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ATB FINANCIAL
BUSINESS SENTIMENTS INDEX™

WHERE IS THE ALBERTA ECONOMY GOING?
2007 QUARTER 3

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Contents

Where is the Alberta Economy Going?

- The **ATB Financial Business Sentiments Index™ (BSI™)** predicts a continuing strong Alberta economy in the third quarter of 2007.
- While strong, the growth is comparable to levels attained in 2006.
- The job market remains strong but at a slightly lower level than a year ago.
- The positive sentiment and increase in job opportunities is most strongly evident in North Alberta, largely due to earlier seasonal change.
- There is a rebounding of sentiments in the oil and gas sector.

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:

- Oil and Gas exploration and Development (68)
- Construction (67)
- Manufacturing (68)
- Transportation and Warehousing (68)
- Wholesaling (68)
- Professional and Technical services (68)

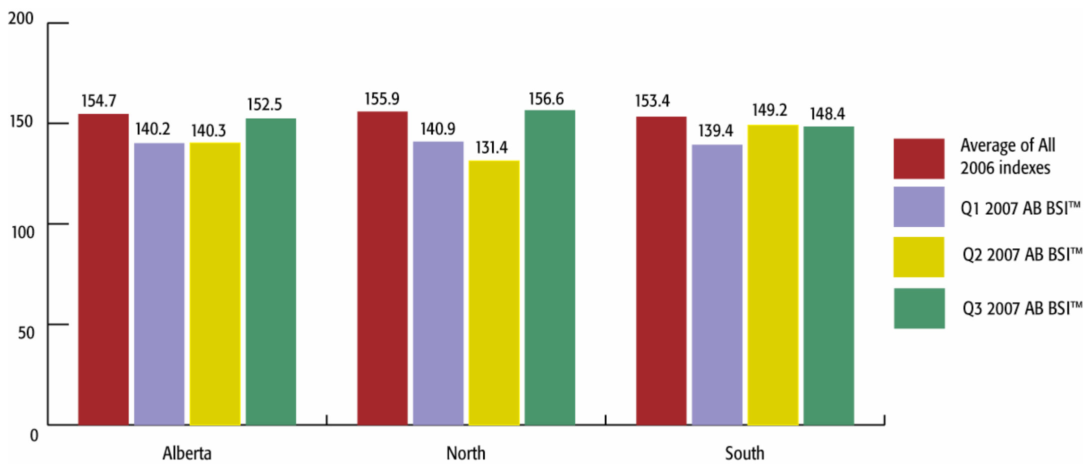
The Q3 2007 survey sampled 407 firms between May 9 and May 22, 2007. Figures in parentheses are the number of respondents from each sector included in the sample.

The geographical distribution of respondents is as follows:

- North Alberta excluding Edmonton (69)
- Edmonton/Red Deer (136)
- South excluding Calgary (68)
- Calgary (134)

Alberta growth in the third quarter will accelerate led by the northern regions and by a rebound in the oil and gas sector (Figure 1 below). The Alberta Financial/WCER Business sentiments Index stands at 152.5 for the Q3 2007 compared with 140.2 in Q2 2007 and a quarterly average of 154.7 in 2006. The difference between Q3 2007 and the quarterly average level for 2006 is well within the 4.5% margin of error.

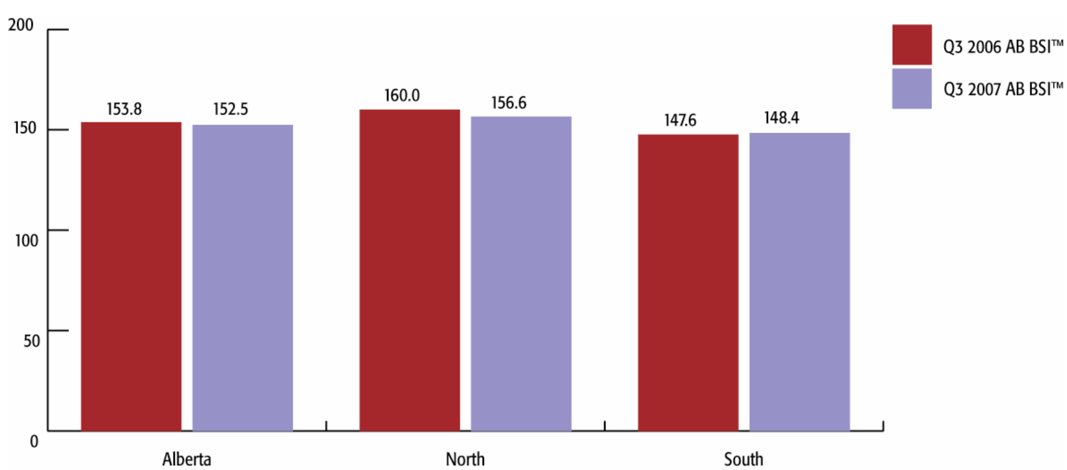
Figure 1. Regional Comparison of the ATB Financial Business Sentiments Index™: All Quarters 2006, Q1 2007, Q2 2007 and Q3 2007



Source: WCER

The Q3 2007 BSI™ of 152.5 is similar to the 153.8 in the comparable quarter last year (Figure 2 below). However, note that the BSI™ for the North in Q3 2006, like that for Q3 2007, was stronger than that in the South. This could well be a seasonal phenomenon.

