ECONOMIC CLIMATE
for BARGAINING

March 2010 **Vol. 7, No. 1**
Frontline Summary

Economic Outlook Summary

Canada's economy is recovering from the recession thanks to significant stimulus spending. Corporate profits have increased, but business investment in the economy has actually declined in recent months.

Canadian governments have wisely decided to maintain their stimulus spending this year. If they pull back too soon and cut public spending, then we will probably have a double-dip recession.

It's too soon to tell if private sector businesses will fill the void to be created by the withdrawal of stimulus and slowdown of consumer spending. If not, the federal government's lack of an economic strategy beyond cutting taxes and hoping for the best could spell difficult times ahead.

On average, private economic forecasts expect:

- Economic output (GDP) to increase by an average of 2.8% in 2010 and by 3.0% in 2011.
- Unemployment to average of 8.3% this year and 7.8% in 2011.
- Consumer price inflation to rise to an average 1.7% in 2010 and 2.0% in 2011.

Wasn't that a Party? Now who's going to pay for it?
Now that the economic boom and bust are over, who is going to pay for the cost of it and the clean-up? Those who benefitted the most from the boom are trying to get the public to pay for the bust by cutting public services. Not so fast. Not only is that not fair, but we need to reform the tax system to prevent another boom and bust cycle from developing again.

Public sector's role in the economy shrinking
It's a myth that public spending in Canada is too high and we need to cut to prevent a fiscal crisis. The reality is public sector spending, revenues and debt payments as a share of the economy haven't been this low in decades. All levels of government have been diminished, but none more than the federal government. A large majority of Canadians would benefit from more public spending, not less.

Job growth key to short and long-term economic growth
Economic stimulus measures have had positive impacts on jobs and growth, but these measures are set to phase out soon. This points to slower job growth as the economy improves. Governments need to maintain stimulus, but also need to shift its focus to the challenge of increasing employment growth over the long-term.

What's driving inflation up, down and up again?
Inflation rates have seesawed up and down in recent years, but they are now set to rise again. Inflation has been most affected by changes in oil and housing prices and sales taxes.

Economy improves but negotiations get tougher
The economy may be improving, but public sector negotiations are getting tougher as governments focus on spending cuts. This follows a similar trend to what we saw after the last recession.

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.

Wasn't that a Party? *Now who's going to pay for it?*

Now that the party is over, the big question is "Who is going to pay for the bill and the cost of the clean-up?"

"What party?" many people will ask.

If you feel you missed out on this recent party, you weren't the only one. Most people actually *did* miss out on it. Even if others knew about it, they didn't have the money—or the time—needed to take part. Most people were working longer hours just to keep up.

Preparations had been under way for many years, but in Canada, the party of excess really got going ten years ago in 2000 when the federal government slashed tax rates on corporations and high incomes.

The central bank turned up the volume by cranking down interest rates. And deregulation led to the equivalent rage of an open liquor cabinet. The well-heeled partygoers distilled and mixed up ever more elaborate cocktails of financial derivatives.

With the house exercising little control over the financial cocktail laboratory, young men in expensive suits sold these lethal products at a high mark-up to unsuspecting investors and pension funds through the back-door.

From the alleyway, the party looked great! And for those who hadn't received an invitation, this seemed like the only way to join in the fun. There was so little of substance in these mixed money drinks that they were known only by obscure acronyms: CDOs, SIVs, CDS, ABCP, etc. In the daylight, they evaporated into thin air but still left a wicked hangover.

Now the time has come to pay the bill. And the cost for just the clean-up is already in the trillions worldwide and hundreds of billions for Canada alone. The question of who is going to pay this bill is a central issue that politicians and budget officials have to deal with for the next few years.

The clean-up isn't even over and already some of the main instigators of the party are raising alarm about government deficits and pushing hard for public spending cuts. By whipping up resentment about the pay, pensions and benefits of public sector workers, these workers are becoming an all-too-convenient target for a population hit hard by the recession.

The reality of corporate excess and the platinum pensions of the executive suite are becoming a distant memory in the public's mind—just as their private party is getting going again.

The stock market has roared back, banks are making billions in profits, Wall Street and Bay Street are awash in bonuses and hedge funds are on the prowl again, eager to pick up public assets cheap through "distress-sale" privatizations.

Some governments even have the gall to further slash corporate tax rates, leading to a loss of tens of billions in public revenues, while cutting spending for public services and hospitals are laying off workers and closing beds.

It's no coincidence that the governments most intent on cutting corporate taxes—such as the Federal, British Columbia and New Brunswick governments—were also the first to freeze public sector wages and spending.

Conservatives are fond of saying that "if you commit a crime, you should do the time (or pay a fine)".

The same principle should apply to economic crimes as well. Those who profited from the boom and caused the economic crisis should pay for the party and for the costs of the clean-up.

Instead, public sector workers—and the public—are getting stiffed with the bill again. This will hurt all except the wealthiest in society because public services provide an excellent deal to a large majority of Canadians.

Conservatives are once again arguing that we all need to "share the pain" and that tax cuts combined with public spending cuts will do a better job of stimulating the economy, even though their own evidence shows otherwise.

Never mind that there was little sharing of the gains on the way up, as numerous studies by policy institutes, statistical agencies and even major bank economists have admitted.

We may need economic growth to increase revenues, but we don't need growth at any cost, nor do we want growth that doesn't trickle down. How can we expect anything different from the same economic policies again?

