



TD Economics

Special Report

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WHAT TO EXPECT IN CANADA'S LABOUR MARKET AS THE ECONOMY SLOWS

The recent performance of Canada's labour market has eclipsed that of the overall economy. While economic growth has remained solid, the labour market has expanded by leaps and bounds, recently setting a record high for the share of the working-age population employed. At the same time, the unemployment rate has fallen to, and remains at a generational low. Some concerns have been raised, however, regarding the ability of the economy to support such robust employment growth. Indeed, the last two labour force surveys showing small job losses were widely interpreted as a return to more typical labour market behaviour for this point in the economic cycle. The hope for robust future employment growth will be called increasingly into question as the Canadian economy is expected to slow over the next twelve months. Adding to the malaise is an expected pickup in labour productivity, which after remaining quite abysmal since 2000, will likely show signs of recovering over the second half of this year and into 2007, putting additional downward pressure on employment gains. This leads to the following question: Will the tether between the overall economy and the labour market run out and snap the labour market back down to earth or will Canada's job machine continue to soar?

Construction and health care have led the pack

In order to answer the above question, it is important to understand where the employment growth has been observed. Since the end of 2001, the labour market has added an astonishing 1.5 million jobs. While every industry classification, with the exception of manufacturing contributed to the increase, two industries stand out as having contributed the greatest, and coincidentally, the same number of net new positions. Both the construction industry and

CANADIAN JOB GROWTH BY INDUSTRY (DECEMBER 2001 - JULY 2006)		
	NEW JOBS (Thousands)	GROWTH (Per Cent)
Goods-Producing Industries	246.7	6.6
Construction	249.5	30.3
Forestry, Fishing, Mining, Oil & Gas	51.4	18.7
Agriculture	42.2	13.9
Utilities	0.9	0.7
Manufacturing	-97.4	-4.4
Service-Producing Industries	1296.5	11.5
Health Care and Social Assistance	249.9	16.0
Trade	242.6	10.2
Educational Services	175.9	17.7
Finance, Insurance, Real Estate	164.2	18.6
Business, Building & Other Support Services	137.7	24.9
Professional, Scientific & Technical	106.7	11.0
Public Administration	63.2	7.9
Accommodation and Food Services	57.7	6.0
Information, Culture and Recreation	41.9	5.9
Transport and Warehousing	33.1	4.4
Other Services	23.8	3.5
TOTAL	1543.3	10.3

Source: Statistics Canada, TD Economics

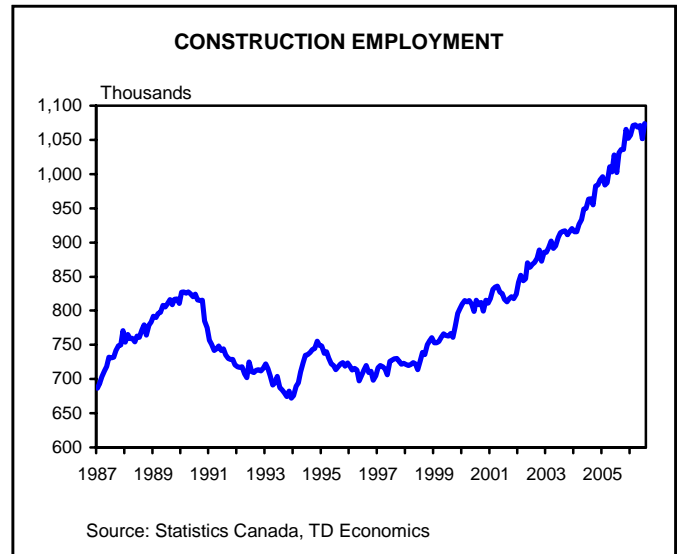
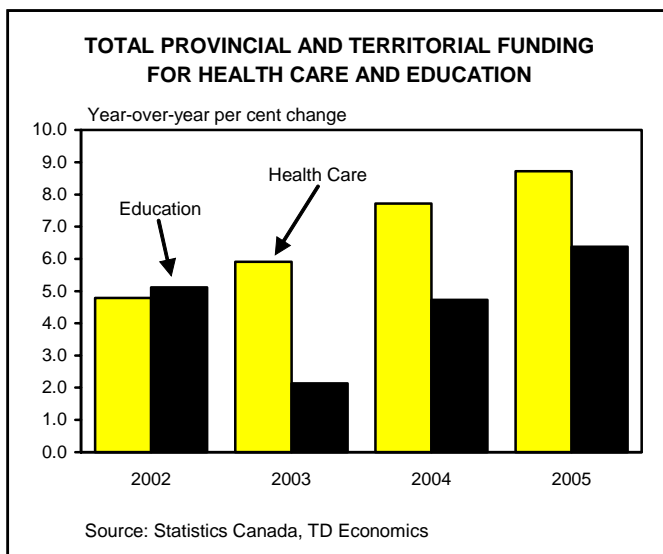
health care and social assistance grew by 250,000 jobs between the end of 2001 and July of this year.

