

# The Riksbank's Business Survey

RECOVERY CONTINUES BUT UNCERTAINTY RETURNS

SEPTEMBER 2014



## ■ The Riksbank's Business Survey in September 2014

*Economic activity is continuing to slowly improve according to the Business Survey conducted by the Riksbank in September 2014. As in May, the recovery is mainly driven by household consumption but also by the construction sector's investments in housing.*

*Uncertainty concerning global developments has increased in the export sector. The risks mainly relate to the recovery in Europe but also to developments in China, Latin America and Russia. The general election in Sweden and the discussion of potential measures to subdue the growth of household debt are also factors contributing to increased uncertainty, particularly in consumer-related companies. The more uncertain situation is affecting corporate investment, leading to continued cost reductions and holding back price increases.*

*The companies' pricing plans have fallen since May and are now back to the same low level that has prevailed since 2012. Relatively weak demand, low cost increases and squeezed margins have contributed to slow price increases over the last 12 months. At the same time, competition is perceived to be strong, which is holding back price increases and undermining profitability. In order for the companies to be able to increase prices it is important that demand picks up more speed, which could enable higher margins and prices in the year ahead.*

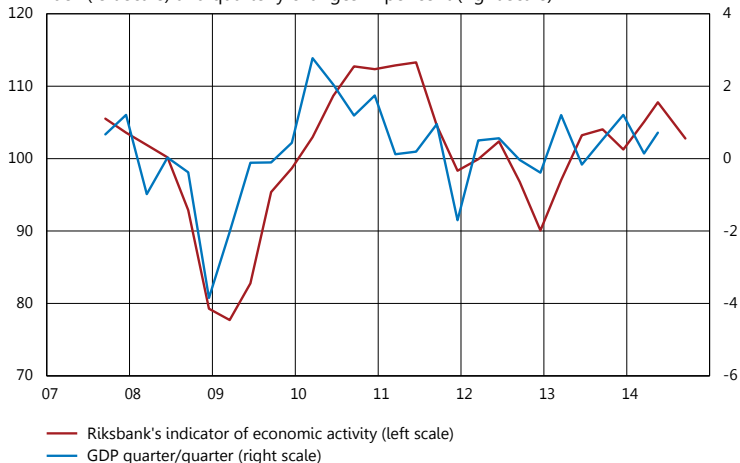
*Prior to each Monetary Policy Report, that is three times a year, the Riksbank interviews the largest companies in the construction, retail, manufacturing and service sectors. Representatives of 44 companies with a total of approximately 246,000 employees in Sweden were interviewed this time. The interviews were mainly conducted between 1 September and 19 September.*

"BUSINESS ISN'T SLOWING DOWN, BUT IT'S NOT PICKING UP SPEED EITHER"

Overall, the Riksbank's indicator of economic activity suggest that the economic climate is somewhat weaker than it was at the time of the previous survey in May, but still somewhat stronger than on average, see Figure 1. The companies are in general satisfied with the prevailing

climate but are also a little disappointed that demand has not picked up more speed.

Diagram 1. **The Riksbank's corporate indicator and changes in GDP**  
Index (left scale) and quarterly changes in per cent (right scale)



Note. The Riksbank's indicator is calculated as a weighted average of the responses to various questions in the survey. The responses are then weighed together on the basis of their ability to predict seasonally-adjusted GDP changes from quarter to quarter. The indicator is calculated up to two months before the outcome for GDP is published and provides an early indication of developments in economic activity. The indicator has been standardised so that the mean value = 100 and the standard deviation = 10. This means that a value above (below) 100 should be interpreted as a somewhat stronger (weaker) business cycle than the average. Figures for quarterly GDP growth are seasonally adjusted.

## GLOBAL ECONOMIC ACTIVITY OUT OF STEP

The development of economic activity around the globe is disjointed. The companies feel that it is difficult to assess the state of the economy in Europe, although their perception is somewhat more negative now than it was in May. In the case of the major European economies, the Swedish companies' assessment is that demand in France is weak and they are planning to reduce their workforces there. Some companies felt that "things are subsiding in Germany", but the picture is not clear as others saw no such tendencies.

The positive signs in Europe are said to mainly come from the United Kingdom, where growth continues to be good. The countries in southern Europe, particularly Spain, appear to have begun a recovery, but from low levels.

Developments in China continue to be a cause for concern as it is believed that demand is weaker than previously. The Chinese economy is also said to be important for the global mining industry, which has experienced a slowdown. This in turn has repercussions for several export companies in Sweden; those that sell products directly to China as well as those that sell to the mining industry.

