ICIC Construction Sector Quarterly Insights

Published January 2024

Canadian Construction Association
Best Practices Services

Key insights for Q3 2023

- **Q3 2023 slowdown:** Interest rate increases by the Bank of Canada have impacted growth, slowing consumption and business investments.
- **Interest rate impact:** Elevated interest rates are diminishing investments, causing a decrease in spending. This trend is impacting both the overall economy and the construction sector, which is particularly sensitive to interest rate fluctuations.
- **Higher oil prices:** Geopolitical tensions and increased global demand influenced a Q3 energy price surge.
- **Construction labour:** Labour force and employment in the construction sector declined, with substantial job losses in British Columbia, Ontario, and Quebec; however, there are still 58,000 unfilled roles.
- **A comprehensive housing strategy will require more public investment in the foundational infrastructure required to support new homes and communities.**

This report was prepared by the Canadian Construction Association (CCA) to provide an overview of the last quarter, the current economic health of the industry, and its implications for member businesses.

Impact of interest rates on economic activity

The Canadian economy slowed in Q3 following a mild uptick in activity across all industries in Q1 and a relatively stable Q2. This deceleration was mainly induced by ongoing pressure from interest rate hikes, resulting in a 0.1 per cent contraction of the economy.

Despite some resilience in the labour market and industry output earlier in the year, the Bank of Canada's rate increases have gradually impacted growth during the third quarter. Canadian households are slowly depleting their savings, leading to restrained consumer spending, evidenced by the -1.8 per cent decline in Q3's year-over-year retail sales. The construction sector, an industry highly sensitive to interest rate changes, experienced a slowdown similar to the broader consumption trend.

Quarterly changes Q3 2023

+0.6%
Industrial product price index (IPPI)

-3.6%
Building construction investments $35 B

-2.3%
Current employment 1.56 M

-0.52%
Building construction price index (BCPI)

ICIC construction sector: performance and sectoral trends

The construction industry's output remained stagnant in Q3 2023, marking another period of unchanging activity following the previous quarter. The residential construction sector activities increased during Q3, marking the sector's first positive quarterly growth (3.7 per cent) after five consecutive quarterly declines.

All other segments within construction however faced setbacks. The non-residential sector contracted by -0.1 per cent, repair construction activity decreased by -1.5 per cent, and engineering and other construction activities saw a notable contraction of -2.4 per cent, marking the engineering construction sector's first decline since Q3 2020 [Chart 1: GDP]. Despite the contractions documented this quarter, the engineering construction sector experienced a year-over-year growth of 8.9 per cent.

Industrial capacity utilization rate

The industrial capacity utilization rate is a key indicator of an industry's output relative to its estimated potential output, offering insights into the dynamics of an industry's demand and supply.

In Q2 2023, the pressure observed during the pandemic recovery eased as the economy slowed. The average capacity utilization rate for all industries in Q3 experienced a slight decline of -0.6 per cent, reaching 81.4 per cent. However, this rate remains higher than its 10-year average of 80.5 per cent.

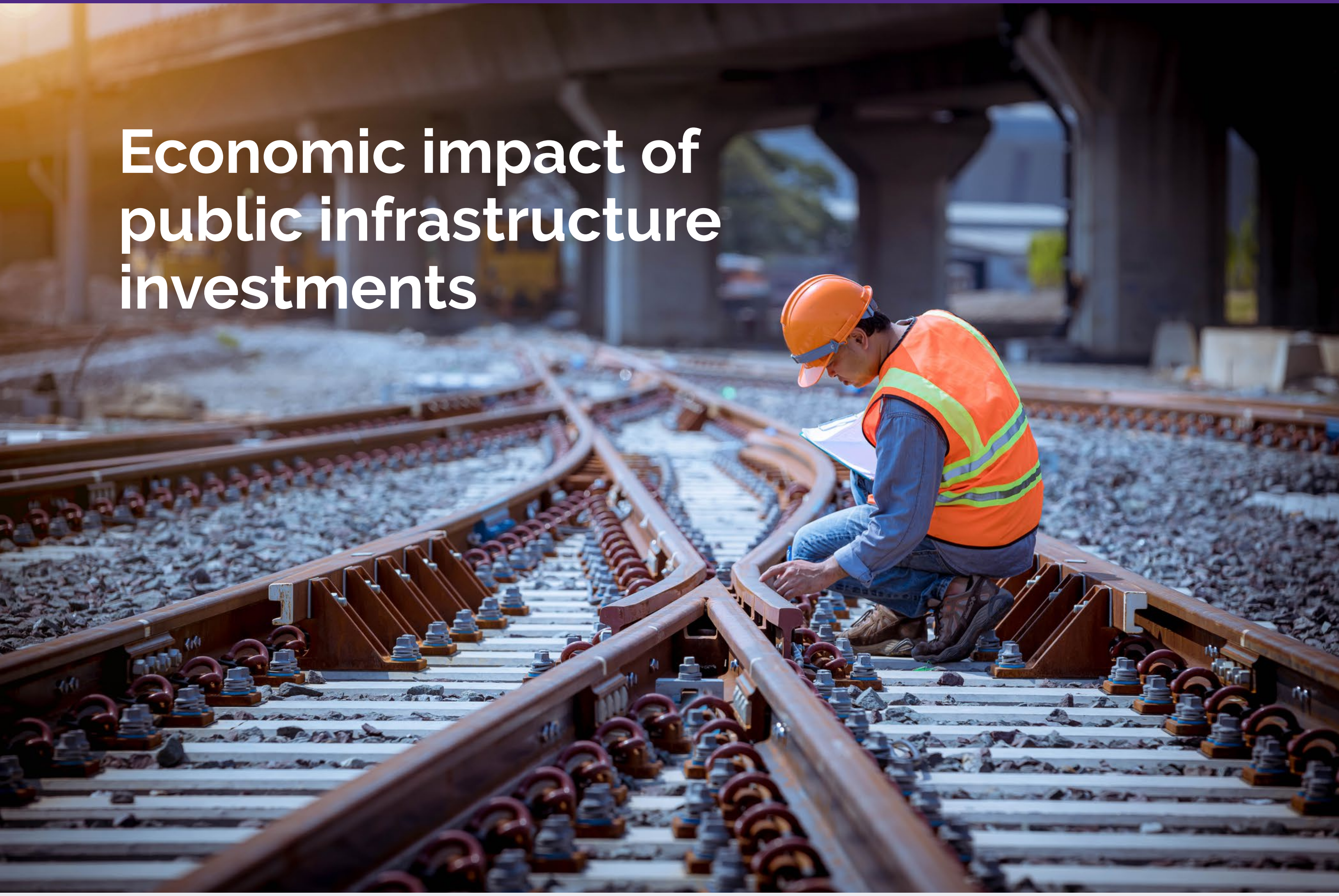
In comparison, the construction industry saw a sharper decline in its capacity utilization rate, decreasing by approximately two per cent to 88.5 per cent. Despite this decline, the sector's rate still surpassed its 10-year average (2010-2020) of 87 per cent and remains above the rate of all other industries [Chart 2: CUR].

