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Commentary

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MLI Labour Market Report for Q1, 2019

Cutting Through the "Noise": Stagnant Labour Productivity and a Virtual Absence of Wage Growth

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Overview

Employment growth early in the new year surpassed the recent slowdown in GDP. A major contributor appears to be the election of new governments in Ontario and Quebec. Employers in these provinces froze payroll levels in the months leading up to the vote but quickly started expanding again when more business-friendly governments took power. The dominance of central Canada in job growth was reinforced by employment cuts in Alberta. More broadly, output and employment growth have moved in parallel since 2014, reflecting stagnant labour productivity. Without productivity gains, it is not surprising that real wage growth has lagged over the last three years.

Introduction

Employment growth remained buoyant in the first quarter with a gain of 0.7 percent from the fourth quarter,[1] despite the slowdown in GDP growth late in 2018 and into early 2019 with GDP up only 0.1 percent over the last three months.

Conflicting signals between GDP and employment are not unusual but are often confusing to even the best analysts. Late in 2006, for example, the incumbent Governor of the Bank of Canada David Dodge questioned the reliability of the preliminary GDP estimates because a slowdown in GDP growth was not reflected in the employment estimates. Statistics Canada's response maintained that both estimates were accurate and that there were reasons why output and job growth temporarily converged, a view subsequently validated when the GDP estimates were finalized.[2]

There are a number of possible explanations for why job growth has recently exceeded GDP. One possibility is simply 'noise' in the employment estimates. The monthly estimates of employment are notoriously variable and can stray from the underlying trend for extended periods. However, employment growth has been sustained for six months, suggesting this is more a trend than noise in the data.

Central Canada leads growth after new governments elected

A more convincing explanation for why job growth has exceeded GDP is that firms in Ontario delayed hiring employees in the first half of 2018 until they were certain that the Wynne government would not be re-elected. The Wynne government had adopted several policies that made hiring more expensive for firms, notably an overhaul of labour legislation governing the employer-employee relationship[3] and then a sharp hike in the minimum wage starting on January 1, 2018. Employers responded by freezing employment levels in the six months leading up to the election in June 2018. However, once Doug Ford was elected Premier on June 8, firms became more confident that their labour bill would not be subject to further unexpected increases due to government policies.

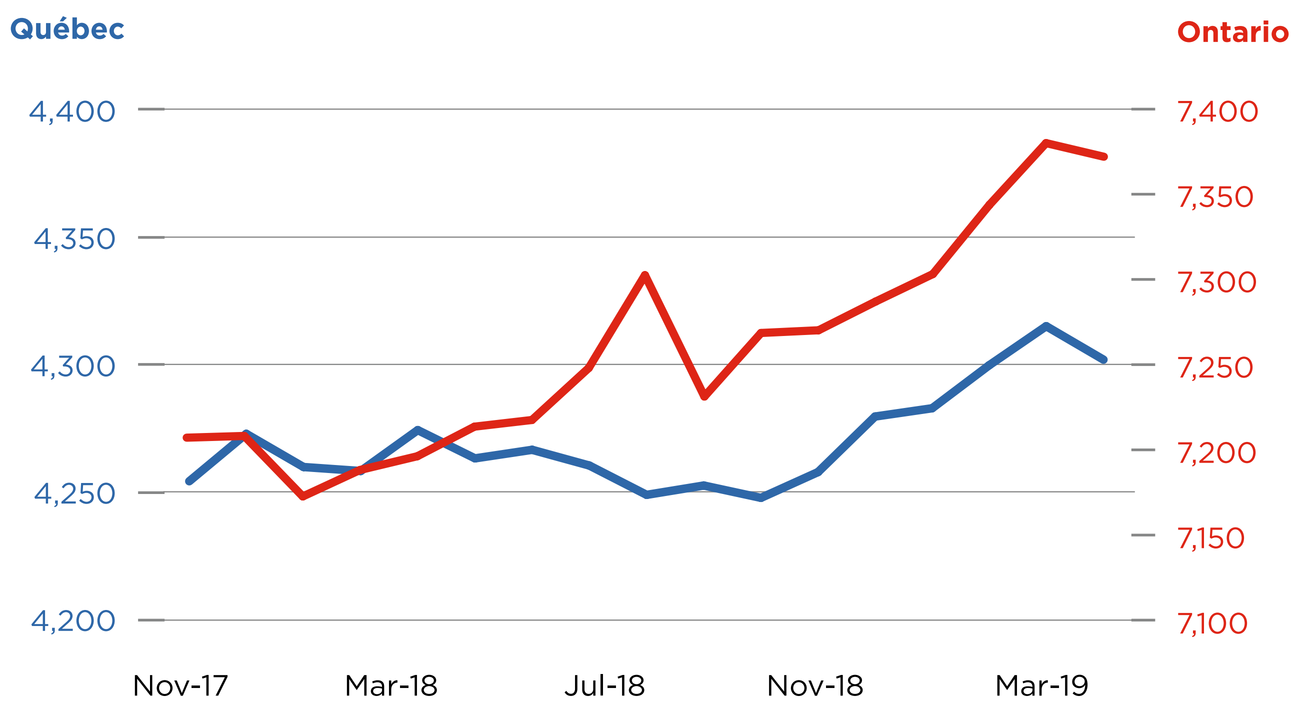
Since the Progressive Conservatives took power, Ontario has driven job growth in Canada, with employment gains accelerating to 0.3 percent in the fourth quarter and 1.1 percent in the first quarter (see Figure 1). By itself, employment in Ontario accounted for 60 percent of Canada's surprising first-quarter burst in jobs.

