Economic Forecasting and Analysis

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Overview

After experiencing a modest increase in the second half of 2018, employment in Metro Edmonton eased in the first quarter of 2019. Real Gross Domestic Product (GDP) growth for 2019 is estimated to be in the range of 1.3 per cent for the city of Edmonton. This will increase to 2.6 per cent in 2020.

In spite of weak employment numbers, average weekly wages in the first quarter of 2019 increased as the number of hours worked rose and employment in some high-paying sectors, such as the energy and manufacturing sectors, continued to recover some of the losses they saw in 2016. With very low inflation, as measured by the Consumer Price Index, the rise in average weekly wages meant that consumers had real gains in their income. These gains will help sustain the consumer side of Edmonton’s economy over the course of 2019.

In 2019 and 2020, growth will persist as the economies of the province and the city continue to recover; this is assuming West Texas Intermediate (WTI, the North American benchmark oil price) holds within the $US 60 - $US 65 range. Growth rates, however, will be very modest when compared to those experienced between 2010 and 2014.

Lower growth prospects for the global economy and continuing uncertainty as to the expansion of energy export infrastructure will mean that Canadian energy prices are likely to be volatile over 2019. While prices improved in the first quarter of 2019, there is considerable downside risk with respect to energy prices that Alberta firms receive. This could have negative implications on the economic outlook for Edmonton and Alberta.
Global and North American Developments

Global economic growth slowed in the first quarter of 2019 and the expansion has become less balanced as downside risks to global growth have risen. In the United States (US), income and employment levels continued to rise. Nonetheless, US growth is expected to slow in 2019 as the impact of the tax cuts introduced in 2018 dissipates. Stronger business investment and consumer spending will underpin US growth, albeit at lower levels than seen in 2018.

The risks arising from Britain’s proposed exit from the European Union (Brexit) are now beginning to impact economic activity in the Euro Zone. As well, renewed banking issues in Italy and civil unrest in France have undercut consumer confidence and growth. Weak employment growth also negatively impacted investment and consumer spending. The uncertainty regarding Brexit negotiations and ongoing concerns about European financial institutions will limit growth in 2019 to about 1.3 per cent.

Emerging market economies are also expected to slow in 2019 with much weaker prospects for Brazil, Mexico and the Middle East than was anticipated last year. Financial and housing market conditions in China appear to have stabilized with growth expected to come in at 6.3 per cent for 2019. Improving commodity prices will contribute to better growth in other key emerging markets though country-specific factors such as tighter financial conditions, geopolitical tensions, and higher oil import bills are weighing against growth for some. As well, US interest rate increases during 2018 have stimulated outflows of capital from several emerging economies, raising concerns of a sharp reduction in investment and currency depreciation, particularly for Argentina and Turkey.

The International Monetary Fund expects the global economy to grow at 3.3 per cent in 2019 – a 0.2 percentage point reduction from the January 2019 World Economic Outlook Update report (see Figure 1). Global growth will increase marginally in 2020 at 3.6 per cent as advanced countries slow slightly and select emerging market and developing economies see more growth.¹

After solid growth in 2018 of 1.8 per cent, the Canadian economy will slow to a pace of approximately 1.2 per cent in 2019\(^2\). Canadian growth will then rise in 2020 to 2.1 per cent due to stronger business investment and exports.

Prospects for Alberta in 2019 are deteriorating, with many commentators calling for slower growth in the province as levels of activity in the energy, manufacturing and professional services sectors stagnate\(^3\). Growth is expected to be 1.4 per cent in 2019, rising to 2.2 per cent in 2020. While global growth is boosting demand for commodities, uncertainty remains around oil transportation issues in Alberta. This could further dampen investment and weigh against growth prospects for both Alberta and Edmonton over 2019 and into 2020.


\(^3\) For additional information on the outlook for the Alberta Economy see ATB Financial, Alberta Economic Outlook – March 2019 at: https://read.atb.com/economics/alberta-economic-outlook-march-2019.
Energy Prices

After bottoming out below $US 30 per barrel in February 2016, the US benchmark oil price (WTI) made a significant recovery, reaching almost $US 70 per barrel in August 2018. However, with US and Canadian oil production rising, North American oil prices have retreated from that high and are expected to hold around the $US 60 to $US 65 range for the balance of 2019.

As can be seen in Figure 2, the discount between WTI and Western Canadian Select – the Alberta benchmark price - widened significantly in late 2018 due to constraints in the North American pipeline system and maintenance outages at key refineries which process Alberta's oil. While pipeline capacity is not going to increase in the immediate future, additional shipments of oil by rail, provincially mandated production cuts, and the return to regular operations of several refiners brought the discount down. Nonetheless, it does mean that so far, Alberta oil producers have not fully benefited from the higher WTI prices seen of late. As well, Alberta natural gas prices have been depressed and very unstable as North American supplies continue to grow.

