North American construction outlook: US Trump boost comes at a cost for Canada and Mexico

Trade tariffs, migration controls, elevated borrowing costs and economic uncertainty are key concerns for the sector at large in North America. We see the US as the clear winner though as a push for manufacturing reshoring prompts an increased need for energy and transport infrastructure investment

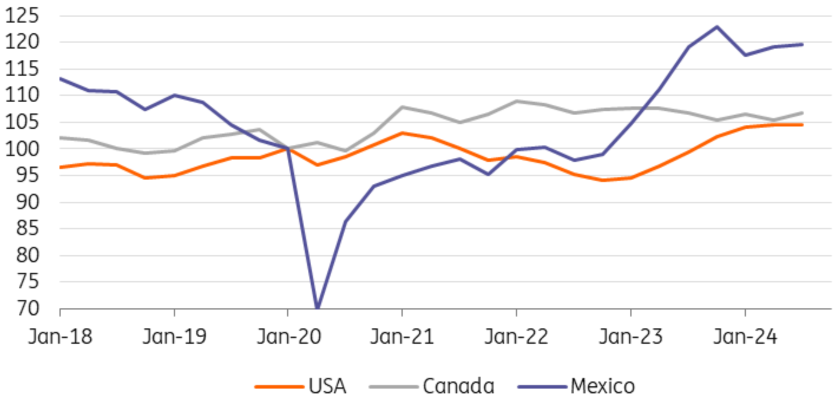
With existing homes in extremely limited supply, those who need to move and want to buy have to increasingly opt for a newly built home

Construction sector set to face higher costs and mixed demand

At the start of 2024, we were cautiously optimistic about the North American construction sector given that unemployment was low and risk sentiment remained positive. Nonetheless, we expected a gradual cooling in the wake of high interest rates, still tight credit conditions, and political uncertainty from the US and Mexican presidential elections.

In the end, the sector proved resilient to those threats with all three countries reporting modest growth. This year, the main challenges centre on potential tariffs, which will raise the cost of imported building supplies while creating economic uncertainty, US immigration controls that could impact labour supply and ongoing elevated borrowing costs.

Construction output volumes (2020=100)



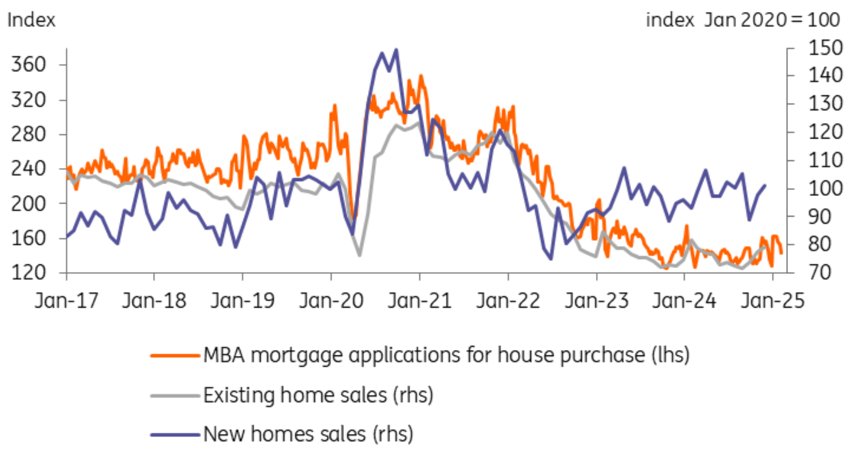
Source: Macrobond, ING

Lack of homes for sale underpins US residential construction

US housing affordability remains poor. House prices nationally have risen 52% since December 2019 while mortgage rates, after a dip in 2024, are back to 7% versus a 25-year historical average of 5.25%. The typical mortgage taken out for a new home purchase is now $440,000, meaning a monthly payment for such a 30-year fixed-rate mortgage is $2,925 or $35,100 per year relative to a median pre-tax household income of a little over $80,000.

Ordinarily, this should be bad news for US homebuilders, but with existing homes in extremely limited supply, those who need to move and want to buy have to increasingly opt for a newly built home. Consequently, home builder sentiment, while a little below the long-run average, is well off the lows hit when the Federal Reserve started raising interest rates aggressively in 2022. Moreover, new home sales are currently trending around the 690,000 mark on an annualised basis, exactly in line with the 25-year historical average. By way of contrast, existing home sales are trending at a 4.1mn annualised rate relative to a 25-year average of 5.25m.

