

The Riksbank's Company Interviews

SEPTEMBER 2010

■ The Riksbank's company interviews in September 2010

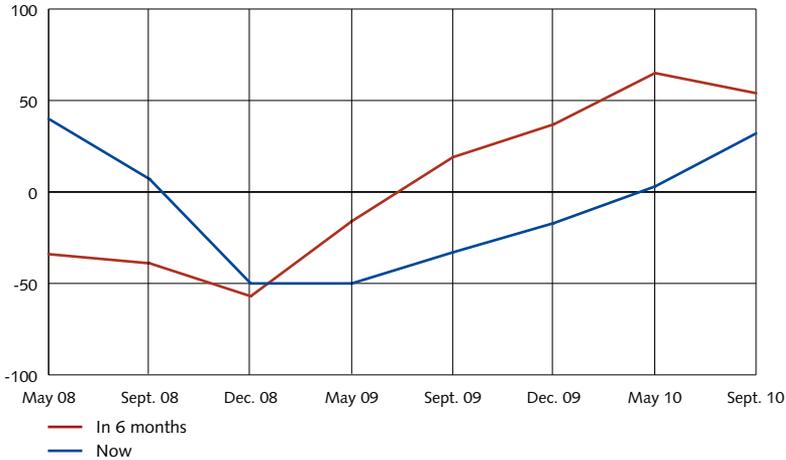
Good momentum under great vigilance

The company survey conducted by the Riksbank in September reveals that most of the companies interviewed feel that the economic climate is good. The figures for demand, production and new orders have improved on a broad front since the previous survey in May. The companies also believe that the risks associated with the development of the economy are lower than in May, although they still characterise them as higher than normal. The companies are restrictive in their investments, which is linked to the limited need to expand their production capacity. With few exceptions, the companies believe that neither production capacity nor the supply of labour will be limiting factors in the period ahead. The companies pricing plans for the next 12 months indicate relatively moderate price increases. Just over half of the companies state that they intend to increase their prices over the next 12 months. It is mainly increased purchasing costs, higher margins and increased demand that justify higher prices.

The overall impression that the companies have of the state of the economy is that it has continued to strengthen, which is illustrated in Figure 1. The upturn in economic activity is broad, with clear improvements for the manufacturing industry, the construction sector and many services, while the situation remains positive for the retail trade.

The upturn is particularly strong in the manufacturing industry. In September, considerably more companies said that the economic climate was good than said so in May. Many manufacturing companies made statements like "things are definitely moving in the right direction". The level of new orders in the manufacturing industry is also still good, although the rate of increase seems to have abated somewhat since May.

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

Most companies expect the economic climate to continue to improve over the next six months. However, several companies stress that they see the future as being uncertain.

This uncertainty can be noted in statements like "the autumn will be volatile – the nervousness will remain" and in more sceptical comments about the strength of the upturn due to the risk that the increase in demand will not last. The companies therefore remain guarded with regard to changes in economic activity.

FEW OBSTACLES TO INCREASED PRODUCTION

The development of economic activity has resulted in a higher level of resource utilisation, but there is still unutilised capacity in most sectors of the manufacturing industry. The utilisation of plant capacity in the manufacturing industry is lower today than it was prior to the financial crisis in 2008. According to the manufacturing companies, investment is expected to increase, but will primarily relate to the replacement of worn-out equipment. In other words, it appears that few companies intend to invest with the primary aim of expanding their production capacity. This picture is also confirmed by the comments of the construction companies, which describe the demand from the manufacturing companies as cautious.

For companies in general, the supply of labour is not a problem even though employment has increased. They have been able to increase their workforce by re-employing personnel who were previously laid off, but also by using employment agencies or by

employing personnel on temporary contracts. The companies see the labour market as being relatively flexible, which makes it possible for them to vary the size of their workforce in the prevailing upturn. The minority of the companies that stated that they have a shortage of labour also often said that their current workforce is adapted to the present level of demand. The problems experienced by these companies seldom seem to be of a general nature but are usually linked to a shortage of key specialist skills, expertise or know-how. In general, the companies also expect relatively low increases in wages and prices.

