Canadian Occupational Projection System 2015 Projections

Macroeconomic Scenario 2015-2024

December 2015

Employment and Social Development Canada
Emploi et Développement social Canada
Canada

Outline

- Demographics, Labour Force and Potential GDP
- External and Domestic Drivers of Aggregate Demand
- Composition of Growth in Aggregate Demand

Introduction

The occupational projections prepared under the Canadian Occupational Projection System (COPS) require the production of a macroeconomic scenario to determine the future long-term trends in overall employment growth and in the distribution of employment across industries and occupations.

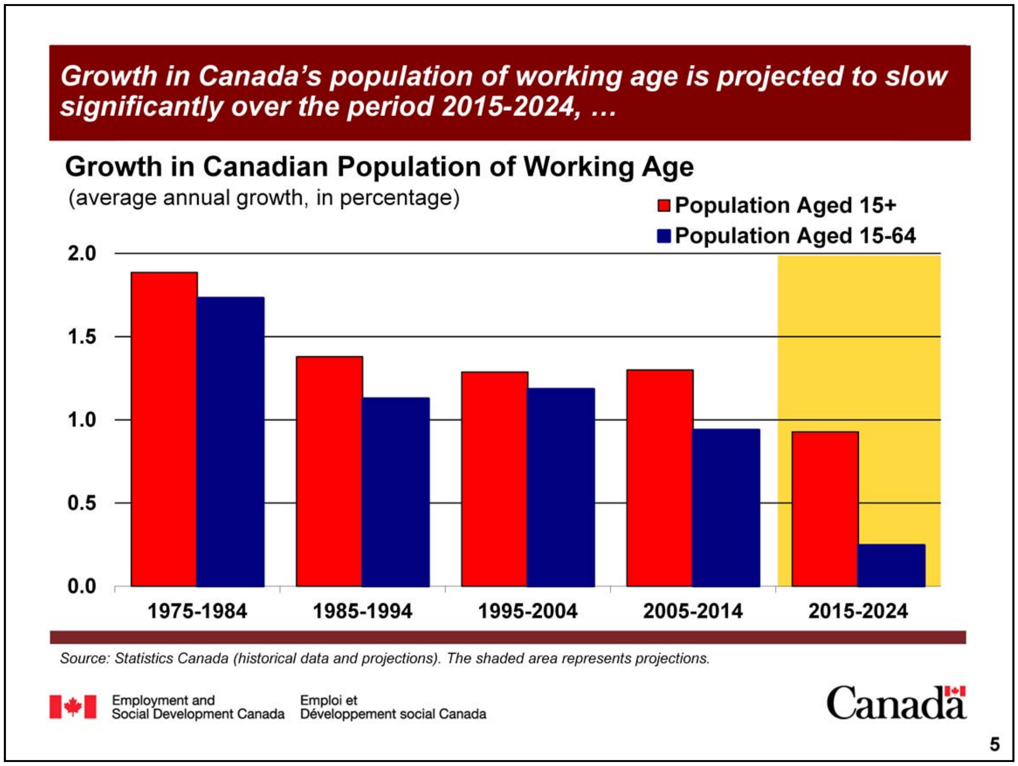
This document presents the macroeconomic scenario that underlies the 2015 COPS projections. This scenario was developed in collaboration with the Conference Board of Canada based on information available as of Spring 2015.

The future long-term trends in Canada's economic growth will be heavily influenced by demographic developments, namely slower population growth and population aging. Such demographic changes, which cannot be avoided, are projected to have a major influence in the long-term evolution of Canada's labour force, employment, and economic potential.

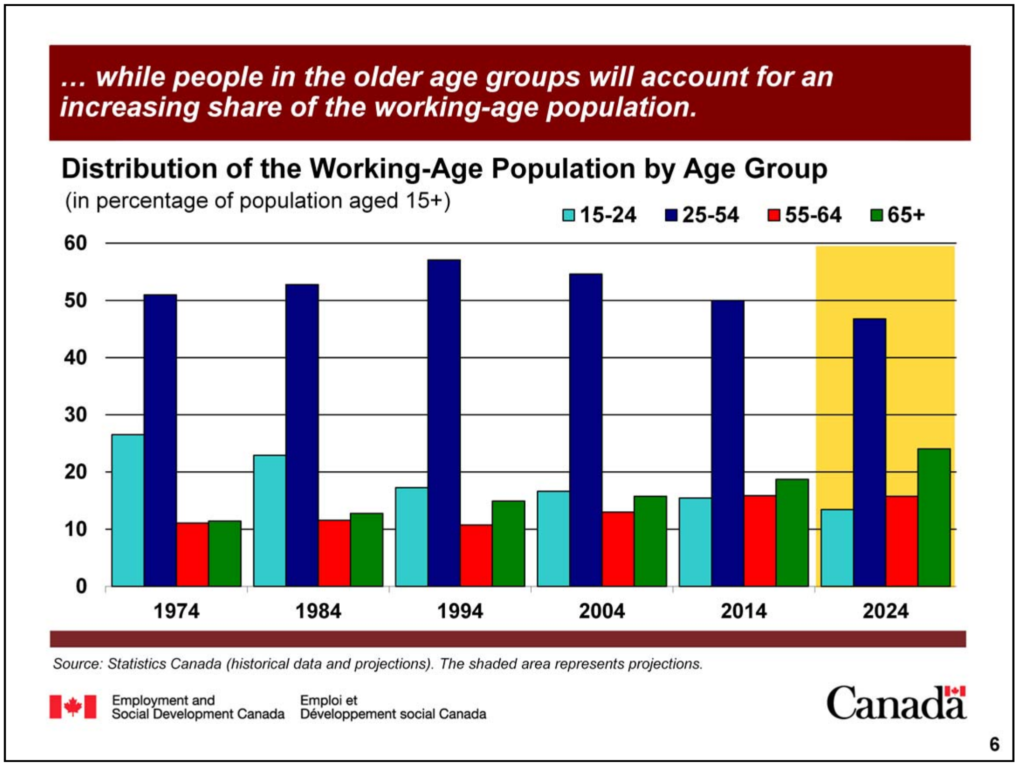
Demographics, Labour Force, and Potential GDP

