

# The Riksbank's Business Survey

WEAKER KRONA SUPPORTS MANUFACTURING INDUSTRY AND  
LEADS TO HIGHER PRICES

May 2015



## ■ The Riksbank's business survey in May 2015<sup>1</sup>

*The Riksbank's Business Survey in May shows that economic activity is continuing to strengthen in a stable manner. The krona has weakened over the past year, which has led to increased profitability in the manufacturing industry and higher prices, particularly in the retail sector.*

*The krona has weakened since spring 2014, and this has gradually contributed to higher profitability for the export industry. Although the demand for exports does not at present correspond to the industry's expectations, they are assuming that exports will rise as soon as global economic activity picks up. For importing companies, on the other hand, the weaker krona has entailed increased costs. They have to some extent already begun to raise their prices, but they will need to raise them further as their profit margins have declined. More retail companies than before now believe that prices will rise and although competition is still considered to be tough, the planned price increases are higher than they have been for several years.*

*Construction companies are on the whole very satisfied with developments in recent months. The uncertainty over future public sector investment in the infrastructure is felt to have declined, and demand for housing to have increased, partly due to the low interest rates. However, Swedish interest rates appear to have less significance for manufacturing companies' investment plans. For them, general demand abroad is a more important factor.*

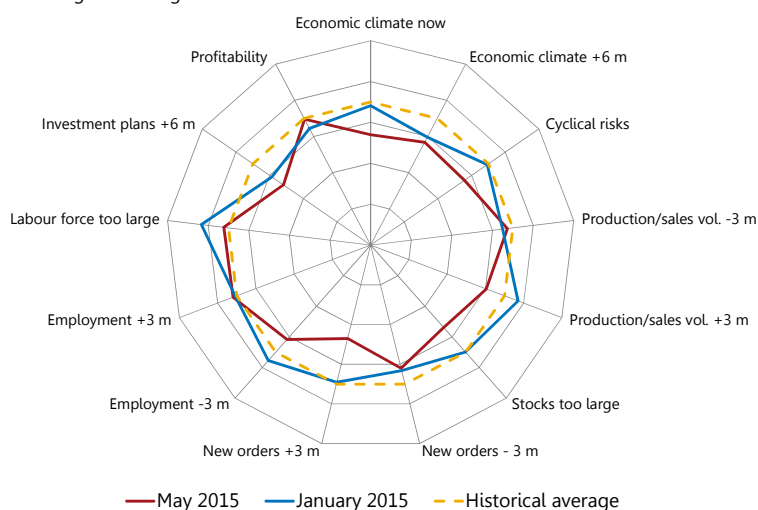
"THERE IS A SLIGHTLY MORE POSITIVE VIEW NOW THAN BEFORE"

The overall response pattern in the Business Survey indicates that economic activity has strengthened somewhat since January and that it is continuing to strengthen. Compared with the historical average, companies are now generally more optimistic in their view of economic activity, see Figure 1.

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<sup>1</sup>Three 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 248,000 employees in Sweden were interviewed this time.

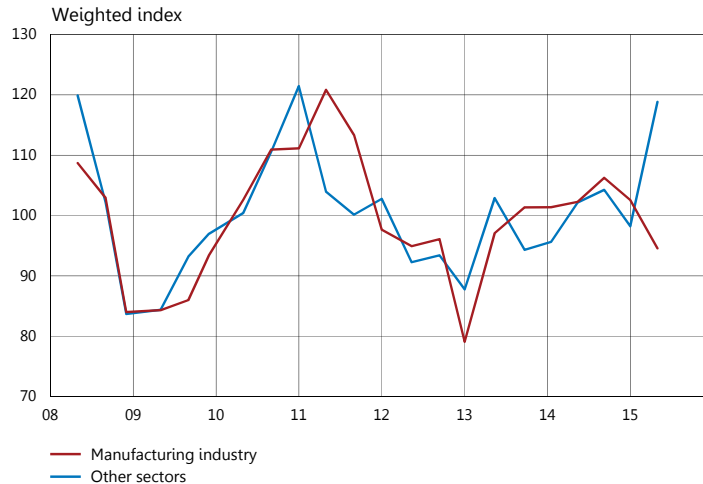
**Figure 1. The companies' overall response patterns**  
Weighted net figures



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.

