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This Halloween BOS full of tricks with few treats

By Taylor Schleich & Ethan Currie

It's been somewhat difficult to pin down the state of the Canadian economy this year, as tried-and-true measures of economic activity (jobs and GDP growth) have been especially volatile. Business and consumer confidence has also ebbed and flowed, though sentiment has been subdued throughout the year. The source of this uneasiness/volatility is simple enough to identify. It's trade-related economic uncertainty, which remains elevated today. The BoC's latest Business Outlook Survey (BOS), conducted between August 7th and September 3rd, reflects this unsettled backdrop and implies a shaky economic outlook:

- Overall business sentiment improved *slightly* but remained weak as the headline BOS indicator inched up to -2.3 from -2.4. While worst case economic scenarios may have been avoided, you'll still see 33% of firms expecting a recession (vs. 28% in Q2 and 15% in Q4:2024).
- With weak business and consumer demand, firms are bracing for soft sales growth. Order books similarly suggest little-to-no growth, though they also aren't pointing to recession. Most exporters aren't subject to tariffs, but the international outlook is weak even so. Not surprisingly, steel and aluminum exporters face "especially weak outlooks".
- Investment and hiring intentions remain well below long-term averages. Most businesses plan to keep staffing levels steady, and "many" businesses are putting new investments on hold.
- Most firms have "ample" capacity. Few struggle with supply chains and labour shortages haven't been less pronounced since 2020.

Earlier this year, downbeat sentiment coincided with growing inflation expectations as tariffs weighed on the minds of firms and households. Fortunately, the fear of higher prices has since moderated as the federal government struck a more conciliatory negotiating stance. Note also that the removal of most retaliatory tariffs came *after* the survey period, which suggests expectations may step lower in the next survey. So even though "underlying" inflation today is running a bit above target, monetary policymakers shouldn't be too anxious about the outlook:

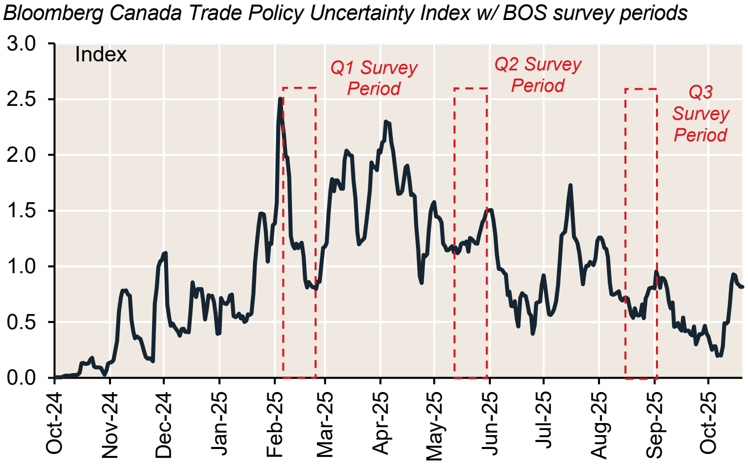
- Firms are "widely" reporting cost pressures, but weakness in demand is limiting the ability of firms to pass higher costs on. As a result, price increases should progress at a similar pace as the last 12 months.
- Overall, longer-run measures of inflation expectations were little changed relative to last quarter, firmly anchored near 2%. *Near-term* inflation expectations have been more volatile but are lower than earlier this year and are in the control band. Look for expectations to moderate in the next BOS thanks to the government removing tariffs.
- The labour market does not look to be a source of inflation as labour shortages are basically non-existent. Accordingly, expected wage growth moderated further and is back to pre-pandemic levels.

Released at the same time as the BOS, the *Canadian Survey of Consumer Expectations* (CSCE) also paints a downbeat picture:

- Technically consumers grew less pessimistic, but sentiment remains weak, below late-2024 levels. Moreover, the improvement was driven by wealthier cohorts (older consumers, homeowners). In contrast to a better spending outlook, labour market sentiment worsened, to its weakest level since 2021 with public sector workers the most uneasy. Inflation expectations were little changed—at an elevated level—but again, the survey was conducted *before* retaliatory tariffs were removed.

