



The Riksbank's Business Survey

Low price increases despite high level of
economic activity

May 2016

Low price increases despite high level of economic activity¹

There is still a high level of economic activity in Sweden and the construction sector in particular is at full throttle. The export companies previously hit by the falls in energy and commodity prices are now starting to recover while demand in Europe is rising and providing better sales and profitability. The risk of economic activity deteriorating is deemed to have decreased and companies do not think that the United Kingdom's imminent referendum on EU membership will change this picture.

Companies in an increasing number of sectors report that it has become more difficult to recruit highly skilled specialists. Salaries for these groups are starting to drift upwards although total salary costs are not rising to any great extent as the availability of less skilled personnel is still good.

As a result of bank deposit fees and the negative deposit rate, companies with large amounts of cash are trying to reinvest their liquidity so as to avoid these new costs. Only a few companies are therefore paying for their bank deposits.

Last year's price rises in the retail sector were largely due to the increase in purchasing costs caused by the strengthening US dollar. Now, companies' plans to raise prices in the year ahead are once again very restrained. In a longer perspective, companies think that greater transparency due to the growth in eCommerce and digitalisation will increase competition. This makes it difficult to raise prices.

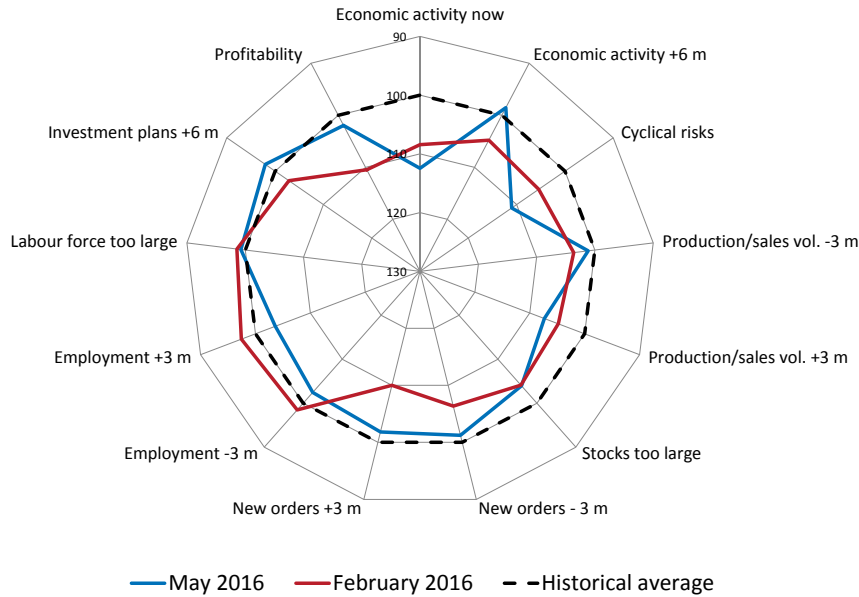
“The level of economic activity is high, no doubt about it”

The overall response pattern from the survey in May shows that the level of economic activity is high, see Figure 1.

The construction and property sectors continue to perform strongly. Companies in these sectors have large-scale production and investment plans, the vacancy rate in commercial properties is very low and construction companies have a long order-book secured. Domestic consumer-related companies in retail and the private services sector also report a high level of economic activity. They meet consumers with good purchasing power who buy capital goods and travel abroad on holiday. Despite geopolitical unease, travel companies are seeing persistent and strong demand while car dealers are reporting record sales and continued good sales prospects.

¹ Three times a year, the Riksbank interviews the largest companies in the construction, retail, manufacturing and part of the service sectors. Representatives of 43 companies with a total of approximately 275 000 employees in Sweden were interviewed this time.

Figure 1. The companies' overall response patterns
Weighted index



Note. The responses to the questions are plotted along "spokes" in the figure where an index figure closer to the centre is better. The historical average is calculated for the periods when 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.

