Quarterly Economic Update
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Economic Forecasting and Analysis

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Table of Contents

Overview

After experiencing a modest decline in the first quarter of 2018, employment in Metro Edmonton stabilized and began to expand over the remainder of the year. Real Gross Domestic Product (GDP) for 2018 is estimated to be in the range of 2.8 per cent for the city of Edmonton. This will decelerate slightly to 2.6 per cent in 2019.

With continuing employment growth, average weekly wages in 2018 increased as the number of hours worked rose and employment in some high-paying sectors, such as the energy and manufacturing sectors, recovered some of the losses they saw in 2016. However, the increase in average weekly wages was below the rate of inflation, as measured by the consumer price index (CPI), at several points in 2018. This acted to constrain consumer spending. Looking ahead, inflation should slow in 2019 but will remain in the 2 per cent range. Lower inflation will help preserve the real value of incomes in Metro Edmonton and support consumer spending.

In 2019, growth will continue 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 55 - $US 65 range. Growth rates, however, will be relatively modest when compared to those experienced between 2010 and 2014.

Moderate 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 late in 2018, 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

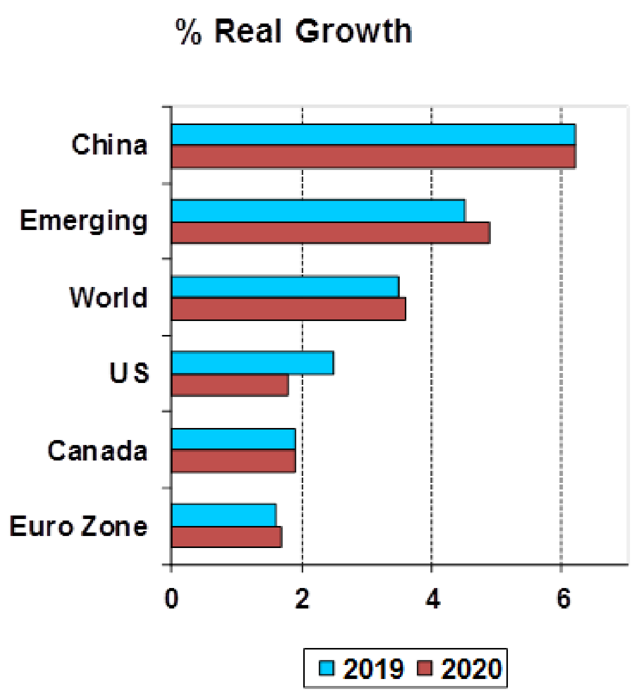
Global economic growth moved forward at a steady pace in the fourth quarter of 2018 though expansion has become less balanced and downside risks to global growth have risen. In the US, income and employment levels continued to rise. US growth is expected to slow in 2019 with continuing interest rate increases and escalating trade tensions. Stronger business investment will underpin higher US growth.

In spite of risks arising from Britain's proposed exit from the European Union (Brexit), economic activity in the Euro Zone held steady in the fourth quarter of 2018. Modest but steady employment growth helped to boost investment and consumer spending. However, uncertainty regarding Brexit negotiations and ongoing concerns about European financial institutions will limit growth in 2019 to about 1.6 per cent.

After a poor start to 2018, emerging market economies were stronger in the second quarter as China's growth improved. Financial and housing market conditions in China appear to have stabilized with growth expected to come in at 6.2 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. Rising US interest rates, however, 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 3.5 per cent in 2019 – a 0.2 percentage point reduction from the October 2018 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].

Figure 1 – Percent Real GDP Growth



Source: International Monetary Fund

[1] For additional information on developments in the global economy see the *International Monetary Fund World Economic Outlook Update, https://www.imf.org/en/Publications/WEO/Issues/2019/01/11/weo-update-january-2019.*

After solid growth in 2018 of approximately 2 per cent, the Canadian economy will slow to a more sustainable pace of approximately 1.9 per cent in 2019[2]. Canadian growth will hold at this level in 2020 as stronger business investment and exports compensate for a slowdown in housing and consumer spending.

