



The Riksbank's Business Survey

“Surprising that economic activity is
holding up so well”

February 2019

The Riksbank's Business Survey in February 2019¹

Swedish companies are in general somewhat surprised that the economic situation continues to be as strong as it is. This applies in particular to the manufacturing industry, which can both export to growing markets mostly in Europe and North America, and benefit from the fact that the relatively weak krona is contributing to good profitability. So far, there are no clear signs that a broad downturn is imminent. But despite the continued good situation, survey respondents are less optimistic over economic activity going forward.

Demand is generally high in the domestic economy too, despite some sectors and operations experiencing harder times. For instance, housing construction is clearly declining, but this has in many cases been offset by continued good demand for other construction. The weak krona exchange rate is also putting pressure on profits in several sectors where it has been difficult to compensate for high purchasing costs.

The generally high demand and rising purchasing costs mean that in particular the retail trade and companies selling services directly to households are planning to raise their prices somewhat in a year or so. At the same time, the structural transformation in the durable goods segment is continuing towards more online trading and more online competitors which is pushing prices down. The non-durable goods segment is also affected by the ongoing structural transformation, but at a slower pace than the rest of the trade sector.

Productivity growth in recent years is on the whole perceived to have been good. According to respondents, this is mainly because they are constantly improving the way they conduct their operations, rather than due to individual changes such as the use of new technology.

“Ridiculous that we are constantly planning for harder times when things continue to go well”

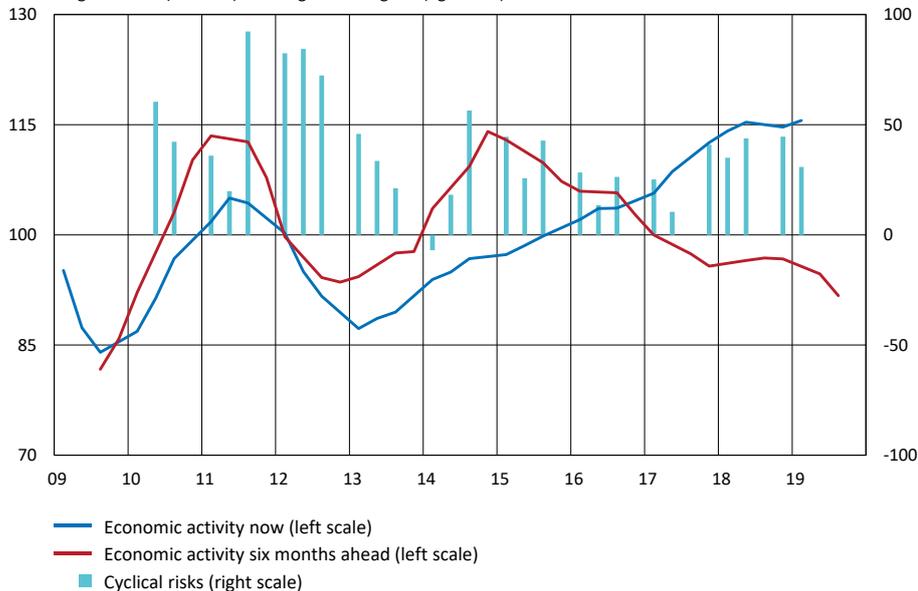
The economic situation remains good, at the same time as an increasing number of companies believe that the situation will deteriorate in six months' time, see Figure 1. One business leader expressed this as follows: “You can't avoid an economic downturn, but the worry lies in some event triggering a downturn that then is deeper and faster than normal.” The less optimistic view of economic developments is also linked to companies on the whole having noticed that orders and sales have deteriorated somewhat at the beginning of the year. They emphasise in the interviews the importance of keeping a close watch on economic developments, but also of being cautious with regard to future decisions and planning their operations.

At the same time, export companies report there is still strong demand from the United States, Europe and parts of Asia. As in earlier surveys, several companies have been surprised that the situation remains as good as it is, because they have been planning for a downturn for some time now. Views on the Chinese market continue to be divided. Some report a

¹ Three times a year, the Riksbank interviews the largest companies in the construction, trade and industrial sectors as well as parts of the service sector. Representatives of 28 companies with a total of approximately 215,000 employees in Sweden were interviewed during the period 13 February to 1 March.

slowdown in demand, while others consider that worries about this market are exaggerated. Demand from North America is still perceived to be particularly strong, while in Europe it is regarded as good, but not as strong as in North America.

