ECONOMIC VIEWPOINT

Growing Public: How Government Compensation Is Keeping Wage Growth High in Canada

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Highlights

- The reacceleration in wage gains in May 2024 despite a rising unemployment rate and modest advances in real GDP raises the question: what's keeping wage growth so high in Canada?
- Drilling down into the data, we see the public sector is making an outsized contribution to wage growth. This reflects already-high hourly wages in the industry, strong recent growth related to labour negotiations, and surging hiring.
- Greater federal public sector compensation is particularly notable, both in growth and level terms, relative to other levels of government and the private sector. Add to this sustained federal hiring at a pace in excess of published plans, and the current trend is unlikely to change soon.
- What does high federal public service wage growth mean for the Bank of Canada? Probably not much. Its focus is likely to be on private sector compensation, which is more strongly linked to the business cycle. And it's moving in the right direction, as still-elevated interest rates are working to cool private sector wage growth and inflation along with it.

The recent Labour Force Survey (LFS) for May 2024 raised some eyebrows when it showed a reacceleration in year-over-year wage growth. This despite a further increase in the unemployment rate as population gains continued to outpace hiring. With real GDP growth and inflation cooling along with the labour market, it raises the question: what's keeping wage growth so high in Canada?

It Pays to Be a Public Servant

Coming out of the COVID-19 pandemic in early 2022, private sector wage growth led the advance in compensation by a wide margin. But since then, public sector wage gains have continued to steadily close the gap even as private sector wage growth has gradually stabilized (graph 1). Public sector wage gains have been particularly concentrated in public administration and health and social services recently, the latter reflecting still-elevated job vacancies. Recent gains in public administration aren't especially

Graph 1
Public Sector Compensation Is Increasingly Driving Wage Growth

*The public sector is defined here as educational services, health and social services, and public administration.
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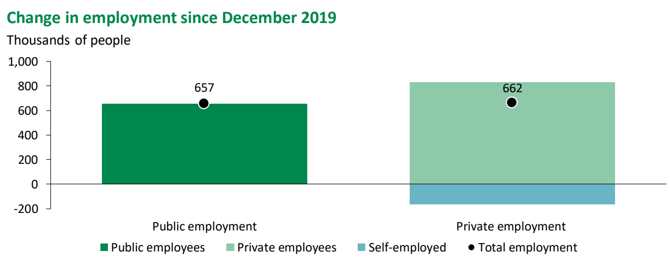
surprising either, reflecting the strike action taken by federal public servants in May 2023 and ongoing wage settlements at the provincial level. (See our overview of the 2024 provincial budget season.)

Not only has public sector wage growth been accelerating, but so has hiring. Since December 2019, public sector employment increased by nearly 657K, or 17% (graph 2). Similarly, private sector job creation was up by 662K over the same period. However, this was equivalent to just a 4% increase in net new jobs. That's because there are a lot more private sector employees than public sector workers. For instance, at the end of 2019, there were over four private sector workers for every public sector worker in Canada. Today, that ratio is closer to 3.5:1.

Graph 2
Public Sector Employment Gains Have Been Substantial since 2019



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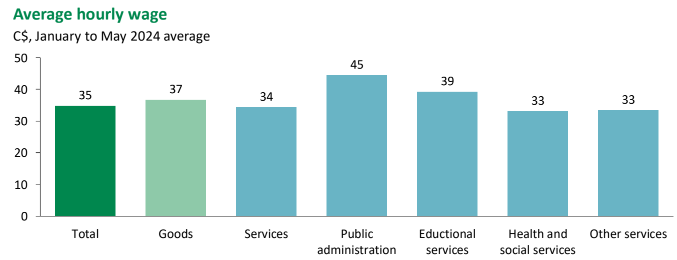
In addition to wage growth and hiring advancing more quickly in the public sector than in the private sector, public sector employees also earn more on average than their private sector peers. Hourly pay for public administration is particularly high (graph 3). Notably, out of 16 industries in the LFS, the only ones to provide higher hourly remuneration than public servants so far in 2024 are utilities, mining and oil and gas extraction, and professional services. Even the average rate of hourly compensation in finance, insurance, real estate and leasing was lower.

