

A stronger, even if stale, Canadian economic outlook

By Taylor Schleich & Ethan Currie

After showing signs of improvement late last year, the Canadian economy has stumbled out of the gate in 2026. Volatility in hard data persists, with economic surprises skewing to the downside, aligned with soft data which has flagged ongoing uncertainty. The BoC's *Business Outlook Survey*, arguably the most important soft data release in Canada, signaled improvements in the outlook, however. The latest survey (2026:Q1, conducted between February 5-25), highlighted an improved outlook on future sales, hiring, and investment intentions prior to the onset of the Mideast conflict—a topic that was discussed in survey follow-up calls.

- In the *first quarter*, overall business sentiment improved as the headline BOS indicator rose to -0.4 from -1.8, near the series' historical average. While this is based on a February (pre-war) survey, the BoC subsequently followed up with the most impacted firms. While these businesses are revising up their inflation outlooks (more on that below), most indicated the conflict had "not materially affected their outlooks for sales, investment or employment". In other words, we may not see a sharp deterioration in Q2.
- Trade-related uncertainty continues to cloud the outlook but it's having less of an impact as firms adapt. Supported by strong public sector spending, more firms are revising up their sales expectations. Less than a year ago, the sales outlook was historically weak, but it was back to its long-run average in Q1 (February).
- Last quarter, we were stuck by the surge in layoff plans. Already, the Q4 increase has been unwound, and layoff intentions are now *below* their long-run average. Meanwhile, hiring plans rose sharply, in conjunction with improving sales expectations. The result is overall employment intentions surging the most in a quarter since 2009.
- Despite lingering trade uncertainty, investment intentions improved for a third straight quarter. These are back to pre-Trump levels and are high on a long-run historical basis. Most notably, these intentions are increasingly about firms expanding capacity and improving productivity. It's less about near-term capacity pressures though businesses do cite expectations for stronger domestic demand. Taken together, this is highly encouraging for the inflation outlook...

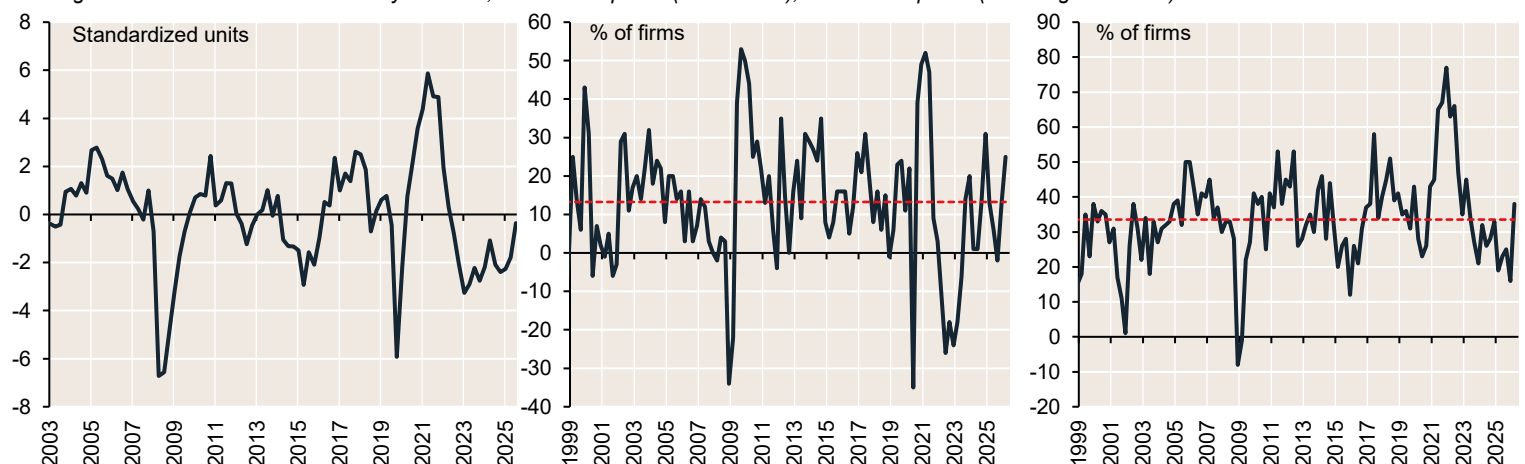
Before the Middle East conflict, inflation data (both hard and soft) were improving. With limited pressures on capacity, wage growth moderating, and fewer firms worried about tariff-related costs, input cost pressures were seen as stabilizing. As a result, expectations for output price inflation were stable too. Not surprisingly, the war in Iran and resulting surge in oil prices has had significant / immediate impacts on expectations. Higher costs are already being felt for some and are widely expected for others. That's contributing to a sharp revision to inflation expectations. Pressures are most acute in the near-term with surveyed businesses bracing for near-4% inflation in a year's time.

