BANK OF CANADA
BANQUE DU CANADA

Business Outlook Survey

Results of the Winter 2016–17 Survey | Vol. 13.4 | 9 January 2017

The results of the winter *Business Outlook Survey* indicate that business prospects have improved following two years of overall modest activity. The responses reflect building domestic demand, a supportive export outlook and an expected recovery in energy-related activity.

Overview

- Forward-looking measures of business activity have improved as domestic sales growth gains momentum. The drag from the oil price shock and related spillovers is gradually dissipating, and demand growth remains steady in less-affected regions. Foreign demand continues to support export prospects.
- Both investment and employment intentions recovered and are more broad-based, driven by stronger demand and, in some cases, the need to catch up following a period of anemic investments and layoffs.
- Capacity pressures are unchanged, but responses point to some firming ahead, albeit from low levels in regions tied to energy. Indicators of labour shortages continue to move up from their recent weak levels, although they still diverge between resource-intensive regions and others.
- Input and output price growth are expected to accelerate, owing to the combination of anticipated stronger commodity prices, pass-through of exchange rate depreciation and signs of firming demand, allowing firms to begin restoring profit margins.
- Inflation expectations edged up from a low level and remain concentrated in the lower half of the Bank's inflation-control range.
- Credit conditions are roughly unchanged, and most firms characterize credit as easy or relatively easy to obtain.

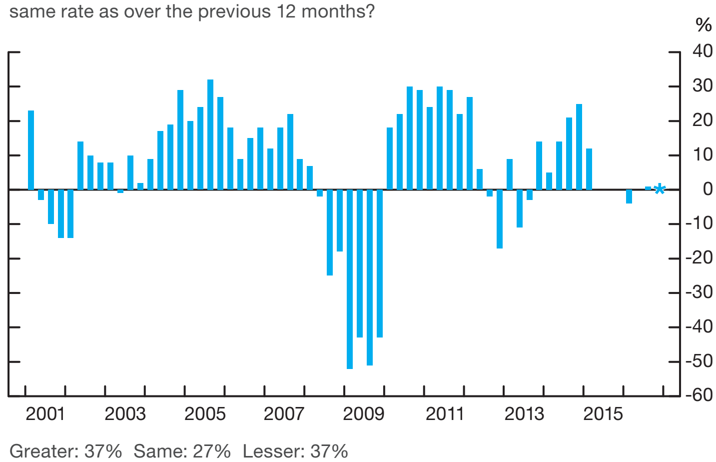
Business Activity

Firms reported little change overall in the pace of past sales growth (**Chart 1**), with the balance of opinion hovering around zero for more than a year. Firms are generally more optimistic about their future sales prospects: both forward-looking measures continued to rise above the modest results

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 the gross domestic product of Canada's business sector. This survey was conducted from 14 November to 5 December 2016. 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.

Chart 1: Sales growth stabilized over the past 12 months...

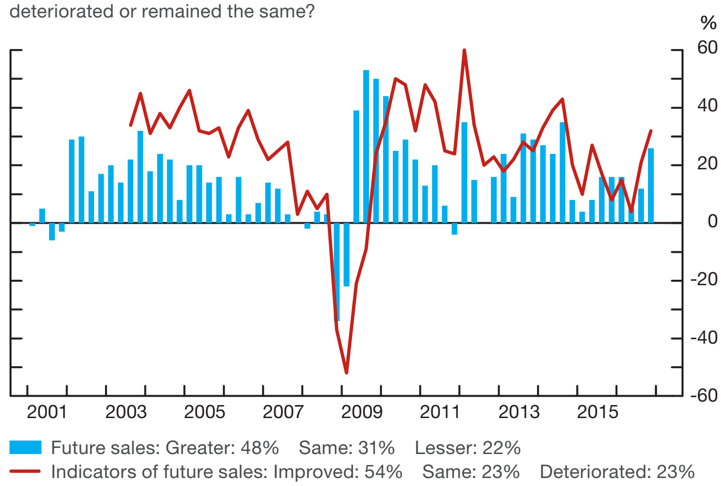
Balance of opinion[a]
Over the past 12 months, did your firm's sales volume increase at a greater, lesser or the same rate as over the previous 12 months?



