BANK OF CANADA
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Business Outlook Survey

Results of the Spring 2015 Survey | Vol. 12.1 | 6 April 2015

In the spring Business Outlook Survey, *lower oil prices continue to dampen the overall sales outlook of firms, weighing on investment and hiring intentions. However, a majority of businesses are benefiting from the strong economic outlook in the United States and the boost in competitiveness from the weaker Canadian dollar.*

Overview

- Firms in the Prairies and in the energy supply chain continue to report being adversely affected by weaker oil prices. Signs of spillovers to other sectors and regions are also emerging. Nevertheless, many businesses indicate that lower oil prices and a weaker currency support their business outlook, and the majority anticipate a positive impact from strong U.S. economic growth. On balance, past sales activity continued to improve, but businesses do not expect a material increase in sales growth over the next 12 months.
- The balances of opinion on investment and employment intentions declined further, driven by the adverse effects of lower oil prices. Intentions to increase investment are more widespread among firms based in Central Canada and those in the services sector.
- The indicator of capacity pressures is little changed, and the number of firms reporting labour shortages that are restricting their ability to meet demand remains low. Overall, firms indicate that labour shortages are less intense than they were a year ago, particularly in the Prairies.
- Firms expect little change in input price inflation over the next 12 months, but they anticipate that output prices will increase at a somewhat faster rate, reflecting the effects of the recent depreciation of the Canadian dollar. 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 spring 2015 survey was conducted from 17 February to 12 March 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

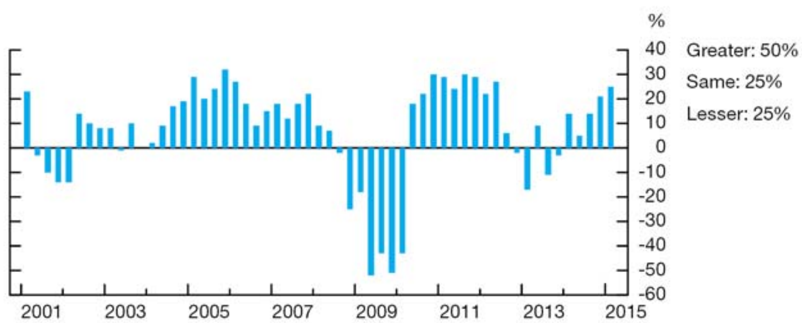
The balance of opinion on past sales growth continued to increase in the spring survey as firms report stronger sales growth over the past 12 months (**Chart 1**). For a second consecutive survey, the balance of opinion on future sales growth declined, to just above zero, indicating that, overall, firms expect sales to increase at about the same rate over the next 12 months as in the past 12 months (**Chart 2**). More businesses than in previous surveys anticipate an outright decline in sales volumes. While lower oil prices are significantly dampening the near-term outlook for firms in the energy sector, responses to the survey indicate some spillovers to other sectors, either for firms that are part of the energy supply chain or through indirect effects.

Firms' outlook for the U.S. economy is generally strong, with the majority expecting this strength to support their future sales, including domestically oriented firms that benefit indirectly through increased demand from their exporting customers. Similar to the winter survey, indicators of future sales were more robust for firms with international customers than they were 12 months ago. Several businesses reported that the depreciation of the Canadian dollar is raising foreign demand for their products, whereas many also see benefits to their domestic sales, including less competition from U.S. firms and increased tourism. While many firms outside the energy sector characterize the effects of lower oil prices and the weaker Canadian dollar as favourable for their business outlook, they expect some of the benefits to unfold only gradually in the future.

Chart 1: Firms report a pickup 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?

