ALBERTA FINANCE
Budget and Fiscal Planning
December 10, 2007

Economic Spotlight

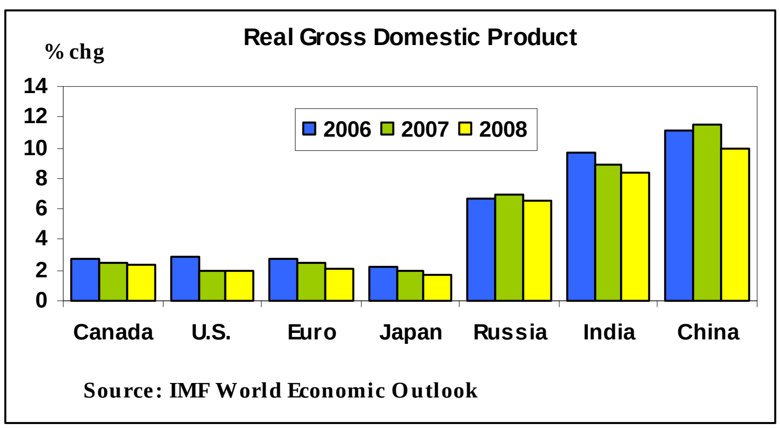
Global Economic Developments

Summary

Recent financial turbulence linked to the U.S. housing correction has introduced a somewhat weaker outlook for the U.S. and world economies. The weaker U.S. economic outlook, combined with a wide current account deficit and recent U.S. interest-rate cuts, have sent the U.S. dollar to record lows against major world currencies.

Major emerging countries, such as China, India and Russia, have taken over as leading contributors to global growth. Strong demand in these countries is likely to continue to support high world commodity prices and solid global economic growth. Rising exports to China and other non-U.S. countries could partially offset the negative impact of the U.S. slowdown on Canadian and Alberta economies.

1. Overview of Global Growth



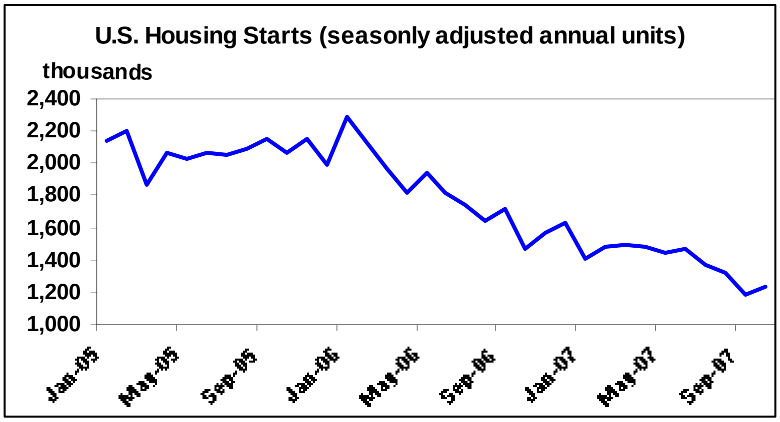
Although world economic growth is expected to remain solid, turbulence in financial markets could dampen the pace of growth. In its October 2007 release, the International Monetary Fund (IMF) forecast that the world economy would expand at healthy 5.2% in 2007 and 4.8% in 2008, down only moderately from the 5.4% growth registered in 2006. Growth in the United States, Japan and Europe is expected to slow to around 2%, due to tight financial conditions stemming from a crisis in the US housing sector, while major emerging countries, such as China, India and Russia, have taken over as leading contributors to global growth.

Inflationary concerns have taken a backseat in most advanced economies because of financial market turbulence. A slowdown in the U.S. economy has prompted interest rate cuts by the U.S. Federal Reserve, whereas expectations of policy tightening by the Bank of England, Bank of Japan, and European Central Bank have been rolled back. In contrast, emerging countries, such as China and India, face more immediate inflation risks from rising food and energy prices; and further monetary tightening may be required. This divergence in monetary policy has further weakened the US dollar.