Even though businesses now expect higher costs and see economy wide inflation picking up, changes to firms' *own* selling price outlooks were less common. Despite an improving sales outlook, businesses cited weak demand and a constrained consumer as reasons why cost pass-through could be difficult. While many will naturally compare this oil shock to the one in 2022 (after Russia invaded Ukraine), *this* (i.e., the demand side of the economy) is the key differentiating factor. Back then, strong demand and limited capacity exacerbated inflation which was already rising before the conflict began. Today, these pressures don't exist, evidenced by benign core inflation momentum before *and* after the U.S. attacked Iran.

Overall, this report isn't going to have an impact on next week's Bank of Canada decision as the central bank is all but assured to leave policy unchanged. And while the improving outlook for the Canadian economy is directionally consistent with eventual rate hikes, we still believe it's unlikely those will be delivered this year. For one, actual economic data is still weak (most notably in the labor market) and the overall economy, by the Bank's own admission, is in excess supply. The Bank will need to see the improving outlook reflected in improving economic data before they're comfortable moving back toward neutral. Limited core inflation momentum reinforces taking a patient approach. Lastly, even though the Bank is mindful of rising inflation expectations, we'd stress that these are most strongly correlated with inflation *today*, not inflation tomorrow. Assuming Middle East tensions continue to de-escalate, inflation will ease and expectations will too.

Chart 1-3: Business conditions improve as sales, hiring outlooks rebound sharply pre-Mideast conflict

From right to left: Business Outlook Survey Indicator, balance of opinion (future sales), balance of opinion (net hiring intentions)

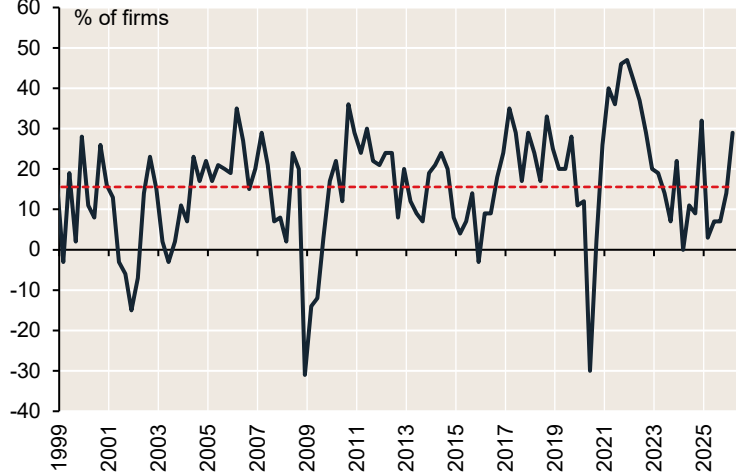


Source: NBC, BoC | Note: BOS Indicator is re-estimated every quarter (where historical average is set to 0); for chart 2-3, red dotted line denotes simple average of historical survey results



Chart 4: Investment intentions picked up notably...

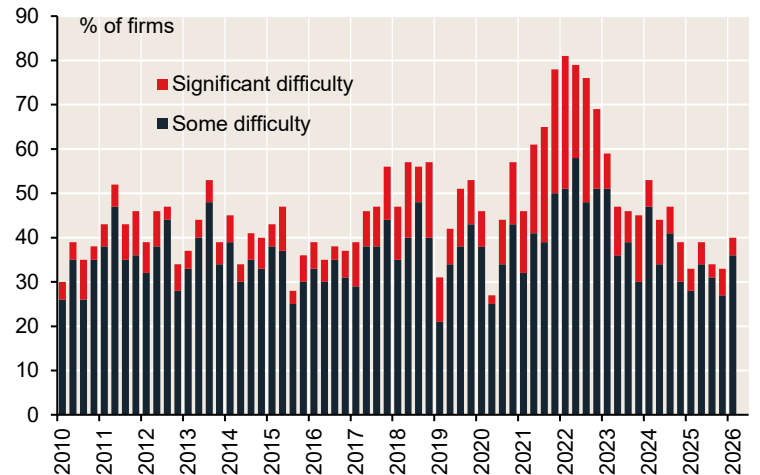
Investment intentions (balance of opinion) and historical survey average



