ECONOMIC CLIMATE *for* BARGAINING

September 2011 **Vol. 8, No. 3**
Frontline Summary

Economic Outlook Summary

Canada's economy stalled in recent months, with a decline of -0.4% in economic output for the 2nd quarter and no growth in jobs during July and August. If there's another decline during the 3rd quarter, we will be in a double-dip recession.

Canada is exposed to both weakening U.S. and European economies abroad and more precarious conditions at home. Household debt now exceeds 150% of disposable income while wage growth has fallen below inflation.

Business investment has increased, but it is still below pre-recession levels. If governments cut more, our economy could be tipped back into recession.

Private economic forecasts now expect:

- Economic output (GDP) to increase by 2.4% in 2011 and 2.3% in 2012.
- Unemployment to average 7.5% this year and 7.3% in 2012.
- Consumer price inflation to rise by an average of 2.7% in 2011 and 2.1% in 2012.

Recovery interrupted
Canada bounced back from the recession at a strong pace, but as stimulus programs ended and are being replaced by austerity, the recovery has been interrupted. Unlike previous recessions, we can't rely on further reductions in interest rates to jump-start economic growth. Politicians are once again acknowledging the importance of focusing on jobs, but higher wage growth is necessary as well.

Job growth stalls in summer, slowdown expected
Job growth unexpectedly stalled in July and August, following two years of relatively strong growth. Public sector employment hasn't gone negative yet, but it is growing at a much slower pace.

Fuel, food and sales tax hikes push inflation to 8-year high
Rising oil and food prices together with sales tax increases recently pushed consumer price inflation to its highest rate in over eight years in May. Since then, inflation has receded, but it is still well above the rates forecasted at this time last year. Despite these price hikes there's no sign higher rates of inflation will become persistent. Canada's "core" inflation rate only increased by 1.6% in July, well below the Bank of Canada's inflation target of 2%.

Wage increases to edge up in 2012
Surveys of Canadian employers indicate average salaries will increase by close to 3% in 2012, slightly above average salary hikes anticipated for 2011. Base wage adjustments in recent collective agreements settled in the 2nd quarter averaged 2%

The *Economic Climate for Bargaining* is published four times a year by the Canadian Union of Public Employees. Please contact Toby Sanger (tsanger@cupe.ca) with corrections, questions, suggestions or contributions.

* Please note that underlined words are hyperlinks available in the electronic version.

ECONOMIC CLIMATE for BARGAINING

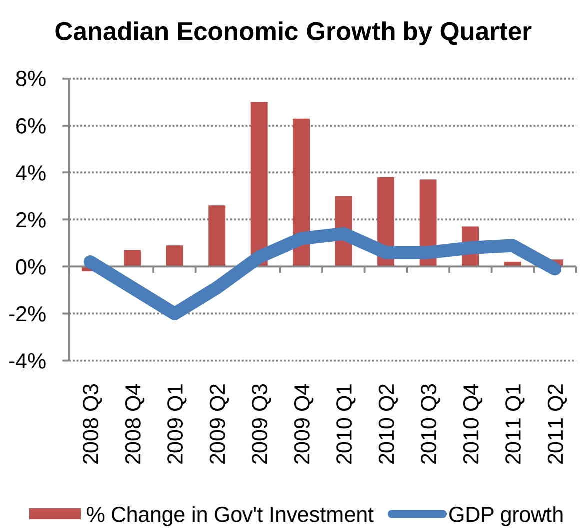
Recovery interrupted

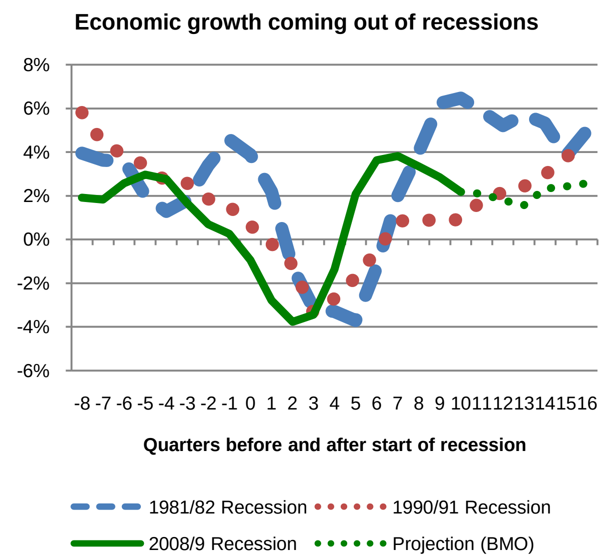
Canada's economy, which had been recovering at a strong pace, stalled in recent months. The value of our national economic output (GDP) declined by -0.4% in the second quarter, followed by two months with no overall job growth.