Figure 2. Regional Comparison of the ATB Financial Business Sentiments Index™: Q3 2006 and Q3 2007

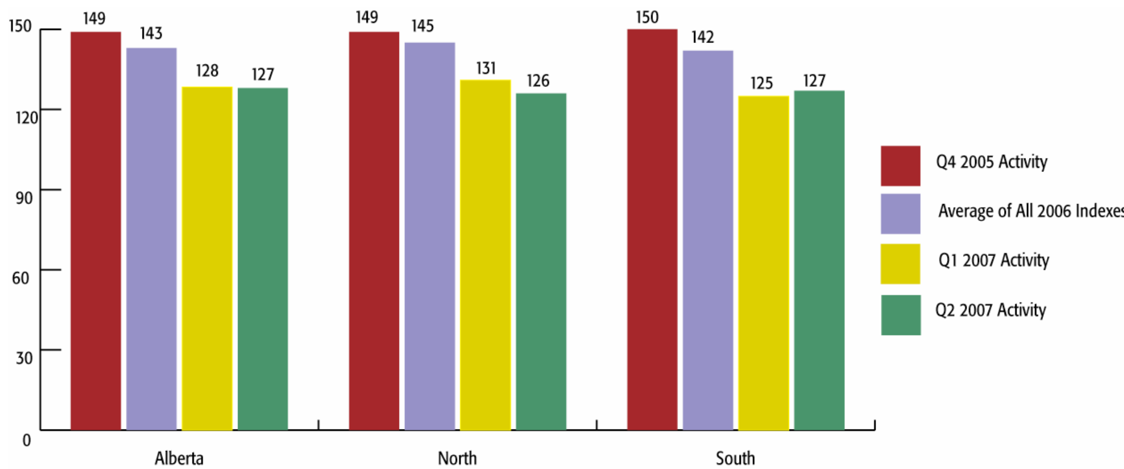


Source: WCER

Activity Levels

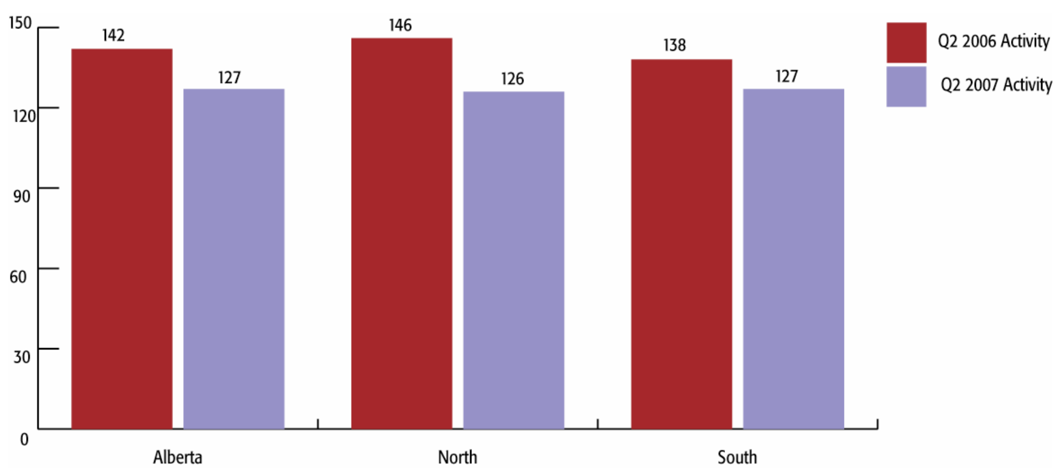
In Figure 3 (below) we assess activity in the economy by responses to our question about sales experience during the prior quarter. The Business Activity Indexes in Figures 4 and 5 (below) confirm the more moderate pace of growth recorded in Q1 and Q2 of 2007.

Figure 3. Business Activity Indexes: Q4 2005, All Quarters 2006, Q1 2007 and Q2 2007



Source: WCER

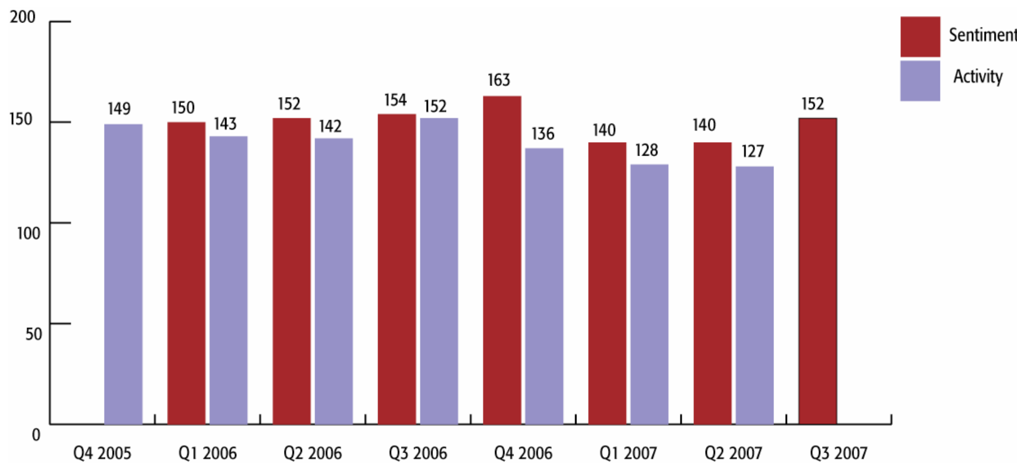
Figure 4: Comparison of Activity Indexes: Q2 2006 and Q2 2007



Source: WCER

Figure 5 (below) 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 Q2 2006 are consistent with previous results and attributable to supply constraints present in the provincial economy.

Figure 5. Comparison of Business Sentiment Indexes™ and Activity Indexes Q4 2005, All Quarters 2006 and Q1 2007



