

The Riksbank's Business Survey

REASONABLE ECONOMIC ACTIVITY BUT CAUSE FOR CONCERN ABROAD

SEPTEMBER 2015

■ The Riksbank's Business Survey in September 2015¹

According to the Riksbank's Business Survey in September, economic activity is continuing to grow at a reasonable rate. But companies are generally more pessimistic about future economic developments.

The industrial sector is increasingly worried about developments abroad. Economic activity in Europe continues to recover slowly, but the slowdown on the growth markets, low commodity prices and tumbling investment in, for example, the energy sector are worrying the export industry. Generally, however, companies feel increasingly secure about the growth in domestic demand. Opinions are particularly positive in the construction sector, where demand continues to rise. The rate at which new homes are being built is very high and there are signs that bottlenecks in the form of a shortage of specialists in metropolitan areas are beginning to appear.

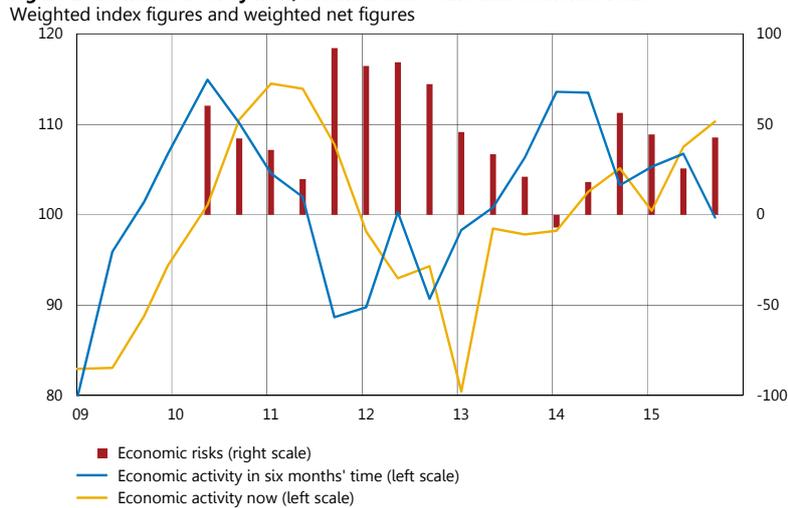
Companies are expecting prices to remain subdued. The industrial sector is finding it difficult to increase its prices since demand is not strong enough yet and costs for input material have fallen along with commodity prices. The retail sector is still cautious about passing on rising purchasing prices to the consumer, which has squeezed their margins. Retail companies have a clear intention to raise prices, but how fast this can happen depends on consumer demand and general competitiveness.

GREATER UNCERTAINTY ABOUT THE FUTURE

Economic activity has gradually strengthened over the last twelve months and the risk of setbacks has constantly decreased. In September, the risk increased again while the assessment of the future economic situation became more pessimistic. In contrast to the previous survey in May, companies no longer believe that the economic situation will be better in six months' time, see Figure 1.

¹Three times a year, the Riksbank interviews the largest companies in the construction, retail, manufacturing and service sectors. Representatives of 42 companies with a total of approximately 250,000 employees in Sweden were interviewed this time.

Figure 1. Economic activity now, in six months' time and economic risks



Note. Index figures show a standardised value (mean value = 100 and standard deviation = 10) of the total percentage of responses about whether the economic situation will be better or worse in six months' time and the total percentage of responses about the current economic situation, on the left scale. The columns show the net figures for those companies that say that the risks are greater (smaller) than normal at present, on the right scale.

"CHINA IS A CLEAR CAUSE FOR CONCERN GOING FORWARD"

It is primarily the risks of a downturn in global economic activity that have increased. Manufacturing companies have noticed for some time that demand in China is not growing as strongly as before. But they are also experiencing greater uncertainty abroad that has been growing at pace with the latest developments in China, including stock market falls and devaluation. Since the Chinese market has a major impact on global market prices and especially commodity prices, there is considerable concern that a prolonged downturn in China may spill over into other markets.