Employment and Social Development Canada
Emploi et Développement social Canada

Canada



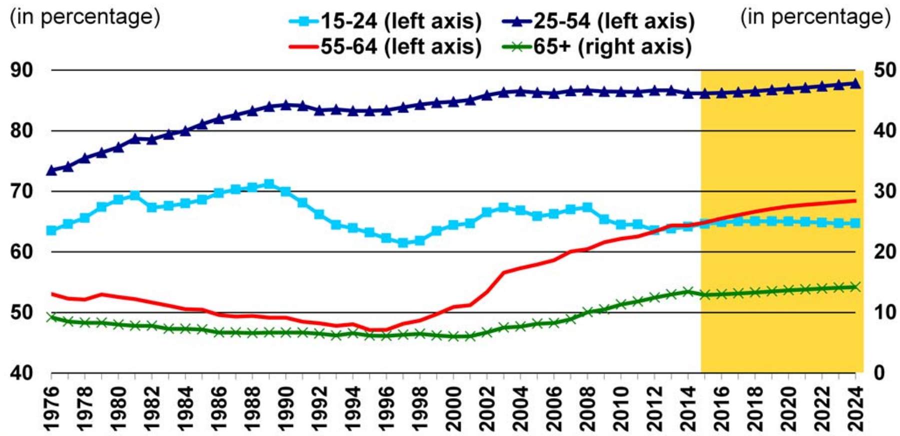
- The pace of growth in the working-age population (15 and over) is projected to slow significantly over the period 2015-2024, particularly among those aged 15-64.
- Growth in population aged 15 and over is projected to average 0.9% annually, down from 1.3% over the period 2005-2014. This slowdown reflects a decline in the natural increase of the population (births minus deaths) attributable to a low fertility rate and a rise in deaths due to population aging. The projected increase in life expectancy and in the number of immigrants will not be enough to offset the growth deceleration of the working-age population.
- The slowdown is projected to be even more pronounced for those aged 15-64 due to the aging of baby-boomers (born between 1946 and 1965) who have started turning 65 in 2011. As baby-boomers represent Canada's largest generation in history, this will reduce population growth by almost three-quarters in the 15-64 age group over the projection period (annual average of 0.2% versus 0.9% in the previous ten years).



- All baby-boomers will be entering in the 55-64 or 65+ age groups over the projection period, boosting population growth in the older age groups relative to the younger age groups.
- As a result, the older age groups will account for an increasing share of the working-age population. By 2024, those aged 55-64 and 65+ are projected to represent 16% and 24% of the working-age population, respectively.
- This means that 40% of the labour force source population will be aged 55 and over by 2024, compared to 35% in 2014.

Labour force participation rates are projected to increase modestly in most age groups,…

Labour Force Participation Rates by Age Group



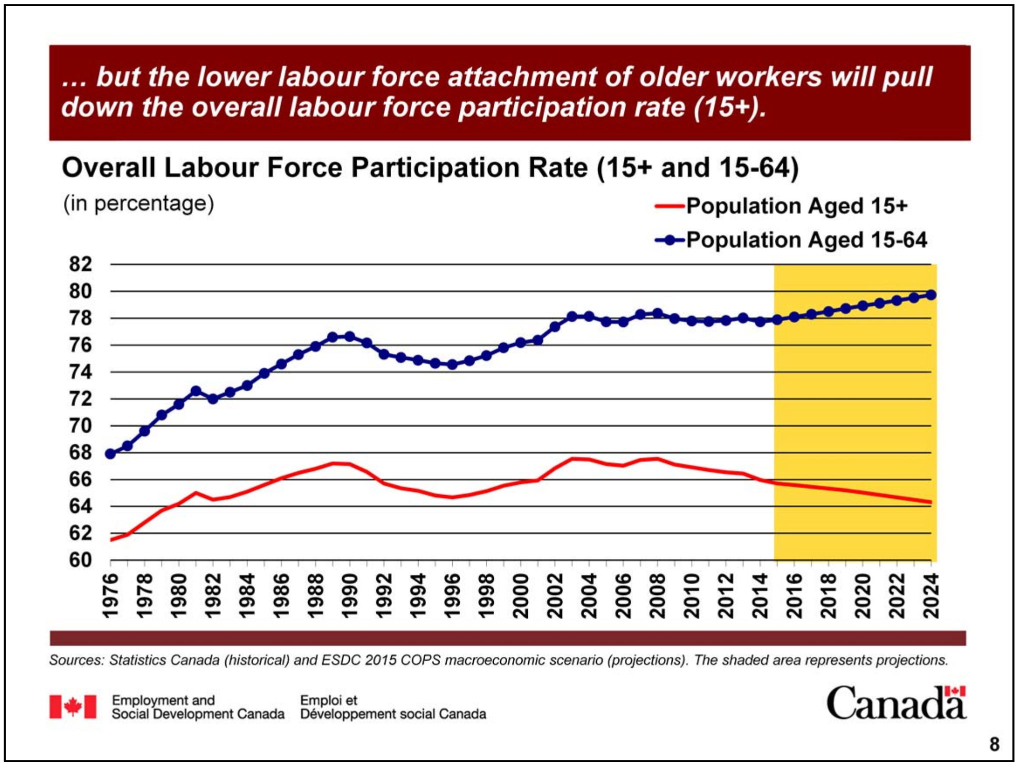
Sources: Statistics Canada (historical) and ESDC 2015 COPS macroeconomic scenario (projections). The shaded area represents projections.

