CANADA’S JOB MARKET NO LONGER LEADING AMERICA’S

Highlights

• The Canadian unemployment rate rose to 7.1% in June, while the U.S. rate fell to 6.1%. There are differences in how unemployment is calculated in each country. Adjusted for methodological differences, both unemployment rates now sit at 6.1%.

• Canada has a higher share of people working than America, but the gap is closing. Narrowing it down to core working-age people (25 to 54), America’s employment-to-population ratio rose 0.3 percentage points in June, while Canada’s fell 0.2 percentage points.

• Canada’s higher employment rate appears to have less to do with cyclical developments and more to do with longer-term structural trends. Female labor force participation is higher in Canada than in the United States and has been for the past 15 years.

• The recent strength in the Canadian dollar belies the convergence in labor market performance. While the odds of an earlier rate hike in the United States have risen, the opposite is true in Canada.

Since the end of the Great Recession, the Canadian job market has been outperforming that of the United States. Relative to Canada, America shed more jobs during the recession and experienced a slower rebound in job growth in the first two years of the recovery. However, over the last year, Canada’s outperformance has diminished substantially. In terms of the pace of job creation, America has clearly had the upper hand. But, even on more traditional metrics, such as the unemployment rate (adjusted for differences in methodology) the gap has been closing swiftly. In June, it finally closed, with the unemployment rates on a comparable basis in both countries sitting at 6.1%.

Nevertheless, the Canadian labor market is still in better shape than south of the border. The labor force participation rate in Canada is significantly higher than in the U.S. and so is the share of the adult population with jobs. However, even here, America has been making significant headway. At its peak in September 2011, the employment-to-population ratio of core working-age people (25-54) was 6.1 percentage points higher in Canada relative to the United States. In June, the gap fell to 3.9 percentage points.

The remaining gap in the employment-to-population ratio appears to be largely explained by a gap in female employment – a gap that has been in place for roughly the last 15 years. In other words, despite a much worse job market disaster in the U.S. during the recession, the two countries are rapidly converging. Financial markets have reacted to the recent improvement in the U.S. labor market by pricing in greater odds that the Federal Reserve will raise interest rates earlier than previously expected. The opposite risk – of later rather than sooner – has risen north of the 49th.
Adjusting for methodological differences, unemployment rates are the same

According to the official unemployment rates, the U.S. has been faring better than Canada since November of last year when the Canadian rate rose to 7.2% and the U.S. fell to 7.0%. However, as we noted in a report in December (link), methodological differences mean that the official unemployment rates are not directly comparable. In Canada, the labour force includes 15 year-olds as well as people who are passively looking for a job (by looking at job ads), people who expect to start a job in the next four weeks, and people who are unavailable for work due to personal or family responsibilities. The exclusion of these groups in the U.S. leads the measured unemployment rate to appear lower than in Canada. Fortunately, Statistics Canada estimates an unemployment rate that adjusts for these differences. The remainder of this discussion focuses on this comparable rate.

For most of the past 35 years, the unemployment rate in Canada has been higher than the United States. This was particularly true around recessions, when the old saying that when the U.S. catches a cold, Canada gets pneumonia accurately described relative labor market performance. Through the 2000s, however, the gap between U.S. and Canadian unemployment closed substantially. Canada escaped the 2001 recession with just a modest increase in unemployment. The 2008 recession grossed up this emerging pattern, with the U.S. in intensive care and Canada getting by on bed rest. By November 2010, the unemployment rate in the United States stood 3.1 percentage points above the comparable rate in Canada, the largest gap on record.

Canada’s job market recovery thoroughly outperformed the U.S. in the early stages. After shedding 431k jobs (2.5% of the workforce) between October 2008 and July 2009, it took just under a year and a half to regain them all back. In the United States, by contrast, it took just under six and a half years – until May of this year – to regain the 8.7 million jobs (6.3% of the workforce) lost during the recession.