a. Percentage of firms reporting faster growth minus the percentage reporting slower growth
* Indicates a balance of opinion of zero

Chart 2: ...while sales expectations for the next 12 months continue to improve

Future sales (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?
Indicators of future sales (balance of opinion)[b]: Compared with 12 months ago, have your recent indicators (order books, advance bookings, sales inquiries, etc.) improved, deteriorated or remained the same?



a. Percentage of firms expecting faster growth minus the percentage expecting slower growth
b. Percentage of firms reporting that indicators have improved minus the percentage reporting that indicators have deteriorated

associated with the energy downturn over the past two years (**Chart 2**). Overall, businesses expect faster sales growth over the next 12 months (**Chart 2**, blue bars). The results partly reflect an expected recovery of activity in regions at the epicentre of the oil price shock, where businesses now anticipate at least some sales growth following a period of decline. The improvement in indicators of future sales, such as new orders, was also more widespread (**Chart 2**, red line). Firms' perspectives are increasingly supported by domestic demand, with sustained strength in areas such as service industries and housing-related activities. The lower dollar is also promoting tourism and benefits several firms that see less competition from their US counterparts.

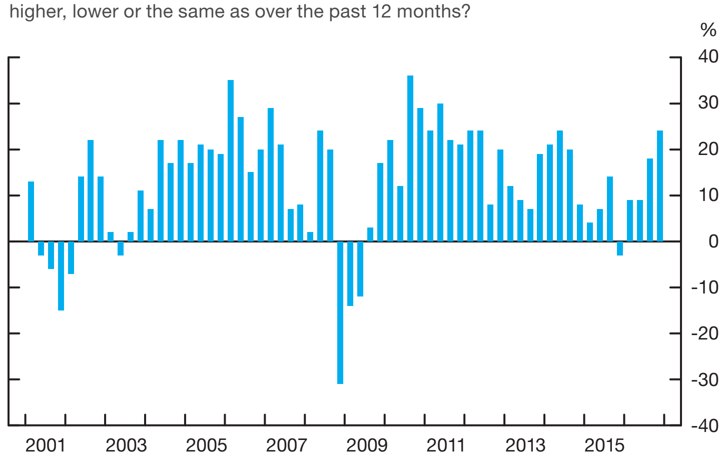
The outlook for exports is providing steady support for firms' sales expectations, with businesses again citing the favourable exchange rate and US demand as the most important supporting factors. Expectations for US economic growth over the next year are generally positive, although considerable uncertainty surrounds the implications of the US election outcome for firms' outlook (**Box 1**). While several exporters saw a positive effect from the weaker dollar on their past and future sales volumes, the majority did not lower their foreign prices and benefited mainly from higher margins. Meanwhile, several firms noted that various regulatory hurdles or trade barriers are limiting export growth, and many expressed concern about the risk of rising protectionism.

The balance of opinion on investment intentions continued to recover (**Chart 3**), mainly because fewer firms pointed to a drop in investment spending. While plans to invest over the next 12 months remain more pronounced in Central and Eastern Canada, positive investment intentions are now evident in all regions and sectors, particularly among exporters. Commodity-linked businesses reported the need to invest following often significant cuts over the past two years.

Chart 3: Investment intentions recovered further...

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?



Higher: 41% Same: 43% Lower: 17%

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

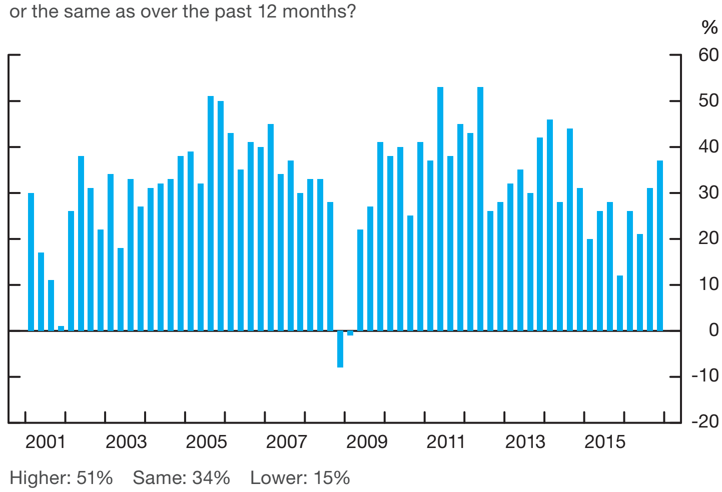
Firms experiencing robust demand reported expanding their operations, for example, by opening new establishments. Others referred to smaller-scale expenditures, such as investments in information technology or office equipment in the case of many service firms. Many businesses reported directing investment efforts toward cost reduction or merely replacing existing physical capital.