Investments in building construction

The higher interest rate level has impacted the cost of accessing capital, resulting in a reduction in investment growth throughout 2023. In Q3 2023, investment growth continued on a downward trajectory. All subcomponents of the ICIC sector showed slight declines, including a substantial contraction in investments in the multiple-residential component. The declines led to an overall negative growth trend for investments in ICIC construction. The industry is seeing the effects of higher interest rates on its economic dynamics, affecting its growth and performance.

Investment growth in the ICIC sector contracted -3.6 per cent to $35 billion [Chart 3: Investments]. The main contributor to the contraction remains the multi-residential component, which experienced a quarterly decline of -3.6 percent. The industrial component and the commercial component both experienced a slight contraction of -0.5 per cent and -0.1 per cent respectively. These declines mark significant changes from previous quarters, considering that both sectors had consistently shown positive growth since Q1 2021. The sole asset class to show a minor quarterly increase was the institutional subcomponent, growing by 0.7 per cent thanks to investments in a hospital renovation in Toronto, a new hospital project in Dawson Creek, B.C., and the construction of a correctional facility in Thunder Bay.

Dawson Creek and District Hospital



Economic impact of public infrastructure investments

Public infrastructure investments overview

Public and private investments in infrastructure have undergone shifts over time. In 2022, public investments accounted for 69 per cent of total infrastructure investments, marking a notable increase from the 63 per cent share recorded in 1981. Conversely, private investments decreased to 31 per cent from 37 per cent in 1981. In 2022, this resulted in $76.2 billion in public investments and $35.9 billion in private investments out of a total infrastructure investment of $112.1 billion in 2022 [Chart 4: Public Investments by Share].

Public investments in infrastructure

Public investments, supported by all levels of government, cover a range of asset classes [Table 1: Public Infrastructure Assets]. Some asset classes rely heavily on private investments like communication networks and oil and gas engineering construction, while others, such as institutional buildings, sewage infrastructure and transportation engineering infrastructure, largely depend on public investments.

Distribution and impact of public investments

In 2022, public investments in infrastructure reached $76.2 billion, with significant contributions from municipal (28 per cent), provincial (20.2 per cent), and government business enterprises (24 per cent) [Chart 5: Public investment distribution]. In terms of asset function, investments were allocated across transportation (37 per cent), fuel and energy (18 per cent), education (14 per cent), health (9 per cent), environmental protection (7.3 per cent), and housing (6.4 per cent) functions, collectively representing 92 per cent of all public investments.

Economic contribution of public investments

The economic contribution of infrastructure investments is estimated in terms of value added (direct and indirect impact), compensation of employees, and job creation. In 2022, the value added by private and public investments amounted to $83.4 billion, with the construction industry attaining $45 billion (54 per cent of total share). The remaining share of value added extends across other industries: information, finance, and professional sectors accounted for 19.3 per cent of the value added, while manufacturing accounted for 10.4 per cent. Total investments in infrastructure generated approximately 675,370 jobs and $51.7 billion in wages across all industries in Canada, with construction accounting for a significant portion—339,000 jobs (50.2 per cent) and $28.5 billion (55.1 per cent) in compensation.

Public infrastructure investments significantly contribute to Canada's economic landscape. Public investments in infrastructure generated a total added value of $56.6 billion (68 per cent of total), contributing $30.5 billion in added value in construction, $18.9 billion in compensations, and 247,000 construction-related jobs.

Asset-class specific impact

Public investments in infrastructure exhibit varying impacts across asset classes. Certain asset classes contributed significantly to construction—electric power infrastructure ($6.6 billion impact, $3.2 billion in wages, and 37,375 jobs), institutional buildings ($8.6 billion impact, $5.5 billion in wages, and 80,320 jobs), and transportation engineering infrastructure ($10.6 billion impact, $6.8 billion in wages, and 91,145 jobs) made substantial contributions to the added value, compensations, and job creation [Chart 6: Public investment by asset impact].

Housing infrastructure

A recent study by the Federation of Canadian Municipalities (FCM) concluded that each new housing unit in Canada requires an average investment in public infrastructure of $107,000 [FCM Public Infrastructure]. Meanwhile, the Canadian Mortgage and Housing Corporation (CMHC) forecasts that the construction of 5.8 million new homes is needed by 2030 across Canada to rebalance housing supply and demand dynamics [CMHC Housing Shortages in Canada]. As a result, the necessary infrastructure fundings required to close the housing gap would represent an investment of $620 billion.

Labour market in construction

Employment

National employment figures in construction experienced a quarterly decline of -2.3 per cent, representing a loss of 36,800 jobs [Chart 7: Employment change by province]. The losses in employment were primarily driven by a significant loss of approximately 14,500 jobs in British Columbia. Ontario and Quebec also saw notable declines in employment, with respective declines of 5,300 and 3,600 jobs in the sector.

Unemployment

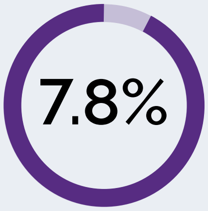
Although employment decreased in Q3, the unemployment rate did not correspondingly rise. This discrepancy stems from how the unemployment rate is calculated. When individuals retire, lose motivation to actively seek jobs, or switch industries, they exit the labour force. As a result, these individuals are no longer counted as part of the unemployed population.

During Q3, there was a decline in the available labour force of approximately 45,200 workers (-2.7 per cent). This decrease contributed to the decline in the overall unemployment rate within the construction industry across Canada, dropping by four percentage points to 5.1 per cent.

Vacancies in construction

In Q3 2023, vacancies within the construction sector declined by 7.8 per cent, resulting in 58,410 open positions across Canada. September experienced a substantial decline in construction vacancies, reaching their lowest level since the rapid rebound of economic activity experienced in Q1 2021. This decrease marks the fourth consecutive quarterly decline of vacancies in construction.

Despite these declines, the construction industry maintains its position as the fourth highest in terms of vacancies across all sectors. Moreover, the current vacancies stand at 1.6 times higher than the pre-pandemic levels documented in 2019 [Chart 8: Vacancies].



vacancy decline resulting in **58,410 open positions** across Canada.

Material inflation [IPPI]

In Q3 2023, after two consecutive quarters of decline, the industrial product price index showed a slight uptick of 0.6 per cent [Chart 9: IPPI]. The increase was primarily driven by two key groups in construction: the energy group (+11 per cent) and the lumber and other wood products group (+4 per cent).

