Economics

IN FOCUS

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Labouring under duress: Insights into Canada's job market

by **Andrew Grantham** andrew.grantham@cibc.com and **Avery Shenfeld** avery.shenfeld@cibc.com

Canada's unemployment rate jumped to 6.8% in November, the highest since 2017 excluding the pandemic. But there's more to the labour market than that single number, and a broader range of indicators points to a labour market that is ailing more than many now suspect. Unlike the Fed's explicit dual mandate, the goal of full employment plays second fiddle to steering inflation to the 2% target. But a balanced labour market is judged to be a key underpinning of having inflation trend at the target rate, and Canadian job seekers are increasingly labouring under duress.

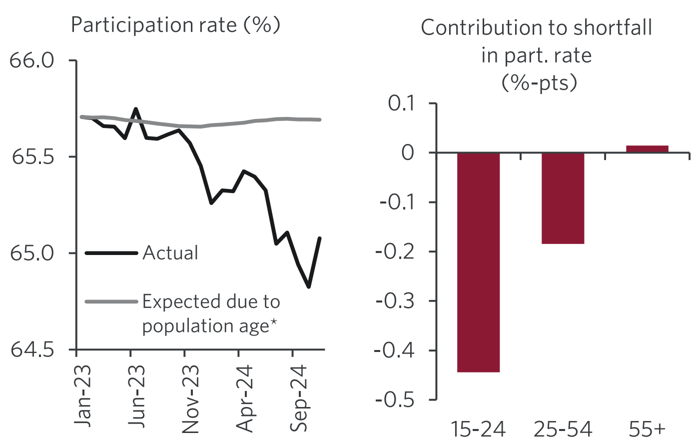
Some brushed aside the latest jump in unemployment on the grounds that it was driven by an increase in labour market participation, rather than an outright employment decline. When those previously on the sidelines decide that they will look for work, they get added to the tally of the unemployed. But this wasn't a case of participation soaring to new heights, but merely a rebound after a disconcerting decline, often a signpost that those who could work are giving up looking.

Who stopped looking?

True, Canada's aging population will over time see an increasing number of residents hit retirement age and opt to leave the job market for that reason. But, thanks to immigration-fueled growth, the population hasn't been aging recently. Indeed, after controlling for population shares, we should have seen little slippage in the participation rate since January 2023 (Chart 1, left).

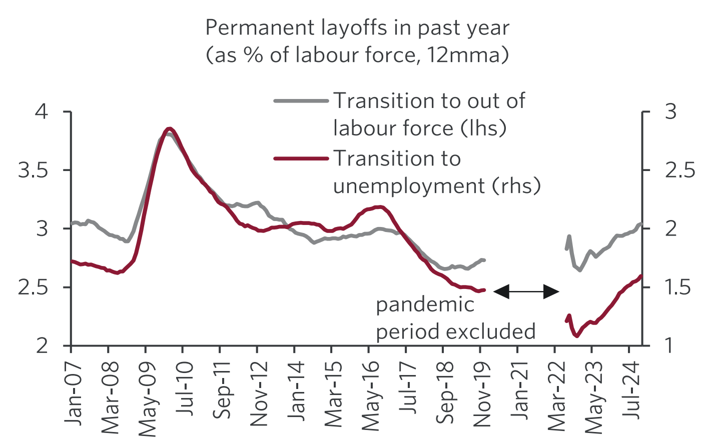
Weakness in the youth job market has been a contributing factor, leading to those under 25 to stop searching (Chart 1, right). Service industries that reopened after the pandemic had earlier been seeing a severe shortage of workers that helped open opportunities for younger, less experienced job seekers. Much reduced job vacancies in those sectors are now reversing that trend. However, we're also seeing some slippage in labour force participation of prime age workers, a potential signpost of weakening labour market health.

