

Information Bulletin

NUMBER 105 • OCTOBER 2007

ATB FINANCIAL BUSINESS SENTIMENTS INDEX™

WHERE IS THE ALBERTA ECONOMY GOING? 2007 QUARTER 4

*By Edward J. Chambers and Nigel Fish
Western Centre for Economic Research
University of Alberta*

**School of Business
University of Alberta**



**Western Centre for Economic Research
University of Alberta
Edmonton, Alberta
www.business.ualberta.ca/wcer**

with support from: The George M. Cormie Endowment

Library and Archives Canada Cataloguing in Publication

ATB Financial business sentiments index : how is the Alberta economy doing.

(Information bulletin)

Quarterly.

[2006, quarter 1]-

Issue 2007, quarter 4 has subtitle: where is the Alberta economy going?

ISSN 1912-3205 ISBN 978-1-55195-954-2 (2007, quarter 4 issue)

1. Business forecasting--Alberta--Periodicals. 2. Industrial surveys--Alberta--Periodicals. 3. Economic forecasting--Alberta--Periodicals. 4. Alberta--Economic conditions--1991- --Periodicals. I. ATB Financial II. University of Alberta. Western Centre for Economic Research III. Series: Information bulletin (University of Alberta. Western Centre for Economic Research)

HC117.A4A82

338.097123'05

C2006-906896-8

Contents

Methodology	1
Where is the Alberta Economy Going?	2
<i>Quarterly Highlights</i>	2
Business Sentiment Indexes – Sector Analysis	3
Business Activity Index	4
Business Activity Index – Sector Analysis	5
Business Hiring Intentions	6
Business Hiring Intentions – Sector Analysis	7
More on Industry Sectors	8
<i>Construction</i>	8
<i>Manufacturing</i>	10
<i>Oil & Gas</i>	11
<i>Professional and Technical Service</i>	11
<i>Transportation/Warehousing</i>	11
<i>Wholesalers</i>	11
Commentary	12
<i>Alberta's Construction Sector Constrained By Labour, Equipment Shortages</i>	12
<i>Has Alberta Broken the Boom-Bust Cycle?</i>	14
Appendix A – Data Tables	16

Methodology

These Indexes are based on responses to a telephone survey of business firms, equally distributed between North and South Alberta, in key driving sectors of the economy. The Q4 2007 survey sampled 409 firms between August 1 and August 10, 2007. Figures in parentheses are the number of respondents from each sector or region included in the sample.

The distribution of respondents by sector is as follows:

- oil and gas exploration and development (68)
- construction (68)
- manufacturing (68)
- transportation and warehousing (68)
- wholesaling (69)
- professional and technical services (68)

The geographical distribution of respondents is as follows:

- North Alberta excluding Edmonton (69)
- Edmonton/Red Deer (136)
- South excluding Calgary (68)
- Calgary (136)

The ATB Financial Business Sentiments Index™ and the Hiring Intentions Index are constructed as follows:

- Take the difference between the percentage of positive and negative responses to questions about current and future sales and employment requirements, *i.e.* percent stating 'increase' minus percent stating 'decrease'.
- Convert the results to an index measure, *i.e.* add 100 to the percentage difference.
- Combine the weighted index of responses from each sector to obtain a composite index.

To interpret the results:

- Growth in the economy if the Index is greater than 100.
- An economy in neutral if the Index is at 100.
- Decline in the economy if the Index is below 100.

The higher the value of the Index, the stronger is the sentiment for expansion. The ceiling value of the index is 200 (all respondents expect increase) and the floor value is zero (all respondents expect a decrease).

The sample has a margin of error of plus or minus 5%.

Where is the Alberta Economy Going?

Business Sentiments Index™
Q4 2007

150.0 ▼

Business Activity Index Q3
2007

131 ▲

Business Hiring Index Q4
2007

129 ▼

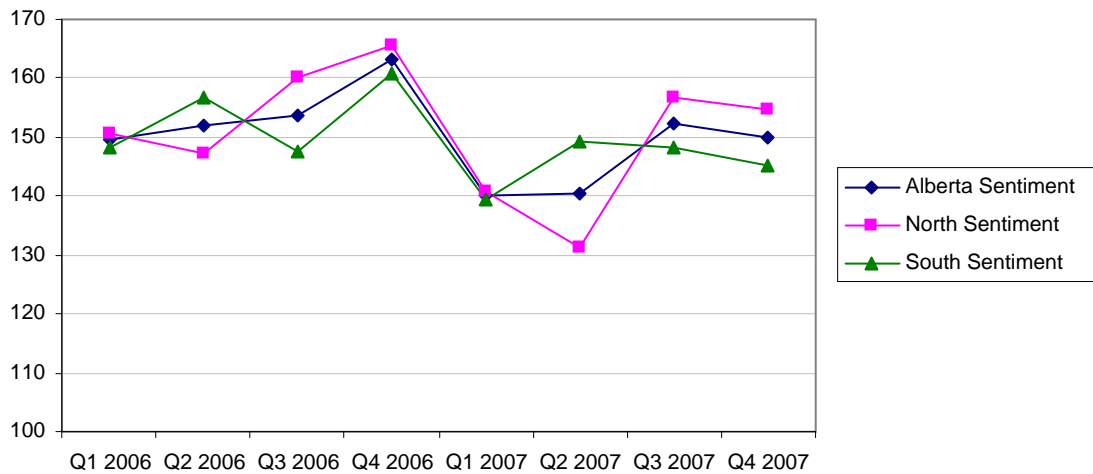
Quarterly Highlights

- Oil & Gas Sector continues rebound (Figures 2 & 10)
- Continued labour shortage in construction sector (Figure 27)
- Manifestation of material and/or equipment shortage (Figure 28)

Feature Figure

Alberta growth in the fourth quarter will continue its pace led by the northern regions and by a rebound in the oil and gas sector. The ATB Financial Business Sentiments Index stands at 150.0 for Q4 2007 compared with 152.5 in Q3 2007, and a quarterly average of 154.7 in 2006. The difference between Q4 2007 and Q3 2007 is well within the 5% margin of error.