The energy group, which had experienced two consecutive quarterly decreases, saw a significant 11.2 per cent increase in Q3. This rise was influenced by quarterly increases in natural gas (+13.4 per cent), diesel (+19 per cent), light oils (+26 per cent), heavy fuel oils (+23.6 per cent), and refined petroleum products (+12.6 per cent). Constrained supply, increasing global demand, and geopolitical tensions in Israel contributed to the rise in energy prices during Q3, reversing the downward trend experienced during the first half of 2023.

After five consecutive quarters of decline, the lumber product group observed a price increase in its components. Factors such as wildfires affecting wood supply in western Canada and heightened construction of residential housing in the US and Canada spurred price hikes in softwood lumber (+7.6 per cent), reconstituted wood products (+9.4 per cent), and veneer and plywood (+6 per cent).

Other key components in construction experienced significant quarterly changes, including a decrease in hot-rolled iron (-9.1 per cent), iron and steel metal pipes (-1.8 per cent), and a slight increase in cement (+0.3 per cent).

Despite the quarterly price increases in these product groups, the index displayed a second consecutive year-over-year decrease of -0.9 per cent.

Building Construction Price Index (BCPI)

The third quarter of 2023 gave a positive outlook for the industry in terms of costs. The Building Construction Price Index (BCPI) recorded two consecutive quarterly declines in its growth rate. During Q3 2023, the BCPI for the non-residential sector decelerated to one per cent. All subcomponents within the non-residential index experienced similar declines compared to their previous quarterly values. On a year-over-year basis, the growth of the index also declined from 7.5 to 5.9 per cent.

While the industry welcomes the slower growth in cost increases, the index remains notably high, standing at 30 per cent higher than in the first quarter of 2020. The BCPI emphasizes the significant impact that material inflation and labour costs had on the industry during the last three years [Chart 10: BCPI].

What's ahead for the industry?

The effects of recent interest rate hikes are expected to continue to weigh on consumer and business investment spending. With a rising supply but slowing growth in the demand for goods and services, indicators suggest that the economy is rebalancing. However, risks to the Canadian economy remain. Uncertainty surrounding the oil and energy markets continue. If uncertainty in oil prices translate into real price increases, the price-through mechanism to other product prices may produce a small uptick in inflation. Near-term inflation expectations, corporate pricing behaviour, and wage growth are yet to normalize, leaving more persistent inflationary pressures on the economy.

The most recent survey of business conditions outlines the challenges that construction businesses foresee in the upcoming quarter. A significant majority, 55.6 per cent of respondents, view rising inflation as their main concern. However, there's been a decline in the number of respondents expressing difficulty in acquiring inputs either domestically or internationally. Notably, 54.8 per cent of respondents highlighted rising interest rates and debt costs as obstacles they anticipate over the next three months. This figure represents an 11.4 per cent increase from the previous quarter [Table 2: Survey of business obstacles].

During Q3 2023, Canadian economic activity was swayed by the effect of higher interest rates on demand and supply. The impact of interest rates continues to constrain both consumer spending and business investments. While indicators suggest a rebalancing of demand and supply, significant risks persist. The fear of higher oil prices poses a threat, potentially triggering broader price increases across various products. Uncertainties surrounding near-term inflation expectations, corporate pricing behaviours, and wage growth add to the challenges, potentially fueling prolonged inflationary pressures.

Looking ahead, the construction sector anticipates challenges, particularly to rising inflation and concerns about increased interest rates and debt costs. CCA will continue to monitor the evolution of the Canadian landscape over the next quarter and will keep the industry informed of any significant economic and political developments.

Looking ahead: key economic and policy considerations

- **Economic slowdown:** Analysts from both public and private sectors anticipate a potential slowdown in the Canadian economy by 2024. Achieving a “soft landing” remains possible, yet heightened global market volatility could pose challenges to this scenario.

- **Geopolitical developments and energy prices:** Geopolitical tensions continue to raise concerns in energy markets, resulting in added volatility in oil prices. The resulting volatility may trigger broader price changes across products if energy price increases materialize.

- **Persistency of inflation:** While inflation expectations indicators have started to ease, they still linger above the Bank of Canada’s desired levels. Energy prices and consumer sentiments will play key roles in determining the duration of anticipated interest rate adjustments.

- **Interest rates:** Trouble could emerge if the Bank of Canada maintains an elevated interest rate policy. Companies that secured low rates through long-term debt issuance will eventually face increased financing costs. With many Canadians facing mortgage renewals soon, the prospect of sustained rates could potentially strain the balancing act between governments and the inflation-targeting central bank.

- **Housing investments:** While the federal government remains focused on increasing housing supply to reduce the costs to consumers, a comprehensive and appropriately funded public infrastructure investment plan will be essential to achieve their objectives.

For more information on this report or the work CCA is currently focused on to address these issues, please email CCA Assistant Manager of Economics and Policy Development, Mario Baker at mbaker@cca-acc.com.

