

# State of the Economy

## *Calgary Semi-Annual Economic Review*

June 2007

### **State of the Economy - Overview**

In late 2006, as we looked forward into 2007, Calgarians were asking “could 2007 be like 2006 – could we perform as strongly?” 2006 was a record year and anything short of a repeat performance would be a slowdown.

CED forecasted a slower rate of growth in 2007 than in 2006, and now that nearly half the year is over, taking stock, it appears our economy has slowed down, but not to the level forecasted and is performing better than forecasted, particularly in building permit value and employment growth.

This year’s economy looks very similar to last year’s with the exception of two things: pace; and cost. If 2006 was an economy in fifth gear, 2007 is more like the throw between third and fourth – a very healthy pace but a slight slowdown. Driving this difference is largely lower energy prices and limited labour pools, which have scaled back the imperative and reality of trying to get everything done all at once.

The Calgary economy experimented with the “get it all done today” approach in 2006 and found that it strained resources to unsustainable levels. In 2007, businesses recognize that there are limits to what can be done, particularly as a result of limited labour pools.

The intense level of demand, and hence competition, to get things done in 2006 created significant cost increases that are still being borne in a slightly slower economy. Therefore we are at a higher cost of business now than we were at the same time last year.

Inflation will be a measure to watch for the balance of the year, for increasing price pressures will impact Calgary’s ability to retain companies in certain sectors, specifically manufacturing, and will impact Calgary’s ability to attract and retain labour, as housing costs are being driven to new highs. This is a particularly critical issue for those on low and fixed incomes.

Therefore, at mid-point, 2007 looks very similar to 2006 but a slower, more sustainable pace, with tightness still being experienced around labour, commercial and industrial space, and an overall higher cost of business. These areas of tightness are the brakes on the economy, holding us back from higher levels of performance.

## Sectoral Analysis

Calgary's economy overall is extremely healthy with nearly 8,000 net new jobs created since January 1, continued wage gains, and continued demand for retail goods and real estate. Looking at employment growth shows some more specific patterns within the Calgary economy in terms of performance of specific sectors:

- **Energy** – the energy sector has remained strong as a result of higher than expected oil prices in the first half of the year, particularly in the second quarter. Rising yet still soft natural gas prices have impacted the gas side of the industry, however overall employment gains have been very healthy at 5,700 jobs YTD. Expected healthy oil prices and increasing natural gas prices over the balance of 2007 are expected to support continued strength in the energy sector.
- **Construction** – existing major commercial, infrastructure and residential construction projects are all driving demand for construction activity. While employment has been lost in the first half of the year, with \$22.5 billion worth of major capital projects underway or on the books, continued strong construction sector activity and employment for the balance of 2007 seems virtually certain.
- **Manufacturing** – manufacturers are being hit with a perfect storm of competitive pressure on their operations: the rising Canadian dollar; rising labour costs locally; rising input costs; and rising real estate costs. Despite this they have been able to maintain employment growth. Manufacturers face an uphill battle in Calgary particularly if their markets are outside Alberta where cost increases cannot be as easily passed along to the customer. Despite this, it is an amazingly resilient and healthy sector that is spurring innovation across its practices to stay competitive.
- **Transportation and Logistics** – having faced employment declines over 2006, Transportation and Logistics has rebounded in 2007. This is likely the result of companies working to aggressively retain and attract workers to an industry that has struggled to retain workers. Calgary's continued growth as a distribution centre should serve to maintain demand for business and hence workers in this sector.
- **Business Services** – companies providing business services are experiencing continued strong demand for their services and therefore employment growth. Continued strength in Calgary's overall economy, particularly in the energy sector will likely continue to drive strong performance in the business services segment.
- **Tourism** – the tourism industry is another segment impacted by two economic conditions: a high Canadian dollar; and rising wages. A higher Canadian dollar will likely continue to put a damper on international travel into Calgary for the balance of 2007. In a rising wage environment, the tourism industry, largely lower wage jobs, is being challenged to compete for workers in Calgary's extremely tight labour market. These two forces have driven employment losses in the sector in the first half of the year. The busy summer tourism season will likely see employment rise into the second half of the year but still remain softer as a result of these two forces.

## Looking Forward

The second half of 2007, all else equal, should continue to perform at a very healthy and respectable level. Continued employment growth driven by continued healthy energy prices, capital projects, business investment and retail spending will provide for a stable and likely nation-leading urban economic growth rate for 2007.

