Canadian Construction Association
Best Practices Services

ICIC Construction Sector Quarterly Insights

Q4 2022

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Overview for Fourth Quarter 2022

HIGHLIGHTS:

- **Following a strong first six months in 2022, Canadian economic growth slowed down during Q3:**
- **Interest rates began to hamper economic growth.**
- **Severe workforce shortages and the rapid inflation of construction materials continued to hinder industry growth**
- **Despite this, construction performed stronger than expected in Q3 2022. Construction GDP increased 0.7 per cent, contributing $1 billion or 7.3 per cent to Canada's GDP.**

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

Canada's economy fares well despite a global economic slowdown

While worldwide economic indicators began showing signs of an economic downturn during Q3, the Canadian economy performed better than anticipated by many institutions. Yet, inflation, workforce shortages, and a tighter financial market remain risks undermining growth for the construction industry.

Inflation indicators from the Bank of Canada remain elevated, showing that the Canadian economy is still working in excess demand. Near-term inflation expectations were lowered but remain high from the Bank's perspective. However, tighter financial conditions due to interest rate hikes are beginning to disrupt consumption slowly by interrupting further spending flowing into the economy.

Business confidence has softened from highs reached in Q2 2022 as reported in the Business Outlook Survey. Starting in Q3, businesses foresaw a reduction in sales and consumer consumption over the next 12 months; and believed that future price increases to compensate for inflation would moderate. The survey shows that firms looking to solve their capacity constraints, specifically those facing workforce shortages, continue to make investments to increase their production capabilities. The survey also points out that fears of an economic slowdown are increasing amongst businesses in Canada, as most businesses surveyed think a recession is now likely to happen in 2023.

Q3 Industry Performance Snapshot

Non-residential construction sector

Canada reported stronger gains in GDP than anticipated as it continued a path of slow growth in 2022. In Q3, the Canadian economy grew by 0.7 per cent, a slight slowdown from the one per cent achieved in Q2. Despite weaker activity across all industries, the construction sector (residential and non-residential) mimicked Canada's growth by edging up 0.7 per cent during Q3, representing an expansion following a small decline in Q2.

The growth in construction was driven mainly by a 4.28 per cent increase in engineering construction activity, while all other construction components declined in Q3. While the non-residential building construction sector suffered a second consecutive quarterly decline, contracting by 0.6 per cent, it occurred at a slower pace than the fall seen during Q2. [Chart 1: GDP].

Investment

The Industrial, Commercial, Institutional and Civil (ICIC) construction reported a sixth consecutive gain in investments during Q3 (2.1 per cent), reaching $16.1 billion. Compared to a year ago (Q3 2021), investments made in this sector are up 13.4 per cent. The main drivers behind the quarterly increase were investments of $192 million made in industrial construction (6.8 per cent) and $230 million in commercial construction (2.6 per cent). [Chart 2: Investments in Non-residential].

Employment

Labour force levels (total adult population available to the construction labour market) in both the residential and ICIC construction industry suffered three consecutive monthly declines, compounding to a quarterly decrease of 0.27 per cent, or 4,300 workers quitting the labour force across Canada in Q3 2022. At the same time, the number of workers employed in construction continued to increase throughout Q3.

Currently, construction employs 7.8 per cent of all workers. [Chart 3: Employment Ratio]. Increases in British Columbia (12,330 new workers or a 5.5 per cent increase) helped offset declines seen across other provinces. Nationally, employment in construction posted a quarterly increase of 2,130 new workers, or a 0.14 per cent increase. Despite losses reported across Canada, employment in construction remains higher (101,800 more workers or a 7.2 per cent increase) than a year ago (Q3 2021). [Chart 4: Employment Change by Province].

The employment rate, that is, the ratio of workers employed in the industry relative to the available labour force, continues its upward trend since Q2 2020, reaching a quarterly record high of 95.6 per cent in Q3. This minimum gap between employment and the number of workers belonging to the construction labour force denotes how tight the labour market is and how workforce shortages in construction continue to hinder the growth of the industry.

Vacancies

The shortage of workers in the industry has kept the number of vacancies at an elevated level across Canada. Construction became the industry with the fourth largest number of vacancies among all sectors in September, with an additional 11,535 vacancies in the sector. The industry saw its third consecutive monthly increase reaching the second-largest number of vacancies seen in construction with a total of 93,905 vacancies. The ratio of openings in construction increased from 8.46 per cent to 9.44 per cent of total vacancies across all industries. The industry currently has 1.2 jobs per unemployed person, a historical low amid a tight labour market. [Chart 5: Vacancies]

Material inflation

Although supply chain pressures have continued to ease through Q3 2022, as shown in the Freightos Baltic Index which continues its downward trend since Q1 [Chart 6: Freightos], the elevated demand for consumer goods has kept upward pressure on the prices of a variety of goods.