If there's another decline in GDP in the third quarter, we will officially be in a double-dip recession—something that hasn't happened for at least fifty years.

Our economic recovery has been heavily dependent on continued consumer spending, public stimulus investment and low interest rates. As anticipated in previous issues of the Economic Climate, once federal and provincial governments phased out these stimulus measures, the economy would stumble.
As is shown below, government infrastructure investment had a major impact pulling Canada out of recession, but after it flatlined earlier this year, so did economic growth.

The chart on the right illustrates that, as a result of these stimulus measures, our recent recovery was relatively strong compared to previous recessions, but the forecast for future growth is weaker. Forecasts of GDP growth for the year have already been revised down by about half a percent compared to last spring.





There's been a lot of media attention about weaknesses in the U.S. and European economies. They will continue to undermine our prospects, especially if these countries implement further austerity measures as appears likely in the U.S. once the current stimulus measures expire in the new year.

Canada is also facing a more precarious economic situation at home.

The Bank of Canada's interest rate was extraordinarily low both going into and coming out of this recession as the chart on the following page shows. In the two previous recessions of 1981/82 and 1990/91, the Bank of Canada raised its interest rate steeply in advance of the recession, in both cases doubling the rate in the three years preceding the recession. In fact, it was these policies that caused these previous recessions: a deliberate attempt to slow down the economy and, in particular, reduce the rate of wage growth. This recession was very different: in the year before it started, interest rates were cut in half, and then slashed again to rock bottom rates to stimulate the economy and prevent a much worse downturn.

The policy worked, but it also means that we can't rely on further interest rate cuts to stimulate the economy, as we did after past recessions. The Bank of Canada's lending rate is already close to zero and can't go down much further.

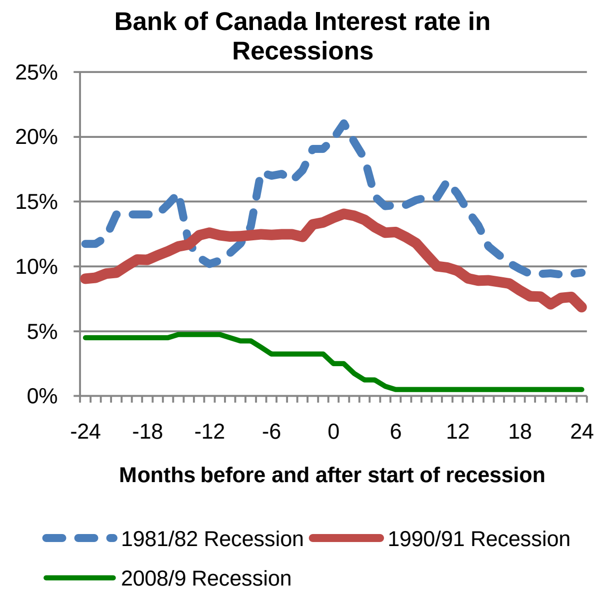
During these previous recessions, the hike in interest rates also caused a severe downturn in the housing market. This time around, other countries have already gone through a housing price correction, but that shoe hasn't dropped yet in Canada. When interest rates move up, a housing market correction will inevitably follow, if not before. As outlined four years ago, a price correction in Canada could erase $500 billion worth of housing "wealth". This would reduce economic output by about 2% through the impact of housing wealth on consumption spending.

Household debt ratios have continued to climb in Canada, rising over 150% in the 2nd quarter, while they've come down in other countries. From the Bank of Canada's perspective, we're in a difficult dilemma. Its rock-bottom low interest rates are encouraging households to pile on more debt, but an increase in interest rates could also plunge us back into a recession.