1. ATB Financial Business Sentiments Index™
By Provincial Region, All Quarters 2006/2007, All Sectors

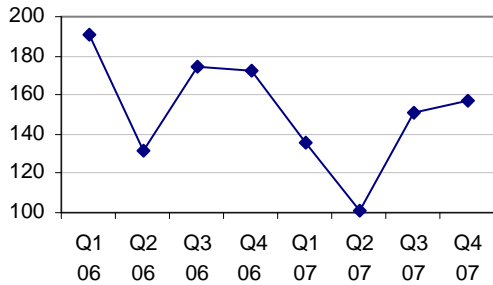


Source: WCER

Business Sentiment Indexes – Sector Analysis

2. Oil & Gas Sector

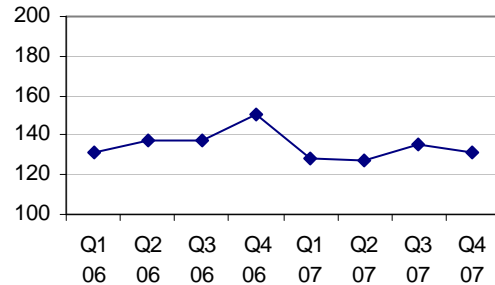
All Regions, All Quarters 2006/2007



Continued turnaround in the Oil & Gas sector from Q2 2007.

3. Construction Sector

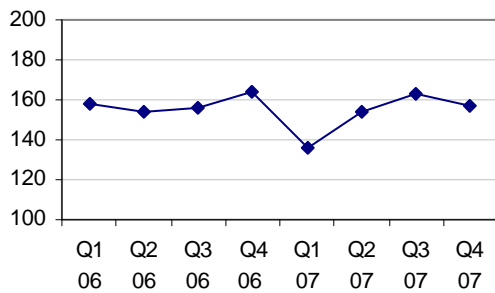
All Regions, All Quarters 2006/2007



General stability in the construction sector, with possible seasonal effects.

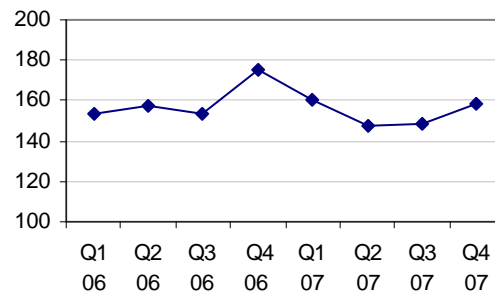
4. Manufacturing Sector

All Regions, All Quarters 2006/2007



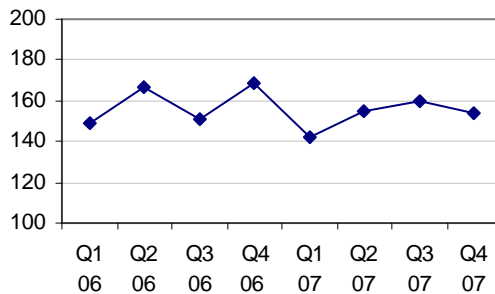
5. Professional & Technical Services Sector

All Regions, All Quarters 2006/2007



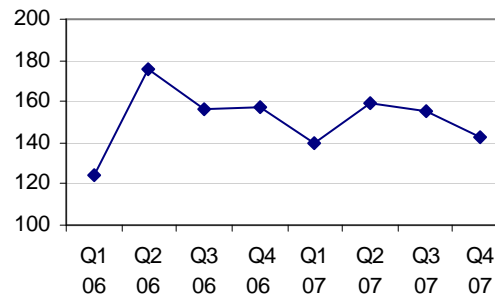
6. Transportation & Warehousing Sector

All Regions, All Quarters 2006/2007



7. Wholesale Sector

All Regions, All Quarters 2006/2007

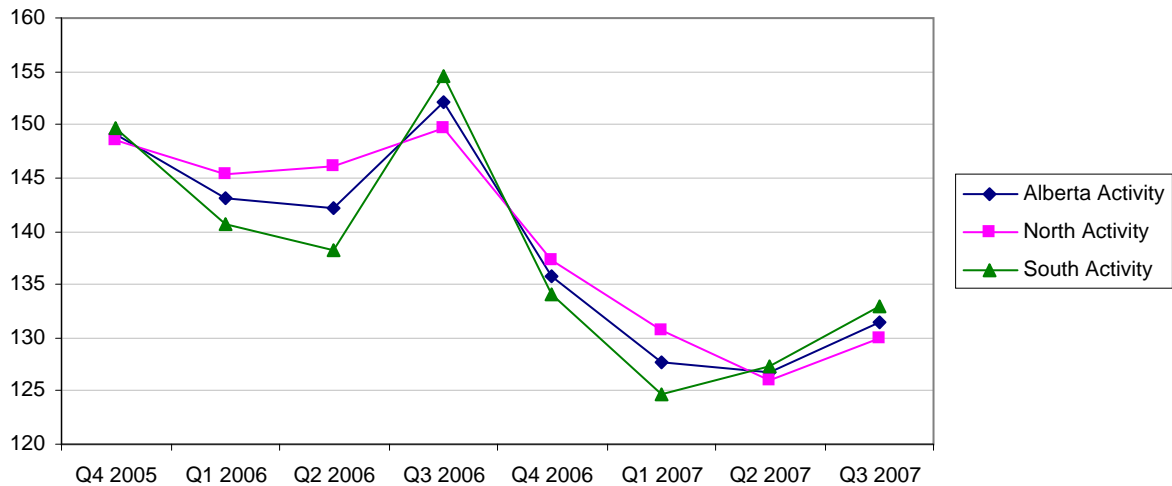


Stability in the wholesale sector, with possible seasonal effects in Q1/06 and Q1/07.

