Competition and prices

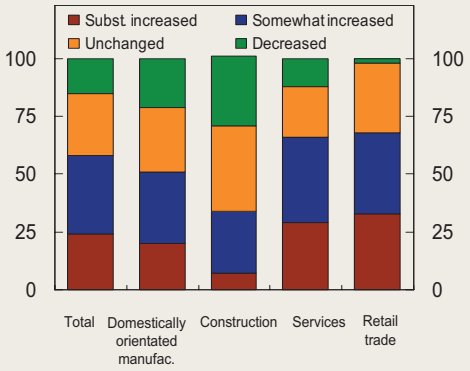
Underlying inflation has been low in recent years, partly reflecting low import prices, high productivity growth and moderate wage growth. Norges Bank has pointed out that increased competition in product markets may have curbed inflation.[1] It was also pointed out that the rise in prices for domestically produced goods and services has been lower than implied by historical relationships between inflation and wage and productivity growth.

Competition is difficult to measure. One method is to link competition to various indicators of product market regulation, the application and formulation of competition legislation, number of firms in a market or the degree of openness of an economy. The relationship between such indicators and competition may be uncertain. In this box, we use the results of a survey of Norges Bank's regional network to shed light on developments in competitive pressures and the effects of increased competition on firms' prices. The results are based on interviews of 220 enterprises which primarily supply goods and services to the domestic market. The industries surveyed comprise domestically oriented manufacturing, building and construction, retail trade and services. The survey was conducted in January and February 2007.

In the survey, 58% of companies responded that competition has increased in the past 2-3 years, while only 15% reported that competition has decreased (see Chart 1). In retail trade and services, almost 70% responded that competition has intensified. About half of the enterprises in domestically oriented manufacturing report increased competition. In the building industry, the share that reported increased competition is about as large as the share that reported reduced competition.

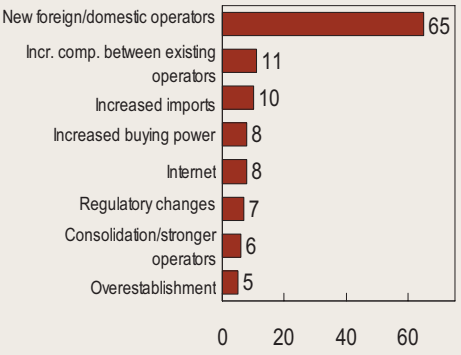
Two-thirds of the companies that report increased competition attribute this to the entry of more operators, including foreign operators, into the market (see Chart 2). Increased competition between existing companies, higher imports, increased buying power, growing online sales and the scaling back of competition regulations are also cited as factors behind increased competition. In the building industry, 9 of 10 companies report that the main factor is an increase in the number of companies. Higher imports are cited by a good 30% of companies in domestically oriented manufacturing. Some companies also report that increased buying power is an important reason. In services, many companies report that they are faced with increased competition from existing companies as a result of improved technical possibilities for offering IT services nationally, for example. In retail trade, many companies report that they are facing increased competition from online sales. Three-fourths of companies that report declining competition explain that higher demand has contributed to reducing competitive pressures. In particular, higher demand seems to have contributed to reduced competition in the building industry.

Chart 1 Developments in competition in the past 2 – 3 years. Per cent



Source: Norges Bank

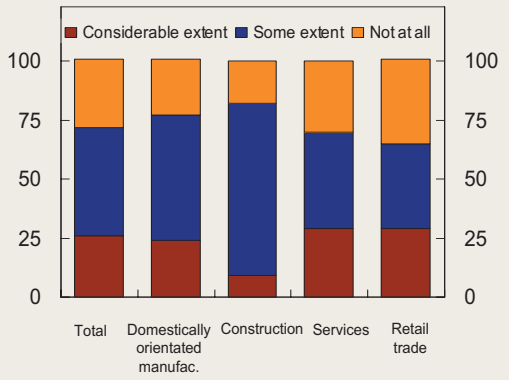
Chart 2 Factors behind intensified competition.[1] Per cent



[1] Each enterprise can list several factors. The percentages therefore add up to more than 100.

Source: Norges Bank

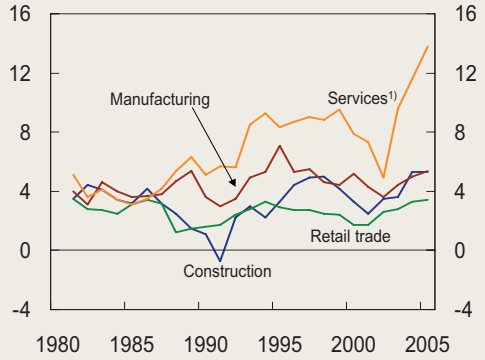
Chart 3 Curbed rise in prices among enterprises due to stronger competition.[1] Per cent



[1] Among enterprises that report stronger competition.

Source: Norges Bank

Chart 4 Operating margins in selected industries. Per cent. Annual figures. 1981 – 2005



[1] Hotel and restaurant, transport, telecoms, ICT, commercial services, travel and tourism and property management

Source: Norges Bank (Sebra database)

The survey via the regional network indicates that increased competition has had a dampening impact on price increases over the past 2-3 years. Among the companies that report increased competition, 71% indicated that it has curbed the rise in prices. In retail trade and services, the figures were 64% and 70%, respectively (see Chart 3).

