BANK OF CANADA
BANQUE DU CANADA

Business Outlook Survey

Results of the Winter 2014–15 Survey | Vol. 11.4 | 12 January 2015

The winter Business Outlook Survey *continues to provide signs of strengthening demand, especially among export-oriented firms and manufacturers. However, the outlook for businesses that are linked directly or indirectly to the energy sector has deteriorated.*

Overview

- Business sentiment remains positive, but falling oil prices have significantly dampened the outlook for firms tied to the energy sector. Overall, following improved past sales activity, businesses expect sales to grow at a slightly faster pace over the next 12 months. Firms anticipating a positive impact from the U.S. economic outlook are more optimistic than others, based on many indicators.
- Although the balances of opinion on employment and investment in machinery and equipment declined overall, hiring intentions and investment plans are more robust for manufacturers than for firms in other sectors. For a majority of manufacturing firms, investment projects are aimed at increasing production.
- Indicators of pressures on production capacity are little changed. Firms expect input prices to grow at a pace similar to that of the past 12 months, since the downward pressures resulting from soft market conditions and declining commodity prices are offset by the effect of the depreciation of the Canadian dollar. Output prices are expected to rise at a somewhat slower pace than over the past 12 months, with strong competition still cited as a source of downward pressure. Inflation expectations declined, and most firms are expecting inflation to be in the bottom half of the Bank's inflation-control range.
- The balance of opinion on credit conditions is near zero, indicating little change.

The *Business Outlook Survey* summarizes interviews conducted by the Bank's regional offices with the senior management of about 100 firms selected in accordance with the composition of Canada's gross domestic product. The winter 2014–2015 survey was conducted from 17 November to 11 December 2014. The balance of opinion can vary between +100 and -100. Percentages may not add to 100 because of rounding. Additional information on the survey and its content is available on the Bank of Canada's website. The survey results summarize opinions expressed by the respondents and do not necessarily reflect the views of the Bank of Canada.

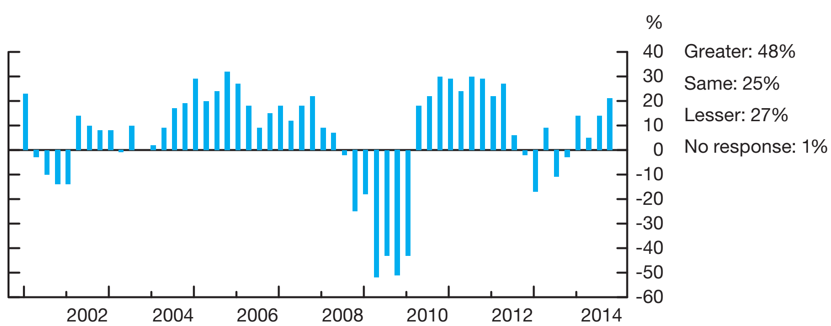
Business Activity

The balance of opinion on past sales growth moved up in the winter survey to its highest level in more than two years, suggesting a widespread improvement in sales activity over the past 12 months (**Chart 1**). Although the balance of opinion on future sales growth declined sharply, it remains positive, indicating that, overall, firms continue to expect a modest further acceleration in sales over the next 12 months (**Chart 2**). Several businesses, especially exporters, foresee similar or slightly lower sales growth after experiencing a sales recovery over the past few quarters. Firms located in the Prairies or linked to the energy sector, however, anticipate a moderation in the pace of sales growth in the wake of falling oil prices.

Expectations of a strengthening U.S. economic outlook are widespread, and firms seeing benefits from improving U.S. demand—either directly through their exports or indirectly through their export-oriented customers—are more optimistic than others. Some businesses indicate that the recent depreciation of the Canadian dollar should also help them to regain market share and boost competitiveness. Indicators of future sales growth have improved more for firms with international customers than for those selling mainly to domestic markets. Nevertheless, firms selling primarily to domestic markets continue to expect their sales growth to pick up modestly over the next 12 months.

