BANK OF CANADA
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Business Outlook Survey

Conducted by the Bank's Regional Offices

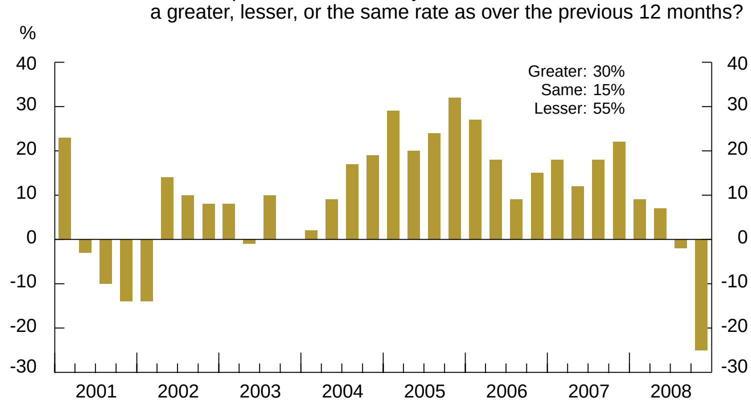
Results of the Winter 2008–09 Survey   Vol. 5.4 12 January 2009

Overview

- Business sentiment has deteriorated markedly since the autumn survey, as the effects of the international financial crisis and the weak global economy intensified and spread to domestic demand. Almost all indicators are at their lowest level since the survey began in 1997.
- Firms expect sales growth to slow over the next 12 months, and the level of uncertainty about sales prospects has risen, with risks skewed to the downside. The balances of opinion for both investment and employment have turned negative.
- Reported pressures on production capacity decreased. The expected pace of price increases has fallen, largely reflecting the recent drop in commodity prices. Expectations for inflation over the next two years have also declined considerably.
- The percentage of firms reporting tighter credit conditions reached a record-high level.

Chart 1 **Past Sales Growth: Balance of Opinion***

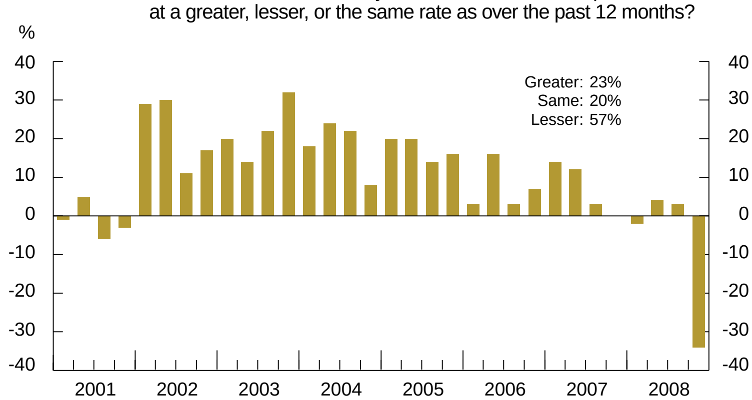
Over the past 12 months, did your firm's sales volume increase at a greater, lesser, or the same rate as over the previous 12 months?



* Percentage of firms reporting faster growth minus percentage reporting slower growth

Chart 2 **Future Sales Growth: Balance of Opinion***

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?



* Percentage of firms expecting faster growth minus percentage expecting slower growth

Business Activity

The balance of opinion on past sales has fallen significantly, reaching its lowest level since the Bank began the *Business Outlook Survey* in 1997 **(Chart 1)**. Similarly, firms expect sales growth to decelerate further over the next 12 months **(Chart 2)**, and many anticipate an outright decline in their sales volume. Rising expectations of a severe recession in the United States are negatively affecting the sales

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 survey's purpose is to gather the perspectives of these businesses on topics of interest to the Bank of Canada (such as demand and capacity pressures) and their forward-looking views on economic activity. Additional information on the survey and its content is available on the Bank of Canada's website at <www.bankofcanada.ca/en/bos/index.html>. The winter 2008–09 survey was conducted from 14 November to 12 December 2008.*

The opinions expressed are those of the respondents and do not necessarily reflect the views or policies of the Bank of Canada. 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.

