



The Riksbank's Business Survey

Economic boom with
signs of a slowdown

November 2018

The Riksbank's Business Survey in November 2018¹

The economic situation continues on the whole to be very good for the business sector. Demand is strong in most parts of the world, which, together with stable domestic demand, is giving major Swedish companies good profitability, output and sales.

However, many companies see developments in the period ahead as uncertain. Those active in Sweden express unease over how household consumption will be affected by higher interest rates and the continued uncertain housing market. Even though export orders are generally good, the rate of increase has slowed somewhat in recent months, which may be a sign of falling demand. There is also a certain unease that the large stocks may be signalling that the economy will slow in the period ahead. In the near term, however, companies see no major changes in the economy.

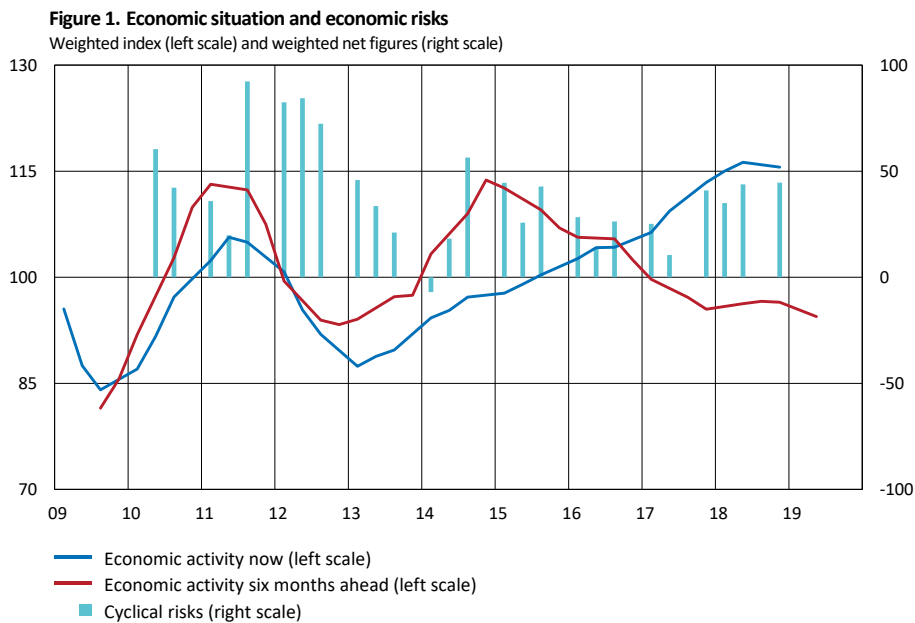
The unusually hot summer has dampened consumer demand, which above all has affected the durable goods segment. In addition, the harvests were worse than normal, which has caused grain prices to rise. This is one explanation for why the consumer goods segment above all expects higher prices for several goods in the period ahead.

In-depth questions about wage-setting indicate that the shortage of labour is the most important factor when wages are determined. On the whole, major Swedish companies are still not having difficulty finding staff, which has also contributed to the modest wage growth. But specialists and persons with longer experience are more difficult to recruit and, for these groups, wages are increasing more rapidly.

“The economic situation remains good”

The strong domestic and global demand has persisted and, compared with the survey in May, the economic situation is largely unchanged, see Figure 1. The rate of production has been at full throttle over the past year and export companies are continuing to report strong demand in most geographical markets. The following quotation is telling: “Europe, the United States and Asia are all going well simultaneously – that’s unusual.” Demand is considered to be particularly strong in North America, which more or less all Swedish export companies also highlight. The vehicle and forest industries say that demand in Europe continues to be good, even though it is not as strong as on the North American market. The situation is also good on the whole on the Asian markets, but developments in China have been slightly poorer.

¹ Three times a year, the Riksbank interviews the largest companies in the construction, trade, manufacturing and part of the service sectors. Representatives of 39 companies with a total of approximately 247,000 employees in Sweden were interviewed this time.