The balance of opinion on employment intentions improved and is positive, pointing more strongly to hiring plans over the next 12 months (**Chart 4**). Hiring intentions are widespread across most sectors and regions. Firms often cited sales growth and expansion plans as the main reasons for increasing staff levels, particularly in regions less exposed to the oil price shock. Yet, a number of firms still reported limited hiring, especially resource-related firms, which often operate with the bare minimum. Firms anticipating staff reductions noted declining sales and demand and, in some cases, efficiency gains through technology and automation.

Chart 4: ...and employment intentions improved

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

While the share of firms that would have difficulty meeting an unanticipated increase in demand is roughly unchanged from the previous survey (**Chart 5**), the result masks some underlying disparities. On the one hand, owing to improving demand, firms in Ontario and British Columbia are seeing greater pressures on their capacity and expect pressures to build further. On the other hand, material excess slack remains in regions still feeling the ramifications of the slowdown in the energy sector. Taken together, the responses point to some firming of pressures, albeit from low levels in resource-intensive regions.

Following the weak levels recorded over the past two years, both indicators of labour shortages continue to edge up (**Chart 6**). For the first time since the oil price shock, firms reported little change, on balance, in the intensity

Chart 5: Capacity pressures are largely unchanged, but responses point to some firming ahead

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

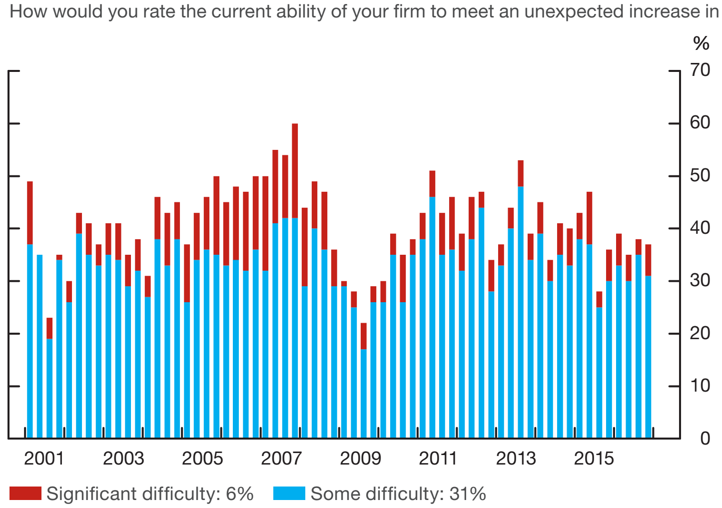
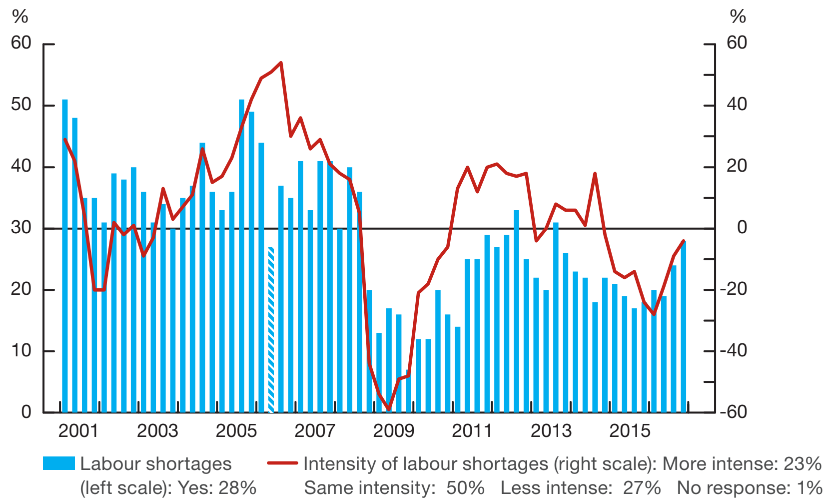


