

2009 Calgary Economic Outlook

Mind Over Matter

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Highlights

- Economies across the globe, particularly the U.S. and Europe, are gearing down. Post Olympics, many expect China's economy to slow. Europe, particularly the U.K., is being hit by the dropping currencies and impacts to the financial services sector. Full recovery in the U.S. is still likely a few years away as some of the impacts from the housing market have yet to be felt by consumers. When the U.S. consumer is in a position to begin spending again – likely only after rebuilding their net worth – will the U.S. truly recover.
- Canada is expected to experience a slower economy in 2009, largely a result of slowing U.S. demand for Canadian goods and services, and a slowdown in housing markets across the country, leading to reduced expenditures by fellow Canadians.
- Calgary's economy is largely on strong footing, demonstrating that it has slowed down from 2005 and 2006, and will continue to do so in 2008 and 2009, as we re-balance to a more sustainable level.
- Competition from other locations in Canada, particularly those with less costly housing, will again serve to curb Calgary's in-migration population growth in 2009 as compared to previous years. Calgary's population growth for 2009 is forecast between 19,000 and 21,000 persons, or between 1.8 and 2.0 per cent growth over 2008.
- Limited capacity to draw more people into the labour force, and slower population growth should also put a brake on employment growth in Calgary in 2009. It must be noted that this is not a result of a lack of opportunity, but a lack of people to fill jobs. It is a shortage of supply that will curb employment growth, not a shortage of demand. Calgary's employment growth for 2009 is forecast between 1.8 and 2.2 per cent.
- With growth in the labour force essentially keeping pace with the population growth rate, the unemployment rate is expected to remain in very low territory. Calgary's unemployment rate for 2009 is forecast between 3.2 and 3.5 per cent.

- With house price growth coming into a more realistic range in 2008 and 2009, combined with expectations of less dramatic spikes in oil prices, inflation should be less of an issue in Calgary as it has been over the past 24 months. Calgary's inflation rate for 2009 is forecast between 3.2 and 3.5 per cent.
- A continued work through of the excess supply in both Calgary's resale and new home market should bring housing starts down significantly from the highs of 2005, 2006 and 2007. Fundamentals remain strong for a healthy housing market into the future but there is likely to be little price growth over the next 12 months. Calgary's housing starts for 2009 is forecast between 8,000 and 9,000 units.
- Non-residential real estate markets remain generally tight, with limited options available in both the office and industrial markets. It will likely take until 2010/2011 before the office market exhibits a greater balance. The industrial market continues to be chronically undersupplied until new major developments are further along and infrastructure issues on the east side of Calgary are addressed.
- With the dramatic slowdown of housing starts forecast for 2009, and the limited number of new non-residential mega-projects to go through the permit process, it is likely that the value of building permits will drop in 2009 compared to 2007 and 2008. Calgary's building permit value for 2009 is forecast between \$4 and \$4.5 Billion.
- 2009 should be the year that Calgary largely brings itself back into balance after years of high growth and imbalances created in key markets like housing, commercial real estate, and people. Calgary's real GDP growth for 2009 is forecast between 2.8 and 3.3 per cent.

Introduction

2008 has seen some interesting activity in the global and local economies. The eyes of the world have been focused on historic events, including the Beijing Olympics, a U.S. Presidential race, and record oil prices.

Calgary Economic Development has prepared this 2009 Calgary Economic Outlook to aid the community in its business planning, budgeting and organizational forecasting. It is meant to give a snapshot of key local indicators and to discuss the directions that they are likely heading in 2009. The report also touches on key pressure points in the economy, as well as bigger picture long term economic issues.

Our aim is to provide increased information on local based performance to support the community in its continual success and prosperity.

Context – Global and National Outlook

General consensus is that economic conditions around the world are slowing. Despite turning in an above 3 per cent GDP growth rate for the second quarter of 2008, the U.S. economy still shows signs of significant trouble including continued job losses, further reductions in house values and slowing housing starts, tight credit markets and high gasoline prices impacting household expenditure.

As TD Economics noted in their June Quarterly Economic Forecast, it is unprecedented to have such numerous shocks hit an economy simultaneously: an oil price shock, two year decrease in house prices and a credit crisis. The U.S. economy is faltering and some believe that it may take a further few years for all the effects to cycle through and get the economy back on its feet. Regardless of the amount of time it takes, consensus is that it is unlikely to make a significant turnaround before the end of 2009, resulting in slower U.S. demand for foreign goods and services.

Additionally, the new global powerhouse, China, is expected to experience a slowing economy as U.S. demand for foreign goods slows, and investment around the Beijing Olympics wanes.

Europe's economy has slowed, including Germany, the EU's largest economy, as well as the U.K. which is being pulled down by the impacts to the financial

sector from the global credit situation. Growth prospects for these economies is bearish for the balance of 2008 and into 2009.

Inflation is still a real fear around global central banks, as the high price of oil and related products has driven inflation rates to new highs. High gas prices have impacted consumer expenditures in slowing economies such as the U.S. Many central banks are weighing their options, for raising interest rates in a slow economy can be extremely harmful. However, expected slowdowns in most economies worldwide should take some of the steam off global inflation in the balance of 2008 and into 2009. Therefore unless oil takes another significant run upwards, global inflation is expected to remain somewhat in check into 2009, likely keeping central banks on the sidelines.

Another challenge that many economies face is that despite slowing conditions, companies around the world are facing higher costs than ever, as well as tighter credit conditions. Higher costs for labour, materials, gas and energy are making it harder to deliver profit and steady prices.

Energy prices have, as usual, been volatile in 2008, with oil reaching a record high of \$147.27 per barrel of WTI on July 11. This level was unsustainable and not driven by true market fundamentals. In reality, while Calgary companies and Provincial government coffers benefit from high oil prices, global economies are hit hard, as companies face rising input costs, pass higher costs along to consumers, and consumers have less disposable income as more goes towards the pumps.

While the price of WTI is likely to fluctuate over 2009, analysts suggest that it should average around \$100 per barrel based on limited refining capacity, tightening crack spreads, geo-political instability, and growing global demand. Things to watch in 2009 that could affect oil prices include any further or sustained slowdown in the EU and its resultant impact on distillate demand, and the level of demand growth in developing economies, specifically China and the Middle East. Slowdowns in demand from these regions could put downward pressure on prices in 2009 given the magnitude of their demand growth of late. This 2009 Calgary Economic Outlook is based on an assumed average price of \$100 per barrel of WTI.

