Downturn confirmed as demand declines

Summary

The cautious outlook in our spring economic report has been confirmed during the course of this year. Europe's technology industries are seeing declining demand and shrinking order backlogs across many sectors. We expect turnover to end the year down 1.2% in real terms, slightly better than previously indicated, but with no sign of any imminent upswing. With the risks weighted towards the downside, the outlook remains subdued at least through the first half of 2024 and current estimates point to a 1.8% drop in real turnover next year. On the positive side, while inflationary pressures remain, costs relating to energy and industrial metals have been easing. We expect stable to slightly rising employment despite the declining demand, amid signs of labour hoarding in a persistently tight market for skilled labour.

Key findings:

- Cautious 2023 outlook confirmed – demand is declining
- 2023 turnover expected slightly down in real terms (-1.2%)
- Downturn expected to persist in 2024 (-1.8%, real) with high uncertainty
- Energy and raw materials costs easing
- Employment stable amid signs of labour hoarding
- Deterioration in competitiveness continues

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.

Slowdown tendency confirmed for 2023

After adjusting for inflation, we expect a drop in turnover of 1.2% for the year. This is slightly better than our previous forecast, as order books in some sectors proved to be more robust in the first half of the year than expected. However, the dominant tendency in the technology industries is one of slowing demand during the course of 2023, as we already signalled in our spring report.

Several factors are contributing to the slowdown. There is a lack of growth impetus from non-EU countries, and China is still in a weak industrial cycle. The catch-up effects post-Covid have run out, and the supply chain bottlenecks have led to a tendency to stockpiling in some sectors – with an adverse impact on new orders. This is currently leading to lower demand and, in many cases, production.

Outlook for 2024 cautious despite glimmers of hope

In view of the downward trend and with no sign of a short-term economic upturn, we are currently slightly pessimistic on the outlook also for 2024. The current estimates show a real decline in turnover of 1.8 % for 2024. These estimates are subject to major uncertainties, however.

The high order backlogs that have supported some sectors well into 2023 are slowly but surely coming to an end. In addition, geopolitical tensions remain, with unpredictable and unforeseeable consequences for commodity prices. Interest rates are also unlikely to have peaked and are expected to remain high in the short and medium term.

On the upside, the fact that costs should ease gives companies hope. Energy prices have already fallen significantly and are still on a downward trend, as are industrial metals. Last winter's fears of an undersupply of gas for European industry have not materialised.

Nevertheless, the S&P Purchasing Managers' Index for manufacturing fell to 43.1 in October, well below the neutral 50 line, thus indicating quite pronounced pessimism across European industry. In the spring, this indicator was still in slightly negative territory at 47.3.

A cyclical upswing is possible, but this is unlikely to occur until the second half of 2024 at the earliest. Among the uncertainties clouding the outlook are whether demand from China recovers, whether the US economy manages a soft landing and whether the European economy can soon extricate itself from the high-inflation scenario with rising interest rates. There are, in any case, pronounced downward risks and therefore the assessment for the coming year remains cautious.

Companies hold onto employees despite falling demand

We are currently seeing an extremely unusual situation around employment in the industry. On the one hand, demand for goods in the technology industries is declining, which normally results in a reduction in the number of employees. On the other hand, however, we are faced with a structural shortage of qualified personnel in all European countries. As a result, companies are holding on to their staff as long as possible because the costs of laying off staff would be very high (employees cannot be brought back when the economy picks up again).

This strategy of retaining staff, even in times of crisis, has worked well for companies during both the financial crisis and the Covid crisis. In addition, there are government measures that make it possible, for example, to reduce hours through short-time work arrangements and to retain personnel at the same time. In many countries there are also possibilities to flexibly adjust working hours.

We therefore still expect a small increase in employment of 1.3% this year and, at present, an increase of 0.9% in 2024. However, should the economy decline faster and more sharply than expected, the point could be reached at which companies are forced to reduce staff. There is thus a risk that the forecasts, for next year in particular, will have to be corrected.

Rising interest rates reduce investment

The willingness to invest in industry is currently assessed as very restrained – we currently expect a slight decline in investment of 1% and a further slight decline of 0.7% next year, after adjusting for inflation.

Broadly, there are many factors that are having a negative impact on companies' willingness to invest. These include rising interest rates, which are leading to positive real interest rates for the first time in many years. Financing costs, which have been very low in recent years, will therefore become significantly higher. In addition, there is uncertainty about the global economic situation

and the critical margin situation of companies. Costs for input materials, financing, energy and wages remain relatively high and cannot be passed on one-to-one on the world markets. This reduces companies' margins and has a negative impact on their willingness to invest.
We see light at the end of the tunnel again for corporate investment if a global economic upturn solidifies. While there is hope for an increase in demand in the second half of 2024, this is still associated with great uncertainty. We are currently seeing major downward risks in capital spending.