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 three-month moving average, based on three observations. The bars show the weighted net figures for those companies that say that the risks to economic development 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.

The cyclical risks are at the same time perceived to have decreased slightly in February compared with the survey in November, see Figure 1. Nevertheless, respondents mention several different risk factors. Export companies, for instance, are concerned about the United Kingdom's withdrawal from the EU (Brexit) and what this will entail for developments in this market, as well as possible effects on economic development in Europe.

A hard Brexit? – “We are postponing potential investment in the United Kingdom”

The United Kingdom's withdrawal from the EU (Brexit), which is planned for 29 March this year, is a risk factor mentioned in several of the interviews. In particular, they mention the risks of a no-deal, or hard Brexit. This could entail problems with the supply of input goods from the United Kingdom to production plants in Sweden (or other parts of Europe). The companies are basing their plans on various possible scenarios and investigating questions that may arise in connection with a hard Brexit. These include what tariffs they may be subjected to and what solutions might simplify the customs administration. Some stocks of input goods have been built up in both the UK and Sweden as a security measure in case of a hard Brexit. Those who supply export companies with services also see risks linked to Brexit. For instance, transportation is directly affected by Brexit in that its administration will become more complex and in the long run this will entail changes in trading and transportation patterns. There is also a risk that Brexit will dampen confidence and economic activity in Europe.

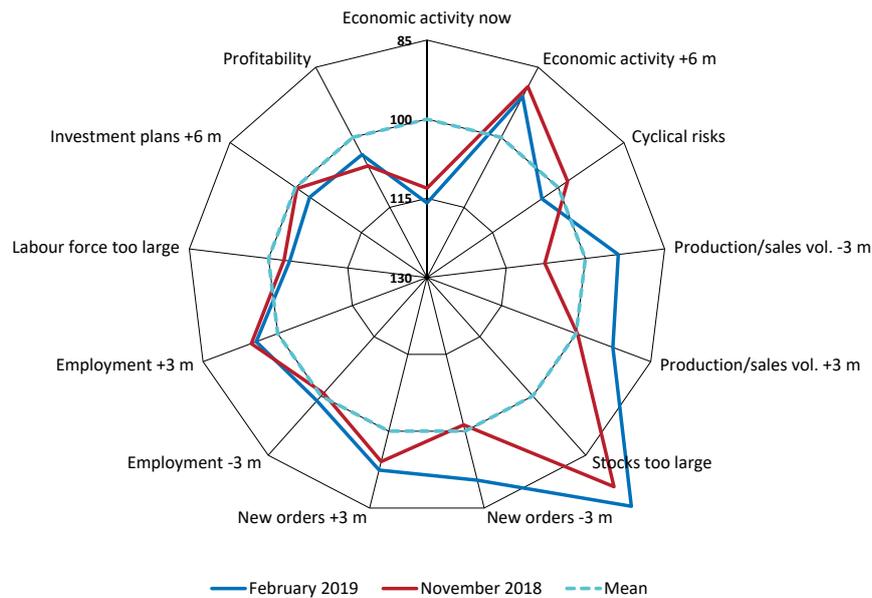
The trade conflict between the United States and China, a clear slowdown in both the Chinese and the European economy and the possible introduction of US tariffs on the European automotive industry are regarded as significant risks. Companies in the trade sector emphasise that the trade conflict between the United States and China has contributed to a

stronger US dollar. These companies are also worried about stock market downturns and how they might affect household consumption going forward.

Other risks that are mentioned include the amortisation requirement, interest rate developments and pricing on the Swedish housing market and the negative impact they might have on Swedish households' purchasing power and propensity. The formation of the government and the publication of the contents of government policy in the most recent budget bill and the political agreement between the parties are perceived on the whole as something positive.² This is a question of there now being a government in place to take the necessary decisions, which also means stability and less uncertainty. And in addition, some of the proposals, such as the infrastructure investments in the political agreement, may increase demand.

