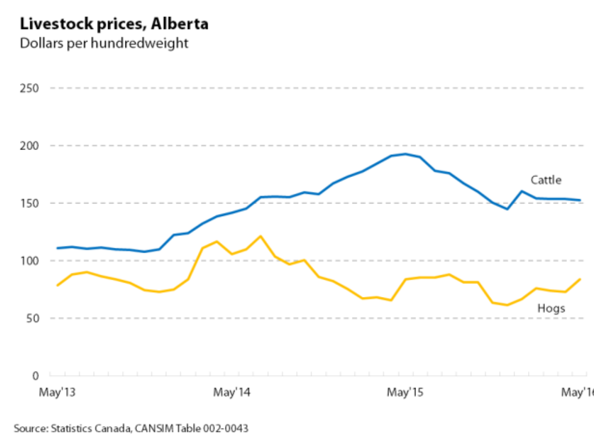
Throughout this year, AECO natural gas prices have ranged between around $C 0.80 - 2.65 MMBtu and have averaged $C 1.70 MMBtu. Henry Hub prices, the North American benchmark, have averaged $US 2.05 MMBtu and is currently floating near $US 2.70 MMBtu. Natural gas prices are likely to recover somewhat, with the Henry Hub benchmark set to settle in the $US 2.85 to 3.00 range.

Agriculture and forestry

Grain and oilseed prices remained anchored at decent levels to start the year. As of March, canola was around $470 per metric tonne, about $35 higher than the same time last year. Prices have slipped a bit recently, but remain slightly higher than last year.



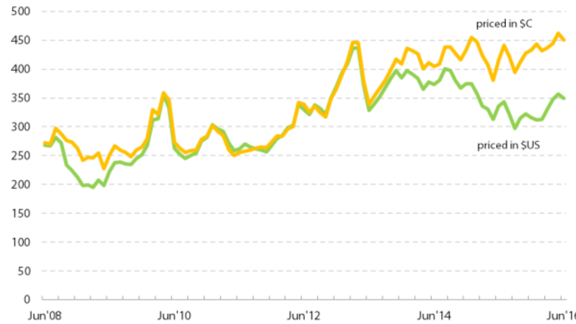
After a very dry winter, Alberta farmers welcomed some much needed moisture at the end of May. Despite the rainfall, it's still too soon to tell if 2016 will be a good year or not. Too much or too little moisture throughout the summer months could affect crops across all parts of the province. Still, assuming only an average growing season, current spot prices for canola and other types of grains and oilseed should support decent farm income in 2016.



Like canola, livestock prices have held up relatively well. It's been a little under a year since cattle prices reached their record highs of $193 per hundredweight (May 2015). Prices have fallen off these heights, but have still remained quite strong by historic standards. The most recent data available show that cattle prices in the $154 per hundredweight range. Hog prices are also stable and have continued to gain ground since the end of last year. The latest data show hog prices in the $75 per hundredweight range.

North American lumber prices*

Dollars per thousand board feet



Source: Random Lengths

* - composite price is a weighted average of 15 key framing lumber prices

Alberta's forestry sector continues to outshine many others, with lumber, pulp, paper and panelboard all important contributors. A strong housing market at home and a resurgence in the US housing market over the last couple of years has lifted lumber prices and helped boost producers' bottom lines. In June, the North American benchmark price of lumber (based on an average of 15 key framing lumber prices) was $US 350. Converted into Canadian dollars, prices are actually near record highs ($C 451).

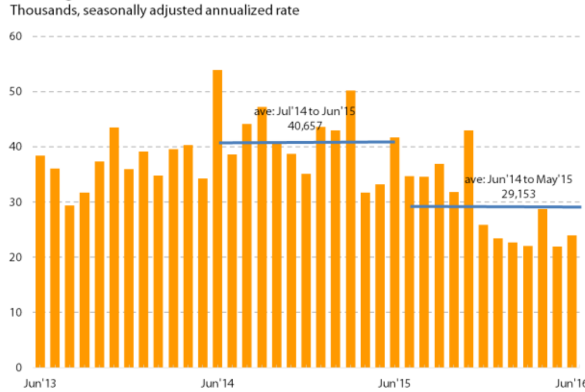
Forestry continues to be a provincial leader in diversification and environmental stewardship—not just in terms of product and market diversification, but also to investment in new industries. Other than traditional products, forestry continues to make progress in converting waste streams into green energy and exploring new opportunities in bio-products.