The implication for Metro Edmonton and Alberta is that investment activity in the energy sector will be muted, resulting in limited growth prospects over the medium-term particularly for manufacturing, logistics and professional services.

Figure 2 - Oil prices, $US per Barrel

Source: Bloomberg
**Interest Rates**

In response to stronger than expected economic results, the Bank of Canada (BOC) increased its policy interest rate in January, July and October of 2018. In 2014, the overnight interest rate was one per cent. By the fourth quarter of 2016, the overnight interest rate had fallen to 0.5 per cent. With the recent rate increases, the BOC’s overnight rate is now at 1.75 per cent. The BOC expects the Canadian economy to expand at a more modest pace in 2019 than previously foreseen. Consequently, short-term interest rates are unlikely to rise again in the second half of 2019 as sluggish growth fails to close the gap between actual and potential output.

Long-term interest rates are expected to continue rising, with forward markets anticipating a gradual increase in long-term rates out to 2022 (see Table 1). The US economy, in response to tax cuts and higher federal spending, expanded rapidly in 2018. The US Federal Reserve Board (FED) responded to higher growth and inflation by raising its target range for the Federal Funds rate to between 2.25 per cent and 2.5 per cent. With the US unemployment rate now well below five per cent, the rule of thumb for the level of full employment, the expectation is that the FED will raise its policy rate once more in 2019.

This means that borrowing costs for households and public institutions will rise in the years following 2019. With relatively high household debt levels, many consumers in Edmonton could be forced to reduce spending or delay major purchases such as a new home. This may result in reduced activity in the residential construction sector and some downward pressure on the value of existing homes in the medium term.
Table 1 – Canadian Interest Rates

<table>
<thead>
<tr>
<th>Actual</th>
<th>5-Year</th>
<th>10-Year</th>
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</thead>
<tbody>
<tr>
<td>2008</td>
<td>1.69</td>
<td>2.68</td>
</tr>
<tr>
<td>2009</td>
<td>2.77</td>
<td>3.61</td>
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<tr>
<td>2010</td>
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<tr>
<td>2020</td>
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<tr>
<td>2021</td>
<td>1.78</td>
<td>1.96</td>
</tr>
<tr>
<td>2022</td>
<td>1.83</td>
<td>2.03</td>
</tr>
</tbody>
</table>

Rates for December 31 of each year. Forward rates as of May 2, 2019. Source: FWCV function on Bloomberg

Current Developments in the City and Metro Edmonton

Metro Edmonton’s economy slowed in the first quarter of 2019. Inflation eased due largely to lower gasoline prices while housing starts and building permit values were lower. Each of these indicators is discussed in greater detail in the following sections. As well, business and consumer bankruptcies rose quarter-over-quarter in the fourth quarter of 2018.

Employment in Metro Edmonton

Employment in Metro Edmonton for the first quarter of 2019 was up by approximately 34,300 positions over the same period in 2018 (see Figure 3). Good gains in public administration, health care, and manufacturing were partially offset by weaker employment numbers in construction, finance and real estate, and logistics. Though employment rose year-over-year in the first quarter of 2019, the gain was about the same as labour force growth, leading to an unchanged unemployment rate of 6.8 per cent.

Employment growth in the Edmonton region has largely been in full-time positions which point to businesses’ growing confidence as they add to their workforce and increase
hours worked. Growth in average weekly wages has continued to build momentum, picking up to a very solid 2.6 per cent on a year-over-year basis in the first quarter of 2019.

For the first half of 2019, employment in Edmonton should see renewed growth in the professional services, health care and education sectors. However, the unemployment rate is unlikely to move much lower than the seven per cent range as individuals who were discouraged by less favourable employment conditions in early 2019 return to the active labour force. Growth in the working-age population, up by 2.1 per cent from March 2018 to March 2019, will be a key factor in addressing labour and skill shortages that may emerge in Edmonton as the local economy continues to recover and the labour market tightens.

**Figure 3 – Employment in Metro Edmonton**

![Employment in Metro Edmonton](source: Statistics Canada, Table 14-10-0294-01, seasonally adjusted)

**Inflation in Metro Edmonton**

Inflation, as measured by the CPI, moved lower in the first quarter of 2019 (see Figure 4) as increases in energy-related prices slowed, reducing transportation and home heating costs. Inflation is expected to pick up over the balance of 2019 to about two per cent. Moderate inflation will help preserve the real value of incomes in Metro Edmonton and support consumer spending.

