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Analysis in Brief

Shifting Economic Conditions Impact Service Industries in 2023

by Marie-Christine Bernard

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Table of contents

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Introduction

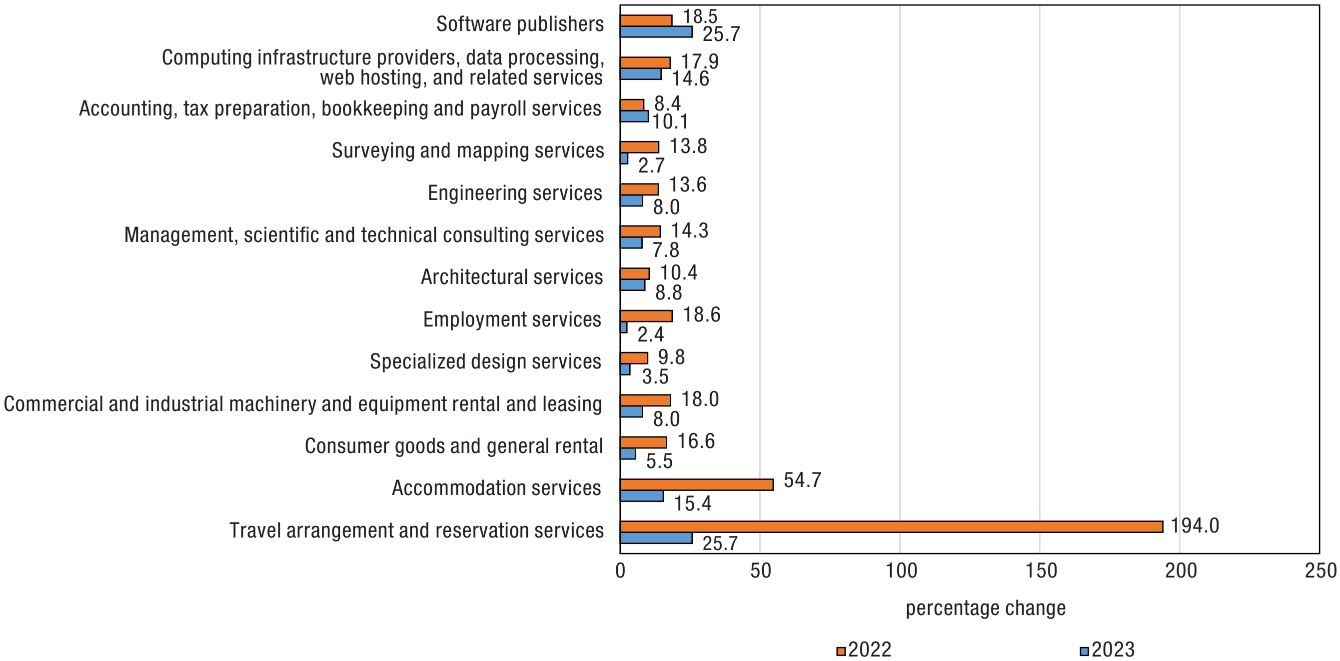
The COVID-19 pandemic recovery lost momentum in 2023 for many service industries because of changing economic conditions. Persistent inflationary cost pressures, rising interest rates and tighter credit conditions have influenced growth across most service industries. Moreover, global demand eased, while supply gradually caught up. This study focuses on key Canadian service industries, leveraging alternative data sources such as goods and services tax revenue, which serves as an indicator for operating revenues.[1] This method provides timely and valuable insights on business performance prior to the availability of annual financial business survey estimates.

Service industries are navigating through volatility and adjusting to fundamental economic changes. Macroeconomic factors and technological advancements—in particular the integration of artificial intelligence (AI)—are simultaneously shaping the dynamics of many service industries.

