ECONOMIC VIEWPOINT

The Bottom Line on Canadian Wage Growth

Job creation is doing well in Canada right now. However, growth in hourly wages, as compiled by Statistics Canada's *Labour Force Survey* (LFS), rather tell the story of a disaster currently unfolding in wages. This *Economic Viewpoint* carries out a counter-verification of the message sent by this survey. We determine that all considered, there is nothing to be alarmed about. Nevertheless, the current experience of several developed countries suggests that even with improving employment, we will need to cope with modest wage growth, which is not without its share of detrimental consequences.

There is no denying that job creation momentum is solid in Canada at present. In the 12 months leading up to April 2017, 276,000 jobs were created, which is not far from the best 12-month rolling performance since the end of 2012. The unemployment rate has dropped to 6.5% in April, the lowest level since the crisis. A piece seems to be lacking to complete this brilliant picture: wage growth. According to the LFS, growth in hourly wages has deteriorated on a consistent basis lately. In April, the year-over-year growth of hourly wages was only 0.7%. This was the smallest pace recorded in the history of the series, which date back to 1997 (graph 1).

GRAPH 1
The *Labour Force Survey* provides a disturbing picture of hourly wage growth in Canada

Sources: Statistics Canada and Desjardins, Economic Studies

Remember that after Canada went through the Great Recession in 2008 and 2009, growth in hourly wages slowed considerably, but even at its bottom it was still at twice to current pace.

Inflation may be low, at 1.6%, but hourly wage growth as depicted by the LFS does not compensate for it. That is to say that real hourly wages are in contraction, to the tune of 1.1%. Between 2010 and 2016, the average growth rate was 2.3%.

The "Alternative Facts" of Wage Growth in Canada

To say that the signal sent by hourly wages is not as upbeat as what the flagship labour market variables are portraying is perhaps even an understatement. That wage growth trajectory is nothing short of alarming! All the more a reason to verify the validity of this information. The *Survey of Employment, Payrolls and Hours* (SEPH) provides helps perform such sanity check. Like the LFS, it is a monthly survey that, as its name suggests, compiles information on the level of employment, wages paid and hours worked. There are, however, several differences between the two surveys[1]. Among them, the SEPH population is made up of employers, while the LFS collects information directly from households. This means that the LFS takes into account the self-employed and unpaid family workers, who cannot be picked up by the SEPH. SEPH also excludes the agricultural sector[2], while the LFS encompasses it. Finally, another difference between the two surveys is the treatment of persons holding the multiple jobs. The LFS collects salary information only for the individual's main job. In the SEPH, there is no distinction between main and secondary jobs; wages for each job are accounted for.

[1] For a detailed discussion of the differences and similarities between the two surveys, see Section 8 of: *Guide to the Labour Force Survey*, Statistics Canada, Catalogue no. 71-543-G, April 2016, 90 p.

[2] In this sense, SEPH is akin to the Bureau of Labour Statistics' non-farm employment survey, which is the flagship indicator of monthly job creation in the United States.

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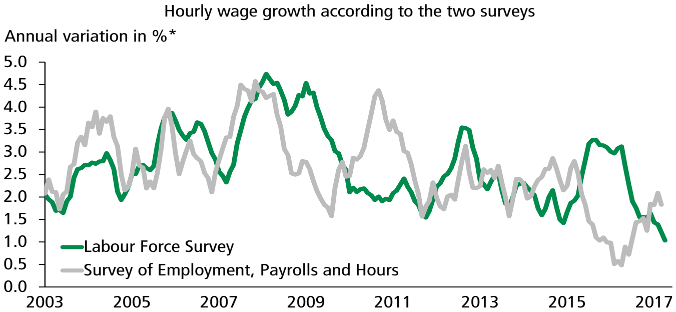
Over a sufficiently long period, both surveys tend to give a rather similar picture of wage growth. However, there are periods of great discrepancy, and this is currently the case. Indeed, while the LFS reports that hourly wage growth is collapsing, the SEPH tells us the opposite (graph 2).

GRAPH 2

The survey administered to businesses sends a different message than the one administered to households



* 3-month moving average.
Sources: Statistics Canada and Desjardins, Economic Studies

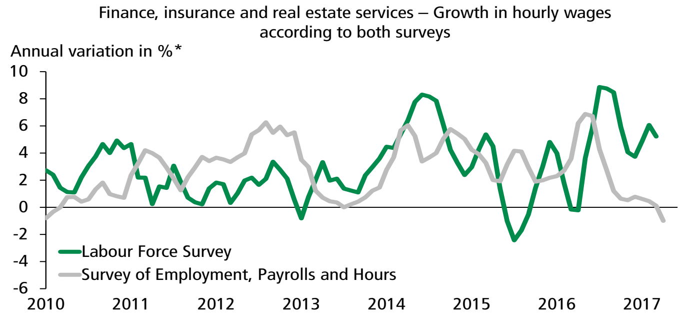
Without being spectacular, annual growth of hourly wages according to this survey does not stand too far from 2%, which is slightly higher than inflation. Note that according to this survey as well, hourly wage growth experienced a period of significant weakness. But this was more a 2015 story[3].

