TD Bank Financial Group

TD Economics

Special Report

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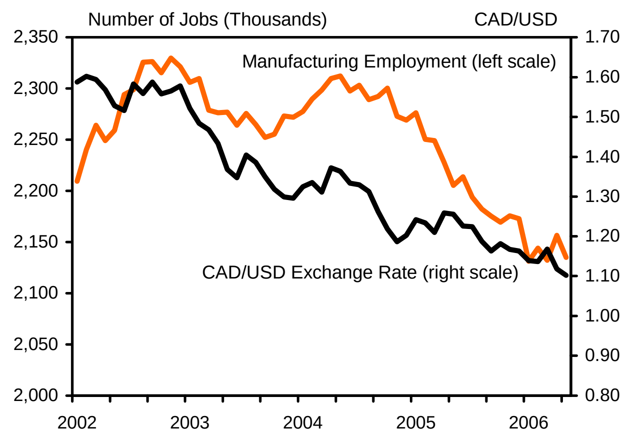
DOMESTIC RESILIENCE TRUMPS MANUFACTURING WOES IN CANADA'S LABOUR MARKET

Canada's labour market has grabbed a great deal of headlines lately, especially with last week's report for the month of May, which featured an unemployment rate of 6.1% – the lowest level on record since December of 1974. A significantly less nostalgia-inspiring headline noted the continued job losses in the manufacturing sector, which since beginning its decline in December 2002 has contracted by 8% or nearly 187,000 jobs. Interestingly, the past peak employment in the manufacturing sector coincided with a value of the Canadian dollar of 64 U.S. cents in late 2002, fractionally higher than the record low of 62 U.S. cents observed earlier that year. Since that time, the dollar has appreciated by nearly 40% to stand in the neighbourhood of 90 U.S. cents. So why haven't both the rise in the value of the dollar and the job losses in the manufacturing sector had a greater injurious impact on the aggregate labour force data? The answer lies in the sectoral composition of the job gains and highlights a set of potent offsets that have pushed the unemployment rate down to a level that was last seen when Barbra Streisand was at the top of the charts.

CAD/USD EXCHANGE RATE AND CANADIAN MANUFACTURING EMPLOYMENT

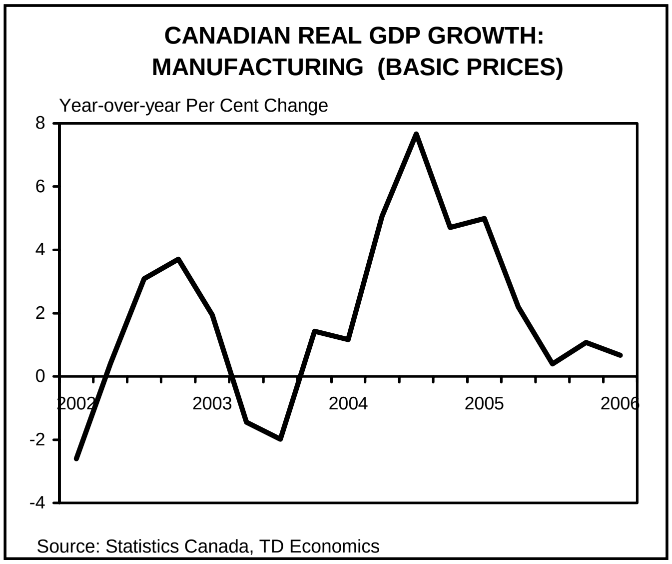


Source: Statistics Canada, TD Economics

What the dollar takes away…

The flight of the loonie clearly has had a role to play in the job losses within the manufacturing sector. However, in an international context, many industrialized countries share Canada's experience of declining manufacturing employment but without the same degree of exchange rate appreciation. For example, since the end of 2002, employment in Germany's manufacturing sector has fallen by 5.6% while the euro has appreciated by a relatively modest 16% against the U.S. dollar. Furthermore, in the case of the United States, the job losses in the manufacturing sector (4.7% since the end of 2002) have come at a time when the trade weighted exchange rate actually *depreciated* by 15%. This suggests that an important part of the explanation for the international trend of job losses in the manufacturing sector is the emergence of low cost producers in China and India, as well as rising North American market share of exports from other countries like Japan and Korea who have heightened global competition for manufactured products.

