Economics

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Labour market mismatch will limit BoC's maneuvering room

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The speed and the magnitude of the current easing campaign by the Bank of Canada will be determined largely by developments south of the border and by the bargaining power of Canadian workers. Recent cyclical forces are clearly working to erode that bargaining power for some Canadian workers. But one sticking point for the BoC continues to be wage inflation, which is still running hotter than what various measures of labour market slack would imply.

Although wage growth lags overall economic conditions, part of what is keeping that figure elevated could be due to important divergences underneath the surface. We've identified numerous pockets of labour shortages that have worsened slightly in recent years, owing to well documented structural factors that are limiting labour supply. That's likely not going to reverse any time soon, and in fact might get worse, carrying two important implications. First, without these shortages, the labour market might be notably weaker than it currently is, as the impact of higher rates is being offset in part by chronic supply shortages in some sectors. Second, once we get through this cycle, labour could emerge as more inflationary than it was pre-2020, owing to the stronger bargaining power of some workers.

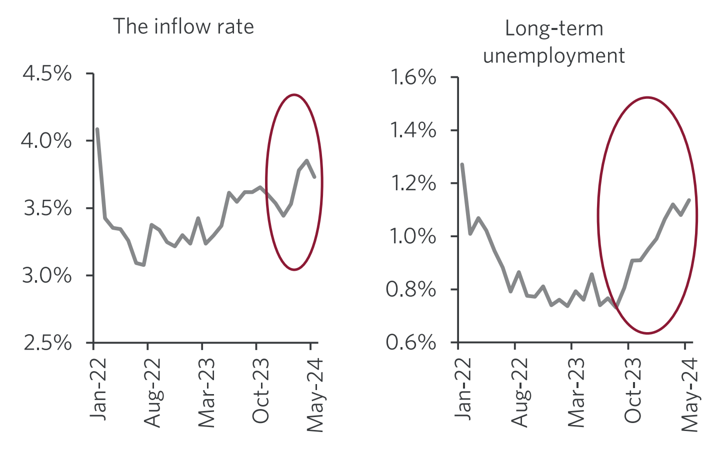
Labour market— cyclical weakening

The Canadian labour market has clearly loosened by enough to allow the Bank of Canada to embark on its interest rate cutting cycle. The number of job openings per unemployed person is back to a normal level (Chart 1), while joblessness statistics are starting to show early signs of stress. At any point in time, the jobless rate encompasses both the number of unemployed people who recently became unemployed, and the number of those who have stayed unemployed for a longer period of time. Accordingly, an increase in the unemployment rate can occur not just because of an increase in the rate at which people are losing their jobs, but also because of the fact that on average, people are staying unemployed for longer periods of time as they are not rehired. As illustrated in Chart 2, measures of becoming and staying unemployed are both on the rise. Not surprisingly, the exit rate from unemployment (the likelihood of exiting unemployment for a job or for some other reason within

Chart 1: Labour market back to normal on the surface

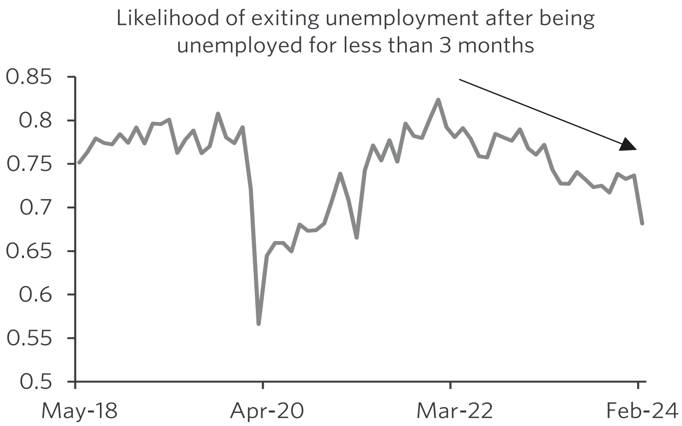
Source: Statistics Canada, CIBC

Chart 2: More people becoming unemployed (l) and staying jobless (r)



Source: Statistics Canada, CIBC

Chart 3: Low chance of exiting unemployment



Source: Statistics Canada, CIBC

the coming three months after being unemployed for less than three months) is also heading in the wrong direction (Chart 3).