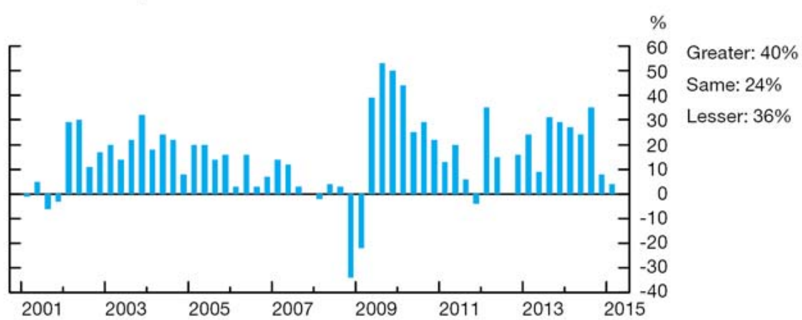


a. Percentage of firms reporting faster growth minus the percentage reporting slower growth

Chart 2: ... but expect little further acceleration in 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

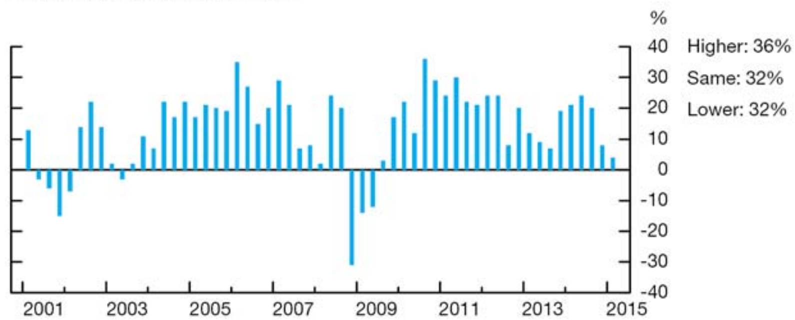
The balance of opinion on investment in machinery and equipment edged down, to just above zero, suggesting that firms expect to invest about the same amount during the next year as they did over the past 12 months (**Chart 3**). Weakness in investment intentions was concentrated in the goods sector and among firms that reported being adversely affected by lower oil prices, and was often associated with higher levels of uncertainty. Intentions to invest are more widespread among firms based in Central Canada and those in the services sector. Although firms outside the energy sector report that the outlook for U.S. growth and a weaker Canadian dollar are generally favourable for them, the positive impact on their investment intentions is taking time to materialize.

While intentions to increase employment are positive, the balance of opinion decreased to its lowest level since 2009 (**Chart 4**). Hiring intentions are weaker for most sectors and regions, but especially for firms tied to the energy sector, which plan to reduce the size of their workforces in light of lower oil prices. Firms planning to curtail employment also cite efficiency gains as a factor driving their intentions.

Chart 3: The balance of opinion on investment in machinery and equipment edged down…

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?

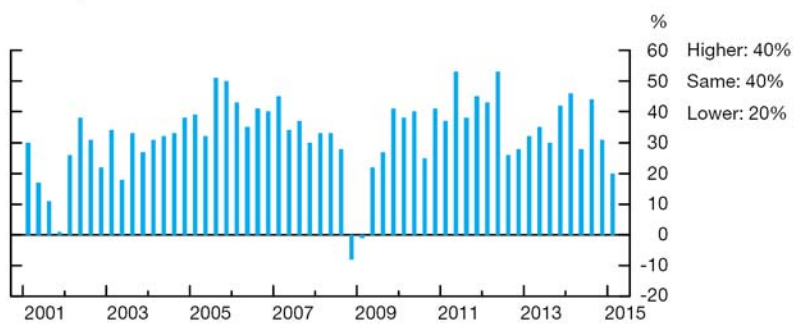


a. Percentage of firms expecting higher investment minus the percentage expecting lower investment

Chart 4: … while intentions to increase employment decreased further

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

Capacity pressures are little changed from the winter survey (**Chart 5**), with few firms anticipating "significant" difficulty meeting an unexpected increase in demand. As in previous surveys, pressures are more prevalent among export-oriented firms, which frequently point to physical capacity constraints as a key obstacle to meeting a sudden rise in demand.

The percentage of firms reporting that labour shortages are restricting their ability to meet demand is almost unchanged in the spring survey and remains low (**Chart 6**), with fewer reports of shortages from firms in the goods sector and those located in the Prairies.