Signs of more stable demand in China

The situation in China over the past year has been difficult for many Swedish exporters due to the fall in both the demand and prices of several commodities. In general, the Chinese economy now seems to be on firmer ground and there are signs that sales may pick up again after previous declines. But the recovery is seen as fragile and there are concerns that price increases in commodities this spring may be a "false start". Other manufacturing companies with less exposure to the commodity industry see a continuing positive development, however. One business leader says: "There's a lot of moaning about China but our sales continue to grow".

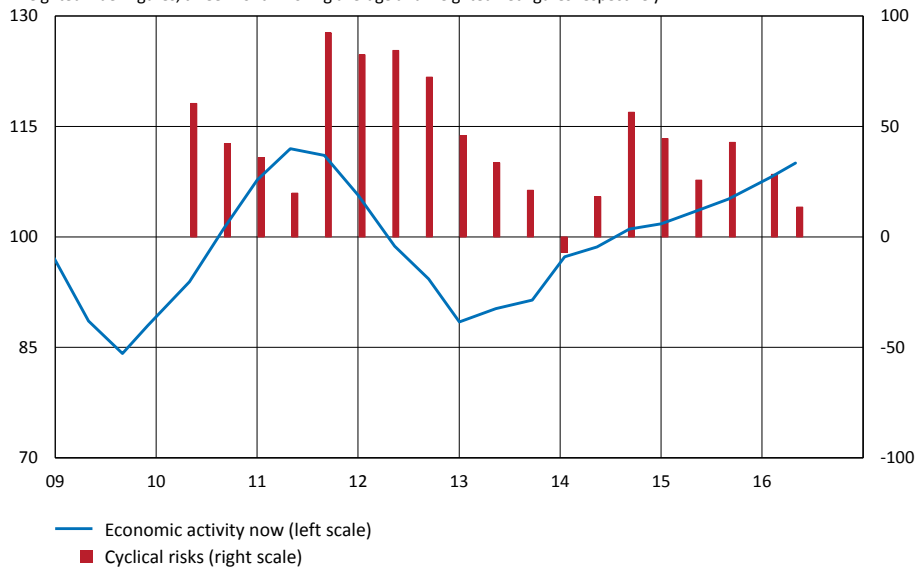
At the same time, export companies report a steady improvement in economic activity on the all-important European markets, where Germany in particular continues to grow. Although demand has also strengthened in several countries in southern Europe albeit from low levels. There is no sign of improvement in South America, however, while demand on the North American market has risen slightly.

"There is no heightened risk"

Despite the discussions about the United Kingdom's possible exit from the EU, the risk of a dip in economic activity is perceived to be less than previously, see Figure 2. It is above all unease among export companies about global developments that has decreased. In May, companies received a special question about the risks associated with a possible Brexit. In general, companies do not believe that the United Kingdom will leave the EU and neither have they drafted any particular plans for such an event. If the Brexiters win, companies are mostly worried about a further weakening of the British pound, which would weigh on their profitability. In the short term, they do not expect trade to be affected to any great extent.

Figure 2. Economic situation and economic risks

Weighted index figures, three-month moving average and weighted net figures respectively



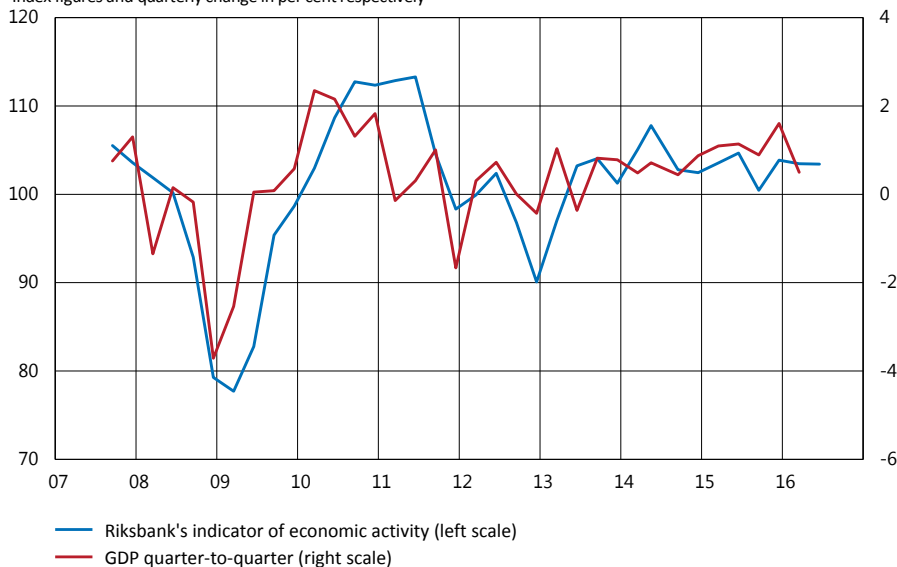
Note. The weighted index figures show a standardised value (mean value = 100 and standard deviation = 10) of the net figures for the companies that say that the economic situation is good or bad. The line shows these weighted index figures expressed as a three-month moving average. The columns show the weighted net figures for those companies that say that the risks are currently greater or smaller than normal.