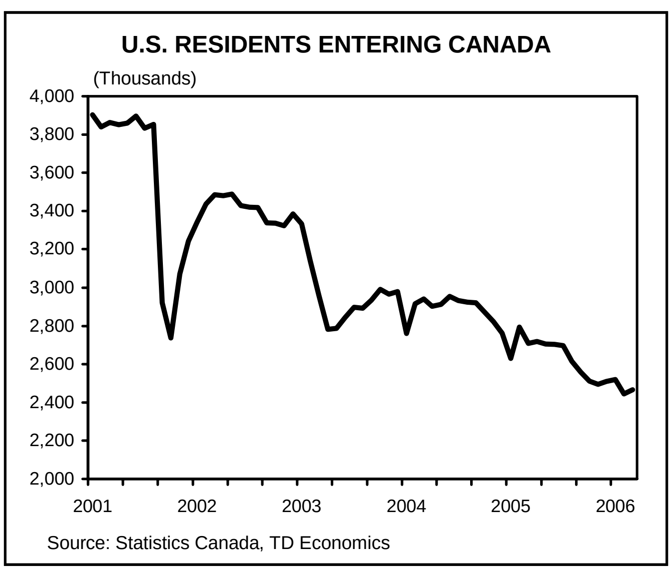
The combination of the higher dollar and increased global competition has necessitated a significant restructuring of Canada's manufacturing sector, epitomized by the magnitude of job losses. During this time, however, the year-over-year growth rate of output, which has slowed in recent years, has yet to register an outright decline, limiting the negative spillover effect to other industries. For example, employment in transport and warehousing, which



is closely tied to manufacturing, saw an increase in job creation, albeit at an extremely modest 2.8% growth rate.

The combination of job losses and continued production has pushed labour productivity within the manufacturing sector markedly higher. From this perspective, the elevated value of the currency has had a silver lining, as it reduced the cost of imports of productivity-enhancing capital goods, most of which are priced in U.S. dollars. This development has been reflected in the growth rate of imports of machinery and equipment, which in the last two years has rebounded after declining from 2001 through 2003.

The effect of the higher dollar has also affected industries outside of manufacturing. For example, there is some evidence to suggest that the tourism sector has also suffered. While Statistics Canada does not identify a unique tourism category in the labour force survey, a suitable proxy would be the accommodation and food service category, which has shown negligible job growth over the last three and a half years. This, when compared to the 8.4% increase in retail and wholesale trade, suggests that while the domestic economy continues to fuel job growth, the effect of the currency has limited the job gains in more tourism-sensitive sectors. Furthermore, data on travel between the United States and Canada have shown a deteriorating trend over the last three years, reflecting in part the effect of the higher dollar.



… the domestic economy swamps

In contrast to the 187,000 jobs lost in the manufacturing sector since December 2002, the other sectors of the economy have created a whopping 1.1 million jobs. These gains have been broadly based, but one of the strongest industries has been construction. Following the economic slowdown of 2001, the Bank of Canada cut interest rates by 275 basis points in a little over a year, providing the liquidity to fuel the housing boom. With the pace of home building and renovations increasing at a rapid rate, jobs in the construction industry blossomed as well, adding over 185,000 net new positions since the peak in manufacturing employment at the end of 2002. Employment in the

CANADIAN JOB GROWTH BY INDUSTRY (DECEMBER 2002 - MAY 2006)

