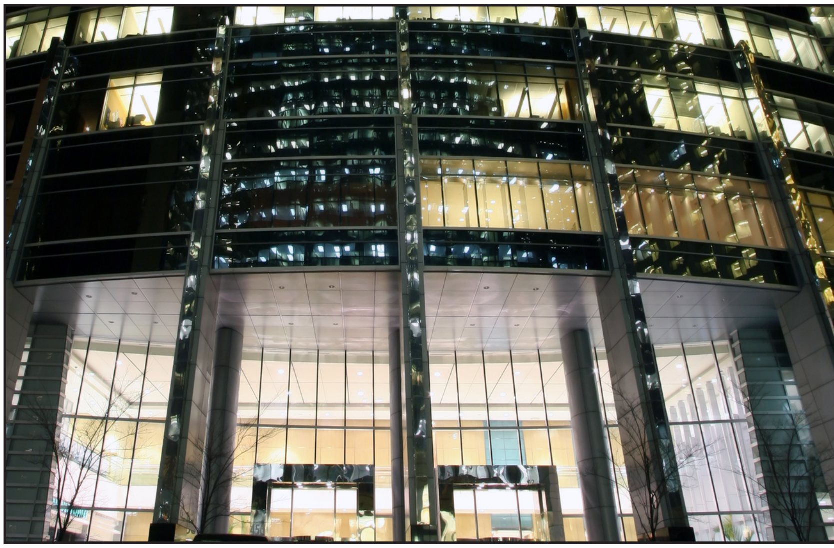

A Little Breathing Room

Alberta Economic Profile and Forecast

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Economist

June 2007

Canada West Foundation

WESTERN CANADA'S ECONOMY

Monitoring economic activity in the four western provinces is a priority for the Canada West Foundation. Four provincial economic profile and forecast reports are produced each year (one for each western province). These reports are supplemented by extensive media commentary and presentations on the western Canadian economy. To find out how you can support the Canada West Foundation's economic research, please contact Julie Johnston, Director of Fund Development, by email (johnston@cwf.ca) or phone (403.538.7355).

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ISBN 1-897423-02-8

Graphic Design and Layout by Jason Azmier

1. Overview

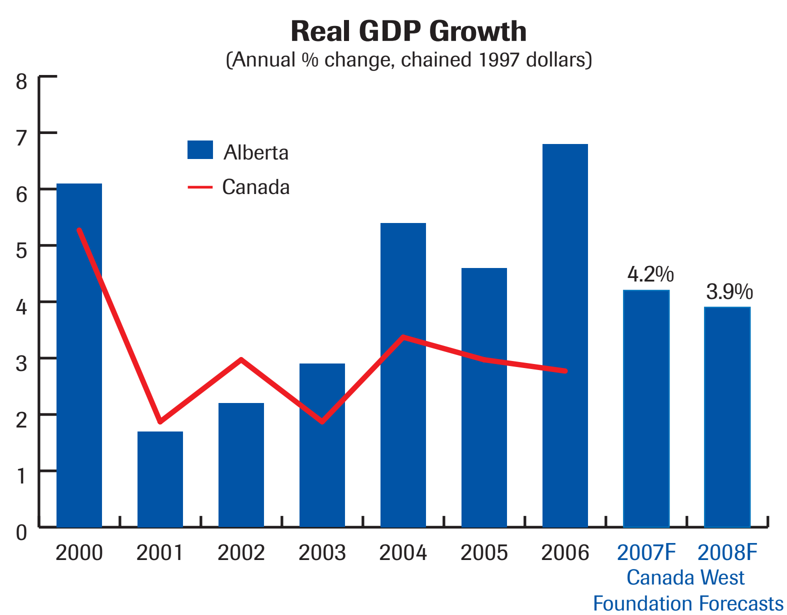
Explosive. Record breaking. Frenzied. Blistering.

