March 8, 2019

Canadian Jobs Defy The Rate Hike Haters

Canada, Net Change in Employment SA (m/m 000s) / UR (%), February:

Actual: 55.9 / 5.8

Scotia: 25.0 / 5.7

Consensus: 1.2 / 5.8

Prior: Unrevised from 66.8 / 5.8

- The Bank of Canada is underestimating strength in Canada's household sector. Jobs numbers like this strongly lean in favour of expectations toward a stabilizing and then rebounding consumer and housing market over the duration of the year. The wage gain is a leading indicator of what to expect to happen to the BoC's preferred wage common metric. The combined points support our case for a return to BoC rate hikes later this year. They reinforce my view that the BoC acted prematurely—not to mention erratically—in removing guidance toward returning to a neutral rate over time such that it remains prudent to caution in favour of rate hikes returning over H2. The C$ strengthened marginally by about a quarter cent to the USD while short-term rates did most of the adjusting. The yield on a 2 year GoC bond jumped 7bps after the report. The 2s yield is now only 4bps lower than where it was before Wednesday's BoC statement and has reversed much of the 12bps drop post BoC.

- A gain of 55,900 jobs was all full-time (+67,400) as part-time employment fell by 11,600. By way of forward guidance for the March jobs numbers, I wouldn't be surprised to see another gain. See chart 1. It shows what happened to job growth in months after large gains of at least 60,000 jobs like we had in January. February's addition of another 55,900 jobs is the fourth biggest subsequent gain in history. We can now say that over 38 times when 60,000 or more jobs were created in a single month, another gain was posted in all but nine of the following months. By corollary, the odds favour another gain a month from now when we get March numbers and that's where I'll land with another upside driven by probabilities not to be confused with certainty.

- **Since job growth began to accelerate at about the mid-point of 2016, Canada has created a whopping 885,000 jobs.** In year-ago terms, Canada has created 383,000 jobs. In just the past two months, Canada has created 122,700 jobs. Canada has created 290,000 jobs since the last down-print in August 2018. Over 2017–2019 to date, there have been only three months of declines and one of them was so tiny it doesn't even count. **Ka-boom, so much for employers lacking confidence to be heaping on this kind of job growth.**

- **By sector, breadth was solid with eleven of 16 sectors adding jobs.** The gains were led by services but goods producing industries also chipped in. Goods sectors added 9.5k jobs led by resources (+8k), agriculture (+6k) and manufacturing (+4k) while utilities shed 1.8k and construction dropped 6.6k. Service industries added 46,200 jobs. Within services, 8 of 11 sectors added jobs. Professional/scientific/technical services added 18,300 jobs, followed by 14,200 public administration jobs, 12,100 jobs in the retail/wholesale sector, 7,100 in finance/insurance/real-estate services, 5,700 in information/culture/recreation, 9,100 in business and building services, and smaller gains elsewhere.

- **The private sector led job creation overall with private payrolls up 31,800 and self-employed jobs up 15,100 while the public sector payroll expanded by 8,900.**

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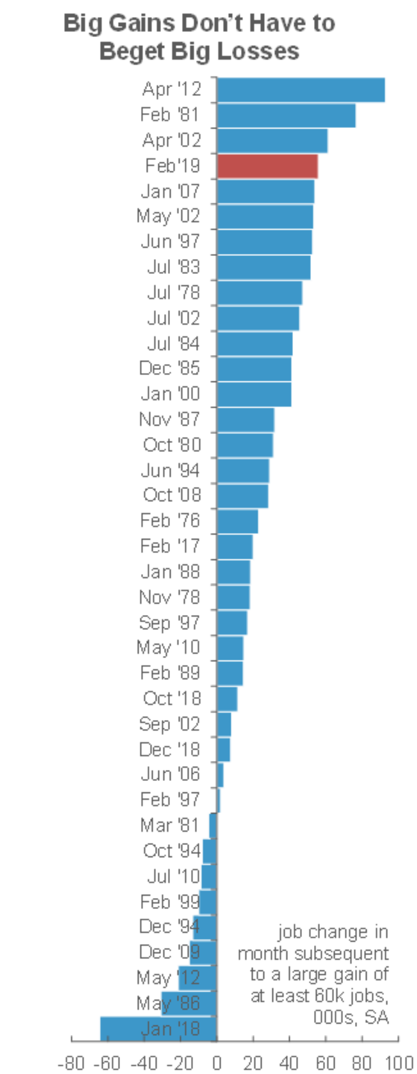
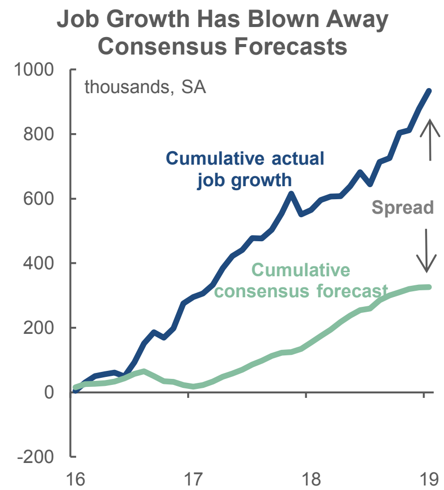
Chart 1



Sources: Scotiabank Economics, Statistics Canada, Haver Analytics.

