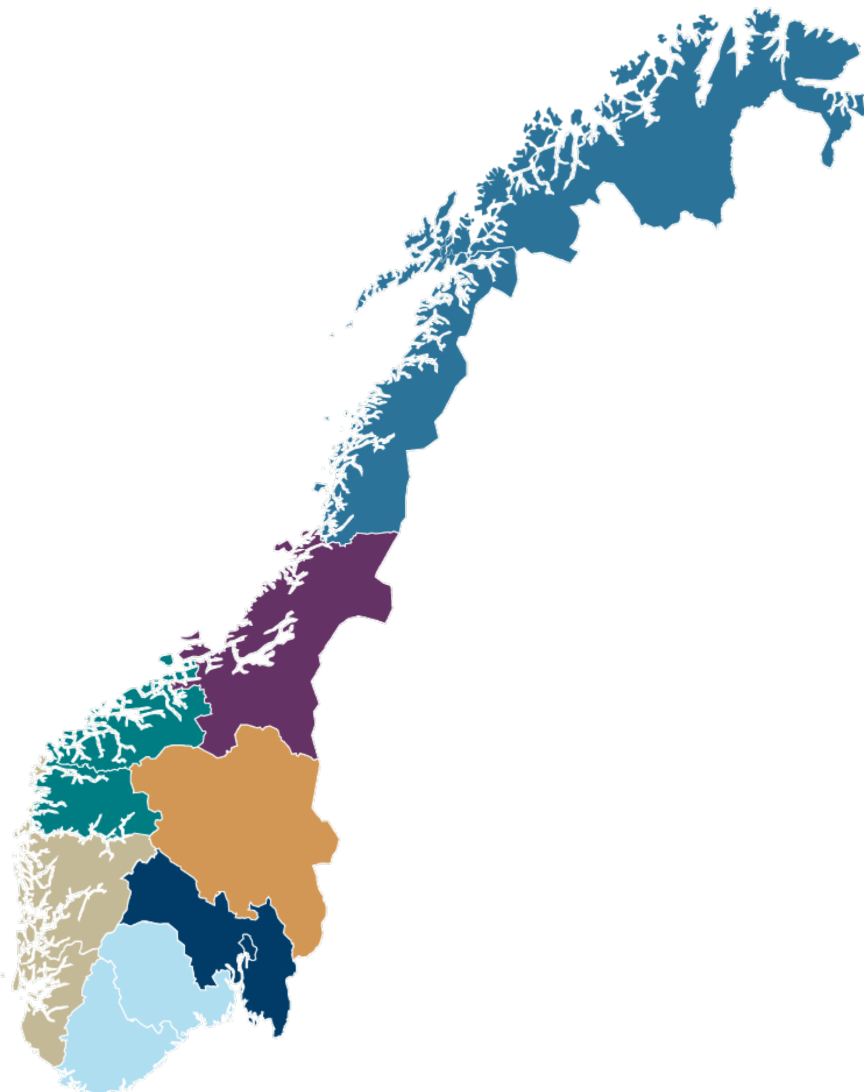
REGIONAL NETWORK

National report

NO. 2 | 2020

INTERVIEWS WERE PRIMARILY CONDUCTED IN THE PERIOD
27 APRIL - 15 MAY



NORGES BANK

Sharp decline in activity

According to Regional Network contacts, the Covid-19 outbreak and containment measures have led to a sharp fall in activity this spring. The oil price fall has contributed to amplifying the decline. Contacts expect a broadly unchanged activity level over the next half-year. They anticipate higher household and public sector demand, but on the other hand believe that weaker demand from export markets and the oil sector and reduced residential and commercial construction will have a dampening effect on growth.

The outbreak has also resulted in a downward revision of investment plans, reduced capacity utilisation and lower employment. Contacts plan to increase employment over summer. The estimate for annual wage growth in 2020 has been revised down from 3.2% in February to 1.8% in May.

The Covid-19 outbreak and containment measures have led to a sharp decline in activity from mid-March. According to Regional Network contacts, activity has fallen at an annual rate of 5.3% over the past three months (Chart 1). By comparison, contacts reported a reduction of slightly below 3% during the financial crisis in autumn 2008. Owing to limitations in the index used in Regional Network surveys, the actual fall is not fully captured in all sectors. There is therefore reason to believe that the real fall in output is greater than 5.3%. Activity has fallen in all sectors (Chart 2). The decline is most pronounced in household services, but activity has also fallen substantially in commercial services, oil services and retail trade.

