Bank of Canada Banque du Canada

February 2004

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

Note: Responses were obtained during 100 interviews with 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 the industry visits conducted from 17 November to 16 December 2003, a number of questions were asked to gauge the effects and responses of Canadian businesses to the appreciation of the Canadian dollar over the last year. The broad conclusions are:

- Manufacturing and natural resources are the sectors most adversely affected by the appreciation of the Canadian dollar. For some of the affected companies, however, the impact of the appreciation was largely offset by higher commodity prices over the last year.

- Adversely affected firms experienced lower Canadian-dollar prices for their exports and, to a lesser degree, a reduction in their export volumes. Many also reported negative effects on their domestic operations from more intense competition from imports.

- Many adversely affected firms had already initiated measures to alleviate the impact of the exchange rate appreciation, mainly through cost-cutting measures and improvements to productivity. The adjustment process was ongoing, and further measures were being considered, including raising U.S.-dollar selling prices and moving some production abroad.

- Fully one-third of adversely affected companies did not think it necessary to make significant changes, despite the appreciation.

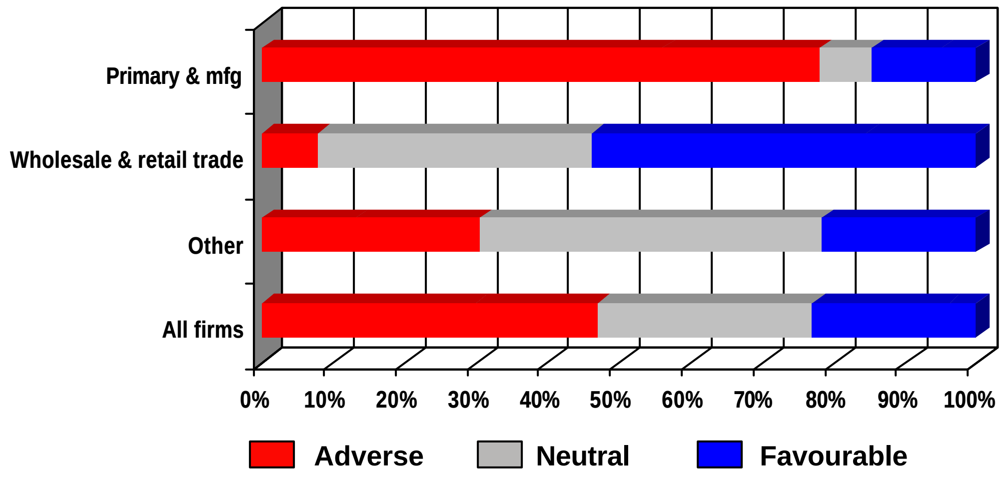
- Firms favourably affected by the appreciation experienced lower costs for their imported inputs. Their main response was to lower their selling prices in Canada, although many were also increasing their profit margins.

- The extent of selling-price reductions related to the appreciation may be limited since the magnitude of firms' cost reductions was relatively small.

- Despite the appreciation, adversely affected companies were as optimistic as others about future growth in sales, although less so with regard to future employment and investment.

Effect of the Exchange Rate Appreciation by Sector

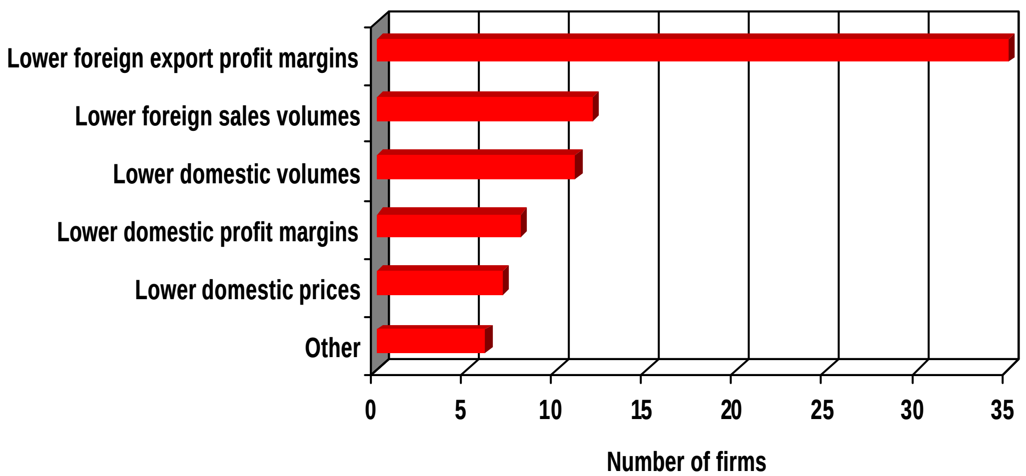
Primary and manufacturing sectors were most adversely affected by the appreciation



Firms Adversely Affected:

Main Effects (47 Firms)

Firms experienced lower revenues from exports and from domestic sales because of the appreciation

