Economics

IN FOCUS

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Trade tensions, steady labour

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It will probably get worse before it gets better. Canada-US trade tensions will not be resolved any time soon, and we expect to see a material dent in Canada's growth rate in the fourth quarter. Should the tariffs imposed on Canada remain in place, and threatened further measures show up, Canadian growth could remain sluggish in 2027.

But even if, as we expect in our base case, Canada and the US reach a deal to roll back tariffs, this summer's negotiations suggest that it will leave enough barriers in place to shave about a half of a percentage point from Canada's GDP growth in the coming year. One of the reasons we expect the damage in that base case to be manageable is our assessment that the job market is facing these challenges from a somewhat healthier position than it may appear. Headline numbers come and go, but beneath the surface, where job market demons usually hide, conditions are firmer than one would expect, two years into the trade dispute with the US.

Breakeven

Job growth has been very choppy lately, but the trend beyond the noise points to still respectable job growth given the circumstances (Chart 1, left). Over the past six months, the economy has generated 136K new jobs vs. 81K created in the prior six-month period, according to the Labour Force Survey. Payrolls (SEPH) data for most recent six months available have seen a similar improvement.

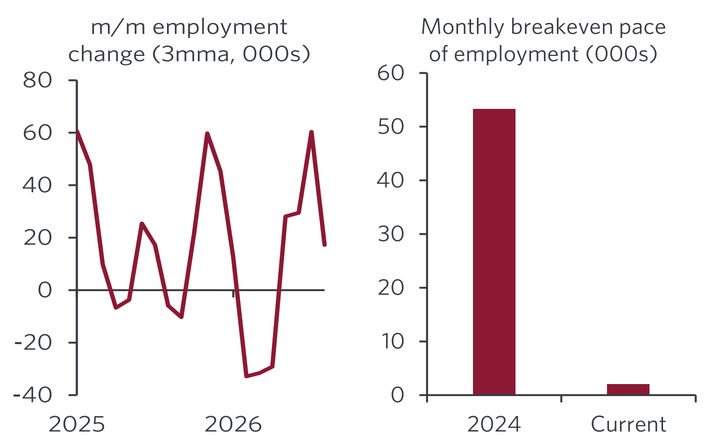
What's more, the monthly job growth tally is increasingly being assessed against a changing benchmark. The key issue is not simply whether monthly job growth is slowing, but whether the pace of job creation required to stabilize the unemployment rate is itself moving lower. On that front, the direction is clear: breakeven employment growth in Canada is falling. Put differently, a softer employment print in the coming quarters may be less negative than a similar number would have been in prior years. We estimate that the breakeven monthly employment growth rate today is around 2K vs. over 50K in 2024 (Chart 1, right). That's hardly a surprise in an environment of a stagnant labour force.

The youth factor

Low and falling breakeven job growth will limit any rapid worsening in the unemployment rate in the near future. At 6.4%, the jobless rate is only around 0.6%-points north of our estimate of a neutral level. And even here the actual number might be lower. As we have indicated in previous research, there are fewer missing work hours associated with the youth unemployment rate than suggested by the headline numbers. The official rate includes youth aged 15-19 that are enrolled in high school and are also searching for employment. Since their main activity is learning, the missing jobs these students are seeking would typically entail fewer hours per week.

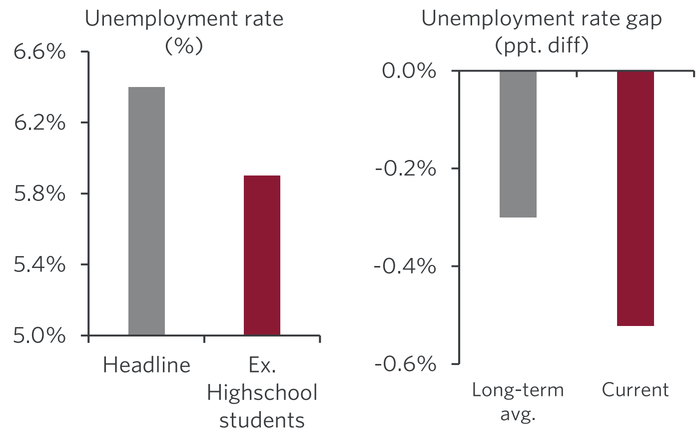
Excluding high school students from unemployment causes the unemployment rate for that age group to drop from over 20% to 6.4%, as of April, which is the last available data point. And excluding high school students from the national unemployment rate reduces it by about 0.5%-points. That is, if it was not for the "unemployed" high school students, the Canadian unemployment rate today would be around 5.9%

