TD Bank Financial Group

# TD Economics

Special Report

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## CANADIAN JOB MARKET TO BE MORE SEDATE IN 2008

Amidst the well publicized woes of the credit markets and the troubled manufacturing and export sectors in 2007, the Canadian job market didn't flinch. A total of 355,000 jobs were created – the most jobs seen in a single year since 2002. Of course, where you lived made all the difference. While the country as a whole enjoyed a falling unemployment rate that averaged 6.0% in 2007 compared to 6.4% in 2006, there were stark differences among the provinces. For instance, Ontario's ego took a hit last year when, for the first time in history, the provincial unemployment rate exceeded the national rate for the entire year. In contrast, employers were hot on the trail of workers in the Western provinces, where unemployment rates were 1.5-2.5 percentage points below the national average. And, even though the Eastern provinces did not depart from tradition with higher rates of unemployment relative to the nation, bragging rights could still be bestowed to New Brunswick, P.E.I. and Newfoundland and Labrador where average annual unemployment rates tumbled nearly a full percentage point or more.

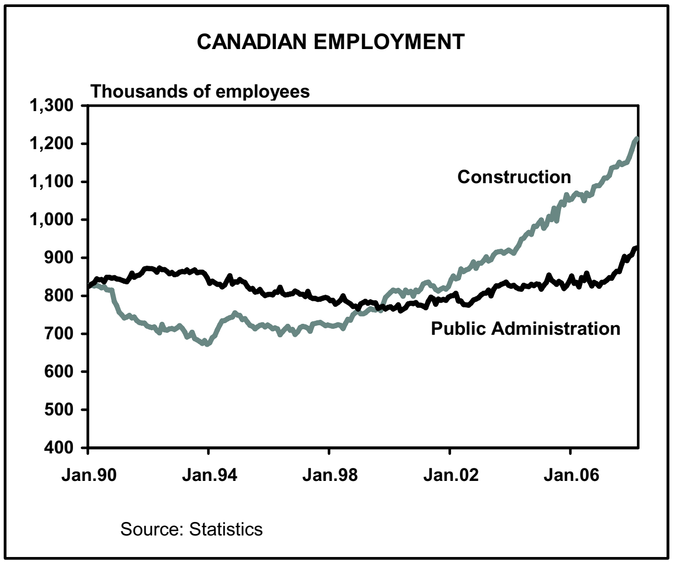
Perhaps most remarkable of all was that the job market flourished in an economy that grew 2.7%, which in itself is merely an average performance blemished by the fact that momentum practically stalled at the end of the year. How could there be this disconnect between an extraordinary job performance alongside a rather ordinary economic performance? For one, two sectors – construction and public administration – accounted for more than 40% of all new jobs in 2007 even though they make up only 12% of real economic activity. Second, while manufacturing activity languished in 2007 – and so too did employment – domestic demand had a phenomenal year, sustaining growth at +4% for the fourth consecutive year. This string of strength has not been seen since the mid-1970s.

### HIGHLIGHTS

- **An ordinary year for GDP growth in 2007 was met with an extraordinary year for job growth.**
- **The construction and public administration sectors accounted for just over 40% of all new jobs.**
- **Quebec, Alberta and Ontario topped the hiring charts, but only Alberta saw meaningful growth in private sector employment that mirrored robust economic activity in the province.**
- **Real wages rose across the nation, and momentum seems to have carried forward into 2008.**
- **A weakened economic backdrop in 2008 does not bold well for another robust year in employment growth.**

Little wonder that job demand remained high for skills in sectors like professional/scientific, information/culture, retail, wholesale and other services.

The jobs market in 2008 has already gotten off to a strong start. Not only were employers in construction and public administration still earnestly seeking out new hires, but so too were firms in the professional/scientific sector. In the first three months of the year, these three sectors have beefed up payrolls by a combined 118,000 positions – one third of all the jobs created in 2007! Can this momentum be sustained? We think not. Since job markets lag economic cycles, the labour momentum in the first quarter of 2008 will be difficult to sustain in an environment with economic activity expected to expand by only 1.1%. Even if we just consider domestic demand growth, the quarterly




pace is expected to average slightly below 3%, a full one-and-a-half percentage points less than the average quarterly pace in 2007. So any way you slice the data, the Canadian job market will have a weaker backdrop in 2008 that will be more conducive to an environment that will add 5,000 positions per month, as opposed to the 32,000 monthly average of 2007.