At a disaggregated level, there are sometimes surprising differences between the two surveys. For example, in professional, scientific and technical services, hourly wages are up 4.5%, according to SEPH, as of March, compared to a drop of 3.1% according to the LFS. This is a sector that has been hit hard by the oil price shock. The decline in investment and exploration activity led companies in the sector to require less workforce in terms of engineers, geologists, chemists and other experts. In 2016, employment fell by 0.9%, following six years of expansion. The sector is nevertheless on the mend, as it stands, and job creation is recovering. Some anecdotal evidence even points to difficulties experienced by Alberta producers in attracting new workers. These circumstances militate much more in favour of the wage rebound indicated by the SEPH than the persistent contraction evoked by the LFS.

A similar finding can be made in finance, insurance and real estate services: SEPH shows annual growth of around 5% versus a 0.2% drop in the LFS (graph 3). Yet, this same latter survey shows that, far from weakening, employment is accelerating in this sector: with year-over-year growth of above 5%,

GRAPH 3

The divergence is particularly striking in finance, insurance and real estate services

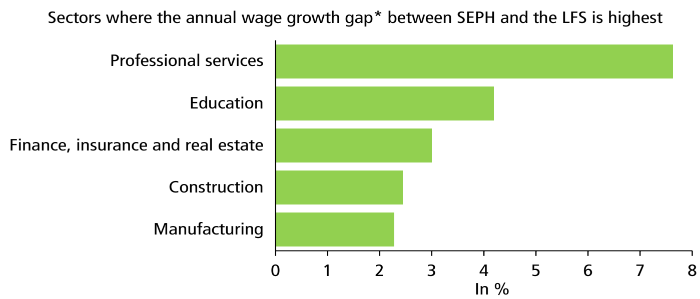


* 3-month moving average.
Sources: Statistics Canada and Desjardins, Economic Studies

employment is progressing at its fastest rate in a decade. In the first quarter of 2017, financial services expenditures were up 4.9% per year, close to the average in recent years. Property sales have recently reached a new high. In fact, real GDP grew by 5.7% in March, far from indicative of an industry in difficulty. There are several other sectors where wage developments look fundamentally better when relying on SEPH data (graph 4).

GRAPH 4

The current divergence in signal can be observed across a number of sectors



LFS: *Labour Force Survey*, SEPH: *Survey of Employment, Payrolls and Hours*; * Growth according to SEPH minus growth according to LFS, as of March 2017.
Sources: Statistics Canada and Desjardins, Economic Studies

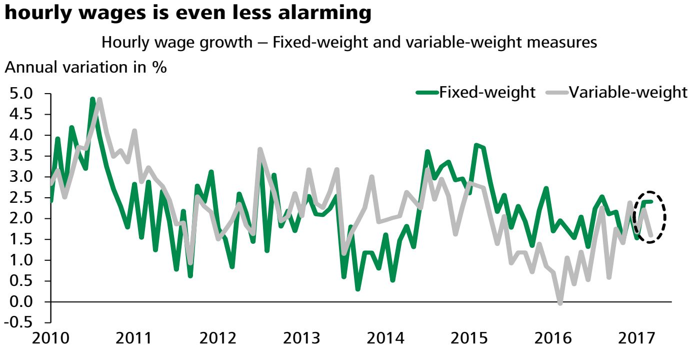
Differences in survey methods make it possible to judge the quality of the data. In particular, the LFS generally contacts households that are part of its sample by telephone. Although each member of a household is included in the survey, interviewers interact with the household member who is deemed to be well informed about the employment situation of all other members. This "proxy" response method accounts for 65% of the information collected by the LFS. While allowing Statistics Canada to save costs and time compared to the alternative of contacting each member of the household directly, proxy response involves the risk that information is reported inaccurately.

[3] One could even wonder whether SEPH wages are not a leading indicator of the LFS's wages. Even though it seemed to be the case recently, there is no persisting evidence of such pattern on a historical basis.