Natural gas prices appeared to be rebounding in mid 2008 after an extended period of low value back in 2007 and early 2008, however prices have since retreated to \$6.22 per GJ as of close September 12. A cooler summer and

higher inventories have contributed to the decline in gas prices. The retreat of prices also reflects seasonality in demand. While analysts believe that natural gas will continue to be in an excess supply position until spring 2009, some estimates are for a rebound to the \$7 per GJ on average.

Continued depressed natural gas prices would result in lower natural gas activity globally, but would specifically affect the Calgary economy. The new Alberta Royalty Regime which kicks in January 1, 2009 may negatively impact Alberta's attractiveness as a location for gas activity, largely a reflection of more desirable environments in B.C., Saskatchewan and the U.S.

Natural gas prices are typically a larger driver of Calgary's energy sector than oil, for the majority of drilling activity is gas related, many large energy companies are more heavily gas focused, and Provincial government revenues are more largely derived from gas than from oil. Therefore continued low natural gas prices have the potential to act as a brake on the Calgary economy. The 2009 Calgary Economic Outlook assumes an average of \$7 per GJ for 2009.

Canada's economy is also cooling significantly, with only modest growth expected for 2008. Canada, while in much better shape fiscally and from an individual household perspective than the U.S., will not escape unaffected. Job growth in Canada has weakened, low U.S. demand has put a slowdown on exports, the housing market has cooled and overall consumer expenditure is expected to slow as a result. Inflation driven by commodities, particularly energy and food, could trigger a rate hike, however the Bank of Canada's steady rate decision on September 3 suggests that inflation fears may be moderating.

The west still is the strength of Canada's economic performance at the present time, led by healthy economies in Alberta, B.C. and Saskatchewan.

Calgary Overview

Imagine the perfect day out in the mountains. You have gotten away from it all, are totally recharged, and feel that great sense of excitement yet fatigue from a good day of play. You are cruising along the Trans Canada Highway, back into Calgary, at of course the speed limit of 110 km/h, and you hit the City limit, then you hit Shouldice Park where the speed limit drops to 50 km/h. At that point, we all get it. That sense that we are going SO SLOW! It is our brain still seeing the landscape fleeting past at higher speeds that needs to adjust to seeing the

landscape fleeting by at the normal and regular speed for city driving. It is a case of mind over matter.

2005 and 2006 were the drive back from the mountains. Our economy was cruising at highway speed and we saw everything around us going by very quickly. Now in 2008, and in 2009, our economy is slowing. We have come back to the normal and sustainable economy that is fundamentally strong yet feels a lot slower than we were just 24 months ago.

What does it feel like for us? We are seeing a lot of things that are causing people to feel worried or concerned:

- Slower job growth;
- Retreating housing prices;
- Slowing retail sales;
- Economic woes in central Canada;
- U.S. and global economic slowdown;
- Stock market volatility; and,
- Lower oil and gas prices.

These conditions result in reduced confidence, a reduction in the sense of net worth and wealth, and are therefore impacting housing purchases, consumer expenditure and some areas of investment. All of these have the potential to negatively impact the economy.

This sentiment was validated in Calgary Economic Development's 2008 Business Survey, which found that 54 per cent of respondents believed that the growth experienced in Calgary has proven to be a challenge. This is likely a reflection of how quickly and deeply these challenges and impacts have appeared or manifest, making them feel that much more apparent and significant.

Are these conditions really cause for concern about a faltering economy, or are they retreats and rebalances back to a more sustainable level? It is the latter. It is a case, again, of mind over matter. The economy feels slower, because it is. It was operating at an unsustainable level and now, at a more sustainable level, it is slower. But that is not cause for concern, despite what headlines may wish you to believe. We just have to teach our brains that our economy is not cruising at high speed and to put some of the conditions into perspective. Many of these are just rebalances back to equilibriums and sustainable levels.

The fundamentals of the economy are strong in Calgary:

- Job growth remains healthy at 2.37 per cent as of August 2008 year-over-year, despite operating at essentially full employment;
- Average weekly earnings growth in Alberta remains the envy of the nation, at 5.4 per cent for May 2008, year-over-year;
- Inflation has moderated from a high of over 5 per cent in 2007, to 3.3 per cent as of July 2008;
- A more refined and wise Canadian mortgage industry that should not result in a U.S. style housing crisis;
- Continued construction in the economy, particularly in the non-residential segment;
- Continued investment in long term projects and assets within Alberta, such as the oil sands, carbon capture and sequestration research, and education.

Overall, the fundamentals for healthy economic performance are in place. This is not to say that things won't feel slower – they will. But they need to, for the levels of years prior were just not sustainable. But what the fundamentals tell us is that our footing is on fairly stable ground, unlike our neighbours to the south, who have perhaps not seen the worst of it yet, and are not likely to emerge from their economic and household challenges for some time.

There are many things driving the overall slowdown in Calgary. First is necessity – previous years were just too much, too fast. The slowing U.S. economy and still moderately high Canadian dollar will likely result in a slowdown of inflation-adjusted exports of many Alberta manufactured products. Continued depressed natural gas prices will likely limit drilling and investment plans for Alberta's most important resource.

Despite being slower, Calgary's economy is still one that exhibits tight conditions in two key areas: labour and commercial real estate. Calgary is essentially at the wall for labour: our participation rate is the highest in the nation at 77 per cent as of August 2008; our employment rate is the highest in the nation at 74.3 per cent; and the unemployment rate is 3.6 per cent. Calgary is essentially at full employment with very little room to move.

Calgary's commercial real estate market, while not as tight as it was 24 months ago, is still very tight and nowhere near balanced or equilibrium levels. Having said that, there are a number of projects being completed over the next few years that should bring, particularly the office market, into a more balanced position. Therefore, despite a slower economy, markets for people and for commercial real estate are still competitive.

Tempering unbridled confidence in Calgary's economic health are two components of the economy: natural gas prices; and, Calgary's residential real estate market. These two topics will be covered in the Pressure Points section of this report.

Calgary Economic Performance

Population Growth

Calgary's 2008 Civic Census reported population growth of 22,950 persons during the period of May 2007 to April 2008. This level is only marginally higher than the 22,500 person growth in 2005 yet well above the 11,180 person growth of 2004. It is well down from the high of 2006 when Calgary grew by 35,861 people.

