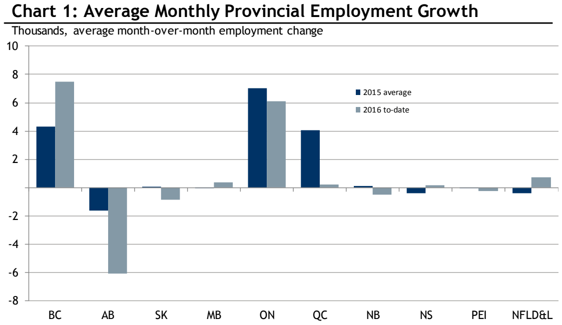
CURRENT ANALYSIS

July 2016

Canada’s labour market not as weak as it might first appear

A persistent feature of the ongoing oil price shock on the Canadian economy has been a divergence between the performance of labour markets and broader activity indicators. Overall GDP growth slowed sharply to just 1.1% last year from 2.5% in 2014 due largely to a sharp pull-back in investment in the oil & gas sector. In contrast, employment growth in 2015 actually strengthened at the national level (averaging 13K/month) from 2013 and 2014 (averages of 11K and 10K per month, respectively). To be sure, conditions in oil-producing regions have deteriorated; however, offset has come from stronger growth in other regions, particularly B.C. and Ontario (Chart 1).

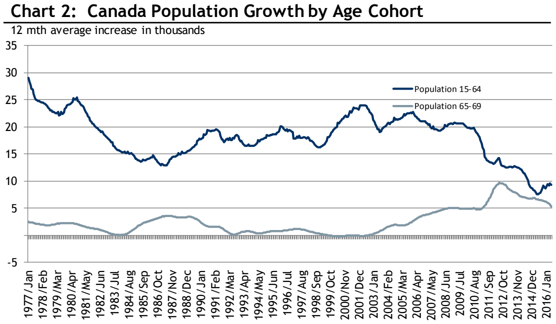
Chart 1: Average Monthly Provincial Employment Growth



Source: Statistics Canada, RBC Economics Research

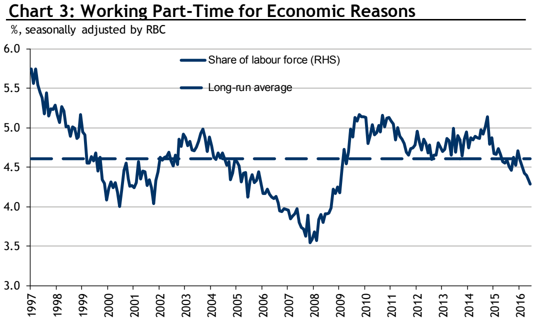
Job growth slowed somewhat in 2016, averaging 7K per-month year-to-date through June and with most of those gains reflecting part-time work. That has prompted some concern that the lagged impact of weaker activity in the oil & gas sector in 2015 is beginning to have a larger impact on labour markets in 2016. The monthly employment data is notoriously volatile, however, and, at least in terms of the headline count, underlying demographic trends (slower working-age population growth as the baby boom generation has begun to reach retirement age) are making it increasingly difficult to disentangle whether slower employment growth is the result of weakening demand or supply factors. Indeed, population growth slowed dramatically among the population aged 15-64 with sub-10K per month growth on average since 2013 less than half of the 20K per month average over the 30 years ending in 2009 (Chart 2). Slower working-age population growth means that, over-time, smaller employment gains are needed to absorb an excess supply of currently unemployed workers and maintain downward pressure on the unemployment rate.

Chart 2: Canada Population Growth by Age Cohort



The weighting towards part-time job growth year-to-date in 2016, on its surface, could also be concerning; however, those numbers are also volatile and the part-time concentration to-date this year follows a year in 2015 when 95% of job gains were of the full-time variety. Even taken at face value, the rise in part-time employment year-to-date in 2016 does not appear to have been involuntary. The total number of workers in part-time jobs due to ‘business conditions’ has actually been declining as a share of the labour force (Chart 3).

Chart 3: Working Part-Time for Economic Reasons



Source: Statistics Canada, RBC Economics Research

Is the ‘Canadian’ Labour Market Deteriorating?

