BANK OF CANADA
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Business Outlook Survey

Results of the Summer 2015 Survey | Vol. 12.2 | 6 July 2015

The summer Business Outlook Survey *points to a diverging outlook across regions. While there are some encouraging signs, owing in part to strengthening U.S. demand, weak oil prices continue to significantly dampen economic perspectives in affected sectors and regions.*

Overview

- While forward-looking indicators of business activity remain low, they edged up modestly, supported by a generally positive outlook for the U.S. economy. However, sales expectations deteriorated sharply in energy-producing regions, where the oil price shock continues to weigh importantly on business sentiment.
- The balances of opinion on investment and hiring intentions are still weak, since firms tied to the energy sector plan to cut back on their investment and hiring. On the upside, intentions to increase investment are more prevalent among manufacturing firms and businesses in Central Canada.
- Capacity pressures increased somewhat, but the number of firms reporting labour shortages that are restricting their ability to meet demand remains low. On balance, labour shortages are less intense than they were a year ago.
- Firms expect input and output prices to rise at a slower pace as upward pressure from the depreciation of the Canadian dollar over the past two years gradually dissipates and weak commodity prices feed through to final prices. Inflation expectations continue to be concentrated in the bottom half of the Bank's inflation-control range.
- The balance of opinion on credit conditions suggests an easing over the past three months.

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 summer 2015 survey was conducted from 15 May to 10 June 2015. 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.

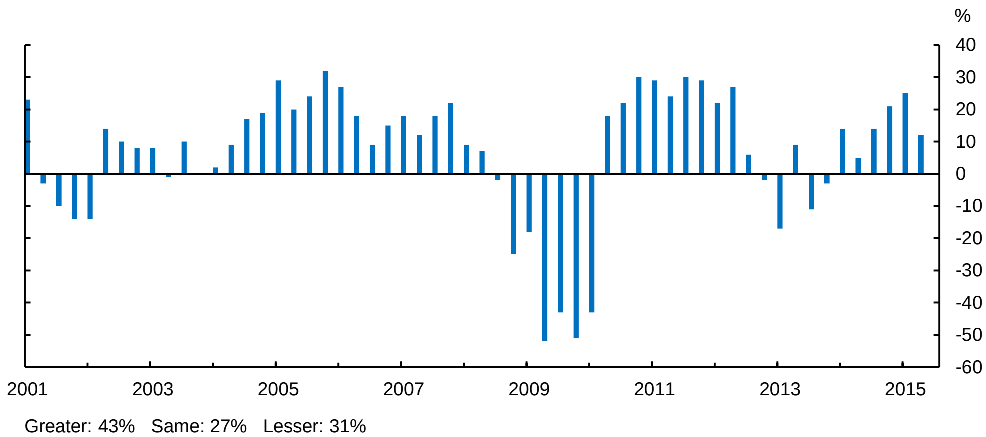
Business Activity

Although the balance of opinion is lower than in previous surveys, firms continue to report stronger sales growth over the past 12 months (**Chart 1**). For the third consecutive quarter, the balance of opinion on future sales remains positive but weak, suggesting that businesses expect an overall modest acceleration in their sales over the next 12 months (**Chart 2**). Similar to the past two surveys, the low commodity-price environment is driving the divergence in firms' outlook: on the one hand, firms in the energy-producing regions and those that are part of the energy supply chain continue to face tough market conditions. In particular, businesses located in the Prairies anticipate that sales will decelerate over the next 12 months as the oil price shock spreads across sectors. On the other hand, domestic demand is strengthening in regions that are less exposed to the energy sector.

Chart 1: Firms report an improvement in sales growth over the past 12 months, although less so than in previous surveys ...

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?

