

The Riksbank's Business Survey

FOCUS ON COSTS AS ECONOMIC ACTIVITY EDGES ALONG

JANUARY 2015

■ The Riksbank's Business Survey in January 2015

According to the business survey conducted by the Riksbank in January 2015, economic activity remains largely unchanged since the previous survey in September. As previously, the companies feel that the situation on the domestic front is relatively positive and that the single greatest concern for the future is that aggregate demand in Europe is still weak.

This weak international recovery in combination with generally severe competition has increased the companies' need to cut costs. Many companies are therefore devoting resources to developing more efficient working methods and production processes. The aim of these cost-cutting programmes is to increase margins and to improve profitability. Several sectors are investing in new technology and eCommerce in order to conquer new markets, but also because the fierce competition is forcing them to keep up with developments.

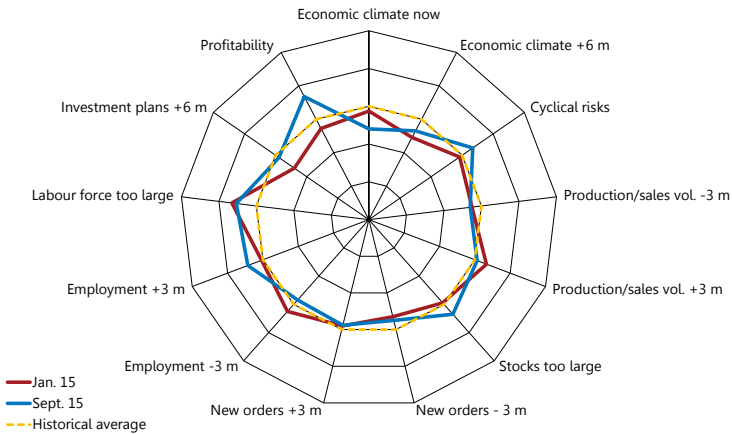
Lower oil and commodity prices and the weaker krona have been of particular benefit to the manufacturing industry. Otherwise, however, there are few signs that the recovery will rapidly pick up speed in the period ahead. The price increases planned for the coming year therefore continue to be minor.

"NO CLEAR MOMENTUM"

The overall picture from the survey in January is that the situation for production, sales and employment is approximately the same as at the time of the previous survey in September. The companies responses are also close to the historical average, see Figure 1.

The lower commodity prices recently, including the lower oil prices, are particularly positive for the manufacturing industry. Several companies also believe that ongoing low oil prices may in the longer term stimulate the economy and contribute to more rapid growth. At the same time, the fall in prices is negative for companies that sell commodities or do business with other companies in the commodities' sector.

Diagram 1. **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 / the coming three months respectively. +6 m means the coming six months.

"ONLY THE UNITED STATES DOING WELL AT THE MOMENT"

Global development continues to be divided. The recovery in the United States is strong and several companies believe that this will continue in the period ahead. Growth is still good in the United Kingdom and the Swedish companies say that the demand for their products is generally high there.

However, the situation has not noticeably improved in the rest of Europe and the companies say that it is relatively unchanged since the previous round of interviews.

Demand in Germany is more or less the same as before and southern Europe has continued to recover from a low level. At the same time, the effects of trading sanctions and low demand from Russia have had an impact on growth throughout eastern Europe.

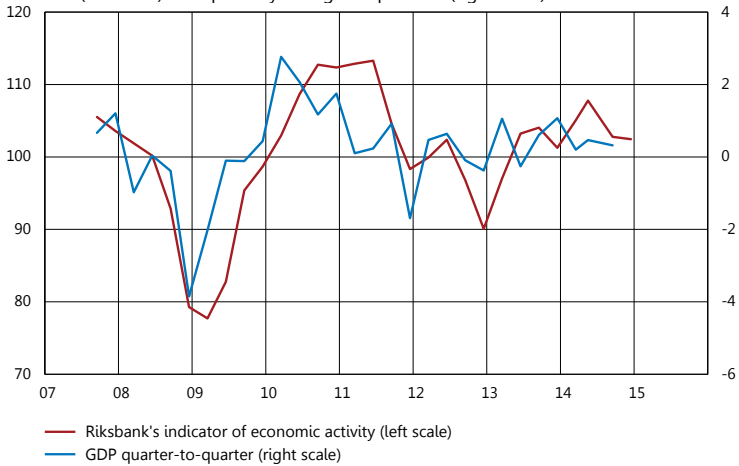
Development in China continues to weaken and the companies say that the downturn in demand is general and not only related to the sectors in which the Swedish companies are active.

