In Focus

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ECONOMICS

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The Canadian Labour Market — Even Better Than You Think

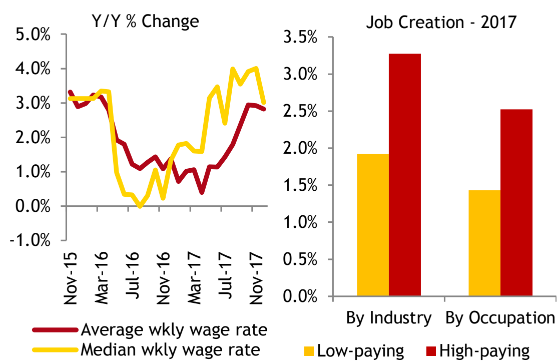
by Benjamin Tal

A "cautious" Bank of Canada should not look to the labour market to confirm any trepidation. Good headline numbers come and go, but beneath the surface, where job market demons usually hide, things are also improving. And where they aren't, it's largely due to structural forces—well beyond the realm of monetary policy.

Strong Headline Numbers

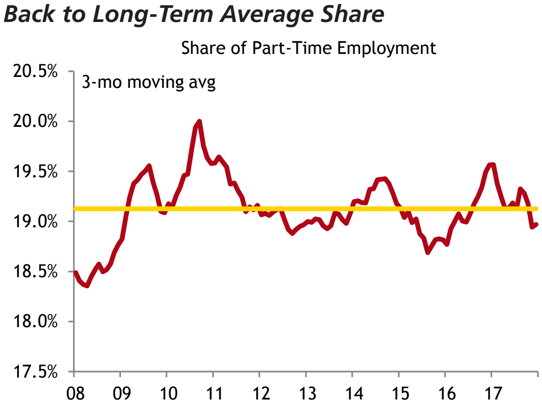
The headline numbers are impressive. In 2017 the economy generated more than 420,000 jobs—the strongest showing in 15 years. And after rising sharply in 2016, part-time employment as a share of total employment is now back to its long-term average (Chart 1). Wages are finally showing signs of life, with both the average and median wage accelerating recently, suggesting broadly-based and more inclusive wage gains (Chart 2, left). Even more important has been the improvement in the composition of job creation. Regardless of how you measure it, by industry or by occupation, the number of high-paying jobs rose faster last year than the number of low-paying jobs (Chart 2, right). So with wage inflation and job composition pointing in the same direction, real labour income is now rising at its fastest rate in five years (Chart 3).

Chart 2
Higher Wages and Better Job Composition



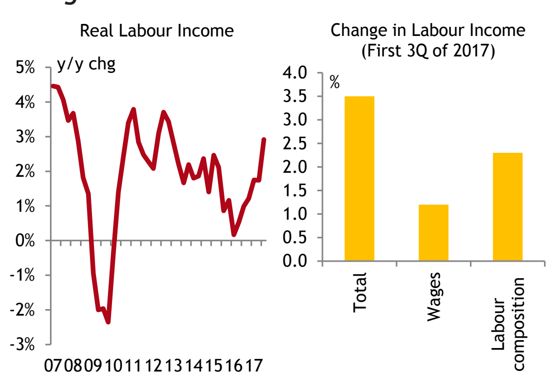
Source: Statistics Canada, CIBC

Chart 1
Part-Time Employment: Back to Long-Term Average Share



Source: Statistics Canada, CIBC

Chart 3
Strong Rebound in Labour Income



Source: Statistics Canada, CIBC

But of course the Bank of Canada will be the first to tell you that the headline numbers are insufficient to justify a shift to a more aggressive rate hiking mode. You have to dig deeper in search of fragilities that might jeopardize the current expansion and the durability of the recent improvement in wage inflation.