However, economic activity is divided. Companies active on the domestic market, such as those in the construction, retail and service industries, have on the whole a brighter view of the current economic situation than before, while the manufacturing industry is somewhat more negative, see Figure 2. Although export companies benefit from the krona weakening, global economic activity is not perceived to be accelerating properly and demand is thus lower than expected. Comments such as "we are not growing organically, but in terms of SEK" are significant for the manufacturing industry when production growth is moving sideways.

**Figure 2. Economic activity now divided into manufacturing industry and other sectors**



Note. The index figures show a standardised value (mean value = 100 and standard deviation = 10) for the sum of the percentage of responses stating that profitability is good and that it is poor.

### "EUROPE LOOKS OK AT THE MOMENT – BUT THE SITUATION IS DELICATE"

The recovery in Europe is continuing, but at a slow pace. Demand is said to be good in the United Kingdom, as before, and there are an increasing number of positive signs from Italy, while developments in France are the opposite to the rest of western Europe. The conditions for economic activity in the United States are good, but several export companies are nevertheless stating that they have been somewhat weaker than expected. One factor that has an impact is the low oil price, which is holding back investments in the oil and energy sector.

In China, companies are noticing a general downswing in demand. The risk of price falls has thus increased and as the Chinese market has a major impact on global market prices, several companies are worried. Demand remains weak in Russia and Brazil, and companies do not see any improvement in the near future.

### "WE HAVE A BETTER MARKET DEVELOPMENT THAN EARLIER THIS YEAR"

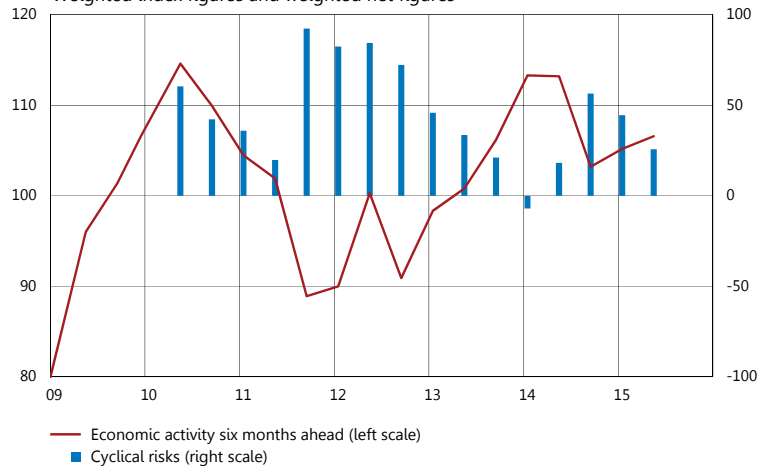
The retail trade reports more positive sentiment in general, with a growing market for the non-durable goods segment and price increases on food. Households' good purchasing power has also benefited the services companies directed at Swedish consumers. Both the hotel and travel industries are experiencing good demand. Construction companies report strong growth in housing investment,

mainly concentrated on metropolitan areas. The high demand also means that prices of newly-produced homes increase.

"IT'S FAIRLY STABLE"

The risk of a deterioration in economic activity have now declined, see Figure 3. In January there was concern in several industries over what impact the political decision would have on construction and employment terms, for instance.

**Figure 3. Economic activity in the period ahead and cyclical risks**  
Weighted index figures and weighted net figures



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

The uncertainty that prevailed at the start of the years has dampened in that it is now clear, for instance, that the discount on employers' social security contribution for young people will be abolished. There is also greater clarity on coming infrastructure projects, which benefits construction companies. As the manufacturing industry sees a small improvement in developments in Europe in the coming period, all segments are optimistic about future economic activity and are expecting increased production, sales and orders. All in all, the Business Survey's indicator point to growth strengthening in the coming period, see Figure 4.

