



The Riksbank's Business Survey

The economic upswing is continuing

May 2018

The Riksbank's business survey in May 2018¹

The economic situation has improved further and demand is strong within all sectors. Companies, particularly within the manufacturing sector, are facing high demand globally and production is at full throttle. The construction sector currently has long order books but notices that demand for housing construction has decreased, above all in the Stockholm region. In general, there is unease over the development of the housing market and companies within the construction sector are now planning for how to react if demand for newly produced housing does not strengthen in the period ahead.

The trade sector and companies selling services directly to households are meeting consumers with good spending power. But the tough competition is making it difficult to raise prices and a lot of work is being expended on cutting costs to improve profitability. The recent weakening of the krona is increasing purchasing costs for imported goods and services, which is putting pressure on companies within the trade sector to raise their prices regardless.

This survey also asked more detailed questions on the digitalisation of the business sector. All companies are investing in or planning to invest in new digital technology to help them follow developments and strengthen customer contacts. The majority expect that increased automation will reduce costs. Several companies in the trade sector expect such investments to lead to the number of employees decreasing at the same time as the increased price transparency restrains sales prices. In the manufacturing industry and services sector, several companies instead make the assessment that new technology will make it possible to produce completely new goods and services for which they will also be able to charge more.

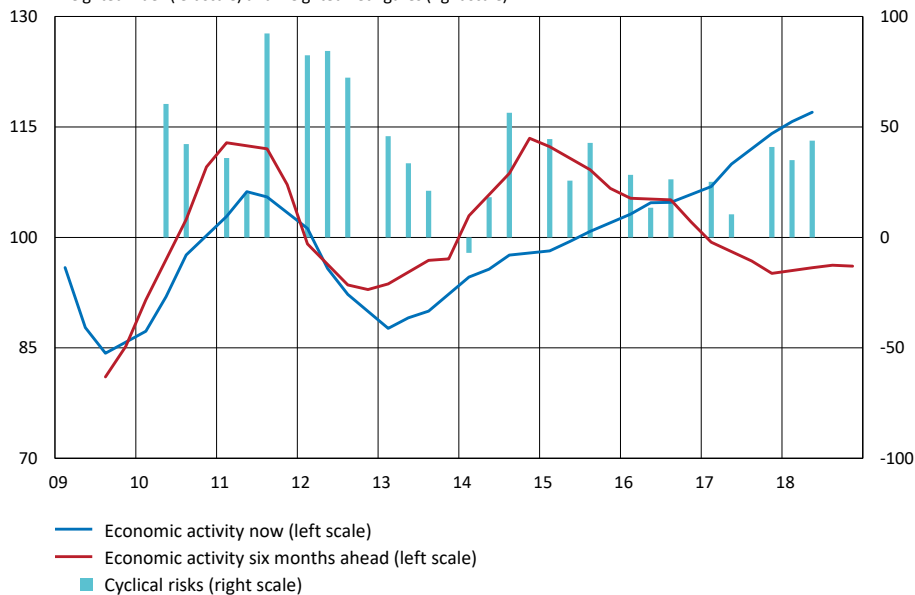
“There's plenty of demand all over”

The economic situation improved further in May and, in the more than ten years that the business surveys have been conducted, the proportion of companies assessing the economic situation as good has never been on such a high level as it is now, see Figure 1. Strong demand is being experienced in all sectors. Export companies in particular report very good demand from more or less all geographical markets. Overall demand from Europe is stable at high levels. The automotive and forestry industries are being strengthened by high demand from Asia in particular, at the same time as the demand situation is cautiously improving in South America. Companies within the domestic transportation, staffing and consultancy sectors are benefiting from the strong industrial production and are continuing to make very positive statements on the economic outlook. The following quote is telling: “It's hard to believe it can go any better, it's at high pressure now, firing on all cylinders on so many markets at the same time”. In the short term, the manufacturing sector sees relatively small risks of a downturn in economic activity. As previously, political risks such as a potential trade war are mentioned, but these risks are not deemed to have increased since the start of the

¹ Three times a year, the Riksbank interviews the largest companies in the construction, trade, manufacturing and parts of the service sectors. Representatives of 40 companies with a total of approximately 285,000 employees in Sweden were interviewed this time.

year. One business leader says: “We haven’t seen any signs that the economic situation will be worse in six months”.

