BANK OF CANADA
BANQUE DU CANADA

Business Outlook Survey

Conducted by the Bank's Regional Offices

Results of the Autumn 2009 Survey

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Overview

- Responses to the autumn survey suggest that the Canadian economy is recovering, as all indicators of business activity have increased since the summer survey. However, because firms continue to expect activity to pick up only gradually, they remain cautious regarding investment.
- Pressures on production capacity have fallen further, from an already low level. Nonetheless, the balances of opinion on both input and output prices have increased compared with the past few surveys, largely reflecting firmer commodity prices. Inflation expectations are well anchored, however, with a vast majority of firms anticipating that inflation will remain within the Bank's target range over the next two years.
- Credit conditions appear to have stabilized over the past three months, following several quarters of tightening.

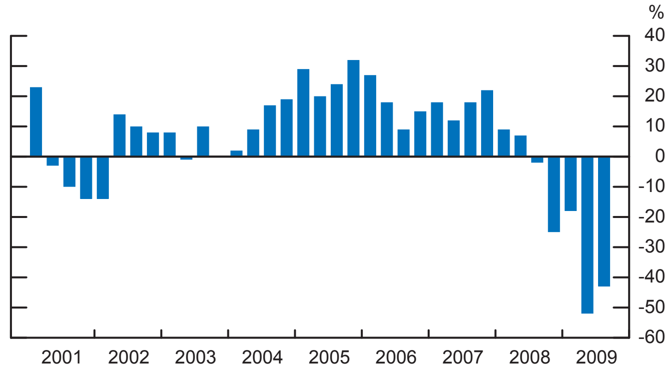
Business Activity

Businesses have continued to experience slower sales growth over the past 12 months **(Chart 1)**, and many reported an outright decline in sales volumes. However, the responses to the survey suggest that the economy is recovering. Because this is the first recession since the survey began in 1997, it is not surprising that the balance of opinion on future sales growth has reached its highest recorded level **(Chart 2)**. This suggests that firms expect sales to grow at a faster rate over the next 12 months. Some

Chart 1: The balance of opinion on past sales growth remains negative . . .

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?



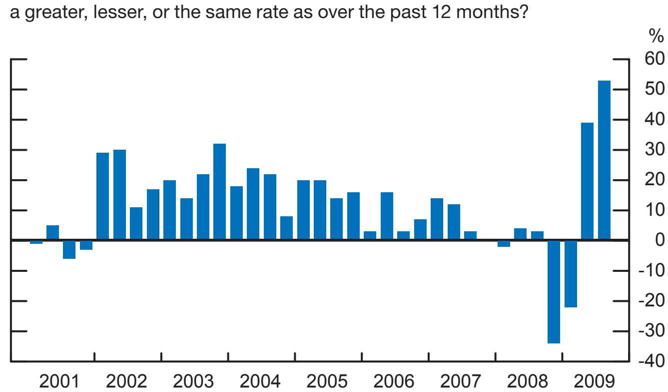
Greater: 22% Same: 13% Lesser: 65%

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

Chart 2: . . . but expectations for future sales growth continue to improve

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?



Greater: 69% Same: 15% Lesser: 16%

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

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 autumn 2009 survey was conducted from 24 August to 17 September 2009. The balance of opinion can vary between +100 and -100. Percentages may not add to 100 because of rounding.*

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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firms have already seen signs of recovery in their sales indicators, but most expect the pickup in activity to be only gradual. Expectations for the U.S. economy have also improved over the last two surveys, and a majority of firms now anticipate at least some growth in economic activity in the United States.

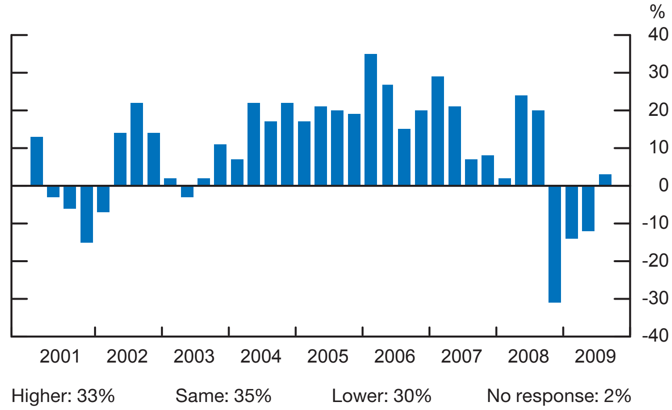
Following three consecutive quarters of negative balances of opinion, firms expect investment in machinery and equipment to be about the same as over the past 12 months **(Chart 3)**. Because they have considerable excess capacity, businesses remain cautious about investment, and spending is focused on repairs and replacement of existing equipment, rather than on expansion. Firms in Central and Eastern Canada expect to increase investment spending, while those based in Western Canada continue to plan on reduced investment.

