Industry outlook 2021: Optimism amid disruption

The outlook for manufacturing remains bright as global economies continue to recover from the pandemic. Still, disruptions from shortages, transport problems, the greening of sectors and trade problems will require agility from manufacturers to profit from the improving demand outlook

Watch: Europe's businesses are fighting back strongly

ING's Bert Colijn says supply, not demand, is the problem for Europe's businesses as they fight back against the coronavirus shock

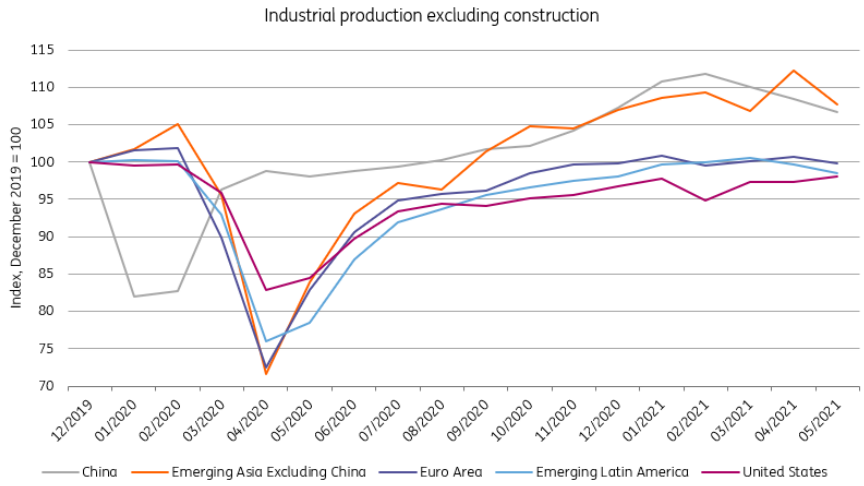
Watch video

A wild ride for manufacturers

The pandemic has truly been a wild ride for the manufacturing business. What started out as a factor disrupting supply chains due to the lockdown in China, quickly turned into the largest downturn in production seen on record. Year-on-year declines were slightly larger than those seen in the 2008 Global Financial Crisis, which was mainly because, in the end, China experienced only a relatively moderate decline in activity. The decline was the largest in the eurozone and in

Emerging Asia outside of China where declines in production were about -30% year-on-year during the first lockdown wave. In the eurozone, industrial production dropped by -28.7%, ranging from -6.9% in Finland to -43.7% in Italy. The decline was caused by the rapid drop in demand, supply chain problems due to Covid-19 restrictions, and due to the (voluntary) shutdown of factories. A shock to supply and demand, both unprecedented and happening at the same time.

Industry experienced a massive shock to output in the first wave



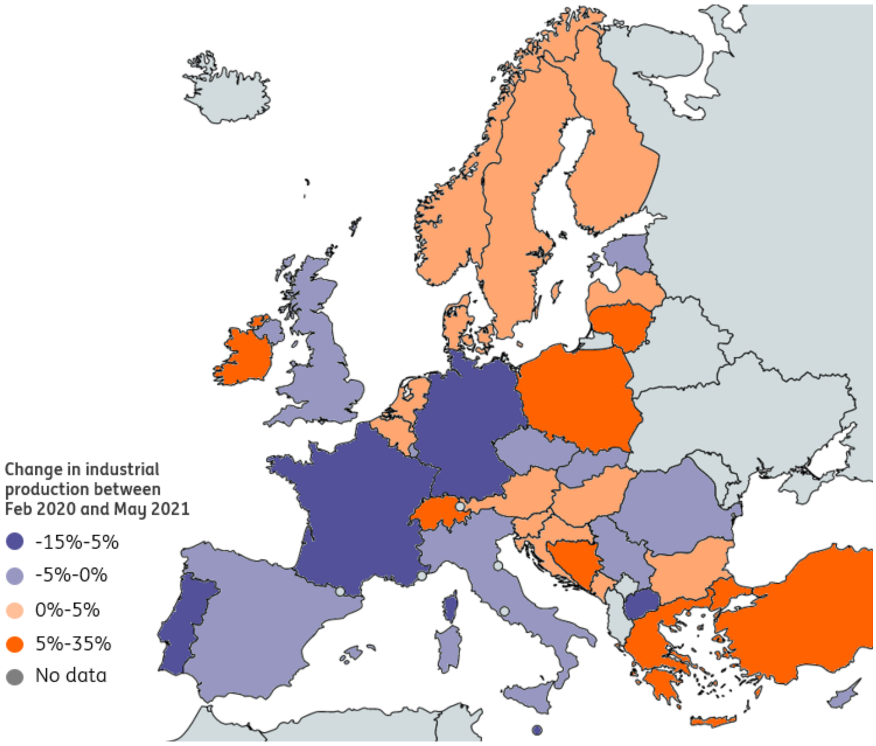
Source: CPB World Trade Monitor, ING Research