A similar pattern played out in Quebec before and after the election of the CAQ (*Coalition pour l'Avenir du Québec*) government under François Legault, although the preceding Liberal government did not raise the cost of labour as much as Ontario's Wynne government. In the six months before the October 1, 2018 election, jobs in Quebec fell outright by 0.6 percent. However, the election of the CAQ with a platform of tax cuts, no referendum on sovereignty and a firmly pro-business cabinet (Legault himself is the former head of a discount airline) saw employment surge by 0.5 percent in the fourth quarter and another 0.7 percent in the first quarter.

Since part of the recent surge in jobs in Ontario and Quebec reflects a catch-up by firms after a long period of not hiring, then rapid growth is unlikely to be sustained for long. However, these provinces should hold onto these gains and resume growth at a moderate rate. This differs from the scenario where job growth was simply 'noise' in the statistical sample, where one would expect these gains to be reversed by losses in subsequent months.

It is also possible that firms are hoarding labour at a time of acute shortages, especially in parts of central Canada. A similar dynamic appeared in Alberta in 2015, when firms waited several months before finally shrinking their payrolls starting in August 2015. However, this only explains why payrolls did not contract rather than why they would expand outright. It also does not explain why, if shortages were really that acute, wage growth continues to be anemic. It is revealing that firms in Ontario and Quebec were able to attract substantially more workers over the last two quarters, suggesting shortages were not as severe as low unemployment suggested.

Figure 1: Employment in Quebec and Ontario (thousands)



Source: Statistics Canada CANSIM Table 14-10-0287-01

Jobs recede in Alberta

The dominance of employment growth in central Canada also reflects weakness in other provinces. Employment in Alberta fell by 0.7 percent in the first quarter, as sharply lower prices for its oil late in 2018 took a toll. As well, a provincial election slated for May 2019 may have led some employers to freeze their payrolls, as occurred in Ontario and Quebec in the months before their elections.

Employment in Alberta over the last four years has risen by a total of only 0.7 percent or less than 0.2 percent a year. Employment has moved in four distinct phases since oil prices nosedived late in 2014 (see Figure 2). Employers at first hesitated to cut jobs, with employment stagnant between January 2015 and September 2015. When it became clear prices would stay low and Alberta's new NDP government increased taxes on business, employers cut jobs by 2.7 percent between September 2015 and May 2016. As oil prices slowly began to recover, these job losses were gradually recouped by December 2017 and small gains were added in the new year. However, another round of slumping oil prices triggered a 1.2 percent drop in employment since November 2018.

Low productivity and investment hinder competitiveness

Whatever the explanation for employment surpassing output growth at the turn of the year, the effect is a further dampening of labour productivity in Canada. Stagnant labour productivity has become chronic in Canada with no net change since the oil price crash late in 2014.[4] The stall in productivity is symptomatic of the declining

Figure 2: Employment in Alberta (thousands)

Source: Statistics Canada CANSIM Table 14-10-0287-01

competitiveness regularly cited by Canada's business leaders. Weak productivity reflects and explains the failure over the last two years of the Bank of Canada to engineer a transition from growth based on household spending to growth driven by business investment and exports. Instead, business investment remains about 10 percent below its peak in 2014 while exports have languished.

One explanation for low business investment is that firms remain uncertain about the course of the global economy and are hobbled by high taxation and regulation in Canada. As a result, firms hesitate to make investments that commit them to staying in Canada for several years. Instead, they increase hiring instead of making investments – effectively substituting labour for capital to meet demand and yet remain flexible about shifting operations abroad in the future.

Income growth slowed over the last three years

In an election year, it is inevitable that pundits focus on how real incomes have fared under the current government. This section compares real income growth in the last three years with the previous decade using the most widely used measures of incomes and prices.

The broadest measure is labour income compensation of employees in all forms: wages and salaries (which reflect the number of jobs and the average wage earned in these jobs) plus supplementary benefits such as pension contributions, health insurance and the like.