Business Activity Index

8. Business Activity Index

By Region, All Sectors, All Quarters 2006/2007



The Business Activity Index offers an evaluation of activity levels in the economy through responses to questions about sales activity in the current quarter. The Business Activity Index in this figure confirms the more sustainable pace of growth recorded in Q1, Q2 and Q3 of 2007 in comparison to 2006.

9. Business Activity Index vs. Business Sentiments Index

All Regions, All Sectors, All Quarters 2006/2007

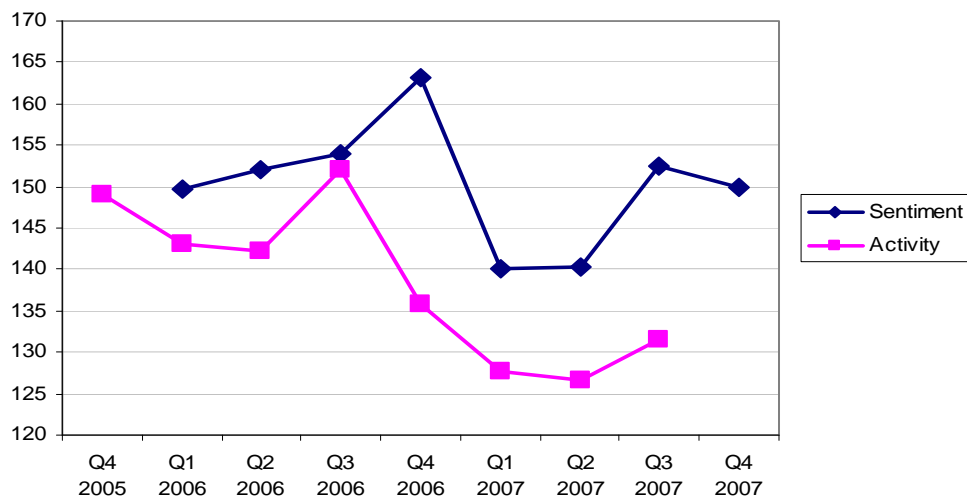
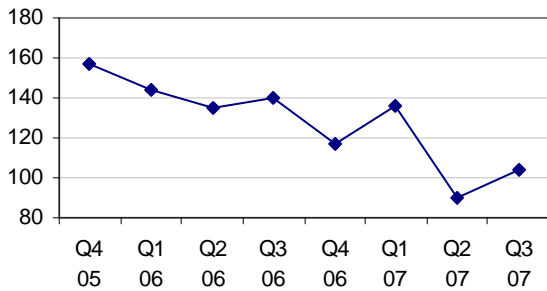


Figure 9 compares the BSI™ and the Activity Indexes since the inception of the survey. The results indicate that with the exception of Q3 2006 there has been a tendency for the BSI™ to exceed the Activity Index. The results in Q3 2006 are consistent with previous results and are attributable to supply constraints present in the provincial economy.

Business Activity Index – Sector Analysis

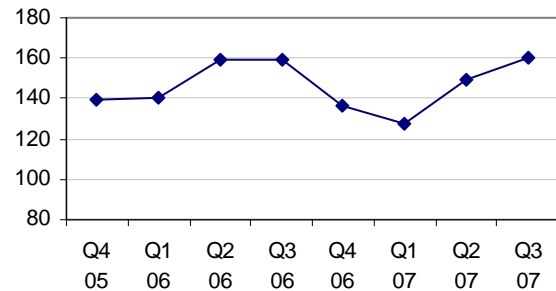
10. Oil & Gas Sector

All Regions, All Quarters 2006/2007



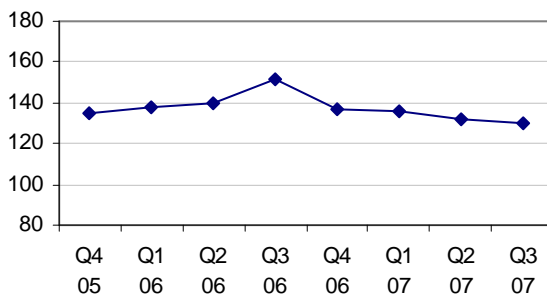
11. Construction Sector

All Regions, All Quarters 2006/2007



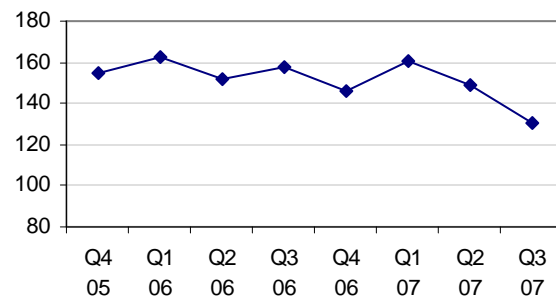
12. Manufacturing Sector

All Regions, All Quarters 2006/2007



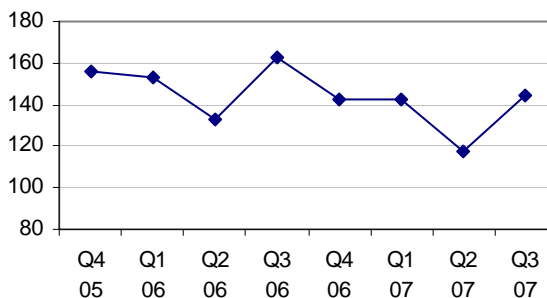
13. Professional & Technical Services Sector