However, the situation in the construction industry differs from that in the other business sectors. The construction companies signal a shortage of labour and concern about increasing wage drift.

THE RISKS COME FROM ABROAD

Many companies believe that the risks associated with the development of economic activity are still higher than normal. However, the companies' evaluation of the seriousness of the risks has lessened somewhat since the previous survey in May, which was carried out at time when the problems with public finances in southern Europe were attracting a lot of attention. It is above all in the manufacturing industry that the companies now assess the risks as being higher than normal.

The companies believe that the greatest risks relate to economic development abroad. They are concerned about development in Europe and the United States and fear that this may lead to a renewed downturn in economic activity. In this context, they also mention the general financial concern that stems from the imbalances in public finances. "It is difficult to know where the debt crisis in the United States and Europe will end up".

Other risks that were often mentioned relate more to the companies specific needs in terms of various resources. In the manufacturing and construction sectors there are tendencies towards bottlenecks in that subcontractors are finding it difficult to increase their production in pace with demand. Some companies, mainly in the construction industry, also see difficulties in finding personnel with the right skills and expertise.

CHINA INCREASINGLY IMPORTANT TO THE SWEDISH EXPORT INDUSTRY

The Swedish export companies see an improvement on the global markets. Increased demand from China is contributing to this, but South America and other parts of Asia are also growing markets for Swedish exports. On the other hand, the export companies' largest markets, Europe and the United States, have not exhibited the same

growth tendencies and there is some concern that the US economy will not pick up quickly enough. The companies say that the weak development of the US economy may also have a disruptive effect on the world as a whole and have negative consequences for the development of the export markets in Europe.

China's increasing importance to the Swedish export industry is also creating uncertainty about the level of demand. The Chinese companies are highly dependent on raw materials and their production capacity is increasing constantly. Several companies comment that the behaviour of the Chinese companies is creating a certain amount of disjointedness; they can purchase large quantities of materials when prices are low and keep them in stock, which makes it difficult for the export companies to forecast both demand and the development of prices.

The transport companies testify to an improved situation now that production has picked up again in the manufacturing industry. "Our customers are really busy just now" was one comment. However, a certain imbalance between imports and exports can be discerned in that imports are higher than exports on the Continent, which means that some lorries must be driven almost empty from Sweden to collect goods.

There were few comments on the exchange rate and the effects of the strengthening of the krona on exports from the companies interviewed in September. A possible explanation of this is that it is mainly large companies that participate in the survey and such companies often conduct currency hedging.

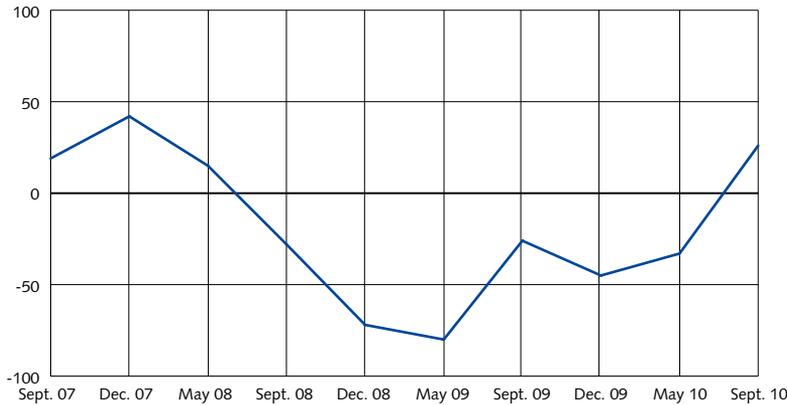
REPLACEMENT INVESTMENT PREDOMINATES

On the whole, the companies state that they will increase their investment in the six months ahead. However, this investment tends to be dominated by replacement and rationalisation investments rather than by investments for expansion. The cautious approach to new investment can be related partly to the limited need to expand production capacity and partly to uncertainty among the companies about whether the current increase in demand is lasting or temporary and, for example, affected by restocking on the part of the customers. Several companies also state that they intend to improve their cash flow and that they are now aiming for higher margins rather than aiming to expand. One company commented on this strategy by saying "we will not build up stocks; we will not invest more than necessary".