In general, the service industries examined in this study saw significant revenue growth in 2023 (see Chart 1). While the growth rates were less robust compared with 2022, they were notably stronger than in the pre-pandemic years. Revenues for management, scientific and technical consulting services grew in 2023 at roughly half the pace observed in 2021 and 2022. There were notable exceptions, especially in informatics services, where demand remained strong and revenue growth accelerated. Additionally, tourism-related service industries, such as travel arrangement and reservation services, along with accommodation services, continued to experience significantly stronger revenue growth compared with other service industries, driven by the ongoing pandemic recovery within this segment of the economy.

1. To provide a first look at economic trends months earlier than annual business survey estimates, administrative data and other alternative data sources can be used. These sources offer an advanced point of reference compared with annual business survey estimates.

Chart 1
Percentage change in revenue for selected industries providing professional and administrative services for businesses and consumers, 2022 and 2023



Source: Statistics Canada, Annual Services Industries Program.

Professional services: Strong growth in 2023 through changing economic conditions

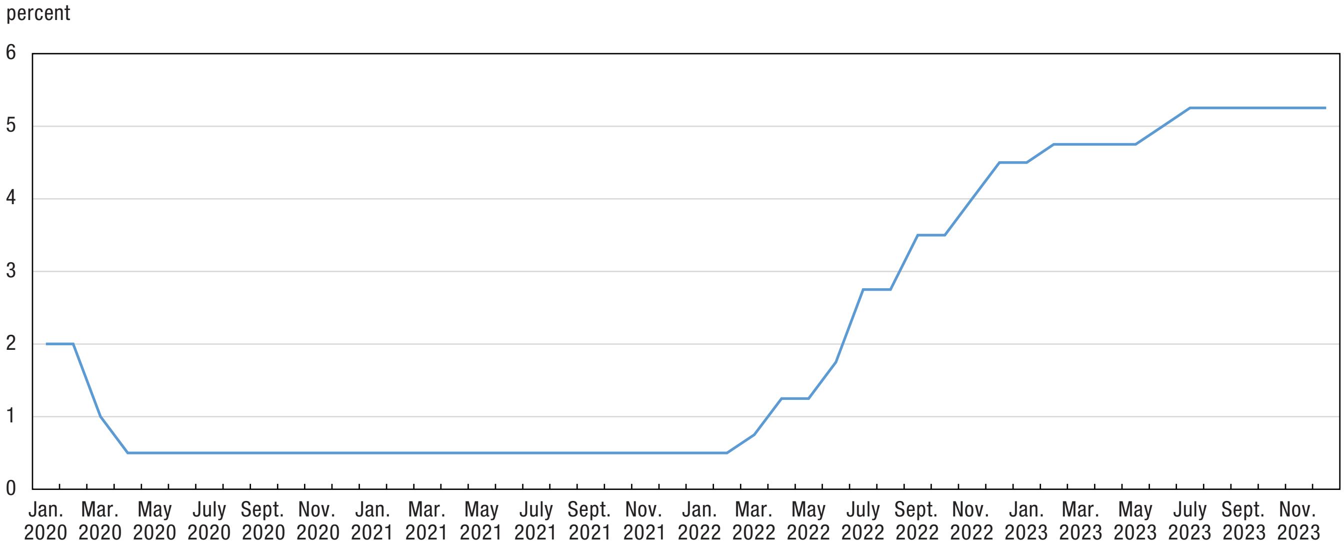
Energy sector supports growth in engineering services

In 2023, engineering services revenue grew by an estimated 8.0%, marking nearly half of the growth observed in 2022.

The growth in 2023 was much stronger than that leading up to the pandemic and was mainly driven by factors such as elevated oil prices, robust global demand for oil and major projects related to fuel transportation. Nonetheless, within the oil industry, challenges such as difficulty getting projects underway, inflationary pressures and labour shortages tempered growth despite the need for increased production capacity and new infrastructure.[2] Additionally, higher borrowing costs have also influenced new capital projects (see Chart 2).

