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TD Economics

Data Release: Canadian business sentiment deteriorated in Q4, as weakness spreads beyond resource sector

- Overall the Bank of Canada Business Outlook Survey (BOS)indicated a deterioration in sentiment in the winter quarter. Most notably the Bank stated that "the adverse effects of the (oil price) shock are increasingly being felt across most regions and sectors."
- Interestingly the assessments of both past and future sales prospects remained unchanged since Q3, with most firms expecting a *modest* improvement in sales. However, the negative effects of the oil price shock are also increasingly spreading beyond the energy-producing regions and sectors to businesses across the energy supply chain.
- Business investment intentions fell to its lowest level since the recession (from 14 in Q3 to -3 in Q4). That is a larger deterioration than the one seen last January immediately prior to the Bank' surprise interest rate cut. Sentiment on the prairies deteriorated further, but weakening investment intentions are now evident in other regions as well.
- Hiring intentions also dropped to the lowest level since 2009. Plans to cut staff are more widespread and not confined to the commodity-producing sectors and regions.
- The one silver lining in the report is that exporters not directly affected by lower commodity prices continue to benefit from strong U.S. demand and the weak Canadian dollar.
- Cutting to the heart of the Bank of Canada's mandate, inflation expectations also softened. A greater share of firms expect inflation to be in the lower half of the inflation control range.
- Finally, firms reported little change in credit conditions in the BOS. However, the Senior Loan Officer Survey showed another modest tightening in credit conditions in Q4, largely in the energy sector driven by non-price conditions.

Key Implications

- This is the most important piece of data before the Bank of Canada's next interest rate decision on January 20th, and unfortunately it does not paint a very positive picture about hiring or investment over the next 12 months. Market speculation for another cut by the Bank has increased since the release. However, the BOS is consistent with many of the themes Poloz highlighted in his speech last week. Canada's economy is going through a difficult adjustment process, which is playing out in the Q4's BOS. The Bank has facilitated that adjustment with two rate cuts in 2015. It will take time, but these should be sufficient to move the economy back toward full employment.
- Today's BOS does not lead us to re-think our outlook for modest growth as outlined in our December Forecast. As such, we think a cut at the January rate decision would be premature. The risks have certainly increased that the Bank of Canada may need to ease policy down the road, but only if our forecast for an improvement in exports, and overall modest growth does not pan out in the coming months.

Leslie Preston, Senior Economist
416-983-7053

@TD_Economics