Contacts expect a broadly unchanged activity level over the next half-year. Household-oriented sectors in particular expect a pick-up in activity over the next half-year, but commercial services are also expecting a little growth. On the other hand, contacts expect weaker demand from export markets and the oil industry ahead, in addition to a fall in residential and private commercial building construction.

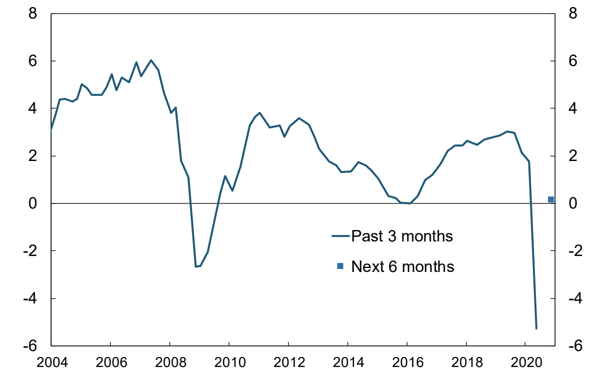
Index

An index is used for most Regional Network survey questions. For output growth, the index ranges between -5 and +5, where -5 corresponds to a fall of at least 10% annualised and +5 corresponds to growth of at least 10% annualised. In this survey, far more contacts than normal reported an index of -5. The majority of these experienced a fall that far exceeds 10%, and some have hardly had turnover in recent months. We use judgement when quantifying growth, and we have taken this into account. However, in many regions the total decline for some sectors is far greater than 10%. This means that the fall has been greater than what appears in the Regional Network survey. There are differences across sectors, with underestimated declines primarily in household services. Likewise, growth ahead is also underestimated.

Network contacts also report a sharp fall in employment over the past three months (Chart 3). There is a decline in all of the private sector industries, but the fall has been most pronounced in services, retail trade and oil services. A large share of enterprises have furloughed parts of their workforce, and several point out that favourable furlough conditions have made it easier to furlough employees. A number of enterprises have already called some

Chart 1

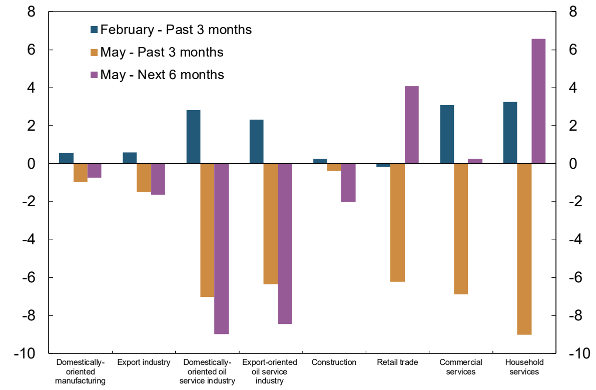
Total output growth



Growth past three months and expected growth next six months. Seasonally adjusted. Annualised. Percent

Chart 2

Output growth. All sectors



Growth past three months and expected growth next six months. Seasonally adjusted. Annualised. Percent furloughed staff back to work. They also expect that even more employees will be returning over the next three months. Nevertheless, a number of enterprises are planning for reduced employment ahead. Redundancies have been fairly uncommon, and only a very few enterprises are planning redundancies in the coming period. The hardest hit enterprises will assess the situation through autumn, and several expect clarification of furlough conditions further ahead.

Since 2016, contacts have been planning increased investment, but in this survey, they report that investment will be reduced ahead (Chart 4). Such a sharp decline in planned investment has not been reported earlier, not even during the financial crisis in 2008. All of the private sector industries expect a decline in investment in the coming year. The sharpest fall is expected by services, reflecting weak developments in tourism and adjacent sectors such commercial property leasing and development. Local governments and hospitals expect increased investment ahead, but growth has been revised down from the previous survey. Containment measures have led to higher costs for local governments, while postponed operations have led to reduced revenue for hospitals. A number of local governments and hospitals therefore believe that they have to cut their investment budgets. On the other hand, the Norwegian Association of Local and Regional Authorities (KS) has asked local governments for a list of projects that can be carried out quickly, and some believe that increased transfers from the central government will pull up investment ahead.