Prospects for Alberta in 2019 are improving, with all commentators calling for continued recovery in the province as levels of activity in the energy, manufacturing and professional services sectors expand[3] . Growth is expected to be 2.1 per cent in both 2019 and 2020. While global growth is boosting demand for commodities, uncertainty around oil transportation issues in Alberta remains. This could further dampen investment and weigh against growth prospects for both Alberta and Edmonton over 2019 and into 2020.

Energy Prices

After bottoming 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 are expected to remain around the $US 55 range for the balance of 2019.

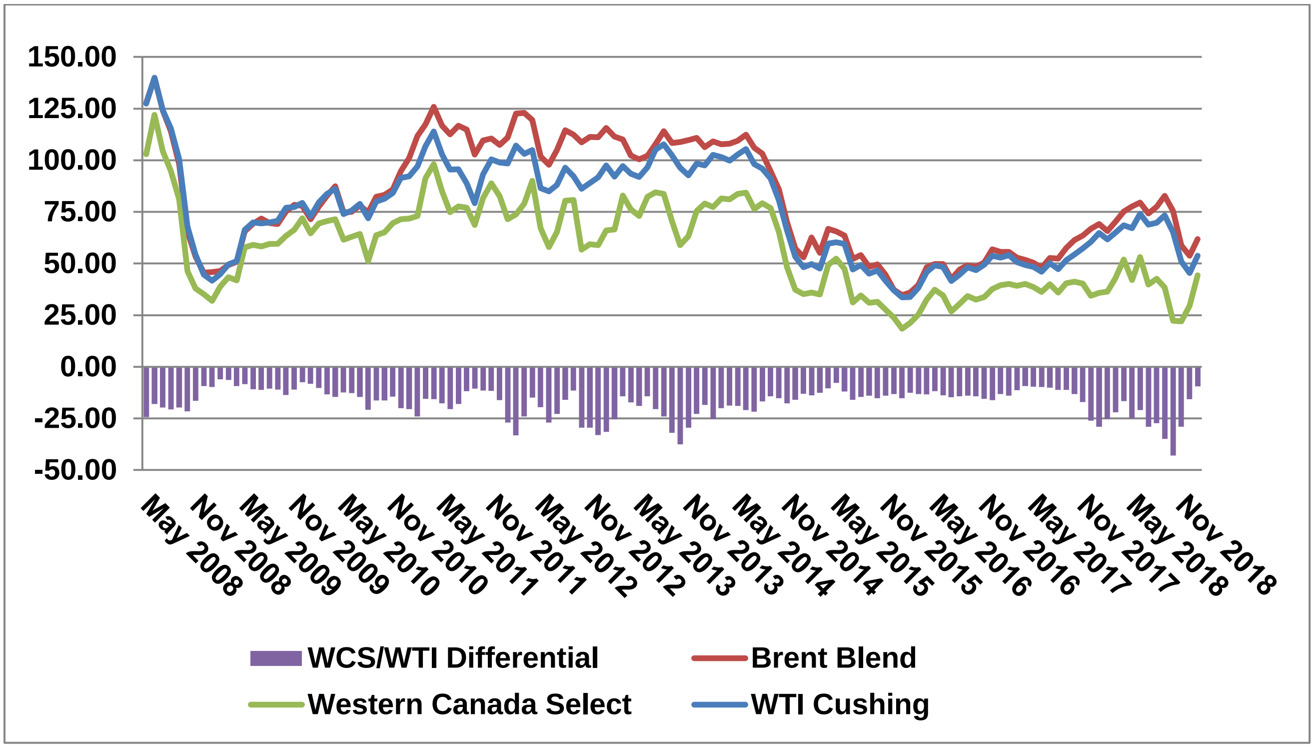
As can be seen in Figure 2, the discount between WTI and Western Canadian Select – the Alberta benchmark price - widened significantly in late 2018 due to constraints in the North American pipeline system and maintenance outages at key refineries which process Alberta's oil. While pipeline capacity is not going to increase in the near term, additional shipments of oil by rail and the return to production of several refiners suggest this wider discount should be temporary. 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.

