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Slow Progress on the Last Mile to 2% Inflation

The final mile on the road to achieving the Bank of Canada's 2% inflation target will not be an easy one. After witnessing inflation surge to a four-decade high in 2022, most of the subsequent disinflation has been a result of falling oil prices and global supply chain improvements. Despite the Bank signalling a halt in rate hikes, domestic indicators of capacity and inflation pressure remain a concern. Key inflation indicators like CPI-trim, though declining, remain well above 3%. Additionally, the year-over-year change for average hourly earnings has been running around 5%, and more than half of businesses expect inflation to remain above 3% over the next two years.

Despite a slowing economy and a negative output gap, the Bank remains cautious in order to preserve its credibility in managing inflation. The last thing it wants to do is signal the expected timing of a rate cut, as this could cause financial markets to react and lead to a premature easing of financial conditions.

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LATEST EMPLOYMENT MARKET DATA

In February, the labor market added 40,700 jobs, with full-time employment rising by 70,600, while part-time positions decreased by 29,900. Despite this, the unemployment rate edged up by 0.1% to 5.8%, while the participation rate remained unchanged at 65.3%. Compared to the previous year, the unemployment rate is up 0.7%. Much of this increase in unemployment stems from prolonged job searches among new labor market entrants. Additionally, there has been a sharp decline in hiring demand, with job vacancies running 25% below levels seen a year ago. This shift is altering the balance of bargaining power in wage negotiations, tilting it away from workers.

Wage growth, as indicated by the labor force survey data, remains firm but dipped slightly to 5.0% year-over-year in February from 5.3% in January. Other estimates derived from employer payroll data suggest a more pronounced slowdown in recent months, although this deceleration has not yet been reflected in Statistics Canada reports.

While the labour market report shows there has been progress on the wage front, wage growth remains too high to align with the Bank's 2% inflation target, especially when productivity is so low. As the labor market continues to show greater balance, the Bank will require further evidence of moderation in wage growth before considering a reduction in interest rates.

ABOUT THE AUTHOR

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Kevin has had a long career in capital markets, housing finance, and public policy. He has worked as an economist for Alberta Treasury, Saskatchewan Policy Secretariat, the Bank of Canada, and the Department of Finance Canada. His work has included tax policy, economic forecasting, as well as monetary policy and debt management. While at the Bank of Canada, he authored two Bank of Canada Review articles on monetary policy tactics. Kevin has worked on a variety of debt programs from treasury bills to domestic and foreign bond issues, and interest rate swaps. He worked on building and managing the federal real return bond program, the Canada Savings Bond program, and built out the bond buyback program and a synthetic foreign funding program – two programs which are still in use today by the federal government. While at CMHC, Kevin managed the market funding program for social housing, built and managed the Canada Mortgage Bonds program, and expanded the products offered under the NHA MBS program. He has worked for several mortgage insurers including CMHC, Canada Guaranty, Triad Guaranty and Genworth. This work encompassed product development and risk management across housing markets in North America, Europe, Asia, Australia, and New Zealand. More recently he has had senior management roles with residential lenders managing underwriting, risk, product development, capital markets, and strategic planning.

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