Chart 1: Participation rate has fallen more than demographics suggest (L), mostly due to young people (R)



Source: Statistics Canada, CIBC

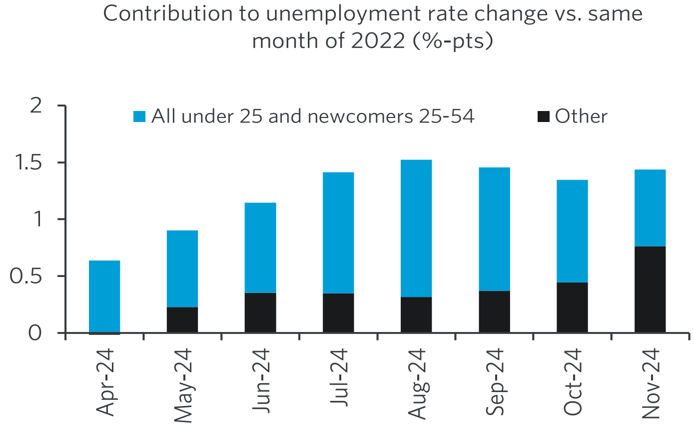
Chart 2: Greater proportion of job losers transitioning to out of the labour force



Source: Statistics Canada, CIBC

*Path with no change in part-rate for each age group.

Chart 3: Excess unemployment vs 2022 no longer just a newcomer and youth story



Source: Statistics Canada, CIBC

Chart 5: Job changing remains below pre-pandemic levels

Source: Statistics Canada, CIBC

In the last two years we have seen only a modest increase in permanent layoffs that is sending some into the ranks of the unemployed, contributing somewhat to the climb in the jobless rate. But an unusually high share of these laid off workers are transitioning to being out of the labour force entirely (Chart 2), and if they would have preferred to keep working, they are an additional element in labour market slack that isn't being captured in the official unemployment rate.

Who's unemployed?

Those who are in the official ranks of the unemployed are increasingly being found in a broader range of Canadians in terms of age and immigration status. In his press conference this week, Governor Macklem pointed to the role of particular groups in recent job market weakness. But the rise in joblessness is no longer just a story of newcomers to the country being out of luck, or of job challenges for students and other youth. Since the spring, the rise in the jobless rate versus where it stood two years prior has been driven by those over 25 who have been in Canada for five years or more (Chart 3).

Sometimes, a lot of churn in the job market can elevate the unemployment rate, by leaving more people in a given month who are caught in a short gap between jobs, and thereby counted as unemployed. But in this case, a more concerning rise in longer term joblessness is clearly part of the story. The share of the workforce that has been looking for a job for 27 weeks or more recently hit levels not seen in the past decade, other than during the pandemic disruptions (Chart 4). The rise in long-term joblessness suggests that those people who don't have the option of temporarily bowing out of the labour force are on average taking much longer to find work.

Those who are employed also appear to be more aware of the softening in labour demand, and are sticking with their current positions to protect their seniority. The percentage of workers changing jobs is now well below levels that prevailed in the prior business cycle (Chart 5).