All Regions, All Quarters 2006/2007



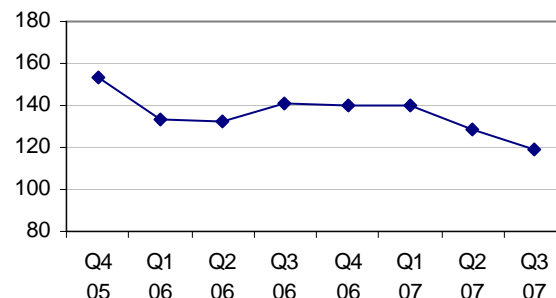
14. Transportation & Warehousing Sector

All Regions, All Quarters 2006/2007



15. Wholesale Sector

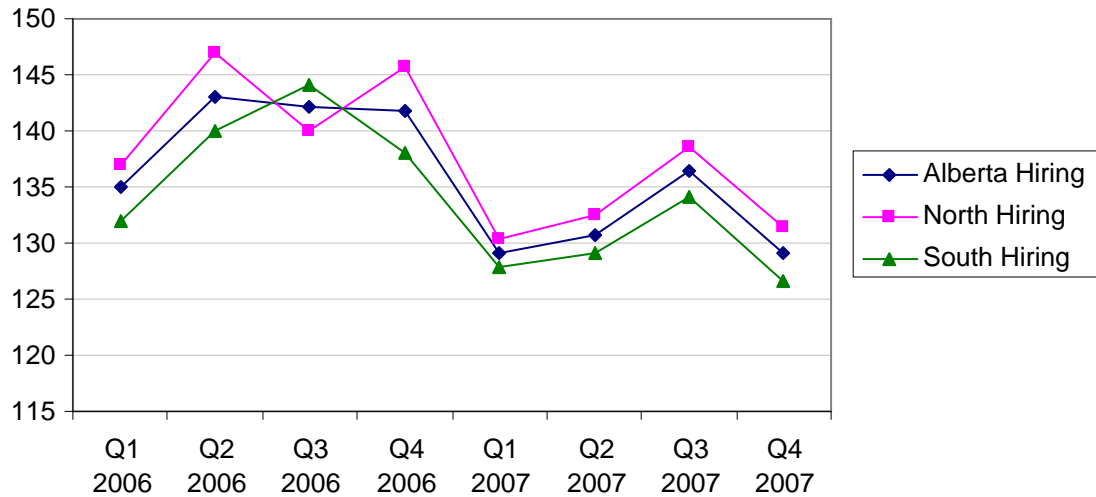
All Regions, All Quarters 2006/2007



Business Hiring Intentions

16. Business Hiring Intentions

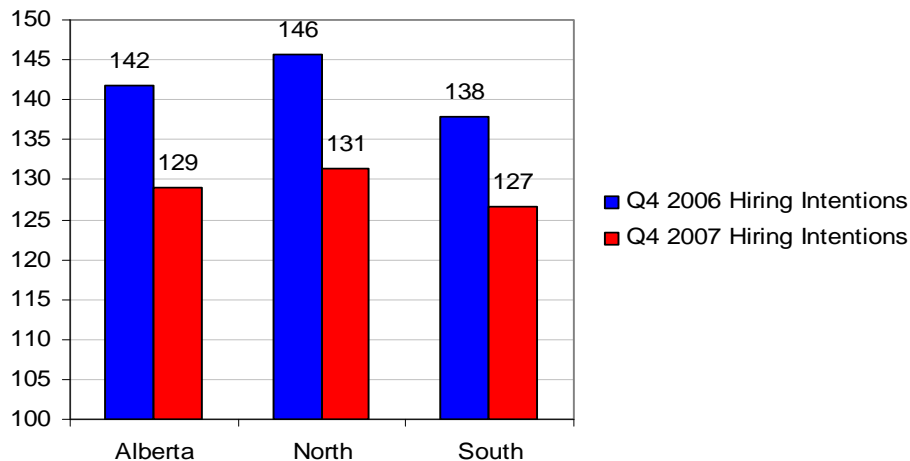
By Region, All Sectors, All Quarters 2006/2007



The quarterly survey also generates information on jobs created by Alberta firms in the form of the ATB Financial Index of Business Hiring Intentions. This index shows a slight moderation in projected job growth from Q3 2007 with the average of 2007 falling short of the quarterly average of 2006.

17. Business Hiring Intentions Q4 2007 vs. Q4 2006

By Region, All Sectors

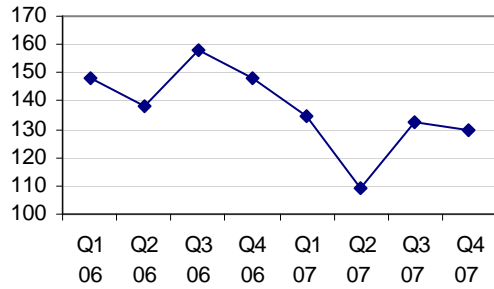


A comparison of Q4 2007 with Q4 2006 confirms the more moderate growth compared with Q4 2006.

Business Hiring Intentions – Sector Analysis

18. Oil & Gas Sector

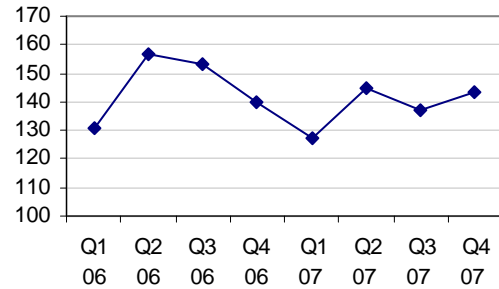
All Regions, All Quarters 2006/2007



Hiring intentions compared with Q3 2007 to continue a steady pace.