Employment and Social Development Canada | Emploi et Développement social Canada

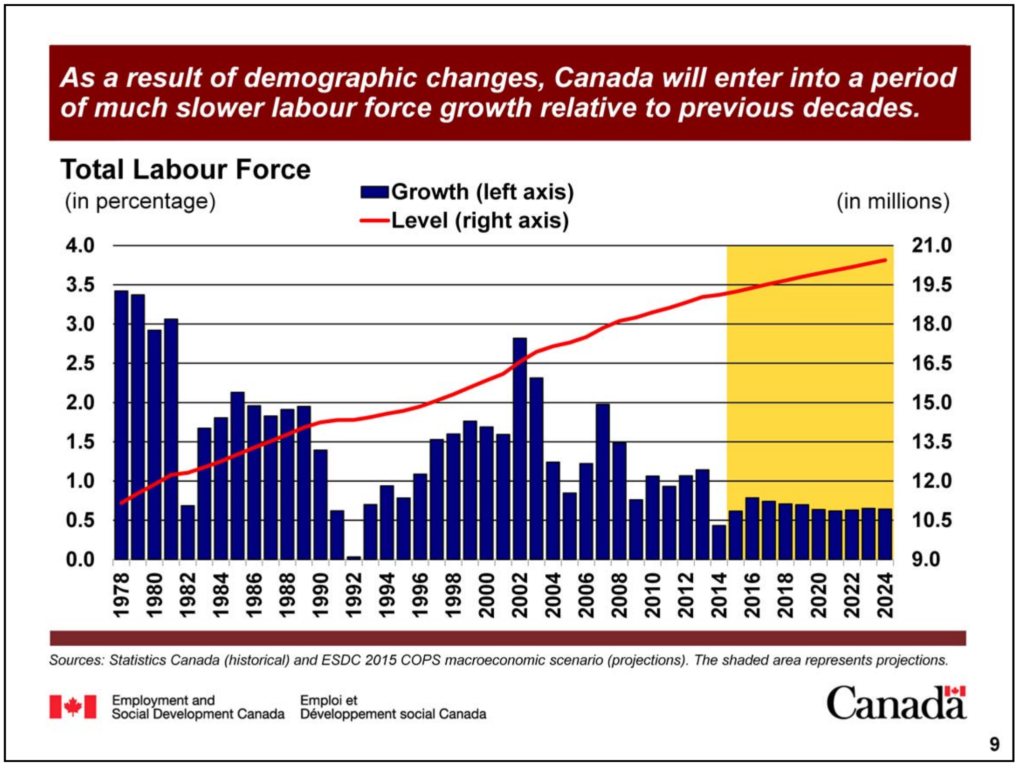
Canada

7

- Participation rates are projected to edge up in all age groups over the period 2015-2024, with the largest increase among the 55-64 years old.
- Labour market attachment is also projected to increase among those aged 25-54, albeit to a lesser extent than their older counterparts, partly reflecting a levelling out of women's participation rate in the prime age group and slower growth in the average level of education.
- After having been negatively affected by the 2008-2009 recession, the participation rate in the 15-24 age group strengthened modestly in 2013 and 2014, reflecting more favourable labour market conditions for youths as the residual effects of the recession started to disappear. While the participation rate in this age group is projected to increase somewhat further over the short-term, labour market attachment among youths is expected to remain essentially stagnant after 2017, partly due to the rising trend in post-secondary school enrollment and the levelling off in the share of students in the labour force.
- In the older age groups of 55-64 and 65+, the participation rates are expected to continue to increase as new cohorts tend to retire at a later age than previous cohorts, party because they are more educated and in better health. The pace of increase in their participation rates is, however, projected to slow with the gradual fading of intergenerational differences.



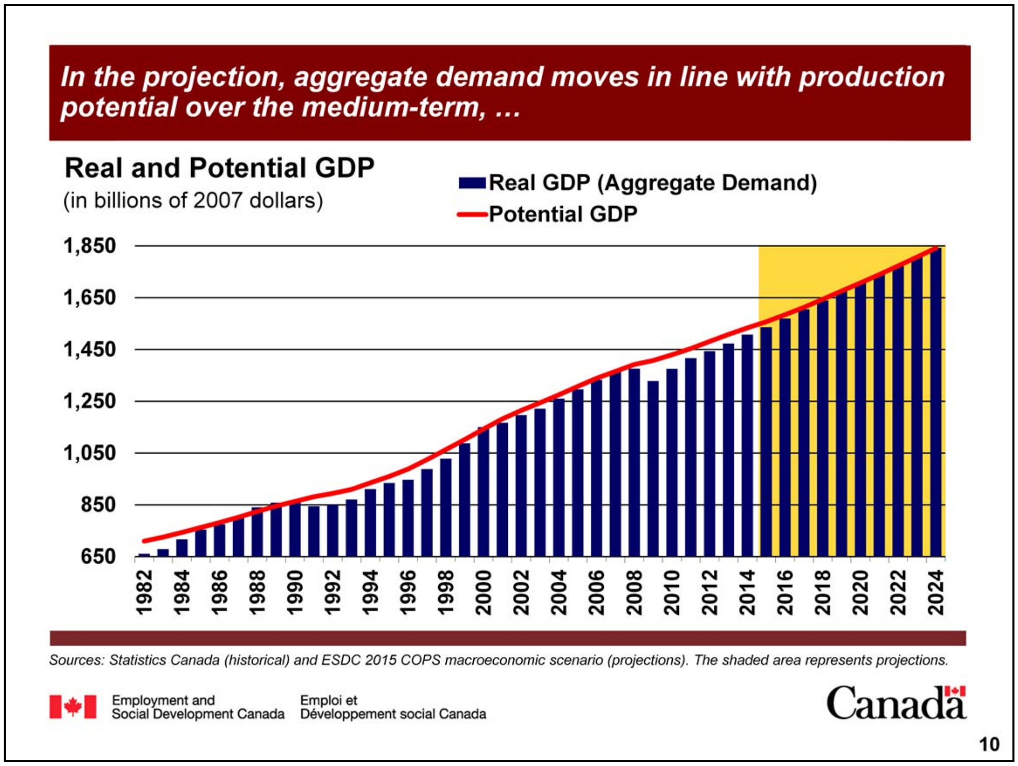
- Despite the small increases projected in the participation rate among most age groups, the overall participation rate of the population aged 15 and over is expected to decline during the period 2015-2024 as a result of population aging.
- Indeed, the shift in the age composition of the working-age population towards the lower attachment group of 65+ is projected to push down the overall participation rate by 1.6 percentage points, from 66.0% in 2014 to 64.3% in 2024 - (the proportion of people with low participation rates will increase while the proportion of people with high participation rates will decrease, lowering the average participation rate in the working-age population of 15+).
- In contrast, the participation rate for those aged 15-64 is expected to keep increasing over the projection period, up by 2.0 percentage points, from 77.7% in 2014 to 79.7% in 2024. While labour force participation is also expected to increase somewhat among those aged 65+, their participation rate will remain much lower relative to the other age groups, standing at 14.2% by 2024 (see chart on page 7).



