Global challenges impact Canadian growth

BY JIM BARNES

CONSTRUCTION MOVES AHEAD DESPITE DISCOURAGING NEWS FROM GLOBAL PARTNERS

“Our country is not immune to global forces,” said Finance Minister Jim Flaherty in November. “Nor can we control the economic shocks that ripple outwards from other nations.”

Global realities have led economists to trim their forecasts in Canada lately. Many set the growth in real GDP at about 2.1 per cent for 2012. The Eurozone debt crisis, political turmoil in the U.S., a sputtering Chinese economy, weakening commodities markets and a strong loonie are major causes.

Domestically, fiscal restraint and slackening spending are also problems. In its Provincial Economic Update in October, TD Economics noted the household debt-to-income ratio in Canada reached a record 152 per cent in the first half of 2012. “Households are going to have to cool borrowing further and increase savings, both of which will imply a modest pace of consumer spending over the long term,” noted the report.

An economic update on March’s federal budget delivered in mid-November by Flaherty revealed that Canada’s deficit would reach $26 billion, $5 billion higher than expected in March. The government may not be able to balance the books before 2016-17, a year later than earlier predicted. As well, only two per cent real GDP growth is predicted for 2013, instead of the 2.4 per cent forecast before.

Leading the pack

Even so, other countries are envious. “Canada seems to have got it a bit more right,” says Toby Mack, president & CEO, Associated Equipment Distributors, Oak Brook, Ill. The Organization for Economic Co-operation and Development, Paris, agrees. It expects Canada to lead the G7 economies in growth for the next 50 years, with growth in real gross domestic product (GDP) averaging 2.2 per cent per year over that period.

Canada is a great construction market, notes Michael Atkinson, president, Canadian Construction Association, Ottawa. “The situation must be good, because the Europeans are here like never before. They see their own market drying up, and they see Canada as a huge potential market.”

The biggest risk is south of the border. Canada’s economy is joined at the hip to that in the U.S., and American legislators are locked in intense negotiations on a budget to save the country from the so-called “fiscal cliff” in January. If not averted, default tax increases and spending cuts could trigger another recession. The upshot of those negotiations is anyone’s guess.

“The key word that keeps ringing in my ears is ‘uncertainty’—there’s a tremendous amount of uncertainty,” says Mack. “I think [the industry] is very cautious. The things that drive the industry—residential construction, commercial construction—are not going to become robust until we get more economic growth.”

“The wounds created during the recession to the construction industry were deep. It will take time before these wounds are fully healed,” notes Edward Sullivan, vice-president and chief economist, Portland Cement Association, Skokie Ill. “Recent reports suggest the economy has entered a new stage of stronger job creation. If this new pace of job creation can be sustained—and the PCA believes it will—then the construction industry could witness a new speed in the recovery process.”

The big spend

Austerity is a byword in most Western industrial economies, but so far has had less effect in Canada. “We have not seen any real signs of austerity affecting Canadian construction investments in 2013, yet,” says Atkinson. “The reason I am reluctant to say that we are going to see less public investment based on some of the larger projects that are already planned. When you look at overall numbers, public sector spending might be down in some regions, in some provinces, but overall, we might not see a big decline.”

Atkinson suggests a total investment of $300 billion next year. “That’s significant, when you consider that $300 billion is almost exactly double what our total volume was in 2004.”

“In fact, while we might see a bit of a slowdown over the next two years or so, it’s only because investment was so much higher in 2011 and 2012,” says Atkinson. “It’s more of a leveling-off, before all hell breaks loose again, depending on the timing of some of these larger projects coming on stream in the resource sector.”

Lucky geography

Canada is a country of regions, and opportunities depend on the specific market. Here is a quick breakdown:

B.C.: Investment in two new projects next year will contribute to an expected acceleration of growth in real GDP to 2.7 per cent next year, according to *Provincial Outlook* published by RBC Economics (RBC), Toronto, in September. The federal government's $8-billion deal with Seaspan Marine in Vancouver for seven ships and the $3.3 billion to be spent on Rio Tinto Alcan's aluminum smelter in Kitimat, B.C. are key developments. The economy has been somewhat hindered by weak commodity prices, apart from lumber, which is getting a lift as U.S. housing demand improves.

ALBERTA: Real GDP growth will reach 3.6 per cent, according to RBC. Massive oil sands projects are driving capital investment spending in the province. However, notes RBC, volatile energy prices in global markets are starting to introduce a note of caution. Nevetheless, the province maintains its position as a powerhouse of the Canadian economy and the construction industry.

PRAIRIES: Saskatchewan is forecast to achieve 4.0 per cent real GDP growth in 2013, while Manitoba reaches 3.2 per cent. In both cases, resources are front and centre.

"Manitoba has the strongest expansion of construction activity among all the provinces across the forecast scenario to 2020," noted the Construction Sector Council (CSC), Ottawa, in its *2012 Construction Looking Forward* report. Manitoba should see strength in residential and non-residential building and electrical utility construction. However, "the major gains in highways, roads and bridges were between 2006 and 2009," according to CSC.

ONTARIO: RBC pegs real GDP growth in 2013 at 2.3 per cent. Cliffs Natural Resources Inc., Cleveland, Ohio, has announced a $3.3-billion investment in a chromite mine, transportation corridor and processing facility in Northern Ontario's Ring of Fire program. Preliminary work is underway and the project should be complete by 2016. It is the first piece of the program–other resources in the same region include nickel, copper and platinum.