Source: NBC, BoC | Note: Dotted line refers to historical survey average

Chart 5: ... despite minimal constraints in meeting demand

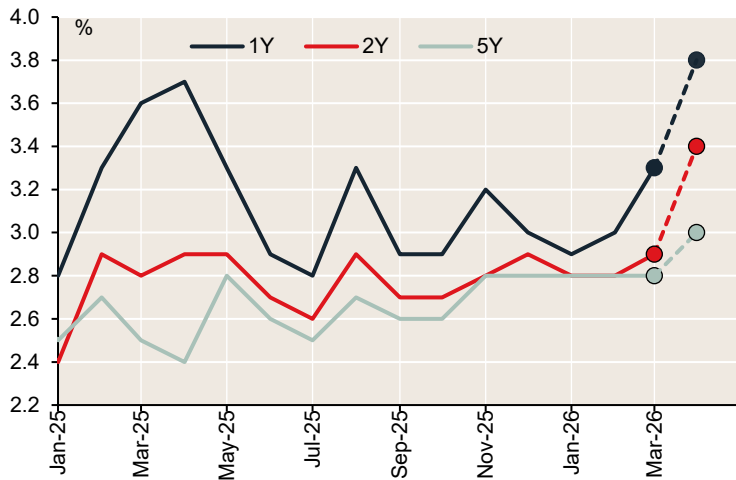
Share of firms signaling a difficulty meeting unexpected demand



Source: NBC, BoC

Chart 6: Mideast war has brought inflation expectations up

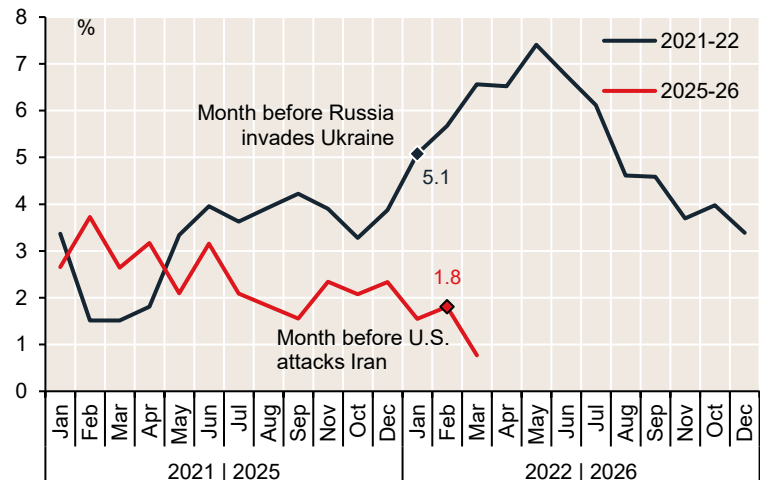
BLP inflation expectations 1-, 2-, and 5-years out