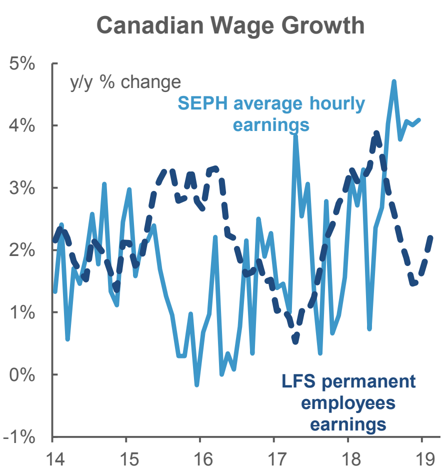
- **By province, the rise was led by Ontario (+36,900) and then Quebec (+14,900) with smaller gains of about 4k in each of BC and Alberta.**
- **The unemployment rate was steady at 5.8%** because the participation rate moved up two ticks to 65.8% as the labour force increased by 55,100. More jobs for more people seeking them is almost idyllic.
- As for tracking consensus, it has now underestimated job growth since the acceleration from mid-2016 onward by a whopping 608,000 jobs. 70% of all job gains over that period were not forecast! Yes, consensus sucks at forecasting job growth. The Canada haters tend to conveniently ignore this and find improper ways of ignoring the gains (more below). Please see chart 2.
- **Oh, but the jobs gain should be dismissed because the report is a random number generator, right? Wrong.** Against random number assertions, Canada would have posted a small gain even if the true number is at the bottom of the 90% confidence interval. 90 times out of 100 in repeating sampling Canada would have posted job growth no matter what and it could have been between anywhere from +12.4k to as much as 99.4k in February given a 90% confidence interval of +/- 43,520 so don't try to talk through this one as a product of sampling error just because the bears do. And don't write off the trend either since in order to dismiss years of strong cumulative beats to consensus expectations you'd have to have a very, very good argument for why the sampling error was so persistent that the actual number was persistently at the bottom of the 90% CI virtually every single month over time. That's rubbish.
- I think the BoC will be closely watching the wage figure. Chart 3 shows two wage growth measures. The dark blue one is what the BoC used to prefer as it measures the year-ago change in average hourly earnings for permanent employees. It is trending upward again. The lighter blue line is the average hourly earnings measure from the payrolls report and it has been stronger for some time but lags the freshness of the LFS gauge. These readings should translate into an improvement in the BoC's preferred wage common metric that is a composite of four readings.
- **The bigger issue is that the commodity shock and minimum wage changes that Canada has gone through over the years have been distorting the year-ago comparisons for a long time.** Wage growth accelerated to a peak of about 4% y/y last Spring and then slid to a trough of about 1.5% by year-end. I still think this is all about base effects and driven by the swings brought on by commodity and minimum wage change shocks. **Now we're on the upswing of those effects.**
- Enter chart 4. I've argued over time that because of these distortions **one should take a smoothed moving average out to 24 months to control for the shifting base effects and transitory distortions**. When that's done, wage growth is at 2.2% y/y and has been very steady around this comfort zone for the past couple of years. Further, it has been in a 2–2.5% y/y range for years. In my personal opinion, the BoC chases shifting base effects and distortions with its wage growth arguments and is underestimating cost-push inflation pressure from this component in support of core inflation expectations. Trend wage growth sustainably just over 2% y/y and core inflation pretty much bang on target doesn't require the BoC to continue to cling to emergency levels of monetary policy stimulus through negative real rates when the economy is largely just going through a transitory Q4/Q1 explainable shock to growth. I wouldn't be surprised to see the BoC begin to shift its bias again over the summer in support of our forecast for a return to hiking in H2. Clearly a lot else needs to go right along that path but we're generally constructive toward the outlook for the domestic economy and cautiously optimistic toward geopolitical factors including trade policy.

Chart 2



Sources: Scotiabank Economics, Bloomberg.

Chart 3



Sources: Scotiabank Economics, Statistics Canada.

Chart 4

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