Given that, it is easy to dismiss the notion of any labour shortage existing these days. All you have to do is look at various business and consumer surveys that suggest ample labour market slack exists. Business surveys have shown widespread pessimism about economic conditions for the past year, with 22% of firms reporting labour shortages in the Bank of Canada's latest Business Outlook Survey. That's down from a pandemic-era peak of 46%, and below the historical average level of 31%. Still, wage growth expectations remain well above pre-2020 norms according to the BoC's Q1 consumer expectations survey.

Labour market mismatch

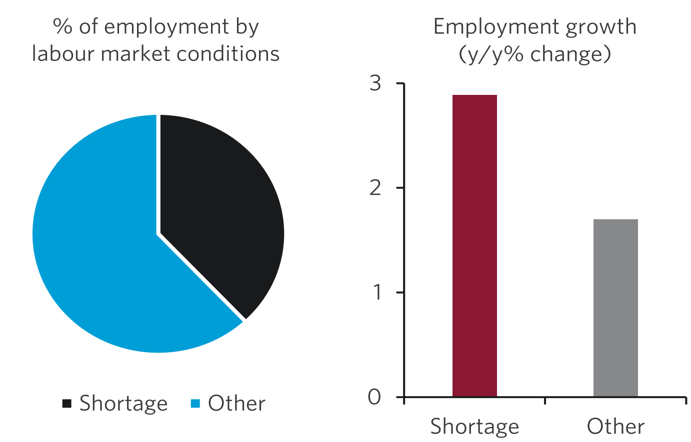
But to get a better sense of the real bargaining power of labour, we need to go well beyond subjective business responses to surveys. Yes, a CEO might indicate that her company is facing a skilled labour shortage, but is it severe enough to force her to raise wages and/or increase on-the-job training activity? Actions speak louder than words. And in this context, it is better to assess the skilled labour shortage by focusing on occupations that are currently experiencing low unemployment rates and a better trajectory in unemployment than the average.

Based on that criteria, we have identified 11 occupations that have recently demonstrated signs consistent with a labour shortage. Unsurprisingly, those include occupations in health, technical trades, administrative positions in supply chain logistics, middle management positions in trade, and professional jobs in finance, amongst others. About one-third of employment in the shortage group is in non-cyclical jobs including healthcare, education, government, and law. Some of those sectors are still adjusting to rapid population growth in recent years and the associated infrastructure requirements, as well as an aging population. Demand for skills tied to supply chain logistics and trade is likely structurally higher than pre-2020 given the acceleration in deglobalization and supply chain pressures faced during the pandemic.

Put together, we estimate that occupations that employ 38% of Canadian workers are currently showing symptoms of a labour shortage (Chart 4, left). While it's true that share could be exaggerated, as more granular data might show that some narrower occupation groupings within the 34 broad groups that we looked at are in surplus, the finding is consistent with structural changes that are underway in the economy. Note that overall employment in the shortage group is rising by almost 3% y/y— well ahead of the increase in employment being seen in other jobs (Chart 4, right), but clearly still not fast enough to dent the labour market skill scarcity.

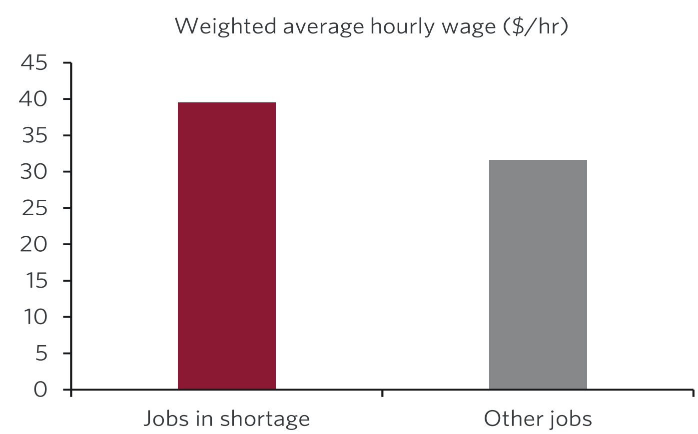
The weighted average unemployment rate of that pool of occupations is under 3% and their wage level is 25% higher than the weighted average wage seen in the rest of the labour market (Chart 5). And their wages are now rising at an annual pace of 4.4%. Of course, skill shortages are not the only problem facing the labour market. On the other end of the

