Industry Outlook 2021
28 July 2021

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

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

Inga Fechner
Economist, Germany, Austria
inga.fechner@ing.de

Joanna Konings
Senior Economist, International Trade
joanna.konings@ing.com

Optimism & disruption
Industry outlook 2021

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*

**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

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

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

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.

Bert Colijn, bert.colijn@ing.com
Carsten Brzeski, carsten.brzeski@ing.de
ING forecasts for 2021, 2022 and 2023

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

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 disproportionately 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?
Worldwide automotive production saw an unprecedented fall in 2020 due to factory and car dealership shutdowns, the distortion of supply chains, and complete lockdowns of countries due to the coronavirus pandemic. All of the main producing countries saw sharp declines, leading to a 16% year-on-year drop in world auto production including cars, trucks and buses, according to OICA data. In the second half of 2020, however, some markets recovered very quickly, with Asian production declining by only 10% year-on-year. The Chinese and South Korean markets performed particularly well due to a quick reopening of their economies and pent-up demand.

Lack of semiconductors will persist

With economies recovering worldwide, car production and sales will continue to rebound in 2021, potentially by 7% to 9% compared to last year. Yet the road remains bumpy for unhindered car production this year due to supply chain frictions, mainly the lack of semiconductors for OEMs. When car production slumped last year, orders for car parts were cancelled, while demand from other industry branches rose. Together with the production problems in Taiwan due to the drought, OEMs faced a significant shortage when the overall economic outlook brightened faster than initially expected. The semiconductor problem has turned out to be quite persistent, not only impacting this year’s production numbers but also next year’s, resulting in a potential loss of five million vehicles this year and three million next, according to the Center for Automotive Research. As our consumer goods become ever smarter, the need for electronics, and thus the need for semiconductors, is rising. This is not only true for car manufacturers, but also for consumer electronics, computing and wireless communication, meaning that the battle for chips will continue.

What about demand?

We did not expect Covid to hit car demand on a lasting basis, and the data has proved us right. Demand remains high despite the pandemic, with the current problems in the market clearly being due to a supply shock. Order books are full, economic growth is rebounding and consumers are as confident as before the crisis. In the EU and eurozone, economic sentiment hit a 21-year high in June 2021, with the intention to buy a car within the next 12 months almost being back to pre-coronavirus levels. Private balance sheets proved resilient, according to IMF data, despite higher unemployment and shorter working hours, as policy measures helped households maintain financial stability. In the US, consumer confidence also rose strongly and is currently at the highest level since March 2020. In China, however, sentiment has started to falter as of...
late with demand for cars being soft in May, growing only 4.5% year-on-year as risks to the economy pile up.

**Electrification means a battle for chips and batteries**

The EU’s ambitious ‘Fit for 55’ climate goals, which must still be ratified, do not represent an immediate risk to our production outlook as OEMs have been working on the electrification of their production targets for some time now. In addition to reliable infrastructure, demand for EVs is key and this has seen a significant surge in the EU over the last year. Sales of battery electric vehicles more than doubled between 2019 and 2020 while sales of plug-in hybrids more than tripled, resulting in over one million units in 2020. If the current speed were to persist, all new registrations in the EU could be electrically powered by 2030. Regardless of the speed, however, competition for batteries and electric components is set to heat up given the ever-growing need for entertainment technology, potentially leading to another round of supply shocks in the next couple of years.

**Sales outlook**

Overall, we expect global new car production and registrations to bounce back moderately this year, with light vehicle sales growing 7% to 9% in 2021. Nevertheless, uncertainty around a potential fourth wave of infections with variants spreading, unresolved supply issues caused by supply chain disruptions and material shortages, as well as rising prices, pose a downside risk to our sales outlook. As for the years ahead, the phase out of fossil fuel vehicles and rise of electric cars will have the greatest impact on production and sales numbers, with a shortage of components likely resulting in moderate growth rates in the medium term.

Inga Fechner, inga.fechner@ing.de
Volatility and uncertainty in supply chains
During the pandemic, world trade in goods has benefited from the global recovery in retail sales and industrial production, while other sectors remain much harder-hit by lockdowns and uncertainty, so much so that global trade’s recovery has outpaced global GDP. Ocean freight, normally responsible for the bulk of world goods trade, has had to compensate for reductions in air freight capacity while passenger travel remains restricted.

Ocean freight has become even more important, putting all capacity under pressure
Global trade in goods and different freight types, annual growth

But the positive picture from world trade volumes has come with supply chain volatility and uncertainty. Trade volumes have bounced back after lockdowns at ports, as well as the blockage of the Suez canal, but supply chain disruptions have accumulated and worsened. With some inputs taking much longer to be delivered, and containers becoming displaced, each setback is causing shortages of inputs and price increases to become more acute.