Note. The weighted index figures show a standardised value (mean value = 100 and standard deviation = 10) of the net figures for companies that say that the economic situation is currently good or bad and those who say that the economic situation will improve or deteriorate in six months' time. The red line, the economic situation in six months' time, has been moved forward two quarters. The lines show the weighted index figures expressed as a moving average based on three observations. The columns show the weighted net figures for those companies that say that the risks to economic developments are currently greater or smaller than normal. The survey is performed three times a year, which means that there are only observations for the first three quarters of each year in the figure. As of 2017, there are observations for the two first quarters and for the final quarter of every year in the figure.

Despite the strong economic situation, several companies consider the risk that economic development will weaken to remain high, see Figure 1. For export companies, it is above all the United States' current trade policy, with the steel and aluminium tariffs introduced, the risk of a trade war between the United States and China, and the trade sanctions introduced against, among others, Iran and Turkey, that are causing concern. The lower demand from the United Kingdom due to Brexit is another factor that is causing concern among some of the companies that sell intermediate goods there.

The risks of an economic downturn have, above all, led companies to have a higher level of preparedness to change their planning rapidly if necessary. However, uncertainty over economic developments in the period ahead may lead companies' customers to choose to postpone investments, which, in turn, could lead to decreasing sales for the companies. "It all comes down to making decisions based on the slightly more uncertain global market", says one business leader.

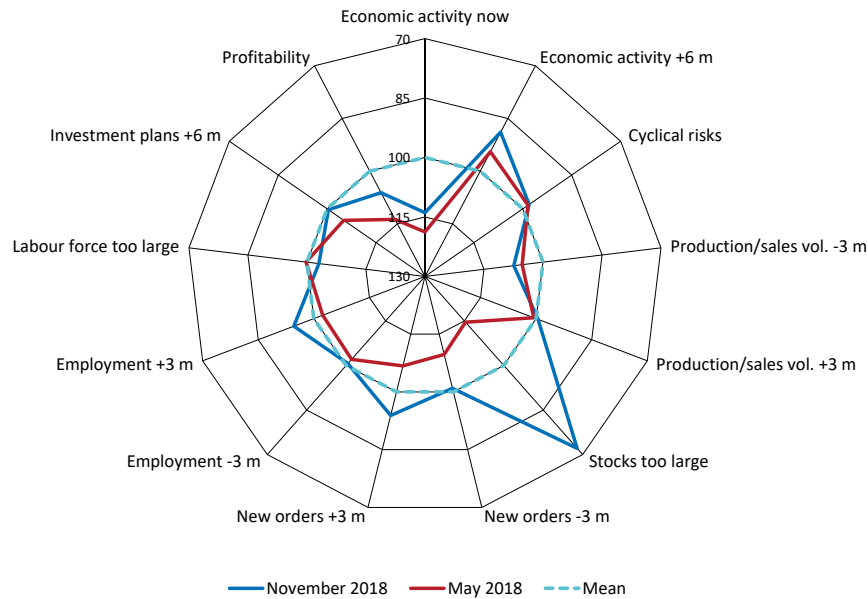
"There wasn't a person in the shops"

The warm summer with drought as a consequence benefited sales within the consumer goods segment but, for the durable goods segment, the effect was instead the reverse. Households seem to have postponed their consumption of durable goods and have focused more on consumer goods. One business leader describes it as "interest in buying things vanished". One consequence of this was that volumes of stocks increased and these are still deemed to be too large, see Figure 2. Consumer-related services companies, such as hotels and restaurants, describe strong sales. Households still have good spending power, which has led sales to increase further since the summer.

The trade sector and companies selling services directly to households primarily see risks linked to the domestic market. These include the parliamentary situation in the Riksdag (the Swedish Parliament), the development of the housing market and the effects of interest rate rises on households' scope for consumption.

Figure 2. 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 and for all sectors. The term -3m / +3m refers to the most recent three months and the coming three months respectively. +6m refers to the coming six months.

High level of construction but “really hard to sell housing in Sweden”

In general, economic activity continues to be good for the major construction companies. Demand for infrastructure, public and commercial construction is strong and orders remain on high levels. Property companies are reporting a strong market for both premises and rental housing. However, as regards sales of tenant-owned apartments, a clear decrease is visible and housing developers are being particularly impacted by the declining demand for newly produced tenant-owned apartments.

Construction companies and housing developers consider that financing requirements for households have clearly been tightened over the last year. Among other things, they mention the tightened amortisation requirement, the banks' tighter lending conditions and the banks' recommendation to sell one's home before buying a new one. Quotations such as the following are telling: “There have been altogether too many powerful measures, altogether too quickly” and “Major customer groups are disappearing because they can't get funding anymore”.

