

Supply chain issues hold back growth in Europe's technology industries after months of solid increase

Twice a year, Orgalim's economists compile data and examine the main economic developments for Europe's technology industries. The result is this report outlining future economic trends for our industries.

- Better than expected upswing, as demand surged in 2nd and 3rd quarters
- +9.7% full year turnover growth now forecasted for 2021
- 4th quarter slowdown expected amid supply chain disruptions
- 2022 growth forecast to slow to +3.9% overall
- Lack of skilled labour - another brake on growth

In spring 2021 Orgalim economists were still relatively cautious regarding the growth forecasted for 2021 – a weak first quarter was followed by the first signs of a surge in demand in the technology industries. They anticipated an upswing but underestimated the extent of it. The +5.8% growth originally forecasted six months ago has now been followed by a significant upward correction: from the current perspective, our economists are assuming a turnover growth of +9.7% for the full 2021 year.

What were the reasons for the extremely dynamic development in demand in the 2nd and 3rd quarters of 2021? A number of factors have come together which, in combination, have led to a market situation that is almost overheating. As a result of the progress of the vaccination campaign, investment plans by companies were reactivated and final consumer demand was strengthened. Investments that had been postponed during the crisis have also additionally increased demand. Industries also created additional growth impulses through inventory build-up and thus anticipated future demand.

However, in the 4th quarter, the forecasts are once again more cautious and, in some cases, even pessimistic. Huge disruptions in supply chains have led to production difficulties across the industry. This is gradually having an impact on demand, where we see signs of a clear slowdown in growth, and in some industries – like automotive supply – even of crisis situations.

The decoupling of production growth on the one hand and profit margins on the other is also striking. The profits of the companies cannot keep pace with the increases in production, because of the enormous increase in costs for primary materials – which may only partially be passed on to the customer.

The impact on the supply side with shortages of pre-materials, rising energy prices and pressure on the labour market presents us with a completely unexpected situation. Instead of limited demand, there are currently bottlenecks in our supply chains. This is a situation that has not existed to such an extent for decades. We are currently assuming that further growth will continue to slow down in 2022, with an expected growth rate in the technology industries of +3.9 %.

Key figures



2,076 billion EUR

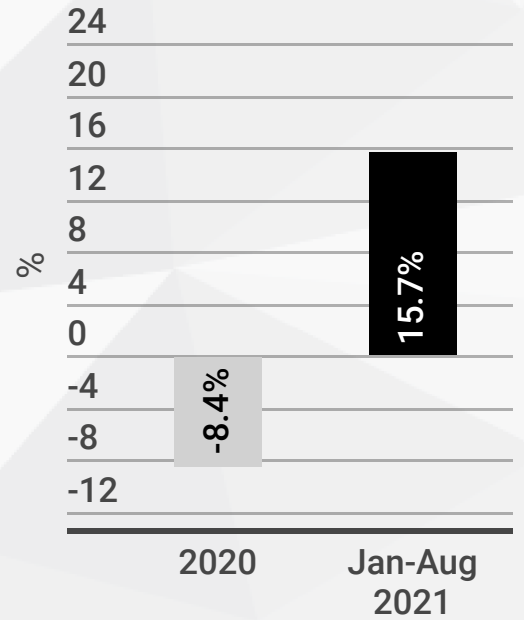
Turnover value of Europe's technology industries in 2020