Source: WCER

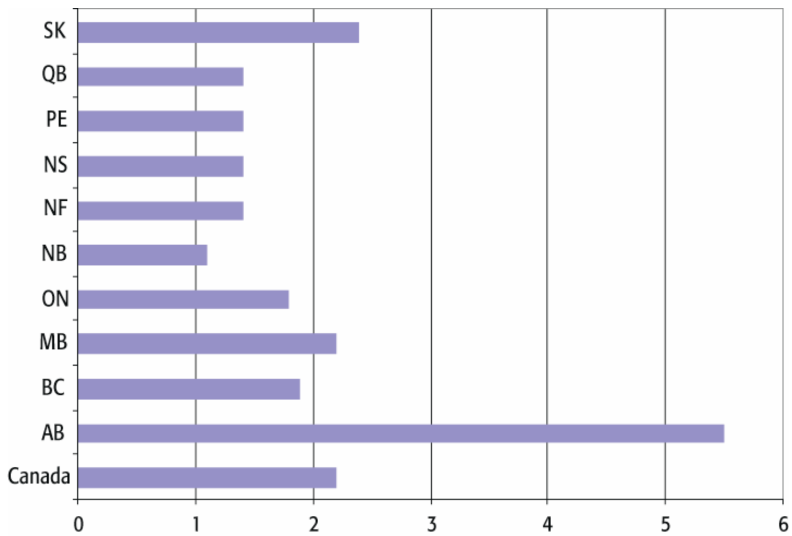
Taking a Broader View

With the BSI projecting an acceleration in provincial growth during the coming quarter to levels approximating those of 2006, a somewhat broader look at the economy is in order. This will turn on price performance, employment growth and the impact of oil sands development, both actual and potential.

Price Performance

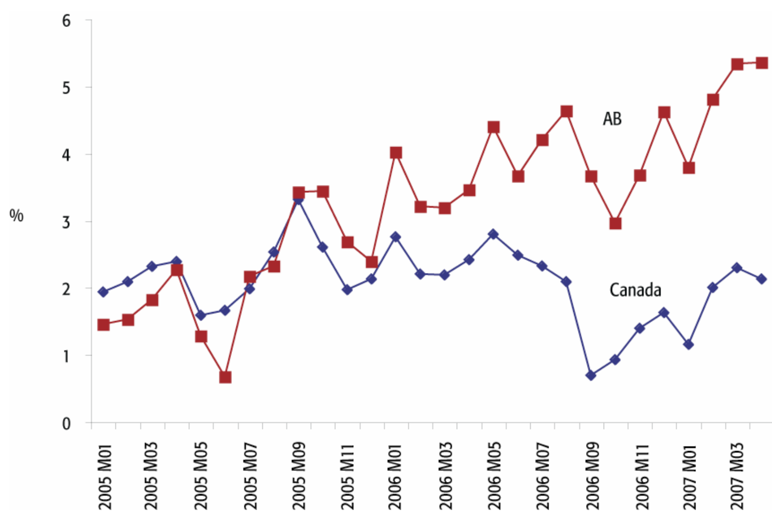
Figure 6 (below) shows the national CPI inflation rate for the year ending in April and that experienced in each province. What is striking about this figure is the Alberta rate, which is almost three times the national rate and substantially exceeds that recorded in any other province. Figure 7 (below), showing the annualized rate of inflation from January 2005 through April 2007, indicates that the difference between the national and the Alberta experience revealed by Figure 6 was not an aberration but has been evident since January of 2006. It is interesting to speculate that if the rate observed in Alberta were experienced nationally we would have a Bank of Canada rate of at least 8%. But the reality is that the Bank cannot respond to inflationary (or deflationary) pressures in any one province. Hence, there is little scope for a monetary policy response to this condition.

Figure 6. Annual Percentage Rate of Increase in the All-Item CPI, April 2007, by Province



Source: Statistics Canada

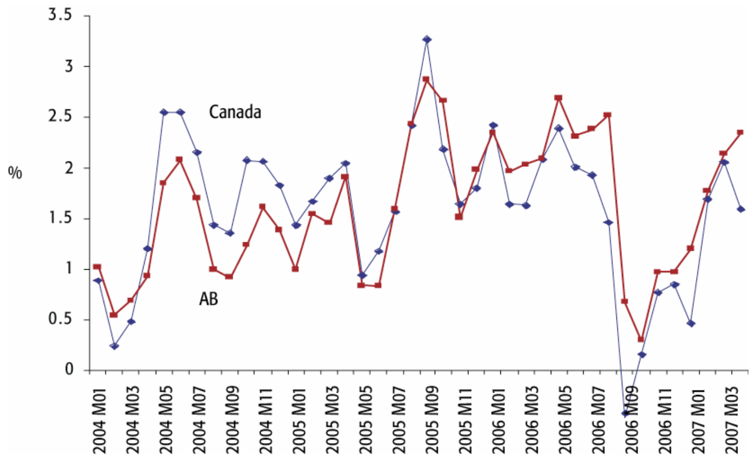
Figure 7. Annual Percentage Rate of Increase in the All-Item CPI, January 2005 to April 2007



Source: Statistics Canada

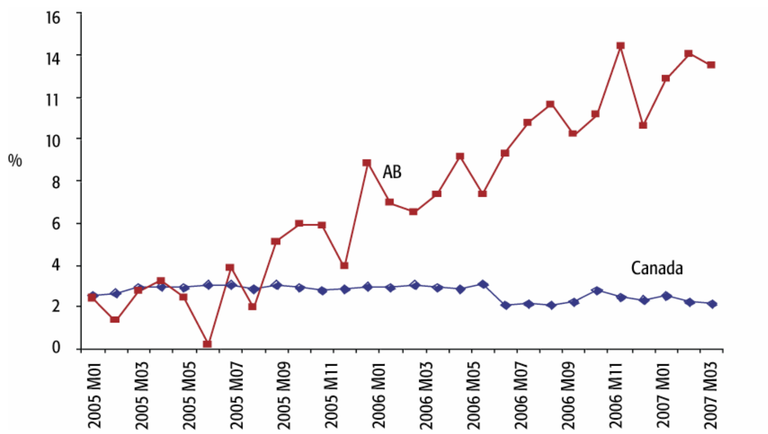
Figures 8 and 9 (below) help us identify the source of this gap. Figure 8, showing the annualized rates of increase in the national and the Alberta CPI measure excluding the shelter component, indicates that there is little to choose between the two price paths. Figure 10 makes clear the source of the divergence. Where the shelter component ranged from 2-3% nationally over the period, the Alberta shelter index accelerated in the range of 12-14%. The shelter portion of the index represents primarily what economists refer to as 'non-tradables', or goods or services which are generally place specific and cannot be imported in order to meet increases in demand. Put another way, if there is a shortage of housing units we cannot call a distributor and ask him to deliver, within the week, sufficient units to alleviate the shortage.