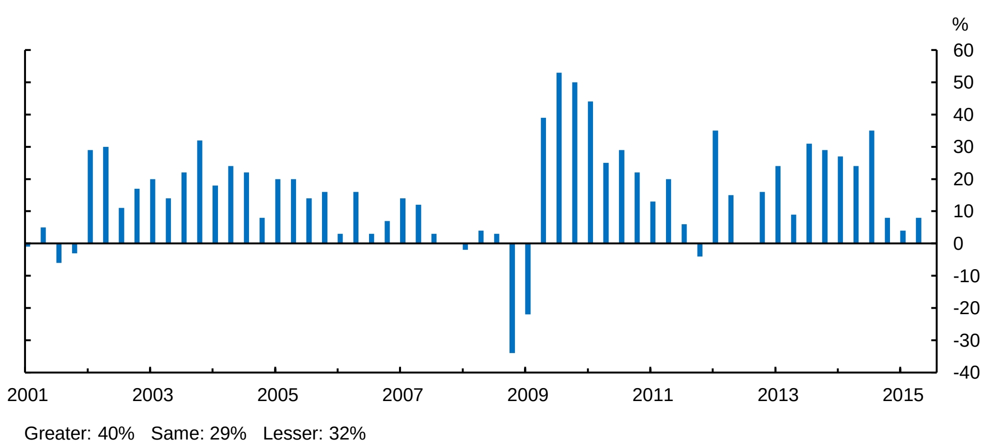


a. Percentage of firms reporting faster growth minus the percentage reporting slower growth

Chart 2: ... and expect a modest acceleration in their sales 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

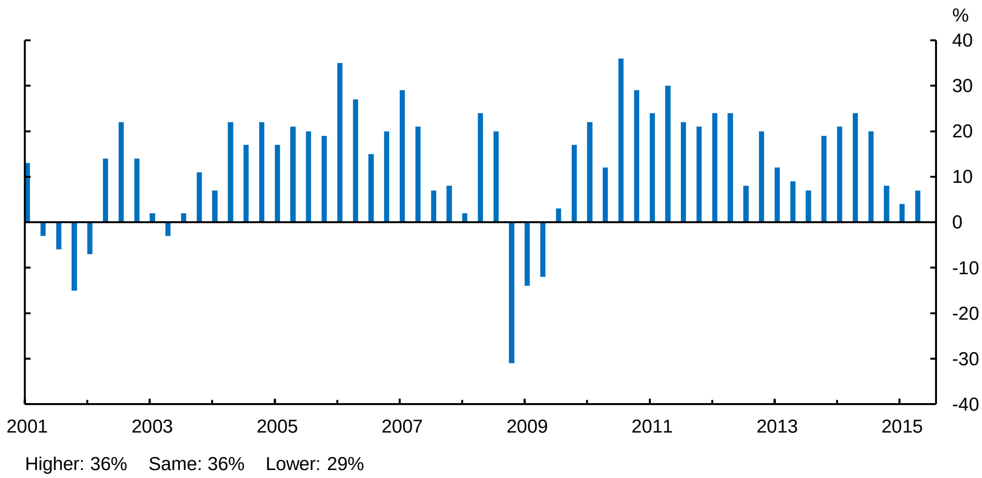
At the same time, firms' perception of U.S. economic growth is positive, and many, particularly manufacturing firms, note that strengthening U.S. demand has translated into improved indicators of future sales, such as advance orders and inquiries. Other businesses are still adjusting their strategies to expand sales opportunities abroad. In this context, many firms reported that the lower Canadian dollar is a welcome development. Several exporters also cited a positive impact on sales volumes as a result. Following some softening in past sales growth, they expect stronger sales activity over the next 12 months.

The balance of opinion on investment in machinery and equipment edged up from just above zero in the previous quarter, pointing to an overall moderate increase in investment spending over the next 12 months (**Chart 3**). The result masks a growing divergence across regions and sectors. In particular, plans to increase investment are more prevalent in Central Canada and in the manufacturing sector, where firms generally benefit from a lower domestic currency and a positive U.S. outlook. Conversely, in light of weak oil prices, firms in energy-related regions and sectors plan to further curtail investment over the next 12 months. Businesses holding back their investment plans cited reasons such as insufficient domestic and foreign demand for their products, as well as ample capacity.

Chart 3: The balance of opinion on investment in machinery and equipment edged up but remains low...

