

Subdued outlook for Europe's technology industries

Europe's technology industries are slightly more optimistic at the start of this year than they were last autumn, but the overall outlook remains very subdued. We currently expect real turnover to decline 2.3% in 2023.

Turnover ended 2022 up 4.8% in real terms, after demand proved more robust than expected. The order backlog remains high in most sectors and supply shortages are easing. But with global industrial demand now slowing, new orders are down, and investment is shrinking in the face of tighter financial conditions and reduced profitability.

Employment in the technology industries meanwhile remains tight and rose 2.1% in 2022. Growth could be much higher but continues to be limited by the structural shortage of workers across Europe.

The key headlines are:

- Demand was more robust than expected in 2022
- Outlook for 2023 remains subdued and cautious
- Employment stays high in tight market
- Willingness to invest remains weak
- Producer prices appear to have peaked
- Unit labour costs indicate erosion of industrial competitiveness

Our report further details the outlook for each of the three technology industries sectors represented by Orgalim: mechanical engineering; electrical engineering, electronics and ICT; and metal technology.

Demand was more robust than expected in 2022

The technology industries had a turbulent, but overall positive, year in 2022, with full year turnover expected to come in higher than 2021 at +4.8% in real terms.

At the beginning of last year, skyrocketing energy and input material prices, the war in Ukraine with all its negative side effects, and the expiry of the post-Covid effects, made for an extremely gloomy outlook. Demand then developed in a surprisingly robust manner, helped by the high order backlog in the first half of the year, before declining again end year amid fears of gas rationing in the winter.

At the same time, the shortages in the supply of labour and pre-materials remained. On the labour market side, the problem was compounded by the ongoing structural shortage of both skilled and unskilled workers. On the input materials side, the omnipresent shortage, especially for industrial metals and electronic components, massively restricted production capacities in 2022. Added to this were longer delivery times and increased energy prices which often made cost calculations very unpredictable.

Outlook for 2023 remains subdued and cautious

Overall, Europe's technology industries are slightly more optimistic at the start of this year than they were last autumn, but the outlook remains very subdued. We currently expect real turnover to decline 2.3% in 2023.

Contributing to the cautious sense of relief was the fact that the worst fears of a winter energy crisis did not materialise. Prices on the energy markets are expected to ease further and producer prices appear to have peaked and may be on the verge of a trend reversal. At the same time, availability on the supply side is gradually improving. Meanwhile the order backlog remains high in most sectors, especially those with long delivery times.

On the downside, a global decline in industrial demand is showing up in fewer new orders. If production growth is to be maintained and no longer be dependent on working off order backlogs, demand would probably have to pick up again in the coming months. However, there are no signs of this happening at the moment.

One indicator, sentiment in the European industrial sector, declined significantly towards the end of 2022. The S&P Purchasing Managers Index for industry in the Eurozone dropped to 47.3 in March. Though a slight improvement compared to sentiment in the autumn, this still indicates an imminent contraction in industrial activity in the Euro zone.

Feeding into the uncertainty and cautious outlook are big question marks about the momentum from China in particular. The 5% GDP growth target in 2023 for the Chinese economy is the lowest in decades. On the other hand, there is some hope that the reopening of the Chinese economy after the expiry of the Covid restrictions will fuel growth momentum in this market. China is an important export and import market for the technology industries and our sectors are therefore particularly exposed to the adverse effects of potential high-tech decoupling and restrictions in pre-material imports.

A further concern is the expected decline in investment in the face of squeezed profits and tighter financial conditions. Rising interest rates and stricter lending policies on the part of banks are making it more expensive for companies to obtain financing; this is not only a problem for the technology industries themselves, but can also potentially lead to financing difficulties in the customer sectors and thus to falling demand. Here, however, we are still at the beginning of a development that is difficult to assess at the moment.

Employment stays high in tight market

Employment in the technology industries grew 2.1% to 11.19 million people in Europe in 2022, despite the increasingly difficult competitive position of the sector. This high level of employment has remained fairly constant over the medium term – during the Covid crisis and since.

Growth could be much higher, but the structural shortage of workers across Europe limits upward prospects. For 2023 we are currently expecting employment to remain the same, which does not mean that companies have covered their needs on the labour market. On the contrary, in many sectors there is a pronounced lack of workers to process orders, but the labour market is not currently meeting this need.

Willingness to invest remains weak

Real investment in our industries is an indicator that gives us some concern in the short and medium term. Investments fell by 3.1% last year and, for this year, we are expecting an even bigger real decline of 7.5%.