2. Weakening U.S. Economy

U.S. Housing Slump

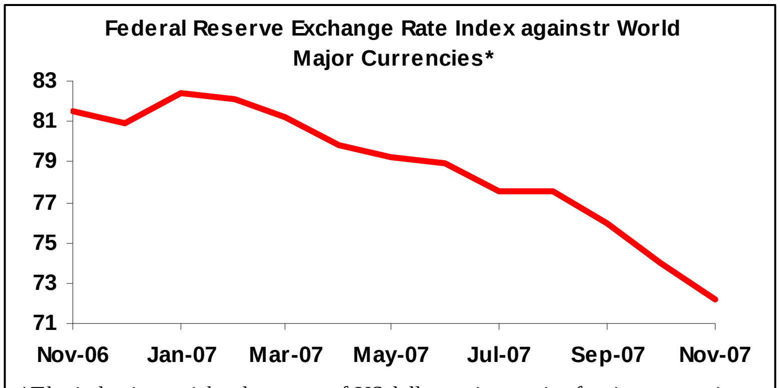
Deepening problems in the U.S. housing market and turmoil in financial markets are hurting U.S. growth. Overall growth in the U.S. is expected to be around 2.0% in both 2007 and 2008, almost 1% lower than growth in 2006. Recent indicators show continuing difficulties in the US housing market. U.S. housing starts fell to an annualized rate of 1.23 million units in October, down 46.3% from the peak in January 2006. Ongoing difficulties in the housing market are expected to extend the decline in residential investment, while higher energy prices, sluggish job growth, and weaker house prices are likely to dampen consumer spending.



The U.S. Federal Reserve cut the federal funds rate by one quarter of percentage point (to 4.5%) on October 31, amid concerns of slowing growth, after cutting the rate by half a percentage point in September in an attempt to stabilize financial markets. Federal Reserve Chairman Ben Bernanke said that the housing correction is "likely to be a significant drag on growth in the current quarter and through early next year".

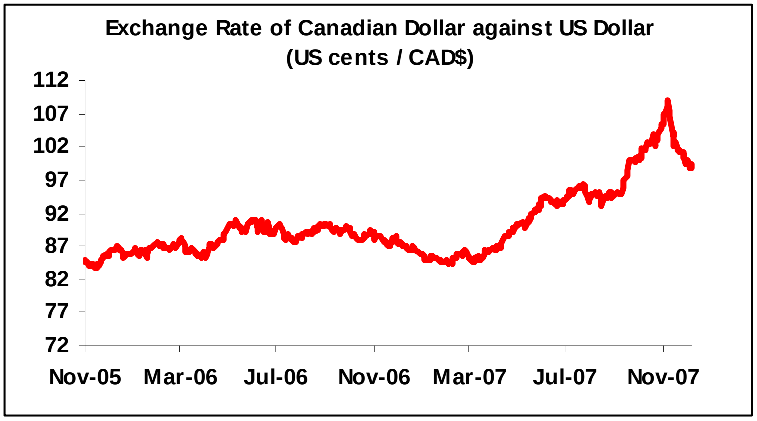
A Weakening U.S. Dollar

The weaker U.S. economic outlook, combined with a still wide current account deficit (which is running at an annualized rate of US$763 billion) and recent interest-rate cuts by the U.S. Federal Reserve, have sent the U.S. dollar to record lows against world major currencies.



*The index is a weighted average of US dollar against major foreign currencies.

The Canadian dollar has gained more than any other major currency against the U.S dollar, on the strength of commodity prices and a strong domestic economy. The U.S. interest rate cuts have eliminated the interest-rate gap between Canada and the United States, which has further strengthened the Canadian dollar. Although the Canadian dollar has retreated to near parity from a record high of 109.1 US cents on November 7, 2007, it is up by around 18% since its February low of 84.4 US cents. In contrast, so far this year, the euro is up around 14% from its January low and the Japanese yen about 11% since its low in June.