	NEW JOBS (Thousands)	GROWTH (Per Cent)
Manufacturing	-186.5	-8.3
Forestry, Fishing, Mining, Oil & Gas	59.6	20.9
Construction	185.2	20.2
Finance, Insurance, Real Estate	151.7	16.2
Educational Services	124.5	12.1
Business, Building & Other Support Services	69.3	11.6
Professional, Scientific & Technical	90.4	9.0
Trade	207.2	8.4
Information, Culture and Recreation	54.9	7.7
Health Care and Social Assistance	116.5	6.9
Public Administration	53.7	6.5
Transport and Warehousing	21.7	2.8
Agriculture	6.6	2.0
Other Services	6.4	0.9
Accommodation and Food Services	5.1	0.5
Utilities	-7.3	-5.6
TOTAL	**959.2**	**6.1**

Source: Statistics Canada, TD Economics

CANADIAN JOB GROWTH BY PROVINCE (DECEMBER 2002 - MAY 2006)		
	NEW JOBS (Thousands)	GROWTH (Per Cent)
Alberta	176.3	10.2
British Columbia	212.6	10.5
Manitoba	14.7	2.6
New Brunswick	13.8	4.0
Newfoundland and Labrador	6.5	3.0
Prince Edward Island	5.0	7.6
Nova Scotia	17.0	3.9
Ontario	375.4	6.0
Quebec	129.0	3.6
Saskatchewan	8.9	1.9
TOTAL	**959.2**	**6.1**
Source: Statistics Canada, TD Economics		

construction sector also received an additional boost in Western Canada with the development of infrastructure projects in response to the sustained increase in commodity prices. The building boom has also resulted in increased employment in a range of other related services. For example, job growth in the category encompassing real estate, insurance, and finance increased by over 150,000 positions, while employment in business, building and other support services rose by 69,000 jobs.

Increased global demand for commodities has directly resulted in a significant jump in primary sector employment, which has risen by nearly 60,000 jobs or 21% since December 2002. The growth in the resource sector has also spilled over into a range of other industries, resulting in employment gains in support services and other trades. For example, employment classified in the professional, scientific and technical industries has increased by over 90,000 jobs, corresponding to a growth rate of 9%. Regionally, these gains have been led by Alberta and British Columbia, who are the only two provinces to experience double-digit job growth since the end of 2002. Furthermore, with the exception of 9 months, Alberta has had the lowest unemployment rate in the country over this period.

The improvement in Canada's fiscal position over the last three years has translated to a strong increase in public sector employment, which has grown by 8% and added nearly 300,000 jobs since the end of 2002. Within the public sector, educational services have shown the greatest rate of increase, growing by over 12% or 124,500 jobs. Health care has also seen considerable growth, expanding by nearly 7% by adding 116,500 new positions.

Outlook

Looking forward, a number of headwinds facing the Canadian economy will begin to restrain both the pace of aggregate economic growth and employment over the next two years. First, an expected mid-cycle slowdown in the U.S. economy will add to the woes faced by the manufacturing sector, implying further job losses. The slowing in the U.S. economy will also translate into a correction in commodity prices, which will help temper future employment growth through Western Canada. The pace of job creation in Western Canada may also see some signs of moderating as shortages for high skill positions persist. Furthermore, data has begun to show a slowing in the housing market, especially in Central and Eastern Canada. This trend is expected to continue and move West over the next two years, slowing the pace of job creation in the construction industry, although the level of employment will remain sky high. As the main pillars of job creation over the last three and a half years begin to weaken, employment in the related service industries will also begin to moderate somewhat. All told, growth the pace of job creation will peak in the current quarter with the addition of 98,000 jobs before slowing to a more trend-like growth of between thirty and forty thousand new jobs a quarter over the remainder of the year and into 2007. The unemployment rate is also expected to creep up modestly over the next seven quarters, reaching 6.6% by the end of 2007.

The bottom line is that the labour market will deliver a more moderate performance going forward, but continue to remain very healthy. Regionally, Western Canada will likely remain the engine for job growth, outstripping the gains in the rest of Canada. The value of the dollar will continue to exert an influence on sectors of the labour market but the economic performance of both the United States and Canada will play a more important role in forming the employment picture in the coming quarters.

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