Shaping a just recovery from COVID-19

Economists often use letters of the alphabet to describe how they think the economy will recover from a recession. A 'V' shaped recovery, where everything bounces back very quickly, is often talked about but rarely experienced. An 'L' shaped recovery describes a sharp drop and a long delay before any recovery can be seen. For the current economic situation, commentators are frequently using the letter 'K' to describe what they see happening. A 'K' shaped recovery refers to the two legs of the K – things get better very quickly for those on the upper leg of the K, but a recovery is delayed for those on the bottom leg.

Recessions have different impacts on workers, depending on factors like industry, location, and age. COVID-19 has magnified this reality for two reasons. The scale of employment impacts has been much larger than recent recessions, and there have been markedly different outcomes for workers based on a few key characteristics.

Workers largely fell into three categories: those who were able to work from home, essential workers whose work must be conducted in person, and workers who lost employment because their workplace scaled down or shut down completely. At the peak in April, five million people were able to work from home, seven million continued to work in person, and 5.5 million people lost their job or most of their hours of paid employment.

Initial job losses and the extent of employment recovery vary significantly by industry. Those who were able to work from home were concentrated in a few industries with higher wages, like finance, insurance, and professional and technical services. Those who lost their jobs or hours of work were more likely to be precarious workers in service industries, such as accommodation and food services, recreation, and retail. Even within industries, precarious workers are more likely to have lost employment compared to people with permanent and full-time jobs.

When talking about the shape of an economic recovery, economists are usually thinking about graphs marking the change in a few key indicators, like gross domestic product (GDP), stock market prices, and employment rates. Sometimes these indicators have similar recovery trajectories, but this will depend on what has caused the recession, and how adept policy makers are at responding to the crisis.

With COVID-19, the stock market recovered faster than any other measure, largely because of central banks that lowered lending rates, and national governments that offered numerous lending and income support measures to stabilize parts of the economy.

Savings rates have increased, as higher income households have spent less money on eating out, travel, and recreation. The housing market has surprised by continuing to grow in most Canadian cities, but this may be partly due to low mortgage rates and households deciding to put their increased savings into

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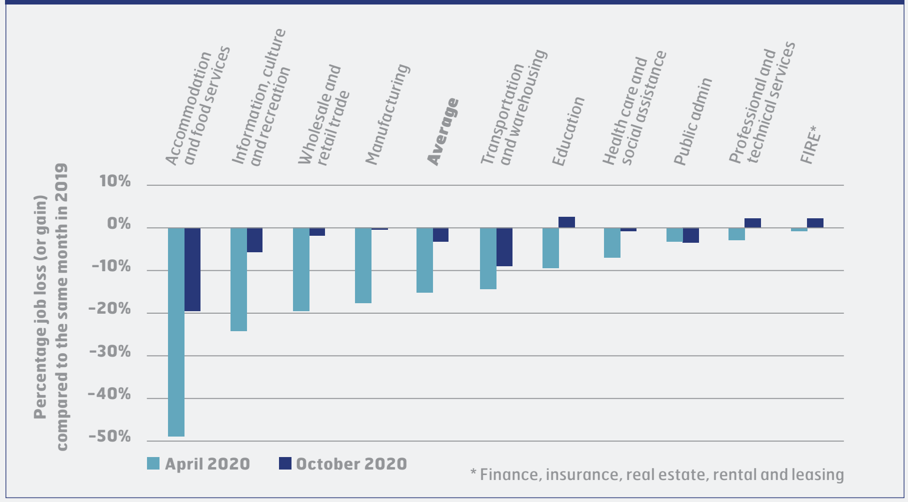
real estate. At the same time, an increased number of renters who have been unable to keep up with rent payments are facing evictions.

The current economic crisis has not had an equal impact, whatever shape is used to describe it. The shape of the recovery from this point on depends on how well jurisdictions are able to limit the spread of COVID-19 and maintain support for those who have been most affected through job loss and illness. Governments must not shy away from continuing to make much-needed investments in our health and our economy throughout the recovery.