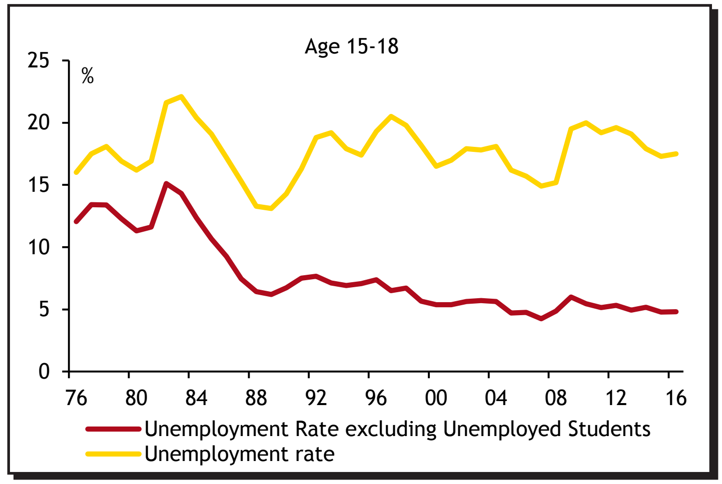
The Kids are Alright

The youth unemployment situation has been a source of concern for a while, with young Canadians unable to take full advantage of the early stages of the economic recovery. That, however, isn't the case anymore. Not only has the youth unemployment rate been trending downward in recent years to reach a record-low of 10.3% in December of 2017, but it has been falling faster than the unemployment rate among adults. Today, the youth-to-adult unemployment ratio is if anything below its long-term average (Chart 4).

What's more, the real youth unemployment rate is much lower than suggested by the headline numbers. The official rate includes youth aged 15-18 that are enrolled in high-school and also search for employment. It's reasonable to suggest that many of these high-school students should not be classified as unemployed as their main activity is learning. Excluding students, the unemployment rate for this age group falls from close to 20% to a record-low of 7% (Chart 5). In fact, this factor also works to reduce the headline national unemployment rate by close to 0.5%. That is, if it was not for the "unemployed" high-school students, the Canadian unemployment rate in December 2017 would have been 5.2% as opposed to the headline number of 5.7%.

Chart 5

Unemployment Among Teens—Not Really A Problem



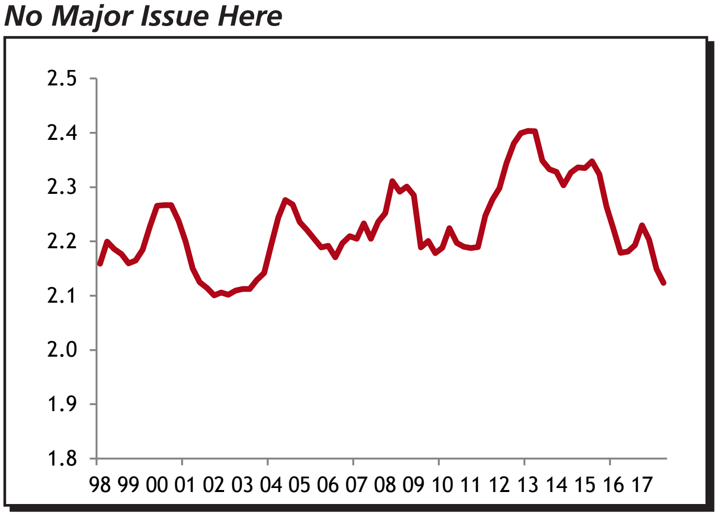
Source: Statistics Canada, CIBC

Yes, Mr. Poloz has said that what keeps him up at night is not youth unemployment, but rather the dramatic decline in the participation of youths in the job market. And as illustrated in Chart 6 left, the participation rate indeed fell notably from 64% before the recession to the current 61%. But take a look at the right side of the chart. Nearly all of that decline is due to lower participation among….. you guessed it…..high-school students. The simple fact that an increased number of high-school students decide to focus more on school and less on part-time employment is not a macro factor indicating real labour market slack.

From a labour market policy perspective, the focus should be on youth that are neither enrolled in school nor