These are only a sample of words that have been used to describe Alberta's recent economic performance. Alberta has led the country on almost every traditional economic metric. Economic power has shifted to the West from central Canada, and Alberta is playing a key role in this fundamental transformation of the Canadian economy.

While Alberta has outperformed the country in the past few years, its performance in 2006 was astounding (see Figure 1). Alberta's rate of growth, as measured by real GDP, more than doubled the national rate in 2006. Alberta alone accounted for 30% of Canada's economic growth—impressive for a province that has about 10% of Canada's total population.

Alberta's current dollar GDP per capita was $68,600 in 2006, compared to $43,900 for Canada as a whole. Alberta's unemployment rate in 2006 was yet again the country's lowest. The rate of job creation and the percentage increase in wages and salaries from 2005 to 2006 were both more than double the Canadian average. Annual average retail sales in 2006 were up 16.1% from 2005.

Figure 1



Source: Statistics Canada, Provincial and Territorial Economic Accounts Review: 2006 Preliminary Estimates, Catalogue no. 13-016-XIE

But, there is another word that can be applied to Alberta's growth in 2006: unsustainable.

It is highly unlikely that the province can continue growing at last year's pace. Escalating consumer prices have the ability to rein in housing activity and retail sales from the levels witnessed in 2006. Industry is running up against capacity pressures, including the pervasive shortage of labour. Labour shortages are leading to large increases in wages and salaries, which, of course, mean higher costs for businesses.

Record levels of interprovincial migration have provided a boost to the workforce. But, housing affordability has eroded substantially, both for home buyers and renters. Rental vacancy rates dropped below 1% in late 2006. These, along with the rising cost of living generally, are now genuine concerns for those considering a move to Wild Rose Country.

Construction costs continue on their upward trajectory. The non-residential building construction price index rose 21.3% in Calgary and 18.5% in Edmonton from the first quarter of 2006 to 2007. Drilling activity was on the wane in 2006 and the slowdown is expected to continue throughout 2007 (Petroleum Services Association of Canada 2007).

The rapid climb of the Canadian dollar to well over 90 cents—a 30 year high vis-à-vis the US dollar—has been largely unexpected. While the overall effect of a strong dollar on Alberta is far from straightforward, oil and gas companies will experience lower revenues and the provincial government can expect lower resource royalties if the dollar retains the strength it has gained in 2007.

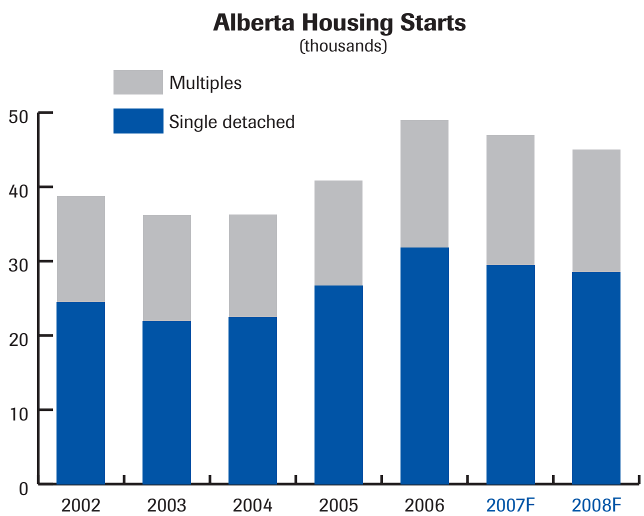
Ordinarily, economists cringe when they use the word slowdown. But in the case of Alberta, slower economic growth means something different. Besides, some easing off will provide the province a little breathing room.

The Canada West Foundation is forecasting real GDP growth of 4.2% for 2007 and 3.9% for 2008.

2. Construction, Capital Investment and Major Projects

After increases of 12.6% and 19.9% in 2005 and 2006, housing starts are expected to cool off this year and next. The Canada Mortgage and Housing Corporation forecasts that total housing starts—single detached and multiple units—will fall 4.0% in 2007 and 5.3% in 2008 (see Figure 2).