**Figure 4. 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.

#### INCREASED PRODUCTION BUT NO NEED FOR NEW RECRUITMENT

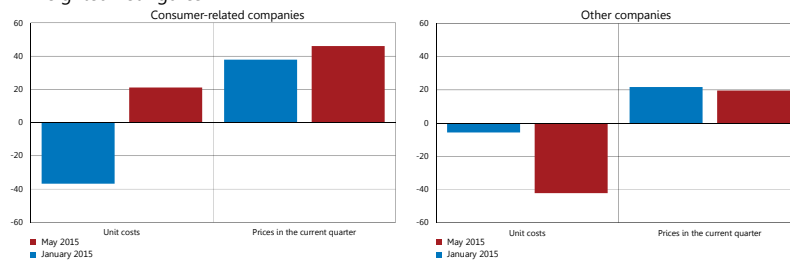
Despite somewhat increased optimism, companies in the manufacturing sector state that there is still considerable pressure to rationalise their operations and to continuously adapt production processes and make them more efficient. On the one hand, there will probably be no major staff cutbacks, but on the other hand the staff is not expected to grow in the coming period, even if economic activity improves. Most manufacturing companies have the capacity to increase their production significantly without any new recruitment. One company said "There is a slightly more positive view now than before, but at the same time one must remember that there is a large installed capacity".

There is also considerable pressure to improve productivity in the retail and service industries. Costs will increase in that the employers' social security contribution for young people is being raised and this puts further pressure on companies to become more efficient. The companies in these sectors will review their schedules and optimise staffing in relation to demand, to hold down the number of hours worked. The effect is expected to be both that the number of employees declines and that the increased costs are passed on to the customers.

## DIVIDED COST DEVELOPMENT

Developments in costs and prices have differed between the various industries, see Figure 5. Unit costs, measured as the cost per unit produced (or equivalent) have declined in the manufacturing industry, partly thanks to lower commodity prices and continued efficiency gains. On the contrary, they have increased substantially in the consumer-related industries, which include the retail trade and the service companies mainly aimed at households. The latter mainly highlight the weak krona in relation to the dollar as a reason for cost increases. To some extent, consumer-related companies have already passed on the costs to their customers by raising their sales prices, while companies with falling unit costs have held prices relatively unchanged.

**Figure 5. Unit costs and price changes for the current quarter**  
Weighted net figures



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

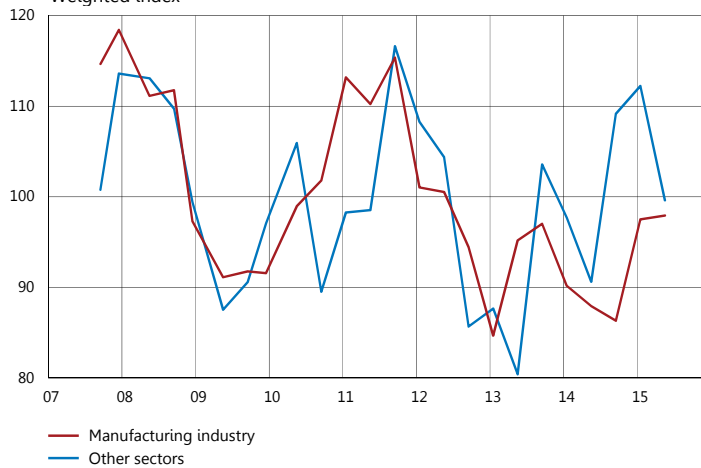


"THE EXCHANGE RATE NEEDS TO CHANGE, BUT IT MUST BE ALLOWED TO TAKE TIME"

The manufacturing industry, and above all export companies, will benefit as before from the weak krona and are now somewhat more satisfied with their profitability than before, see Figure 6. However, there is some concern among export companies regarding future exchange rate developments. One company pointed out that: "It is important that the krona is not too strong if we are to be able to compete in Europe". As production costs are to some extent sluggish, a too fast appreciation of the Swedish krona could lead to a fall in the manufacturing industry's profitability. At the same time as several companies are expressing concern that the krona will strengthen, the increased exchange rate fluctuations are a problem. Normally, exchange rate fluctuations have little effect on sales prices for export companies, but over the past year the fluctuations have been so large that the companies have been forced to change their prices on several occasions.

Other sectors that have experienced increased unit costs have not fully succeeded in compensating themselves and say that profitability has deteriorated recently.