It's not an issue of retribution or even of simple fairness. Unless economic justice is done, we'll all pay these costs again and again. We need to take steps now to prevent another damaging cycle of booms and busts from developing again.

They will say that to innovate and grow we need to reward risk. But it isn't risk if all they do is gamble with OPM (Other Peoples' Money), if there are high returns on the upside, little lost on the downside, and if the government always bails them out, forcing others to pay the bill.

So what should be done to pay for the cost of the clean-up and to prevent another economic boom bust crisis from developing?

For starters, we need to reform a tax system that encourages CEOs to manipulate stock prices for personal gain and speculators to gamble with other peoples' money, deduct the cost of borrowing this money, *and then pay half the income tax rate* that applies to people who work for a living.

The stock option tax deduction is not only unfair, but it is also highly damaging for the economy and should be completely eliminated. Income from short-term capital gains should be taxed at the full rate, with longer term gains adjusted for inflation. These two measures would not only encourage more long-term investments and less speculation, but they would also increase federal revenues by about $10 billion a year.

Corporate income tax cuts have failed to stimulate investment and productivity growth in Canada. Further cuts planned by federal and provincial governments should be cancelled. This would increase federal revenues by almost $6 billion a year, and by $15 billion a year if the federal rate were restored to its 2006 level.

Canada and other countries should introduce a "Financial Transactions Tax" to control or slow damaging financial speculation. Funds raised from this could be redirected to more productive ends, such as reducing poverty and preserving the environment.

These tax measures alone could soon eliminate deficits without forcing innocent bystanders to pay through public service cuts.

They would also put us on track to achieve more stable, equitable and sustainable economic growth: good growth and not growth at any cost.

Public sector's role in the economy shrinking

Governments don't have a spending problem, they have a revenue problem

There's a convenient fiction increasingly being spread in Canada: public spending is too high and governments need to cut spending to prevent a fiscal crisis from developing.

Business lobby groups and some media commentators are trying to generate hysteria over public spending and deficits and stir up resentment against public sector workers.

This is being done to build up support for public service spending cuts, further tax cuts, privatization of public assets and attacks on public sector workers in order to weaken the power of labour.

But the facts are at odds with these attacks.

The public sector is at its smallest share of the economy in decades.

The fact is the public sector's share of Canada's economy hasn't been this low for decades.

- **Total public spending**—including all spending on health care, education, social services, community programs, public transit, roads, public water, other utilities, etc [1]— **dropped to less than 36% of our economy in 2007, the lowest since 1974.**
- **Tax revenue as a share of the economy hasn't been this low for decades.** Total government revenues from major taxes (income taxes, sales taxes, property taxes, etc.) dropped to less than 32% of our economy in 2009, the lowest since 1985.
- **Total government debt payments fell to 3.8% last year, the lowest since 1975**, less than half of what they were during the 1980s and 1990s. While recent deficits will increase these costs slightly, continuing low public borrowing interest rates will keep them very manageable.

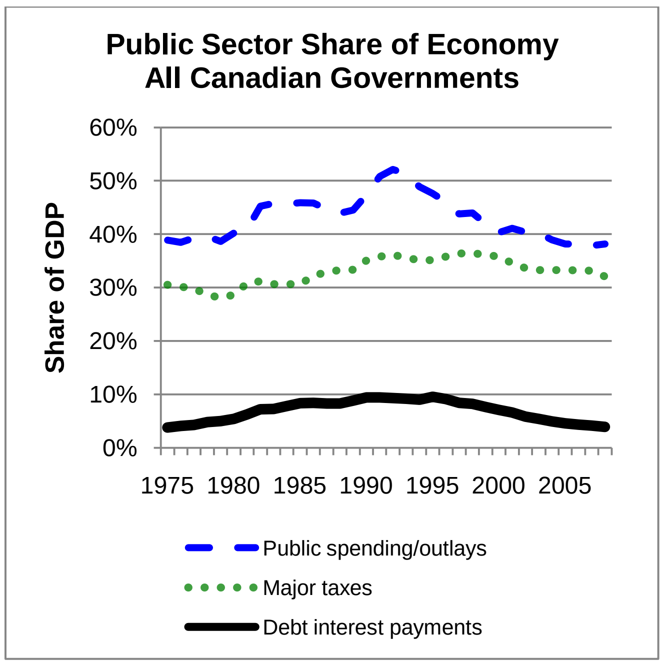
Less than 10 cents in every dollar of total government revenue now goes to interest payments. It hasn't been this low since 1975.

The public sector's debt interest ratio is far less than the gross debt ratios that major banks and the government allow households to borrow to as a share of their income. The CMHC (Canada Mortgage and Housing Corporation) and major banks allow families to take out mortgages so a maximum of 40% of their income goes to mortgage and debt payments. If adjusted to an interest-only basis this maximum debt service ratio works out to 30%.

Using this measure should be no concern about average public sector debt ratios of 10%, or even twice that.

There's even more reason for governments to invest to a greater degree than households: with population growth, our economy grows over time and doesn't retire or die as individuals do. This means governments can and should invest more now to provide services for a growing population. With a growing economy, the cost of these investments can be more readily paid off.

International comparisons also show that Canada's public sector is a smaller share of our economy than most other large industrialized countries and our fiscal situation better than all others.



[1] Not including CPP & QPP which are self-funded.

Federal government is most diminished

The role of all levels of government in Canada's economy has been diminished, but none more than the federal government.