Figure 2

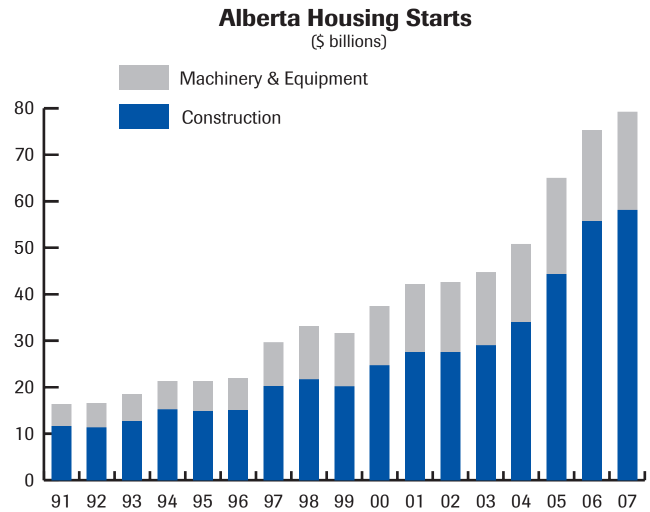


Canada Mortgage and Housing Corporation, Housing Market Outlook - Canada Edition, Second Quarter 2007

The growth rate of investment in construction and machinery and equipment should also be lower this year compared to 2006. Statistics Canada reported that investment intentions for non-residential construction and machinery and equipment will be up 5.2% in 2007. This is on the heels of increases of 13.6% in 2004, 28.0% in 2005 and 15.7% in 2006. Private and public sector investment—construction and investment in machinery and equipment—are expected to reach nearly $80 billion in 2007 (see Figure 3).

The oil and gas sector accounts for over half of all capital expenditures. Capital construction in the oil and gas sector is reported to fall 2.0% in 2007, following an increase of 24.3% in 2006.

Figure 3



Note: The value for 2006 is preliminary actual and the value for 2007 is intentions.
Source: Statistics Canada, CANSIM Table 029-0024

The Alberta government's *Inventory of Major Alberta Projects* provides a wider look at activity in the province. This inventory includes proposed and recently completed projects and 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 2007, there were over 850 major projects (valued at $5 million each or greater) planned, underway, or recently completed in Alberta (Alberta Employment, Immigration and Industry 2007b). These projects total nearly $170 billion. One-quarter of the total number of projects are infrastructure projects.

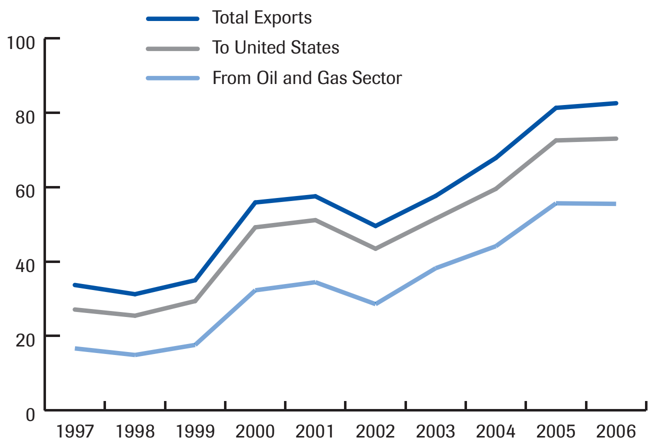
While oil sands projects account for only 6.3% of the total number of projects, they are valued at over $100 billion or 62.0% of the total value of all Alberta projects. These tend to be multi-year projects, many with proposed completion dates ranging from 2010 to 2015.

3. Exports

From 2003 to 2005, Alberta's exports abroad increased 18.0% per year on average. In 2006, the increase was much lower at 1.5%. The double digit increases prior to 2006 were largely due to high oil and gas prices. These increases happened in the face of an appreciating Canadian dollar, a factor that has dragged down the export sector in other parts of Canada.