Still, despite the positive news, challenges lie ahead in 2016. *The Softwood Lumber Agreement* with the United States expired in October of last year. The countries remain at a standstill, with both sides prohibited from imposing duties or tariffs. Achieving a new agreement this year is critical for the future of Alberta's and Canada's forestry sector, but the political uncertainty in the US (particularly in this election year) makes it difficult to anticipate the outcome.

Construction and real estate

Housing starts, Alberta

Thousands, seasonally adjusted annualized rate



Source: CMHC, Statistics Canada CANSIM Table 027-0054

After an unexpected jump in housing starts in April, the latest housing reports suggest Alberta's homebuilders are indeed pulling back. Construction on new housing did rise by about 2,000 homes between May and June (seasonally adjusted at annualized rates), however new housing starts are actually 42 per cent lower than a year earlier.

The primary reason for the pullback is the weaker labour market and resulting consumer hesitancy. Even with favourable mortgage rates, many potential buyers may be anxious about job security and as a result are reluctant to make a major purchase.

Another factor is fewer buyers. Interprovincial out-migration from Alberta has reduced the market demand for new homes. Builders have responded by scaling back activity.

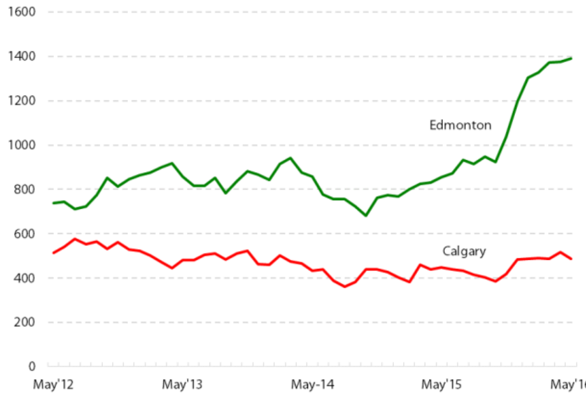
All things considered, it's likely that new housing starts will stay at their current levels. For 2016, ATB projects a 37 per cent reduction in new housing starts compared to last year, suggesting housing starts will fall to around 23,800 this year.

In May, approximately 2,400 structures in Fort McMurray were destroyed by the wildfire. The majority of these structures were houses, but some were businesses. Much of the rebuilding efforts won't begin until 2017, so the lift in housing starts are unlikely to show up this year.

Average home prices have been relatively stable in Alberta's two main cities. As of May, total prices are up 3.2 per cent year-over-year in Calgary, recovering some of the losses experienced in 2015. In Edmonton, prices have actually depreciated by about half a per cent as consumer sentiment remains tepid. Some Albertans will look for job opportunities in other provinces and fewer people are moving to Alberta from other parts of the country, so prices for all types of housing may slip somewhat lower.

Completed but unabsorbed, Alberta

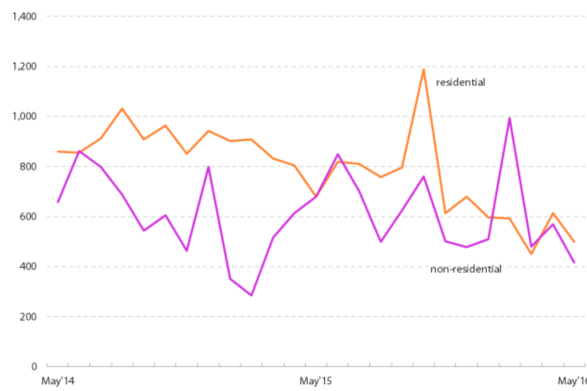
Number of unabsorbed



Source: Statistics Canada, CANSIM Table 027-0038

Building permits, Alberta

Dollars, millions



Source: Statistics Canada, CANSIM table 026-0006

As new housing is set to struggle this year, recent data show that building intentions are following a similar path. A total of $912 billion worth of building permits (adjusted for seasonality) were issued in May, a 22.5 per cent drop month-over-month. The value of total construction intentions in our province is actually down 33 per cent compared to the same point last year.

