State of the Economy

Calgary Semi-Annual Economic Review
December 2007

State of the Economy - Overview

If the Calgary economy were likened to the landing of a plane, the pilots of flight 2007 would indicate we are at good speed and have come in for a "soft landing."

Last year, at the 2007 Economic Outlook, Calgary Economic Development forecasted the economy would slow in 2007 from the blistering pace of 2006. And that it has. But it has shown tremendous resilience and has slowed to a still very healthy and enviable level.

The economy has performed well in 2007, with overall economic growth forecast to come in the 4 per cent real GDP annual growth rate range. Companies found ways to continue solid economic performance and hiring despite, record low unemployment, limited real estate options and a rising cost environment.

The overheated, unsustainable economy of 2006 created one challenging scenario for the economy and population in 2007 – inflation. The inflation rate in 2007 saw a high of 5.7 per cent year over year, driven predominantly by the rising price of housing and replacement costs. With the slowing of housing price growth in the latter part of 2007, the rate of inflation has cooled, and should be a less significant issue for 2008.

Employment growth in 2007 has slowed from a phenomenal 8.1 per cent in 2006, to a cooler 1.7 per cent year over year as of November 2007. Companies are figuring out how to do more with fewer people, as the labour shortage entrenches itself as part of Calgary's economy and is no longer a short-term news story. But there has also been rationalization of employment in Calgary whereby companies are allocating jobs to a level more reflective of long-term sustainable trend, and not the ramped up level which companies may have brought themselves to in order to try and achieve the 2006 workload.

What will truly be remembered as 2007 economic landscape hallmarks were a range of macro-economic conditions faced by Calgary businesses and Calgarians alike:

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- Canadians going south to shop – few expected the Canadian dollar to reach parity with the U.S. dollar this year, let alone reach $1.10 at any point in trading – but it did. This created a wave of Canadians going south for shopping, but at home has created a greater headwind for the manufacturing sector that relies on exports for their business, has made Canada a less attractive location for film, and has reduced returns for the oil sector as their revenues are based on a U.S. dollar price per barrel. The Canadian dollar has since retreated from that high and as of December 2007 was floating near parity or slightly stronger than.

- Low natural gas price – natural gas has been hit hard in 2007, a continued trend from 2006. Prices remain depressed due to moderate weather and high inventory levels. This has affected numerous firms in Alberta, particularly gas services companies. Expectations are for higher gas prices in 2008 but likely not to a level high enough to generate significant growth in this side of the energy sector.

- $100 Oil – oil *nearly* reached $100 U.S. a barrel in 2007 fueled by high global demand, tight supply, refining capacity and geo-political risk premiums. Slowing U.S. demand, OPEC production increases and continued uncertainty regarding the stability of the U.S. economy have brought oil down from that near milestone. Overall global oil demand still remains robust from economies like China and continues to fuel activity in Alberta's energy sector.

- U.S. housing market correction – August saw markets react to significant concern regarding the sustainability of the U.S. housing market, particularly in light of the proportion of sub-prime mortgages that are posing significant default risk in the U.S. The short-term asset-backed paper market crashed during the month of August and saw some significant losses amongst corporate and individual portfolios, however impacts in Canada were far less than in the U.S. While a high degree of stability has been re-injected into both the U.S. and Canadian economies, concern still exists regarding the short-term health of the U.S. economy and housing market.

Finally, the major topic for the Alberta and Calgary economies in 2007 was the Provincial government's revisions to the energy royalty program. While the exact impacts on the economy have yet to be determined, there are mixed opinions amongst Albertans and energy companies as to the extent of the changes and their effects on business, employment, overall cost of extraction and future drilling activity and investment. Many companies will be spending much of late 2007 and 2008 flowing the new royalty regime into their models to assess the overall impact to their operations and investments. It is therefore too early to tell exactly how the new program will impact the economy once it comes into force January 1, 2009.

Overall, Calgary companies are tired, with 2007 spent trying to catch their breath from 2006, while still trying to satisfy demand and keep business operations stable. Many have used 2007 as a means of re-evaluating business processes, and trying to do what they can with what they have. 2007 will be a year that the economy performed well, despite a range of macro-economic conditions that put varying degrees of pressure on companies, and one where we returned to a more sustainable, stable flight path than we had in 2006.