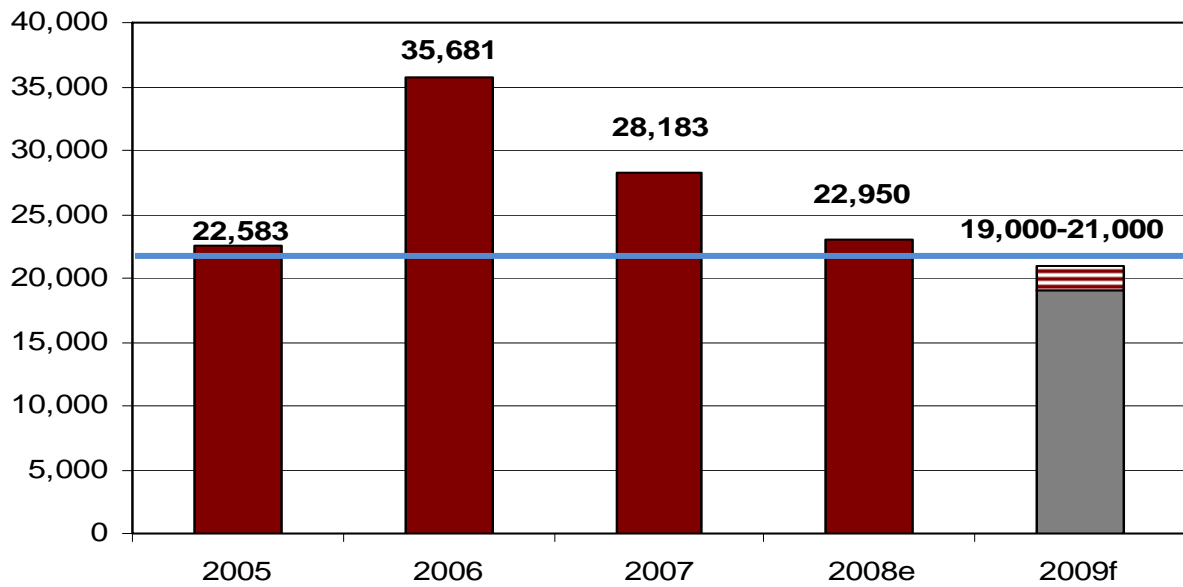
Calgary is facing slowing population growth for a number of reasons. First, Calgary's economy is not the blistering near 8 per cent growth of 2006 – thank goodness – so fewer people are being lured here based solely on astronomical growth prospects. Second, Calgary's rising house prices have priced some migrants out of the market, redirecting them to less expensive markets in B.C. and Saskatchewan. Other centres in Canada are experiencing strong economic activity, such as Newfoundland and Saskatchewan; both places with much lower housing costs. As the single largest household purchase, lower housing prices can play a significant role in attracting migrant populations.

From a natural increase perspective, the baby boom in Calgary is expected to continue due to the young average age of Calgarians, however not at the 2006 or 2007 levels.

One should not see cause for concern, as the numbers tell us that more people are still moving to Calgary than are leaving. Expect Calgary's population growth to continue to moderate in 2009, as increased competition from other centres in Canada and higher housing prices may successfully lure migrants otherwise bound for Calgary.

Natural addition is forecast to be 9,000 and 9,500, with net migration at 10,000 and 11,500, resulting in total population growth of between 19,000 and 21,000 persons. This represents annual population growth of between 1.8 and 2.0 per cent.

Calgary Population Growth Forecast



Source: Calgary Civic Census, CED

Employment Growth

Labour – more specifically, finding enough of it – has been a hot topic in Calgary over the past three years. And it would appear that it isn't losing its luster as the Calgary business community's most important issue facing economic development.

In Calgary Economic Development's 2008 Business Survey, 86 per cent of businesses identified access to skilled labour as the most important issue facing economic development. When asked to identify the top issues facing their individual businesses, 53 per cent identified lack of skilled labour and staff retention as their top issues. 73 per cent of business respondents indicated that they are experiencing worker shortages, and 70 per cent indicated that they are experiencing difficulty hiring workers.

The feeling around Calgary, however, is that while labour is still very tight, and that companies are experiencing challenges finding good people, the situation is not as dire as it was in 2006 and 2007. This is a result of slower economic activity, freeing up more people to be searching for work and finding a better fit. Additionally, slower drilling activity in Alberta has freed up labour as well. For employers, it is obviously still a critical issue, but it appears that it isn't as difficult as it has been to find people to fill certain occupations in the past few years.

The challenge that Calgary faces with respect to employment growth is that we are essentially at the wall of growth. In the first eight months of 2008, job creation has outstripped labour force growth – meaning that to achieve more job creation, people who weren't otherwise in the labour force have now joined, boosting Calgary's participation rate. Calgary's participation rate is the highest of any major urban centre in Canada, and is near the highest of developed economies. Unemployment is at record lows, with the rate dipping down to 2.9% for a few months in the first half of 2008.

This all adds up to mean one thing – slowing employment growth in the future. But we are not alone in this challenge. It is one being felt the world over in developed economies. Most major centres around the world are facing a competition for talent. In addition, the problem is being exacerbated by the looming retirement of the baby boom generation. The Conference Board of Canada, in its report "Slowing Down with Age: the Ominous Implications of Workforce Aging for Canadian Living" indicates that by 2010, Canadian economic performance could be significantly impacted due to the loss of baby

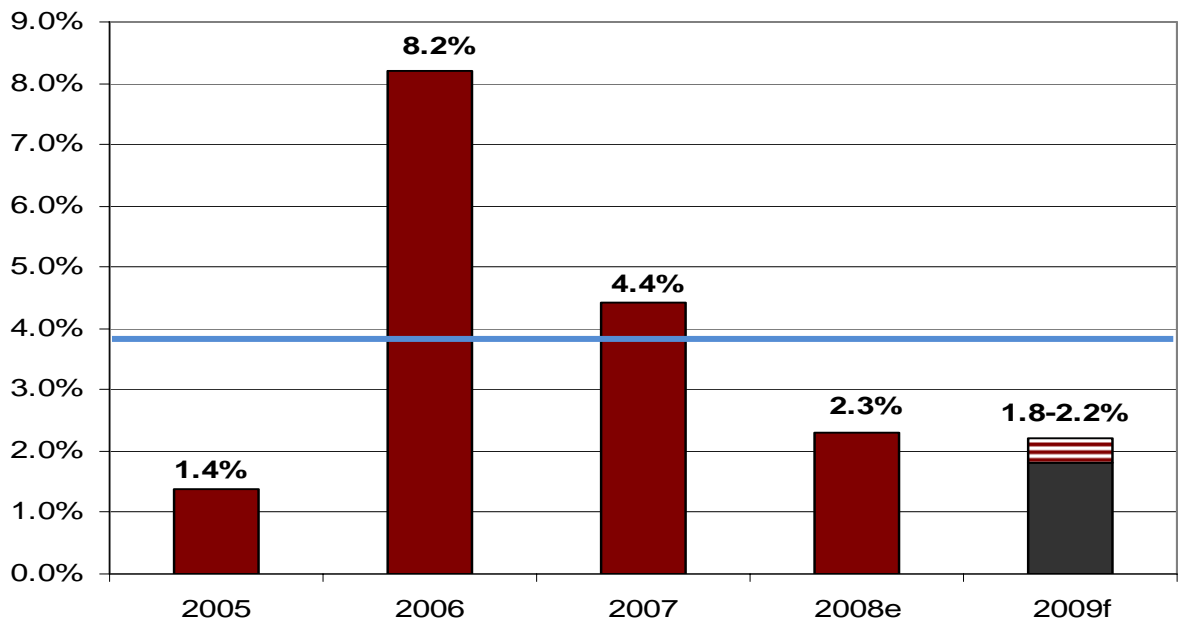
boom workers. Gains in economic growth after 2010 will have to rely on unprecedented levels of growth in productivity, something Canada does not have a very strong track record in.

