

No more settling for negative real wage growth

By Taylor Schleich

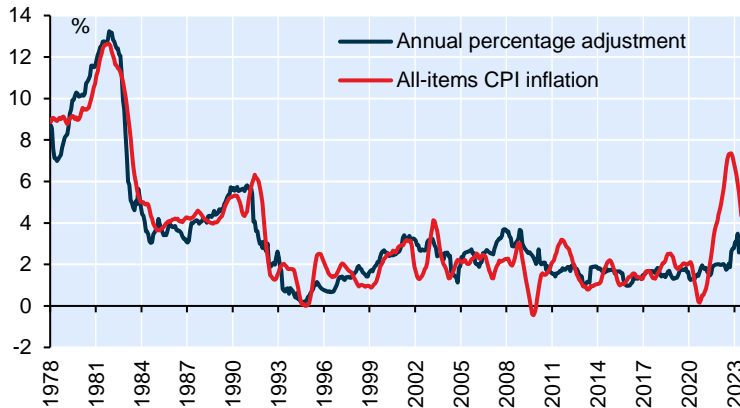
Following a full year of nearly uninterrupted disinflation, year-on-year price growth reaccelerated in July as per StatCan's latest CPI report. With favourable base-year effects behind us, the Bank of Canada's assessment that inflation will "hover around 3% for the next year" may be less of a hollow threat. The risk, as the central bank has reiterated, is that this period of above-target price pressures may cause inflation expectations to stay high. Is there evidence of this already? Market-based measures (i.e., breakevens) don't say so. Another place one might expect to see higher expectations rooted is in wage settlements. Is there evidence of that here? The answer, as we explore here, is *sort of*.

Economic and Social Development Canada's [dataset](#) on major wage settlements (covering collective agreements with 500+ employees, or ~2.5 million workers) indicate that unionized workers are seeing wages grow faster than over the last decade. That's not too surprising given the rising cost of living and the fact that CPI inflation and wage settlements historically track very closely. However, a 2.9% average annual pay raise (YTD, over an average contract of 39 months) is hardly the stuff that serious wage-price spirals are made of. Moreover, considering how much prices have risen in recent years, purchasing power is definitively lower for these workers. We estimate that real wage growth for a representative agreement ratified from 2019 to 2021 will be *negative 2% to 3% on average per year* over the contract term. You'll see stagnating/declining living standards in other economic data too, like [real per-capita GDP](#) which has fallen and is expected to fall further.

Assuming a reasonable path for inflation from here, contracts signed in 2023 might mean workers can eke out marginally positive real wage gains over coming years. Still, this won't be anywhere close to enough to offset earlier real wage declines. That doesn't imply a particularly buoyant or healthy consumer. At the same time, barring a more significant economic downturn (i.e., a recession), don't expect wage settlement pressures to ease. Given the significant *real* pay cuts absorbed over past years, above-2% wage gains will be asked for, and likely granted, given a still-tight labour market. Now this doesn't mean 2% inflation can't be achieved. We still see a weaker economy providing *cyclical* inflation relief and expect corporations to be more concerned about productivity as profit margins increasingly come under pressure. That said, there's now an additional source of upward pressure that we'd not previously been used to (not to mention, energy-transition and deglobalization related pressures). For the coming years it's more likely inflation ranges between 2 and 3% rather than the 1-2% band it resided for much of the post-GFC period. Again, that doesn't preclude lower rates next year. But while the economy may warrant *less restrictive* monetary policy by mid-2024, the extent of rate relief may be limited and a return to a neutral (2-3%) policy rate may still be years away.