With continuing problems in its housing sector, the U.S. Federal Reserve recently took the exceptional step of committing to keep its key interest rate close to zero for the next two years. Following this, the Bank of Canada also indicated it would keep interest rates low for the foreseeable future. It is also concerned about higher interest rates in Canada further weakening our export sector through a higher dollar.

Low interest rates can help to prevent an immediate downturn, but they aren't enough to lay the foundation for more sustainable economic growth. For this we need stronger employment and real wage growth together with continued growth in public investment, but the prospects for these don't look very bright right now.

Inflation rates have risen above wage increases, taking a bite out of consumer spending. The end of stimulus programs and fast-tracking of infrastructure spending for future years will mean a reduction in public infrastructure investment, unless additional commitments are made. Total government spending is expected to go down next year, which will act as a significant drag on growth.



Business investment, while recently rising from the plunge it took during the recession, won't continue to grow unless people can afford to buy their goods.

It's too soon to tell what direction Canadian governments will take in their upcoming budgets.

Federal finance minister Jim Flaherty continues to talk tough about austerity both at home and abroad. He even recently told Greece—now suffering with a record one in six people unemployed and an economy declining by 8%—it should stick with its austerity programs or have to leave the Euro currency.

At the same time, Prime Minister Harper said he will be more flexible in managing Canada's economy. Following Obama's announcement of a jobs plan, federal ministers have said they will focus more on jobs as well. Stronger job growth is important, but higher wages are also necessary.

There's a lot of uncertainty at the provincial level as well. Five provinces and two territories are holding elections this fall. Some could usher in politicians intent on more severe spending cuts. Whatever governments are elected will have to deal with higher deficits and reduced revenues as a result of slower job and economic growth.

Other countries that implemented austerity measures have experienced a sharp decline in economic growth and large increases in unemployment, with little relief from financial markets. Canada now has the opportunity to learn from these mistakes and focus on actions that will create jobs, increase wages, reduce household debts and generate sustainable economic growth.

Economic outlook – main points

Economic growth projections for this year and next have been downgraded for all provinces by all major bank forecasters. After an increase of 3.2% in 2010, Canada's economy is now expected to expand by 2.4% this year and 2.3% next. Ontario, Quebec and New Brunswick are likely to take a bigger hit as a result of economic problems south of the border.

With a slowing economy, employment will also grow at a slower pace than previously expected, averaging 1.6% this year and 1.2% in 2012. That's less than the 1.4% average rate of labour force growth from 2006 to 2010. Normally this would lead to higher unemployment rates, but labour force growth has slowed.

National consumer price inflation is expected to average 2.7% this year and 1.9% in 2012, slightly below the projections of last spring. Oil prices hikes have combined with sales tax increases to boost inflation higher in eastern and central Canada.

Interest rates are expected to remain low, with the Bank of Canada putting off rate hikes for another year. Both short-term and longer-term borrowing rates will rise only very gradually and are expected to be almost a full percentage point lower next year than had been forecast just last spring. This will help keep both mortgage and government borrowing costs low.

Canadian and Provincial Economic Forecasts

Canadian Economic Outlook- Average of Private Sector Forecasts				
Annual growth rates unless indicated	**2009**	**2010**	**2011**	**2012**
	Actual		*Forecast*	
Growth in the Economy				
Real GDP	-2.8%	3.2%	2.4%	2.3%
- Consumer Spending	0.4%	3.3%	2.1%	2.3%
- Business Investment	-20.8%	7.3%	14.2%	8.1%
- Government Spending	4.3%	4.7%	1.5%	-0.1%
Labour Market				
Employment growth	-1.6%	1.4%	1.6%	1.2%
Unemployment rate	8.3%	8.0%	7.5%	7.3%
Productivity growth	0.6%	1.3%	1.0%	1.2%
Inflation - Consumer Price Index	0.3%	1.8%	2.7%	1.9%
Corporate Profits before tax	-32.3%	21.2%	13.0%	6.2%
Real Personal Disposable Income	0.8%	3.6%	1.6%	2.3%
Personal Savings Rate	4.6%	4.8%	4.3%	4.3%
Housing Starts (000s)	149	192	184	177
Interest Rates and Exchange Rate				
Short-term 3-Month T-Bill	0.33%	0.56%	0.98%	1.41%
Long-term 10-Year Bond	3.23%	3.24%	2.94%	3.11%
Exchange rate C$ in U.S. cents	$ 96.0	$ 97.1	$102.5	$103.6

Averages based on latest forecasts from seven different Canadian forecasters as of September 12, 2011.