The faltering of supply chains is partly because of the strange effects that the pandemic has had on global economies. Even as demand for goods overall has remained strong, the stop-start nature of different recoveries has disrupted supply chains at different

Supply chain issues are here to stay
As global demand improves and continues to support industrial production, we think supply chain problems are here to stay, making it difficult and expensive for firms to get hold of industrial inputs even as more countries recover from the pandemic, particularly in a policy environment increasingly geared towards reshoring and domestic production.
points, displacing empty containers and becoming one of the pinch points in international trade.

Ocean freight capacity more generally has also reached the limits of what it can deliver while health measures remain in place at ports. The growth in traffic has reached a point where globally, the majority of ships are missing scheduled arrival times, and late ships are being delayed for around a week before new slots open up for them. Reflecting the intense competition for capacity, shipping costs have been growing strongly since autumn 2020, adding pressure on input prices.

**Among widespread shortages and price rises, metals stand out**

Shortages are rising across sectors, including rubber producers, plastics products, electrical equipment, motor vehicles, wood, and computers and electronics. And among rises in the prices of many inputs, industrial metals stand out with more than 70% increase relative to pre-pandemic levels.

Like other commodities, a combination of pandemic and non-pandemic-related factors are at play. Mine closures in the initial round of lockdowns in 2020 led to a temporary pause in supply, which then resumed but faced unprecedented demand as inventories were rebuilt alongside serving current demand. That demand includes manufacturing, hit less than services during the pandemic, and infrastructure and energy-transition related projects.

The pauses in production which have driven some input prices so high are being magnified by the poor performance of supply chains. Both metals and lumber prices have come down from recent peaks, as falls in supply are replaced by more normal rates. However, new price spikes are possible into 2022 during the next phase in the global recovery, while supply chains and inventories offer little chance of catching up after setbacks.

**Shipping costs to remain higher**

Globally, capacity on major shipping routes has recovered to levels before the major lockdowns in 2020, although blank sailings (container ship journeys being scheduled but then cancelled) continued to cut 10% of scheduled capacity through the first half 2021. On current plans, cancelled sailings will come down to around 1% in 3Q. But cancellations are partly a response to delays, so the picture may still change.

A flood of new container capacity will ease price pressures, but not before 2023. Having enjoyed outstanding financial results during the pandemic, shipping companies have placed record levels of new orders for container vessels during 2021. But the companies also seem to have learnt how to manage capacity better in their alliances. They may continue to take capacity out of the system at short notice, reducing the price-dampening impact of new capacity coming onstream.

Pressure on ocean freight capacity will rise further as trade partners gradually recover from the effects of the pandemic at different speeds. But uncertainty about the recovery, including the possibility of new port closures, may well continue to exacerbate the displacement of empty containers and delays for key inputs.

**Warning signs for global supply chains, will businesses reshore?**

Costs have been rising before the pandemic for industries making intensive use of foreign inputs, thanks to increases in trade barriers, which aren't going away any time soon. But the ongoing disruptions to supply have brought the risks of using global supply chains into focus, with a new push to develop domestic capabilities, especially in technology, and create a degree of independence in the supply of essential medicines and technology goods.
The pandemic has seen a rise in trade barriers affecting food and medical products and subsidies to domestic industries across a wide range of sectors. These measures were primarily introduced as an emergency response. But they have largely remained in place as the pandemic has progressed. The measures taken during the pandemic add to the difficulties of access to foreign markets that had been rising before the pandemic, including during the US-China trade war.

But a global effort to dismantle trade barriers is not on the cards. Instead, progress is unlikely to go much beyond piecemeal progress within the context of bilateral talks, such as the suspension of tariffs in the Airbus-Boeing dispute between the EU and the US. Policy effort in China, the EU and the US seems instead to be focusing on reshoring in key sectors, likely through subsidies, which in the case of the US especially have been supercharged by large fiscal stimulus plans.

One consequence of more support for domestic production could be to bring down the relative costs of producing locally, which may tilt the balance for some supply chains to be brought home. Still, reshoring is hard to do and not necessarily the right move for increasing resilience.

**Input shortages to continue into 2022**

With input shortages to continue into 2022 and container prices remaining elevated into 2023, the supply of inputs is likely to be one of the major challenges for industrial production. Even as some frictions ease as the recovery progresses, trade barriers have risen.

Add to that a policy environment increasingly geared towards reshoring and domestic production, and it becomes clear that while global demand will continue to support industrial production globally, firms face a difficult and more costly environment to get the inputs they need for production.

Joanna Konings, joanna.konings@ing.com
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 deemed authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. The nature and extent of consumer protections may differ from those for firms based in the UK. Details of the Temporary Permissions Regime, which allows EEA-based firms to operate in the UK for a limited period while seeking full authorisation, are available on the Financial Conduct Authority's website. 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 https://www.ing.com.