For the SEPH, Statistics Canada obtains data on gross monthly payrolls from administrative information that all companies must provide to the Canada Revenue Agency. The survey complements this information with a form sent to a sample of 15,000 companies and which collects monthly data on total hours worked. From these elements of information are derived estimates of average weekly and hourly earnings. Already, these estimates may be presumed to be closer to the reality than ones from the LFS.

But there is another interesting aspect in SEPH, in that it also compiles data on aggregate hourly wages, with an adjustment made to account for changes in the sectoral composition of employment. For instance, if employment in low-wage sectors increases as a percentage of total employment, all other things being equal, the average wage for the overall economy will tend to decline. Estimates of fixed-weight hourly wages eliminate this composition change effect by assuming a constant sectoral distribution of employment over time. According to this definition, annual hourly wage growth was measured at 2.4% as of March (graph 5). Moreover, it can be determined that the decline in the unadjusted (variable-weighted) measure in 2015 was largely a compositional effect. Recall that many displaced workers in the oil sector have had to accept lower wages in other industries, as they coped with recessionary conditions in affected areas.

GRAPH 5
When compositional effects are taken into account, growth in hourly wages is even less alarming



Sources: Statistics Canada and Desjardins, Economic Studies

The National Accounts' Perspective

The relevance of the SEPH data can be further appreciated by remembering that they form the main basis for household compensation estimates in the national accounts. Statistics Canada supplements this information with additional sources of data to account for self-employed workers and for the agricultural sector, which, recall, are not covered by SEPH. LFS data collected from households are used as well, but so are other available indicators, depending on their relevance. For example, high-frequency data on real estate commissions are used to estimate the earnings of some self-employed individuals in the finance and insurance sector on a quarterly basis[4]. Giving a much more comprehensive picture of household income for both payroll employees and the self-employed, and also incorporating rent income, the national accounts are unquestionably the ultimate reference when it comes to earnings at the economy-wide level. By combining these sources of income, it can be seen that in the first quarter of 2017, they were up by a decent 3.1% annually (graph 6).

GRAPH 6
National accounts suggest that income growth is recovering

* Wages and salaries plus gross mixed income.
Sources: Statistics Canada and Desjardins, Economic Studies

Beyond Wages

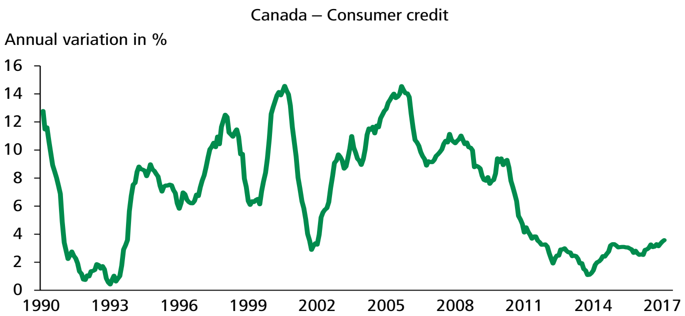
Discriminating in favour of SEPH and national account statistics, the strong performance portrayed by consumer spending is a bit better explained. While it cannot be denied that the level of indebtedness of Canadian households is relatively high, consumer credit growth has slowed considerably since the crisis (graph 7 on page 4), leaving most of the responsibility for high indebtedness to mortgage credit expansion.

Rather than the sometimes advertised notion of profligate credit use, households benefit from non-wage support to help finance their spending. Indeed, although earned income is the main factor influencing the disposable income of Canadian households, changes in fiscal policy may also have an impact. For example, last year, the boost in Childcare benefits and the tax cut targeting the middle class did not go unnoticed: the reduction in net transfers to governments in 2016 facilitated an acceleration in disposable income growth[5]. Other measures announced by some provincial governments may further be beneficial this year. For example, in Quebec, the retroactive elimination of the health tax means higher-than-usual tax refunds for many taxpayers. In British Columbia, to compensate for increasingly difficult housing

[4] Another example is in agriculture: administrative data from Agriculture and Agri-Food Canada, the Canadian Wheat Board, and various regulatory entities are used to estimate revenues.

[5] Canada: Consumers Remain the Cornerstone of Growth, Desjardins, Economic Studies, *Economic Viewpoint*, April 10, 2017, 4 p.