All in all, the overall response pattern points to the economic situation at the beginning of the year being at least as good as it was in November, see Figure 2. Nevertheless, companies continue to believe that there will be a slowdown in six months' time. Another distinctive factor is that stocks are still large. The somewhat lower production at the beginning of the year, which should also be regarded in the light of the high level of production last year, could be due to a decline in orders or to the fact that companies have begun to reduce their stocks.

Figure 2. Companies' overall response patterns
Weighted index



Note. The responses to the questions are plotted along "spokes" in the figure where an index number closer to the centre is better. The historical average is calculated from the date the question concerned was first included in the survey. The term -3m / +3m refers to the most recent three months and the coming three months respectively. +6m refers to the coming six months.

“2018 was the best year ever”

Last year was a financial year with high (or even record-high) sales, good profitability and increased market shares for many companies in the **industrial sector**. On the whole, development continues to be favourable for them. The quotes “The situation has not deteriorated since the autumn” and “Surprising that economic activity is holding up so well, as it looked a bit gloomier towards the end of last year” are very telling. In light of the good financial year 2018, respondents are now less optimistic about the economic situation six months ahead. This is not only because the prevailing economic boom is perceived to be

² See *Utkast till sakpolitisk överenskommelse mellan Socialdemokraterna, Centerpartiet, Liberalerna och Miljöpartiet de gröna* (Draft political agreement between the Social Democratic Party, the Centre Party, the Liberal Party and the Green Party) in Swedish only from 11 January 2019.

(unusually) long, but also because orders and production have fallen back somewhat at the start of the year.

The downturn in production so far this year is partly due to export companies having large stocks. They need to reduce them somewhat, which means that they also expect production to decrease three months ahead. There are several good reasons for the previous build-up of stocks. For instance, there is a need to maintain a high level of service towards customers, but it is also the case that global bottlenecks, such as overcrowded ports, have delayed some deliveries and thus contributed to further build-up of stocks.

Although production has decreased somewhat, in several cases companies have reached or are close to their capacity ceiling. But no new investments to increase capacity are planned. Investments are instead aimed at short-term solutions to bottlenecks. This caution can be partly explained by the reduced orders, but also by the discussions in the mass media regarding a coming economic slowdown.

An ongoing structural transformation in the trade sector

The **retail trade sector** has been in the process of a structural transformation for several years now, with for instance, digital stock management, self-scanning of goods and the build-up/development of e-Commerce. The entire sector is very much subject to competition by e-Commerce and all of its online participants. Respondents' views of the economic situation may thus be partly affected by the ongoing structural transformation. The economic situation is perceived either as satisfactory or as poor and they envisage a downward trend in economic activity over the coming six months.

Those active in the **non-durable goods segment** are on the whole satisfied with the economic situation and also expect to feel the same way in six months' time. But they also point out that the sales volume for the non-durable goods segment is not as dependent on economic activity. However, if economic activity slows down, profitability may be affected when customers switch from expensive to cheaper foodstuffs. This is summarised well by the quotation "If there is a slowdown we may see a value effect rather than a volume effect on the market".

"Absolutely the best economic situation ever in the entire history of the IT industry"

The view of the economic situation varies considerably in different segments of the **service sector**. While the IT industry perceives the economic situation as very good thanks to the high demand, there are companies in the travel and charter business that are finding things very difficult as a result of the weak krona and restrained households, which also affects their assessment of the economy. The view of staffing agencies is somewhere in-between and they describe the current economic situation as satisfactory but somewhat hesitant. Demand is described as unchanged and they have enough assignments, but at the same time they perceive their client companies to be somewhat hesitant: "Customers don't really dare to expand, but at the same time they are not downsizing".

