ECONOMIC VIEWPOINT

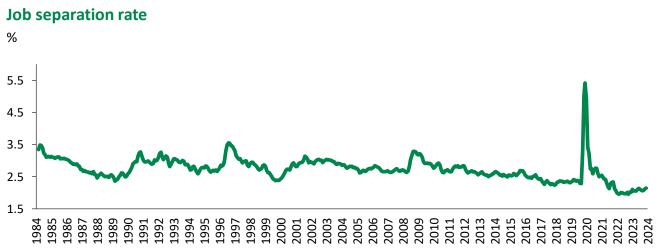
# Verging on Recession or Just a Regression?

## By Royce Mendes, Managing Director and Head of Macro Strategy, and Tiago Figueiredo, Macro Strategist

**The recent jump in Canada's unemployment rate has many worried that a recession is lurking around the corner.** It's not like Canada's economy has been firing on all cylinders lately. However, there are reasons to believe that the economy is not destined for such an outcome and that a soft landing is still possible.

**One clue is that the rising unemployment rate has not been driven by job losses.** The net decline in employment seen in June is a drop in the bucket compared to the gains over the past year. The separation rate, which tracks workers who had a job a month ago but are now unemployed, remains extremely low (graph 1). That's a sign of stability for those who are already employed.

**Graph 1**
**Canadian Workers Are Not Losing Jobs**

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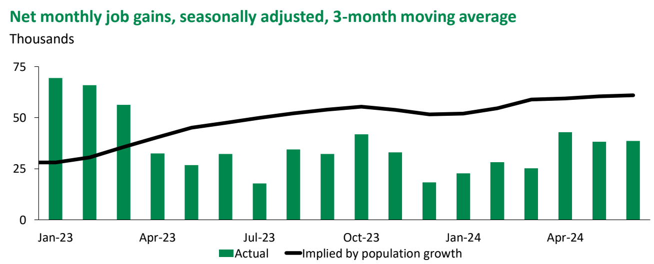
**The increase in the jobless rate has instead been the result of newcomers not finding work upon arrival.** The record surge in immigration has meant that even the healthy pace of job growth over the past year has fallen well short of what would have been needed to keep the unemployment rate steady (graph 2).

**Graph 2**
**Employment Growth Has Not Kept Up with the Sharp Rise in Population**

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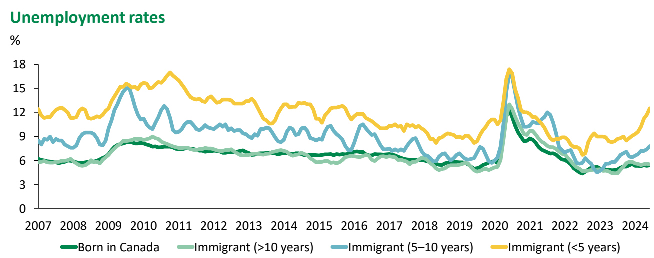
**Indeed, the unemployment rate for newly landed immigrants has risen markedly over that time.** Outside of the pandemic, the jobless rate for new entrants hasn't been this high since the oil price crash in 2014–15 pummeled Canada's labour market. Conversely, the unemployment rate remains very low for residents born here and those who immigrated more than ten years ago (graph 3).

**Graph 3**
**The Unemployment Rate for Newly Landed Immigrants Is Rising Sharply**

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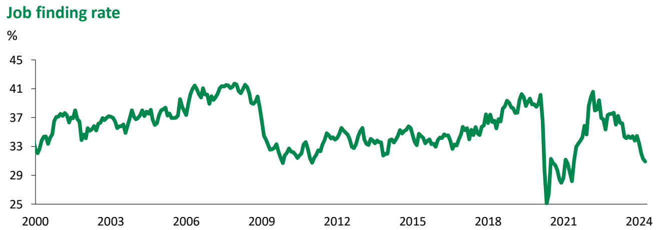
NOTE TO READERS: The letters k, M and B are used in texts and tables to refer to thousands, millions and billions respectively.