Figure 8. Alberta and Canada: Rate of Increase in CPI excluding Shelter, January 2004 to April 2007



Source: Statistics Canada

Figure 9. Alberta and Canada: Annual Percentage Rate of Increase in the Shelter Component of the CPI, January 2005 to April 2007

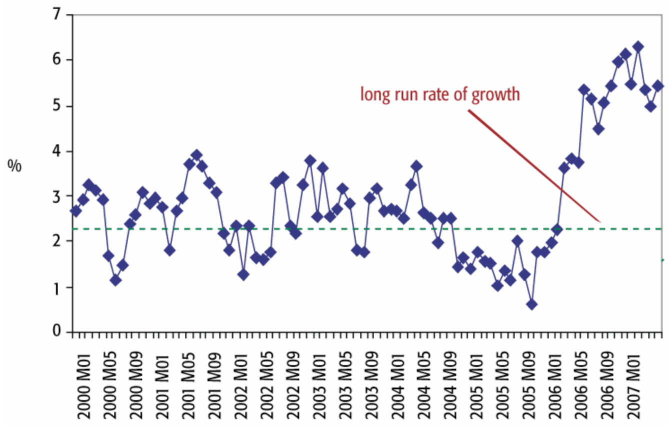


Source: Statistics Canada

Employment Growth

With the source of Alberta's inflation difficulties identified, we can look into why they have occurred. Figure 10 (below) shows the annual growth in employment over this decade. For comparison, the straight line marks the long term average growth of 2.4% in employment over the past three decades.

Figure 10 Alberta: Annual Percentage Rate of Growth in Employment, January 200 to April 2007



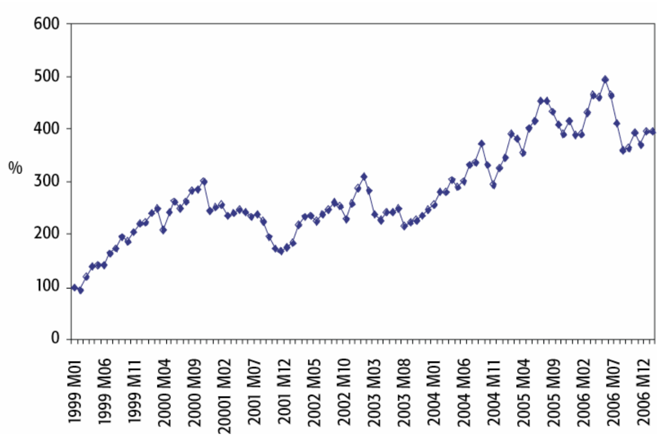
Source: Statistics Canada

Commencing in January of 2006, there is a substantial departure of the actual growth from the long term average. The long term average rate of increase in employment would produce in the order of 40,000 to 45,000 new jobs annually. In 2006, employment in Alberta rose to rates well over twice the long term average (resembling the situation in the boom conditions of the late 1970s and early 1980s) with the result that employment increased by more than 100,000 during the year. Since the provincial economy has been operating at capacity during the decade, this very large bulge in employment represented in-migration. So far in 2007, the acceleration in growth shows little signs of abating. The impact is on the housing market, so evident in housing starts and in the extraordinary increases in the selling prices of existing homes in Edmonton and Calgary.

The Oil Sands and Employment Growth

What does the current rate of development in the oil sands have to do with these price and job pressures in Alberta? We can begin with Figure 11 (below) showing the path of crude oil prices since January of 1999. Of special interest is the acceleration commencing in late 2003 that coincides with the Iraq War and increased Middle East supply uncertainties. In this changing international environment, reinforced by the incentive of substantially higher crude oil prices, the resource value of the oil sands grew commensurately. The conditions for more rapid development were in place.

Figure 11. Index of Crude Oil Prices, January 1999 = 100



Source: Statistics Canada

The impact of development under a variety of price scenarios and policies instituted by the resource owner (the Alberta government) have been laid out in studies by the Canadian Energy Research Institute (CERI) using the methodology of a provincial input/output model. This generates estimates under a variety of scenarios of the direct and indirect impacts of oil sands development on GDP, on employment, and on government revenues. The estimated impact on Alberta employment is of special interest here. Selected findings on employment requirements and their implications are found in Table 1 (below). The table shows these for two years—2005 and 2010.

Table 1. Impact of Oil Sands Production and Development on Alberta Employment

Year	Employment Impact (Thousands of Person Years))	AB Employment (Thousands of Person Years)	Long Term Average Growth %	Growth Due To Oil Sands %
2005	123	1,784		
2010	239	2,018	47.0	23.2

Source: CERI, Economic Impacts of Alberta's Oil Sands Vol. 1 Study No. 110, October 2005

The estimated employment requirement for 2005, both direct and indirect, of oil sands development is calculated at 123,000 person years. This amounts to 6.9% of 2005 employment levels. The CERI model estimates that under a resource owner policy of unconstrained growth and at a crude oil price averaging $40/barrel, direct and indirect employment requirements in 2010 would amount to 239,000 person years, or an average increase just over 23,000 per year. Should 2005 employment levels increase at the long term average rate of 2.4% through 2010, then the oil sands employment requirement of 239,000 person years would amount to 11.8% of provincial employment. The required annual increase of just over 23,000 person years would amount to very nearly one-half of the 47,000 person years, the long term average increase in absolute numbers over the period.

Note that unconstrained oil sands development is superimposed on an economy that has been operating at full capacity for a number of years. In these conditions what will happen is what we see. Namely, price and cost pressures—specifically in housing, shortages of labour, in-migration, feedback effects to in-migration from housing shortfalls, and wage pressures.

How to Cope

What are the options for restoring levels of sustainability to the Alberta economy?

