



BANK OF CANADA

ADJUSTING TO THE APPRECIATION OF THE CANADIAN DOLLAR

Supplement to the Spring 2006 Business Outlook Survey

Highlights

During visits conducted between 17 February and 17 March 2006, 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 response to that appreciation.¹

This is the sixth time firms have been surveyed about this issue, and the key messages are quite similar to those obtained previously.²

- As in the past surveys, about half of the firms reported being adversely affected by the appreciation.
- Again, most of those adversely affected were companies exporting resources and manufactured products. The primary effect came from lower Canadian-dollar revenues and profit margins on exports. As before, less than 20 per cent of adversely affected firms reported smaller export volumes.
- A number of adversely affected firms also experienced lower profit margins, prices, or sales volumes in their domestic markets because of increased competition from imports.
- Slightly more than one-third of adversely affected firms reported that strong demand conditions wholly or partially offset the effects of the appreciation.
- About 70 per cent of adversely affected firms had actively responded to the appreciation. Among these reactions, firms reported having increased their financial hedging activities, using more imported inputs or outsourcing work abroad, cutting labour or material costs, or increasing investment to better cope with the appreciation.
- About one-quarter of the firms surveyed reported being favourably affected by the appreciation, principally by benefiting from lower prices for imported inputs.
- On balance, firms hurt by the dollar's appreciation reported investment and hiring intentions somewhat less strong than those of other firms. But in contrast to previous surveys, their balance of opinion on future sales was stronger than that of other firms. Many firms in this last group, particularly those that were little affected by the dollar, reported that a further acceleration in the already-strong pace of sales was unlikely.

1. Firms' planning assumptions regarding the exchange rate had moved up to a range of 85 to 87 cents U.S., compared with a range of 80 to 84 cents U.S. in the last survey (winter 2004–05).
2. Autumn 2003, winter 2003–04, spring 2004, autumn 2004, and winter 2004–05. For more details, see the article in the autumn 2005 issue of the *Bank of Canada Review*, "How the Appreciation of the Canadian Dollar Has Affected Canadian Firms," by Jean Mair.

Note: This document and the spring Business Outlook Survey summarize responses obtained during interviews with about 100 businesses across Canada between 17 February and 17 March 2006. 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 unknown, given the small sample size and selection process.

Chart 1: Effects of Appreciation by Sector

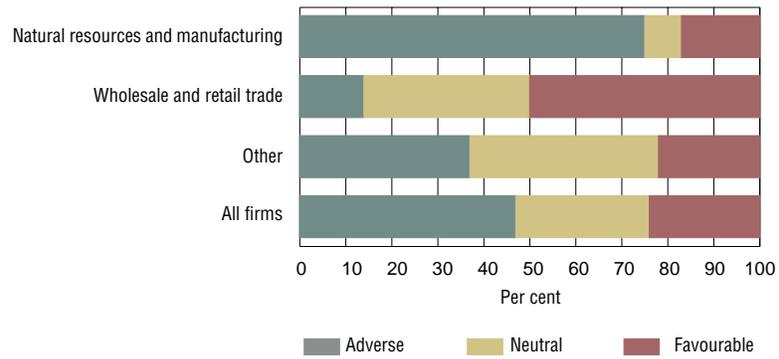


Chart 2: Firms Adversely Affected: Main Effects (48 Firms)

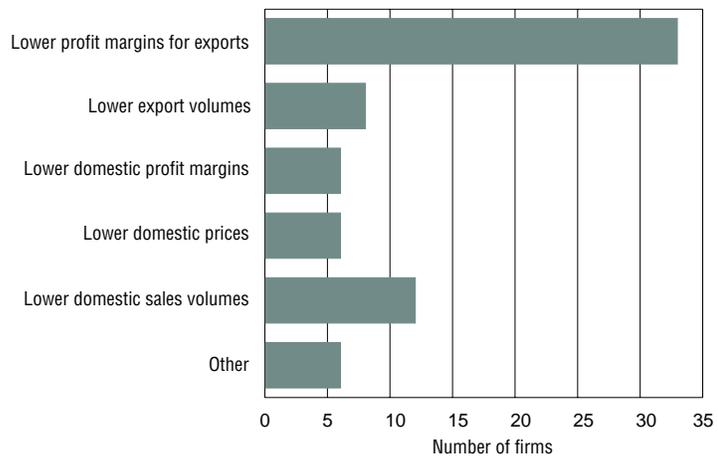


Chart 3: Firms Adversely Affected, Offsetting Factors (48 Firms)

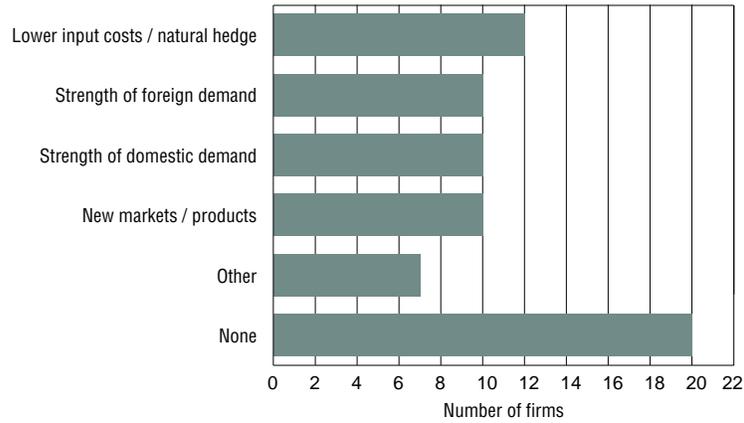


Chart 4: Firms Adversely Affected, Main Reactions (48 Firms)



Chart 5: Firms Favourably Affected, Main Effects (24 Firms)

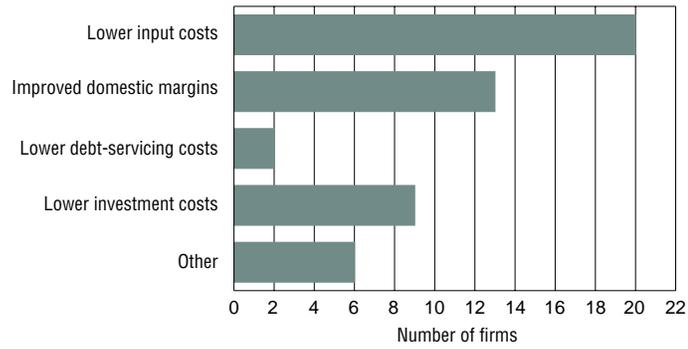
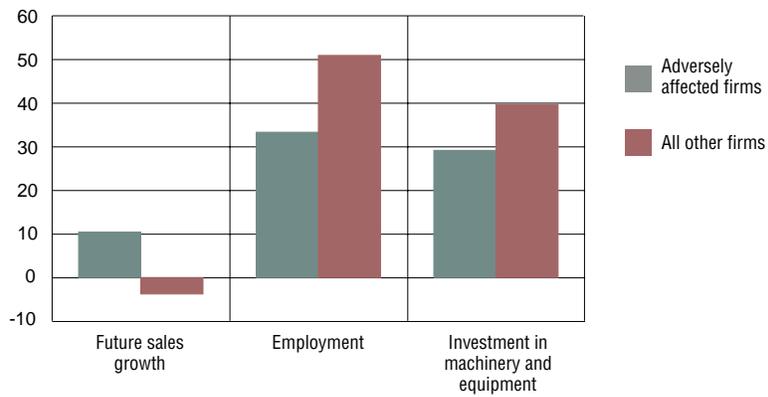


Chart 6: Balance of Opinion¹ on Selected Variables



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