**Who's got them, who needs them?**

The public administration sector went toe-to-toe with the construction sector last year to see which would hire the most workers. Public administration won out with 78,300 new hires, compared to almost 74,000 new construction positions. However, that's where the similarities end between the two.

The construction sector has been adding workers steadily since 2002. Housing demand kicked into high gear on improved affordability when the Bank of Canada slashed interest rates by a cumulative 325 basis points in a little over a year. Following the initial rate cuts, the prime lending rate bounced around a low range of 3.75-4.5% for the better part of four years, keeping the fire lit under housing demand. It wasn't long before housing starts revisted 20-year highs and homeowners sought to renovate their existing or recently purchased homes. Meanwhile, when new housing subdivisions are built, water, sewer lines and other infrastructure need to be put in place. The expansion in population in a region can also create demand for nearby retail facilities. So demand for construction workers was not isolated to homebuilders, but rather, the effect rippled through to workers in a number of specialty trades and non-residential construction. In addition the Western provinces were benefiting from a boom in commodity prices and non-residential investment that further intensified demand for construction workers in these areas. By the time 2007 came to an end, a total of 339,000 construction workers had been hired since 2002, over 90% of which occurred in Ontario, Quebec, Alberta and British Columbia. Within that six year time span (2002-2007), 2007 was the strongest year with 74,000 construction workers added to payrolls, the bulk of which were in Quebec and Alberta.

While the construction sector had been on a hiring spree for many years, heightened demand for workers in the public administration sector was more of a new phenomenon. This sector had shed 12,000 workers in 2006 alongside stagnant job growth since the start of the decade. From 2000-2006, a total of only 56,000 positions were created, barely offsetting the 48,000 employees shaved from payrolls in the prior decade. However, 2007 marked the comeback year. Growth in broader public sector jobs (which would include healthcare workers, educators etc) surged by 6.7%, three times the growth for jobs in the total economy. Part of this growth reflects the fact that all levels of government have seen improved fiscal positions in recent years, thereby allowing governments to make up for lost ground after significant job cutbacks in the 1990s. During that entire decade a paltry 13,600 public sector jobs were created (compared to 879,100 private sector jobs). Health care is one area that has been a recipient of extra funding and stronger job growth. The share of provincial and territorial program spending dedicated to health care was 42% in 2006, 10 percentage points higher than a decade earlier. Likewise, 102,000 health care workers were hired in 2006, and an additional 45,000 workers found jobs in the sector in 2007.

In contrast, private sector job growth stalled in 2007 at 0.3%. Of course, this brings to mind the question as to whether the impressive 2007 job performance was really that impressive at all if the private sector was unable to generate much in the way of new jobs. After all, hiring activity in the private sector is a barometer for the underlying health of the economy. The manufacturing sector's loss of nearly 130,000 jobs in 2007 was a particularly weak sign.

However, the manufacturing sector is in a cycle rather unique to the rest of the economy. Hit by a barrage of negative external influences, including lost competitiveness from a rising currency, increased global competitive pres-

| CANADIAN JOB GROWTH BY INDUSTRY (DECEMBER 2006 - DECEMBER 2007) | | |
|---|---|---|
| | NEW JOBS (Thousands) | GROWTH (Per Cent) |
| **Goods-Producing Industries** | **-42.8** | **-1.1** |
| Construction | 73.9 | 6.8 |
| Forestry, Fishing, Mining, Oil & Gas | 12.0 | 3.5 |
| Utilities | 16.2 | 13.0 |
| Agriculture | -15.2 | -4.4 |
| Manufacturing | -129.6 | -6.1 |
| **Service-Producing Industries** | **400.9** | **3.2** |
| Health Care and Social Assistance | 45.0 | 2.5 |
| Accommodation and Food Services | 8.6 | 0.8 |
| Trade | 63.8 | 2.4 |
| Professional, Scientific & Technical | 57.2 | 5.2 |
| Information, Culture and Recreation | 65.2 | 8.9 |
| Public Administration | 78.3 | 9.5 |
| Educational Services | 20.9 | 1.8 |
| Other Services | 30.6 | 4.3 |
| Transport and Warehousing | 39.8 | 4.9 |
| Finance, Insurance, Real Estate | -0.4 | 0.0 |
| Business, building and support services | -8.2 | -1.1 |
| **TOTAL** | **358.1** | **2.2** |
| Source: Statistics Canada | | |

sures and, more recently, tempered U.S. demand, the manufacturing sector has shed a total of 347,300 jobs in a little over five years (November 2002-December 2007). Real output in the sector has contracted in three of the five years. In contrast, over that same period, real domestic demand in Canada has expanded by an average annual pace of 4.2%, which is above the historical norm.