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



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

## "CONSUMERS ARE NOT USED TO PRICE INCREASES"

For the first time since spring 2013, consumer-related companies are raising the level of their pricing plans expressed in per cent, see Figure 7. But at the same time there is uncertainty within the retail trade in particular as to how increased import costs should be managed. There is still tough competition and in several industries customers' price comparisons are made easier by the increase in e-commerce. Companies are therefore allowing cost increases to affect their margins first and foremost, at the same time as working intensively on reducing other costs. By becoming better at negotiating with suppliers or increasing the productivity of their operations in other ways, companies are trying to avoid raising their sales prices as long as possible. Statements such as "one tries not to, but finally one has to" are characteristic of companies importing goods priced in dollars.

**Figure 7. Companies' pricing plans 12 months ahead**  
Weighted expected price increases, per cent

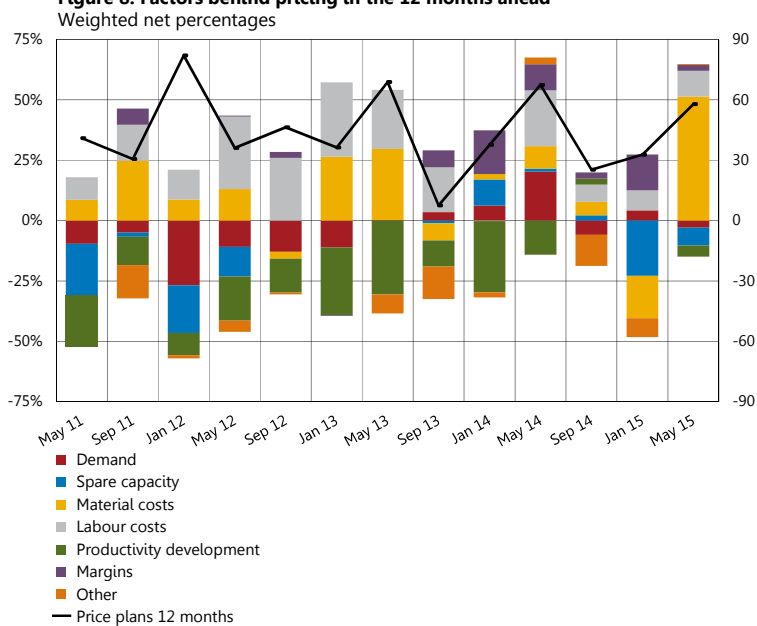


Note. Shows companies' weighted expected pricing plans 12 months ahead.

## "WE WILL NOTICE THE WEAKENING OF THE KRONA"

The consumer-related companies' main motivation for raising prices over the next year is the increase in material costs linked with the weakening of the krona, see Figure 8. Several companies within the retail and service sectors say that a change in exchange rates will not have a direct impact on sales prices as they hedge part of their purchases via forward contracts. It can thus take up to a year for an exchange rate fluctuation to have an impact on sales prices. However, all in all, more companies than before intend to increase their sales prices over the coming year. Demand, which is usually an important factor, is of secondary importance for these companies' pricing plans this time.

**Figure 8. Factors behind pricing in the 12 months ahead**

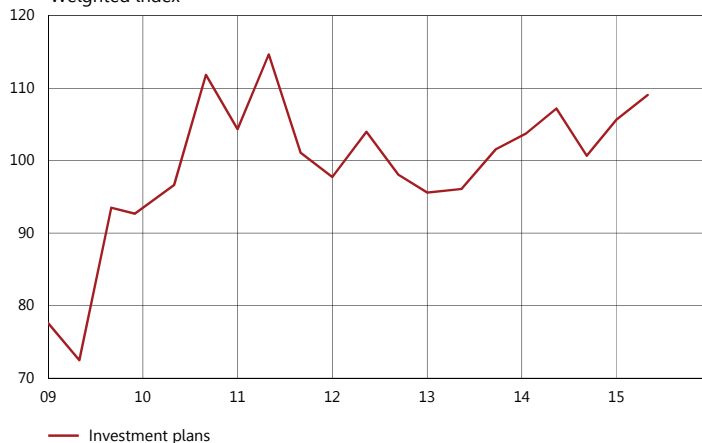


Note. The bars (left scale) show the net balance between responses that the factor concerned will have an upward or downward effect on prices in the year ahead. A bar above (below) zero means that the factor will contribute to rising (falling) prices in the period ahead. The net totals (right scale) show the percentage of responses as to whether prices will be increased or decreased over the next 12 months.