Chart 6: Labour shortage indicators continue to edge up

Labour shortages: Does your firm face any shortages of labour that restrict your ability to meet demand?
Intensity of labour shortages (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

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.

of labour shortages compared with a year ago (**Chart 6**, red line). The results suggest ongoing, substantial labour market slack, especially in regions tied to oil, with mild tightening in provinces experiencing sustained demand. The number of firms reporting that labour shortages are restricting their ability to meet demand increased for the second consecutive quarter, almost reaching the survey average (**Chart 6**, blue bars). These firms were more likely to report plans to expand their workforces.

Prices and Inflation

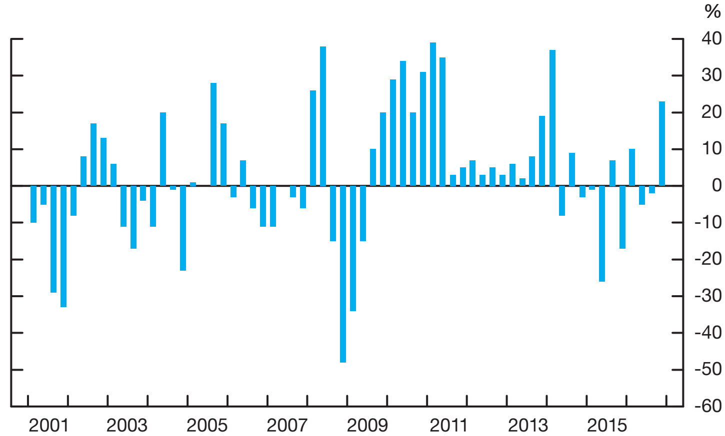
After being close to zero for two quarters, the balance of opinion on input price growth swung into positive territory, indicating faster cost growth over the next 12 months (**Chart 7**). Reports of firming input price pressures were relatively widespread across sectors and stemmed from several drivers. Some respondents indicated that suppliers are now attempting to stabilize or increase prices following cuts over the past two years. Others attributed faster input price growth to an anticipated recovery in commodity prices. Only a few firms expected an outright decline in input costs, which some related to structural factors such as lower information technology costs.

The balance of opinion on output prices also turned positive in this survey (**Chart 8**). As in the autumn survey, firms referred to the pass-through of recovering commodity prices. The result also reflects gradually firming demand and somewhat less drag from competitive pressures, enabling firms to start restoring profit margins and passing increased costs through to their customers. While some firms still refer to delayed pass-through of past depreciation, a number anticipate more pressure to come because of an expected strengthening of the US dollar.

Chart 7: Input price growth is expected to accelerate...

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?



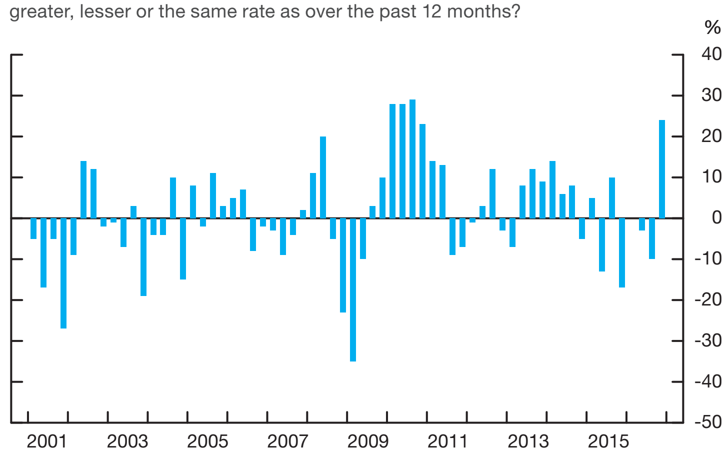
Greater: 37%   Same: 50%   Lesser: 14%

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

Chart 8: ...while firms also anticipate faster growth of their 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?