Clearly, recent labour market outcomes have varied significantly by region within Canada. Digging beneath the headline employment numbers, however, somewhat surprisingly shows a relatively clear reduction in labour market slack, on balance, across most measures of labour market ‘tightness’ at the national level despite the still-challenging economic backdrop. The unemployment rate rose modestly through 2015 but not all that much from a historical perspective and has dipped lower in 2016. In June, the rate was just 0.1 percentage points (ppts) higher than its end-of-2014 level. To be sure, the relatively modest movements in the national rate hide more extreme swings on a regional basis with a sharp move higher in unemployment rates in oil-producing regions offset, for the most part, by declines elsewhere. The unemployment rate itself can also admittedly fall amid weak labour markets if worker discouragement results in unemployed people giving up their job search and thereby no longer being counted as ‘in the labour force.’ However,

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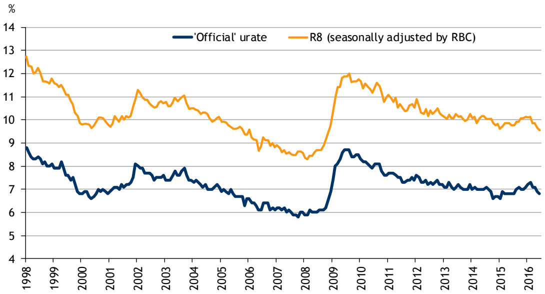
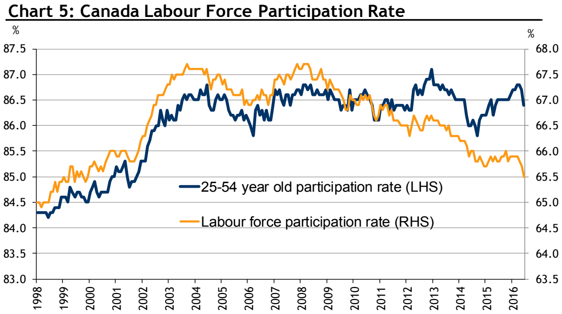
Chart 4: Unemployment Rate



Source: Statistics Canada, RBC Economics Research

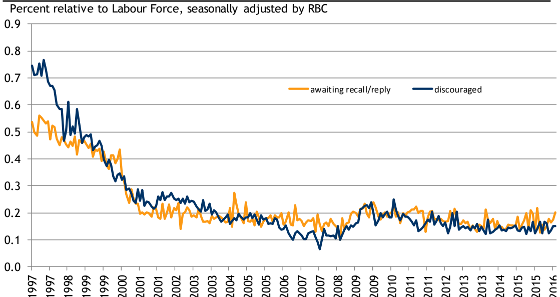
Chart 5: Canada Labour Force Participation Rate



Source: Statistics Canada, RBC Economics Research

Chart 6: Canada Want a Job but Not in Labour Force by Reason

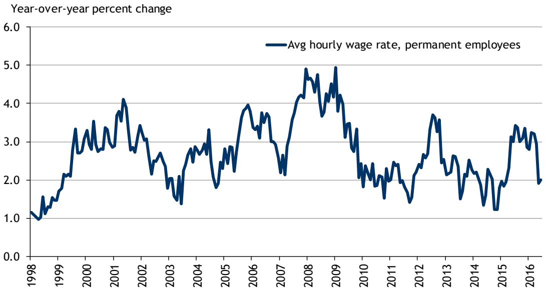
Percent relative to Labour Force, seasonally adjusted by RBC



Source: Statistics Canada, RBC Economics Research

Chart 7: Wage Growth

Year-over-year percent change



Source: Statistics Canada, RBC Economics Research

broader measures of labour market underutilization (including the so-called "R8" unemployment rate that includes both discouraged workers and those working part-time for economic reasons) have also slipped lower (Chart 4).

The labour force participation rate has been falling (hitting its lowest level since 1999 in June) but most if not all of the persistent downward trend in the measure can be explained by population aging (via a trend increase in the number of retirees in the population as discussed previously here). The participation rate for those aged 25-54 (the age cohort that accounts for the bulk of the working age population and is not impacted as significantly by demographic shifts) also pulled back the last two months but is still 0.2 ppts *above* its December 2014 rate (Chart 5). Moreover, participation rates can move higher or lower on a monthly basis for any number of reasons and there is little evidence that worker discouragement is trending higher. This is shown both by the recent decline in the R8 unemployment rate referenced above and by Statistics Canada's direct estimate of 'discouraged' workers which, along with other potential sources of cyclical labour market nonparticipation, remains very low as a share of the labour force (Chart 6).