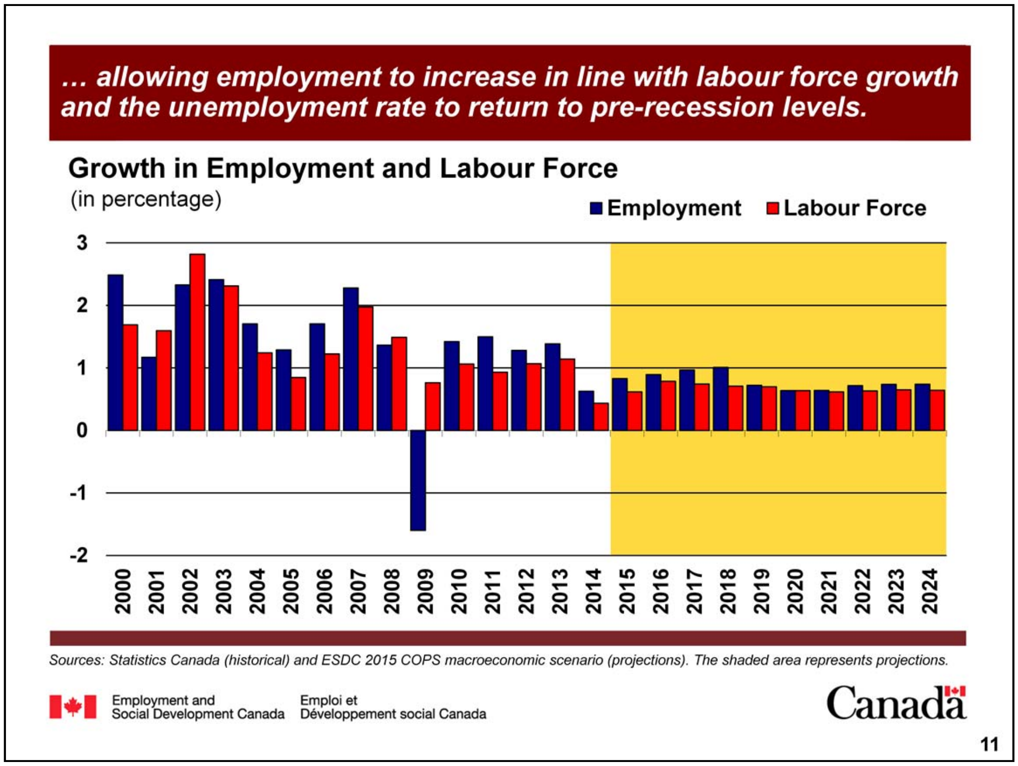
- The number of people in the labour force is the product of the working-age population and the overall participation rate:

  (Labour Force 15+ = Population 15+ x Participation Rate 15+)

- The slower growth projected in the working-age population over the period 2015-2024, combined with a decline in the overall participation rate, will lead to a period of much slower labour force growth relative to previous decades.
- Indeed, while the number of people entering the labour market will continue to exceed the number of people leaving the labour force, the gap is projected to shrink over the projection period, largely due to the massive retirements of baby-boomers.
- As a result, labour force growth is projected to average 0.7% annually over the period 2015-2024, down from 1.1% in the previous ten years.

