Market View
Economics and Strategy

NATIONAL BANK OF CANADA
FINANCIAL MARKETS

November 15, 2024 - (Vol. VIII, No. 92)

Canada's underlying productivity problem laid bare (again)

By Warren Lovely & Stéfane Marion

Fresh estimates of Canada's non-residential capital stock lay bare a key contributor to our abysmal productivity record: insufficient investment.

In 2023, Canada's non-residential capital stock, net of depreciation, amounted to $2.6 trillion (2017 constant dollars) (Chart 1). That figure covers all industries, including government (Chart 2). The non-residential capital stock did manage to grow a bit last year, as new investment technically exceeded depreciation. But a 1.2% year-over-year expansion is no reason to rejoice. For some time now, the pace of net capital accumulation has been lukewarm at best (Chart 3).

In per capita terms, Canada's capital stock peaked almost a decade ago. Since 2015, the real value of capital notionally available to the average Canadian has shrunk 5% (Chart 4). Little wonder we're having difficulty generating more for a given hour of work. Sort of flips that old adage on its head; in Canada, we're 'working harder, not smarter'.

Another dimension to an already gloomy picture? The remaining useful life of Canada's capital stock is getting shorter… year after year after year. You won't find a lower remaining useful service life ratio since StatCan started estimating it (with data back to 2009) (Charts 5-6).

Arresting these well-established patterns will require no little amount of new investment. Yet, businesses are understandably cautious. The stated goals of America's incoming administration risk tipping the scales (even further) against us on relative tax and regulatory burdens. Any potential loss of relative competitiveness could inhibit much-needed new investment north of the border, to say nothing of prospective tariffs which could making doing business in Canada less predictable (and profitable) for export-orientated firms.

Meantime, the relative skew/balance of the capital stock speaks to the faulty/risky growth model Canada has pursued for some time, one that's overly housing-centric. Consider: Even with restrictive interest rates weighing on the housing market, Canada has ever more of its real capital allocated to residential property than to non-residential buildings, engineering, machinery/equipment and IP (Chart 7). This imbalance is more extreme in some regions than others (Chart 8). It's not that housing capital is bad mind; we need *more* housing. But the national capital scale has been tipped notably towards residential over non-residential investment for ages. Beyond poor productivity, an offshoot of this is a relatively heavily indebted household sector, which left the economy ultra-sensitive to (still) restrictive policy interest rates.

There are additional angles one could pursue with this dataset, be more detailed industry-by-industry or region-by-region comparisons. There's even an ability to isolate absolute/relative investment, depreciation and useful life trends in very specific elements of the non-residential capital stock. Clearly, more could be said or illustrated. But the simple point remains: An unrelenting underinvestment phenomenon helps inform Canada's current productivity crisis.

So who's problem is this? Everyone's really. Loosely speaking, investment begets productivity. Productivity growth in turn drives a country's long-term standard of living. If you've not noticed, Canada has been losing ground particularly vs. the traditional bellwether, the U.S.

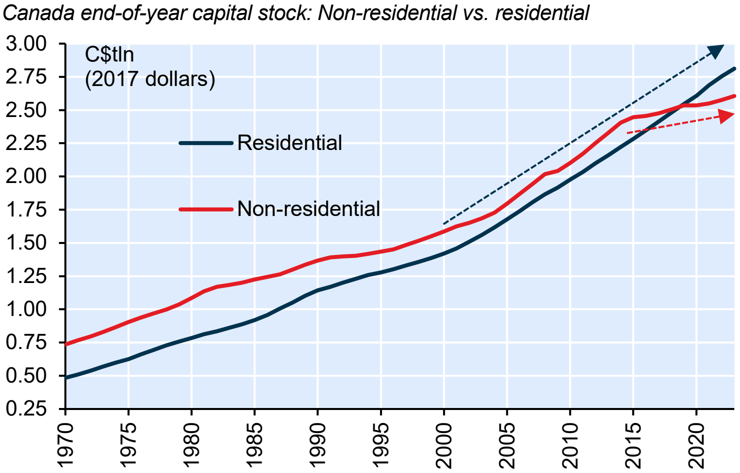
Effective investment that grows the non-residential capital stock and breeds enhanced productivity can lower business operating costs, boost corporate profitability and ultimately get workers paid. For governments, productivity growth can directly (and indirectly) lower the effective cost of providing vital social programs and effective/efficient public infrastructure. That becomes a vital consideration as populations age and more taxpayers head for retirement.

