

Economic Outlook
November 2016



Economic Insights



Overview

Edmonton's economy slowed in the third quarter of 2016, an indication that dramatically lower oil prices are impacting the region. Despite the sluggish economy and a GDP of -0.4%, average weekly earnings in Edmonton continued to rise during the third quarter. Population growth and the fact that employment losses occurred in mainly lower paying jobs only, helped to moderate reductions in housing, retail and personal services expenditures.

Assuming energy prices continue to improve, Edmonton's economy is expected to recover and grow by 1.8 %, modest when compared with the growth experienced between 2010 and 2014. While oil prices are expected to improve over the remainder of 2016 and into 2017, there is considerable downside risk with respect to energy prices with negative implications for the outlook for both Edmonton and Alberta. Energy prices will also be volatile as the global economy faces restrained growth and OPEC's commitment to lower production levels continues to be in doubt.

Global and North American Developments

Global economic growth moved forward at a slightly stronger pace in the second half of 2016. And after a very poor start to the year, conditions in the US improved in the third quarter and will remain relatively robust into 2017. Better export growth and stronger business investment will underpin this growth.

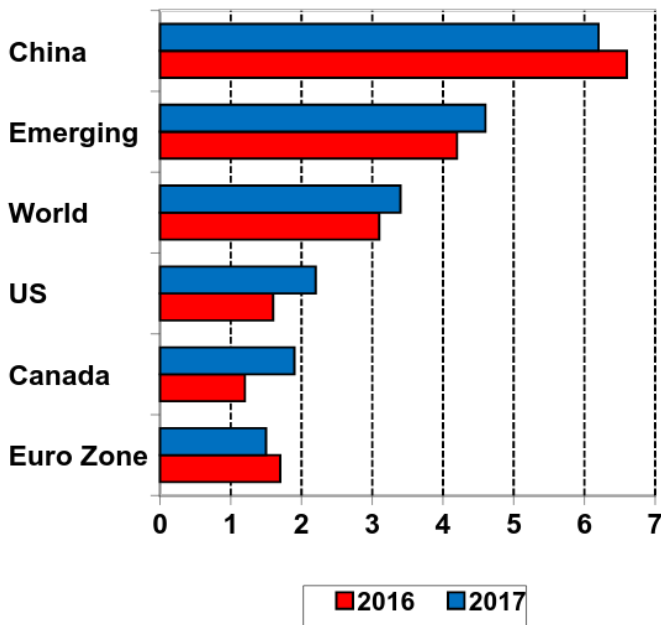
In spite of risks arising from Britain's proposed exit from the European Union (Brexit), economic activity in the Euro Zone held up well in the third quarter of 2016. Lower energy prices and modest but steady employment growth helped to boost investment and consumer spending. However, the uncertainty as Brexit negotiations are initiated in 2017 and ongoing concerns about European financial institutions will limit growth in 2017.

Emerging markets slowed during the first half of 2016 as ongoing issues in China, Brazil, South Africa and Russia limited expansion during the opening months. Financial and housing market conditions in China appear to have stabilized, suggesting growth will hold up at about 6.7% for 2016. However with continuing low commodity prices, improvement in other key emerging markets is unlikely until the latter half of 2017.

The International Monetary Fund expects the global economy to grow at 3.1% in 2016 – unchanged from the forecast provided in the June 2016 World Economic Outlook update report. (See figure 1) Global growth will rise in 2017 to 3.4% as the advanced countries accelerate and emerging economy see more robust growth.^{1\}

¹ For additional information on developments in the global economy see the *International Monetary Fund World Economic Outlook Update October 2016* at: <http://www.imf.org/external/pubs/ft/weo/2016/02/index.htm>

Figure - Percent Real GDP Growth



Source: International Monetary Fund

After a sharp downturn earlier in the year due to the fires in Fort McMurray, growth in Canada rebounded in the third quarter of 2016. Overall economic growth in 2016 is expected to be minimal though, at about 1.1%². With better conditions in the US and improved exports 2017 should be a better year for Canada with growth in the 2.2% range.

