BANK OF CANADA
BANQUE DU CANADA

Business Outlook Survey

Conducted by the Bank's Regional Offices

Results of the Autumn 2011 Survey Vol. 8.3 17 October 2011

Overview

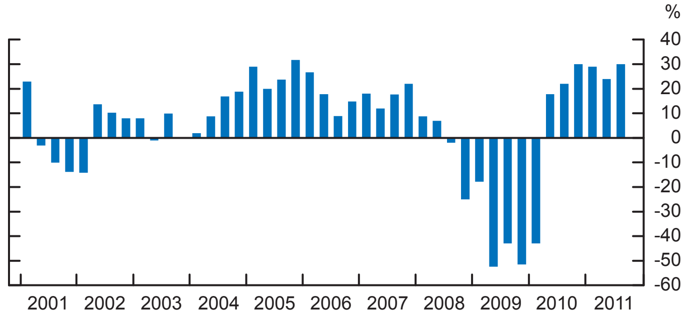
- Responses to the autumn survey point to less optimism among firms than in the summer survey, as weaker expectations for U.S. growth and a more uncertain global outlook weigh on business sentiment. Indicators of future business activity, capacity constraints and price pressures have all moved down from the levels recorded in the previous survey.
- The balance of opinion on future sales growth has fallen to just above zero, indicating that firms now expect little change in the pace of growth over the next 12 months. Businesses still intend to increase investment and employment, but the balances of opinion are lower.
- On balance, firms expect increases in input costs to stabilize over the next 12 months, and foresee output prices rising at a slower pace. Expectations for inflation over the next two years have declined.
- The balance of opinion on credit conditions continues to point to an easing, but to a lesser degree than in the summer survey.

Business Activity

Driven by robust sales activity over the past 12 months among firms in Western Canada or those that are tied to commodities, the balance of opinion on past sales growth remains strongly positive (**Chart 1**). The balance of opinion on future sales growth (**Chart 2**) has fallen to just above zero, however, as a weaker U.S. economic outlook and

Chart 1: Firms report higher sales growth over the past 12 months . . .

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?

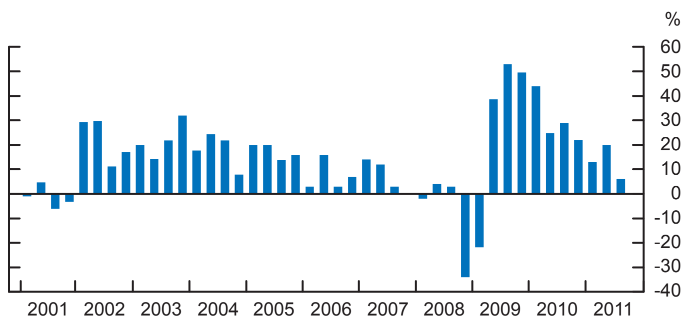


Greater: 53% Same: 24% Lesser: 23%

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

Chart 2: . . . but expect little change in the pace of growth over the next 12 months

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: 39% Same: 28% Lesser: 33%

* 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. The autumn 2011 survey was conducted from 22 August to 22 September 2011. 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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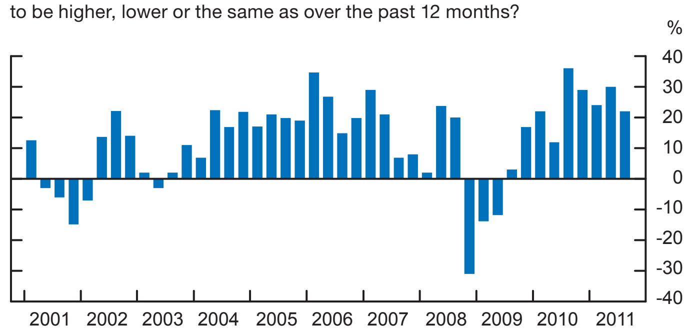
global uncertainty weigh more heavily on sales expectations, and fewer commodity-related firms expect sales to increase at a rate above that experienced over the past 12 months. Amid concerns about the level of demand, many firms forecasting an increase in sales growth over the next 12 months reported that they expect to achieve this by introducing new products or by adopting strategies to increase market share.

The balance of opinion on investment in machinery and equipment remains solidly positive, although it has moderated since the summer survey (**Chart 3**). While the balance continues to point to an increase in investment over the next 12 months, a number of firms reported a more cautious approach to their capital spending plans, and a few reported that projects may be put on hold, given the uncertainty in the current economic environment. Overall, more firms cited plans to repair or replace existing equipment than in the summer survey.