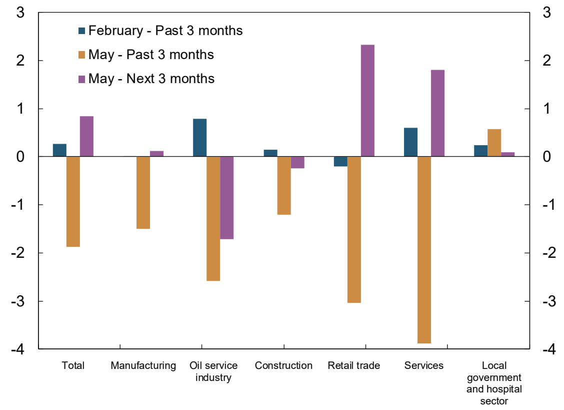
Reduced household demand

Growth in retail trade has been weak over the past year, and retail trade contacts reported weakly falling sales volume through autumn and winter (Chart 5). In this survey, retail trade contacts have experienced a substantial decline in turnover volume. Demand fell sharply during the last two weeks of March, but sales have picked up gradually thereafter. Car dealers and stores in shopping centres have experienced the most pronounced decline. On the other hand, sales of groceries and home furnishings have risen over the past three months. Retail trade contacts expect solid turnover growth in the next six months, and they believe that cancelled holidays abroad will lead to more customers in Norwegian shops.

Activity in household services has risen fairly steadily since 2014. When containment measures were introduced in mid-March, many services such as restaurants, cultural venues, hairdressers and fitness centres had to close. Activity has therefore fallen sharply over the past three months (Chart 6). As the authorities permit larger gatherings, activity is gradually rebounding. Travel restrictions will lead to higher demand from Norwegian households, but at the same time will result in few foreign tourists. For some enterprises, it will take time before activity returns to its pre-outbreak level. The ban on events for more than 200 persons will result in cancellations of large events. This will also create spillovers such as reduced travel and less activity surrounding the cancelled events.

Chart 3

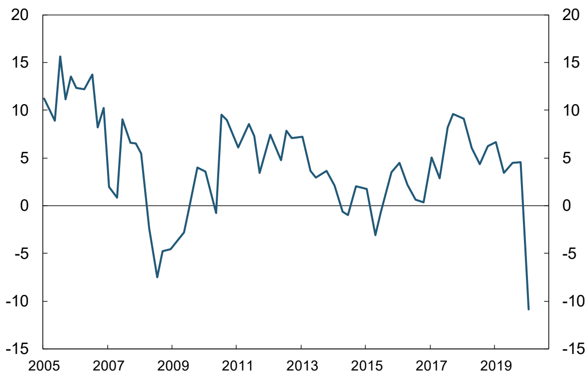
Employment growth



Growth past three months and expected growth next three months. Seasonally adjusted. Percent

Chart

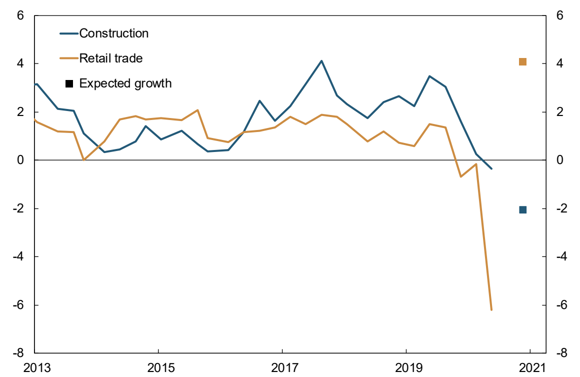
Investment growth



Expected growth next 12 months. Percent

Chart 5

Output growth. Retail trade and construction



Growth past three months and expected growth next six months. Seasonally adjusted. Annualised. Percent.

Broad-based decline also in enterprise-oriented industries

Commercial services have accounted for a large share of growth after the cyclical trough in 2016. Growth slowed a little through 2019 and into 2020, and after the introduction of containment measures in March, activity has fallen substantially (Chart 6). The decline is steepest for travel industry contacts, but activity is also being pulled down by the introduction of cost-saving measures by large segments of industry. This means reduced demand for services such as marketing, consultancy and temporary staffing. Many contacts had large order backlogs prior to the pandemic, but few new orders have come in since the outbreak. A number of contacts are therefore expecting a sharper fall in activity ahead. On the other hand, there are enterprises in eg the travel industry temporary staffing and commercial real estate leasing that believe that the worst is behind them and now expect increasing activity ahead. Services contacts expect that increased public demand will cushion the fall, and they anticipate that activity will rise slightly in the next half-year.