Provincial Economic Outlook								
% annual growth except where noted								
	Real GDP		**Employment**		**Unemployment Rate**		**Inflation**	
	2011	**2012**	**2011**	**2012**	**2011**	**2012**	**2011**	**2012**
Canada	2.4	2.3	1.6	1.2	7.5	7.3	2.7	2.1
Newfoundland and Labrador	3.9	1.8	3.3	1.2	12.3	11.9	2.6	2.0
Prince Edward Island	2.1	1.8	1.1	1.0	11.4	11.2	2.3	1.9
Nova Scotia	1.6	1.8	-0.1	0.9	9.2	9.1	3.2	1.9
New Brunswick	1.4	1.8	-0.9	0.8	9.7	9.4	2.5	1.9
Quebec	2.0	2.0	1.5	1.1	7.6	7.5	2.8	2.2
Ontario	2.4	2.2	1.9	1.3	7.9	7.7	3.1	2.1
Manitoba	2.5	2.6	1.0	1.2	5.3	5.1	2.5	2.0
Saskatchewan	3.8	3.3	0.7	1.5	5.1	4.9	2.5	2.3
Alberta	3.6	3.3	3.2	2.1	5.6	5.3	2.3	2.1
British Columbia	2.5	2.4	0.9	1.5	7.6	7.2	2.3	1.9

Based on the average forecasts from five different bank forecasters as of September 12, 2011
National averages may differ from those reported in the Canadian outlook table because they are from a smaller group.

Job growth stalls in summer, some slowdown expected

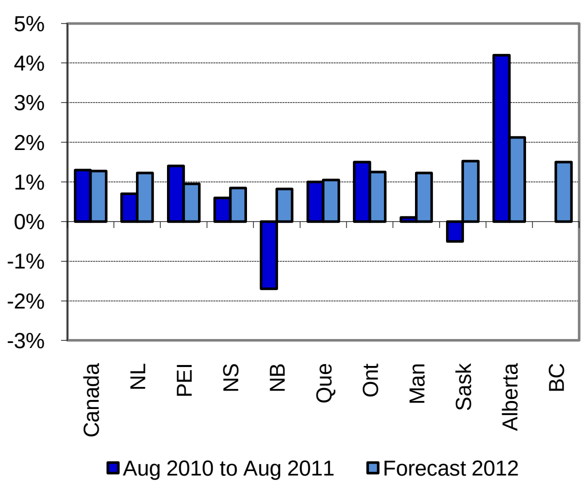
Job growth unexpectedly stalled during the past two months following two years of relatively strong growth. Overall employment levels declined by an estimated 5,500 in August, following a marginal gain of 7,100 the previous month. Both these amounts are far below the survey's statistical margin of error.

Employment in construction, utilities, resources and transportation declined significantly in July, offset in part by an increase of 50,000 jobs in health care and social assistance jobs.

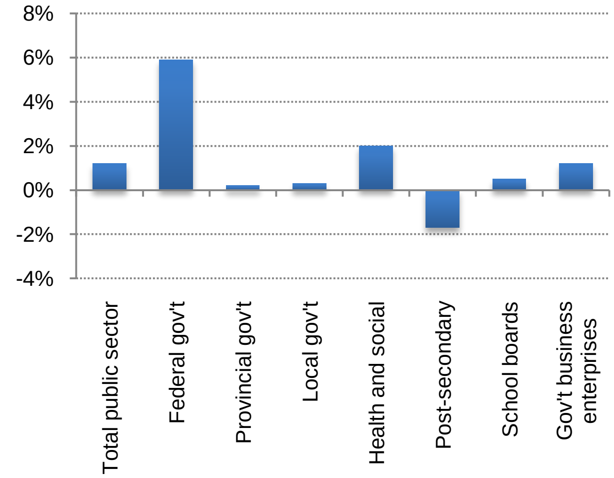
At a provincial level, job growth is by far the strongest in Alberta, where the number of people employed has increased by 4.2%. The employment situation weakened the most in New Brunswick, where there's been a -1.7% decline in the number of people working over the past 12 months. Despite the weakening U.S. economy, job growth in the more export-dependent provinces of Ontario and Quebec has been stronger than the national average, while little or no increase was reported for Manitoba, Saskatchewan and British Columbia. Next year job growth is forecast to grow faster than the national average in Alberta and all provinces west of Quebec.