Chart 1: Survey responses indicate a widespread improvement in sales growth over the past 12 months…

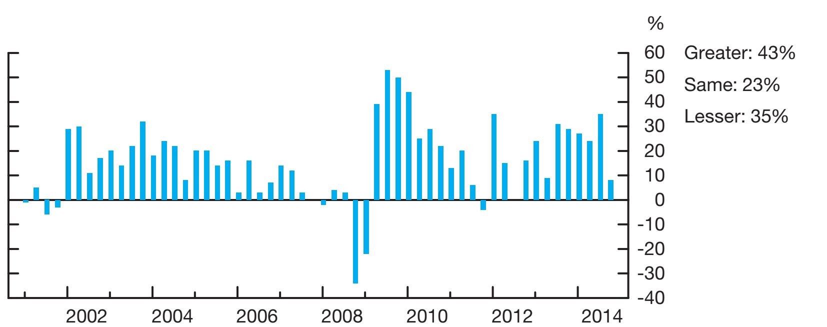
Balance of opinion[a]
Over the past 12 months, did your firm's sales volume increase at a greater, lesser or the same rate as over the previous 12 months?



a. Percentage of firms reporting faster growth minus the percentage reporting slower growth

Chart 2: … and firms expect a modest further improvement over the next 12 months

Balance of opinion[a]
Over the next 12 months, is your firm's sales volume expected to increase at a greater, lesser or the same rate as over the past 12 months?



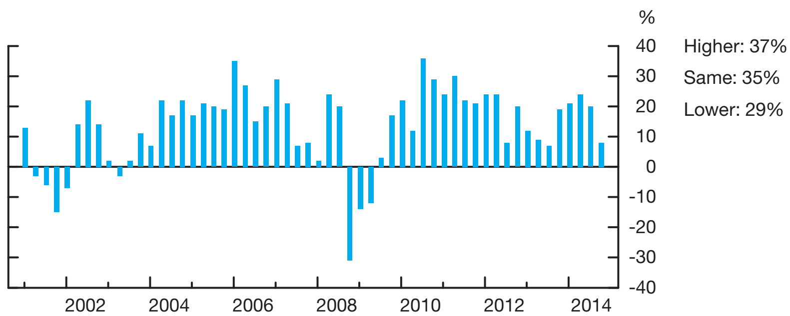
a. Percentage of firms expecting faster growth minus the percentage expecting slower growth

The balance of opinion on investment in machinery and equipment is modestly positive, although markedly lower than in the autumn survey (**Chart 3**), primarily owing to lower expectations from firms based in Western Canada, where the collapse in oil prices is weighing on investment intentions. Oil price developments have led many firms to be more uncertain about the outlook for their businesses, which has had an impact on their upcoming investment projects. In contrast, firms in Eastern and Central Canada are planning to increase their investment spending. Compared with recent surveys, reports of higher investment in machinery and equipment are more widespread in the manufacturing sector, and more projects are aimed at expanding production capacity and reducing costs.

Intentions to increase employment remain positive, although the balance of opinion decreased somewhat (**Chart 4**), as hiring plans for businesses based in the Prairies have declined. Firms expecting to benefit from the strengthening economic outlook in the United States, mainly manufacturers, are more optimistic than domestically oriented firms. Businesses reporting positive employment intentions often linked them to firmer sales prospects and plans to expand their capacity.

Chart 3: Investment intentions moved down but are more robust for manufacturers

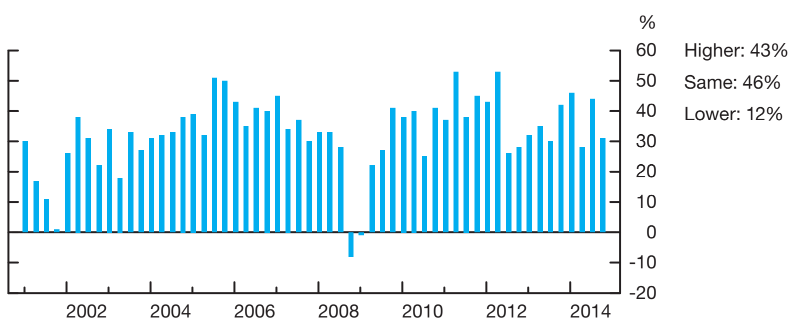
Balance of opinion[a]
Over the next 12 months, is your firm's investment spending on M&E expected to be higher, lower or the same as over the past 12 months?



a. Percentage of firms expecting higher investment minus the percentage expecting lower investment

Chart 4: Plans to increase employment remain positive

Balance of opinion[a]
Over the next 12 months, is your firm's level of employment expected to be higher, lower or the same as over the past 12 months?



a. Percentage of firms expecting higher levels of employment minus the percentage expecting lower levels

Pressures on Production Capacity

The percentage of firms reporting that they would experience difficulty meeting an unexpected increase in demand is essentially unchanged (**Chart 5**), and few businesses anticipate that they would face "significant" difficulty. Capacity pressures are more prevalent among exporters and firms that reported improved sales activity over the past 12 months. Many of these businesses are planning to increase their investment and employment to address capacity constraints.