The indicator of economic activity points to continuing good growth

The Business Survey in May indicates a good economic situation with reduced risks. All in all, demand continues to strengthen and the Business Survey's indicator of economic activity shows continued good growth during the second quarter of 2016, see Figure 3.

Figure 3. The Business Survey's indicator of economic activity and changes in GDP

Index figures and quarterly change in per cent respectively



Note. The Business Survey's indicator of economic activity 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 business 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.

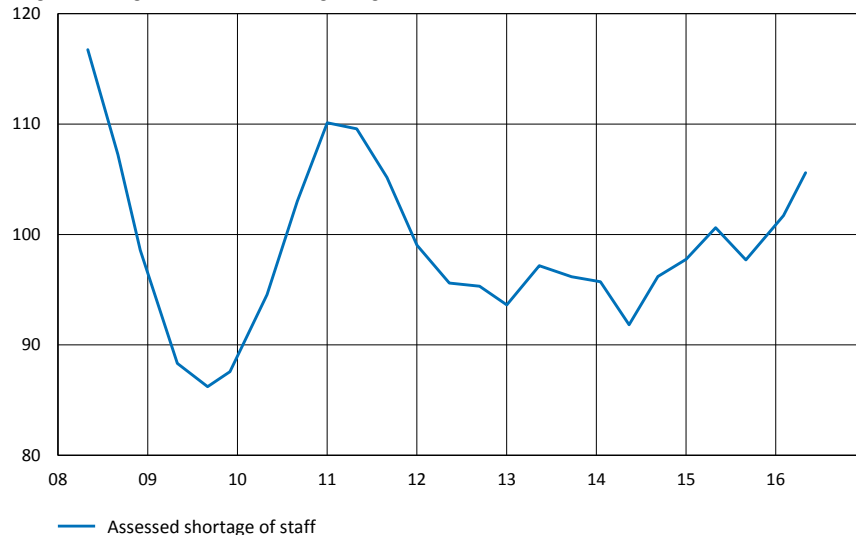
“It’s becoming more difficult to find the right skills”

The improved economic situation also leads to a gradual increase in output and employment. An increasing number of companies say that they are having difficulty recruiting experienced and qualified specialists and that the shortage is, in some cases, starting to become a problem, see Figure 4. In addition to the continued shortage of project managers and construction engineers in the construction sector, other industries are now reporting the lengthy processes needed to obtain personnel with the right skills. Staffing companies point out the particular shortage of IT specialists as well as experienced engineers and economists. According to one company, “it is particularly difficult to find engineers - it is a bottleneck for us and we are starting to buy more and more engineering services abroad”.

Salary costs for in-demand professional groups have started to rise. At the same time, staffing companies say that cost pressures have increased for consultants doing simple tasks, which compensates for the wage drift among in-demand specialists. As before, companies are trying to reduce the number of hours worked to hold total costs in check. In this way, they are trying to deal with the increased costs they are incurring as a result of the gradual phase-out of tax rebates for young people.

Figure 4. Companies’ assessment of the shortage of staff

Weighted index figures, three-month moving average



Note. Refers to the retail, construction and service sectors’ assessed shortage of staff.