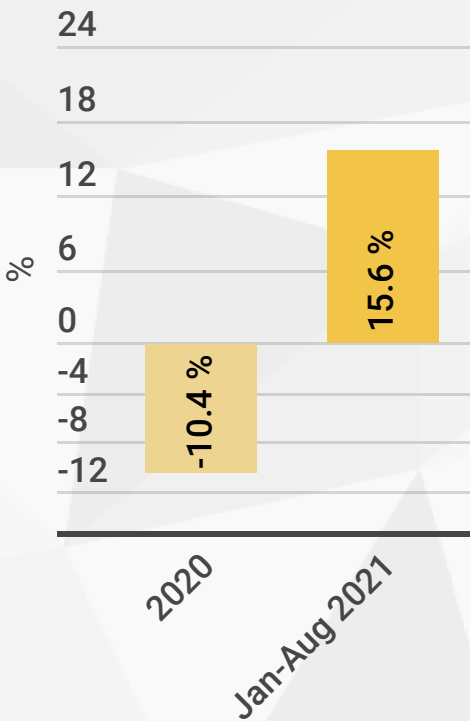
11.326 million

Direct employment of Europe's technology industries in 2020

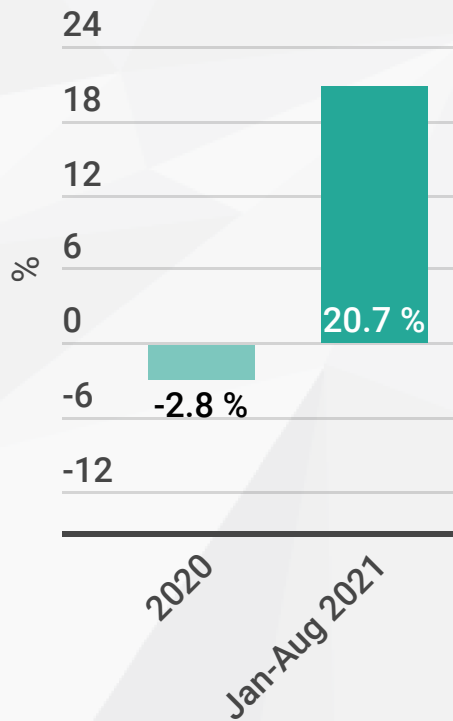
Total technology industries



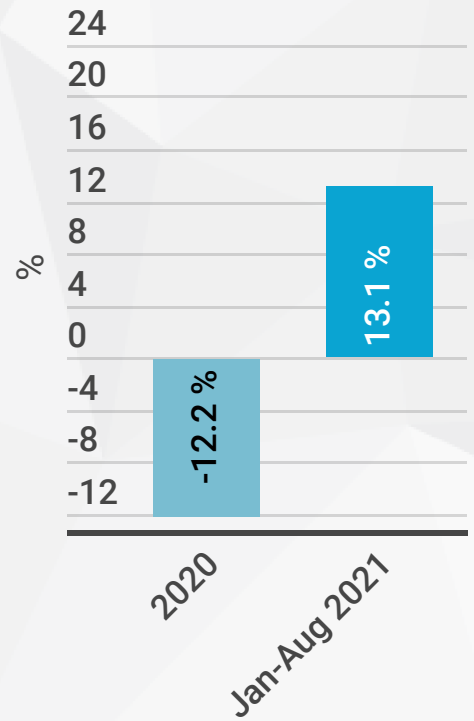