2. Garrison Strategy. (December 2023). *State of the Industry Report Fall 2023-2024*. Enserva. https://enserva.ca/wp-content/uploads/2023/12/Final-Enserva-Fall-Report-Executive-Summary.pdf.

Chart 2
Bank of Canada bank rate, January 2020 to December 2023



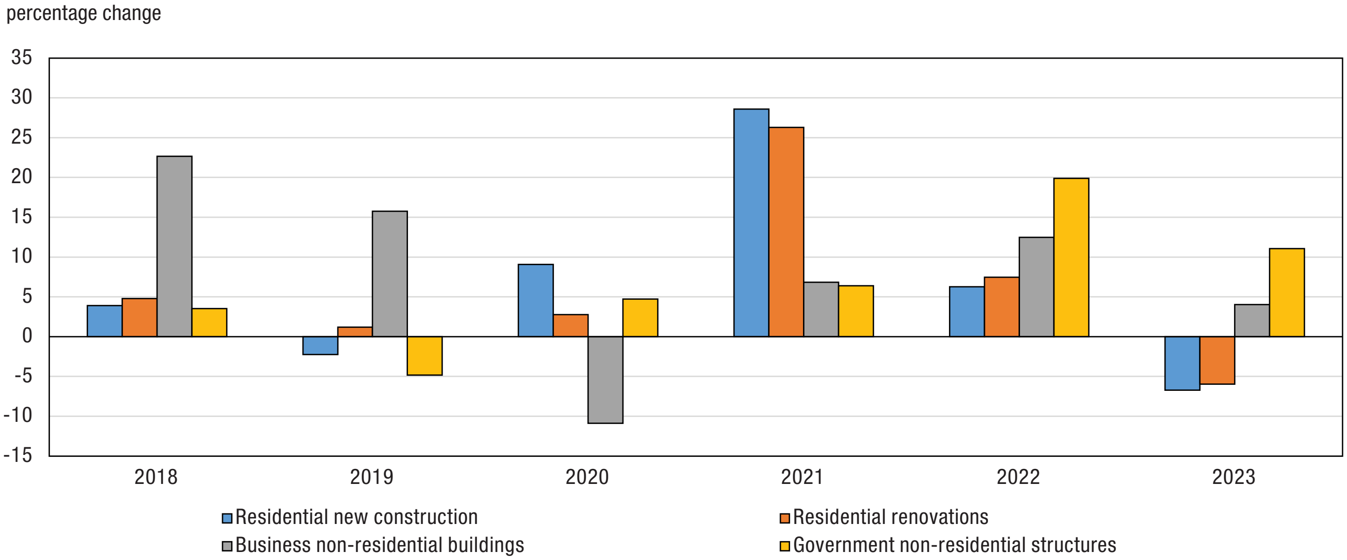
Source: Statistics Canada, Table 10-10-0122-01.

Architectural services and specialized design services impacted by rising interest rates and economic uncertainty

Since 2021, architectural services have been experiencing a gradual easing in revenue growth. Revenue increased by an estimated 8.8% in 2023 compared with 10.4% in 2022 and 15.8% in 2021. Economic conditions for building construction have been shifting. The weakening growth can be attributed to decreasing home construction and renovations as a result of rising fixed-rate mortgage renewals.[3] Despite this trend, the architectural services industry continued to benefit from strong investments in the public sector (see Chart 3). The industry is also adapting to emerging technological trends such as the use of AI-powered tools mainly to bolster operational efficiency and for marketing and proposals.[4]

3. Royal LePage. (2023, October 26). *Renewal jitters: Canadians concerned about upcoming mortgage renewals consider extending their amortization periods, switching lenders*. https://www.royallepage.ca/en/realestate/news/renewal-jitters-canadians-concerned-about-upcoming-mortgage-renewals-consider-extending-their-amortization-periods-switching-lenders/.
4. Daily commercial news-Journal of commerce (DCN-JOC) news services, "Survey finds engineering, architecture firms optimistic about growth," May 13, 2024, https://canada.constructconnect.com/dcn/news/usa/2024/05/survey-finds-engineering-architecture-firms-optimistic-about-growth.