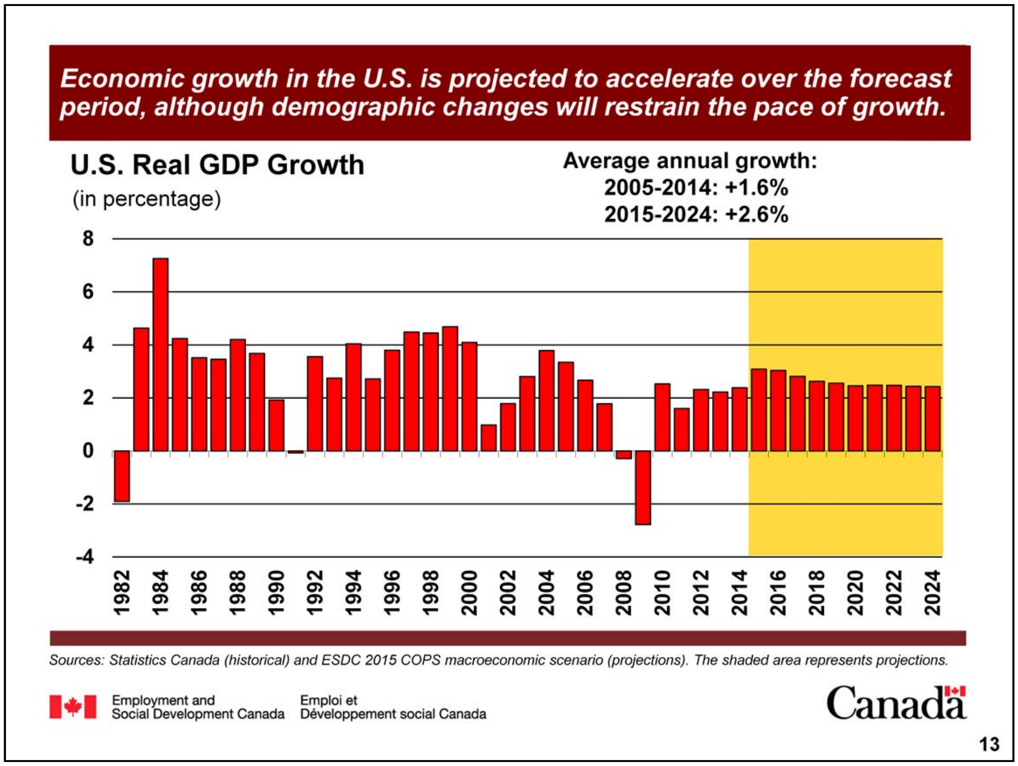


- In the long-term, aggregate demand is determined by potential GDP, which is the level of activity the economy can reach when all factors of production are fully and efficiently utilized.
  - Potential output is a function of the size of the labour force, the level of fixed capital, and total factor productivity.
- Over the period 2003-2007, growth in aggregate demand outpaced growth in potential output, creating some pressures in the labour market and lowering the unemployment rate significantly. Thereafter, the economy went into recession and aggregate demand fell below potential output, leading to a negative output gap.
- Growth in aggregate demand is projected to exceed growth in potential output over the short-term, allowing the Canadian economy to gradually close the output gap and return to potential GDP by 2016-2017. Thereafter, aggregate demand moves in line with potential GDP.

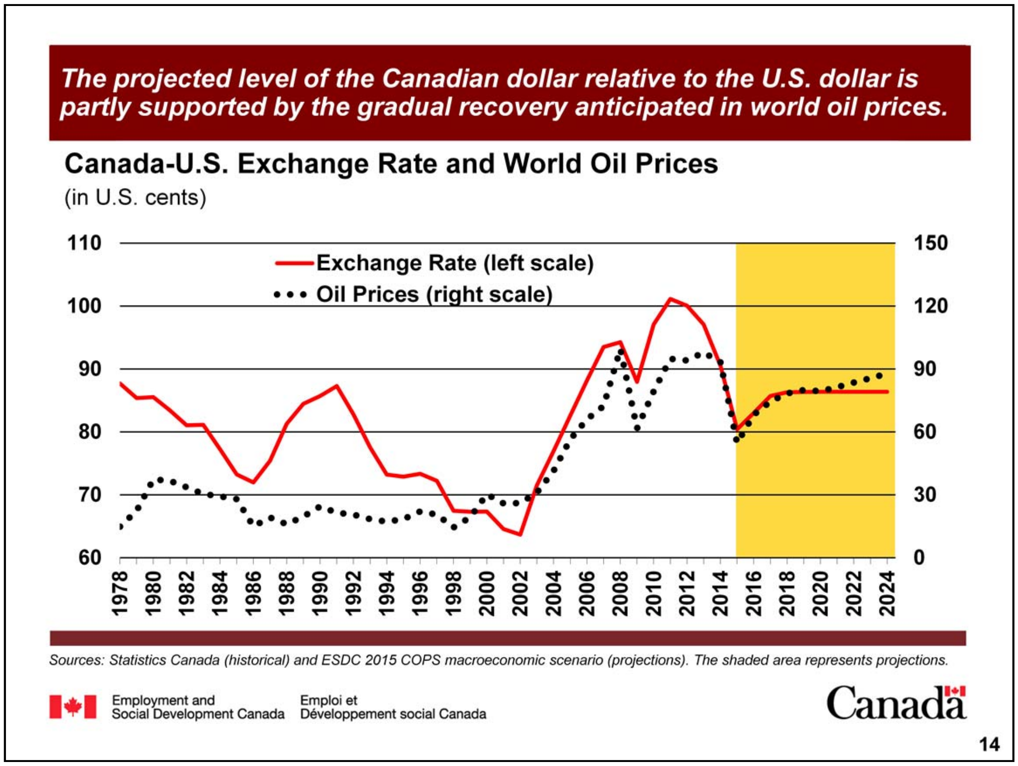


- The gradual closure of the output gap will increase the demand for labour, allowing employment to grow in line with labour force growth and the unemployment rate to return to pre-recession levels.
- Indeed, in the short- to medium-term, employment growth is projected to exceed labour force growth, pushing down the unemployment rate.
- Over the longer term, however, employment growth will become increasingly constrained by slower growth in the labour force and by a return of the unemployment rate close to its pre-recession lows.
- As a result, employment growth is projected to average 0.8% annually over the period 2015-2024, down from 1.1% in the previous ten years.

