

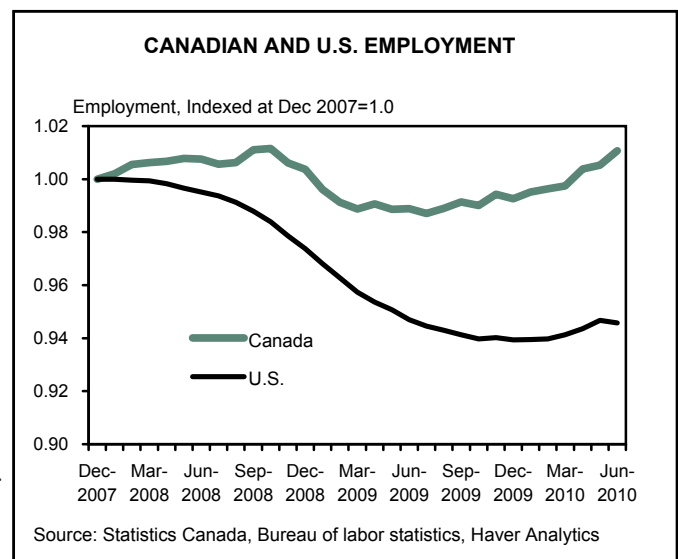
## HIGHLIGHTS

- The hit to Canadian employment during the recession was not as large as could have been the case given the severity of the downturn, and the recovery thus far has outperformed that following the last two major recessions.
- Job growth has become more reliant on industries linked to domestic demand, and thus the labour market has benefited from the resilience of domestic spending.
- Moving into the second half of 2010, we anticipate slower than normal job creation, as the pace of economic recovery ratchets down.
- Growth in domestic demand is expected to cool to a modest pace of 1.5-2% over the next year and a half, significantly down from the robust 4.5-5% pace experienced over the last three quarters. As such, employment in industries tied to domestic spending will likely moderate in the coming months. In addition, a diminishing rate of U.S. growth will likely weigh on hiring in export-oriented industries.
- We anticipate average monthly job creation in the range of 15,000 to 20,000 over the second half of 2010, with a gradual decline in the unemployment rate to 7.7% by year end.

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## CANADA'S JOB MARKET THROUGH RECESSIONS AND RECOVERIES – WHY THIS TIME IS DIFFERENT

Since the start of the global economic recovery in August of 2009, the Canadian labour market has been a top performer among peer G-7 nations. Canada job numbers in June not only showed that job creation continues to sizzle, but was well beyond forecasters' expectations. The gain of 93,000 brought the average monthly job creation in Q2 to 175,000 representing the largest quarterly gain since 1975. And, the Canadian economy has now recouped 97% of the jobs lost during the recession. At the same time, the unemployment rate continued to fall, breaching 8% for the first time since January 2009. Particularly surprising, all of this has occurred while the other broad indicators have showed signs of a ratcheting down in economic growth as mid-year approached.



What gives? Is this what typically happens during the first year of recovery following a recession? And what can we expect going forward?

### The typical behaviour of employment during recessions and recoveries

Employment growth is highly correlated with real GDP growth during times of economic prosperity. However, during recessions, employment tends to suffer more severely as employers shave payrolls faster than the drop in output. Meanwhile, after recessions, employment does not play “catch-up” like GDP does, as employers are slow to begin hiring in the wake of uncertainty around the future outlook, and a significant amount of excess capacity in the economy. In this environment, businesses prefer to ramp-up production through the existing workforce, rather than hire new employees. Typically, employment takes about 3-5 quarters longer to return to pre-recession levels than real GDP. For instance, real GDP returned to pre-recession levels within three-quarters following the 1980's recession, while the labour market took 6 quarters to recoup all the jobs lost during the recession. The job market recovery was even slower post the 1990's recession, as the economy continued to shed jobs for five-months following the downturn. While the economy was at pre-recession levels by 9 quarters into the recovery, employment didn't fully recover for five quarters after that. Moreover, the recovery in the labour market following the past two major recessions was led by part-time employment

