Canada: November SME Sentiment Falls Back to March Levels

- **Small- and medium-sized enterprise (SME) sentiment dropped back to March levels, but the index remained in optimistic territory at 56.1. Still, this is well below the average of 61.7 for January 2011–present.**
- **Alberta and Saskatchewan led the decline at the regional level, with volatile natural resources posting the largest sectoral drop.**
- **In the details, SMEs' capex intentions are up, but hiring plans turned negative on increased concerns about domestic demand and general business health.**

MIXED MESSAGES IN A DOWNBEAT READING OF SME SENTIMENT

The Canadian Federation of Independent Business' (CFIB) monthly Business Barometer Index, a product of a survey of 10,000 small- and medium-sized enterprises (SMEs), remained in optimistic territory at 56.1 in November, but this was down 3.7 points from October and took the overall index back to its lowest level since March 2019 (chart 1). The index now sits 5.6 points lower than its decanal average since January 2011. The index is constructed on a scale between 0 and 100, with readings above 50 indicating that more than half of SME owners expect their business to perform more strongly in the coming year. The Barometer tends to move concurrently with real GDP growth, which we expect to lift gently in Canada from 1.6% in 2019 to 1.8% in 2020 (chart 2), as detailed in our Q4 *Global Outlook*.

At the regional level, the retreat in sentiment was widespread as the index came down in 7 out of 10 of the provinces (chart 3). Alberta and Saskatchewan led the decline in sentiment, with drops of almost 9 and 6 points, respectively, which meant that they were the only provinces where the Index was below 50. British Columbia and Newfoundland & Labrador were the only other provinces where the index was below the national average, but both remained above the 50 mark. Regional SME sentiment continues to contrast strongly with our expectation that Alberta and BC will lead the provinces in growth next year (chart 4), though in both cases large projects are expected to fuel much of this rebound. Still, SMEs are likely to be indirect beneficiaries.

Softer sentiment extended across 9 of the 13 sectors surveyed (chart 5). Natural resources saw the biggest turn in sentiment, with an 8 point drop in its sectoral index. Although the sector's sentiment is consistently one of the most volatile surveyed, it still remained in expansionary territory at 52.7 in November, slightly below its average since January 2011. At 49.2, transportation was the only sector where more than half of SME owners expect their businesses to perform more weakly in the next year. Combined, both sectors account for over 12% of GDP.

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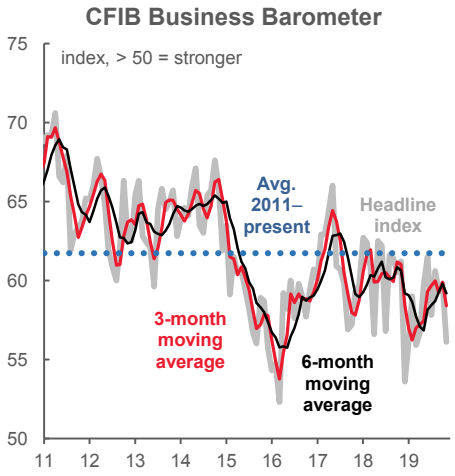
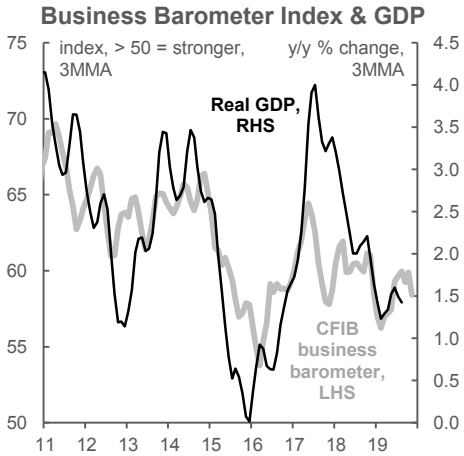
Chart 1



Sources: Scotiabank Economics, CFIB.

Chart 2



Sources: Scotiabank Economics, Statistics Canada, CFIB.

Overall, the Barometer appears to be tracking consistently more negatively than the Conference Board's Index of Canadian consumer confidence, but it has been moving in line with the Bloomberg Nanos Canadian Confidence or 'Economic Mood' Index (chart 6). Both surveys are based on four key questions: one on recent economic well-being; a second on near-term prospects; and a third on the job market. The fourth question in both surveys is concerned with the same issue—the valuation of a major household asset—but the Conference Board asks whether it is a good time to make a purchase, whereas the Bloomberg Nanos Index asks whether the value of real estate in one's neighbourhood is set to increase.[1] The same situation could reasonably prompt a positive answer to the Conference Board and a negative response to Bloomberg Nanos.

