October 22, 2019

BoC's BOS & SLOS Offer A Mixed Picture

- Overall sales growth expectations are holding firm…
- …with improved cap-ex intentions…
- ...but softened hiring intentions…
- ...as capacity pressures rise
- The survey offers weak tracking of actual behaviour
- Inflation expectations remain in the lower half of the BoC's target range
- Credit conditions eased for mortgages…
- ...but tightened for non-mortgage consumer lending…
- ...and held unchanged for business lending products
- Implications for the BoC

This Business Outlook Survey (here) was fairly good on balance but it settles little about the policy outlook facing the Bank of Canada. CAD appreciated a little and the two year Canada yield reversed some of the earlier rally after the survey was released.

Chart 1 summarizes recent trends in several of the key component gauges. Businesses are signaling slowing sales growth, continued expectations for future sales growth, improved cap-ex plans and softer hiring intentions. At the same time, they are signalling that capacity pressures are increasing including through more acute labour shortages. On net, however, businesses are indicating little expected pressure on inflation and continue to indicate they expect inflation to be in the lower half of the BoC's target range. The survey's tracking abilities are nevertheless of limited usefulness.

The companion Senior Loan Officer Opinion Survey (here) also came in fairly healthy on balance and mostly due to the easing of mortgage credit conditions. Mortgage lending conditions eased through pricing decisions which isn't new information to anyone monitoring mortgage lending conditions in the open market but non-mortgage consumer lending conditions tightened somewhat due to both price and non-price variables. Business lending conditions were unchanged in Q3.

The component measure of future sales expectations held firm at 23 and thus retained the improvement of the prior two quarters. That is despite the escalating risks to the global outlook into the survey reference period that covered August 20th to September 13th.

Having said that, the pace of improvement has levelled off according to the separate question on whether indicators like orders, advance bookings and sales inquiries have improved compared to a year ago. Further, it's worth observing that the future sales expectations reading typically turns too late; for instance, it only dipped negative in Q3 of 2008 amidst ample evidence by then of deep challenges facing the outlook.

Other positives included that investment intentions improved somewhat with a net +28% of firms saying they expect to raise rather than lower cap-ex compared to the previous 20% in Q2.

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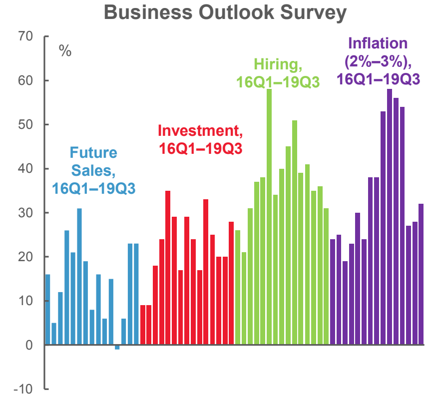
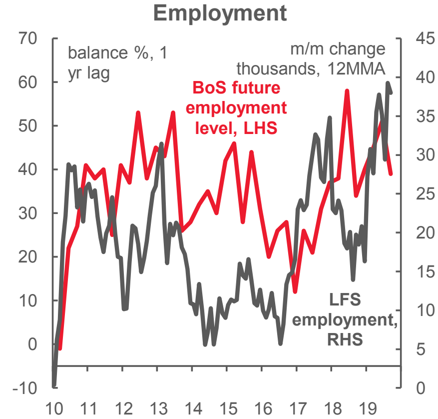
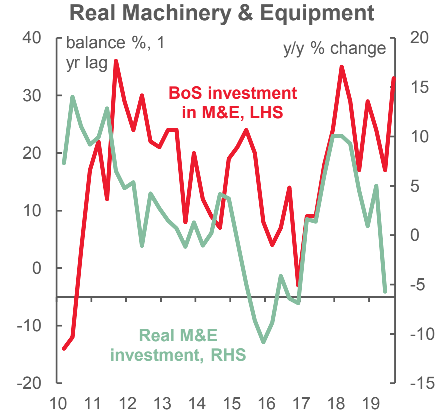


Sources: Scotiabank Economics, Bank of Canada.



Sources: Scotiabank Economics, Bank of Canada, Statistics Canada.



Sources: Scotiabank Economics, Bank of Canada, Statistics Canada.

Hiring intentions weakened a little with a net 31% of firms expecting to expand the number of employees over the next year (36% prior). That's the lowest share since 2016Q3.

How do investment intentions and hiring intentions track actual data? Not very well as charts 2 and 3 depict. When hiring and investment intentions over the coming year are plotted against actual hiring and investment both lagged out a year, the result is that a) the BOS is much more volatile than actual behavior which isn't surprising for sentiment surveys, and b) that inventions don't track actual behavior with a degree of reliability that anyone would be wise to hang their hats upon.

Reported capacity pressures also increased. Half of businesses reported they'd have either some difficulty (37% of firms) or significant difficulty (13%) meeting an unexpected increase in demand. That's not a cycle peak, and it still says half of businesses don't face any capacity pressures, but it's a sizeable jump from a combined 31% of firms in Q1 who said they were capacity constrained back then.

Price expectations eased somewhat. A net 7% of firms now expect the pace of cost increases to slightly ease. A net 5% of firms expect to keep raising output prices, but this is very slightly weaker than the prior report and not exhibiting cyclical strains on inflation.

In fact, businesses' inflation expectations remain skewed to the lower half of the BoC's inflation target range. An unchanged 64% of firms expect inflation to land between 1–2% over the coming year. The BoC's policy target range is 1–3% with a 2% mid-point. Businesses are signaling unmoored expectations

Thus, we continue to face an outlook in which inflation expectations derived from both business expectations and market expectations like the 5 and 10 year RRBs breakevens are tracking in the lower half of the BoC's inflation target zone.

Why does this matter? It offer a Canadian parallel to the Fed's arguments. After years of perennially missing its inflation target (chart 4) and with expectations riding beneath the target, perhaps the BoC should emphasize the symmetry of its 2% target and indicate a willingness to tolerate a mild overshoot for a period. At the margin, that may require adding stimulus.

Canadian Core Inflation

Sources: Scotiabank Economics, Statistics Canada.

Indeed, if the Fed is determined to go along this policy path with its current policy review then through the BoC may be dragged along with it through the implications for the exchange rate. If the Fed cuts on top of the BoC's overnight rate by month-end and quite possibly cuts again and the longstanding negative BoC-Fed policy rate differential turns positive, then CAD risks being ignited by hot money flows. There is no MCI or type 1 and type 2 framework surrounding currency effects today as the BoC utilized in the past. That does not mean the currency is irrelevant to the country's export competitiveness, the rotation of the sources of growth toward net exports and all in the context of great uncertainties facing the outlook for global trade policy and the world economy.

Overall, the survey and its tracking abilities should carry little influence upon BoC decisions. Hard data on activity and inflation readings, forward looking global event risks, an inverted Canada yield curve and spillover effects from foreign central bank actions notably the Fed's all matter much more. The surveys reinforce our expectation that while the BoC will probably revise its world and domestic growth forecasts lower in the October 30th MPR, it will continue to monitor conditions at home and abroad and potentially return with easing thereafter.