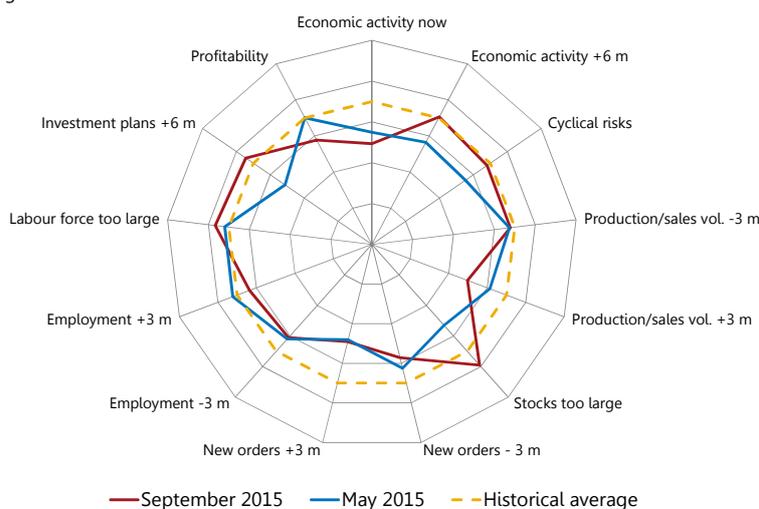
Demand continues to be weak in Brazil and Russia and a recovery is not to be expected in the near future. One business leader expressed this by saying that "the BRIC countries have disappeared", which is significant for how the markets are perceived. Demand in India has grown surprisingly well, but for most companies the country is not their most important export market.

The recovery in the United States and Europe is continuing at a slow pace. The low oil price is still holding back investment in the oil and energy sector. In Europe, demand is good especially in Germany and the United Kingdom and there are positive signs in southern Europe. It is still weak in France, however.

"THERE IS REASONABLE ECONOMIC ACTIVITY"

The overall response pattern from the Business Survey in September indicates that companies have an unchanged positive view of the current economic situation, see Figure 2. Production/sales, orders and employment are about the same as in the survey in May, while the assessment of profitability is slightly better. Stocks have increased for companies but this seems mostly to depend on temporary factors. In the retail sector, the weather, with a cold summer and a warm autumn, has contributed to uneven sales while manufacturing companies that sell mostly to the commodity sector have noticed a lower demand and have still to adjust their stocks accordingly.

Figure 2. The companies' overall response patterns
Weighted index



Note. The responses to the questions are plotted along a "spoke" in the figure where an index figure closer to the centre entails an improvement. The historical average is calculated for the periods for which the questions were put. The term -3 m / +3 m refers to the most recent three months and the coming three months respectively. +6 m refers to the coming six months.

"A BOOMING HOUSING MARKET"

Domestic demand is perceived as good and in contrast to companies in the industrial sector, the assessment of the construction, retail and consumer-related service companies is that the risks of deterioration in the economic activity have diminished. Opinions in the construction sector are particularly strong, where the economic situation is expected to improve even more in the period ahead.

The demand for housing is still very high, especially in the Stockholm and Gothenburg regions. One company says: "We are seeing quite clear signs of overheating on the supplier side, our costs are rising and delivery times are increasing" and others state that they are "close to the production ceiling". It is also difficult to find staff with

specific skills, such as project managers, site managers and engineers. One company says that "it's becoming a free-for-all on staff", which is expected to contribute to increased wage drift further down the line.

Another sign that the market is looking favourable is the growing number of construction companies that can turn down projects that they don't feel are profitable enough.

Demand is also strong as regards other types of construction. Companies are seeing an increase in orders for projects in public-sector construction. Procurements of major infrastructure projects are underway and will generate many long-term assignments for several years, providing stability for construction companies.

"WE CAN'T INVEST SIMPLY BECAUSE MONEY IS CHEAP"

Falling global market prices for commodities have hit investment in the oil, gas and mining industry hard, which has also influenced investment in Swedish companies highly exposed to these sectors. Apart from companies in these sectors, investment plans are relatively unchanged. Corporate investment continues to be dominated by productivity-enhancing initiatives aimed at reducing costs.

Access to external funding is still good. It is generally easy for major companies to obtain new loans and credit costs are very low. There are even examples of individual situations where companies have had negative interest rates on short-term loans, i.e. they have been paid to borrow. Low interest rates reduce companies' costs but have only had a minor effect on the investment plans of larger companies. By and large, the size of the demand is the most important factor. One company said: "This situation with negative interest rates feels like a very temporary thing that we can't change our strategy for".

There is an ongoing discussion between companies and banks about negative deposit rates. In general, companies don't need to pay to keep liquid assets in the bank but if the repo rate is cut even more, they feel that there is a major risk of the banks in Sweden starting to charge for deposits. Companies say that they are analysing how to optimise their cash flows so that they can avoid such costs in the future.

NO EXPECTED CHANGE IN WAGE AGREEMENTS NEXT YEAR

New collective agreements are to be concluded next year for a large number of employees on the Swedish labour market. In light of this, questions were asked as to how much wage agreements are expected to increase compared to the previous bargaining round. A relatively large number of companies were unwilling to answer these questions for one reason or another. Of those who did answer, most believed that the increase in next year's agreements will be about the same as last time. More companies expected lower rather than higher wage increases and the most common explanation for this was the low rate of inflation.