Chart 1: Employment growth has been choppy (l); breakeven pace down sharply (r)



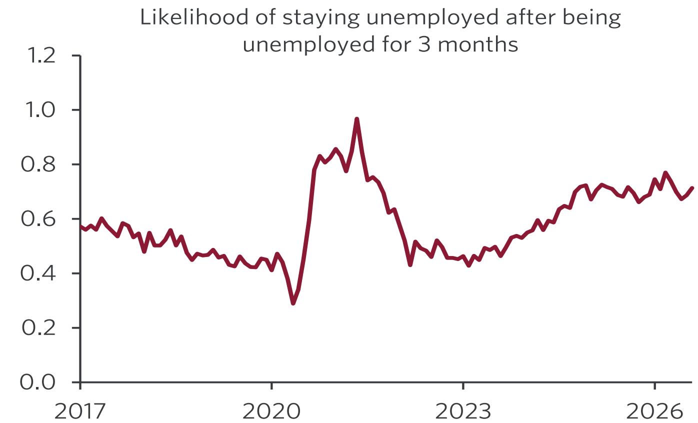
Source: StatCan, CIBC

Chart 2: Unemployment rate would be lower if high school students excluded (l); gap is unusually wide currently (r)



Source: StatCan, CIBC

Chart 4: Long-term unemployment becoming more likely



Source: StatCan, CIBC

(Chart 2, left). Although the "full employment" jobless rate would also be lower if we excluded the 15-19 cohort, and historically, excluding high school unemployment only shaved 0.3%-points from the headline unemployment rate (Chart 2, right).

The composition of unemployment

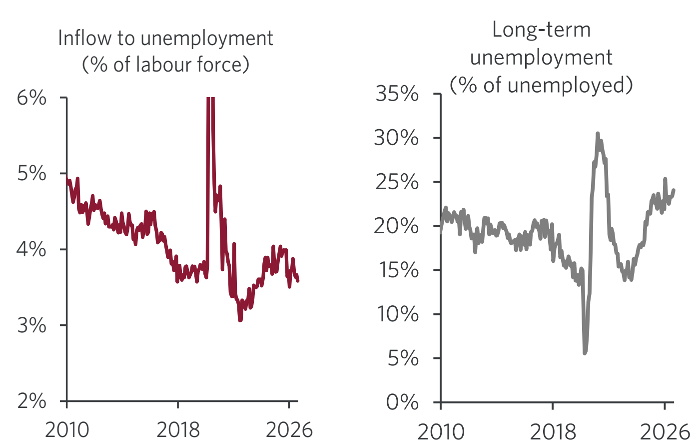
One source of vulnerability often cited by the Bank of Canada is the relatively long duration of unemployment. At any point in time, the jobless rate encompasses those who have only recently become unemployed and those that have been unemployed for a period of time. Accordingly, an increase in the unemployment rate can occur not only because of an increase in the rate at which people are losing their jobs, but also because of the fact that on average, people are unemployed for a longer period of time. Chart 3 illustrates those two forces. The inflow rate into unemployment, namely the rate at which people are becoming unemployed, is currently relatively low despite a recent increase. However, the share of long-term unemployment, defined as being jobless for 27 weeks or more, has been on the rise, and is notably higher than the rate seen before Covid.

Consistent with that trend is the recent increase in the likelihood of staying unemployed after being unemployed for less than 3 months. This rough measure of that likelihood, which looks at the ratio of the number of unemployed persons for more than 3 months to those that have been unemployed for less than 3 months (with a 3 month lag), is currently at a level that is notably higher than it was pre-Covid (Chart 4). The issue here is that the Bank of Canada can generally only influence the inflow rate, where clearly there is no problem.The increase in long-term unemployment is largely due to a mismatch in the labour market, and therefore to an extent, is beyond the domain of monetary policy.