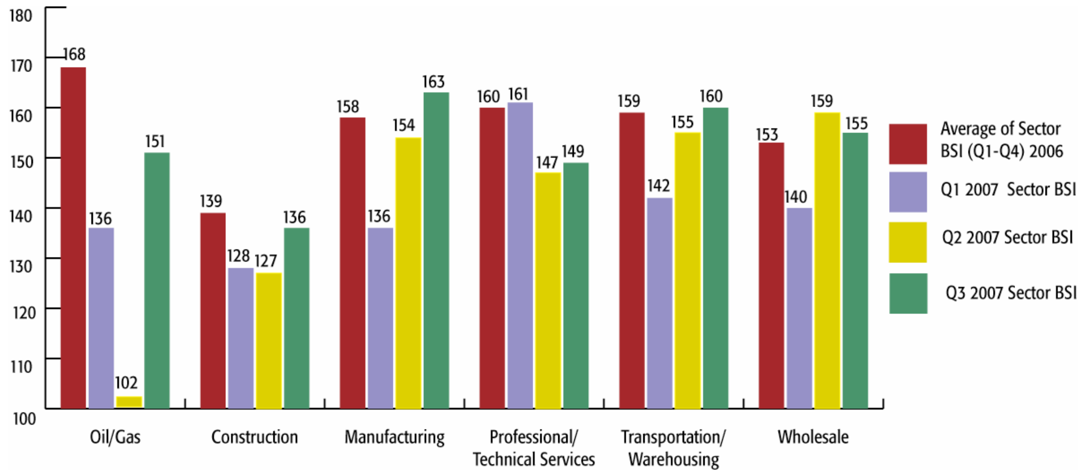
One possible approach is to allow market forces to correct the situation. In this option the resource owner, the Alberta government, allows market forces in the form of either crude oil prices or costs of production, or a combination of the two, to determine the pace of oil sands development. Market conditions in Alberta have no effect on crude oil prices—the province is a price taker and what happens in the province has no relevance for these prices. However, cost conditions are very much influenced by market conditions in Alberta since about one-half of direct and indirect oil sands expenditures are intra-provincial. The costs of acquiring and maintaining the services of qualified labour and assuring high levels of productivity in labour utilization are very much dependent on provincial market conditions. In these circumstances constraints have already emerged and will likely continue on the cost side. Were oil sands contractors squeezed, not only by costs but also by a falling off in crude oil prices, the general impact might be both quicker and more severe. Just as importantly, their effects as they grew would extend substantially beyond the orbit of the oil sands.

An alternative approach is for the resource owner, the provincial government, to also determine the pace of development. To do so would be to acknowledge the presence of extreme inflationary pressures and through legislation allow an appropriate authority to set the pace of development subject to the capacity of the provincial economy to accommodate it. What monetary policy, which is essentially national, cannot do—namely tame inflation that is highly specific to a province—the owner of the resource that underlies the cost-price pressures can do. The resource owner can set terms under which resource exploitation occurs consistent with provincial economic health and sustainability.

Industry Sector Sentiment

Figure 12 (below) contains a comparison of industry sector sentiment for Q3 2007 with that for Q2 2007, Q1 2007 and the average for 2006. The most notable feature here is the turnaround in the oil and gas sector from Q2 2007 which is a response to the actual and forecast increase in natural gas prices. The BSI of other sectors, save Professional and Technical Services, are approaching the 2006 quarterly average.

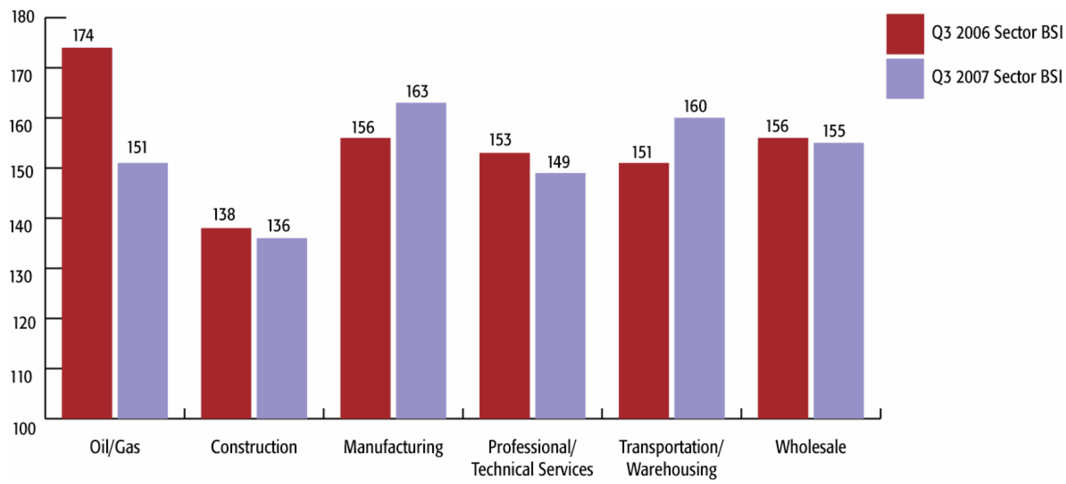
Figure 12. Business Sentiments Sector Indexes: All Quarters 2006, Q1 2007, Q2 2007 and Q3 2007



Source: WCER

A BSI sector comparison of Q3 2007 with Q3 2006 (Figure 13 below) suggests approximate equivalence in projected activity across all sectors with the exception of Oil and Gas.