[2] For additional information on developments in the Canadian economy see Bank of Canada, *Monetary Policy Report – January 2019* at https://www.bankofcanada.ca/2019/01/mpr-2019-01-09/

[3] For additional information on the outlook for the Alberta Economy see ATB Financial, *Alberta Economic Outlook – November 2018* at: https://read.atb.com/economics/atb-economic-outlook-nov-2018.

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 1 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 economy to expand at close to potential growth for the rest of 2019. Consequently, short-term interest rates are likely to rise again in the second half of 2019 as the economy expands and closes 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 twice more in 2019. This will drive both US and Canadian long-term rates higher as anticipated by the futures interest rates in Table 1.

This means that borrowing costs for households and public institutions will continue to rise into 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 a fall in the value of existing homes.

Table 1 – Canadian Interest Rates

		Canada Bond Yield	
		5-Year	**10-Year**
Actual	2008	1.69	2.68
	2009	2.77	3.61
	2010	2.42	3.12
	2011	1.28	1.94
	2012	1.38	1.80
	2013	1.94	2.76
	2014	1.34	1.79
	2015	0.73	1.39
	2016	1.11	1.72
	2017	1.87	2.05
	2018	1.89	1.97
Forward	2019	1.80	1.96
	2020	1.85	2.03
	2021	1.89	2.10
	2022	1.94	2.16

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

Current Developments in the City and Metro Edmonton

As noted earlier, the Metro Edmonton economy slowed in the first quarter of 2018, then stabilized and returned to growth during the latter half of 2018. Inflation was up 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 bankruptcies rose slightly in the third quarter of 2018 while consumer bankruptcies were down from Q2.

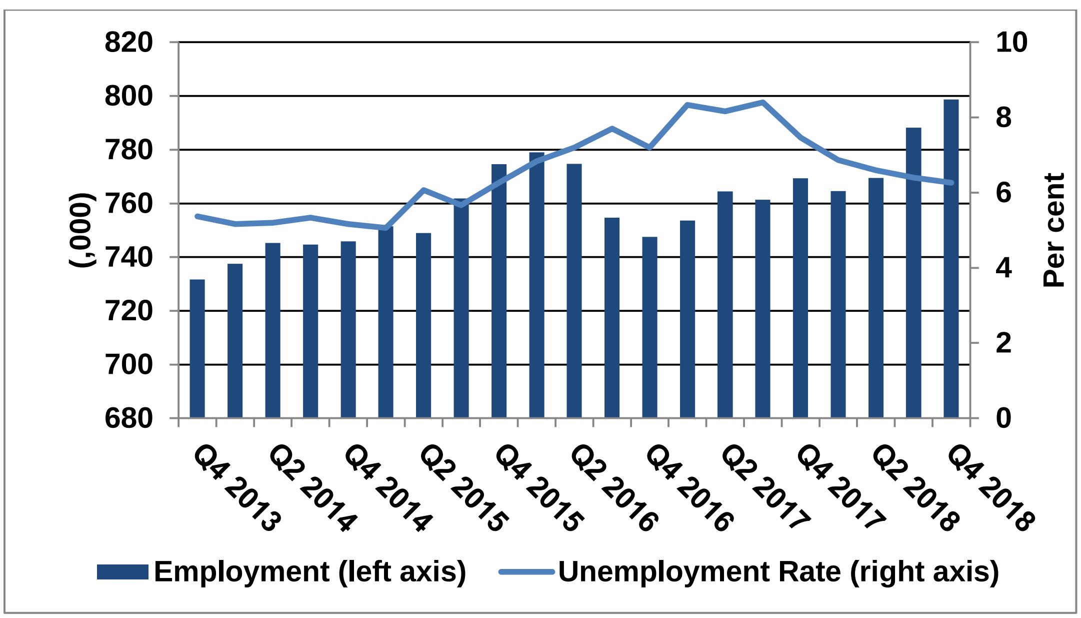
Employment in Metro Edmonton

Employment in Metro Edmonton for the fourth quarter of 2018 was up by approximately 29,300 positions over the same period in 2017, exceeding the previous peak levels reached in the first half of 2016 (see Figure 3). Good gains in educational services, public administration, and manufacturing were partially offset by weaker employment numbers in logistics, construction and wholesale and retail trade. With employment gains outpacing growth in the labour force, the unemployment rate fell from 7.5 per cent in the fourth quarter of 2017 to 6.3 per cent in the same quarter of 2018.