Metal technology



Electrical engineering & electronics

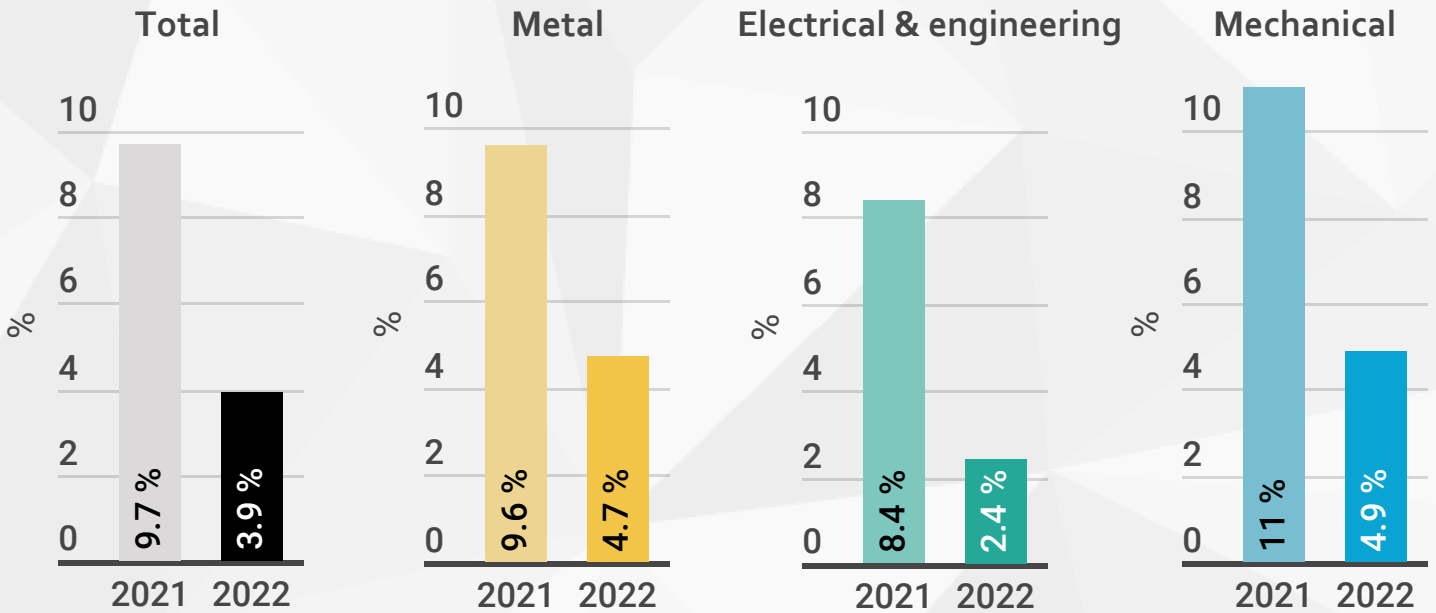


Mechanical engineering



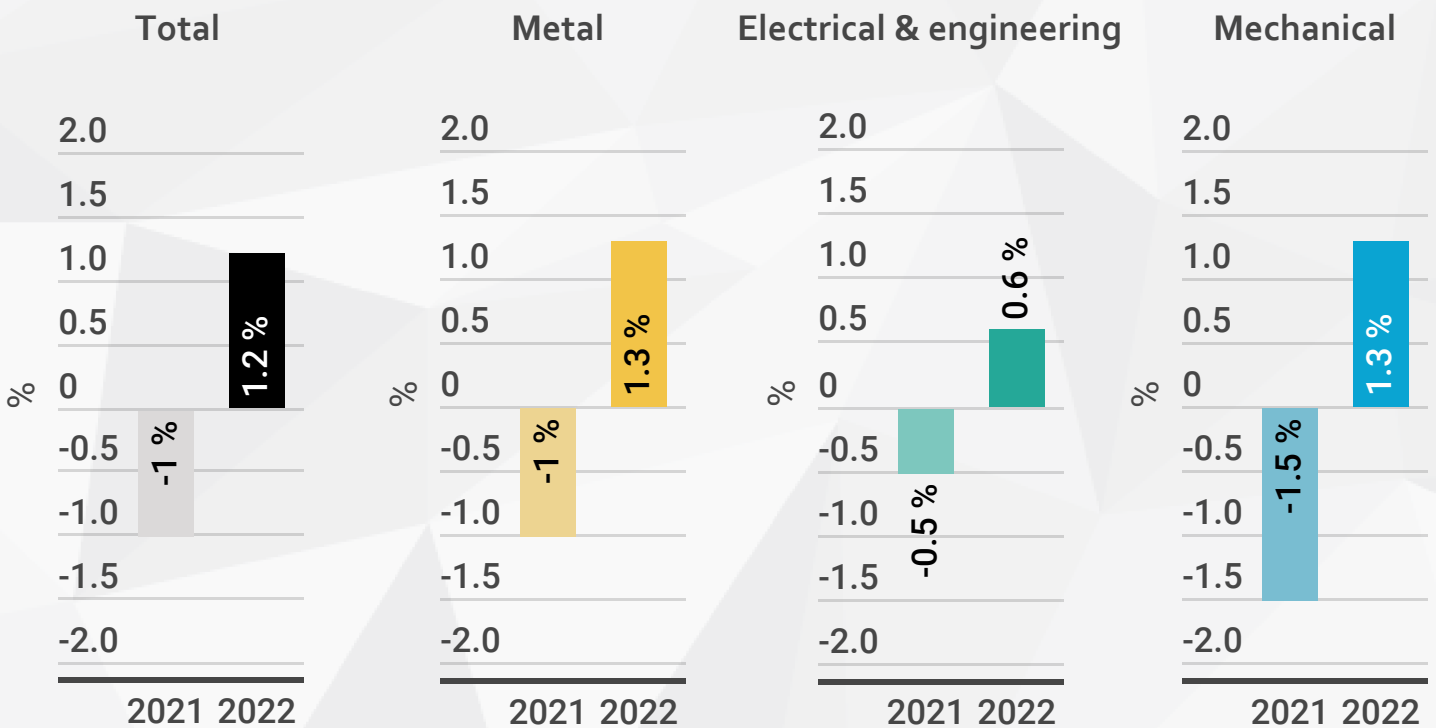
Production % change for same period year on year