Ultimately, we need to be conscious of the fact that the current labour situation is merely the tip of the iceberg. It will get worse before it gets better. Demographics alone will assure that. So companies and governments need to swiftly implement measures to address both the demand for and supply of labour. Strategies range from increased education, increased immigration, increased technology, increased supports to enable people to work, and staggering of projects. No single strategy will work in isolation, but rather a suite of strategies needs to be employed to ensure future economic growth.

Standing at the wall of employment growth is a challenge to Calgary's businesses and economy. There is just very little room to move. It is unlikely that Calgary's participation rate can go much higher without significant improvements to areas such as child care, elder care, public transit, changes to pension legislation, changes to immigration policy and more accommodative practices to support growth in the employment of underemployed groups such as persons with disabilities, aboriginals, immigrants, women and seniors. Therefore one is left to conclude that employment growth simply can't occur at any greater rate than population growth going into the future.

Currently maximized participation and employment of the Calgary population results in an employment growth forecast of between 1.8 and 2.2 per cent in 2009.

Employment Growth

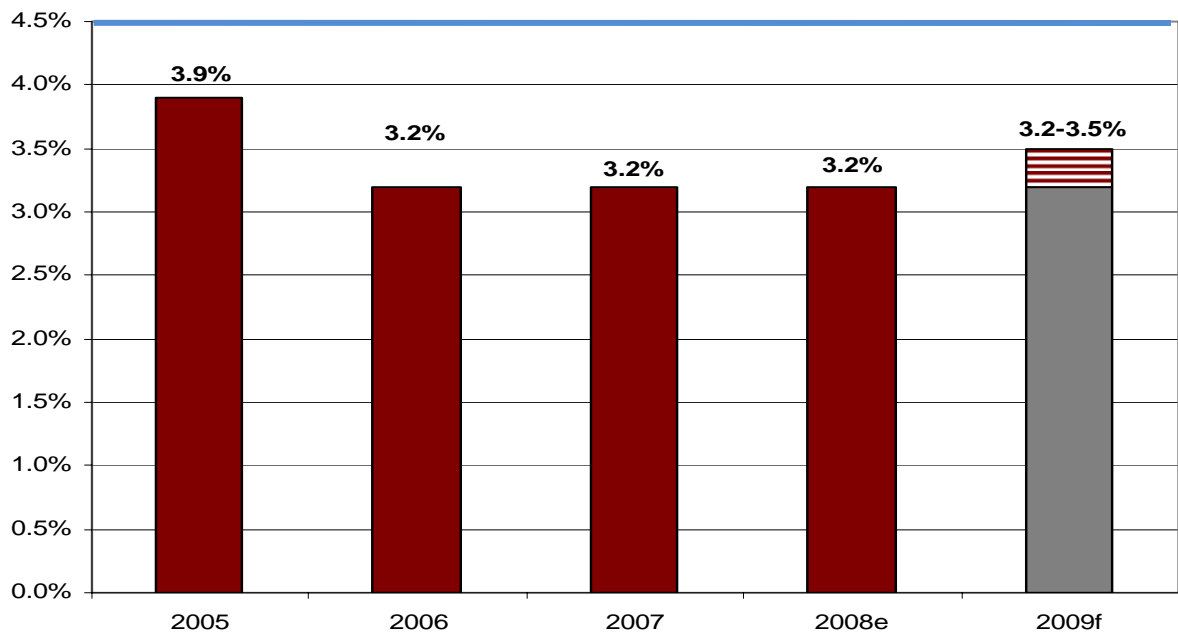


Source: Statistics Canada, CED

Unemployment Rate

With a continued tight labour market in Calgary now and into the foreseeable future, combined with limited growth in the participation rate, the unemployment rate in Calgary is expected to remain at historical lows.

The unemployment rate in Calgary is forecast at 3.2 and 3.5 per cent for 2009.



Source: Statistics Canada, CED

Inflation

Calgary had a rather dubious title in Canada in previous years – that of leading centre of inflation. With cooling housing market activity, and more robust markets in other parts of Canada, it is unlikely that Calgary will retain that title in 2008 or 2009.

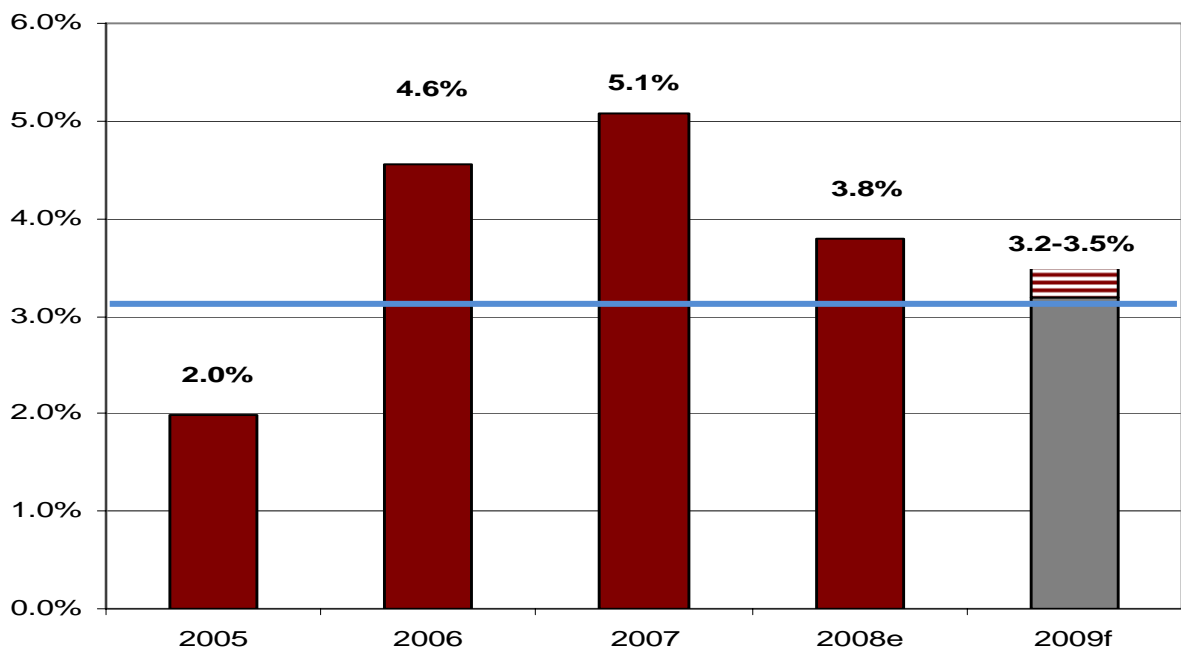
Housing price growth was the primary reason for Calgary's astronomical inflation rate increases during 2006 and 2007. Inflation reached an annual high in 2007 of 5.1 per cent. Since, Calgary's house price growth has slowed significantly, leading to a strong tempering of the shelter component of the Consumer Price Index. This has led to a reduction in headline inflation in Calgary to 3.3 per cent as of July 2008, year-over-year.