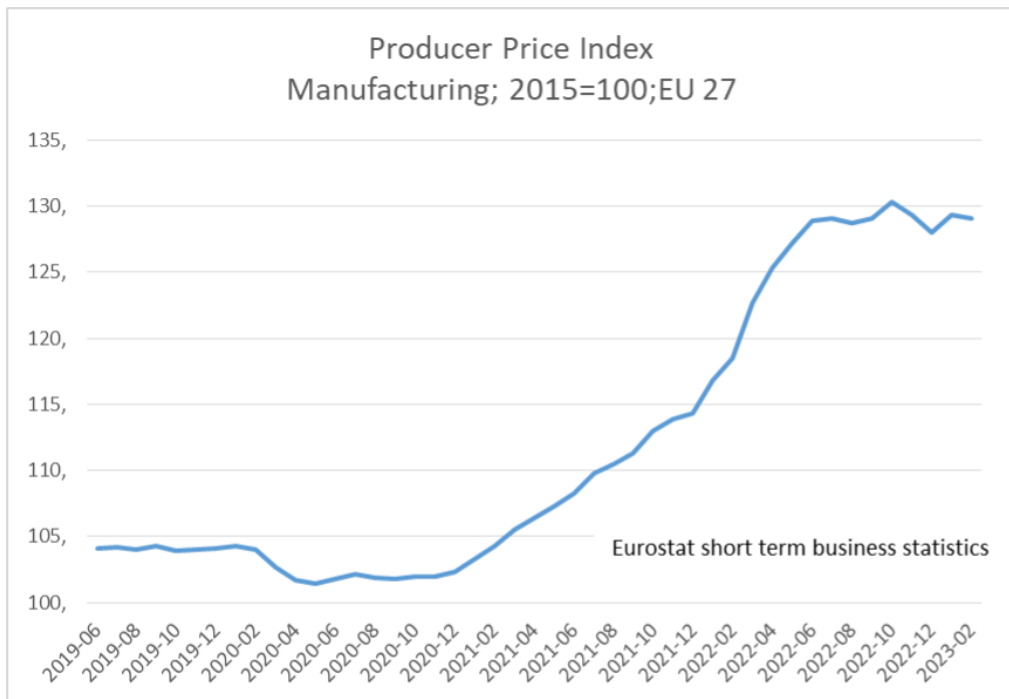
The reasons for this are clear. First and foremost, there is great uncertainty about the global economic business trend this year, which is making companies cautious when it comes to investment planning. A rapidly growing set of new laws in Europe has added unprecedented regulatory uncertainty. Profitability has decreased in large parts of our sectors, which means that there are significantly fewer funds available for investments. Catch-up investments from the Covid period have mostly already been completed. Ultimately, rising interest rates will also have an adverse effect on the development of investments.

The same dynamics are also at work in the customer sectors of the technology industries, so that our sectors are also confronted with a declining demand for capital goods, which in turn restricts the production prospects for the technology industries. Despite unprecedented public subsidies for manufacturing certain products, notably related to clean tech and the energy transition, we assume that these factors will have a negative impact on the overall level of private investment again this year. Improving the underlying investment conditions in Europe therefore remains critical.

Producer prices appear to have peaked

The development of producer prices has been a major challenge for our companies in recent years. Not only have they found it difficult to pass cost increases on to their customers, but, when they did, they saw higher prices reducing demand. In 2022 alone, the producer price index for goods manufacturing rose by 15.8%.

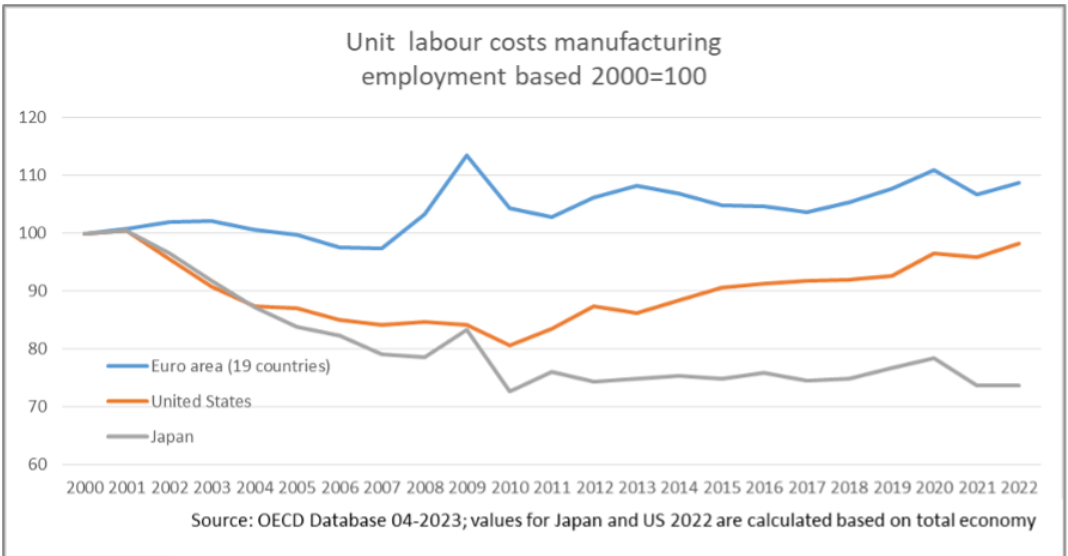
However, a look at the development of the index gives us a little hope that we are on the verge of a trend reversal. The level of producer prices has not increased since early summer 2022, except for this January, when annual price adjustments kicked in. We expect a downward trend reversal from now on, but it is currently unlikely that producer prices will reach pre-Covid levels in either the short- or medium-term.