The job gains observed in the construction industry account for virtually all of the net new employment in the goods-producing sector. The strength in the construction sector since the end of 2001 should come as no surprise given the backdrop of the housing boom taking place during this time. Spurred by extremely accommodative monetary policy following the implosion of the equity bubble in 2001, housing starts increased dramatically as greater affordability raised demand. With higher home prices

came rising household wealth, allowing existing homeowners to extract increasing amounts of equity from their homes. Part of this equity was subsequently returned either to new homes or back into existing properties in the form of renovations and other improvements, adding an additional source of demand for construction employment.

The construction industry has also benefited from investment in the non-residential sector. This investment has primarily taken place in Western Canada and has been focused on the infrastructure projects related to the commodities boom. The sustained increase in the price of most commodities has also had a direct effect on employment in primary industries. Employment in the fishing, mining, oil, and gas industries has shown the second-largest increase in new jobs in the goods-producing sector. While the size of these gains since the start of 2002 totals approximately 20% of the new positions created in the construction industry, employment in the primary industry has shown a considerable degree of upwards momentum over the last two years, in tandem with commodity prices.

Turning to the other major job gainer, the boom in health care and social assistance employment reflects renewed fiscal investment in the health sector. With higher federal transfers and increases in their own funding, health care has risen to 42% of provincial program spending, 10 percentage points higher than a decade earlier. The improved fiscal position of all levels of government has also translated to more financing for education spending. In fact, employment in education has increased by 176,000 jobs since the end of 2001, and stands as the third highest job growth industry among service-producing industries.



Manufacturing and construction to bear the brunt of the slowdown

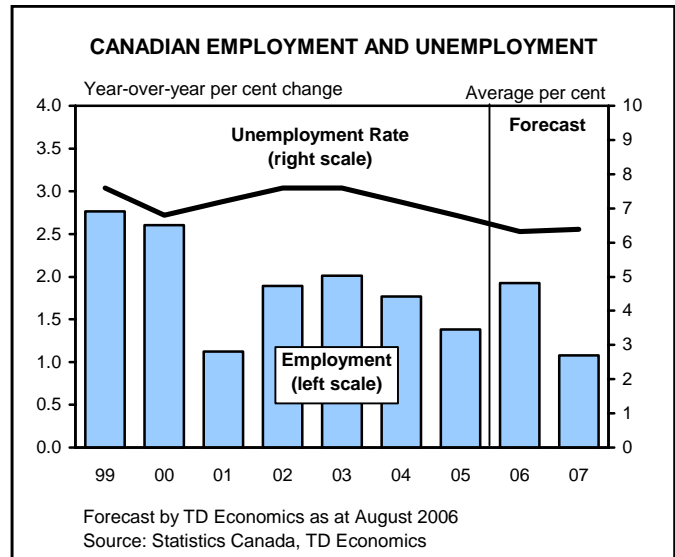
The second step in answering the question posed at the outset is to understand the nature of the upcoming economic slowdown and to assess its impact on the labour market. The primary cause of slowing economic activity in Canada over the next twelve months is most likely to be a weaker performance by the U.S. economy. Underlying the U.S. slowdown is a moderation in consumer spending motivated in large part by a deceleration in the housing market. With slower U.S. consumption on the horizon, demand for Canadian products will also moderate, reducing exports and overall economic activity. As a result, a likely source for job losses will come in industries directly related to trade with the U.S. such as manufacturing. In some sense, this is not a new story since the manufacturing sector has suffered substantial job losses as the industry has struggled to adjust to the soaring loonie, elevated energy costs, and enhanced global competition. Since the end of 2001, employment in the manufacturing industry has declined by 4.4% or roughly 100,000 positions. In addition to manufacturing, industries that support Canada's trade such as transport and warehousing will likely see job losses. Meanwhile, on the services side, tourism-sensitive industries, such as accommodation and food services, are expected to record meager job gains.

A second component of Canada's economic slowdown is the lagged impact of more restrictive monetary policy. The Bank of Canada has removed a substantial amount of stimulus from the economy over the last two years, bring-

ing their overnight lending rate from 2.00% in August of 2004 to its current value of 4.25%. The interest rate sensitive construction industry will feel the brunt of the tightening, reflecting the flipside of the gains made during the period of falling interest rates beginning in 2001. In all likelihood, the residential construction industry will likely see some job losses over the next twelve months as the pace of new construction slows, especially across Central and Eastern Canada, a development that is already showing up in the recent data. Limiting the severity of this fall will be continued demand for workers on non-residential projects across Western Canada related to continued development in the primary sector and strong housing demand out West.

