Alberta: 2018–19 Outlook

RECOVERY CONTINUES AS GROWTH DRIVERS ROTATE

- **Alberta real GDP growth is expected to ease to an average of about 2.5% during 2018–19 after last year's 4.9% surge; this reflects a stronger rebound than anticipated following the 2015–16 recession, and total output is now projected to surpass its 2014 peak by 2019 (chart 1).**
- **Private-sector investment and exports increasingly drive the expansion as last year's spike in Fort McMurray reconstruction-related housing expenditure fades and infrastructure spending slows.**
- **Alberta's demographics remain more conducive to growth than most other provinces, with elevated incomes and relative housing affordability bestowing it a competitive advantage amid changes in the energy sector.**

Oil production, Alberta's proverbial bread and butter, is expected to rise by 5–10% this year thanks to oil sands projects approved prior to the 2015–16 recession. The Fort Hills mine yielded first oil in January and is scheduled to reach 90% of its 194,000 barrels/day (bpd) nameplate capacity by year-end. The Phase 3 expansion project, completed late last year, added 80,000 bpd of production capacity at the Horizon mine. Output as of late June at the major Syncrude oil sands facility should be disrupted for at least five to six weeks, but we foresee a subsequent rebound that keeps Alberta's real GDP growth this year only 0.1 percentage points lower than the base case. We look for more modest oil production gains approaching 5% in 2019 as construction wraps up on several smaller in situ expansion projects.

We expect growth in oil sands investment to be subdued this year before turning moderately higher next year. No major projects are waiting in the wings for 2018, though construction progresses on a number of previously approved SAGD ventures. In 2019, the $400 mn Long Lake expansion and $440 mn Rigel projects—both with first oil scheduled for early 2020— will provide a small boost to non-conventional capital outlays. Volatility in the light-heavy oil price differential due to pipeline capacity constraints is expected to continue to depress investor sentiment through 2019. The green light for the Line 3 pipeline refurbishment is encouraging, as is full operation of the Sturgeon oil refinery, which last year contributed to Alberta's 30% share of Canada's petroleum & coal products GDP (chart 2). Yet the quashing of the Trans Mountain Pipeline Expansion's approval raises the stakes for the Keystone XL pipeline, which still faces significant opposition (see commentary, here).

By contrast, conventional oil & gas investment—which includes tight or so-called "shale drilling"—should continue to climb after the 2017 rebound exceeding 50% growth. US competition plus renewed concerns regarding the approval and viability of large energy projects encourage a move towards shorter-term, lower-cost ventures. The Duvernay Shale formation, with significant quantities of untapped marketable light resources, presents significant upside potential for conventional drilling.

Ventures under construction as part of the *Petrochemicals Diversification Program* are expected to provide further support for investment. Work has begun

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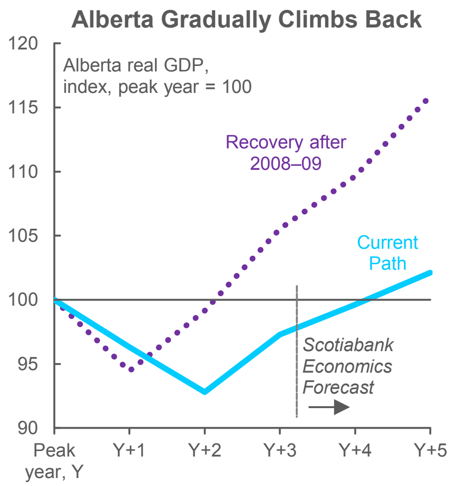
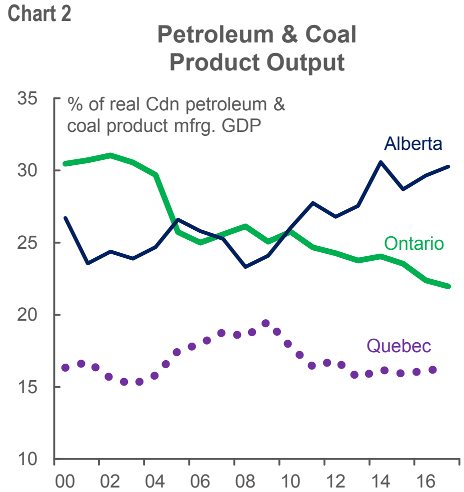
Chart 1



Sources: Scotiabank Economics, Statistics Canada.

Chart 2



Sources: Scotiabank Economics, Statistics Canada.

on the $3.5 bn Heartland Petrochemical Complex, authorized in the *Program*'s first phase and scheduled to come online in 2021. A second project, which would operate under phase 2, is undergoing front-end engineering design work and a final investment decision for the venture is anticipated in early 2019.