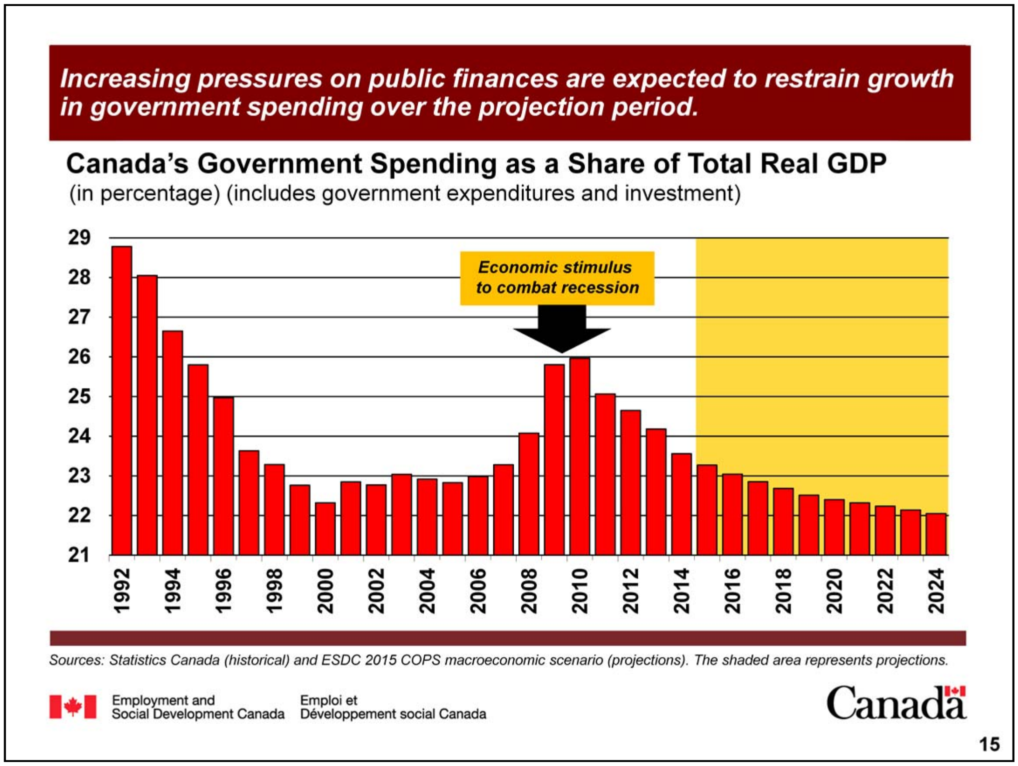
External and Domestic Drivers of Aggregate Demand



- The average pace of growth recorded in the U.S. real GDP over the period 2005-2014 was significantly lowered by the 2008-2009 recession. Economic growth is projected to accelerate over the period 2015-2024, particularly in the short-term, driven by a boost in household consumption as a result of notable improvements in labour market conditions and lower gasoline prices. Low vacancy rates and a large source of pent-up demand for housing are also expected to lead to stronger gains in residential investment, contributing to foster U.S. economic growth in the short-term.
- While improved confidence, strong corporate profits and low interest rates are expected to stimulate business investment in non-residential structures and equipment, the sharp drop in crude oil prices will have a negative impact on energy-related investment in the short-term, restraining growth in overall business investment. Net exports are also expected to continue to subtract from U.S. real GDP growth, due to weak global demand conditions and a stronger U.S. currency.
- Over the medium- to long-term, the impacts of demographic changes on domestic demand and potential output are expected to intensify, restraining economic growth in the United States. Indeed, growth in the labour force will gradually weaken due to slower growth in the working-age population and massive retirements of baby-boomers.
- The most important impact on aggregate demand should be felt on household consumption and residential investment. The pace of growth in household consumption is projected to slow as an increasing number of people will be entering their high-savings pre-retirement years. At the same time, slower population growth should lead to a gradual decline in household formation, and therefore, weaker increases in residential investment. Demographic changes are also expected to put pressures on public finances, limiting the capacity of the U.S. federal government to stimulate economic growth.



- Since the early 2000s, the movement in the value of the Canadian dollar against the U.S dollar largely reflected fluctuations in world prices for commodities, particularly oil prices.
- The rapid decline in world oil prices during the second half of 2014 has resulted in a steep depreciation of the Canadian dollar relative to the U.S. dollar. Additionally, the decision by the Bank of Canada to lower its target for the overnight rate at the beginning of 2015 resulted in further downward pressure on the Canadian dollar.
- With the gradual strengthening in global demand, world oil prices are expected to recover progressively over the projection period. This factor, combined with the eventual increase in interest rates as a result of improved economic and labour market conditions, should lead to a modest appreciation of the Canadian dollar which is expected to stabilize around 0.86 U.S. dollar by 2018.
- On average, the projected value of the Canadian dollar for the period 2015-2024 remains significantly below the value recorded in the previous ten years (0.85 versus 0.93 U.S. dollar).

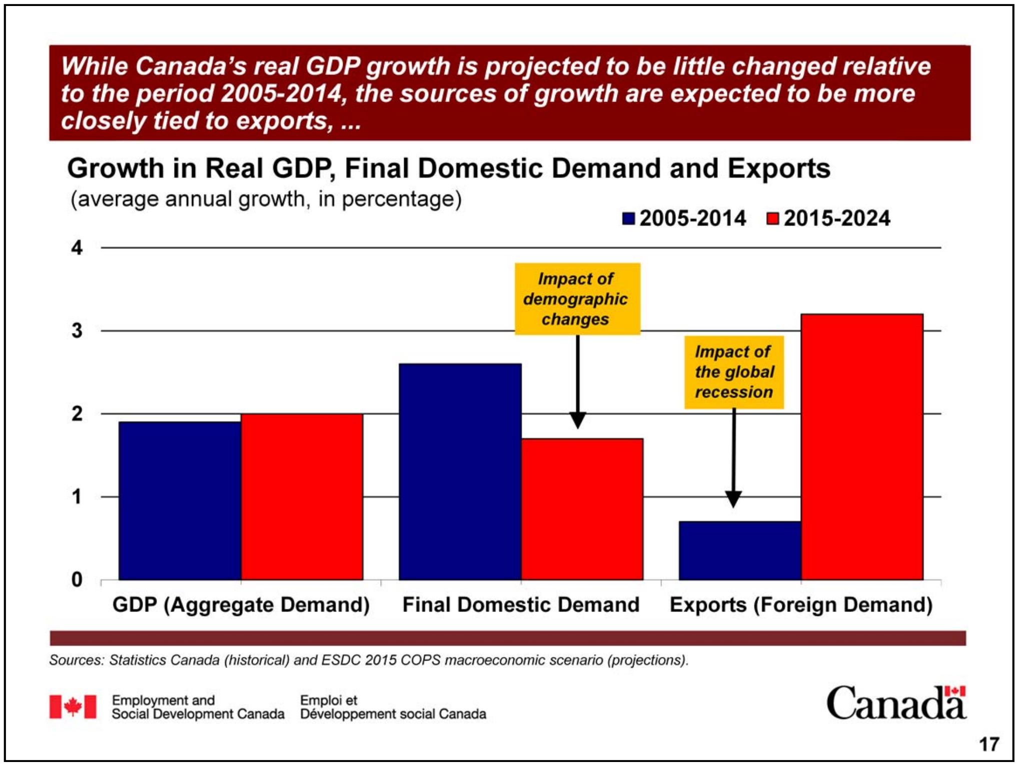


- After increasing rapidly in 2009 and 2010 due to the implementation of large stimulus packages to combat the recession, the share of government spending in total GDP fell back from 2011 to 2014, reflecting the federal and provincial governments' decision to curtail growth in program spending in an attempt to return to fiscal balance.

