

## Bank of Canada Surveys Reinforce Escalating Inflation Risk

- **Businesses signal rising inflation worries...**
- **...and so do consumers**
- **Surveys reinforce front-end underperformance to US**

The Bank of Canada's twin business ([here](#)) and consumer ([here](#)) surveys shout out inflation risk in pretty clear terms. Canadian short-term bond yields were rising faster than the US partly in anticipation of these surveys and Wednesday's inflation figures and retained this performance after the release.

That doesn't mean businesses and consumers are right, but the surveys offer another set of tools to bolster other measures of expectations across private forecasters and market-based measures that point toward the BoC durably achieving its inflation goals even if nearer term rates of inflation may be overshooting.

A record share of firms now think that inflation will be above 3% on average over the next two years. A record 87% of firms think inflation will be above the 2% mid-point of the BoC's 1–3% inflation target range (chart 1).

That sentiment is broadly shared by consumers (chart 2). Consumers are mirroring the concerns of businesses on inflation as expectations have become dislodged. 1-year ahead inflation expectations climbed to 3.7%. Consumers think that inflation will persist toward the upper end—if not slightly beyond—the BoC's 1–3% inflation target as both the two-year ahead and 5-year ahead measures now since at about 3.1% y/y.

Arriving at this point is informed by several other readings drawn from the business survey and pieced together below.

In terms of underlying sales growth expectations, the moderation shown in chart 3 should surprise few as the ginormous percentage rebounds off the pandemic will be impossible to repeat.

Further, a record share of firms is saying they would face 'some' or 'significant' difficulty meeting an unexpected increase in demand (chart 4) dating back to the survey's inception in 1999. 'Record' clearly doesn't include prior bouts of inflationary pressure in Canada given the survey's limited history but is significant in covering multiple cycles.

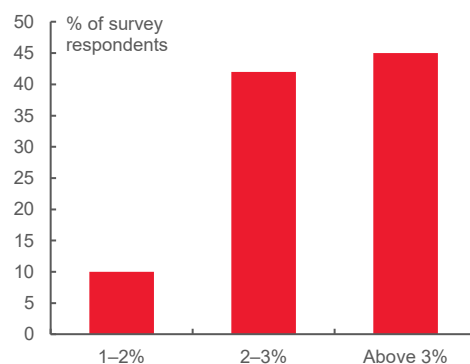
Businesses are saying the number one area causing them capacity constraints relative to an unexpected rise in demand lies in terms of labour shortages. A massive 81% of firms say labour shortages are the most pressing capacity issue compared to 61% the prior quarter. By comparison, 46% of firms say supply chain disruptions are the main problem and only 15% say that physical capacity bottlenecks are the issue.

### CONTACTS

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Chart 1

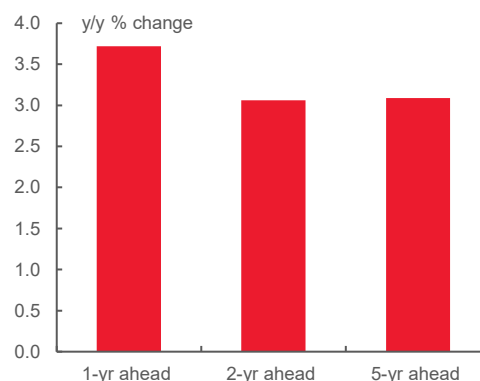
#### Canadian Businesses Expect Inflation to Surpass BoC's Target



Sources: Scotiabank Economics, Bank of Canada's Business Outlook Survey.

Chart 2

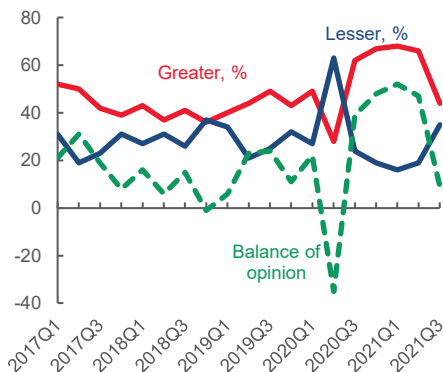
#### Inflation Expectations



Sources: Scotiabank Economics

Chart 3

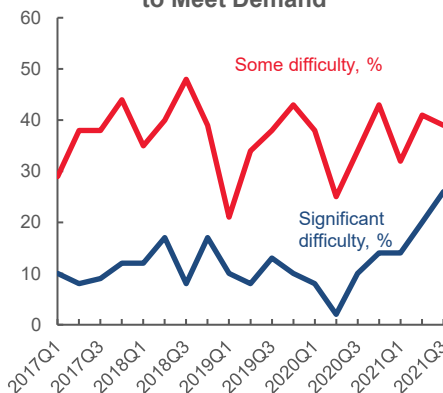
### Futures Sales Growth Moderates After Massive Rebound



Sources: Scotiabank Economics, Bank of Canada.