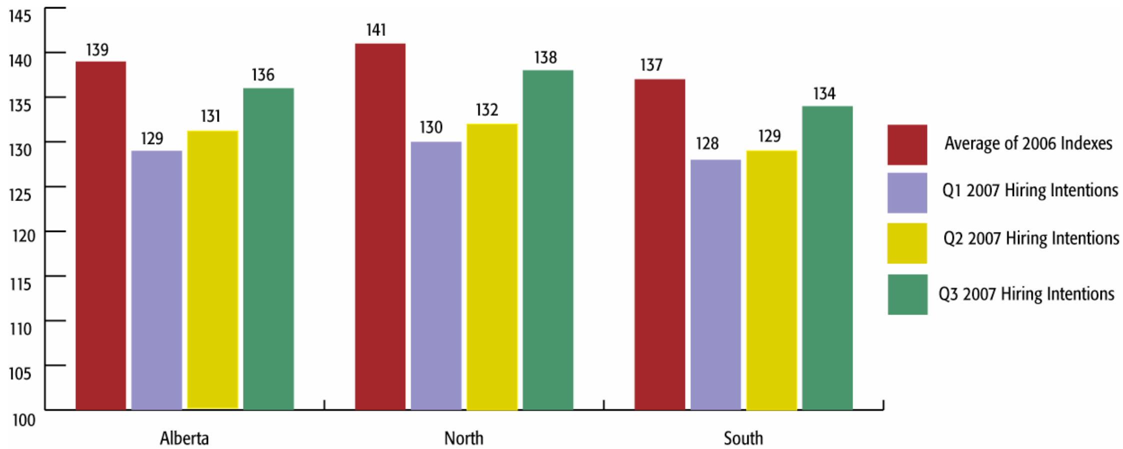
Figure 13. *C*omparison of Business Sentiments Sector Indexes: Q2 2006 and Q2 2007



Source: WCER

The quarterly survey also generates information on jobs created by Alberta firms in the form of the ATB Financial Index of Hiring Intentions. This index shows increased labour demands approaching those of the quarterly average of 2006.

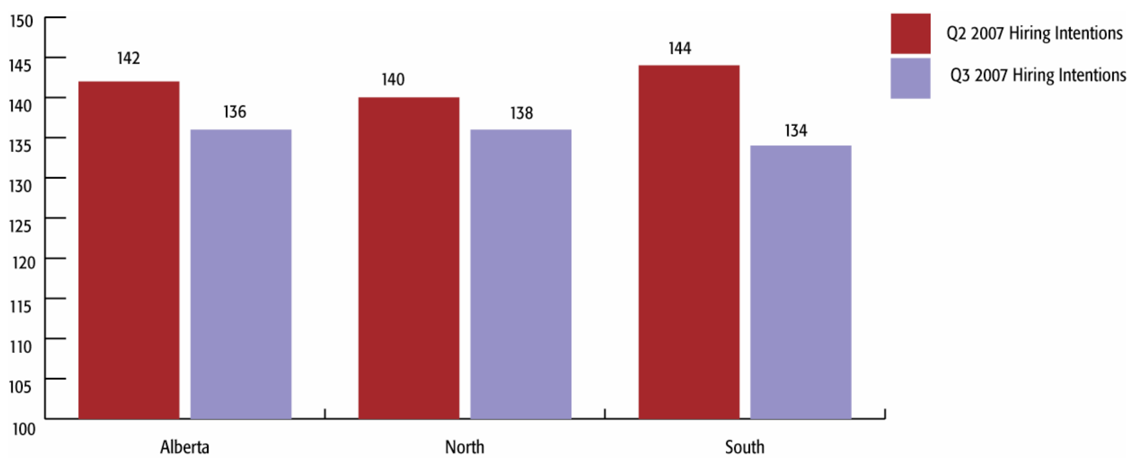
Figure 14. Comparison of ATB Financial Index of Hiring Intentions: All Quarters 2006, Q1 2007, Q2 2007 and Q3 2007



Source: WCER

A comparison of hiring intentions in Q3 2007 with Q3 2006, as shown in Figure 15 (below), confirms the anticipated strength of labour market demands

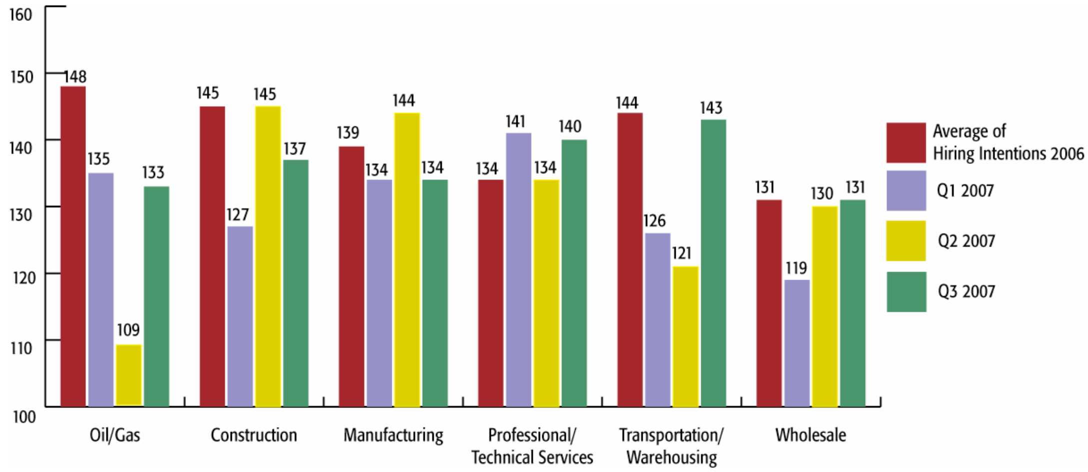
Figure 15. ATB Financial Index of Hiring Intentions: Q3 2006 and Q3 2007



Source: WCER

Figure 16 (below) compares hiring intentions by industry sector of the first three quarters of this year and the average for 2006. The results indicate hiring intentions compared with Q2 2007 to accelerate in Oil and Gas, Professional and Technical Services, Transportation, and Wholesaling; they will decelerate in Manufacturing and Construction. There is a clear rebound in the Oil and Gas sector.