The outlook for non-residential, non-energy investment is dominated by weakness in industrial & commercial building that lingers following the 2015–16 recession. Most estimates indicate all-time high office vacancy rates in Calgary and Edmonton in 2017, and Alberta is the only province in which industrial & commercial building construction fell more than 10% y/y in both Q4-2017 and Q1-2018. Vacancy rates in both cities have been trending generally downward over the last 12 months but we expect the glut of office space will continue to discourage new investment in Calgary and Edmonton this year and next. A $360 mn potato processing plant in Lethbridge, with construction this year and next, offers a partial near-term offset.

Tech activity is aiding office space absorption in Alberta's largest cities. Early-stage funding of $59 mn in a software firm and $78 mn in a Cleantech startup announced over the last year should support continued sectoral growth in Calgary. In Edmonton, an artificial intelligence research division of Google will set up its first international research lab. With Toronto-Waterloo and Montreal, the city was selected to share funding for artificial intelligence research as part of the federal government's Pan-Canadian Artificial Intelligence Strategy. The Alberta Investor Tax Credit, offering a 30% to rebate for equity investments in technology-oriented Alberta businesses and extended in *Budget 2018* until FY22, will support the province's technology industry.

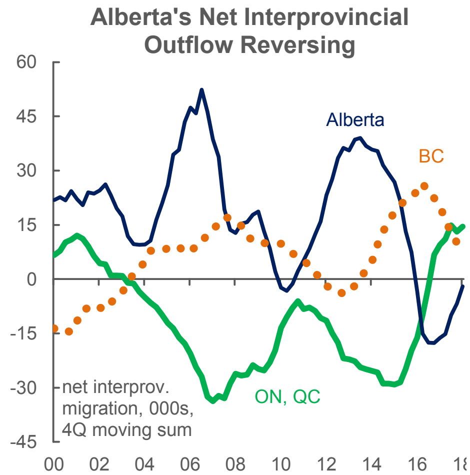
Infrastructure spending is expected to slow this year and next. With the recovery progressing at a pace faster than expected last year, capital expenditures were scaled back in *Budget 2018.* Infrastructure spending of $6.4 bn is now expected via the *Alberta Capital Plan* in FY19—a marked decrease from the $8.0 bn forecast in *Budget 2017* and more than 28% lower than FY18 outlays. Alberta still plans to eliminate the provincial deficit by FY24. Provincial public sector outlays are expected to fall again to $5.9 bn next fiscal year, with phase II of the federal government's infrastructure plan providing assistance during FY19–20.

Real energy exports are expected to realize strong gains this year before easing in 2019. External shipments of crude oil mirror the projected growth in output.

We anticipate steady rises for non-energy exports through 2019, with domestic manufacturing industries a key driver. Chemicals should benefit this year from a polyethylene plant expansion completed in 2017. Capacity constraints in Central Canada and rising M&E outlays in both Canada and the US in 2018 are expected to spur demand for exports of machinery. Forecast production declines this year for key crops such as wheat and canola do not bode well for agricultural exports, but investments announced in 2017 in oilseed processing are encouraging. As the Lethbridge plant moves into production in late 2019, we look for rising exports of processed food products.

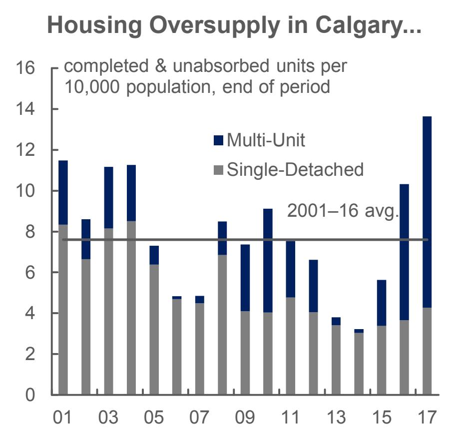
The global rise of protectionism poses risks for Alberta, as in other provinces, with the possibility of NAFTA termination leaving the agricultural sector especially vulnerable. Yet other trade agreements present opportunities. The Comprehensive and Progressive Agreement for Trans-Pacific Partnership is particularly auspicious.

Chart 3



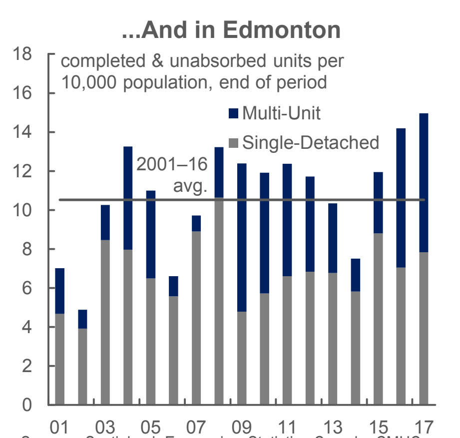
Sources: Scotiabank Economics, Statistics Canada.

Chart 4



Sources: Scotiabank Economics, Statistics Canada, CMHC.

