Yes, Canadian Labour Markets Are Tight

There has been some debate about the true health of Canada’s labour markets, even with the unemployment rate sitting right around four-decade lows. The longest run of job gains in 17 years—a 17-month streak from August 2016 to December 2017—came to an end in January. But it’s hard to get too worried about one month of weakness, particularly at a time when business surveys indicate labour shortages are a growing concern. Indeed, Canadian labour markets are probably close to, if not somewhat beyond, long-run capacity limits. That is good news for wage earners, at least in the near term, although it also suggests interest rates are more likely to continue grinding higher.

Little evidence of ‘hidden’ unemployment

Canada’s official unemployment rate frequently comes under fire for failing to capture discouraged workers who have given up their job search. While that’s a legitimate criticism, there is little evidence of significant “hidden” joblessness in Canada. Broader measures of unemployment produced by Statistics Canada have been declining even faster than the ‘headline’ unemployment rate. True, Canada’s overall labour force participation rate has declined over the last decade but that reflects the country’s aging population and the tendency for older workers (those aged 65 and over) not to participate in the labour markets. Controlling for changes in the age composition of the population, Canada’s participation rate has been setting record highs.

Youth labour markets: not weaker than ‘normal’

The Bank of Canada has singled out weakness in youth labour markets as a concern, but even that argument is becoming more difficult to defend. It’s true that the unemployment rate for 15-24-year-olds is almost twice the national average. But that has pretty much always been the case, in good and bad economic times. The average youth jobless rate of 10.8% over the three months ended in January was the lowest since the late 1980s and is down a substantial 2.2% from a year ago.

As for the youth labour market participation rate, it’s currently lower than the long-run average—but that has more to do with a longer-term structural rise in school enrollment rates than cyclical labour market weakness. Excluding students, the labour force participation rate for 15-24 year olds was 87% in 2017—exactly equal to that of the population aged 25-54. There isn’t much evidence that students are going to school just to avoid weak labour markets, either. The 2.8% of students that reported they would rather be working in 2017 was the lowest in almost two decades. And it’s hard to argue that a higher school enrollment rate is a bad thing, given the ever-increasing potential for automation to replace less-skilled jobs.

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Businesses are reporting labour shortages

The Bank of Canada’s closely watched Business Outlook Survey has shown increases in the share of businesses reporting labour shortages over recent quarters as well as an increase in the intensity of those shortages. Results from the Canadian Federation of Independent Business’s monthly Business Barometer survey are consistent with the Bank of Canada numbers. The most frequently-cited impediment to growth in business production/sales in that survey currently is a shortage of skilled labour.

A tighter labour market is good news for wage earners

Legislated hikes to minimum wages in some Canadian provinces—particularly Ontario’s 21% hike at the start of 2018—will make it a little more complicated to determine how much of any near-term wage growth was due to organic labour market tightening versus government-mandated changes. But there were already convincing signs of stronger wage growth in Canada.

The Bank of Canada, using a new measure, recently pegged wage growth at around 2.2% in Q4 of 2017. That fell slightly short of some other prominent indicators running in the 2.5% to 3% range. Nonetheless, the upward drift is clear regardless the measure chosen. Wage growth historically tends to lag improvement/deterioration in labour markets. So stronger labour markets today mean wages would be more likely to rise faster going forward, even without minimum wage hikes.

What does it all mean for monetary policy?

Improving labour markets have added to the evidence that the Canadian economy is operating close to—if not beyond—its long-run sustainable production capacity. To use Bank of Canada Governor Stephen Poloz’s terminology, the economy looks pretty close to “home.” At the same time, monetary policy remains significantly stimulative. The current 1.25% overnight rate is still well below the 2.5% to 3.5% range the central bank pegs as its long-run “neutral” level. High household debt levels mean the central bank will probably still be very cautious about the pace of rate hikes. But the healthy state of Canada’s labour market is a big part of the reason that we continue to think it would take a significant downside surprise or a negative shock—like a ‘bad’ NAFTA outcome—to prevent further gradual rate hikes altogether.