In the United States, the recovery is continuing on a broad front. In South America, on the other hand, economic activity is weak, above

all in Brazil. However, the situation in Argentina, Chile and Venezuela is also commented on in negative terms.

#### "20,000 PRODUCTS AND NOT A SINGLE ONE FROM RUSSIA"

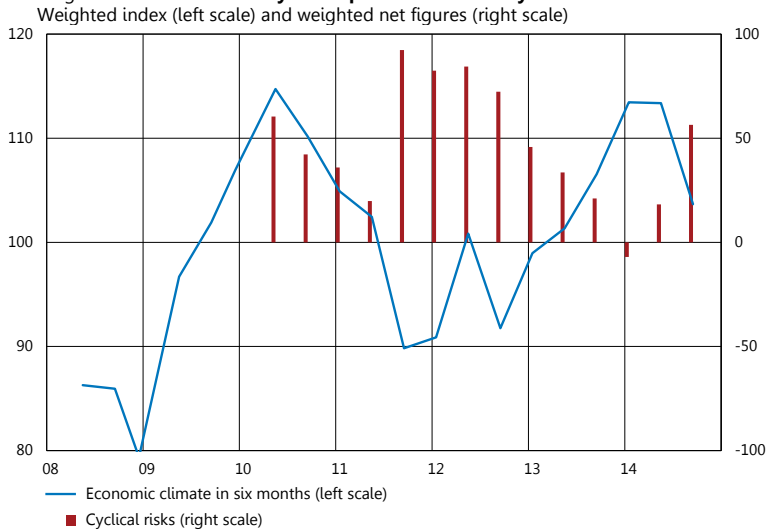
In September, the companies were specifically asked about the trading sanctions imposed by Russia and whether they have been affected by them. In general the restrictions have not had any direct impact as few of the companies interviewed trade in goods covered by the sanctions. However, several companies, mainly in the export sector, are concerned about indirect effects in the form of lower demand from Germany or an escalation of the conflict in Ukraine.

#### "THE ELECTION IS A CONCERN FOR US"

Fewer companies than previously believe that economic activity will continue to strengthen, see Figure 2. As a result of the uncertainty about the economic situation abroad, together with the uncertainty about the parliamentary situation in Sweden, the companies believe that there is a higher level of risk than normal and this is having a dampening effect on their plans for the future.

Companies that were interviewed before as well as after the general election were worried about the results of the election and the political orientation of the new government. Companies that have many young employees were mainly worried that employers' social security contributions for young people will be increased and about the effects this would have on their employment plans and profitability. Construction and consumer-related companies, above all, were also worried about the discussions concerning the high level of household indebtedness and how this issue would be dealt with in the future. One company representative said: "We must be careful not to ruin everything in our eagerness to deal with indebtedness".

Diagram 2. **Economic activity in the period ahead and cyclical risks**



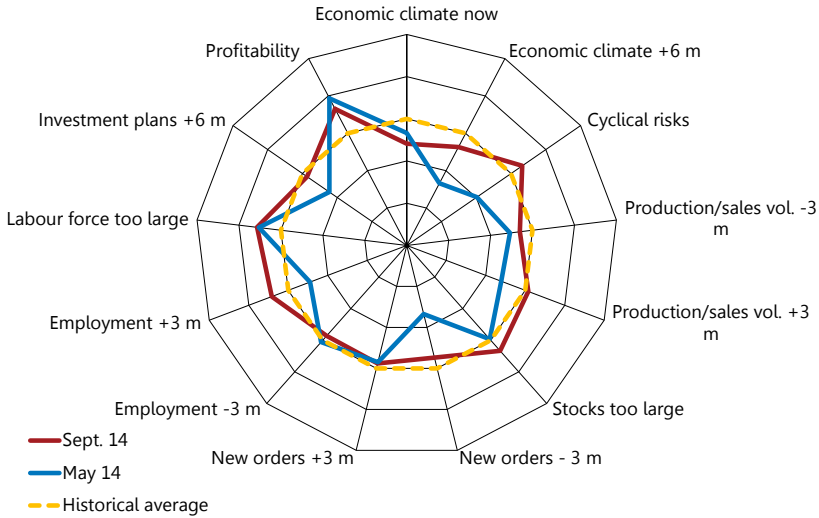
Note. The index shows a standardised value (mean value = 100 and standard deviation = 10) for the balance between the percentage of responses that the economic situation will be better or worse in six months' time. The net figures show the balance for responses that economic activity is perceived to be higher or lower than normal.