| CANADIAN EMPLOYMENT - PERFORMANCE DURING RECESSIONS AND RECOVERIES |                |        |            |   |        |            |   |        |            |
|--|----------------|--------|------------|---|--------|------------|---|--------|------------|
| % CHANGE   |                |        |            |   |        |            |   |        |            |
|  | Peak-to-trough |        |            | Trough-to-Current (11-months into the recovery) |        |            | Peak-to-Current (11-months into the recovery) |        |            |
|  | 1980's         | 1990's | 2008/2 009 | 1980's  | 1990's | 2008/2 009 | 1980's  | 1990's | 2008/2 009 |
| <b>Employment</b>  | -5.4           | -3.4   | -2.4       | 3.8   | 0.6    | 2.4        | -1.8  | -2.7   | -0.1       |
| Public   | -0.9           | 1.9    | -1.7       | 2.3   | 0.7    | 2.6        | 1.3   | 2.6    | 0.9        |
| Private  | -9.0           | -7.2   | -4.0       | 4.4   | -0.1   | 3.3        | -5.0  | -7.2   | -0.8       |
| Self-Employed  | 5.7            | 6.7    | 3.1        | 3.8   | 3.5    | -1.3       | 9.8   | 10.4   | 1.7        |
| Full-Time  | -7.1           | -5.5   | -3.4       | 3.5   | 0.4    | 2.6        | -3.9  | -5.1   | -0.9       |
| Part-Time  | 4.6            | 7.1    | 2.0        | 5.6   | 1.8    | 1.5        | 10.4  | 9.0    | 3.5        |
| Goods  | -13.1          | -11.5  | -9.0       | 4.2   | -0.6   | 1.7        | -9.4  | -12.0  | -7.5       |
| Service  | -1.6           | 0.0    | -0.4       | 3.6   | 1.1    | 2.6        | 2.0   | 1.1    | 2.2        |

\*Source: Statistics Canada/Haver Analytics

as employers cautiously added to payrolls. As well, self-employment has tended to be a leading area, as those who lost their job during the downturn seek self employment as a better alternative to unemployment.

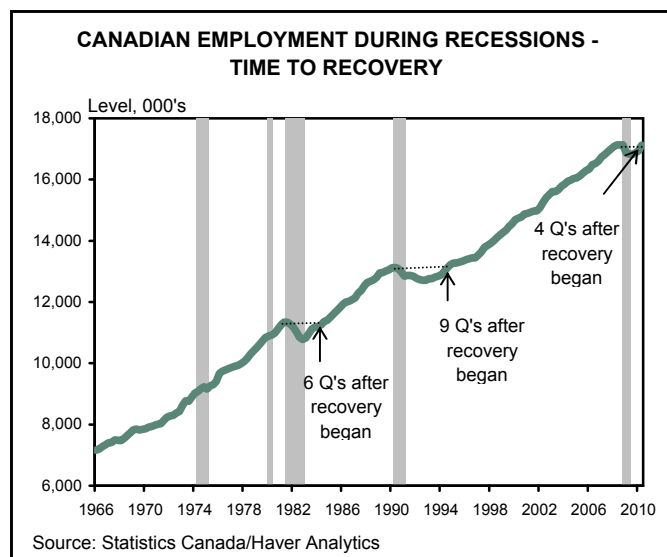
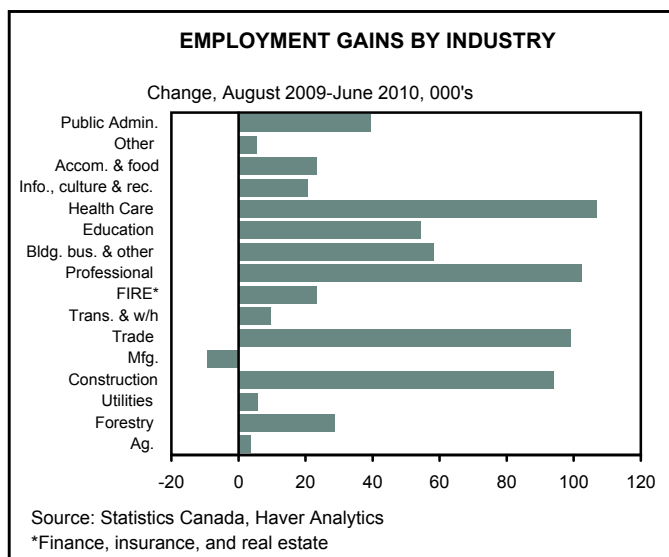
**Job growth outperforms in the 2008/2009 downturn**