Figure 1. Economic situation and economic risks
Weighted index (left scale) and weighted net figures (right scale)



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. From 2017 there are observations for the first two quarters and the last quarter of each year in the figure.

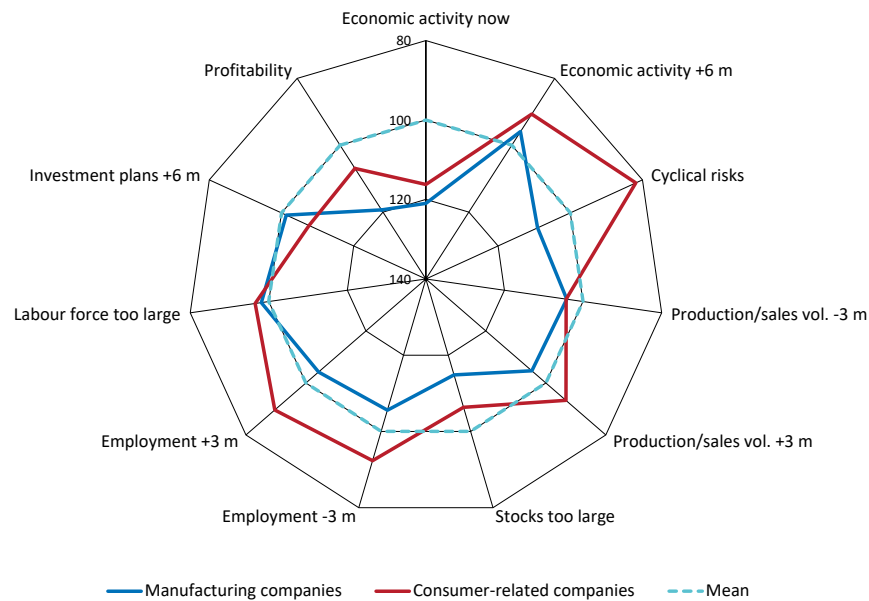
“It’s tough in the retail sector in general”

The consumer-related retail trade and service companies are encountering households with good spending power but, despite this, they still make a more pessimistic assessment of the economic situation in the period ahead and see much greater risks in economic developments than the manufacturing sector does, see Figure 2.

Trading companies highlight the risks of falling housing prices and future interest rate increases, which could trigger a decline in domestic economic activity. There is concern among them over what could happen if consumer confidence in the economy turns down, something formulated in the quotation: “If things feel a little sluggish when the economic situation is great and interest rates are low – how will it be if a slowdown takes place?”

The ongoing structural transformations arising from the rapid development in e-Commerce is boosting competition and price transparency and is seen, like before, as a major risk to profitability. One business leader expresses this as follows: “This doesn’t have anything to do with the economic situation, it’s more a matter of competition”. In the trade sector, measures have therefore been taken such as closing shops, cutting costs and postponing expansion.

Figure 2. Companies' overall response patterns
Weighted index



Note. Consumer-related companies are the trade sector and companies that sell services directly to households. 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.

“The risk is the housing market”

Like the trade sector, the construction and property sectors have a more cautious view of economic developments in the period ahead. Demand for infrastructure projects, public and commercial construction remains strong overall, while demand for housing has clearly slowed down. One respondent says: “We are seeing a turnaround in our order inflow: from housing to infrastructure and public premises”.

The risk that economic developments, and the housing market in particular, will weaken is deemed to have increased in conjunction with the introduction of new regulations on lending, for example the extended amortisation requirement. It has also been reported that, in certain cases, banks are demanding that old housing be sold before they are willing to approve new mortgage loans. Combined with mass media reporting, this is deemed to have contributed towards restraining the development of the housing market. Construction and property companies focused solely on housing are therefore experiencing a tougher situation than construction companies with broader activities. The latter can shift production from housing projects to those segments of the market where demand is still strong. At the same time, several companies say that falling demand for housing mostly applies to the Stockholm area, while order inflow and sales are still decent in other parts of the country.

