

Bank of Canada Business Outlook and Senior Loan Officer Survey — Q1 Survey Says: BoC on Hold...For Awhile

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The Bank of Canada's Q1 **Business Outlook Survey** weakened sharply from the prior quarter, with the summary measure falling to the weakest level since 2016Q4. The survey was taken between February 19 and March 13, so it captured a good chunk of the rebound in oil prices. Even so, the Prairies remain a weak spot across the board. While nearly every question weakened from Q4, the BOS doesn't paint the picture of an economy falling off a cliff, but rather, one dealing with a meaningful soft patch.

Some of the details of the Q1 report:

The headliner was capacity pressures or the share of firms that would have **some or significant difficulty meeting an increase in demand** plunging to 31%, a three and a half year low. Labour shortages also declined sharply to 19%, a two-year low. According to the BOS, capacity "*pressures eased across all regions and sectors*" but "*they continue to be prevalent in Quebec and British Columbia*". Past investment/hiring contributed to fading pressures, though softer demand was cited as well. The decline is consistent with the weakness in Q4 GDP and expected Q1 GDP widening the output gap. Accordingly, it's going to take a period of above potential growth to narrow that gap, putting the Bank clearly on hold for now, consistent with what we heard from Governor Poloz over the weekend.

Future sales growth was the lone positive in the survey climbing 7 ppts and climbing back into positive territory. However, that's still about 10 ppts below long-run norms, so there's plenty of room to improve further. Meantime, employment and investment expectations both dropped and now sit around their long-term averages. These suggest there's no need for the BoC to panic and ramp up the chatter around rate cuts.

Putting it all together, the **BOS indicator**, a summary measure, plunged to -0.64 from 2.31, the first trip into negative territory since 2016Q3, "*suggesting a softening in business sentiment.*"

Inflation expectations moved lower as well.

Nearly two-thirds of firms (64%) expect inflation will be 1%-to-2%, nearly double the Q4 result driven by the softening economic backdrop. Most of the rest (27%) are in the 2%-to-3% camp (half of Q4's level). Don't be shocked if that reverses next quarter assuming energy hold relatively steady in the meantime. Meantime, input price expectations faded as the impact of tariff-related pressures fade. Output price expectations moved into negative territory for the first time in two



Bank of Canada Business Outlook Survey

Canada (balance of opinion : greater minus lesser : %)

	19Q1	18Q4	18Q3	18Q2	18Q1	17Q4
BOS Indicator	-0.64	2.31	2.87	3.12	1.90	2.42
Difficulty Meeting Increased Demand ¹	31	56	56	57	47	56
Credit Conditions	-7	11	-1	-5	9	-4
Future Sales Growth	6	-1	15	6	16	8
Investment in M&E	20	25	33	17	24	29
Employment	35	41	39	51	45	40
Labour Shortages ¹	19	37	37	34	26	30
Input Price Inflation	2	7	26	30	22	26
Output Price Inflation	-6	10	12	12	6	2

¹ (yes, % of firms)

years, with competition cited as the main factor restraining price pressure.

Lastly, credit conditions were little changed for the most part, with reports of tightening contained to the Prairies. The Senior Loan Officer Survey showed a net loosening of conditions for business, while household credit conditions were about steady with a small improvement in non-mortgage conditions, and slight tightening in mortgage-related loans.

Bottom Line: The Business Outlook Survey weakened almost across the board, but the big story was the steep drop in capacity pressures. The latter points to a wider output gap, which will take at least a few quarters of above potential growth to narrow. That strongly suggests the BoC will be on hold through the rest of this year, though the risks are tilted toward a cut, should a negative shock hit. Two important notes: 1) While the responses were mostly weaker, they don't reflect an economy falling off a cliff. 2) Governor Poloz already had this information in hand over the weekend, yet he maintained a consistent tone, suggesting the BOS didn't change their big-picture view that we're in the middle of a soft patch and a rebound is still expected in Q2.

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