While there are no dark clouds on the horizon, as identified in the 2007 Economic Outlook, there are three pressure points that are exerting a restraining force on the local economy: labour shortage, office space shortage and an affordable housing shortage.

Despite the stronger than expected performance of the Calgary economy in the first half of 2007, these pressure points are still factors to watch that, depending on their magnitude, may begin to apply a greater brake to the economy than currently. This could likely be in the form of continued high inflation, which some businesses and individuals will face increasing challenge in meeting. Ultimately, these pressures could impact Calgary's attractiveness as a place to do business and to live, therefore efforts across government and private industry to create solutions to meet these pressures head on will be needed.

## Consumer Price Index/ Inflation

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### Consumer Price Index and Inflation

High housing costs are keeping inflation high. In May, prices paid by Calgarians for goods and services, as measured by the Consumer Price Index (CPI) basket rose by 5.0% since May 2006. From May 2006 to May 2007, increases in the shelter (owned and rented accommodation) component of the CPI, which accounts for roughly one quarter of the consumer's basket of goods and services were estimated at 11.5%, while the price of water, fuel and electricity grew by 3.0%.

Indicator	May 2007	Dec 2006	May 2006	YTD Change (Inflation)		YOY Change (Inflation)	
<b>CPI (2002=100)</b>	117.6	114.7	112.0	2.9	2.5%	5.6	5.0%

## Labour

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### Average Hourly Wage Rate (Alberta)

The strong labour market currently experienced in Alberta continues to exert pressure on the province's wages, which increased by 4.9% from May 2006 to May 2007. This growth was tempered by a 5.0% rise in consumer prices over the same period, as discussed above.

## Employment

Calgary's economy created 7,900 new jobs (1.1% increase) since January 1 and 36,500 new jobs (5.2% increase) since May 2006. Total employment was estimated at 732,400 in May 2007, up from 695,900 a year prior. Job gains averaged about 43,000 for the first five months of this year, compared to 42,500 in 2006. Calgary accounted for 41% of the job creation in Alberta.

## Unemployment Rate

Calgary's unemployment rate rose to 3.3% in May 2007, compared to 2.6% in December of the previous year and 3.2% in May 2006, as the labour force grew at a faster pace than employment.

## Employment by Industry

The services producing industries led the way in job creation, adding 5,200 more since December 2006 and 19,200 more since May 2006. Over the past year, across both the goods producing sector and services producing sector, the major drivers were Utilities (44.3%, Business, Building and other Support Services (16.3%) and Construction (14.6), while a downward trend was experienced by Accommodation and Food Services (-22.5%) and Information, Culture and Recreation (-1.3%).

Indicator	May 2007	Dec 2006	May 2006	YTD Change		YOY Change	
Average Hourly Wage Rate	\$21.97	\$21.62	\$20.95	\$0.35	1.6%	\$1.02	4.9%
Employment	732,400	724,500	695,900	7,900	1.1%	36,500	5.2%
Unemployment Rate	3.3%	2.6%	3.2%	0.7%	-	0.1%	-
<b>Employment by Industry</b>							
Total Industries	732,400	724,500	695,900	7,900	1.1%	36,500	5.2%
Goods-Producing Sector	194,300	191,600	177,000	2,700	1.4%	17,300	9.8%
Agriculture	4,900	5,400	4,500	-500	-9.3%	400	8.9%
Forestry, Fishing, Mining and Oil & Gas	61,100	55,400	56,000	5,700	10.3%	5,100	9.1%
Utilities	10,100	9,100	7,000	1,000	11.0%	3,100	44.3%
Construction	64,400	68,200	56,200	3,800	-5.6%	8,200	14.6%
Manufacturing	53,700	53,500	53,200	200	0.4%	500	0.9%
Services-Producing Sector	538,100	532,900	518,900	5,200	1.0%	19,200	3.7%
Trade	102,500	101,400	100,800	1,100	1.1%	1,700	1.7%
Transportation and Warehousing	45,900	37,000	43,300	8,900	24.1%	2,600	6.0%
Finance, Insurance, Real Estate and Leasing	46,000	44,100	42,400	1,900	4.3%	3,600	8.5%
Professional, Scientific and Technical Services	81,200	80,400	79,400	800	1.0%	1,800	2.3%
Business, Building and Other Support Services	29,300	26,900	25,200	2,400	8.9%	4,100	16.3%
Educational Services	48,600	51,800	47,700	3,200	-6.2%	900	1.9%
Health Care and Social Assistance	63,500	62,000	62,600	1,500	2.4%	900	1.4%
Information, Culture and Recreation	31,100	32,000	31,500	-900	-2.8%	-400	-1.3%
Accommodation and Food Services	33,400	45,900	43,100	12,500	-27.2%	-9,700	-22.5%
Other Services	32,200	33,400	20,800	1,200	-3.6%	11,400	54.8%
Public Administration	24,300	18,000	21,900	6,300	35.0%	2,400	11.0%

