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GLOBAL ECONOMICS

SCOTIA FLASH

December 2, 2022

Canadian Wage Gains are Keeping Upward Pressure on Inflation

- **Canadian job growth stayed positive after the massive prior surge**
- **Canada's job market is tighter than the US…**
- **…posting faster wage gains than the US and in real terms…**
- **…while productivity has sunk**
- **The BoC is underestimating wage-price risks…**
- **…and should hike 50 next week while leaving the door open to more**

Contributors

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CDN jobs 000s // UR % // wages m/m %, November, SA:
Actual: 10 / 5.1
Scotia: -10 / 5.3
Consensus: +10 / 5.3
Prior: 108.3 / 5.2

The latest job market readings tilt the balance a little further in the direction of expecting a half-percentage point rate hike by the Bank of Canada next week. It's still not a slam dunk by any means, but the odds of a half point have gone up.

Two reasons for this are a) employment moved to another record high and didn't give an inch of ground after the prior massive gain to post 128 new jobs in two months, and b) wage growth is exploding. Frankly I'm relieved that jobs didn't crater after that super-size-me surge in October. Further, while the BoC may be using its moral suasion powers to try to convince folks that wage growth is peaking and hence trying to temper expectations in order to contain inflation, the facts are screaming otherwise.

Markets reacted by pushing the Canada two-year yield up by about 12 bps post-data, bearing in mind that this is outperforming a 17bps spike in the US two-year yield post-nonfarm that is dragging yields higher in both markets. Pricing for next week's BoC decision moved up by 11bps with all but 10–11bps of a half point move priced. The Canadian dollar responded by depreciating a touch not because of weak Canadian data but because of the broad-based fixation on USD strength after payrolls and against all major crosses.

WAGES ARE THE MAIN POINT OF EMPHASIS ACROSS THE DETAILS

The details to the overall figures are broadly constructive. See the summary table in chart 1 for starters.

Regarding the composition of job gains, I liked the fact that aggregate incomes got a lift out of the conversion of part-time to full-time jobs. Full-time jobs were up by 50,700 with part-time jobs down 40,600.

Payroll jobs were up 25k in the private sector and down 25k in the public sector with the 10k gain in self-employed jobs the tie breaker.

Wage growth is absolutely ripping. Wages of permanent employees were up by 7.3% m/m at a seasonally adjusted and annualized rate in November. This follows a 9.1% gain in October. The only softish month of late was September's 2.6% gain.

Chart 2 drives the point home. Wage gains have been very strong on a trend basis dating back to July of last year. In fact, wage growth has been between 4–9% m/m at a seasonally adjusted and annualized rate for 13 of the past 17 months. Further, Canada has been posting real wage gains since Spring (chart 3).

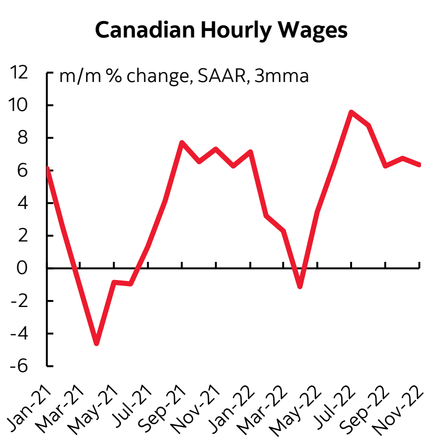
Chart 1

Canadian Jobs Break Down

Province	m/m
Quebec	+28.1k
Ontario	+22.6k
Nova Scotia	+1.6k
Saskatchewan	-1.3k
Prince Edward Island	-1.5k
Prince Edward Island	-1.5k
Newfoundland & Labrador	-3.5k
Manitoba	-5.4k
British Columbia	-13.7k
Alberta	-15.1k
Employment Type	**m/m**
Full Time	+50.7k
Part Time	-40.6k
Public Sector	-24.9k
Private Sector	+24.7k
Self Employed	+10.4k

Sources: Scotiabank Economics, Statistics Canada.

Chart 2

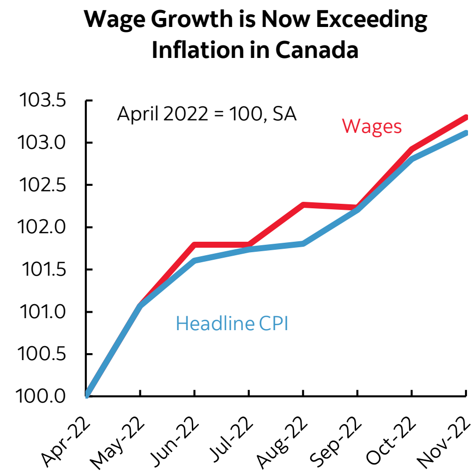


Sources: Scotiabank Economics, Statistics Canada.