From 1990 to 2008, (both years at the same stage in the economic cycle), the share of total government spending in the economy has been cut by 20%.

- Despite increases in health care costs, provincial government spending as a share of the economy was 9% lower than it was in 1990.
- While local governments have had a boost through infrastructure spending in recent years, in 2008 they were still spending 15% less as a share of the economy than in 1990.
- Federal spending as a share of the economy has been cut by 32% almost a third.
- Federal revenues as a share of the economy fell to 14% this past year. Statistics going all the way back to 1961 show they haven't been this low for at least fifty years.

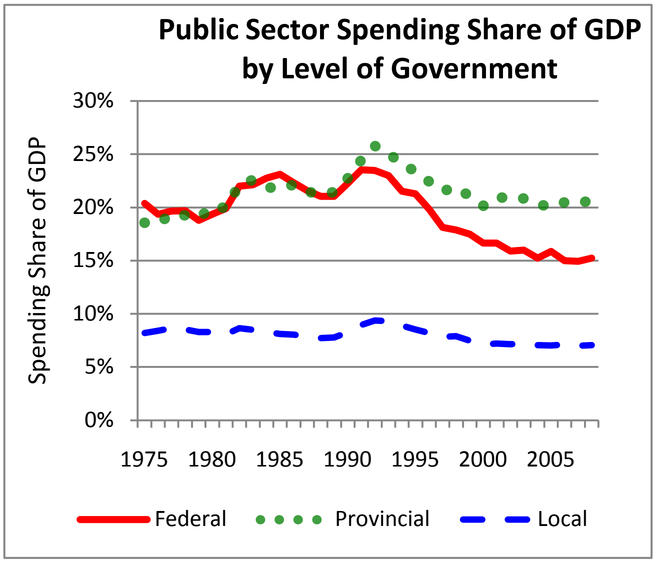
There's been an increase in public spending during the past two years because of the recession. This will largely be temporary. The federal government estimates that, without this stimulus spending, the economy would have declined by another 2% and another 130,000 people would be unemployed.

With spending cuts and freezes on the horizon, the role of the federal government in the economy will be diminished even more.

A large majority of Canadians would benefit from more funding for public services and increased revenues.

The share of public services in Canada's economy has been shrunk even though it provides an excellent deal for a large majority of Canadians.

Each year every Canadian receives public services—whether health care, education, seniors benefits, etc.—valued at an average of $17,000 per person and $40,000 per household, according to a pathbreaking study by the Canadian Centre for Policy Alternatives (CCPA).



The average benefits for seniors and single parents are proportionately higher, but for virtually all different types of Canadians the annual value of public services exceeds $13,000 a year.

The CCPA study found that:

- 80% of Canadians would have been better off if the federal government had transferred the value of 1% on the GST to local governments instead of cutting the tax.
- 75% of Canadians would have been better off if provincial governments had invested more in health care and education instead of cutting income taxes in the late 1990s and early 2000s.
- 88% of Canadians would have been better off if the federal government had increased funding for federal public services instead of cutting capital gains taxes in the early 2000s.

From this evidence it is clear that Canadian governments don't have a spending problem or a deficit problem, but they do have a growing revenue problem.

This revenue gap will become an even bigger problem in future years. The federal government's plans to cut its tax rate on corporate income from 18% to 15% will reduce federal revenues by a total of more than $20 billion during the next five years. The Ontario government's plans to cut its provincial corporate income tax rate from 14% to 10% over the next three years will lead to a loss in revenues of over $8 billion during the next five years.

Canadian economic outlook: growth driven by stimulus

Canada's economy is recovering from the recession thanks to significant stimulus spending. GDP grew at a solid rate annualized of 5% in the 4th quarter of 2009 after eking out an increase of only 0.9% in the 3rd quarter.

This growth is entirely due to increased household spending and government stimulus, particularly infrastructure investment. Corporations increased their profits by 9% in both quarters, but still reduced business investment in the economy.

With governments planning to reduce their stimulus spending, interest rates set to rise, and households at record debt levels, if business doesn't invest more in the economy we're going to have slow economic growth ahead. However, despite rising profits and low corporate tax rates, we've seen little sign of that.

The following table presents average economic forecasts for the Canadian economy, provided by the major banks.

On the key indicators:

- **Economic Output.** The Canadian economy is expected to grow by an average of 2.8% this year, following a drop of -2.6% in 2009. GDP growth is expected to increase by 3.0% next year, but then gradually slow down.
- **Unemployment.** The unemployment rate is expected to average 8.3% this year, the same as last year. Relatively slow employment growth will mean a stubbornly high unemployment rate for a few years.
- **Inflation.** Consumer price inflation is expected to increase by an average of 1.7% or more in 2010, then rise to 2% or more in 2011 and beyond.