This led manufacturers to think back to 2008 and the horrible fallout of demand that followed. Investment plummeted as capacity was scaled back in the aftermath of the global breakout of the virus. Remarkably, the opposite of 2008 occurred and demand for produced goods returned very rapidly. This can be attributed to quite a few factors; think of the rapid central bank intervention that prevented a financial crisis, and especially the quick government intervention stabilising incomes through furlough schemes (most of Europe) or income support (US). Add to that the unexpected forced shift in consumer spending from services to goods as services were to a large extent unavailable. In short, the balance sheet recession following the 2008 financial crisis was avoided by unprecedented government and central bank intervention. This resulted in a remarkably quick comeback of goods demand and a strong rebound in manufacturing production.

This surprisingly quick rebound caught the world of manufacturing off guard. With many businesses having scaled back production, some key producers going out of business, and transportation severely disrupted, supply chains have been very vulnerable in the recovery phase. Lead times of supply have lengthened dramatically according to the global PMIs, and inventories have been drawn down to very low levels in order to continue to produce. On top of the supply chain frictions caused by the pandemic and the surprise rebound, the long drought in Taiwan led to severe disruptions in semiconductor production. All of this has put the brakes on the rapid recovery and has caused declining production in places like Germany and the US. In the meantime, demand continues to flow, which has resulted in a bright outlook despite severe disruptions. Agility may be a corny buzzword, but it is required in manufacturing over the course of this pandemic.

There are big differences between sectors of course. Just look at production compared to the pre-pandemic period: electronics production is 44% above February 2020 levels, while auto production is still 26% below. The electronics sector has profited enormously from the shift to working from home, while the car industry suffers from chip shortages which are curbing supply in times of high demand. Other shortages have not caused such pronounced declines in production. Plastics production continues to hold steady, while sectors related to lumber – which also experienced shortages and exuberant price rises – continued to see output increase for now.

Large differences in production between eurozone economies still exist as shortages bite