Unit labour costs indicate erosion of industrial competitiveness

A comparison of the change in unit labour costs (ULC) for the US, Japan and the Euro zone clearly shows the creeping erosion of the competitiveness of European industry measured by the change in unit labour costs. These are calculated as the coefficient of change in labour costs and change in productivity. Rising ULC means productivity cannot keep up with rising labour costs.

Since 2000, ULC for manufacturing have fallen by 26.3% in Japan and by 1.8 % in the US, according to the OECD. In the Euro zone, however, they have risen by 8.8 %. As can be seen in the curve, this development started during the financial crisis of 2008-2009 and before. The future development of ULC in Europe will be very much driven by the rapid inflation trend, which will continue to put pressure on labour costs. Higher productivity growth in European industry will therefore be a prerequisite to strengthen our global competitiveness.



Key figures



2,906 billion EUR

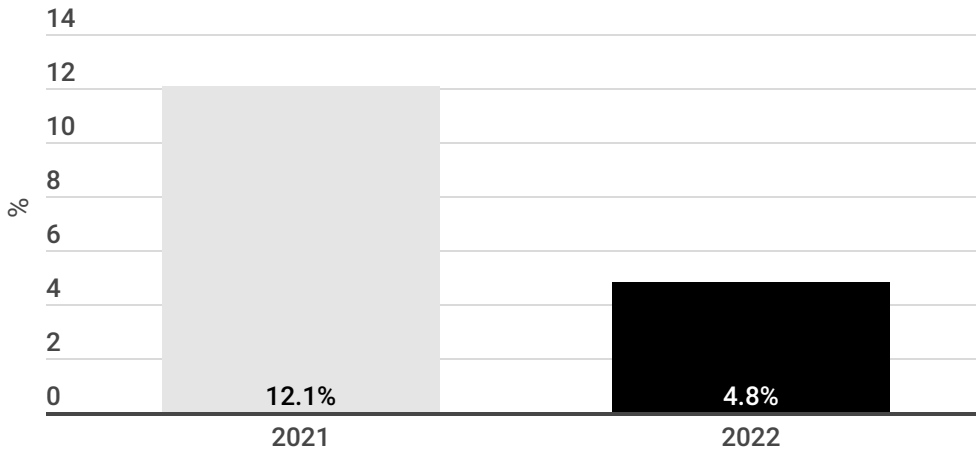
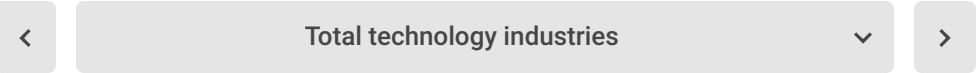
Nominal turnover value of Europe's technology industries in 2022



11.19 million

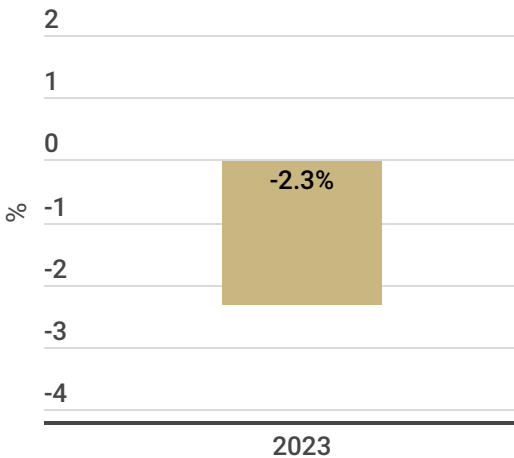
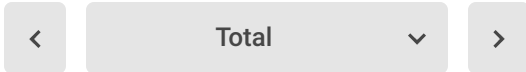
Direct employment of Europe's technology industries in 2022