Chart 3
Gross fixed capital formation, current prices, Canada, 2018 to 2023



Sources: Statistics Canada, Table 36-10-0108-01.

Similarly, specialized design services experienced a considerable easing in revenue growth from 9.8% in 2022 to 3.5% in 2023. This reduction can be linked to weaker investment gains in commercial and residential construction projects. Surveying and mapping services also experienced weaker growth; after advancing by 13.8% in 2022, revenue grew by 2.7% in 2023.

Steady revenue growth for accounting, tax preparation, bookkeeping and payroll services

Accounting, tax preparation, bookkeeping and payroll services have been growing steadily since the onset of the pandemic, by 11.5% in 2021, 8.4% in 2022 and 10.1% in 2023. The nature of this industry has allowed it to grow despite pandemic challenges. The industry has been fuelled by the strategic integration of AI and new technologies into accounting processes.[5] Namely, small and medium-sized businesses are increasingly turning to accounting professionals to incorporate cloud-based accounting into their practices to alleviate financial pressures.[6]

Revenue growth for management, scientific and technical consulting services losing momentum

In 2023, revenues for management, scientific and technical consulting services grew by 7.8%, which was approximately half the rate observed in 2021 and 2022, mirroring the trend seen in other professional business services. Nevertheless, many organizations are still relying on external consulting firms for expert guidance to leverage technology such as generative AI and other forces reshaping the economy.[7]

5. Coleman Molnar, "*Embracing the AI advantage in accounting and business*," Chartered Professional Accountants of Canada (CPA Canada), (January 4, 2024), https://www.cpacanada.ca/news/Pivot-Magazine/ai-advantage.
6. The Globe and Mail, "*Accounting in the cloud empowers small businesses*," *The Future of Accounting,* (February 14, 2024), https://www.theglobeandmail.com/business/adv/article-accounting-in-the-cloud-empowers-small-businesses/.
7. Workday Staff Writers, "*Professional Services Industry Outlook: 4 Ways Tech and Trends Will Impact Firms," Workday,* (March 24, 2024), Workday US.

Rental and leasing services expanding at slower rates

Commercial and industrial machinery and equipment rental and leasing

Revenue estimates in the commercial and industrial machinery and equipment rental and leasing industry were primarily influenced by developments in the energy sector. However, revenue growth was more modest in 2023, at 8.0%, largely because of the timing of infrastructure projects. This represented a contrast with stronger growth rates of 18.0% in 2022 and 22.3% in 2021.

Consumer goods and general rental

Revenue for consumer goods and general rental experienced weaker growth of 5.5% in 2023. This stands in contrast to the revenue growth of 16.6% observed in 2022. Inflationary pressures have likely contributed to consumer hesitancy in spending on leisure rental items. Additionally, the slowdown in housing construction has led to a decline in household-related rentals.

Informatics services in high demand

Software publishers and computing infrastructure providers, data processing, web hosting, and related services

The demand for software publisher services has been strong, primarily attributable to the accelerating digitalization of the economy. Simultaneously, there is high demand for data processing and hosting services as businesses outsource their IT needs to enhance data efficiency. In 2023, computing infrastructure providers, data processing, web hosting, and related services experienced 14.6% growth in revenue, while software publishers saw a larger 25.7% increase in revenue. The number of paid employees in those industries has been rising quickly since 2019, by 19.4% for software publishers and by 57.1% for computing infrastructure providers, data processing, web hosting, and related services.[8] The widespread adoption of AI across various domains and substantial investments in this field have supported growth in informatics services.

