BANK OF CANADA
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Business Outlook Survey

Results of the Autumn 2017 Survey | Vol. 14.3 | October 16, 2017

Results from the autumn Business Outlook Survey *point to continued positive business sentiment across the country, with business activity becoming entrenched. Firms' prospects remain healthy, although several survey indicators have moderated from the strong summer results.*

Overview

- Building on solid results in the summer, responses to the autumn survey reflect expectations for sustained sales growth across regions, with firms in some sectors anticipating a return to a more sustainable pace. Overall positive sales prospects rest on an ongoing turnaround of activity in energy-producing regions and supportive foreign demand.
- Investment and employment indicators softened from recent highs, pointing to continued, though somewhat less widespread, plans to increase investment and hiring.
- There is a generalized view among firms that capacity and labour market pressures have intensified over the past year, suggesting that slack is being absorbed amid robust demand. That said, difficulties in meeting demand and reports of binding labour shortages are not yet widespread.
- Expectations for growth of input and output prices are stable, as an uptick in costs for labour and non-commodity inputs is offset by the recent appreciation of the Canadian dollar. After two years of little change, inflation expectations moved up but remain modest overall.
- Credit conditions, beyond the increase in the policy rate, are unchanged; for the majority of firms, access to credit remains easy, or relatively easy.
- The Business Outlook Survey indicator, which summarizes the survey results, declined from its high level in the summer survey but remains positive and continues to point to healthy business sentiment.

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 the gross domestic product of Canada's business sector. This survey was conducted from August 24 to September 19, 2017. The balance of opinion can vary between +100 and -100. Percentages may not add to 100 because of rounding. Additional information on the survey and its content is available on the Bank of Canada's website. The survey results summarize opinions expressed by the respondents and do not necessarily reflect the views of the Bank of Canada.

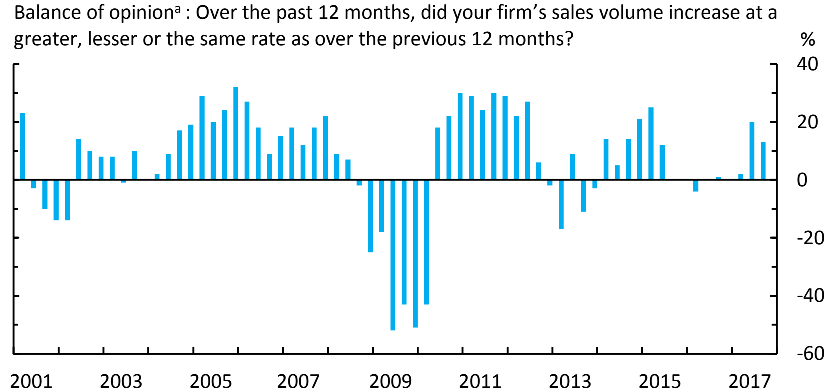
Business Activity

After recovering in the summer survey, the balance of opinion on past sales growth edged down but remains positive (**Chart 1**). While sales activity accelerated for the first time since the energy downturn for firms in affected regions, some businesses experienced a moderation in growth after a strong year. Prospects for the coming 12 months remain robust; a large majority of firms foresee a rise in sales volumes, with some further pickup in sales growth (**Chart 2**, blue bars), suggesting that growth is becoming entrenched. For domestic sales, a number of firms expect a return to a more sustainable pace (in housing, retail trade and tourism, for example). Following recent restructuring efforts in the energy sector, affected firms are cautiously optimistic about their sales prospects, as a turnaround in activity is starting to be felt in the related supply chain. The sales outlook is backed by yet another widespread year-over-year improvement in indicators of future sales (**Chart 2**, red line and **Box 1**).

Foreign demand is also providing a lift to export prospects, with firms reporting improved orders from foreign customers compared with 12 months ago. Expectations for US growth have moderated somewhat from recent surveys, but respondents expect foreign demand for commodities and the still-supportive level of the Canadian dollar to underpin their exports. Despite lingering uncertainty about US policies, most firms reported no impact on the outlook for their business.

Chart 1: After recovering in the summer survey, the indicator of past sales growth remains positive

Balance of opinion[a] : 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?