Initial COVID-19 job loss and recovery varies by industry



Source: Statistics Canada Table 14-10-0355-01

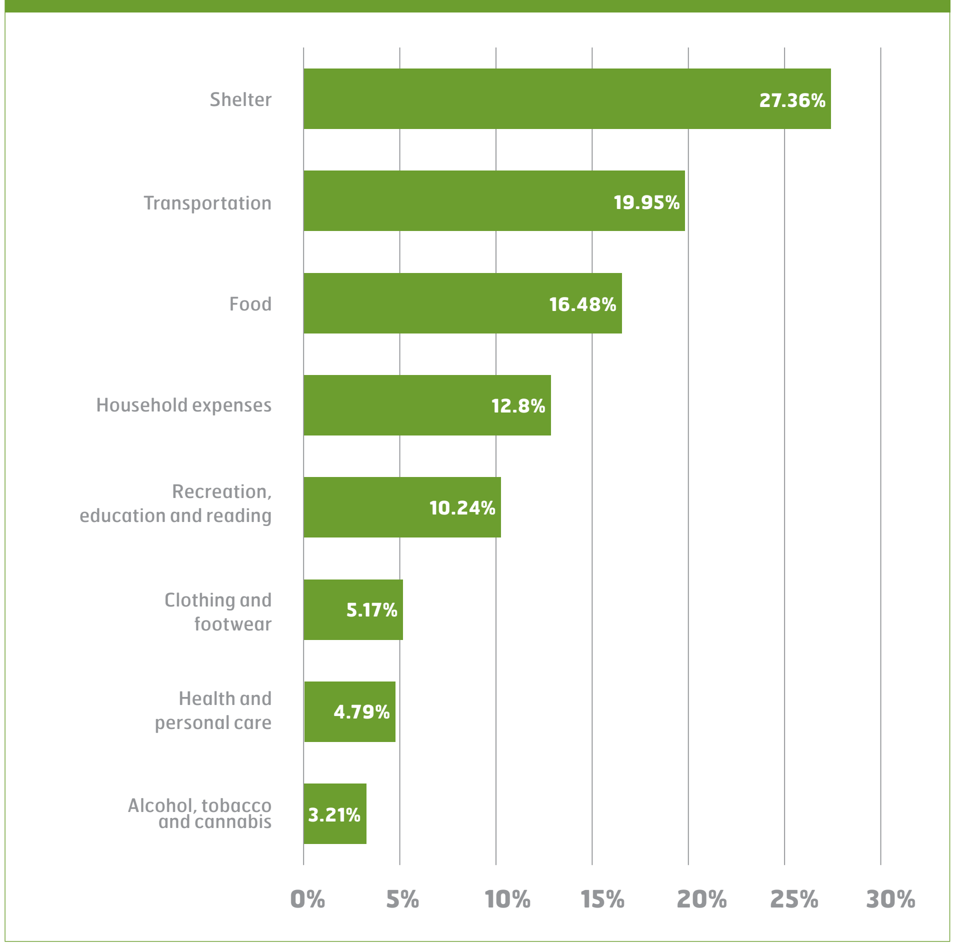
Why is inflation low while prices rise?

The Consumer Price Index (CPI) is important to workers because it is often used to determine wage increases in collective agreements, pension indexing, and increases in the value of income supports such as the Canada Child Benefit (CCB) or Guaranteed Income Supplement (GIS).

CPI is not a cost-of-living index, but it is often used to approximate one. A cost-of-living index would give us the changing cost of meeting a specific standard of living, where CPI measures price changes in the average basket of goods and services that Canadians actually purchase. This difference might seem unimportant, but it's one of the reasons why CPI doesn't reflect the real increases in costs in some of our household budgets.

The CPI basket has nearly 200 basic categories of items that people consume, and data from Statistics Canada's Survey of Household Spending is used to estimate the average amount that households spend in each category. The index tracks eight broad areas of spending, and each of these areas is assigned a weight based on its proportion of the average household's spending.

