January 13, 2020

The BoC's New Consumer Survey

- **A new survey is a welcome development…**
- **...but timeliness needs improvement**
- **Consumers lowered their already ridiculous inflation expectations**
- **Consumers are equally puzzled over who's getting wage gains**
- **House price expectations remain stable with a mild lift from B20**
- **Expected real house price gains around 2% shouldn't fuss the BoC**
- **Overall, it's unclear that this survey significantly informs BoC expectations**

The BoC released its inaugural Survey of Consumers' Expectations this morning. While the initiative itself is a welcome development, the fact that the survey is stale on arrival and offers readings that are totally disconnected from actual trends in wages, inflation and house prices makes the survey of limited use to BoC watchers and market participants. Both short-term bond yields and USDCAD shook off the BoC's pair of releases.

The BoC's release is here, the survey parameters and questions are here and the backgrounder is here.

Two thousand heads of households were polled. Data began to be collected in 2014Q4 so limited history is available thus far but it will be updated on a regular quarterly basis.

The CES sample period was from November 11th to November 29th. Key developments such as the US-China trade deal that was announced on December 13th, traction toward advancing the NAFTA 2.0 deal, ongoing equity market gains and the widespread deterioration of Canadian macro data including the last pair of jobs reports would not have factored into the sentiments formed over these periods. That's likely enough to significantly cast doubt upon the usefulness of the survey responses.

CONSUMERS' INFLATION EXPECTATIONS

Consumers' inflation expectations one year ahead slipped from 2.4% y/y to 2.2%. Expectations two years ahead held steady at 2.9% and the 5 year ahead measure of inflation expectations also fell from 3.9% to 3.6%. Consumers tend to regularly overestimate CPI inflation as evidenced by chart 1 that plots actual inflation (red line) with the one-year ahead expected figure lagged by one year (blue line) to correspond with actual inflation and the two years' ahead metric similarly lagged (green line).

Over the 2014Q4 to 2019Q4 period, consumers expected inflation to be 2.4% one year ahead and yet it averaged 1.7% over this period. That expectations are falling and typically overshoot actual inflation may be a bit of a red flag.

The question becomes whether the BoC should be concerned that expectations are above target on a fairly consistent basis. I think that would be attaching far too much significance to how consumers form price expectations.

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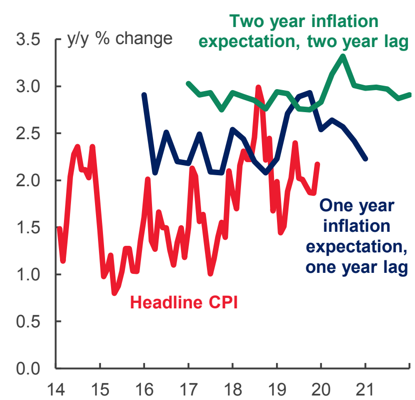
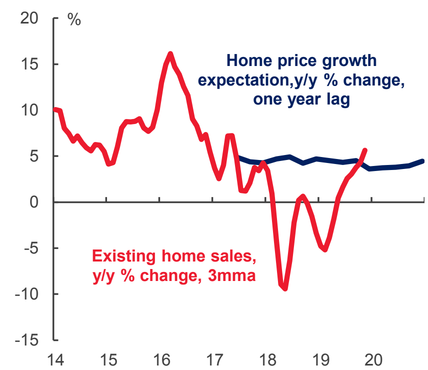
Consumer Inflation Expectations



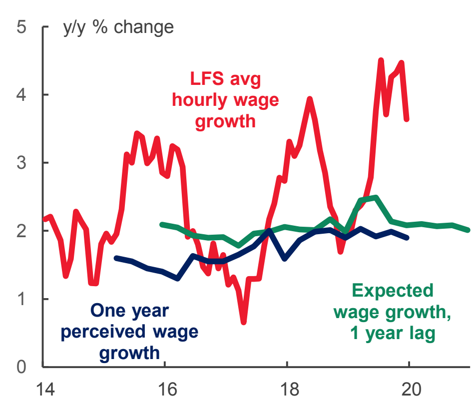
Sources: Scotiabank Economics, Statistics Canada, Bank of Canada.

Housing Price Growth Expectations



Sources: Scotiabank Economics, CREA, Bank of Canada.

Wage Growth Expectations



Sources: Scotiabank Economics, Statistics Canada, Bank of Canada.

Consumers' inflation expectations are usually not terribly useful. In the US, the Conference Board's measure for what consumers expect for the next year ahead's inflation rate is 4.4%. Enough said. All such measures are usually too high. Consumers look at their own prices. CPI is a different beast.

HOUSE PRICE EXPECTATIONS

To Governor Poloz's recent remark about being worried about housing when consumers extrapolate gains, there is little if any evidence that this is happening. Expected house price gains moved up to just over 4.4% over the next year.

That's a slight acceleration from 2018 when B20 temporarily tamped down such expectations. The trough was 3.6% in late 2018, so the rise to 4.4% now is largely immaterial. Prices should likely rise somewhat faster than inflation so it's unclear that a real price gain of around 2% would fuss the BoC.

How well do expectations track reality? Not very is the short answer (chart 2). Expected price gains are remarkably stable relative to volatility in average resale price changes, but higher than actual changes throughout the limited available sample period.

WAGE EXPECTATIONS

Consumers' expected wage gains are totally at odds with what StatsCan is telling us about wage growth. Chart 3 compares actual LFS wage growth over the past year (red line) to consumers' perceptions toward what happened to wage growth over the past year (blue line) and expected wage growth over the coming year (green line). The latter line is lagged by one year to correlate with actual contemporaneous wage growth to see if expectations nailed reality.

Consumers' perceptions about wage growth over the past 12 months have held largely unchanged for the past couple of years at just below 2% versus actual wage growth that is running around double that according to StatsCan. That's a pretty big divergence when consumers say they aren't getting the pay hikes StatsCan says they are.

Expected future wage gains over the next year are also at 2%. Past perceptions and forward expectations don't really match reality.

When the inflation and wage expectations are paired and regardless of whether we use what consumers expect for CPI versus adjusting that for tracking error, the implication is that consumers don't anticipate material *real* (inflation adjusted) wage gains over the year ahead. That might matter to a consumption model. If people don't expect material real wage gains, they're less likely to bank spending now.