TD Bank Financial Group

Observation

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TD Economics
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INDUSTRIAL BREAKDOWN OF THE RECOVERY: AN OUTPUT-EMPLOYMENT MISMATCH

HIGHLIGHTS

- **The Canadian economy has recouped about two thirds of the output decline experienced during the recession, leaving the level of economic activity sitting at only 1.6% below the pre-recession peak**
- **The goods-producing sector has been outperforming during the recovery, led by strong gains in manufacturing and residential construction**
- **Growth in services has been lagging behind, although export-related industries, such as wholesale trade and transportation and warehousing, have been quite strong**
- **Employment has been growing alongside the rebound in economic activity; however, aside from construction, the sectors that have been creating jobs do not match those driving overall growth**

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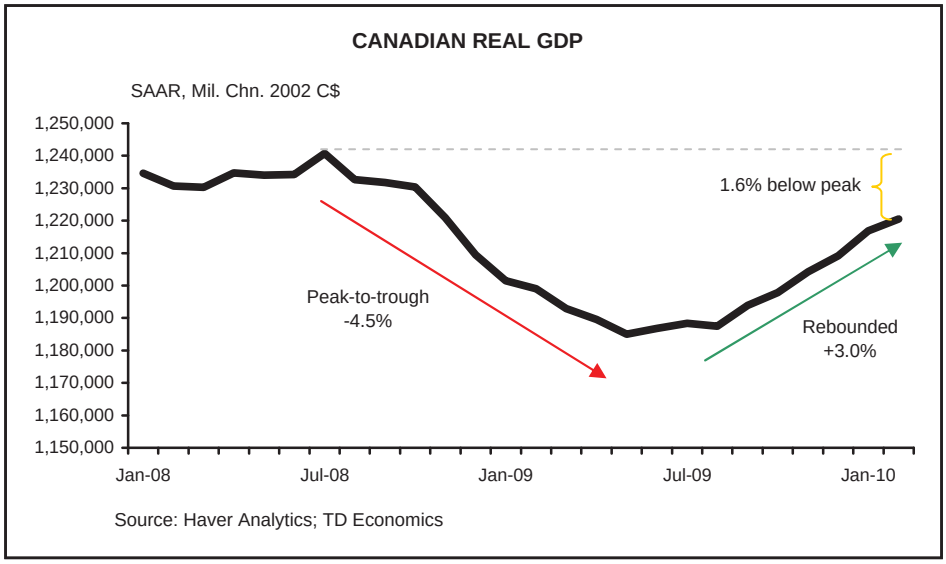
As the data roll in, we continue to see signs of further improvement in Canadian economic activity. The recovery to date has been much stronger than most had anticipated, with growth in the first quarter of 2010 on track for an annualized pace of over 5% for a second consecutive quarter. Between its peak reached in July 2008, and the trough hit in May 2009, the Canadian economy contracted by 4.5%. Since then, about two thirds of that drop has been recouped, leaving the level of economic activity sitting at only 1.6% below the pre-recession peak. With such a stellar pace of expansion seen in recent months, we examine which sectors have been driving the growth and if these gains in output have translated into similar gains in employment.



Goods-producing sector charging ahead

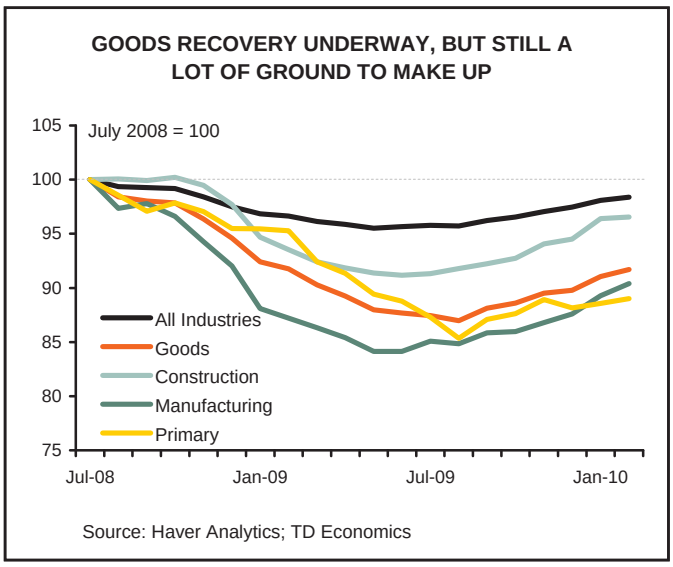
In terms of output growth, the goods-producing sector has been outperforming during the recovery, which comes as no surprise given that it was hit much harder on the way down. In fact, despite the outsized 4.2% improvement seen since last May, real output in the sector still has a lot of ground to make up, as it remains more than 8% below July 2008 levels. The recent growth in goods-producing industries has stemmed largely from manufacturing and construction activity, although the primary sector, after having bottomed later than the economy as a whole, has also contributed to total output growth over the past two quarters.

