Economic Forecasting and Analysis

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# Table of Contents

Overview ........................................................................................................................................... 3  

Global and North American Developments ....................................................................................... 3  
  Figure 1 – Percent Real GDP Growth ............................................................................................... 4  

Energy Prices ....................................................................................................................................... 5  
  Figure 2 - Oil prices, $US per Barrel ............................................................................................... 6  

Interest Rates ....................................................................................................................................... 6  
  Table 1 – Canadian Interest Rates ................................................................................................. 7  

Current Developments in the City and Metro Edmonton .................................................................. 7  

Employment in Metro Edmonton ........................................................................................................ 7  
  Figure 3 – Employment in Metro Edmonton .................................................................................. 8  

Inflation in Metro Edmonton .............................................................................................................. 8  
  Figure 4 – Edmonton Metro Area’s CPI Inflation ......................................................................... 9  

Building Permits ................................................................................................................................. 9  
  Figure 5 – Edmonton Metro Area’s – Value of Building Permits .................................................. 10  

Housing Starts .................................................................................................................................... 10  
  Figure 6 - City of Edmonton – Housing Starts ........................................................................... 11  

Summary .............................................................................................................................................. 11  
  Figure 7 – Real GDP Growth ......................................................................................................... 12
Overview

After experiencing a modest decline in the first quarter of 2018, employment in Metro Edmonton stabilized and began to expand over the course of the second quarter. Real Gross Domestic Product (GDP) for 2018 is estimated to be in the range of 2.6% for the city of Edmonton. This will accelerate slightly to 2.7% in 2019.

With a return to employment growth, average weekly wages in 2018 increased as the number of hours worked rose and employment in some high-paying sectors such as manufacturing and professional services recovered some of the losses seen in 2016. This allowed for gains in real disposable income across Metro Edmonton even though inflation, as measured by the consumer price index (CPI), rose above 2% in the first half of 2018. These income gains will help to sustain activity in the housing, retail and personal services sectors. This progress will continue through 2019.

In 2019, growth will improve marginally 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 70 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 the remainder of 2018 and into 2019. While prices improved over the first half of 2018, there is considerable downside risk with respect to energy prices that Alberta firms receive. This could have negative implications on the outlook for Edmonton and Alberta.

Global and North American Developments

Global economic growth moved forward at a steady pace in the second quarter of 2018. In the US, income and employment levels continued to rise. US growth is expected to remain relatively robust into 2019 in spite of continuing interest rate increases. Stronger business investment will underpin higher US growth. As well, the recent sharp reduction in US corporate and personal income taxes will boost growth in the near term. Consequently, US growth could exceed current expectations in both 2018 and 2019.

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 second quarter of 2018. Modest but steady employment growth helped to boost investment and consumer spending. However, uncertainty as Brexit negotiations unfold over the remainder of 2018 as well as ongoing concerns about European financial institutions, will limit growth in 2018 to about 2.2% and 2.0% in 2019.
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 now expected to come in at 6.6% for 2018 as a whole and then decelerating to 6.4% in 2019. Improving commodity prices will contribute to better growth in other key emerging markets in the second half of 2018. 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 3.9% in 2018 – in line with the forecast from the April 2018 World Economic Outlook Update report (see Figure 1). In 2019, global growth will hold at 3.9% as the Organization of Economic Cooperation and Development (OECD) countries slow slightly and emerging economies see more growth.

Figure 1 – Percent Real GDP Growth

![Chart showing real GDP growth by region, with China leading in 2018 and 2019, followed by emerging markets and then the world, with US, Canada, and Euro Zone lagging behind.]

Source: International Monetary Fund

After very solid growth of approximately 3% in 2017, the Canadian economy will slow to a more sustainable pace of approximately 2.0% in 2018\(^2\). Canadian growth will improve marginally in 2019, as stronger business investment and exports compensate for a slowdown in housing and consumer spending.

Prospects for Alberta in 2018 are improving, with all commentators calling for continued recovery in the province as levels of activity in the energy, manufacturing and professional services expand\(^3\). Growth is expected to be 2.7% and 2.3% in 2018 and 2019, respectively. However, with ongoing renegotiations on the North American Free Trade Agreement, increased uncertainty with respect to Canadian export performance could dampen growth prospects for both Alberta and Canada over 2018 and into 2019.

**Energy Prices**

After bottoming below $US 30 per barrel in February 2016, the US benchmark oil price (WTI) made a significant recovery, reaching approximately $US 74 per barrel in early July 2018. However, with US and Canadian oil production rising, North American oil prices are expected to slip back below the $US 70 per barrel range during the second half of 2018.

As can be seen in Figure 2, the discount between WTI and Western Canadian Select – the Alberta benchmark price - has widened significantly in recent months due to constraints in the North American pipeline system. While this wider discount should be temporary, it does mean that Alberta oil producers have not yet 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.

