



# The Riksbank's Business Survey

The economic boom continues

February 2018



## The Riksbank's Business Survey in February 2018<sup>1</sup>

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The economic situation is deemed to be good and has been so the past twelve months. Manufacturing companies are seeing strong demand from basically all export markets. The situation in Europe is still good while other markets that were previously weak have stabilised as global demand has steadily improved.

Construction companies have a good inflow of orders from civil engineering and infrastructure projects, but uncertainty over developments on the housing market continues to be evident. They are no longer as optimistic about the future demand for housing and are therefore focusing more on their costs.

Within the manufacturing sector, the high demand is creating bottlenecks in production, leading to short-term solutions that increase the costs for input goods and transport, for example. The strong demand situation and higher cost pressures mean that many manufacturing companies are planning to raise their sales prices going forward.

The trade sector and companies that sell services directly to households continue to describe their customers as having good spending power. But as before, the tough competition from online traders is a challenge. Companies in the trade sector therefore see little scope for increasing prices at their preferred pace.

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### **“The economy is doing well, it is not possible to say otherwise”**

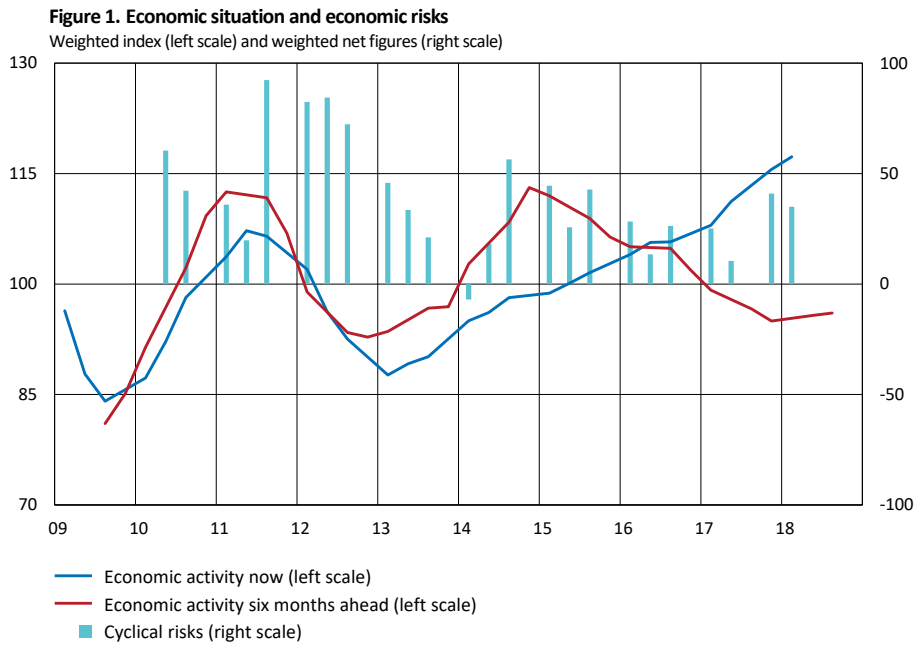
The economic situation is deemed to be very strong and the overall picture in February is relatively unchanged compared with the survey in November 2017, see Figure 1. The manufacturing sector in particular is seeing good demand in that both Swedish and global markets have developed well in recent years. The commodity-exporting sector is benefiting from rising commodity prices. The following quote is telling: “All markets and segments are developing reasonably well just now, it is positive everywhere.”

Demand in Europe is strong and stable, although Swedish companies are reporting some signs of a slight slowdown in orders in the United Kingdom. This is compensated, however, by demand from other countries in Europe developing even more strongly than previously. The situation in North America has been uncertain over the past twelve months, but now seems to have stabilised and several manufacturing companies have reported stronger demand from the United States in recent months. Demand in China and neighbouring countries is still perceived as good.

The trade sector and companies that sell services directly to households on the domestic market, such as travel companies, describe their customers as having good spending power. One business leader expresses this as: “The average Swede is doing quite well.” Despite this, the situation for the durable goods segment (such as clothing trade) is challenging, mainly as a result of tough competition from online traders. Digitalisation and growing e-Commerce are also forcing companies to adapt their operations and offer the solutions demanded by consumers.