2017 CPI basket: what did the average household spend?



Source: Statistics Canada Table 18-10-0007-01

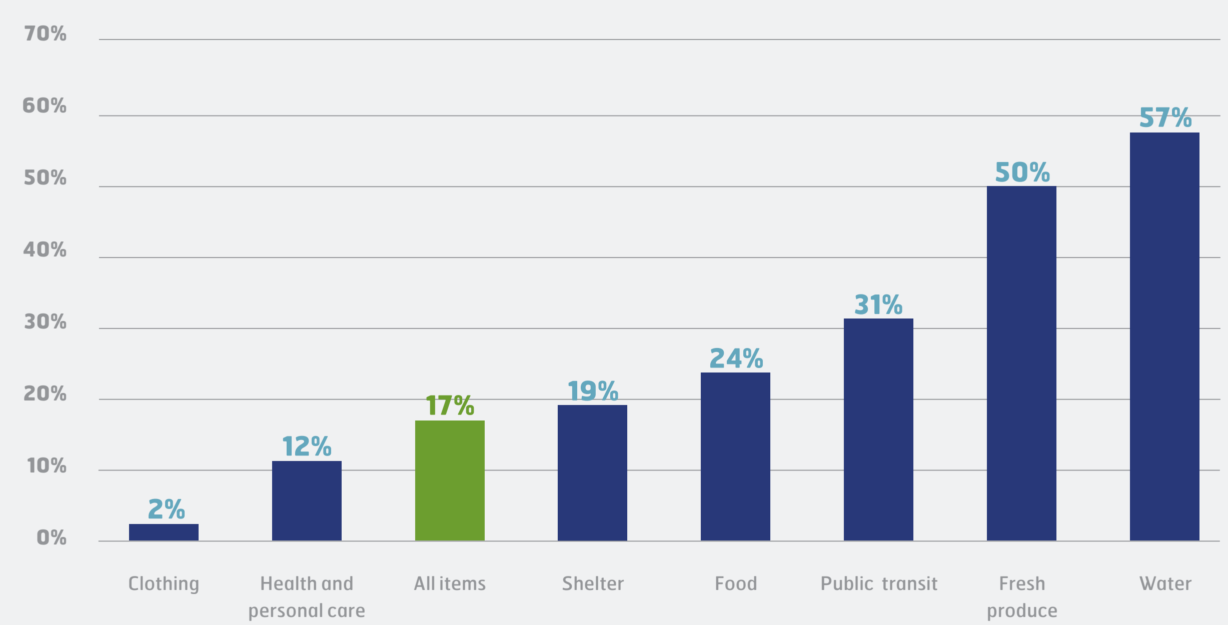
The CPI gives us the relative importance of price increases on specific items for the average Canadian, but it may not be reflective of an individual's situation. Lower income households will spend a much greater share of their income on necessities like shelter, food, and transportation, and so price changes for these items have a greater impact on their overall cost of living. At different stages of life, families may spend a greater share of their budget on child care, tuition, or recreation, making changes in those prices relatively more important. Those with specific health care needs may be required to devote a substantial share of their budget to meet those needs, leaving little left over to accommodate price increases in any other category.

If we look at how different elements of CPI have changed over time, we can get a sense why reports of low inflation don't make sense to some of us. Over the past 10 years, the cost of shelter, food, and public transit have all increased faster than the overall price index. User fees for water continue to steadily increase – a small component of the average household's budget, but an important trend to note for those with fixed incomes.

CPI doesn't just measure prices; it tries to measure value as well. If the price of an item has increased partly because of new features that increase its value to a consumer, Statistics Canada makes an adjustment to take this into account. This is common for new vehicles and electronics, but it can be hard to find low-cost options without all the new bells and whistles. If an item's price remained the same, but its quality had decreased over time, an adjustment would be made to take this into account as well. This type of quality reduction is difficult to measure and is usually only caught when the size of an item is decreased – for example if juice makers reduced their containers from 1L to 900 mL, but charged the same price.

It can also take some time for changes in consumption patterns to make it into the CPI basket, since it is only updated once every two years. The current basket elements and weights were released in 2019 and are based on data from 2017. As an example of how the basket elements change over time, this edition of the basket started including the prices of ride-sharing services and cannabis and stopped including the cost of DVD rentals. Changes in household spending habits because of COVID-19 will make estimating CPI challenging for the near future, as we learn what changes were temporary, and what adjustments may be more permanent.