Manufacturing is the only sector that bottomed simultaneously with the overall economy. And, as we expected, it has also experienced the biggest bounce in production since May, rising by 7.4% – more than double the clip of the overall economy. The rebound in manufacturing activity has been broad based, with 7 of 17 sub-sectors recording double digit gains. The transportation sector in particular has been quite strong, driven by a nearly 50% increase in auto and parts output, which was hammered during the first half of last year due in part to the bankrupt-

cies of GM and Chrysler. Wood and paper products, chemical and rubber products, and metal and mineral products manufacturing have also been among the top performers during the recovery stage. This robust pace of growth has helped the manufacturing sector recoup about 0.5 percentage points of its share of total GDP, bringing that ratio to 13% in February (although it is still well off the 18% seen a decade ago). As well, the manufacturing sector alone has contributed roughly 20% to the total growth in the overall economy. Having said that, the sizable rebound in output only makes up a small fraction of the ground lost during the recession – activity in the sector is still about 10% lower than the pre-recession July 2008 level.

The construction sector has also played an instrumental role in the recovery, as it has grown by 5.7% since the economy hit its trough. While non-residential activity has contracted steadily over the 10 month period, the red-hot housing market has led to a 15% surge in residential construction. In fact, residential activity has nearly returned to the all-time high seen in May 2008. Engineering, repair and other construction activities have also supported overall growth, up 3% since hitting bottom.

In contrast, the primary sector has been slower to bounce back, despite having plunged dramatically during the recession. Indeed, while higher prices have triggered a 19% surge in forestry and non-oil and gas mining since these sectors hit bottom in August 2009 (compared to May, the former is up by a more modest 7% and the latter is still down), output in other areas has remained weak. Agriculture production has flattened out, but has yet to record any meaningful gains, while oil and gas extraction has continued to trend down – likely due to excessive inventories – and is sitting at the lowest level seen since 2001. As a result, the sector as a whole is up 4% since August 2009, but it is still slightly below the levels seen when the overall economy troughed.



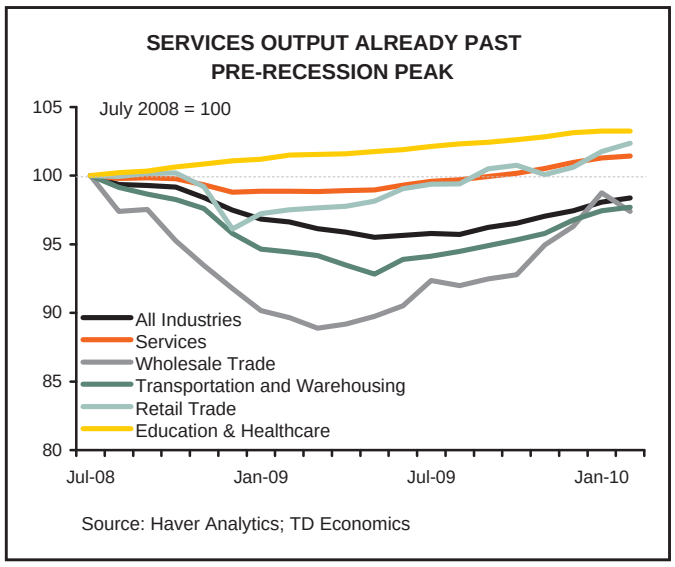
REAL GDP PERFORMANCE BY INDUSTRY

	Change in output between July-08 and May-09	Rebound since May-09	Feb-10 level relative to Jul-08
All Industries	**-4.5%**	**3.0%**	**-1.6%**
Goods	-12.0%	4.2%	-8.3%
Manufacturing	-15.9%	7.4%	-9.6%
Auto & Parts	-39.5%	47.8%	-10.5%
Wood & Paper	-20.0%	12.1%	-10.3%
Chem. & Rubber	-16.6%	12.5%	-6.2%
Metals & Minerals	-24.5%	10.6%	-16.5%
Primary	-10.6%	-0.5%	-11.0%
Agriculture	-6.1%	-2.9%	-8.8%
Forestry	-19.1%	7.2%	-13.2%
Oil & Gas Mining	-7.7%	-3.8%	-11.2%
Other Mining	-17.4%	-3.0%	-19.8%
Construction	-8.6%	5.7%	-3.5%
Residential	-12.8%	15.4%	0.6%
Services	-1.0%	2.5%	1.4%
Wholesale Trade	-10.3%	8.5%	-2.6%
Trans. & Ware.	-7.2%	5.3%	-2.3%
Retail Trade	-1.8%	4.3%	2.4%
Prof. & Tech.	-0.9%	-0.8%	-1.7%
Education	1.2%	1.5%	2.7%
Healthcare	2.2%	1.5%	3.7%
FIRE	1.4%	2.3%	3.7%
Public Admin	2.0%	1.9%	3.9%