Nonetheless, after the initial period of outperformance, job growth in Canada over the past two years has underperformed the United States. While America’s recovery has been far from robust, it has managed steady job growth that has made continuous improvement in bringing down unemployment. Canada’s economic recovery, on the other hand, has shifted into slower gear as the initial surge in domestic demand cooled and the export sector continued to be challenged by slower global growth and flagging commodity prices. As a result, after six years in which the comparable Canadian unemployment rate has been below America’s, in June the outperformance ended, with both rates at 6.1%.

Canada still wins on employment to population, but gap is closing swiftly

Judging a labor market solely on its unemployment rate is a bit like judging a book by its cover. A significant portion of the decline in U.S. unemployment has been due to fewer people participating actively in the labor market. Participation in the job market has held up much better in Canada and the labor force has continued to grow (albeit at a slower rate recently).

In both Canada and the United States, aging populations are putting downward pressure on labor force participation. In fact, population aging has a more detrimental effect on
labor force participation in Canada because older age cohorts have historically had relatively lower rates of labor force participation (although Canada has been closing this gap). In order to focus on changes in participation unrelated to population aging, it is useful to focus on individuals in the core working-age population between 25 and 54.

Up until recently, Canadian participation of 25- to 54-year-olds in the labor force had remained buoyant. However, after reaching an all-time high of 87.1% in December 2012, it stumbled in early 2013 and has continued to trend downward in early 2014. As of June 2014, the core participation rate is down 1.2 percentage points from its peak. By comparison, over the same period, the core participation rate in the U.S. has fallen by a smaller 0.4 percentage points. The decline in the participation rate of core-working age people in Canada is concerning and suggests that, as in the United States, the unemployment rate may not be capturing the full degree of labor market slack.

Perhaps the best metric for comparing the two countries is to compare the share of the core working age population currently employed. The rate is still higher in Canada, but the two are moving in opposite directions (with Canada’s moving down and America’s moving up). In June, the core employment-to-population ratio moved up 0.3 percentage points in the U.S., but fell 0.2 percentage points in Canada. As a result, the gap between the core employment rates in the two countries, which reached a high of 6.1 percentage points in September 2011, is now 3.8 percentage points.

**Secular trends explain much of the remaining difference in the labor market**

Digging a bit deeper, there is another feature of the gap between the employment-to-population rate in Canada and the United States that is worth noting. Much of the gap appears to be driven by a significantly larger share of adult females working in Canada relative to the United States. For females, the Canada-U.S. gap between the core employment rates is 6.8 percentage points, while for males it is just 0.8 percentage points.

While some of this development can be attributable to the business cycle, it is also reflective of longer-running secular trends. The gap between female labor force participation in Canada and the United States has been in place and widening since 2000. At the same time, the labor force participation rate of core working age males in America has been declining for the past 60 years. Data does not go back as far for Canada, but a similar trend can be observed, albeit
with bigger jumps around recessionary periods. The recent decline in the labor force participation of males in Canada simply moves it closer in line with the trend in the United States. The conclusion is that just as a portion of the decline in the working share of the (core) adult population in the United States appears increasingly structural, the risks are rising that this may also be the case in Canada.

**Bottom line**

The U.S. labor market recovery has been gaining speed while Canada’s has been slowing. As a result, the amount of labor market slack, which had been much more significant in the United States, is quickly converging between the two countries. While the same outperformance has not been registered in terms of estimated real GDP growth, (the U.S. contracted by 2.9% annualized, while Canada grew by 1.2% in the first quarter) what matters to people, especially at this stage in the cycle, is job growth and on this metric, America has pulled ahead.

American labor market outperformance will have implications for monetary policy and exchange rates. With relatively similar labor markets, the central bank policy rate is 1.0% in Canada, but is still 0% in the United States. Should current trends continue (and there is reason to believe they will), this divergence in monetary policy is unlikely to be maintained.

The closing of the gap in labor market performance is not all bad news for Canada as it is partly a story of the U.S. gaining strength. A faster U.S. recovery will benefit Canada going forward. Nonetheless, the divergent trends between the two countries suggest that the rise in the Canadian dollar relative to the U.S. over the first half of this year will not continue. Look for it to reverse course over the remainder of this year.