2. Robust Growth in Emerging Asia

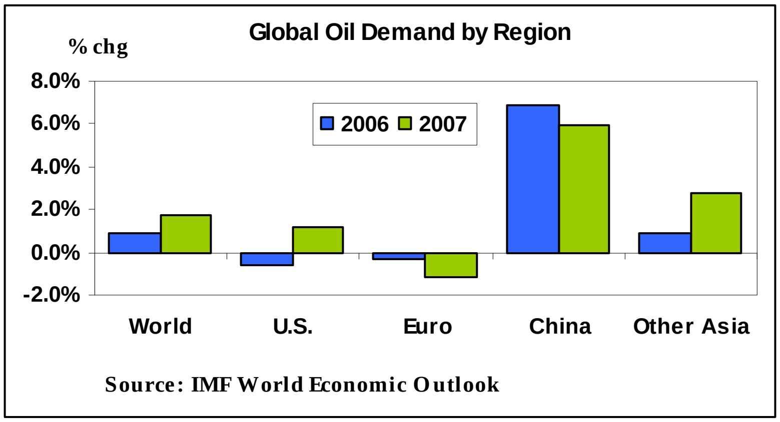
Vigorous Economic Growth in China

Emerging Asia maintained exceptionally strong economic growth. China led the regional expansion, with real GDP growing 11.5% (annualized rate) in the first half of 2007. For the first time, China is making the largest contribution to global growth, evaluated at both market and purchasing-power-parity exchange rates.

Inflation surged to a 10-year high of 6.5% in October and was at 6.2% in September, mainly driven by soaring domestic food prices. Against this background, China's central bank is expected to increase its key interest rates for the sixth time this year in the coming months. However, it remains unclear to what extent this policy tightening will prove effective in cooling China's rapid growth.

Accelerating Oil Demand in Emerging Asia

Global oil demand growth is expected to accelerate to about 1.7% in 2007, compared with around 0.9% in 2006. Buoyant oil demand in emerging Asia is expected to more than offset the weaker overall demand in developed countries, reflecting rapid income growth in emerging economies such as China and India. The strong demand in emerging Asia is expected to support continued high energy prices.



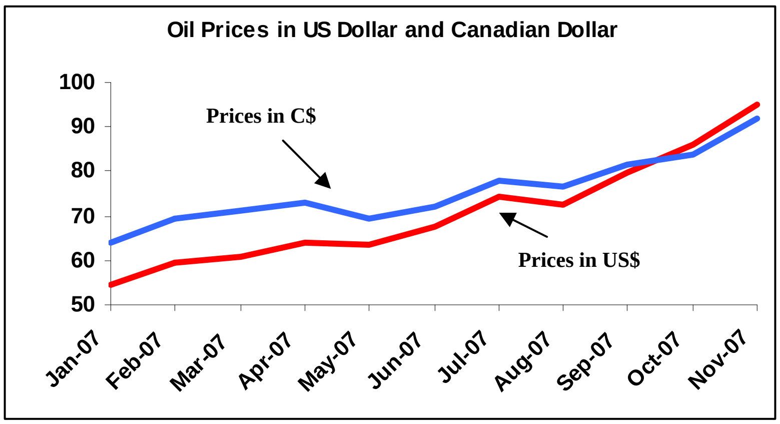
3. Challenges and Opportunities for Canada and Alberta

Weaker US Economy

The Canadian economic outlook is clouded by the weaker U.S. economy and the financial market turmoil. Canada is expected to grow by 2.5% in 2007 and 2.3% in 2008, down from 2.8% in 2006. Alberta is also affected by the health of the U.S. economy, with around 90% of total energy shipments and 36% of non-energy sales going to the U.S. markets.

A Strong Canadian Dollar

The stronger Canadian dollar is likely to narrow Canada's trade surplus, negatively impacting exports while positively supporting imports. In particular, the manufacturing sector is under pressure, as factory shipments slid 0.9% in September, the fifth drop in six months. The auto sector in central Canada is weak as declines in sales of cars in the U.S. are affecting auto exports.



In Alberta, the stronger Canadian dollar mitigated the increase in the value of energy and agricultural exports, as these products are priced in US dollars. So far this year, US dollar oil prices surged by more than 75%, while Canadian dollar prices increased by only around 43%. Additionally, the stronger Canadian dollar makes Alberta manufacturing exports more expensive to international buyers, which also lowers the demand for our exports.

Opportunities from China's Robust Growth

The strong growth in China has led to accelerating demand for Canadian natural resources. Between January and July 2007, Canada's exports to China surged 43%, compared to the same period in 2006. This was more than double the pace of Canada's imports from China (+17%). Also, robust demand from China has helped to propel world commodity prices to record highs. China became Canada's second largest export market for crude oil in the first seven months of 2007.

With the sharp gain in exports to China and other non-U.S. countries, the share of Canada's exports to these countries rose sharply between 2002 and 2007, from 16% to 24% of total exports. This development was well-timed, given the onset of the housing-induced slowdown in the United States.