The unemployment rate fell a tick to 5.1%. That's because the labour force shrank (-14k) by slightly more than the 10k rise in jobs. The labour force participation rate slipped (chart 4). Why did the labour force shrink? Partly because "6.8% of employees were absent due to illness or disability during the reference week." The average pre-pandemic rate was 5.8% and the pandemic high was 10%. So clearly the pandemic's effects on the job market are not over except that it's not just the pandemic having this effect. Statcan noted that the absences were concentrated upon parents looking after their kids who have been walloped by covid, the flu, rsv, playdoh mishaps, running with scissors and I'm sure all manner of things that keep parents on edge in today's world. Nevertheless if this is a transitory shrinkage of the labour pool then the downtick in the unemployment rate should be treated cautiously.

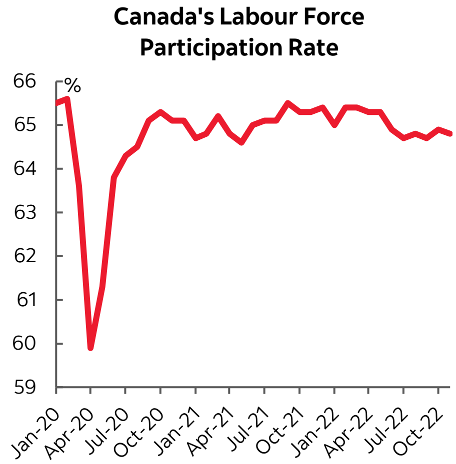
Hours worked were up by just 0.1% m/m in November but this follows a large 0.7% rebound the prior month. Hours worked are tracking a 1.6% q/q SAAR rise which is a plus for continued GDP growth given that GDP is an identity expressed as hours times labour productivity (chart 5). That's an encouraging sign that momentum may be continuing after the strong Q3 GDP beat.

Chart 3



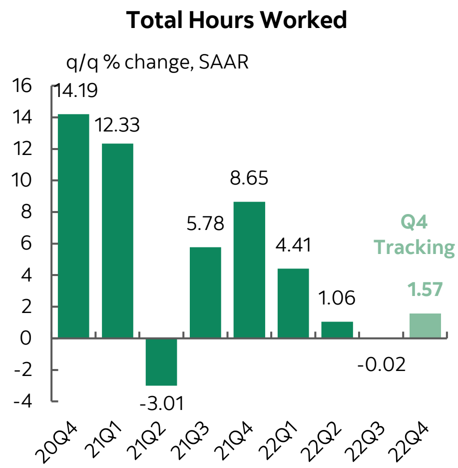
Sources: Scotiabank Economics, Statistics Canada.

Chart 4



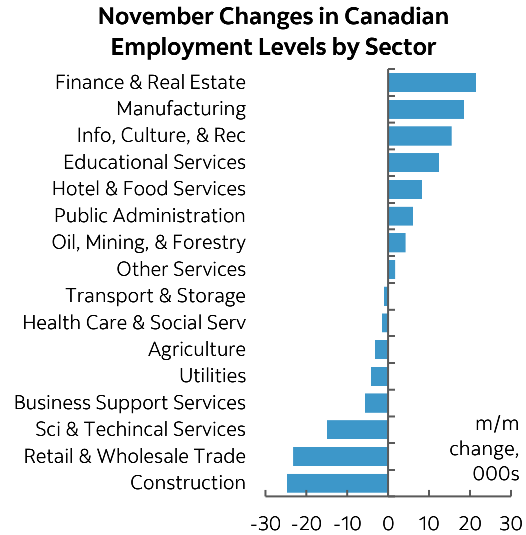
Sources: Scotiabank Economics, Statistics Canada.

Chart 5



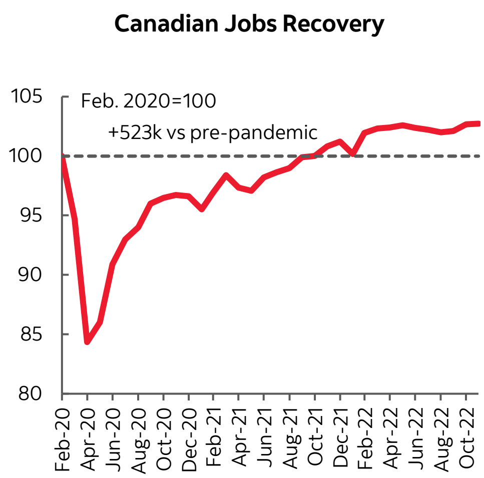
Sources: Scotiabank Economics, Statistics Canada.

