Will The Bank of Canada Use Jobs As Cover For A Micro Rate Cut?

- **Canada shed jobs in line with expectations last month…**
- **...with the effects concentrated sectors most exposed to restrictions**
- **Several underlying details were more constructive**
- **Why markets shook off the tally**
- **Seven perspectives on a micro rate cut on January 20th**

Canada jobs m/m change (000s) / UR (%), SA, December:
Actual: -62.6 / 8.6
Scotia: -60 / 8.7
Consensus: -37.5 / 8.7
Prior: 62.1 / 8.5

Canada shed a modest number of jobs last month that markets largely ignored. See the accompanying table for highlights.

There are a few plausible explanations for why markets ignored the figures. On the rates side, there wasn't much left to price with the short-term rates complex already priced beneath the BoC's overnight rate; I'll come back to why I don't think the BoC should or will do a so-called micro cut after doing clean-up on the jobs numbers.

Furthermore, markets may have passed on the readings because they weren't any worse than what you would expect in the wake of tightened restrictions and the concentrated effects on the most affected sectors. It's also likely that markets are biased toward looking through what should prove to be transitory hits on employment that will rebound once restrictions eventually abate. As for the Canadian dollar's muted reaction, that was likely at least as influenced by the drop in employment on both sides of the border for similar reasons as it was by the other arguments above.

Where this leaves us in tracking overall employment throughout the pandemic is highlighted by chart 1. Overall employment has been little changed over the past four months. The initial recovery plateaued as second wave considerations mounted and there is probably further downside risk in subsequent reports. We expect employment to rebound once restrictions eventually ease and vaccines arrive.

Chart 2 updates which sectors are still down the most since the pandemic first struck versus the minority of sectors that have expanded employment.

In terms of the details, the fact that the hit to employment was concentrated in part-time jobs, the self-employed and a handful of sectors generally reinforced the sense that the headline tally was driven by tightened restrictions as opposed to something much more sinister lurking in the details.

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Canadian Jobs Break Down

Province	m/m
Quebec	-16.8k
Ontario	-11.9k
Alberta	-11.9k
Nova Scotia	-9.6k
Saskatchewan	-6.7k
Manitoba	-6.6k
Newfoundland & Labrador	-1.3k
Prince Edward Island	-0.9k
New Brunswick	-0.8k
British Columbia	+3.8k
Employment Type	**m/m**
Full Time	+36.5k
Part Time	-99.0k
Public Sector	+14.6k
Private Sector	-15.2k
Self Employed	-62.0k

Sources: Scotiabank Economics, Statistics Canada.

Chart 1

Sources: Scotiabank Economics, Statistics Canada.

By sector (chart 3), jobs fell by 74k in the service sectors and increased by 11k in the goods sector. Within goods, jobs were up by 15.4k in manufacturing and little changed in agriculture, resources, utilities and construction. Within services, the largest decline was in accommodation and food services (-56.7k) which makes sense in terms of the concentrated effects of tightened restrictions upon restaurants, bars and hotels etc. Ditto for the effects of restrictions on lost jobs in info/culture/rec (-18.8k). Other service sector jobs fell by 30.8k and business, building and other support services shed 10.5k. Other service sectors added jobs led by 16.8k in professional/scientific and technical services.

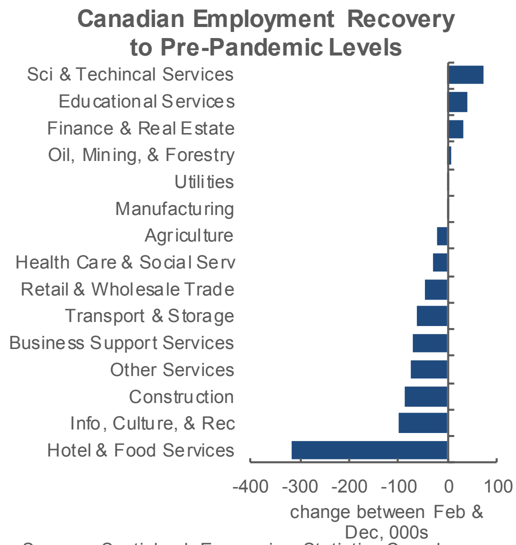
Self employment fell by 62k as overall payroll employment was unchanged.

Within payroll employment, the public sector added 14.6k while the private sector shed 15k jobs.

Full-time jobs were up by 36.5k and part-time jobs fell by 99k.