Looking Forward

- The global economy is expected to cool off slightly in 2008, as central banks around the world begin raising interest rates in an effort to stem inflation. The timing and magnitude of these rate hikes will in many instances be highly dependent upon the state of the U.S. economy however.

- Uncertainty regarding the credit crisis in the U.S. will create a slow year for the U.S. economy, and may further impact the Canadian economy depending on how much further the crisis extends. Canada's, and therefore to some degree Calgary's, economy will be impacted should interest rates rise and/or the Canadian dollar rise further.

- Calgary's economy should continue its slower growth trend off the peak in 2006, to a more sustainable level, a level of economic growth slower than 2007, yet one that is very healthy, and the envy and desire of any city around the world.

- Calgary's higher housing costs and limited rental housing should serve to curb in-migration and slow population growth, resulting in population growth for 2008 between 22,000 and 25,000.

- Continued high demand for labour, yet uncertainty regarding labour supply and natural gas impacts, should bring employment growth in at 2.5 to 3 per cent in 2008.

- Labour supply is expected to remain tight, resulting in a continued low unemployment rate of between 3 and 3.3 per cent over 2008.

- Inflation should moderate in 2008, with price escalation of the main contributor to our high inflation – housing – slowing to more reasonable levels of 3 to 3.5 per cent in 2008.

- Housing market fundamentals remain healthy and in place, however slowing in-migration and the plethora of listings should bring housing starts in at 13,500 – 14,000 in 2008.

- Given the slowing trend of Calgary's economy, uncertainty around natural gas prices, and an unclear picture of how the U.S. economy will perform in 2008, Calgary's real GDP growth is forecast at 3.3 to 3.8 per cent in 2008.

Consumer Price Index/ Inflation

Consumer Price Index and Inflation

From October 2006 to October 2007, prices paid by Calgarians for goods and services, as measured by the Consumer Price Index (CPI) basket, rose by 4.6 per cent. Over this same period, increases in the shelter component of the CPI (which accounts for roughly one quarter of the consumer's basket of goods and services), were 9.4 per cent, with the price of water, fuel and electricity increasing by 13.5 per cent.

Indicator	Oct 2007	Dec 2006	Oct 2006	YTD Change Inflation %	YOY Change Inflation %
CPI (2002=100)	118.7	114.7	113.5	3.5	4.6

Labour

Average Hourly Wage Rate (Alberta)

Despite some cooling off, demand for labour in Alberta continues to be strong. Seasonally adjusted unemployment was 3.6 per cent for November 2007, with 53,000 jobs created in Alberta over the same time last year. The current labour market in Alberta continues to exert pressure on the province's average hourly wages, which increased by 8.0 per cent from November 2006 to November 2007.

Employment

As expected at this time last year, employment growth in Calgary has cooled off in 2007. Calgary's economy created 9,500 new jobs (1.3 per cent increase) since January 1 and 12,600 new jobs (1.7 per cent increase) since November 2006. Total employment was estimated at 734,000 in November 2007, up from 721,400 a year prior. Calgary accounted for 17.9 per cent of the job creation in Alberta, on a year over year basis.

Unemployment Rate

Calgary's unemployment rate rose to 3.1 per cent in November 2007, compared to 2.6 per cent in December of the previous year and 2.7 per cent in November 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 19,100 jobs since January 1, while the goods-producing sector suffered a loss of 9,600 jobs over the same period. Over the past year, across both the goods-producing and services-producing sectors, the major drivers in terms of job gains were Health Care (8,900), Transportation and Warehousing (8,200) and Public Administration (8,000), while losses were experienced by Educational Services (-16,800), Manufacturing (-10,000) and Accommodation and Food Services (-4,400).

