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TD Economics

Data Release: Business sentiment remained subdued in the second quarter

- The Bank of Canada's Business Outlook Survey (BOS) indicated that overall business sentiment remained subdued in the second quarter of the year. As in the previous survey, the boost to businesses from foreign demand remains insufficient to overcome the drag from the commodity sector and weak domestic demand.
- Sales growth over the past 12 months was flat, a modest improvement from the Spring survey. Although firms continue to expect sales to accelerate over the coming 12 months, the balance of opinion fell, reaching its lowest level in more than a year (Balance of opinion: +5; previous survey: +16).
- Investment intentions among those surveyed remained in expansionary territory, steady at a balance of +9 in the summer survey. The main drag was reportedly from firms in the Prairies, held back by weak commodity prices, but modest domestic demand, insufficient foreign demand, and uncertainty were all cited as factors holding back firms' investment plans in general.
- In terms of employment, intentions declined somewhat, but remained firmly in positive balance (+21; Spring survey: +26). Although in positive territory, this indicator remains below its post-crisis average as firms tied into the energy supply chain continue to plan staffing reductions. This is offset by stronger hiring intentions within the service industries.
- With capacity pressures falling and reports of insufficient demand, the outlook for inflation remained muted, with the balance of firms indicating roughly stable price growth expectations (compared to the past 12 months), both in terms of input and output prices. 92% of those surveyed expect inflation to fall within the Bank of Canada's 1% to 3% control band, an 8 percentage point increase from the previous survey.

Senior Loan Officer Survey

- Released alongside the BOS, the Senior Loan Officer Survey indicated a further tightening of credit conditions in the second quarter of 2016, driven largely by non-price conditions. As was the case in the previous survey, tightening conditions continues to be largely for corporate borrowers, with the oil and gas sector the most affected among the borrower categories. Tightening also affected small business and commercial borrowers in the Prairies. On the demand side, there was little change, with a slight downtick in demand reported for corporate borrowers.

Key Implications

- The slight downtick in business sentiment in the second quarter provides further evidence that momentum in the Canadian economy has faded somewhat following a strong start to the year. Indeed, today's survey provides more evidence that we remain in the early stages of the economic rotation process. Although exporters expect sales to accelerate, many firms suggest that foreign demand is not yet strong enough to offset domestic drags. This effect is impacting investment intentions, which have remained stubbornly weak in recent surveys. We continue to expect that it will be some time before we see a meaningful uptick in investment intentions.
- Today's BOS thus remains consistent with a Bank of Canada that will be on hold for some time. With credit conditions tightening, the Bank of Canada will want to keep monetary policy accommodative for as long as possible to help mitigate the non-price tightening reported in recent surveys and support the eventual uptick in business investment. With inflation expectations remaining firmly grounded in the 1% to 3% range, the Bank should have no problem maintaining its policy interest rate at 0.50% into 2018.

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