Chart 4: Occupations employing 38% of jobs show signs of shortage (l), and seeing strong employment gains still (r)



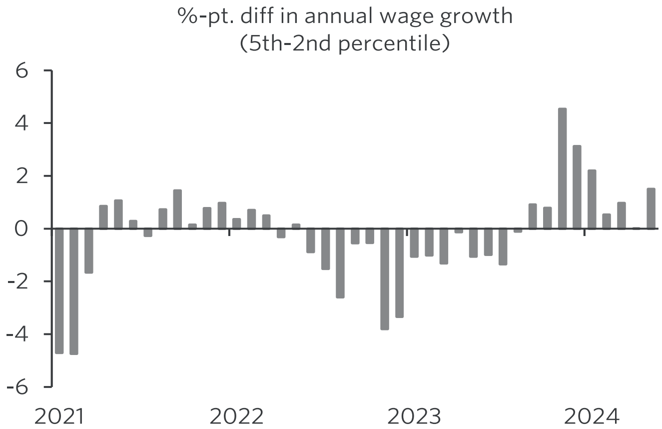
Source: Statistics Canada, CIBC

Chart 5: Jobs in shortage are higher skilled, offering higher wages



Source: Statistics Canada, CIBC

Chart 6: Wage gap elevated, favoring higher income earners



Source: Statistics Canada, CIBC

spectrum, there is a sizable segment of the market that is in a surplus labour supply position, and the aggregate labour market would be in a markedly weaker spot if it were not for these pockets of shortage beneath the surface.

Comparing today's labour market to 2017, when conditions were very tight and the BoC was beginning to raise interest rates, shows that the labour shortage in many jobs began years ago and has persisted or worsened in some cases, particularly for healthcare jobs. In 2017, 16% of total employment showed signs of a labour shortage, as unemployment rates were falling rapidly across the board, leaving little divergence between jobs. The persistence and worsening of the labour shortage into 2024 suggests that these issues will likely extend in the years to come.

The mismatch is becoming apparent in the broader Labour Force Survey data that shows that since late 2023, wage increases for lower-income earners have eased off materially relative to higher-wage earners (Chart 6), which in turn has contributed to sluggish consumer spending, as lower(higher) income groups have higher(lower) marginal propensities to consume. So far, wage inflation isn't feeding through to the CPI, as employers are hesitant to raise prices to pass on higher wages given the deterioration in demand. The drop in profit margins for non-financial industries in Q1 seems to confirm that, with profit margins sitting well below year-ago levels.

Those cyclical forces are at, the end of the day,… cyclical. They come and go. What is more important is that there is a risk of a permanent change in the composition of the labour market in a way that in aggregate puts higher pressure on wage inflation relative to the pre-Covid period, as employers will have to keep wage growth strong in order to attract labour. That will not prevent the Bank of Canada from continuing to ease this cycle, but if these pockets of labour shortages continue to grow over time while demand returns to the economy, it will make the Bank's life complicated and affect where the overnight rate ultimately rests.

