

## Op-ed: The BoC should offer an unemployment rate forecast

By Warren Lovely, Stéfane Marion & Matthieu Arseneau

Some five years back, we argued that the Bank of Canada should add the unemployment rate to the short list of economic variables projected quarterly in the *Monetary Policy Report*. At the time, we dubbed the jobless rate ‘the missing link’ in the BoC’s macro forecast. Alas, our plea fell on deaf ears. But it’s not too late to reconsider, so we’ll ask again. It’s past time for the Bank of Canada to permanently incorporate the unemployment rate as part of the baseline economic forecast. There’s no reason to delay; the sooner the Bank’s economic forecast is enhanced the better.

### Fit with monetary policy mandate

The Bank of Canada’s current monetary policy framework focuses on price stability. Specifically, the goal is to keep year-over-year CPI inflation at the mid-point of a 1-3% control range (i.e., aimed at 2%). Strictly speaking, you could call this a ‘single mandate’ and, as we’ll show, it’s a reasonably common way to conduct monetary policy. An explicit emphasis on price stability makes an inflation forecast a must. As such, BoC projections for headline and more recently core CPI inflation are spelled out in the *MPR* (along with real GDP growth forecasts).

As much as low, stable inflation is the primary objective, the existing framework—up for renewal before the year is out—also acknowledges that “monetary policy should continue to support maximum sustainable employment”.

The labour market is not meant to supplant inflation and a simple word count illustrates this notional subordination. There are more than 430 references to “inflation” in the BoC’s 2021 framework renewal, whereas “employment”, “labour” and “jobs” jointly show up less than half as often (nearly 200 times if you’re counting, which was still far greater than the number of references to “growth”).

There’s no disputing that price stability is the BoC’s main focus and we believe that should remain the case when the policy framework is soon renewed. Yes, that’s our formal recommendation. But if maximum sustainable employment is also to be retained as a complementary objective—as sensible today as it was in 2021—shouldn’t the Bank outline its thinking on the subject? After all, standard economic theory postulates that inflation and unemployment are inter-related. (Hello Phillips curve.) Whether striving for maximum sustainable employment or not, it’s perhaps just as appropriate to project labour market slack as it is to forecast GDP growth (and by extension the ‘output gap’).

Beyond monetary policy, the Bank of Canada is tasked with financial system oversight. To that end, the Bank provides a detailed risk assessment via its annual *Financial Stability Report* (the latest version of which landed only a handful of days back). Household indebtedness remains top of mind here, with the BoC rightly noting that “households would feel the effects of a weaker economy largely through the labour market”. It’s important to have a view on the labour market at the best of times and even more so when headwinds gather and change is afoot.

Indeed, an important speech by BoC External Deputy Governor Nicolas Vincent recently raised serious questions about the labour market’s ability to adapt to major structural shifts, including U.S. trade protectionism, the rise of AI and slower population growth. As Vincent put it, “distinguishing

between temporary and long-lasting change [in the labour market] is difficult but essential.” We agree. If the BoC can’t take its eyes off the labour market, it would be helpful to know not only what they are *seeing* but what they are *expecting*.

Finally, to the extent the BoC gives any thought to social considerations, including wealth distribution and income equality, the outlook for the labour market is absolutely vital.

To be fair, there’s ample labour market commentary/analysis in your average BoC *MPR*. And yet, something important is missing: an official projection. Adding just a single labour market indicator to the BoC’s economic forecast table would jibe with the Bank’s established mandate, acknowledging the connection between inflation and unemployment while simultaneously illustrating a focus on maximum sustainable employment. As for the metric best suited to the job, well there’s one obvious option: the unemployment rate.

### Broadly understood and widely accepted

Is there an economic concept more broadly understood and/or widely accepted than the unemployment rate? Not many, if any. This statistic—the share of unemployed individuals in the labour force that are actively looking for work—is a fundamental measure of economic performance.

The BoC’s last policy framework renewal highlighted only a few core economic variables—the unemployment rate, real GDP growth and CPI inflation—when discussing how Canada performed before and after moving to an inflation targeting regime.