US mortgage applications for home purchases and home sales



Source: Macrobond, ING

From a demand perspective, we are in an unusual situation in that the Federal Reserve has cut the policy interest rate by 100bp since September 2024, yet the 30-year mortgage rate has risen by 90bp over the same period. This reflects the move higher in longer-dated US Treasury yields with President Trump's policy mix of low taxes and light-touch regulation perceived to be supportive for economic growth while immigration controls and the use of trade tariffs are seen as potentially inflationary. Consequently, financial markets have been scaling back their views on how deeply the Federal Reserve can cut interest rates, which has put upward pressure on longer-dated borrowing costs.

At the same time, there are lingering concerns about US fiscal sustainability with the US government running a fiscal deficit of 7% of GDP when unemployment is low and growth is good. We see the risk of the US 10Y yield ending the year at around 5%, which would mean 30Y mortgage rates ending the year potentially around the 7.3% area.

From a supply perspective, the sector is vulnerable to President Trump's immigration controls. Deportations have been increasing, but the primary way this is set to impact the economy is by deterring people from attempting to move to the US. In an environment of falling numbers of American-born workers, this may mean labour supply is constrained in some key sectors including construction, agriculture and leisure & hospitality, which have relatively large immigrant workforces. This could push up pay rates and costs for homebuilders.

Then there is the prospect of tariffs, which could come into force in the second quarter. Lumber and steel were subject to tariffs in President Trump's first term and he has now proposed tariffs on steel and aluminium in his second. Canada, which is an important source of lumber, remains in his sights with a proposed 25% tariff on all Canadian imports.

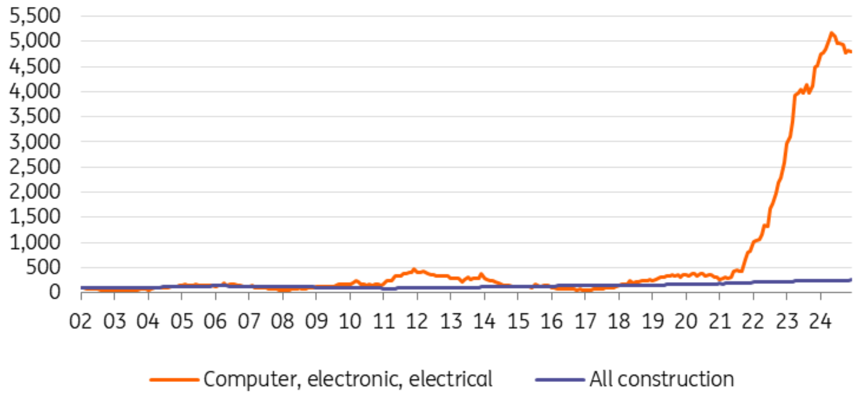
As such there is the threat of a perfect storm for US home builders – rising raw material costs, potential worker shortages boosting pay rates with demand constrained by high mortgage rates. In this environment, we see housing starts, which hit a 15-year high of 1.6m in 2021 before falling to 1.55m in 2022, 1.42m in 2023 and 1.36m in 2024 dropping to 1.275m in 2025 and staying at a similar level in 2026 before rising to 1.35m in 2027.

Tech investment, reshoring and return to the office boost the outlook for US non-residential construction

US non-residential construction received a significant boost from President Joe Biden's incentives to reshore semiconductor manufacturing through the CHIPS Act of 2022 (Creating Helpful Incentives to Produce Semiconductors). The tax credits prompted a sharp increase in the construction of chip fabrication plants, which has been supplemented by the Innovation and Competition Act that authorised $110bn for technology research.

Construction of data centres has been particularly robust and the excitement about advances in Artificial Intelligence will mean more investment and construction tied to this.

Construction spending levels Jan 2002 = 100



Source: Macrobond, ING

One concern that could hold back this expansion is the resilience of the US power grid. The likely soaring electricity consumption fuelled by AI means that in the long term, more power supply is needed to match the demand. In the short term, the key is to make the grid more efficient so that it can take on more load before having to be expanded. But there are challenges to both. Boosting the power supply requires comprehensive permitting reform to reduce the significant project backlog. Grid enhancement lacks awareness and standardisation. Moreover, the rising interest in co-located plants to supply electricity directly to data centres can alleviate grid pressure but add to uncertainty, leaving regulators unprepared. All this will be a test of whether the grid can handle the AI rush that's spinning into the construction sector.

President Trump is looking to build on the tech investment and reshoring by incentivising more manufacturers to base operations within the US via the use of trade tariffs on foreign imports. We assume this will gain some traction, but facilitating reshoring will require more investment in power, water and transportation infrastructure that should boost construction activity.

