

The Riksbank's Company Interviews

MAY 2010

■ The Riksbank's company interviews in May 2010

Recovery on a broad front, but new financial concern

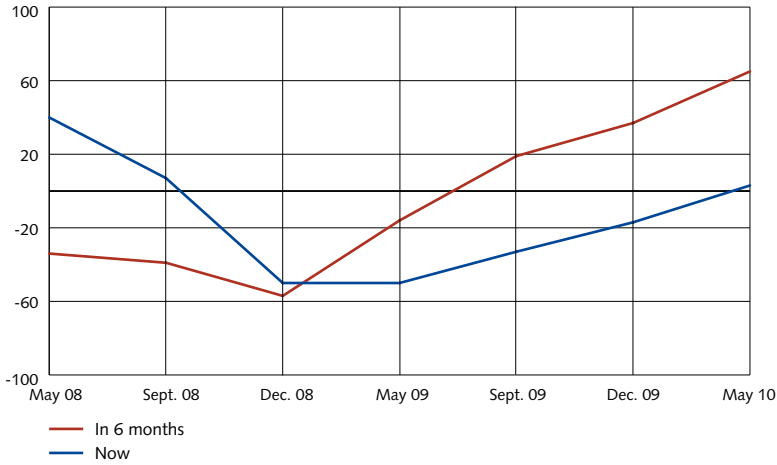
The Riksbank's company interviews in May show that the economy is continuing to recover on a broad front after the crisis.¹ According to the companies, production, orders and employment are increasing, but there is still a long way to go to reach the level of demand that prevailed before the crisis. For the export companies it is mainly the low level of demand from Europe that is restraining development, while the markets in Asia, for example, are exhibiting good growth. The greatest cause of concern about the development of economic activity is linked to the possible consequences of the problems with public finances in the EMU. More than half of the companies were concerned that the development of economic activity may be undermined. Partly as a result of rising commodity prices, the companies now intend to increase their prices more than in the last few years.

The general picture of economic activity presented by the companies is that it has continued to increase from a low level over the last six months, as shown in Figure 1.

The most rapid upturn is in the manufacturing industry, but the construction companies are also experiencing distinct growth. In the retail sector it appears that the economic climate is still good and the expectations are that this will continue to be the case. The companies in the service sector generally expect that economic activity will improve over the next six months.

¹ The Riksbank's interviews with the companies were conducted in May 2010. All of the 62 selected companies were interviewed. For a more detailed presentation of the survey's purpose, methods, sample and so on, we refer to "The design of the Riksbank's company interviews", 2 February 2009, which can be downloaded from the Riksbank's website www.riksbank.se under the heading Press & Published/ Reports. This makes it clear that the sample of companies is not representative of the business sector as a whole but focuses on large companies and that the manufacturing, construction and retail sectors are overrepresented.

Figure 1. Assessment of the economic climate now and in six months' time
Net figures



Note. Weighted net figures based on the number of employees in Sweden at the interviewed companies. The question concerns the companies' assessment of the economic climate now and in six months time. The net figures in the diagram represent the balance between the percentage of companies stating that the economic climate is (is expected to be) good (better) or poor (worse).

Source: The Riksbank

"Demand is good at the moment but we are concerned about what the turbulence may lead to" is a type of comment that reflects many companies' views of the new unease about public finances in the EMU. There is thus underlying optimism, but there is also concern that the upturn is resting on fragile foundations. The effects of the recent crisis following the collapse of Lehman Brothers are still with us to some extent. In addition, the fiscal crisis in Europe is difficult to assess. There are considerable fears that this will have repercussions that will further dampen the rate of the recovery.

HIGHER RISKS THAN "NORMAL"

During the interviews in May, the companies were asked to state what risks they could see with regard to the development of economic activity and how serious they thought these risks were. Approximately 60 per cent of the companies stated that the risks were higher than normal and approximately 35 per cent that they were normal, while only around 5 per cent believed that they were lower than normal. The table below presents the risks mentioned by the companies.

Table 1. What risks do you see regarding the development of economic activity for your company?

	Per cent
Financial concern in the EMU	52
Future interest rate increases	18
The election in September	13
Other risks (credit supply problems, rapid increases in commodity prices, strong krona)	17

The table reveals that concern about the effects of the problems regarding public finances in the EMU has had an immediate and considerable impact, as approximately half of the companies mentioned this as a risk. Many of the interviewees were worried that demand could be curbed by psychological mechanisms both in Sweden and internationally and in connection with fiscal policy restraint measures abroad. Others emphasised the risks relating to the future supply of credit due to this concern about public finances.