Source: Haver Analytics

Services sector lagging behind

Services sector growth, which accounts for over 70% of overall economic activity, has been lagging behind that of the goods sector, rising by only 2.5% since May 2009. This is to be expected given that output in the sector only fell by 1% during the recession, and it has already surpassed pre-recession levels. Still, some service-providing industries have grown quite rapidly – particularly those related to manufacturing and the export sector, which have benefited from a recovering global economy. Indeed, wholesale trade has been particularly strong, rising by a robust 8.5%, while transportation and warehousing increased 5.3%. Still, the level of activity in these sectors is about 2.5% below July 2008 levels. Meanwhile, strength in the domestic economy helped retail trade advance at a decent 4.3% clip, reaching new heights. Also helping to boost growth during the first quarter was the arts, entertainment and recreation sector,



which shot up by a substantial 7%. This will prove temporary, however, as the bulk of this growth was in February alone as a result of the Olympics. On the other hand, growth in finance, real estate and insurance services – which accounts for about a fifth of overall economic activity – and public services has been moderating in recent months, although output in these industries is about 3-4% above July 2008 levels.

Employment up, but in different sectors than output

With the recovery in the Canadian economy gaining traction, the labour market has been following suit. After shedding over 400,000 jobs during the recession, the Canadian economy began adding positions, on net, in August, and has recouped nearly 70% of all jobs lost. Interestingly, the sectors that have been enjoying job creation are not necessarily those that have been leading the recovery in output. In fact, while the goods-producing sector has been outperforming on the output side, it is the services sector that is leading the way on the employment front.

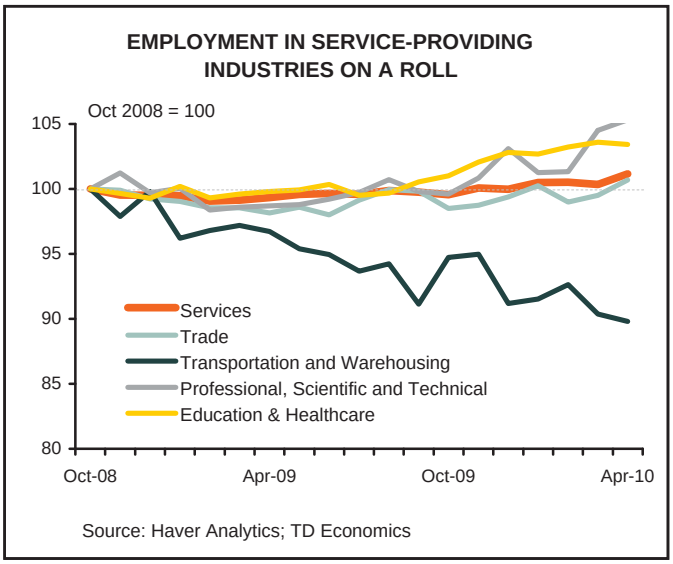
Indeed, of the total 285,000 jobs created since July, over 200,000 have been in service-providing industries. What's more, the majority of these positions have been concentrated in three sectors: healthcare, education and professional, scientific and technical services. Gains in the former two industries are consistent with post-recession history, whereby hiring in these sectors tends to outperform the broader economy during the first year of recovery. The sizable gains in the latter, however, is somewhat surprising given that output in the industry has been in a general decline since the start of the recession, and not many jobs were shed in that industry to begin with. Meanwhile, employment in wholesale trade and transportation and warehousing – the growth engines of the services sector – has been much softer. Compared to the 50-70,000 positions added in the abovementioned industries, only 40,000 jobs have been recouped in the trade sector (and the majority were likely in retail trade), while employment in transportation and warehousing has continued to slide and is now sitting at a 5-year low. Nonetheless, service-providing industries as a whole have not only fully recouped all the jobs lost during the downturn, but they have created even more jobs than existed prior to the recession.

