OBSERVATION

TD Economics

August 2, 2016

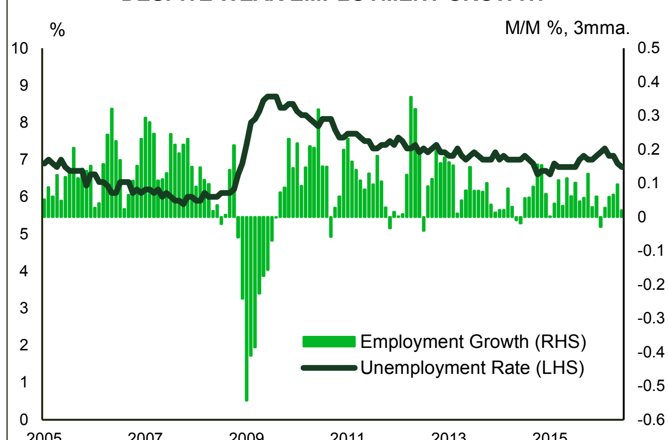
CANADIAN LABOUR MARKETS: LOOKING BACK, LOOKING FORWARD

Highlights

- Headline labour market indicators point to a mixed performance so far this year. Mirroring a challenging economic environment, Canadian job creation has run at an unremarkable average rate of 8k net positions per month. Still, the unemployment rate managed to fall below 7% as some Canadians left the labour market.
- The TD Labour Market Indicator, which aims to provide a broader assessment of underlying job conditions, has continued to make steady progress this year. Despite weaker labour market participation, the quality of jobs appears to have been improved, marked by a decline in the involuntary unemployment rate.
- Employment growth this year has been largely concentrated in service industries, led by the accommodation and food services, which in turn is benefiting from strong growth in visitors to Canada. Bucking the trend has been the manufacturing sector, where net job losses appear to be a reflection of both softer than expected growth in foreign demand and weaker demand from resource-oriented regions of Canada.
- Looking ahead to the next 4-6 quarters, we expect job creation to remain tepid at around 7-10k per month, despite prospects for a moderate rebound in underlying economic activity. A swing back to positive job gains is expected for manufacturing, with healthy employment gains also forecasted for healthcare and trade. In contrast, agriculture, and commodity-focused industries will likely underperform, although the declines in commodity related employment are likely to come to an end.
- Although job gains are expected to be broadly distributed across most industries, they will not be evenly distributed across provinces. The majority of employment gains are expected to accrue to B.C., Ontario, and Quebec. In contrast, little hiring growth is expected in the Atlantic Provinces, while Alberta is expected to continue to lose jobs through the remainder of this year and into next.
- The unemployment rate is expected to rise slightly over the coming quarters, averaging 7.0% in 2017. Employment growth will likely be unable to keep pace with gains in the labour force as participation rates normalize.

With half a year's labour market data in hand, it is an opportune time to both take stock of how the year has developed so far, and look forward to where we are headed. Although it has in many ways been an unremarkable start to the year, beneath the headline employment numbers lurk a number of interesting trends which will be explored in this note. The middle of the year also provides a good opportunity to update our employment outlook, with the sources of employment growth expected to shift somewhat in the coming quarters.

CHART 1. UNEMPLOYMENT RATE DOWN DESPITE WEAK EMPLOYMENT GROWTH



Source: Statistics Canada, TD Economics.

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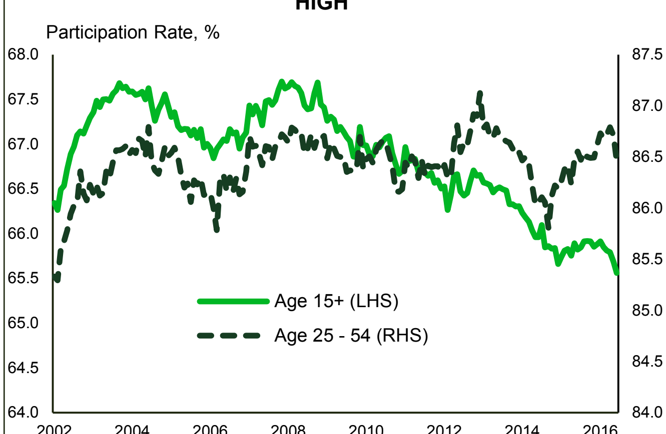
Unemployment Rate Down For Wrong Reasons, But No Need To Worry