“It can't keep going indefinitely”

In the slightly longer term, there exists a certain unease within the manufacturing sector that economic activity will slow down. One business leader expresses this as follows: “We're at the peak of a peak and things can only get worse, but I think it will be a while until it does get worse”. Awareness that economic activity can change rapidly is significant. For example, one business leader notes that, even if the order book is long now, it is well known that this can change rapidly when economic activity slows down. Several companies are trying to prepare their operations in various ways for the next economic slowdown. There is some restraint in the matter of investments to expand operations and businesses are avoiding taking on excessive costs that will be difficult to reduce at a later stage. Since the financial crisis,

businesses have also been working actively with various flexible solutions for employees and consultants so as to be better able to handle changes in economic activity. This differs from how companies reasoned during the most recent economic upturn in 2007. At that point, they were not as restrained in their assessments, but were planning for things such as the extension of production capacity to be able to handle the strong demand.

Major exchange rate fluctuations are problematic for companies and are considered a risk that affects companies' own financial results. Although the weaker Swedish krona benefits the goods-exporting manufacturing sector, several manufacturing companies have pointed out that they see this development as a problem for the Swedish economy in the long term. In connection with the discussions of the weaker krona, the companies also express some criticism of the monetary policy conducted. They ask themselves when the Riksbank will start to raise the repo rate and whether it will have time to raise it to the extent needed to have enough scope for action ahead of an approaching recession.

Different strategies for managing exchange rate fluctuations

Companies often use various forms of contract to take the edge off fluctuations on the foreign exchange markets. Consequently, it takes a little time for the exchange rate to have an impact on companies' sales prices. Several companies are attempting to assess how the krona exchange rate will develop in the months ahead by analysing the market's forward pricing, after which they will be able to take a decision on whether to hedge forward contracts with different maturities. Long-term business relationships and competitiveness are also two important factors that determine whether and how rapidly exchange rate fluctuations can be transferred to customers. Impact on prices is therefore specific to both company and sector.

For export companies in the manufacturing sector, the exchange rate has an impact on sales prices after three to six months. For the commodities sector, where production is usually close to maximum capacity and prices are set on global markets, exchange rate fluctuations instead has a direct impact on companies' costs and margins. Exchange rate fluctuations are also transferred to sales prices relatively rapidly within the consumer goods segment. The quotation "The entire sector is facing world market prices and fluctuating currencies and it is not possible to be smarter than the market" indicates that it is mainly the market that determines the krona's value and that it is difficult to make a long-term assessment of the development of the exchange rate.

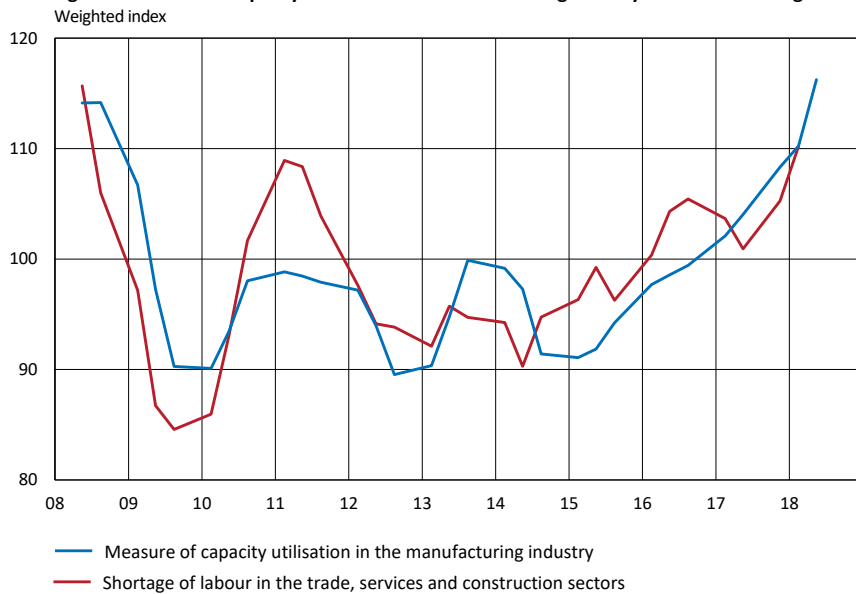
In the retail trade, the impact takes a longer time, in general between six and twelve months, as currency hedging is generally performed ahead of each season, when orders are made for new goods. It is usually difficult for these companies to raise their prices in response to exchange rate fluctuations due to the stiff competition from e-Commerce. The weak krona is thus leading to lower margins for the retail trade.