Job gains in Metro Edmonton continue to demonstrate that the region is recovering from the downturn in 2016. 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. As well, with employment growth concentrated in full-time positions, average weekly wages in the Metro Edmonton area were up 1.7 per cent on a year-over-year basis in the fourth quarter of 2018.

For the first quarter of 2019, employment in Metro Edmonton should see growth in the manufacturing, professional services, and financial services sector. However, the unemployment rate is unlikely to move much lower than the 6.3 per cent seen in the fourth quarter as individuals discouraged by less favourable employment conditions at the start of the year return to the active labour force. As well, with Metro Edmonton's unemployment rate now well below the provincial average of 6.7 per cent and converging on the national rate of 5.7 per cent, migration into Metro Edmonton from other parts of Alberta and Canada should increase, boosting the growth rate of the working age population and active labour force. Growth in the working age population will be a key factor in addressing labour and skill shortages that may emerge in Metro Edmonton as the local economy continues to recover and the labour market tightens.

Figure 3 – Employment in Metro Edmonton



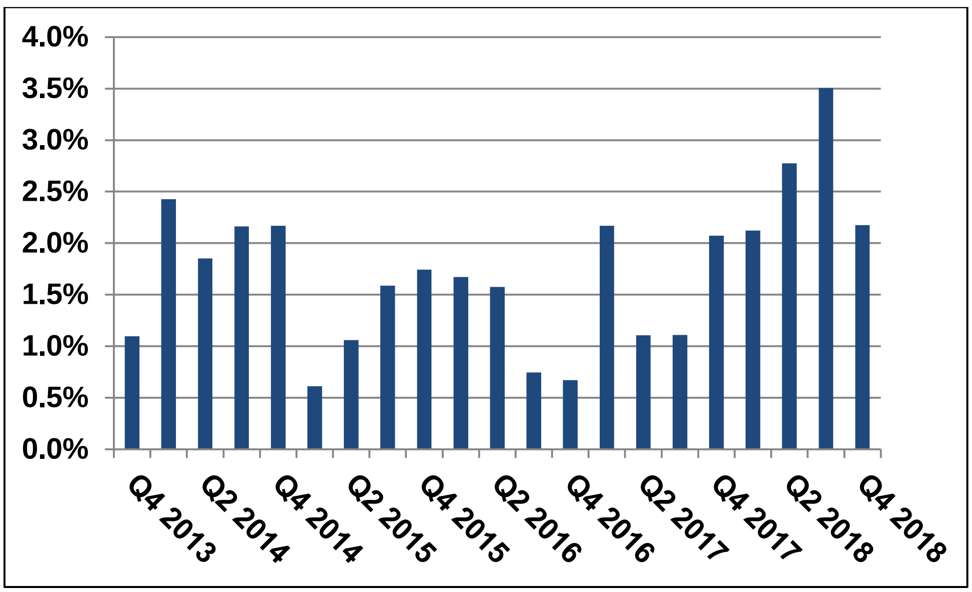
Source: Statistics Canada, Table 14-10-0294-01, seasonally adjusted

Inflation in Metro Edmonton

Inflation, as measured by the CPI, moved lower in the fourth quarter of 2018(see Figure 4) as increases in energy-related prices slowed, reducing transportation and home heating costs. Inflation should slow over the balance of 2019 but will remain above two per cent. Lower 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