NACE 25/26/27/28/33 Eurostat production index EU 27; short term business statistics; Price adjusted, calendar and seasonally adjusted



Orgalim forecasts for turnover

Data sources: E&S WG Forecasts year on year; NACE 25/26/27/28/



Orgalim forecasts for employment

Data sources: E&S WG Forecasts year on year; NACE 25/26/27/28/

Highlights per sector

Metal technology sector – dependent on automobile production

The VDA (Association of the German Automotive Industry) recently published a shocking forecast: that automotive production in Germany will collapse by 18% in 2021. Only a few months ago, at the beginning of the year, an increase of 20% was expected. The main reason for this slump is the lack of components such as semiconductors.

This will have a major impact on the metal technologies sector across Europe, which is often directly or indirectly dependent on the automotive industry. Nonetheless, we estimate a growth in this sector of around +9.6 % this year, albeit after a heavy drop of -10.4 % in 2020. High demand in the 2nd and 3rd quarters caused production to increase by 15.6% up to August this year. Growth will slow down in the 4th quarter, and this trend will continue in 2022 with an expected growth of +4.7%. However, we can expect this forecast to vary, notably due to supply chain disruptions.

Electrical engineering and electronics sector – profiting from digitalisation

Looking at 2020 and 2021 together, the electrical engineering and electronics sector should emerge from the crisis with a marked increase in production. Last year, the sector withstood the crisis relatively well with a loss of 'only' -2.8%. And this year we expect a growth of +8.4%, which overall will be a significant increase compared to 2019.

The Covid-19 crisis has created additional impetus towards digitalisation, both in industry and in the consumer sector. Demand has increased accordingly and there was a boom in production for the first few months of 2021: production increased by over 20% during this period.

Since spring there have been extreme shortages in semiconductors supply and growth is expected to slow down significantly in the second part of the year as the effects of the shortage of materials begin to show in the production figures. The ZVEI (German Electrical and Digital Industry Association) believes that the shortage of chips will continue well into the coming year. Due to the enormous increase in demand, they do not expect the market for semiconductors to stabilise until 2023.

The outlook for 2022 with a positive +2.4 % is correspondingly cautious. Here, too, we see a risk of a downward correction if the situation in the supply chains does not improve.

Mechanical engineering sector – probably an incomplete recovery in 2021

The mechanical engineering sector was hit hardest among the technology industries by the Covid-19 crisis in 2020 with a decrease in turnover of -12.2%. This is no surprise, as investment in large capital goods naturally declines sharply in times of crisis. The rebound was correspondingly strong with an increase of +13.1% in the first eight months of 2021.

For the full year 2021 we are expecting an overall growth in turnover of +11%, just below the 2019 level. As is also the case in other industries, mechanical engineering is directly dependent on the availability of pre-materials. As an example, the lack of electronic components can result in significant delays or unavailability of machine controls – and a machine without a control cannot be delivered.

In mechanical engineering too, we anticipate a significant slowdown in growth in the 4th quarter. We however foresee a solid growth of +4.9% in 2022 – which would bring the sector back above the pre-crisis level. A major challenge here is the transformation of the automotive sector in the direction of e-mobility – this development is also leading to a significant shift, and ultimately a reduction, of overall demand in mechanical engineering.

Employment

Stable employment and massive lack of skilled labour

During the crisis we were able to observe an extremely unusual development in the labour market. Employment remained stable in 2020, with a decrease of 'only' -1.9%. This could be perceived as a surprisingly small decline, notably when comparing to the drop in production numbers. This paradox can be explained by the extensive use of public measures, such as short-time working schemes and similar concepts, that have successfully minimised the rise in unemployment.