Table: Canada forecast detail (real % change, SAAR, unless otherwise noted)

Variable	23Q3A	23Q4A	24Q1A	24Q2F	24Q3F	24Q4F	2023A	2024F	2025F
Real GDP Growth (AR)	-0.3	0.1	1.7	1.9	0.8	1.1	1.2	1.0	1.6
Real Final Domestic Demand (AR)	0.2	0.0	2.9	0.9	1.4	1.3	0.5	1.2	1.9
Household Consumption (AR)	0.1	3.2	3.0	0.2	0.5	0.8	1.7	1.5	1.4
All Items CPI Inflation (Y/Y)	3.7	3.2	2.8	2.5	1.8	1.8	3.9	2.2	1.7
Unemployment Rate (%)	5.5	5.8	5.9	6.2	6.4	6.3	5.4	6.2	5.8

Table: US forecast detail (real % change, SAAR, unless otherwise noted)

Variable	23Q3A	23Q4A	24Q1A	24Q2F	24Q3F	24Q4F	2023A	2024F	2025F
Real GDP Growth (AR)	4.9	3.4	1.2	2.4	0.9	1.8	2.5	2.3	1.9
Real Final Sales (AR)	3.6	3.9	1.7	1.6	2.0	1.5	2.9	2.4	1.9
All Items CPI Inflation (Y/Y)	3.5	3.2	3.2	3.3	3.0	3.2	4.1	3.2	2.7
Core CPI Inflation (Y/Y)	4.4	4.0	3.8	3.5	3.4	3.2	4.8	3.5	2.6
Unemployment Rate (%)	3.7	3.7	3.8	4.1	4.3	4.2	3.6	4.1	4.0

Table: Canadian interest rates (end of period)

Variable	2024 Jun 17	2024 Sep	2024 Dec	2025 Mar	2025 Jun	2025 Sep	2025 Dec
Overnight target rate	4.75	4.50	4.00	3.50	3.25	3.00	2.75
98-Day Treasury Bills	4.65	4.35	3.85	3.40	3.15	2.85	2.60
2-Year Government Bond	3.88	3.60	3.30	2.90	2.80	2.75	2.90
10-Year Government Bond	3.34	3.25	3.10	3.00	3.10	3.15	3.30
30-Year Government Bond	3.28	3.25	3.20	3.25	3.30	3.35	3.40
Canada - US T-Bill Spread	-0.73	-0.70	-0.90	-0.80	-0.60	-0.80	-1.05
Canada - US 10-Year Bond Spread	-0.95	-0.75	-0.70	-0.65	-0.50	-0.35	-0.35
Canada Yield Curve (10-year — 2-year)	-0.54	-0.35	-0.20	0.10	0.30	0.40	0.40

Table: US Interest rates (end of period)

Variable	2024 Jun 17	2024 Sep	2024 Dec	2025 Mar	2025 Jun	2025 Sep	2025 Dec
Federal funds rate (midpoint)	5.375	5.125	4.875	4.375	4.125	3.875	3.625
91-Day Treasury Bills	5.38	5.05	4.75	4.20	3.75	3.65	3.65
2-Year Government Note	4.75	4.50	4.20	3.70	3.50	3.35	3.25
10-Year Government Note	4.29	4.00	3.80	3.65	3.60	3.50	3.65
30-Year Government Bond	4.43	4.30	4.25	4.00	3.90	3.85	3.80
US Yield curve (10-year — 2-year)	-0.46	-0.50	-0.40	-0.05	0.10	0.15	0.40

Table: Foreign exchange rates

Exchange rate	2024 Jun 17	2024 Sep	2024 Dec	2025 Mar	2025 Jun	2025 Sep	2025 Dec
CAD-USD	0.73	0.72	0.72	0.74	0.74	0.74	0.75
USD-CAD	1.37	1.39	1.38	1.36	1.35	1.35	1.34
USD-JPY	158	157	153	150	147	146	145
EUR-USD	1.07	1.08	1.08	1.09	1.10	1.11	1.12
GBP-USD	1.27	1.26	1.27	1.28	1.29	1.31	1.31
AUD-USD	0.66	0.65	0.66	0.66	0.67	0.67	0.68
USD-CNY	7.26	7.27	7.25	7.23	7.20	7.18	7.15
USD-BRL	5.41	5.20	5.00	5.10	5.10	5.00	5.00
USD-MXN	18.60	18.20	18.00	17.50	17.80	17.80	17.50

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