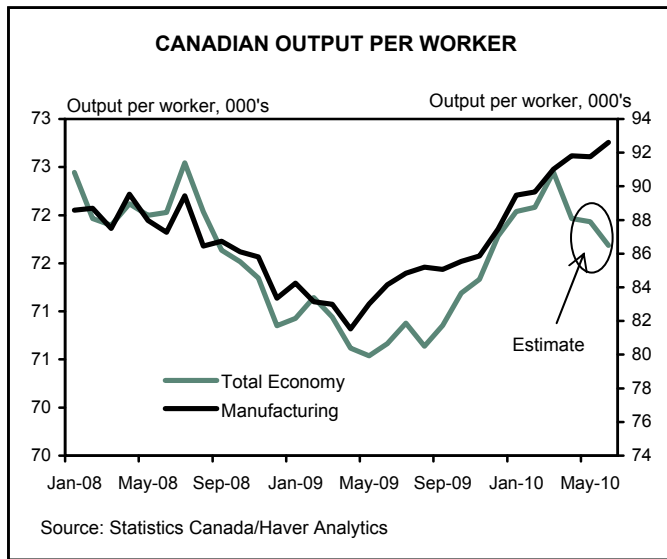
This time around has been vastly different. First, the hit to employment was not as large as could have been the case given the severity of the recession. While the 3.6% peak-to-trough decline in real GDP was equal to that of the 1990's recession, the employment losses this time around were less severe. The unemployment rate only increased 2.8 percentage points, peaking at 8.7% – about half the increase experienced over the 1990's and 1980's downturn. Moreover, the recovery in employment began instantaneously with the recovery in real GDP – they both bottomed at the same time in July 2009. And in contrast to past recessions, employment will return to pre-recession levels a quarter ahead of economic activity and in half the time of past recessions.

A significant amount of the job creation (88%) has been in full-time paid positions underscoring the strength in the labour market.

So, what made this time so different? First, job growth has become more reliant on domestic conditions since the last two recessions. Jobs strongly linked to domestic demand, like construction and service industries, now account for 85% of employment, up from 78% at the time of the 1990's recession and 73% in 1980's. Thus, the fact that the domestic side of the economy and banking sector remained resilient during the recession and strong during the early stages of recovery has spelled good news for hiring. In contrast to low levels of manufacturing and commodity production, domestic demand has surpassed pre-recession highs. In contrast, the last two recessions were largely concentrated in domestic demand, while growth in international trade remained positive.

The strength of domestic-led jobs has been born out in the data. Industries highly tied to domestic consumer spending like accommodation and food services, information and culture, and recreation, professional, scientific and technical services, and retail and wholesale trade, which together have contributed 159,000 jobs of the 403,000 jobs since July 2009. The rebound in the resale housing market and new home building has also been like no other post-recession recovery. This in turn has helped to spur employment in housing related goods and services such as finance, insurance and real estate, and construction which together have added 117,000 jobs over the downturn. Lastly, we can't forget government's stimulus plans. Public sector jobs have played a larger role through this recovery than they did during the last two recessions, but they have not been a key driver of the labour market recovery.