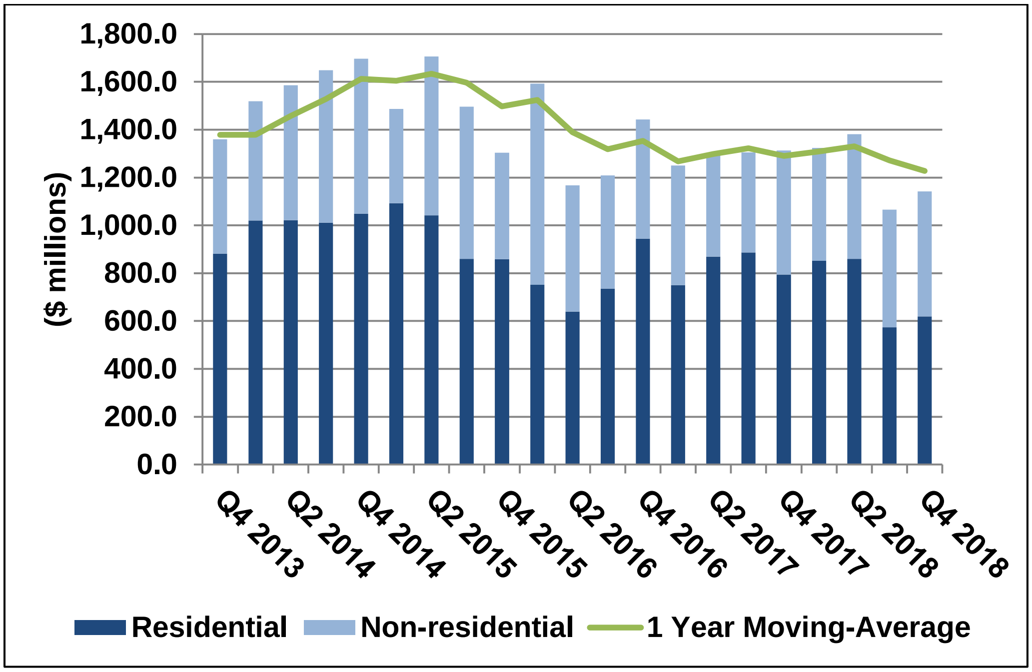


Source: Statistics Canada, Table 18-10-0004-01, not seasonally adjusted

Building Permits

Construction intentions in the Metro Edmonton region decreased in the last half of 2018. Residential and non-residential builders in the Edmonton CMA took out permits valued at slightly more than $1.1 billion combined in Q4 2018, an almost eight per cent improvement quarter-over-quarter. The improvement in construction intentions in Q4 2018 was due to increases in both residential and non-residential building permits.