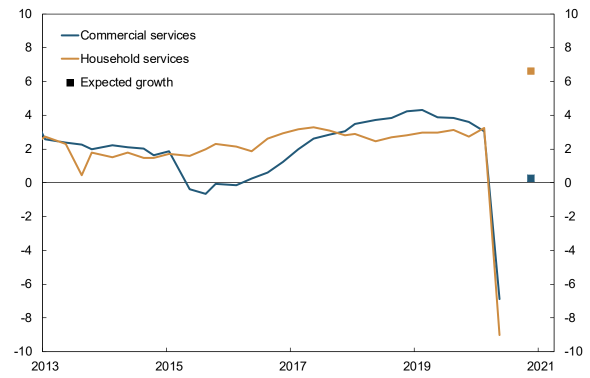
In construction, growth slowed through 2019, but contacts expected that growth would pick up again when they were interviewed in February. Since then, activity has fallen somewhat, but substantial order backlogs at a number of enterprises have dampened the decline (Chart 5). Through spring there were few new home sales, and there is little willingness to invest in private commercial buildings. Contacts expect that the weak order intake will lead to a fall in output over the next half-year. Public investment in buildings and infrastructure will help to cushion the decline ahead.

Growth in manufacturing has slowed over the past two years, and recently, output has fallen (Chart 7). The fall in output reflects lower demand for Norwegian manufactured goods resulting from containment measures abroad and in Norway, in addition to problems sourcing intermediate goods and recruiting foreign labour. In the food industry, sales to the grocery trade have risen, whereas sales to food service such as restaurants and canteens have nearly disappeared. The reopening of more and more restaurants and hotels will lead to higher growth ahead. Demand for building materials has remained fairly high recently, but prospects ahead are weaker. Like construction enterprises, building materials manufacturers believe that a fall in residential and private commercial building construction will lead to a decline in output ahead.

The pandemic and containment measures have led to a complete or partial closure of many export markets, and demand for furniture, building materials and aircraft and car parts has fallen sharply. Demand for fish and fish products has also fallen. This has led to slightly lower sales volume, but the most pronounced impact is on prices. Contacts believe that it will take time before export markets recover and expect output to fall more over the next half-year.

Chart 6

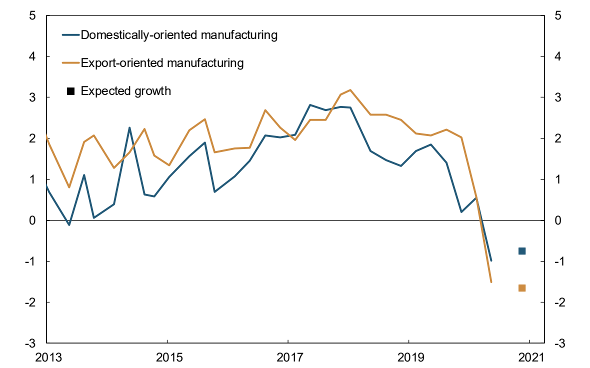
Output growth. Services



Growth past three months and expected growth next six months. Seasonally adjusted. Annualised. Percent

Chart 7

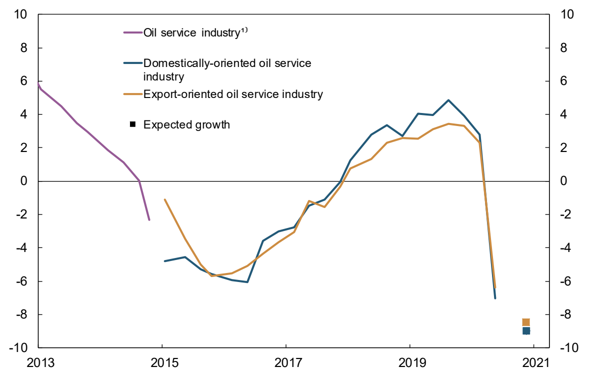
Output growth. Manufacturing



Growth past three months and expected growth next six months. Seasonally adjusted. Annualised. Percent

Chart 8

Output growth. Oil services



Growth past three months and expected growth next six months. Seasonally adjusted. Annualised. Percent.1) Discontinued series.