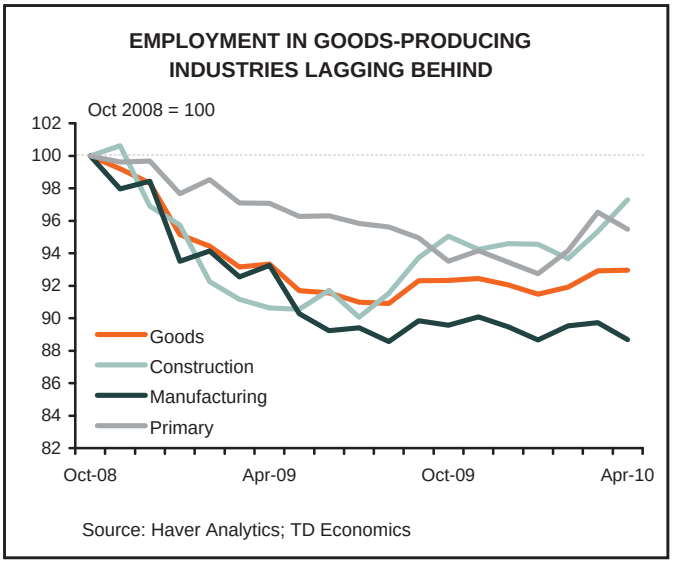
On the goods side, a net 80,000 jobs have been added since July – due entirely to the construction sector, where gains in output have actually translated into meaningful job growth of 90,000 positions. In contrast, the manufacturing

EMPLOYMENT BY INDUSTRY

	Change in employment between Oct-08 and July-09	% chg	Change in employment since July 2009	% chg
All Industries	**-417,400**	-2.4%	**285,000**	1.7%
Goods	-363,800	-9.0%	79,500	2.2%
Manufacturing	-208,600	-10.6%	-14,500	-0.8%
Primary	-27,700	-4.2%	-2,300	-0.4%
Construction	-124,600	-9.9%	90,600	8.0%
Services	-53,700	-0.4%	205,600	1.6%
Trade	-22,800	-0.9%	41,300	1.6%
Trans. & Ware.	-54,700	-6.3%	-33,500	-4.1%
Prof. & Tech.	-3,300	-0.3%	67,500	5.6%
Education	-30,700	-2.5%	53,000	4.5%
Healthcare	15,500	0.8%	69,300	3.6%

Source: Haver Analytics





RECOVERY IN EMPLOYMENT VS RECOVERY IN GDP	Rebound in GDP*	Rebound in Employment*
All Industries	**3.0%**	**1.7%**
Goods	4.2%	2.2%
Manufacturing	7.4%	-0.8%
Primary	-0.5%	-0.4%
Construction	5.7%	8.0%
Services	2.5%	1.6%
Trade	6.3%	1.6%
Trans. & Ware.	5.3%	-4.1%
Prof. & Tech.	-0.8%	5.6%
Education	1.5%	4.5%
Healthcare	1.5%	3.6%

*Rebound in GDP since May-09; rebound in employment since Jul-09
Source: Haver Analytics

sector has shed a net 14,000 jobs since July, despite the 7% rebound in output. This is not necessarily uncharacteristic of the sector, as it is natural for jobs to lag behind output as producers increase productivity rather than hiring workers during the early stages of the recovery. But with output per worker in the sector having risen sharply over the past 10 months, reaching the highs seen prior to the recession, it suggests that job gains in the manufacturing sector are likely just around the corner. Employment in the primary sector is slightly below the levels seen last July, as ongoing losses in agriculture have been almost entirely offset by gains in forestry and mining industries, which lagged the start of the recovery in output by only two months. As a whole, employment in the goods-producing sector has about 300,000 jobs still to recoup in order to return to pre-recession levels.

Manufacturing to lead job gains going forward

Based on our current forecast tracking, which assumes a moderation in overall growth to a more sustainable 3-3.5% in the coming quarters, real output is expected to hit its pre-recession level by the third quarter of 2010. Still, this conceals the fact that for some industries – notably manufacturing and primary – a return to activity levels that prevailed a few years ago will take at least another 18-24 months. In the case of manufacturing, output levels may not return to the all-time peak set back in 2000 for at least a decade. Structural impediments on Canadian manufacturing output include the impact of a high Canadian dollar, increased competition from Asian markets, and the lasting effects from the financial crisis on U.S. and global demand. In the primary sector, the long road back largely reflects the elevated levels of output in 2008 during the height of the commodity bubble.

Employment levels are also likely to reach their pre-recession level this year, albeit one quarter later (ie. Q4 2010) than output. But hidden within this overall trend is a significant change in the composition of jobs. Industries that have seen job growth run ahead of output gains – particularly in construction, public services and professional, scientific and technical services – are likely to experience a cooling in hiring demand in the coming months. In the construction sector and public services, an expected slowdown in housing market activity and government spending is likely to add to the hiring woes. In contrast, the manufacturing sector in particular appears poised for a significant bounce in hiring spurred by the recent – and future – output gains. Echoing the output story, however, employment in the sector is likely to remain well below its pre-recession June 2008 level, not to mention its historical high set back in 2002.

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