Hold on – the Canadian labour market has not fully recovered yet

By Parisa Mahboubi
January 25, 2018 – *The Globe and Mail*

The Canadian labour market beat expectations and performed strongly in 2017 based on various indicators, specifically job creation and the unemployment rate. At the same time, however, hourly-wage growth shows no sign that the labour market is approaching maximum employment.

An economy reaches maximum employment when all available workers have jobs except those who are between jobs or are new entrants into the labour market. Usually, this results in stronger wage growth as firms struggle to fill vacant positions.

Canada generated more than 420,000 new jobs in 2017, while the average annual unemployment rate fell to 6.4 per cent – the lowest rate since 2008. More importantly, the vast majority of job gains (93 per cent) were in full-time positions. And by December, the unemployment rate had fallen to its lowest level since 1974.

While a low unemployment rate can indicate tight labour-market conditions, the 2017 average hourly wage of full-time and part-time employees combined grew by only 1.7 per cent – the lowest year-over-year growth since 1998 and more or less at the same rate as consumer price inflation.

But if we break out the two types of employment, while full-time workers did indeed have the lowest wage growth in 19 years, part-time hourly wages, on average, increased by 2.7 per cent, above the inflation rate. What can account for this discrepancy?

Price setting in any market depends on supply and demand. In the labour market, wages are expected to increase as the supply of workers declines. However, unemployment may be higher than it seems once accounting for underemployed workers who are unable to find full-time work. Full-time job seekers – either employed or unemployed – may be willing to accept more hours without bargaining for more pay.

The economy had previously witnessed a significant shift from full-time work to part time, including as recently as 2016. Although part-time employment is desirable for some workers including youths, women and seniors, not all employed workers work part time voluntarily. A C.D. Howe Institute study shows that of all prime working-age workers in part-time positions, 50 per cent of men and 33 per cent of women would prefer full-time employment. As such, it is reasonable to assume some or all involuntary part-time employees are actively looking for full-time job opportunities. In turn, the difference between the wage growth of part-time and full-time workers may well reflect these strong preferences toward full-time employment.

Given the share of involuntary part-time employees, the headline unemployment rate alone is not a sufficient tool to monitor the labour market. Specifically, it does not account for discouraged workers – who have given up looking for a job. Instead, the latter phenomenon manifests itself in the declining labour-force participation rates observed since the 2008-09 recession.

As the economy expands, real wages should recover. Indeed, a closer look at price and wage movements reveals the real wage decline in the beginning of 2017 dragged down the average wage-growth rate for the year. Real (after-inflation) wages recovered during the second half of the year.

However, the labour-force participation in December, 2017, was still about 2 per cent below its rate in April, 2008. We need to remember that those who have stopped searching for a job are not considered unemployed and excluded from the labour force. As the economy expands, we should also expect higher labour-force participation, which should put a damper on further declines in the unemployment rate and will likely mean very modest wage growth, reducing inflationary pressures.

The lesson is that both underemployment and labour-force participation are important indicators to understand market dynamics. They have particularly important implications for the Bank of Canada, as labour-market statistics are a factor in its interest-rate decisions.

Parisa Mahboubi is a PhD and senior policy analyst at the C.D. Howe Institute