The data on wage growth (which should be strengthening if labour markets are tightening) has admittedly been more mixed recently. With that said, while annual wage growth has slowed somewhat the last two months, the pace remains above 2% on a year-over-year basis. Looking through monthly volatility, broader trends remain generally constructive. Despite slower growth the last two months, wages rose 2.8% from a year ago over the first half of 2016 as a whole. That is up from a 2.7% increase in all of 2015 that in turn was stronger than the 1.9% rise in 2014 (Chart 7). Wage growth has been outpacing underlying growth in consumer prices (core CPI growth averaging 2% year-to-date in 2016 after a 2.2% gain in 2015) likely at least in part because the latter tends to be more 'sticky' around the Bank of Canada's 2% inflation target due to well-anchored inflation expectations. The hourly wage growth numbers are also broadly consistent with the distribution of jobs by wage which has continued to show an increasing concentration of job growth in higher paying positions (Chart 8). This is occurring despite the weakness in the high-paying oil & gas sector.

What should we expect going forward?

The outperformance of labour markets compared to activity indicators like GDP raises legitimate questions about whether the improvement can be sustained given a still challenging broader economic backdrop. Indeed, a sharp increase in the number of workers in involuntary part-time employment in Alberta could be a symptom of labour hoarding in the province (with employers initially cutting back on hours to avoid laying off workers) perhaps due to what, prior to the oil price shock, were very tight labour markets where hiring qualified workers was difficult (Chart 9). Those workers could ultimately be let go with a lag as hope for a quick recovery in oil prices continues to fade. There remains, however, little evidence that weakness is spreading more significantly beyond oil-producing regions. As noted earlier, the share of involuntary part-time employment has been declining nationally with offset to the increase Alberta coming from declines in most other regions.

The potential for a broader deterioration in labour markets on a national scale to emerge ultimately depends on the extent to which lower corporate profits (mainly to-date among companies in or closely-related to the oil & gas sector) and government revenues resulting from lower oil prices spill over to other industries and regions. On that front, governments have, on balance, opted to run deficits for now rather than pass the hit to their revenues onto households and businesses. On the corporate side, the fact that the revenue hit, and downturn in activity indicators, has been concentrated mainly in the relatively capital-intensive oil & gas sector provides some reason to expect that owners of capital (rather than labour) will continue to bear a larger share of the profit pullback than would be expected if there were a more broadly-based drop in revenues. Natural Resources Canada estimates that the oil & gas sector, including all direct and indirect links, accounted for about 4% of all employment in 2014. Although significant, that's less than half of the 11% estimated share of GDP. Statistics Canada data shows that about a quarter of net income from activity in the mining sector is paid to labour with the remainder going to holders of capital. That share paid to labour is significantly smaller than the average of close to 60% for the business sector as a whole (Chart 10). It is, then, perhaps less surprising that, notwithstanding the negative impact on labour markets in oil-producing regions, the income hit from lower oil prices to-date at the national level has been disproportionately concentrated in corporate earnings rather than labour income (chart 11).

Of course, many households are also owners of capital via equity in energy companies; however, most would not own strictly energy stocks so the hit to household net wealth has been muted by portfolio diversification. The value of Canadian household holdings of equities was up almost 5% from end-of-2014 levels as of Q1 2016 while overall holdings of financial assets are up 7% over the same period.