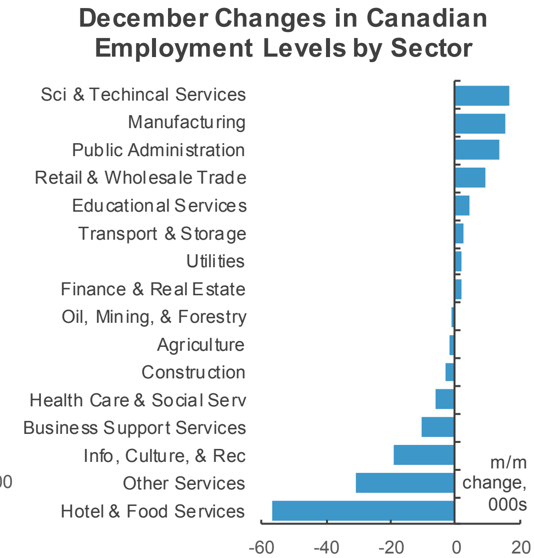
Hours worked were up by 15.9% q/q at a seasonally adjusted and annualized rate in Q4 following the 88% surge in Q2 (chart 4). That said, the recovery in hours worked stalled in December as they fell by 0.3% m/m despite the compositional shift toward full-time employment, but it's still the case that of the 27% decline over February through April, all but 5% has been recouped.

Chart 2



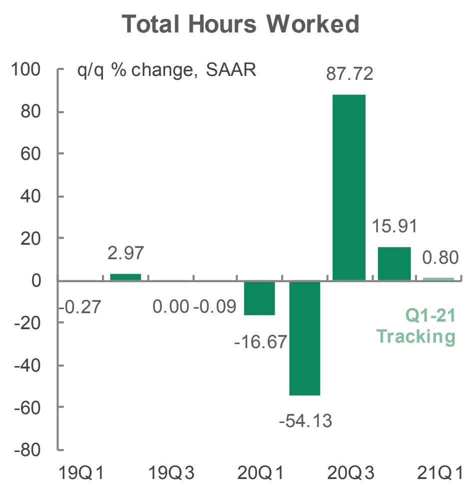
Sources: Scotiabank Economics, Statistics Canada.

Chart 3



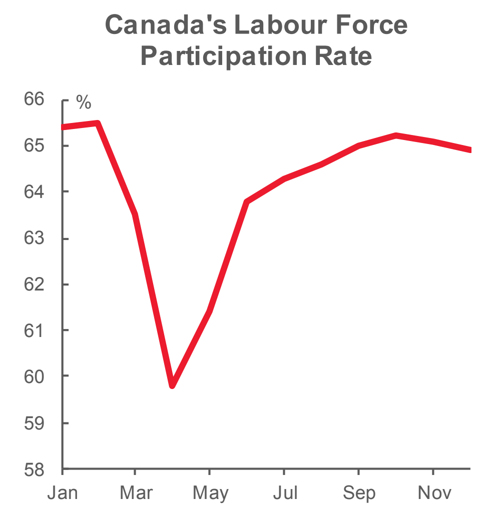
Sources: Scotiabank Economics, Statistics Canada.

Chart 4



Sources: Scotiabank Economics, StatsCan.

Chart 5



Sources: Scotiabank Economics, Statistics Canada.

Youth employment fell by 26.5k or almost half of the total hit. Men (-15k) and women (-21k) over the age of 25 were similarly impacted especially taking into account the bounds of statistical error in the survey.

The labour force participation rate has also plateaued over recent months and slipped a touch last month (chart 5).

By province, Ontario lost 12k jobs (all part-time with a mild full-time gain. Quebec lost 17k which was split between full-time and part-time. Alberta's employment fell by 12k all through part-time as full-time jobs were up 30k. BC was little changed at +3.8k, but it was the only province to stay positive as a full-time gain offset a part-time drop. All other provinces were mildly lower.

BANK OF CANADA

So how will the Bank of Canada view all of this as it dots the i's and crosses the t's in its upcoming Monetary Policy Report and statement on January 20th? I think they definitely should look through the jobs report as opposed to using it as cover for a so-called micro cut. Even if they don't, a micro cut—while not impossible—should have largely zero bearing on the rates complex versus the possible impact of not delivering one. There are several reasons for this view.

1. **The BoC is likely to be encouraged by the compositional details of the report.** That includes the full-time job gain and the narrow focus upon lost part-time jobs with most of the damage narrowly focused upon three out of sixteen sectors versus something deeper going on.