Figure 16. Comparison of Hiring Intentions by Sector: All Quarters 2006, Q1 2007 and Q2 2007



Source: WCER

More on Industry Sectors

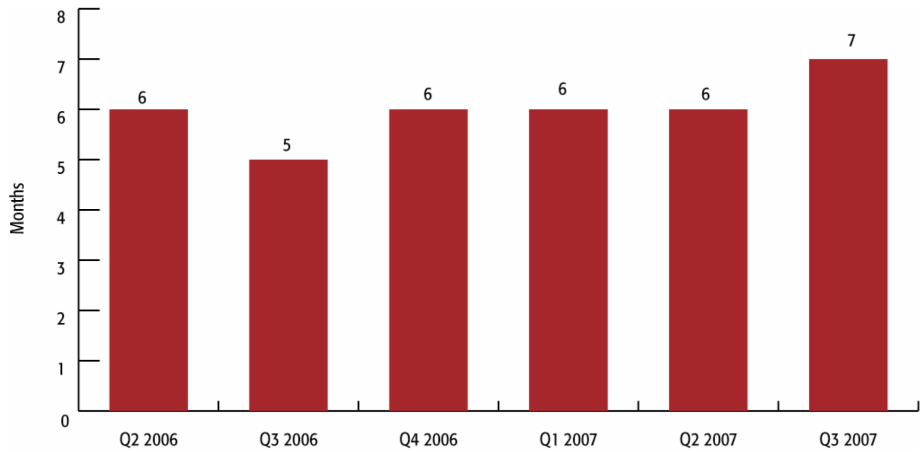
Oil & Gas

Of the 68 respondents, 28% experienced increased activity over the past three months while 38% indicated that their activity had decreased. This decrease was anticipated by 32% of respondents in the last survey. In the coming Q3 2007, only 8% expect a decrease in activity. With respect to hiring intentions, some 58% of respondents indicated there would be no change in employment in the coming quarter. 37% of respondents indicated they would add employees while 5% indicated there would be a decrease in employment.

Construction

Of the 67 respondents in Construction, 59% indicated that their activity had increased in the past three months and 31% indicated that their activity levels had remained unchanged. This compares with 43% and 45% respectively for Q2 2007. 39% indicated that their current contract work was more than sufficient while only 3% indicated that it was insufficient. Some 40% indicated that they planned to increase employment in the coming quarter while 57% planned no change in employment. Only 3% planned to have fewer workers in the coming quarter. Figure 17 (below) indicates that, assuming normal working hours, one-half of the respondents have at least seven months work in hand or already under contract. Further, 39% of respondents had a backlog of one year's work, up from 29% in Q2 2007, and 5% had a backlog of two year's work.

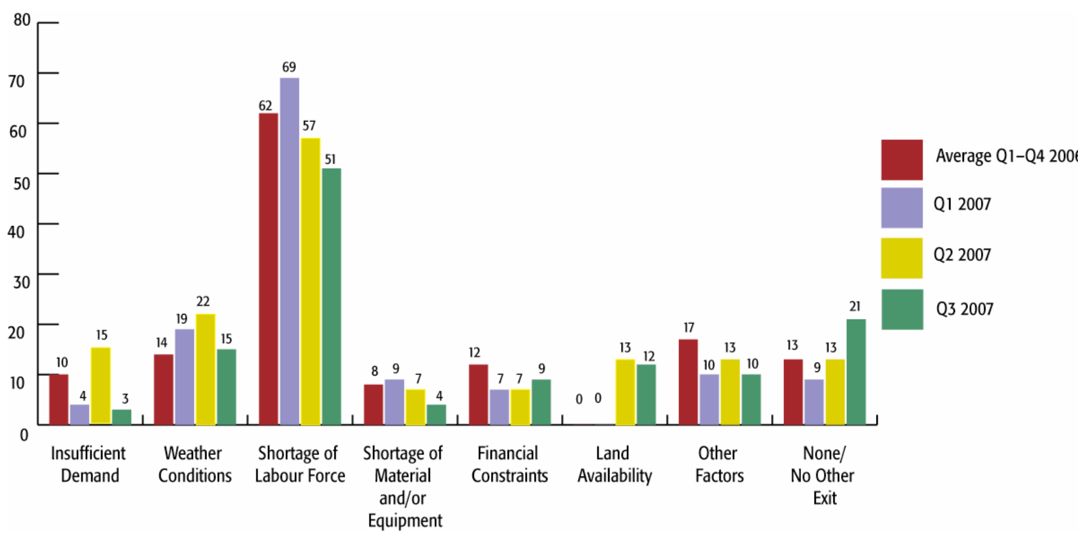
Figure 17. Median Number of Month's Work Accounted for by Work in Hand or Already Under Contract: All Quarters 2006, Q1 2007, Q2 2007 and Q3 2007



Source: WCER

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. Figure 18 (below) reveals that the shortage of labour was identified as an inhibiting factor by 51% of respondents, slightly lower than in past quarters. Weather conditions (15%), land availability (12%), and financial constraints (9%) were next in importance. 21% of respondents expected no constraints. 41% of respondents expect the prices they charge to increase in Q3 2007, down from 49% in Q2 2007. 58% expect no change in prices.

Figure 18. Factors Limiting the Construction Sector: All Quarters 2006, Q1 2007, Q2 2007 and Q3 2007