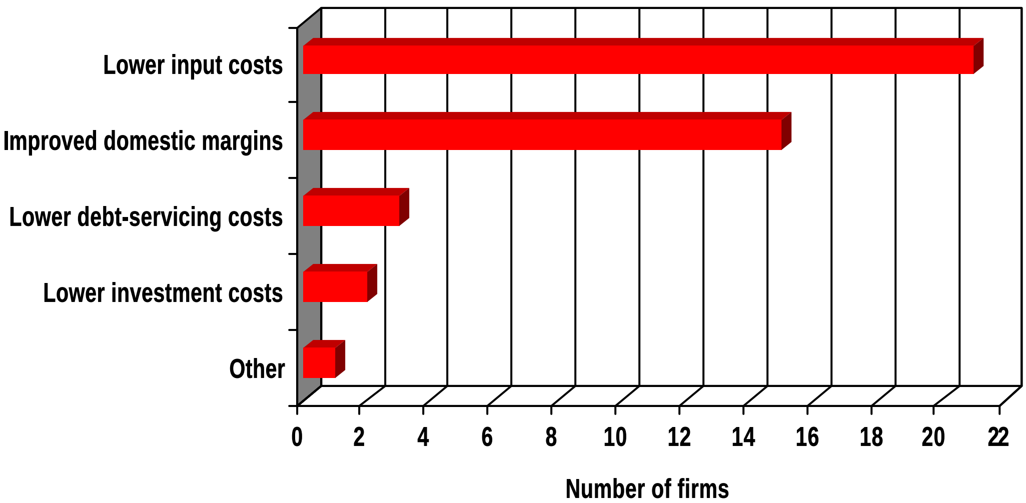


Firms Adversely Affected:
Main Reactions (47 Firms)

Firms were taking various measures mainly directed at improving productivity and reducing costs

Firms Favourably Affected:
Main Effects (23 Firms)

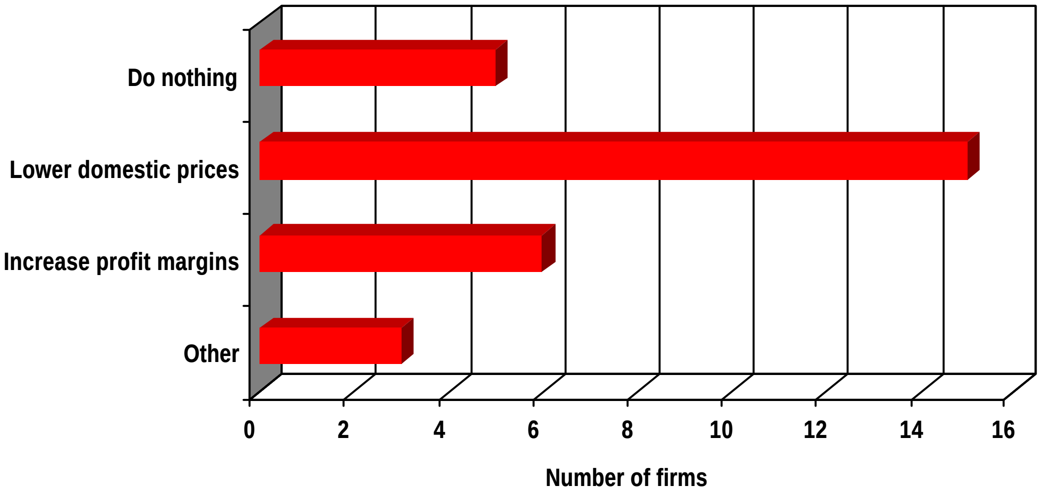
Firms were benefiting primarily from cost reductions on imported inputs



Firms Favourably Affected:

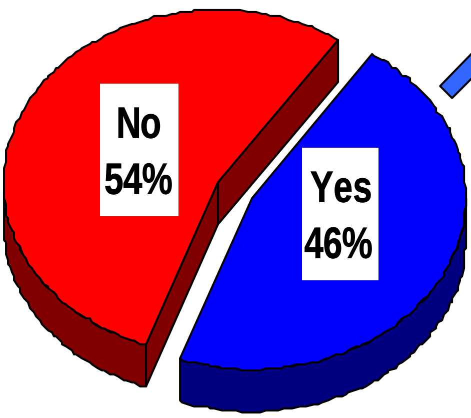
Main Reactions (23 Firms)

Most firms were reducing domestic prices; some were also attempting to increase profit margins



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	50%	35%	15%

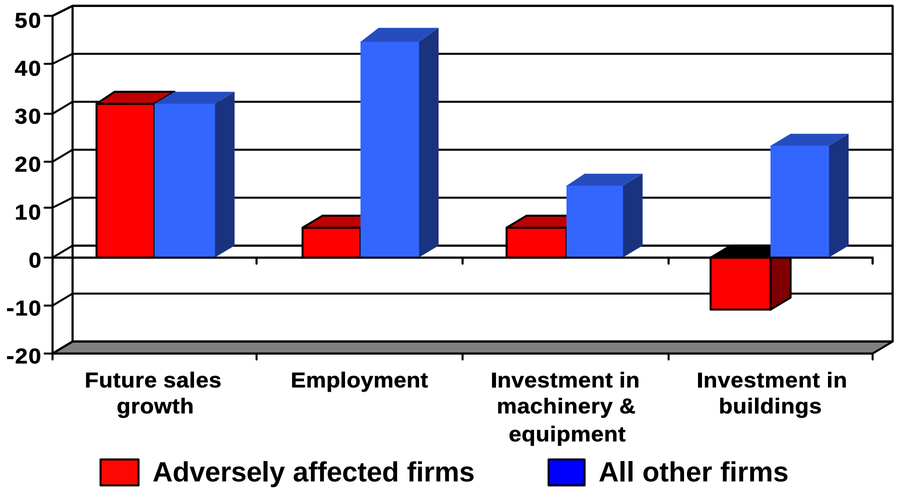
Pass-Through to Output Prices

Reactions	Have not reduced	Already reduced *
% of Firms	39%	61%

* Of the 28 firms that have already reduced output prices, 13 are planning for further reductions.

Balance of Opinion[1] on Selected Variables

Adversely affected firms are as optimistic about future sales as other firms but are less positive about future employment and investment



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