Other factors mentioned by many companies were future interest rate increases and the general election in September. It was primarily in the retail sector that many companies were worried that demand would decline if the households' scope for consumption is limited by interest rate increases. Concern about the general election was mainly linked to the difficulty of assessing what rules and regulations may apply in the future.

The percentage of companies that assessed the level of risk to be higher than normal was approximately the same in the various sectors.

Over half of the companies believed the risks to be higher than normal. This result is difficult to interpret as this was the first time this question was asked. This concern should thus be seen in the light of the recent financial crisis.

UPWARD REBOUND IN THE MANUFACTURING INDUSTRY

The upturn in economic activity in the manufacturing industry is tangible and in this survey there are considerably fewer companies that state that the current economic climate is poor compared to the survey in December. *"Things are looking brighter, there has been a strong turnaround"* is one comment from the steel industry. Another indication that the economic climate has improved came from the forestry and paper industry: *"Sales of packaging materials is a good measure of the economic climate and here we have seen an improvement over the last four to six weeks"*.

It must be remembered, however, that the recovery began from very low levels and that the most rapid increase is taking place in those sectors where the downturn was greatest during the crisis. For some companies, production was extremely low in certain periods.

Order intake and production volumes are now increasing again and it is expected that they will continue to do so for most of the companies. The picture presented by the export companies is that a gradual recovery is taking place internationally. Growth is still good in Asia (primarily China), followed by South America. Things are also beginning to move in the USA, while Europe is generally weak with the exception of the Nordic countries and Germany.

However, in some sectors there is concern that parts of the increase in demand may be temporary and linked to the build-up of stocks following extensive destocking during the crisis.

In general, the level of production at the companies is well below capacity. The main impression is that the companies could increase their production rather easily if demand were to increase. In the course of the interviews, several large engineering companies also pointed out that the demand for their products normally arises late in the business cycle.

The manufacturing industry laid off a large number of employees during the crisis. Many large manufacturing companies see most of these cutbacks as permanent as they have managed to improve the efficiency of their production processes. For those companies that are increasing their workforce once again it is usually a case of a limited increase. It can be noted, however, that there is a marked difference between the companies' expectations in December and their responses in May. Many more companies now stated that the number of employees has increased compared with the expectations in December.

LEVEL OF INVESTMENT STILL LOW

In general, the manufacturing companies indicated in May that investments would continue to decline over the next six months. This type of response has been received from the manufacturing companies since the financial crisis began in the autumn of 2008. Prior to this, that is during the boom, many investment decisions were taken with the aim of increasing production capacity, while the aim since then has been to replace or rationalise.

However, the responses of some of the companies deviate from this pattern. In May, there were concrete plans for new investments for expansion in parts of the steel, forestry and automotive industries.

Investment decisions are in turn often dependent on external funding. The large and medium-sized companies that predominate in this survey stated that for their part the funding situation had almost normalised, but that other, smaller companies may still have problems getting loans from the banks. It is therefore possible that the development of investment may be dampened for smaller companies if they have problems with their external funding. In general, the responses and comments of the companies indicate that the level of investment will continue to be low in the six months ahead.

THE MANUFACTURING INDUSTRY IS EXPECTED TO INCREASE ITS PRICES

During the recent crisis, the companies substantially cut their costs by reducing their personnel and increasing the efficiency of their production processes. The fact that a majority of the companies nevertheless characterise their current profit levels as unsatisfactory is due above all to the continuing low level of capacity utilisation. To a certain extent it is also due to the recent significant increases in the price of input goods (commodities) such as metals and wood products.

The manufacturing industry is now experiencing upward pressure on the prices of input goods following a period with stable, or even falling, prices. This applies above all to the iron and steel industry where commodity prices have increased substantially recently and are expected to continue to do so. *"A clear correlation between the development of China and increases in the prices of coal and iron ore"* is one statement from a company that describes how a shortage of commodities is leading to rising prices.

The rising steel prices are in turn due to the considerable increase in the price of iron ore. During the interviews, several companies were also concerned about the plans for a transition from annual to quarterly prices for iron ore. More recent information indicates, however, that the Swedish steel industry will continue to have access to annual contracts for supplies of iron ore.