Competitiveness concerns escalate

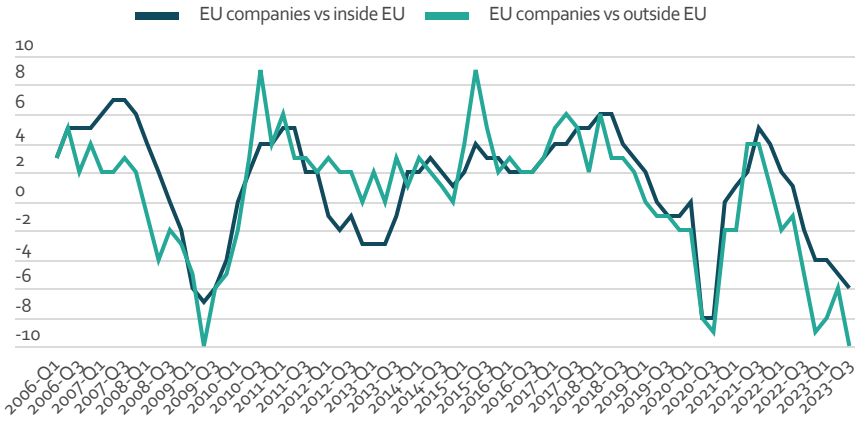
The alarm bells continue to sound on the erosion of European industrial competitiveness. In our spring economic report, we flagged the deteriorating trend in unit labour costs (ULC), which points to an erosion of the relative competitive position of EU manufacturing industry: since 2000, ULC for manufacturing have fallen by 26.3% in Japan and by 1.8% in the US, while in the Euro zone they have risen by 8.8%, according to the OECD.

The current data from the EU Business and Consumer Survey[1] confirm this trend: companies see a significant deterioration of their competitiveness compared to extra-EU regions. This trend began already in 2019 and was only briefly interrupted by the huge upswing after the Covid crisis.

What has worsened the starting position in the EU in recent quarters? There are primarily two factors: energy prices have skyrocketed in Europe due to the Russia-Ukraine war, and the lack of availability of gas has also caused electricity prices to rise, not to mention concerns about the availability of gas in industry. This cost problem has translated into higher inflation; high inflation, in turn, has resulted in high wage increases and thus rising relative personnel costs to the extra-EU world. Since this increase cannot be offset by productivity gains, unit labour costs in the EU are rising faster than in the rest of the world. Falling energy prices and lower inflation are therefore some of the prerequisites for a turnaround in the negative development of competitiveness.

Competitiveness position versus inside- and outside-EU competition

Balance of positive and negative sentiment



Data source: EU Business & Consumer Survey, October 2023

[1] Monthly EU Business and Consumer Survey, October 2023

Key figures

2,819 billion EUR

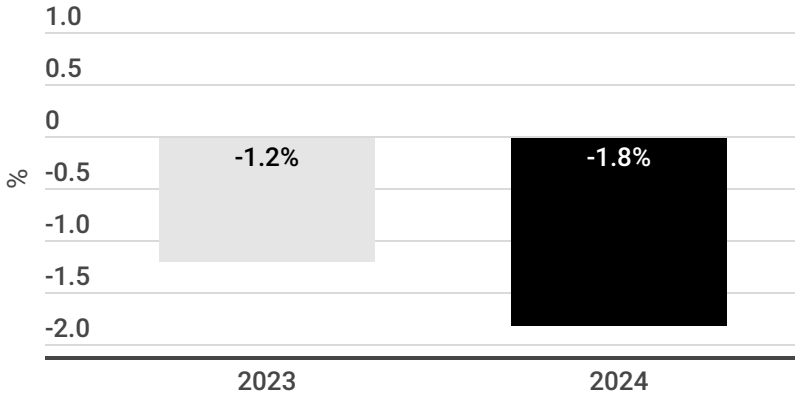
Nominal turnover value of Europe's technology industries in 2022

11.90 million

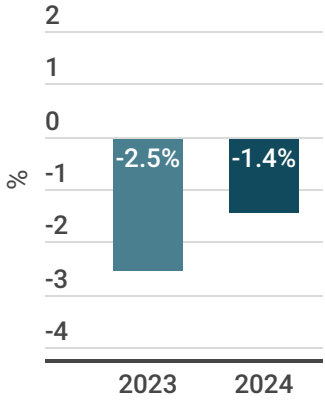
Direct employment of Europe's technology industries in 2022