Chart 4

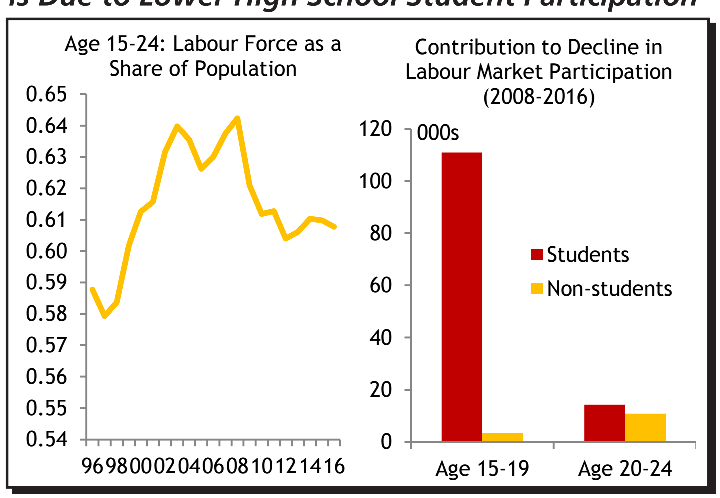
Youth/Adult Unemployment Ratio—No Major Issue Here



Source: Statistics Canada, CIBC

Chart 6

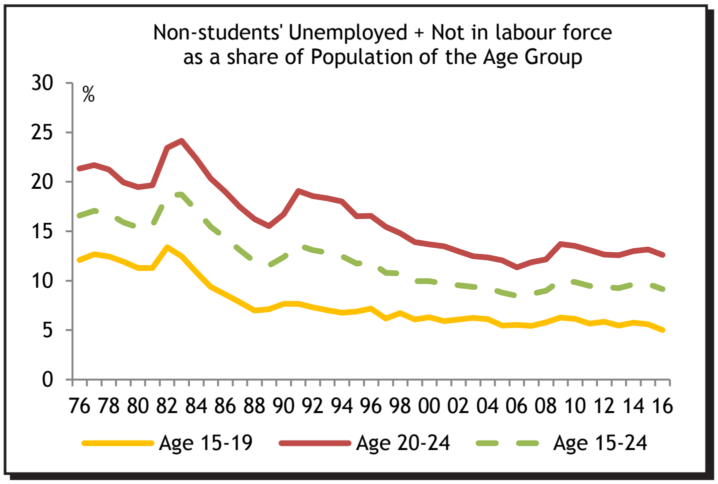
Basically All the Decline in Youth Participation Rate is Due to Lower High School Student Participation



Source: Statistics Canada, CIBC

Chart 7

Share of Most Vulnerable Youths— On a Decline



Source: Statistics Canada, CIBC

participate in the labour market, as well as non-students that are unemployed. That vulnerable segment of the youth population amounts to close to 400,000. But even here the trend is positive with that segment's share of the youth population trending downward (Chart 7).

Duration of Unemployment—Beyond the Realm of Monetary Policy

Another source of vulnerability often cited by the Bank of Canada is the relatively long duration of unemployment. At any point in time, the jobless rate encompasses both the number of unemployed people who have recently become unemployed and the number of those who have been unemployed for a period of time. Accordingly, an increase in the unemployment rate can occur not only 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 unemployed for a longer period of time. Chart 8 illustrates those two forces. The inflow rate into unemployment, namely the rate at which people become unemployed, is currently at a record low. However, the share of long-term unemployment rose notably during the recession and hasn't really recovered since then.

The issue is that the Bank of Canada can generally only influence the inflow rate where clearly there is no problem, while the increase in long-term unemployment is largely due to a mismatch in the labour market—way beyond the domain of monetary policy. And even here that mismatch suggests increased wage pressure down the road as the share of occupations showing signs of skill shortages is rising faster than the share of occupations that are in a labour surplus situation (Chart 9).

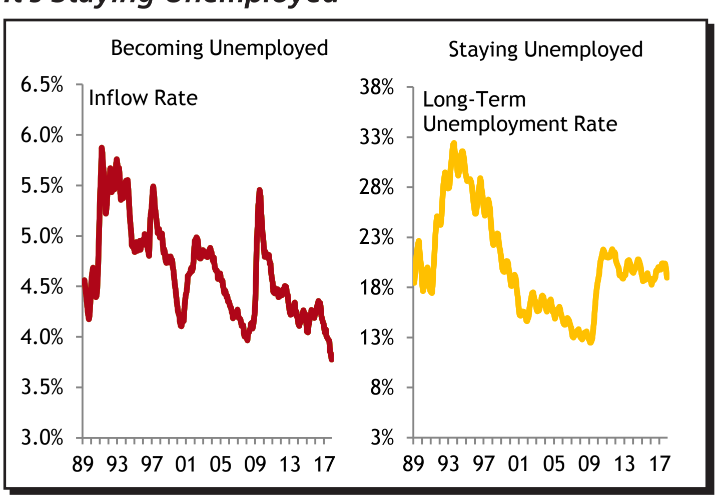
The 55+ factor

You can't really say anything about the labour market without taking a closer look at the major demographic forces shaping its trajectory. Chart 10 captures the story very well. The share of youths in total employment is relatively stable but there is a dramatic substitution between prime-age workers and the 55+ category.

