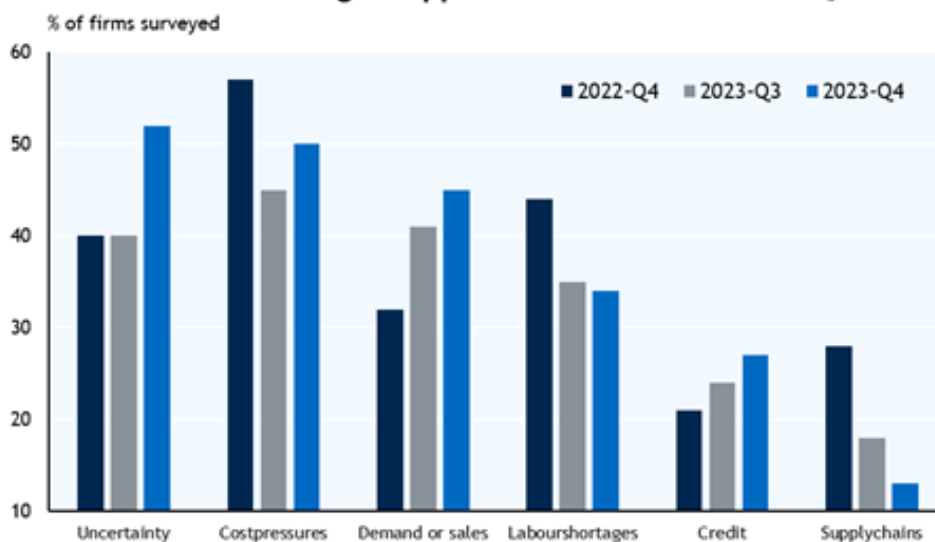


January 15, 2024

Bank of Canada Q4 BOS confirms softening economic backdrop

- The latest Bank of Canada Business Outlook Survey (BOS) confirmed a softening economic backdrop in Q4 as consumer demand further contracted. Sentiment plummeted and top concerns among business saw a decisive shift to more demand-oriented factors including uncertainty (in economic conditions), insufficient demand and access to credit, away from challenges like supply chain issues or labour shortages.

Demand side challenges topped business concerns in Q4 2023



Source: Bank of Canada Q4 2023 Business Outlook Survey, RBC Economics

- The BoC has been paying particularly close attention to business pricing behaviour and wage growth expectations for signs that slowing domestic inflation trends will persist, and both showed improvement in Q4.
- The share of businesses that planned larger than normal price increases for the next year dropped lower from 42% in Q3 to a still-elevated 37% in Q4. Rising competitive pressure and a softening consumer demand backdrop are limiting businesses' ability to pass on abnormal price increases to consumers.

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- Wage growth is expected to slow “only gradually” – to 4.1% for the next year that was still higher than the 3.2% historical average rate. The persistence of wage growth was attributed in large part to delayed cost of living adjustments and union negotiations. But the share of firms experiencing labour shortages continued to shrink with “about three-quarters” of firms expecting wage growth to revert to ‘normal’ by 2025.
- Expected future sales and M&E investment improved, but fewer businesses expected to increase staffing in the year ahead with more planning cuts. The expectation was still for more hiring in the year ahead in Q4, but the net balance for employment dropped to the lowest level since Q2 2016.
- Businesses in Q4 showed some optimism in future sales but that was not echoed by the consumers. In the separate Canadian Survey on Consumer Expectations (CSCE), households reported an increase in the amount of financial stress they faced in Q4. Over two quarters of consumers suggested that they have either already or were planning to cut spending, in light of expectations for impact from rising interest rates.
- Finally, inflation expectations have eased among both Canadian businesses and consumers in Q4, but only marginally. At 3.9%, consumers’ expectation for inflation over the next two years also continued to outpace that of businesses at 3.2%. Longer-term inflation expectations appeared to be much better anchored, at 2.6% each year over the next five years for consumers, and 2.5% for businesses.
- **Bottom Line:** Details reported in today’s Bank of Canada surveys were largely in line with prior expectations. Businesses reported further deterioration in economic activity in Q4 amid ongoing easing in consumer demand. The BoC has been watching firm pricing and wage growth closely for signs that recent slowing inflation will persist - and both measures continued to trend (albeit slowly) back towards 'normal' levels. That for the most part confirms the cautiously optimistic view among BoC officials that interest rates are high enough for now. Inflation readings are still too firm to justify immediate rate cuts from the central bank, but we look for a softer economic backdrop and further easing in price pressures will push the BoC to pivot to gradual rate cuts by mid-year.