BOS Survey flagging softening business sentiment in Q2

- Commentary attached to this morning’s Bank of Canada BOS survey struck a relatively hawkish tone, by highlighting still-solid domestic demand indicators reported by Canadian businesses in Q2. That’s broadly in line with stronger consumer spending data we’ve been tracking to-date. Still, details in the actual survey painted a softer picture when it comes to expectations for the next 12 months.

- Businesses’ future sales expectations continued to soften with weakening sentiment spreading beyond those that are tied to housing and discretionary spending activities. Lower sales prospects, together with rising borrowing and construction costs again weighed on investment intentions for businesses, except for those that are in the commodity sector where demand and output prices are still high.

- Firms continued to report tightness in labour markets, especially in the skilled trades. But similar to the first quarter and in line with falling job vacancies, the degree of intensity of labour shortages eased again. Softer demand and rising labour supply boosted by immigration were the main elements that helped alleviate the pressure. Average expected wage growth at 4.5% over the next year is still high. But for the first time since the start of the pandemic, more businesses were expecting slower wage growth over the next 12 months, rather than higher.

- In line with easing supply side constraints and slower wage growth expectations were further moderations in the growth rate of input and output prices among businesses. In terms of digesting high costs pressures, more businesses reported to have either adopted new technology or lowered their margins to lessen the blow from
rising expenses to their output prices.

- Inflation expectations over the short run continued to moderate among both businesses and consumers, according to the separately released Canadian Survey on Consumer Expectations. Signs of rising interest rates biting into consumers’ purchasing power is more evident in the CSCE report, with nearly half of those surveyed reporting rising cost of living to be their biggest financial concern.

- **Bottom line:** Today’s BOS survey flagged more softening in a slew of business sentiment indicators in Q2, including deterioration in the future sales outlook, further easing in capacity pressures, and slightly lower inflation expectations. Those however, probably aren’t enough to prevent another interest rate hike from the BoC in July. Labour market momentum has still been solid and consumer spending resilient. Inflation data earlier this week showed more easing in price pressures, but to levels that are still higher and broader than pre-pandemic. We expect the BoC to move the overnight rate higher by another 25-basis point in its next meeting in July, for it to reach a terminal of 5% and to stay at that level through the remainder of this year.