All of Canada, if not the world, is facing increased oil and gas prices. Leading the rise in Calgary's inflation rate at the current time is significant growth in the price of gas at the pump. Additionally, the cost of food has been rising steadily over the past year. All in all, the inflation being experienced in Calgary right now is being led by higher gas prices, a scenario which we are not unique in facing.

The slowing of house price growth in Calgary has put Calgary in a unique situation whereby inflation in Calgary is actually *decreasing*, while with the rise in gas prices, inflation is *rising* in most urban centres in Canada.

House price growth in Calgary is expected to continue its re-balancing. Given the oversupply in the housing market across both single and multi-family segments, it is not likely that house price growth will be significant in 2009, which would be reflected in a lower headline inflation rate for 2009. Gas prices are expected to remain high due to elevated oil prices.

Inflation in Calgary is forecast at 3.2 to 3.5 per cent in 2009.



Source: Statistics Canada, CED

Residential Real Estate – Housing Starts

Calgary's housing market is still a "buyers market", as it was in this report last year. Calgary's housing market is currently over-supplied with product. This is likely a result of homeowners wishing to make a move up, or by speculators hoping to make some profit by flipping a property. Unfortunately, many people did this all at once, drove prices to new highs, and are all looking for the same customer at the same time. Essentially, there is a handful of Calgarians who expected the good times to roll for a little bit longer than they did.

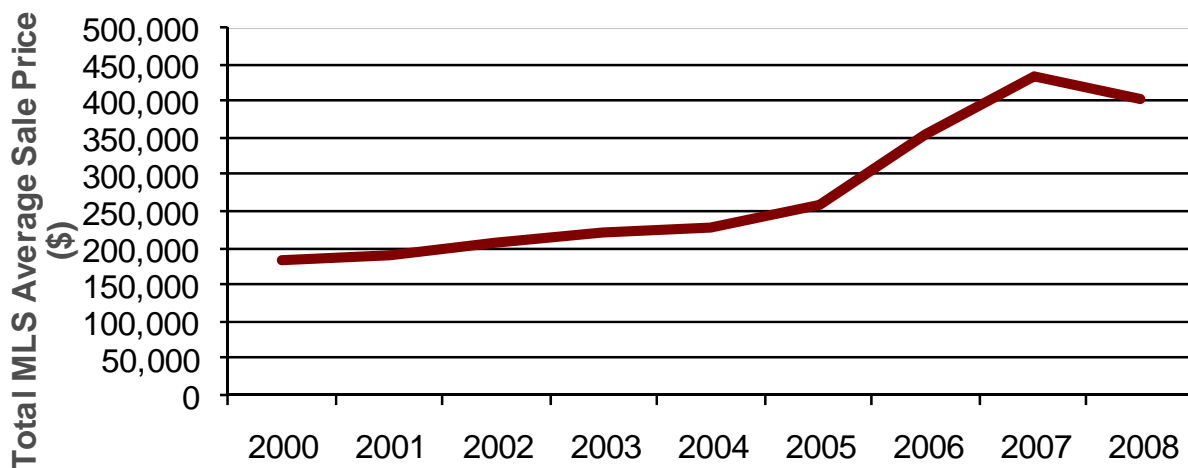
Is the housing market in trouble? No. Will the bottom drop out? No. Is Calgary's economy in trouble? No. What is being experienced right now is a working through of the market. It is a re-adjustment to bring the market back into equilibrium whereby it is a balanced market in terms of listings, sales and price. House prices just grew too much, too quickly.

We should not fear a collapse. Job growth in Calgary remains healthy, wage gains are strong, and Canada's stronger lending practices should not see Calgarians facing the situation being faced in the U.S. with drastic erosion of house value and therefore net worth. All in all, the long term outlook for Calgary's housing market is fundamentally strong.

Despite the fundamentals for long-term optimism, there are signals in the housing market that could impact overall economic growth. And they are more psychological. With an over supply situation, buyers typically are "waiting and seeing" if the price will drop further. Those motivated to sell will drop their price, resulting potentially in a reduction in the median or average MLS price, which has fluctuated since August of 2007, but has been on a consistent downward trend since May 2008. This has a major psychological impact to the population – some people translate a reduction in house price to be a faltering economy. This gets perpetuated in the media and around the water cooler and soon it truly does affect perceptions and expenditures. Spending is cut back and economic growth is curtailed.

The important thing to remember in this instance is the long term picture – exactly what many people buy their house for – long term capital appreciation. The average MLS house price in Calgary has risen 121 per cent from 2000 to August 2008 as shown on the chart below.

