



April 2004

## Adjusting to the Appreciation of the Canadian Dollar: Results of Bank of Canada Business Interviews

*Note: Responses were obtained during interviews with 102 businesses across Canada. Firms were selected to provide a representative profile of the Canadian economy by region, industry type, and firm size. The method of sample selection ensures a good cross-section of opinion. Nevertheless, the statistical reliability of the survey results is limited, given the small sample size.*

### Highlights

During industry visits conducted from 16 February to 16 March 2004, a number of questions were asked to gauge the effects and responses of Canadian businesses to the appreciation of the Canadian dollar over the past year. Results were broadly similar to those obtained in December.<sup>1</sup> The broad conclusions are:

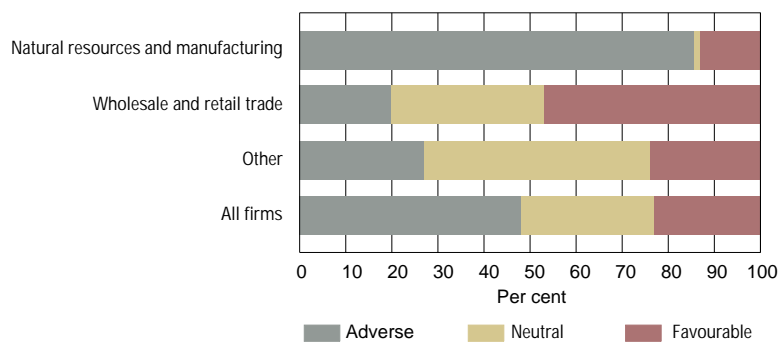
- The number of firms adversely affected by the appreciation continues to outweigh the number positively affected. The proportion of firms severely affected is, however, smaller than in December.<sup>2</sup>
- Manufacturing and natural resources continue to be the sectors most adversely affected by the appreciation of the Canadian dollar.
- The major impact for adversely affected firms continues to be lower profit margins on exports, although some companies again reported reductions in export volumes. Some firms also reported negative effects on their domestic operations from more intense competition from imports.
- The process of adjustment to the appreciation appears to be well underway at many adversely affected firms. As before, efforts are directed mainly at cutting costs and improving productivity.
- As in December, about one-third of adversely affected companies did not think it necessary to make significant changes, despite the appreciation. Many of these firms were only moderately affected.
- Firms favourably affected by the appreciation are primarily in the trade and services sectors. As in December, these firms experienced lower costs for their imported inputs. However, fewer of these firms appear to be responding by lowering their selling prices, and the number of firms not reacting to the stronger exchange rate appears to have risen.
- Overall, the extent and size of downward pressure on input costs was greater than in December, but firms appear to be somewhat less inclined to pass on those cost reductions.
- Despite the appreciation, adversely affected companies were still as optimistic as other firms about future growth in sales; however, their intentions regarding employment and investment were less sanguine.
- Over half of the firms exposed either positively or negatively to exchange rate changes were using some kind of financial instrument to help them hedge their exposure.

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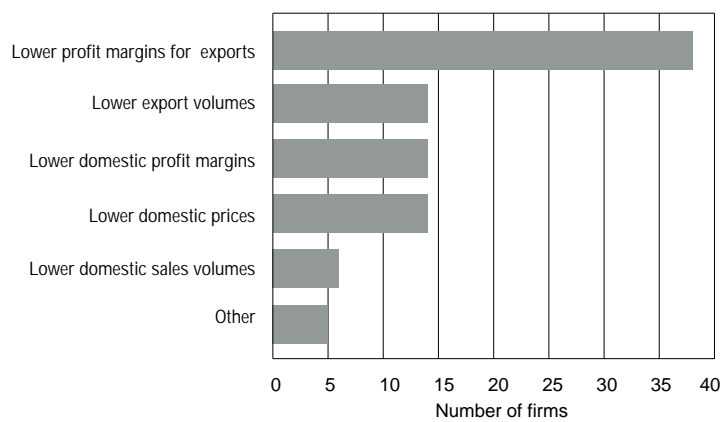
1. Results of the December interviews are available at [www.bankofcanada.ca/en/speeches/2004/canadian\\_dollar.pdf](http://www.bankofcanada.ca/en/speeches/2004/canadian_dollar.pdf)

2. The average exchange rate expected by firms over their planning horizons was 75.5 cents U.S.—close to the current level. While this question was not asked explicitly in December, many firms seemed to be expecting a somewhat higher rate at that time.