Conditions in Alberta during 2016 remained poor, with all commentators calling for a continued contraction as levels of activity in the energy, manufacturing and construction sectors continues to fall. However the rate at which GDP contracts in the province will ease from 4% recorded in 2015 to approximately 2% in 2016. Relatively modest positive growth in the 2% range is expected to return to Alberta in 2017 as oil prices recover to the US\$50 to \$55 range and rebuilding continues in Fort McMurray.³

Energy Prices

After bottoming out below US\$30 per barrel in February 2016, the US benchmark oil price (West Texas Intermediate or WTI) has made a significant recovery reaching approximately US\$50 per barrel in late October. As can be seen from Figure 2, the downturn in oil prices since

² For additional information on developments in the Canadian economy see Bank of Canada *Monetary Policy Report – October 2016* at: <http://www.bankofcanada.ca/2016/10/mpr-2016-10-19/>.

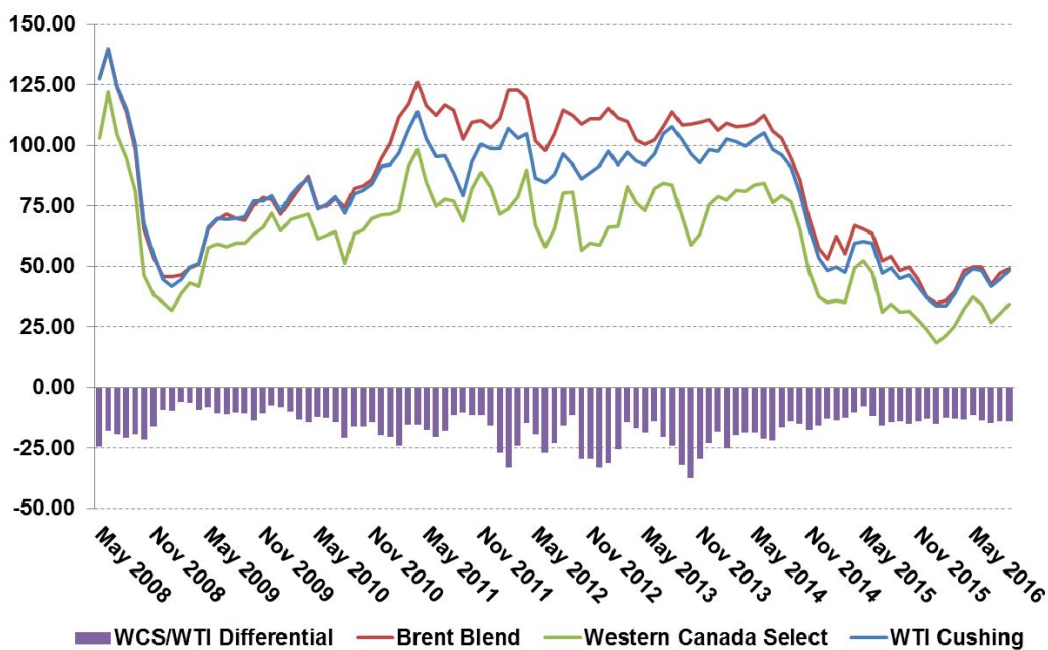
³ For additional information on the outlook for the Alberta Economy see ATB Financial Alberta Economic Outlook Q3 at: <http://www.atb.com/SiteCollectionDocuments/About/Q32016Outlook.pdf>.

mid-2014 lasted longer and the recovery has been more modest than what was seen between 2008 and 2010.

This 'lower for longer' trend reflects the difference in key factors behind lower oil prices. The collapse in 2008 was driven by a demand shock as the global economy went into recession. Prices recovered as soon as economic activity picked up. Since mid-2014, oil prices have fallen due to excess supply. Adjusting supply to meet demand is a much more difficult and time consuming process, even with the recent agreement between OPEC and other oil exporters to reduce output. Hence, while energy prices will improve, the profile of the recovery will be much longer and potentially volatile.

The implication for Edmonton and Alberta is that investment activity in the energy sector will be muted, resulting in modest growth prospects over the medium term.