INDICATOR SUGGESTS GROWTH

The business survey's overall indicator of economic activity is somewhat lower than in September but suggests that growth will continue, see Figure 2.

The export companies are negatively affected by the slow recovery in Europe, while development in the construction and retail sectors, which are dependent on domestic demand, is satisfactory.

Diagram 2. **The Riksbank's indicator and changes in GDP**
Index (left scale) and quarterly changes in per cent (right scale)

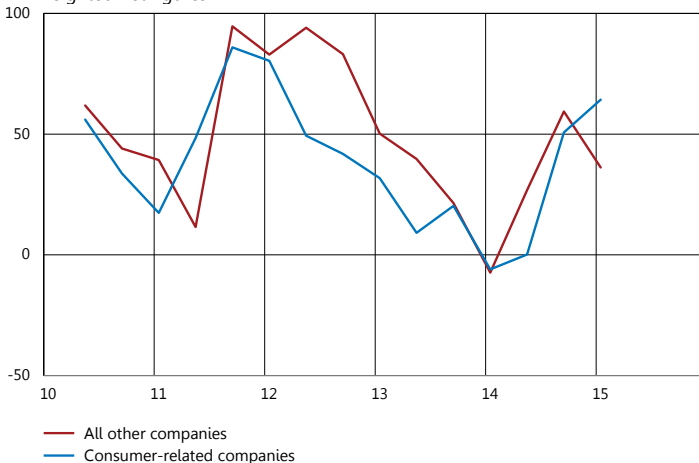


Note. The corporate indicator is calculated as a weighted average of the responses to various questions in the survey. The responses are then weighed together on the basis of their ability to predict seasonally-adjusted GDP changes from quarter to quarter. The indicator is calculated up to two months 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.

"YOU CAN'T REALLY TRUST THE SITUATION AS IT IS AT PRESENT"

The assessment of the companies in January was that the risks to the development of economic activity are still higher than normal. In general, there is still uncertainty about how various political decisions in Sweden will affect the economy in the period ahead. This particularly applies to companies that have a large proportion of their sales to consumers, see Figure 3.

Diagram 3. **Risks to the development of economic activity**
Weighted net figures



Note. The lines show the net figures for those companies that say that the risks are greater (smaller) than normal at present.

The construction companies are mainly worried about what will happen with investments in infrastructure going forward. In the case of consumer-related companies, it is mainly a lack of clarity about tax regulations, for example concerning employers' contributions for young people, that are affecting their plans for the future. The companies' employment plans will be affected if the subsidised employers' contributions for young people are abolished.

Discussions concerning possible amortisation requirements and cutting tax deductions for interest expenditure are also contributing to uncertainty about the households' future scope for consumption.

“NO INFLATION – WE ARE CUTTING COSTS ALL THE TIME”

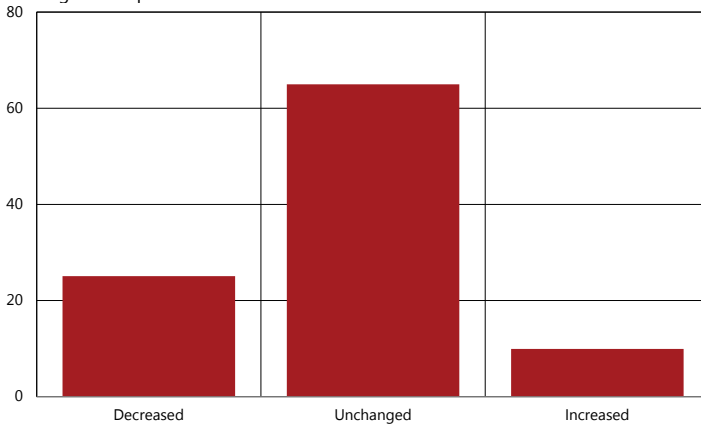
In January, the companies were asked about the development of average unit costs. For most companies these costs have remained unchanged over the last three months, see Figure 4.

Approximately a quarter of the companies reported that unit costs have fallen, which is partly due to falling world-market prices for commodities but also to the companies' own efforts to improve efficiency.

These efforts have been underway for a long time but have been intensified in recent years. In the manufacturing sector the attempt to cut costs entails improving machinery capacity, while in the retail sector it is a question of increasing sales per employee. The companies do this, for example, by updating the software in machinery in the manufacturing sector and by increasing the degree of self-service in the shops.