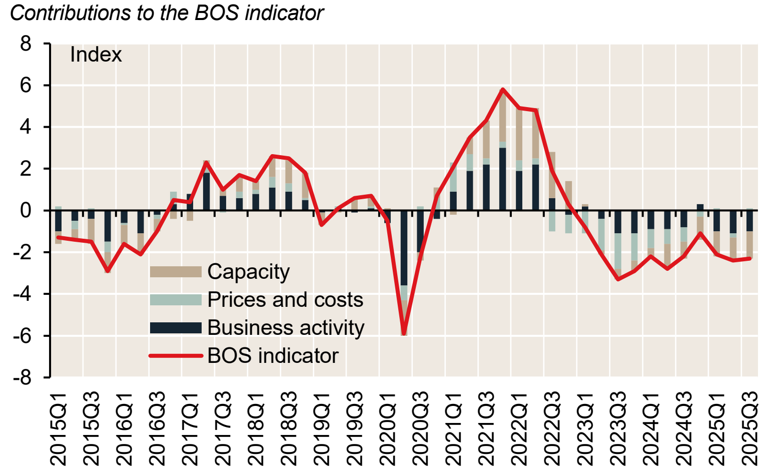
After the reported hiring surge earlier this month, the outlook for next week's rate decision became a bit cloudy. While markets now appear to be looking through that earlier jobs data, the upcoming decision is still unsettled. This survey represented a *potential* obstacle but, unsurprisingly to us, there was nothing in there that should take a cut off the table. The ball is now in the CPI's court, with an inflation update due in less than 24 hours. So long as recent trends (i.e., moderating inflation momentum) aren't totally derailed/recast, the Bank is likely to ease again next week. That's particularly true given the central bank's more dovish inflation stance (see Deputy Governor Mendes speech from earlier this month). For our part, we expect the BoC to ease next week and see even further rate relief being needed. While stimulative fiscal policy will be helpful (with more detail to come on 4-Nov), we don't see its effects being felt quickly enough to lift the economy out of its current malaise.

Chart 1: Uncertainty lower but still elevated in survey window
Bloomberg Canada Trade Policy Uncertainty Index w/ BOS survey periods



Source: NBC, Bloomberg, BoC

Chart 2: Overall, firms see little to be excited about
Contributions to the BOS indicator

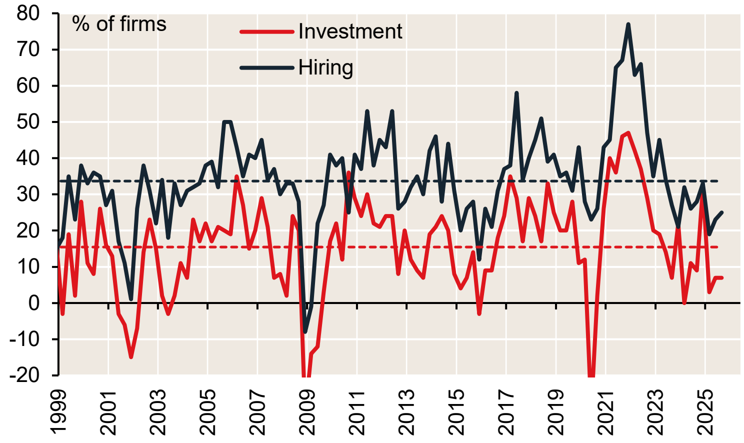


Source: NBC, BoC

Uncertainty may have been lower when this survey was conducted but that did little to boost the spirts of Canadian exporters. Reports of "ample" capacity are widespread, as is weak demand from both consumers and other businesses. If it wasn't for rising cost pressures, the headline Business Outlook Survey indicator would look even worse.

Chart 3: Hiring & investment intensions remain subdued…

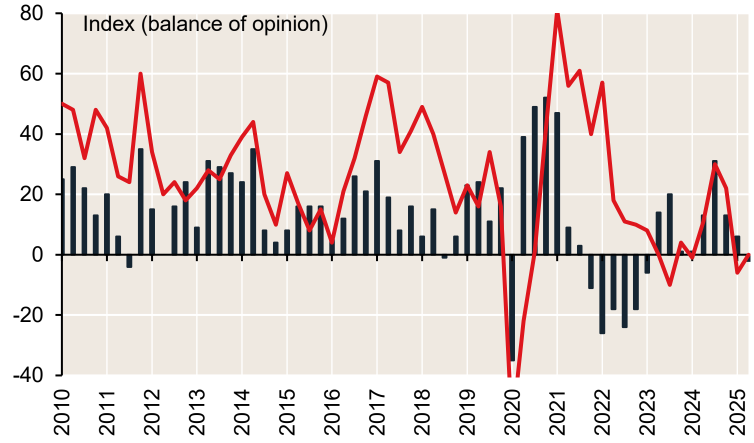
Balance of opinion on hiring and investment intentions