Chart 3

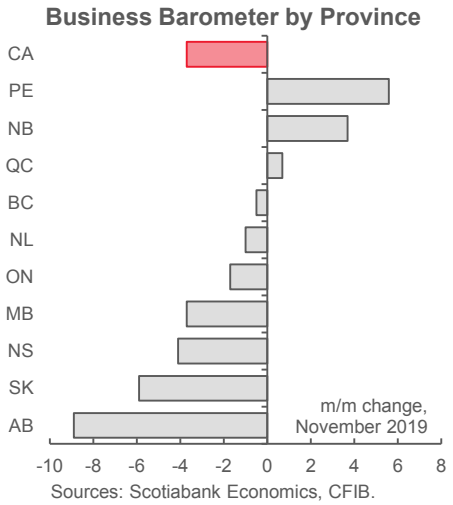


Chart 4

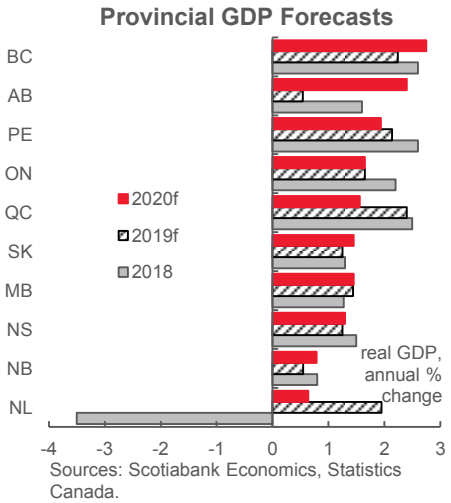


Chart 5

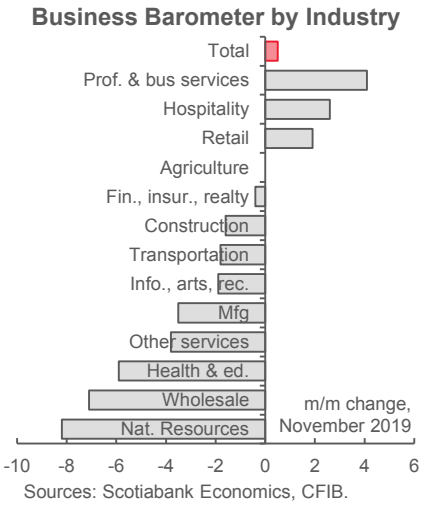


Chart 6

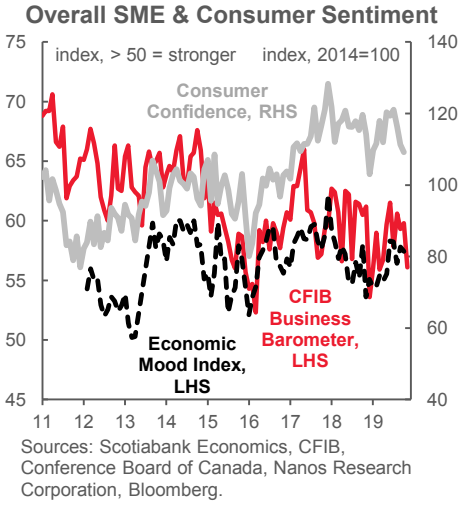
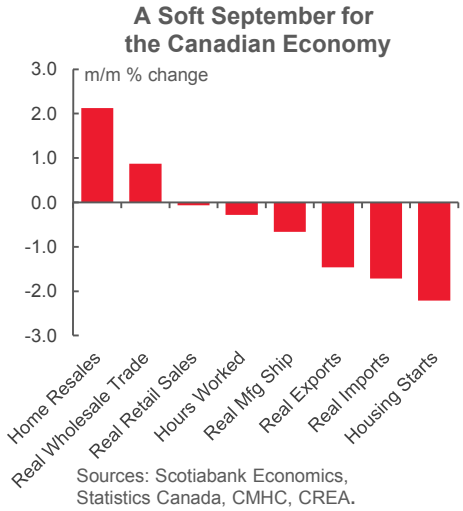


Chart 7



[1]The Conference Board Index of consumer confidence is constructed from responses to four attitudinal questions posed to a sample of Canadian households. Those surveyed are asked to give their views about their households' current and expected financial positions and the short-term employment outlook. They are also asked to assess whether now is a good or a bad time to make a major purchase of a big-ticket item such as a house or a car.

The Bloomberg Nanos Canadian Confidence Index (BNCCI) is a weekly measure of the economic mood of Canadians on the strength of the economy, job security, real estate in their neighbourhood, and their personal financial situation. They are asked, in terms of their personal finances, are they are better off, worse off, or the same over the past year? Would they describe their job, at this time, as secure, somewhat secure, somewhat not secure, or not at all secure? In the next six months, do they think the Canadian economy will become stronger, weaker, or will there be no change? In the next six months, do they believe that the value of real estate in their neighbourhood will increase, stay the same or decrease?

Looking into the details, November's Barometer provides some mixed messages, with investment plans up, hiring intentions down, heightened concerns about general business health and worries about domestic demand. The share of SMEs intending to make capital expenditures over the next three months increased from 50.6 in October to 54.0 in November, the highest reading since June. This squares with our expectation that investment growth in Canada will turn from a 2.3% contraction in 2019 to an expansion of 3.0% in 2020. At the same time, hiring intentions turned the most strongly negative they have been since December of last year, as the share of SMEs expecting to decrease staffing rose by 3.4 points; a greater share of firms expected to shed staff rather than add staff by the widest margin since December 2016. Although shortages of skilled and unskilled labour together remained by far the dominant constraint on production and sales, insufficient domestic demand saw a nearly 5 point jump in its reading, taking it to its highest level since April this year. This points to a possible softening in wage growth, which hit 4.3% y/y in October, more than twice headline inflation. The share of owners that assess their general business health as 'bad' jumped 8.1 points from October to 17.9, the highest reading since March 2016.

Altogether, November's SME sentiment readings are consistent with the weak end to Q3 and the soft hand-off into Q4 that we've seen in the macro data. Nearly all major high-frequency indicators, with the exception of wholesale trade, registered weak prints in September that together imply that growth was flat in that month (chart 7). Our Scotiabank Nowcast put Q3 growth at 1.25% q/q saar, in line with the Bank of Canada's 1.3% projection. Q3 GDP data will be released tomorrow. November's mixed SME sentiment indicators heighten the possibility that, going forward, growth could undershoot the Bank of Canada's 1.3% q/q saar projection for Q4.