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Upbeat survey may pave way for interest rate hike

BY JULIAN BELTRAME

OTTAWA — Canadian firms are giving the recovery a vote of confidence in a key quarterly survey, paving the way for the Bank of Canada's expected interest rate hike next week.

The central bank's quarterly survey, released Monday, showed firms were concerned about the fallout from the European sovereign debt mess, but still generally upbeat about the coming year.

"Overall, (business executives) are positive about the outlook for business activity over the next 12 months," the bank wrote.

"For the first time in two years, firms, on balance, reported an improvement in their past sales activity."

The bank's governing council next interest rate announcement is next Tuesday.

Following a strong jobs report last week, the survey likely represents the last piece of evidence governor Mark Carney was looking for to confirm a predisposition to continue raising rates.

"I'd say there's a 75 or 80 per cent probability they will hike next week by 25 basis points," said Derek Holt, vice-president of economics with Scotia Capital.

"I think they'd want to avoid the perception that they just came out with a whole new round of bullish forecasts and then got wobbly knees after just one quarter-point hike (in June)."

What could stay Carney's hand, economists say is the unknown factor of what will happen to the global economy as governments move from spending to restraint later this year and next.

Canada's domestic economy appears well grounded. Statistics Canada reported on Friday that an additional 93,000 jobs were added in June, bringing total re-hiring since the recession's end to over 400,000.

And the business outlook survey showed that 50 per cent of firms surveyed said they planned to add workers over the next 12 months, as opposed to only 10 per cent that planned to cut their workforce.

TD Bank economist Diana Petramala viewed that finding as the strongest in the report, although she said it might indicate some hiring that's already taken place.

While an increase in the bank’s policy rate to 0.75 per cent will raise short-term interest rates for consumers, most economists say it is unlikely to have much of an impact on longer-term, fixed mortgage rates. Many see a hike at this time as not applying the brakes to growth, since the rate would remain near the historic low, but as a judgment by the bank that the recovery is taking hold.

Not all agree, however. A bearish minority argue that Canada still faces considerable headwinds from the European situation and ongoing U.S. weakness, and that Carney should refrain from adding a further impediment to growth.

But failing a climb down from its forecast of 3.7 per cent growth this year, and 3.1 per cent next year, the bank appears on track to take interest rates a little higher next week, analysts say.

“With price pressures expected to rise in the production line, excess economic slack continuing to melt away, and credit and lending conditions continuing to ease, the survey results weigh on the tightening side,” noted economist Michael Gregory of BMO Capital Markets.

The summer poll, and a separate survey of loan officers also released Monday, found sentiments positive, if not deliriously so, across a range of topics.

The bank said credit conditions appear to be easing, especially for larger corporations, a critical prerequisite for expansion.

The balance of opinion was also positive on questions of sales volume prospects for the coming year, and future investment intentions.

Not all doubts have vanished, however.

Business executives expressed concerns about “recent global economic and financial uncertainties and possible spillover effects in Canada.”

And although on the plus side of the ledger, expectations on future sales and investment intentions were softer than three months ago. That’s partly because of the way the Bank of Canada couches its questions, contrasting expectations to what they were in the earlier survey.

The bank noted the responses suggest that firms that have already experienced strong sales growth from recession lows now believe that the growth rate will slow to more sustainable levels, but remain positive.

And many firms that do not expect to increase spending on new machinery have already made those investments, particularly firms in the services sector.

On other elements of business activity, executives said they expect the cost of their inputs to increase at a greater rate during the next 12 months, and plan to pass on these cost increases to their customers.

But the inflationary expectations over the next two years were modest, within the central bank’s one-to-three per cent range.