The companies in the forestry industry also describe a situation in which there are great cost pressures on the commodities side. In the paper industry, the costs for recycled paper and pulp have increased following a period of falling prices. This is partly because China has increased its imports and partly because growth has gradually begun to accelerate in important countries, above all the USA and Germany. A recovery is also clearly evident in the area of packaging material, for which demand arises early in the business cycle.

SLOW, BUT DISTINCT, GROWTH IN THE CONSTRUCTION SECTOR

The major construction companies do not believe that there will be a rapid recovery but see a gradual improvement in the economic climate in which both construction and new orders are steadily increasing. The long and cold winter was a factor that contributed to the delay of a large share of the planned projects, which in turn had an affect on construction and led to a weak first quarter for many of these companies. The economic climate therefore looked better in May, although most of the companies emphasised that the level of uncertainty is high for a cyclically-sensitive sector such as construction.

INCREASED DEMAND FOR HOUSING

The construction companies presented a relatively mixed picture of developments in the different segments of this market. The construction of housing has decreased substantially in recent years, but as the demand for housing has now begun to increase construction is beginning to pick up again. Housing construction is thus the segment that is increasing most, while the construction of commercial properties appears to be more sluggish. Infrastructure construction, which often entails long processes, continues to be a strong market.

The estate agents confirm the picture of an increased demand for housing by stating that price levels for houses and tenant-owned apartments are recovering. *"The entire market was affected in the autumn of 2008. 2009 was a year of recovery."*

Order intake has developed positively and is expected to continue to do so over the next three months. *"I find it very difficult to believe that demand will not pick up now,"* is one of the comments on expectations. Despite the positive assessments of development on the housing side, the construction companies emphasise that there is not sufficient pressure for either the construction of housing or the construction of commercial properties to be able to say that the market is good.

FROM FALLING TO RISING TENDER PRICES

As it is expected that the prices of commodities such as steel and wood products will increase there is a need to increase prices in the three months ahead. The construction companies are therefore counting on tender prices increasing, even though fiercer competition has resulted in a downward pressure on prices.

The financial restrictions that have been an impending problem for the construction industry during the financial crisis now seem to have eased. However, some of the companies still feel that there is somewhat of a shortage of capital for beginning new projects and that the ongoing high margins of the banks make it expensive to start such projects.

The low interest rate together with the ROT scheme (tax deductions for repairs, maintenance, conversions and extensions) have stimulated the demand for construction materials and helped to increase the sales of the builders merchants. The increase in prices for, for example, timber, has also had an impact on the purchasing costs of these companies, which they may need to compensate for with higher prices in the period ahead.

The other industrial and service companies that can provide additional information on the economic climate in the construction sector support the general picture provided by the large construction companies; that is of slow but distinct growth with severe price pressures at present.

THE TRANSPORT SECTOR CONFIRMS THE PICTURE OF A GRADUAL RECOVERY

The transport sector largely reflects the development of the manufacturing and construction sectors as these sectors contribute large transport volumes. The responses of the transport companies therefore appear to confirm the picture of a relatively slow recovery in important parts of the business sector. The transport companies reported that they are able to see certain positive signs, but the recovery is not strong enough to generate any significant effects for the transport sector at present. There are, however, expectations that the economic climate will improve over the next six months.

As this sector was hit hard by the downturn and has not yet recovered there is a lot of excess capacity, above all on the vehicle side, which is squeezing prices and holding back the pent-up need for price increases. *"You could say that we have volumes that justify the personnel situation, but not prices that justify the current workforce,"* is one comment from the transport sector.

The factor that is nevertheless pushing the transport sector in the right direction is the strong development of the Asian markets. In Europe and on the domestic market, however, the same development as in Asia is not apparent, *"Europe is still struggling"*.

"MONEY TO SPEND"

Most of the retail companies reported that sales volumes continued to increase during the spring and many of them also had a positive view of the development of sales volumes in the period ahead. One retailer's comment on the situation was that *"the households have an unusual amount of money to spend."* Others feared that the households will reallocate part of their scope for consumption and, for example, spend more on trips abroad.

Food retailers pointed out that they have benefited from the fact that households have cutback on their visits to restaurants recently and comments from wholesalers that supply restaurants confirm this. It appears that restaurants outside the capital often have a strained situation with fewer guests and lower sales compared to the situation before the financial crisis.

It seems that the regional differences in the development of sales remain in that development in western Sweden is often characterised as weaker than in the Stockholm region and southern Sweden.