Upward pressure on housing costs, particularly rents, has eased considerably over the past 18 months and will keep inflation relatively stable into 2019. Edmonton’s rental
vacancy rate was 5.3 per cent in October 2018, an improvement over seven per cent in October 2017 but still well above the 2013 low of 1.4 per cent. While this is improving housing affordability in the rental sector, it has had a negative impact on multi-family residential construction.

Figure 4 – Edmonton Metro Area’s CPI Inflation

Source: Statistics Canada, Table 18-10-0004-01, not seasonally adjusted

Building Permits

Construction intentions in the Metro Edmonton region saw a reduction in the first quarter of 2019 compared to both Q4 2018 and Q1 2018. Residential and non-residential builders in Metro Edmonton took out permits valued at $897 million in Q1 2019, representing a decline of 19.3 per cent quarter-over-quarter and 34.3 per cent year-over-year. First quarter developments in construction intentions indicate that an already anticipated pullback in construction activity may be more pronounced which may be a further drag on economic growth prospects for 2019.
Housing Starts

Total housing starts within city limits saw a reduction in the first quarter of 2019 as single-family housing production saw a significant year-over-year decline. The multi-family segment saw a year-over-year increase due to the apartment segment. However, as noted earlier, rental vacancy rates in Metro Edmonton remain elevated, undercutting the incentive for adding to the multi-family housing stock. Looking ahead, larger new home inventory (particularly for single-family homes), along with a well-supplied existing housing market are expected to slow the pace of construction for the balance of 2019.
Risks to the Economic Outlook

While growth at a moderate pace is expected to continue, there is considerable downside risk given current market conditions. For Edmonton these include:

1. Oil prices fall again in 2019 causing a severe slump in energy investment and provincial government revenues and spending. This would negatively impact Edmonton’s manufacturing, professional services, and logistics sector as well as the broader public sector including health care, education, and public administration.

2. Consumer confidence falters with concerns growing over debt, rising unemployment, and higher inflation. Edmonton’s housing sector and the consumer side of the local economy would be vulnerable to a reduction in consumer spending.

3. Conclusion of a number of major construction projects in the Edmonton region leads to further contraction in the building sector. This would result in a loss of high paying full-time jobs in Edmonton that would limit demand for housing and growth of the residential assessment base.

4. Stricter controls on carbon emissions and opposition to energy investments constrain longer term growth in the energy sector. For Edmonton, this would result in slower growth in employment and lower population growth.
5. Growing international trade conflicts limit global growth and depress commodity prices as well as reduced exports of manufactured goods and professional services. Edmonton’s employment levels, net in-migration, and consumer spending could be depressed as a result.

Summary

After a solid recovery in 2017, growth in Alberta and Edmonton moderated in 2018 and weakened further in the first quarter of 2019. Rising incomes, combined with continuing population growth, helped to steady retail and other components of both the region’s and the city’s economies.

Looking forward, growth will continue to be modest by historical standards in the province, the region, and the city. In addition, consumer confidence in an environment with higher unemployment could have negative implications on the housing market and the consumer side of the economy. Similarly, businesses could face challenges with higher input prices driven by rising import tariffs which may further constrain investment.

Inflation-adjusted GDP in the city is estimated to have grown by a solid 3.4 per cent in 2018. However, the city’s economy will slow markedly in 2019 to 1.3 per cent. This is a significant reduction from the growth rate estimated in the fall of 2018. The reduction in the forecast for 2019 is largely attributable to:

- A sharper than expected slowdown in construction activity.
- Weak employment data for the first quarter of 2019.
- A lower forecast for industrial and commercial investment in the city and the Edmonton region.

A modest rebound in growth is anticipated for 2020. This will be driven by:

- Stabilization and some growth in both the manufacturing and construction sectors as the Alberta, regional, and city economies continue on a slow but steady recovery.
- Retail and wholesale trade pick up as employment and incomes in the City and the region gradually improve.

Employment will continue to expand in 2019. However, the unemployment rate will remain relatively high as Metro Edmonton’s labour force will grow almost as quickly as the employment base. Over the medium–term, economic growth for the city and the Edmonton region will accelerate to slightly above two per cent as presented in Figure 7.
Growth for Alberta will be slightly slower than Edmonton in the medium term as a result of limited new investment in the energy sector.

For more information, a summary of quarterly economic indicators can be found here. As well, the City will be releasing shortly its Long Term Economic Outlook, 2019 to 2028. Keep an eye on this location.

Figure 7 – Real GDP Growth

Source: City of Edmonton, Conference Board of Canada