CHART 1

Real GDP growth of construction and non-residential investment growth

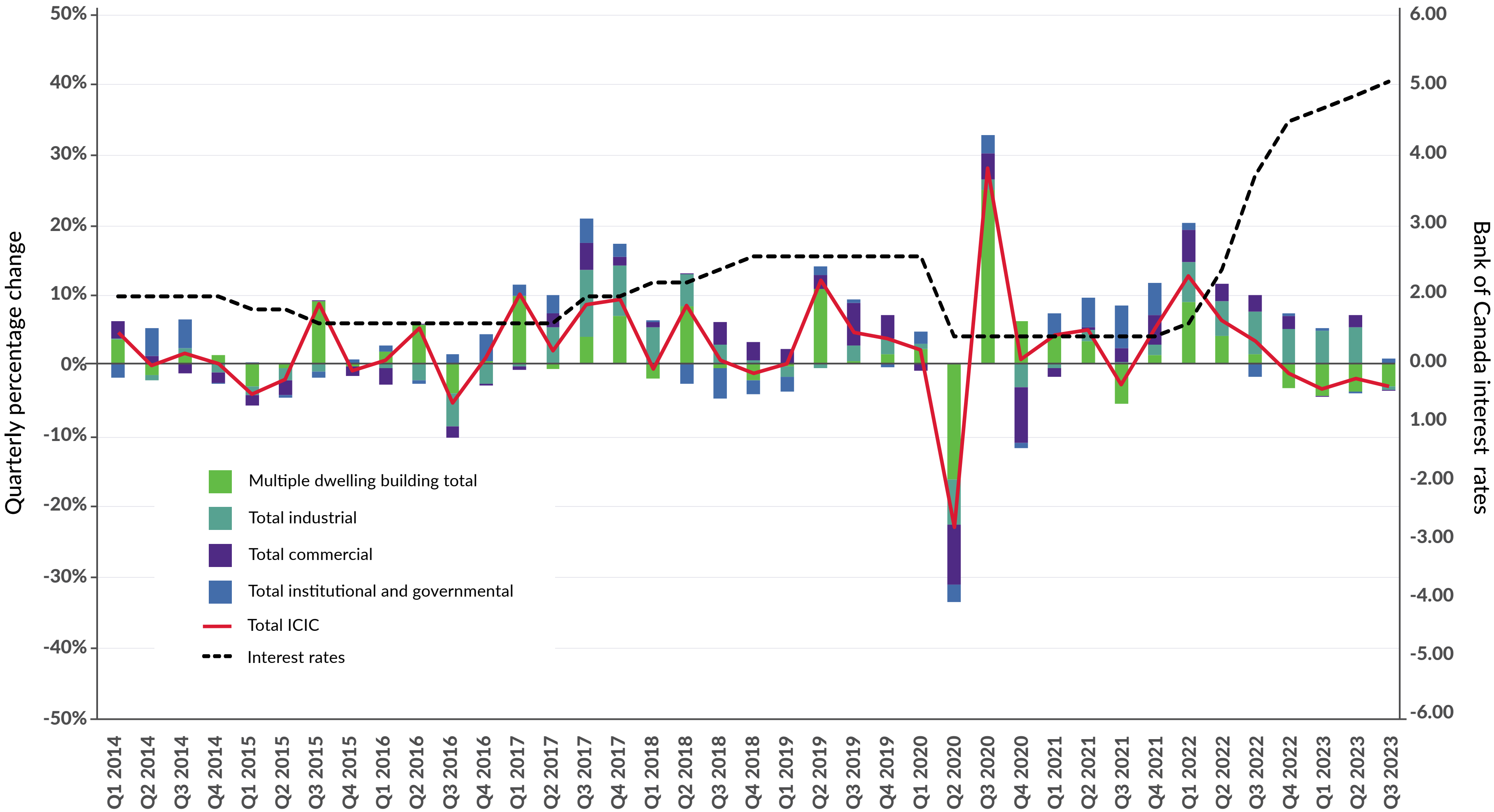
Source: Infrastructure Economic Accounts, CCA