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<sup>1</sup> Three times a year, the Riksbank interviews the largest companies in the construction, trade, manufacturing and parts of the services sector. Representatives of 27 companies with a total of approximately 209,000 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 bars 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 three quarters of each year in the figure.

### “This economic peak seems to be quite persistent”

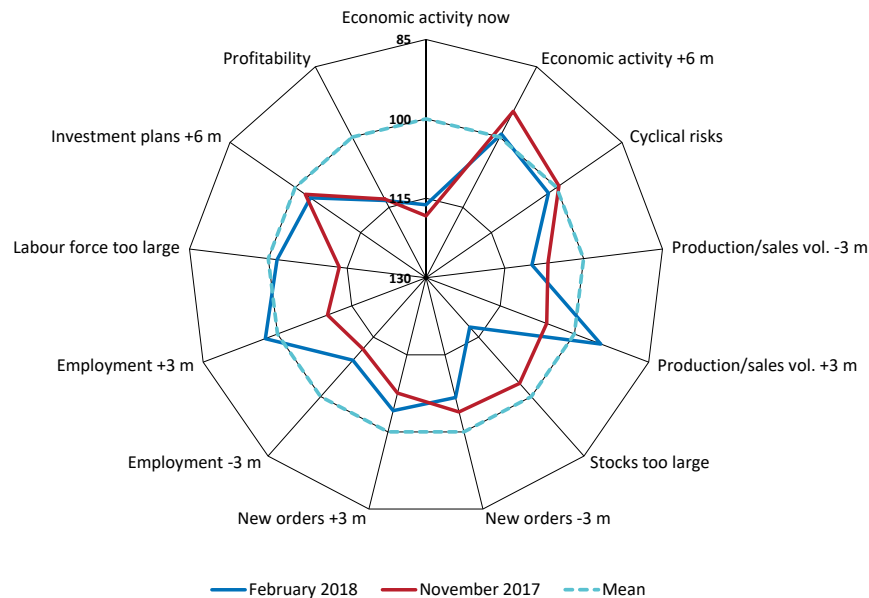
Several manufacturing companies feel they are now at the peak of the economic cycle and note that the current favourable situation has been beneficial for a long time. The majority therefore do not believe that the economic situation can get much better.

At the same time, there is some concern among manufacturing companies for how the economy will develop. The following quote is telling: “If we are on historically high levels, the risks must be higher than normal.” Others agree with this description, but think that there are few signs of a turnaround any time soon. One business leader says: “In such situations, when everything is going so incredibly well, you look for signs of something that could cause a turnaround, but there are no such indications just now.” The risks that nevertheless are mentioned include the Swedish parliamentary election in the autumn, the United Kingdom's exit from the EU and US international relations that may disrupt the Swedish and global recovery.<sup>2</sup> The risks are largely deemed to have decreased slightly in February compared with the survey in November, see Figure 2.

<sup>2</sup> Most of the business survey interviews were conducted before the US President announced plans to introduce tariffs on steel and aluminium imports.

**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.

## Uncertainty regarding developments on the housing market

In recent years, many new housing projects have started and new homes have been easy to sell. In February, however, orders declined slightly for housing projects and construction companies are no longer as optimistic about the future demand for newly built homes.

Sales of uncompleted homes already began to fall in the autumn and it is still difficult for construction companies to sell homes that only exist in blueprint. One business leader says: "We're only selling completed apartments at the moment, but we have had to reduce the price." The point is raised that price cuts are, in the long run, mainly expected to affect smaller construction companies that focus only on housing production.

But the situation is causing construction companies to be slightly more cautious and they "are following developments closely, especially on the housing side." Uncertainty regarding developments on the housing market going forward means that they have greater focus on cost developments. One respondent says: "We are focusing a lot on wage drift at the moment. It must not increase too much, as it is a fixed cost which affects us in another economic situation." Another company has introduced a cost-cutting programme to improve long-term profitability.

