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Article

Canadian wages - what's wrong?

The security of the United-States-Mexico-Canada-Agreement doesn't take away all of Canada's uncertainties. But we now focus on the 'deep-rooted' problems, underlying what has been a positive economic performance over the past few months

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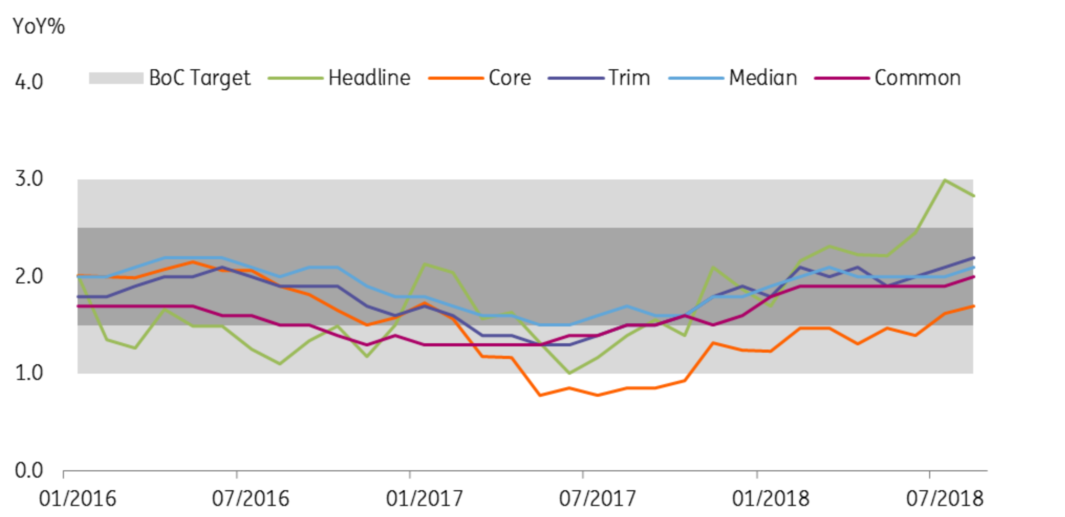
Although high gasoline prices have driven recent headline inflation - we think Canada touched peak price growth in July at 3% YoY, but core inflation still sits around the Bank of Canada's 2% target. This, along with the positive run of domestic data, indicates Canadian consumers are still spending – but with what money?

Core measures sit around the 2% target



Source: Macrobond

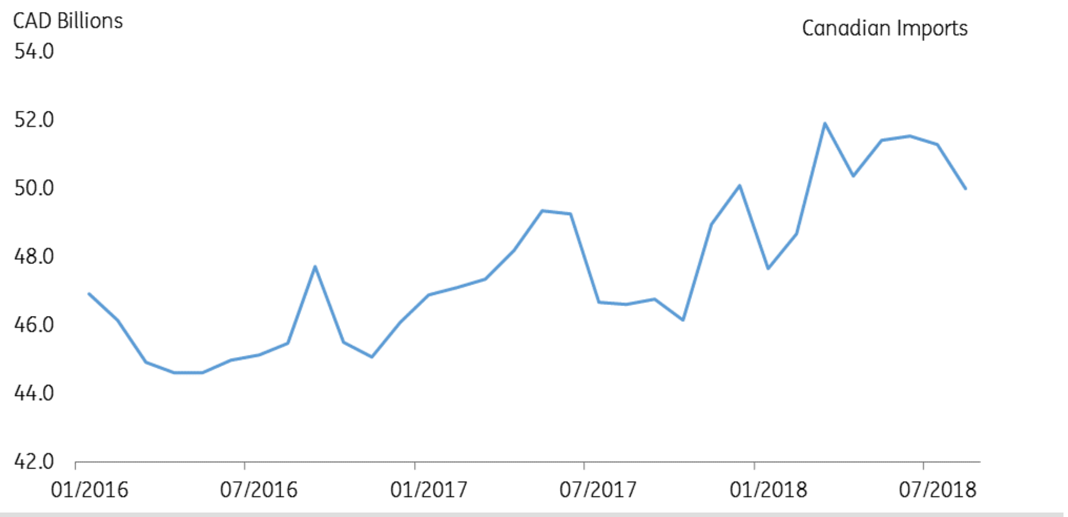
The battle between living cost and wage growth

Wage growth is slowing down. Average hourly wages of permanent workers slumped further to 2.2% year on year in the September jobs report, down from 2.6% in August. So, how are Canadian's keeping up with the cost of living and how long can they go on?

Low borrowing costs have contributed to somewhat maintaining healthy domestic demand and are likely to have played a part in disguising some negative impacts, caused by wage slowdown, by helping households finance large expenses.

It's also worth mentioning Canada's trade surplus (CAD 0.526 billion) in August was the first surplus in 20 months and came with a 2.5% fall in imports. This could suggest that economic demand is starting to feel the disparity between living cost and wage growth.

Canadian imports decline for second month in a row



Source: Macrobond

Why is wage growth declining?

However, focusing exclusively on the unemployment rate doesn't tell us the full story about the labour market. At 5.9%, the unemployment rate is close to a 40-year low and thus relatively positive, but aside from the noted drop in wage growth, the 5.9% print was fed by part-time gains, with the majority in the 25-54 year old range seeing virtually no change in youth employment. So, what does this figure actually say?

1 Productivity growth is poor

Poor productivity growth can be a strain on business profitability which means businesses are reluctant to offer higher wages and bonuses to workers. The flood of part-time positions won't help productivity growth either, especially if these workers want to be in full-time employment.

2 There is still some slack in the labour market

There is more slackness in the labour market than the unemployment rate suggests - a slowdown in wage growth signals competition between firms (for labour) is also diminishing.

Wage growth is declining, but is this a problem?

If wages don't pick up, household purchasing power will weaken further, and this could become a challenge for domestic demand growth next year, particularly for the retail sector. It also poses an issue for the younger generation who wants to enter the housing market, and with Canada's house price to income ratio already ahead of the US (129.1% and 110.8% in 1Q18 respectively), homes aren't exactly affordable, to begin with. And the environment is only going to get tougher for Canadian households.

The Bank of Canada is set to continue their gradual policy tightening path – we see three more hikes from now until the end of 2019. Repayments on borrowing will become larger, so borrowing becomes undesirable which places a barrier on financing living conditions while piling on debt.

Lending conditions for households aren't great either as the central bank expects a tightening in 3Q18 stemming from the tough new mortgage rules that came into effect at the beginning of the year.

It's not all doom and gloom

On the face of it, the United-States-Mexico-Canada-Agreement has been secured, unemployment is low, and income gains are evident, albeit more moderate than desired.

These facts, coupled with upward inflationary pressures, won't deter the central bank from a rate hike in October, nor alter its current tightening plan. It will come as no surprise that growth rate and prices will undergo a cooling period in 4Q18 and into next year, mimicking the modest forecasted US slowdown. But for now, wage growth is one to watch closely – persistent weakness could have the central bank reconsidering their 2019 tightening plans.

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