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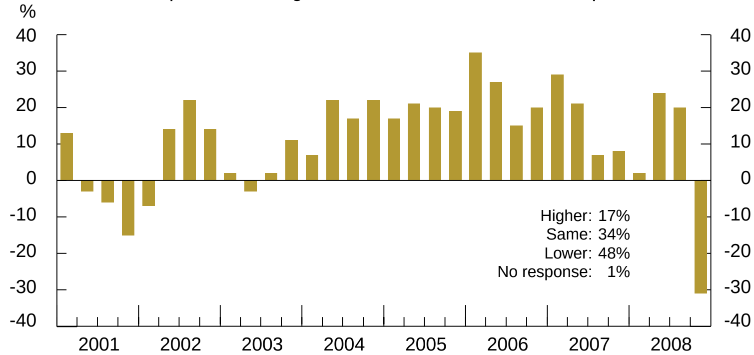
prospects of many firms. In addition, more firms indicated significant downside risks to their sales outlook, owing to the high level of uncertainty stemming from current global economic and financial conditions.

The balance of opinion on investment intentions has fallen from the solid positive position of the past two surveys, suggesting that firms will invest less over the next 12 months **(Chart 3)**. Many firms have curtailed planned investment in response to the weaker economy, tighter credit conditions, and falling commodity prices. The replacement or repair of existing equipment is the most frequently cited target for investment spending.

Chart 3 Investment in Machinery and Equipment: Balance of Opinion*

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?

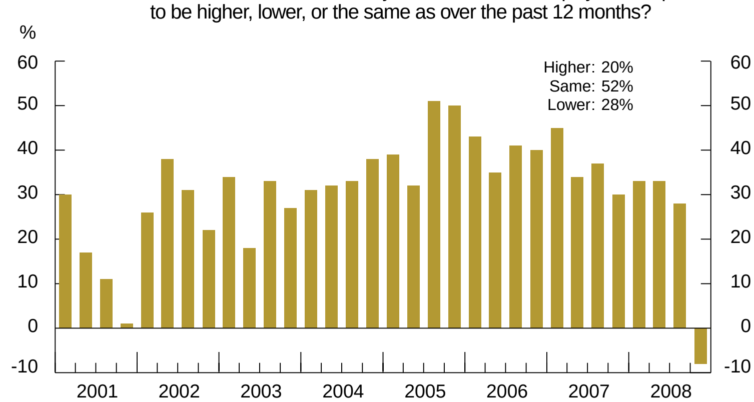


* Percentage of firms expecting greater investment minus the percentage expecting less investment

The balance of opinion on employment has turned negative for the first time in the survey's history **(Chart 4)**, indicating that firms expect the level of employment to contract over the next 12 months. Hiring intentions are lower among firms in the goods sector than for those operating in the services sector.

Chart 4 Future Employment Level: Balance of Opinion*

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?



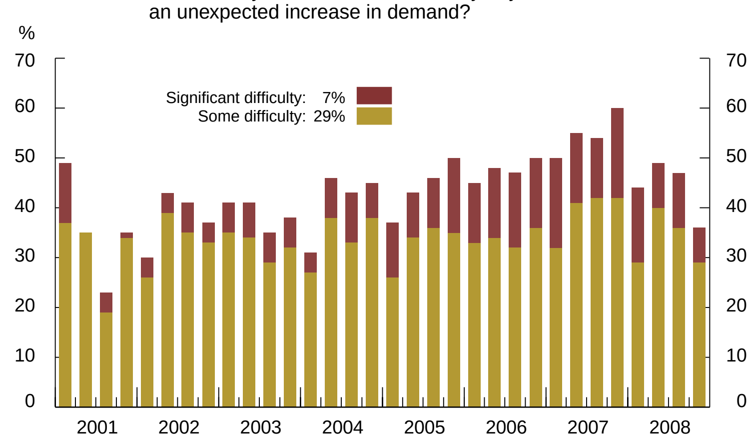
* Percentage of firms expecting higher levels of employment minus the percentage expecting lower levels

Pressures on Production Capacity

Reflecting the recent slowdown in sales, the percentage of firms reporting that they would have difficulty meeting an unexpected increase in demand has fallen, but not as much as other survey indicators would suggest **(Chart 5)**. Many firms are indicating that the level of demand remains reasonable or are working off past backlogs. Nonetheless, pressures on production capacity are well below levels reached in 2007.