The exchange rate – a challenge for the travel business

For the retail trade in general and parts of the service industry, the weak Swedish krona is exerting strong pressure for adjustment on their operations. One example is the **travel business** where revenue is mostly received in Scandinavian currencies while costs are normally in euros and jet fuel is paid in US dollars. One business leader expressed this situation as "The exchange rate is a nightmare". Apart from the exchange rate, they are being influenced by several other factors, including the climate debate on consumer preferences (known as "flying shame") and European regulations relating to delayed flights. The ongoing

transformation means cost savings and better operational efficiency for many. Examples mentioned include reduced expenses for marketing, attempts to renegotiate existing agreements with sub-contractors, postponed or cancelled investment plans, ongoing restructuring and staff downsizing.

“Newly built homes already have quite high rents so a much broader approach is required in housing policy to make a difference”

Even if the housing market has cooled, demand in the **construction industry** is generally described as high. Last year was a strong year for construction with a high, or even record-high, order inflow. One respondent expressed it thus: “2018 was an incredible boom year for us” But as the construction and sale of homes is an essential part of operations for several companies in the industry and as it is now difficult to initiate new housing projects, several say that economic activity in construction has now peaked. By and large, the economic situation for the construction industry is also expected to be worse in six months' time. Several have also seen a slowdown in new orders at the start of the year, although it is also pointed out that this is from a high or very high level. Regarding the economic situation, one respondent said: “One of our sub-contractors that manufactures concrete foundations already noticed a slowdown in the autumn and this tends to be an early indicator of economic activity”.

At the same time, construction companies note that there is an underlying need for public sector construction, such as care homes for the elderly, prisons, schools and pre-schools, as well as for commercial construction, such as offices, department stores and hotels, which at least in part is compensating for the reduction in housing construction. Similarly, infrastructure/plants are deemed to be partly compensating for the reduction in residential housing: “There is strong demand, but residential housing is clearly much weaker than before.” Construction companies also have a major backlog of orders to work through over the next few years: “We will have a lot to do throughout 2019 and some way into 2020 even if the economic cycle is turning now. There will be a time lag for us”.

The demand for housing has decreased in the Stockholm region in particular, leading to a number of construction companies already having reduced their housing production workforce there. Campaigns are also under way to try to stimulate housing sales. Households are, for example, being offered reduced prices or various gifts if they sign a contract for a newly built home. Newly built tenant-owned apartments are also being converted into rented accommodation. As regards the housing market, the proposal in the recently concluded political agreement was also mentioned. According to this proposal, new legislation allowing unrestricted rent-setting for newly built rented accommodation will come into force on 1 July 2021. Such a change is not expected to have much of an impact on the housing market, however.

“Shortage of specialist - yes, but generally no!”

Despite a lengthy economic boom, there is no general shortage of labour overall. Wage growth and wage drift are therefore expected to continue to be modest over the next twelve months. The shortage of specialists remains high, however. Demand is high primarily for IT specialists, experienced officials and engineers with digital skills. Construction companies report a continued major shortage of specialists, such as project managers, and they are tackling the situation by giving relatively inexperienced workers more advanced duties than they would normally do. They are not employing workers with high salary demands as they wish to avoid having a wage structure with substantial pay differentials between new recruits and existing staff, whose wages increase in accordance with collective agreements. An HR

manager described it thus: "It is a difficult situation with low agreed wages but high wage demands".

It is basically only the service sector that continues to report a general shortage of labour. For example, it is still difficult to recruit drivers and mechanics. The wages of these groups are rising much more rapidly than those of other employees. "The shortage has not had such a major effect on collectively agreed wages in total but has led to wage premiums for some" is a revealing quote.

Only temporary effects on sales prices from the summer drought

Purchasing costs rose during the autumn, particularly for many companies in the trade sector, due to the hot summer. However, most of the higher purchasing costs could be passed on to consumers. Several companies in the sector thought that purchasing costs would continue to rise in 2019 due to delayed effects. At the start of the year, however, they have not seen any such effects, at least not in the non-durable goods segment. Instead, costs have increased as a result of the weak krona and the relatively strong demand that still prevails. "Above all, it is the currency that is affecting us" is a quote from one business leader which exemplifies the opinion of several companies.

Sales prices have been more or less unchanged while costs have increased slightly compared with in November. This has led to slightly lower profitability in the trade sector, which continues to be under pressure from tough competition as a result of the expansion in e-Commerce. As in previous surveys, several companies in the trade sector mention the ongoing digital shift with increased e-Commerce and squeezed margins as a consequence.