The percentage of firms reporting that labour shortages are restricting their ability to meet demand remains relatively low in the winter survey (**Chart 6**), with many firms citing continued slack in the labour market. Compared with the autumn survey, fewer firms reported that labour shortages are more intense than 12 months ago.

Chart 5: Capacity pressures are essentially unchanged

How would you rate the current ability of your firm to meet an unexpected increase in demand?

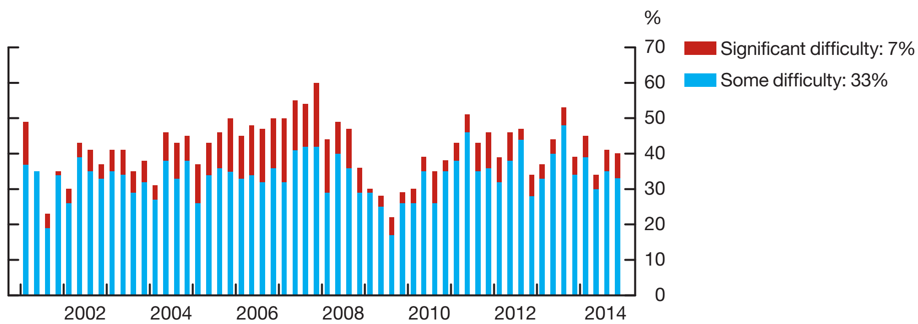
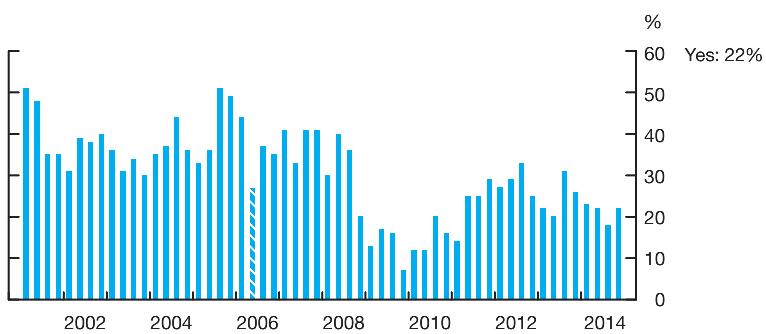


Chart 6: Reports of labour shortages remain relatively low

Does your firm face any shortages of labour that restrict your ability to meet demand?



The summer 2006 results are not strictly comparable with those of the other surveys, owing to a difference in the interview process for that survey.

Prices and Inflation

The balance of opinion on input prices fell to just below zero in the winter survey (**Chart 7**), suggesting that firms expect input prices to increase over the next 12 months at a similar pace to that experienced over the past 12 months. Market conditions in general, and weaker commodity prices—notably the fall in oil prices—are cited as the main sources of downward pressure. More firms than in previous surveys are anticipating declines in their input costs. The impact of the recent depreciation of the Canadian dollar on the cost of imported inputs lessens those negative pressures.

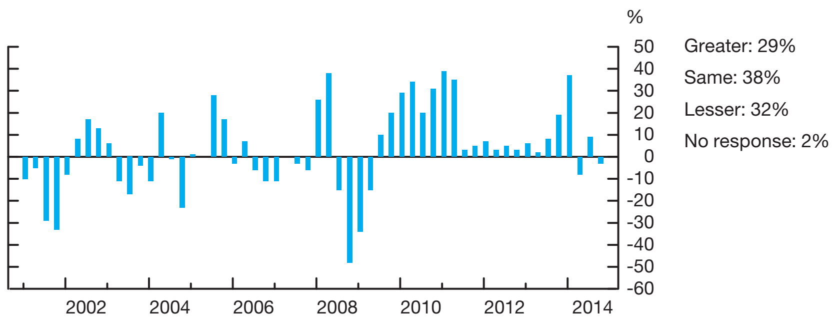
The balance of opinion on output prices turned slightly negative, indicating that firms expect output prices to rise at a slower pace over the next 12 months (**Chart 8**). Firms report that intense competition continues to restrain their ability to raise prices, while some also cite soft demand conditions as a factor.

Inflation expectations declined, with a majority of businesses anticipating total CPI inflation over the next two years to be in the bottom half of the Bank's 1 to 3 per cent inflation-control range (**Chart 9**). The recent decline in oil prices was most often cited as the driver of weaker expectations. Almost all businesses anticipate that inflation will remain in the Bank's inflation-control range.