The reported increase of 22,000 public sector jobs in August reversed trends we've seen over the past year. According to the labour force survey, public sector employment has only increased by 0.2% or 9,000 over the past 12 months, far below the 2.3% in private sector employment, which has accounted for 97% of job gains during the past year.

Employment growth by province



Public sector employment growth
Payroll survey 2nd Quarter 2010 to 2011



Other surveys, such as Statistics Canada's more comprehensive payroll survey, suggest public sector job growth has been slightly stronger, amounting to 1.2% over the past year. There's been stronger growth in the federal public service and in health and social service institutions, very little increase of provincial and local government employment, and a drop in jobs in post-secondary education.

The unemployment rate increased slightly to 7.3% and would have increased more if labour force growth hadn't slowed so much. Canada's total labour force—including both those employed and those actively looking for work—increased by only 0.5% over the past twelve months, less than half the rate of population growth. Some of this represents short-term cyclical factors—people who have given up looking for work—but there are also longer-term demographic changes at work.

With an aging population, increasing number of retirees and slower population growth, the annual labour force growth is expected to fall in half over the next decade, from an average of 1.4% in the last five years to less than 0.7% a year. This could have dramatic consequences for the character of the labour force as well as major fiscal impacts. On the positive side, unemployment rates will decline, but it also means underlying economic growth will be slower.

Fuel, food and sales tax hikes push inflation to eight-year high, but core rate remains low

Rising oil and food prices together with sales tax increases recently pushed consumer price inflation to its highest rate in over eight years, with the CPI increasing by 3.7% in May.

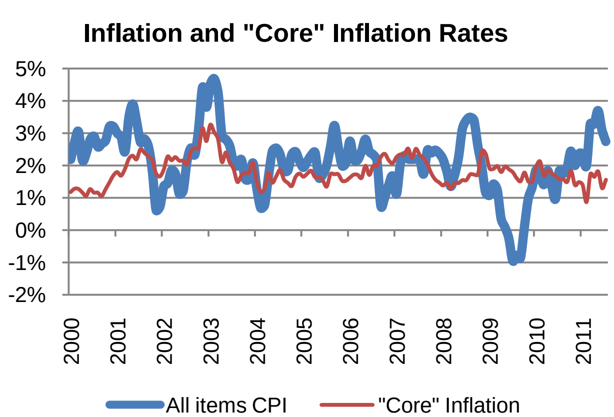
Following the anniversary of the introduction of the HST in Ontario and British Columbia, inflation receded to 2.7% in July, similar to expected average for 2011, but considerably higher than the 2.1% forecasters predicted at this time last year.

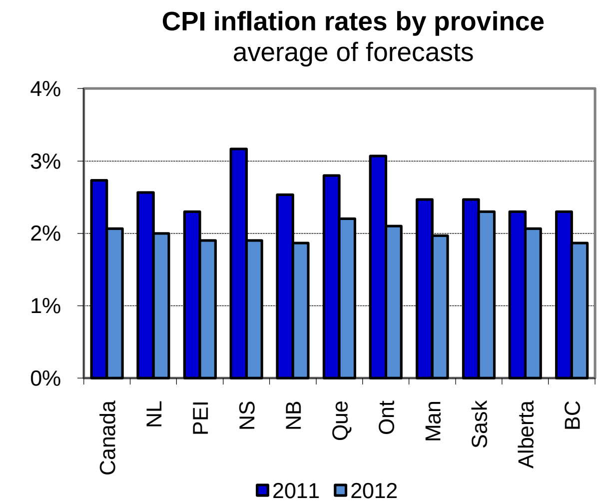
Prices for gasoline at the pump are 20 to 30 cents higher than they were a year ago across Canada, up an average of 24% with fuel oil 25% higher. In contrast, prices for natural gas were 3.3% lower.