As an example of this dichotomy, the growth in private sector jobs when the manufacturing sector is excluded from the tally resulted in job growth of 1.9% in 2007, a far cry from the headline rate of 0.3%. Among the big gainers were information/culture (+65,200), professional/scientific (+57,200), retail trade (+45,500), transportation/warehousing (+39,800) and the list goes on. As the first quarter of 2008 closed, most of these sectors retained their strength, particularly professional/scientific which tacked on a massive 45,000 jobs over the three months.

### You can go your own way

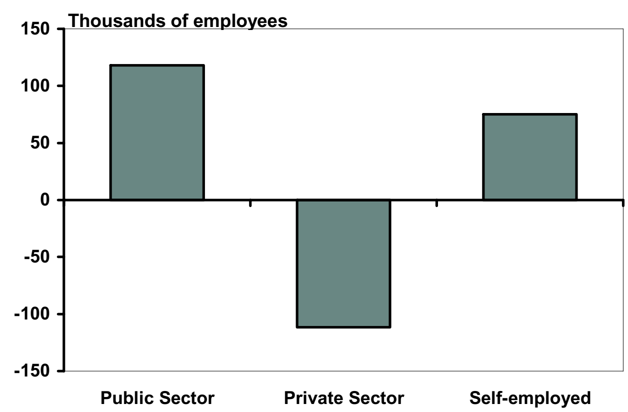
There was also a big movement towards self-employment last year. A massive 109,700 individuals became their own boss, marking the largest gain in five years. As economists, we're always suspicious when a big shift occurs towards self employment. It could be an indication of weak labour market conditions or a trend towards greater job contracting or outsourcing. But, it can also be an indication of labour market tightness if a greater number of individuals are choosing to be self-employed for personal reasons rather than being pushed into it under more difficult economic conditions. Although intuitively it would seem that Canada's tight labour market conditions in 2007 would argue in favour of choice, the evidence is not entirely conclusive on this. Two-thirds of the newly declared self-employed positions occurred in a single province, Ontario, where 7 of 15 industries had shed jobs in the year. Self employment rose within a mix of industries that were both active in hiring and those that were not.

In contrast, the nearly 10,000 self employed additions in Alberta likely represented personal preferences given that the province had an unemployment rate at a historic low of 3.2% at the end of the year and firms were out in full force trying to attract workers.

### Three provinces dominate hiring spree, but for different reasons

Regionally, all the provinces contributed to job growth in 2007, but three in particular – Ontario, Quebec, Alberta – accounted for three-quarters of all the job gains. However, the industry mixes and economic drivers within the provinces produced vastly different hiring trends. For instance, the largest Canadian province by economic mass – Ontario – added 81,500 jobs in 2007, representing 23% of all jobs created in the country. For a province that makes up 40% of national economic activity, Ontario did not pull its weight on the job front. This outcome is not surprising given that nearly 20% of real economic activity in the prov-

**2007 ONTARIO EMPLOYMENT: BY CLASS OF WORKER**




Source: Statistics Canada


ince is directly related to the manufacturing sector, compared to only 14% for the rest of the nation. All told, Ontario's manufacturing sector cut nearly 64,000 positions in 2007, which marked more than half of all private sector jobs that were shed in the province that year. In addition to this, jobs in forestry, agriculture, construction and finance were also in the loser's column. It may seem odd to see a loss of construction workers when demand for these workers was high elsewhere in the nation, but in Ontario, housing starts declined in 2007, and the province does not have the offsetting strength in non-residential demand created by the commodity boom that exists elsewhere in the country. All the job growth in the province stemmed from the public sector and self-employment.

Alberta's job market trends were the polar opposite to Ontario's in 2007. First, Alberta added more workers than Ontario in spite of the fact that it is about one-third the economic size of Ontario. Second, of the nearly 84,000 new hires in the province, the bulk were in the private sector (+51,000), with relatively diverse distribution across sectors. It's no surprise here that the booming commodity cycle that started several years in advance, particularly for oil/gas, created positive ripple effects to the broader Albertan economy.

Among all the provinces, Quebec created the most jobs in the country (+91,300), representing nearly 26% of all new jobs in 2007, which wasn't too far off its economic size of 20% of national GDP. Like Ontario, virtually all were in the public sector (47,000) and the self employment sector (36,000). Also like Ontario, the large manufacturing base cleared out nearly 40,000 jobs from the private sector.