When it comes to labour markets, Canada has had a fairly unexceptional start to 2016. Monthly employment growth has averaged only about 8k net positions in the first half of the year, an unremarkable rate but not out of step with the economy's somewhat sluggish growth. Moreover, it represents a continuation of trends from last year, which also saw weak hiring of about 11k per month.

Yet in contrast to 2015, when the unemployment rate trended gradually higher, the jobless rate has managed to decline by 0.3 percentage points since December 2015. This somewhat perplexing development has been the result of a shrinking labour force in Canada. The participation rate (or ratio of those in the labour force to the total population) has declined markedly this year as nearly 20k Canadians left the labour force. While the absolute size of the labour force has generally grown in recent years, the participation rate has been declining gradually since the mid-2000s given the aging of the Canadian population (Chart 2). What is surprising about the recent decline is that it was not driven by the aging effect, as the participation rate among 'core age' workers (those aged 25 to 54) fell accordingly.

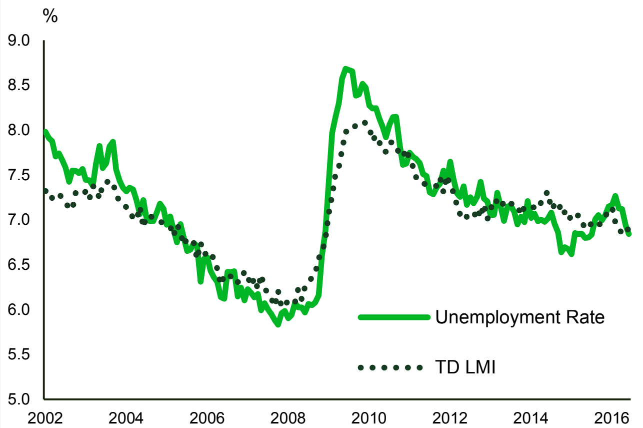
An unemployment rate that falls as a result of declining participation is less inspiring than one driven by employment gains. However, the current moves should be put in some perspective. To begin with, although the drop has been sizeable, labour market data are notoriously noisy, and the size of the change is well within historic norms. Moreover, the core working age participation rate, at 86.5%, matches its longer-term average. Thus, while the drop so far this year is of note, we don't yet see cause for concern.

CHART 2. CORE PARTICIPATION RATE REMAINS HIGH



Source: Statistics Canada, TD Economics.

CHART 3. UNEMPLOYMENT RATE AND LMI IN AGREEMENT



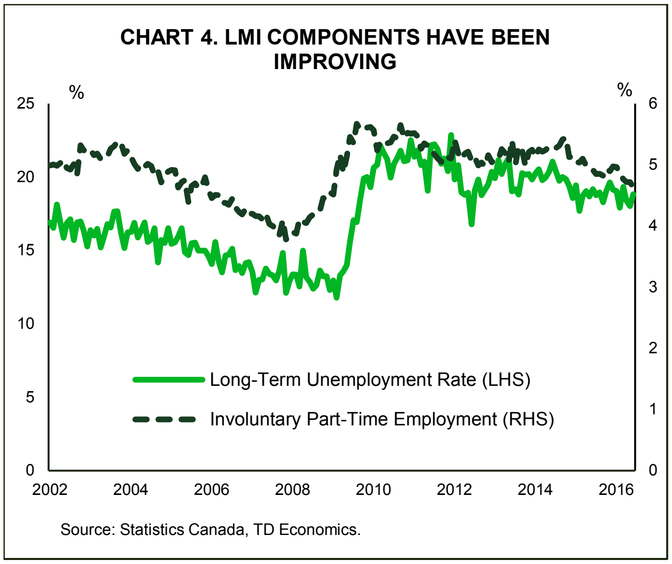
Source: Statistics Canada, Bank of Canada, TD Economics.