In the US, our research suggests that the rising share of older workers in overall employment is playing a role in subduing wage inflation, as older workers on average receive lower wage gains. But as illustrated in Chart 11, that's hardly the case in Canada. Both wage inflation and absolute wage levels among the age 55+ segment are

Chart 8

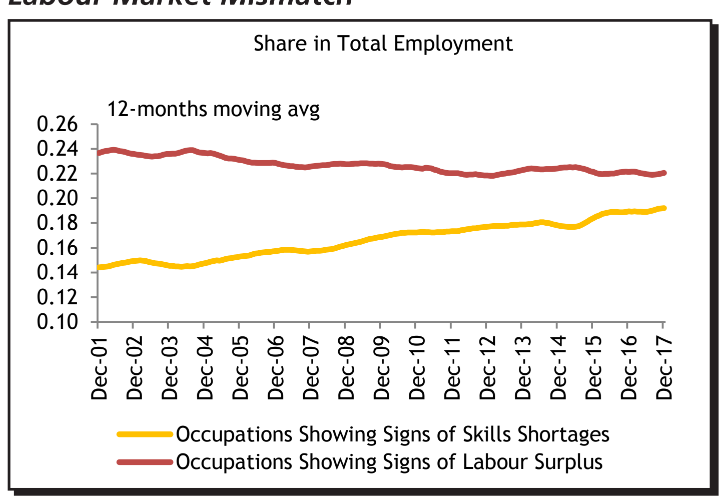
The Issue is Not Becoming Unemployed, It's Staying Unemployed