These changes mean that the companies need to develop the skills and expertise of their existing workforces and they are therefore increasingly recruiting qualified personnel with other skills than previously.

Diagram 4. **Companies' unit costs over the last three months**
Weighted responses



Note. The question was worded as follows: How have average unit costs developed over the last three months compared with the previous three months?

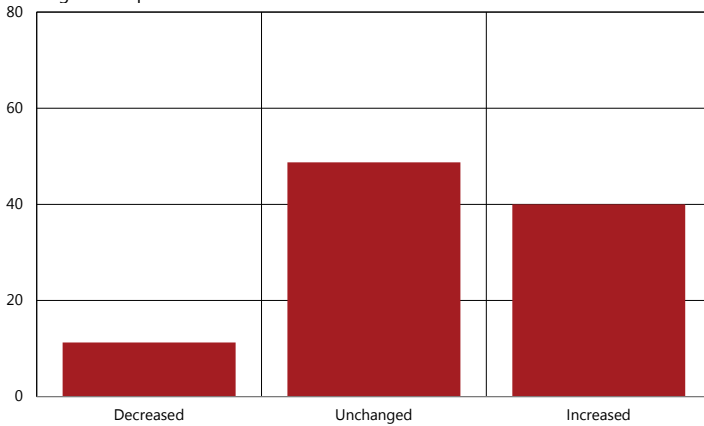
"ALL THE EASY SAVINGS HAVE ALREADY BEEN MADE"

As several companies have carried out major rationalisation programmes in recent years, few of them are now planning to make further staff cuts. The companies are instead using other measures to reduce labour costs. One way of doing this is to optimise schedules, which means that they are working to reduce additional payments of various kinds. The companies are also more restrictive about wage increases over and above those they have agreed in central negotiations.

SLIGHTLY HIGHER MARGINS

The response of most of the companies, as in the case of unit costs, is that margins have also remained unchanged, see Figure 5.

Diagram 5. **Companies' margins over the last three months**
Weighted responses



Note. The question was worded as follows: What is your assessment of how net margins have developed over the last three months compared with the previous three months?

Around 40 per cent of the companies responded that margins have increased over the last three months. Slightly more than a third of these said that the increased margins are due to lower unit costs. However, for most of the companies the development of margins is a result of the recent strengthening of the US dollar. A few of the companies have also managed to raise their prices recently, although the increases have been slight in many cases.

However, the fact that margins have increased over the last three months does not change the companies' view that margins are lower than normal, and most of them hope to be able to increase their margins in the period ahead.

EXCHANGE RATE STRENGTHENING PROFITABILITY FOR EXPORT COMPANIES

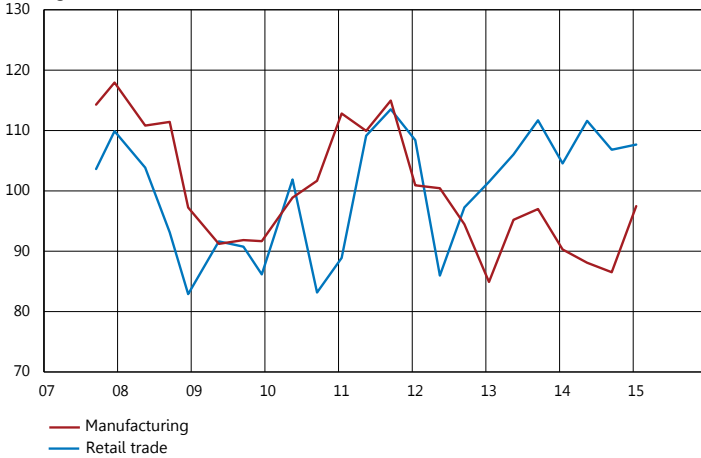
The Swedish krona has weakened against other currencies, and particularly against the US dollar, over the last six months. When the Swedish krona weakens against other currencies it strengthens the profitability of global exporters, while domestic companies meet higher costs.

The fact that commodity prices in dollars have also fallen during the period has reinforced the effect of the weaker krona and profitability has improved, especially for manufacturing companies, see Figure 6.

Changes in exchange rates generally have small effects on sales prices in the near term. They affect margins and profitability instead.

However, if the lower exchange rate persists, the companies say that they will compensate for their costs by raising prices.