Figure 5 – Edmonton Metro Area's Value of Building Permits

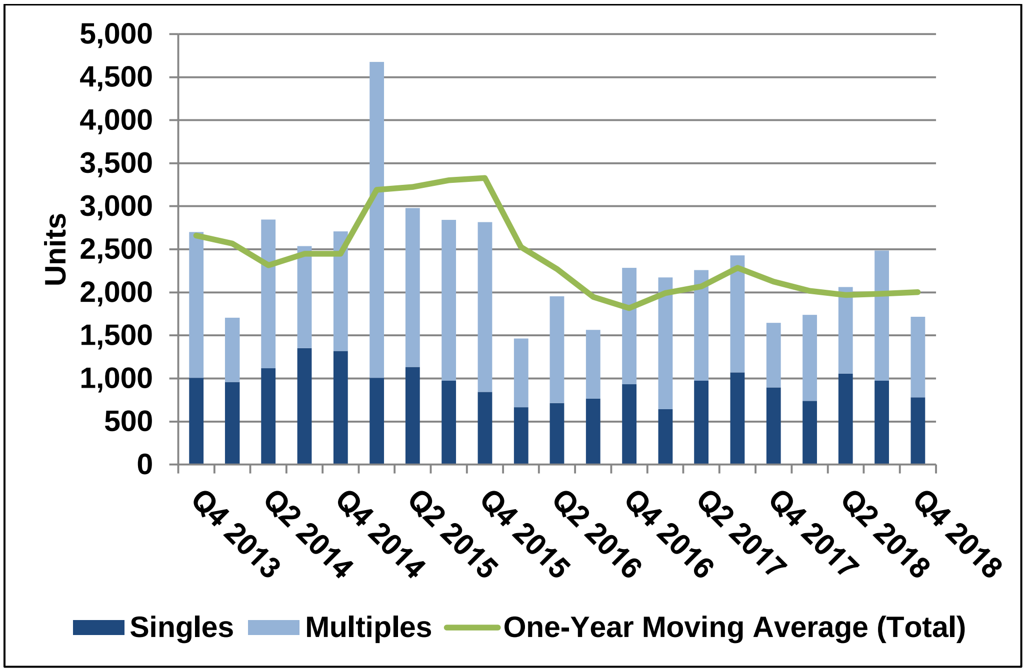


Source: Statistics Canada, Table 34-10-0066-01, seasonally adjusted

Housing Starts

After turning sharply lower in late 2017, the overall level of housing starts showed signs of improvement throughout the first three quarters of 2018 (see Figure 6). However, housing starts slowed in the fourth quarter as both multi-family and single starts eased. 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.

Figure 6 - City of Edmonton – Housing Starts



Source: Canada Mortgage and Housing Corporation, not seasonally adjusted

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 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 interest rates, and 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

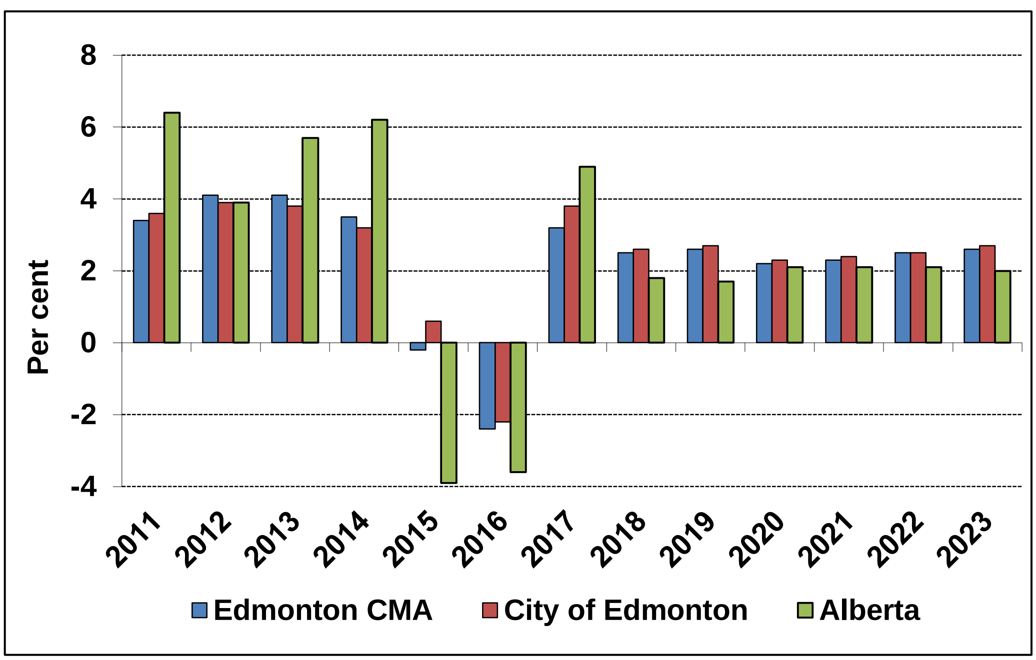
services. Edmonton's employment levels, net in-migration and consumer spending could be depressed as a result.

Summary

After a solid recovery in 2017, growth in Alberta and Edmonton moderated in 2018. Rising employment numbers, combined with continuing population growth, helped to steady retail, personal services 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 increased inflation and interest rates could have negative implications on the housing market and the consumer side of the economy. Similarly, businesses could face challenges with higher interest rates and prices which could further constrain investment. Inflation-adjusted GDP in the city is estimated to have grown by 2.8 per cent in 2018 and then is forecast to decline marginally in 2019 to 2.6 per cent.

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 approximately 3 per cent as presented in Figure 7. Growth for Alberta will be slightly slower as a result of limited new investment in the energy sector.

Figure 7 – Real GDP Growth



Source: City of Edmonton, Conference Board of Canada