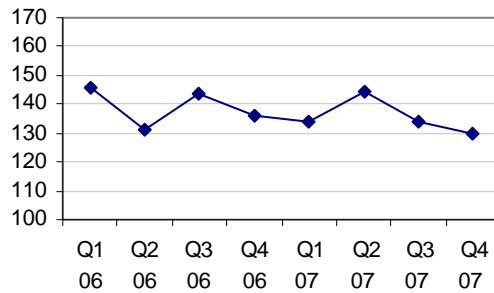
19. Construction Sector

All Regions, All Quarters 2006/2007



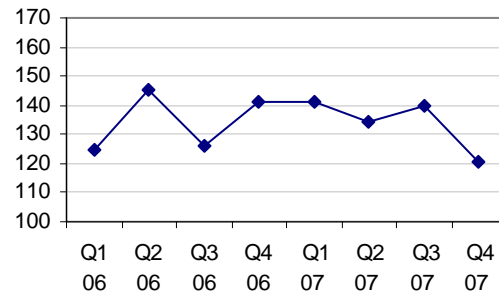
20. Manufacturing Sector

All Regions, All Quarters 2006/2007



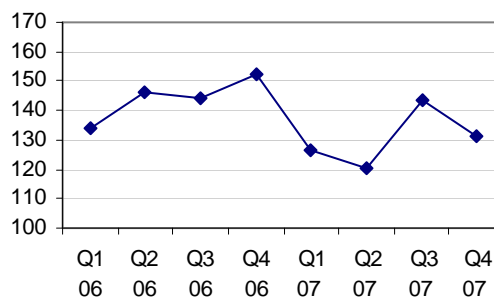
21. Professional & Technical Services Sector

All Regions, All Quarters 2006/2007



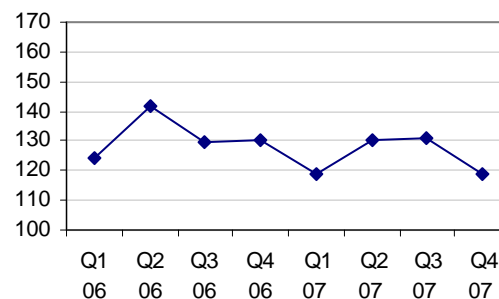
22. Transportation & Warehousing Sector

All Regions, All Quarters 2006/2007



23. Wholesale Sector

All Regions, All Quarters 2006/2007

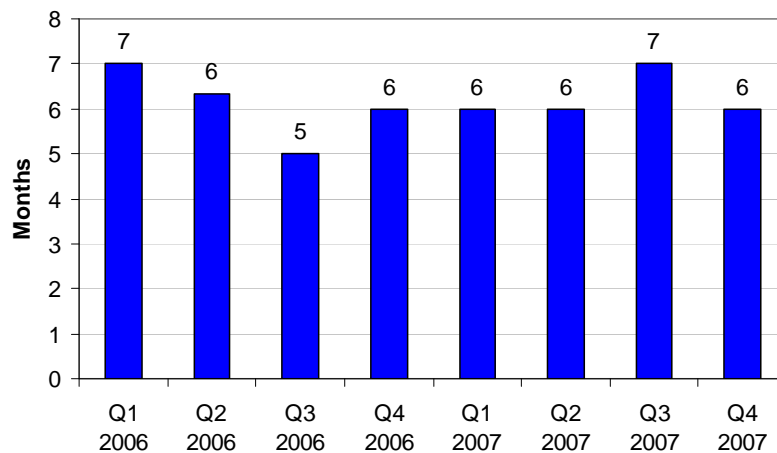


More on Industry Sectors

Construction

Of the 68 respondents in Construction, 69% indicated that their activity had increased in the past three months and 22% indicated that their activity levels had remained unchanged. This compares with 59% and 31% respectively for Q3 2007. 37% indicated that their current contract work was more than sufficient while only 6% indicated that it was insufficient. Some 49% indicated that they planned to increase employment in the coming quarter while 45% planned no change in employment. Only 6% planned to have fewer workers in the coming quarter. The figure below indicates that, assuming normal working hours, one-half of the respondents have at least six months work in hand or already under contract. Further, 20% of respondents had a backlog of one year's work, down from 39% in Q3 2007, and 6% had a backlog of sixteen months to two year's work.

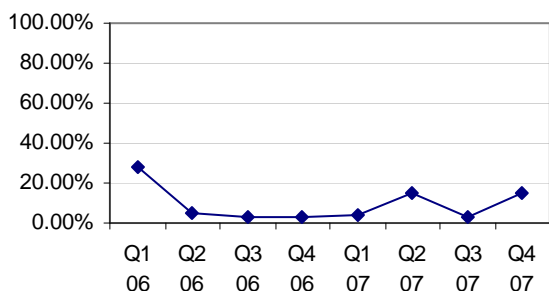
24. Median No. of Month's Work Accounted for by Work in Hand or Already Under Contract
All Regions, All Quarters 2006/2007



Our survey also asks about potential bottlenecks in the Construction industry including: shortage of labour, weather conditions, insufficient demand, shortages of construction material or equipment, financial constraints, land availability, and other factors.