Chart 5



Sources: Scotiabank Economics, Statistics Canada, CMHC.

The pact could take effect as early as the end of this year and should improve Alberta's trade ties to Asia, where just 7% of merchandise export receipts were bound during 2013–17, lagging the nearly 11% share for the rest of Canada.

Merchandise import volumes are forecast to shift higher in both 2018 and 2019, eroding some of the projected export gains but maintaining Alberta's trade surplus. The anticipated climb in machinery imports, a consequence of forecast upswing in investment, is the major driver.

Household spending is expected to moderate in 2018 before stabilizing in 2019. Several factors should assist consumer expenditures this year and next, but they will be dominated in 2018 by the dissipation of Fort McMurray replacement purchases that last year contributed to torrid 12.8% gains in retail sales of durable goods. Job creation is forecast to accelerate to 1.7% this year—an upward revision from early-year forecasts—and ease to 1.2% in 2019; the latter advance will lead the provinces. A minimum wage hike of over 10% in October should boost weekly earnings for payroll employees in Alberta—already the highest in Canada at $1,130 in 2017. The pace of wage growth should diminish only slightly next year given continuing skills shortages in some industries.

Healthy population gains in the 1.5% range forecast for 2017–18 and 2018–19 also pose a floor under consumer expenditures as monetary stimulus is withdrawn. The net outflow of more than 30,000 migrants to other provinces from Q3-2015 to Q2-2017 is reversing (chart 3, p.2) and should remain modestly positive through 2019 with the energy sector recovery improving Alberta's attraction. A birth rate far outpacing deaths plus greater attraction of newcomers via increases to Ottawa's immigration targets this year and next provide further support for population growth.

Alberta's age profile remains supportive of housing demand. Calgary's 24.7% and Edmonton's 24.3% shares of population aged 25–39 years old, considered the prime home-buying age bracket, are the highest of all CMAs.

Though demand fundamentals are strengthening, Alberta's housing inventory overhang should dampen residential construction and price gains. Completed and unabsorbed dwellings through July are up 4% and 7% in Edmonton and Calgary, respectively, after both cities accrued a significant housing glut during the commodity price correction (charts 4 & 5, p.2). Excess rental market supply is reflected in respective October 2017 rental vacancy rates of 6.3% and 7.0% for Calgary and Edmonton—well above the 3.0% consistent with balanced conditions. As such, we project that housing starts across Alberta will hold steady at 29,000 units this year and rise modestly to 30,000 units in 2019. Little home price or rent appreciation is anticipated until the glut of housing units is absorbed. Stricter mortgage stress tests implemented January 1st, 2018 are also discouraging marginal buyers from entering the market, further weighing on near-term prices.

Improving labour markets and limited housing affordability pressures offer a competitive advantage to Calgary and Edmonton businesses seeking to attract and retain talent. Calgary's MLS benchmark price of $430,000 in July was just 56% of the Greater Toronto (GTA) benchmark home price and 60% lower than in Greater Vancouver (GVA). The benchmark price in Edmonton sat 56% and 69% below those across the GTA and GVA, respectively. Rents in 2016 accounted for only 19.3% and 20.7% of renters' incomes on average in Calgary and Edmonton, respectively, comparing favourably to the GTA's 28% and the GVA's 29.8%.

Alberta Profile, 2017

Population, July 1	4.3 mn (11.7% of Cda)
annual % change	*1.2*
Calgary CMA	1.5 mn (34.7% of AB)
annual % change	*1.8*
Edmonton CMA	1.4 mn (32.9% of AB)
annual % change	*1.8*
Rest of Alberta	1.4 mn (32.3% of AB)
annual % change	*-0.1*
Real GDP, Chn. 2007$	315.3 bn (17.0% of Cda)
Per Capita Nom. GDP, $000	79.3 (136% of Cdn avg.)

Economic Outlook

	2010–16	16	17*	18f	19f
	'annual % change except where noted				
Alberta					
Real GDP	2.7	-3.7	4.9	2.4	2.5
Nominal GDP	3.6	-4.9	7.9	5.5	5.5
Employment	1.6	-1.6	1.0	1.7	1.2
Unemployment Rate, %	4.9	8.1	7.8	6.6	6.5
Housing Starts, 000s	32	25	29	29	30
Canada					
Real GDP	2.2	1.4	3.0	2.1	2.1
Employment	1.1	0.7	1.9	1.2	1.0

Governance

Premier	Rachel Notley, NDP (as of 2015)
Legislature	54 of 87 seats
Next Election	May 2019
Credit ratings:	
Moody's	Aa1 (N)
S&P	A+
DBRS	AA (N)

* AB real GDP growth, 2017, by industry at basic prices.
Sources: Scotiabank Economics, Statistics Canada, CMHC, Alberta Legislature, Ratings Agencies.