Figure 4

International Merchandise Exports from Alberta
($ billions)



Source: Industry Canada, Trade Data Online

Two things are certain about Alberta's exports: 1) Alberta is highly dependent on trade with the US; and 2) the oil and gas sector is responsible for the majority of export activity. Alberta's reliance on the US as a export market has grown over time. Likewise, the oil and gas sector's share of total exports has increased.

4. Inflation

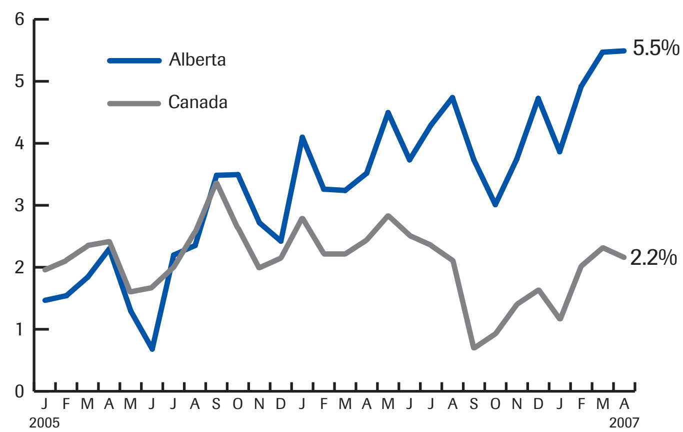
Just as Alberta has diverged from the rest of the country in terms of economic growth, its inflation rate is considerably higher than the national average (see Figure 5). The gap has been considerable since the summer of 2006.

Alberta's rising consumer price index and its distance from the national rate are due in large part to the booming housing market and escalating housing costs. Price wise, Alberta's housing market is getting ever closer to that of BC, the most expensive housing market in Canada (Canada Mortgage and Housing Corporation 2007).

As Alberta's economy backs off from the breakneck pace of growth in 2006, the gap between Alberta's rate of inflation and the national rate should lessen.

Figure 5

Consumer Price Index
(% change from the same month of the previous year)



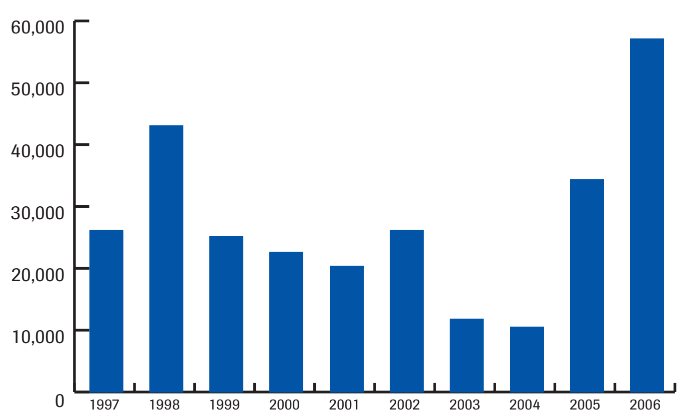
Source: Statistics Canada, CANSIM Table 326-0002

5. Population Growth

Between the 2001 and 2006 Census, Canada had the highest rate of population growth of G8 countries (Statistics Canada 2007). And, within Canada, Alberta's population grew the fastest. Alberta's population grew 10.6% between 2001 and 2006, nearly double the national rate. Alberta was home to the country's second fastest growing community (Okotoks). The population of this southern Alberta community was up an incredible 46.7%. Other communities bursting at the seams are Grande Prairie, Red Deer and Wood Buffalo. All three grew by more than 20% between 2001 and 2006.

Figure 6

Net Interprovincial Migration
(persons)



Note: The reference period is July 1 to June 30 (e.g., 2006 is July 1, 2005 to June 30, 2006)
Source: Statistics Canada, CANSIM Table 051-0018

While the increase in the national population was driven by international immigration, Alberta's was due mostly to interprovincial migration. Alberta's economic conditions made it a magnet for people from other provinces. In fact, interprovincial migration to Alberta reached a new high last year (see Figure 6).