The expansion in demand we have experienced in 2021 has not led to a boom in employment though. On the contrary, the technology sector is seeing a slight decline again this year (-1%). This could be due to the gradual withdrawal of public support measures which have exposed 'hidden unemployment' in many areas. For next year we again expect a slight increase in employment of +1.2%.

A striking, and worrying factor, is the continuing complaint of many European industries about a lack of skilled labour. This deficiency is often seen as one of the most important production barriers. This structural problem was already apparent before the crisis and is now coming to light again because of increasing demand. In the skilled labour market, an overheating of the market can be observed; the lack of skilled labour is another factor that is holding back the upswing of the technology industries in Europe.

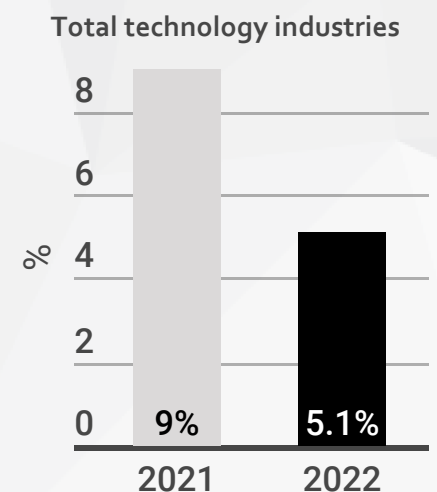
Investments

Investments this year are still below pre-crisis level

The level of investment also says a lot about the confidence of companies in the medium- and long-term economic situation. Capacity utilisation was relatively low when the Covid-19 crisis began in 2020, so companies are cautious about building new capacities. Orgalim's economists foresee an investment increase of +9% in technology industries in 2021. Bearing in mind the profound decline of 2020 (-13.6%), this increase will not compensate for the loss of investment, and we face a cumulative decline in investments of -6% for the two years of the Covid-19 pandemic. Governments are trying to counteract this gap by introducing various measures to promote investment, but policy decisions in unrelated fields can also act as disincentives.

For 2022 we expect an increase of +5.1% and thus a solid growth in investments. These increases are led by the electrical engineering, electronics and ICT sector. The high pressure to invest due to digitalisation will continue in the coming years.

Orgalim forecasts for investments



Data sources: E&S WG Forecasts year on year; NACE 25/26/27/28/

Conclusion

An extraordinary situation leads to cautious growth forecasts

All things considered, this is a more-than-extraordinary situation. Demand remains steady in most industries but, sooner or later, it will be affected by the disturbances to the supply side. We are already observing these disruptions in some industries, such as the automotive supply industry.

The loss of momentum in terms of growth for Europe's technology industries is a direct consequence of the state of the supply chains. If individual bottlenecks can be resolved soon, growth could pick up again. However, Orgalim's economists are more cautious and thus expect that growth will slow down in the mid and long term.

There are some positive points nonetheless. 2021 will probably compensate for the 2020 turnover losses in the technology industries as a whole – and we can expect further growth in 2022. The global outlook for 2022 remains however subject to significant downside risks. The bottlenecks in the supply chains could lead to the collapse of the highly sensitive system of global industrial value networks and permanently limit demand.

Policy makers will need to balance the need to support the recovery while safeguarding price stability and fiscal sustainability, and to continue paying close attention to the aggregate effect on industrial investment and competitiveness of the numerous policy reforms underway.

Orgalim represents Europe's technology industries: companies that innovate at the crossroads of digital and physical technology. Our industries develop and manufacture the products, systems and services that enable a prosperous and sustainable future. Ranging from large globally active corporations to regionally anchored small and medium-sized enterprises, the companies we represent together comprise Europe's largest manufacturing branch, directly employing 11.55 million people across Europe, generating an annual turnover of €2,298 billion, and producing one-third of the EU's manufactured exports.

Orgalim commits to champion an EU policy agenda for sustainable growth; to support the industry in its transformation; and to advance dialogue between business, policymakers and citizens on the relationship of technology to society. We are shaping a future that's good.