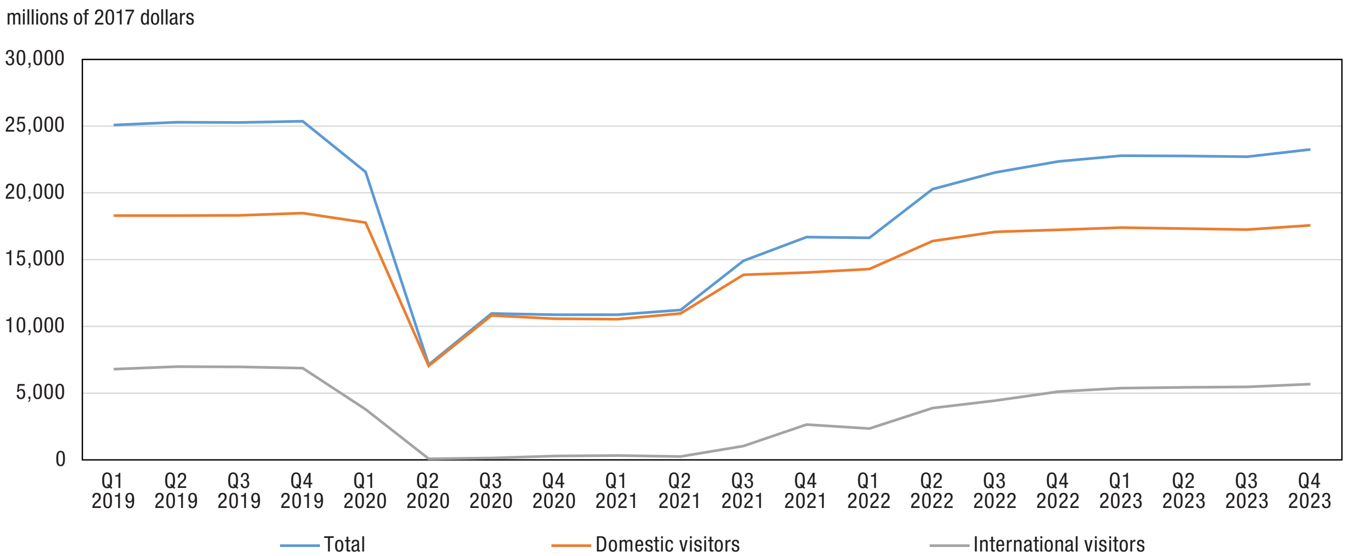
Administrative and support services

Travel arrangement and reservation services, along with accommodation services, continue to see strong revenue growth

While revenues in the travel industry continued to grow rapidly in 2023, the increases were more modest compared with the robust expansion observed in 2022. Notably, revenue from travel arrangement and reservation services increased by 25.7%, a significant contrast to the 194.0% growth estimated in 2022. Meanwhile, revenue for accommodation services was up 15.4% in 2023, compared with a gain of 54.7% in 2022. The travel industry surged in 2022, fuelled by the easing of pandemic-related travel restrictions, but growth normalized in 2023. Despite making progress, the industry is still catching up to pre-pandemic levels of activity, with resident and non-resident tourism spending in constant dollars lagging 2019 levels (see Chart 4).

8. Statistics Canada. (2024). *Table: 14-10-0202-01 Employment by industry, annual* [Data table]. DOI: https://doi.org/10.25318/1410020201-eng.

Chart 4
Tourism expenditures, 2017 constant prices, Canada, first quarter of 2019 to fourth quarter of 2023