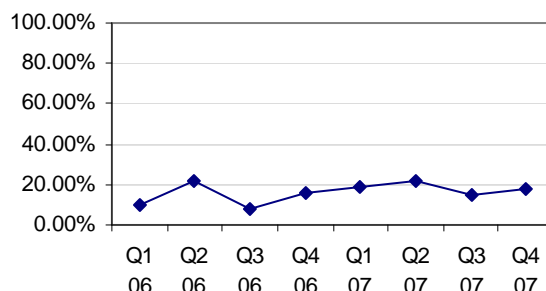
25. Insufficient Demand

All Regions, All Quarters 2006/2007



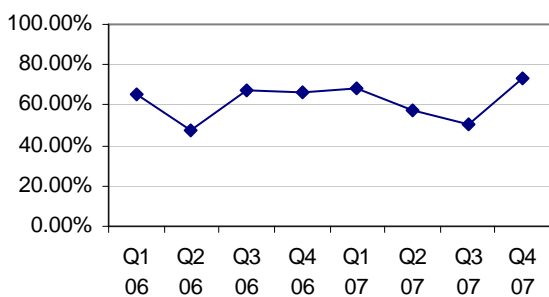
26. Weather Conditions

All Regions, All Quarters 2006/2007



27. Shortage of Labour

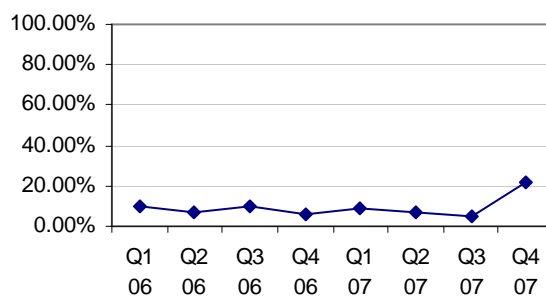
All Regions, All Quarters 2006/2007



Labour shortage continues as primary bottleneck in construction industry. Up to 74% from last quarter.

28. Shortage of Material and/or Equipment

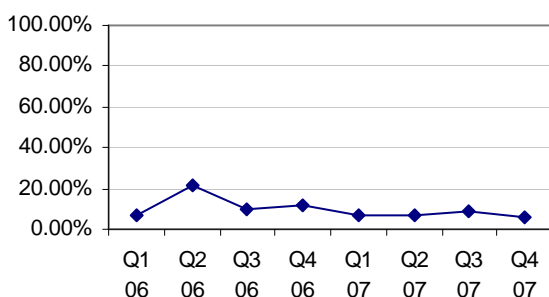
All Regions, All Quarters 2006/2007



Material & Equipment shortage rose significantly in this quarter.

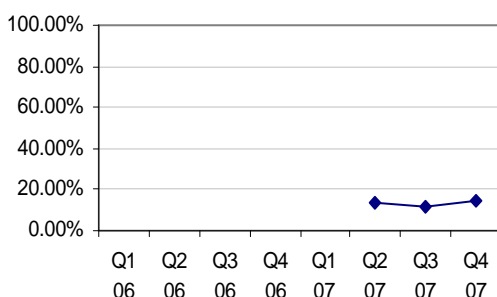
29. Financial Constraints

All Regions, All Quarters 2006/2007



30. Land Availability*

All Regions, All Quarters 2006/2007



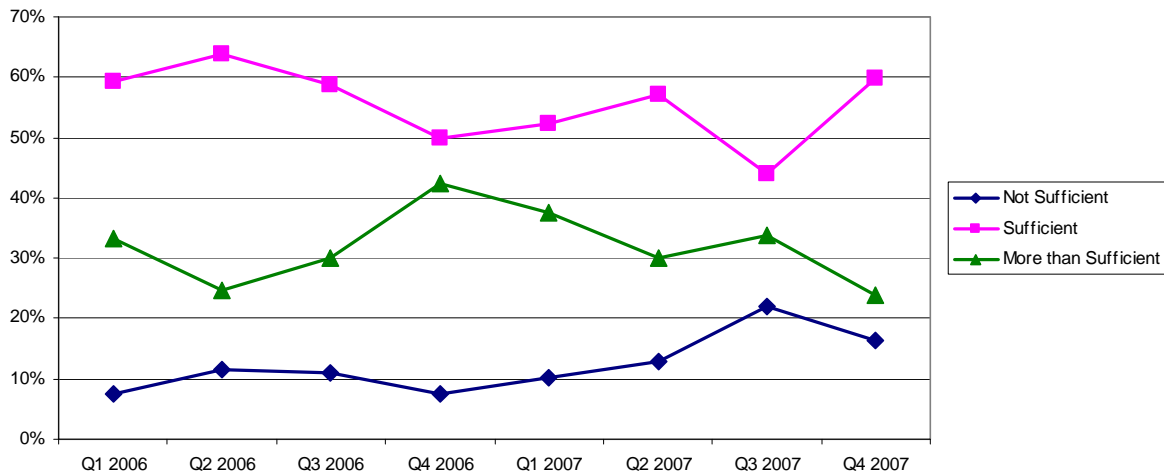
* Collection of Land Availability data began in Q2 2007

Manufacturing

Half of the 68 manufacturing respondents indicated that their production had increased over the past quarter. Some 64% anticipate further increases in production over the coming quarter, down from 72% in the last survey, and 34% plan to increase employment.

31. Orders on Hand

Manufacturing Sector, All Regions, All Quarters 2006/2007



This figure shows that 24% of respondents indicated that there were more than sufficient orders while 16% regard current orders as insufficient, down from 22% in the last quarter. 75% of respondents regard their stocks of finished products as adequate for needs.

32. Price Expectations

Manufacturing Sector, All Regions, All Quarters 2006/2007



Approximately two-thirds of respondents expect their selling prices to remain unchanged in the coming quarter. A third of respondents expect to increase their prices.

Oil & Gas

Of the 68 respondents, 35% experienced increased activity over the past three months while 31% indicated that their activity had decreased. This decrease was anticipated by only 8% of respondents in the last survey. In the coming Q4 2007, only 7% expect a decrease in activity. With respect to hiring intentions, some 56% of respondents indicated there would be no change in employment in the coming quarter. 37% of respondents indicated they would add employees while 7% indicated there would be a decrease in employment.

Professional and Technical Service

There were 68 respondents in this group of which 46% experienced increased demand for their services during Q3 2007, down from 56% in the previous survey. In the coming quarter, 60% expect demand to increase and 25% plan to increase employment. No change was expected by 39% and 70% of respondents respectively.