CHART 2
Capacity utilization rate by industry

Source: Infrastructure Economic Accounts, CCA

CHART 3

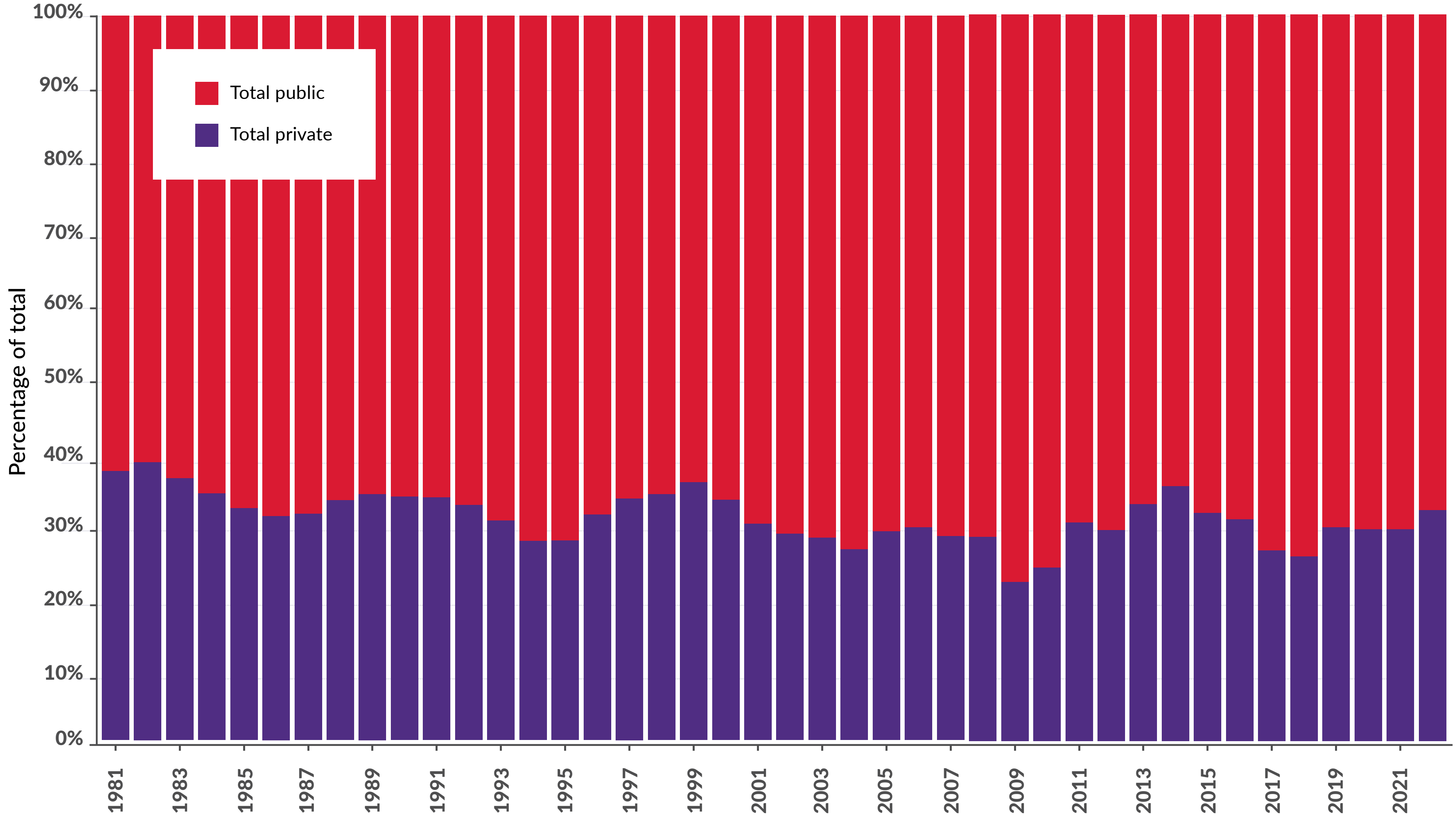
Investment in building construction



Source: Infrastructure Economic Accounts, CCA

CHART 4

Infrastructure investments by purchasing industry