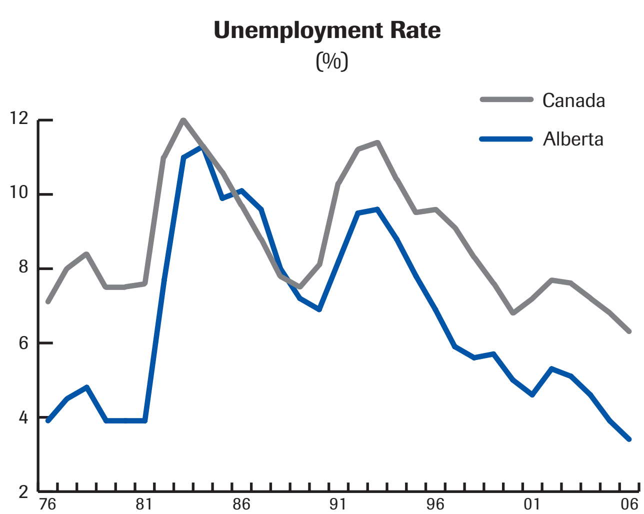
6. Alberta's Workforce

By all accounts, Alberta is operating at full employment. Employment growth has been outstanding. In 2006, 86,300 jobs were created, a 4.8% increase. Alberta was responsible for more than one-quarter of all the new jobs in Canada. The largest gains in the number of people employed occurred in public administration (13,255), mining and oil and gas extraction (13,043), and construction (12,882) (Alberta Employment, Immigration and Industry 2007). Percentage increases in these industries were 19.5%, 10.6% and 8.1% respectively.

The unemployment rate fell to a 30 year low of 3.4% and remains well below the national rate (see Figure 7).

The seemingly insatiable demand for labour continues. The shortage of labour—described by some as critical—could very well play a role in constraining Alberta's economic growth. And this issue is likely to persist. The province could face a shortfall of 109,000 workers over the next 10 years (Alberta Employment, Immigration and Industry 2006).

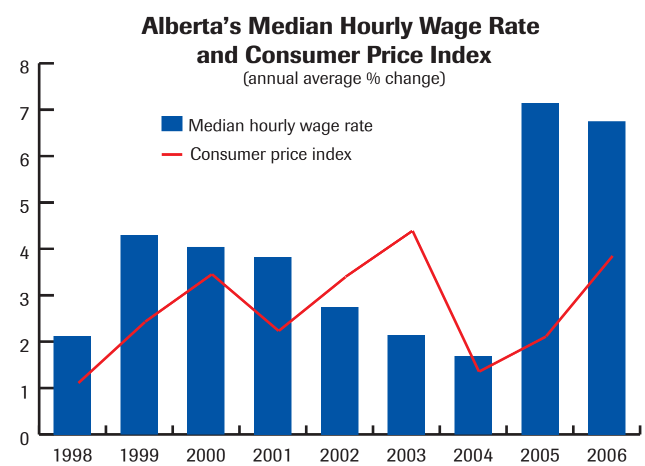
Figure 7



Source: Statistics Canada, CANSIM Table 282-0002

The basics of supply and demand are evident as wages in Alberta have gone up considerably. In the past two years the annual average increase in the median hourly wage rate outpaced the rate of inflation (see Figure 8). Albertans, not surprisingly, are the highest paid workers in the country.

