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GLOBAL ECONOMICS

SCOTIA FLASH

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The BoC May be About to Do the Wrong Thing

- **Why the BoC is likely to cut 50bps has very little to do with this jobs report**
- **Risk management, bowing to markets, and Macklem's intrinsic dovishness are more likely drivers of upsizing that could backfire**
- **The seasonal adjustment factors look too fudged to have faith in the report.**
- **Temps are driving higher unemployment…**
- **…and cutting rates to employ more unemployable temps won't help productivity…**
- **…and risks overheating conditions for the bulk of the economy**

Canada employment m/m 000s / UR %, November, SA:

Actual: 50.5 / 6.8

Scotia: 20 / 6.4

Consensus: 25 / 6.6

Prior: 14.5 / 6.5

The Bank of Canada is likely to cut 50bps next week. This is not a high conviction call from the standpoint of what we think they should do. In fact, there are really only two main reasons for doing so, neither one of which having much of anything to do with the jobs report we just got (see summary in chart 1).

The jobs trend is very strong, cutting to address the area of weakness would create unintended consequences, and Statcan made up seasonal adjustment factors at a beer-and-darts party that calls into question the reliability of the whole set of figures before even mentioning the +/-57k 95% confidence interval around reported changes in jobs. My interpretation of the jobs report strongly counsels against rapid easing.

Chart 1

Canadian Jobs Break Down	
Province	**m/m**
Alberta	+24.3k
Quebec	+22.2k
Manitoba	+6.6k
Prince Edward Island	+2.7k
Saskatchewan	+1.6k
British Columbia	+1.4k
Nova Scotia	+0.6k
New Brunswick	-1.0k
Newfoundland & Labrador	-1.9k
Ontario	-5.7k
Employment Type	**m/m**
Full Time	+54.2k
Part Time	-3.6k
Public Sector	+45.0k
Private Sector	+6.3k
Self Employed	-0.7k

Sources: Scotiabank Economics, Statistics Canada.

Two Reasons to Cut By 50bps

One reason for the call is that the BoC may take a risk management approach that attaches less concern to the risk of reigniting inflation with aggressive easing than it does to its concern about not wishing to risk inflation dropping materially below 2% by not doing enough to ease. That's their schtick. Time will tell if it's the right approach, but it's their bias. I think they should be more careful, but Macklem is a dove who reacts to inflation far too late and is quick to ease.

The second reason is that the BoC may find it more difficult to explain why it is doing less than markets are pricing than to simply bow before traders and wish them all happy holidays. That's because Governor Macklem has been sounding so dovish with guidance that the BoC is nowhere close to the limit of undershooting the Fed while he is signalling ambivalence toward the effects on the currency. Markets are pricing almost all of a half point cut in the wake of this morning's numbers. So give it to them and blow a party favour. Put on the Santa Clause costume for the presser as a nice added touch.

But ease because the job market is cratering? Give me a bloody break. This is a very strong job market. Where it is not is not something for rates to fix; if they try, they'll break something else.

The Jobs Trend is Strong…

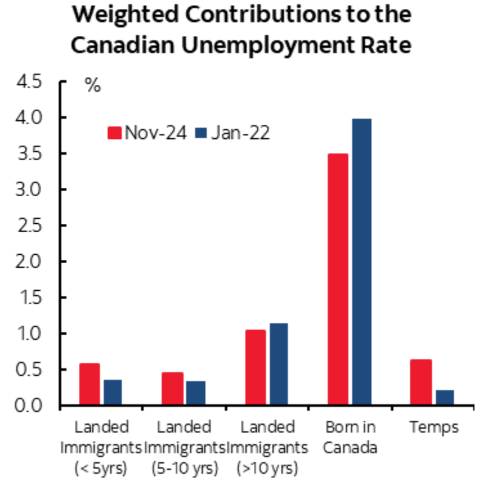
The headline job gain of 50.5k is nothing to spit at. Ditto for the trend. Canada has created a whopping 112k jobs in the past three months. Almost all of that was in private payrolls (+88k) and self-employed (19.5k) as public sector payrolls were only up 4.2k with civil servants down 10.7k. That's not exactly a labour market that is shrivelling away.

…But Canada Keeps Letting In Too Many Temps

It's just that relative to the continued flood of labour market entrants it's not good enough from the standpoint of the unemployment rate and that is what spooked markets. Oh my, you could hear traders shriek (or in some other choice words…) look at the UR! That UR edged up three-tenths to 6.8% because the labour force was up by 138k last month, two and a half times the pace of job creation. Yes, 138k.