Information about price developments from the regional network seems to be consistent with developments observed in CPI components:

- Price for food and other grocery products fell sharply through 2004 ahead of Lidl's entry into the Norwegian market. However, the rise in prices for these goods picked up again towards the end of 2004 and through 2005 after the entry of Lidl. The rise in food prices in the CPI-ATE fell sharply again towards the end of 2005 and into 2006. Earlier reports from our regional network indicate that this may have been the result of increased competition in the grocery trade. It was reported that the chains in the grocery trade managed to exert increasing downward pressure on Norwegian supplier prices.

- The rise in the prices for many services has been subdued in recent years. For example, telecom services have shown a marked price fall. High productivity growth in the production of these services has made a contribution, but strong competition from a rising number of operators has probably also had an impact. Airfares fell markedly from the beginning of 2002 to May 2004. Competition in the financial industry also seems to have increased in recent periods.

A lower rise in prices as a result of intensified competition will in isolation be reflected in lower margins in enterprises. However, operating margins[2] in most industries have increased since 2002 (see Chart 4). Higher operating margins may indicate that price competition has been countered by lower cost growth. Increased competition may have contributed to cost reductions via rationalisation and by restraining wage demands.[3] Moreover, some companies have probably increased imports of processed intermediate goods from low-cost countries. In an upturn, companies may also have to increase margins after being exposed to pressures in the preceding downturn.

Overall, the companies surveyed also report that gross margins[4] have shown an overall improvement over the past 2-3 years. Among the companies reporting increased competition, however, 38% reported a fall in margins, while 29% reported an increase. Domestically oriented manufacturing, services and the building industry reported lower margins (see Chart 5). In retail trade, however, more companies reported an increase in margins than a reduction in spite of strong competition.

The survey from the network shows that companies expect competition to intensify further in the next 2-3 years (see Chart 6), but that it will increase somewhat less than in the past 2-3 years. 58% report stronger competition in recent years, while 47% expect stronger competition in the period ahead. 24% report a marked increase in competition, while only 8% expect a marked increase ahead. Companies expect competition to intensify as a result of an increase in the number of domestic and foreign operators, stronger competition among existing companies, higher imports and growing online sales (see Chart 7).

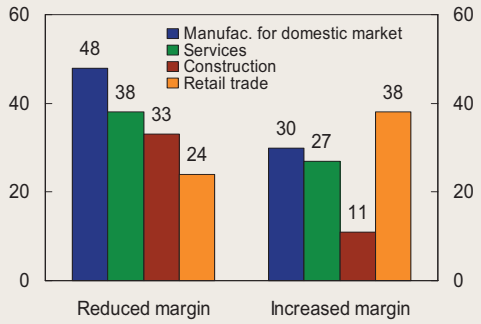
The expected increase in foreign competition must be seen in connection with the high price level in Norway. Norwegian consumer prices were about 45% higher in 2005 than the average for EU member states.[5] The high price level reflects among other things a high level of excise duties and income, but may also indicate that there is limited competition in some goods producing sectors. Owing to technological developments, a rising number of services are exposed to international competition. This trend will continue, and in addition the EU services directive will increase competition facing Norwegian service providers. A breakthrough in the Doha negotiations and a new WTO agreement could increase competition in the food market.

Many Norwegian industries are attracting both domestic and foreign operators thanks to high profits and operating margins, which may increase competition and push down margins and prices.

On the other hand, there are some factors suggesting that competition will not increase in the period ahead. Capacity utilisation in the Norwegian economy is high and increased demand may result in higher prices. In some sectors, there is a relatively high degree of concentration that may limit competition. High productivity and market power in those sectors may be an entry hurdle for other operators even if profitability in the industry is high.

1 See articles evaluating Norges Bank's projections in Economic Bulletin 1/05, 2/06 and 2/07 (to be published in July 2007).
2 Operating margin is defined as turnover less operating expenses as a share of total turnover.
3 See box in this report on uncertainty surrounding wage growth ahead.
4 Gross margin is defined as sales revenues less purchasing costs as a share of sales revenues.
5 Price level relative to 25 EU member states.

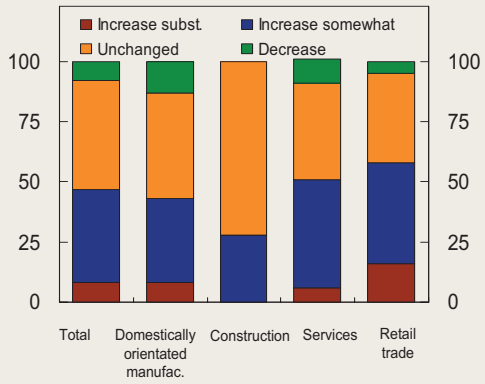
Chart 5 Developments in gross margins[1] in the past 2 – 3 years among enterprises that report stronger competition. Per cent



[1] Sales revenues less purchasing costs as a share of sales revenues.

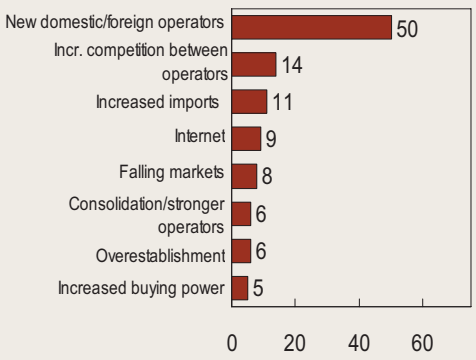
Source: Norges Bank

Chart 6 Expected developments in competition in the next 2 – 3 years. Per cent



Source: Norges Bank

Chart 7 Factors behind expectations of intensified competition.[1] Per cent



[1] Each enterprise can list several factors. The percentages therefore add up to more than 100.

Source: Norges Bank