Chart 5 Ability to Meet Demand

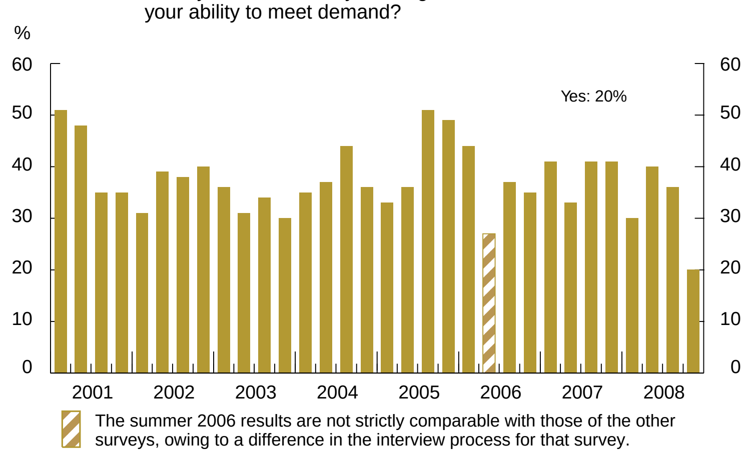
How would you rate the current ability of your firm to meet an unexpected increase in demand?



The balance of opinion can vary between +100 and -100. Percentages may not add to 100 because of rounding.

Chart 6 Labour Shortages

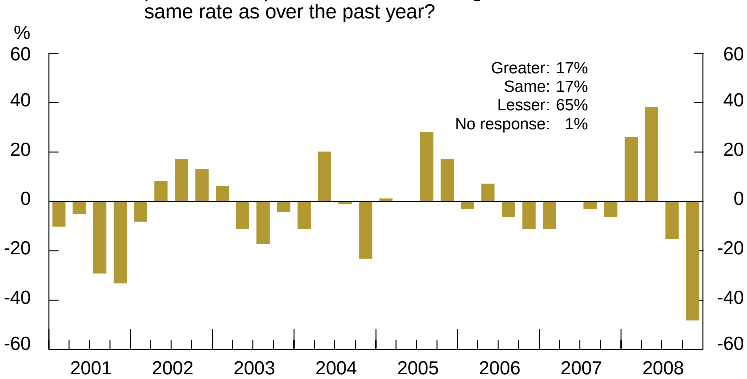
Does your firm face any shortages of labour that restrict your ability to meet demand?



The percentage of firms reporting that labour shortages are restricting their ability to meet demand fell sharply to a record-low level **(Chart 6)**. Much of the decline occurred in Western Canada, where labour constraints have been more prevalent than in the rest of the country for the past few years.

Chart 7 Input Price Inflation: Balance of Opinion*

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 year?



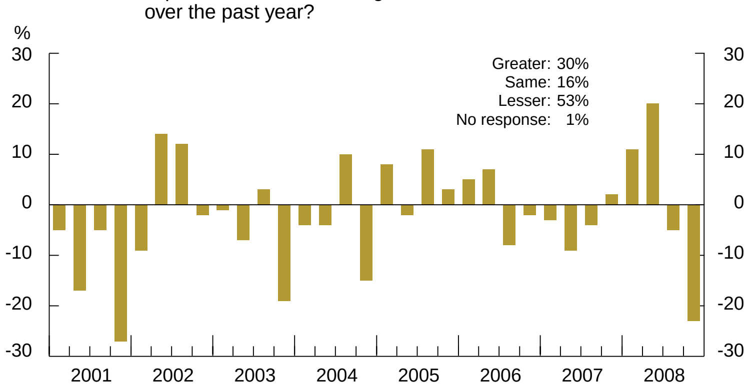
* Percentage of firms expecting greater price increases minus the percentage expecting lesser price increases

Prices and Inflation

For the second consecutive survey, firms expect slower growth in input prices over the next 12 months **(Chart 7)**, and many believe that input prices will decline. This view mainly reflects the recent drop in commodity prices and the expected impact that this will have on the prices of key inputs. Some firms also felt that, faced with weaker demand, suppliers will need to lower prices to move their inventories.