A big part of that was driven by another 80k increase in population during the month, with population up by 1.179 million over the past year. You can stop any day now Ottawa. Really, I mean, look at all the temps who are hitting the unemployment lines as the single-biggest driver of the rise since it began rising (chart 2). Rahhhh-diculous! I've lost count of the press conferences and photo ops that have announced tightened rules. The other part of the jump in the labour force was driven by lagging entry of folks looking for work.

Chart 2



Sources: Scotiabank Economics, Statistics Canada.

Clearly Ottawa's tightened immigration policies are having zero effect so far. This issue is only going to get bigger into 2025 as the immigration file continues to be ineffectively managed. If we go into an election with an ongoing torrent of new entrants hitting the unemployment lines then Canadian voters are going to be choking on their sugary beaver tails. And Mexico says we have no culture; pfft!

Cutting Rates to Create More Jobs for Temps Would Drain Productivity

But cut rates faster because Canada is accepting too many folks? Someone please tell me how that would help the situation. Job growth is strong, just not strong enough because Canada keeps taking on more immigration than it can handle. So cut. Righto. Ease rapidly in order to force an over abundance of folks looking for work into work and very likely at the expense of productivity. That's because so many of the overshooting numbers of folks arriving are international students and temporary foreign workers that don't match the productivity of other workers. But with thanks from almost everyone else that is doing much better in the workforce such that they take the lower rates, go and spend and buy homes, and drive up inflation again. And on we go, Canada doing the rinse-repeat on the long-run path to lousy productivity, weak incomes, and ever soaring prices for hockey tickets. Well done.

It's important to understand what I'm saying here. Let in too many temps who can't get work and tend to have low productivity, so the unemployment rate rises, so cut rates to unleash even more of a torrent of recent activity via soaring home sales and vehicle sales by the rest of the population that is generally not experiencing the same employment weakness. And wonder how inflation gets resurrected. Gawleee Gomer, how'd that happen?! And that's what the shops that are ranting on and on about per capita numbers would have the BoC do. And if one day Canada stops talking about lower immigration and actually implements it, then those shops will be proven to have given such advice at the worst possible moment just as population shrivels and per capita spending soars. Loud clap for them folks!

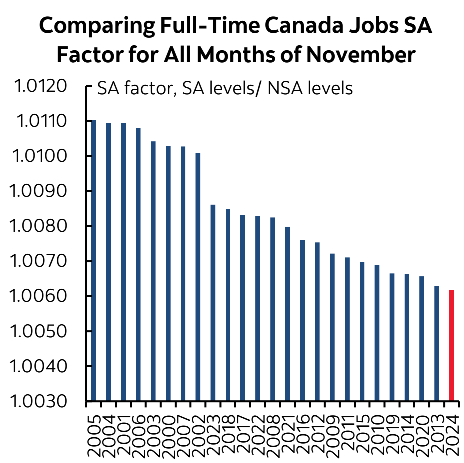
Statcan's Fudged Seasonal Adjustments Signal Their Own Lack of Confidence in the Data

A second consideration in terms of not overreacting to this report is that Statcan needs to explain what it is doing with SA factors. I mean really needs to explain.

Unless there is a very good explanation for what they are doing then I'm strongly inclined to advise ignoring this report altogether. Line the kid's gerbil cage with printed copies of it. Key are the SA factors they chose to apply in arriving at a 54k rise in full-time employment and flat part-time employment (-3.6k).

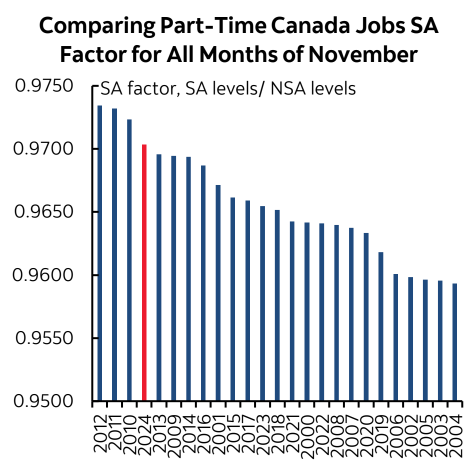
The SA factor that they chose to make the lowest on record for full-time jobs this November compared to like months of November in history (chart 3) sharply constrained the full-time job gain.

Chart 3



Sources: Scotiabank Economics, Statistics Canada.

Chart 4



Sources: Scotiabank Economics, Statistics Canada.