Unemployment rate reflective of underlying conditions

The headline job creation and unemployment numbers are useful in providing a simplified snapshot of how labour markets are evolving. However, their simplicity can be misleading, particularly when participation rates are volatile or declining. For this reason, TD Economics prefers to take a more fulsome view of labour market performance that includes a broad swathe of the underlying data to account for issues such as job quality, underutilization of labour, and the duration of unemployment.

These varied measures of labour market health have been distilled into the TD Economics Labour Market Indicator (LMI), yielding a measure comparable with the unemployment rate, but richer in terms of the information captured. The latest LMI points to an underlying picture of the labour market that is largely in line with what the headline unemployment rate suggests (Chart 3). This comes after several years of labour market underperformance, as a number of improvements have been observed. For one, the involuntary unemployment rate has declined. As well, the long-term unemployment rate (those unemployed for 27 weeks or more) has also fallen somewhat despite multiple rounds of layoffs in the oil and gas sector (Chart 4).

Still, not all components of the TD LMI have improved. The job finding rate has declined slightly, while wage growth has decelerated. Average hourly earnings in Canada grew 2% in June. This is markedly slower than the 3% average pace over the 12 months prior, and below its long-run average of 2.4%.



Despite some weak areas, the TD LMI thus suggests that in spite of an economy seemingly stuck in neutral and a declining labour force, the job market continues to make some moderate headway. It is important to note that due to limitations in the data, the TD LMI is restricted to the national level. As will be discussed subsequently, labour market conditions vary wildly across Canada at present, something that is not captured within the LMI.

Where has the growth been?

The breakdown by industry of job growth in Canada this year has been in line with broad trends, yet confounding expectations set at the beginning of the year. To understand this, job growth by industry this year should be placed in the broader macroeconomic context. The first half of the year can be broadly characterized by recovering (but still low) oil prices, a relatively low Canadian dollar, and somewhat more modest growth in foreign demand than expected.

Perhaps the most easily explained trend has been the continued weakness in the forest, fishing, mining, and oil and gas industry group. The net 35k position decline in employment (year-to-date from December), while disheartening, is not surprising. The backdrop of weak commodity prices, as well as the transition in the oil and gas sector from labour-intensive capital building phase into the production/maintenance phase at a number of major projects, has compressed labour demand.

The more interesting dynamics emerge when the industries traditionally associated with foreign demand and weaker exchange rates are considered. Tourism, as measured by cross-border trips, has risen dramatically this year, and this growth appears to be reflected in the relative performance of major industries (Chart 5). Both accommodation and food services (+37.1k) and information, culture, recreation (+34.5k) saw marked gains in net employment, likely – at least in part – to serve the growth of visitors to Canada enticed by the low level of the loonie against the U.S. dollar (U.S. residents were responsible for the bulk of the increase in visits to Canada in 2016 to date).

In contrast, it has been manufacturing that has largely confounded expectations, with net employment down 52.4k positions as of June, offsetting much of the growth elsewhere. Although the exchange rate has generally remained in favourable territory this year, the volume of exports declined markedly. After reaching a new all-time high in January, goods export volumes retreated to levels not seen since early 2014. Falling exports, together with a less supportive domestic spending mix likely resulted in the drop in manufacturing employment this year. Indeed, the most recent Bank of Canada Business Outlook Survey reported that the pick-up in foreign demand in 2016 was generally not sufficient to offset falling domestic demand. Foreign demand has underperformed our expectations this year, and with it, manufacturing employment.