These current dollar measures can be adjusted for inflation in one of two ways: using the consumer price index (CPI) or using the implicit price index (IPI) for personal expenditure from the National Accounts. The CPI measures a fixed basket of goods and services prices in Canada. The IPI measures prices paid by Canadian consumers anywhere in the world (capturing the price of travel abroad) and allows consumers to shift quickly to cheaper goods when prices change. One would expect the IPI to rise more slowly, and indeed that is what has happened since 2005; the CPI has risen 22.3 percent up to 2018 while the IPI rose 18.4 percent.

Nominal labour income rose 61.4 percent from 2005 to 2018. This represents a real income gain of 36.2 percent using the IPI and 32.3 percent using the CPI. During the Harper era, the IPI rose 14.1 percent and the CPI by 16.0 percent; the comparable figures for Trudeau are 3.7 percent for the IPI and 5.4 percent for the CPI.

> “The virtual absence of real wage growth between 2014 and 2018 is not surprising given the stagnation of labour productivity.

From 2005 to 2015, which covers the Harper years, real income grew by 29.7 percent using the IPI, or an average annual gain of 3.0 percent. From 2015 to 2018 under the Trudeau government, real income using the IPI rose 5.1 percent or an average 1.7 percent per year, which is 1.3 percent less than the Harper years. Using the CPI as the measure of inflation, the increase in the Harper years was 27.8 percent or 2.8 percent a year. Under Trudeau, the gain was 3.4 percent or 1.1 percent a year, a drop of 1.5 percent a year from the Harper average.

We can roughly break down the income gains into those due to job growth and those due to higher wages and supplementary benefits. Job growth totaled 11.3 percent under Harper, an average annual increase of 1.1 percent. Under Trudeau, jobs rose 4.0 percent for an average of 16.5 percent.

Average earnings and benefits per job in the Harper years rose 16.5 percent using the CPI and 18.4 percent using the IPI, or annual averages of 1.7 percent and 1.8 percent. In the Trudeau years, average income per job rose 1.1 percent using the IPI but fell 0.6 percent using the CPI, yielding annual averages of a 0.4 percent increase with the IPI and a 0.2 percent decline with the CPI. Both are well over 1.0 percent a year less than in the Harper years.

The conclusion is that incomes, by any measure or using either price index, fared better in the Harper years. While employment growth was marginally less in the Harper years (due to the decline in the global financial crisis of 2009), average incomes rose more than in the Trudeau years.

The virtual absence of real wage growth between 2014 and 2018 is not surprising given the stagnation of labour productivity observed in the previous section. Over the long-term, real wages and productivity are inextricably linked.

Endnotes

1 Quarterly growth in this commentary compares the average of the three months in one quarter to the average of the three months in another quarter. This provides consistency with other quarterly averages calculated by Statistics Canada, notably for GDP. The labour force survey is unique in calculating the first quarter as March compared with December. Not only is this not consistent with the definition of a quarter everywhere else in Statistics Canada, it introduces yet more noise into the estimates. For example, bad weather could have temporarily depressed employment in December, which would exaggerate the calculated increase in the first three months of the year. Comparing the average of the first three months of the year with the average for the three months of the fourth quarter minimizes this type of distortion. A similar inconsistency exists for the definition of annual growth. The labour force survey uniquely in Statcan defines annual growth as the change from December to December. Every other survey at Statcan, notably GDP and the CPI, defines the year as the sum total of all four quarters. Again, this makes the annual calculation less vulnerable to an outlier in December distorting the underlying trend. To further muddy the waters, in its year-end review of labour markets for 2018 Statcan used the annual average.

2 Philip Cross. 2017. Recent Trends in Output and Employment. Canadian Economic Observer. Statistics Canada Catalogue 11-010-XIB, March. Available at https://www150.statcan.gc.ca/n1/pub/11-010-x/00307/9602-eng.htm.

3 These regulations cover everything from defining what is an employee, working conditions and union rights.

4 Statistics Canada Cansim Table 36-10-0206-01 shows that the index of labour productivity was 106.2 in the fourth quarter of 2018 compared with 106.0 four years earlier. Statistics Canada measures labour productivity for the business sector only.

About the Author

Philip Cross is a Munk Senior Fellow at the Macdonald-Laurier Institute. Prior to joining MLI, Mr. Cross spent 36 years at Statistics Canada specializing in macroeconomics. He was appointed Chief Economic Analyst in 2008 and was responsible for ensuring quality and coherency of all major economic statistics. During his career, he also wrote the "Current Economic Conditions" section of the Canadian Economic Observer, which provides Statistics Canada's view of the economy. He is a frequent commentator on the economy and interpreter of Statistics Canada reports for the media and general public. He is also a member of the CD Howe Business Cycle Dating Committee.

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