Chart 8 Output Price Inflation: Balance of Opinion*

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 year?



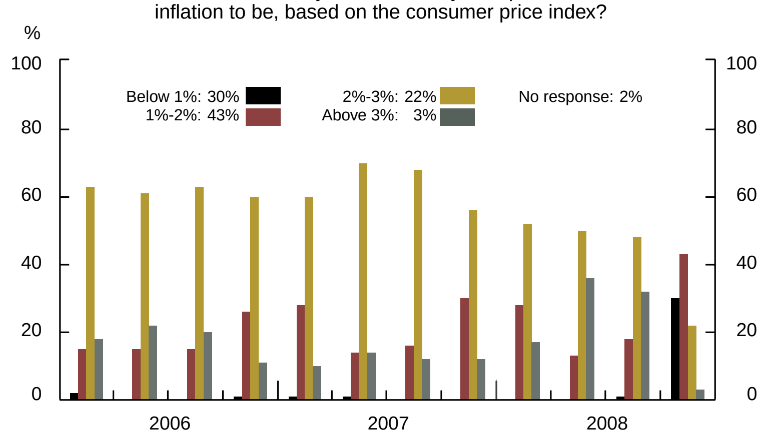
* Percentage of firms expecting greater price increases minus the percentage expecting lesser price increases

The balance of opinion on output prices also suggests that firms expect their output prices to grow at a slower pace than over the past 12 months **(Chart 8)**. Weaker demand conditions and the intention to pass on some of the lower cost of inputs to customers were the main factors underlying this result. Both the goods and services sectors expect a slowdown in the growth of output prices.

Inflation expectations have declined significantly **(Chart 9)**. Nearly three-quarters of firms expect inflation to be below the 2 per cent target midpoint of the Bank's inflation-control range over the next two years. Only 3 per cent of firms feel that inflation will exceed the range's upper bound of 3 per cent, compared with about a third of firms in the previous survey. Falling commodity prices, especially for oil and related energy products, and the weaker economic environment are the main factors cited for the change in expectations.

Chart 9 Inflation Expectations

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

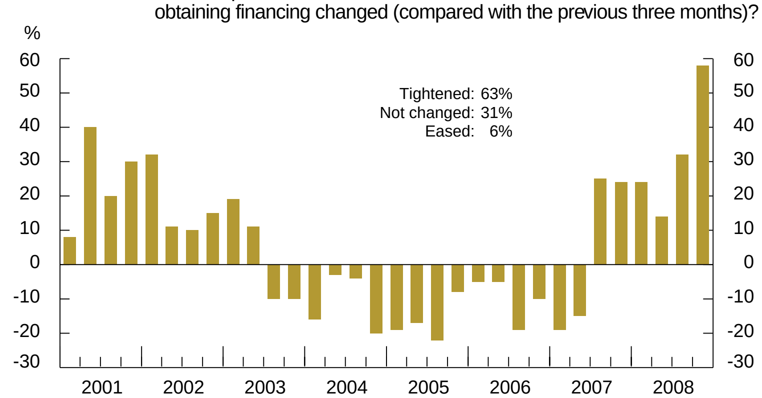


Credit Conditions

The balance of opinion on credit conditions reached a record-high level in the winter survey, as nearly two-thirds of firms reported tighter credit conditions over the past three months relative to the previous three months **(Chart 10)**. The majority of these firms characterized the change as being significant and felt that it was driven mainly by a market-wide adjustment in risk premiums. Most firms reported that the tightening came in the form of higher borrowing costs. The deterioration in credit conditions is widespread across sectors.

Chart 10 Credit Conditions: Balance of Opinion*

Over the past three months, how have the terms and conditions for obtaining financing changed (compared with the previous three months)?



* Percentage of firms reporting tightened minus percentage reporting eased. For this question, the balance of opinion excludes firms that responded "not applicable."

Bank of Canada offices

Atlantic Provinces
1583 Hollis Street, 5th Floor
Halifax, Nova Scotia B3J 1V4

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
404 – 6th Avenue SW, Suite 200
Calgary, Alberta T2P 0R9

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

HEAD OFFICE
234 Wellington Street
Ottawa, Ontario K1A 0G9
1 877 782-8248