The Industrial Product Price Index, a measure of the average change in the price of goods used for production, saw a slowdown in price increase growth of most of its components. The IPPI index had a third consecutive monthly slowdown for the first time since the beginning of the supply chain shock caused by the early pandemic shutdowns (-3.45%). [Chart 7: IPPI Quarterly %change for Q3]. Yet, the average price of all IPPI components remains 27.6 per cent higher than in Q1 2020.

Important components for construction included in the IPPI:

Prices of lumber products declined 15 per cent, driven by significant decreases in the price of softwood lumber (-27 per cent) and veneer and plywood (-22 per cent). The demand for lumber in the U.S. housing market is a major driver of price fluctuations for lumber products in Canada. The high average mortgage rates in the U.S., which reached a peak of 7 per cent in November, caused a slowdown of the housing market in Q3.

Excess inventories and lower demand for petroleum drove declines in energy prices, as the group of energy products contracted (-11.5 per cent), with decreases across all its components. On the other hand, the supply of petroleum grew as global production increased with the release of strategic reserves to enhance inventories. Canada became one of the key contributors to the increased production of the global oil supply, which helped domestic prices to remain low in the near term.

China plays a major role in the worldwide production of some materials important to the industry, primarily steel and concrete. These prices are driven by the demand for these materials in the Chinese construction industry; which has not performed well over the last two quarters and continues to falter. Steel producers face many constraints to trim output to avoid overproduction. The current levels of steel production and a steep slip in demand within the Chinese construction market caused the prices in the group of primary ferrous materials to decrease by -7 per cent. Declines were driven by lower prices of hot rolled iron products (-14.6 per cent) and steel pipes and tubes (-15 per cent). On the other hand, cement production in China weakened, creating a shortage in supply and causing an increase of 8 per cent in cement prices.

Although total costs in building construction are still increasing, as captured in the Building Construction Price Index (BCPI), Q3 reported the first slowdown of the index since the beginning of the pandemic. The BCPI fell from a quarterly peak increase of four per cent in Q2 to an increase of 2.07 per cent in Q3. Although inflation decelerated in Q3, the growth in construction costs remains higher than its pre-pandemic average levels, with a 22.6 per cent increase since Q2 2020. [CHART 8: BCPI].

What's ahead for the industry

Global and Canadian growth projections for Q4 2022 and 2023 have been lowered due to tighter monetary conditions and uncertainty surrounding energy prices. On the supply side, workforce shortages in construction continue to constrain the growth in project activity. On the demand side, interest rates are weighing on the industry. Investments in construction are sensitive to increases in interest rates as higher rates makes the value of accessing capital more expensive. And though inflation slowly began to deaccelerate in Q3, it remains elevated.

Intentions for new projects in the non-residential sector fell by 2 per cent during Q3. The number of applications for building permits was pulled down by declines in commercial construction (-3.5 per cent), mostly due to reduced interest in constructing warehouses and office buildings. The number of permits for new industrial buildings increased 2.5 per cent while institutional buildings saw a decline of 2 per cent. [CHART 9: Building Permits].

The Canadian Survey of Business Conditions for Q4 is an indicator measuring business conditions and business owners' expectations for Q4. More than half of the respondents cited the rising cost of inputs, transportation costs and recruitment of skilled labour continuing to be the biggest challenges to growth for the construction industry over the next three months. However, the percentage of respondents who cited the rising cost of inputs as an obstacle declined by 10 per cent, while those who cited transportation costs as an issue declined by 9 per cent. [Table 1: Survey]. Although conditions remain tight for the industry, businesses in construction remain optimistic about their outlook over the next 12 months.

The following macroeconomic shifts are important for the industry to continue monitoring in 2023:

- **Global Economic Slowdown:** Q3 and Q4 2022 indicators showing a slow down in global economic health will likely continue into 2023.

- **Energy prices and oil production:** A cap on the price of Russian oil and its effect on global oil production may put pressure on energy prices. OPEC+ may introduce further caps on oil production.

- **Additional interest rate hikes and inflation performance:** Following the December hike, the Bank of Canada signaled that this may be the last rise of interest rates.

  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 mbaker@cca-acc.com.