Chart 3: Firms expect to increase investment in machinery and equipment, but are somewhat more cautious

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?



Higher: 41% Same: 40% Lower: 19%

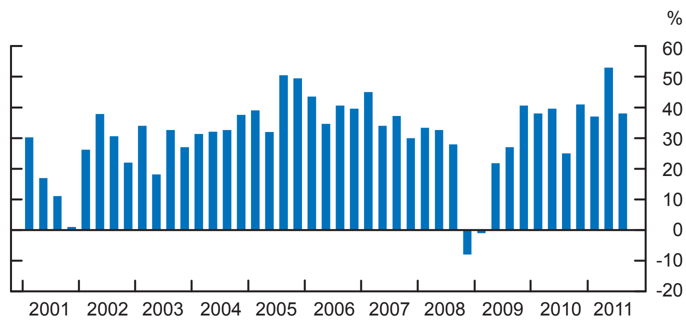
* Percentage of firms expecting higher investment minus the percentage expecting lower investment

The balance of opinion on employment also remains positive but has declined from the record high observed in the summer survey (**Chart 4**). Intentions to increase employment over the next 12 months continue to be widespread across regions and most sectors.

Chart 4: Intentions to increase employment have moderated from a record high

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?



Higher: 52% Same: 34% Lower: 14%

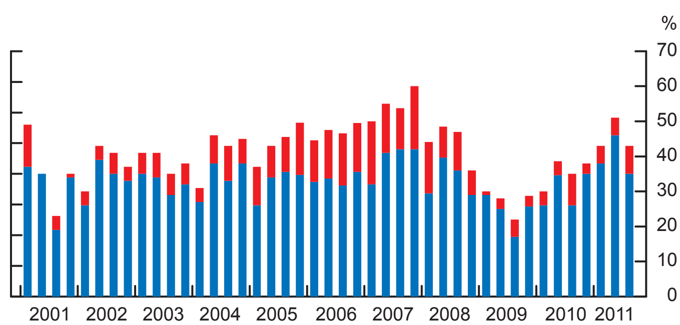
* Percentage of firms expecting higher levels of employment minus the percentage expecting lower levels

Pressures on Production Capacity

The indicator of capacity pressures moved down in the autumn survey, owing to a decline in the percentage of firms reporting that they would have some difficulty meeting an unexpected increase in demand (**Chart 5**). The change was driven by fewer reports of capacity pressures among firms in Central and Eastern Canada. Given the high level of activity in the commodity sector, capacity constraints continue to be more prevalent in the Prairies region than elsewhere.

Chart 5: Capacity pressures have moved down . . .

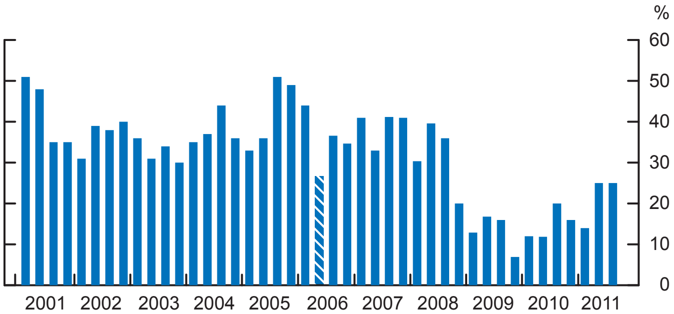
How would you rate the current ability of your firm to meet an unexpected increase in demand?



Significant difficulty: 8% Some difficulty: 35%

Chart 6: . . . and reports of labour shortages are unchanged

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



Yes: 25%

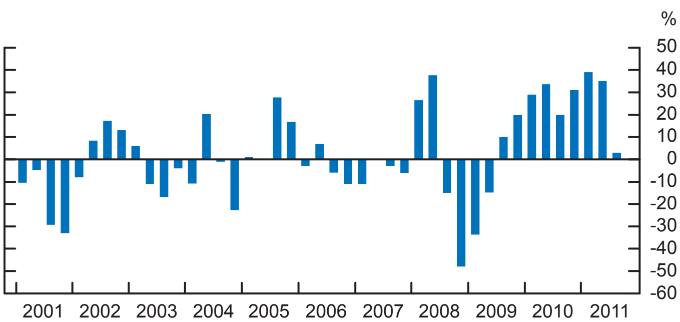
The summer 2006 results are not strictly comparable with those of the other surveys, owing to a difference in the interview process for that survey.

The percentage of firms reporting shortages of labour restricting their ability to meet demand is unchanged from the summer survey (**Chart 6**), and remains below the average for the survey. Labour shortages are more evident in the goods sector, where some firms report difficulty recruiting skilled workers.