Canadian Economic Outlook- Average of Private Sector Forecasts

Annual growth rates unless indicated	2008	2009	2010	2011
	Actual		*Forecast*	
Growth in the Economy				
Real GDP	0.4%	-2.6%	2.8%	3.0%
- Consumer Spending	3.0%	0.2%	2.7%	2.9%
- Business Investment	0.2%	-17.4%	-0.3%	4.7%
- Government Spending	4.8%	4.0%	4.8%	1.8%
Labour Market				
Employment growth	1.5%	-1.6%	1.0%	1.7%
Unemployment rate	6.1%	8.3%	8.3%	7.8%
Productivity growth	-1.1%	-0.8%	1.1%	1.4%
Inflation - Consumer Price Index	2.4%	0.3%	1.7%	2.0%
Corporate Profits before tax	5.7%	-34.8%	15.5%	12.1%
Real Personal Disposable Income	4.2%	1.4%	2.8%	2.4%
Personal Savings Rate	3.7%	5.0%	4.9%	4.5%
Housing Starts (000s)	212	148	179	177
Interest Rates and Exchange Rate				
Short-term 3 Month T-Bill	2.33%	0.33%	0.68%	2.51%
Long-term 10 Year Bond	3.61%	3.23%	3.60%	4.25%
Exchange rate C$ in U.S. cents	$ 93.81	$ 95.97	$ 99.99	$97.65

Averages based on latest forecasts from seven different Canadian forecasters as of 9 March, 2010.

Provincial economies: the harder they fall, the more they bounce

During the past year, the economies of all Canada's provinces declined, with no region left out from the recession. In 2010 all will grow again and as is often the case with recoveries, some of those that fell the most will bounce back faster.

The provinces most battered by the recession are also some of the largest, Ontario, Alberta and BC. Unemployment rates increased by about three percentage points in all of these provinces last year.

There won't be any quick recovery for jobs, though. Employment is expected to increase by an average of only 1% this year, barely above the average rate of labour force growth.

As a result, unemployment rates will only come down slowly this year. The outlook for 2011 is better, but only if private sector growth picks up. Inflation averaged 1% or less in every province last year with overall declines in some. Thanks to higher gas prices, inflation rates are already rising across the board and further gradual increases are expected this year and next.

New harmonized sales taxes will push inflation up the most in Ontario and British Columbia. If Quebec follows through with a 1% increase to its QST next January, then inflation there will bump up as well.

This table presents an average of the recent publicly-available forecasts of main economic indicators at the provincial level, calculated from forecasts provided by TD Bank, the Royal Bank of Canada, BMO Capital Markets, CIBC Wood Gundy and the Bank of Nova Scotia. The national averages may be different from those reported above because they include a smaller group of forecasters.

Provincial Economic Outlook

% annual growth unless where noted

	Real GDP		Employment		Unemployment Rate		Inflation	
	2010	2011	2010	2011	2010	2011	2010	2011
Canada	2.6	3.2	1.0	1.9	8.6	8.1	1.6	1.9
Newfoundland & Labrador	2.9	2.4	1.0	1.7	15.6	14.1	1.7	1.8
Prince Edward Island	1.9	2.5	1.3	1.2	12.2	11.6	1.7	1.7
Nova Scotia	2.2	2.8	0.7	1.5	9.5	9.0	1.7	1.8
New Brunswick	2.3	2.8	0.8	1.5	9.1	8.6	1.6	1.7
Quebec	2.3	3.0	0.9	1.7	8.7	8.2	1.5	1.7
Ontario	2.6	3.3	0.9	1.9	9.4	8.8	1.9	2.1
Manitoba	2.5	3.2	0.8	1.8	5.6	5.1	1.5	1.7
Saskatchewan	3.1	3.7	1.1	2.2	5.4	4.8	1.7	2.1
Alberta	2.6	3.9	1.1	2.2	7.0	6.3	1.5	2.0
British Columbia	3.0	3.4	1.3	1.5	7.8	7.4	1.7	2.2

Based on the average forecasts from five different bank forecasters as of 9 March 2010.
National averages may differ from those reported in the Canadian outlook table because they are from a smaller group.

Job growth key to short and long-term economic growth

There's little question: economic stimulus measures put in place by federal, provincial and local governments have had positive impacts on jobs and the economy.

Over the past year, financial markets have become more stable, consumer spending has grown, and investments in residential renovations and public infrastructure have increased rapidly.

The federal government estimates that its stimulus spending created or maintained 130,000 jobs by the end of January 2010.

An estimated half of these jobs (67,000) were created or maintained in the services sector (such as retail trade) with approximately 29,000 created in construction and another 32,000 maintained in manufacturing. Contrary to public perception, this public stimulus spending created or maintained extremely few jobs in the public sector.

The federal government's estimates seem generally reasonable: without these actions unemployment would be at 9% instead of 8.3%. These figures don't include the stimulus impact of the Bank of Canada's deep cuts to interest rates, which have generated perhaps about 100,000 more jobs.

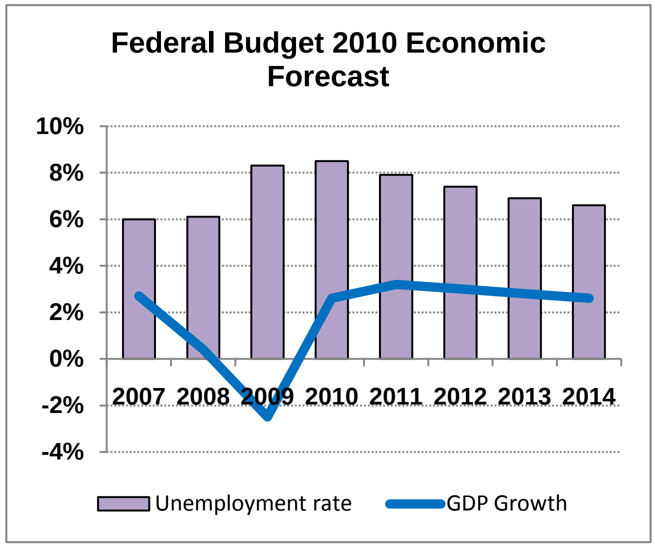
Without these aggressive stimulus measures, the national unemployment rate could have reached 10%. Instead, we've had intermittent but gradual job growth since the summer.

