April 3, 2023

Bank of Canada’s Q1 Business Outlook Survey flags building growth headwinds and easing inflation

- Businesses continue to expect sales growth to slow, with some (mostly those that depend on housing activity and consumer spending) looking for outright declines in sales. “About half” of businesses expect a recession in the year ahead, but most of those expect the downturn to be ‘mild.’

- Broader supply chain concerns have eased substantially. Concerns about “credit” and “demand or sales” have increased substantially from a year ago. The survey was conducted before ‘pressures on the global banking system’ increased in early March – but results from more recent follow-ups suggested business sentiment had not changed very much since then.

- Wage pressures showed further signs of easing. Employment demand is still positive but fewer firms reported labour shortages, and the reported intensity of those shortages eased sharply. Planned wage increases are still high but the BoC reported firms expect the pace of wage increases to “slow materially over the next 12 months.”

- Most businesses (~4 of 5) still expect inflation to be above the BoC’s 1% to 3% target range over the next two years, but inflation expectations edged lower as expected input price growth slowed sharply.

- Business investment plans edged lower for a fifth straight quarter but remain relatively firm given business’ recession fears. Although firms’ sales outlook has moderated, labour shortages are still acute and that is pushing businesses to plan productivity-enhancing investments, even at a higher borrowing cost and given an uncertain outlook.

- The separately released Canadian Survey of Consumer Expenditures showed higher inflation and interest rates cutting into household spending plans, particularly on discretionary services like travel or dining out.

- **Bottom line:** The BoC will likely be encouraged by signs of moderation in the growth outlook from what have been unsustainable levels. Recent labour market reports have still been very strong, but signs that credit conditions are a growing issue reaffirm that broader growth headwinds are building as higher interest rates gradually feed through to household and business purchasing power with a lag. The data should leave the BoC feeling comfortable with the decision to pause their interest rate hiking cycle in January to assess the impact of increases to-date.