Source: NBC, BoC | Note: Dotted lines refer to long-run averages

Chart 4: …as sales indicators point to little growth ahead

Balance of opinion on expected sales growth and future sales indicators

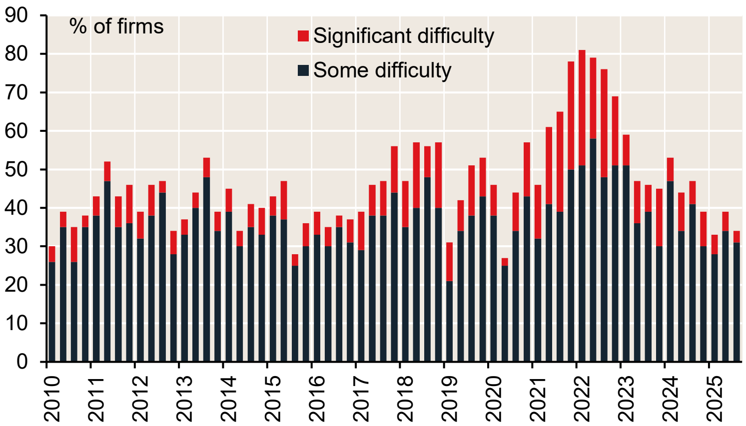


Source: NBC, BoC

Businesses are planning to hire and invest less than they normally would, an assessment that's little changed from last quarter. That's not ideal in the best of times but in this current context, investment has already been muted, and the labour market is already weak. It's hard to fault firms for their caution. Uncertainty is high and the sales outlook is weak, with little-to-no growth expected.

Chart 5: Businesses aren't constrained by demand…

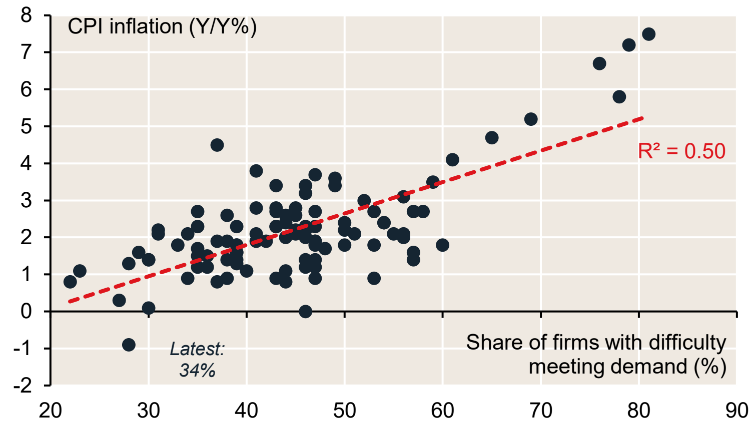
Share of firms with difficulty meeting an unexpected increase in demand



Source: NBC, BoC

Chart 6: …which, historically, implies muted inflation ahead

CPI inflation 1-quarter ahead vs. share of firms with difficulty meeting demand

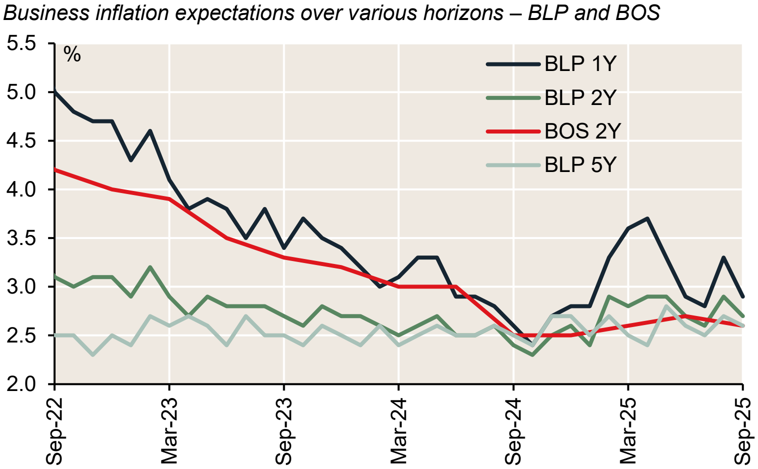


Source: NBC, BoC, StatCan

Capacity constraints are not an issue. About 1/3 of firms would have some degree of difficulty meeting an unexpected surge in demand vs. a 10-year average of roughly 50%. Moreover, only 3% of firms would have *significant* difficulty, the lowest share since peak COVID (Q2:2020). Historically, this series is correlated with CPI inflation and current readings imply price pressures *below* 2%.