Figure 8



Source: Statistics Canada, CANSIM Tables 326-0002 and 282-0069

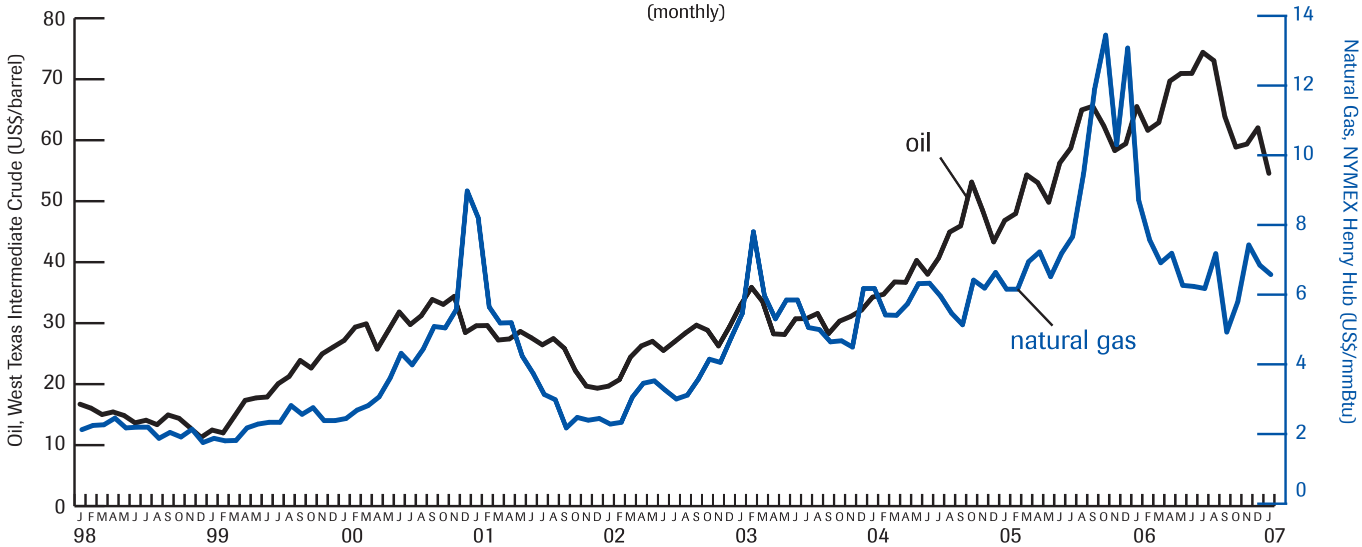
7. Oil and Gas Sector

In July of last year, the price of oil reached US$77 per barrel. By January of this year, the price slipped to US$50. Despite the downward movement in the latter part of 2006, the average price for the year was roughly 17% higher than the average for 2005. The Alberta government and many private sector forecasters are anticipating the price of oil to soften in the next few years and remain below US$60 per barrel (Alberta Finance 2007).

The price of natural gas has been very volatile in recent years. At the continental level, supply did not keep up with demand and the price rose accordingly. In 2006, natural gas prices retreated somewhat relative to the year before. The Alberta government, along with many private sector forecasters, are

Figure 9

Oil and Natural Gas Prices
(monthly)



Source: Federal Reserve Bank of St. Louis

anticipating the price of natural gas to remain at about US$7 per mmBtu over the next two years (Alberta Finance 2007).

Alberta's total production of oil is expected to rise steadily over the next few years. The oil sand's share of total oil production will increase significantly as new projects come on stream and production of conventional oil diminishes. Oil sands production reached just over one million barrels per day in 2005 and production could more than triple by 2020 (Alberta Energy 2006). On the other hand, the Petroleum Services Association of Canada expects overall drilling activity in Alberta to be down about 20% in 2007, largely due to a drop in the number of natural gas wells expected (Petroleum Services Association of Canada 2007).

While the oil and gas sector will continue to be the driver of the provincial economy, it is facing a number of challenges. Cost over-runs at major projects, notoriously volatile prices and elevated concern over the sector's impact on the environment will require the industry's attention.

