

**July 4, 2022**

## Canadian business confidence holding up as inflation headwinds build

- Future sales growth not expected to repeat last year's surge but near-term momentum still positive
- Acute labour shortages continue to limit near-term growth prospects
- Business investment plans positive but edging lower
- Rising longer-run inflation expectations should reinforce large near-term BoC rate hikes

The Bank of Canada's Q2 Business Outlook Survey showed expected future sales growth is slowing - the balance of opinion on whether next year's growth will match the surge over the last year fell to -26 percentage points in Q2. But near-term momentum is still reasonably solid. Indeed, production capacity limits are still a bigger issue for businesses than a shortfall in orders. Labour shortages only intensified in Q2 and the share of businesses being disrupted by supply chain bottlenecks remained very high.

Businesses continue to invest more in equipment to help boost the productivity of a scarce workforce, although the machinery and investment indicator ticked slightly lower. Businesses continue to plan to hire more, and expect to pay more to do so. Expected wage growth over the next year jumped to 5.8% from 5.2% in Q1 and 4% a year ago.

That businesses were bumping up against long-run production capacity limits was well-known. The Bank of Canada has been more concerned that an overheating economy and surging prices are creeping into higher longer-run inflation expectations. Most businesses still expect current inflation pressures to ease beyond the next 2-3 years with higher interest rates, improved supply chains, and the end of the conflict in the Ukraine cited as some of the more important drivers. But the share expecting inflation will remain significantly above the BoC's 2% price target beyond the next 3 years continued to edge higher. The separate survey of consumer expectations also showed 5-year ahead price growth expectations rising back to pre-pandemic levels.

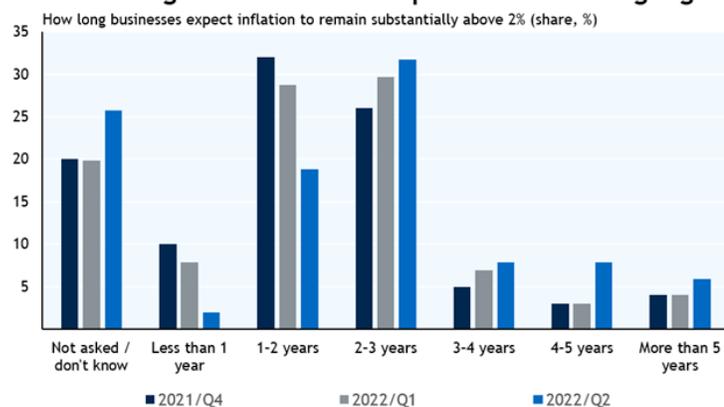
The BoC is concerned that longer-run inflation expectations could come unhinged, making it much more difficult (ie. requiring much higher interest rates) to bring inflation back to target. To prevent that outcome, moving rates higher from still-low levels currently is an easy call to make and we expect today's survey only further raises the odds that the central bank will follow the U.S. Fed with at least a 75 basis point hike in July.

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## Canadian longer-run inflation expectations drifting higher



Source: Bank of Canada, RBC Economics Research

## Business Outlook Survey Summary

	2021/Q4	2022/Q1	2022/Q2
<i>Balance of opinion (%) unless otherwise indicated</i>			
<b>BOS indicator</b>	<b>5.9</b>	<b>5.0</b>	<b>4.9</b>
Past sales growth	63.0	42.0	48.0
Future sales growth	3.0	-11.0	-26.0
M&E Investment	47.0	42.0	37.0
Future Employment	77.0	63.0	66.0
Difficulty meeting demand (%)	78.0	81.0	78.0
Labour shortages (yes %)	41.0	40.0	42.0
Input price inflation	7.0	16.0	12.0
Output price inflation	16.0	26.0	22.0

Source: Bank of Canada, RBC Economics Research