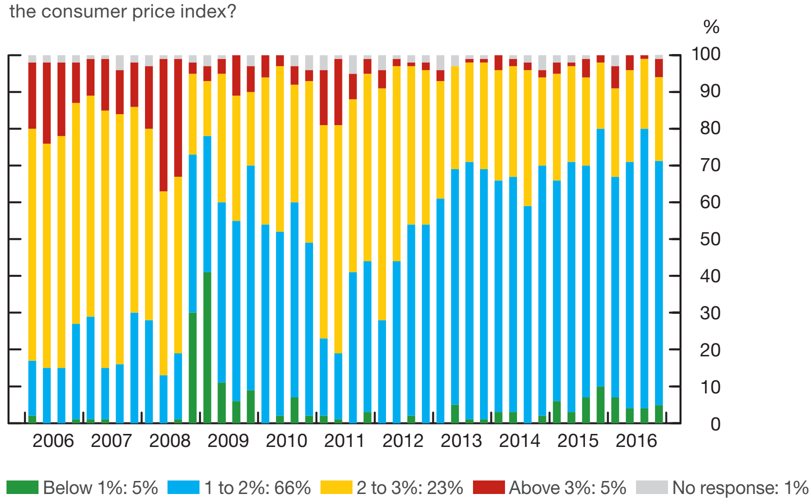
Greater: 39%   Same: 47%   Lesser: 15%

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

Inflation expectations moved up slightly from the low level recorded in the autumn survey (**Chart 9**) and remain concentrated in the bottom half of the Bank's inflation-control range. The most frequently cited reasons for modest inflationary pressures include still-anemic commodity prices and overall slack in the economy. Nevertheless, a number of firms anticipate that a rise in energy prices, expansionary fiscal policies south of the border and additional depreciation will contribute to somewhat higher inflation.

Chart 9: Inflation expectations ticked up from a low level

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

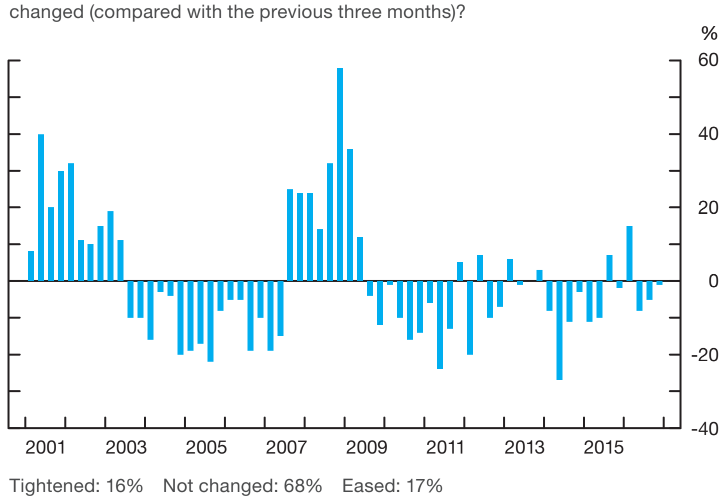


Credit Conditions

The balance of opinion on credit conditions is near zero, suggesting little change in the ease with which firms can access credit (**Chart 10**). The majority of firms across all regions and most sectors saw no change in the terms and conditions for obtaining financing. Some businesses reporting more-favourable terms linked this development to greater competition among banks, while others pointed to firm-specific factors such as their own stronger performance. Among those reporting tighter conditions, some businesses cited second-round effects of the oil price shock, while others referenced firming rates following the US election.

Chart 10: Credit conditions are largely unchanged

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."

Box 1

The Outlook for the United States

Given the importance of the US economic outlook for Canadian exports and Canada's economy more generally, firms in the *Business Outlook Survey* are asked about their expectations for US growth. Over the past year, nearly all firms expected the US economy to grow, although the outlook had moderated somewhat from the quite robust stance over the 2014–15 period (**Chart 1-A**). While the majority of respondents in the winter survey still anticipate slow growth, more firms than in the autumn survey expect strong growth, citing the outcome of the US election as one of the underpinning factors.

Businesses are also asked to evaluate the impact of the US outlook on their sales expectations (**Chart 1-B**). In recent surveys, about half of the respondents reported a positive impact,[1] most often because US demand is providing a lift to their exports. Others referred to more indirect effects; for example, they gain from the performance of their exporting clients. The majority of participants in the winter survey reported seeing benefits: several businesses cited opportunities related to increased US oil and gas production and consumption, for example, as well as US tourism in Canada.