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

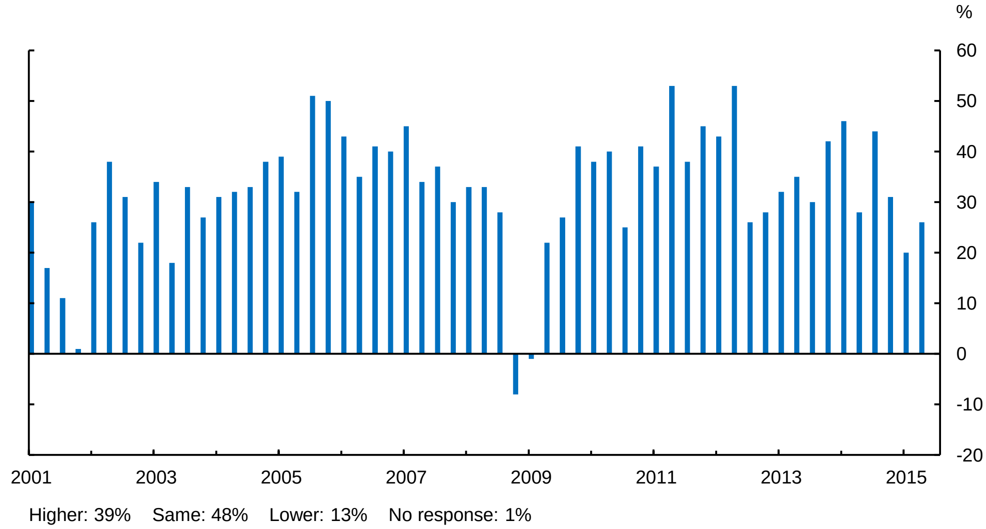
The lower Canadian dollar is having an impact on firms' investment intentions. Of the many businesses facing higher costs for imported machinery and equipment, some indicate that they plan to restrain investment as a result. On the upside, some of the exporters that are experiencing higher margins on their U.S.-dollar-denominated sales reported that they plan to use the additional earnings to increase their investment.

The balance of opinion on employment remains below post-recession levels (**Chart 4**). It increased slightly in the summer survey, however, as fewer firms plan to reduce staff. Hiring intentions improved in regions less affected by energy prices, and businesses often cited expansion plans to meet strengthening demand from both domestic and foreign customers. In contrast, firms planning to reduce employment remain heavily concentrated in the oil-producing regions, where the low commodity-price environment is dampening demand. Other reasons raised for reducing staff include efficiency gains from, for example, automating processes.

Chart 4: ... while, overall, firms expect to increase employment over the next 12 months

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?



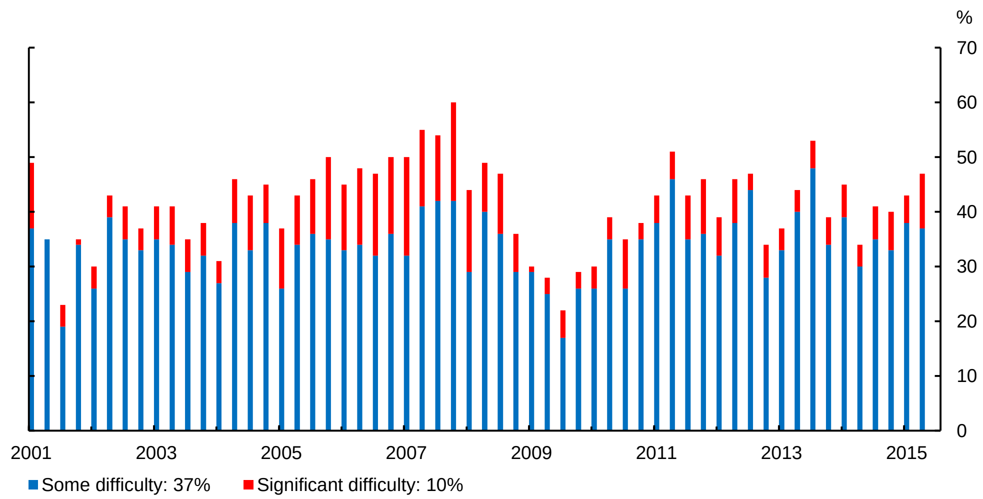
a. Percentage of firms expecting higher levels of employment minus the percentage expecting lower levels

Pressures on Production Capacity

The indicator of capacity pressures moved up in the summer survey (**Chart 5**), with firms most often referring to limits on physical capacity as the main obstacle to scaling up output. Capacity pressures are now more prevalent among firms surveyed in Central Canada and in the manufacturing sector, where sales have strengthened over the past 12 months. Many of these businesses are planning to increase their investment and employment to address capacity constraints.

Chart 5: Capacity pressures moved up in the summer survey...