"SLIGHTLY BETTER VOLUMES THAN PREVIOUS YEARS, BUT NOT MUCH"

The companies' assessments of production, sales and employment in recent months remain more or less unchanged since the survey conducted in May, see Figure 3. The level of new orders, on the other hand, has been somewhat lower over the last three months, which indicates that production and sales will decline in the period ahead.

The situation in the retail sector is still better than for other companies. Retail companies are in general satisfied with the level of sales, which is supported by the strong purchasing power of the households.

Diagram 3. **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 averages are calculated for the periods for which the questions were put. The term -3 m / +3 m means the most recent three months and the coming three months respectively. +6 m means the coming six months.

### "PROFITABILITY WEAK BUT RISING"

Profitability remains weak, which is due to the fact that demand has been relatively low. One executive said: "At present, we don't have the volumes required to carry the cost structure we have". In their efforts to improve profitability, the companies are working primarily with various measures to improve cost-effectiveness rather than with growth and expansion.

Companies that sell directly to consumers are generally more positive in their assessments of their own profitability compared with companies in the manufacturing industry. It takes longer for manufacturing companies to adapt and they cannot quickly change their production in relation to demand.

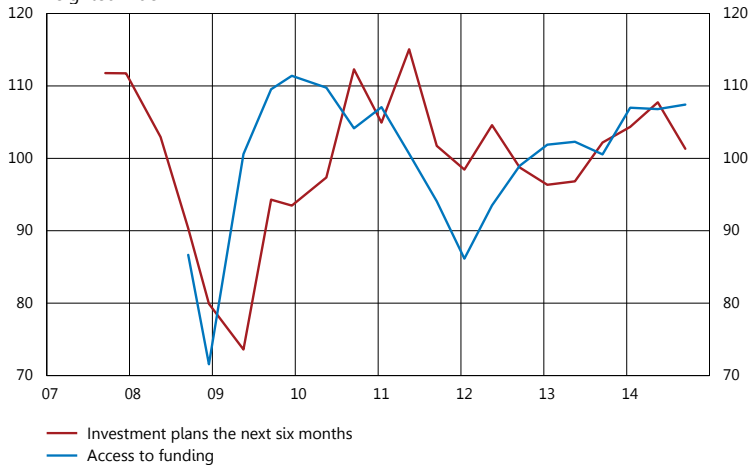
### "MORE DEFENSIVE THAN OFFENSIVE INVESTMENTS"

The companies' investment plans for the next six months have declined somewhat since May, but are still higher than on average, see Figure 4. Companies in the manufacturing sector are increasingly investing to improve efficiency as they need to reduce their costs. The investments mentioned include new machines that require fewer working hours per unit produced, new IT systems and improved logistical flows.

International risks have also had a negative effect on the companies' investment plans and one comment was: "Concern makes you cautious".

Companies are still finding it easier to fund their operations and few companies think that access to capital is restricting their investment plans. It is rather the subdued faith in the future that is holding back investment.

Diagram 4. **Investment plans and access to external funding**  
Weighted index



Note. Indexes show a standardised value (mean value = 100 and standard deviation = 10) for the balance between the percentage of responses that planned investments will increase or decrease over the next six months and whether access to funding has improved or worsened over the last three months.

### INFRASTRUCTURE INVESTMENTS - AN UNCERTAIN PROSPECT

The construction sector is meeting a high demand for housing in the metropolitan regions. However, housing construction is significantly lower in other parts of the country. Demand for commercial properties such as offices, warehouses and industrial buildings remains relatively unchanged and stable.

Major planned infrastructure projects, such as Förbifarten (a road by-pass project in Stockholm) and Västlänken (a railway tunnel project Göteborg) are a source of great uncertainty for the construction companies because the final political decisions have not yet been made. The companies' profitability and future planning will be hit if the projects are cancelled or further postponed.

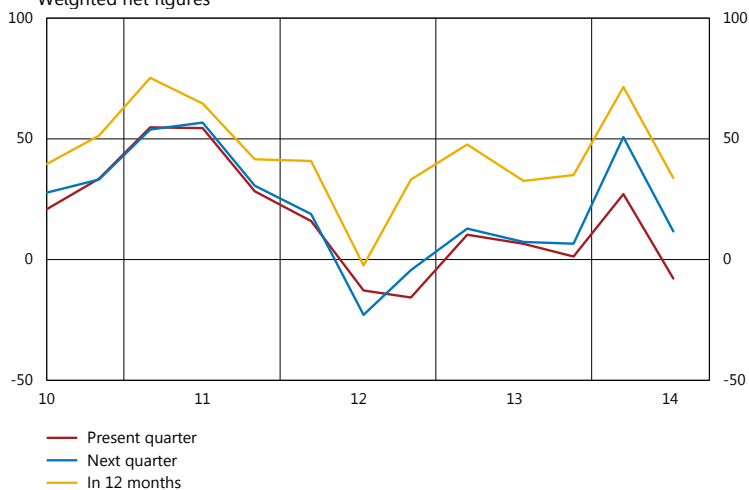
### "PRACTICALLY NO MOVEMENT IN CONSUMER PRICES"