The balance of opinion on employment has increased slightly from the summer survey **(Chart 4)**. Firms in all regions now expect to increase their level of employment over the next 12 months as activity rises.

Chart 3: Firms expect investment in machinery and equipment to be about the same as over the past 12 months

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?

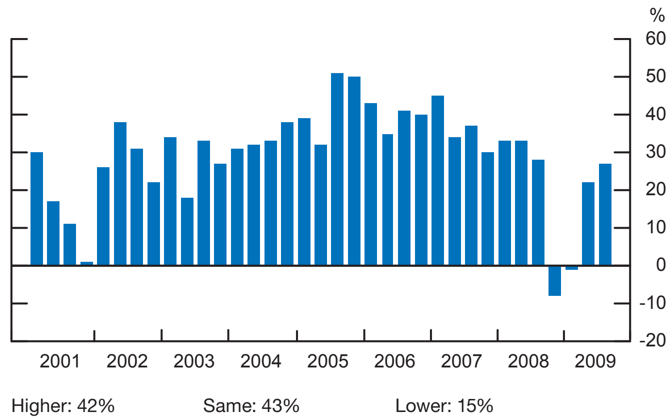


* Percentage of firms expecting greater investment minus the percentage expecting less investment

Chart 4: Hiring intentions continue to improve

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

The percentage of firms reporting that they would have difficulty meeting an unexpected increase in demand has fallen further, reaching a record low **(Chart 5)**. Most firms have excess capacity, which they expect to persist for at least the next six months, anticipating that demand will recover slowly.

Chart 5: Pressures on production capacity are at a record low

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

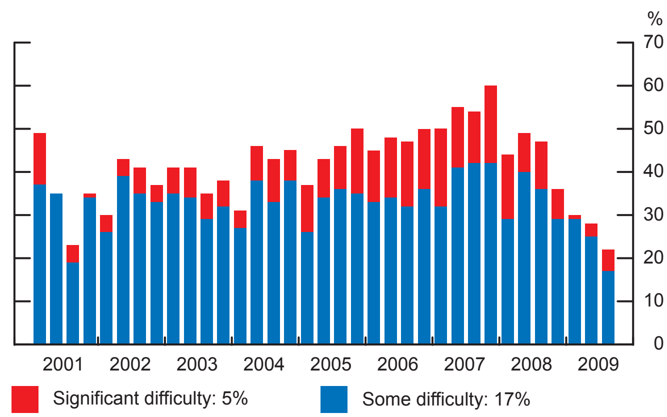
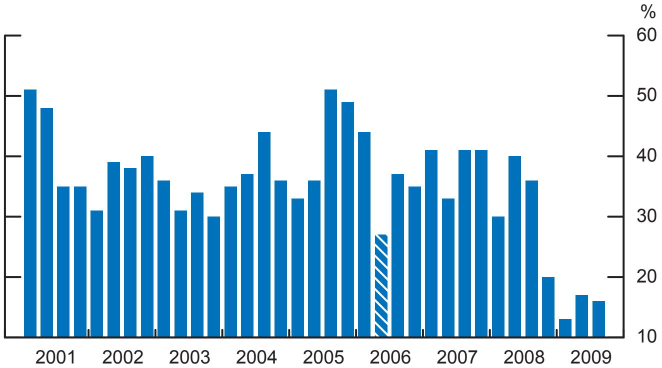


Chart 6: Few firms report labour shortages

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



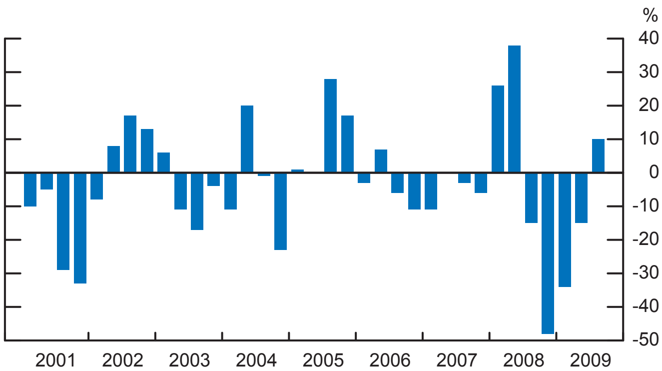
Yes: 16%

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.

Chart 7: The balance of opinion on input prices has turned positive

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 12 months?