**In other words, the labour market is fairly solid for those who already have a job, but it's become extremely tough for those looking for work.** Youth graduating from high school and post-secondary institutions are facing similar challenges to new immigrants insofar as their unemployment rate has been steadily rising since last year. The job finding rate, which measures the likelihood of an unemployed person finding work, is hovering around levels seen during the financial crisis (graph 4). Roughly 18% of unemployed workers have now been searching for a job for more than 27 weeks, up from a recent low of 13% in August 2023. This reduced hiring appetite has also been reflected in the falling job vacancy-to-unemployed ratio, which is now below pre-pandemic levels.

**Graph 4**
**It's a Tough Labour Market for Those without a Job**

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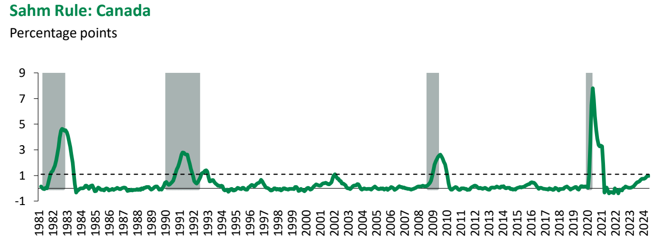
**The way the unemployment rate has risen means it's not a sign of an imminent recession.** Canada has never experienced a layoff-less recession in part because most definitions of recession include a drop in employment. But even abstracting from the underlying drivers, just looking at the absolute magnitude of the increase in the unemployment rate shows that it has yet to breach key thresholds.

**The Sahm Rule, named after former Federal Reserve economist Claudia Sahm, has been a reliable early indicator of recessions in the US.** It measures the increase in the three-month moving average of the unemployment rate relative to the minimum of that average over the past twelve months. The trigger level for calling a recession in the US is an increase of 0.5 percentage points, while in Canada it looks more like 1.1 percentage points. The current reading of 1.0 percentage point comes in just beneath that level (graph 5). The absence of mass layoffs has allowed for a gradual rise in the unemployment rate, in contrast to the spikes that have characterized episodes of recession. That's helped avoid triggering the Sahm Rule in Canada.

**Graph 5**
**The Change in the Unemployment Rate Is Still below the Key Sahm Rule Threshold**

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**Regardless of the unique factors surrounding this latest rise in unemployment, central bankers will view the labour market dynamics as reinforcing their view that underlying inflationary pressures are still cooling.** Slack is clearly building, which will pull price pressures lower. Policymakers view wages and inflation as lagging indicators. Indeed, it's no surprise to the Bank of Canada that readings on wages and inflation haven't come down as quickly as the unemployment rate has gone up. As a result, after seeing last week's Labour Force Survey, we continue to believe the central bank will reduce rates another 25bps later this month.

**At least for now, governments and businesses can breathe a sigh of relief.** The labour market is cooling enough to keep rate cuts coming, but not so much that a recession is knocking on the door. Indeed, if central bankers cut rates as fast as we expect them to, a soft landing is still possible. Moreover, as Bank of Canada Governor Tiff Macklem recently noted, the rising unemployment rate of newly landed immigrants gives the government scope to reduce the number of non-permanent residents, thereby addressing affordability concerns without reigniting labour shortages. Addressing shelter cost inflation without spurring any more wage pressures would also give central bankers more confidence to cut rates.

**We're still forecasting the Bank of Canada to cut rates three more times this year, totaling another 75bps in rate reductions.** This forecast reflects the reduced appetite for hiring we've witnessed recently, consistent with a regression from the very tight labour market seen in recent years. That's in line with the gradual easing in monetary policy the Bank of Canada has signalled and in contrast to the more rapid rate cutting cycles that have tended to occur when the economy enters a recession.