"Competition has increased," was a common comment from several of the segments of the retail sector. This type of assessment was made by food retailers, the retailers of building materials and electronics retailers. In the latter segment, several of the companies expected that a fierce struggle for market shares will lead to structural changes.

GRADUAL IMPROVEMENT IN FUNDING

It appears that the gradual improvement in the companies' funding situation has continued. In May, slightly more than half of the companies said that the situation on the financial markets has normalised, while the corresponding figure in December was slightly less than half. There is thus still a significant minority of the companies that do not believe that the situation on the financial markets has normalised, although many add the reservation that it is difficult to assess what can be considered to be a normal situation. Many companies also said that the banks have increased their interest rate margins in a way that indicates an abnormal situation.

The companies' responses to the question of whether access to funding had changed in the latest quarter indicated a somewhat clearer improvement. Most companies answered that this had not changed, but approximately 20 per cent said that it had improved and only a few percent said that it had worsened. The responses to these questions do not differ significantly between the different sectors.

During the interviews in May, the companies were also asked about their views regarding the future development of different forms of funding. Most of the companies did not appear to expect any particular changes and the most common response was that they count on continuing to use a combination of equity capital and bank loans. Among the larger companies, however, there were several that said they were interested in reducing their borrowing from banks and increasing their market funding (bonds, certificates etc.) and there were also a few comments about the difficulty of getting loans at sufficiently long maturities.

The companies' spontaneous comments on their funding included complaints about high interest rate margins and comments from construction companies that it is still a problem to get funding for construction projects. Some of the large companies were also still concerned about the funding situation of their subcontractors. This is because the borrowing requirements of the subcontractors are increasing due to the build up of stocks that occurs when production is increased. It should be pointed out, however, that this survey primarily reflects the situation of large companies.

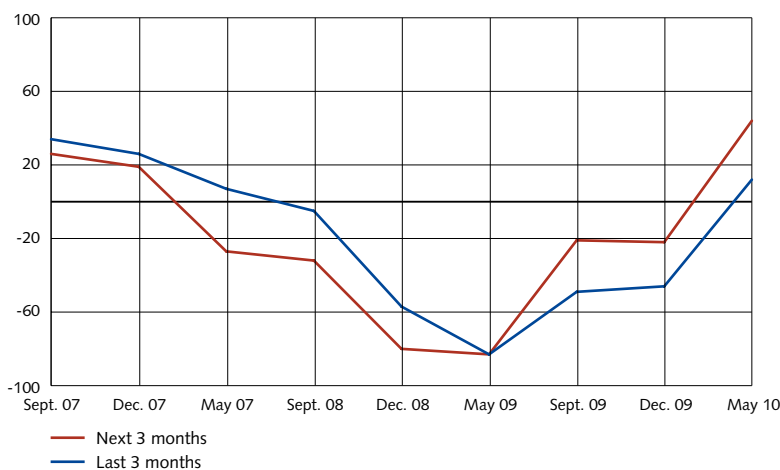
RECRUITMENT LIMITED IN NUMBERS, BUT ON A BROAD FRONT

Many of the interviewed companies are planning for a marginal increase in employment over the next three months and very few are planning to cut jobs. This type of response was received from the manufacturing industry, the retail sector and the other services sector, while the construction companies differed somewhat by reporting a greater need for more personnel.

These responses have a strong impact in terms of the net figures in Figure 2 (difference between those that report increased and those that report decreased employment). The change compared with the responses in the company interviews conducted in December 2009 is considerable. However, it is probable that Figure 2 exaggerates the picture of the increase in employment as many companies pointed out that the increase is marginal.

The employment agencies painted a positive picture of the situation. Both recruitment and leasing assignments appear to be increasing for the agencies, which indicates that these companies are now growing faster than employment as a whole. Part of the explanation for the increase in demand for leasing assignments may be that many companies are still doubtful about employing personnel on a permanent basis.

Figure 2. Assessment of employment
Net figures



Note. Weighted net figures based on the number of employees in Sweden at the interviewed companies. The question relates to the companies' assessments regarding the development of employment in the last three months and in the three months ahead. The net figures in the diagram represent the balance between the percentage of companies stating that employment has increased (is expected to increase) or decreased (is expected to decrease).

Source: The Riksbank

Some companies are planning for larger personnel increases. This applies primarily to the construction sector. Some of the companies in the manufacturing industry that previously made considerable job cuts are also planning to recruit new personnel. However, these plans are generally modest in relation to their previous cuts.