Still, in January there were 380,000 more people unemployed and 270,000 fewer people employed than 15 months ago at the start of the recession.

While the economy is slowly improving, employment growth is expected to be slow for a number of reasons:

- Federal and provincial governments are gradually phasing out their stimulus actions this year.
- Interest rates are set to rise after this summer.
- Despite rising profits, businesses are still not increasing their investment in the economy.
- Households are at record debt levels. With rising interest rates and slow job and wage growth, family finances will remain under pressure.
- The Canadian dollar is expected to rise in value, which won't help our exporters.

In addition, a lot of the federal government's stimulus measures have simply maintained jobs, such as the EI work sharing program and support to the manufacturing sector. This has created a lot of employment slack, which will mean slower job growth as the economy improves.



Other measures, such as the renovation tax credit, have "borrowed" spending from the future, which will mean slower spending and job growth in coming months.

With this less than optimistic outlook, public spending freezes, cuts and layoffs will be even more damaging for the economy.

Too much of the federal government's "stimulus" spending is going to merely maintaining spending, with too little in investments to strengthen our economy over the longer term.

The federal government's budget forecasts show that after an initial bounce back, economic growth will slowly decline and the unemployment rate will remain stubbornly high.

It will likely take until at least 2011 for employment levels to recover to where they were at the start of the recession and many more for the unemployment rate to come down.

But over the longer term, we're going to face a different problem in the labour market.

Virtually all long-term economic forecasts are unanimous on one thing. With the baby boom generation going into retirement and slower population growth, Canada will experience declining labour force growth.

High rates of retirement will have a big impact on many parts of the public sector. For instance, 40% of the federal public service workers are due to retire in the next five years.

Canada's Parliamentary Budget Office (PBO) expects labour force growth to flatline close to zero after a decade and to remain close to that for the foreseeable future. Another recent study by Rick Miner forecasts there could be labour force "shortages" of one million or more in Ontario alone by 2030.

This would normally lead to a steep drop in the unemployment rate. But if workers don't have the skills necessary for the new jobs being created, we could have high unemployment co-existing with skilled jobs going unfilled. The Ontario report predicts there could be 700,000 unemployed in the province in twenty years, while 1.7 million jobs go unfilled because of a lack of workers with the appropriate skills.

It is unlikely that the imbalance in the labour market will develop to this degree. For one thing, neither the PBO nor the Ontario report take account of rising labour force participation by older workers. This trend will continue as governments push up the retirement age and with more workers working longer either to gain more income in retirement or because they simply want to keep working.

This will lessen the imbalance, but only by a bit. The other reason is that the economy will adjust to some degree. If skilled workers aren't available, then our economy won't grow as fast. And this is the problem. A shortage of workers in general—and especially of those with the necessary skills—will put a serious brake on our future economic growth. This will lead to lower public revenues and steeply rising public debts. Even without accounting for skills mismatch, the PBO forecasts that the federal government's debt/GDP ratio could triple in forty years. The danger is alarmism about public deficits and debts will lead to public spending cuts when exactly the opposite is needed.

We need to take action now to stimulate employment growth now and in the future, otherwise slow labour growth and underinvestment in education and skills will become a serious drag on our economy and public finances. Some of these priorities are:

- We need to increase funding for universities and colleges focused on increasing access to quality education. With rising unemployment especially among youth, the demand for higher education has increased steeply.
- A recession is a great time to retool workers' skills and find opportunities in emerging industries. Instead of looking at unemployed people as a problem, they need to be considered as an asset, with skills and abilities that can be put to better uses. The Nova Scotia government's initiative to convert the closed TrentonWorks plant and re-employ its workers to make wind turbines is a good example of proactive industrial policy.
- Moving ahead with quality public early learning and child care, as Ontario is doing, will liberate more parents to acquire skills and rejoin the workforce. An added benefit is investments in this area generate the greatest number of jobs and the strongest economic stimulus of all sectors. New evidence shows they can also help to reverse declining fertility rates and therefore increase the population base in future years.
- Measures to help equality-seeking groups obtain skills, necessary qualifications and get decent work are critical for both social and economic reasons.
- With an aging population, we'll need more public investments in preventative health care and quality long-term care, otherwise families and workplaces will face increasing disruptions.

Jobs Impact of the Recession

Employment and Labour Force Changes for the Latest Month,
and since October 2008, start of the recession