Source: NBC, BoC | Note: Dotted lines are end-of-March expectations post-ME war

Chart 7: Better positioned heading into this supply shock

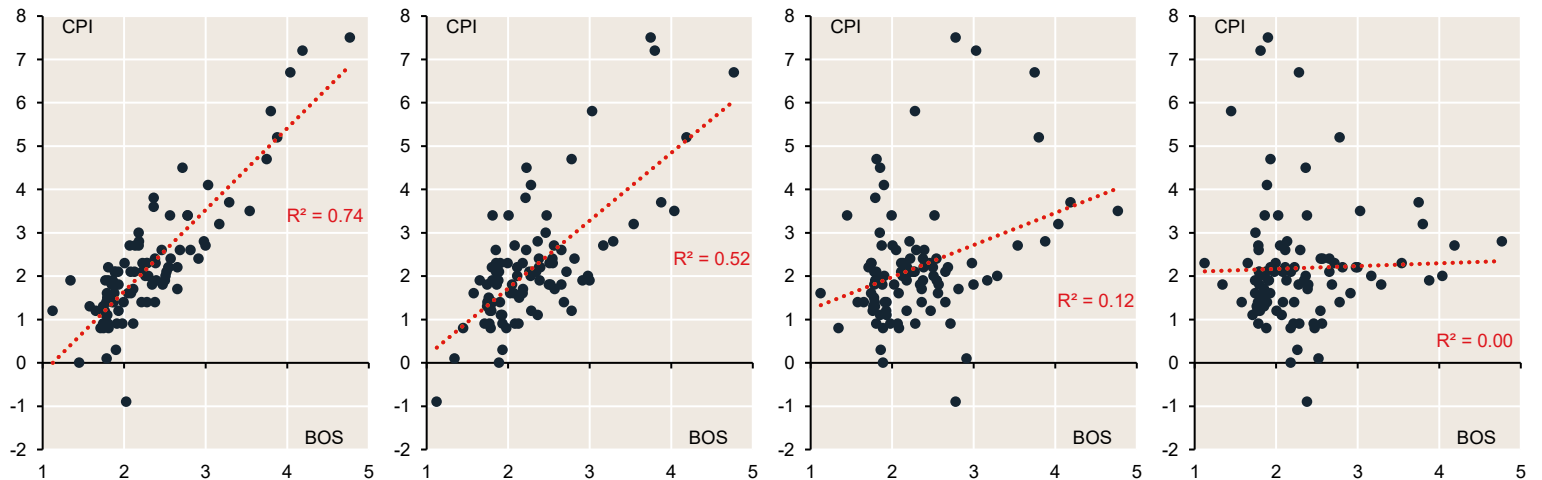
Core CPI (ex. F&E) 3M annualized change: 2021-22 vs 2025-26



Source: NBC, StatCan, Bloomberg

Chart 8-11: Empirically, inflation expectations tell you what inflation is doing now... not what it's going to do

Headline CPI (quarterly average) vs BOS 2Y inflation expectations—from left to right: Contemporaneous (no lag), CPI lagged 2Q, CPI lagged 4Q, CPI lagged 6Q



Source: NBC, BoC, StatCan, Bloomberg | Note: Quarterly data from Q2:2001 (n=100); Y-axis reflects CPI inflation at time T; X-axis is 2Y inflation expectations leading by 0, 2, 4, and 6 quarters



Table: Business Outlook Survey Results

Survey indicator with latest / prior readings, interpretation, trend, and question details