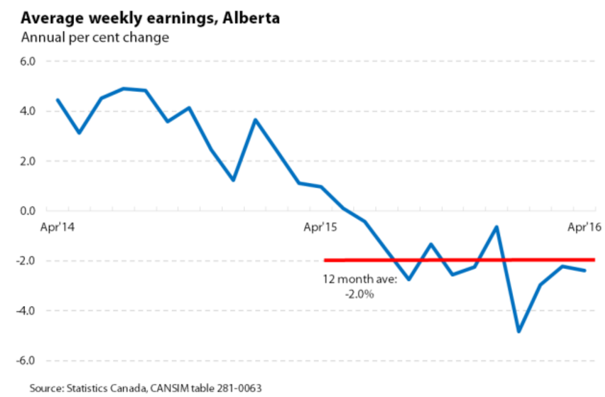
Permits for non-residential building construction are the leading cause of poor construction investment. After rising in April, permits for commercial, industrial and government and institutional projects slipped again to $417 million in April, a 26 percent decline from the previous month and 39 per cent lower than this point last year. Like the non-residential sector, the value of residential permits is down from last year as well (-27 per cent).

Labour market

Alberta shed another 1,900 jobs in June, the third month in a row of losses. The good news is that far fewer people lost their jobs last month than in April and May (a combined loss of 45,000 jobs). But even though June's drop was smaller, there was a disproportionate number of full-time job losses—over 7,000 of them, which was partially offset by a gain of some 5,000 part-time jobs.

Alberta's unemployment rate in the province ticked a tenth of a percentage point higher to 7.9 per cent. So far in 2016, the jobless rate has yet to quite reach the eight per cent mark. That could change as we move into the second half of the year, however. With West Texas Intermediate oil prices stuck below $US 50 per barrel, the petroleum industry remains challenged. That's likely to prompt more layoffs in the months ahead. Alberta's unemployment rate should crest above eight per cent over the summer or early fall, before it stabilizes towards the end of the year.

Alberta's job situation is probably even worse than what is being reported. Statistics Canada noted in its June release that due to the wildfires in northern Alberta, data were not collected for the regional municipality of Wood Buffalo. That means the jobs lost due to business closures in Fort McMurray do not factor into the 24,100 lost jobs in May.



The unemployment rate of Alberta's two largest cities has pushed higher over the course of the year. Calgary's unemployment rate was 8.3 per cent in June (three-month moving average), one of the highest rates among major Canadian cities. Edmonton's unemployment rate remained unchanged from May at 7.0 per cent.

In April, average weekly earnings in the province slipped to $1,126.62, down 2.4 per cent from a year ago and down almost four per cent from the record high of $1,171 in January of 2015.

Much of the reason for the drop in earnings is due to fewer overtime hours being worked and workers taking jobs that pay less than their previous jobs.

Retail, wholesale and manufacturing

Considering the strain on the economy, Alberta's retail sector is holding up well. After a notable drop in sales at the beginning of the year, consumer spending has stabilized. In April, retail sales increased by 2.8 per cent compared to March to $6.25 billion (seasonally adjusted) This was the first monthly increase in four months and the highest monthly total for retail activity since last November.

Since the onset of lower energy prices, retail sales have pulled back somewhat, but this is no surprise. In the coming months, there may be a boost to sales. Spending during the evacuation, clean up and rebuilding periods by those affected by the Fort McMurray wildfire could be captured in the next few retail sales reports.

Wholesale trade has been adversely affected by the downturn and has also slowed. Total sales reached \$6.18 billion (seasonally adjusted) in April, down 11.4 per cent from the previous 12 months.