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Interest Rates

In response to stronger than expected economic results, the Bank of Canada (BOC) increased its policy interest rate in January and July of 2018. In 2014, the overnight interest rate was 1%. By the fourth quarter of 2016, the overnight interest rate had fallen to 0.5%. With the recent rate increases, the BOC’s overnight rate has returned to 1.5%. The BOC expects the economy to expand at above-potential growth for the rest of 2018. Consequently, short-term interest rates are likely to rise again in the second half of 2018 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 2020 (see Table 1). The US economy, in response to tax cuts and higher federal spending, was growing at about 4% in June. The US Federal Reserve Board (FED) responded to higher growth and inflation by raising its target range for the Federal Funds rate from 1.75% to 2%. With the US unemployment rate now well below 5%, the rule of thumb for the level of full employment, the expectation is that the FED will raise its policy rate twice more in 2018. This will drive both US and Canadian long-term rates higher as anticipated by the futures interest rates in Table 1.
Table 1 – Canadian Interest Rates

<table>
<thead>
<tr>
<th>Actual</th>
<th>Canada Bond Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>5-Year</td>
</tr>
<tr>
<td>2007</td>
<td>3.87</td>
</tr>
<tr>
<td>2008</td>
<td>1.69</td>
</tr>
<tr>
<td>2009</td>
<td>2.77</td>
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<tr>
<td>2010</td>
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<td>0.73</td>
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<tr>
<td>2016</td>
<td>1.11</td>
</tr>
<tr>
<td>2017</td>
<td>1.87</td>
</tr>
<tr>
<td>Forward</td>
<td>2018</td>
</tr>
<tr>
<td></td>
<td>2.41</td>
</tr>
<tr>
<td></td>
<td>2019</td>
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<tr>
<td></td>
<td>2.44</td>
</tr>
<tr>
<td></td>
<td>2020</td>
</tr>
<tr>
<td></td>
<td>2.46</td>
</tr>
<tr>
<td></td>
<td>2021</td>
</tr>
</tbody>
</table>

Rates for December 31 of each year.
Forward rates as of August 2, 2018.
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 second quarter. Inflation, housing starts, and building permits were all up. Each of these indicators is discussed in greater detail in the following sections.

Employment in Metro Edmonton

Employment in Metro Edmonton for the second quarter of 2018 was up by approximately 3,800 positions over the same period in 2017, but still below the levels reached in the first half of 2016 (see Figure 3). Good gains in manufacturing, health care and energy were offset by weaker employment numbers in education and public administration. With higher employment and some shrinkage in the labour force, the unemployment rate fell from 8.1% in the second quarter of 2017 to 6.6% in the same quarter of 2018.

To date, the reduction in employment experienced in 2016 in Metro Edmonton has not severely impacted average wages and salaries. This reflects the fact that that there has been a shift over the past 18 months toward full-time employment and job gains that
have occurred were in relatively high-paying sectors of the economy. Average weekly wages in the Metro Edmonton area were up 4.1% on a year-over-year basis in June of 2018.

Edmonton’s population continues to expand due to strong international immigration, intraprovincial migration and natural population growth (more births than deaths). However, at 6.6%, Metro Edmonton’s unemployment rate in June 2018 was still above the national average of 6%. This gap will act as a brake on net interprovincial migration as individuals pursue employment opportunities outside of Alberta and Edmonton.

**Figure 3 – Employment in Metro Edmonton**

![Employment in Metro Edmonton](image)

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

**Inflation in Metro Edmonton**

Inflation, as measured by the CPI, moved higher in the second quarter of 2018 (see Figure 4) as increases in energy-related prices drove up transportation and home heating costs. Year-over-year inflation was 3.0% in the month of June 2018. Inflation should slow over the next few months to closer to 2.0%. Lower inflation will help preserve the real value of incomes in Metro Edmonton and support consumer spending.

Housing costs, particularly rents, have eased considerably over the past 18 months and will keep inflation relatively stable into 2019. Edmonton’s rental vacancy rate is in the 7% range, well above the recent low of 1%, causing rents to drop. While this is improving housing affordability in the rental sector, it has had a negative impact on multi-family construction.
Building Permits

Construction intentions in the Edmonton metro region increased in the second quarter of 2018 compared to both Q2 2017 and Q1 2018.

Residential and non-residential builders in the Edmonton CMA took out permits valued at almost $1.4 billion combined in Q2 2018, representing a gain of 6.8% on a year-over-year basis and a 4.4% increase compared to Q1 2018. The quarter-over-quarter lift in construction intentions in Q2 2018 was attributed to a marginal gain in residential building permits and higher non-residential building permits, specifically for commercial buildings.

Residential building permit values were almost 1% higher in Q2 2018 on a quarter-over-quarter basis. The gain was driven by higher construction intentions for multi-family dwelling units. On the non-residential side, the value of building permits rose almost 11% quarter-over-quarter in Q2 2018. The gain was attributed to an almost 37% increase in commercial building permit values, which more than offset declines in the industrial and governmental components.
Housing Starts

After turning sharply lower in late 2017, the overall level of housing starts was up significantly in the first two quarters of 2018 (see Figure 6). However, as noted earlier, rental vacancy rates in Metro Edmonton are now hovering in the 7% range, undercutting the incentive for adding to the multi-family housing stock. Total housing starts for the city should hold steady over the remainder of 2018 and into 2019 as continuing gains in employment and population support the demand for new housing.

Source: Statistics Canada, Table 34-10-0066-01
After a solid recovery in 2017, growth in Alberta and Edmonton will moderate 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. Inflation-adjusted GDP in the city is expected to grow by 2.6% in 2018 and then increase marginally in 2019 to 2.7%.

Employment will continue to expand in 2018. 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% 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