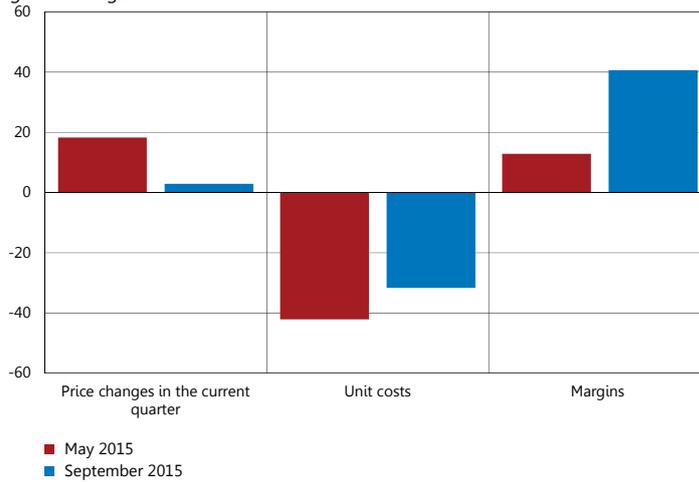
"WE HAVE NO PRICE INFLATION ON RAW MATERIALS"

For non-consumer-related manufacturing and construction companies, input goods such as steel and oil have become increasingly cheaper, which has reduced unit prices, see Figure 3. In the industrial sector, market development with less and less cost pressure has also had an impact on prices. Several companies say that they have been forced to reduce their sales prices during the summer to keep up with the competition. It has been particularly tough for companies in the commodity sector, which is a consequence of low global demand pushing down commodity prices. One business leader expressed this by saying that "the current market situation does not allow any price increases".

Despite depressed prices, the margins in the industrial sector have increased recently, spurred on in particular by a weak Swedish krona. In general, companies have a large percentage of their sales abroad while a large proportion of their production costs are incurred in Sweden. They have not used the weak krona to further reduce their export prices but have been content with maintaining a constant market share in order to be able to benefit from the higher margins.

Figure 3. Unit costs, margins and price changes, current quarter for non-consumer-related companies

Weighted net figures



Note. The weighted net figures show the total percentage of responses to the question of whether unit costs have increased (decreased) over the past 3 months and the total percentage of responses about whether margins have increased (decreased) over the past 3 months and the total percentage of responses about whether prices will be raised (cut) in the current quarter.

THE INDUSTRIAL SECTOR IS NOT PLANNING TO INCREASE PRICES

Companies exposed to the commodity sector believe price growth will continue to be subdued. Other parts of the industrial sector, where demand is stronger, also feel that it is difficult to increase prices, however. Major companies speak of an unwillingness to accept price increases from suppliers, while they themselves have little scope for raising their own prices. New product launches increase the price but simultaneously lead to older products becoming less attractive and fetching a lower price.

Even transparency and competitiveness among companies are constantly increasing and pushing down prices. For example, more and more tenders in the industrial sector are being advertised on digital platforms, where various suppliers compete in real time to win contracts. One company expressed this by saying: "There are more and more e-auctions, where the lowest bid wins".

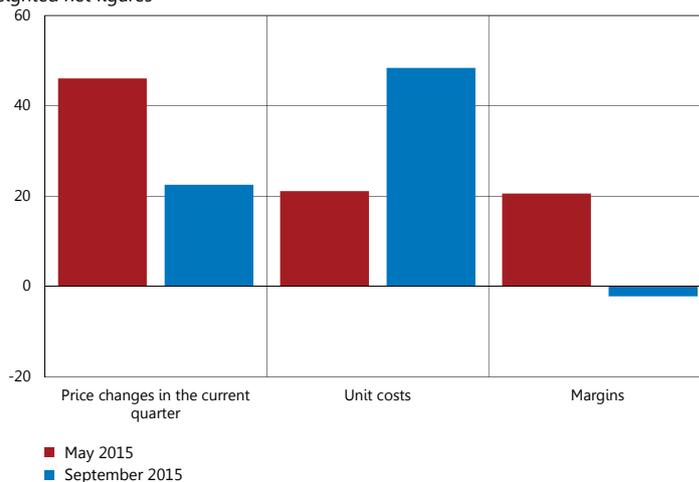
"THE COST TREND IS EXTREMELY TOUGH"

Costs in the consumer-related retail and service sectors are increasing, see Figure 4. This is due partly to the abolition of tax rebates for young people, which has increased the staff costs for companies, and partly to the continuing rise in costs as a result of the previous strengthening of the US dollar. Currency-related cost increases happen gradually for companies and are only incurred once currency hedges expire and are reset at new levels or when purchases for a new season are made at a new krona exchange rate. Companies have therefore continued to see their costs rise, despite the krona not having changed noticeably in value against the dollar or the euro in recent times.