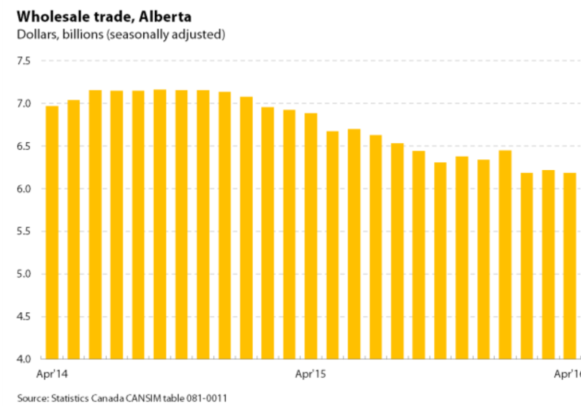
Wholesale trade is likely to continue its decline during the second half of 2016. Alberta has seen its wholesale numbers fall over the course of the year mainly because of falling optimism levels amongst all types of businesses.

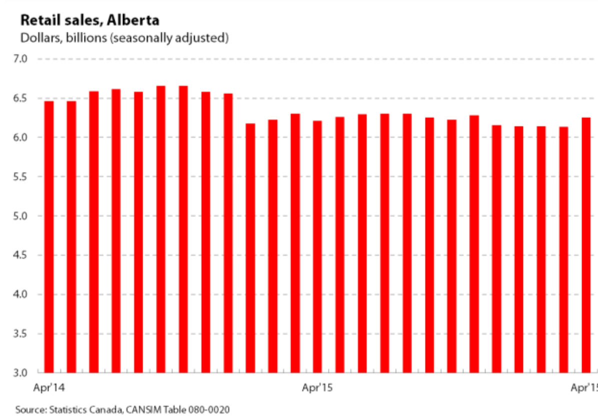
For the second consecutive month, manufacturing shipments in Alberta grew. Shipments totalled \$5.07 billion in April, up 3.5 per cent drop from March. However, compared to the same time last year shipments are still down 11 per cent.

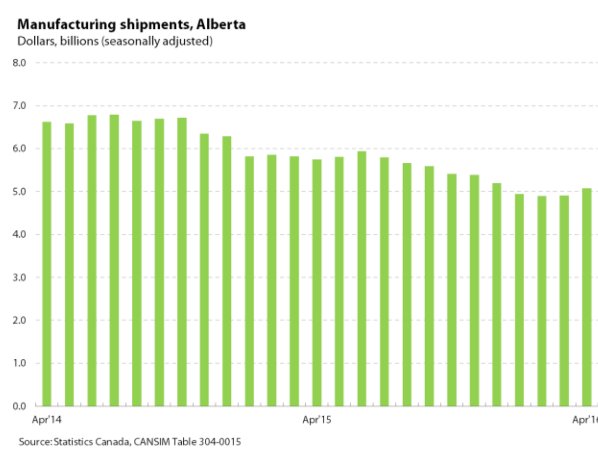
The general decline in manufacturing activity is still largely the result of contractions in the energy sector. Although shipments of petroleum and coal products gained a bit of traction in April increasing to \$1.07 billion (+19.6 per cent month-over-month), sales are still down significantly compared to a year ago (-13.3 per cent year-over-year).

Naturally, the adverse effects in the oil patch have continued to leach into manufacturers supplying the oil and gas industry. As of April, machinery (-45.8 per cent), transportation equipment (-16.8 per cent) and primary metal manufacturing (-12.2 per cent) are all still down considerably from last year's levels. Even some industries outside the energy sector like food manufacturing (-4.3 per cent) are beginning to suffer from the economic maladies.

Sales of manufactured goods are expected to stay muted throughout this year, recovering only slightly next year.



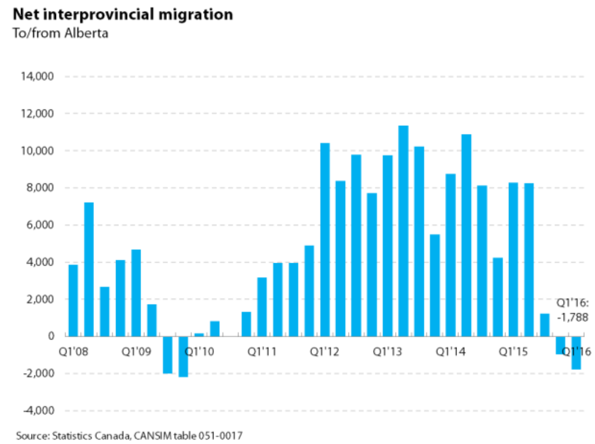




Interprovincial migration

For two consecutive quarters, Alberta has seen a net outflow of interprovincial migrants. Net out-migration was close to 1,000 in the final quarter of last year, rising to 1,800 in the first quarter of 2016. Still, that is modest compared to the net gain of more than 140,000 over the last five years.