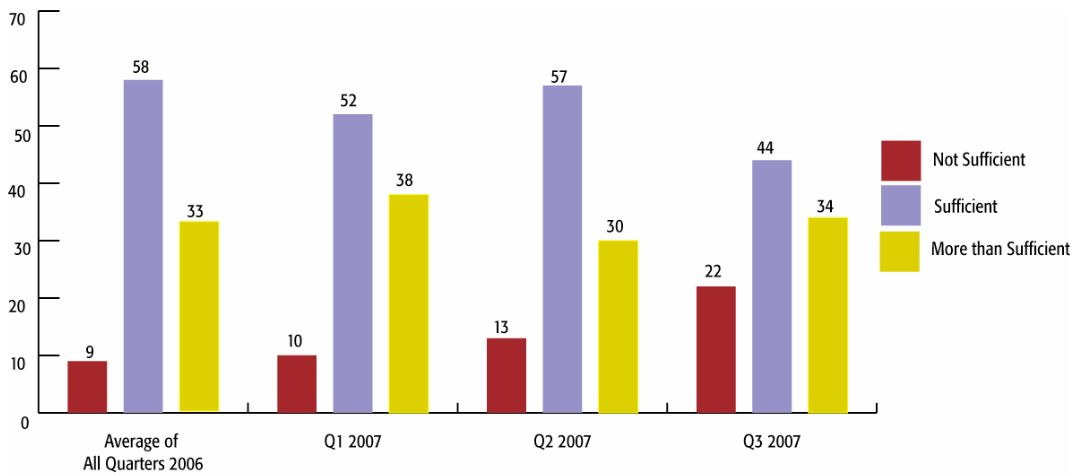


Source: WCER

Manufacturing

Half of the 68 manufacturing respondents indicated that their production had increased over the past quarter. Some 72% anticipate further increases in production over the coming quarter, up from 64% in the last survey, and 35% plan to increase employment. With regard to orders, Figure 19 (below) shows that 34% of respondents indicated that there were more than sufficient orders while 22% regard current orders as insufficient, up from 13% in the last quarter. 77% of respondents regard their stocks of finished products as adequate for needs.

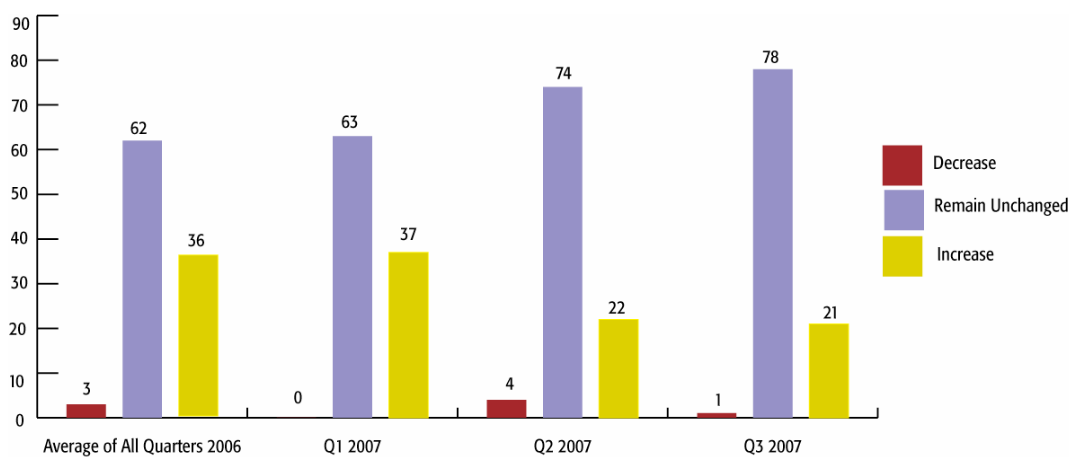
Figure 19. Orders on Hand, Manufacturing Sector: All Quarters 2006, Q1 2007, Q2 2007 and Q3 2007



Source: WCER

Figure 20 (below) reveals that just over three-quarters of respondents expect their selling prices to remain unchanged in the coming quarter.

Figure 20. Manufacturing Price Expectations: All Quarters 2006, Q1 2007, Q2 2007 and Q3 2007



Source: WCER

Professional and Technical Service

There were 68 respondents in this group of which 56% experienced increased demand for their services during Q2 2007, up from 48% in the previous survey. In the coming quarter, 59% expect demand to increase and 40% plan to increase employment. No change was expected by 31% and 60% of respondents respectively.

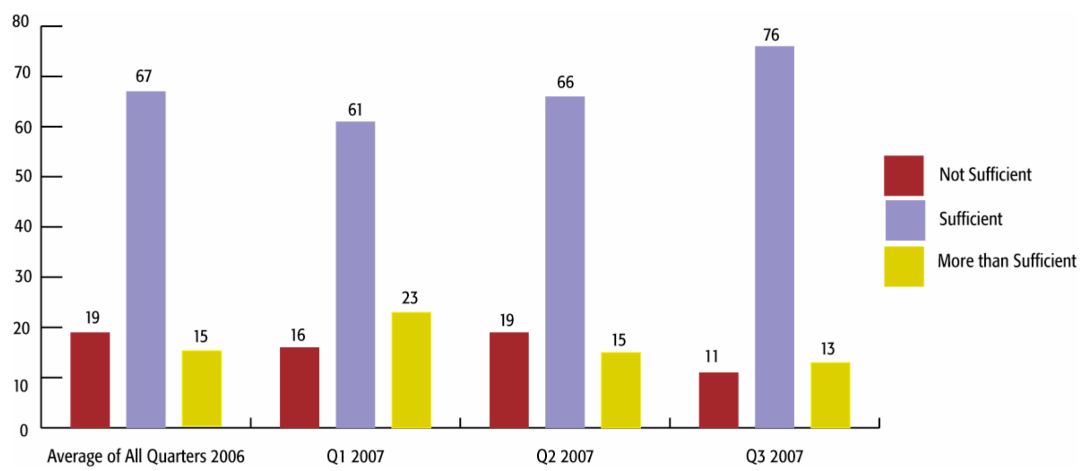
Transportation/Warehousing

Of the 68 respondents in this group, 38% recorded increased business while 21% experienced decreases in Q2 2007. 28% increased employment in Q2 2007. Almost two-thirds expect their business to increase again in Q3 2007 while 3% expect decrease in business. Almost half of the respondents are planning to add employees while 44% plan for no change in employment.

Wholesalers

Of the 68 respondents in this group, one-half recorded increased business while 22% experienced decreased business in Q2 2007. As shown in Figure 21 (below), three-quarters of firms believe their inventories to be sufficient for the coming quarter. 58% plan to place increased orders with suppliers in Q3 2007 while 30% will leave their orders unchanged.

Figure 21. Wholesale Firms' Satisfaction with Current Inventory Levels: All Quarters 2006, Q1 2007, Q2 2007 and Q3 2007



Source: WCER