Orgalim forecasts for real turnover

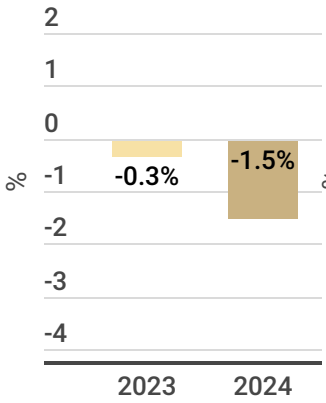
Total technology industries



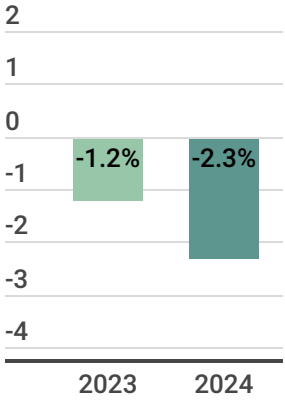
Metal technology



Electrical engineering, electronics & ICT

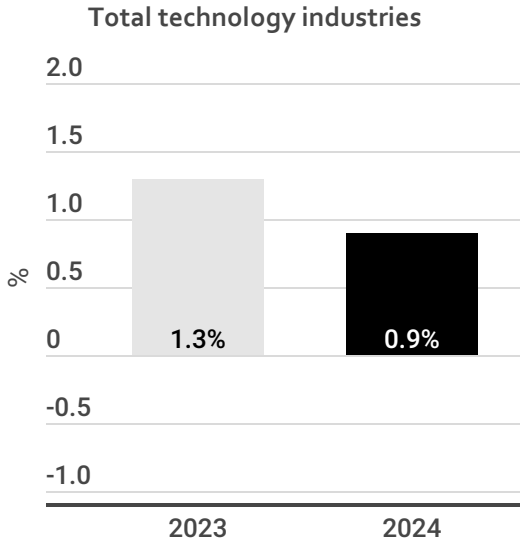


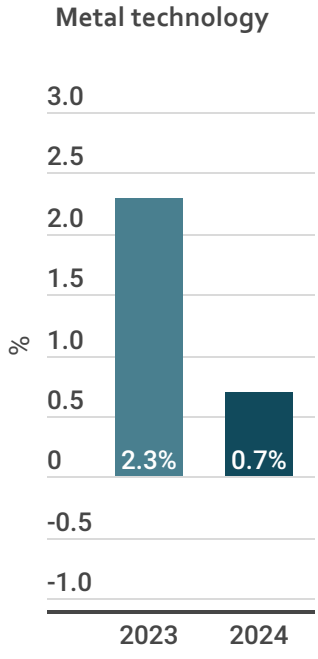
Mechanical engineering

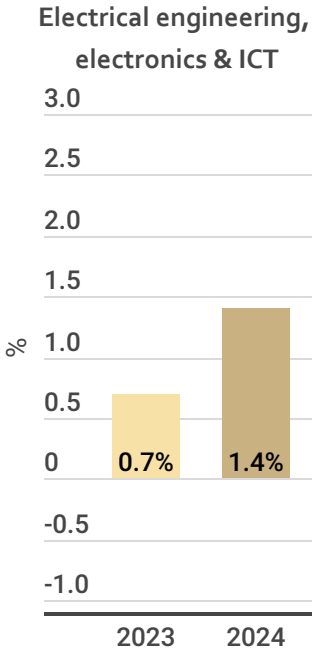


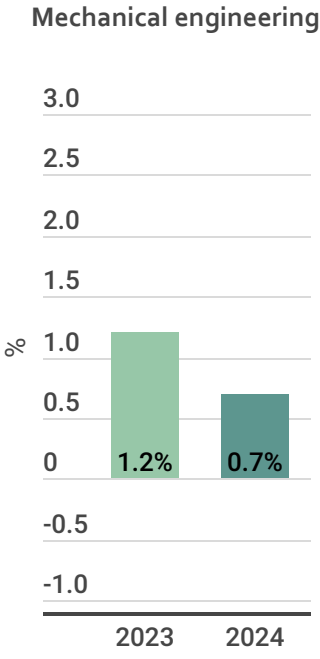
Data source: E&S WG Forecasts year on year; NACE 25/26/27/28, and Eurostat detailed enterprise statistics; technology industries 'total' also includes NACE 32.5 and 33