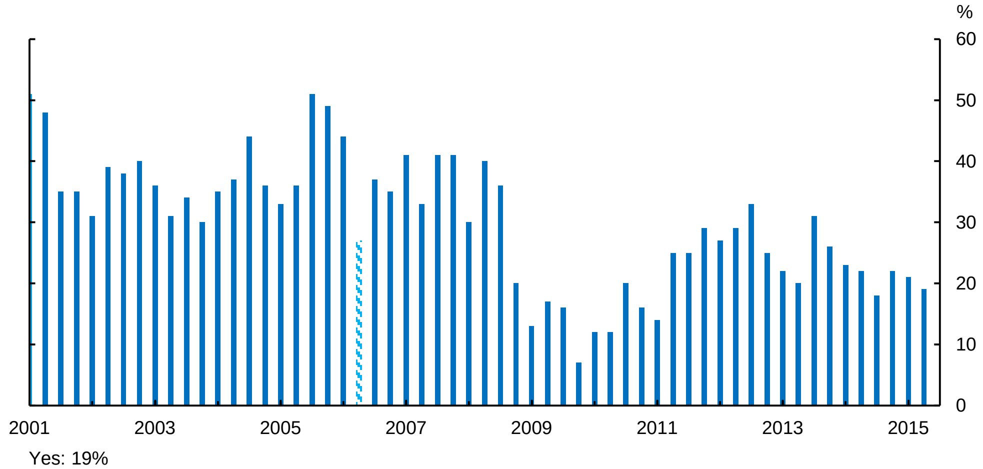
How would you rate the current ability of your firm to meet an unexpected increase in demand?



The number of firms reporting labour shortages that are restricting their ability to meet demand remains low, however (**Chart 6**). This response signals continued slack in the labour market. Shortages were most frequently cited in relation to skilled or specialized labour.

Chart 6: ... but the number of firms reporting labour shortages that are restricting their ability to meet demand remains low

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



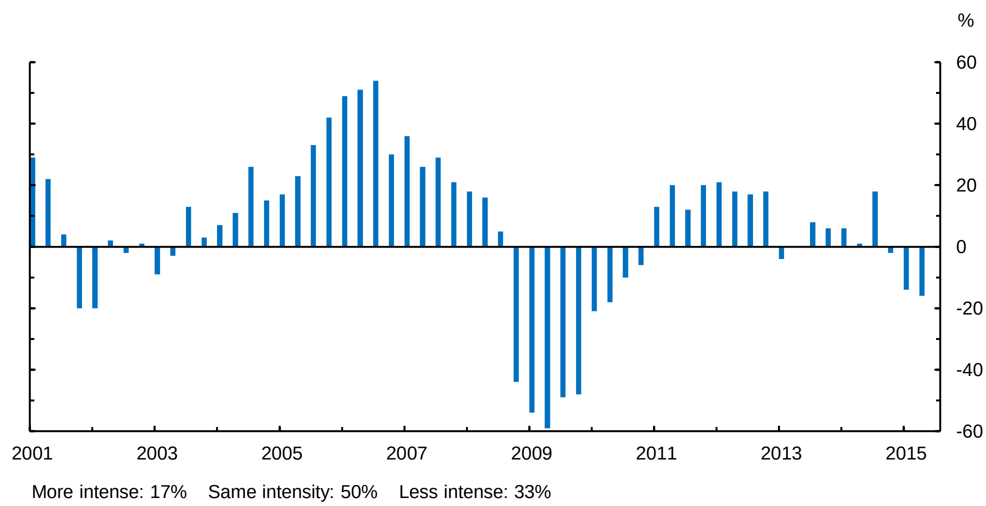
The summer 2006 results are not strictly comparable with those of the other surveys, owing to a difference in the interview process for that survey.

As in the spring survey, firms reported that labour shortages are generally less intense than they were 12 months ago (**Chart 7**). Workers in certain occupations are more readily available as the effects of the oil price shock unfold, particularly in energy-producing regions. Labour shortages also eased in regions where interprovincial workers are returning from the oil patch. In contrast, businesses in Central Canada reported that filling positions has become modestly more challenging, although it is not yet impeding their ability to meet demand.