Quarterly insights summary data

Chart 1: Real GDP growth of construction and non-residential investment growth

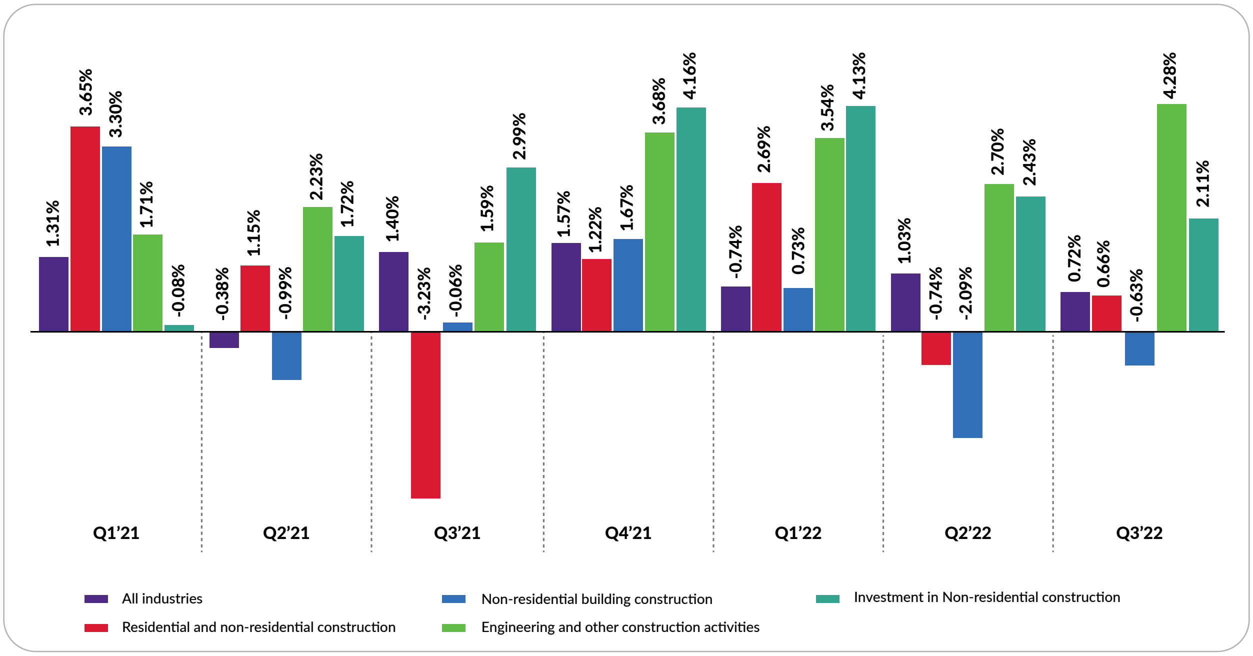
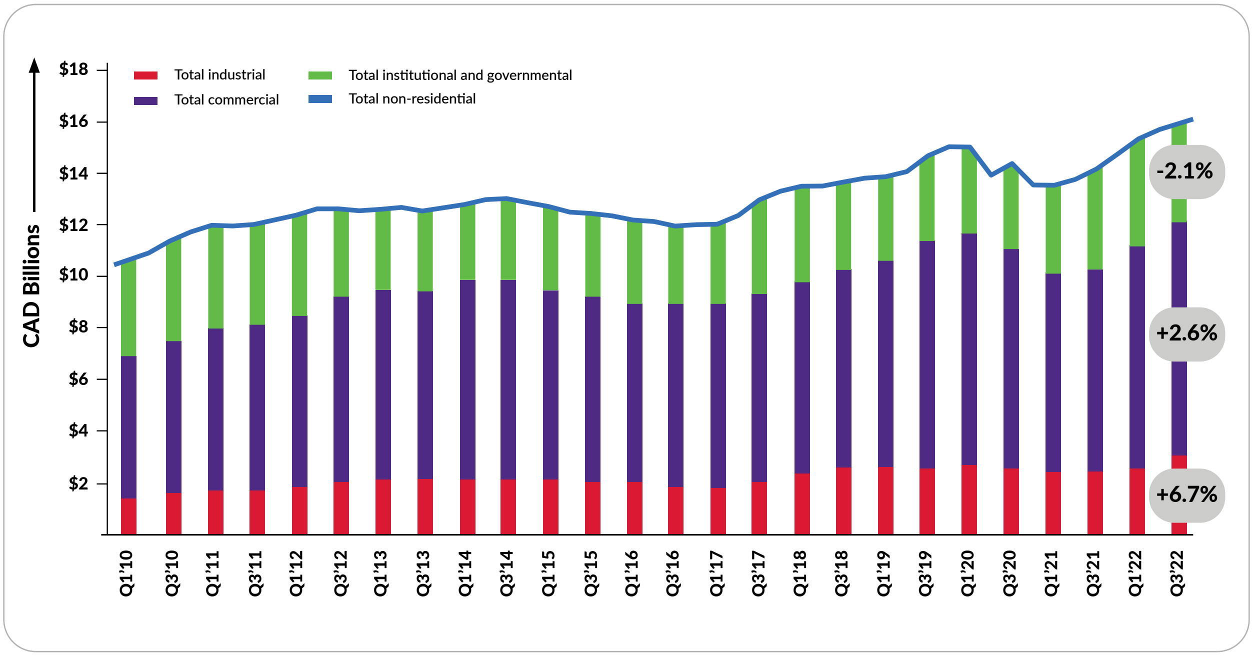