Banking stresses in early 2023, coupled with high interest rates, suggested that highly leveraged US sectors, such as construction and real estate, would struggle. That has not been the case. Even in the office market, where utilisation rates remain down 50% on pre-pandemic levels, activity has held up well, with spending growth running at 5.7% year-on-year. Moreover, lending conditions are improving and it appears that this sector can continue to make a positive contribution to growth, especially with more US businesses insisting on workers spending more time in company offices.

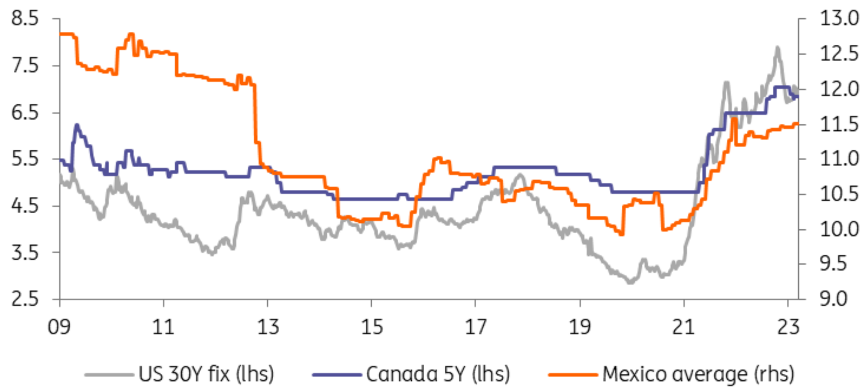
Elevated borrowing costs, tariffs that raise the cost of imported building materials and immigration controls impacting working availability are the main headwinds, but the strength of demand means that these are obstacles that can be overcome with US non-residential construction set to outperform.

Canada is vulnerable to a painful trade war with the US

The Canadian economy struggled through 2024 as the legacy of high interest rates depressed growth and contributed to the unemployment rate rising to 6.9% from a low of 4.8% in 2022. An added pressure point for the Canadian housing market is that borrowers are more exposed to higher mortgage rate costs over a longer period. While the typical mortgage taken out by a US home buyer is a 30Y fixed, in Canada, it is a five-year mortgage, amortised over 25 years. That means borrowers are subject to periodic interest rate resets, so homeowners have been experiencing the lagged effects of Bank of Canada interest rate increases over time. The Bank of Canada has cut the overnight rate by 200bp over the past 12 months and we expect at least 50bp more by the summer, but given the structure of the mortgage market, relief will take time to materialise.

Note too that Canadian household debt is equivalent to more than 180% of disposable income versus 100% in the US. So, more debt exposure with more people facing mortgage rate resets implies a greater chance that the Canadian household sector faces stress that feeds into weaker housing transactions. This is highlighted by the fact the median house price is nearly nine times median income versus a mere five times income in the US – there is a degree of vulnerability to a larger price correction in the near term.

Mortgage rates limited response to central bank rate cuts (%)



Source: Macrobond, ING

Canada's population growth has been rapid thanks to immigration, rising 4.3% between 2020 and 2024, with total employment up 6.25%, while the US population has increased just 1.4% over the same period, and Mexico's has increased 2.6%. However, this has led to public dissatisfaction with the government's response to the 2025–27 Immigration Levels Plan, designed to result in a marginal population decline of 0.2% in both 2025 and 2026, before returning to population growth of 0.8% in 2027. This may lead to a moderation in demand in the coming years but is unlikely to impact construction this year or next given housing backlogs.

Canada is particularly exposed to the threat of a prolonged trade war with the US given that 76% of Canada's exports, equivalent to around 20% of the total Canadian GDP, go there. The proposed tariffs will undoubtedly hurt the competitiveness of Canadian products, with a clear risk that substitution away from Canadian-sourced items leads to an economic downturn and potential recession that pushes unemployment higher. Reciprocal tariffs on US goods will raise cost pressures in the Canadian economy and squeeze household spending power.

There is a clear risk that this will deter near-term private investment projects as well. Economic growth has been poor in any case and we expect to see construction activity in the non-residential sector fall outright in 2025 and 2026 despite ongoing government investment projects.

After 263,000 in 2022, 240,000 in 2023 and 245,000 in 2024, Canadian housing starts are expected to drop to 225,000 in 2025 and 2026. As with the last round of tariffs under President Trump, we expect them to be withdrawn over time as Canada offers concessions on trade practices and we expect to see improving sentiment in a lower interest rate environment prompt stronger housing starts in 2027 of 250,000.