Due to the changed situation on the housing market, construction companies and housing developers have taken a number of measures. Fewer housing projects are being started now than previously and it is also taking longer before planned projects can be started as it is taking longer to sell. Projects are being divided up into smaller construction stages to shorten the time between production start and moving in, which is also reducing risks for the housing developers. Several also mention a reorganisation from tenant-owned apartments to rented accommodation but also other types of construction.

Initial signs of a slowdown, but from high levels

As previously, export companies have been uncertain over the year as to how long the strong demand will last. The following quote is telling: "There's no basis for it to continue to increase as it has in previous years."

Unlike the outcome in May, there are some signs that concern export companies. One business leader says: "I'm more uneasy now than I was six months ago". More companies than previously are seeing fewer orders, see Figure 2. But the primary source of unease is the weaker rate of increase in order inflows as this could be the first sign of a slowdown. Those companies that are exposed to the construction sector are seeing a clear downturn in demand on the Swedish housing market. Staffing agencies are also reporting a certain decrease in activity among their customers, including decreased demand for some of their services in the construction sector. Several companies also report some signs of a slowdown in China, above all within parts of its automotive industry.

However, despite some signs of a slowdown, no dramatic downturn in economic activity is expected, but rather a levelling-off from high levels.

"If stocks are wrong from the beginning, the rest can follow terribly quickly"

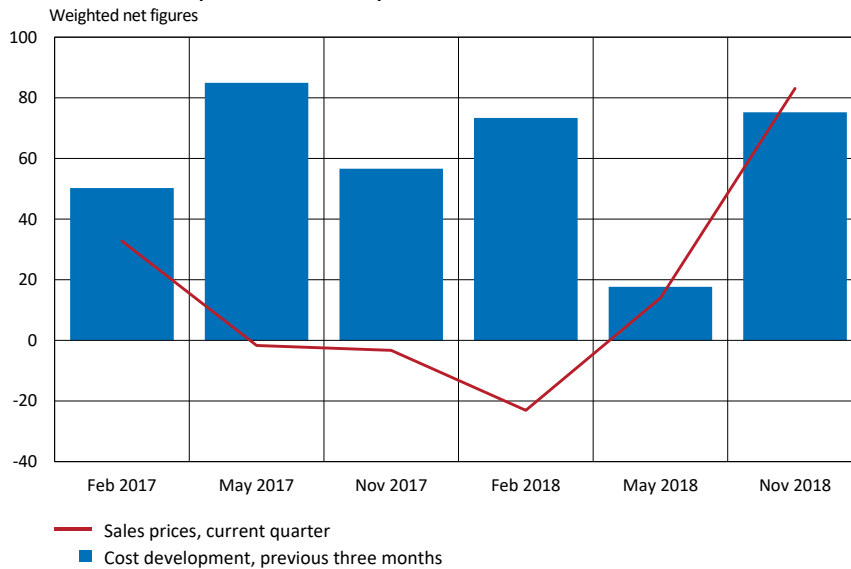
Even if the large existing stocks are not generally seen as a problem, there is some unease that these may be a further sign of falling demand. At the same time, there are several reasons that companies' stocks are too large. Some export companies have built up reserve stocks to maintain a high level of service towards their customers while simultaneously managing to maintain a high rate of production. Another explanation is that the high level of capacity utilisation has resulted in various bottlenecks, for example strikes and congestion at the ports, which has delayed deliveries and contributed towards stocks growing further. Unless their stocks decrease soon, a number of companies deem that they will have to cut down on the rate of production in the period ahead, so as not to be left with too large stocks if economic activity slows down.

The summer's extreme warmth and drought are leading to increased costs

The summer's drought and forest fires have affected companies' costs in several different ways. Companies in the forest industry needed to redirect logging to areas less exposed to risk, with increased costs as a result. In other cases, companies imported much more expensive intermediate goods to meet their delivery contracts.

As mentioned above, several companies in the durable goods segment have seen their stocks grow due to the summer's drought. To get rid of these large stock volumes, in many cases, they have held sales of the remaining product range, which, in turn has put pressure on their profitability. In the consumer goods segment, the warm summer instead contributed to increased demand for holiday-related articles and food products. But the drought also contributed to smaller harvests in large parts of northern Europe, with increased purchase prices above all for perishable goods.