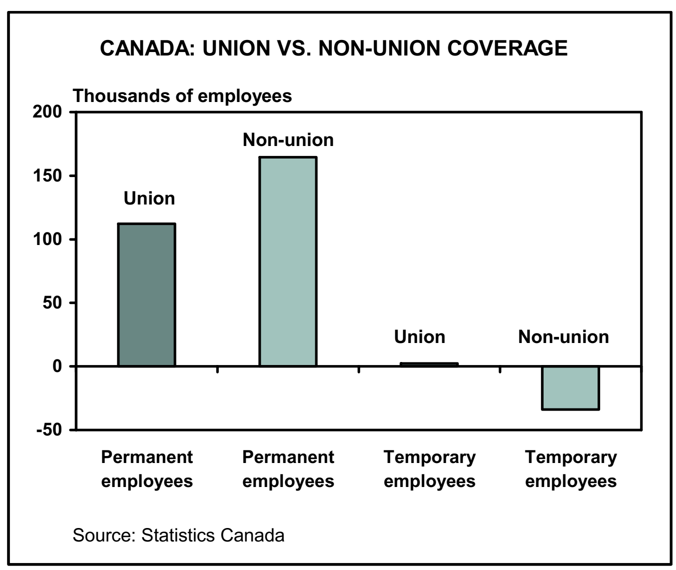
**Public sector hiring = increase in union jobs**

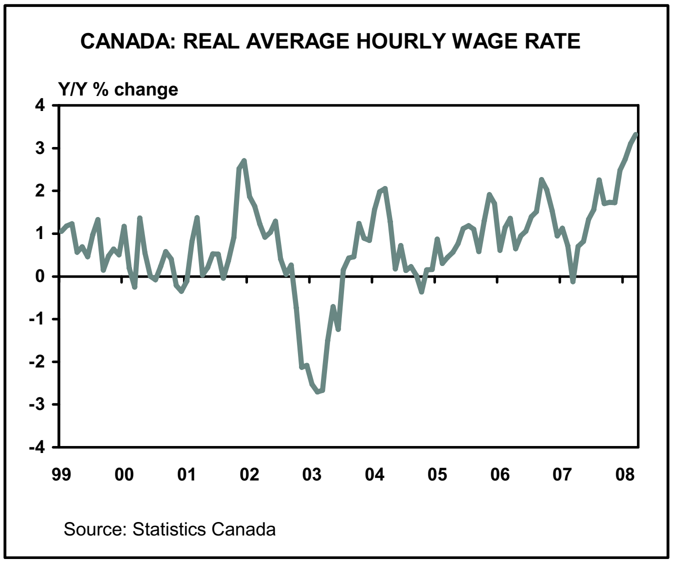
With the public sector dominating the hiring charts in the two largest economies in the country, it's probably safe to say that many of these positions were unionized. As such, union jobs gained significant ground in 2007, in spite of well-publicized losses in a number of union manufacturing jobs. The number of employees covered by a union increased by 114,400 last year, nearly on par with the increase of non-unionized employees (+130,700), and the second largest increase in a decade (data extends only to 1997). And, the vast majority of the new hires covered under a union contract were permanent employees.

From a wage perspective, union jobs generally command higher wages than their non-unionized counterparts. According to Statistics Canada data, wages for permanent unionized positions received an average of $4.06 more per hour of work than their non-unionized counterpart in 2007.

Many of the sectors that experienced strong job growth in 2007 were sectors that tend to have a high concentration of union-related positions or were high-paying sectors in general. In particular, relative to the national average hourly wage rate, public administration positions received an average of $6.68 more, while health and educational positions received $5.31 and $1.17 more per hour, respectively. Meanwhile, the highflying mining/oil/gas industry paid an average of $6.58 over the national average, while professional/scientific positions were topped up by an extra $5.64.

But straight hourly wage rates can be deceiving. A number of the jobs lost in the manufacturing sector were






in the auto industry where the Big-3 auto makers pay an average hourly wage rate of US$77 when benefits are included in the tally.[1] As such, workers displaced in the manufacturing sector would likely experience significant losses in long-term earnings. Statistics Canada concluded that the income loss of displaced workers is in the range of 25% in new jobs.[2] Plus, a former manufacturing worker would likely require significant retraining and possibly even relocation in order to transition to a service-sector job or an oil/gas position, so it's not a simple matter of moving from an industry in decline to one of growth.