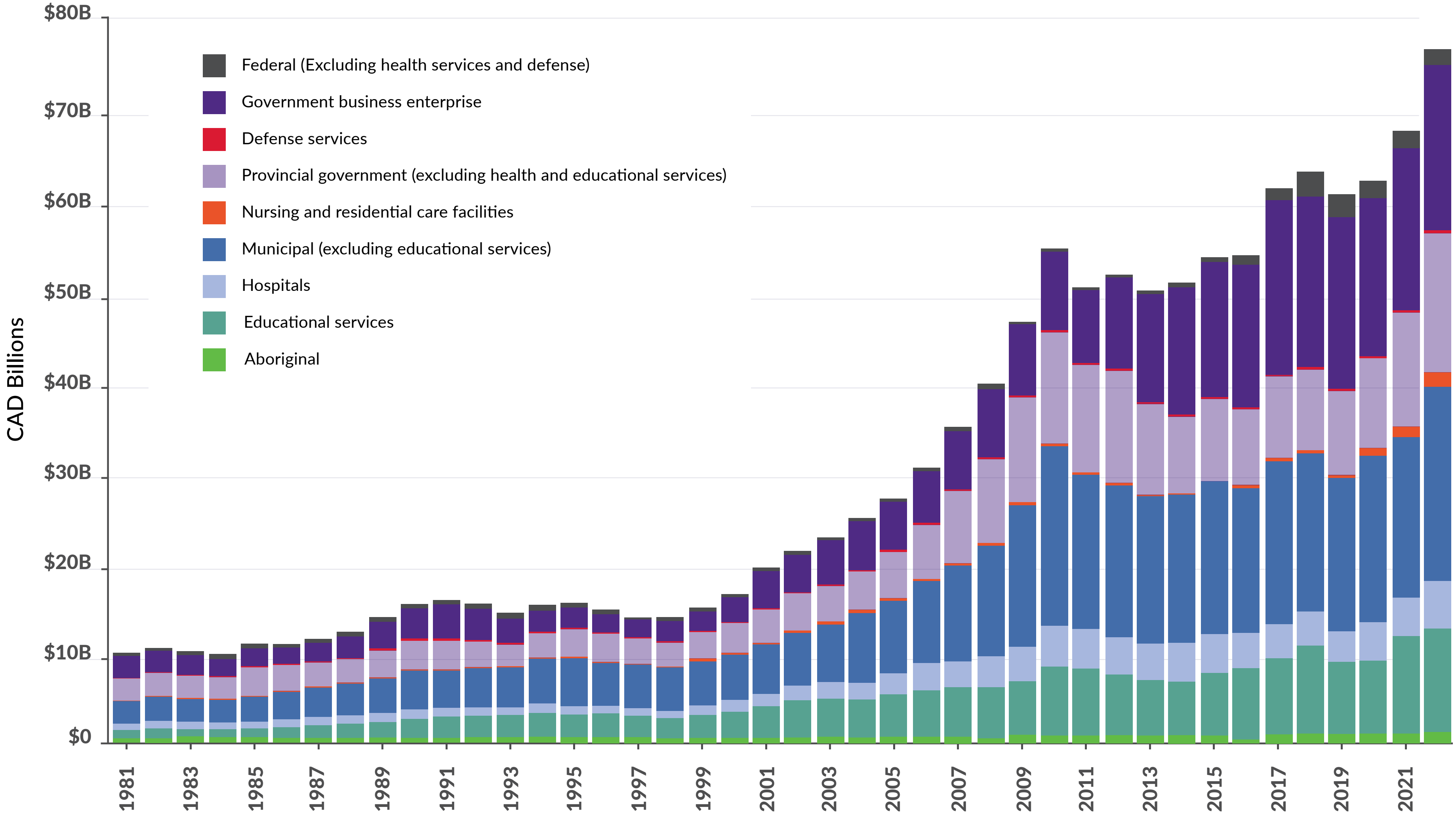


Source: Infrastructure Economic Accounts, CCA

Canadian Construction Association Best Practices Services

CHART 5

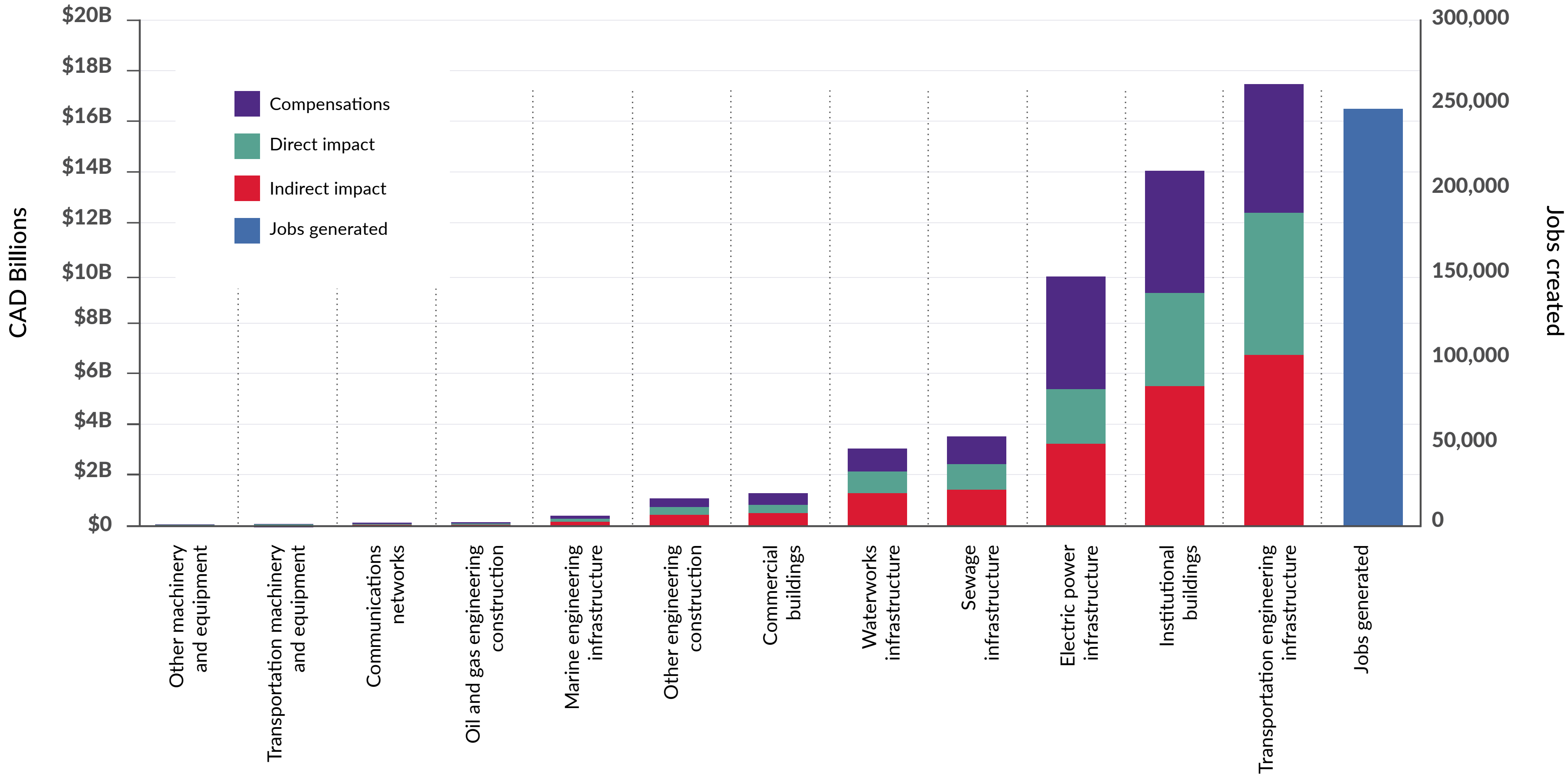
Public investments in infrastructure by purchasing industry