All figures in thousands except where indicated as %

					January 2010		
					Change from		% change
Labour Force	**Oct-08**	**Dec-09**	**Jan-10**		**Dec-09**	**Oct-08**	**from Oct-08**
Labour force	18,346	18,437	18,456		18.9	109.8	0.6%
Employment	17,195	16,881	16,924		43.0	-270.3	-1.6%
Full-time	14,004	13,677	13,679		1.4	-325.6	-2.3%
Part-time	3,191	3,204	3,246		41.5	55.3	1.7%
Unemployment	1,152	1,556	1,532		-24.1	380.2	33.0%
Unemployment rate (%)	6.3%	8.4	8.3		-0.1	2.0	
Participation rate (%)	67.8%	67.1	67.1		0.0	-0.7	
Employment							
Women 25 +	6,854	6,880	6,911		31.0	56.7	0.8%
Men 25 +	7,740	7,610	7,592		-17.3	-147.8	-1.9%
Youth	2,601	2,392	2,421		29.3	-179.2	-6.9%
Public sector	3,462	3,437	3,451		13.4	-11.4	-0.3%
Private sector	11,082	10,704	10,758		53.7	-323.8	-2.9%
Self-employed	2,651	2,740	2,716		-24.0	64.9	2.4%
Employment by Industry							
Goods							
Agriculture	326	315	305		-10.4	-21.1	-6.5%
Forestry, fishing, mining, oil and gas	339	306	311		5.7	-27.5	-8.1%
Utilities	149	147	144		-2.2	-4.3	-2.9%
Construction	1,251	1,186	1186		-0.4	-64.5	-5.2%
Manufacturing	1,975	1,763	1747		-15.7	-227.6	-11.5%
Services							
Trade	2,677	2,654	2,677		23.4	0.6	0.0%
Transportation and warehousing	871	789	792		2.9	-78.3	-9.0%
Finance, insurance, real estate and leasing	1,071	1,113	1,127		14.3	56.0	5.2%
Professional, scientific and technical services	1,204	1,242	1,220		-22.4	15.5	1.3%
Business, building and other support services	670	616	651		34.4	-19.4	-2.9%
Educational services	1,208	1,229	1,229		0.0	20.5	1.7%
Health care and social assistance	1,922	1,994	1,990		-4.0	67.8	3.5%
Information, culture and recreation	749	775	778		2.2	28.7	3.8%
Accommodation and food services	1,066	1,055	1,069		14.1	3.7	0.3%
Other services	766	784	774		-10.0	8.1	1.1%
Public administration	953	913	924		11.0	-28.6	-3.0%

What's driving inflation up, down and up again?

The consumer price inflation rate in Canada has seesawed up and down and up again in the past two years.

In the summer of 2008, the national inflation rate increased by +3.5%; last summer it fell by -0.9% and then in January it was back up to +1.9%. Inflation has also gyrated up and down at different rates in different provinces.

What's going on and what can we expect in the next couple of years?

The inflation story in Canada has had three main factors in the past few years:

- Oil and gas prices, which have swung from year to year and affected provinces to different degrees.
- Housing prices and costs have followed different waves across the country and had a major impact on provincial inflation rates.
- Sales taxes, including both cuts to the GST and anticipated increases to provincial sales taxes.

Oil and gas prices are very difficult to forecast. They are affected by the weather in different ways and are increasingly the subject of speculation by enormous hedge funds. Single traders have made or lost billions in these bets. Extraction technology, new sources of supply and production decisions by major exporter also have a large impact.

Current forecasts are for crude oil prices to increase moderately over the next two years. Natural gas prices have rebounded a bit since lows reached in the fall, but are trending down again. On average, prices will be higher than last year, which will push the inflation rate up. Oil prices also have a bigger impact in Atlantic Canada because of its wider use for home heating.

House prices in Canada have had a long ride up, fell back by an average of 10% because of the recession, and then reached new heights in most markets from the stimulus of record low interest rates.

As interest and mortgage rates begin to rise later this year and new taxes take effect, it is inevitable that house prices will start to deflate. But unless house prices plummet, this shouldn't bring inflation down too much. This is because the consumer price index measure only takes account of new house prices, which in Canada have been the least volatile. Furthermore, increases in mortgage rates will counteract this downward price pressure by increasing the cost of homeownership. Increases in property taxes will boost the price index.

Cuts in the GST in mid 2006 and mid 2008 reduced the inflation rate by about a quarter of a percent in each of the past four years. The shift to a harmonized sales tax (HST) in Ontario and BC this year is expected to increase the rate of inflation by a third of a percent this year and next in the two provinces. At a national level, the increase will be about half that.

The proposed increase to Quebec's HST in January 2011 would increase inflation in the province by approximately 0.6% in 2011.

Other factors have been significant over the longer term, but they've played a more minor role recently. For instance, low cost imports from Asia and big box retail competition have driven down consumer prices for many years now, but there are limits to how much further down these can go. Changes in the exchange rate also have an impact on consumer prices, but this "pass-through effect" is now more moderate for various reasons.

In summary, we can expect inflation rates to rise over the next two years towards beyond the Bank of Canada's 2% target.