	Indicator	Latest	Prior four surveys				10 year		Average	Interpretation	Trend		Survey question / NBF calculation
		2026:Q1	2025:Q4	2025:Q3	2025:Q2	2025:Q1	max	min	2017-19		Recent surveys	vs. prior survey	
BOS	Overall BOS Indicator	-0.4	-1.8	-2.3	-2.4	-2.09	5.9	-5.9	1.2	N/A - Summary indicator of BOS		Improving	The BOS indicator is a summary measure of the main Business Outlook Survey questions that gauges overall business sentiment
Sales indicators	Future sales [Balance of opinion]	25.0	13.0	-2.0	6.0	13	52	-35	14.9	Sales expected to accelerate next 12M		Improving	Over the next 12M, the rate of increase in your firm's sales volume (compared with the past 12M) is expected to be...
	Future sales indicators [Balance of opinion]	24.0	13.0	0.0	-6.0	22	81	-58	36.7	Future sales indicators better than 12M ago		Improving	Compared with 12M ago, have your recent indicators (order books, advanced bookings, sales inquiries, etc.)...
Investment indicators	Investment intentions [Balance of opinion]	29.0	14.0	7.0	7.0	3	47	-30	24.0	More investment spending next 12M than last 12M		Accelerating	Over the next 12M, your firm's investment spending on M&E (compared with the past 12M) is expected to be...
	Credit conditions [Balance of opinion]	-2.0	9.0	-6.0	16.0	-3	30	-16	-0.9	Credit conditions tightened over last 3M		Deteriorating	Over the past 3M, how have the terms and conditions for obtaining financing changed (compared with the previous 3M)?
Jobs	Employment level [Balance of opinion]	38	16	25	23	19	77	16	40.9	Employment will be higher 12M from now		Accelerating	Over the next 12M, your firm's level of employment is expected to be...
Capacity pressures	Some difficulty meeting demand [Share of firms]	36	27	31	34	28	58	21	37.3	36% would have significant difficulty meeting unexpected demand		More firms with some difficulty	How would you rate the current ability of your firm to meet an unexpected increase in demand?
	Significant difficulty meeting demand [Share of firms]	4	6	3	5	5	30	2	11.2	4% would have some difficulty meeting unexpected demand		Fewer firms with signif. difficulty	How would you rate the current ability of your firm to meet an unexpected increase in demand?
	Any difficulty meeting demand [Share of firms]	40	33	34	39	33	81	27	48.5	40% would have at least some difficulty meeting unexpected demand		More firms with difficulty	NBF calculation - Share of firms that would have some or significant difficult meeting an expected increase in demand
	Labour shortages [Share of firms]	21	22	13	16	20	46	13	28.6	21% of firms experiencing labour shortages		Fewer firms reporting shortages	Does your firm face any shortages of labour that restrict your ability to meet demand?
	Labour shortage intensity [Balance of opinion]	-11	-15	-33	-36	-38	74	-54	28.8	Labour shortages less intense than 12M ago		Accelerating	Compared with 12M ago, are labour shortages generally...
Price, wage & inflation expectations	Wage growth [Balance of opinion]	-15	-10	-21	-34	-33	72	-50	17.5	Wages will rise at a slower pace next 12M vs. past 12M		Fewer firms expect faster wage growth	Over the next 12M, are increases in labour costs expected to be higher, lower or about the same rate as over the past 12M?
	Input price growth [Balance of opinion]	2	12	10	9	4	46	-63	11.4	Input prices will rise faster next 12M vs. past 12M		Fewer firms expect faster input price growth	Over the next 12M, are prices of products/services purchased expected to rise at a greater, lesser, or the same rate as past 12M?
	Output price growth [Balance of opinion]	-8	6	-1	-1	3	45	-43	4.6	Output prices will rise slower next 12M vs. past 12M		Fewer firms expect faster output price growth	Over the next 12M, are prices of products/services sold expected to increase at a greater, lesser, or the same rate as over the past 12M?
	Inflation below 1% next 2 years [Share of firms]	0	1	0	1	0	25	0	1.8	0% of firms expect inflation below 1% over next 2 years		Fewer firms expect sub-1% target inflation	Over the next two years, what do you expect the annual rate of inflation to be, based on the consumer price index?
	Inflation 1-2% next 2 years [Share of firms]	14	16	21	12	23	76	0	53.3	14% of firms expect 1-2% inflation over next 2 years		Fewer firms expect 1-2% inflation	Over the next two years, what do you expect the annual rate of inflation to be, based on the consumer price index?
	Inflation 2-3% next 2 years [Share of firms]	72	60	51	51	44	72	11	39.0	72% of firms expect 2-3% inflation over next 2 years		More firms expect 2-3% inflation	Over the next two years, what do you expect the annual rate of inflation to be, based on the consumer price index?
	Inflation above 3% next 2 years [Share of firms]	11	16	18	23	23	84	0	3.5	11% of firms expect inflation above 3% over next 2 years		Fewer firms expect 3%+ inflation	Over the next two years, what do you expect the annual rate of inflation to be, based on the consumer price index?
	Inflation in target range next 2 years [Share of firms]	89	82	80	72	74.4	100.0	13.3	94.6	89% of responding firms expect inflation between 1-3%		More firms expect inflation in target band	NBF calculation - Share of firms (only those who provided estimate) that expect inflation between 1-3% over the next 2 years.
Inflation above 2% target next 2 years [Share of firms]	86	82	77	85	74.4	100.0	20.0	43.5	86% of responding firms expect inflation above 2%		More firms expect inflation above 2%	NBF calculation - Share of firms (only those who provided estimate) that expect inflation above BoC's 2% target over next two years.	

Source: NBC, BoC



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