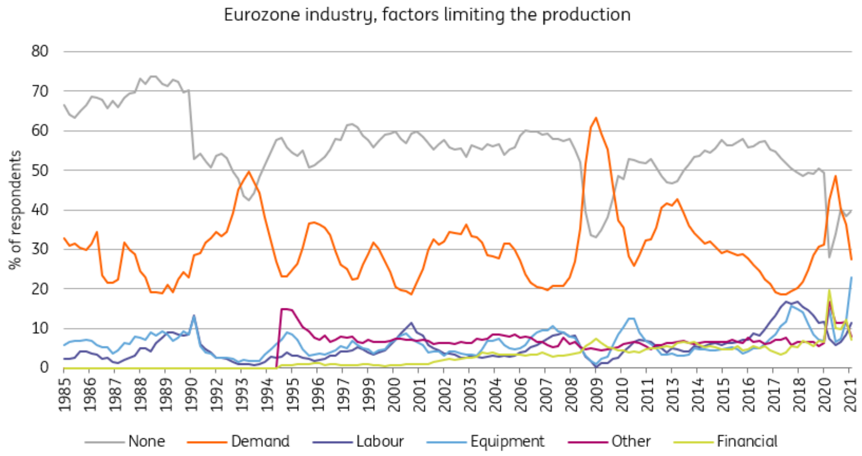
Source: Eurostat, ING Research

A time of extremes continues

Even though the biggest economic shock from the pandemic seems to be behind us, the disruptions continue and are likely to stay with us well into 2022. Looking at what is moving manufacturers at the moment, we see that order books have never seen as rapid an inflow as in June. The same holds true for export expectations over the months ahead, which have never been improving this quickly. Manufacturers are expecting to profit from the global upturn as Covid-19 retreats. This illustrates that despite all the disruptions for manufacturers, the outlook remains very bright. It's not demand but supply which is holding back businesses at the moment.

More than a third of businesses are now reporting labour and equipment as factors limiting their production, of which 22.8% is equipment. It is hard to find the right workers at the moment, but much harder to get hold of supplies, which have been in short supply for quite some time now. The supply chain problems will continue to cause backlogs of work to increase, having already crept up considerably. According to the European Commission, the average duration of production assured by current orders is now four and a half months, again a record high. This means that optimism about production in the months ahead has already faded somewhat. Businesses are seeing that the sky isn't the limit at the moment, inputs are.

Equipment shortages have never been a problem to so many manufacturers as now



Source: European Commission DGECFIN, ING Research

Higher costs are set to be priced through to the consumer

Prior to the pandemic, fierce competition for volumes caused moderate consumer price increases. The current higher input costs are forcing manufacturing businesses to price through to the consumer though, which is showing to a small degree now, but we expect this trend to continue well into 2022. Goods inflation has been moderate at best ranging between -0.1 year-on-year and 0.7% YoY in the 2013-2020 period. The pandemic initially caused a sharp downturn, but goods inflation is now on the rise and has reached 1.2% YoY in June. It is set to take off from here as businesses are currently indicating en masse that they will increase prices in the months ahead. With container prices severely elevated and prices for several commodities also well above pre-crisis levels, this is a logical conclusion to follow. As we expect shortages to remain a pressing issue until at least early 2022, we expect elevated goods inflation for the coming quarters before settling down.

Optimism prevails for 2022 and 2023

Looking through all of the disruption happening at the moment, the outlook remains quite bright on average. Even with shortages for at least a few more quarters, new regulations on the horizon challenging businesses to adhere to climate change targets, and global trade relations remaining tense, the key factor driving the outlook remains demand. With a globally synchronised demand recovery underway, expectations are for a strong 2021 and fading growth after that, as countries revert to previous trends of demand.

ING forecasts for 2021, 2022 and 2023

YoY growth in industrial production excluding construction

	2020	2021	2022	2023
Austria	-7.1	8.7	4.4	2.5
Belgium	-3.8	7	4.4	3.8
France	-10.7	8.7	4.6	1.2
Germany	-10.6	9	6	3
Italy	-11	10.4	3.8	2.1
Netherlands	-4.4	4	2.5	1.5
Poland	-1	10.9	6	6.5
Spain	-9.5	6	4	2
Turkey	1.6	12.0	4.0	3.5
UK	-8	6.6	3.3	0.9

Source: ING Research

Looking at the larger European markets, we see strong recovery in production in Turkey and Poland, countries with a strong growth trend prior to the pandemic. Germany is expected to have a weaker recovery for 2021 due to the continuing supply chain problems that disproportionally hit auto production, which is larger in Germany than in most other countries. This has resulted in a stronger expected growth rate for 2022 than we see for most peers. In the UK, we expect the effect to be the other way round, as a tax break currently allows machinery investment to be offset against taxes. This will moderately push up production now, but weigh on 2023 figures.

This doesn't mean that we don't expect disruptions to continue. Agility continues to be key for businesses to thrive in the environment that industry currently faces. The businesses able to adapt to quickly changing demand, erratic supply, regulations and tariffs and taxes are set for a strong performance after the pandemic. The demand is there, but can the supply adjust quickly enough to deliver?

Authors

Bert Colijn
Senior Economist, Eurozone
bert.colijn@ing.com

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("**ING**") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit http://www.ing.com.