- As a result of deficit reductions efforts, the share of government spending in total GDP is expected to continue to decline over the projection period, limiting the impact of the public sector on economic growth.

- Over the longer term, demographic changes will constrain real GDP growth in Canada, which in turn will reduce growth in government revenues, thus limiting the capacity of governments to increase expenditures.

Composition of Growth in Aggregate Demand



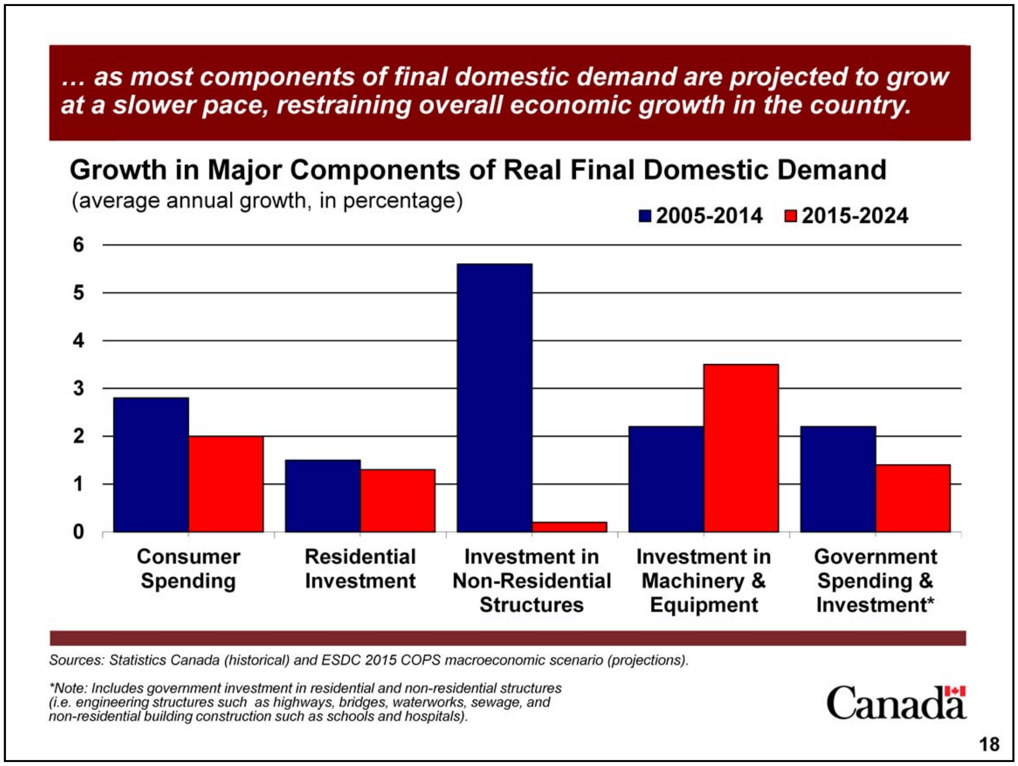
- The very modest acceleration projected in Canada's real GDP growth over the period 2015-2024 is expected to be driven by a notable improvement in exports growth, as the pace of growth in final domestic demand is expected to slow significantly.

EXPORTS:

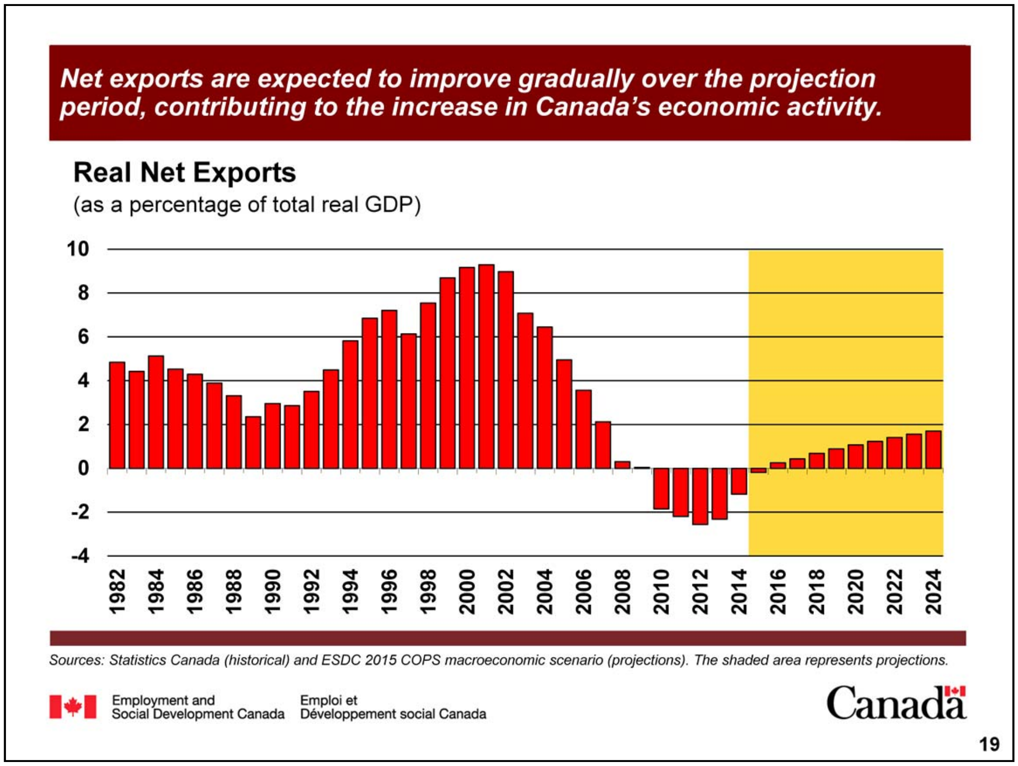
- The average pace of growth recorded in Canadian exports over the period 2005-2014 was substantially lowered by the weakness in foreign demand brought by the global recession of 2008-2009. Exports are projected to increase at a much faster pace over the forecast horizon, particularly in the short-term, as a wide range of sectors are expected to benefit from the ongoing strength in residential activity, consumer spending and business investment in the United States. The majority of Canada's exporters are also expected to benefit from the recent depreciation of the Canadian dollar (largely attributable to the sharp decline in oil prices), making Canadian exports more competitive on international markets.
- While stronger economic growth in the United States is expected to be the primary source of foreign demand for Canadian exports, recent international trade agreements signed with the European Union and South Korea and the negotiations currently in place to join the Trans-Pacific Partnership will also help Canada's exporters to gain greater access to other markets over the longer term horizon.

