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TD Economics

Data Release: Economic recovery improves business confidence, but energy sector still sees challenges ahead

- The Bank of Canada Business Outlook Survey indicated that business confidence is gradually improving. While most businesses noted a sharp slowdown in past sales, 46% of businesses surveyed anticipate a pick-up in future sales. The cautious optimism, however, was largely concentrated in services and manufacturing. Businesses outside the energy sector feel they have well positioned themselves (through innovation) to benefit from improving U.S. demand and a lower Canadian dollar. Businesses within the energy sector, along with businesses who rely on household and business spending in oil dependent economies, continue to see challenges ahead.
- Business investment intentions also improved from the low point at the start of the year, but still remain relatively depressed compared to historical averages. 41% of businesses intend to increase spending on machinery and equipment. The majority of these are in the service and manufacturing industry and are looking to expand capacity to meet foreign demand. Hiring intentions remained modest, however.
- The number of firms reporting at least some difficulties meeting demand is at its lowest level since the 2009 recession, while the share of firms reporting labour shortages fell in the quarter. Only 17% of firms reported a labour shortage.
- Inflation expectations remained well anchored, with 63% of firms expecting inflation to remain within 1% to 2%. However, there was a rise in the share of firms anticipating a pick-up in both input and output prices due to the depreciation of the Canadian dollar and the resulting higher import prices. 36% of firms expect prices to increase at a faster rate over the next 12-months, relative to the last 12 months.
- Finally, both the Business Outlook survey and Senior Officer Loans Survey showed a modest tightening in credit conditions, mostly for the energy sector. While pricing conditions remain stimulative (for example, interest rates are still low), lenders have tightened non-pricing conditions for bigger business in the energy sector.

Key Implications

- In a recent speech, Bank of Canada Governor Stephen Poloz noted that in the wake of low oil prices, the Canadian economy would have to look for other industries to drive economic growth. The Bank of Canada's role is to help facilitate that adjustment. Indeed, today's report underscores the view that other sectors of the economy would pick-up some of the economic slack caused by the collapse in oil prices. In particular, the survey shows nascent signs of an improvement in the willingness of businesses in non-energy related sectors to invest in machinery and equipment. As outlined in our recent report, we expect trade-based sectors to step out of the resource sector's shadow and see a pickup in investment spending over the next couple of years.
- Overall, the worst of the economic soft patch is now behind us, and the economy is recovering, albeit modestly. Having said that, we recognize the challenges that will remain. For one, we continue to expect a modest pace of hiring due to a lagged impact of past weakness in real GDP growth, with the unemployment rate holding steady relatively lofty at around 7.0% through the next year. Second, the oil sector will continue to be a sore spot for the economy with oil prices remaining low.
- The Bank of Canada is likely to keep monetary policy accommodative over the next year, helping the economy transition to one more dependent on business investment and non-energy exports. Low and stable inflation will allow the Bank to do so.

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