"Constant struggle to increase prices"

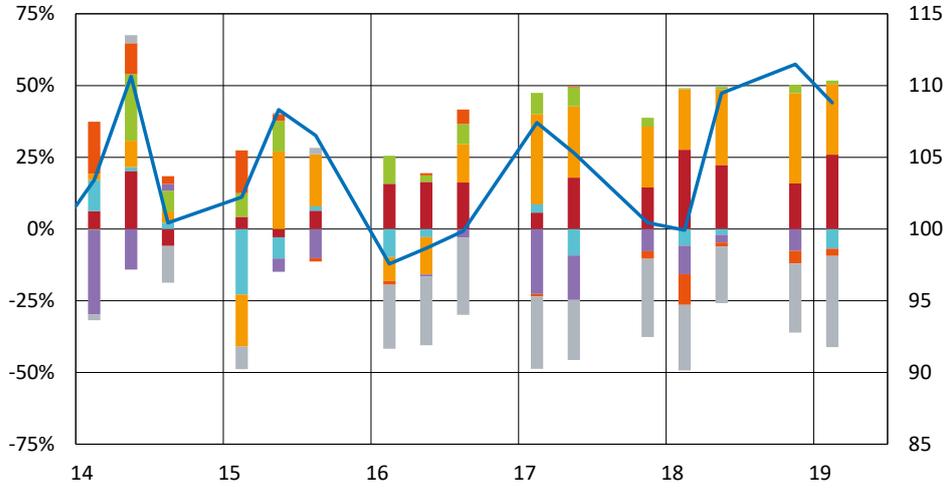
To improve their margins and their profitability when costs rise, several companies are planning to increase prices in the coming year. By and large, both consumer-related companies and industrial, construction and some service companies (i.e. other companies) believe that the high demand will contribute to higher prices in twelve months' time, see Figure 3. Consumer-related companies also expect higher purchasing costs, partly as a result of the weak krona exchange rate against the euro and the US dollar, which will also lead to increased prices. At the same time, however, it is difficult to pass on price increases to customers despite the high demand, due to the tough competition from e-Commerce.

For industry and the construction sector, the high level of capacity utilisation is also a significant factor that may lead to higher prices going forward. But despite bolder plans (and perhaps greater hopes) for price increases than in the previous survey, only small actual price increases are being discussed.

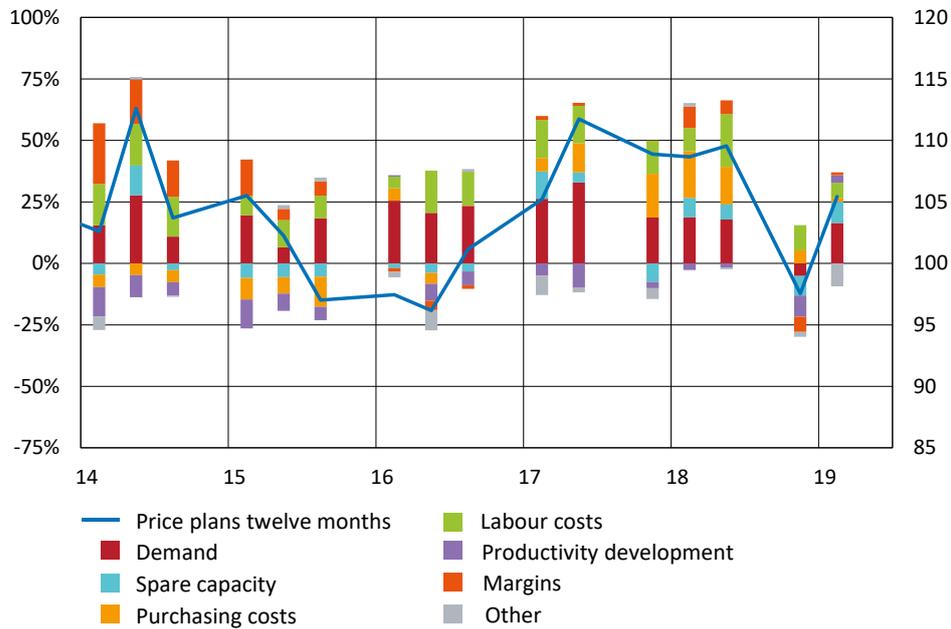
Figure 3. Factors behind pricing in the next 12 months