Chart 4: Long-term unemployment at historically high levels

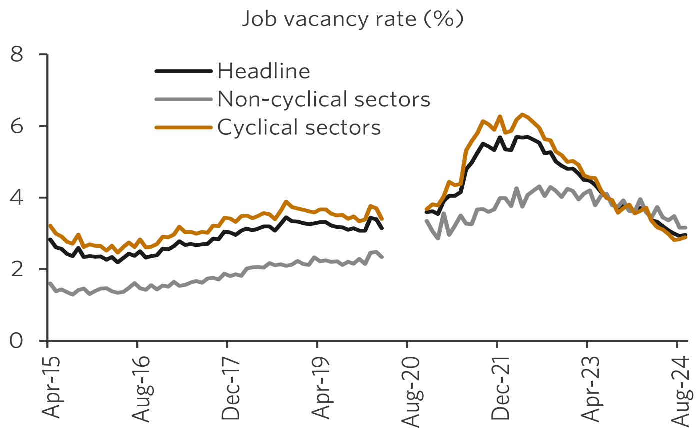
Source: Statistics Canada, CIBC

Measuring labour market slack

The Bank of Canada has historically stressed the output gap as an indicator of downward pressure on inflation ahead. Instead, research by CIBC Economics has made the case that given frequent reassessments of both real GDP and potential GDP, labour market measures of economic slack provide a better real-time indicator than the GDP-based output gap. Perhaps that's starting to catch on with policymakers, as a recent speech by Deputy Governor Mendes used the unemployed/vacancy ratio in an analysis of the sensitivity of inflation to economic slack. That indicator also performed well in our analysis of the drivers of US wage inflation.

As noted, the numerator in that indicator, the number of unemployed Canadians, has been moving steadily higher as a share of the workforce, and there may be others who are being left out of that count since they've stopped looking. But the denominator, job vacancies, has also been contributing to the

Chart 6: Decline in job vacancies driven by cyclical sectors



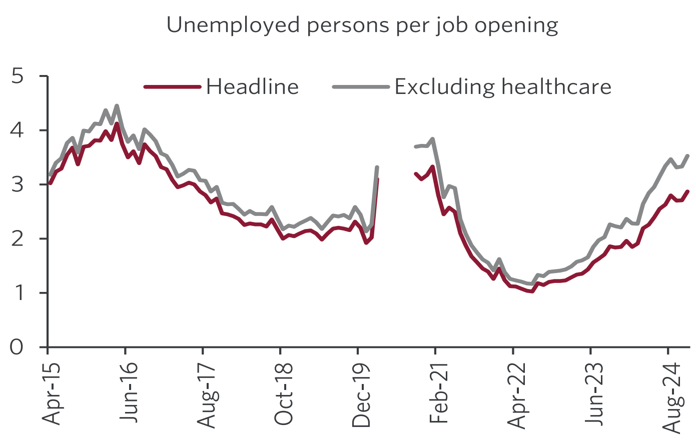
Source: Statistics Canada, CIBC

trend toward more slack. There was a plethora of vacant jobs as the economy opened up after pandemic restrictions, when in late 2021 and 2022 it seemed like every restaurant, airport, and trucking company had a help-wanted sign.

Those days are now well behind us. The headline job vacancy rate has essentially normalized, with the share of positions waiting to be filled now below pre-pandemic levels in cyclical industries (Chart 6). Vacancies are now concentrated in non-cyclical sectors, including fields like health care where there is simply a chronic shortage of those with the right skill set.

The upshot is that our preferred measure of job market slack (the number of unemployed persons per job vacancy) has steadily increased, and sits above where it stood in 2018-19, a period in which inflation was calm and overnight rates were below 2%. Strip out health care, and it's now chronic shortage of workers, and the ratio of unemployed to vacant jobs sits at its highest level since 2016, again ignoring the deep economic chasm of the pandemic (Chart 7).

Chart 7: Unemployment-to-vacancy ratio high, particularly excluding healthcare



Source: Statistics Canada, CIBC

That economic slack should translate into further downward pressure on core inflation measures, particularly those that strip out mortgage interest costs. In turn, that provides plenty of fuel for further Bank of Canada rate cuts in 2025. Indeed, barring a turn to large scale fiscal stimulus, the Bank will likely have to drive the overnight rate into at least mildly stimulative territory, and like us, it will be eyeing these measures of labour market slack to determine when its work is done.

Contacts:

Avery Shenfeld
avery.shenfeld@cibc.com

Benjamin Tal
benjamin.tal@cibc.com

Andrew Grantham
andrew.grantham@cibc.com

Ali Jaffery
ali.jaffery@cibc.com

Katherine Judge
katherine.judge@cibc.com

CIBC Capital Markets
PO Box 500
161 Bay Street, Brookfield Place
Toronto, Canada, M5J 2S8
Bloomberg @ CIBC

economics.cibccm.com