Source: Statistics Canada, CIBC

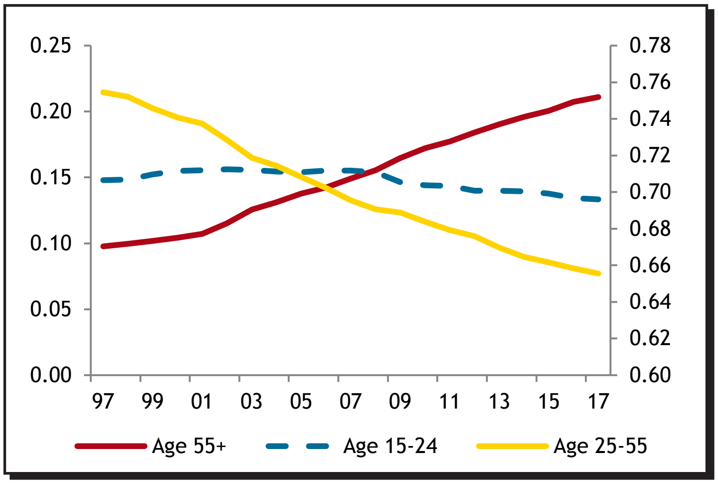
Chart 9

Labour Market Mismatch



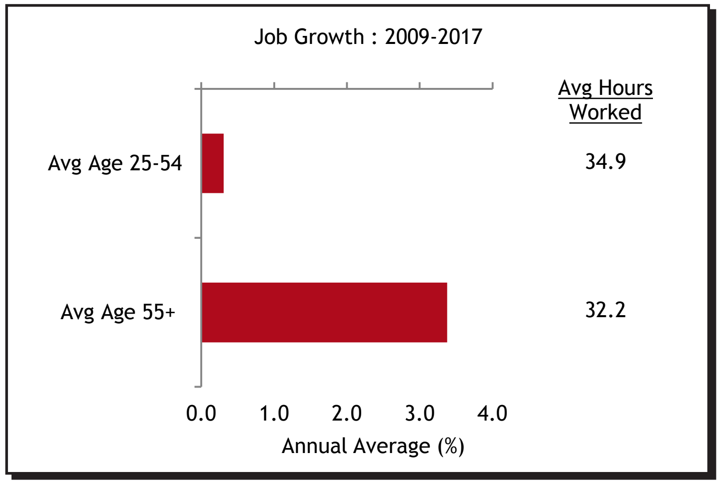
Source: Statistics Canada, CIBC

Chart 10
Share in Employment



Source: Statistics Canada, CIBC

Chart 12
More Working Less



Source: Statistics Canada, CIBC

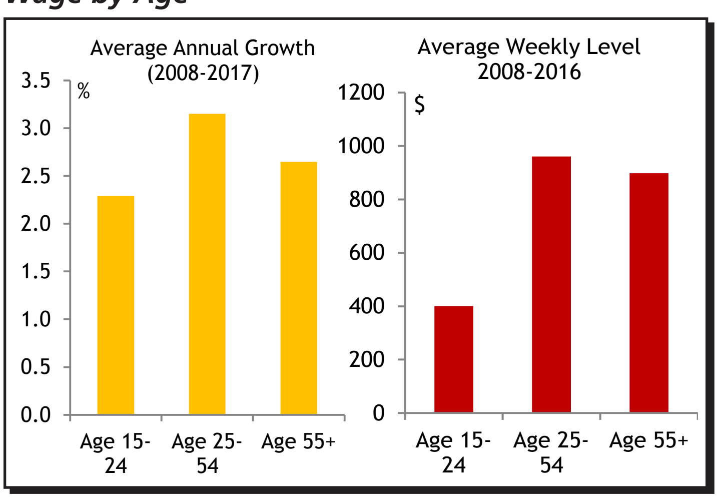
not materially different from that seen among prime-age workers. That suggests a limited impact from the rising share of older workers on the wage trajectory in the Canadian job market.

Much more material is the impact of that demographic force on the number of hours worked in the economy. Workers aged 55+ represent the fastest growing segment of the labour market, but they are also slowly disengaging via reduced hours worked (Chart 12). With more people working less, the average numbers of hours worked has been on a steady decline. We estimate that in 2017, the 55+ factor reduced the total number of hours worked by no less than 2%, by far the largest impact on record. In fact, with every year that passes the negative impact of the 55+ factors on hours worked is larger (Chart 13). And given the way the demographic story is unfolding, that force will become even larger in the future.

The Bank of Canada has on many occasions pointed to the reduction in average hours worked as a sign of labour market slack. In fact, that factor is featured in the Bank's labour market indicator that still suggests that the labour market is not as strong as perceived. But from the discussion above, it's clear that the Bank cannot do anything to reverse that demographically-induced trend.

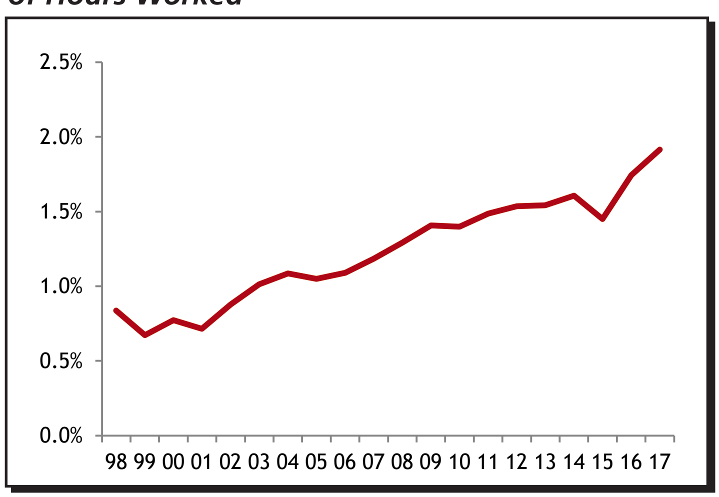
The labour market of 2018 will be tested. Minimum wage hikes will act as a negative for job creation as will the headwind blowing from the tricky NAFTA negotiations. The ultimate impact of those forces is unknown. But what we do know is that the labour market is well positioned to face what's coming.

Chart 11
Wage by Age



Source: Statistics Canada, CIBC

Chart 13
Negative Impact of the 55+ Factor on Overall Number of Hours Worked



Source: Statistics Canada, CIBC