Chart 2: Quarterly investments in ICIC increase driven by industrial investments



Source: Statistics Canada, CCA

Chart 3: The ratio of employment in construction has risen since 1987

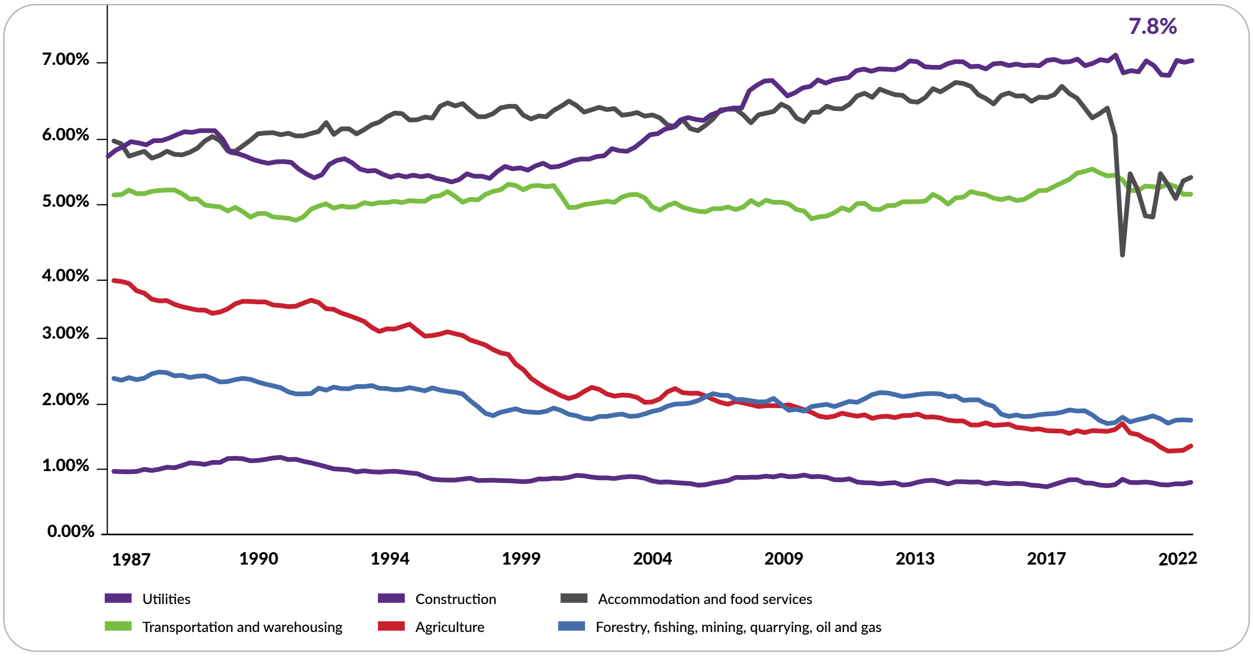
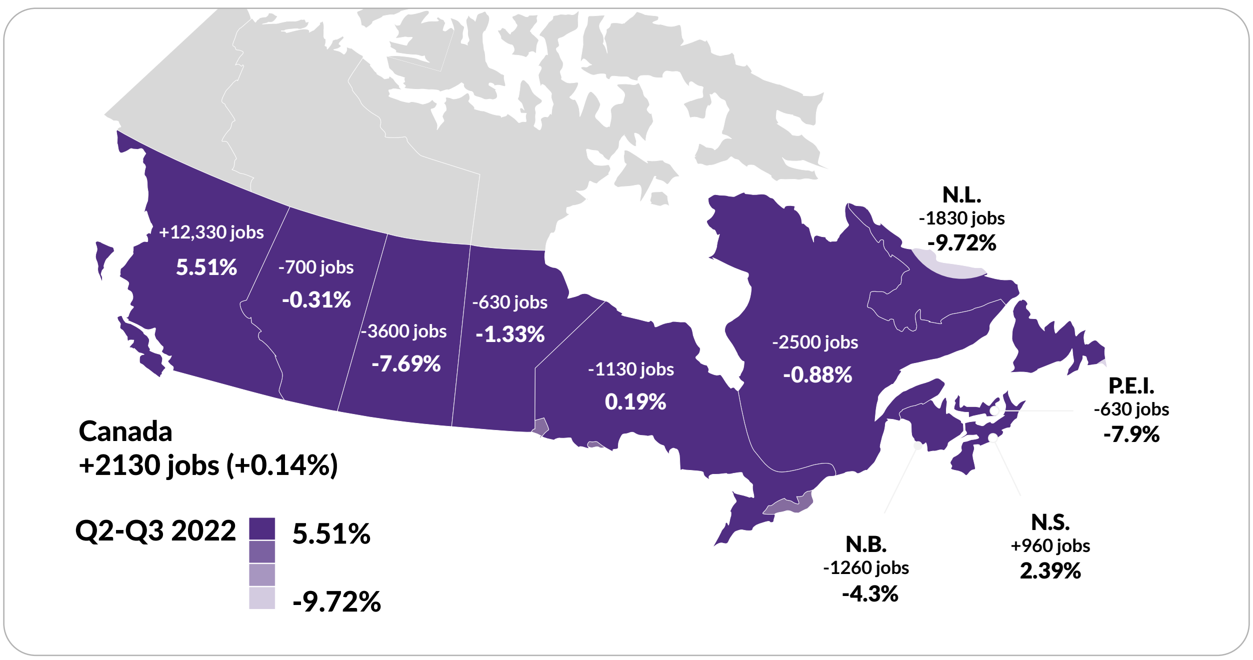
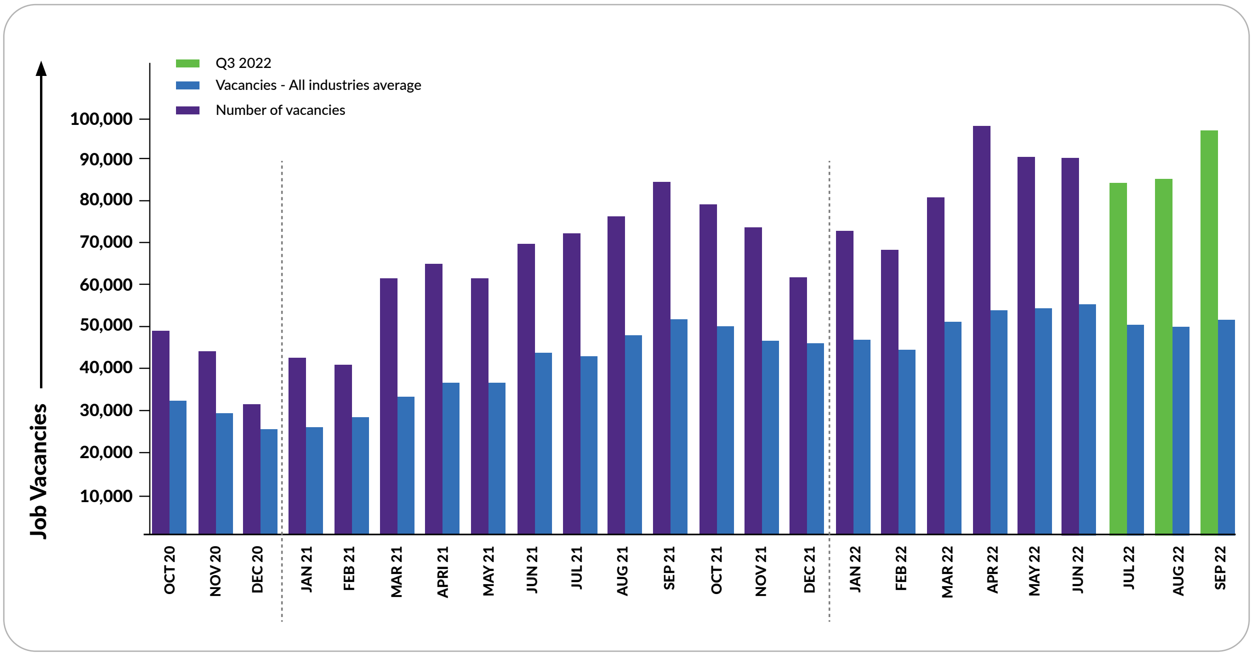