Weighted net percentages and weighted index figures

Consumer-related companies



Other companies



Note. 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 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 – It is continuous improvement that increases productivity

In recent years, productivity growth in Sweden and abroad has been weak according to official statistics. At the same time, many respondents in the business survey describe the growth as good. To increase understanding of productivity growth in Sweden in recent years, more detailed questions have therefore been asked in the survey. By and large, companies describe continued good productivity growth, often linked to the high level of demand. Companies highlight continuous improvement of working methods, work processes, logistics and management planning as the most important factors behind higher productivity. Several have also introduced new technology that has contributed to good productivity growth in their operations. However, other factors, such as regulatory compliance and IT security that are more difficult to streamline, have contributed to slower productivity growth.

Companies not seeing the same weak productivity growth as in the official statistics

Since the financial crisis of 2008–2009, productivity growth has been weak in both Sweden and other developed economies. However, economists are divided as to what the reasons for this might be. Some believe that current innovation is generating less productivity growth than previously, while others claim that the effects of new technology are not yet visible in the official statistics although they in time will be.³

Questions have been asked about companies' productivity growth ever since the first business survey in 2007. By and large, productivity growth has been consistently described as good, while official statistics have, at least periodically, provided a different picture.

To gain a better idea of how companies view productivity growth, some extra questions were asked this time on how companies measure productivity and what factors are the most significant for this growth. Companies were also asked to react to a number of statements on productivity growth.⁴

Productivity is measured in many different ways

To gauge productivity, companies use both measures that vary with demand and those that are more associated with technological development and the continuous improvement efforts made in companies.⁵

For the demand-related measures, it is common to relate the value of production to operational costs, such as turnover, production value, share of value added and/or sales value to number of employees, number of hours worked and/or square metres/premises/plant/shop/warehouse. The quote "Change in value in relation to cost base" describes the idea behind these measures very well. Some companies also use different types of margin and profitability measures. Sector-specific measures also exist, such as employee leasing rate in the temporary employment sector, billing rate and share of overheads in the consultancy sector and conversion rate in the trade sector.⁶ These indicators are monitored weekly or monthly on a central level in the organisations.⁷

"Continuous improvement has a major impact in the longer term"

The other type of productivity measure, which is of a more technical nature, often concerns efficiency in work

³ See for instance Gordon (2012), "Is US Economic Growth Over? Faltering Innovation Confronts the Six Headwinds", *NBER Working paper series*, No. 18315, and Brynjolfsson and McAfee (2011), *Race Against the Machine*, Digital Frontier Press, New York.

⁴ Similar statements on productivity growth were presented to US companies in Federal Reserve Bank of Atlanta (2018), "Assessment of Firm Productivity", *Business Inflation Expectations Survey*, July.

⁵ Respondents also emphasise the difficulties in measuring productivity.

⁶ Employee leasing rate = ratio of leased employees to the total number of temporary employment agency staff, billing rate = ratio of hours billed to customers to the total number of hours worked, share of overheads = ratio of employees who do not invoice customers to the total number of staff, and conversion rate = ratio of customer visits converted into purchases of goods in relation to the total number of customer visits.

⁷ Today, a few companies only measure productivity growth on a local level and note that "We have to change that!" in order to have better control and a broader overview of it.

processes and working methods, for example lead times, time taken for production or delivery times. This also includes results from surveys on, for example, customer satisfaction or measures such as customer footfall after a marketing campaign. The construction industry also uses self-assessment measurements in which employees state the perceived level of productivity in a project compared with previous projects. This allows a knowledge base to be built up for future projects. Operations are in many cases so fragmented into different parts and stages that several different measures, sometimes hundreds of them, are needed to obtain a clearer picture of productivity growth. The different measures described here are mainly used on a local level in the organisations.