And oh yes, a vibrant capital stock that generates productivity gains can boost an economy's potential growth rate. More appropriately (in Canada's case), sustained underinvestment and the absence of productivity growth can lower the non-inflationary speed limit, all else equal. A (s)low speed-limit can mean more inflation for a given economic advance. Once again, investment-fueled productivity gains become seemingly more important when the other natural driver of potential—labour force growth—is arrested, as will be the case in Canada for the next couple of years as we go through a demographic detox. Makes this is an issue for the Bank of Canada too.

The problems then are legion; easy solutions, on the other hand, remain stubbornly elusive.

Chart 1: A slow-growing non-residential capital stock

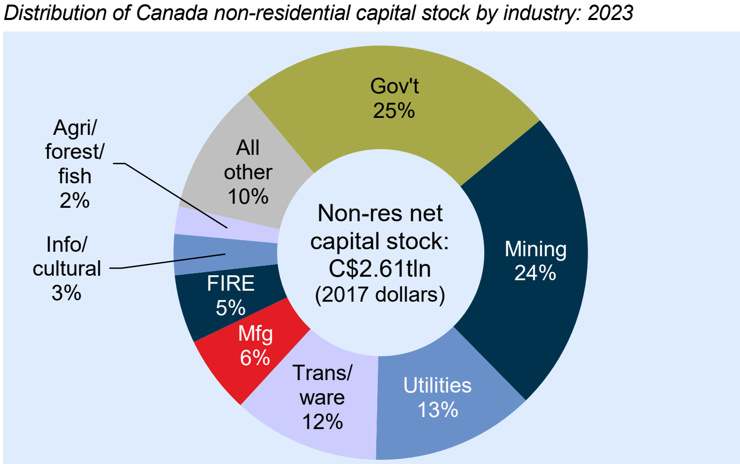
Canada end-of-year capital stock: Non-residential vs. residential



Source: NBC, StatCan | Note: Stock net of geometric depreciation; latest data point is 2023

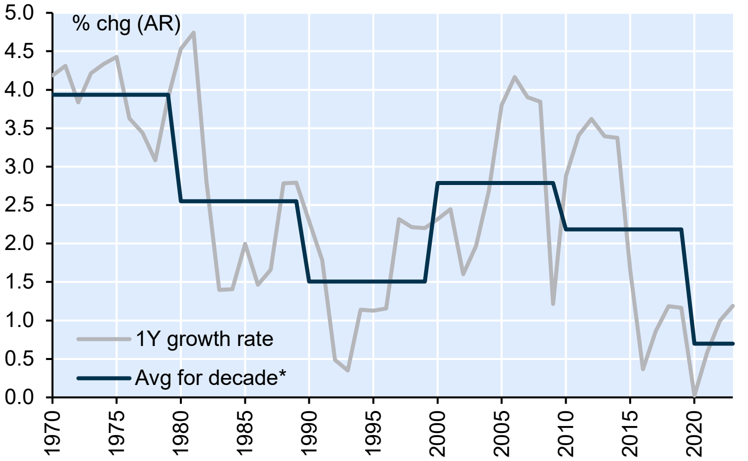
Chart 2: Where Canada's non-residential capital resides

Distribution of Canada non-residential capital stock by industry: 2023



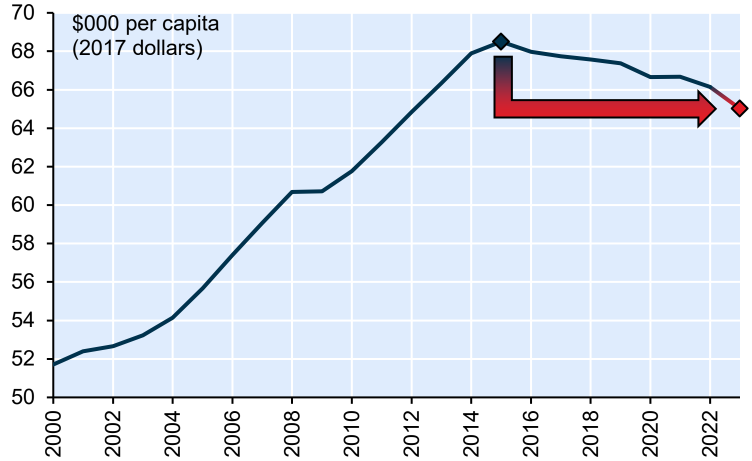
Source: NBC, StatCan | Note: Stock net of geometric depreciation

Chart 3: Non-res investment growth stuck in the mud
Growth in Canada non-residential capital stock: Annual & average by decade