“Current low interest rates are having very little effect on us”

Despite rising demand, manufacturing companies are not investing to increase their production capacity. In addition to maintenance initiatives, they are mainly investing in order to eradicate minor bottlenecks to improve productivity. As before, they report that individual investment decisions are not directly affected by the low interest rates, but are indirectly affected by higher demand. This can be explained to a certain extent by the fact that more companies are funding their investments via their own cash flow. In a slightly longer perspective, it is also clear that they have strategies to reduce their indebtedness. This is being done to strengthen their balance sheet and increase resilience in the face of future financial challenges and to reduce their dependence on bank funding. Other reasons to reduce their debt are to improve their credit rating in order to secure better funding conditions and to have greater flexibility in their choice of funding.

“The Swedish property market is doing great”

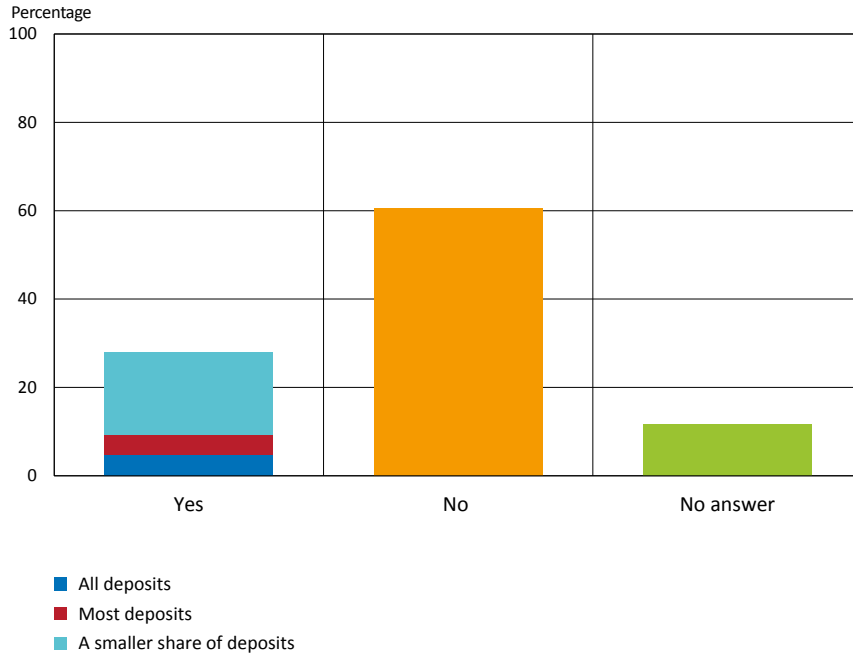
The low interest rates are, on the other hand, affecting property companies' investment to a greater degree. Property companies are increasing the pace of their investment and their investment plans are now, they say, on historically high levels. Profitability is very good and the availability of cheap capital has led an increasing number of new international players entering the Swedish property market. One business leader expressed this as: “Sweden's macro and Stockholm's growth are an attraction”. Investment is mainly being funded by bank loans and equity. Market borrowing is mostly seen as a complement, although the share of market borrowing is increasing and is expected to continue to do so. This is because market borrowing is currently reported to be more advantageous than bank loans and because companies wish to diversify their forms of funding.

“Our current focus is trying to avoid paying for liquidity”

Since February 2015, the repo rate has been negative and companies have previously reported that banks have started to charge for deposits to a certain extent. In May, therefore, companies were asked specifically about negative deposit rates and about deposit fees. It emerged from the discussions that companies with large amounts of cash devote both time and effort to avoiding deposit costs. One of their strategies is to spread their deposits among more banks to avoid exceeding the threshold levels at which banks start to charge. Some are considering investing some of their liquidity in riskier assets in order to avoid current deposit costs. Others are considering changing their view of liquidity entirely and trying to reduce it instead: where previously they have wanted their customers to pay as quickly as possible and pay their suppliers as late as possible, the situation is now the reverse. Their management of payment flows on which they could previously make money is now becoming a cost instead.