Source: Infrastructure Economic Accounts, CCA

CHART 6

Impact of public infrastructure investments in construction



Source: Infrastructure Economic Accounts, CCA

CHART 7

Quarterly employment change by province Q2 - Q3 2023

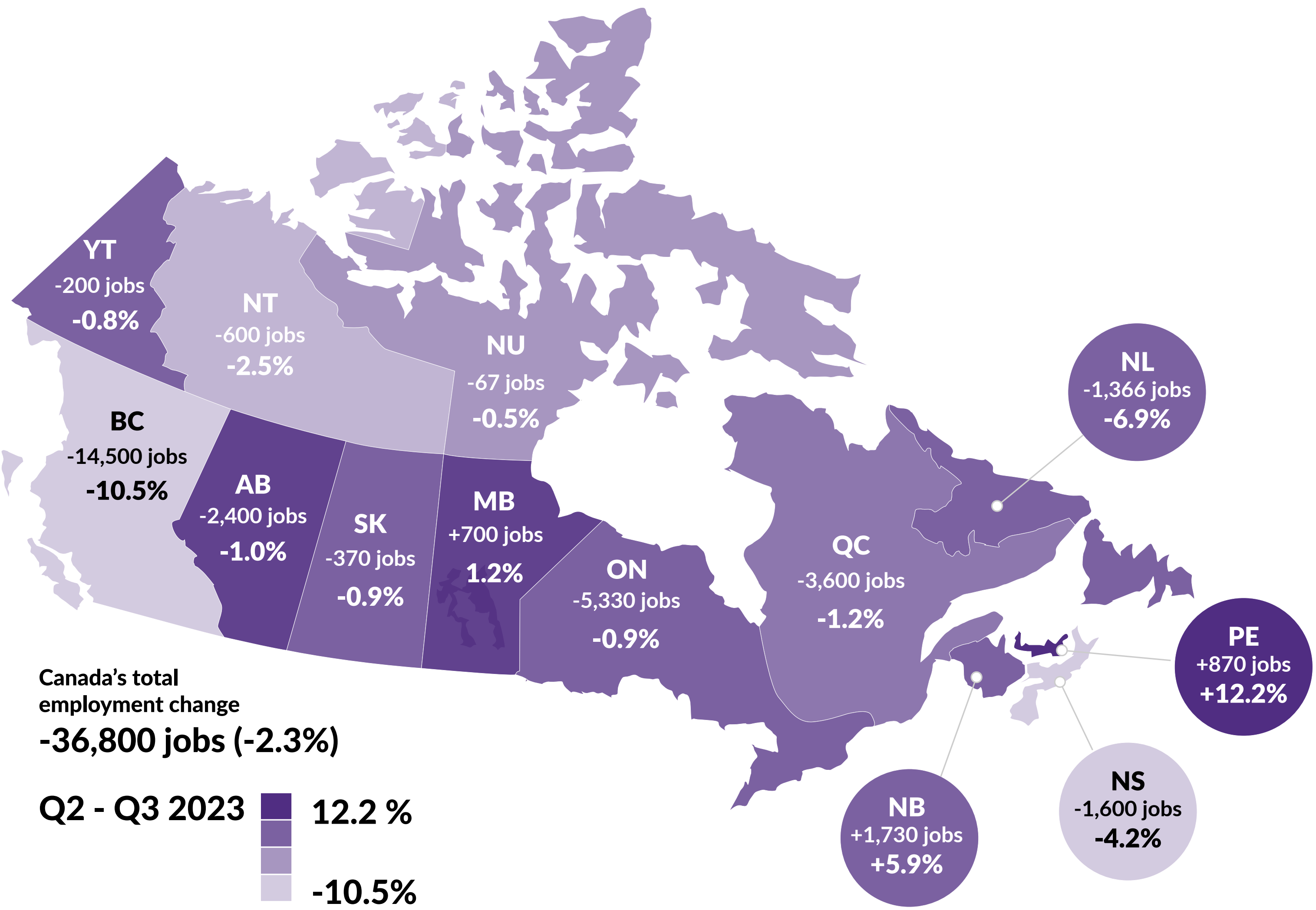
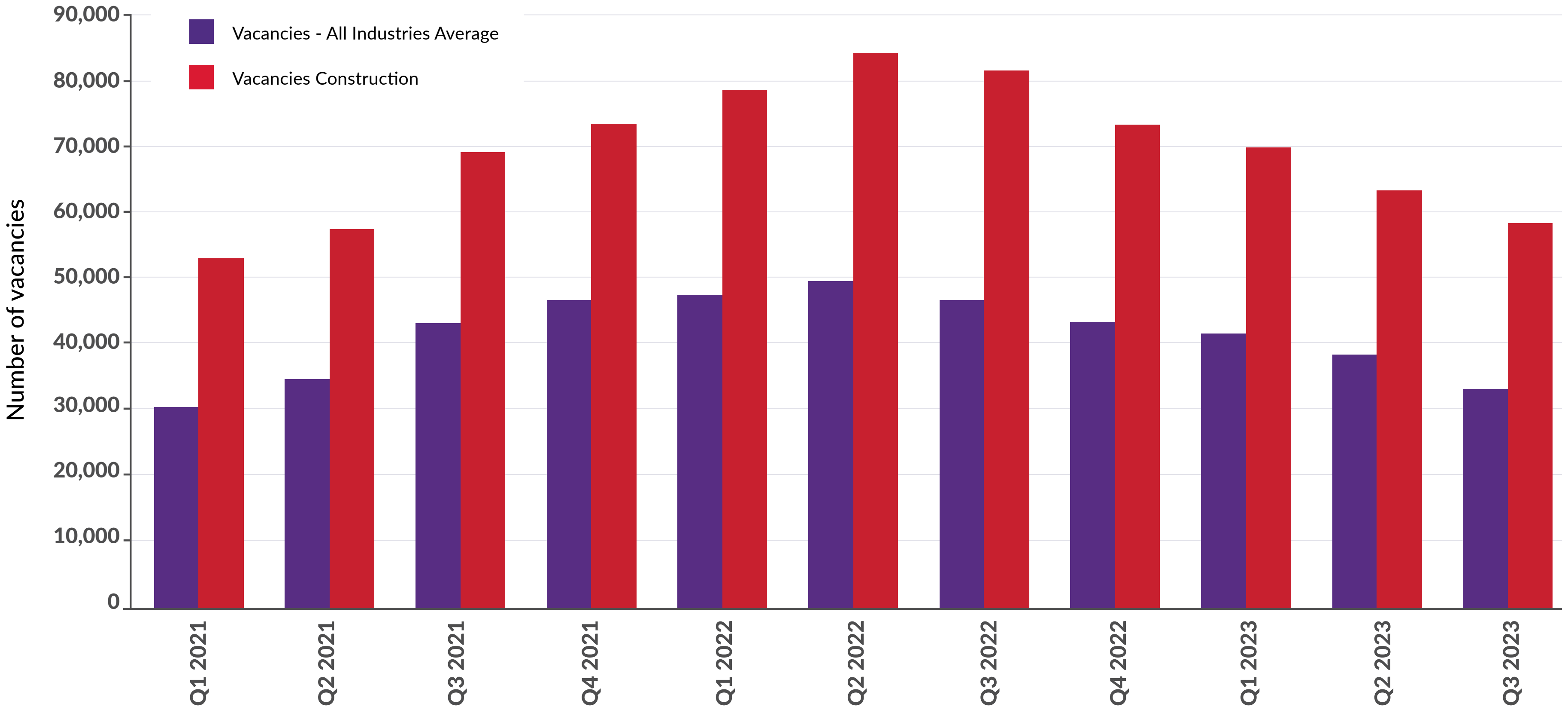


