Poloz keeps close eye on wage growth as he plots his rate hike course

By David Parkinson
October 31, 2018 – *The Globe and Mail*

Ever since the Bank of Canada opened the door last week to speeding up its interest-rate hikes, market handicappers have been speculating how fast the central bank might be willing to go. The answer to that question may lie in one of the last unresolved riddles of the far-from-usual recovery from the Great Recession: wage growth.

In raising its key rate one-quarter percentage point to 1.75 per cent last week, the central bank dropped its commitment to a "gradual" pace of rate hikes and indicated it is intent on marching its rate to "neutral" territory, which it says is in the range of 2.5 to 3.5 per cent. It also said the economic data will tell it how quickly to get there.

Thing is, most of the economic data are already flashing a green light for the bank. Inflation has been persistently at or above the bank's 2-per-cent target for months, including the central bank's favoured measures of core inflation. Unemployment is near multi-decade lows, and employers are reporting intensifying labour shortages. The economy continues to grow somewhat faster than the bank believes it can grow without fueling further inflation.

The one factor that has not come along for the ride is wage growth. And it may prove to be the most crucial. The path wages take from here will not only contribute substantially to the inflation outlook, but will also speak to consumers' capacity to absorb higher interest rates – both central questions in the bank's rate-policy deliberations.

The Bank of Canada acknowledges that wage indicators have been surprisingly tepid, given the advanced stage we have reached in the long post-recession recovery, with little spare production capacity and near-full employment. But the bank's words over the past week or so also indicate that it is not convinced the numbers are as weak as they look – and it does not think they are going to stay that way for much longer.

The main gauge the Bank of Canada relies on for wage growth is something it calls "wage-common" – a statistical cocktail that blends four different and sometimes divergent measures of Canadian wages and extracts the common trend among them. It has been showing annual growth at 2.3 per cent for several quarters now, even as the labour market has continued to tighten and labour shortages have grown more acute.

But in the opening statement at last week's press conference accompanying the central bank's rate increase, the bank noted pointedly that wage-common is "backward looking" – it reflects where wages were months ago, not where they are now. Because some key components of the indicator only come out quarterly (and even then with a significant time lag from the quarter end), much of the 2.3 per cent reading that the Bank of Canada has been working with reflects where wages were in mid-summer.

The central bank appears to be leaning increasingly on the findings of its recent quarterly business outlook survey for direction on where wages are headed. In the official announcement of last week's rate increase, as well as in a couple of public comments since, the bank has noted that the survey found businesses expect wage growth to accelerate significantly in the coming quarters.

In testimony on Tuesday to the Commons finance committee, Bank of Canada senior deputy-governor Carolyn Wilkins said the

central bank believes labour-income growth will accelerate to “the 3-to-4 per cent range.”

“That corresponds with what companies are telling us – they say that they’re expecting to have to pay more to get the workers that they need,” she said.

It certainly suggests the Bank of Canada is bracing for a significant wage surge to kick in – perhaps beginning as early as the current quarter. But how quickly those expectations start to show up in the data will determine whether and when the bank sees its way to speeding up rate hikes.

The next indicator of wage growth comes this Friday, with the monthly labour force survey. But while this survey is a popular yardstick for employment numbers, its wage gauge is prone to mood swings and is not considered particularly reliable. For this reason, the survey’s data carry by far the lowest weight in the Bank of Canada’s wage-common, making up less than 5 per cent of the indicator. The figure will be closely watched, but probably will not sway the central bank.

But before the Dec. 5 rate decision, the bank will also have in hand all the other components of the wage-common, including the most heavily weighted data, the employee compensation figures in third-quarter gross domestic product report on Nov. 30. If those figures show a serious increase in wage growth, the odds of a December rate hike will go up with them.