Chart 4: Employment Change by Province



Source: Statistics Canada, CCA

Chart 5: Job vacancies in construction



Source: Statistics Canada, CCA

Chart 6: Freightos Baltic Index (FBX)

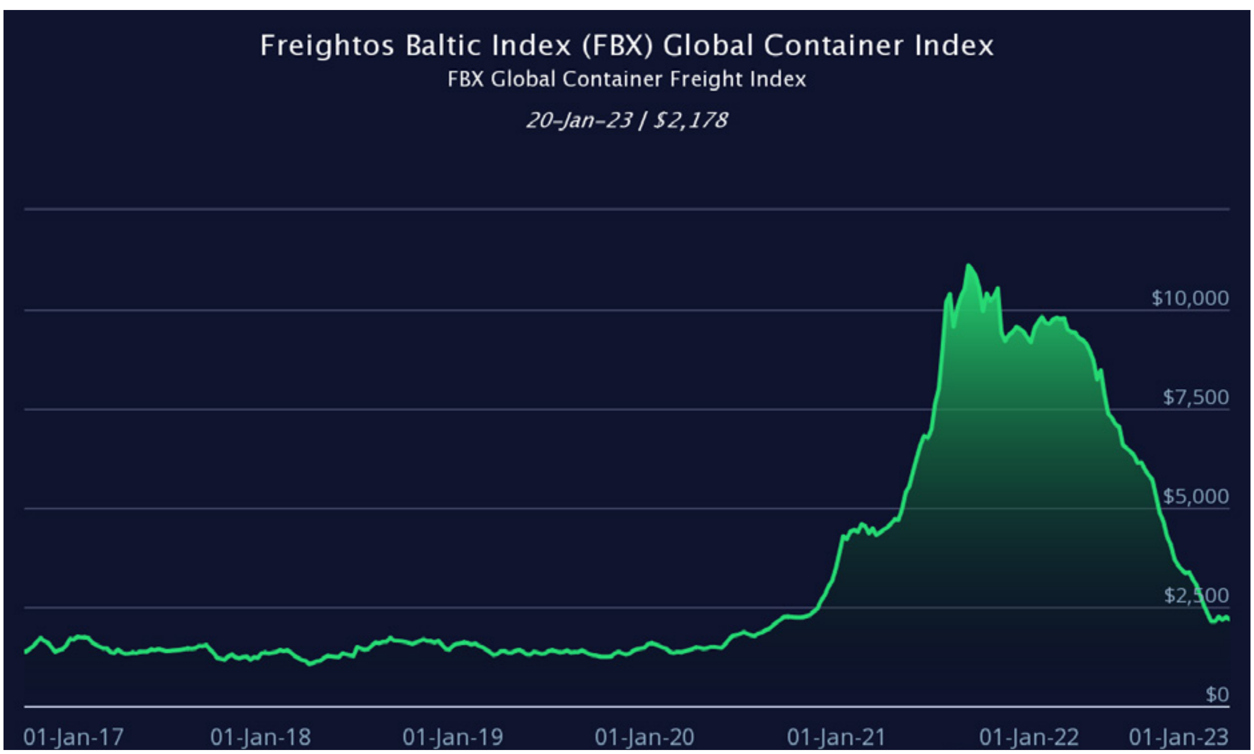