Many of the companies in the manufacturing industry state that investment will increase over the next six months (see Figure 2), but that this will primarily concern the replacement of worn-out equipment. This is confirmed by the construction sector which has noted that the manufacturing industry is restrictive with regard to construction investments. Like the manufacturing companies, the construction companies state that investment will mainly focus on replacing

machinery, but they also state that they will invest in new land for future construction.

Figure 2. Investment plans in the manufacturing industry for the next six months
Net figures



Note: Weighted net figures based on the number of employees in Sweden at the interviewed companies. The net figures in the diagram represent the balance between the percentage of companies that reported an increase and those that reported a decrease in investments over the next six months.

Source: The Riksbank

HOUSING INVESTMENT INCREASING MOST

The construction companies say that the construction of housing is increasing very rapidly, above all in the major cities. The number of housing starts is now approaching the levels that prevailed in 2007 and 2008.

Builders merchants report increasing sales volumes for both the previous and the next three months and thus complement the picture of a good construction climate, seen from the household perspective with regard to conversions and repairs.

STIMULATION FROM LOW INTEREST RATE AND TAX CUTS

The companies that supply goods and services to households say that demand is still good. The low interest rate and the tax cuts are two important reasons for this according to the companies. Several companies have noted that the households' consumption patterns have shifted somewhat from the consumption of non-durables to an increased consumption of durables. Most companies in the retail and service sectors have a positive view of development over the next few months and expect to increase their sales, despite some concern that interest-rate increases will reduce the households' scope for consumption. Many of these companies are increasing their investment, although in general this concerns limited sums relating to new shops. At the same time, competition is often severe in these sectors which may be part of the explanation of why few of these

companies expect to increase their workforce. One comment on this situation was: "Personnel costs must not accelerate; if they do they will kill the margins."

THE FINANCIAL MARKETS ARE LARGELY WORKING NORMALLY

The companies' access to external funding has continued to improve since the previous survey in May. Approximately 80 per cent of the companies now report that the conditions on the financial markets are normal as far as they are concerned, which compares to the corresponding figure of approximately 60 per cent in May and of approximately 50 per cent in December 2009. Comments such as: "We have seen a clear normalisation of the financial markets over the last six months, with lower premiums" are common. Some companies pointed out that there has been a complete turnaround in the situation on the financial markets with comments such as "it's now the banks that are chasing us."

Several companies report that the financial crisis has somewhat changed the view of future forms of funding. Companies have become more interested in other, alternative forms of borrowing than traditional bank loans. These may include, for example, syndicated loans from several banks or issuing corporate certificates and bonds. Another consequence of the crisis is that the companies examine conditions in contracts relating to credit facilities more carefully. The companies also say that they now have a greater need to retain a relatively large buffer of liquid assets as a precautionary measure in case new problems arise on the financial markets. However, the low interest rate means that the return on liquid investments is low at present and it is therefore costly to retain a large amount of cash. One company commented on this by saying "there is now an excess of liquid funds."

The minority of the companies that say that the situation has not normalised are in part worried about the ongoing restructuring process on the financial markets and believe that volatility has increased, which increases uncertainty. Several of these companies believe that it may take a long time before the markets have normalised.