Chart 6



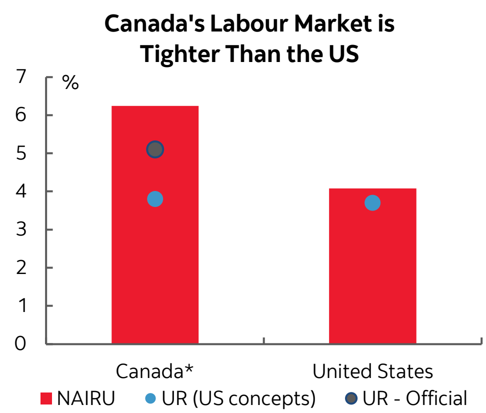
Sources: Scotiabank Economics, Statistics Canada.

Chart 7



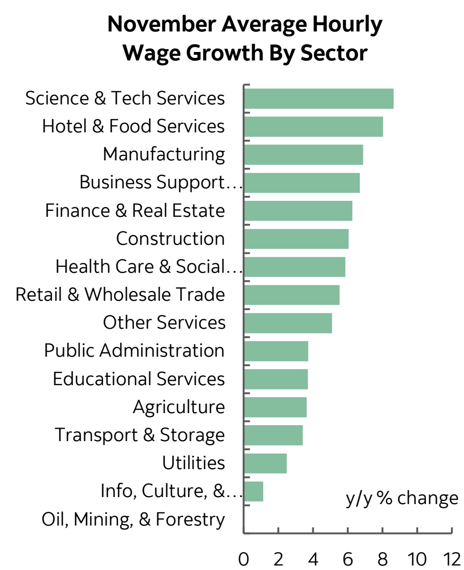
Sources: Scotiabank Economics, Statistics Canada.

Chart 8



*Canadian unemployment rate as adjusted by Statistics Canada to be comparable to the US.
Sources: Scotiabank Economics, OECD, Statistics Canada, BLS.

Chart 9



Sources: Scotiabank Economics, Statistics Canada.

By sector, jobs in the service sector were up by 20k and led by FIRE, education, info/culture/recreation and support services. Chart 6 shows mixed breadth as gains in some sectors were significantly offset by losses in three main areas including construction, retail/wholesale and the professional/scientific/technical categories.

Regionally, all of the gain was in Ontario and Quebec as the rest were flat or down especially the 13–15k drops in BC and Alberta.

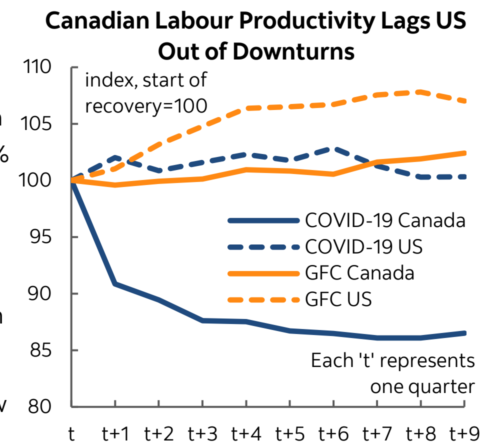
Chart 7 shows the surge toward all-time high levels of employment with over a half-million more jobs now than just before the pandemic struck.

Canada's job market is significantly tighter than the US and that's why we're seeing wage gains like this. Canada's unemployment rate measured using the same methods in the US is 3.8% versus 5.1% official. That's because Canada has a relatively more lax definition of what constitutes searching for work than the US does and because Canada's definition of the labour force starts one year earlier for youths than the US, among other considerations. Measured with the same practices, Canada's unemployment rate is on par with the US at 3.7% (US) versus 3.8% in Canada.

Then consider that structural unemployment is higher in Canada with a higher natural rate of unemployment and so Canada's spread between the unemployment rate and a measure of the natural rate is more deeply negative than the US by a long shot. ie: it's a tighter labour market in Canada as shown in chart 8.

Chart 9 breaks down wage gains by sector of the labour market in year-over-year terms to show the breadth of gains across sectors.

Chart 10



Sources: Scotiabank Economics, Statistics Canada, Bureau of Labour Statistics.

CONCLUSION

Canada's labour market is very tight, tighter than stateside, while generating strong wage gains at a faster pace than the US and despite the plunge in labour productivity (chart 10). Simply put, Canada's tight labour market is driving wage gains that are inflationary because the pace of pay increases is in excess of the rate of growth in output per hour worked. The Bank of Canada's guidance that wage growth has peaked is wishful thinking as it underestimates pressures on the labour market that pose ongoing upside risk to price pressures on a smoothed basis over time going forward. Everyone naturally wants a pay increase given pressures on the cost of living but those gains are exceeding inflation and productivity and present the risk that either the cost of borrowing will push higher yet and/or stay higher for longer. I will elaborate upon the BoC call in the Global Week Ahead later today.