Firms report that, overall, labour shortages are less intense than they were 12 months ago, particularly for businesses in regions and sectors tied to the energy sector (**Chart 7**). The decline in the intensity of labour shortages signals somewhat higher labour market slack compared with the previous survey.[1]

Chart 5: Capacity pressures are little changed

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

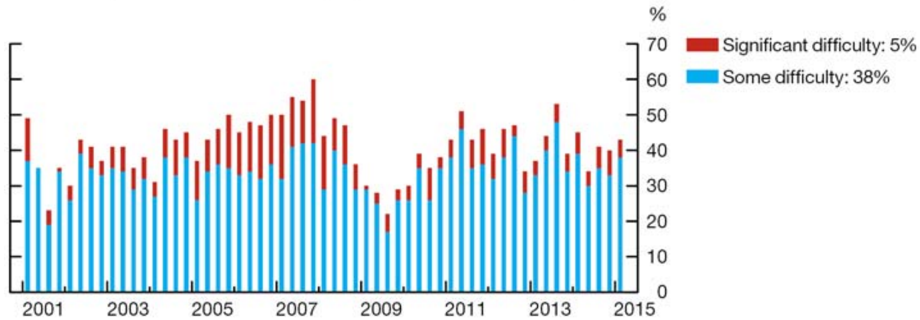
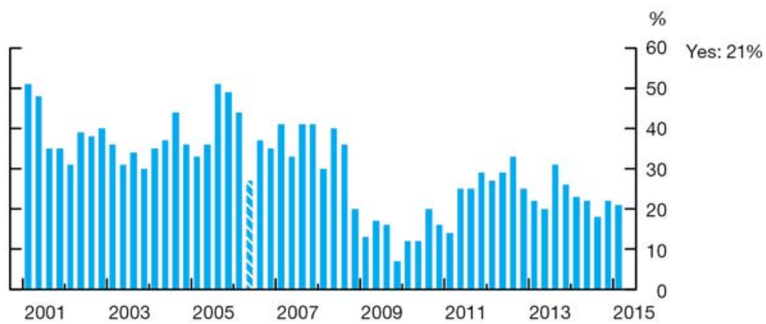


Chart 6: The percentage of firms reporting that labour shortages are restricting their ability to meet demand remains low…

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



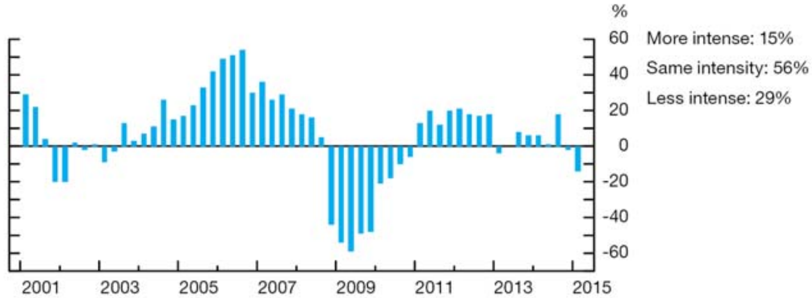
The summer 2006 results are not strictly comparable with those of the other surveys, owing to a difference in the interview process for that survey.

[1] For background information on the new chart introduced in this publication, please refer to the document "Backgrounder on the Question in the *Business Outlook Survey* Concerning the Intensity of Labour Shortages," on the Bank's website at http://www.bankofcanada.ca/wp-content/uploads/2015/04/backgrounder-question-bos-intensity-labour-shortages.pdf.

Chart 7: ... and businesses report that, overall, labour shortages are 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

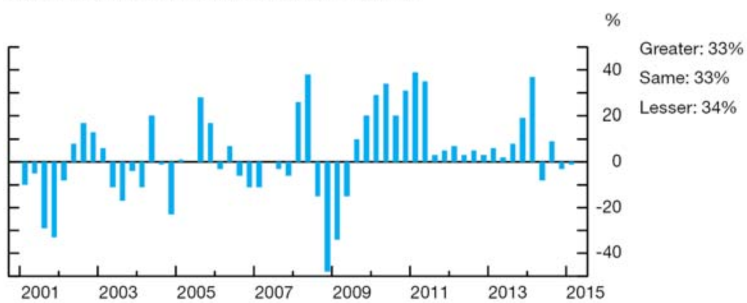
Prices and Inflation

The balance of opinion on input prices is little changed in the spring survey (**Chart 8**). At just below zero, it indicates that firms expect input prices to increase at a similar rate over the next 12 months to that experienced over the past 12 months. As well, the number of businesses anticipating outright declines in input costs is growing. Firms cited the fall in oil prices as the main source of downward pressure over the next 12 months. However, the recent depreciation of the Canadian dollar has put upward pressure on input costs denominated in U.S. dollars.