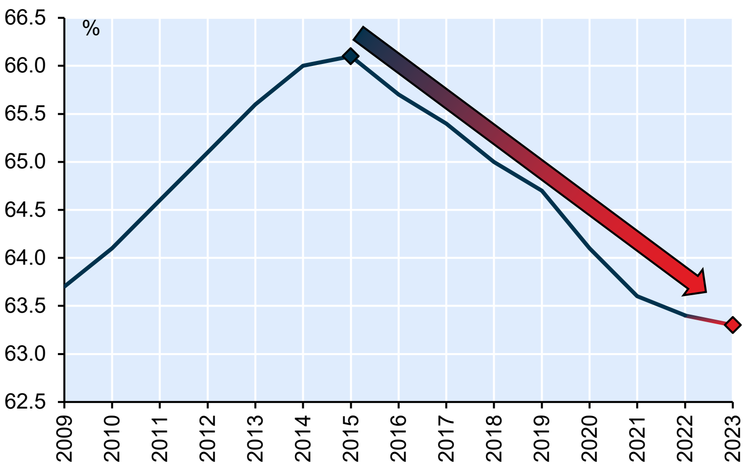
Source: NBC, StatCan | Note: Based on stock net of geometric depreciation; average for 2020s is based on 4-year average (2020 to 2023 inclusive)

Chart 4: Increasingly less capital available for each Canadian
Canada non-residential capital stock on per capita basis



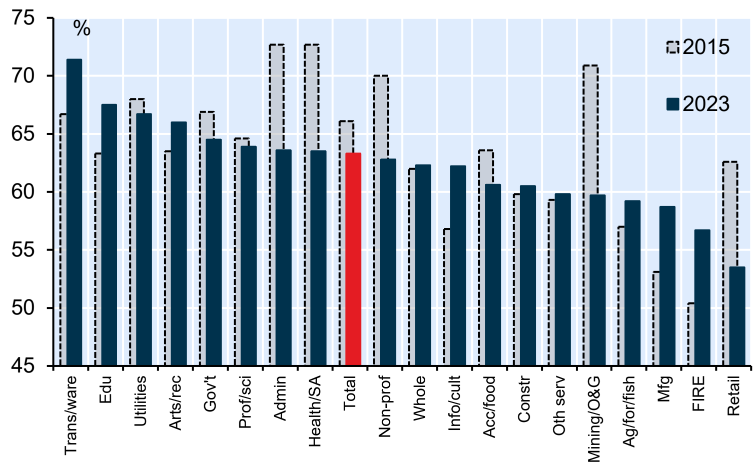
Source: NBC, StatCan | Note: Stock net of geometric depreciation divided by annual population; latest data point is 2023; peak value achieved in 2015

Chart 5: Get me off of this (useless) ride!
Canada remaining useful service life ratio of non-residential capital stock



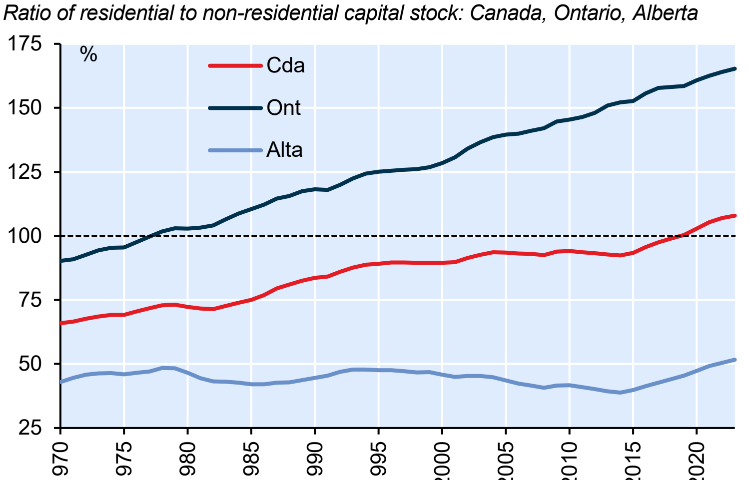
Source: NBC, StatCan | Note: Based on all-industry total

Chart 6: Industry perspective on remaining useful life
Canada remaining useful service life ratio of non-res capital stock by industry