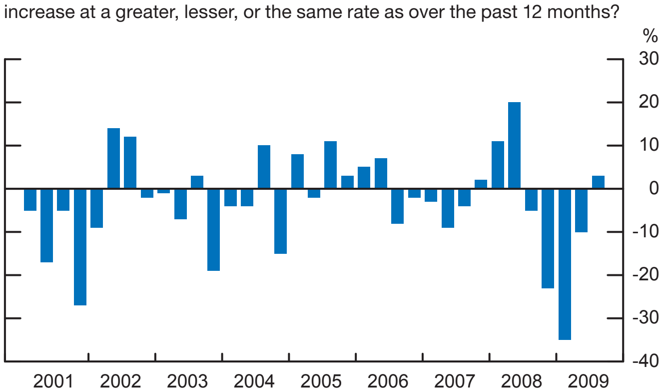
Greater: 37% Same: 36% Lesser: 27%

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

Chart 8: Output prices are expected to grow at about the same pace as over the past 12 months

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 12 months?



Greater: 37% Same: 28% Lesser: 34% No response: 1%

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

As in the previous three surveys, only a small percentage of firms report that labour shortages are restricting their ability to meet demand **(Chart 6)**. Owing to the decline in economic activity, skilled labour resources are now readily available.

Prices and Inflation

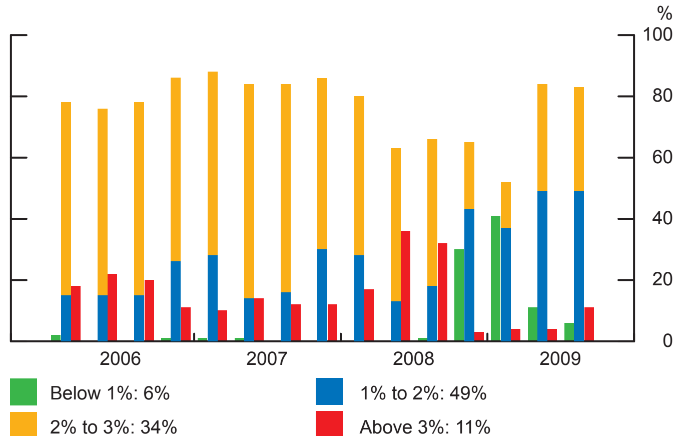
Following four quarters of negative readings, the balance of opinion on input prices has turned positive **(Chart 7)**, indicating that firms expect input prices to grow at a faster pace over the next 12 months. Anticipated increases in commodity prices are the most frequently cited factor driving these higher expectations. The balances of opinion in both the goods and services sectors have risen, but the increase was more significant for goods-producing firms, since they are more sensitive to commodity prices.

Similarly, the balance of opinion on output prices has increased to a level just above zero, suggesting that firms expect output prices to grow at about the same pace as in the previous 12 months **(Chart 8)**. This change is driven mainly by firms operating in the goods sector. Many of these firms plan to pass some of the expected increase in commodity prices on to their customers, and others want to restore their profit margins as demand recovers. Overall, far fewer firms than in the past three surveys foresee price reductions.

A high percentage of firms continue to expect total CPI inflation to be within the Bank's target range of 1 to 3 per cent for the next two years. This result is virtually unchanged from the summer survey **(Chart 9)**.

Chart 9: Inflation expectations appear to be well anchored

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



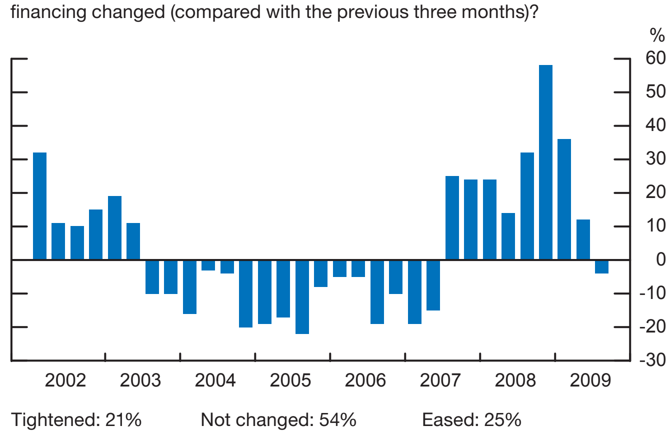
Credit Conditions

For the first time since the summer 2007 survey, prior to the start of the financial market turmoil, the balance of opinion on credit conditions has fallen to just below zero, suggesting that conditions have stabilized over the past three months **(Chart 10)**. This follows several quarters of tightened conditions. Access to credit has improved primarily for large businesses, and firms that source their financing from capital markets continue to be more likely to cite an easing in credit conditions. In addition, of the firms that borrow from domestic banks, fewer indicate a tightening.

Chart 10: Credit conditions have stabilized over the past three months

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."

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