Chart 7: Inflation expected to remain in the control band

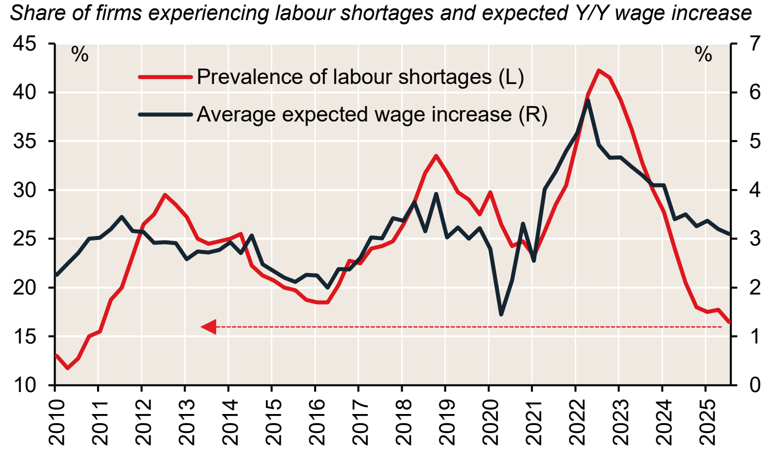
Business inflation expectations over various horizons – BLP and BOS



Source: NBC, BoC

Chart 8: The job market won't be a source of inflation

Share of firms experiencing labour shortages and expected Y/Y wage increase



Source: NBC, BoC | Note: Prevalence of labour shortages in 4Q rolling average

Overall, 80% of firms are expecting inflation within the BoC target range over the next two years. Since the removal of Canadian retaliatory tariffs occurred *after* the Q3 survey period, it's likely that inflation expectations will moderate further in the next BOS. Meanwhile, little-to-no labour shortages will keep wage growth in check and prevent the job market from being a source of inflation.

Table: Perspective on the Business Outlook Survey

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

		Latest	Prior four surveys						Average		Trend		
	Indicator	2025:Q3	2025:Q2	2025:Q1	2024:Q4	2024:Q3	10 year max	10 year min	2017-19	Intepretation	Recent surveys	vs. prior survey	Survey question / NBF calculation
BOS	Overall BOS Indicator	-2.3	-2.4	-2.1	-1.1	-2.2	5.8	-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]	-2.0	6.0	13.0	31.0	13	52	-35	14.9	Sales expected to slow next 12M		Deteriorating	Over the next 12M, the rate of increase in your firm's sales volume (compared with the past 12M) is expected to be…
Sales indicators	Future sales indicators [Balance of opinion]	0.0	-6.0	22.0	30.0	11	81	-58	36.7	Future sales indicators worse 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]	7.0	7.0	3.0	32.0	9	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…
Investment indicators	Credit conditions [Balance of opinion]	-6.0	16.0	-3.0	-3.0	-7	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]	25	23	19	33	28	77	12	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]	31	34	28	30	41	58	21	37.3	31% would have significant difficulty meeting unexpected demand		Fewer firms with some difficulty	How would you rate the current ability of your firm to meet an unexpected increase in demand?
Capacity pressures	**Significant** difficulty meeting demand [Share of firms]	3	5	5	9	6	30	2	11.2	3% 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?
Capacity pressures	**Any** difficulty meeting demand [Share of firms]	34	39	33	39	47	81	27	48.5	34% would have at least some difficulty meeting unexpected demand		Fewer firms with difficulty	NBF calculation - Share of firms that would have some **or** significant difficult meeting an expected increase in demand
Capacity pressures	Labour shortages [Share of firms]	13	16	20	17	18	46	13	28.6	13% of firms experiencing labour shortgages		Fewer firms reporting shortages	Does your firm face any shortages of labour that restrict your ability to meet demand?
Capacity pressures	Labour shortage intensity [Balance of opinion]	-33	-36	-38	-42	-34	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]	-21	-34	-33	-42	-36	72	-50	17.5	Wages will rise at a slower pace next 12M vs. past 12M		More 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?
Price, wage & inflation expectations	Input price growth [Balance of opinion]	10	9	4	-33	-28	46	-63	11.4	Input prices will rise faster next 12M vs. past 12M		More 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?
Price, wage & inflation expectations	Output price growth [Balance of opinion]	-1	-1	3	-1	-28	45	-43	4.6	Output prices will rise slower next 12M vs. past 12M		More 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?
Price, wage & inflation expectations	Inflation below 1% next 2 years [Share of firms]	0	1	0	0	2	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?
Price, wage & inflation expectations	Inflation 1-2% next 2 years [Share of firms]	21	12	23	24	10	76	0	53.3	21% of firms expect 1-2% inflation over next 2 years		More 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?
Price, wage & inflation expectations	Inflation 2-3% next 2 years [Share of firms]	51	51	44	51	62	62	11	39.0	51% 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?
Price, wage & inflation expectations	Inflation above 3% next 2 years [Share of firms]	18	23	23	20	15	84	0	3.5	18% 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?
Price, wage & inflation expectations	Inflation in target range next 2 years [Share of firms]	80	72	74	79	80.9	100.0	13.3	94.6	80% 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.
Price, wage & inflation expectations	Inflation above 2% target next 2 years [Share of firms]	77	85	74	75	86.5	100.0	20.0	43.5	77% of responding firms expect inflation above 2%		Fewer 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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