## Retail Trade

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### Retail Sales (Alberta)

Alberta retail sales surged by 13.3% in March 2007 compared to March 2006, nearly topping \$5 Billion. Christmas spending is reflected in December's sales of more than \$5.5 Billion. In the first quarter of 2007, gains were observed across all industries, however, the largest sales increases were represented by motor and recreational vehicle dealers, gasoline services stations and clothing & accessories retailers.

Indicator	Mar 2007	Dec 2006	Mar 2006	YTD Change		YOY Change	
<b>Retail Sales (\$Millions)</b>	\$4,930.7	\$5,541.1	\$4,354.5	-\$610.4	-11.0%	\$577.2	13.3%

## Construction

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### Housing Starts

Calgary year-to-date housing starts decreased over the past year, from 7,140 in May 2006, to 5,777 in May 2007. The decline was largely reflected in single housing starts, which plunged by nearly 31% over the same period, offset by all other types of housing starts, which increased by 2.1%. It should be noted that single-detached housing starts in May 2006 were the highest ever for any month on record and that this year is a more typical year.

Indicator	May 2007	May 2006	YTD Cumulative		YOY Change	
			2007	2006		
<b>Total</b>	1,633	2,010	5,777	7,140	-1,363	-19.1%
<b>Single-Detached</b>	718	1,166	3,204	4,621	-1,417	-30.7%
<b>All Others</b>	915	844	2,573	2,519	54	2.1%

### Building Permits

The Bow (slated to be the tallest building west of Toronto) was the highest construction value ever applied for in Calgary's history and contributed to another record month for Calgary construction values in May 2007. Total building permit values reached 1.1 Billion in May, bringing the year-to-date total to \$2.51 Billion. Non-residential permit values saw the largest increase in year-to-date growth, with \$1.5 Billion this year compared to \$722 Million last year – an increase in value of more than 100%. The continued growth in Calgary's building permits is a testament to the confidence businesses have in Calgary as a place to invest.

Indicator	May 2007	May 2006	YTD Cumulative		YOY Change	
			2007	2006		
<b>Total (\$Millions)</b>	\$1,118.6	\$351.0	\$2,514.3	\$1,718.9	\$795.4	46.3%
<b>Residential (\$Millions)</b>	\$279.0	\$156.9	\$1,042.7	\$996.9	\$45.8	4.6%
<b>Non-Residential (\$Millions)</b>	\$839.6	\$194.1	\$1,471.6	\$722.0	\$749.6	103.8%

## Major Projects

The cost of major Calgary projects (\$5 Million or more) has aggressively climbed over the past year, with a 47.1% increase from May 2006 to May 2007. Continuing the trend, costs jumped 24.0% since December 2006. The project sectors with the highest costs this past month were Infrastructure, Commercial/ Retail and Institutional.

Indicator	May 2007	Dec 2006	May 2006	YTD Change		YOY Change	
<b>Cost (\$Millions)</b>	\$22,552.3	\$18,181.6	\$15,334.1	\$4,370.7	24.0%	\$7,218.2	47.1%
<b>Number</b>	244	239	215	5	2.1%	29	13.5%

## Real Estate

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### Residential

#### New Housing Price Index

Calgary's price advances are mostly attributable to high costs for materials and trade labour. Most of the 27.4% increase was experienced in 2006, as the year to date increase has been relatively small, at 3.3%. Land prices have also risen as a result of development beginning on new land and limited supply of developable land.