GREATEST RECRUITMENT NEED IN THE CONSTRUCTION SECTOR

Approximately half of the interviewed companies state that they have increased the number of employees over the last three months. Roughly the same percentage of companies say that they will continue to employ new staff in the quarter ahead (see Figure 3). This generally relates to moderate increases of the workforce. The responses from the

manufacturing companies indicate that vigorous measures have been taken both during and after the crisis to reduce costs and increase productivity, which could indicate that the manufacturing companies will not re-employ as many workers as they laid off during the crisis.

A clear majority of all the companies say that their current workforce is adequately dimensioned at the moment. Among the companies who say this is not the case, there are more that say the workforce is too small than say it is too large, which indicates a continued increase in employment in the period ahead.

It is above all in the construction sector that the increase in employment is strong. The rapid increase in demand and the considerable numbers of experienced, key personnel that are retiring have led to a situation in which several companies are finding it difficult to recruit personnel. "In the slightly longer term the workforce is definitely too small considering the strength of the increase in demand," was a comment from one of the construction companies.

Figure 3. 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 employment in the last and the next three months. 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

There is some need to increase the workforce in the manufacturing and service sectors too. "There is a pent-up need for personnel as we have not recruited for two years". In the retail sector the companies report that on the whole the workforce is slightly too large and that there is thus no shortage of labour.

LIMITED WAGE DRIFT

Within the framework of valid agreements, the companies state that wages will increase somewhat more than previously over the next 12 months. This is largely linked to the structure of the agreements which provide somewhat higher wage increases at the end of the contractual period.

In the service sector, there is a greater element of individual agreements and smaller element of collective agreements and in this sector a higher proportion of the companies state that development may lead to a slight increase in wage costs as economic activity has now improved.

Some companies say that wage drift, which has been almost non-existent in recent years, is now increasing again. The most tangible tendencies toward this are in the construction sector. Here, competition for specialist skills and expertise is expected to lead to increased wage drift throughout the construction industry. The same tendencies can also be seen in certain parts of the service sector with regard to the recruitment of those with special expertise and know-how.

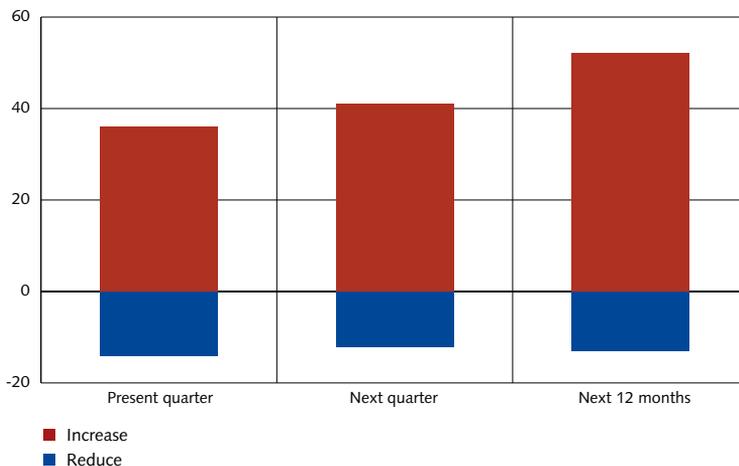
RELATIVELY CAUTIOUS PLANS TO INCREASE PRICES

Figure 4 shows that approximately one third of the companies intend to raise their prices during the present quarter (third quarter) compared to the previous quarter.¹ Somewhat more companies (almost 40 per cent) plan to increase their prices in the next quarter (fourth quarter). In total, no more than just over half of the companies say that they are planning to increase their prices over the next 12 months. There are relatively few companies that say that prices will be reduced during any of the various periods.

In general, the companies are planning to make comparatively low price increases over the next 12 months. The price increases specified by the companies indicate average price increases in the range of one to two per cent in the next 12 months. This average comprises both producer and consumer prices and the pricing plans vary from sector to sector. In the construction sector, both material and labour costs are expected to increase, and this in turn is expected to lead to price increases both three months and 12 months ahead.