The majority of those asked have managed so far to avoid paying for their deposits. But some companies encounter negative interest rates or a fee equivalent to the repo rate on a smaller proportion of their bank deposits, see Figure 5.

In discussions on deposit rates, companies have commented on current monetary policy. On the one hand, there are companies that refer to the connection between the repo rate and the development of the exchange rate and say that recent healthy corporate profits are in part linked to the exchange rate. On the other hand, there are a few companies who are very critical of current monetary policy for various reasons. There are those who think “that the Riksbank's focus on the Swedish krona and not allowing it to appreciate will be problematic in the long term”. The vast majority of companies have a relatively neutral, albeit slightly puzzled, attitude to current monetary policy. Quotes such as “interest rates are a rather different world these days” and “normal principles on the market no longer seem to apply” are particularly telling.

Figure 5. Percentage of companies who pay for their bank deposits

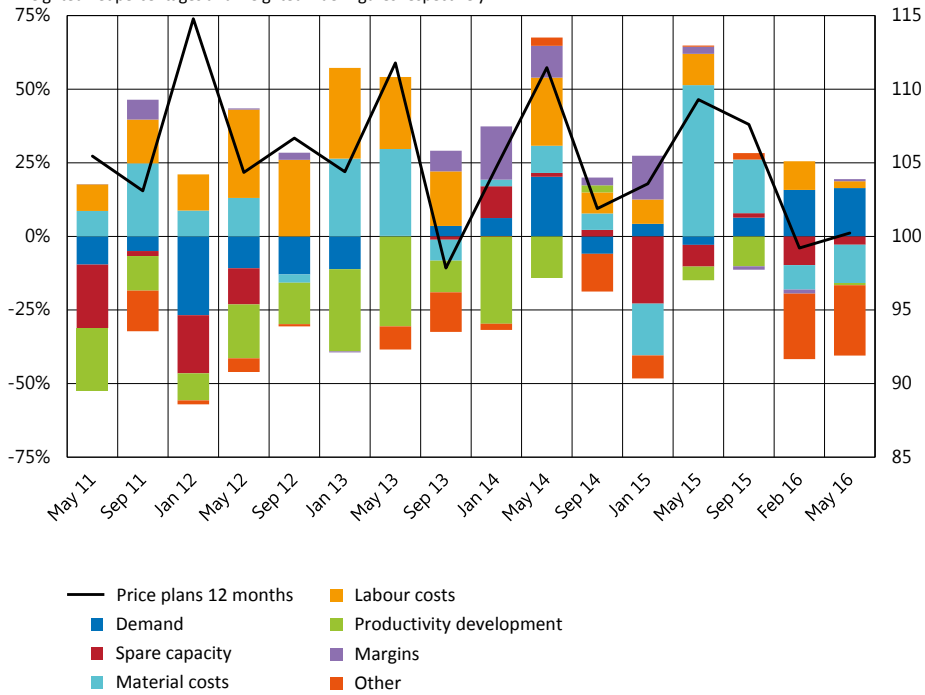
Note. The question posed to companies was “Do you have bank deposits in Swedish kronor at negative nominal interest rates or an equivalent fee?, if yes: “What proportion of your bank deposits is subject to a negative interest rate?”.

“The competition out there is razor-sharp just now”

Despite rising demand, companies generally believe that price trends will be subdued in the year ahead. For consumer-related companies, the pressure to increase prices has now petered out, see Figure 6. Companies have already gradually compensated for the increased purchasing costs in the wake of the last year’s appreciation of the US dollar and are now planning for very minor additional price rises. At the same time, costs are expected to fall in the period ahead, partly because companies believe the krona will appreciate, and partly because the global market prices of, for example, consumer goods are low. In addition, several companies talk of the ever-increasing competition. One striking quote is: “We can’t be more expensive than our competitors. If we are, we won’t sell anything”. In cases where prices are expected to rise, it is almost exclusively due to strong demand.

Figure 6. Driving forces behind pricing in the 12 months ahead, consumer-related companies

Weighted net percentages and weighted index figures respectively



Note. The columns (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 column above (below) zero means that the factor will contribute to rising (falling) prices in the period ahead. In February and May 2016, the "Other" column consists mainly of competition. The weighted index figures (right scale) show a standardised value (mean value = 100 and standard deviation = 10) of the net figures for the companies that responded to the question regarding whether sales prices will be raised or lowered in coming twelve months.