Figure 3. The consumer-related trade and services companies' assessment of cost increases over the last three months and sales prices in the current quarter



Note. Consumer-related trade and services companies correspond to the trade sector and those companies that sell services directly to households. The weighted net figures show the total percentage of responses to the question of whether prices in the current quarter will be raised or cut and whether unit costs have increased (decreased) over the past three months.

The weaker krona is having a rapid impact on the consumer goods segment

Like earlier, the weak krona exchange rate has led to higher costs for imported intermediate and finished goods. At the same time, there are major differences between different parts of the trade sector. In the consumer goods segment, cost increases have had a relatively rapid impact and the weak krona has entailed higher unit costs overall, while margins, at the same time, have been more or less unchanged. This has meant that large parts of these cost increases have been transferred to customers through higher sales prices, see Figure 3. On the other hand, the impact on costs of the weaker krona is slower within the durable goods segment. Another important factor that determines whether cost increases are transferred to customers is the competitive situation the company is in or whether the company is attempting to win market share.

As in previous surveys, several trading companies mention the ongoing digital shift with increased e-Commerce and squeezed margins as a consequence. Some of the companies focusing more on e-Commerce are experiencing the situation as somewhat lighter. Their sales are high and their fixed costs are significantly lower than they are for companies engaged in traditional brick-and-mortar retail. This means that they can set more competitive prices and still maintain good profitability due to large volumes and high turnover. Even if unit costs increase due to exchange rate fluctuations, sales are also increasing in EUR and NOK, for example, which is contributing towards balancing costs and incomes for these companies.

Temporary effects are raising prices for consumers

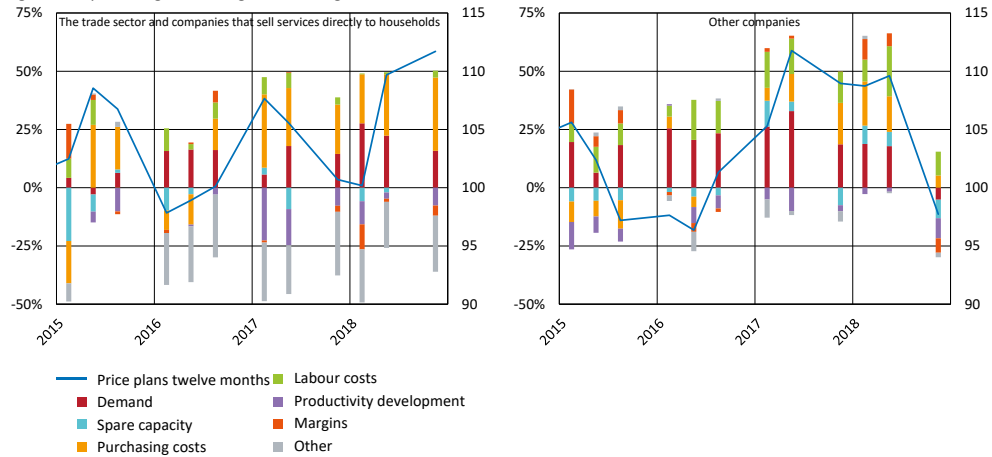
The effects of the summer's poor grain harvests in Sweden and elsewhere in Europe will also lead to increased prices for grains in the period ahead. Grains are often used as intermediate goods in the production of food, for example in the manufacture of flour and breakfast cereals, but also for feeding cattle. Suppliers to the consumer goods segment and restaurant industry have signalled that prices will be raised in the period ahead for these kinds of food products.

In addition to the increased purchasing costs within the trade sector, the favourable demand in Sweden is expected to continue to support domestic price development, see Figure 4. On average, trading companies expect price increases of around two per cent. At the same time, the trade sector's sales prices are being restrained due to the continued hard competition from Swedish and foreign e-Commerce. "The industry is extremely exposed to competition" and "The new normal is a rapid transformation" are revealing quotations on the effects of digitalisation on trading companies' sales prices and business models.