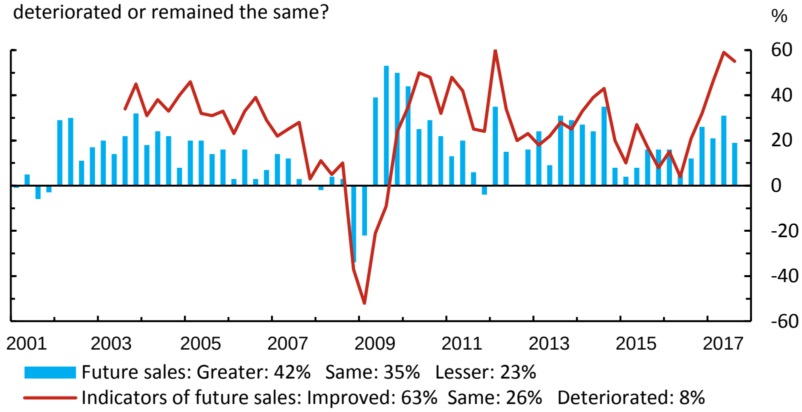


Greater: 42% Same: 29% Lesser: 29%

a. Percentage of firms reporting faster growth minus the percentage reporting slower growth

Chart 2: Firms expect sales growth to pick up, supported by a further widespread improvement in indicators of future sales

Future sales (balance of opinion)[a]: 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?
Indicators of future sales (balance of opinion)[b]: Compared with 12 months ago, have your recent indicators (order books, advance bookings, sales inquiries, etc.) improved, deteriorated or remained the same?

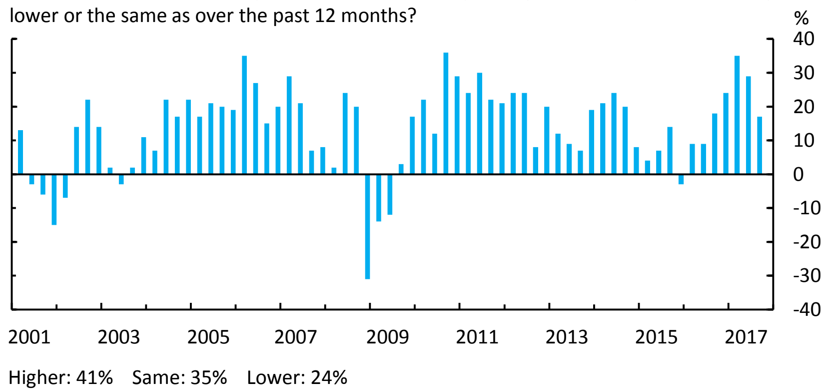


a. Percentage of firms expecting faster growth minus the percentage expecting slower growth
b. Percentage of firms reporting that indicators have improved minus the percentage reporting that indicators have deteriorated

The balance of opinion on investment receded closer to its historical average, indicating that plans to increase spending over the next 12 months are somewhat less widespread than in the previous two surveys (**Chart 3**). In several cases, firms are completing recent projects. Driven by firming domestic demand, investment plans often relate to the expansion of operations, as well as to improving efficiency, for example, through automation. Respondents most often reported investing in equipment and technologies such as customer-facing solutions and software to enhance operational efficiency.

Chart 3: The balance of opinion on investment intentions moderated from elevated levels

Balance of opinion[a]
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?



a. Percentage of firms expecting higher investment minus the percentage expecting lower investment

The indicator of employment intentions fell back after surging in the summer survey (**Chart 4**). Hiring intentions nevertheless remain positive across all regions and continue to be elevated in the service sector, where firms often cited sound demand as a reason for adding staff. At the same time, hiring intentions in the goods sector have moderated, following the recovery observed in previous surveys.

Chart 4: The indicator of employment intentions softened after surging in the summer survey

Balance of opinion[a]

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: 48%   Same: 38%   Lower: 14%

a. Percentage of firms expecting higher levels of employment minus the percentage expecting lower levels