The general economic situation in the sector is still good, however, with increased orders for civil engineering and infrastructure projects. Quotes such as the following are telling: "As a result of all the housing construction in recent years, there will be a need for other infrastructure and buildings, such as schools, child and elderly care centres, and so on."

### **Manufacturing and construction companies see minor risks linked to their order books**

In the business survey in November, construction and manufacturing companies reported a strong inflow of orders and well-filled order books. In February, orders are still higher than the historical average, see Figure 2. In February, specific questions have been asked about companies' order processing to gain a better understanding of how it works and what risks are linked to the order books.

In the construction industry, an agreement with a customer is normally preceded by a tendering process. This is in most cases long and exhaustive, especially when it comes to major infrastructure and construction projects. When a company has won a tender, a contract is signed and the project is entered into the order book. It is often a question of a subcontractor's agreement, but cooperation agreements also occur. The agreements are very extensive and contain a full range of contractual conditions. The customer normally pays in instalments as work is completed and cancellations are uncommon as it is costly for customers to pull out of a contract.

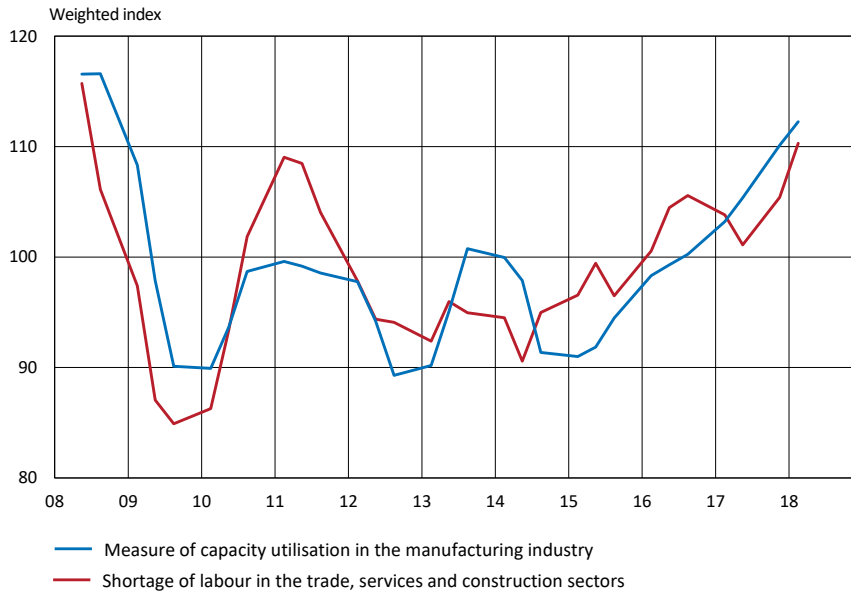
In general, manufacturing companies are dependent on a relatively small number of large customers. For many of them, their order books only contain orders one or two months ahead, which limits the companies' bargaining room with respect to customers. Framework agreements valid over longer periods do, however, help to bring some predictability and a long-term perspective to planning. At the same time, it is important to maintain good customer relations, which can make it difficult for companies to get compensation if a customer chooses to withdraw a placed order.

In the prevailing economic situation, many construction and manufacturing companies have a relatively long and well-filled order book and they generally see minor risks linked to it. Construction companies are certain that they will be able to implement the projects agreed upon as they have a relatively strong position in relation to their customers.

## **“We have reached the capacity ceiling globally”**

An increasing number of respondents are now saying that production is close to an “all-time high” and capacity utilisation in the manufacturing industry has continued to rise since the survey in November, see Figure 3. This means on the one hand that some companies are not managing to produce at the rate required, leading to stocks being adjudged to be small in relation to demand. On the other hand, others say that stocks are slightly larger than they would like as they have produced somewhat more than necessary in order to keep down delivery times to customers.

Only a small number of companies are planning to expand their production facilities to increase capacity. Instead, companies are mainly working to reduce bottlenecks, making replacement investments to maintain current production levels, or making productivity-enhancing investments to increase capacity in their existing facilities. Long-term investments are primarily focused on research and development of new technology that safeguards competitiveness on global markets.