So, putting all these pieces together—high average hourly compensation, accelerating wage growth and surging hiring—it's no surprise that public sector compensation has been contributing increasingly to overall wage growth in Canada.

Graph 3
Public Servants Are among the Highest Paid Workers in Canada



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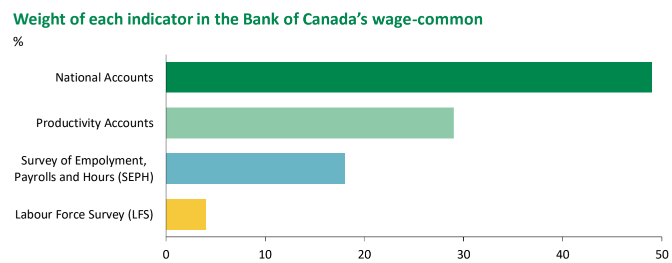
Federal Public Servants Are Particularly Well Compensated

Given that the LFS is the first labour market survey published in Canada every month, it tends to be the source of jobs data analysts put the most weight on. But analysis by the Bank of Canada (2018) has demonstrated that it is by far the least reliable indicator of wage pressures in Canada. Indeed, the Bank of Canada estimates a measure that extracts the common signal from a range of wage indicators, and this procedure assigns the least weight to the LFS (graph 4) as it tends to be noisy. Instead, the Bank puts the most weight on National Accounts wage data, followed by the Productivity Accounts and then the Survey of Employment, Payrolls and Hours (SEPH).

Graph 4
The LFS Is the Least Reliable Indicator of Wage Growth in Canada

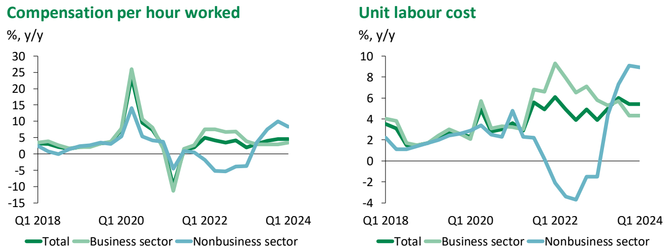


LFS: Labour Force Survey
Bank of Canada and Desjardins Economic Studies

Looking first to the National Accounts data, we see that growth in wages and salaries for the whole economy slowed to just shy of 6% y/y in Q1 2024. That's just slightly below the 6.2% pace from the LFS for the same period. But unfortunately, the National Accounts data don't get more granular than this on a sector basis.

In contrast to National Accounts, compensation per hour worked from the Productivity Accounts clocked in at a more modest 4.6% y/y in Q1 2024. That number was weighed down heavily by business sector compensation gains, which advanced by only 3.4%. However, nonbusiness sector compensation increased by 8.4% in that same quarter, albeit cooling from the torrid 10% pace recorded in the final quarter of 2023 (graph 5). It comes as no surprise then that nonbusiness sector unit labour cost also shot up. While some of this comes mechanically from the contractions in quarterly nonbusiness sector compensation growth posted in 2022, even quarter-over-quarter gains in public sector earnings over the past year have been nearly unprecedented in their pace and persistence.

Graph 5
Nonbusiness Sector Compensation Growth Has Skyrocketed



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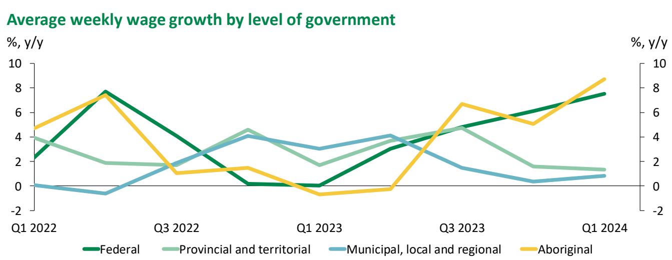
Finally, this brings us to the SEPH. According to the Bank of Canada, it's the least reliable indicator of wage growth in Canada save only for the LFS. Average weekly earnings including overtime is the measure of compensation growth with the greatest sector granularity in the SEPH, and it increased by 4.1% y/y in Q1 2024 for all industries. In contrast, public administration saw average weekly earnings growth advance by a more modest 3.5% in the same period.