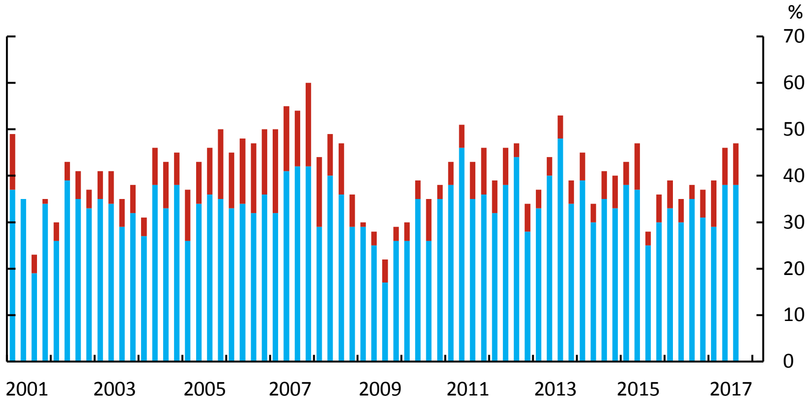
Pressures on Production Capacity

After increasing in the summer survey, the indicator of capacity pressures is roughly unchanged (**Chart 5**). Although the degree of slack differs across regions, there is a widespread view that capacity pressures have increased over the past 12 months, and, on balance, firms expect pressures to intensify over the next year. Capacity constraints are more prevalent in the goods sector: as in the summer survey, firms most often referred to sales growth and labour-related constraints as reasons for difficulties in responding to an unexpected increase in demand.

Firms are increasingly reporting that labour shortages are more intense than a year ago, pushing the indicator of labour shortage intensity to its highest level since the 2008–09 recession (**Chart 6**, red line). Reports of more intense shortages are prevalent across all regions and sectors, pointing to tightening labour markets. Yet, the number of firms judging that such shortages are limiting their ability to meet demand is unchanged and remains modest overall (**Chart 6**, blue bars). Slack remains in energy-producing regions, and, so far, binding shortages are prevalent only in hot sectors such as tourism, construction and information technology, where some firms reported raising wages in response. Finding talent in more remote areas and replacing retirees are also challenges for some firms.

Chart 5: The share of firms reporting difficulties meeting an unexpected increase in demand is roughly unchanged

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

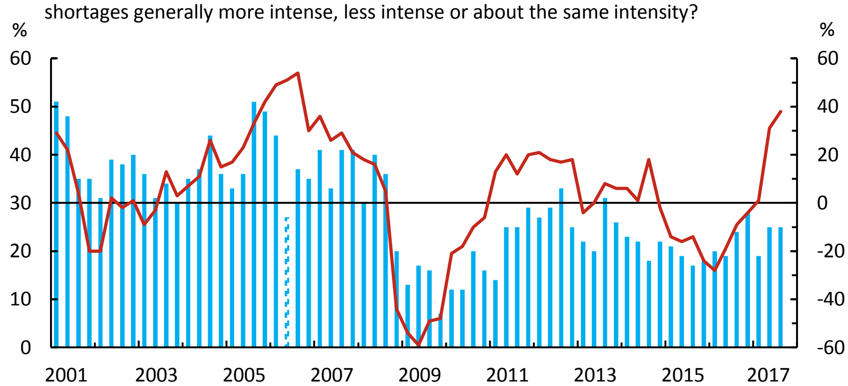


Some difficulty: 38%   Significant difficulty: 9%

Chart 6: Labour shortages are becoming more intense, although the number of firms reporting binding shortages remains modest

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

Intensity of labour shortages (balance of opinion)[a]: Compared with 12 months ago, are labour shortages generally more intense, less intense or about the same intensity?



Labour shortages (left scale): Yes: 25%   Intensity of labour shortages (right scale): More intense: 41% Same intensity: 56% Less intense: 3%

a. Percentage of firms reporting more intense labour shortages minus the percentage reporting less intense shortages

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.