Chart 7: Firms expect input prices to increase over the next 12 months at a similar pace to that experienced over the past 12 months...

Balance of opinion[a]

Over the next 12 months, are prices of products/services purchased expected to increase at a greater, lesser or the same rate as over the past 12 months?

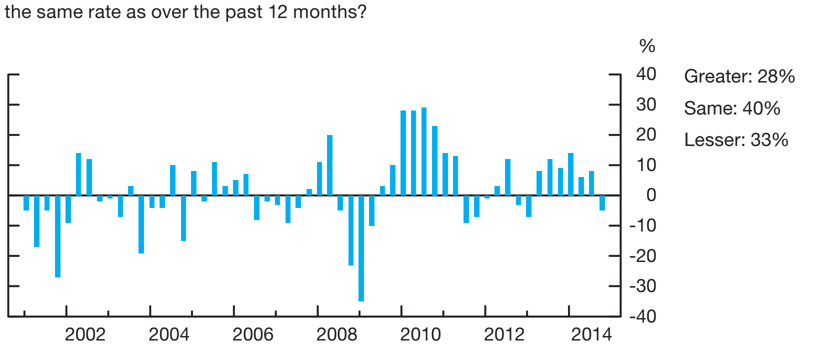


a. Percentage of firms expecting greater price increases minus the percentage expecting lesser price increases

Chart 8: ... and intense competition continues to restrain their ability to raise output prices

Balance of opinion[a]

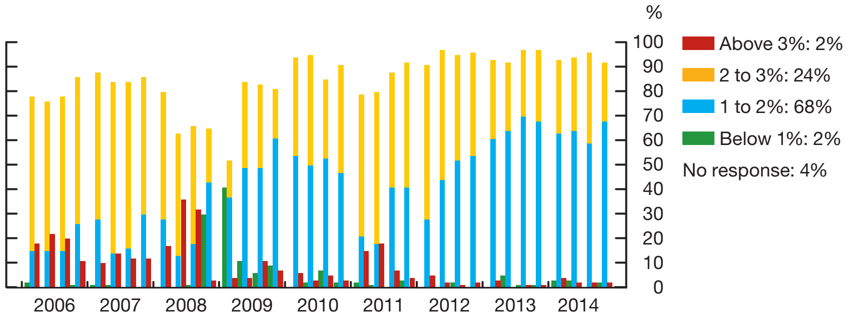
Over the next 12 months, are prices of products/services sold expected to increase at a greater, lesser or the same rate as over the past 12 months?



a. Percentage of firms expecting greater price increases minus the percentage expecting lesser price increases

Chart 9: Inflation expectations declined, but remain concentrated in the Bank's inflation-control range

Over the next two years, what do you expect the annual rate of inflation to be, based on the consumer price index?



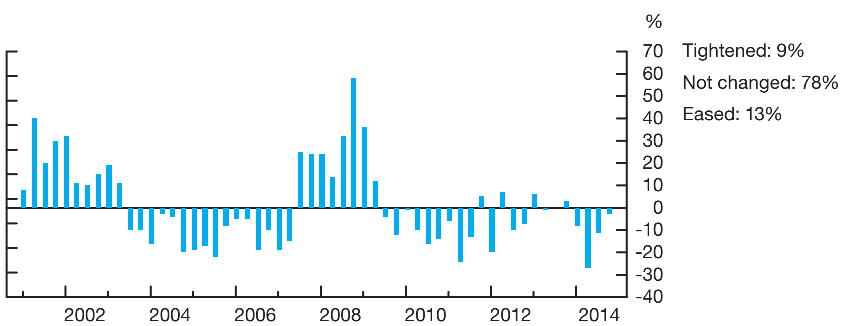
Credit Conditions

A majority of firms reported no change in credit conditions over the past three months, and the balance of opinion is close to zero (**Chart 10**). Among businesses reporting a tightening, most are large firms that source their financing from capital markets. Overall, however, most businesses continue to characterize credit as easy or relatively easy to obtain.

Chart 10: Overall, firms reported no change in credit conditions over the past three months

Balance of opinion[a]

Over the past three months, how have the terms and conditions for obtaining financing changed (compared with the previous three months)?



a. Percentage of firms reporting tightened minus the percentage reporting eased. For this question, the balance of opinion excludes firms that responded "not applicable."

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