Real turnover % change year on year

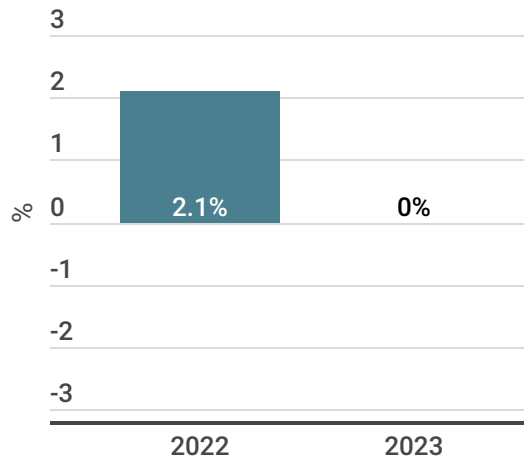
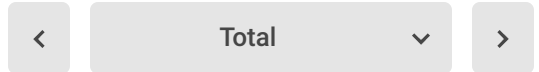


Data source: NACE 25/26/27/28/33 Eurostat Turnover Index EU 27; short term business statistics; price adjusted with EU Producer Price Index for the same NACE Codes

Orgalim forecasts for real turnover



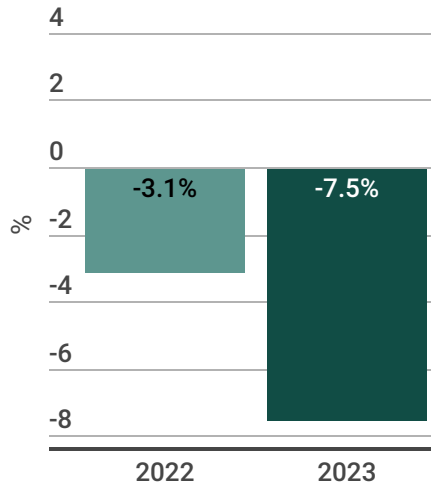
Orgalim employment growth and forecast



Data source: E&S WG Forecasts year on year; NACE 25/26/27/28, and Eurostat detailed enterprise statistics; technology industries 'total' also includes NACE 32.5 and 33

Orgalim forecasts for real investments

Total technology industries



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

Highlights by sector

Metal technology sector – prospects look weak

- 2023 real turnover drop expected (-3.1%)
- Full year 2022 real turnover marginally increased (+1.9%)
- Automotive sector upturn should help

The metal technology sector ended 2022 marginally higher, with turnover up 1.9 %, adjusted for prices. Some momentum in demand should return in 2023, driven by an upturn in German automobile production. For 2023, the VDA (German Association of the Automotive Industry) expects a production increase of 6%. But, at a production level of 10.3 million cars, automobile production in Germany is still below the pre-crisis figure of 11.4 million, indicating a structural shift in this important demand sector of the metal technology industry.

Production expectations remain significantly clouded, and the shortage of both skilled and unskilled workers remains a limiting factor. From the current perspective, we are expecting a real drop in production of 3.1% in 2023.

Electrical engineering, electronics and ICT – forecast lower after solid 2022

Production rose in 2022 in real terms (+6.9%)

2023 expected to be down slightly (-0.7%)

Shortage of components remains a limiting factor

A high level of investment in digitalisation and automation kept the demand strong in the electrical engineering, electronics and ICT industries in 2022. Production increased by 6.9% in real terms (more than 13% nominal).

For 2023, production is forecast to be down 0.7% on last year in real terms – a bit better than the average for the technology industries as a whole. Declining demand due to the global industrial weakness will also be felt in this sector and many companies are still reporting problems in procuring raw materials – this makes production more expensive and lengthens order processing times. However, due to the big increases in production in recent years, a slight decline in production from the current high level should not necessarily be viewed negatively, and there is still no sign of a significant slump in this sector.

Mechanical engineering sector - supply chain bottlenecks still impacting

Real turnover grew in 2022 (4.2%)

Decline expected in 2023 (-3.4%)

High order backlog and investment prospects positive

Well-filled order books helped mechanical engineering companies increase production by 4.2% in real terms, despite ongoing supply chain bottlenecks. Today, order backlogs remain high, but new orders are falling as demand declines. Production in 2023 is therefore expected to be down 3.4% in real terms – less severe than expected last autumn, thanks to the high order backlog and the mild winter alleviating fears of gas rationing. A boost in investment in individual sectors in mechanical engineering due to investments in clean tech should support demand in 2023 and ensure positive momentum in the medium term at least for certain sectors. But a lack of ICT specialists is still restricting production capacities.