Employment composition

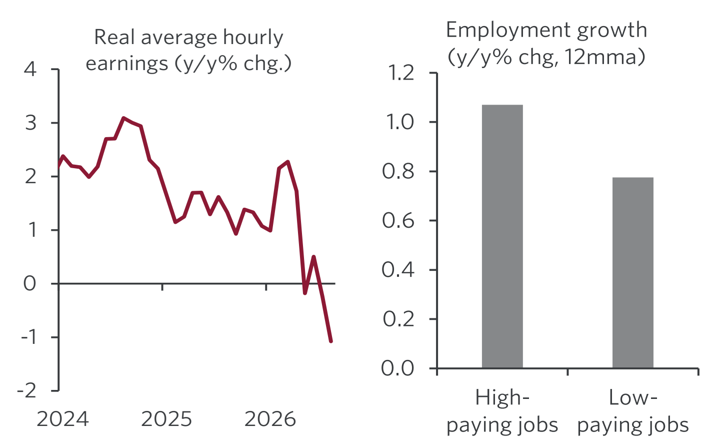
Any change in labour income is a combination of wage growth and the change in the composition of jobs in the market. As illustrated in Chart 5, real wage growth taken a nosedive lately

Chart 3: Newly unemployed down (l), but already unemployed are staying jobless longer (r)



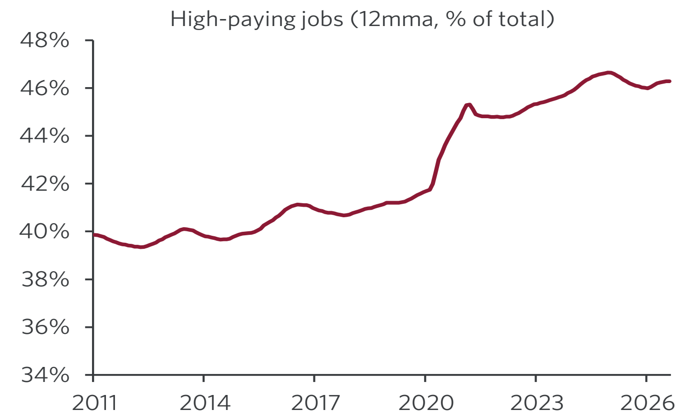
Source: StatCan, CIBC

Chart 5: Average real wage growth is stagnant (l), but employment composition looks better (r)



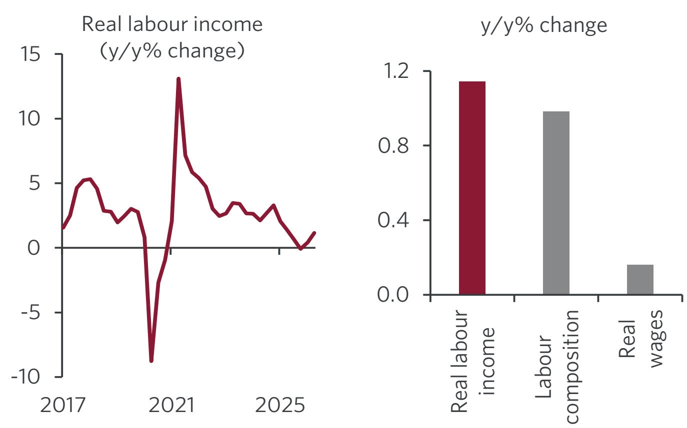
Source: StatCan, CIBC

Chart 6: Share of high-paying jobs on the rise



Source: StatCan, CIBC

Chart 7: Real labour income growth staying afloat (l) due to better quality of jobs (r)



Source: StatCan, CIBC

but the composition of employment has improved over the past year. High-paying occupations, defined as those earning above the average hourly wage, have led job growth, particularly professional occupations in health, and natural and applied sciences. High-paying jobs now account for 46% of employment, a 5%-point increase from the pre-Covid share (Chart 6). That improvement in the composition of employment has helped keep real labor income growth afloat, which ticked up in the second quarter, masking the weakness seen in growth in real wages (Chart 7).

The demographic factor

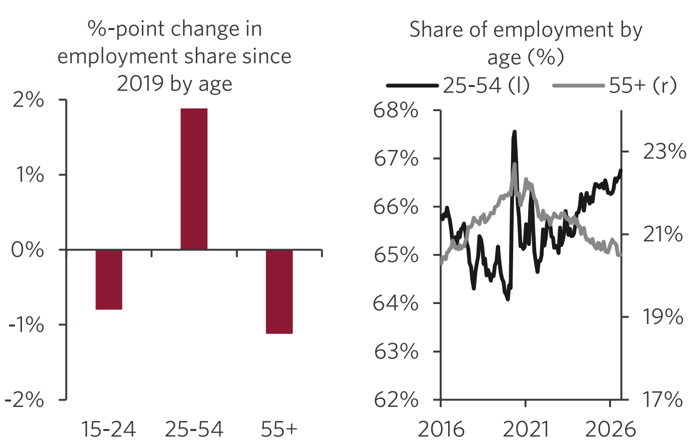
One cannot fully assess the labour market and its composition without examining the major demographic forces shaping its path. Chart 8 illustrates clearly the substitution between prime-age workers and the 55+ and youth cohorts that is underway.