Chart 7: Labour shortages are generally less intense than they were 12 months ago

Balance of opinion[a]

Compared with 12 months ago, are labour shortages generally more intense, less intense or about the same intensity?



a. Percentage of firms reporting more intense labour shortages minus the percentage reporting less intense shortages

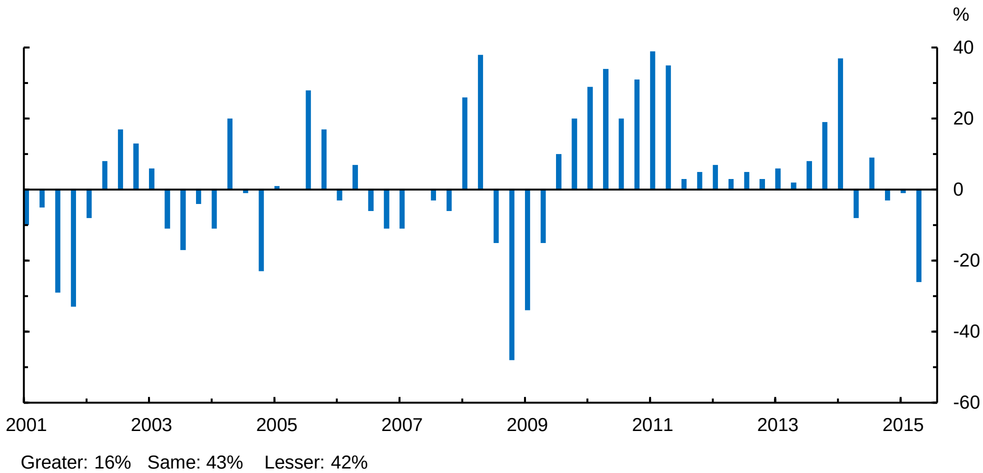
Prices and Inflation

Following two quarters during which it showed little change, the balance of opinion on input price growth dropped sharply in this quarter (**Chart 8**), suggesting that firms expect the prices of inputs to increase at a slower pace over the next 12 months. A key factor driving the momentum in input prices was the past depreciation of the Canadian dollar, which has raised the costs of imported inputs. However, most firms judge that the adjustment has already taken place, and thus anticipate less upward pressure on input prices over the coming 12 months. Moreover, many firms reported that weak oil prices are modestly beneficial to their cost structure, resulting, for example, in lower energy and transportation costs.

Chart 8: The balance of opinion on input price momentum dropped sharply in this quarter …

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

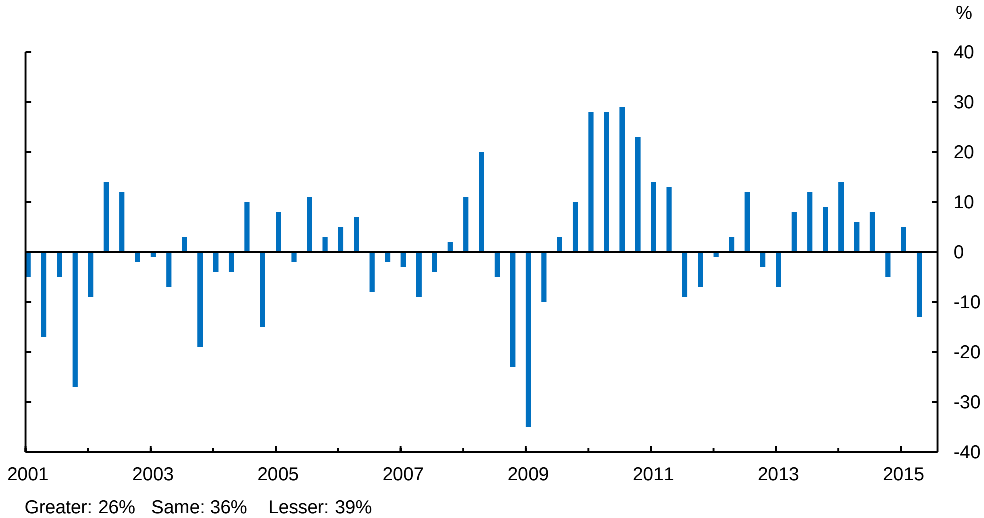
The balance of opinion on output prices turned negative, an indication that firms expect output prices to rise at a slower pace over the next 12 months (**Chart 9**). In most regions, firms have already passed on to their customers the bulk of the increase in input costs related to the past depreciation of the Canadian dollar. While some firms stated that strengthening demand allows them to increase prices at a faster rate, several others still see weak demand as a factor limiting their ability to raise prices.

The impact of the lower currency on margins is two-sided: while most exporters now receive higher Canadian-dollar prices for their products, firms relying on costlier imported inputs often reported that they are seeing their margins squeezed.

Chart 9: … and the balance of opinion on output prices turned negative

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?