Chart 8: Firms expect input prices to increase at about the same rate over the next 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

Firms expect output prices to rise at a somewhat higher rate over the next 12 months, as the balance of opinion on output prices turned slightly positive (**Chart 9**). Compared with recent surveys, more firms report upward pressure related to the exchange rate. While several exporters to the United States expect the weaker dollar to result in higher Canadian-dollar prices for their products, some businesses also plan to pass on to their domestic customers at least some of the higher input costs related to the depreciation of the Canadian dollar.

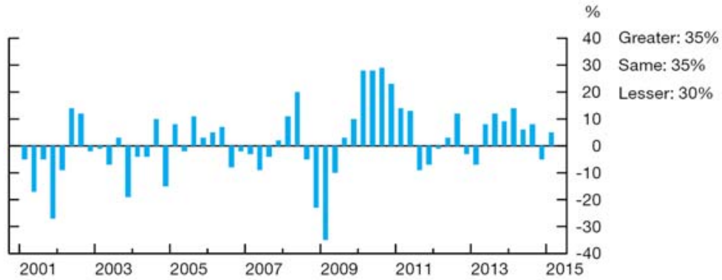
Expectations for inflation are little changed from the winter survey (**Chart 10**), and the majority of firms anticipate that, over the next two years, total CPI inflation will be in the bottom half of the Bank's 1 to 3 per cent inflation-control range. Weak oil prices continue to moderate firms' inflation expectations.

(continued)

Chart 9: … and output prices to increase at a slightly greater rate as a result of the depreciation of the Canadian dollar

Balance of opinion[a]

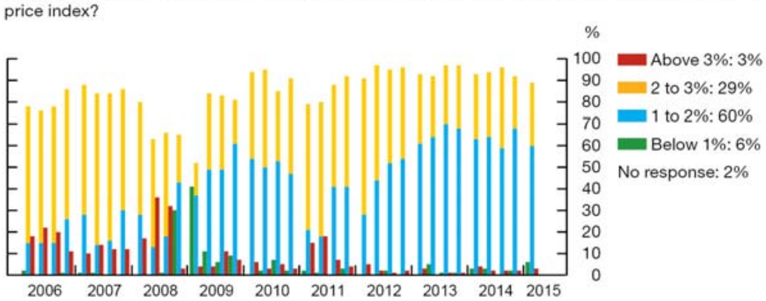
Over the next 12 months, are prices of products/services sold expected to increase at a greater, lesser or the same rate as over the past 12 months?



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

Chart 10: Inflation expectations are concentrated within 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?



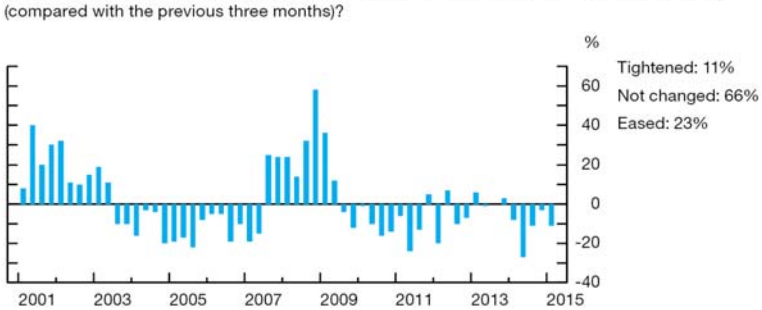
Credit Conditions

The negative balance of opinion on credit conditions points to an easing over the past three months (**Chart 11**). Small firms and those positioned to benefit from strong U.S. economic growth contributed the most to this negative balance of opinion. Firms experiencing an easing often attribute it to modestly lower borrowing costs. Those citing tighter credit conditions, on the other hand, were often tied to energy and other commodities. Overall, most businesses continue to characterize credit as easy or relatively easy to obtain.

Chart 11: On balance, firms report that 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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