FINAL DOMESTIC DEMAND:

- The pace of growth in final domestic demand is projected to slow gradually over the period 2015-2024, as a result of changing demographics, limited growth in government spending and a less accommodative monetary policy. Lower oil prices are also expected to weigh on final domestic demand, particularly in the short-term, through major cutbacks in energy-related business investment.



- Most components of final domestic demand are projected to grow at a slower pace over the period 2015-2024.
- Weaker growth in consumer spending is primarily attributable to demographic changes. Slower growth in the working-age population (15 years and over) is expected to constrain employment growth, while the aging of the population will result in massive retirements of baby-boomers from the labour market. These two factors are expected to restrain growth in disposable income and, as a result, growth in consumer spending. An anticipated reduction in household debt to more sustainable levels is also expected to weigh on consumer spending. Consumption growth is projected to slow for most categories of goods and services.
- Growth in residential investment is projected to slow marginally. With the gradual decline in household formation and the eventual rise in interest/mortgage rates, new housing is expected to start declining in 2021, resulting in negative growth for the overall projection period. Despite slower growth anticipated in renovation spending, this component will be the primary source of growth in residential investment over the period 2015-2024, followed by ownership transfer costs (associated with the resale of existing houses) which are expected to grow at an accelerating pace relative to the previous ten years. Beyond 2020, renovation spending is projected to exceed new housing spending.
- After surging during the period 2005-2014, average annual growth in non-residential investment is projected to weaken drastically over the next ten years. This reflects major investment cutbacks anticipated in engineering structures from the oil and gas sector in 2015 and 2016, as a result of the sharp drop in crude oil prices (oil and gas account for about 50% of total investment in engineering structures in Canada). While investment in oil and gas engineering structures is expected to rise back with the gradual recovery in oil prices, this will not be sufficient to offset the large declines anticipated in 2015-2016. As a result, the very modest pace of growth in non-residential investment will be mainly supported by additional, albeit slower, increases in electric power engineering structures and non-residential building construction.
- The return to deficit reduction programs, particularly in the provinces, and additional pressures on public finance due to demographic changes are expected to restrain growth in government spending and investment.
- Investment in machinery and equipment (M&E) is the only component of final domestic demand where growth is projected to accelerate over the period 2015-2024. While lower investment from the oil sector and a weaker Canadian dollar are expected to weigh on M&E investment in the short-term, the gradual recovery in oil prices, solid growth in manufacturing exports, and the need to upgrade existing M&E are expected to boost capital investment over the medium- to long-term. The notable slowdown projected in labour force growth (labour supply) will also represent an incentive for businesses to invest more in physical capital.



- As growth in real exports is projected to exceed growth in real imports, Canada’s trade sector is expected to improve over the projection period, contributing positively to the increase in overall economic activity. Indeed, the trade deficit is expected to turn into a surplus in 2016, and this surplus is projected to keep growing, reaching 1.7% of total real GDP in 2024.
- The projected improvement in net exports is primarily attributable to stronger growth in foreign demand, primarily from the United States, which should allow the export sector to post faster gains over the period 2015-2024 (see page 17). Growth in exports is expected to be particularly strong in the short-term, benefiting from a weaker Canadian dollar and the economic stimulus provided by lower energy costs in oil-importing countries such as the United States, China and India.(1) Export growth is projected to ease somewhat over the medium- to long-term, primarily reflecting slower economic growth in the United States, as demographic changes are expected to restrain growth in domestic demand and potential output in Canada’s largest trading partner.
- In contrast with the export sector, imports are expected to post slower gains over the period 2015-2024. The recent depreciation of the Canadian dollar and the decline anticipated in energy-related business investment, particularly in machinery and equipment, are expected to weigh on Canadian imports in the short-term. Over the longer term, growth in imports will be primarily restrained by the gradual slowdown anticipated in final domestic demand, more particularly in high import propensity consumer spending. With population aging, Canadians are expected to consume more services and slightly fewer goods. Since services tend to have a lower import content, this change in consumer demand is expected to restrain import activity.

---

(1) Oil-price declines due to abundant supply tend to stimulate economic activity in countries that are net oil importers, boosting real incomes and consumer spending and improving current account balances in those countries, which tend to spur foreign demand for Canada’s non-energy exports.

Conclusion

Changes in external and domestic drivers of aggregate demand are projected to lead to changes in the pace of growth of industrial output and employment, which in turn affect occupational labour demand over the period 2015-2024.

See presentation titled: Industrial Scenario 2015-2024