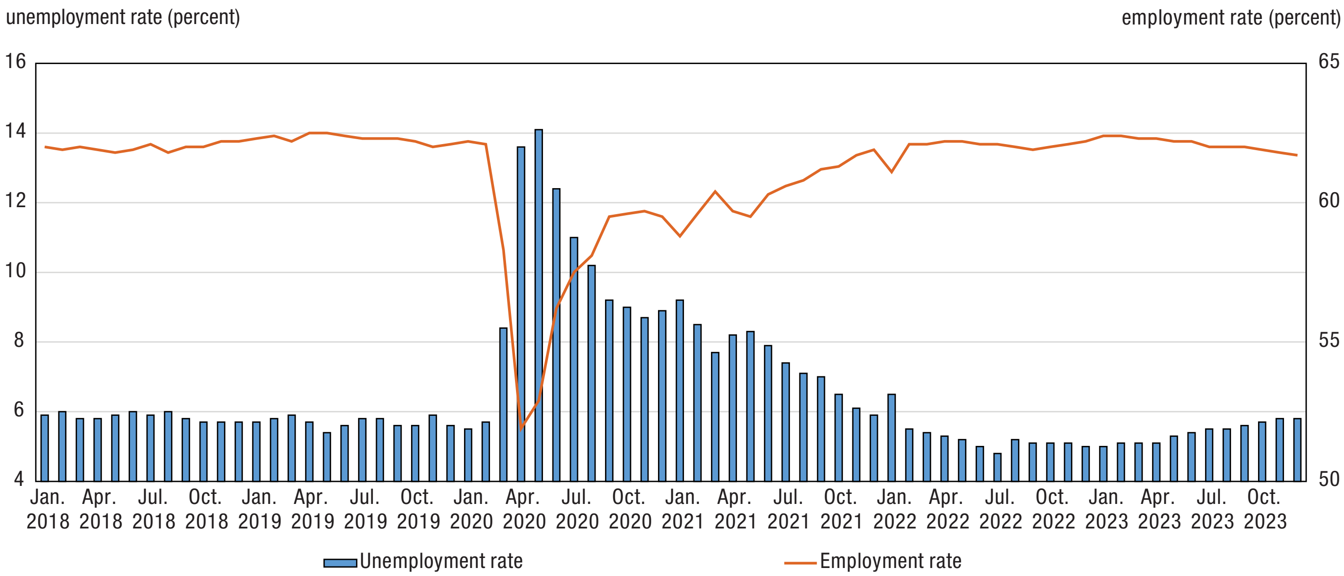
Source: Statistics Canada, Table 36-10-0230-01.

Easing tightness of the labour market is limiting growth in employment services in 2023

Revenue in employment services grew by a modest 2.4% in 2023, weaker than the double-digit increases in 2021 and 2022. The employment rate—the proportion of the population aged 15 and older who are employed—declined in 2023, as population growth generally outpaced employment gains. In December 2023, the employment rate was 61.6%, almost 1 percentage point lower than at the start of the year. The job vacancy rate came down to 3.6% in December 2023, the lowest level since 2020. The unemployment rate moved up from 5.0% in January 2023 to 5.8% in December 2023, closer to the levels in 2019 (see Chart 5).

Although labour market pressures have eased, several key trends—including the aging Canadian population, retirements, newcomers skill sets and technological transformations—are supporting the demand for employment services.

Chart 5
Unemployment rate and employment rate, Canada, January 2018 to December 2023



Source: Statistics Canada, Table 14-10-0287-01.

Concluding remarks

With the easing of pandemic recovery shocks, most service industries saw slower revenue growth in 2023. Nonetheless, compared with pre-pandemic years, revenue in these industries still showed significant expansion. Macroeconomic factors and technological advancements, in particular the integration of AI, are concurrently shaping many service industry dynamics. A recent survey on business conditions in Canada highlighted that technology adoption and innovation have been the primary drivers enhancing operational efficiency over the past year.[9] Although the use of AI in professional services remains limited, its potential to enhance operational efficiency and transform operations is increasing. The evolving landscape of these technological trends will justify closer analysis in the near future.

9. Valerie Bryan, Shivani Sood, and Chris Johnston. (2024). Analysis on artificial intelligence use by businesses in Canada, second quarter of 2024. https://www150.statcan.gc.ca/n1/en/pub/11-621-m/11-621-m2024008-eng.pdf?st=o9xloB0m.