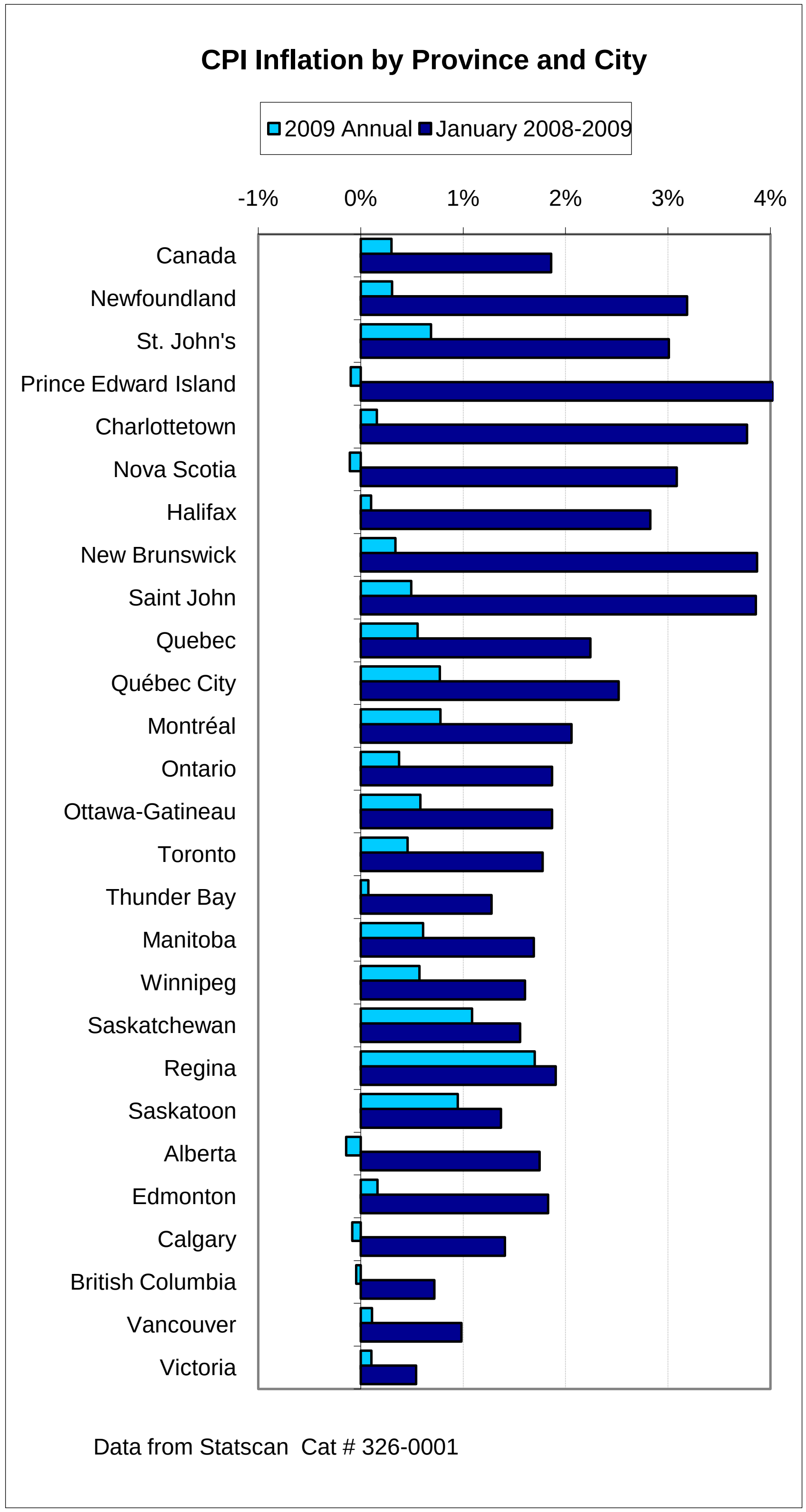
Economists at the big banks are forecasting an increase in the national inflation rate averaging 1.7% in 2010 and 2.0% in 2011. Given the pressures pushing prices up, inflation is likely to reach these rates or higher.

The federal government's 2010 budget forecasts inflation to be 1.7% in 2010, rising to 2.2% in 2011, and then 2.1% from 2012 to 2014.

On a provincial basis, the big banks expect prices to increase the most in Ontario (by an average of 1.9% in 2010 and 2.1% in 2011) and in British Columbia (average 1.7% in 2010 and 2.2% in 2011) because of the shift to a Harmonized Sales Taxes in those provinces. These averages are probably on the low side. The TD Bank, which has done a detailed analysis of the impact of the HST on prices, forecasts inflation in Ontario and BC will hit 2.4% in 2011.

As shown in the Provincial Outlook table, inflation rates in other provinces are all expected to rise over the next two years, but at a slightly slower rate than in Ontario and BC.

Prices will also increase at a faster rate in Quebec if the QST is increased in 2011, but that doesn't seem to be factored into the forecasts yet.

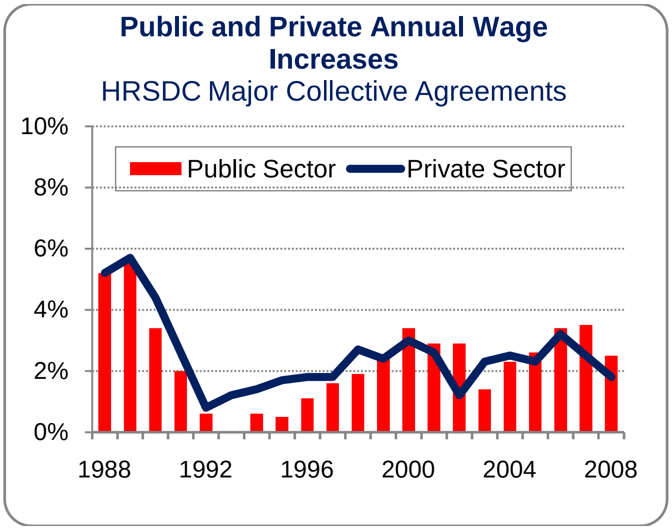


As the economy improves, public sector negotiations are getting tougher

The economy may be on the mend and inflation rising, but workers in most regions and sectors of the economy have already or will soon experience declines in their base wage increases.

During an economic downturn workers in the private sector are usually hit first with layoffs, slower wage increases, outright cuts and/or concessions.

High unemployment, growing deficits, funding cuts, public resentment and sometimes legislative measures are used to drive down increases in the wage bill for public sector workers.



This was the storyline in previous recessions—whether they were engineered by high interest rates or caused by internal problems of the economy—and it seems to be the same this time.

