Economic Commentary

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Economics

Bank of Canada Outlook Survey points to decelerating economic growth and price moderation

There are more signs that the Bank of Canada is nearing peak policy rate with the cumulative impacts of previous rate hikes slowing business performance expectation and capacity pressures ease. The latest Bank of Canada Business Outlook Survey (BOS) for the fourth quarter fell for a second straight quarter and the lowest level since Q3 2020 reflecting erosion in confidence.

According to the Bank's survey, there was broad-based weakening in expectations driven by both demand and supply factors. The majority expect a recession, although pattern will be mild and unlikely to change longer term operational plans.

Specifically, the bite of higher interest rates reflected in heightened credit tightness and is expected to feed through consumer demand channels and lower investment. As a result, nearly 1/3 of businesses expect sales to decrease over the next 12-month period marking an above normal share of respondents.

Moreover, firms are hunkering down when it comes to capital investment due to financing costs and uncertainty. On balance, 20 per cent of firms planned to have higher investment spending, compared to near 30 per cent in Q3 and more than 40 per cent in same-quarter 2021. About a quarter of firms looked to reduce capital investment.

Hiring intentions are still robust, reflecting high job vacancy rates, but trends are easing with 35 per cent looking to have a higher full-time equivalent employment over the next 12 months compared to 47 per cent in Q3. On the bright side, firms also reported improvements in supply-side bottlenecks. Supply chain issues are resolving and while the labour market is tight, challenges are similarly easing.

On the pricing and wage front, the Bank of Canada will find some comfort in business expectations. While short-term inflation expectations are high with 1- and 2- year ahead expectations above 4 per cent, expectations are still anchored 3- to 5- years out suggesting belief that inflation returns back to more normal levels although remaining relatively high for three years. Output and input prices are expected to be significantly higher one year out, but expectations of wage growth look to be abating with a 4.7 per cent average expected increase over the next 12 months.

Broadly the BOS is a positive sign that higher interest rates are having the intended effect and leading to slowing economic conditions and coupled with supply-side adjustments are moderating price and wage growth. We see this as further confirmation that the Bank of Canada is near the end point of the rate cycle, although another 25-basis point hike could be in the cards this year. That said, we are unlikely to see much of a pivot in 2023 as it looks to ensure that stronger inflation does not re-accelerate.

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