Chart 4

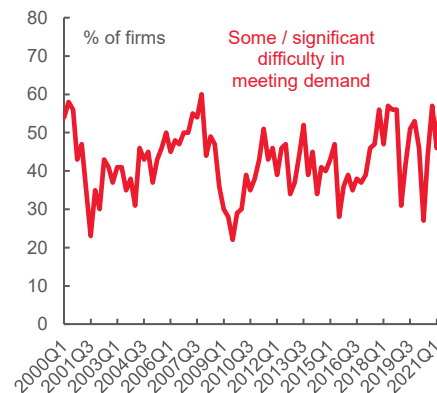
### Capacity Pressures - Ability to Meet Demand



Sources: Scotiabank Economics, Bank of Canada.

Chart 5

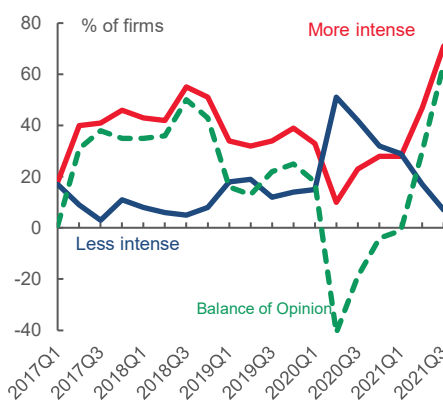
### Labour Shortages



Sources: Scotiabank Economics, Bank of Canada.

Chart 6

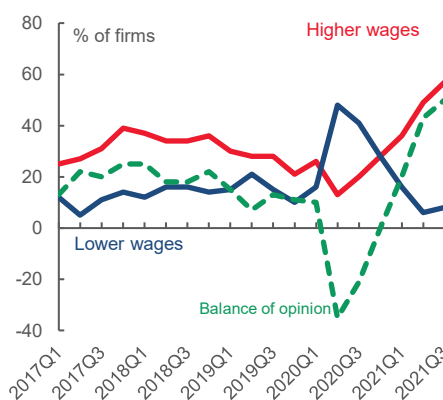
### Intensity of Labour Shortages



Sources: Scotiabank Economics, Bank of Canada.

Chart 7

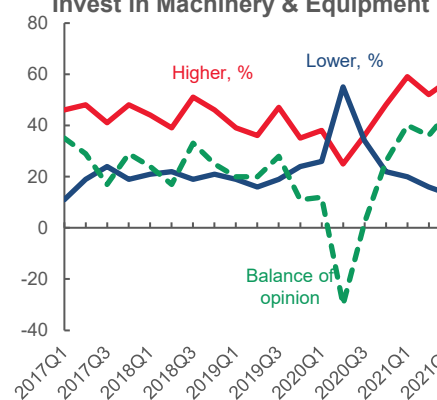
### Wage Growth Expectations



Sources: Scotiabank Economics, Bank of Canada.

Chart 8

### Businesses Plan to Aggressively Invest in Machinery & Equipment



Sources: Scotiabank Economics, Bank of Canada.

This point is backed up by an increase in the share of firms saying they presently see labour shortages (36%) and by an increase in the reported 'intensity' of labour shortages into record territory (again, since 1999). Charts 5, 6.

Hiring intentions remain very strong with a record net 67% of firms saying they plan to increase employment at their firms over the next year.

In order to get this labour, a record net 50% of firms expect to have to increase wages over the next year (chart 7).

To help address competitive implications stemming from labour market pressures and how they feed into overall capacity constraints, a record high share of businesses say they plan to invest more in capital goods over the next year (chart 8).

And now, bring on Canadian CPI on Wednesday. At the margin it should only affect market gyrations, whereas the building cyclical pressures are what will guide monetary policy. The first step toward this is to shift to the reinvestment phase of the BoC's balance sheet management tactics on October 27th.