8. Manufacturing Sector

The manufacturing sector as a whole experienced robust growth last year. Manufacturing output was up 7.6% in real terms in 2006 (Statistics Canada 2007b). Manufacturing industries related to the booming energy industry—oil and gas machinery, and steel and fabricated metal products manufacturers—and chemical manufacturing were the drivers behind this increase. These industries were responsible for roughly 80% of the sector's increase. Machinery manufacturing, for example, was up 17.7% in real terms.

On the other hand, industries such as pulp and paper, wood products manufacturing, and food product manufacturing displayed lackluster performance in 2006.

Growth in the oil sands bodes well for manufacturing industries such as machinery manufacturing and fabricated metal products. However, capacity pressures—especially the shortage of skilled trades people—will continue to be an issue.

9. Public Finance

The Alberta Government tabled its 2007-08 budget on April 19, 2007. With a booming economy, no outstanding provincial debt, and huge revenues in the form of non-renewable resource royalties, outside observers can be excused for thinking that it would be easy to craft a budget that could please everyone. The response to the budget from a wide variety of stakeholders—ranging from social services agencies to taxpayer watchdogs—suggests otherwise.

The government brought down a balanced budget with unprecedented levels of spending for ministry operating budgets and infrastructure. This follows a number of consecutive years of large increases. On the taxation side, there were few changes that will have a noticeable effect on the provincial economy. However, the level of spending is large enough to add fuel to the economic fire.

Many commentators, analysts and experts have expressed grave concern that recent trends in government spending are not sustainable. In fact, Lyle Oberg, Minister of Finance, admitted as much on budget day (Alberta Finance 2007b). Months before the 2007-08 budget was released, two prominent Alberta economists—Ronald Kneebone and Paul Boothe—warned that Alberta could be headed in the direction of budget deficits (*National Post* 2006).

There are a number of things on the government's horizon that create uncertainty about the future—for both provincial finances and the long-term health of the provincial economy. Oil royalties are shifting from conventional wells to the oil sands. The review of the province's oil and gas royalty system is currently underway and slated to be completed in August 2007. Albertans will have to wait and see if the government follows through on its promise of more disciplined fiscal management in future budgets. And the provincial government has yet to develop a thoughtful, long-term plan for saving its non-renewable natural resource revenue.

10. Conclusions

With growth of more than double the national rate, Alberta is in a class by itself. The province's economic strength is playing a pivotal role in the shift of economic dominance from central Canada to the West. Looking forward, Albertans can expect continuing prosperity. Ongoing strength in worldwide demand for energy resources and other commodities, high levels of construction activity and business investment, and an educated and skilled workforce will all contribute to sustained economic growth.

Public policy developments such as the implementation of the BC-Alberta Trade, Investment, and Labour Mobility Agreement (TILMA) will also contribute to a positive future. By working cooperatively with BC on the TILMA, Alberta has gone a long way in further enhancing its economic competitiveness.

However, one would be ill-advised to wager that the Alberta economy will sustain the rate of growth of 2006. Another year of real growth approaching 7% is highly unlikely. Furthermore, growth rates of this magnitude are arguably detrimental in the long-term, given the resulting strains on infrastructure, housing shortages, and environmental degradation.

Labour shortages continue to be one of the most talked about factors facing the province. Housing starts are expected to cool off and the rate of increase in construction and investment will likely slow down. Alberta's inflation rate, which exceeds the national rate by a wide margin, may give consumers pause in 2007. In late May, the Bank of Canada announced that it was leaving its key interest rate unchanged but signaled that an increase may be required in the near term to bring Canada's inflation rate back to its 2% target (Bank of Canada 2007). Construction costs continue to rise and significant cost overruns on large scale projects are not uncommon.

The oil and gas sector will continue to drive the economy forward, creating jobs and filling the provincial government's coffers. Oil sands production will more than offset anticipated declines in conventional oil production. However, drilling activity is expected to be down in 2007. Weaker natural gas production will dampen oil and gas sector output.

The Canada West Foundation is forecasting real economic growth of 4.2% for 2007 and 3.9% for 2008. CWF

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Our Vision
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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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