ARTICLE – Competition an important factor in pricing

In the May 2016 survey, in-depth questions have been asked about companies' pricing. The background to this is that companies during the past twelve months have said that they have found it difficult to increase prices despite rising demand and greater cost pressures. An interpretation of the responses is that eCommerce has gradually enabled more companies to enter different markets and given consumers more scope for constantly comparing prices. These are important factors behind the increased competition.

“The distinction between eCommerce and physical trading is becoming increasingly blurred”

Customers are exerting pressure on companies to offer eCommerce and even though it is not immediately profitable, companies are investing in order to satisfy their customers' wishes. Companies say that eCommerce can indeed take market share from their physical shops in the short term but the risk of them losing market share to their competitors if they stand on the sidelines is greater in the long run.

eCommerce has created opportunities for existing companies, who were previously limited to local markets, to expand into new geographical markets. At the same time, thresholds have been gradually lowered for new companies and made it easier and cheaper for them to reach more consumers. A contributory factor to this is the fact that sales are taking place via eCommerce to a greater extent without any requirement for physical shops. Over time, this development has increased competition in several sectors.

“Our price-setting must follow the competition”

And as eCommerce grows, companies can be more flexible when setting their prices. In sectors where online trading is well developed, such as the travel business, this development has been visible for quite some time. Prices change all the time and companies follow sales curves where prices are directly adjusted in the event of deviations from their sales plans. These companies are reducing the number of physical shops they have and primarily use eCommerce channels, where prices can be adjusted directly, and more or less automatically, based on a running price analysis. Even in sectors where eCommerce is not as well established, companies report a similar development. For example, they have cut down on printed catalogues so that prices can be changed more flexibly in physical shops or online.

It seems as though a number of new phenomena have increased price transparency and helped boost competition.

Thanks to digitalisation, consumers can now systematically compare prices before they buy, using for example price comparison websites. Price comparison is very much on the increase and is often possible using a mobile

phone immediately prior to a purchasing decision in a shop. One business leader expressed it thus: “the customer now has complete information all the time”.

This greater price transparency also leads to suppliers being pitted against each other and being pressurised by purchasers, who are becoming increasingly professional.

Even the market-places in which companies operate themselves are becoming increasingly translucent. Companies systematically gather and analyse an increasing amount of detailed data, “Big Data”, in order to keep track of their competitors and the market. They employ different methods of gathering information; by visiting their competitors' shops in person, conducting various types of market surveys and constantly monitoring different price comparison websites.

As transparency and data-driven price analysis increase, companies see a development towards final sales prices being centrally determined to an ever-greater extent. Local price-setters, such as store managers, therefore have less and less influence on prices.

“We cannot be too expensive for our customers”

Companies do not want to risk losing market share by raising their prices first unless their competitors follow suit. To avoid raise prices while maintaining their margins, companies are continuously trying to improve their productivity. A clear example of this is how retail companies are dealing with increased purchasing costs as a result of last year's appreciation in the dollar. As a result of difficulties in passing on the costs directly to the customer, they are, for example, moving production to low-cost countries. The competition is driving costs down, in other words. One business leader in the retail sector expressed it thus: “every cost increase is an incentive to rationalise”.

All in all, the discussions with companies that sell directly to households suggest that easier access to more markets and greater price transparency are the most important factors underpinning the increased competition. Different retail and service sectors have been affected to varying degrees, but the development is expected to continue and will affect more and more companies in the years ahead.

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.

Approximately 40 companies are interviewed as part of the survey in May, September and February. 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 indices 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 2016 report presents the results of interviews with 43 companies, which were mainly held between 2 May and 23 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.

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



SVERIGES RIKSBANK
SE-103 37 Stockholm
(Brunkebergstorg 11)

Tel +46 8 - 787 00 00

Fax +46 8 - 21 05 31

registratorn@riksbank.se

www.riksbank.se