**Chart 1: Effects of Appreciation by Sector**



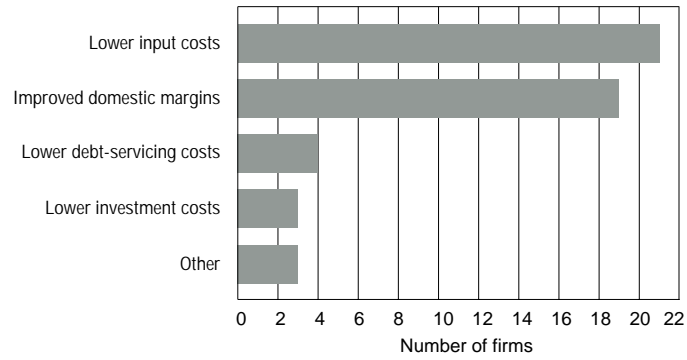
**Chart 2: Firms Adversely Affected: Main Effects (49 Firms)**



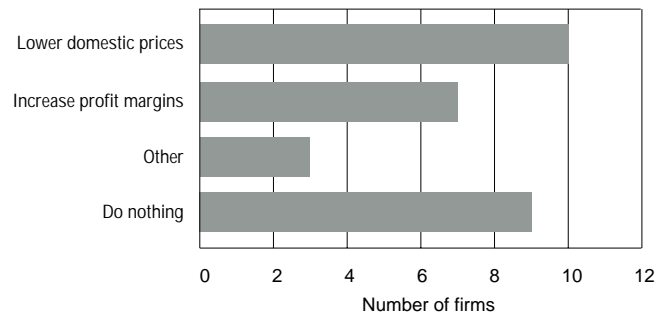
**Chart 3: Firms Adversely Affected: Main Reactions (49 Firms)**



**Chart 4: Firms Favourably Affected: Main Effects (24 Firms)**

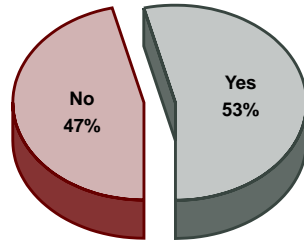


**Chart 5: Firms Favourably Affected: Main Reactions (24 Firms)**



**Chart 6: Exchange Rate Pass-Through**

Since January 2003, has there been downward pressure on your input costs because of the appreciation of the Canadian dollar?



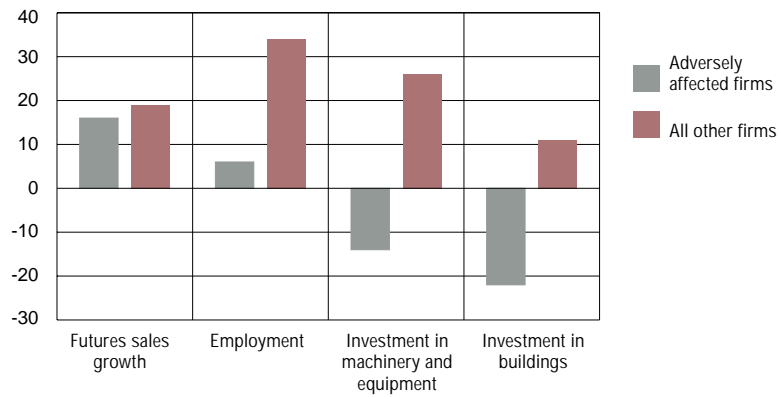
**Magnitude of Cost Reductions**

Magnitude	< 5%	5-10%	> 10%
% of firms	30%	44%	26%

**Pass-Through to Output Prices**

Reactions	Have not reduced	Already reduced
% of firms	46%	54%

**Chart 7: Balance of Opinion<sup>1</sup> on Selected Variables**



1. Percentage of firms expecting faster growth (for sales) or higher levels (for employment and investment) minus percentage of firms expecting slower growth or lower levels over the next 12 months.