Overall food prices are 4.3% higher than a year ago July, with fresh vegetables costing 12.3% more than last year, coffee and tea up 14% and flour 13% more. Higher price increases for basic necessities such as food and energy lead to a larger increase in the cost of living for low-income families.

Despite these price hikes there's no sign higher rates of inflation will become persistent. Canada's "core" inflation rate—which excludes eight of the most volatile components such as food and fuels—only increased by 1.6% in July, well below the Bank of Canada's inflation target of 2%. As the chart below illustrates, this core inflation rate has remained below 2% for most of the past four years.

This means there's no rationale for the Bank of Canada to raise its interest rate to control inflation. In any case, a number of leading economists, including the IMF chief economist, have argued that higher rates of inflation would help economies emerge from this recession.





Alberta, which had the highest rate of inflation a few years ago, now has one of the lowest rates of all provinces, together with British Columbia. This is mostly because new house prices in Alberta and B.C. are still below the peak they reached in 2008, according to Statistics Canada's *New Housing Price Index*, while they've been rising elsewhere.

But new house prices aren't an accurate measure of the overall cost of housing. According to the Canadian Real Estate Association, the cost of resale homes—which make up more than 75% of all homes sold—has increased by more than 16% in British Columbia during the past year while Statistic's Canada's calculation of new house prices for B.C. shows a *decline* over the past 12 months. Despite the introduction of the HST, which was expected to push B.C.'s inflation rate up by over half a percentage point, the province's inflation rate has curiously remained below the national average this year.

According to major bank economists, national consumer price inflation is expected to moderate to 2.1% in 2012, down from an average increase of 2.7% this year. Inflation rates in all provinces are expected to cluster fairly closely to this average, with Saskatchewan's rate only slightly higher at 2.3%.
(see Provincial Outlook on page 4).

Wage increases to edge up in 2012

Surveys of Canadian employers indicate average salaries will increase by close to 3% in 2012, slightly above the increase budgeted for 2011.

Four different recent surveys of employers—conducted by Mercer, Hay Group, Morneau Shephell and WorldatWork—estimate salaries will increase by an average 2.8% to 3.2% next year. In all cases these amounts were above projected increases for the current year, and close to recent rates of inflation.

Salary increases are projected to be highest for the mining and oil and gas industries and lowest for health care and public administration.

Along with their natural resource sectors, average salary increases are expected to be highest in Alberta, Saskatchewan and Newfoundland, with average increases in Ontario slightly lagging the national average.

2012 Salary Increase Surveys

Survey	2011 Average	2012 Average	Public Admin
Morneau Shephell	2.8%	2.8%	2.0%
Mercer	2.7%	3.1%	
Hay Group	2.6%	2.8%	2.3%
WorldatWork	3.0%	3.2%	

These survey results, which include both union and non-union employers, are consistent with recent trends in large collective agreements.

Average base wage increases for agreements settled in the second quarter of 2011 increased to 2.0%, up from 1.3% in the first quarter and above last year's average of 1.8%. Private sector workers continued to gain higher average increases (2.2%) than public sector workers (1.9%). Increases for base wages are generally lower than those for overall salaries.

Workers in primary industries such as oil and gas and mining will receive higher wage increases (averaging 3.9%) than other industries, followed by utilities (3%), finance and professional services (2.6%) and transportation (2.5%). Average wage increases negotiated were lowest for those in manufacturing (1.5%), entertainment and hospitality (1.6%) and education, health and social services (1.8%).

By province, wage increases continue to be lowest in New Brunswick (0% in 2nd quarter), Nova Scotia (1.0%), British Columbia (1.2%) and Ontario (1.4%). Public sector employers in all these provinces have announced some form of wage freeze. Settlements for individual CUPE agreements reflect these broader industry and regional trends, as the table below shows.

While wage increases are slowly moving up, employers are taking steps to reduce their costs and risks connected with pension and benefit plans. This includes Air Canada's proposals to shift new hires into a defined contribution pension plan instead of the employer's defined benefit plan.

There's also increased interest in preventative health care measures, including in areas of mental health, and taking steps to reduce absenteeism. The agreement between CUPE 301 and Montreal includes joint measures to reduce absenteeism. If targets are reached, the employer will pay the union an amount equal to 0.3% of total payroll.