Figure 2 - Oil prices \$ US per Barrel



Source: Bloomberg

Developments in the City and region

As noted above, the Edmonton economy slowed sharply in the second quarter of 2016. This reduction in activity was evident in the main economic indicators of employment, inflation, housing starts and building permits. Each of these is discussed in greater detail in the following sections. The appendix provides data for a wider variety of indicators.

Employment in Metro Edmonton

Employment in the Edmonton Census Metropolitan Area for the third quarter of 2016 was down year-over-year with particularly sharp losses in construction and manufacturing (see Figure 3). Good job gains in retail, public administration and education only partially offset these losses. As a result, Edmonton's unemployment rate stood at 6.8% in November 2016.

To date, the reduction in employment experienced in Edmonton has not impacted average wages and salaries. However, if job losses continue, higher levels of unemployment will begin to depress wages and further undercut consumer spending. At 6.8% Edmonton's unemployment rate is now slightly above the national average of 6.7%. This will reduce net migration as individuals pursue employment opportunities outside of Alberta. However international and intra-provincial migration along with natural population growth will result in slow but steady population increases for Edmonton.

Lower employment levels have led to rising vacancy rates for both industrial and commercial space in the Edmonton region. Industrial vacancy across the Edmonton region stood at 5% in the third quarter up from the 1% to 2% rates typical of recent years⁴⁵. Most of increase in vacant industrial space occurred in the Nisku – Leduc area. However industrial vacancy was also up in the northwest and southern areas of the City as well.

Commercial vacancy across Edmonton stood at 14.5% in the third quarter up from the 12% rate recorded for 2015⁶. Much of this rise was the result of higher vacancies in suburban areas where vacancy was 16.4%. As well higher rates of vacancy were recorded for B and C class buildings. Major additions of new A class space in the downtown core will tend to boost vacancy rates in 2017.

As well, rising unemployment resulted in a sharp rise in personal bankruptcies in the first quarter of 2016. While still elevated, the number of individual insolvencies leveled off in the second quarter. Business insolvencies are much more volatile quarter to quarter and no clear

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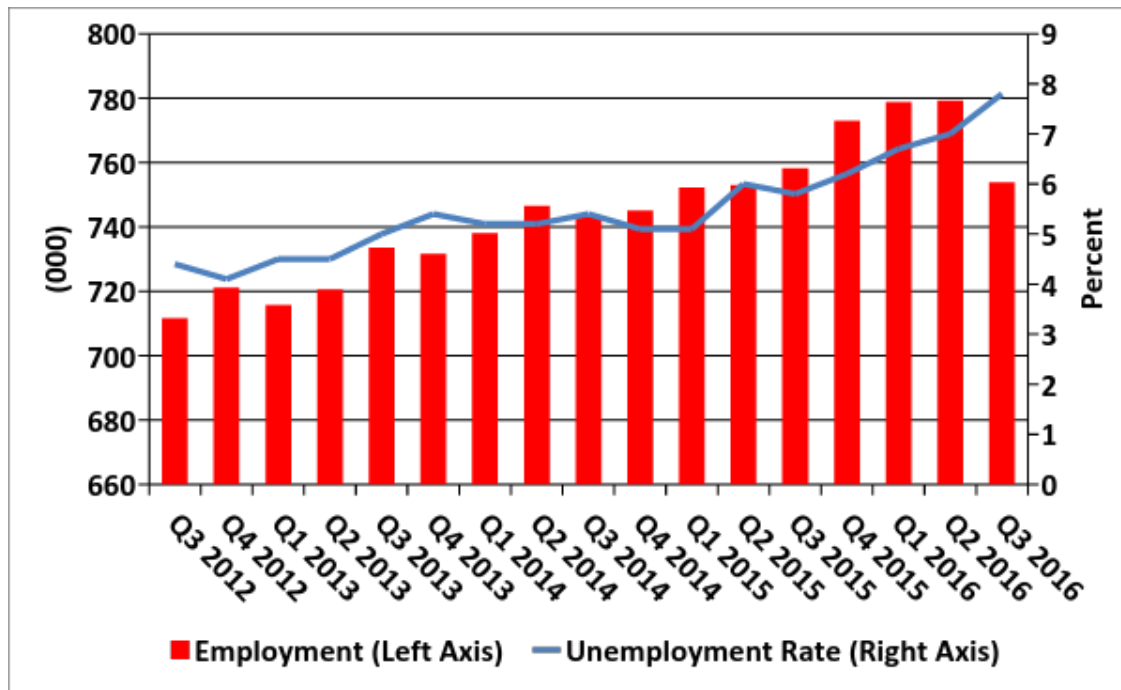
⁵ For additional background see *CBRE Market View Edmonton Industrial* at:<http://www.cbre.ca/EN/o/edmonton/Pages/market-reports.aspx>.