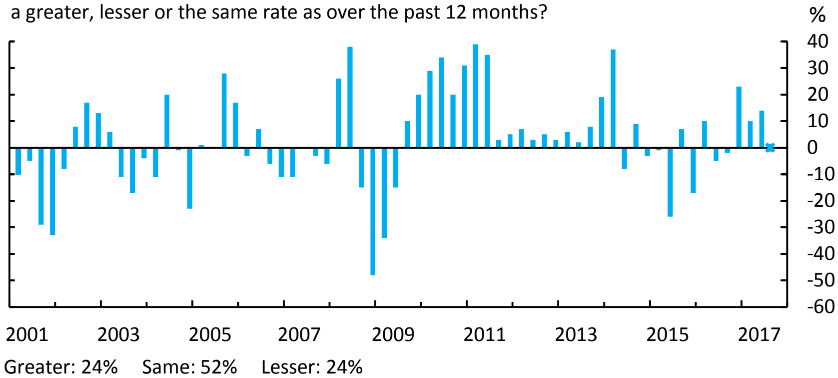
Prices and Inflation

Firms expect input price growth to remain similar to that observed over the past 12 months, as indicated by the zero balance of opinion (**Chart 7**). The majority expect no change in the pace of input cost growth, although several firms, particularly in Western Canada, cited a pickup in prices of non-commodity inputs such as subcontractor prices. However, some offset to increasing costs is coming from lower prices for imported inputs due to the recent appreciation of the Canadian dollar.

Chart 7: Firms expect stable cost growth over the next 12 months

Balance of opinion[a]

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?



a. Percentage of firms expecting greater price increases minus the percentage expecting lesser price increases

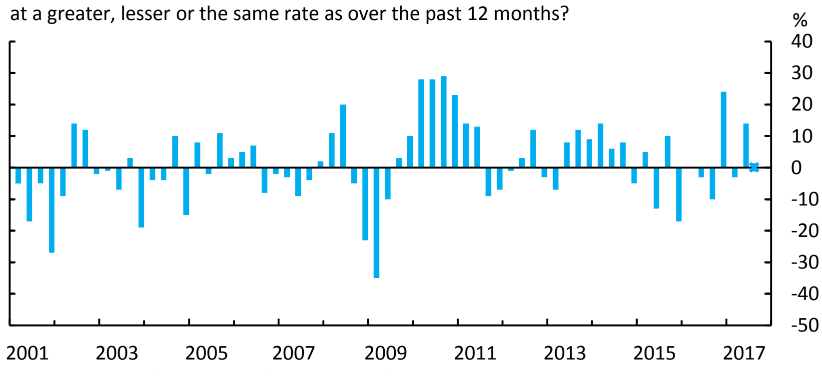
* Indicates a balance of opinion of zero

The balance of opinion on output prices also fell to zero in the autumn survey (**Chart 8**), implying stable output price growth ahead. Several firms plan to pass on lower costs for imported inputs to their customers, and exporters now receive lower export prices expressed in Canadian dollars. These downward pressures on sales prices from the recent appreciation are partly offset by emerging labour cost pass-through. Some businesses also sense that demand is firm enough to support upcoming price increases.

Chart 8: Respondents foresee little change in the rate of sales price growth

Balance of opinion[a]

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?



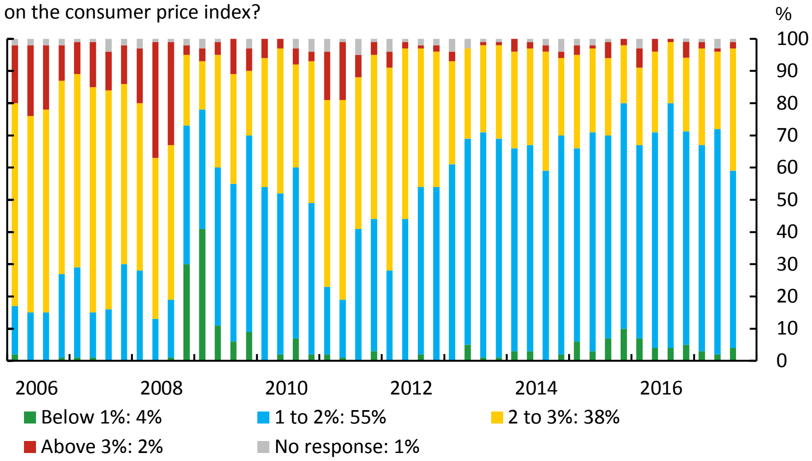
a. Percentage of firms expecting greater price increases minus the percentage expecting lesser price increases

* Indicates a balance of opinion of zero

For the first time since the energy downturn, inflation expectations marked a small gain (**Chart 9**), with somewhat more firms expecting consumer price growth to be in the upper half of the Bank's inflation-control range. Although still the minority, these firms referred to a strong economy and minimum wage increases as contributing factors. Most respondents still expect below 2 per cent price growth, based on the recent trend in inflation.