Orgalim employment growth and forecast





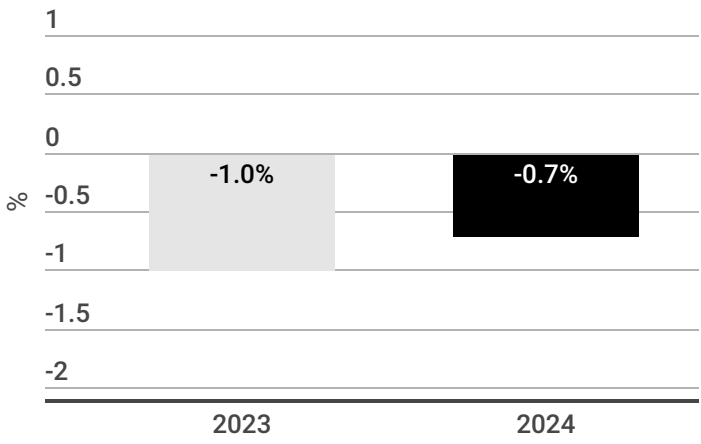




Data source: E&S WG Forecasts year on year; NACE 25/26/27/28, and Eurostat detailed enterprise statistics; technology industries 'total' also includes NACE 32.5 and 33

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 – car industry prevents a bigger decline

Real turnover decline of 2.5% expected in 2023
Further 1.4% drop forecast for 2024
Automotive sector mitigates slowdown for now

For the metal technology sector, we expect a 2.5% decline in real turnover this year. This decline is mitigated by the still-robust production situation in the car industry in Germany and throughout Europe. The German Association of the Automotive Industry, VDA, expects new registrations in Europe to be 9% higher this year than a year earlier. Some of last year's orders could only be carried out this year due to supply chain bottlenecks. However, this sector is also expected to suffer a significant setback in the coming quarters.

Demand in the metal technology sector has already decreased noticeably in 2022 and, due to the shorter order times in this sector, the decline in production has also set in relatively quickly. Should economic activity in the automotive sector weaken more rapidly than expected, the downside risks in this sector are considerable.

From the current perspective, we expect a further slight decline of 1.4% in real terms in 2024. Reasons for the decline in global demand in this sector include falling investment triggered by declining corporate profits. Added to this is weak demand from China and rising interest rates, which are reducing the willingness to invest.

Electrical engineering, electronics and ICT – growth is slowing despite tailwind

Signs that previously robust growth is stalling
Real turnover expected flat to down in 2023 (-0.3%)
Outlook is for further 1.5% real decline in 2024

The electrical engineering sector has been the growth driver of the technology industries in recent years, after the Covid crisis. The digitalisation trend in industry, the office sector and the private sector has driven demand for products from this sector in recent years. This growth was only slowed by shortages of raw materials. The transformation strategy in the energy sector investing in green energy also contributes to growth. This strengthens investments in the area of sustainable energy production and ensures demand. These structural factors should continue to provide a tailwind.

Nevertheless, due to the decline in demand in global industry, the order situation in this sector is also deteriorating somewhat. Companies expect declining orders and are still faced with shortages of raw materials. Adjusted for prices, we no longer expect any growth in this sector this year and are assuming a decline in volumes of 0.3%. For 2024, companies expect a further slight decline of 1.5% in real terms. However, what must be taken into account here is the industry's very strong starting position, which was driven by enormous demand in the post-Covid years.

Mechanical engineering sector – high order backlogs are beginning to expire

2023 turnover expected to fall 1.2% in real terms
High interest rates impacting demand
Expect further decline of 2.3% in real terms in 2024

The mechanical engineering sector held up rather well through the first part of 2023. The reason is the order backlog, which was still at a very high level at the beginning of 2023 – despite a decline in new orders. This decline already began at the end of 2022, but due to the long order lead times and the lack of components such as semiconductors, electronic components and machine controls, many orders could not be processed. The order backlog therefore extended well into 2023, but has now started to shrink.

For the year as a whole, we expect to see sales decline 1.2% in real terms across Europe, with no imminent prospect of an upswing. Business survey responses indicate the EU machinery industry is looking pessimistic on their production expectations for the upcoming months, as high interest rates put a strain on customers' willingness to invest and limit their financial flexibility. The lack of growth impulses from China also plays a major role. Strong demand from China has had a positive impact on the mechanical engineering industry in recent years. For next year, mechanical engineering companies expect a further decline of 2.3% in real terms.