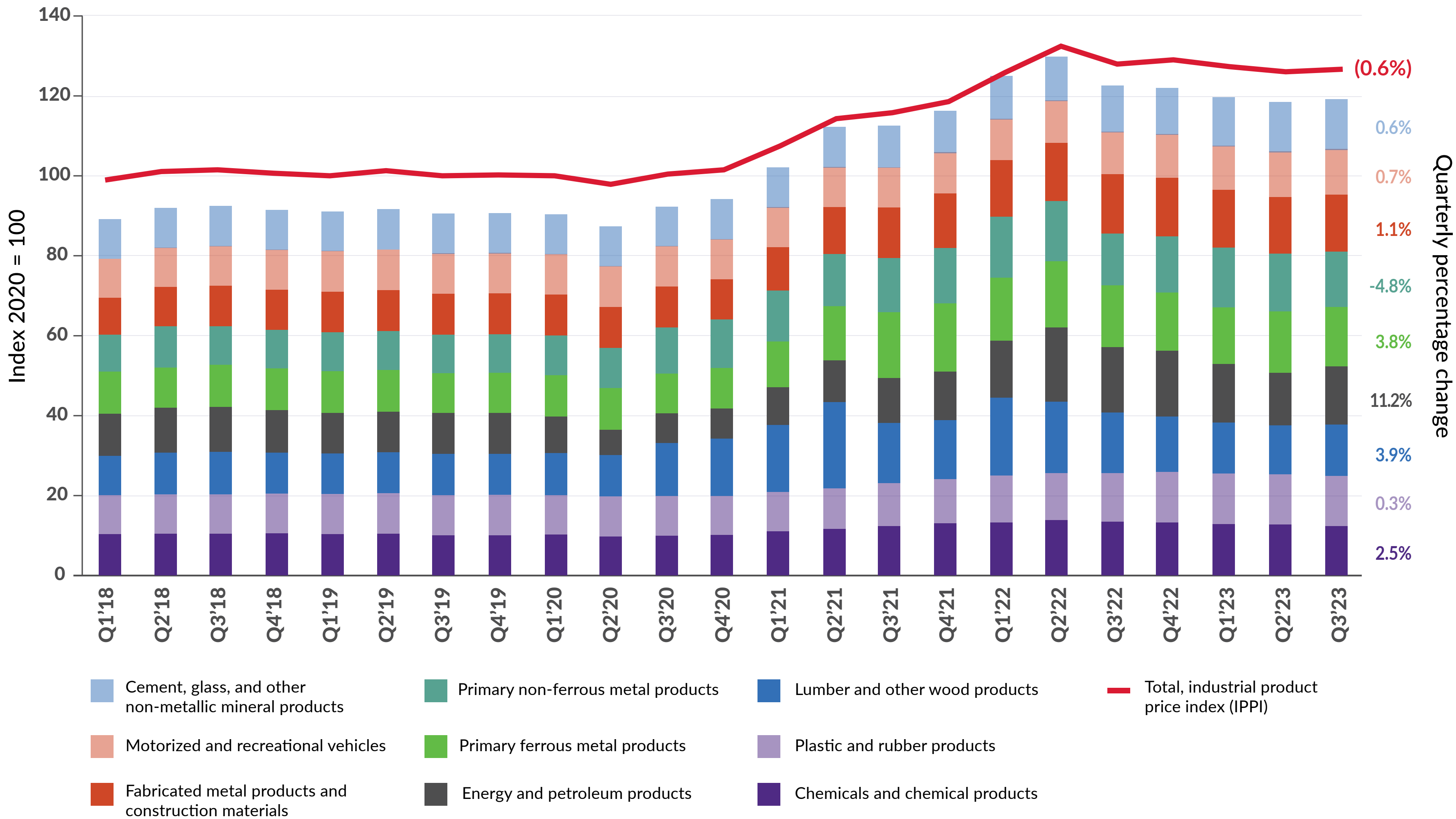
CHART 8
Vacancies in construction



Source: Infrastructure Economic Accounts, CCA

CHART 9

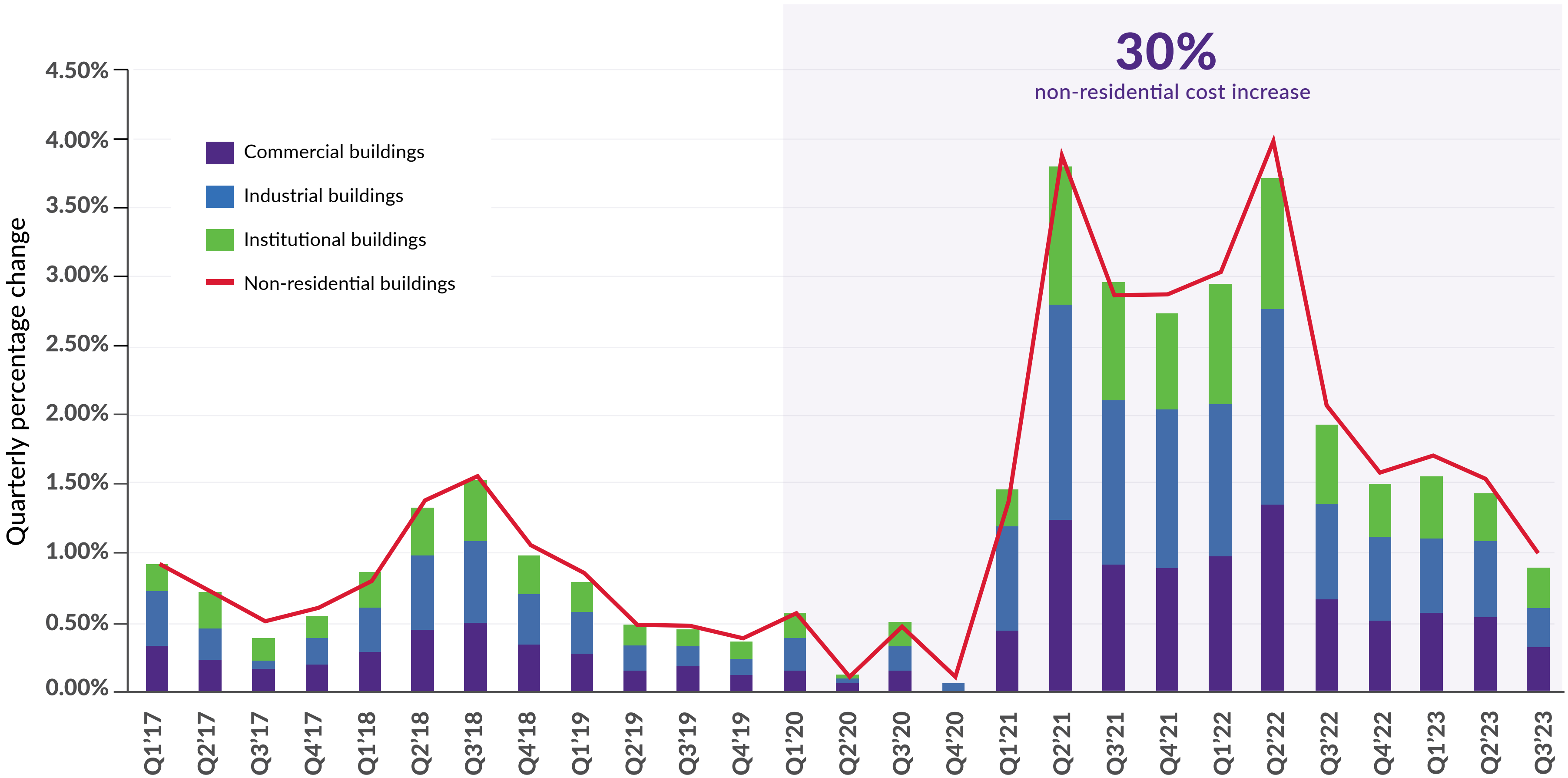
Quarterly fluctations of the industrial product price index



Source: Infrastructure Economic Accounts, CCA

CHART 10

Quarterly changes - Building construction price index



Source: Infrastructure Economic Accounts, CCA

TABLE: 1

Public infrastructure assets		
Commercial buildings	Marine engineering infrastructure	Sewage infrastructure
Communications networks	Oil and gas engineering construction	Transportation engineering infrastructure
Electric power infrastructure	Other engineering construction	Transportation machinery and equipment
Institutional buildings	Other machinery and equipment	Waterworks infrastructure

Source: Infrastructure Economic Accounts, CCA

TABLE: 2
Survey of business obstacles for Q3 2023

GEOGRAPHY	CA	NL	PEI	NS	NB	QC	ON	MB	SK	AB	BC	YT	NT	NU
Difficulty acquiring inputs, products or supplies from within Canada	15.8%	24.5%	2.4%	30.1%	26.2%	9.2%	9.3%	37.5%	20.7%	8.6%	36.5%	22.9%	29.3%	30.2%
Difficulty acquiring inputs, products or supplies from abroad	3.4%	1.4%	0.3%	2.8%	0.3%	0.8%	2.4%	5%	0.9%	6%	8.7%	0%	10.5%	0%
Rising cost of inputs	48.4%	28.1%	15%	49.5%	44.6%	31.9%	56%	66.8%	61%	32.8%	61.5%	45.1%	48.4%	30.4%
Rising inflation	60.1%	35.4%	26.9%	54.2%	66.4%	46.6%	64%	71.8%	76.6%	54.8%	71.2%	68.3%	55.2%	39.4%
Transportation costs	40.2%	46.7%	31.7%	52.7%	58.4%	35.8%	38.5%	52.5%	49.7%	39%	43.8%	38.8%	46.2%	46.6%
Fluctuations in consumer demand	18.2%	15.8%	0%	12%	26.6%	9.3%	16.9%	27.2%	26.9%	18.5%	30.9%	1.5%	7.3%	20.8%
Insufficient demand for goods or services offered	13.2%	10.4%	1.5%	2.6%	14.3%	11.4%	12.9%	7.4%	6.5%	12.3%	20.5%	5.9%	8.3%	9.6%
Obtaining financing	16.4%	17.2%	9.4%	19.4%	16.3%	17.8%	16.1%	16.8%	19.1%	10.5%	17.9%	11.9%	12.5%	20.3%
Cost of insurance	40.3%	42.3%	11.8%	39.8%	41.1%	39.7%	41%	40.7%	33.2%	28.4%	48.7%	26.8%	41.2%	46.4%
Rising interest rates and debt costs	54.8%	34.8%	39%	49.8%	55.7%	49.8%	60.2%	61.5%	63.6%	45.7%	55.3%	56.6%	29.5%	39.3%
Recruiting skilled employees	33.1%	39.4%	55.9%	39.3%	41.2%	30.4%	27.6%	35.2%	43.2%	26.9%	47.9%	31.4%	62.4%	49.5%
Retaining skilled employees	26.7%	25.4%	27.4%	26.1%	39.2%	24%	26.4%	22.9%	29.8%	22.1%	32.8%	7.9%	40.7%	36.6%
Shortage of labour force	25.5%	38.6%	44.1%	38.5%	33.8%	31.5%	18.7%	31.8%	34.8%	26.8%	24.8%	23.1%	60.7%	47.1%

Source: Infrastructure Economic Accounts, CCA

Canadian Construction Association
Best Practices Services