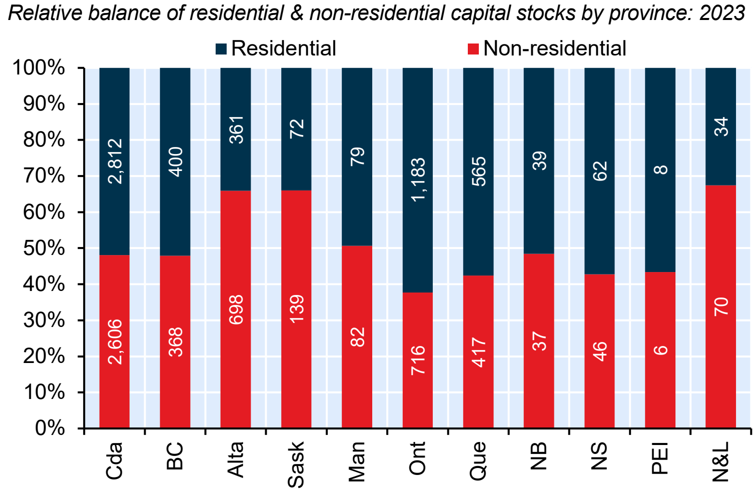
Source: NBC, StatCan | Note: 2015 included for reference (peak ratio for all-industry total)

Chart 7: Canada's housing-centric model (still) on display
Ratio of residential to non-residential capital stock: Canada, Ontario, Alberta



Source: NBC, StatCan | Note: Based on stock net of geometric depreciation by type and region (in 2017 dollars)

Chart 8: The capital stock balance struck across the nation
Relative balance of residential & non-residential capital stocks by province: 2023



Source: NBC, StatCan | Note: Based on stock net of geometric depreciation by type and region; values in each column are C$bln (in 2017 dollars)

Subscribe to our publications: NBC.EconomicsStrategy@nbc.ca – To contact us: 514-879-2529

General

This Report was prepared by National Bank Financial, Inc. (NBF), (a Canadian investment dealer, member of CIRO), an indirect wholly owned subsidiary of National Bank of Canada. National Bank of Canada is a public company listed on the Toronto Stock Exchange.

The particulars contained herein were obtained from sources which we believe to be reliable but are not guaranteed by us and may be incomplete and may be subject to change without notice. The information is current as of the date of this document. Neither the author nor NBF assumes any obligation to update the information or advise on further developments relating to the topics or securities discussed. The opinions expressed are based upon the author(s) analysis and interpretation of these particulars and are not to be construed as a solicitation or offer to buy or sell the securities mentioned herein, and nothing in this Report constitutes a representation that any investment strategy or recommendation contained herein is suitable or appropriate to a recipient's individual circumstances. In all cases, investors should conduct their own investigation and analysis of such information before taking or omitting to take any action in relation to securities or markets that are analyzed in this Report. The Report alone is not intended to form the basis for an investment decision, or to replace any due diligence or analytical work required by you in making an investment decision.

This Report is for distribution only under such circumstances as may be permitted by applicable law. This Report is not directed at you if NBF or any affiliate distributing this Report is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you. You should satisfy yourself before reading it that NBF is permitted to provide this Report to you under relevant legislation and regulations.

National Bank of Canada Financial Markets is a trade name used by National Bank Financial and National Bank of Canada Financial Inc.

Canadian Residents

NBF or its affiliates may engage in any trading strategies described herein for their own account or on a discretionary basis on behalf of certain clients and as market conditions change, may amend or change investment strategy including full and complete divestment. The trading interests of NBF and its affiliates may also be contrary to any opinions expressed in this Report.

NBF or its affiliates often act as financial advisor, agent or underwriter for certain issuers mentioned herein and may receive remuneration for its services. As well NBF and its affiliates and/or their officers, directors, representatives, associates, may have a position in the securities mentioned herein and may make purchases and/or sales of these securities from time to time in the open market or otherwise. NBF and its affiliates may make a market in securities mentioned in this Report. This Report may not be independent of the proprietary interests of NBF and its affiliates.

This Report is not considered a research product under Canadian law and regulation, and consequently is not governed by Canadian rules applicable to the publication and distribution of research Reports, including relevant restrictions or disclosures required to be included in research Reports.