Turbulence abroad and uncertainty concerning the result of the election in Sweden have also affected the companies' pricing plans. Low cost increases in combination with low margins have also dampened the development of prices over the last 12 months. Consequently,



fewer companies than in May are now planning to increase their prices. The net figures are thus back to approximately the same levels that have prevailed since 2012, see Figure 5.

Diagram 5. **Planned price changes**  
Weighted net figures



Note. The lines show the net figures for the companies that intend to increase or lower their prices during the present quarter, next quarter or next 12 months.

The consumer-related companies have had low price increases and are concerned that this will continue to be the case in the period ahead. Some companies may even need to lower their prices. One comment was: "We are not planning anything, but we are afraid that this could happen".

Planned price increases for companies that offer services to other companies are generally higher and these companies are not noting the same price pressures as, for example, retail companies.

#### "NOT MUCH HAPPENING WITH PURCHASING COSTS"

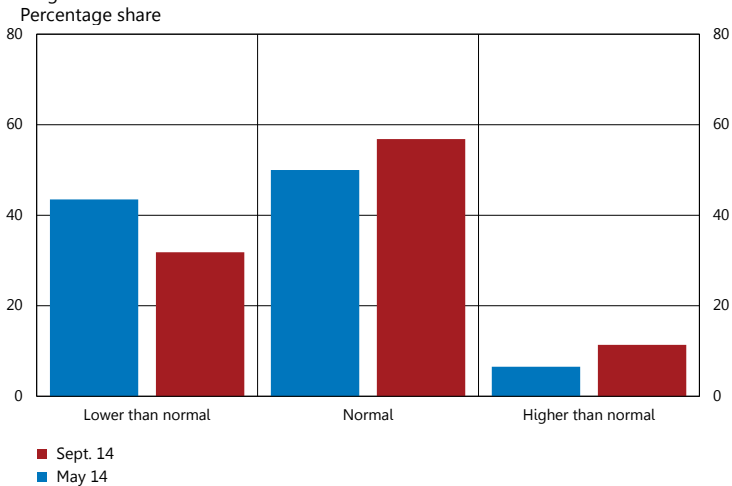
The results of a questionnaire that the Riksbank circulated to a large sample of companies in the spring indicated that, above all, large companies had had lower cost increases than normal.<sup>1</sup> These results are supported by the business survey conducted in May and by the one conducted in September. The results are probably due to the fact that large companies can exert more pressure on their subcontractors to lower their prices than small companies can.

<sup>1</sup> See the Economic Commentary "Results from a survey on company pricing"

[http://www.riksbank.se/Documents/Rapporter/Ekonomiska\\_kommentarer/2014/rap\\_ek\\_kom\\_nr04\\_140924\\_sve.pdf](http://www.riksbank.se/Documents/Rapporter/Ekonomiska_kommentarer/2014/rap_ek_kom_nr04_140924_sve.pdf)

In September, slightly fewer companies said that cost increases have been low than said so in May, see Figure 6. Common for most of the companies is that the largest costs are for intermediate goods and wages. It is also these costs that have contributed to the fact that total costs have increased more slowly than normal. According to the companies, the lower costs for the purchase of goods are mainly due to the low level of international demand, but also to strong competition between suppliers and improved purchasing functions at the companies.

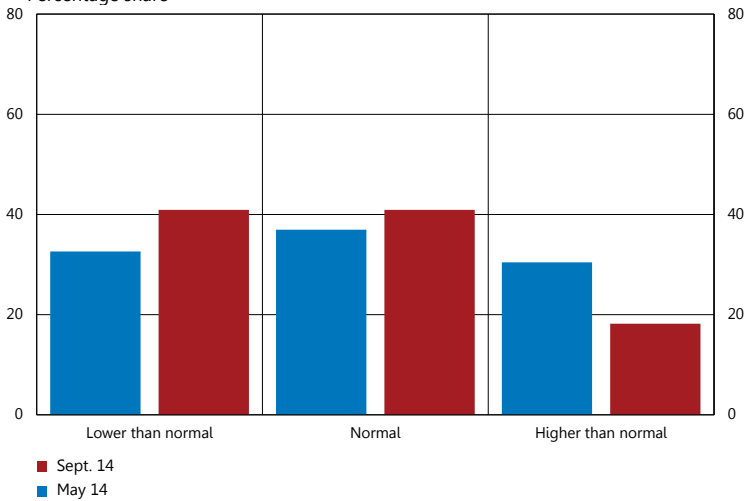
Diagram 6. **Total cost increases over the last 12 months**



Note. The question was worded as follows: How have the total cost increases for a representative good or service developed over the last 12 months?