**Figure 3. Measurements of capacity utilisation in the manufacturing industry and labour shortage**

Note. The weighted index figures show a standardised value (mean value = 100 and standard deviation = 10) of the net figures for the number of manufacturing companies that say that they at present have major difficulties or have no difficulties in managing an unexpected increase in demand (measured as capacity utilisation in the manufacturing sector) and the number of companies responding that they either perceive or do not perceive a labour shortage. Both series are shown as moving averages based on three observations.

### “It is now taking longer to recruit”

It is difficult to find staff in an increasing number of professional groups both in Sweden and abroad, see Figure 3. Construction companies have perceived a general shortage of labour for a long time. This applies to both construction workers and specialists, including project managers and site managers. The shortage is also becoming increasingly evident among consumer-related companies in the trade and services sectors. It is pointed out that there is a shortage of stockroom workers and lorry drivers and of people with more specific vocational training. In general, there is as before razor-sharp competition for IT specialist and it is difficult to recruit and retain skilled personnel in this area. Companies are managing this by, for example, using staffing agencies, consultants or sub-contractors.

A number of companies are also saying that they are working actively to recruit and train newly arrived migrants, both to take advantage of the increased labour supply, and so that newly arrived migrants have the language skills that are increasingly necessary within certain service professions.

In the construction sector, the shortage of workforce has helped increase the proportion of foreign labour, both directly as a result of recruitment by companies and indirectly via labour from sub-contractors. An increasing number of construction companies are now conducting business in Sweden more permanently. Within the construction sector, the use of foreign labour is said to have affected wage formation. One business leader says: “Foreign labour may have helped keep down wage growth in the industry.”

## “The shortage of labour is leading to a clearer price tag”

The continued shortage of labour means that an increasing number of companies expect wage costs to continue to rise more in the year ahead than previously, see Figure 4. It is primarily within pronounced shortage occupations that wages are expected to rise more than before. A contributory factor is said to be the increase in staff turnover within these groups.

In the manufacturing industry, wage growth is in many cases linked to the increase in profitability: “Obviously there are wage pressures when companies are doing well” is a telling quote. For construction companies, there has been a turnaround and the situation is now the opposite. They expect more modest wage growth and less wage drift over the next twelve months, which are in part linked to the recent uncertainty surrounding developments on the housing market. Trading companies are as a rule expecting wage growth in line with collective agreements, but also perceive tendencies towards increased wage drift among several occupational groups.

At the same time, the rate of wage increases is being subdued by international competition, digitalisation and automation.

**Figure 4. Wage costs and wage drift in the next twelve months**



Note. The weighted index figures show a standardised value (mean value = 100 and standard deviation = 10) of the net figures for the number of companies saying that wage costs per hour will increase more than before during the next twelve months or increase less than before during the next twelve months and the net number of companies who expect wage drift to increase or decrease over the next twelve months.

