Canada: The Labour Market Slack Seems to Be Fading Away

In its latest establishment survey, the Bank of Canada (BoC) said: “Indicators of labour shortages suggest that labour market slack remains but is no longer widening.” We would normally see the effect of this slack on wage growth, which has stayed relatively modest despite strong employment growth since last August. For example, the annual change in the average hourly wage was only 1.1% last March, which is lower than the inflation rate.

That being said, some indicators are starting to signal a gradual absorption of excess capacity in the labour market. On the one hand, the overall unemployment rate, which includes discouraged job seekers, workers waiting for jobs and involuntary part-time workers, has improved recently. The difference between this metric and the traditional unemployment estimate has therefore dropped significantly in recent months (graph 1). On the other hand, the employment rate, which corresponds to the number of workers compared with the entire Canadian population, has increased quite a bit since its cyclical low in July 2016 (graph 2).

**IMPLICATIONS**

The sustained employment growth we have seen for some months should gradually tighten up the labour market slack. If this trend continues, we could see upward pressure on wages in a few quarters, which in turn could boost inflation. In the meantime, the BoC still has a lot of flexibility to manage its monetary policy. That should prompt it to keep its key interest rates stable throughout 2017.

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