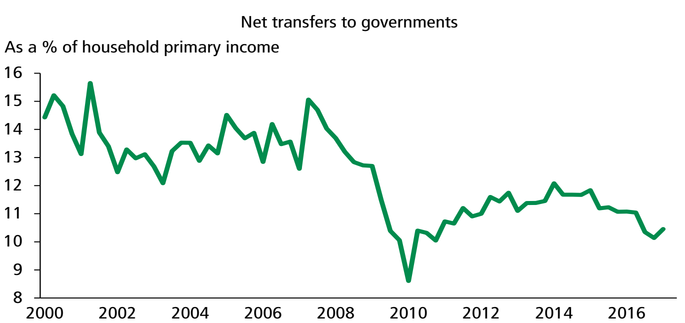
GRAPH 7
Consumer credit growth is much more modest than some believe



Sources: Statistics Canada and Desjardins, Economic Studies

affordability, enhanced property tax credits were announced. Without necessarily lowering income taxes, Ontario has rolled out relief measures aimed at addressing high electricity costs, which should help households. Overall, the recent decline in net transfers to governments as a share of total household income (graph 8) is likely to continue to support consumer spending over a short-term horizon.

GRAPH 8
Governments have offered some relief to households



Sources: Statistics Canada and Desjardins, Economic Studies

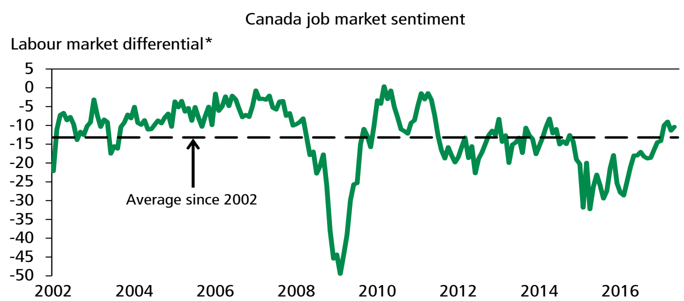
A Situation That Remains Problematic

While it is important to consider the overall income perspective, wage developments are a critical issue, not only in Canada but around the world. In the eyes of many, this variable has the upper hand over the unemployment rate at present, when it comes to indicators that best reflect the state of surplus capacity in the labour market. In the United States, where the unemployment rate has recently hit a cyclical low, hourly wages are up only 2.5% per year. During the last cycle, when U.S. unemployment had reached a low of 4.4% (same level as at present), hourly wages were not far from 3.5%. The more moderate wage trend is partly behind the Federal Reserve's gradual approach to monetary policy normalization.

In the United Kingdom, wage developments are closely monitored by the Bank of England, and the unemployment rate is also continuing to decline. Nevertheless, officials recently confessed being surprised by the weakness of wage growth. In Japan, the unemployment rate reached 2.8% in March, the lowest level since 1994, while the ratio of available jobs to the number of applicants is at its highest level since 1990. Regardless, real wage growth remains virtually inexistent. The case of Germany is not much better: it's official unemployment rate of 5.7% is the lowest since the Reunification. In the first quarter, hourly wages were up a tepid 0.7% year-over-year.

In the Canadian case, the good news is that in all likelihood, hourly wages are not collapsing, unlike what the LFS suggests. After all, if this were the case, it would be difficult to imagine solidifying household sentiment towards the labour market, as is currently the case (graph 9).

GRAPH 9
Canadians have regained confidence in the labour market outlook



* Percentage of respondents anticipating improvement in the labour market six months forward minus percentage anticipating deterioration.
Sources: Conference Board of Canada and Desjardins, Economic Studies

But the experience of many developed countries suggests that even with a healthy labour market, modest wage growth might linger for some time. One reason is that in many industries, especially the goods-producing ones, labour markets have become globalized. From this point of view, low wages at the national level are partly the result of the massive labour market surplus capacity that still exists globally, with production able to move faster than ever to countries where labour costs are cheaper. Workers in these industries thus find themselves devoid of arguments to claim generous wage increases. Other factors that play a similar role are sluggish labour productivity growth[6] and low inflation. The latter has the effect of a vicious circle: it limits wage pressures, and hence the increases in labour costs that firms would try to pass on to consumers through price increases (i.e. by generating inflation).

[6] According to neo-classical economic theory, assuming competitive markets, marginal labour income will be equivalent to its marginal productivity at the equilibrium state.

Finally, let us note that low wage growth has its share of harmful consequences. It has the effect of making debt reduction, or access to property, more difficult. In some cases it may be a disincentive to education. It brakes saving and undermines future pension income. Furthermore, when wages are tepid, a central bank will tend to apprehend the effect of interest shocks on the income available to households after the payment of interest charges. This is especially the case in economies where debt is elevated. This creates a vicious circle whereby accommodative monetary conditions are maintained for longer periods, incentivizing indebtedness and inflating the value of the assets this debt is used to finance. Ultimately, the economy is made even more vulnerable to an interest rate shock, which causes the central bank to become even more hesitant. In a forthcoming *Economic Viewpoint*, we will analyze in more detail the consequences of low wages.

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