“Right is the watchword for productivity”

The most important factors behind productivity growth according to companies are: continuous improvement of working methods, production processes, management planning and logistics. “Further development of existing processes and methods is a good way of increasing productivity”, “It is a question of making things a bit better all the time”, and “Right is the watchword for productivity” are three quotes that exemplify the opinion of many companies.

Together with continuous improvement efforts and demand, the competitive situation and technological development are also important factors. Companies in the trade and service sectors also mention the importance of giving the customer the right offer and the right information and of adjusting staffing to customer demand. “The ability to adjust working hours to demand is the key to productivity”, as one respondent in the trade sector put it.

“Difficult to attain greater efficiency in regulatory compliance”

Almost every fourth company in the survey considers that they have had productivity growth in their operational activities thanks to the introduction of new technology while developments in other parts of the organisation have had a dampening effect on their productivity, see Figure 4. The quote “We are on the ball out in the factories, but then we are swamped by other central, manual tasks such as regulations and IT security” describes the situation well. A machine or work process can constantly be improved, but it is difficult to attain greater efficiency in aspects such as regulatory compliance. New requirements and interpretations of

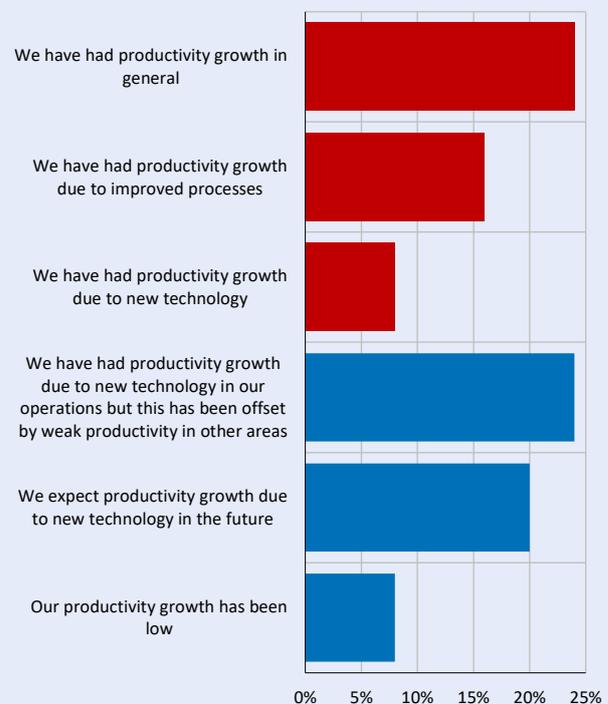
regulations and laws are time-consuming, take up a great deal of resources and have no directly positive effect on profits or turnover.

“A new digital future is ahead”

Almost every fifth company in the survey expects strong productivity growth going forward thanks to new technology, but they currently consider that it is either too expensive to invest in this new technology or that they have invested without any clear effects so far, see Figure 4.

Figure 4. Statements that companies think best describe their productivity growth over the last 2-3 years

Percentage of responses



Note. The question was worded as follows: Productivity growth (measured as GDP per hour worked) in Sweden has been weak in recent years. From your perspective, which of the following statements best describes your situation over the last 2-3 years? Please explain your reasoning for choosing a particular statement. Respondents could choose one of the following: 1) We expect productivity improvements from new technology going forward, but so far it has been too expensive to invest in the new technology. 2) We have had productivity improvements for our company. The official statistics feel somewhat misleading. 3) We have had productivity improvements from new technology in our operational activities, but this has been offset by weak productivity growth in our other activities (e.g. regulatory compliance, IT security, etc.). 4) Productivity growth has been strong/weak due to other reasons. The figure has been created both on the basis of choice of statement and explanation of reasoning.

The fact that investments have nevertheless been made in new technology has mainly to do with the competitive situation: “We have to keep up. There is so much happening in the digital field all the time” as one business leader put it. Several companies also think that the use of new technology will dominate their operations even more in the future.

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 30 companies are interviewed in the survey in February and about 45 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 report for February 2019 presents results of interviews with 28 companies which were mostly carried out between 13 February and 1 March.

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_sve.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