## High capacity utilisation leads to increased cost pressures

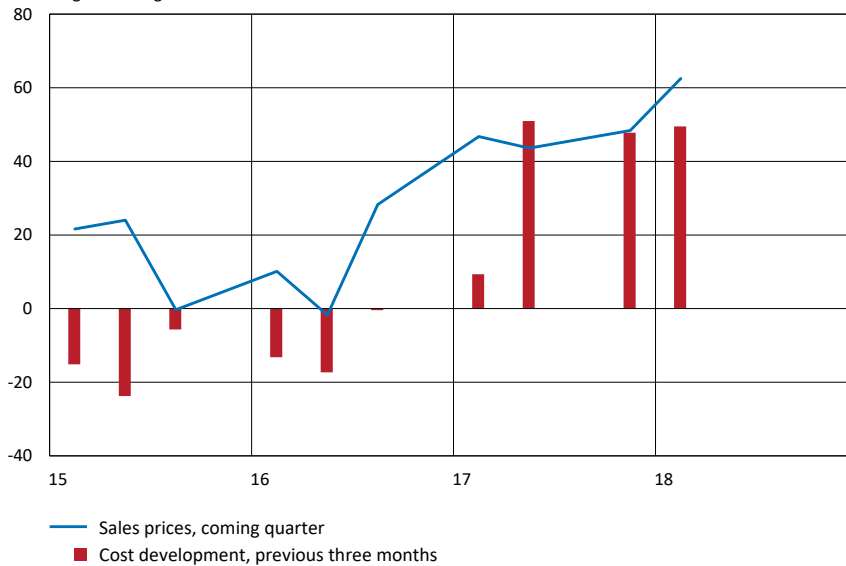
Alongside wage costs, commodity prices and other costs for input goods continue to increase. One reason is the bottlenecks occurring among sub-contractors. For example, delivery times for certain types of material needed at a later stage of production are still long. To manage the bottleneck problems, companies are being forced into short-term and more costly solutions, such as acquiring materials and input goods via other means of transport and from more remote places than they would like. In addition, some of the economies of scale that large volumes tend to bring disappear when production is as close to the capacity ceiling as it is now.

As a consequence of the good demand situation, manufacturing companies have increased their prices and are also planning to raise prices in the coming quarter to compensate for increased costs, see Figure 5.



**Figure 5. Cost developments and sales prices**

Weighted net figures



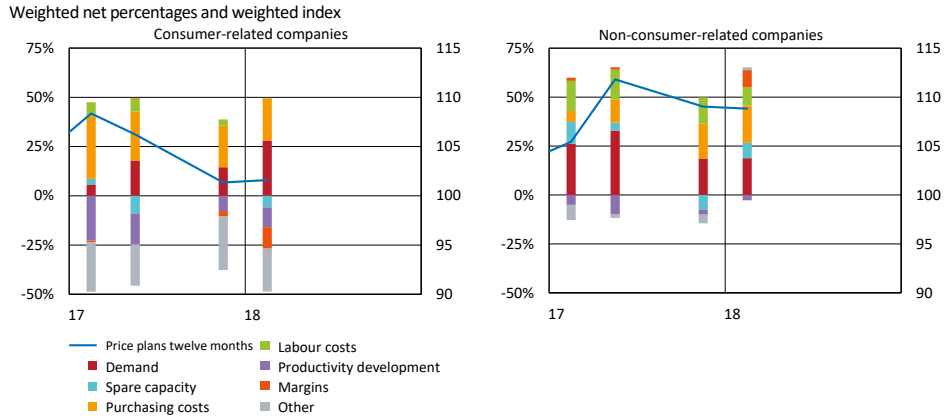
Note. The bars show the weighted net figures for the companies saying that costs have increased or declined over the past three months. The line shows the weighted net figures for companies saying that sales prices will increase or decrease in the coming quarter.

## Strong demand enables manufacturing companies to increase their prices

In the slightly longer term, the favourable demand situation, in combination with increased costs, is expected to provide manufacturing companies with the prerequisites to further increase their prices, see Figure 6. For many companies, price increases can be necessary to enable that positive trend in profitability since 2014 to continue. In the construction sector, there are concerns that the reduced demand for housing will push down offer prices one year ahead.

For the trade sector, prices are being held back and margins are subdued as a result of the continued tough competition from Swedish and foreign online traders. The following quote is telling: “We have so many new online players – both here in Sweden and abroad – and this pushes the price down.” and “Increasing prices when there is a greater demand, that’s not possible.”

**Figure 6. Driving forces behind pricing in the twelve months ahead**



Note. Consumer-related companies are trading companies and companies that sell services directly to households. Non-consumer-related companies are manufacturing and construction companies. The bars (left scale) show the net balance between responses that the factor concerned will have an upward or downward effect on prices in the year ahead. A bar above (below) zero means that the factor will contribute to rising (falling) prices in the period ahead. The "Other" bar 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

**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 services 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 relevant to monetary policy.

Approximately 30 companies are interviewed as part of the survey in February and about 40 companies in 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 February 2018 report presents the results of interviews with 27 companies, which were mainly held between 14 February and 28 February.

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



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