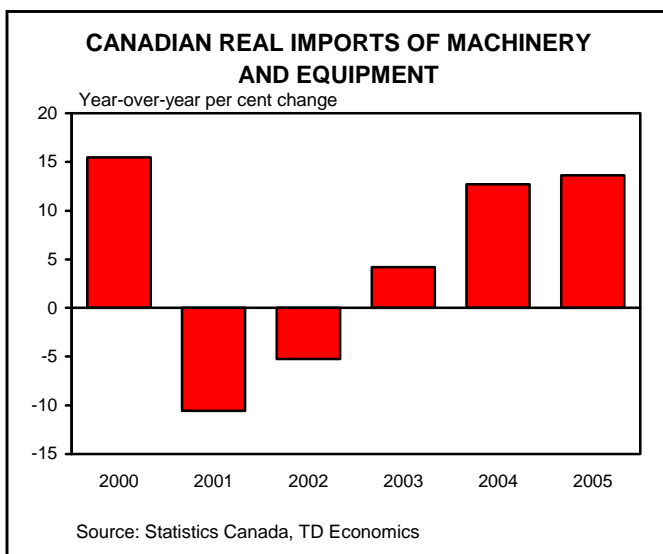
Domestically-orientated job growth will remain healthy

Of course, the outlook for the labour market is not without some potent offsets. In fact, measured on aggregate, growth in the labour market is expected to remain fairly robust despite the slowing in overall economic activity. TD Economics predicts that the pace of job creation will slow from the 27,000 net new jobs added per month since the end of 2001 to 14,000 through the end of the year before hitting a trough of an average of just 10,000 new jobs over the first three months of 2007. The labour market is then expected to recover somewhat through the second half of 2007 with the addition of a monthly average of 18,500 new positions. So while on an aggregate level, employment growth is expected to remain positive, it will likely under perform the trend-like monthly addition of between 20,000 and 25,000 net new jobs traditionally as-



sociated with the TD Economics forecast of 4th quarter over 4th quarter real GDP growth of 2.9% in both 2006 and 2007. An expected recovery of labour productivity will also contribute to the weakness in employment as firms have used the elevated value of the Canadian dollar to import new capital goods. For example, imports of machinery and equipment have risen by double-digit growth rates in each of the last two years, the first such increase since 2000. Meanwhile, the unemployment rate will undulate around the 6.4% reported in June for the next year and a half, reflecting continued tightness in the labour market. One of the main reasons for this aggregate strength is that relative to previous periods of economic slack, the balance sheets of Canadian firms are extremely healthy and the level of operating profits remains near the record high set in the fourth quarter of 2005. As a result, the vast majority of firms are in a much better position to weather this economic downturn without resorting to layoffs or job cuts.

Specifically, there are some industries in which employment will likely remain robust as the economy slows.



AVERAGE LABOUR PRODUCTIVITY	
Long Run Average (1981Q2 - 2006Q1)	1.4
Recent Period (2001Q4 - 2006Q1)	1.1
Forecast (Real GDP per Employee)	
2006Q2 - 2007Q4	1.3
2006Q2 - 2006Q4	0.5
2007Q1 - 2007Q2	1.9
2007Q3 - 2007Q4	1.9
Source: Statistics Canada, TD Economics	

For example, slackening U.S. demand will likely blow some of the froth from commodity prices but strong demand from emerging Asia, and particularly China, will ensure that most commodity prices remain at an elevated level. As a result, job growth within the primary sector will remain respectable. Furthermore, Canada's fiscal position is expected to remain solid through the slowdown so the job gains observed across the public sector and in health care and education will remain intact.

There is also a pronounced regional dimension to Canada's labour market outlook. An additional source of support for the national labour market is provided by the gains made in the Western Provinces. Continued labour shortages, particularly in Alberta, will draw workers from across Canada, helping to keep a lid on jobless rates nationally. At 3.5 to 6.0 per cent, unemployment rates across Western Canada will remain the lowest in the country, with Alberta leading the pack. Unemployment rates are expected to edge higher across the country, but the regional disparities that have come to define Canada's economy will be preserved.

Returning to the question posed at the outset, Canada's labour market will continue to perform well over the coming economic slowdown. While the pace of new job creation is expected to slow, particularly in industries tied to international trade and in construction, the service industry will keep employment growing at an aggregate level. Looking further ahead, the weakness in the U.S. economy is expected to be short-lived. Similar to the 1995 mid-cycle slowdown, the soft-patch should last around four quarters with growth in Canada and the U.S. recovering by the second half of 2007. During this time it is unlikely that any significant slack will be built up in the labour market. Indeed, with the forecast for the unemployment rate to remain essentially unchanged, tightness in the labour market will remain a feature of the Canadian economy. This will allow wage and salary growth to outrun inflation, providing consumers with an extra boost to help the economy regain traction.

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