Transportation/Warehousing

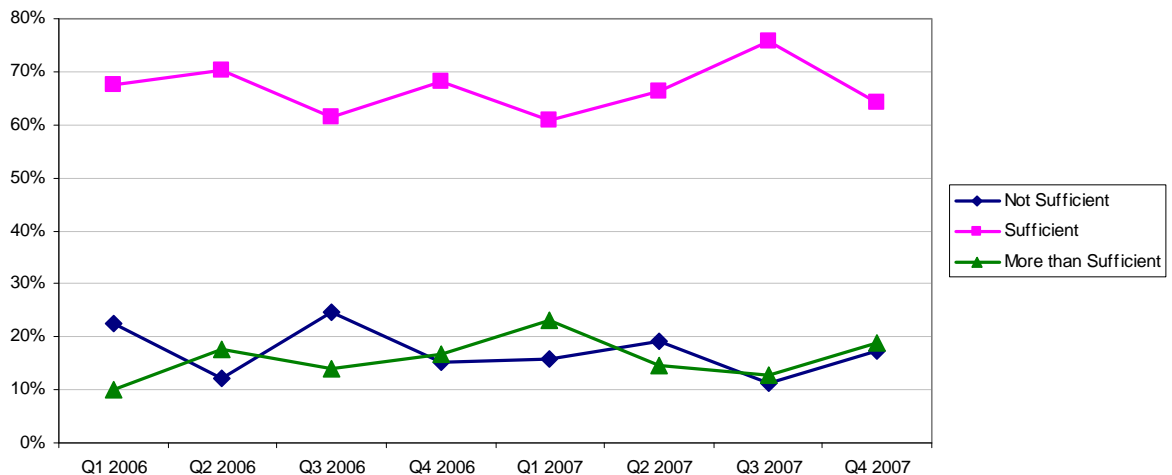
Of the 68 respondents in this group, 50% recorded increased business while 6% experienced decreases in Q3 2007. 31% increased employment in Q3 2007. 57% expect their business to increase again in Q4 2007, while 3% expect decrease in business. One-third of the respondents are planning to add employees while 63% plan for no change in employment.

Wholesalers

Of the 69 respondents in this group, 41% recorded increased business while 22% experienced decreased business in Q3 2007.

33. Firms' Satisfaction with Current Inventory Levels

Wholesale Sector, All Regions, All Quarters 2006/2007



As shown above, two-thirds of firms believe their inventories to be sufficient for the coming quarter. 44% plan to place increased orders with suppliers in Q4 2007 while 41% will leave their orders unchanged.

Alberta's Construction Sector Constrained By Labour, Equipment Shortages

By Edward J. Chambers, Western Centre for Economic Research, University of Alberta

In Alberta, it is hard to talk about sports without debating Oilers-Flames matchups or the Eskimos-Stampeders rivalry. Comparing and contrasting the teams' strengths and weaknesses is a natural part of conversation. And while the topic may not be discussed with the same intensity over double-doubles at the local Tim Horton's, comparisons can also be made about two key teams in Alberta's red hot economy.

The first is the energy sector. It tends to be the glamour girl of the economy; the one we identify most often as an economic driver and curse most often when prices go up at the pump or on our monthly natural gas bills.

The second is the sector that, in a sense, makes much of the progress in the energy sector possible: the construction sector. It is the centre of attention when we want the house renovated, a hospital expanded, or an overpass constructed around that hazardous intersection.

The importance of the sector to the Alberta economy cannot be denied. It generated revenue of over \$28 billion in 2005, the most recent year data are available, employs over 230,000 people, exports over \$490 million and consists of over 23,000 firms.

The construction industry received special attention in the 2007 fourth quarter ATB Financial Business Sentiments Index™, or BSI for short. Prepared quarterly by the Western Centre for Economic Research at the University of Alberta School of Business on behalf of ATB Financial, the index is based on a survey of over 400 firms in six key sectors in Alberta's economy: oil and gas exploration and development, construction, manufacturing, transportation and warehousing, wholesaling, and professional and technical services.

The survey asks firms about revenue expectations and hiring intentions for the coming quarter and enquires about business performance in the past quarter. The information is then converted into a series of indexes that show whether business conditions are improving or deteriorating. The information gleaned from the index - the only source for this kind of business index in Alberta - is particularly useful for business planners and policy makers.

The 2007 fourth quarter BSI illustrate some interesting findings about the positive performance and outlook in the construction sector compared to the other sectors surveyed. Over the past eight quarters, the construction sector showed the greatest degree of stability in anticipated business performance. Put another way, it is the sector in which firms were the most consistently optimistic about the next quarter's business performance.

In the most recent survey, the construction sector also reported the highest level of activity for the previous quarter compared to the other five sectors. The

responding construction firms reported that the outlook for work in hand or already under contract is solid. One half of the firms have at least six months work under way or on the books. A further 20% had a backlog of one year's work, while six percent had a backlog of 16 months to two year's work. In other words, you may have to wait a while for that renovation, office building, or overpass.

For each of the past eight quarters, the BSI survey also asked some specific questions about potential bottlenecks in the construction industry. Not surprisingly, shortage of labour was consistently and by far the greatest challenge. In the most recent survey nearly 80% of firms reported a labour shortage--the highest percentage of construction firms that the survey has ever encountered reporting that difficulty.

But a shortage of labour is not the only challenge facing the construction sector. This quarter, over 20% of construction firms reported a shortage of material or equipment. Anecdotal evidence suggests part of the problem is finding the equipment to rent or buy from local providers and international dealers. And once the equipment is obtained, finding someone to service it becomes a problem. Financing, however, does not appear to be a problem: less than five percent of firms reported financial constraints as a bottleneck.

The big question is what the future holds for the construction sector. One reason for the sector's stability over the eight quarters the BSI has been produced is that all the major components - housing, commercial and industrial construction and public spending on infrastructure - have been very strong. The overall sector has been operating at capacity. The challenge will lie in how the industry adjusts should any of the components display a retreat from current levels due to reduced demand, labour disruptions or other unanticipated reasons.