Only a few companies are making long-term assessments of the krona exchange rate. These companies' normal operations are in commodity-heavy industries where guide prices for key commodities and exchange rates are set for planning purposes and to take decisions on establishment, investments and workforce over the long term.

Resource utilisation continues to be high

Many companies are continuing to experience difficulties in locating the right skill sets, see Figure 3. There is a general shortage of labour in areas such as technology, economics and sales. As previously, it is very difficult for companies to recruit personnel with different types of IT competence, but even drivers are reported as being increasingly difficult to locate. Although labour shortages are relatively widespread, companies are hesitating to raise wages to attract the skills they need. Productivity and competition reasons make it important to maintain wage structures and companies report that there are other ways of attracting new skills or retaining the skills that are already present. Examples mentioned include increased wage benefits, increased possibilities for flexible working hours and increased career possibilities.

Another clear sign of high resource utilisation is that increasing numbers of manufacturing companies report that they would find it difficult to raise the rate of production from the present level if demand were to increase further, see Figure 3.

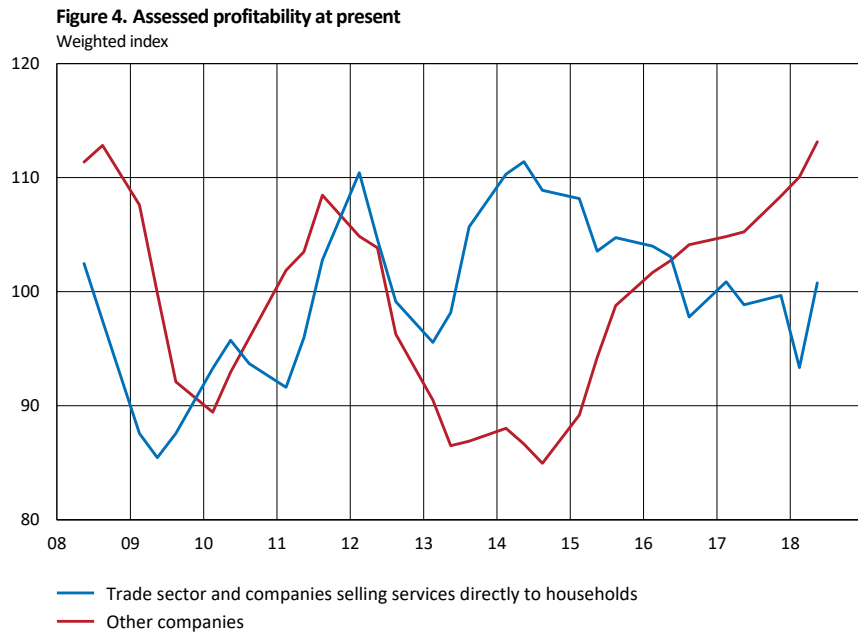
Figure 3. Measure of capacity utilisation in the manufacturing industry and labour shortages in different sectors

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.

Costs are increasing but profitability is good in the manufacturing sector

Thanks to a longer period of strong demand, manufacturing and construction companies have gradually been able to strengthen their profitability, see Figure 4. However, costs for various input goods are rising at the same time as the high rate of production is creating a number of challenges for the manufacturing sector. Among other things, it is putting pressure on the logistics chain: from order and delivery of input goods to sale of the produced goods to customers. This means, for instance, that deliveries have to be made by road or air transport in certain cases, instead of by sea, which is the normal procedure as it is cheaper. At the same time, several companies have managed to streamline their operations in recent years, which, together with increased sales and the weaker krona, has contributed towards the good profitability.