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Indicator	Nov 2007	Dec 2006	Nov 2006	YTD Change		YOY Change	
				Number	%	Number	%
Average Hourly Wage Rate ($)	23.32	21.62	21.60	1.70	7.9	1.72	8.0
Employment	734,000	724,500	721,400	9,500	1.3	12,600	1.7
Unemployment Rate (%)	3.1	2.6	2.7	3.0	-	0.4	-
Employment by Industry							
Total Industries	734,000	724,500	721,400	9,500	1.3	12,600	1.7
Goods-Producing Sector	182,000	191,600	187,800	-9,600	-5.0	-5,800	-3.1
Agriculture	8,800	5,400	4,200	3,400	63.0	4,600	109.5
Forestry, Fishing, Mining and Oil & Gas	53,800	55,400	54,500	-1,600	-2.9	-700	-1.3
Utilities	5,900	9,100	7,900	-3,200	-35.2	-2,000	-25.3
Construction	71,400	68,200	69,200	3,200	4.7	2,200	3.2
Manufacturing	42,100	53,500	52,100	-11,400	-21.3	-10,000	-19.2
Services-Producing Sector	552,000	532,900	533,500	19,100	3.6	18,500	3.5
Trade	107,200	101,400	99,300	5,800	5.7	7,900	8.0
Transportation and Warehousing	45,000	37,000	36,800	8,000	21.6	8,200	22.3
Finance, Insurance, Real Estate and Leasing	43,200	44,100	42,200	-900	-2.0	1,000	2.4
Professional, Scientific and Technical Services	79,900	80,400	81,700	-500	-0.6	-1,800	-2.2
Business, Building and Other Support Services	34,300	26,900	27,700	7,400	27.5	6,600	23.8
Educational Services	33,800	51,800	50,600	-18,000	-34.7	-16,800	-33.2
Health Care and Social Assistance	70,500	62,000	61,600	8,500	13.7	8,900	14.4
Information, Culture and Recreation	35,600	32,000	33,800	3,600	11.3	1,800	5.3
Accommodation and Food Services	44,200	45,900	48,600	-1,700	-3.7	-4,400	-9.1
Other Services	32,600	33,400	33,400	-800	-2.4	-800	-2.4
Public Administration	25,800	18,000	17,800	7,800	43.3	8,000	44.9

Retail Trade

Retail Sales

Calgary retail sales reached a cumulative total of nearly $23 Billion by the third quarter of 2007, an increase of more than $1.9 Billion (or 9.3 per cent) year-to-date. Market observers predict that the 2007 Christmas shopping season will be one of Calgary's strongest, given a generally high sentiment of increased household wealth in the community, a strong Canadian dollar and more competitive pricing at retailers.

Indicator	Q3 2007	Q4 2006	Q3 2006	YTD Change		YOY Change	
				Number	%	Number	%
Retail Sales ($Millions)	22,983.5	21,036.9	20,956.5	1,946.6	9.3	2,027	9.7

Construction

Housing Starts

Cumulative housing starts in Calgary increased by 7.6 per cent as of October 2007 from 14,050 in October 2006 to 15,124. A decline of 10.3 per cent was experienced in single-detached starts, while starts for all other housing types soared by 40.6 per cent, from 4,945 in 2006 to 6,953 in 2007. This was driven by a very strong year in the multi-family segment of new construction. A significant number of new high-rise projects commenced in Calgary in 2007, offering a wider range of choice to those wishing a more urban, centre city lifestyle close to downtown.

Indicator	Oct 2007	Oct 2006	YTD Cumulative		YOY Change	
			2007	2006		
			Number		Number	%
Total (Units)	1,324	1,011	15,124	14,050	1,074	7.6
Single-Detached (Units)	680	801	8,171	9,105	-934	-10.3
All Others (Units)	644	210	6,953	4,945	2,008	40.6

Building Permits

Total cumulative building permit values as of October 2007 climbed by an impressive 46.4 per cent, from $5.0 Billion in 2006 to $7.3 Billion. The non-residential component was the main contributor of this increase, at 75.1 per cent growth year-over-year.

Indicator	Oct 2007	Oct 2006	YTD Cumulative		YOY Change	
			2007	2006		
			Number		Number	%
Total ($Millions)	773.6	565.5	7,259.7	4,959.1	2,300.6	46.4
Residential ($Millions)	267.0	267.7	3,667.0	2,907.5	759.5	26.1
Non-Residential ($Millions)	506.5	298.4	3,592.8	2,051.6	1,541.2	75.1

Major Projects

Though the number of major Calgary projects ($5 Million or more) has decreased by 7.4 per cent over the past 12 months, the total value of these projects has steadily increased during this same period, by 34.3 per cent. The project sectors with the highest value in November 2007 were Infrastructure ($6.7 Billion), Commercial/ Retail ($5.9 Billion) and Institutional ($5.2 Billion). Leading developments among Calgary's major projects include the Calgary Health Region's South Calgary Campus, EnCana's Bow tower, Torode's Ramsay Crossing and the Penny Lane development.