Increasing numbers of manufacturing companies expect their price increases to be lower in the period ahead. Price rises are expected to be restrained by slightly lower demand, greater supply and decreased margins, while increased labour costs are expected to push prices up, see Figure 4. The companies' view of price development is often strongly linked to their assessment of the economic situation over the coming year. Lower economic growth in the coming year is therefore expected to restrain price growth slightly.

Figure 4. Factors behind pricing in the next twelve months

Weighted net percentages and weighted index figures



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. The "Other" bar otherwise 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 companies that responded to the question regarding whether sales prices will be raised or lowered in coming twelve months.

ARTICLE – Moderate wage drift among Swedish companies

Wage growth in Sweden has been restrained in recent years despite the gradual strengthening of economic activity. The survey in November 2018 therefore put more detailed questions to companies on which factors have affected their wage-setting over the last year. The focus is on wage drift, which is to say the part of wages determined on a local level by the companies and not by the prevailing collective agreements. The results show that, for broad groups of employees, companies are only granting wage increases in line with collective agreement levels, with no extra increases. On the whole, companies are not having any problems in getting the labour they need. It is, however, more difficult to find experienced labour and specialists, which has increased wage pressures for such groups. This may, in turn, affect wage-setting for other groups, but such a spillover effect may also be counteracted by the slightly lower expectations for economic growth in the period ahead.

Collective agreement levels and local wage negotiations determine wages in Sweden

In the Swedish business sector, wages are determined both centrally via negotiations over new collective agreements between the labour market's central organisations and through wage negotiations in the companies.² Since 1997, the Swedish wage formation model means that the manufacturing sector, through its collective agreement levels, sets a cost framework, known as the benchmark for wage increases, that the other areas of the labour market then follow in their collective agreements.³

In recent years, nominal wage growth in the business sector has developed weakly in relation to resource utilisation. This is because wage increases in the collective agreement levels have been relatively low after the financial crisis but also because wage drift, that is the part of wage growth taking place over and above the collective agreement levels, has been lower than normal.⁴ The survey in November therefore asked specific questions about wage drift.

Wage strategies are important for companies

Many companies have the strategy of raising wages in line with collective agreement levels, but no more, for broad

groups of employees. One business leader expressed this as "Our wage-setting strategy is very strict – we have no wage drift".

Companies can also make use of an extra wage margin, above and beyond the collective agreement levels, for example to increase productivity. This can also be used to set more market-adjusted wages and thereby help reduce personnel turnover. "We pay market-adjusted wages but we don't want to be market-leading" says one business leader.

Performance or profitability-based wage-setting, in the form, for example, of bonuses, extra monthly salaries or stock options, often occur for representatives of management in all sectors. But this also occurs for broader groups of employees, for example in consultancy companies and companies whose production requires comprehensive research and development operations. In the manufacturing sector and the trade sector, it has become increasingly common for more than just management teams and senior managers to be covered by various kinds of profit sharing. In some companies, all employees are covered by profit sharing programmes and these do not have to be based solely on profitability criteria but good collaborative skills can also be rewarded, for example.

Labour shortages are a common cause of increased wage drift

Figure 5 shows the companies' assessments of how different factors have affected their wage-setting over and

² In 2016, the coverage ratio of collective agreements, which is to say the percentage of employees aged between 16 and 64 covered by a collective agreement, was about 90 per cent in the Swedish business sector if those covered by a so-called application agreement are included.

³ The terms of collective agreements differ between various professional groups. For example, no level of wage increase is specified in the collective agreements for some

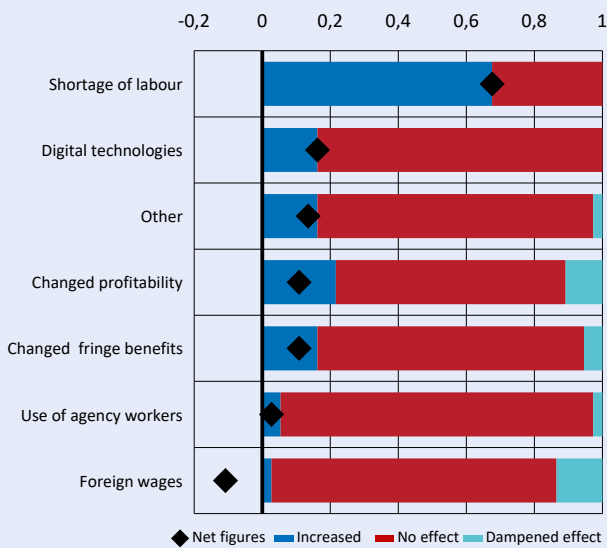
groups of white collar workers, with wage formation instead taking place entirely on a local (corporate) level.