In general, many manufacturing companies are cautious about introducing additional shifts, which would increase their need for personnel. In several cases it appears uncertain whether demand justifies an increase in production. Some engineering companies have also continued to work a four-day week on the production lines.

ADAPTED WORKFORCE

The companies were also asked whether their workforce was adapted to the prevailing level of demand. Those companies that answered that this was not the case were then asked whether the workforce was too large or too small and the reasons for this.

Approximately 80 per cent of the companies reported that they had a workforce adapted to prevailing demand in May, approximately 15 per cent that the workforce was too small and only a few that the workforce was too large. These responses strengthen the impression that the increase in employment is moderate despite the fact that the net figures in Figure 2 show a marked increase.

The fact that only a few of the interviewed companies reported that their workforce was too large indicates that problems relating to surplus staff were limited in May. Spontaneous comments from some companies indicate that having surplus staff may have been more common earlier.

The few companies that have retained a larger workforce than they need gave as the main reasons for this that demand is expected to increase and that it is difficult to find workers with the right skills and know-how. Only one company gave planning ahead of retirements as a reason.

WAGE COST INCREASES STILL LOW

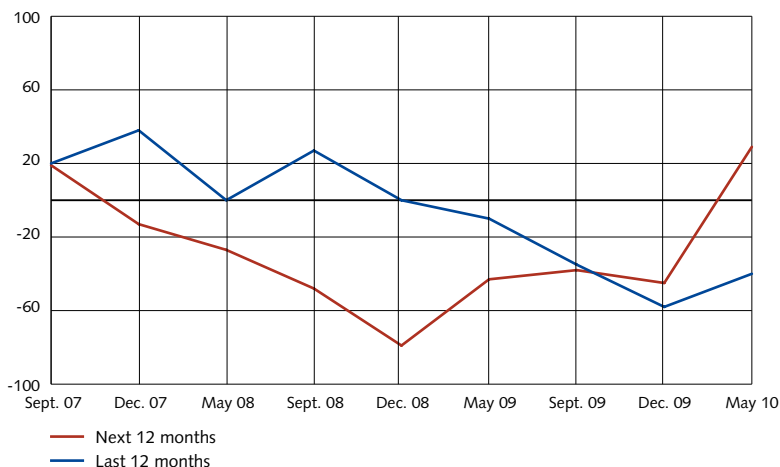
In general, the companies expect the same or a slightly decreasing rate of increase in wages over the next 12 months compared to the rate of increase registered during the last 12 months. The expectations regarding declining pay increases are more widespread in the manufacturing industry than in the other services sector, while several large companies in the construction and retail sectors indicated that there may be some increases, although often from a situation reminiscent of a wage freeze.

The companies' comments on their expectations regarding the development of wage drift are in general relatively similar to their responses concerning the development of wage costs; that is many companies expect to see only a low or moderate level of wage drift while several companies claim that they have no wage drift. However, there are marginally more companies that report rising wage drift than falling wage drift. This is particularly the case in the construction sector where several companies fear that wage drift may increase due to an increase in competition for experienced skilled labour.

PLANS AND HOPES FOR HIGHER PRICES

The companies' responses on the development of prices indicate that in general they are planning larger price increases than previously. This is a clear change compared to the companies' responses in December 2009. At the same time, they are often uncertain about whether the competitive situation will enable them to implement these increases and many companies said they were currently exposed to price pressures. The picture of a turnaround in the development of prices is strengthened, however, by the fact that practically none of the companies still expect to see falling prices over the next 12 months, while in December approximately 10 per cent of the companies expected prices to fall in the period ahead.

Figure 3. Assessment of price increases
Net figures



Note. Weighted net figures based on the number of employees in Sweden at the interviewed companies. The question relates to the companies assessments regarding price increases over the last 12 months and in the next 12 months. The net figures in the diagram represent the balance between the percentage of companies that have reported an increasing or declining rate.

Source: The Riksbank

However, the responses differ from sector to sector. Many companies in the manufacturing and construction sectors are planning for higher price increases than previously, while most companies in the other services sector are counting on approximately the same price increases as before.

In the retail sector too, most of the companies are planning to increase their prices more than previously after having reported a declining rate of price increases for several years. At the same time, comments indicate that this turnaround may be relatively limited and above all linked to rising prices for a number of product groups (dairy products, fish and fruit and vegetables). In the retail sector as in other sectors, many companies point out that they believe that competition has increased.



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