Diagram 6. **Companies' perception of profitability**
Weighted index



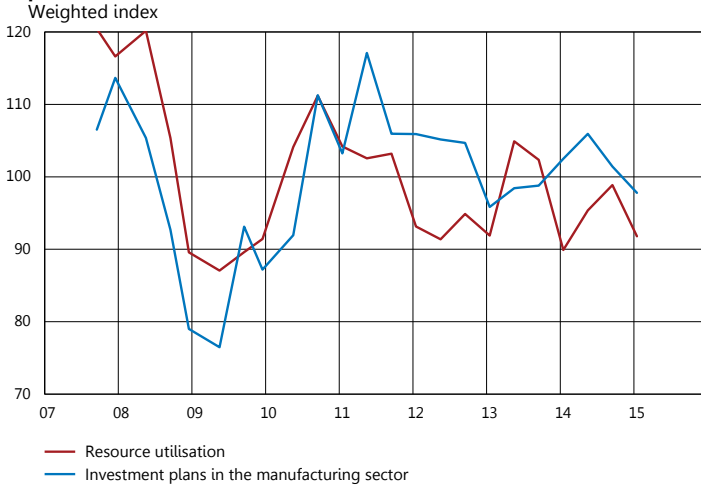
Note. Index shows a standardised value (mean value = 100 and standard deviation = 10) for the balance between the percentage of responses stating that profitability is good and that it is poor.

"WE'RE KEEPING A TIGHT HOLD ON OUR INVESTMENT MONEY RIGHT NOW"

As in September, many manufacturing companies reported that they are focusing most of their investments on improving the efficiency of existing operations and not on increasing production capacity. As capacity utilisation is still low and most companies will have no problem meeting an increase in demand, the manufacturing sector's need to invest for growth is limited, see Figure 7.

Investment plans are somewhat more positive in other sectors. The planned investments often relate to IT systems and better warehousing and logistics solutions.

Diagram 7. **Companies' resource utilisation and manufacturing sector's investment plans**



Note. Index shows a standardised value (mean value = 100 and standard deviation = 10) for the balance between the percentage of responses that investment plans for the next six months have increased or decreased. Capacity utilisation is a combination of two questions ("Is there a shortage of labour?" and "Can you manage an unexpected increase in demand?").

"EVERYTHING HAS TO HAPPEN MUCH MORE IN REAL TIME"

A question that has been much discussed recently is to what extent digitalisation is affecting the economy. In this survey, the Riksbank therefore specifically asked whether the companies had invested in information technology that had affected their core operations over the last three years.

The consumer-related companies have invested in such technology in order to be able to gather and interlink data from different parts of their operations. This improves the possibility to create specific offers to each individual customer, which is seen as an important competitive advantage.

In addition to more effective communication with their customers, consumer-related companies see that access to data increases their possibilities to cut costs in every part of the goods chain, from purchase to storage and, finally, transportation to the shops. However, this work is part of a continuous improvement programme and the companies make it clear that the new technology does not involve any "big bang" for productivity development.

"THE ONLY LIMIT IS OUR IMAGINATION"

For the manufacturing companies, the IT investments have above all entailed introducing information technology into the products being developed. Among other things, this enables the products to gather and process data. One example is provided by eSafety systems in vehi-

cles, which collect data on road conditions and the like and communicate this to other interested parties.

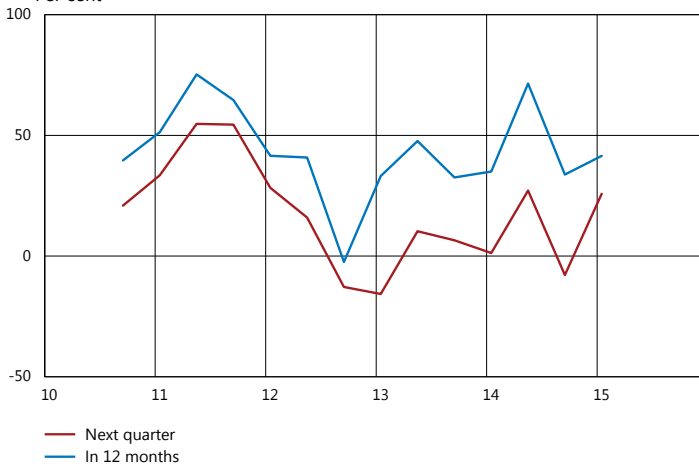
The production processes seem to be less affected by IT investments. The companies speak instead about a continuous improvement of existing technology that gradually increases productivity.

Companies in the telecom industry have to a greater extent invested in new technology in recent years in order to increase productivity in their operations. This has led to major changes in working methods and organisation. Companies in this sector also believe that investments in new technology will continue to be central to improving productivity in the near future.