The Bank’s latest *MPR* (from April) likewise placed the unemployment rate at the top of a list of ‘labour market indicators’ where slack is being closely monitored. It’s a similar story when looking at the Bank’s ‘indicators of capacity and inflation pressures for Canada’. Debate if you must the full slate of measures that belong in the labour market section of such lists, but the unemployment rate will *always* be there. On this, there should be no debate.

In formal communications, members of Governing Council regularly offer qualitative assessments of how the labour market is expected to perform. Such remarks give the impression that the BoC has a view on the unemployment rate (if not other measures of labour market slack). We’re asking for them to quantify their thinking, ideally positioning the jobless rate against the best estimate of trend/natural unemployment.

Meanwhile, over at Statistics Canada—tasked with generating much of the key data the BoC relies on—the agency’s main landing page features four ‘key indicators’: population, CPI inflation, real GDP growth and, you guessed it, the unemployment rate. When StatCan releases its most important labour market report—the monthly *Labour Force Survey*—the two most important headlines relate to the change in employment and the unemployment rate.

It follows that when the media report on Canadian economic performance, the jobless rate is reliably used. It’s simply better understood by those consuming the news. In recent years, the Bank of Canada has placed added emphasis on its communications with a view to “building trust” and ensuring Canadians understand monetary policy



actions. Part of that effort has involved “plain-language content”. A natural extension of this communications strategy presumably involves using easier-to-understand measures and statistics.

We’ve nothing against sophisticated/complex statistical analysis, but if making yourself understood is a priority, then a central bank may want to favour digestible concepts like the unemployment rate. Come to think of it, there’s a very important related discussion on how best the BoC should measure and communicate ‘core’ inflation. We’ve made our views and preferences well known. Refer to our *Special Report* [here](#).

## Limitations sure, but what statistic is nuance-free?

True, as a statistical concept, the unemployment rate has limitations. It is an imperfect measure of slack. The unemployment rate is derived from a monthly survey of households, which is notoriously choppy (i.e., confidence bands can be wide).

Perhaps most notably, the unemployment rate concept is susceptible to a discouraged would-be worker effect. When times are tough/uncertain, job seekers can give up, exiting the labour force (which is the denominator in the unemployment rate calculation). In the realm of labour market analysis, economists might well consider the *employment rate* a truer measure of labour utilization. Unlike the jobless rate, the employment rate controls for cyclical shifts in participation. No ‘discouraged worker effect’ here. However, this indicator makes it difficult to compare data (and hence labour market slack) over time because it is affected by structural changes in the composition of the population (e.g., a higher proportion of women, population aging, etc.). For this reason, the employment rate is much less commonly used and accepted.

More fundamentally, in searching for maximum sustainable employment one must understand the trend or natural rate of unemployment. Here, the BoC cites earlier work showing that confidence intervals around estimates of trend unemployment can be large. Point well taken.

Meanwhile, when it comes to economic relationships, the Phillips curve—which in its most common form plots inflation against the unemployment rate—is likewise imperfect. The BoC’s monetary policy framework renewal (from 2021) devoted a section to the “implications of a flat Phillips curve”, highlighting two-sided risks to monetary policy. At the same time, it was argued that “the Bank may choose to actively seek, and continuously update its estimates of, maximum sustainable employment.” More active monitoring of labour market conditions then, which we admit is not the same as committing to a forecast.

All that to say, the unemployment rate is hardly the ‘be-all and end-all’ of economic statistics. But name a competing capacity measure that is fully nuance-free, unsaddled with technicalities or without drawbacks?

The ‘output gap’? Well, if understandability is a consideration, this esoteric measure surely falls flat. Real GDP can be subject to substantial revisions, which risk altering one’s understanding of economic slack as measured by the ‘output gap’. This is something the BoC has been forced to contend with more recently, since large upward revisions to prior GDP data changed the thinking on potential growth. Despite serious discrepancies in the measurement of real GDP, the BoC offers a forecast here and guesstimates the ‘output gap’ with a proverbial finger in the air.