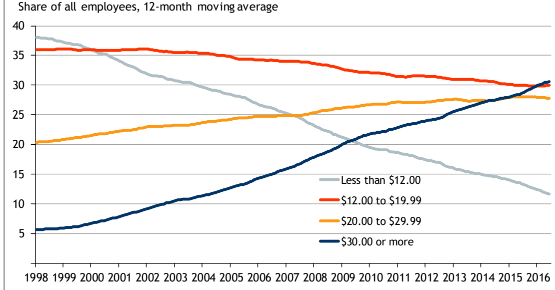
Implications

Employment growth has slowed to-date in 2016; however, analysis of near-term labour market movements is being complicated both by normal monthly volatility as well as a sharp underlying slowing in the pace of growth in the population aged 15-64 as the baby boom generation began to hit retirement age. Ultimately what constitutes 'weak' or 'strong' labour markets is really the extent to which the available supply of labour is being utilized. In an era of slower working-age population growth, which based on population projections is expected to persist for decades, smaller employment gains do not necessarily mean 'weaker' labour markets as smaller increases may also reflect supply factors that have lowered the underlying pace of growth needed to absorb current unemployed workers and discouraged labour force non-participants. Digging below the headline numbers, most measures of labour market slack in Canada appear to have actually improved year-to-date in 2016. Those measures include declines in official estimates of the unemployment rate and a broad range of alternative indicators that account for things like non-participation in labour markets due to worker discouragement and those working involuntarily in part-time jobs.

Labour markets will likely remain split sharply along sectoral and regional lines with weakness in natural resources employment likely to continue, particularly in Alberta where labour markets have been most negatively impacted by the fall in oil prices. The relatively capital-intensive nature of activity in the oil & gas sector, however, provides reason to expect that spill-over to other sectors and regions of the economy will continue to be limited compared to what would be expected from a more broadly-based negative shock to the economy. We continue to expect that, absent some new shock to labour markets in other regions, national employment will continue to rise going forward at a pace that, although modest by historical standards, should be enough to prompt further reductions in measures of labour market slack, such as a falling unemployment rate, and attendant further wage gains. Improving labour markets alongside record low interest rates mean spending by households (which including both residential investment and consumer spending already accounts for a record share of GDP) will, for good or bad depending on household debt concerns, remain a key support to GDP growth.

Chart 8: Employment Distribution by Hourly Wage

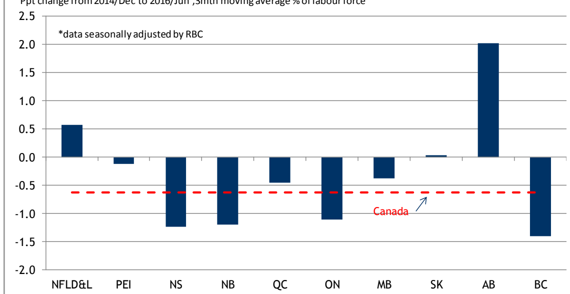
Share of all employees, 12-month moving average



Source: Statistics Canada, RBC Economics Research

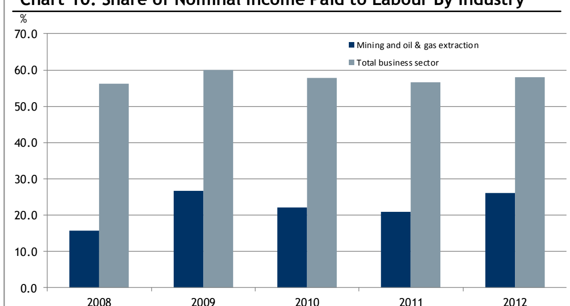
Chart 9: Involuntary Part-Time Workers by Region

Ppt change from 2014/Dec to 2016/Jun ,3mth moving average % of labour force



Source: Statistics Canada, RBC Economics Research

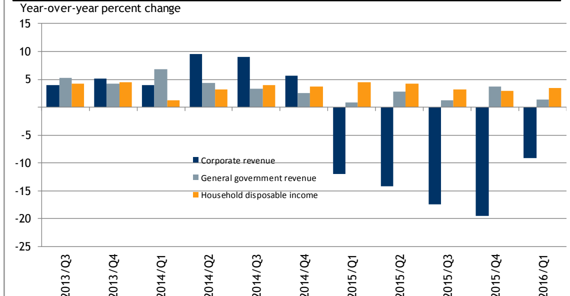
Chart 10: Share of Nominal Income Paid to Labour By Industry



Source: Statistics Canada, RBC Economics Research

Chart 11: Revenue Growth by Sector

Year-over-year percent change



Source: Statistics Canada, RBC Economics Research