As the table on the next page shows, private sector wage increases slowed down going into this downturn while most public sector workers were still able to gain wage increases above the cost of living.

Workers in oil-rich provinces gained the highest average wage increases in collective agreements settled last year, with 5% average increases in Newfoundland and Saskatchewan and 4.5% in Alberta.

Wage increases negotiated in most other provinces averaged between 2% and 3%, with the exception of New Brunswick and PEI, where the averages represent a single or just a few agreements.

Unionized workers in the construction and utilities industries have been able to maintain higher than average wage adjustments. However, this doesn't reflect broader wage trends in the construction industry where average wages have dropped.

Over the past year, workers protected by a union contract have received higher hourly wage increases than those without, a contrast to the trend before. This usually happens during the economic cycle: union contracts may increase less during the boom, but they provide greater job and wage protection during downturns.

But now negotiations—or imposed settlements—are getting much tougher. CUPE is now engaged in or entering major negotiations with:

- provincial governments in Nova Scotia and Quebec focused on deficit reduction
- in Saskatchewan where potash revenues have plummeted
- in BC where funding transfers has been frozen
- financially squeezed universities in Ontario.

Compensation planning studies indicate that non-union workers can expect average base pay increases of 2.7% in 2010, while the average for unionized workers is expected to be 2.1%. Other major issues on the table besides wages are contracting out and job security, as governments threaten to contract out and privatize, and preserving pensions.

Some Recent Major CUPE Agreements

Employer	**Average Increase**
Vancouver Paramedics (imposed 1 year)	3.0
City of Medicine Hat	4.5
Manitoba Hydro	2.4
McMaster University	3.0
Toronto Public Library	2.0
University of Toronto	3.1
Ontario Hospitals (OCHU)	2.0

Major Collective Bargaining Average Wage Settlements by Year and Quarter							
	2007	**2008**	***2009***	***2009Q1***	***2009Q2***	***2009Q3***	***2009Q4***
All Average	3.3	3.2	*2.4*	*2.4*	*2.7*	*1.9*	*2.1*
Public Sector	3.4	3.5	*2.5*	*2.4*	*2.8*	*2.2*	*2.3*
Private Sector	3.2	2.5	*1.8*	*2.8*	*1.9*	*1.6*	*1.5*
CPI Inflation:	***2.2***	***2.3***	***0.3***	***1.2***	***0.1***	***-0.9***	***0.8***

Average Wage Settlements by Province – Major Agreements											
	NL	**PEI**	**NS**	**NB**	**QC**	**ON**	**MB**	**SK**	**AB**	**BC**	**Multi Prov**	**Federal**
2007	1.6	2.8	3.0	2.5	3.2	3.1	3.0	4.1	4.9	3.0	3.6	2.8
2008	*5.0*	*3.0*	*4.1*	*3.7*	*2.3*	*2.6*	*3.4*	*5.1*	*4.8*	*2.7*	-	*2.8*
2009	*5.0*	*3.6*	*2.9*	*6.0*	*2.2*	*2.4*	*2.8*	*5.0*	*4.5*	*2.8*	*2.3*	*1.6*
2009Q1	*5.0*	*3.6*	*3.0*	-	*1.7*	*2.5*	*2.8*	*5.3*	*4.5*	-	-	*1.8*
2009Q2	*5.0*	-	-	-	*2.8*	*2.5*	*3.2*	-	*4.5*	*2.8*	-	*1.6*
2009Q3	-	-	*3.4*	*6.0*	-	*2.2*	-	*4.8*	*4.5*	*2.9*	*3.0*	*0.8*
2009Q4	-	-	*2.1*	-	*2.1*	*1.9*	*2.4*	-	*4.2*	*3.0*	*0.0*	*1.8*
2009CPI	***0.3***	***-0.2***	***-0.2***	***0.3***	***0.6***	***0.4***	***0.6***	***1.0***	***-0.1***	***0.0***	***0.3***	***0.3***

Average Wage Settlements by Industry – Major Agreements						
Industry	**2007**	**2008**	***2009***	***2009Q2***	***2009Q3***	***2009Q4***
Primary	4.7	*4.3*	*2.5*	-	-	-
Utilities	3.9	*2.3*	*3.0*	*3.0*	*3.0*	*2.4*
Construction	3.4	*5.4*	*3.7*	*3.7*	*4.2*	*2.5*
Manufacturing	2.5	*1.1*	*1.6*	*1.8*	*1.2*	*1.1*
Wholesale and Retail	2.4	*2.8*	*1.7*	*2.0*	*1.9*	*1.6*
Transportation	2.7	*3.1*	*1.1*	*1.7*	*0.3*	*2.1*
Information and Culture	3.0	*2.0*	*2.0*	*2.2*	*2.7*	*1.9*
Finance & Professional Services	3.6	*2.8*	*2.6*	*2.8*	*2.9*	*2.8*
Education, Health, Social Services	3.5	*3.8*	*3.0*	*2.9*	*2.7*	*2.4*
Entertainment and Hospitality	3.3	*1.9*	*2.0*	*1.5*	*1.9*	-
Public Administration	3.4	*2.8*	*2.1*	*2.4*	*2.0*	*2.3*

Source: Human Resources and Skills Development Canada, Major Wage Settlements, [latest information as of March 8, 2010] http://www.hrsdc.gc.ca/en/lp/wid/adj/01wage_adj.shtml, Consumer Price Index (Statistics Canada 326-0001).

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