Indicator	Nov 2007	Dec 2006	Nov 2006	YTD Change		YOY Change	
				Number	%	Number	%
Value ($Millions)	24,130.2	18,181.6	17,972.4	5,948.6	32.7	6,157.8	34.3
Number	263	239	284	24	10.0	-21	-7.4

Real Estate

Residential

New Housing Price Index

On a year-over-year basis, Calgary was the only Canadian city to experience an increase below 10 per cent with regards to the New Housing Price Index. Its 5.9 per cent growth rate from September 2006 to September 2007 occurred despite higher development costs, as new lots were released into the market.

This suggests that the market is currently priced near its maximum, and that there is limited capacity within the market for further price escalations. Calgary is at a new level in terms of housing affordability therefore cooling of price growth will aid in stemming continued escalation of affordability challenges. Cooling price growth will also assist in softening the inflation rate.

Indicator	Sept 2007	Dec 2006	Sept 2006	YTD Change		YOY Change	
				Number	%	Number	%
New Housing Price Index 1997=100	250.7	237.1	236.8	13.6	5.7	13.9	5.9

MLS Sales

The frenetic pace of the Calgary housing market of 2006 and early 2007 has cooled significantly, flipping conditions from a sellers market to a buyers market, with a high level of listings on the market. Single family sales in November 2007 were 1,103, a significant decrease from the 1,397 sales of November 2006, with sales in the more affordable condo market also decreasing from 603 to 496 during this same time. While monthly sales are down in 2007 compared to 2006, year-to-date cumulative sales activity shows a fairly similar year in 2007 to 2006. The median price of a single family home in November 2007 was $407,500, an 8.7 per cent growth over November 2006, when the median price was $375,000. The condo market showed a slightly stronger price growth of 10.5 per cent over the same period, with the median sale price increasing from $258,000 in November 2006 to $285,000 in November 2007.

Indicator	Nov 2007	Nov 2006	YTD Cumulative		YOY Change	
			2007	2006		
			Number		Number	%
Single Family						
Sales	1,103	1,397	17,592	17,923	-331	-1.8
Median Sale Price ($)	407,500	375,000	-	-	32,500	8.7
Condominium						
Sales	496	603	7,844	7,863	-19	-.2
Median Sale Price ($)	285,000	258,000	-	-	27,000	10.5

Commercial

Downtown Office

An increase in sublease space accounts for the continued rise in downtown office vacancy. Though Calgary's vacancy rate has risen over the last three quarters to a current rate of 3.1 per cent, it is still far from being deemed a balanced market. Downtown supply remains tight, offering tenants few choices, particularly where large spaces are required.

In spite of softening demand for downtown office space, lease rates continue to rise to $43.90 per SF (average "A" space) this quarter, showing that the market is still tight enough to maintain record high levels.

Weak gas prices, the Federal government trust reversal and the uncertainty surrounding investment and hiring as a result of the new energy royalty system are contributing to tenants being more cautious about real estate commitments.

Indicator	Q3 2007	Q4 2006	Q3 2006
Absorption	-98,812	10,285	15,037
Vacancy Rate (%)	3.1	0.5	0.6

Suburban Office

A substantial amount of construction completions in the suburban office market have resulted in an increased vacancy rate for the third consecutive quarter. Despite the current vacancy rate of 3.6 per cent, the suburban market is nearing its fourth year of positive overall absorption.

In spite of high demand and rising construction costs, lease rates appear to have stabilized, with a current rate of $23.24 per SF.

Year-to-date construction completions total 1,030,000 SF, with another 256,000 SF feet by year-end, alleviating some of the current suburban space crunch. Moreover, 4,000,000 SF of suburban office space is scheduled for completion by 2010, with an additional 6,000,000 SF in pre-leasing and proposed stages. This new supply is expected to ease vacancy to a more sustainable rate of 10 per cent by the end of 2008.

Indicator	Q3 2007	Q4 2006	Q3 2006
Absorption	341,995	338,948	859,886
Vacancy Rate (%)	3.6	1.9	2.5

Industrial

Calgary's industrial market continued to tighten throughout 2007 with a current vacancy rate of 0.7 per cent. Net lease rates continued to climb to an average of $8.56 per SF this quarter as demand for space exceeded present and future supply. Several new construction projects are now underway with 1,500,000 SF under construction (Stoney Industrial and South Glenmore Distribution Centre) and over 3,000,000 SF proposed. Calgary's raw land supply continues to be scarce, limiting developers and owners/users to Eastlake and the 84th Street Corridor, where land prices continue to rise and are approximately $600,000 per acre (fully serviced).