Profitability is under greater pressure in the trade sector and among companies selling services directly to households. Purchasing prices are rising due to the weaker krona, but it is the ongoing structural transformation of the durable goods segment in particular, caused by the increase in e-Commerce, that is having an impact. However, companies are impacted to varying extents by the structural transformation. In recent years, companies within clothing and electronics retail in particular have found it difficult to maintain profitability, while the travel business, for example, which has already been through major changes, has not had the same problem. Retail sales in consumables, of which e-Commerce continues to make up a relatively small share of sales, are not as exposed, although these companies report that they are experiencing increasingly tough competition for parts of their product range.



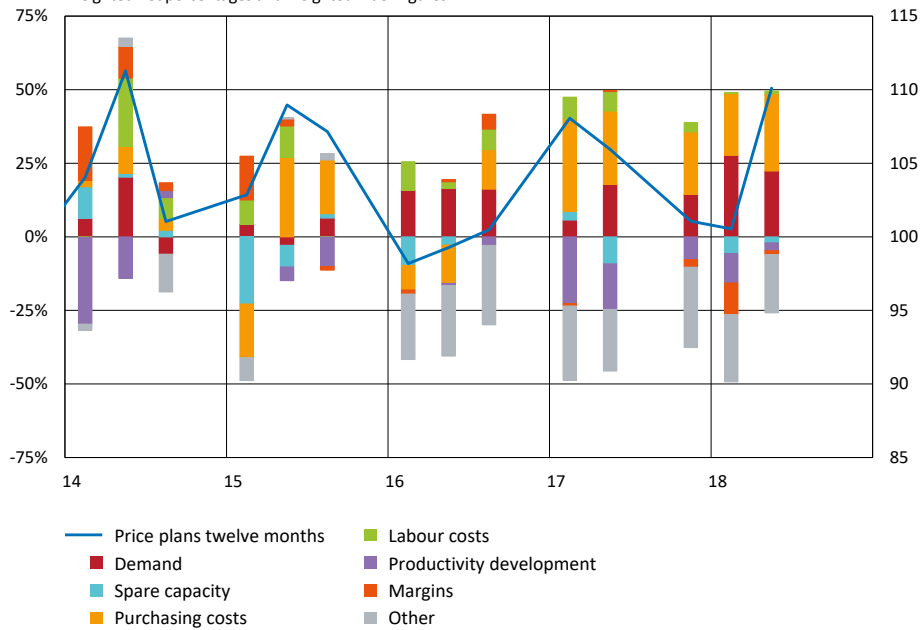
Note. The weighted index figures show a standardised value (mean value = 100 and standard deviation = 10) of the net figures for the number of companies currently assessing their company's profitability to be good or bad. The weighted index figures are expressed as moving averages based on three observations.

In the long run, the weak krona could lead to higher prices in the trade sector

For a longer period of time, it has been difficult for many trading companies to raise their prices, see Figure 5. Even if demand is considered good, the increasingly global nature of e-Commerce is setting limits to the price increases that companies can make. The durable goods segment in particular is experiencing difficulties in maintaining the desired margins. Quotations such as “That time is over, competition is stiffening now, so it will be hard to raise prices” are revealing and reflect something that many in the trade sector have expressed in the Riksbank’s business surveys in recent years.

Retail sales in consumables have not been as heavily impacted by this development and these companies have had greater scope for raising prices. In this segment too, companies state that the continued weak Swedish krona will lead to raised sales prices in the period ahead. The durable goods segment is also planning to raise prices slightly as, in many cases, there is no possibility of allowing the raised import costs to impact margins in full.