Inflation too can be tough to measure accurately. Beyond data collection issues and the associated need for statistical inference, consumer spending patterns evolve. So there can be some debate as to how well a given CPI inflation reading reflects the cost-of-living pressures actually faced by households. From a monetary policy perspective, there’s arguably the bigger issue of how to measure and report on ‘underlying’ or

‘core’ inflation. Let’s just say that the Bank of Canada’s approach has been less than consistent over the years.

So if there’s a genuinely unblemished measure of capacity out there, we’re still searching for it. The unemployment rate isn’t perfect, but it will do. While financial market participants certainly take into account various indicators of labour market health when adjusting their views on monetary policy, the unemployment rate alerts that hit their screens are the most frequently used among all economic indicators published in Canada—along with CPI—which underscores the importance of this particular indicator to the financial community.

Moreover, the unemployment rate can be fully expected to remain one of the most commonly forecasted economic variables.

## One of the most common forecasts offered

The BoC might not forecast the jobless rate (at least not yet), but most others do. At home and abroad, most (all?) major private sector forecasters have a view on the unemployment rate as part of any basic economic outlook. It follows that forecast summaries (whether produced by Bloomberg, Consensus Economics, Focus Economics, etc.) always capture and include the assorted views on joblessness. In Canada, you won’t have any trouble sourcing regional unemployment rate forecasts (for each province, if not the large cities).

International bodies like the IMF, OECD and World Bank, along with policy think tanks, various consultants, academic economists and credit rating agencies all forecast the u-rate too. As do governments. Your standard public sector budget might not have a forecast for every statistic under the sun, but you can bet on an unemployment rate projection. All this highlights the fundamental importance of the labour market and the broad acceptance of the jobless rate as a primary indicator.

It likewise remains the case that the unemployment rate is one of the more vital inputs when stress-testing and projecting financial health in the banking sector. That’s because unemployment is correlated with consumer behavior, housing activity, loan losses, etc. Given Canada’s heavily indebted citizenry and more housing-dependent economy, a view on labour market conditions might be more important here than in other international jurisdictions.

And yet, unemployment rate forecasts are more common across the Bank of Canada’s most immediate peer set: other central banks.

## Central bank peers mostly agree

As we detailed back in 2021, most (though not quite all) of the developed world’s largest/most influential central banks provide regular unemployment rate forecasts.

In a couple of instances, there exists a ‘dual mandate’, whereby the monetary authority explicitly steers policy to achieve both inflation *and* employment goals. Most notably, that’s how the U.S. Federal Reserve Board operates, aiming for both 2% PCE inflation and maximum sustainable employment. It’s little wonder that the FOMC’s quarterly *Summary of Economic Projections* provides median forecasts (plus a central tendency and range) for the U.S. jobless rate alongside headline/core inflation and real GDP growth.

The Reserve Bank of Australia (RBA) explicitly adopted a ‘dual mandate’ back in 2023. But even prior to that mandate change, the RBA had been focused on full employment, which included regular projections of the unemployment rate. Obviously, with a ‘dual mandate’, there’s every reason to continue to project Australia’s jobless rate and you will see those forecasts spelled out in the quarterly *Statement on Monetary Policy*.



Going the other way in 2023, the Reserve Bank of New Zealand (RBNZ) had its policy mandate officially narrowed to price stability. New Zealand may have given up on a 'dual mandate' for its central bank, but the RBNZ still includes the unemployment rate as one of handful measures that are consistently forecasted.

Despite a narrow(er) focus on price stability, a number of other venerable central banks consider the unemployment rate of sufficient importance to warrant a forecast. Beyond the RBNZ, that list would include the European Central Bank, the Bank of England, Sweden's Riksbank, Norges Bank and the Bank of Israel to name but a few. Indeed, our survey of ten BoC peers found only the Bank of Japan and the Swiss National Bank failing to project the unemployment rate.

We are not suggesting that Canada's monetary policy blindly follow the path(s) trod elsewhere. A central bank's framework and related decisions must be best suited for and calibrated to the domestic economy. Nor are we suggesting that a central bank must provide an undue level of guidance on its policy intentions. But having an unemployment rate forecast does not constitute excessive handholding for market participants. Surely these other central banks forecasting the jobless rate are on to something.