**Recovery to lose steam**

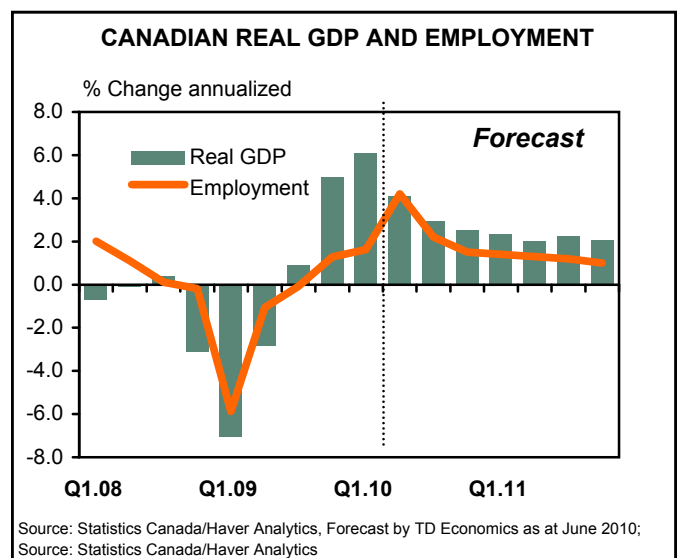
While such job growth has been welcome, it is unlikely to continue in the second half of 2010 and into 2011. A flat reading in output per worker is the first indication that businesses may be poised to slow their additions to payrolls. Growth in labour productivity is key to the hiring decision – there is only so much output you can squeeze out of your current workforce before you have to turn to new employment to help spur growth. As employment growth outpaced real GDP growth in the last eleven months, output per worker has yet to recover to pre-recession levels – leaving employers less likely to continue to build their workforce in the near-term.

Manufacturing has been an exception to the rule. In spite of the strong rebound in manufacturing output so far, employment in the industry has yet to hit a bottom. As manufacturers have been squeezing more output out of existing workers, output per worker has soared to historically high levels. While this may be a sign that employment in this industry will start to recover in the near future, we don't expect a fast and furious recovery in manufacturing employment. First, the rebound in manufacturing output does not appear sustainable, and will likely moderate in the second half of this year. Second, a lofty Canadian dollar, coupled with high unit labour costs, has put Canadian export-orientated manufacturers at a competitive disadvantage. The labour productivity gains in this industry over the recovery were much needed to help manufacturers gain some ground in global markets. This leads us to believe that manufacturers will continue to be reluctant to hire in the coming months.

Looking out over the second half of 2010 and 2011, the most significant factor weighing on overall labour demand

is likely to be a downshifting in the rate of growth in both domestic spending and total real GDP. The most recent data suggests that economic growth in the second quarter of this year has cooled to a 2.5-3.5% annualized range, down from 5-6% in the previous two quarters. This slowdown is likely to be led by the household sector. It is our view that a significant amount of strength in domestic demand was the result of households bringing purchases of consumer and housing related goods and services forward to take advantage of record low interest rates and retail discounting. In addition, government infrastructure spending, which has helped to bolster construction activity and employment since the end of 2009, will likely peak in the third quarter of this year, and U.S. economic growth will probably diminish. All being said, the Canadian job recovery will face significant headwinds going forward.

As such, rather than revving up over time as is typically the case, we believe the second phase of the economic recovery will bring with it unusually soft job creation. Economic growth in the range of 2.5-3.0% in the second half of this year will be consistent with average employment gains of 15,000-20,000. What's more, we don't think it unlikely to experience a few months of net job destruction as a bit of payback for the most recent strength. Historically it is not uncommon to see spouts of strong employment gains followed by a month or two of losses. Nonetheless, job growth in the coming months will be enough to bring the unemployment rate down, but at more gradual pace than experienced over the last eleven months. We forecast an unemployment rate of 7.7% by the end of this year, down from its current rate of 7.9%. The unemployment rate will remain above its pre-recession peak of 6.5% on account of strong labour force growth in the last year.





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