Motor vehicle production is close to pre-recession levels and major investments are being made in electrical infrastructure, transportation and hospitals. About a billion dollars will be spent on the Pan-American Games in 2015, with another billion allocated to the Toronto-York Region Spadina Subway Extension.

On the downside, decreases in public sector spending are anticipated.

QUEBEC: Real GDP growth will accelerate next year to 1.7 per cent, predicts RBC. Plan Nord is an ambitious plan to develop mining, hydroelectric and other resources in northern Quebec. Some $1.625 billion is budgeted for the period 2011-2016. A priority is transportation infrastructure, to improve access to targeted sites.

In Quebec, too, deficit reduction will be a growing priority, with a negative impact on construction volumes in the public sector.

ATLANTIC CANADA: RBC predicts 1.8 per cent real GDP growth in 2013 for New Brunswick. Potash production, electricity exports and forestry should help stabilize the economy.

Real GDP growth in Nova Scotia is forecast at 2.3 per cent in 2013. Slowing the economy down in 2013 are potential delays in the $25-billion Irving shipyard contract, declines in natural gas and paper production and slow growth in U.S. export markets.

In Prince Edward Island, RBC expects real GDP growth to be 1.9 per cent in 2013. A 21-per-cent reduction in provincial capital spending in 2013 will cause a chill. Manufacturing, especially in the machinery industry, has been strong, partly offsetting weakness in the agricultural sector.

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Increases in oil production in Newfoundland and Labrador in 2013 and continued growth in metal mining and machinery exports lead to projections of real GDP of 3.3 per cent in 2013. Major project spending is healthy. It will include construction at the Hebron oil field and pre-development work at the Muskrat Falls hydroelectric project.

TERRITORIES: Climate change could soon be driving construction in Canada's north, notes Atkinson. As the weather becomes milder, new infrastructure will be needed and old infrastructure will require rehabilitation as the permafrost melts. Access to resources will increase, necessitating new infrastructure. Canada's northern ports could become ice-free year-round, demanding yet more construction.

Residential

Canada's housing market has defied predictions of decline thus far. However, the party may be winding down. According to the TD Economics report, "The housing market correction appears to be underway. Given the low interest-rate environment, home prices are likely to unwind their roughly 10 per cent over valuation over the next two to three years."

A quarterly outlook released in November by Canada Mortgage and Housing Corp. (CMHC), Ottawa, said between 177,300 and 209,900 housing units will be started in 2013—significantly less than 2012.

"For next year, we had been talking about 193,600 starts, a decrease of about 9.4 per cent compared to this year, says Mathieu Laberge, CMHC's deputy chief economist. "We have expected some moderation for late 2012 in early 2013 for some time now."

He notes 2012 sales were supported by pre-sales that occurred when the economy was recovering between late 2010 and mid-2011


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as consumers gained confidence. "Those pre-sales are mostly related to the multiple-unit component of the market," he notes.

Mortgage rates were another enticement. "Interest rates are expected to remain relatively low, though they will go up at some point. They're at a 50-year low right now," says Laberge.

"A lot of factors are at play here. In some regions, for example in Toronto, Montreal and Vancouver, you had net immigration. That is a strong demographic fundamental. At the same time, you had low vacancy rates," says Laberge.

Non-residential

Building permit data published by Statistics Canada has shown dramatic swings in intentions for non-residential building this year. Will the data level out?

"The prognosis is very, very good for the non-residential side of the industry," says Atkinson.

Industrial construction is on the upswing, especially in light of shipbuilding, with the awarding of a $33-billion program for naval vessels to Seaspan Marine Corp., North Vancouver, B.C. and Irving Shipbuilding Inc., Halifax, N.S. There will be significant spinoff in ancillary infrastructure.

Commercial construction generally reflects consumer confidence, and Canadian households are heavily leveraged. "I think the commercial is going to continue to ride the coattails of what's going to happen in the other sectors. However, the growing population doesn't hurt," says Atkinson.

Institutional spending, too, will be affected by fiscal restraint in both provincial and federal governments. Again, that depends on your specific part of the business and region. "There's a move now more toward public transit and sewer and water, particularly wastewater treatment, given the new federal regulations," notes Atkinson.

Engineering construction is on the rise, according to Atkinson. "There's no question that a lot of our projects in the engineering construction area are becoming much bigger and more complex."

Recently, the federal government indicated some 600 resource-development projects worth $650 billion would be planned or underway over the next decade.

"Five years ago, if you had asked for a list of billion-dollar projects in Canada, you could easily have counted them on the fingers of one hand," says Atkinson. Now, there are at least 30 that are $1 billion or more.

While energy megaprojects continue to drive the economies in Canada's west, the situation may face challenges. One might be declining demand in the U.S.

The U.S. is developing domestic energy sources with new extraction technologies such as hydraulic fracturing—so much so that it could become the biggest oil producer in the world by 2020, according to a report by the International Energy Agency, Paris.

Natural Resources Minister Joe Oliver said the report shows Canada's need for new export markets. Even as the debate on the Keystone XL Pipeline to Nebraska rages on, it could turn out that the Northern Gateway Pipeline to Kitimat, B.C. for exports to Asian customers is as important, if not more so.

"Change and diversity should be the keys for 2013," says Atkinson. "More and more, owners in the public sector are going to be looking to the contractor for solutions," says Atkinson. Design-Build-Maintain-Operate is no longer the exception. It is already a reality, says Atkinson. "I'm seeing firms that would never have thought of co-venturing or joint-venturing in the past doing it now. More and more, I am seeing firms going into areas of construction that they have never been in before. □

Jim Barnes is On-Site's contributing editor.