As it stands, the BoC is more of an outlier. Its economic outlook is hardly 'best in class' (in terms of completeness), with key stakeholders missing guidance on the labour market. Canadian households, businesses and governments, to say nothing of the growing army of investors with direct or indirect exposure to Canadian assets, would benefit from a more complete BoC forecast. Consumer price inflation, real GDP growth *and* unemployment should be projected. Sorry Meatloaf, but two out of three ain't great.

### In summary...

The Bank of Canada would do well to formally slot the unemployment rate into its economic outlook, offering an official view via the quarterly *Monetary Policy Report*. We came away empty handed the last time we asked for this, but it's time for a considered reconsideration.

The requested unemployment rate forecast should ideally be lined up against an estimate of trend/natural level. Doing so could allow the Bank of Canada to potentially do away with the esoteric 'output gap' measure, which is not only harder for the public to understand but prone to non-trivial revisions.

Our recommended change would provide stakeholders (including Canadian households, businesses, governments and financial market participants) a clearer understanding of how the BoC anticipates slack will evolve. Yes, measures/estimates of labour market slack are imprecise. New data will arrive, events will transpire, threats will emerge, the outlook will change. But whether it's on inflation, real GDP growth or the unemployment rate, that's something every forecaster (and economic decision-maker) has to contend with.

Notwithstanding a flatter Phillips curve, labour market conditions help inform inflation. If you're forecasting one, you should be forecasting the other. Moreover, as the BoC itself just argued, closer monitoring of the labour market will be needed as structural changes ripple through the economy. Surely this argues for having a more explicit view on how labour market conditions are likely to shift.

Ours is not a big ask, with most central bank peers having long offered a jobless rate forecast. While it may seem natural to reflect on our proposed change as part of the BoC's monetary policy framework renewal, there's really no reason to delay. From our perspective, the sooner the BoC shifts its focus from the 'output gap' to labour market slack the better.

Again, to be clear, there needn't be any change to the explicit monetary policy mandate to support or justify this overdue addition to the Bank's economic outlook.

## Table: Most major central banks consider the unemployment rate important enough to forecast

Comparison of key macroeconomic forecast elements at select central banks

Country/region	Canada	United States	Euro-area	Japan	United Kingdom	Australia	New Zealand	Switzerland	Sweden	Norway	Israel
Central Bank	BoC	Fed	ECB	BoJ	BoE	RBA	RBNZ	SNB	Riksbank	Norges	BoI
Currency	CAD	USD	EUR	JPY	GBP	AUD	NZD	CHF	SEK	NOK	ILS
Primary MP goal	PS	PS+MSE	PS	PS	PS	PS+FE	PS	PS	PS	PS	PS
<b>Quick comparison of major economic forecast elements presented in official monetary policy documents:</b>											
Inflation	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Real GDP	✓	✓	✓	✓	✓	✓	✓	✓*	✓	✓	✓
Unemployment rate	✗	✓	✓	✗	✓	✓	✓	✗*	✓	✓	✓

Source: NBC (with the assistance of Taylor Schleich & Ethan Currie), official central banks (monetary policy reports/statements) | Note: 'Primary MP goal' refers to primary monetary policy mandate/objective, which in most cases is focused on some form of price stability (PS) implemented via inflation rate targeting; in the case of the U.S. Federal Reserve Board, maximum sustained employment (MSE) is also a formal monetary policy objective, resulting in a 'dual mandate'; in Australia, the RBA explicitly adopted a 'dual mandate' in 2023, focused on price stability and full employment (FE); in New Zealand, the RBNZ mandate switched to a single focus on price stability in 2023; in many cases, economic forecasts are not limited to inflation, real GDP and the unemployment rate, with some providing comprehensive guidance; in the case of the SNB, real GDP growth is currently an approximation (e.g., around 1% for 2026, around 1.5% for 2027); previously, the SNB had provided directional guidance on unemployment, though none was included in the latest Quarterly Bulletin



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