If, instead, they had used something closer to the historical average full-time SA factor for months of November, then 92k full-time jobs would have been created last month. Had they gone higher toward the highest SA factor on record for months of November, then 135k full-time jobs would have been created. Ok, so the swing factor on full-time jobs created last month is anywhere between 55k that they went with and 135k and with no real explanation for going with the lowest number.

That says to me that the numbers are not reliable. Barring a good explanation, it looks to me like the analysts didn't believe the numbers, got nervous they wouldn't be believed, and so made up the SA factor.

There is something a little less fishy on the part-time side as well. Statcan went with among the highest SA factors on record for part-time jobs in like months of November to arrive at a flat reading of 3.6k (chart 4). If they had instead gone with an historical November average SA factor for part-time jobs then p-t jobs would have fallen by -22k; a historically low part-time SA factor would have resulted in -46k fewer part-time jobs.

When I see this going on and with no clear reason for doing so the natural inclination is to chalk it up to noise and move on.

And on the size of the labour force, there was a similar signal in that Statcan went with an SA factor that dramatically held back the already strong gain in the size of the labour force. Chart 5 shows that the SA factor for the size of the labour force was the second lowest used for like months of November this century. Had they gone with, say, an average SA for months of November, then the labour force would have been up by over 170k instead of 138k. The UR would have been even higher.

And so again the observation is that the massive jump in the size of the labour force was so huge and unbelievable in the eyes of the analysts at Statcan that were assigned the task of making sense of the small sample Labour Force Survey that they chose to offset some of what was being spat out by choosing a very low SA factor.

And markets have confidence in these numbers?

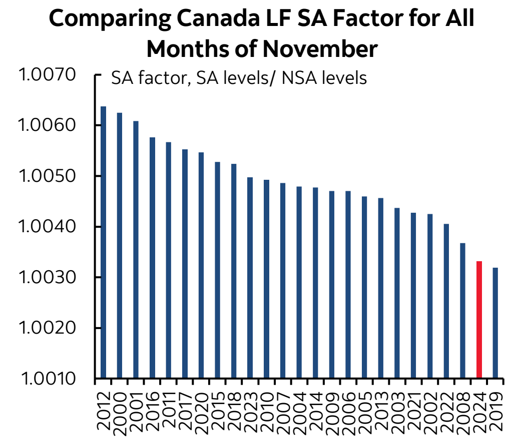
Details

But what markets also dwelled upon is not the trend that I think the BoC should focus upon, and instead the details behind the latest report. The 50.5k jump in payrolls was all in the public sector (45k) as private sector payrolls were up only 6.3k and self-employed jobs were flat (-0.7k). In one month. Never mind the trend that shows public sector jobs down over the past few months as noted and the private sector sharply higher; markets only cared about the latest month and attached normative judgement to what is a good job and what isn't.

Mind you, there are a lot of very good public sector jobs. The rise last month was not driven by public administration roles (-2k) which is encouraging at least to me since that category has absolutely gone bonkers since 2015. I'm not entirely sure what drove it to be honest. The education sector combines private and public sector employment and it saw 15k more jobs. The health care and social assistance sector was up only 8.6k and also combines public and private sector jobs. So where was the rest of the 45k public sector gain? It's possible that the public components to those sectors were up strongly as an offset to weaker private components. It's also possible that survey noise makes this a fabricated report.

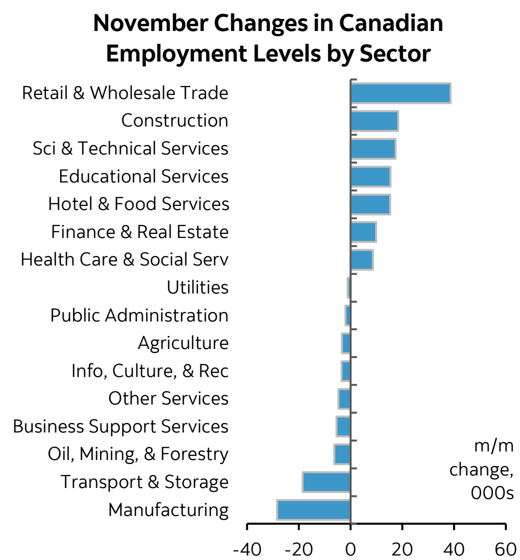
Other details were robust. All of the gain was in full-time jobs (+54k) as part-time employment fell 3.6k. That have been the trend for a while now with full-time up 192k over the past three months and part-time down 80k.