What does this demographic trend mean for wage inflation? Youth are still a relatively small share of employment at 13%, so the substitution between prime-age and 55+ is more impactful. Over the past year, 55+ employment has fallen by 22K, while prime-age employment has increased by 223K. Average wages for those age cohorts are relatively similar (Chart 9, left), meaning that the impact on wage inflation due to this trend is negligible. The more significant effect is on total hours worked in the economy. Workers aged 55+ account for a declining share of the labour market, and many of those who remain employed are gradually reducing the number of hours they work (Chart 9, right). With fewer workers putting in fewer hours, the demographic effect on total hours worked is therefore a net positive at the margin.

Self- and part-time employment fading

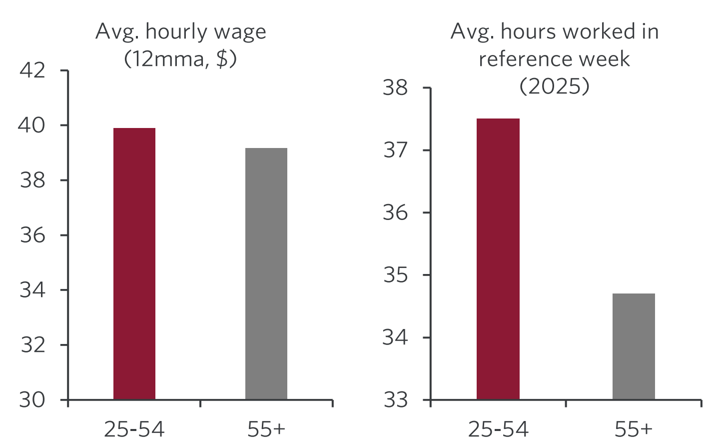
Another favourable aspect of the job market can be seen in self-employment trends. Many workers exited self-employment during Covid and did not subsequently re-enter those jobs. The

Chart 8: Shifting demographics of the workforce



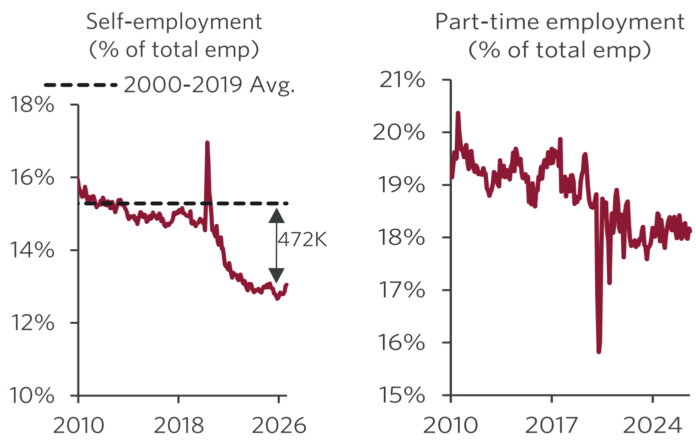
Source: StatCan, CIBC

Chart 9: Workers aged 55+ earn roughly the same as prime age (l), but are working fewer hours (r)



Source: StatCan, CIBC

Chart 10: Lower self-employment (l) and part-time positions (r)



Source: StatCan, CIBC

result is that the level of self-employment is almost 500K lower relative to pre-Covid (Chart 10, left), with paid employment accounting for 63% of jobs created over the past year. While it's difficult to quantify, it is reasonable to assume that a large portion of those that left self-employment during and after Covid were in relatively low quality positions and therefore any shift to paid employment can be seen as a positive from a job composition perspective.

Part-time employment is also at a very low level (Chart 10, right), and the number of workers that report that they are employed part time due to business conditions is no higher than it was in 2019. In the past year, only 17% of job creation was attributable to part-time positions. That is clearly good news for the quality of employment, given that those jobs tend to be lower paying.

Those factors have likely helped to improve hours worked over the past few months, with actual hours worked up by 1.4% y/y, outpacing total employment growth at 1.0% y/y.

The path of any journey is shaped by where it begins. For the Canadian labour market, the quarters ahead are likely to be challenging, as the direct and indirect effects of the current trade war will weigh on employment growth. Even so, the job market appears to be entering this period from a position of relative strength, which should help limit the damage. That said, this favourable starting point is unlikely to be enough to prompt the Bank of Canada to raise rates in the near term, because the road ahead for the labour market could end up being much rougher if no progress is made on Canada-US trade tensions.

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