### "WE'RE DOING THE SAME AS EVERYBODY ELSE – WAITING"

In the survey in May, the companies were asked specifically about the extent of their investment plans. Apart from developments in the near term, the direction and underlying causes of the companies' investment plans in the long term were also discussed. All in all, the companies expect investments to increase somewhat over the next six months, see Figure 9.

**Figure 9. The companies' investment plans**  
Weighted index



Note. The index shows a standardised value (mean value = 100 and standard deviation = 10) for the total share of responses showing that investment plans for the next six months have increased or decreased.

For the manufacturing industry, the investments primarily refer to replacements and investments aimed at increasing productivity. One company from the manufacturing industry expressed this as "investments for increased productivity are actually the only investments that can be recouped today." Apart from continual maintenance investments, retail trade and services companies are as before talking a lot about investments in digital technology to increase productivity and increase e-commerce.

### "LIKE FUEL FOR THE HOUSING MARKET"

The low interest rates and urbanisation are two important factors lying behind the increased demand for housing in the major cities. Demand and high housing prices have pushed housing investments up for the construction companies and they are now finding it difficult to increase the rate of construction as much and as rapidly as actually required by demand. One company representative said: "If we had more land and resources, we would be able to start more in Stockholm. The demand is there, but we're close to maximum production with the resources we have at present." One long-term

challenge for the construction industry is that the process for starting new projects is so long." One company representative said: "On average, it takes seven years for a project to get going", which is due to planning permission, development plans and the usual appeals.

#### INTEREST OF SECONDARY IMPORTANCE IN INVESTMENT DECISIONS

In general, the companies report that access to capital is good and that conditions for external funding are very favourable. One company representative expressed this by saying: "Money is free". However, the present interest rate situation is not reported to be affecting the larger manufacturing companies' investment decisions to any greater extent. For these companies, demand is the single most important factor behind investment decisions, even if other, more company-specific causes such as product cycles also weigh heavily. The present low interest rates are also reported to be having little direct impact on the investment plans of companies in the retail trade and services sectors. At the same time, it is regarded as one of the causes behind households' strong purchasing power.

#### "IF WE DON'T INVEST, WE'LL DIE"

The manufacturing industry sees Sweden as an important country to invest in over the long term. One company executive expressed this by saying: "We have a large and important structure in Sweden that we have to maintain and intend to keep." But predictable and favourable conditions to work under are a prerequisite for the companies to continue to invest in Sweden over the long term. This is reported to be particularly important for the manufacturing sector companies, as, compared to other countries in which competitors are active, conditions in Sweden need to be good for the companies to continue to be competitive in the future.

## "THE NEGATIVE INTEREST RATE HAS NOT PERMEATED THE ENTIRE SYSTEM"

Interviews with the companies on the present interest rate levels have revealed that new situations have arisen due to the negative interest rate. Some companies report that the banks are setting a floor for the lending rate at the same time as the deposit rate has been allowed to fall and, in certain cases, become negative. Occasionally, this has led to cash accounts, previously held locally, now being transferred to the parent group overseas as the Swedish company no longer receives any interest on the money in Sweden. This means that the companies, in various ways, are trying to minimise their own cash accounts or other liquid funds, which, in some cases, may also result in the companies reducing their borrowing. In addition, there is also a general unease over what the low interest rates may lead to for the Swedish economy if the valuation of assets, which have rapidly increased in price due to the low interest rates, was to be adjusted downwards.

#### 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 figures in the report present the companies' responses weighted in terms of the respective companies' number of employees in Sweden. The indexes in the figures capture upturns and downturns in the pattern of responses well. These responses are then combined with the companies' reflections during the interviews. The May 2015 report presents the results of interviews with 42 companies, which were mainly held between 4 May and 22 May.

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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