Change in CPI September 2010 – September 2020



Source: Statistics Canada. Table 18-10-0004-01

ECONOMIC BRIEFS

Avoiding the liquidity trap

Central banks have flooded the global economy with cash to keep the financial system functioning throughout the COVID-19 pandemic. Now, experts suspect the world is experiencing a 'liquidity trap,' where interest rates and economic growth are low, making monetary policy ineffective. In a liquidity trap, savers prefer to hold their savings as cash rather than investing or spending on goods and services, because they believe a negative economic event may be on the horizon. One proven path out of a liquidity trap is fiscal stimulus. Governments can and should invest in public services and public infrastructure to prevent a prolonged recession. As the chief economist for the International Monetary Fund recently noted, debt service costs remain low, and public spending has a much higher return in a liquidity crisis.

Widespread wealth tax support

Wealth taxes are enjoying a great deal of popularity in North America. Aside from US Senator Elizabeth Warren's proposal, federal and provincial branches of the NDP have proposed an annual wealth tax in recent elections. Polling shows an annual net wealth tax of one to two per cent is incredibly popular in Canada. Toby Sanger and Andrew Jackson have outlined the arguments for and against implementing such a tax, and find it would be an effective way to limit the concentration of wealth and power in Canada, especially if accompanied by higher capital gains tax rates and increased enforcement to stop the use of tax havens. Capital gains taxes would appropriately tax wealth as it is accumulated, while the annual net wealth tax would target extreme wealth with the assumption that this level of wealth could only be accumulated because of previous under-taxation or regulatory failures. Implementing inheritance taxes on recipients could augment an overall wealth tax regime that would not only raise revenues, but also ensure a more equal distribution of wealth and power in our society.

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CUPE Canadian Union of Public Employees

ECONOMIC DIRECTIONS

This expanded edition of Economic Directions takes a deeper dive into the economic impacts of COVID-19: what we know so far, what we might see in the coming months, and what it all means for CUPE members.

Economic growth – The Bank of Canada estimates that Canada's economy will shrink by 5.5 per cent in 2020 and rebound by almost 4.0 per cent in both 2021 and 2022. The economic recovery in the United States, Canada's biggest trading partner, is far more uncertain, as the number of COVID cases continues to rise. Promising news from vaccine trials provides hope that a complete economic recovery is on the horizon, as the economic recovery is fully dependent on how well public health issues are managed globally.

Jobs – While there are significant differences across sectors and provinces and many laid-off CUPE members have not returned to work, overall, most of the jobs in the broader economy that were lost in April have been recovered. The remaining recovery is likely to be slow. Canada's employment rate fell from 61.8 per cent in February to 52.1 per cent in April. By October, this measure had recovered significantly, and was up to 59.4 per cent. There are still 1.8 million workers unemployed and looking for work, and an additional 500,000 who want work but who aren't looking because of economic conditions. Long term unemployment has increased dramatically, as almost half a million unemployed workers have been without work for 27 weeks or more.

Wages – The deep and dramatic impacts of this recession will affect bargaining, with public sector employers likely being especially reluctant to move on wages. Temporary top-ups for many essential workers have ended, even though private sector employers include some of the largest businesses that kept operating during the pandemic and became even more profitable. The need to recruit and retain more workers in child care, education and health care may result in long overdue wage boosts for these sectors.

Inflation – Overall inflation has been low, coming in at 0.5 per cent in September. The Bank of Canada expects inflation to remain low for some time, leaving significant room for governments to increase spending without causing excess inflation.

Interest rates – The Bank of Canada (BoC) expects to maintain its key lending rate at 0.25 per cent for an extended period, since inflation remains well below its target range of 1.0 to 3.0 per cent. The BoC has slightly reduced the size of its federal government bond purchasing program, but moved to purchasing longer term bonds. One of the BoC's goals at the beginning of the pandemic was to ensure that the secondary market for government bonds, where investors buy and sell bonds from each other, continued to operate smoothly. The need for this was greatest in the market for short term bonds. Shifting to longer term debt will provide more economic stimulus per dollar, because it has a bigger impact on the borrowing rates that individuals and businesses are offered by commercial banks. This means that the BoC expects this change to provide at least as much economic stimulus as their previous actions. Government borrowing remains affordable, with 30-year federal government bonds selling at 2.0 per cent interest.