Chart 7: Quarterly Fluctations of the Industrial Product Price Index

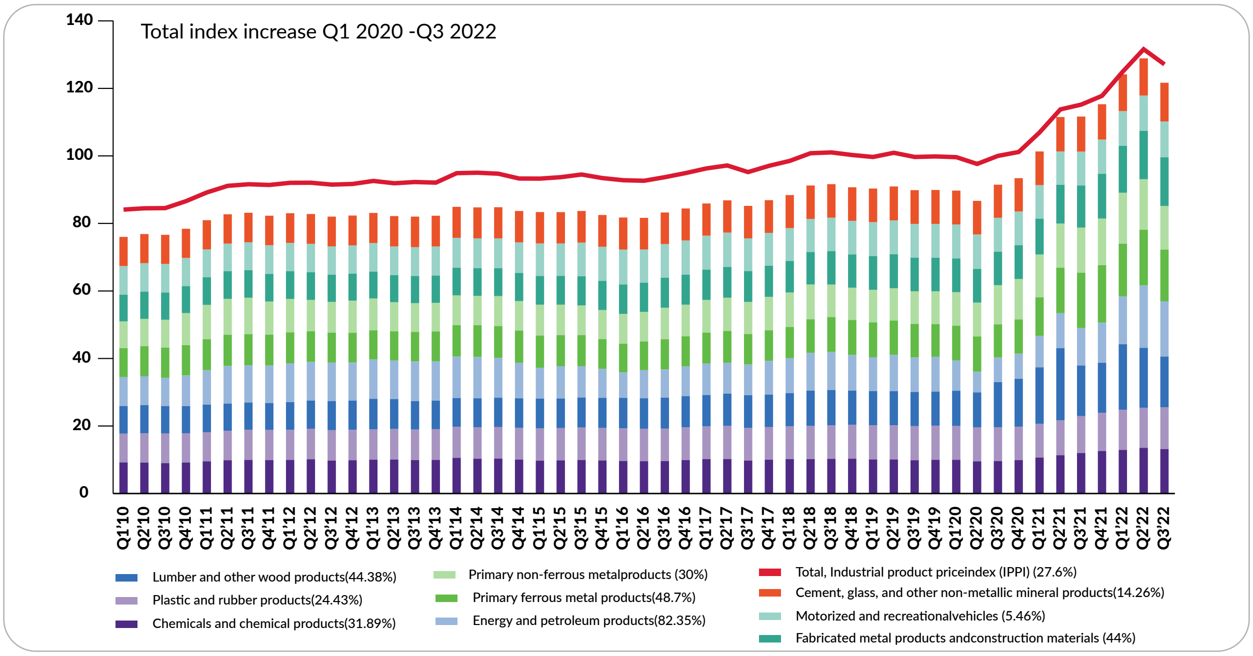
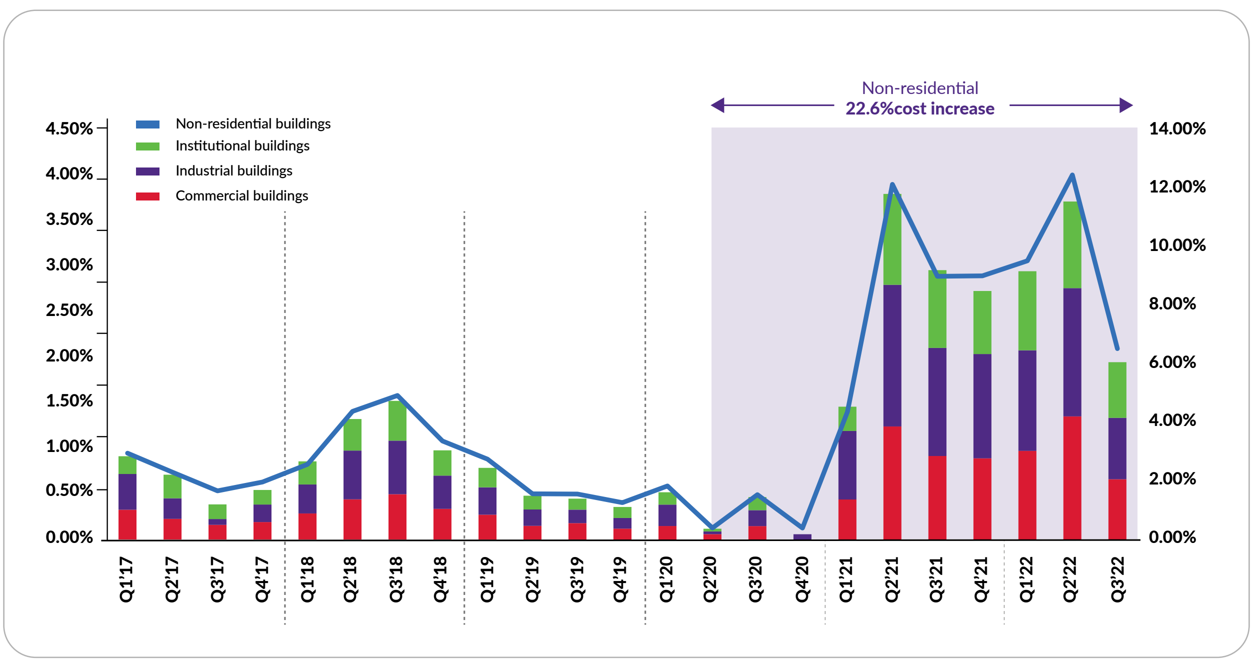
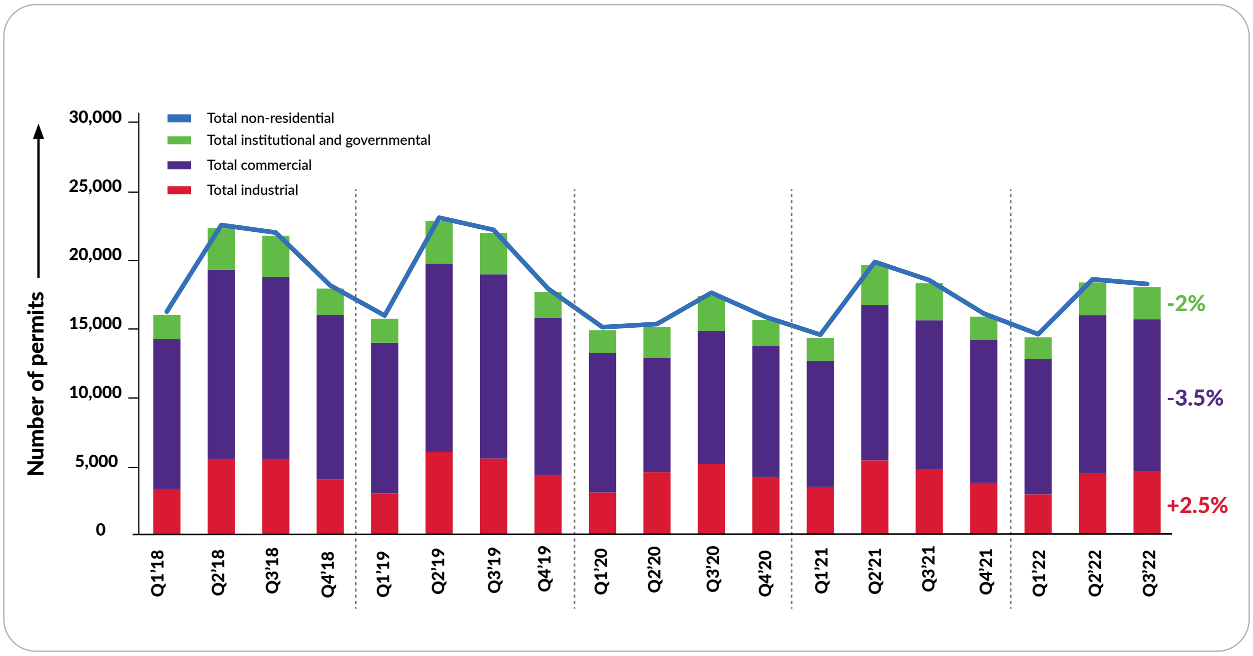