### Real wages on the rise

Nonetheless, labour markets were tight across the nation, irrespective of significant losses in manufacturing, and with that, many workers experienced a welcome rise in real wages. Real average hourly wages rose by 2.5% in Canada, with much stronger gains in Alberta (+4.7%) where labour markets were tightest. And, it appears that momentum carried forward into 2008. Real wages rose at a 3.3% clip in the nation by the end of the first quarter, with most provinces benefiting from a pick-up in wage growth from the end of last year. In particular, Ontario was tracking 3.7% in March 2008 compared to 2.8% in December 2007. Quebec saw an increase from 1.6% to 2.4%, while a number of western provinces maintained real wage gains in the 4% range (Manitoba, Saskatchewan, Alberta).

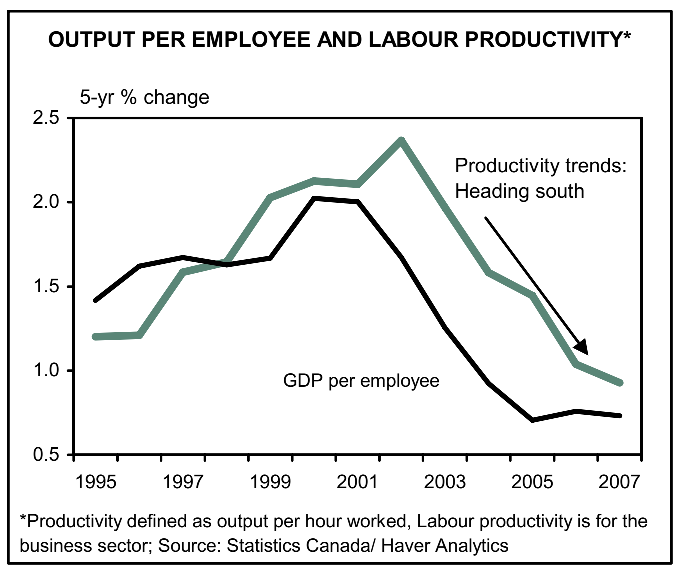
### Productivity languishes in Canada

Although workers were in high demand in 2007, productivity growth languished. In order to grow the Canadian real economy by 2.7% last year, it took a 2.2% increase in hours worked. Simple math shows that the end result was meager Canadian productivity growth of just 0.5%. In contrast, the U.S. economy required a modest 0.4% increase in working hours to produce a 2.2% economic expansion in the same year. The difference in performance almost seems like a set-up to a joke. How many Canadians does it take to screw in a light bulb? One to put in the light bulb, and three to turn the person.

While that may seem facetious, it does raise an important question as to why the Canadian economy required many more hours worked for an economic performance that was relatively indifferent to that of our southern neighbor. There is no single explanation, but a number of factors seem to have come together to undermine productivity growth in Canada.

For one, industry composition matters. The manufacturing sector with all its economic troubles was still a highly productive industry in Canada. It churned out 1.9% productivity growth last year, as it was able to squeeze more output out of every worker. However, high-employment growth industries like construction were at the opposite end of the spectrum. Working hours rose by an average of 7.2% last year, outpacing output growth with the result being a near-3% *contraction* in construction productivity.

There could be measurement issues when it comes to the construction industry on two levels. Productivity may become underestimated when there have been substantial quality changes – such as more energy efficient or lower maintenance structures – that are not appropriately re-



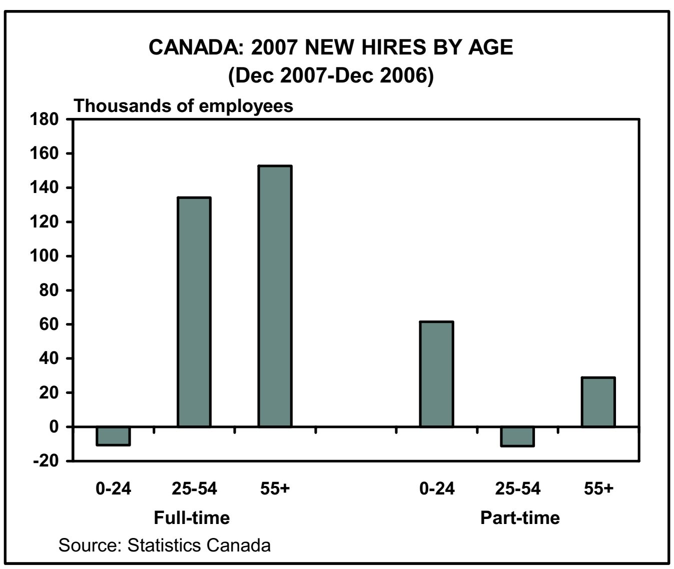
flected in a price index. When this occurs, prices become biased to the upside and, likewise, real output and productivity gains become biased to the downside. In addition, the construction industry seems to be prone to underground activity that distorts productivity gains. One regional study found that workers have a greater incentive to underreport income when filing tax returns and to overestimate their hours worked when responding to the Labour Force Survey.[3]