⁶ For additional background see *CBRE Market View Edmonton Commercial* at:<http://www.cbre.ca/EN/o/edmonton/Pages/market-reports.aspx>.

trend is apparent. Regardless, business insolvencies were up 13% in the second quarter of 2016 when compared the second quarter of 2015.

Looking forward, employment growth in Edmonton will return in the first half of 2017. As the available labour force will be increasing at a rate higher than that of new job creation, the unemployment rate will rise to the range of 7.5% in the coming months. Continuing employment growth in the second half of 2017 will slowly bring the unemployment rate down to 7.0% to 7.5% for the year.

Figure 3 – Employment in Metro Edmonton

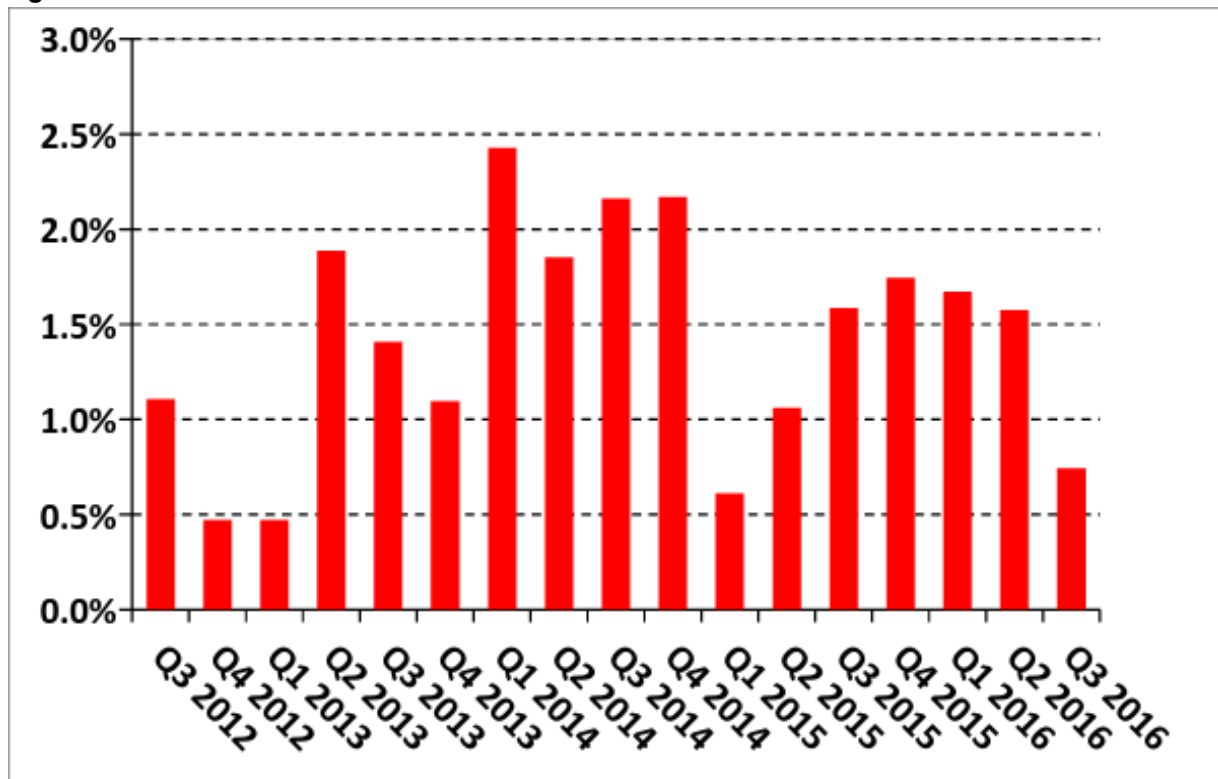


Source: Statistics Canada

Inflation in Edmonton

As measured by the Consumer Price Index (CPI), inflation moved lower in the third quarter of 2016 (see Figure 4). Year-over-year inflation was 0.7% in October of 2016 as lower energy and shelter costs more than balanced higher food and clothing prices. Housing