Indicator	Q3 2007	Q4 2006	Q3 2006
Absorption	664,000	902,096	757,359
Vacancy Rate (%)	0.7	0.8	0.8

Sectoral Analysis - Manufacturing

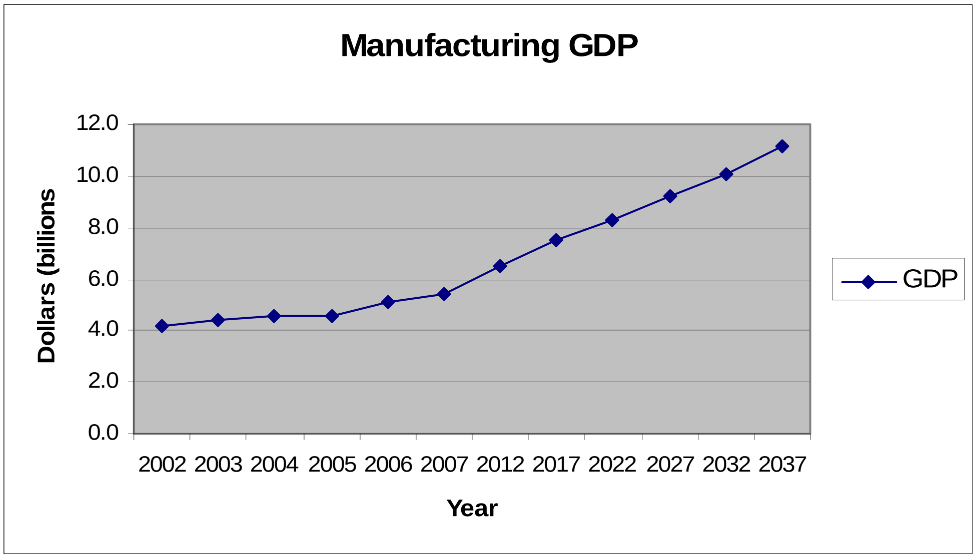
The manufacturing sector is a major contributor to both Calgary and Alberta's strong economic growth. Contributing $5.1 billion, or over 9 per cent, to Calgary's economy, the manufacturing sector is the economy's fifth largest economic industry. Additionally, employing over 42,000 people, it sustains and supports economic well being for those and many more Calgarians.

Calgary's manufacturing industry is a dynamic sector, comprised of numerous specific activities, but dominated by food, machinery, furniture and fabricated metal product manufacturing.

The sector has faced a broad array of business issues over the past few years, impacting operations, employment and viability. Despite this range of business challenges, many Calgary manufacturers are using this time to re-examine processes and resources to become more lean, efficient and successful operations in a global economy of continual pressure on competitiveness.

GDP

Calgary's manufacturing GDP increased by 18 per cent over the past 5 years (2002-2006), from $4.3 billion in 2002, to $5.1 billion by 2006. GDP growth in 2006 over 2005 was an astonishing 8 per cent. Manufacturing GDP contribution is forecasted to increase an additional 21 per cent over the next 5 years (2007-2012).



Source: City of Calgary, Corporate Economics

Business Establishments

Over the past five years, Calgary's manufacturing sector has experienced some consolidation, reflected in the reduced number of business establishments. This has, however, created larger firms; ones that have an increased ability to compete globally. In fact, there were 105 fewer companies in 2006 than in 2002, representing a loss of -5 per cent over the five year period. This trend has increased the average size of companies in the sector, providing the competitive advantage of size and resilience in the unpredictable global market.

Year	Business Establishments
2002	2,090
2003	2,070
2004	1,979
2005	1,931
2006	1,985
Total Growth(%)	-5.00

Employment

A number of macro-economic factors have impacted Calgary's manufacturing sector in 2007. The outcome of this has been a reduction of manufacturing employment. At the beginning of the year, over 53,000 people were employed in the sector, but by the end of November, this number had dropped by approximately 11,400 people, a decrease of 21.3 per cent, to 42,100.

The reduction of employment is likely a result of two key factors: some job losses at individual firms; and, an inability of many manufacturers to replace or hire for the jobs available in their businesses. Some workers, as they leave manufacturing companies, may be lost to the sector and may gain employment in another sector. Therefore, a reduction of jobs year-over-year is not solely layoffs but reflective of a tight labour market and movement of workers across to other, higher paying sectors.