Figure 5. Driving forces behind pricing in the twelve months ahead, consumer-related companies
Weighted net percentages and weighted index figures



Note. The figure shows the result for the consumer-related companies, which are the trade sector and companies that sell services directly to households. 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– Digitalisation will have different consequences for prices and employment within different parts of the business sector

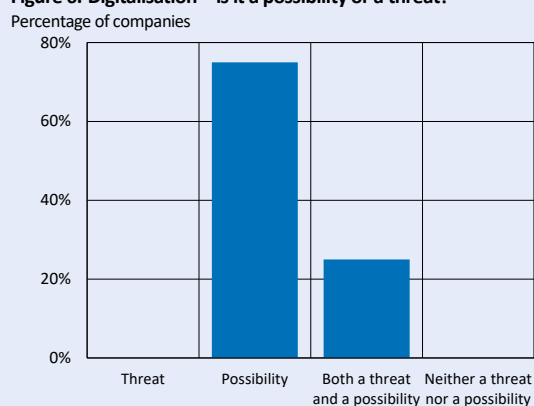
Digitalisation and its consequences is a relevant issue for a majority of the companies. This is impacting their business models and competitiveness and, ultimately, will also impact their investment decisions. Consequently, the survey in May 2018 asked companies detailed questions on their use of digital technology and how this affects sales prices and the number of employees three years ahead, among other things.² Overall, the new technology is seen as a possibility for strengthening customer relationships at the same time as it improves productivity. For consumer-related retail and service companies, sales prices are expected to fall slightly three years ahead due to the new technology. For others, the situation will instead be that the new technology will make it possible to raise prices as it will strengthen the companies' position on international markets. Furthermore, digitalisation is expected to lead to a shift in competence in the labour force as a need to recruit more workers with digital competence than before is predicted.

“Digitalisation is a possibility if it's used in the right way”

Investments in digital technology are a part of most companies' long-term strategy and something that has been worked on for a longer time. In general, companies see digitalisation as a possibility, see Figure 6. Companies consider that it is necessary for them to follow technological developments. Quotations like “Following these issues is a survival strategy” and “The great risk is not being part of digitalisation” are revealing. The structures that the companies are working within may be challenged by technological developments. In a number of cases, this concerns refining business models, while, in other cases, it could lead to a shift from previously having produced and sold a product to selling a service instead.

The retail channel may be challenged and is expected to play an increasingly minor role as increasing amounts of new technology are introduced, bringing customers increasingly closer to the producing company. Digitalisation has also led to the development of new alternative trading platforms and different types of partnerships. For example, this may involve shops opening up their e-Commerce platforms for other players' goods. This is happening, above all, in the trade sector and forms a complement to the companies' own sales.

Figure 6. Digitalisation – is it a possibility or a threat?



“The customer must always stand in the centre”

Digital development is driven, above all, by demand from customers but is also affected, to a certain extent, by the actions of competitors. This is particularly apparent within the trade sector and among companies selling services directly to households. Efficiency gains with reduced costs as a consequence, better competitiveness and more satisfied customers are other explanations given for why digital technology of various kinds is introduced.

² The digital technologies referred to in the question include cloud computing, big data, e-Commerce, robotics, the Internet of Things, artificial intelligence and 3D printing.

“We are investing in new technology”

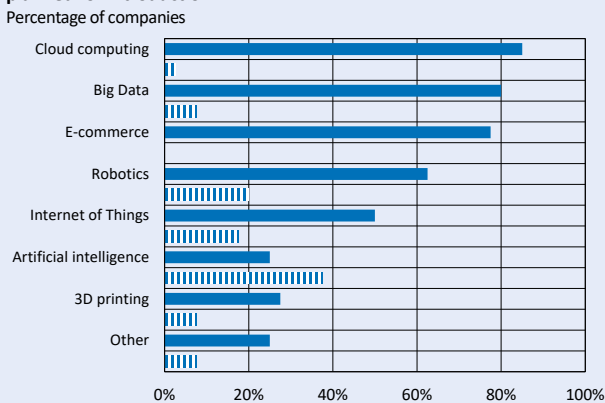
Many digital technologies have already been introduced by the companies. Several respondents also say that the introduction of several interacting digital solutions in particular is what creates better competitiveness and customer benefit. According to the survey, the most companies have introduced various types of cloud service. For example, administrative systems have moved from server rooms to cloud solutions, see Figure 7. E-Commerce is also used by the majority of the companies for which the question is relevant.