costs, particularly rents, are beginning to ease and will lead to very modest inflation for the remainder of 2016. Edmonton's rental vacancy rate is in the 7.1% range - well above the recent low of 1% - causing rents to fall. While this is improving housing affordability in the rental sector, it has had a negative impact on multifamily construction.

Figure 4 – Edmonton Metro Area's CPI Inflation

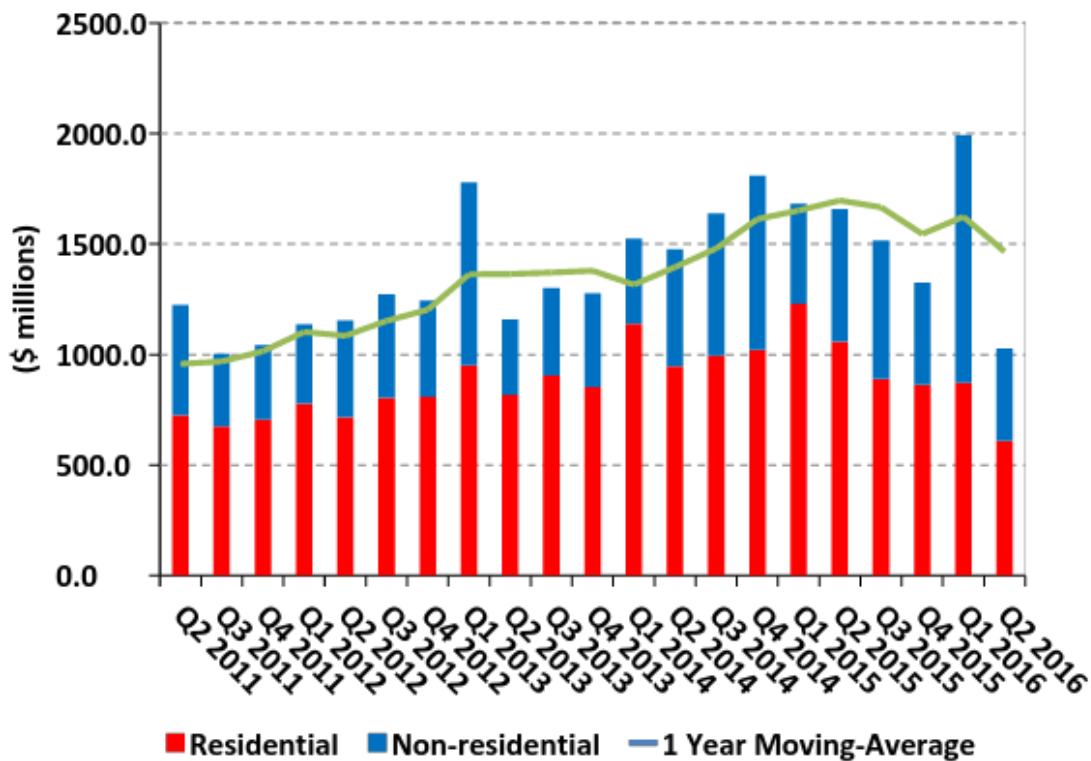


Source: Statistics Canada

Building Permits

Total building permits fell sharply as residential and non-residential values contracted. The one-year-moving average, which smooths out sharp changes in quarterly results for building permit values, was also lower in the second quarter, with the value of permits well below recent levels (see Figure 4). The value of building permits will remain close to second quarter levels, particularly for multi-family residential buildings, as the rental vacancy rate starts to rise over the remainder of 2016. Looking to 2017, permit values will hold at the levels recorded for Q2 2016.