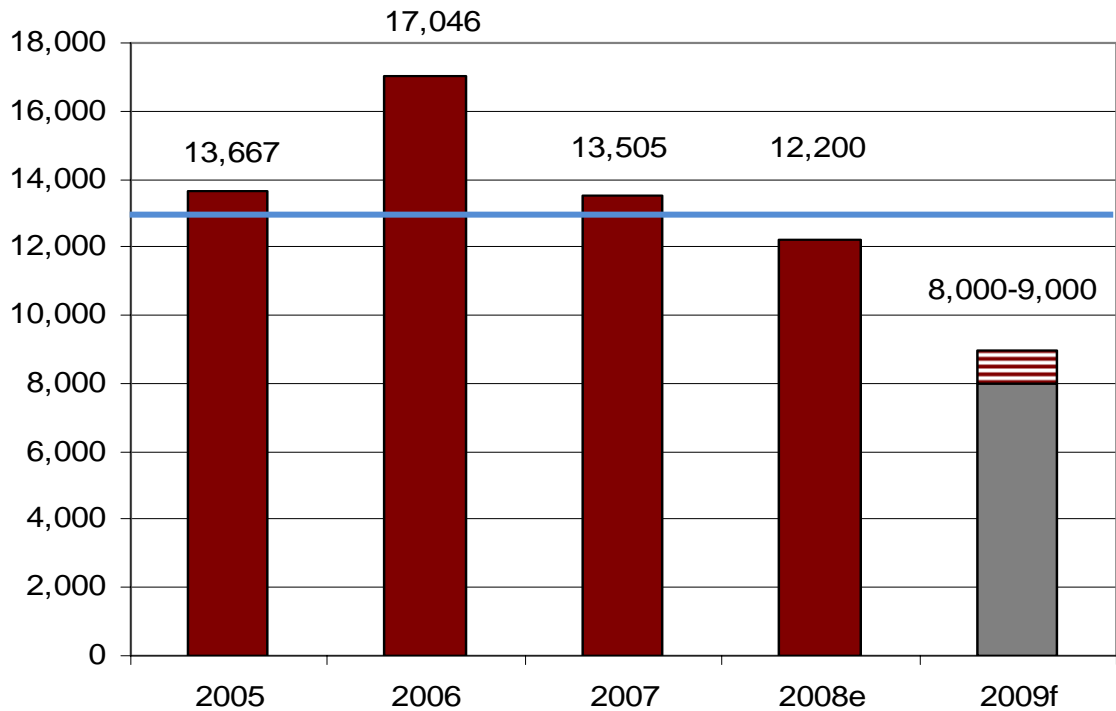
Total MLS Average Sales Price (\$)



Source: Calgary Real Estate Board

The monthly house price decreases that Calgary has been experiencing since May 2008 is truly only relevant to the 12,673 homeowners trying to sell their home. For the remainder of the more than 420,000 dwelling and building owners, the value of those properties has risen significantly over the past eight years – 121 per cent. And if you are staying put, and not selling, history shows that long-term the value of real estate rises over time. For they aren't making any more land! Therefore, we need to remind ourselves – it is mind over matter - just because house prices are retreating for a few months, it is not indicative of a struggling economy.

As a result of continued rebalancing in the market, housing starts in Calgary are forecast between 8,000 and 9,000 units for 2009.



Source: Statistics Canada, CMHC, CED

Non-Residential Real Estate

While Calgary's residential real estate sector is currently over supplied, the non-residential real estate sector, essentially the office and industrial markets, is still very tight. Both markets are in a natural rebalancing cycle after record growth years.

The downtown office market is still undersupplied, with 4.5 per cent vacancy as of Q2 according to Barclay Street. Currently there is over 5 million square feet of office space under construction in the downtown core. Some projects such as the Homburg Harris old post office site and the Bentall Jamieson Place are already fully leased.

2009 will not likely bring much relief in terms of the vacancy rate, as most of the major projects that will leave space on the market will not be complete until the 2010/2011 time frame. It is only then that the Calgary downtown office market will likely achieve a more balanced status of between 8 and 10 per cent vacancy depending upon absorption performance.

The Beltline office market is a more niche market with tenants typically looking for more affordable space but also space and a local environment with a different feel. The Beltline, with its vacancy rate of 6.0 per cent as of Q2, will not likely see too much movement in 2009 given more reserved building activity than in the downtown.

The suburban office market is currently in a more balanced state than the downtown or Beltline. With vacancy at 9 per cent, this market is in equilibrium. A significant amount of building has occurred in the suburbs over the past few years as a result of a rapid rise in downtown office rents, the ability to complete a project faster and more plentiful parking. 2009 is likely to see continued addition to the inventory, and therefore slight rise to the vacancy rate, as projects underway now are brought to a close.

Fears of overbuilding in Calgary's office market are unfounded, for developers are doing far more due diligence than has been done in previous building cycles. Additionally, a balanced market is generally accepted to be between 8 and 12 per cent vacancy, a far cry from the current 4.5 per cent being experienced in the downtown for example. That level of vacancy – 8 to 12 per cent - provides tenants choice, sufficient blocks of contiguous space and still enables landlords to operate successfully.

Again, it is a situation of mind over matter. The 1 per cent vacancy rates experienced a few years ago are not the norm, and any deviation from those historic or record lows is not indicative of a faltering economy.

On the industrial side of commercial real estate, the market still remains very tight. With limited serviced land supply for industrial purposes available at the present time, rates continue to rise amidst relatively strong demand. Much of the new product being developed is small bay condo type developments and owner operated local businesses on small land parcels, while medium to large scale demands are difficult to meet.

Calgary's real estate markets are resilient and are in a generally healthy operating mode. Overall sentiment in the non-residential real estate sector remains positive. Adjustments and re-balances to the market can create perceptual issues around a slowing economy, however the sector remains a fundamentally strong pillar of Calgary's economy. But the high degree of demand for both office and industrial space, combined with high level of demand with limited supplies in certain geographies, should result in continued limited land and space for a few more years.