The large number of new development projects has contributed to solid growth among oil service enterprises over the past few years, but activity on these projects will slow ahead. Contacts therefore expected in February that growth would be fairly weak further out in 2020. The fall in oil prices and the pandemic have severely impacted oil services and led to a sharp decline in activity (Chart 8). Owing to containment measures, offshore and shipyard activity has fallen markedly, at the same time as the fall in oil prices has led to cost-saving in areas such as exploration, maintenance and modification. As a consequence of low oil prices and prospects for weak global growth, a number of planned projects have been postponed or cancelled. Oil services therefore expect activity to fall even more over the next half-year than in the past three months. Both growth in the recent period and the outlook are substantially worse than they were at their weakest in connection with the oil downturn in 2016.

Long-term effects of Covid-19 on the business sector

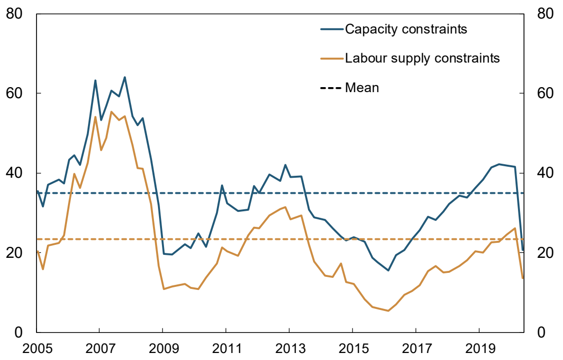
Contacts believe that the Covid-19 pandemic will result in a number of permanent changes. There are prospects for a large number of bankruptcies worldwide, which will alter the competitive situation for a large number of enterprises. In addition, a greater degree of consolidation is expected, so that in the period ahead, many markets will consist of fewer and larger firms. The introduction of home office arrangements and travel restrictions have led to the increased adoption of digital tools by most enterprises. They believe that new ways of working will result in reduced travel activity also in the future. Some contacts expect that globalisation will slow and that demand for Norwegian-made goods will experience an upswing. Contacts also expect that growth in online shopping and streaming services will continue at the expense of physical shops and experiences.

Fall in capacity utilisation

The indicator for enterprises' capacity utilisation shows the share reporting full utilisation of resources such as labour, available intermediate goods and machinery. The indicator rose gradually from the cyclical trough in 2016 but showed little change in the period to February 2020 (Chart 9). Since February, capacity utilisation fell owing to the sharp decline in activity, but the indicator is still higher than it was during the oil downturn in 2016. In this survey, a number of enterprises are experiencing logistics problems, including challenges sourcing intermediate goods. Moreover, quarantine rules have led to difficulties in recruiting foreign labour. A number of enterprises have experienced higher sickness absence and introduced changes in shift arrangements, but only a few have reported this as a capacity constraint. Few services and retail trade contacts are experiencing capacity problems, while a higher share of construction, manufacuring and oil service contacts report the challenges mentioned above (Chart 10).

Chart 9

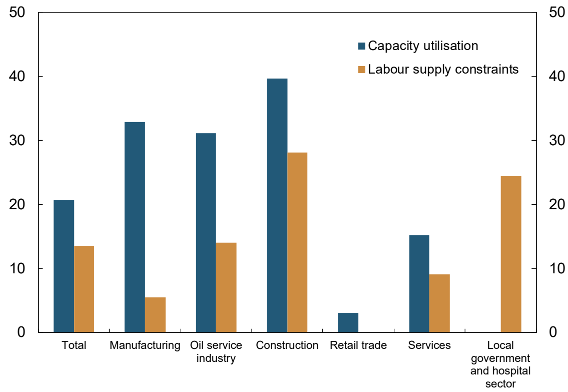
Capacity utilisation[1)] and labour supply constraints [2)]



Percentage shares.1) Share of contacts that will face some or considerable difficulty increasing output/sales without committing additional resources such as labour or machinery. 2) Share of contacts citing shortage of labour as a constraint on production/sales. The question about labour is asked only of the enterprises reporting full capacity utilisation, but the series shows the share of all contacts included in the interview period. The local government and hospital sector is omitted from the capacity utilisation series, but is, however, included in the labour force series.

Chart 10

Capacity utilisation[1)] and labour supply constraints[2)]. All sectors



Percentage shares.1) Share of contacts that will face some or considerable difficulty increasing output/sales without committing additional resources such as labour or machinery. 2) Share of contacts citing shortage of labour as a constraint on production/sales. The question about labour is asked only of the enterprises reporting full capacity utilisation, but the series shows the share of all contacts included in the interview period. The local government and hospital sector is omitted from the capacity utilisation series, but is, however, included in the labour force series.

