BoC BOS, aka Hiking Handbook Part I
By Warren Lovely, Taylor Schleich & Jocelyn Paquet

The Bank of Canada’s penultimate rate decision of 2022, on October 26th, is less than 10 days away. Governor Macklem has flagged a strong resolve when it comes to getting inflation under control. That means additional tightening, the debate centering on whether the BoC hikes by 50 or 75 basis points next week. The Bank’s rate-setting path (and eventual terminus) is influenced by a variety of factors. Enter today’s Business Outlook Survey. For while this survey is based on ~100 firms, the outlook will influence the Bank’s decision-making process. There’s much to explore here, with this Market View only touching on core elements. Complete BOS details can be found here.

The BOS highlights a deteriorating sales outlook amidst global economic uncertainty. Businesses appear less eager to invest in machinery and equipment (even if the balance of opinion remains positive). Readings on available slack, labour shortages and inflation expectations offer a modicum of relief. Three-quarters foresee difficulty meeting unexpected demand. More firms report labour shortages (46%), but the intensity of those shortages has let up some while hiring intentions have softened. The wage growth outlook isn’t as aggressive, while input and output prices are now expected advance at a slower rate. On inflation expectations—a source of anxiety at the BoC—just 15% expect CPI inflation to run inside the 1-3% target zone over the next two years. While 77% see inflation above 3%, the 2-year estimate eased to 4.26% (vs. 4.8% prior).

Overall, a notably weaker sales outlook suggests that while firms currently have little ability to absorb unexpected demand, slack is likely to open up. Although labour markets remain exceptionally tight, wage pressures appear less acute. CPI inflation has been north of 3% since April 2021 and is expected to remain elevated. Notably, however, inflation expectations have receded at the margin. With inflation still too high, additional hikes are needed but the weaker picture presented here (and hints of progress on inflation/prices) might lean towards a 50 bp hike next week, all else equal. Combined with a housing correction, stagnating-to-declining labour markets and a worsening growth outlook, it’s clear that rate hikes are working. Additional hikes will only lead to further softening. At the end of the day, it’s (mostly) inflation that will dictate how aggressive the BoC will be and where the terminal rate will settle. And with that, our focus now shifts to Wednesday’s CPI report.

Table: Parsing the BOS, with a focus on available slack, labour shortages & inflation expectations
Select readings from latest Business Outlook Survey for 2022:Q3 [Note: Survey of ~100 firms conducted between July and October]

<table>
<thead>
<tr>
<th>Latest</th>
<th>BOS indicator</th>
<th>Invest M&amp;E*</th>
<th>Credit conditions*</th>
<th>Employment*</th>
<th>Difficulty meeting demand/</th>
<th>Some</th>
<th>Significant</th>
<th>Labour shortages/intensity</th>
<th>Wage growth*</th>
<th>Input prices*</th>
<th>Output prices*</th>
<th>Inflation expectations:*</th>
</tr>
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<tbody>
<tr>
<td>Latest (2022:Q3)</td>
<td>1.69</td>
<td>23</td>
<td>-18</td>
<td>29</td>
<td>12</td>
<td>47</td>
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<td>-39</td>
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<td>Prior qtr (2022:Q2)</td>
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<td>-26</td>
<td>37</td>
<td>16</td>
<td>66</td>
<td>57</td>
<td>21</td>
<td>42</td>
<td>63</td>
<td>61</td>
<td>12</td>
</tr>
<tr>
<td>Prior yr (2021:Q3)</td>
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<td>30</td>
<td>9</td>
<td>46</td>
<td>-12</td>
<td>67</td>
<td>39</td>
<td>26</td>
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<td>50</td>
<td>8</td>
</tr>
</tbody>
</table>

Source for table & charts: NBF, BoC | Note: BOS indicator expressed in standardized units; * denotes balance of opinion (i.e., % reporting greater/higher less % reporting lower smaller)
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