The interviews with the companies also reveal that margins have been lower than normal, see Figure 7. This is primarily due to low demand in combination with high competition.

Diagram 7. **Margins/price mark-ups over the last 12 months**  
Percentage share



Note. The question was worded as follows: How have margins/price mark-ups for a representative good or service developed over the last 12 months?

## HIGH COMPETITION IN SEVERAL AREAS

The reasons for the increase in competition differ from sector to sector. For some companies, competition has increased due to structural changes that have been underway for some time.

In the retail sector, in particular, the perception is that competition has increased due to price-comparison websites and e-commerce, which are increasing transparency and thus the price awareness of the customers. Although e-commerce still accounts for a limited part of total retail sales it is growing rapidly and becoming increasingly important to more companies. One company representative said: "It is a structural change, the market is opening up and becoming increasingly transparent".

Some service companies state that competition in Sweden has increased due to low demand in Europe and the rest of the world. Low demand abroad means that competitors are turning their attention to the Swedish market, and this is squeezing prices here.

In the manufacturing sector, some companies say that competition has increased as a result of more companies improving products that were previously only sold on low-price markets. These refined products are now being sold on more high-quality markets, which has reduced prices on these markets. This is happening on several markets at the same time, which means that general price pressures are falling.

Companies that sell to other companies and the public sector often say that the customers' purchasing functions have improved. This makes it more difficult to gain acceptance for price increases and even-

ry contract is closely scrutinised. "Purchasers have a lot sharper teeth these days" was one comment.

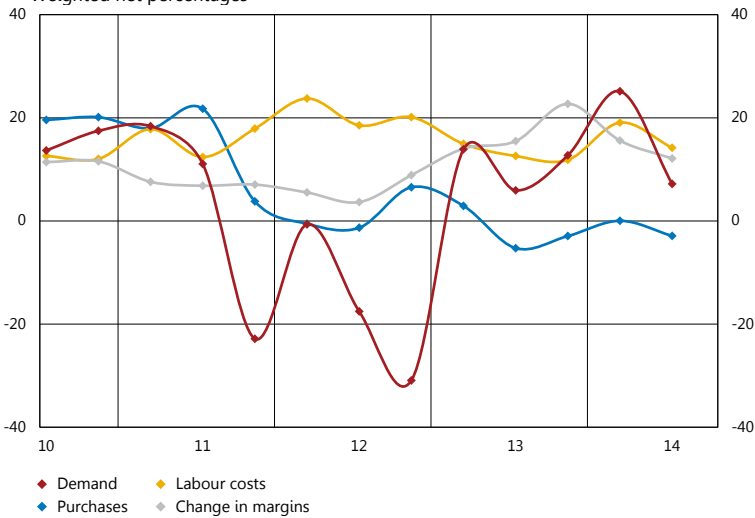
"PRICING PLANS GOOD ON POWERPOINT – NOT SO IN REALITY"

The factor that affects pricing plans most is the expected level of demand. Recently, however, the companies have also experienced a growing need to increase their margins at the same as the development of their costs has been relatively weak.

In September, it was once again the expected level of demand that was most important for the possibility to increase prices one year ahead. Wage costs and the need to improve margins were also important, see Figure 8. At the same time, costs for intermediate goods are low, which in combination with high productivity and spare capacity is holding back price increases.

All-in-all, the planned price increases are low, particularly in the retail sector where competition is expected to further restrain price increases. At the same time, however, the companies say that pricing plans are changeable and may increase quickly if demand picks up.

Diagram 8. **Factors behind pricing in the 12 months ahead**  
Weighted net percentages



Note. The lines show the net balance between responses that the factor concerned will have an upward or downward effect on prices in the year ahead.

## ABOUT THE RIKSBANK'S BUSINESS SURVEY

The Riksbank's Business Survey aims to reflect developments in prices and economic activity in the manufacturing and construction industries, the retail sector and (parts of) the service sector. As a few companies 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 companies.

The survey is conducted by personnel from the Riksbank who visit the companies for approximately one hour. The interviews are usually 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.

Around 40 companies are normally interviewed in May and September, and around 25 companies in 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 2014 report presents the results of interviews with 44 companies, which were mainly held between 1 September and 19 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.



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