Building Permits

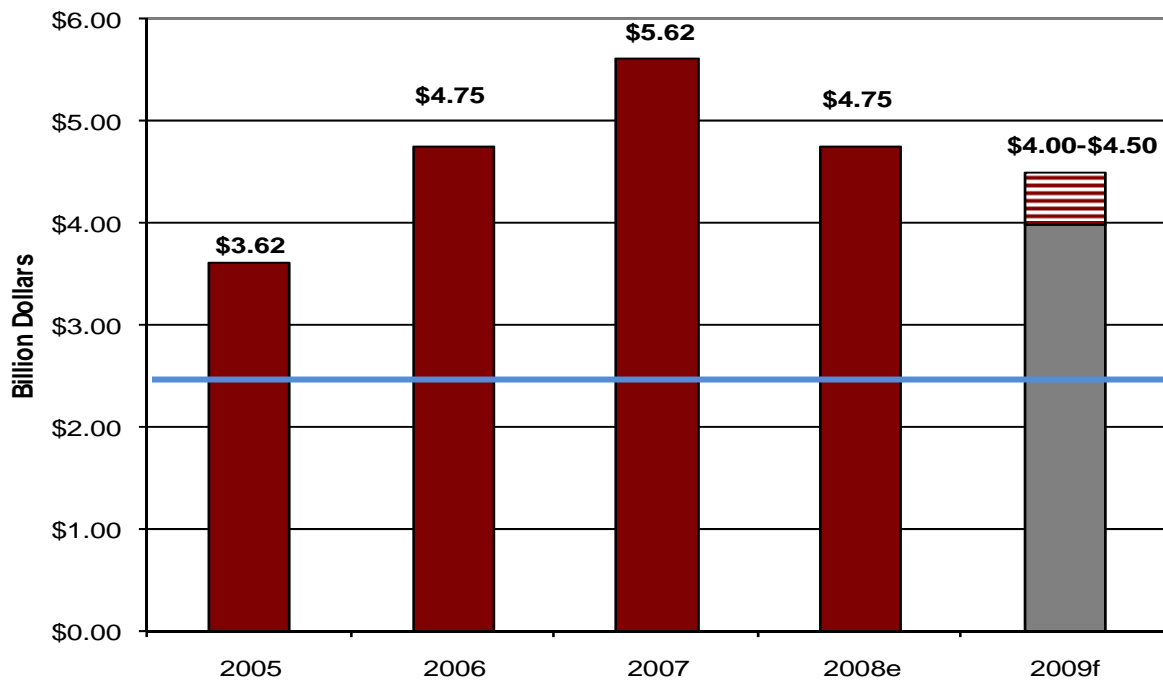
Historically the leader in building permit values, residential building permit values were surpassed by non-residential building permit values in 2007. This was a result of a number of large projects that received building permits in that year, including The Bow, Penny Lane, the Calgary South Health Campus and numerous other large scale projects. This switch is on track to repeat itself in 2008, as City of Calgary January to August 2008 building permit figures indicate that non-residential permit values are over 50 per cent greater than residential permit values.

The slowdown in residential permit values in 2008, down 35 per cent year to date, is not unexpected given the oversupply conditions in the market discussed earlier. With the pronounced slowdown in housing starts forecast for 2008 and 2009, residential building permit values in 2009 are also expected to be lower.

On the non-residential side of building permits, a slight slowdown on this side of the equation can be expected for the balance of 2008 and for 2009 as well. There is currently nearly 10 million square feet of office space under construction across the city. Once this is complete, Calgary should be back to a more balanced market. Therefore it leads one to believe that little new major office construction activity will likely take place unless economic or market conditions change. Most of the major projects are already through the issuance of their building permits. Therefore a reduction in office building permit values should be expected in 2009. This is not a reflection of a soft office market, but a market with sufficient square footage under construction to meet market needs in the future, and ultimately, prudence on the part of developers.

Industrial and infrastructure projects are expected to continue to fuel non-residential permit values in 2009. On the industrial side, a variety of projects by major developers should bring continued permit activity. Continued infrastructure development in Calgary, including LRT expansion, and other roadway and community projects should help to keep non-residential permit values moving ahead. However, given the magnitude of major projects already through the permit process, it is unlikely that 2008 or 2009 will set records as seen in 2007.

Building permit values are forecast between \$4.0 and \$4.5 Billion in 2009, still above the ten year average of \$2.45 Billion.



Source: City of Calgary, CED

Real GDP

Calgary's economy has come off the peak of 2006 and is now back to a more healthy and sustainable economic level for the most part. Real GDP growth measured 3.8 per cent in 2007, and is estimated to be 3.6 per cent for 2008.

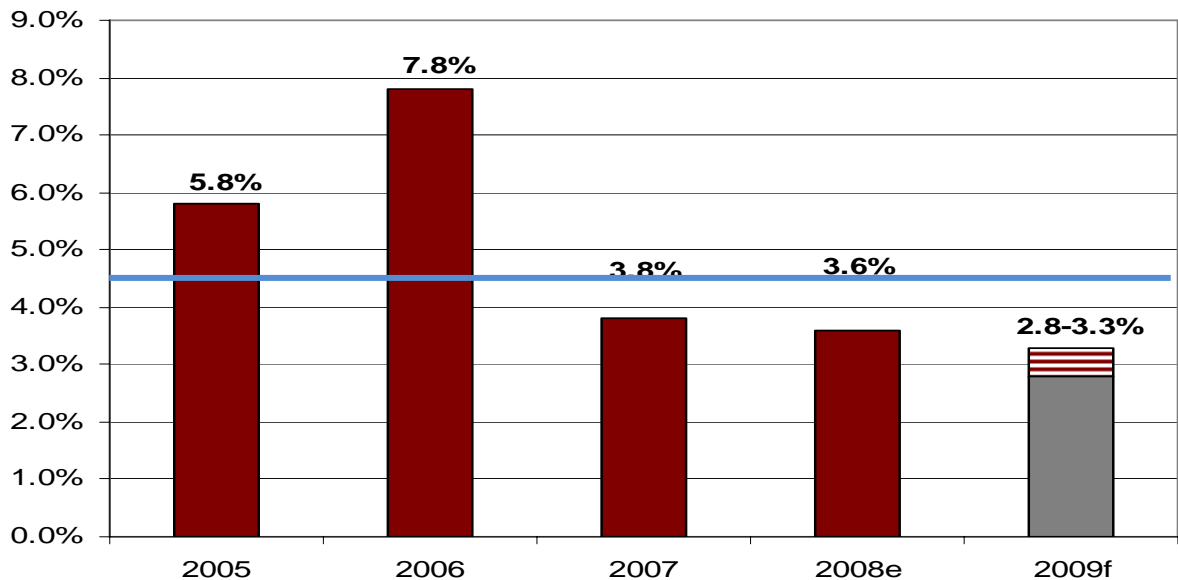
Calgary labour markets are still tight, as are some commercial real estate markets, therefore there are still shortage conditions reflective of a strong economy. Driving these conditions are a global shortage of skilled and trained people, and the impacts of a lag in space demand with space supply.

Higher housing prices are expected to continue to slow in-migration resulting in a further slowdown in population growth. This will also put a limit on employment growth in Calgary, but again it is a limit as a result of limited supply, not limited demand. The over-supply conditions in the housing market should exert a brake on economic growth in Calgary in 2009 through actual and perceptual issues, which are discussed below in the Pressure Points section of this report. The housing over-supply condition, plus the limited number of mega projects to go through building permit issuance, should serve to reduce building permit values in 2009.

General consensus is that oil prices should remain around \$100 per barrel of WTI into 2009. This price level should support continued strong investment and employment in the oil sector, resulting in economic growth from this segment of the economy. However, natural gas prices, another potential pressure point for the economy, are currently depressed and may be so into the first quarter of 2009, resulting in potentially reduced investment depending on the tenure of the low prices.