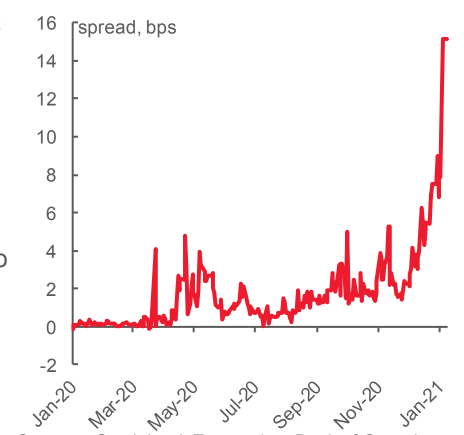
2. They will be concerned about at least one other decline in January given further restrictions and extended school closings, but a) **they can't do anything about these reports with the blunt lagging tools at their disposal**, and b) **they will likely be of the bias that these are transitory hits** that should swing the other way if/when restrictions are eased. The lagging effects of whatever they could do now would be concentrated upon the period when jobs may very well be rebounding anyway!

3. While it's not impossible they cut, the **risk-reward payoff matrix should counsel market participants to take limited positions that lean against cutting** since cutting the o/n rate would just bring it to about where the short-term rates complex sits. There would be a greater potential payoff to speculative positioning if they didn't cut than if they do ease.

4. **Further, a micro cut would apply the wrong tool to the underlying driver of the s-t rates complex.** T-bills outstanding have been in free fall and that has driven the massive move in short-term rates beneath the BoC's policy rate (chart 6). The BoC's holdings of bills reflect that as they are down by around two-thirds from the peak last summer. High liquidity and paper shortages have driven a scarcity premium that has bid upward short-term paper prices and put downward pressure upon their yields. Short-term rates are not where they are because markets have priced a cut in my view. So, if this scarcity effect on pricing were to stabilize or possible reverse at some point, then the BoC could face a challenge similar to times when the Fed has to cut its IOER relative to the upper bound of the fed funds target range as market rates drifted higher. Thus, the BoC could wind up cutting for the wrong reason only to face a potentially more awkward dynamic later if scarcity stabilizes—if not reverses. They could wind up looking like the keystone cops chasing the short-term rates structure.

Chart 6

Spread Between the BoC Overnight Rate and Money Market Financing Rate



Sources: Scotiabank Economics, Bank of Canada.

5. Both Governor Macklem and Deputy Governor Beaudry have said that "should things take a more persistent turn for the worse, we have a range of options..." and one of them was a micro cut and reassessment of the ELB while other options included LSAP increases or extended maturities. A first point is that it's interesting that all of the market attention is upon whether there will be a cut and no one is talking about increased LSAPs or extending the maturity composition just yet. That seems like cherry-picking the easing tools, but regardless, the BoC remains more likely to reduce LSAPs and extend maturity again over 2021H1. **But, the question at hand is whether this a persistent turn for the worse. It's highly premature to argue that it is.** For example, vaccine trials against mutations could disappoint, or they could entirely set aside worries about vaccines not being effective but we simply don't know that at this stage versus possibly knowing over the coming weeks. I still like the bias that Q1 is a transitory and milder hit on restrictions with improved conditions ahead as other risks (Brexit, US stimulus etc) have subsided. ie: look through.

6. **I think that what the BoC is really trying to do here is to clarify its communications around the effective lower bound**. Recall that it used to be defined at -50bps until March of this year, then they said +25bps likely because they didn't want markets to think they would really go negative and were not prepared to go there. **If they were not prepared to risk being pushed there when the economy cratered in Q2, then why now??** At some point they may reassess the ELB and have to take steps toward being open to that, but I think that's best left to when we're firmly on the sustained recovery path and markets are paying less attention. They should can the talk at this juncture.

7. Lucky number seven now. It's a grab bag of miscellaneous arguments. One is that in reference to housing, Governor Macklem said on December 18th "We are keeping an eye on it. "In general, we believe markets work. So, you want to be cautious when you are nudging the market. **You want to be pretty confident it needs a nudge."** That was before Toronto's ripping home resale figures for December were released. Another point is that **the baton is arguably being passed to fiscal policy in both Canada and the US** pending budgets on both sides of the border. Further, core inflation has proven to be sticky and just inches from the BoC's target, while market-based measures of inflation expectations have risen.