The retail sector has to some extent compensated for rising costs by increasing their sales prices. But the increases have not corresponded to the rises in costs and more companies than previously speak of shrinking margins. Some are worried that the demand will not cope with higher prices while others say that "it is now that prices will start to rise". By and large, the retail sector talks about a major need to increase their prices, and one telling comment on the situation is: "if the retail sector were to compensate for the stronger dollar, it would have to increase its prices quite significantly".

Figure 4. Unit costs, margins and price changes, current quarter for consumer-related companies

Weighted net figures

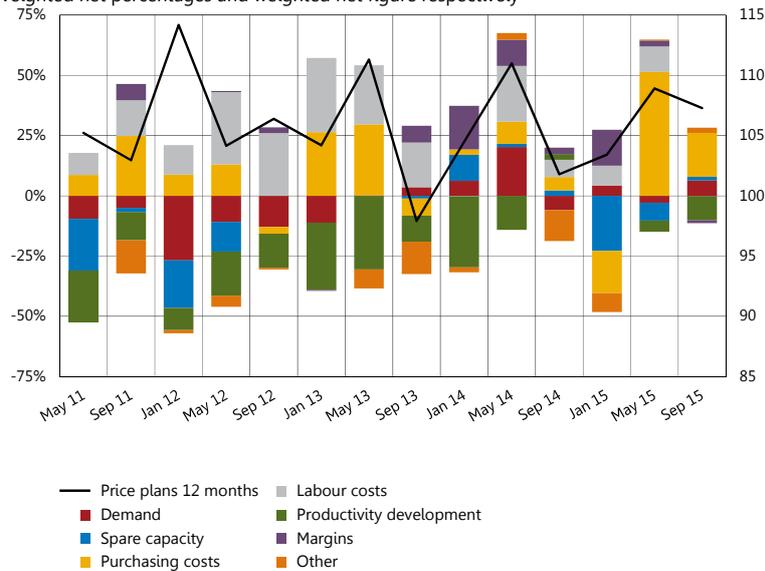


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"FEW PLAYERS CAN ABSORB ALL THE PRESSURE FROM THE DOLLAR"

Consumer-related companies believe prices will continue to rise, see Figure 5. Service companies are counting on passing on most of the increased costs, incurred as a result of higher payroll taxes for young people, to their customers. The majority of retail companies also believe that prices will continue to rise in the period ahead as a result of rising purchasing costs, but there is some hesitancy as to how much sales prices can be raised by and if so, when. One business leader in the retail sector described the situation thus: "in all probability, there will be some form of price inflation in the period ahead, but we won't be the first to raise prices".

Figure 5. Price plans of consumer-related companies in a 12-month perspective
Weighted net percentages and weighted net figure respectively



Note. The bars (left scale) show the net balance between responses that the factor concerned will have an upward or downward effect on prices in the year ahead. A bar above (below) zero means that the factor will contribute to rising (falling) prices in the period ahead. The net figures (right scale) show the total percentage of responses to the question as to whether prices over the next twelve months will increase or decrease.

ABOUT THE RIKSBANK'S BUSINESS SURVEY

The Riksbank's Business Survey aims to reflect developments in prices and economic activity in the manufacturing, construction and retail sectors and in parts of the service sector. As only a few players account for a very large part of the Swedish business sector, relatively few interviews can provide information about a large part of the sector. Many of the interviewed companies also provide information about other parts of the business sector through their contacts with, for example, small and medium-sized enterprises.

The survey is conducted by personnel from the Riksbank who visit the companies for approximately one hour. The interviews are as a rule conducted with members of the company's management. The discussions give the companies an opportunity to develop their answers and the interviewer the chance to ask more detailed follow-up questions. From time to time, specific questions are asked about current issues in monetary policy.

The survey entails interviewing approximately 40 companies in May, September and January. Over 300 companies have taken part in the survey since it was started in 2007.

The diagrams in the report present the companies' responses weighted in terms of the respective companies' number of employees in Sweden. The indexes in the diagrams capture upturns and downturns in the pattern of responses well. These responses are then combined with the companies' reflections during the interviews. The September 2015 report presents the results of interviews with 42 companies, which were mainly held between 31 August and 18 September.

A more detailed description of the survey can be found on the Riksbank's website: Hokkanen, Melin and Nilson (2012), "The Riksbank's Business Survey – a quick indicator of economic activity", Sveriges Riksbank Economic Review 2012:3.

http://www.riksbank.se/Documents/Rapporter/POV/2012/rap_pov_artikel_3_121017_eng.pdf



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