Canadian Dollar Over-Reacts To BoC's Survey

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- You know it's a slow day in currency markets when the Canadian dollar appreciates by a half cent on the back of a stale survey that sheds mixed signals. Granted, Trump's 'almost there' NAFTA remarks are somewhat caught up in the market response now (albeit amidst mixed autos headlines). The limitations of a small survey sample size and hence high sample error are always added reasons for market caution. I believe the survey should be discounted in terms of market relevance. The BoC would be informed by this survey, but more focused upon what its forecasts and other sources of information are saying as Governing Council is fully aware of the survey's usefulness and limitations.

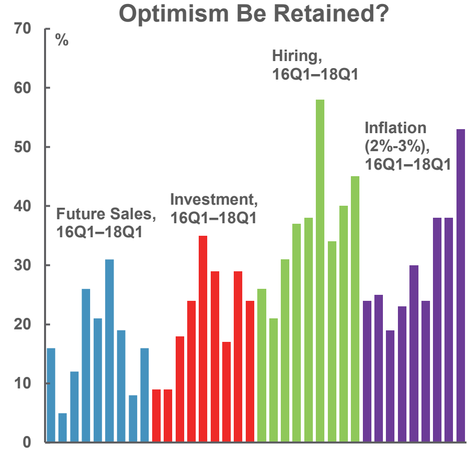
- The survey was conducted from Feb 12th to March 9th so it is 1-2 months out of data on NAFTA headlines and it doesn't capture anything related to US-China tariffs. It's likely that had the survey been conducted over the past couple of weeks, the results could well have been worse. Going forward, there is momentum to the NAFTA talks but how that may trade off against increased tensions between the US and China in terms of business attitudes is very uncertain.

- **The sales outlook slightly improved which is positive, with caveats.** The net percentage of firms expecting stronger growth over the next year than the past year improved to 16 from 8 the prior month. This measure captures the spread between the percentage of firms saying they expect higher sales over the next year minus the percentage saying they expect slower sales. Therefore all that happened is that 8% more of respondents swung more favourably. In a sample of about 100 firms, that means that eight of them were more upbeat about hiring plans. Uh huh. That's not a big deal in my opinion especially given sampling error that could well envelop the swing. Further, the Canadian economy has been stuck in a trap of one-handled average quarterly GDP growth through 2017H2-2018Q1 and so businesses may simply be saying—like our forecasts—that this was primarily a transitory cooling in the wake of the brought-forward growth due to the prior explosion in child benefit payments from Ottawa. In all, I don't see much materially new info to our forecasting exercises or the BoC's on this component.

- **Hiring intentions improved only by being somewhat less negative than the prior two quarters.** Is being less bearish more bullish? Is losing less often much better for a sports team? Meh. I suppose technically so, but it's not very convincing. In fact, it still says that about 55% of firms expect lower employment over the next twelve months. The rise in this component just says it's less negative on the net percentage of firms expecting lower employment in the prior survey, but it is still mildly negative and a signal of lost hiring momentum. Woo hoo!

- **Fewer firms are reporting labour shortages.** 26% of firms said they face shortages which is down from 30% the prior quarter and this brings the labour shortages reading in line with its long-run historical average which isn't terribly hawkish as a signal on wage developments. That said, a net 35% of firms continue to report *more* intense labour shortages than less intense shortages now than a year ago which is unchanged from the prior quarter's reading of 35% and more intense doesn't mean *intense* as indicated by the overall response on labour shortages.

Business Outlook Survey: Will C-Suite Optimism Be Retained?



Sources: Scotiabank Economics, Bank of Canada.

- **Investment intentions cooled a little**. The net percentage of firms saying they plan on increasing investment over the next year compared to the last year slipped from 29 to 24. That's still constructive and 5% fewer firms saying they plan to increase investment is not to be treated very seriously given sample error. But recall StatsCan's investment intentions survey for machinery and equipment investment that is a very slightly positive signal after subtracting inflation from the nominal planned increase (see chart below). The BoC's survey does not subtract inflation and does not give any sense of the weighted dollars that go with the net percentage of firms variable. Also recall that about two-thirds of equipment spending by Canadian businesses tends to be imported and so the fact that investment has done nothing for two quarters after ironing out a transitory effect of changes to emissions regulations on January 1st also tends to downplay some of the investment optimism here. It makes sense for firms at capacity limits—or beyond—to be contemplating more investment, assuming it goes into Canada given trade uncertainties and a deterioration in relative tax competitiveness. But the combined array of sources is not terribly bullish toward business investment prospects in my opinion.

- **On capacity pressures, fewer firms are signalling worries.** 47% of firms say they would have some difficulty meeting an unexpected increase in demand (35% 'some' and 12% 'significant' difficulty) which obviously implies that 53% of firms say they would have no difficulty. The 47% figure is down from 56% the prior quarter which signals less concern about capacity limits. In all, 88% of firms are saying they would face either no capacity pressures or 'some' which doesn't really sound terribly hawkish to me.

- **Price pressures moved up, but I think businesses are telegraphing more about what has already happened to several input and output prices than necessarily what they fear going forward.** These surveys can be significantly adaptive in nature as businesses extrapolate what they think has already happened to price pressures (e.g. commodity changes over the past year, firming 'core' prices, higher minimum wages, etc.). The net percentage of firms reporting they expect higher output prices over the next year than the past year inched up from 2% in Q4 to 6% in Q1. Big deal and well captured by sampling error.

- **The composition shift behind inflation expectations may be more material** as the share of firms saying they expect inflation to ride at 2-3% over the next two years climbed to 53% from 38% while the 1-2% inflation category fell to 41% from 56%. Is that a hawkish signal? In my opinion, **that's kind of just telling us what we already know:** CPI inflation crossed 2% to 2.2% in February on a combination of sustainable (capacity pressures, wage ties, etc.) and transitory influences across several price categories. Businesses are just reaffirming the data we already know and we expect inflation to hang it at or slightly north of 2%.

- The net percentage of firms saying they expect to pay more for inputs over the next year than the last year slipped to 22% from 26% the prior quarter. Again, this is a small change given sampling error.

- **Firms reporting tightened financial conditions at the margin increased** to 18% from 12% previously which is small and probably statistically insignificant but the deterioration makes sense given rate hikes and broader market developments.

- The survey contained **special questions on the impact of US policy changes or associated uncertainty**. There was a small deterioration in the assessment of the impact of US policy measures over the next year which makes sense, but again, the survey period is 1-2 months out of date already and doesn't capture the possible competing effects if there is more constructive evidence on the NAFTA front at the same time that global trade policy risks have deteriorated.

- Please see the accompanying chart showing the trends in some of the survey's components.

- Please go here for the BoC's full write-up of the Business Outlook Survey.