Much of the change in employment has occurred since July 2007, which corresponds directly with the rise in the value of the dollar. With this reduction in employment, the manufacturing sector now makes up 5.7 per cent of Calgary's total employment.

Industry Employment	Nov 2007	Dec 2006	Nov 2006	YTD Change		YOY Change	
				Number	%	Number	%
Manufacturing	42,100	53,500	52,100	-11,400	-21.3	-10,000	-19.2

2007 – the year in review

As exemplified by the reduction in employment, 2007 will not be remembered as one of the manufacturing sector's best years. A persistent high Canadian dollar, increasing wage costs, tight labour markets, expensive and limited real estate, a slowing U.S. economy and increased energy prices are creating, unfortunately, a perfect storm for manufacturers. Some manufacturers have already moved, or are looking to move, some of their operations to lower cost jurisdictions. Continuation of this perfect storm may serve to hollow out some of the manufacturing activity in Calgary.

The labour shortage in particular affected the productivity of Calgary-based manufacturers. According to the quarterly manufacturing conditions survey, published by Statistics Canada in October of this year, 48 per cent of Alberta manufacturers cited skilled labour shortages as their major impediment to productivity. It is particularly acute in Alberta as compared to other provinces, as manufacturers here must compete for workers with oil and gas and construction companies, many of which are able to offer higher pay.

According to Alberta Employment, Immigration and Industry's manufacturing workforce strategy, the competitive salaries offered in other industries have affected the meat processing segment of Alberta's food and beverage sector in particular, as it is mostly reliant on workers with lower skill levels. Increased recruitment and training costs typically lead to a reduction in productivity. It should be noted that food manufacturing is the largest sub-sector of the 21 manufacturing sub-sectors in Calgary, and the economic impact of their productivity losses has repercussions across the rest of Calgary's economy.

In 2007, manufacturers also had to deal with the Canadian dollar at a thirty year high, making it more difficult for exporters to compete with international suppliers who may have access to low labour costs, larger production facilities and more efficient equipment. As a result, Calgary companies have had to, in some cases, reduce the size of their workforce and restructure the way they do business in response to the Canadian dollar appreciations. According to Mel Svendsen, President of Calgary-based Standens, North America's largest full line manufacturer of leaf springs and agricultural tillage components, "those of us who export are at the crossroads of our businesses today." Manufacturers whose traditional customers are U.S.-based have rapidly seen their profit margins shrink, as well as having seen reduced demand from U.S. customers as a result of a slower U.S. economy.

As a result manufacturing leaders now realize that cost reduction and productivity improvement may be the best option for survival, and 2008 looks like the year that Calgary companies will move towards making investments to mitigate the effects of a strong loonie and contribute to reversing Canada's productivity trend.

2008 – Outlook

2007 has brought about a wide range of macro-economic conditions placing significant pressure on Calgary manufacturers. As some of these conditions are forecast to continue into 2008, now is the time for companies to examine their productivity. An August report by TD Economics states that productivity will be an increasingly important determinant of economic growth. The report notes that

Canada has a poor productivity track record and that "abysmal productivity performance has resulted in the widening of the business sector labour productivity gap versus the United States from 17 percentage points in 2000, to 26 points in 2006."

With the rapid economic growth of both Calgary and Alberta over the past five years, manufacturers have been exceedingly busy filling their plants to capacity and seeking an adequate supply of workers to fill customer orders. Few have had the time or the incentive to seek real productivity improvements.

However, current market conditions provide an excellent opportunity for Calgary manufacturers to make strong investments in their productivity. The strength of the Canadian dollar is making investments in machinery, equipment and technology a much easier decision to rationalize. In addition, the Federal government's currently limited acceleration of capital cost allowance is making investments in machinery and technology a more tax favourable opportunity. Both these conditions create a great time for manufacturers to "go shopping."

In 2008, manufacturers are likely to continue to face a multitude of challenges to their operations and competitiveness: a continued strong Canadian dollar; weak U.S. demand; labour shortages; and limited real estate options. Therefore, in order to remain competitive, productivity may be the area where manufacturers begin to place focus in 2008, whether it be through new technology platforms, research and development, or advanced skills training for employees.

Sources:

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Calgary Real Estate Board
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