



BANK OF CANADA

ADJUSTING TO THE APPRECIATION OF THE CANADIAN DOLLAR

Supplement to the Winter 2004–05 Business Outlook Survey

Highlights

During visits conducted between 16 November and 15 December 2004, Bank of Canada staff again interviewed businesses to gauge the impact on their operations of the appreciation of the Canadian dollar since the beginning of 2003, as well as their reaction to that appreciation.¹

Generally, firms' planning assumptions regarding the exchange rate had moved up to a range of 80 to 84 cents U.S., compared with a range of 75 to 77 cents U.S. in the autumn 2004 survey.

- About 55 per cent of firms reported being adversely affected by the appreciation, compared with 45 per cent in the autumn survey.
- Again, most of the companies adversely affected were those exporting resources and manufactured products, who were seeing lower Canadian-dollar revenues and profit margins on exports. Less than 20 per cent of adversely affected firms reported smaller export volumes.
- At some firms, domestic sales had suffered because of increased competition from imports or the effect of the appreciation on their clients in Canada. The appreciation had also affected the profits and assets of the U.S.-based operations of some firms, which were worth less in Canadian-dollar terms.
- As in the autumn survey, about 40 per cent of adversely affected firms were not planning any changes to their operations because of the appreciation.
- Many other firms are taking measures to improve productivity and lower costs, not only in response to the dollar's appreciation, but also because of increased competition from Asian suppliers. A growing number of firms have chosen to cut costs by increasing their imports of inputs and finished goods from Asia.
- A number of firms are adjusting to the appreciation by moving away from low-profit products and markets towards those yielding higher returns.
- Most of the firms favourably affected by the appreciation had benefited from lower prices for imported inputs.
- In contrast to the previous survey, firms hurt by the dollar's appreciation are now much less optimistic about future sales than other firms. They are also less likely to be planning to increase employment, although their views on investment in machinery and equipment are now as positive as those of other firms. The companies that have been most severely affected by the appreciation of the Canadian dollar are noticeably more pessimistic about sales, investment, and employment than those experiencing a more moderate adverse effect.

1. Some questions that had been asked previously were dropped in these visits, because, over time, it is difficult for firms to isolate the effects of the appreciation from other factors.

Note: This document and the winter Business Outlook Survey summarize responses obtained during interviews with about 100 businesses across Canada between 16 November and 15 December 2004. Firms were selected to provide a representative profile of the Canadian economy by region, industry type, and firm size. The method of sample selection ensures a good cross-section of opinion. Nevertheless, the statistical reliability of the survey is limited, given the small sample size.

Chart 1: Effects of Appreciation by Sector

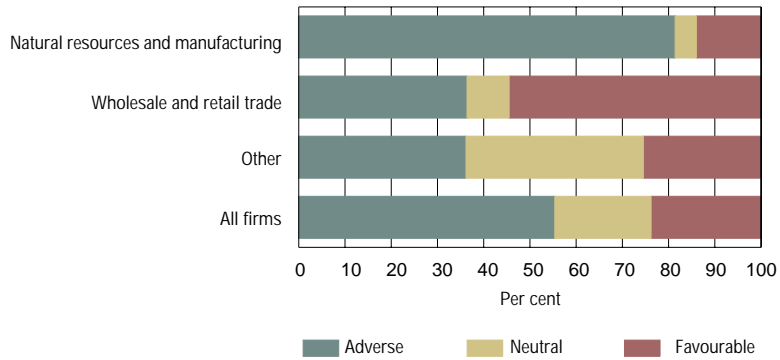


Chart 2: Firms Adversely Affected: Main Effects (56 Firms)

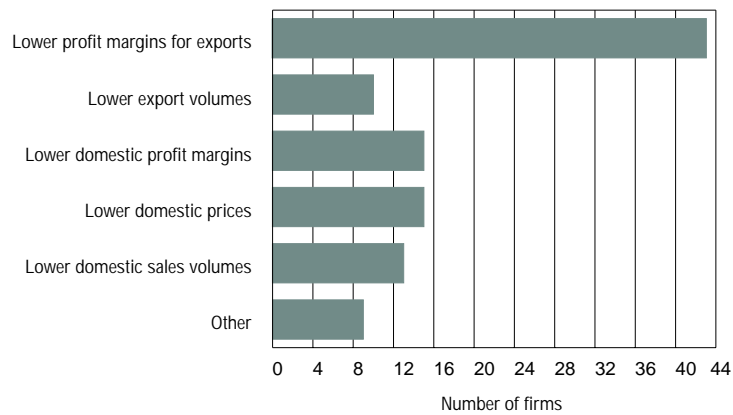


Chart 3: Firms Adversely Affected: Main Reactions (56 Firms)



Chart 4: Firms Favourably Affected: Main Effects (24 Firms)

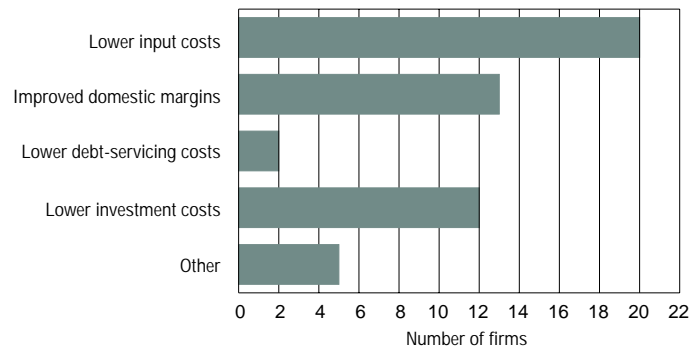
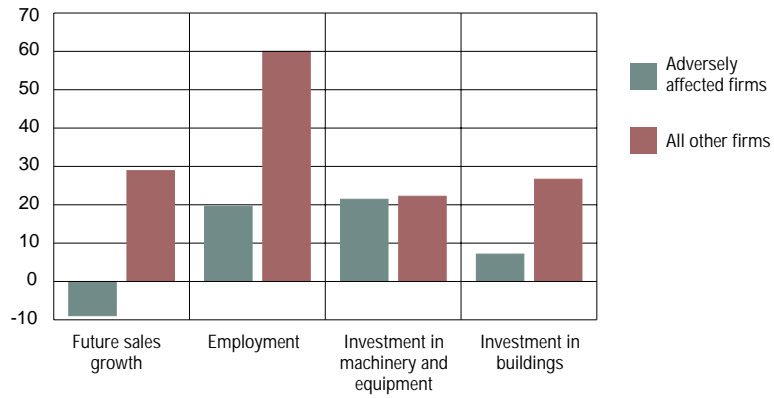


Chart 5: Balance of Opinion¹ on Selected Variables



1. Percentage of firms expecting faster growth (for sales) or higher levels (for employment and investment) minus percentage of firms expecting slower growth or lower levels over the next 12 months