Chart 1: Wage settlements have historically tracked inflation

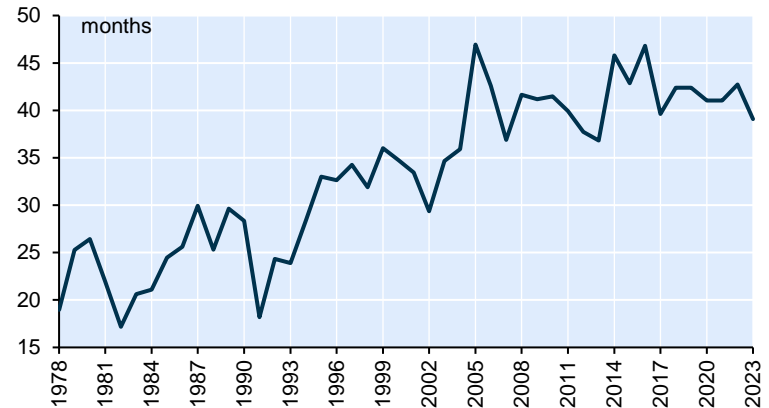
Average annual percentage adjustment vs. all-items Y/Y CPI inflation



Source: NBF, StatCan | Note: Annual adjustment & CPI calculated using a 6M moving avg.

Chart 2: Over time, contracts have grown longer in term...

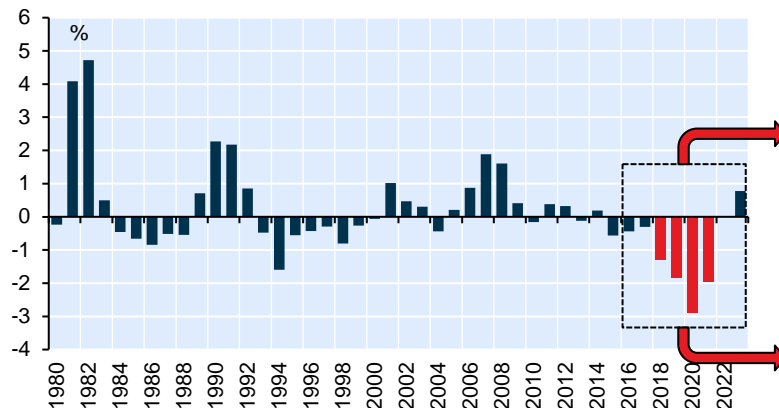
Weighted average duration of agreement by year



Source: NBF, StatCan | Note: Weighted by number of employees covered

Chart 3: ...leading to workers stuck with falling real wages...

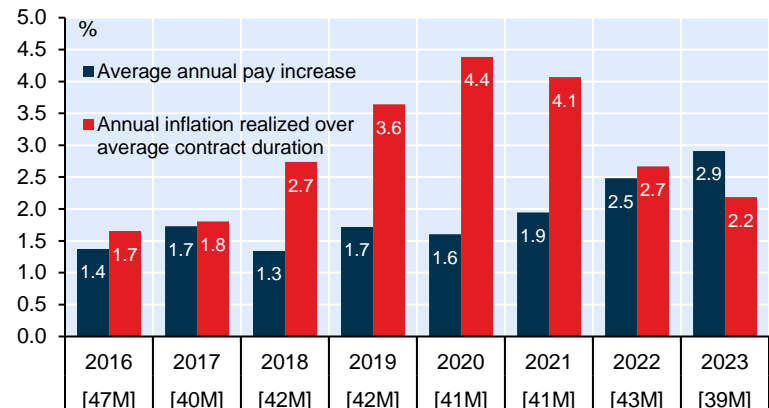
Average wage growth less CPI inflation over life of agreement



Source: NBF, StatCan | Note: Annual inflation projections per BoC July MPR (3.7% in 2023, 2.5% in 2024, 2.1% in 2025. 2.0% is assumed thereafter).

Chart 4: ...but positive real wage growth may soon be in store

Average wage growth less CPI inflation over life of agreement



Source: NBF, StatCan | Note: Annual inflation projections per BoC July MPR (3.7% in 2023, 2.5% in 2024, 2.1% in 2025. 2.0% is assumed thereafter). Avg. contract length in parenthesis.

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