Chart 9: Inflation expectations moved up after a period of little change

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



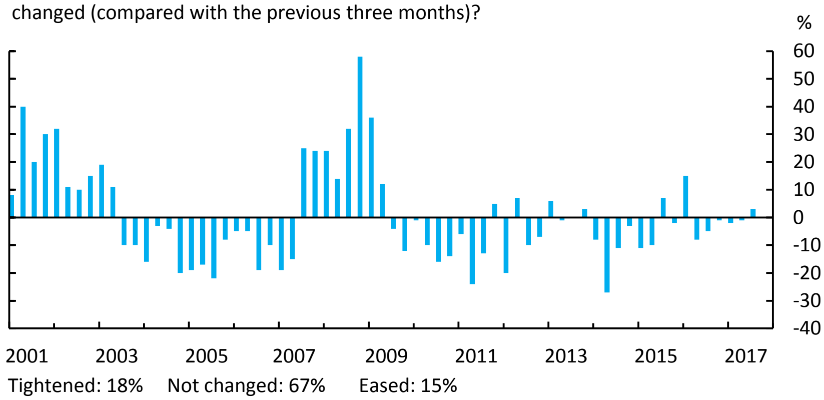
Credit Conditions

As in recent surveys, credit conditions remained unchanged, beyond the direct effect of the increase in policy rates (**Chart 10**).[1] Some firms, particularly small and medium-sized firms in industries related to commodities and real estate, reported higher borrowing costs or tighter non-price conditions. Meanwhile, a few others cited more favourable borrowing rates or an improvement in market receptiveness to new issuance of debt or equity, which they often attributed to a recent improvement in their performance.

Chart 10: As in recent surveys, credit conditions were unchanged

Balance of opinion[a]

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



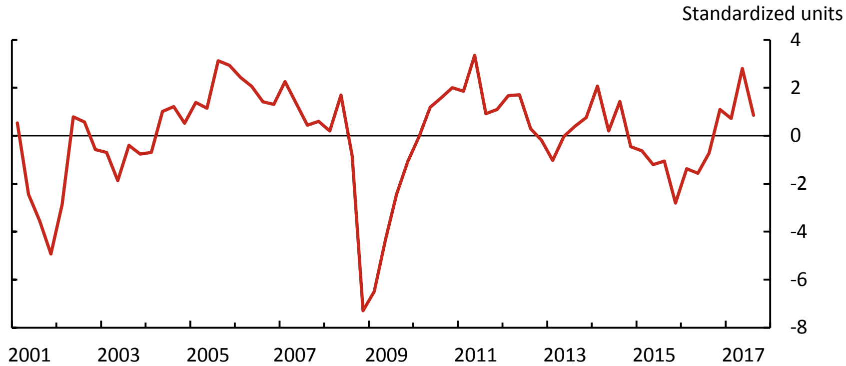
a. Percentage of firms reporting tightened minus the percentage reporting eased. For this question, the balance of opinion excludes firms that responded "not applicable."

[1] As in the *Senior Loan Officer Survey*, firms are asked about the cost of credit, expressed as *spreads over base rates* rather than as the level of rates. Thus, if borrowing costs increase by no more than the recent increase in the policy rate (meaning that the spread over the prime rate is unchanged), credit conditions as reported in the survey are unchanged.

Business Outlook Survey Indicator

The Business Outlook Survey (BOS) indicator, a summary measure of the main survey questions, decreased from its elevated level in the summer survey (**Chart 11**). It remains positive, however, with several BOS survey questions holding above their historical averages, indicating that business sentiment continues to be healthy overall.

Chart 11: The BOS indicator[a] retreated from its elevated level



a. The BOS indicator extracts common movements from the main BOS questions. For a description and interpretation of the indicator, see Box 1 in the Spring 2017 *Business Outlook Survey* and L.Pichette and L. Rennison "Extracting Information from the Business Outlook Survey: A Principal-Component Approach," Bank of Canada Review (Autumn 2011): 21–28.