Chart 5



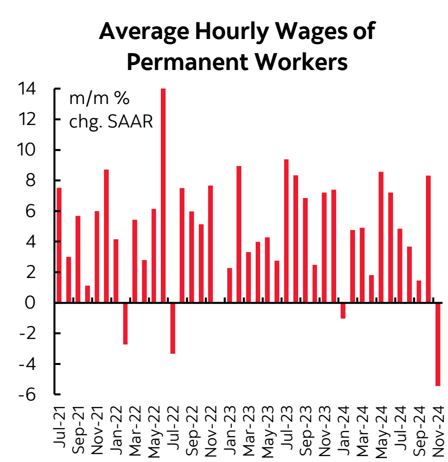
Sources: Scotiabank Economics, Statistics Canada.

Chart 6



Sources: Scotiabank Economics, Statistics Canada.

Chart 7



Sources: Scotiabank Economics, Statistics Canada, Haver.

By industry in Canada, the jump was led by services +71.5k, through wholesale/retail +38.7k, education 15.4k, prof/sci/tech 17.4k, accommodation and food services 15.3k (chart 6).

Hourly wages of permanent employees fell by -5.5% m/m at a seasonally adjusted and annualized rate, but recall that they had spiked by +8.3% m/m SAAR the prior month and so I'm not surprised they mean reverted in November. Smooth it out over many months (chart 7).

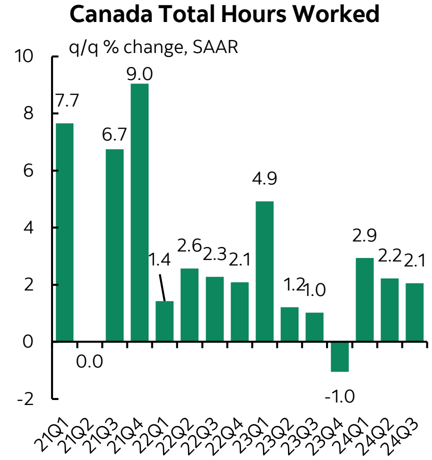
And so I'll end on the one thing that does perhaps signal possible concern. Hours worked fell by -0.2% m/m SA for the third drop in four months. Hours are tracking -0.5% q/q SAAR so far in Q4 after a pair of decent quarterly gains (chart 8), which is not good for Q4 GDP unless somehow we get a productivity miracle. Maybe we will, with multiple activity readings trending upward. That would be a welcome change.

And so in conclusion, I would assign about 70% odds of a 50bps cut by the BoC next week. If they do upsize again, then I hope there is a much more careful bias if not an outright signal that at 3.25% and 175bps below the peak policy rate they are prepared to take a bit of a breather and see how the rest unfolds.

The rest of it could unfold in a way that is very unfavourable to aggressive easing. The Feds, Ontario and BC are going to be handing out billions in cheques by springtime. The GST/HST "temporary" cut gets triggered in days and is very likely to be made permanent. Easier mortgage rules kick in at about the same time as the GST/HST cut. And bring on the distinct possibility that we're hit bottom on real per capita GDP and consumption (chart 9) even without removing temps from the population figures which I continue to think we should.

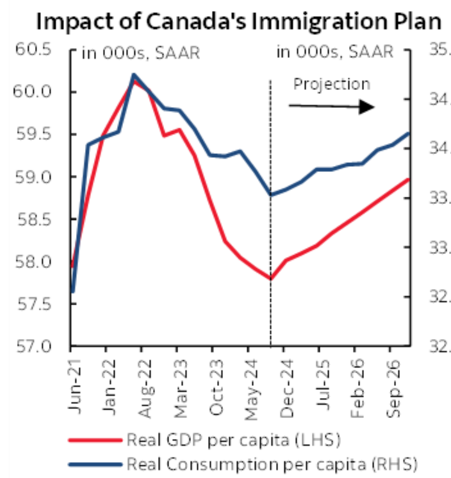
So go ahead. Cut 50bps. You'll be a quarter point above your neutral rate range. If Trump imposes 25% tariffs, you'll look brilliant, even while saying you don't act until things become facts. If Trump doesn't, or if Canada retaliates and invites higher inflation in so doing, then I'll see you on the other side of the lagging effects into the housing and consumer markets. Sorry Mr. Poloz, this economy is nowhere near recession, though I'm sure Governor Macklem appreciates your shadow. I have a hunch that we're at risk of getting too far ahead of ourselves in the face of pent-up demand, pent-up savings and the lagging effects of prior immigration by permanent residents into the housing and consumer markets.

Chart 8



Sources: Scotiabank Economics, Statistics Canada.

Chart 9



Sources: Scotiabank Economics, Statistics Canada.