Chart 7: Firms expect input prices to rise at about the same rate . . .

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: 26% Same: 48% Lesser: 23% No response: 3%

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

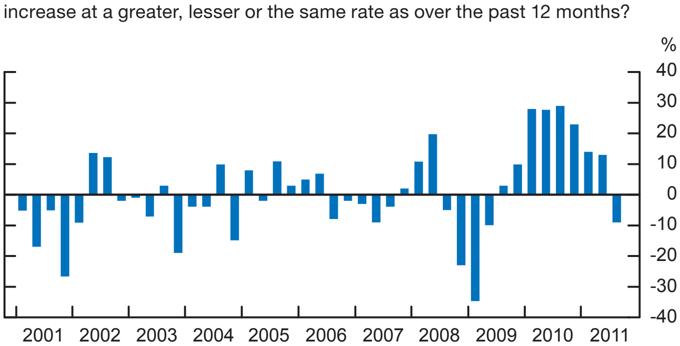
Prices and Inflation

The balance of opinion on input prices has fallen close to zero, indicating that firms expect the cost of inputs to rise at about the same pace as over the past 12 months (**Chart 7**). Relative to recent surveys, considerably fewer firms anticipate that commodity prices will put further upward pressure on input costs over the next 12 months. The drop in the balance of opinion on input prices was most pronounced in the goods sector.

Chart 8: . . . and output prices to increase at a slower rate

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: 24% Same: 41% Lesser: 33% No response: 2%

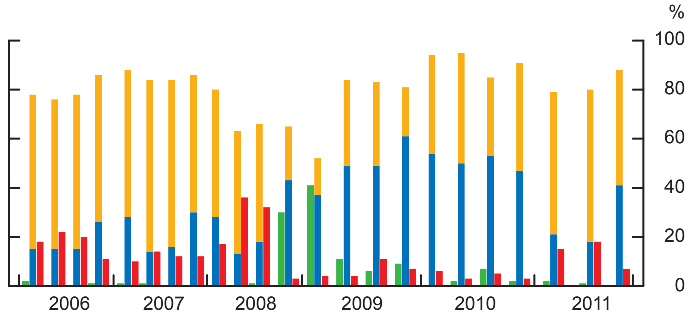
* Percentage of firms expecting greater price increases minus the percentage expecting lesser price increases

The balance of opinion on output prices turned negative, suggesting that firms expect their output prices to rise at a slower pace over the next 12 months (**Chart 8**). The decline in the balance of opinion was driven mainly by a shift in expectations among businesses in Central and Eastern Canada. These firms often cited weaker demand or intense competition as factors in the expected slowing in the pace of output price increases. Commodity producers also generally expect their output prices to rise less rapidly over the next 12 months.

In line with expectations of less pressure on input and output prices and a weaker global economic outlook, firms have lowered their expectations for total CPI inflation over the next two years (**Chart 9**). A larger proportion of firms than in the summer survey expect inflation to be between 1 and 2 per cent, and the percentage of firms anticipating that inflation will exceed 3 per cent has declined. As a result, inflation expectations are now more heavily concentrated in the Bank's inflation-control range of 1 to 3 per cent, and have become more evenly split across the upper and lower half of that range.

Chart 9: Inflation expectations are concentrated within the Bank's inflation-control range

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



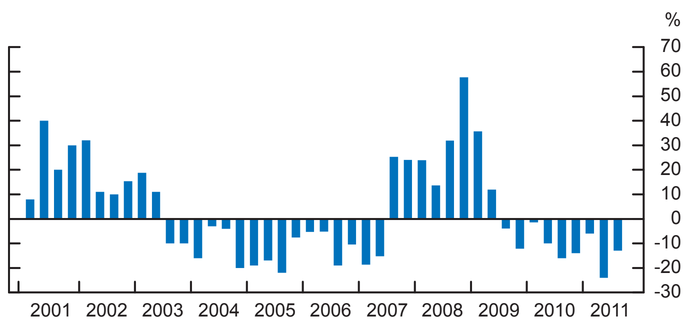
Credit Conditions

The balance of opinion on credit conditions remains negative (**Chart 10**), suggesting a net easing in the terms and conditions for obtaining financing over the past three months. Reports of easing were concentrated among small and medium-sized firms and those that primarily borrow funds from financial institutions. Among large firms and those sourcing financing from domestic capital markets, some businesses reported that the costs of raising capital have increased, owing to recent volatility in financial markets. This contributed to the rise in the overall balance of opinion from its record low in the summer survey.

Chart 10: Credit conditions eased 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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