Box 1

A Generalized Improvement in Indicators of Future Sales Points to Sustained Growth Ahead

Firms participating in the *Business Outlook Survey* are asked to evaluate how their indicators of future sales (such as order books, advance bookings and sales inquiries) have changed compared with 12 months ago (**Chart 2**, red line). The aggregate indicator is therefore based on firms' concrete signs of future sales activity. It shows a strong forward-looking correlation with GDP growth, providing useful signals for future trends in economic activity.[1]

In the autumn survey, the balance of opinion on indicators of future sales remained firmly positive, edging down only slightly from the historical high reached in the summer survey. Firms cited a building backlog of work, more calls and interest from clients, lower vacancy rates, new business or product lines, and new markets or customers. Some also mentioned an uptick in sales after consolidation in their industry or returns on their own efforts to seize business opportunities.

Nevertheless, some caution persists. A few firms believe that the comeback in energy-related activity is tapering off or that oil prices below US$50 per barrel are still too low to foster optimism. Potential policies and protectionist sentiments south of the border also remain a concern. A couple of firms also expressed unease about the housing market outlook amid rising mortgage rates and stricter regulations.

Breaking down the results by region or sector provides a clearer illustration of the drivers and dynamics of firms' sales indicators. **Chart 1-A** shows the contributions to the overall balance of opinion by region. While the Prairies were a drag on the overall result for much of the energy downturn, firms in this region reported a net improvement in more recent surveys with the turnaround in the energy sector. In fact, all regions are now aligned to contribute positively. Similarly, analysis by sector provides evidence that all sectors are participating in the recent upswing (**Chart 1-B**). Taken together, the results show a generalized upturn in sales prospects and point to sustained GDP growth ahead.

Chart 1-A: Indicators of future sales have improved in all regions

Contribution to balance of opinion[a]

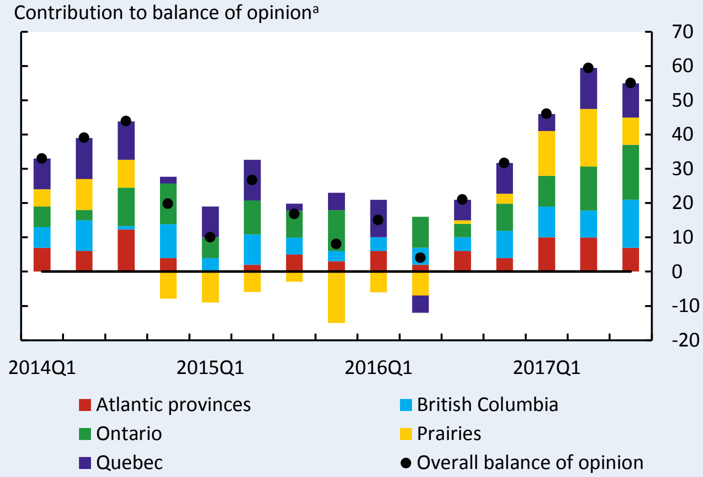
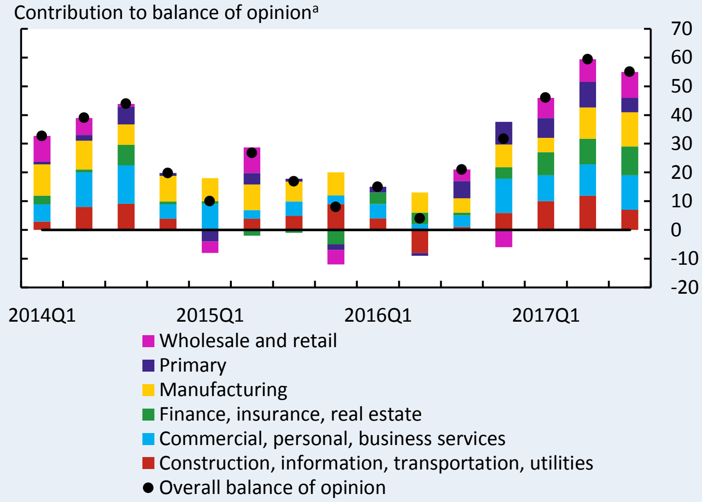


Chart 1-B: All sectors show a year-over-year improvement in indicators of future sales

Contribution to balance of opinion[a]



a. Percentage of firms reporting that recent indicators have improved compared with 12 months ago minus the percentage of firms reporting that indicators have deteriorated
Note: Regional and sectoral results rely on a small sample size.

[1] For background information on this series, see the "Backgrounder on the Business Outlook Survey Question on Future Sales Indicators" on the Bank's website.

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