Figure 5 - Edmonton – Value of Building Permits



Source: Statistics Canada

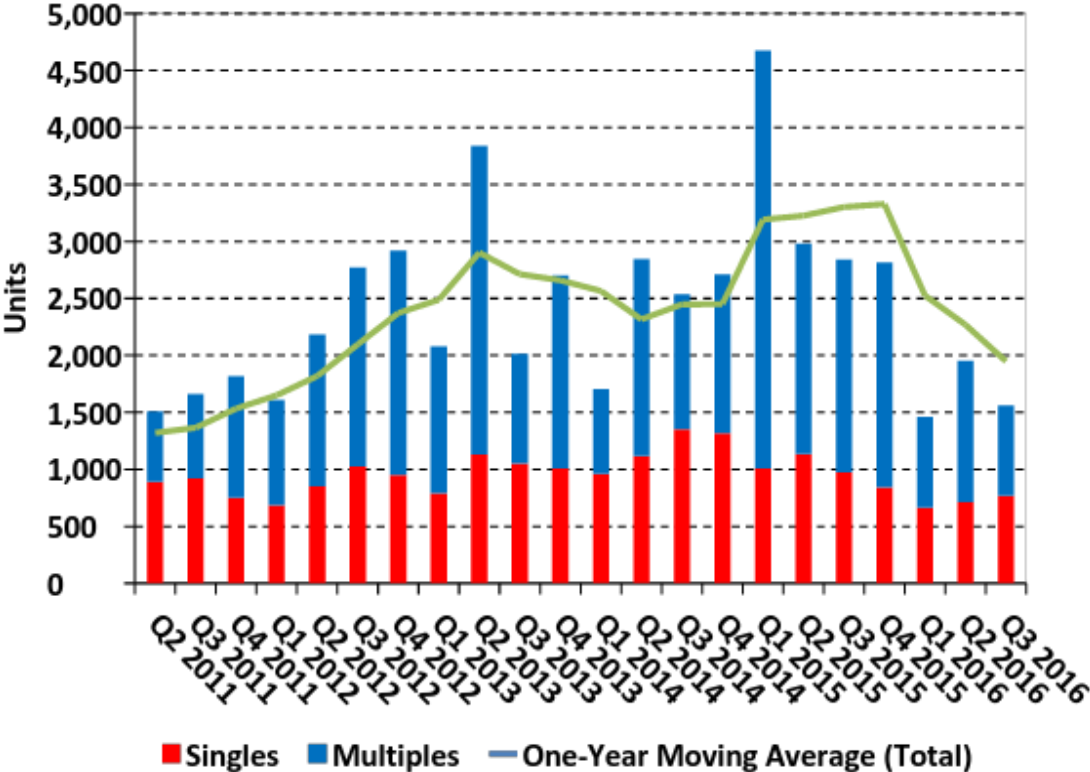
Housing Starts

After extraordinarily strong multi-family housing start figures in 2015, the overall level of housing starts was down sharply during the first three quarters of 2016 (see Figure 5). As noted above rental vacancy rates in Metro Edmonton are now hovering in the 7% range undercutting the incentive for adding to the multi-family housing stock. As well the inventory of

new and existing single family homes is moving up causing builders and developers to slow the rate of new house construction. Housing start values will remain at relatively low levels over until rental demand gradually catches up to the stock of multifamily units. In 2017, housing starts will slow modestly as the number of multi-family starts continue to weaken from current low levels.

Higher infrastructure spending is expected from the Federal and Alberta governments, which will be critical to maintaining employment in the region’s construction sector. In addition, announcements of new petrochemical facilities in Strathcona and Sturgeon county will also provide a much needed boost to non-residential construction activity.