In the present environment, the prime candidate for substantial deceleration or possibly decline is residential construction. How will the construction sector adjust if the housing market slows or stalls?

Has Alberta Broken the Boom-Bust Cycle?

By Todd Hirsch, Senior Economist, ATB Financial

Frank Sinatra used to croon away about a famous coupling...

Love and marriage, love and marriage

Go together like a horse and carriage

This I tell you brother

You can't have one without the other

In Alberta, you can add "boom and bust" to the list of inseparables. With every economic boom comes the inevitable bust. And even now, in the midst of a great period of economic expansion in the province, many would-be prophets are already saying, "It won't last."

Alberta has been here before. And it seems that the bigger the boom, the bigger the bust that follows. Take the boom of the late 1970s. Population growth, housing starts, and construction activity smashed all records. But by 1981 - for a variety of reasons, the most obvious being the collapse of oil prices - the boom had turned into a nasty bust that lasted the better part of the decade.

The similarities between Alberta *circa* 1978 and Alberta in 2007 are eerie. Soaring real estate prices, in-migration, and labour shortages made the headlines both then and now.

Can Alberta dodge the bust bullet this time around?

ATB Financial's Business Sentiment Index (BSI) - prepared quarterly by the Western Centre for Economic Research at the University of Alberta School of Business on behalf of ATB Financial, and based on a survey of over 400 firms in six key sectors in Alberta's economy - is giving some very hopeful signs that perhaps a bust is not as inevitable as the doom-and-gloomers like to think.

The BSI surveys over 400 businesses throughout Alberta and asks a series of forward-looking questions regarding general business sentiment and hiring intentions. The results? Alberta's businesses continue to be very optimistic and positive in their overall feelings about the economy, and hiring intentions are only somewhat softer than they were last year. The economy appears to be holding steady, even if some healthy slowdown and moderation is becoming apparent.

So what is different about this boom that a bust may not be in the cards? Alberta's previous energy booms have been driven purely by conventional oil and gas drilling activity, whereas today the oil sands has decidedly taken front-and-centre.

Conventional drilling is like a car in stop-and-go traffic – it starts up just as suddenly as it shuts down, which is the nature of the boom-and-bust cycle. But the massive oil sands projects are more akin to a 100-car freight train. Once it's going, it's not going to stop any time soon. Shear momentum keeps the train plowing ahead, regardless of any head winds or inclines. There is no such thing as a stop-and-go freight train.

Because of rising costs, the viability of many of the oil sands projects become iffy at around \$US50 a barrel. For prices to fall below that point – and stay there – would require a series of things to happen: a major global recession, an end to geo-political tensions in the Middle East, a sudden discovery of massive oil deposits where no one

thought to look before, or a wonderful new invention that would enable cars to run on salt water.

A major global recession scenario is looking unlikely. Sudden peace in the Middle East – as desirable as that would indeed be – seems improbable. And the other two are purely impossible.

This fall, the price of crude oil topped \$US 80 for the first time. In inflation-adjusted dollar terms, this is not yet a record high. But it is a record in absolute dollar terms, and it is sending a very strong message to consumers and producers. Global energy prices are being supported by starkly different factors today. Surging demand in the developing world (i.e., China) and oil-addicted consumers in the West will ensure at least five more years of high global oil prices, according to the erudite International Energy Agency.

So where does that leave Alberta? With the oil sands freight train plowing full speed ahead, the most likely scenario is for a soft landing. The likelihood of that outcome is supported by the Business Sentiment Index, which shows no real signs of business pessimism on the horizon. Most of the big economic indicators are pointing in this direction, as well. Retail sales, housing starts, inter-provincial migration – all have moderated from last year, but remain very strong.

Will Alberta avoid a bust this time around? If it does, it's because the world and the province are different places today. It won't be because Alberta has diversified beyond energy - it hasn't. But it has diversified beyond *conventional* drilling, and that will make all the difference.

Frank Sinatra sang about love and marriage back in the 1950s. Would he sing the same song today? Given the recent census data about the falling marriage rates - at least in Canada - perhaps not. Love still goes with marriage sometimes, but not always. (The whole horses and carriage analogy needs updating as well.)

Maybe the song should be rewritten for Alberta in 2007:

Boom and bust, boom and bust

Doom and gloom about it, you can't trust

It's too soon for celebration

But now it's boom and moderation

Appendix A – Data Tables

Respondent Distributions by Region vs. Sector					
	North	Edmonton	Calgary	South	Total
Construction	9	25	25	9	68
Manufacturing	11	25	18	14	68
Professional & Technical	13	25	18	12	68
Transportation & Warehousing	11	21	27	9	68
Wholesale	14	20	22	13	69
Oil & Gas	11	20	26	11	68
Total	69	136	136	68	409

Business Sentiments Index by Region vs. Sector			
	North	South	All
Construction	129.4	132.4	130.9
Manufacturing	169.4	141.9	156.7
Professional & Technical	158.3	158.6	158.5
Transportation & Warehousing	156.3	151.4	153.7
Wholesale	144.1	141.2	142.6
Oil & Gas	171.0	145.9	157.4

Business Activity Index by Region vs. Sector			
	North	South	All
Construction	153	168	160
Manufacturing	131	130	130
Professional & Technical	129	133	131
Transportation & Warehousing	141	147	144
Wholesale	124	114	119
Oil & Gas	103	105	104

Business Hiring Intentions by Region vs. Sector			
	North	South	All
Construction	148	138	143
Manufacturing	136	123	130
Professional & Technical	116	128	121
Transportation & Warehousing	132	131	131
Wholesale	126	111	119
Oil & Gas	129	130	129