All in all, Calgary faces a year in 2009 where markets are rebalancing from the highs experienced over the past few years. Whether it is shortages with certain segments, or oversupplies in others, fundamentally Calgary's economy is in healthy condition. Employment demand remains high, wages are growing, and business investment still continues.

Calgary's real GDP growth is forecast between 2.8 and 3.3 per cent in 2009.



Source: Conference Board of Canada, CED

Pressure Points

The 2007 and 2008 Calgary Economic Outlooks identified three pressure points exerting a braking influence on the Calgary economy: labour shortage; shortage of office space; and, a shortage of affordable housing. Significant construction activity should result in a more balanced office market over the next 18 to 24 months, reducing the magnitude of pressure from this component of our economy.

The shortage of people and of affordable housing however are more long term features of our economy and are ones that will inevitably be with us for some time unless significant investments and policy changes are made.

For 2009, the two pressure points that have the potential to exert a brake on the economy are the residential real estate market and natural gas prices.

As discussed earlier in this report, Calgary is facing a record number of listings with a low volume of transactions – a buyers market. Also as discussed above, it is a psychological issue for many Calgarians that this dynamic in the housing market is indicative of a failing economy. It is not. However, all of the salve and economic outlook counseling in the world will not eliminate all perceptions.

There are two key ways that the housing market could exert a brake on the economy in 2009. The first is that perception is reality. Individuals who perceive the economy to be faltering because of the housing market may adjust their behaviours. This includes spending, which is by and large the majority of any economy's annual growth. While increased household savings is always a prudent and responsible thing to do, heavily reducing or eliminating household spending does not appear to be warranted under current economic conditions. Therefore, a slowdown in consumer expenditure has the potential to slow economic activity.

The second, more realistic impact to the economy may come from individuals who paddled out to ride the housing wave and got stuck as the waves died down. With the run up in housing activity, it is very likely that now and over the next 12-18 months, some Calgary households may find themselves having to take ownership of multiple properties when the plan had been to sell one and move into the newly purchased or built property. This may also be the case for speculators who purchased properties on the hopes of a profit once flipped.

With challenges on the sale side, some of these households may have to carry multiple properties for some time, increasing the household level of debt, and exposing them to a higher level of financial risk, as well as reducing their disposable income and savings potential. This has the impact of putting more households at risk of financial troubles, as well as reducing economic activity due to reduced expenditures.

The second pressure point, natural gas prices, is one of the realities of living in a commodity based economy. Fears of low natural gas prices were echoed in this report last year, however the clouds appeared to have parted over the summer of 2008 when natural gas was near the \$10/GJ mark. However, a cooler than expected summer and high inventories have driven the price back down to \$6.22 per GJ as of September 12 close.

With the majority of drilling activity, Provincial government revenue and a strong level of employment based on the natural gas side of energy, continued depressed natural gas prices would result in reduced Provincial revenues, and may impact business investment and hiring decisions. This has the potential to slow economic growth from reduced drilling activity, reduced corporate revenues from natural gas and reduced consumer expenditure.

Analysts believe that natural gas will be in an over-supply situation into the spring of 2009. Therefore it may be a number of months before the full impact of low natural gas prices can be determined in the Calgary economy. At present however, low natural gas prices do have the potential to exert a brake on the economy in terms of spending and investment.

One final topic for consideration in Calgary's economy in 2009 is not necessarily a pressure point but an unknown in terms of the environment for Alberta's oil and gas industry. It is, of course, the implementation of the new Alberta royalty structure which takes effect January 1, 2009. Opinions and perspectives are varied in terms of the actual impact that the new structure will have on operations within Alberta. Many forecasts have been done by government and different private sector organizations, however only once the new structure is in force and companies are evaluating its impact on their cost base will the jury decide its full impact on revenues to the Province and the willingness or ability of oil and gas companies to continue drilling investment and activity in Alberta. At the present time, there are simply too many variables and unknowns to allow for an accurate prediction.

The Bigger Picture

Recall the analogy of our economy as a car cruising along the Trans Canada, now back in the city cruising at 50 km/h. As owners of the car, our economy, we need to ensure that it is always running in top shape. Every so often it needs a tune up and some maintenance to ensure that it performs well in the long-run.

The future of Alberta's and Calgary's economies is bright. But we are facing a world that is beginning to change the way it creates and burns energy. A few years ago, there were no hybrid cars on Calgary's roads. Now there are lots of them. A few years ago, options were limited in buying green power, but not any more. We face a world where pressure is mounting to reduce the amount of greenhouse gasses that are emitted into the atmosphere. This seems like a prime opportunity for Alberta.

And again, it is mind over matter – we cannot expect Calgary's economic success in Canada and around the world to continue unless we remind ourselves that we need to take the economy in for a tune up. And tuning Calgary and Alberta up to be the world's energy capital is just the kind of performance enhancing service that is required to ensure long term prosperity.

Ensuring that Alberta and Calgary are poised for future success will take a sound vision and strategic plan for our energy future. Calgary has the potential to be the world centre of all things energy – fossil fuels, sustainable and renewable energies, research, education, financing, power production and transmission, greenhouse gas reduction etc. The list is endless. And so is the opportunity.

So while the outlook for 2009 looks fundamentally healthy, we must consider the outlook to 2019, 2029 and beyond. It will take collaboration by the private sector and all levels of government, but specifically the Province of Alberta as the steward of our most precious resources – investments in people and energy. To find out more about Calgary's goal of being the global centre of all things energy, see the Calgary Economic Development Strategy 2008 – 2018 by visiting www.calgaryeconomicdevelopment.com.

Risks to the Outlook

Upside

- Rebound in natural gas prices
- Faster than expected turnaround in the U.S. economy
- No slowdown in economic activity in China post-Olympics
- Higher than expected population growth to support employment demand
- Lower inflation than expected

Downside

- Continued depressed natural gas prices
- Slower growth in China post-Olympics
- Poorer economic performance in the U.S. than currently being experienced
- Unexpected drop in oil prices
- Prolonged oversupply in housing market

Sources

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- BMO Capital Markets Economic Research
- CIBC World Markets Economics and Strategy
- Alberta Employment and Immigration
- Alberta Finance and Enterprise
- Calgary Real Estate Board
- ATB Financial
- CB Richard Ellis
- Bank of Canada
- TD Economics
- City of Calgary
- Canada Mortgage and Housing Corporation
- Canadian Association of Petroleum Producers
- Conference Board of Canada

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