In all sectors, fewer contacts than in February report that recruitment problems are a bottleneck. This indicator has fallen the most among oil service enterprises. There are also far fewer construction industry contacts with recruitment problems than in the previous survey, but nearly a third still report that they are unable to recruit qualified labour. As in the previous survey, construction enterprises report problems recruting project managers. In addition, quarantine rules have made access to foreign labour more difficult. Among local governments and hospitals, the share has fallen slightly since February. Around a quarter are now experiencing recruitment problems, with shortages of teachers and nurses in particular. A number of local governments have had problems recruting sufficient qualified labour to perform additional tasks related to containment.

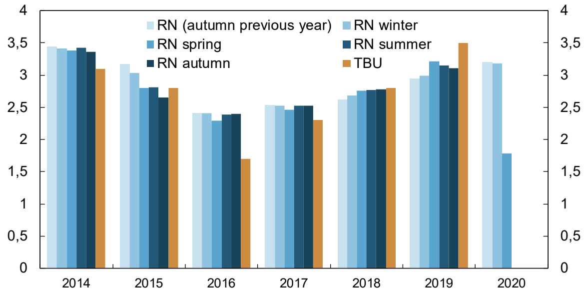
Low wage expecations and high inflation

Tighter labour market conditions have boosted wage growth among contacts in recent years. In February, contacts believed that wage growth in 2020 would be 3.2%. Owing to the weak growth in the wake of the pandemic, they have now revised their estimate down to 1.8% (Chart 11). The local government and hospital sector report the clearly highest estimate, 2.5%, while oil services report the lowest estimate, 1.2% (Chart 12). A large share of enterprises expect a zero settlement in 2020, where wage growth will only consist of the overhang from 2019. Moreover, a number of enterprises have bonus schemes that will result in negative wage growth in 2020.

The rise in prices in retail trade has accelerated in recent months. The primary explanation for the faster rise is the krone depreciation. A large share of contacts expect the weaker krone to pull up prices even more, and a majority are planning for higher inflation ahead. The rise in prices has recently slowed in household services. At the same time, a considerable share of household services contacts have barely had turnover since March, and prices in the recent period will be difficult to compare with earlier periods.

Chart 11

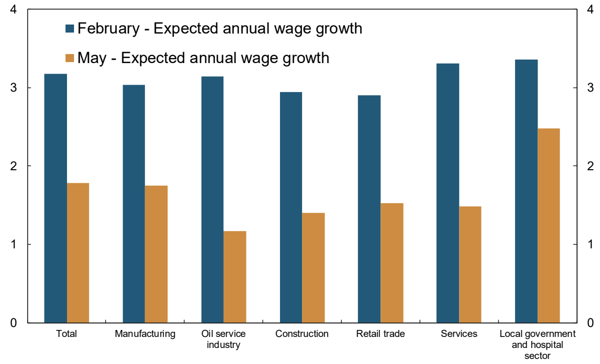
Expected annual wage growth



Technical Reporting Committee for Wage Settlements (TBU) and Regional Network (RN). Percent

Chart 12

Expected annual wage growth



Expected annual wage growth. Percent.

TABLE 1 Economic indicators

	This survey	Previous survey
Output and demand		
Output growth past three months (annualised percentage growth)		
Total	-5,3	1,8
Domestically-oriented manufacturing	-1,0	0,6
Export industry	-1,5	0,6
Domestically-oriented oil service industry	-7,0	2,8
Export-oriented oil service industry	-6,4	2,3
Construction	-0,4	0,2
Retail trade	-6,2	-0,2
Commercial services	-6,9	3,1
Household services	-9,0	3,3
Expected output growth next six months (annualised percentage growth)		
Total	0,2	1,7
Domestically-oriented manufacturing	-0,7	1,1
Export industry	-1,6	1,3
Domestically-oriented oil service industry	-9,0	0,7
Export-oriented oil service industry	-8,4	1,6
Construction	-2,1	0,7
Retail trade	4,1	0,1
Commercial services	0,3	2,7
Household services	6,6	3,2
Labour market and output gap		
Employment growth past three months	-1,9	0,3
Expected employment growth next three months	0,8	0,3
Labour supply constraints	13,5	26,1
Capacity constraints	20,7	41,5
Costs and prices		
Estimated annual wage growth for current calendar year (percent)	1,8	3,2