Figure 5 - City of Edmonton – Housing Starts



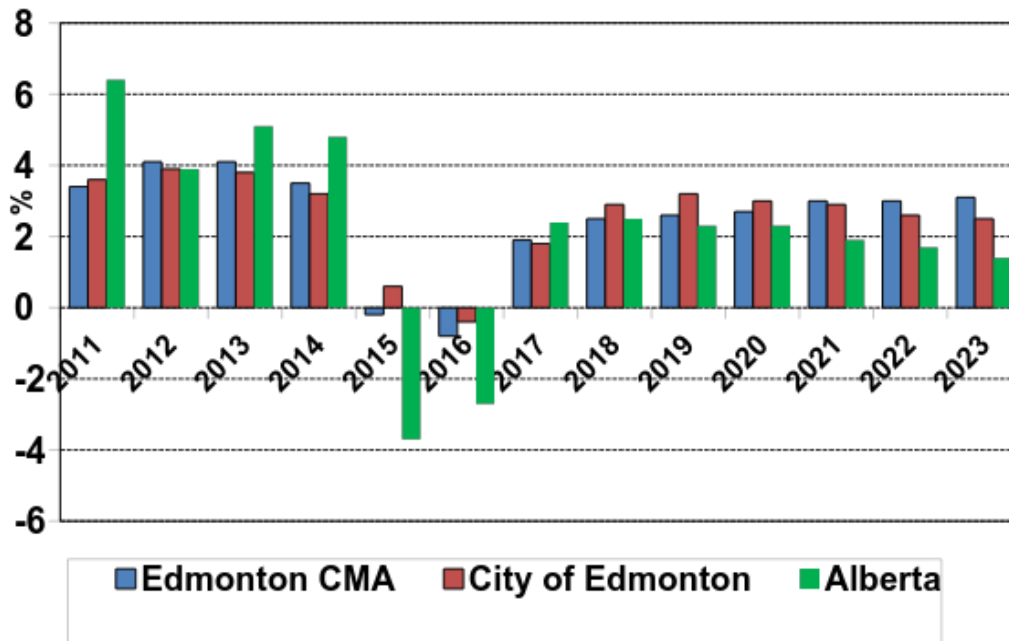
Source: Canada Mortgage and Housing Corporation

Medium term outlook for Edmonton the Region and Alberta

As noted above prospects for Alberta in 2016 remain poor. However with a continuing recovery in energy prices should stabilize investment and production activity in Alberta’s energy sector – albeit at very low levels. This combined with continuing growth in other sectors of the economy including agri-food, forestry and tourism means growth should return to the province in 2017.

However Alberta's GDP will expand at very modest rates when compared to the years from 2010 and 2014. Over the medium term oil prices are unlikely to reach levels necessary to stimulate large new investments in the energy sector. Consequently the provinces growth will be more in line with the Canadian average of approximately 2% per year when adjusted for inflation (see Figure 6).

Figure 6 - Percent Real GDP Growth



Source: City of Edmonton

The outlook for the City of Edmonton and the Edmonton Census Metropolitan Area are somewhat better given their relatively low direct exposure to the energy sector. However the subdued growth of Alberta and the energy sector will also hold growth rates for both the City and the region well below recent strong values.

There is significant upside and downside risk to the outlook as summarized in Table 1. Key among them is uncertainty with respect to the recovery of oil prices. While Edmonton has a relatively limited direct exposure to the energy sector when compared to the province, it does have a very strong indirect connection through its manufacturing and construction sectors, as well as the fiscal situation of the province.

The Edmonton region has approximately 30% of all employment in Alberta, but about 50% of all jobs in public administration. If the province initiates cuts to expenditures or employment in an attempt to address deficits, the impact on Edmonton will be very negative.

As of late December, risk to the outlook is negative, reflecting uncertainty with respect to oil prices. That is, growth rates are more likely to be lower than those presented above.

Table 1 - Risks to the Outlook

Downside Risks	Upside Risks
Energy prices fail to improve, resulting in large ongoing provincial deficits and slower activity in the energy sector	The US economy grows at a faster pace than currently forecasted, boosting exports and energy prices
Consumer confidence falters, resulting in further reductions in retail and housing activity	OPEC and other major oil producers succeed in limiting production, resulting in a more rapid recovery of energy prices
Brexit and ongoing issues with the European banking sector cut growth in Europe and depress commodity prices	Levels of business investment in Canada are higher than expected, resulting in stronger growth for Canada
Carbon taxes and emission controls limit the medium-term demand for fossil fuels, undercutting investment in new production facilities	Emerging markets – particularly India and China – succeed in stimulating faster growth, increasing the demand for commodities and raising prices

Source: City of Edmonton