Sitting somewhere between these groups has been public administration (+7.2k), which was helped by temporary census-related positions in May and June of this year. Construction saw a similar gain, supported by the seemingly insatiable demand for housing in the key Greater Toronto and Greater Vancouver markets. The strong Canadian housing market also appears to have fed through to the finance, insurance and real estate service sectors (which include mortgage brokers and real estate agents), leading to cumulative job growth of 13.3k in the first half of 2016.

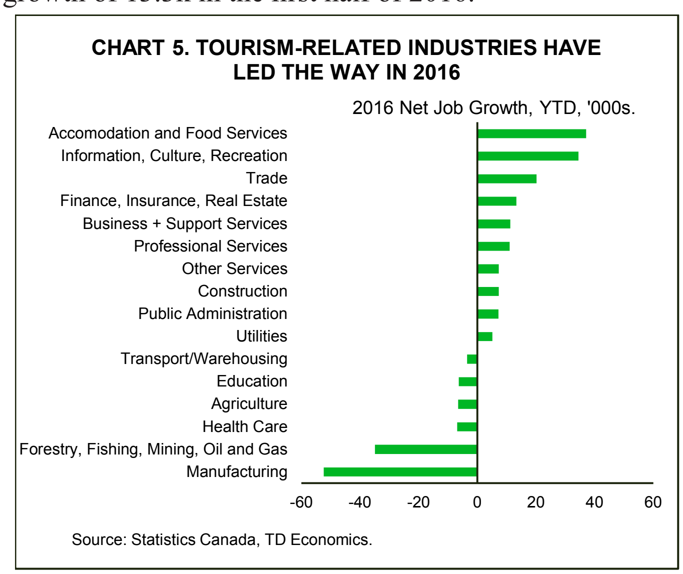
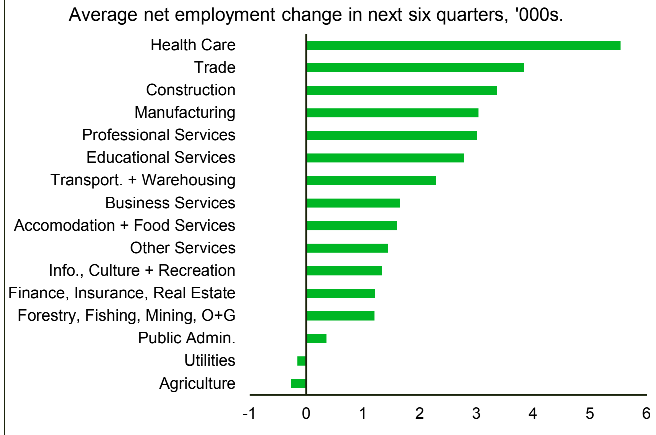


CHART 6. HEALTHCARE, TRADE, PROFESSIONAL SERVICES, CONSTRUCTION LEAD JOB GAINS



Source: TD Economics.

Where will employment growth be?

Looking to the future, employment growth is expected to remain in line with its modest recent performance. We expect job growth to average between 20k and 30k per quarter over the coming year and a half (roughly 7k to 10k per month). The 'new normal' pace of employment gains mirrors the outlook for the economy as a whole, which remains in slow growth mode as the economic adjustment to low commodity prices continues. When combined with an expected recovery in labour force participation, we expect the unemployment rate to tick back up slightly, averaging 7% in 2017.

Beneath the modest expected growth in aggregate employment lurks a divergence in sectoral performances (Chart 6). Health care is expected to lead the way over the second half of this year and into 2017, forecast to gain a net 5.5k positions per quarter on average, supported by continued population aging. While somewhat slower than the gains notched over the past six quarters, the projected pace is nevertheless enough to make health care the fastest growing industry. Healthy employment growth is also expected for trade (+3.8k net positions on average) and construction (+3.4k), as well as manufacturing and professional services (both +3k).