Irrespective of the reason behind weak productivity in construction, the end result is that this industry has dampened national productivity estimates.

But the construction industry isn't solely to blame for Canada's languishing productivity performance, as a number of other sectors also failed to pull their weight. For instance, the commodity price boom made it more profitable for the oil/gas industry to exploit less productive, non-conventional oil and gas wells.[4] Thousands of workers have been hired to work on mega projects that may not produce meaningful quantities of oil for years. As a result, output per employee in the exploration and extraction industries has fallen sharply.

More generally, the tightness in the labour market, as evidenced by a 33-year low in the unemployment rate, may have compelled firms to engage in less-than-optimal hiring practices. Against a dwindling supply of workers, employers may be hoarding existing workers or hiring less qualified employees. The latter would require workers to climb a steeper and longer learning curve before they could become efficient in the task at hand.

These factors may be evident by the fact that there




were not only more older workers (55+) hired in 2007 than those in their prime working years (25-54) – which has only happened one other time – but that the amount of workers hired that were 55 years of age or older was also the largest on record (1990). While older workers can bring plenty of experience to the workplace, they can also have less attachment to the labour force and require significant training due to eroding skills or the development of a new career.[5]

Productivity may have also suffered given that employers may have resorted to more part-time workers as a stop-gap measure to labour scarcity. Nearly one-quarter of all new jobs in 2007 were part-time hires, and these were predominantly filled by young workers aged 15-24 who tend to have less experience and training. The increase in part-time workers was likely a byproduct of tight labour markets given that Statistics Canada data show that all new part-time positions were taken up on a voluntary basis in 2007, not because of a lack of availability in full-time positions.

## OUTLOOK

With the Canadian economy expected to slow to only a 1.1% pace in 2008, job growth will surely follow suit. At the moment, this seems like a bold call. The Canadian economy chalked up 104,300 new jobs in the first quarter, which, if sustained, would put it on track to greatly outperform 2007. However, labour market developments lag the economic cycle, and it won't be long before weak economic growth is reflected in the overall employment data. Economic activity in the final quarter of 2007 slowed to a crawl of 0.8% annualized growth, and the first quarter of this year looks little better. In addition, more than half the jobs created in the first quarter came out of Ontario, the one province that will likely flirt with a recession in 2008. And, there were some oddities in Ontario's hiring trends that are almost certain not to be sustained. For instance, half of the province's jobs were created in the construction sector, which likely represented a last gasp. Certainly, jobs in the manufacturing sector will remain in decline as the industry struggles through a U.S. recession and high dollar. Meanwhile, it's probably safe to say that Ontario's large financial base will take a more cautious approach to hiring in the midst of a global credit crunch. Lastly, the eventual squeeze on government revenues due to weak economic conditions also places the strong hiring trend in the public sector in a more tenuous position.

As for last year's biggest employer – Quebec – the province has added a mere 3,000 jobs in the first three months of the year. This is not a great start, but certainly more consistent with our expectation that economic growth will plod along at 1% in the province this year. The top job performers should remain concentrated in the Western provinces where economic activity is expected to grow at two-to-three times the national average. However, with the exception of Saskatchewan, even these provinces are looking at slower economic conditions than last year. Plus, even if the Western provinces went on a hiring spree, the strength would likely not meaningfully overwhelm weakness in the largest two provinces in the country. For instance, the second largest employer last year – Alberta – is only tracking jobs at just over one-third the gains seen in the first quarter of 2007.

For the Canadian economy as a whole, rather than the average 32,000 net new positions created every month in 2007, we expect the labour market to tack on only about 3,000 to 5,000 new jobs per month in 2008. Likewise, the unemployment rate is expected to rise from recent generational lows to about 6.4-6.5% by the end of the year.

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## Endnotes

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