Indicator	April 2007	Dec 2007	April 2006	YTD Change		YOY Change	
<b>New Housing Price Index</b>	244.9	237.1	192.3	7.8	3.3%	52.6	27.4%

### MLS Sales

Single family sales in May 2007 were 1,995, a slight decrease from the 2,040 sales in May 2006 – however, 2007 year-to-date sales well surpassed those of 2006 by 4.2%. The average price of a single family home in May 2007 was \$487,523, showing a 17.2% increase over May 2006, when the average price was \$415,815. The condo market showed even stronger price growth of 21.5% over the same period, with sales increasing from \$273,407 to \$332,237. With the recent increase in MLS listings, industry professionals are seeing a shift in the market, giving it more balance.

Indicator	May 2007	May 2006	YTD Cumulative		YOY Change	
			2007	2006		
<b>Single Family</b>						
Sales	1,995	2,040	9,775	9,378	397	4.2%
Average Sale Price	\$487,523	\$415,815	-	-	71,708	17.2%

<b>Condominium</b>						
Sales	887	892	4,379	3,923	456	11.6%
Average Sale Price	\$332,237	\$273,407	-	-	58,830	21.5%

## Commercial

### Downtown Office

With the extremely tight supply and strong demand in the downtown commercial real estate market over the recent quarters, the 1,282,000 SF of new supply made available in the first quarter of 2007 impacted the market. The newly available premises in Livingston Place, Opus 8, and Centrium Place drove net absorption rates up to 853,003 SF for the quarter, nearly twice the net absorption in the downtown market for all of 2006. Additionally, downtown vacancy rates rose to 1.8 per cent with both headlease and sublease space becoming available as tenants vacated premises to occupy new buildings. While this vacancy rate represents a significant increase from previous quarters, it remains low by historical standards.

This is reflected by the asking lease rates across all downtown classes continuing to rise through the first quarter of 2007. Average asking rates for all classes reached \$36.31 psf in the first quarter of 2007. The effect of the newly completed construction was felt in the market for Class "AA" premises where asking rates fell slightly to \$46.18 psf, reflecting the rates negotiated in pre-leasing arrangements, which were lower than current asking rates.

While demand remains strong and downtown office markets remain tight, the completion of new construction will continue to work towards balancing this market going forward. A total of 5.21 million SF of office space in eight buildings is scheduled to be added to the downtown market over the next several years. This includes the newly announced Penny Lane project, with 225,000 SF expected to be added to the market in 2007 with the completion of Homburg-Harris I.

<b>Indicator</b>	<b>Q1 2007</b>	<b>Q4 2006</b>	<b>Q1 2006</b>
<b>Absorption</b>	858,003	10,285	276,168
<b>Vacancy Rate</b>	1.8%	0.5%	1.2%

### Suburban Office

In the suburban market the 144,000 SF of new supply was not able to slow the increase in asking lease rates, which rose to a new record high of \$21.15 psf. Net absorption was 134,200 SF, nearly equaling the amount of new space added to the market. As a result, vacancy rates rose marginally to 2.1 per cent. The 820,000 SF of new space expected to become available in the near term is not expected to keep pace with demand. The 2,730,000 SF of new space to be added before the end of next year is expected to have enough of an impact to alleviate the tight market.

<b>Indicator</b>	<b>Q1 2007</b>	<b>Q4 2006</b>	<b>Q1 2006</b>
<b>Absorption</b>	130,779	338,948	271,011
<b>Vacancy Rate</b>	2.1%	1.9%	5.6%

## Industrial

New construction continues in the industrial real estate sector, with 1.3 million SF completed in the first quarter of 2007. This helped bring both vacancy and availability rates to more sustainable levels than experienced in recent quarters, and allowed an eighth consecutive quarter of positive net absorption at 917,000 SF. Demand for industrial land remains strong, which allowed average rental rates to rise to \$8.96 psf in the quarter. Rising lease rates support further new development in this area as they offset the higher costs faced by developers, including higher land costs. Prices rose to an average of \$640,000 and \$300,000 per acre for serviced and limited service land respectively, and are expected to continue to rise with continued interest in developing new projects. As such, 1.7 million SF of new industrial projects is expected to be completed this year.

Indicator	Q1 2007	Q4 2006	Q1 2006
Absorption	916,848	902,096	1,727,032
Vacancy Rate	1.6%	0.8%	1.6%

### Sources:

Alberta Human Resources and Employment  
 CB Richard Ellis  
 Calgary Real Estate Board  
 Statistics Canada, CANSIM (provided by Alberta Finance-Statistics, ASIST)

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