Mexico residential market boosted by stronger remittances and a weak MXN

Mexico's residential property market typically sees less volatility than that of the US and Canada, reflecting the fact that most homes are either bought with cash, self-built, or inherited. Fewer than 20% of homes are purchased using a conventional mortgage from a financial institution versus 70% in the US, so interest rate movements tend to have less of a bearing on the supply and demand of homes.

This means that the state of the jobs market, both in Mexico and in the US from where workers sent $63bn in remittances in 2024, and savings levels are a more important driver of residential property activity than elsewhere. The 25% drop in the value of the Mexican peso versus the US dollar over the past year means these remittances go much further while the strength of the dollar is likely to boost foreign demand for vacation property in Mexico.

President Trump's immigration controls pose real challenges though. After being threatened with tariffs, President Claudia Sheinbaum stepped up border security with 10,000 extra troops deployed. This at the margin may mean the domestic population grows slightly more quickly, pushing up demand for housing.

But as with Canada, a trade war with the US involving tit-for-tat tariffs would be very costly for the Mexican economy given the US is the destination for 80% of all Mexican exports. With Trump seeking to reshore manufacturing to the US, this could put long-term stress on Mexican employment prospects, but we still see foreign money providing a strong boost with a growing population adding to the demand for new homes. As such, we expect to see ongoing gradual growth in residential construction that outperforms both the US and Canada over the next two years.

Mexican non-residential construction set for outright declines

Fiscal consolidation combined with President Trump's reshoring agenda is set to weigh heavily on the Mexican non-residential construction sector. The finance ministry has already announced steep cuts in investment projects that are part of the government's efforts to shrink the fiscal deficit that stood at 6% of GDP in 2024 towards 3.5% of GDP. This will be compounded by the completion of the previous administration's raft of infrastructure projects started in recent years.

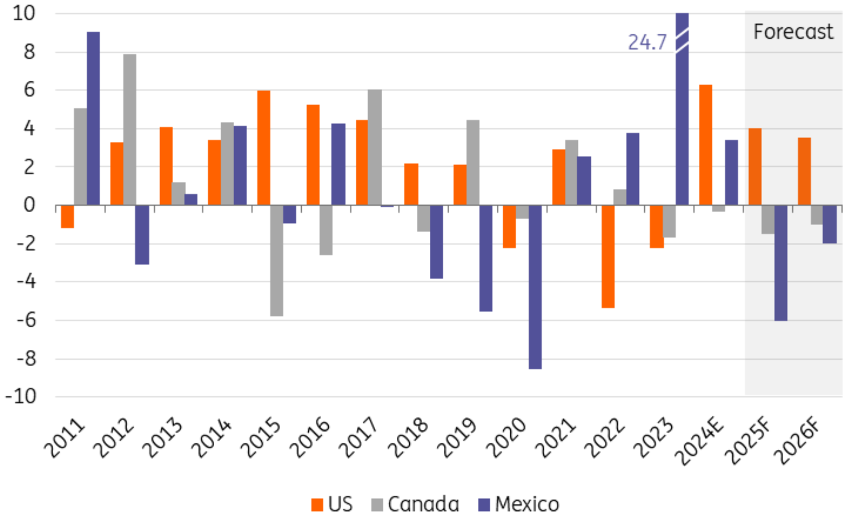
The threat of tariffs on Mexican exports is an area of concern, too. Additional manufacturing investment is likely to be curtailed as President Trump seeks to reshore manufacturing activity back to the US. This will likely mean a far more cautious attitude to private investment projects that prompt a sharp downturn in construction activity overall.

Tariffs and reshoring set to mean US continued outperformance

In the US, elevated mortgage rates will weigh on demand for residential property while home builders could struggle with tariffs pushing up the cost of building materials and a potential reduction in labour supply that puts upward pressure on wages. With profitability being squeezed we expect the sector to struggle. However, this should be more than offset by strength in the non-residential sector where the incentives for reshoring activity remain strong and the appetite for data centres is high. This will require more investment in infrastructure, be it power, water or transportation, which should keep activity strong in the construction sector over the coming years.

Strength in the US comes at the cost of weakness in Mexico and Canada. Such high export dependency on the US means they are highly vulnerable to tariffs. While not introduced yet, the uncertainty that this generates will mean non-residential projects are put on hold. If tariffs bite hard, we could see the Canadian and Mexican manufacturing base undermined and infrastructure projects also cut. With so much economic activity orientated towards trade with the US, there is the threat of further increases in unemployment which runs the risk of rising loan defaults, particularly in Canada where household debt levels are so high. Consequently, we see the prospect of outright contraction in construction activity in both Canada and Mexico.

Annual construction volume growth with ING forecasts (YoY%)



Source: Macrobond, ING

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