But the SEPH tells a more nuanced story. Digging into the details, we see that average weekly earnings including overtime advanced by 7.5% y/y in Q1 2024 for federal government public administration (graph 6). In contrast, public administration earnings growth for provincial and territorial governments as well as local, municipal and regional governments was below the all-industry average. Meanwhile growth in average weekly earnings including overtime for aboriginal public administration increased sharply over the past year. However, the number of people employed in this sector is less than 20% of the number of public administration employees in the federal government. At the same time, the level of weekly compensation is just over half what federal public servants earn. This puts the total wage bill of people working in aboriginal government at around 10% of the total federal government cost. In fact, earnings growth for federal public servants is not only outpacing that of other levels of government, but federal public servants also have a higher average level of compensation than workers employed by any other level of government. And this doesn't include matching pension contributions and other benefits. The federal government has also gone on a more aggressive hiring spree since the end of 2019.

Graph 6
Federal and Aboriginal Governments Have High Wage Growth



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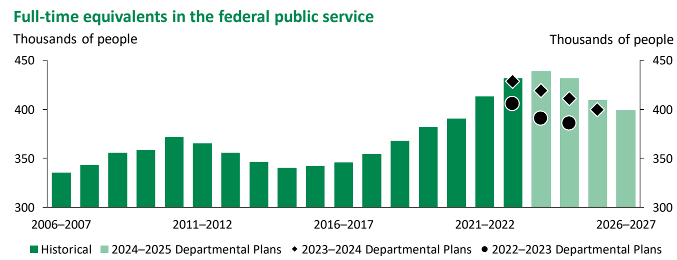
The Bill for Federal Public Servants Is Likely to Go Up

Taken together, it's clear that not only are public sector wage gains keeping overall wage growth elevated, but the impact of the federal government is disproportionately large. Indeed, the federal government has raised staffing levels every year since 2015. And as we wrote following last year's federal public service strike and was again corroborated this year by the Parliamentary Budget Officer (2024), the federal government has surpassed its planned staffing levels time after time (graph 7). There is no reason to believe this won't be the case again in 2025.

Graph 7
Federal Government Hiring Consistently Exceeds Expectations

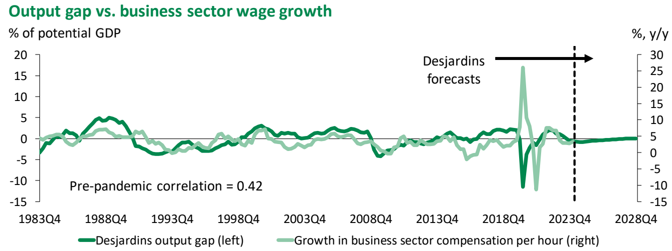


Office of the Parliamentary Budget Officer and Desjardins Economic Studies

What Does This Mean for the Bank of Canada?

Strong growth in federal public service compensation probably won't mean much for the Bank of Canada. Wage-push inflation is less of a concern in this case since the public sector doesn't usually charge consumers directly for its services. Private sector wage growth is more important in this regard. And looking at the relationship between business sector compensation and the state of the business cycle (as proxied by the output gap), the latter tends to lead the former (graph 8). As such, our forecast points to more weakness ahead for business sector wage growth as interest rates remain elevated and growth soft. (See our recent Economic and Financial Outlook for more information.) Still-elevated interest rates are working to cool private sector wage growth and inflation along with it, in spite of federal public service compensation pushing in the opposite direction.

Graph 8
Business Sector Hourly Compensation Is Set to Slow Further



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