¹ In this survey, the questions concerning prices have been altered from those in previous surveys, which means that the responses cannot be compared with those in previous surveys. The main question on the development of prices is: "How do you intend to change your sales prices?", with the alternative responses raise, lower or keep unchanged. This question was put in relation to the present quarter, the next quarter and the next 12 months. The companies were also asked to specify the size of the price increases (per cent) they were planning for the next 12 months.

Figure 4. The companies' pricing plans
Per cent



Note: The percentage of companies that intend to increase or reduce prices during the present quarter, next quarter and next 12 months. Weighted percentages based on the number of employees in Sweden at the interviewed companies.

Source: The Riksbank

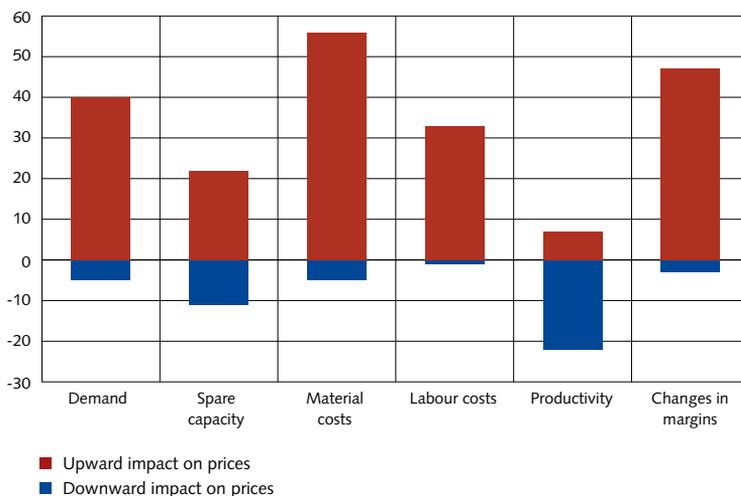
Some service companies in the transport sector hope to be able to increase their prices more significantly, but from the squeezed price levels that became established during the financial crisis. Several manufacturing companies also say that they have already felt the effect of price increases for freight transport. On the other hand, there are companies in some industrial sectors that instead of low price increases expect to see falling world-market prices for their products.

...IN THE RETAIL SECTOR TOO

The general picture of low price increases also applies to the retail sector. Several of the companies in this sector point out that price competition has increased and that the strengthening of the krona is reducing their costs for imported goods. However, food retailers reserve judgement and say that it is still too early to assess the effects of rising world-market prices for grain and that this trend may have a relatively broad impact on food prices, including meat prices.

The companies were also asked a follow-up question about how different factors affect their pricing plans 12 months ahead. For each of the factors demand, spare capacity, material/purchasing costs, labour costs, the development of productivity and changes in margins, the companies were asked to state whether the factor is affecting prices upwards, downwards or not at all (see Figure 5).

Figure 5. Factors that affect pricing over the next 12 months
Per cent



Note: The percentage of companies specifying the upward or downward impact of the various factors on prices 12 months ahead. Weighted percentages based on the number of employees in Sweden at the interviewed companies.

Source: The Riksbank

According to the companies, the factors that have the greatest upward impact on prices are above all material/purchasing costs, changes in margins and demand. In the case of factors that can have a downward impact on prices the effects were not as great. It is mainly increased productivity and spare capacity that can be expected to have a downward impact on prices.

The responses varied somewhat from sector to sector. The most important factors for price increase in the manufacturing industry were demand and purchasing costs and in the retail sector purchasing costs, while the service companies referred to demand, labour costs and improvements in margins.

Some companies say that they do not see any of the specified factors as decisive for how they set their prices. A characteristic of these companies is that they are price takers rather than price setters and it is mainly the competitive situation in the sector that determines the development of their prices. There are also companies that say that increased costs together with an already good level of profitability may mean that they nevertheless choose to retain their current price levels. This can be done by reducing margins and, as a result, gaining greater market shares if the competitors increase their prices.



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