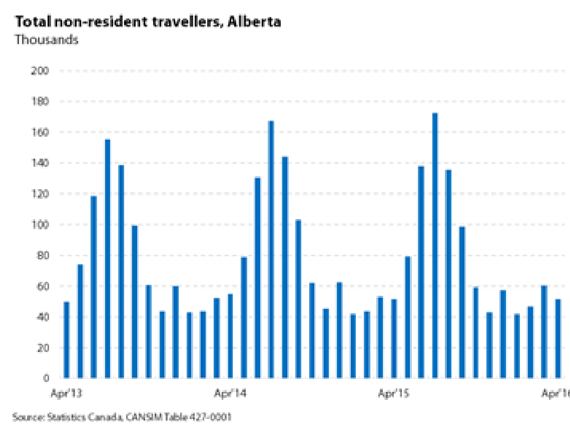
Over the second half of this year, it's likely that we will continue to see an outflow of provincial migrants. Alberta's energy sector continues to cope with low prices. This will run through other sectors in the province and continue to tighten its hold on Alberta's job market. As a result, there will be fewer job openings which discourage migration to Alberta from other provinces. In addition, better economic outlooks for Ontario and British Columbia could encourage more out-migration of job seekers from Alberta.



However, Alberta's population continues to be lifted because of international migration and natural population growth (i.e., births-minus-deaths). Total net in-migration—including both interprovincial and international—is likely to fall from around 40,000 in 2015 to less than half that in 2016. Natural population remains strongly positive mostly because of Alberta's younger age demographic.

Tourism

Last year, the value of Canada's loonie in comparison to the greenback didn't have much impact on manufacturing or other export driven sectors in the province. It did, however, affect the tourism industry greatly. This year, the benefits of a weaker loonie should continue to beef up revenues for Alberta's tourism operators.



The latest statistics show that a total of 52,000 non-resident travellers came to Alberta in May, a slight increase over the same month last year. On top of more international visitors, Calgary's airport continues to see air traffic volumes grow. In March, it welcomed about 1.3 million passengers in total, a three per cent increase from the same time last year. At the beginning of the year, Calgary greeted 10.3 per cent more international travellers and 11.5 per cent more in February compared to 2015.

Despite being somewhat less affected by the downturn in the energy sector, the Edmonton International Airport (EIA) has seen a 10 per cent reduction in air traffic. According to Alberta Tourism, slower trans-border traffic between the United States and Alberta contributed to 58 per cent of the total drop in April. International air travel fell 17.8 per cent compared to this time last year. Air travel at the EIA is expected to pick up over the summer months.

The growth in international travel to Alberta has increased demand for tourism-related industries. This is especially the case in Calgary because of its proximity to the mountains. As the popularity of Alberta tourism continues to spread, it could also encourage spending on infrastructure-related projects, such as tourism projects, hotels, restaurants and roads.

Summary

Without question, the third quarter of 2016 is going to be difficult for many Albertans and businesses in the province. More layoffs in the energy sector and the set-backs presented by the Fort McMurray disaster will add strain to an already struggling labour market. Adding to this is the heightened level of volatility in global financial markets and the questions surrounding the Brexit vote, all of which will continue to grind on optimism.

Yet while the unemployment rate may drift higher over the summer and early fall, there are signs that better days aren't too far off. Oil prices have stabilized and should rally modestly to the range of $US 55-60 by the end of the year, which will bring stability to Alberta's petroleum sector and the labour market. And barring any additional turmoil stemming from Europe (such as another major economy threatening to leave the E.U.), financial markets should calm down by the fall. In the meantime, Alberta's retail, manufacturing, housing and construction sectors will continue to be challenged.

ATB's economics and research team are forecasting a contraction of 1.9 per cent this year—the second consecutive year of recession. This will be followed by a modest recovery of 2.0 per cent growth in 2017.