For a long time, the manufacturing sector has used robots in production and these have also become common in stock management within other sectors. But automation is now also developing rapidly within the companies' administrative functions and services. These solutions are primarily used to increase internal efficiency, for example to handle frequently asked questions in customer service or invoice management.

Neither is the analysis of large amounts of data seen as a particularly new technology, but is something with which companies within all sectors work in various ways. But the companies now see greater opportunities to use this large amount of information to develop their products and thereby be able to offer customers better goods and services. Within the trade sector, the information is used for the analysis of consumption patterns, making possible relevant and customer-driven campaigns.

Several companies express an interest in using artificial intelligence and many are following developments in the area carefully and plan to introduce it into their operations going forward. Several also mention the development of different applications, for example simple digital tools to help customers find the right goods, as an important part of strengthening customer service.

Figure 7. Introduced digital technologies and digital technologies planned for introduction

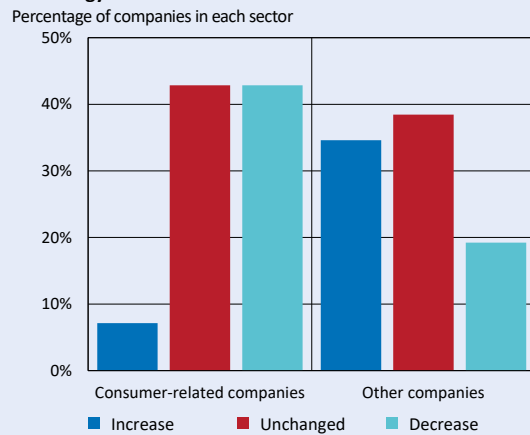


Note. The solid bars indicate introduced technologies, while the striped bars indicate technologies planned for introduction.

Digitalisation is expected to affect employment and prices

There are clear differences between sectors concerning how sales prices are expected to be affected by the introduction of digital technology. Consumer-related retail and service companies expect it to lead to slightly lower sales prices over the next three years, see Figure 8. The trade sector expects the new technology to result in further price transparency, which will continue to push sales prices down. On the other hand, the manufacturing sector and service sector see an opportunity to further refine goods or offer new services and thereby be able to give customers better added value and to charge more.

Figure 8. Expected impact on sales prices of the introduction of digital technology

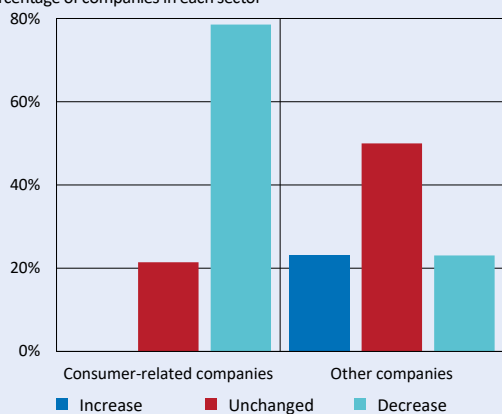


Note. Consumer-related companies are trading companies and companies that sell services directly to households. The response “Don't know” is not reported here.

The majority of consumer-related retail and service companies expect the number of employees to decrease slightly, see Figure 9. This is due, above all, to increased efficiency following from the use of different digital solutions within areas such as case management and other administration. However, several respondents say that this is more a matter of moving competence from customer service and administration, for example, to other types of task that require more IT and digital competence. One business leader puts it this way: “I think that there will be a conversion of competence rather than any downsizing”.

Figure 9. Expected impact on employee numbers of the introduction of digital technology

Percentage of companies in each sector



Note. Consumer-related companies are trading companies and companies that sell services directly to households. The response "Don't know" is not reported here.

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 May 2018 report presents the results of interviews with 40 companies, which were mainly held between 2 May and 18 May.

A more detailed description of the survey can be found on the Riksbank's website: Hokkanen, Melin and Nilson (2012), "The Riksbank's Business Survey – a quick indicator of economic activity", Sveriges Riksbank Economic Review 2012:3.

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



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