The positive average gains forecast for the manufacturing sector are a mirror-image of its performance over the past year and a half. This reflects a more positive view of manufacturing output going forward. Notably, U.S. growth has been perking up somewhat after a slow start to the year. At the same time, Canadian demand for factory goods is expected to strengthen, partly owing to a rebound in activity as the economy recovers from the recent wildfires. Employers may also prefer the 'optionality' of expanding output via hiring, rather than through capital investment. While employers retain the ability to shrink their workforce in the event of a downturn (rather than the more difficult prospect of trying to reduce capital stock), we do not expect that this will be the case. Rather, our view is that as the expansion persists, manufacturing investment is likely to pick up. However, given the relatively modest sales outlook and current spare capacity in many manufacturing industries, investment is not expected to grow meaningfully until early 2018.

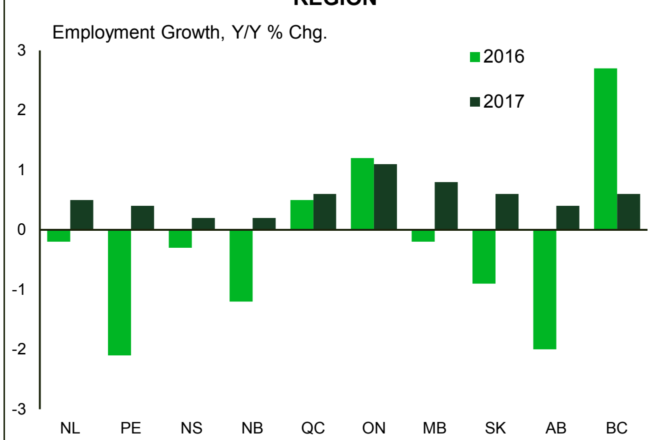
On the bottom of the growth table, employment in both agriculture and the forestry, fishing, mining, and oil and gas sectors is expected to be broadly flat – still a positive development relative to the sizeable job losses since the beginning of 2015. The remaining private sector categories fall somewhere in between, developing largely in line with overall economic output.

For the public sector, our models suggest effectively flat hiring over the next six quarters. In part this reflects an expected post-census pullback of employment, as well as a lack of meaningful impetus for further hiring. Most of the federal government stimulus will have employment effects via its use, feeding into construction and other categories, rather than public administration itself, where provincial budgets in particular remain strapped.

Uneven employment growth across the provinces

While there is only modest variation in the employment outlook across major industries, the same cannot be said for the provincial outlook. As detailed in our July 2016 Provincial Economic Forecast, job gains and unemployment

CHART 7. EMPLOYMENT GROWTH VARIES BY REGION



Source: TD Economics. Forecast as at July 2016.

rates are expected to vary widely across the country. Strong job growth is forecast for B.C., Ontario, and Quebec, all of which benefit from a favourable industry mix. In contrast, commodity-focused provinces, notably Alberta and Newfoundland and Labrador will see job losses this year, extending into 2017 in the latter case (Chart 7).

Positive job growth is expected across the provinces in 2017 (with the exception of Newfoundland and Labrador). This will help stabilize provincial unemployment rates, albeit at elevated levels relative to recent norms. For instance, Alberta's unemployment rate is expected to average 7.3% in 2017, a modest decline from its current level of 7.9%, but still a far cry from its 2014 level of 4.7%.

Bottom Line

The unemployment rate fell slightly in the first half of the year despite only modest job growth in line with the economy's overall performance, helped along by a falling participation rate. Still, our labour market indicator points to a job market that has continued to make some moderate headway. Looking to the next six quarters, job gains are expected to be driven by healthcare, while tourism-related industries are likely to see continued gains. Manufacturing is likely to reverse its recent pace of net job losses, while commodity-related industries will also see their trend of declining employment come to an end – although net job gains are likely to marginal at best in the case of the latter.

Across the provinces, near term gains are expected to accrue largely to B.C., Ontario, and Quebec. However, with the exception of Newfoundland and Labrador, all provinces should see employment rise in 2017. Meanwhile, we don't believe the recent drop in the labour force will be sustained going forward, setting the stage for a modest uptick in the unemployment rate. For 2017, the Canada-wide unemployment rate is projected to average 7.0%.

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