Major CUPE Agreements reported in April – June 2011

Employer	Average Increase	Duration (months)
Canjet flight attendants	3.2	48
Longueuil bus drivers	1.8	84
Durham region	2.3	36
WSIB	1.9	60
Hydro One	3.0	24
City of Hamilton inside and outside	1.4	48
City of Kitchener	1.8	36
City of Winnipeg	1.5	48
City of Saskatoon	2.3	36
University of Manitoba lecturers and teaching assistants	1.5	48
City of Calgary inside and outside	2.8	36
BC Rapid Transit - Skytrain	3.0	12
Pacific Blue Cross	1.9	48
University of Victoria lecturers and instructors	0.0	24

Major Collective Bargaining Average Wage Settlements by Year and Quarter						
	2008	***2009***	***2010***	***2010Q4***	***2011Q1***	***2011Q2***
All Average	3.2	*2.4*	*1.8*	*1.5*	*1.3*	*2.0*
Public Sector	3.5	*2.5*	*1.6*	*1.5*	*1.2*	*1.9*
Private Sector	2.5	*1.8*	*2.1*	*1.2*	*2.2*	*2.2*
CPI Inflation:	***2.3***	***0.3***	***1.8***	***2.3***	***2.5***	***3.4***

Average Wage Settlements by Province – Major Agreements												
	NL	**PEI**	**NS**	**NB**	**QC**	**ON**	**MB**	**SK**	**AB**	**BC**		**Federal**
2008	*5.0*	*3.0*	*4.1*	*3.7*	*2.4*	*2.6*	*3.4*	*5.1*	*4.8*	*2.5*		*2.9*
2009	*5.0*	*3.6*	*2.9*	*6.0*	*2.2*	*2.4*	*2.9*	*5.0*	*4.5*	*2.8*		*1.6*
2010	*1.7*	*2.7*	*1.5*	*2.0*	*1.5*	*2.0*	*2.1*	*2.4*	*3.5*	*0.2*		*1.7*
2010Q4	-	*3.4*	-	*1.4*	*1.2*	*1.4*	*1.4*	*2.4*	*2.0*	*1.7*	-	*1.7*
2011Q1	-	*2.0*	*1.0*	*1.5*	*1.2*	*2.4*	*1.4*	-	*1.1*	*1.5*	-	*2.0*
2011Q2	-	*2.5*	*1.0*	*0.0*	*2.2*	*1.4*	*1.9*	*2.6*	*2.6*	-	-	*2.1*
2011CPIQ2	*3.6*	*3.6*	*4.4*	*3.8*	*3.2*	*3.8*	*3.4*	*2.9*	*2.6*	*2.9*		*3.4*

Average Wage Settlements by Industry – Major Agreements						
Industry	**2008**	***2009***	***2010***	***2010Q4***	***2011Q1***	***2011Q1***
Primary	*4.3*	*2.5*	*3.3*	*3.7*	-	*3.9*
Utilities	*2.3*	*3.0*	*1.0*	*2.0*	*3.0*	*3.0*
Construction	*5.4*	*3.7*	*2.3*	*2.1*	-	*1.9*
Manufacturing	*1.2*	*1.6*	*1.5*	*1.5*	*1.1*	*1.5*
Wholesale and Retail	*2.8*	*1.8*	*1.1*	*0.7*	*0.6*	*2.5*
Transportation	*3.1*	*1.1*	*2.2*	*2.2*	*2.5*	*2.5*
Information and Culture	*2.0*	*2.1*	*0.9*	*0.6*	-	*2.0*
Finance and Professional Services	*2.8*	*2.5*	*3.2*	-	*2.7*	*2.6*
Education, Health, Social Services	*3.8*	*3.0*	*1.6*	*1.4*	*1.0*	*1.8*
Entertainment and Hospitality	*1.9*	*2.0*	*2.2*	*2.2*	*2.0*	*1.6*
Public Administration	*2.7*	*2.1*	*1.5*	*1.6*	*1.7*	*2.0*

Source: Human Resources and Skills Development Canada, *Major Wage Settlements,* [latest information as of September 6, 2011] http://www.hrsdc.gc.ca/eng/labour/labour_relations/info_analysis/index.shtml
Consumer Price Index (Statistics Canada 326-0001). Q1 = 1st quarter (e.g. January to March inclusive).

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