UK Residents

This Report is a marketing document. This Report has not been prepared in accordance with EU legal requirements designed to promote the independence of investment research and it is not subject to any prohibition on dealing ahead of the dissemination of investment research. In respect of the distribution of this Report to UK residents, NBF has approved the contents (including, where necessary, for the purposes of Section 21(1) of the Financial Services and Markets Act 2000). This Report is for information purposes only and does not constitute a personal recommendation, or investment, legal or tax advice. NBF and/or its parent and/or any companies within or affiliates of the National Bank of Canada group and/or any of their directors, officers and employees may have or may have had interests or long or short positions in, and may at any time make purchases and/or sales as principal or agent, or may act or may have acted as market maker in the relevant investments or related investments discussed in this Report, or may act or have acted as investment and/or commercial banker with respect hereto. The value of investments, and the income derived from them, can go down as well as up and you may not get back the amount invested. Past performance is not a guide to future performance. If an investment is denominated in a foreign currency, rates of exchange may have an adverse effect on the value of the investment. Investments which are illiquid may be difficult to sell or realise; it may also be difficult to obtain reliable information about their value or the extent of the risks to which they are exposed. Certain transactions, including those involving futures, swaps, and other derivatives, give rise to substantial risk and are not suitable for all investors. The investments contained in this Report are not available to retail customers and this Report is not for distribution to retail clients (within the meaning of the rules of the Financial Conduct Authority). Persons who are retail clients should not act or rely upon the information in this Report. This Report does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for the securities described herein nor shall it or any part of it form the basis of or be relied on in connection with any contract or commitment whatsoever.

This information is only for distribution to Eligible Counterparties and Professional Clients in the United Kingdom within the meaning of the rules of the Financial Conduct Authority. NBF is authorised and regulated by the Financial Conduct Authority and has its registered office at 70 St. Mary Axe, London, EC3A 8BE.

NBF is not authorised by the Prudential Regulation Authority and the Financial Conduct Authority to accept deposits in the United Kingdom.

EU Residents

With respect to the distribution of this report in the member states of the European Union ("EU") and the European Economic Area ("EEA") by NBC Paris, the contents of this report are for information purposes only and do not constitute investment advice, investment research, financial analysis or other forms of general recommendation relating to transactions in financial instruments within the meaning of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 ("MiFID 2"). This report is intended only for professional investors and eligible counterparties within the meaning of MiFID 2 and its contents have not been reviewed or approved by any EU/EEA authority. NBC Paris is an investment firm authorised by the French Prudential Control and Resolution Authority __ ("ACPR") to provide investment services in France and has passported its investment services throughout the EU/EEA under the freedom to provide services and has its registered office at 8 avenue Percier, 75008 Paris, France. "NBC Financial Markets, a subsidiary of National Bank of Canada" is a trade name used by NBC Paris S.A.

NBF is not authorised to provide investment services in the EU/EEA.

U.S. Residents

With respect to the distribution of this report in the United States of America, National Bank of Canada Financial Inc. ("NBCFI") which is regulated by the Financial Industry Regulatory Authority (FINRA) and a member of the Securities Investor Protection Corporation (SIPC), an affiliate of NBF, accepts responsibility for its contents, subject to any terms set out above. To make further inquiry related to this report, or to effect any transaction, United States residents should contact their NBCFI registered representative.

This report is not a research report and is intended for Major U.S. Institutional Investors only. This report is not subject to U.S. independence and disclosure standards applicable to research reports.

HK Residents

With respect to the distribution of this report in Hong Kong by NBC Financial Markets Asia Limited ("NBCFMA") which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 (dealing in securities) and Type 3 (leveraged foreign exchange trading) regulated activities, the contents of this report are solely for informational purposes. It has not been approved by, reviewed by, verified by or filed with any regulator in Hong Kong. Nothing herein is a recommendation, advice, offer or solicitation to buy or sell a product or service, nor an official confirmation of any transaction. None of the products issuers, NBCFMA or its affiliates or other persons or entities named herein are obliged to notify you of changes to any information and none of the foregoing assume any loss suffered by you in reliance of such information.

The content of this report may contain information about investment products which are not authorized by SFC for offering to the public in Hong Kong and such information will only be available to, those persons who are Professional Investors (as defined in the Securities and Futures Ordinance of Hong Kong ("SFO")). If you are in any doubt as to your status you should consult a financial adviser or contact us. This material is not meant to be marketing materials and is not intended for public distribution. Please note that neither this material nor the product referred to is authorized for sale by SFC. Please refer to product prospectus for full details.

There may be conflicts of interest relating to NBCFMA or its affiliates' businesses. These activities and interests include potential multiple advisory, transactional and financial and other interests in securities and instruments that may be purchased or sold by NBCFMA or its affiliates, or in other investment vehicles which are managed by NBCFMA or its affiliates that may purchase or sell such securities and instruments.

No other entity within the National Bank of Canada group, including National Bank of Canada and National Bank Financial Inc, is licensed or registered with the SFC. Accordingly, such entities and their employees are not permitted and do not intend to: (i) carry on a business in any regulated activity in Hong Kong; (ii) hold themselves out as carrying on a business in any regulated activity in Hong Kong; or (iii) actively market their services to the Hong Kong public.

Copyright