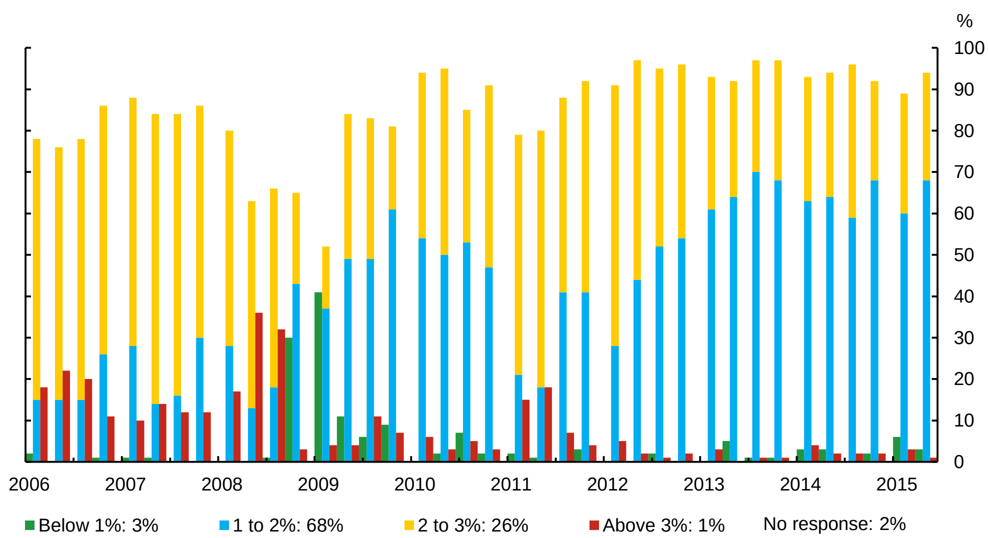


a. Percentage of firms expecting greater price increases minus the percentage expecting lesser price increases

Inflation expectations are little changed. The large majority of businesses—about two-thirds—anticipate that, over the next two years, total CPI inflation will be in the bottom half of the Bank's 1 to 3 per cent inflation-control range (**Chart 10**). Many firms specified weak oil prices as the main driver of their expectations for future inflation. Almost all businesses expect that inflation will remain in the Bank's inflation-control range.

Chart 10: Inflation expectations are little changed

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



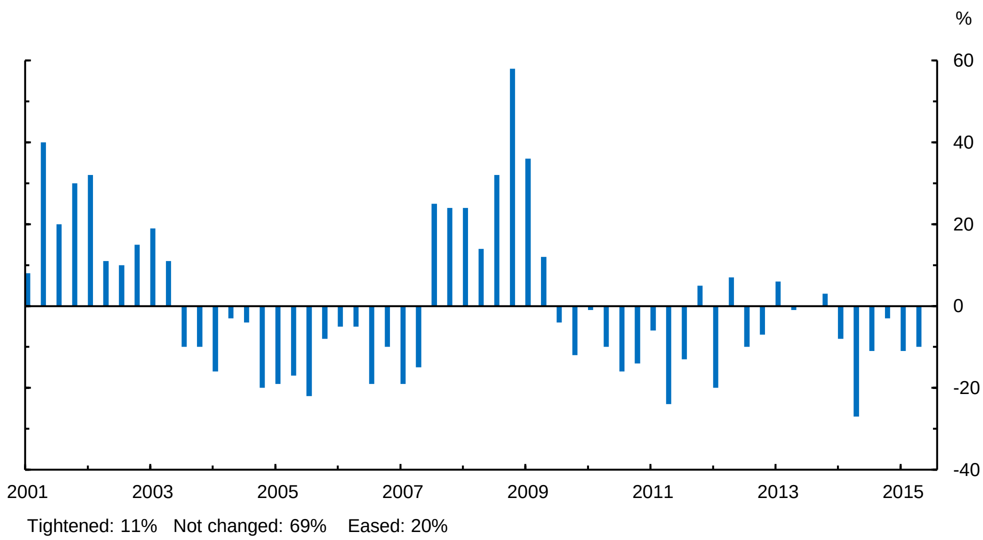
Credit Conditions

The balance of opinion on credit conditions remains negative and points to an easing over the past three months (**Chart 11**). Firms reporting an easing in credit conditions often noted that their solid financial position has allowed them to take advantage of more favourable borrowing costs. As in the previous survey, firms citing tighter credit conditions were frequently tied to energy and other commodities. In general, most businesses continue to characterize credit as easy or relatively easy to obtain.

Chart 11: On balance, credit conditions eased 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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