Chart 8: Quarterly Inflation Growth -Building Construction Price Index



Source: Statistics Canada, CCA

Chart 9: Quarterly Number of Non-residential Building Construction Permits



Source: Statistics Canada, CCA

Table: Survey

Geography	Canada	NL	PEI	NS	NB	QC	ON	MB	SK	AB	BC	YT	NT	NU
Business expects obstacles related to recruiting and retaining skilled employees	52%	41%	68%	67%	61%	36%	62%	51%	48%	49%	53%	67%	90%	52%
Rising inflation	61%	57%	74%	57%	74%	55%	55%	70%	75%	73%	63%	87%	64%	40%
Difficulty acquiring inputs, products or supplies from abroad	13%	2%	9%	17%	8%	14%	16%	8%	18%	4%	18%	2%	12%	0%
Difficulty acquiring inputs, products or supplies domestically	34%	37%	41%	39%	42%	18%	33%	57%	31%	44%	43%	40%	61%	26%
Insufficient demand for goods or services offered	15%	23%	6%	15%	2%	11%	9%	21%	14%	10%	36%	22%	2%	3%
Obtaining financing	9%	6%	3%	16%	19%	7%	10%	13%	21%	6%	9%	34%	7%	0%
Recruiting skilled employees	49%	33%	56%	65%	61%	35%	59%	47%	45%	42%	49%	67%	90%	52%
Retaining skilled employees	26%	30%	36%	21%	38%	15%	27%	34%	22%	30%	32%	31%	55%	23%
Rising cost of inputs	55%	41%	65%	48%	61%	38%	65%	62%	70%	52%	55%	73%	70%	26%
Shortage of labour force	44%	34%	76%	54%	58%	32%	52%	40%	43%	37%	49%	55%	81%	24%
Transportation costs	50%	43%	51%	55%	75%	33%	64%	74%	56%	31%	57%	77%	67%	28%