Uncertainty about the outcome of the US election, which affected the autumn survey, has given way to uncertainty about the measures that will be put in place by the incoming US administration and their impact on Canadian businesses. Firms' views (which in some cases reflect the perspectives of their US customers) are divided: some are optimistic about the prospect of increased infrastructure and military spending as well as changes in energy policies, while others are more pessimistic, often because of the risk of increased protectionism. As in previous surveys, the perception of rising protectionism leads a number of businesses to maintain or build a foreign presence. Some firms expect expansionary US fiscal policies to result in a stronger US dollar, and a number also mentioned inflationary risks. Others observed an impact on credit conditions from the recent increase in long-term rates. Given the uncertainty, few firms reported concrete effects of the US election outcome on their sales expectations for the next 12 months, and the large majority have not yet taken any action in response.

1 Purely domestically oriented firms tend to see little or no effect, which explains the large proportion of firms reporting "no impact" in Chart 1-B.

Chart 1-A: Nearly all firms expect the US economy to grow over the next 12 months

Over the next 12 months, what is your underlying assumption for the US economy?

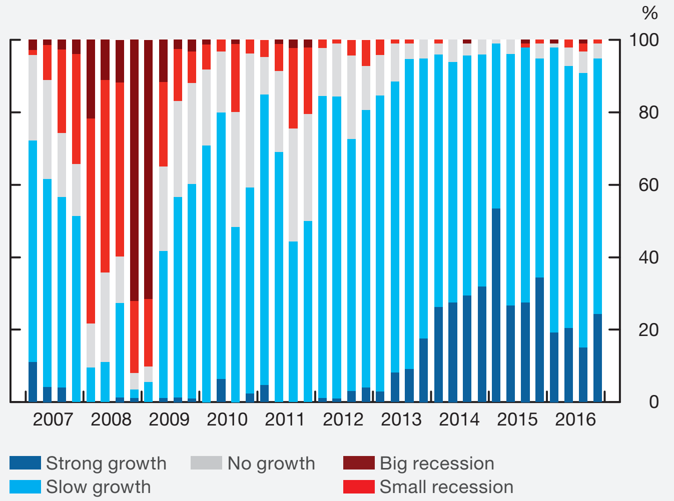
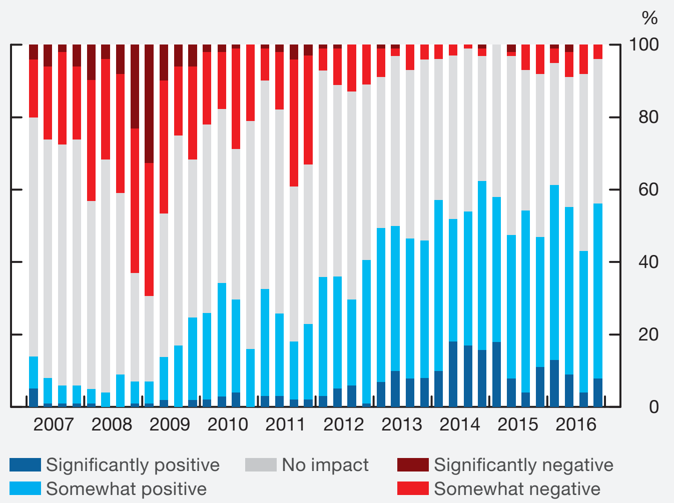


Chart 1-B: About half of respondents see benefits from US growth

How has your outlook on the US economy influenced your future sales expectations?



Bank of Canada Offices

Atlantic Provinces
1701 Hollis Street, 13th Floor
Halifax, Nova Scotia B3J 3M8

Quebec
1501 McGill College Avenue, Suite 2030
Montréal, Quebec H3A 3M8

Ontario
150 King Street West, 20th Floor, Suite 2000
Toronto, Ontario M5H 1J9

Prairie Provinces, Nunavut and Northwest Territories
308–4th Avenue SW, Suite 2411
Calgary, Alberta T2P 0H7

British Columbia and Yukon
200 Granville Street, Suite 2710
Vancouver, British Columbia V6C 1S4

Head Office
234 Laurier Avenue West
Ottawa, Ontario K1A 0G9
1-800-303-1282

ISSN 1916-4076