"WE HAVE TO BE VERY CAREFUL ABOUT PRICES"

Slightly more companies than previously are planning to raise prices three and twelve months ahead, see Figure 8. But the unchanged economic situation, together with severe competition, is reducing the level of companies' planned price increases. This applies in particular to consumer-related companies. Since the survey conducted in May 2013, these companies have continually revised their pricing plans twelve months ahead. Expectations are higher for companies in other sectors, but few believe in price increases of more than 1 per cent.

Diagram 8. **Companies' pricing plans three and twelve months ahead**
Per cent



Note. The net totals show the percentage of responses as to whether prices will be increased or decreased.

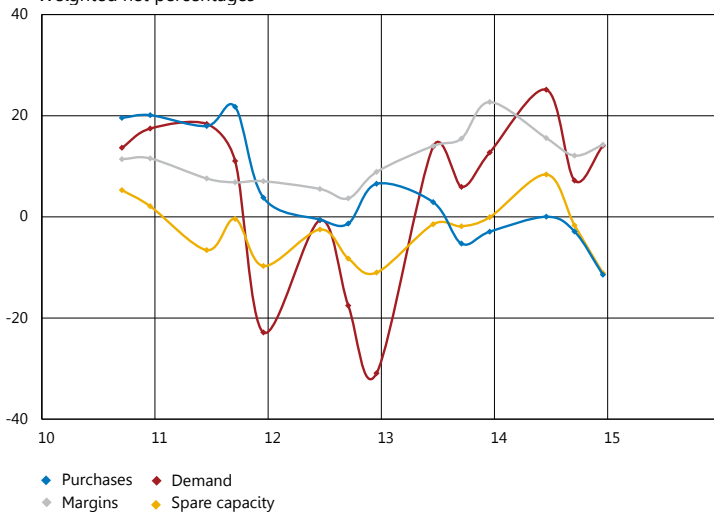
"DEMAND TOO WEAK TO MAINTAIN PRICES"

For the last two years the companies have been hoping that demand will increase. Together with their need to increase margins, this has been an important factor behind the planned price increases, see Figure 9.

In January, the companies reported that demand and margins are still important driving forces behind their pricing plans, while falling commodity prices and spare capacity are expected to subdue pricing plans in the year ahead.

However, demand is the single most important factor for enabling price rises in the period ahead and some companies, above all in the manufacturing sector, expect a future increase in demand to provide scope for slight price increases. At the same time, companies in all sectors feel that competition is stiff, which is holding back price increases. A revealing comment from one executive was that "we can no longer pass everything on to the customers". The focus is instead on working harder with costs in order to maintain margins and profitability.

Diagram 9. **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. A point above (below) zero means that the factor will contribute rising (falling) prices in the period ahead.

ECOMMERCE AFFECTING CONSUMER BEHAVIOUR

Sales over the Internet (eCommerce) have increased successively in recent years. In the January survey, retail companies were therefore asked how they view the development of eCommerce and how it is affecting their operations.

Overall eCommerce sales are at low levels despite the substantial growth in recent years. However, there are major differences between different segments.

In the non-durable goods segment, eCommerce accounts for a very small proportion of sales, while it is more significant for other

retail companies. Many companies say there is evidence of a change in consumer behaviour due to eCommerce and some of these companies have noted a fall in retail-outlet sales.

eCommerce has also led to increased price transparency as the companies products and prices are available on the Internet. This means that consumers can easily compare the price that many different retailers charge for the same product before they decide to buy, which makes it more difficult for the companies to increase the prices offered to their customers. Companies that have falling retail-outlet sales report that this has not yet had any substantial effect on their future planning. However, if eCommerce continues to increase this may contribute to the companies reducing their outlet networks and the number of sales staff in their shops.

Most of the retail companies are investing in IT infrastructure to facilitate eCommerce, but they also say that it will take time before eCommerce accounts for a significant part of their turnover, particularly in the non-durable goods segment.

ABOUT THE RIKSBANK'S BUSINESS SURVEY

The Riksbank's Business Survey should 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, usually 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. Sometimes, the companies are also asked specific questions on current issues regarding monetary policy.

The survey entails interviewing approximately 40 companies in May, September and January. Over 300 companies have taken part in the survey since the Riksbank began conducting it 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 January 2015 report presents the results of interviews with 42 companies, which were mainly held between 7 January and 21 January.

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_sve.pdf



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