⁴ For various conceivable explanations for the weak wage growth in Sweden, see the article "Strong economic activity but subdued wage increases" in the Monetary Policy Report, July 2017.

above collective agreement levels over the last year. Several companies mention labour shortages as the most common cause of their increased wage drift. Disregarding the construction, consultancy and employment agency sectors, however, there has not been any general labour shortage. Rather, it has been difficult to recruit certain specialists, for example engineers, personnel with IT skills and drivers. These recruitment difficulties have entailed some wage drift, but this has been limited to a few professional groups in high demand.

Figure 5. Factors affecting wage drift among companies⁵

Proportions and unweighted net figures



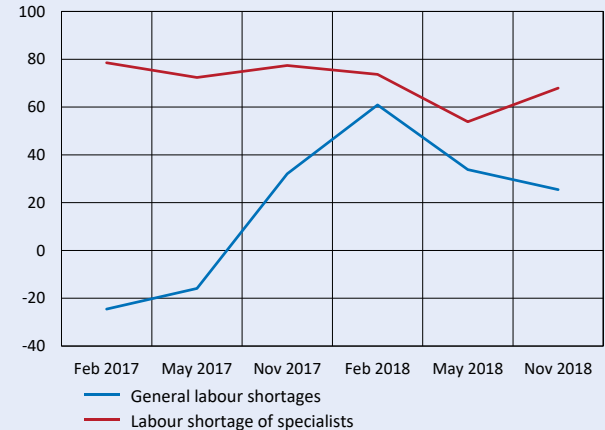
Note. The question asked companies was: How do you deem that the following factors have affected your wage-setting above and beyond prevailing collective agreement levels over the last year?

One example of the strong demand for some professional groups is that students of civil engineering are often employed a year before graduation. As “it is more and more difficult to attract experienced white-collar workers”, a changeover towards employing more junior workers is also taking place in several companies. At the same time, many companies offer good possibilities for development in the workplace to thereby become even more attractive for both existing personnel and potential labour.

The difference in labour shortages between specialists and the labour force in general is illustrated by Figure 6. The lack of specialists has been on a high level relatively constantly, while the more general lack of labour increased from 2017 until the start of 2018, after which it retreated slightly.

Figure 6. Primarily a shortage of specialists

Weighted net figures



Note. The weighted net figures show the total percentage of responses to the question of whether there is a general shortage of labour or there is no general shortage of labour, as well as whether there is a shortage of specialists or there is no shortage of specialists.

Other factors are restraining wage drift

The two factors that are deemed, above all, to have restrained wage drift are low profitability and the wage-setting abroad. It is often construction and transport companies with a high proportion of foreign labour that are affected by the wage-setting abroad. However, the use of temporary agency workers and increased fringe benefits over and above collective agreements are also mentioned as factors that have contributed towards restraining wage pressures.

Lower economic growth is expected to restrain expectations of wage increases

Even though the economic situation continues to be favourable, many companies are uncertain about economic developments in the period ahead. Lower economic growth can have a negative effect on wage growth. One business leader expressed this as “We won’t be able to afford to raise wages”. Other companies see other possibilities for giving an extra increase over and above the collective agreement levels in the period ahead, even if, in many cases, they point out that this may be small. Most believe that wage growth next year will be higher than this year, but it is still expected to be reasonably close to the levels specified in the prevailing collective agreement levels.

But if the economic situation instead continues to be strong in the period ahead, wage drift will probably increase. One business leader says that higher wages for

⁵ Under “Other reason”, the companies mention recruitment of qualified labour and training/skills enhancement of existing labour. These factors can be said to be strongly linked with labour shortages.

specialists “sooner or later will spill over to wage developments of existing personnel, who, naturally, are disappointed if it turns out that they have lower wages than a newcomer to the company”.

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 trade 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 February, May and November. 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 November 2018 report presents the results of interviews with 39 companies, which were mainly held between 25 October and 9 November.

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