hpo economic commentary 1st quarter 2024

What does a typical crisis look like?

Cham, February 2024

A glimmer of light on consumer sentiment in the United States and Europe

Inflation-adjusted retail sales in the West have been moving sideways for around three years, with a slight downward trend. However, consumption levels are still high, particularly in the United States. After a brief and sharp slump in the initial phase of the pandemic, retail sales exploded before moving sideways from 2020 onwards. Even today, consumption in the United States is still around 13 % above the pre-crisis level (Europe: 2 %) and thus above the long-term trend. The high level of consumption is primarily due to high spending on consumer durables.

This strong consumer spending contrasts with the pessimistic mood among consumers. Since the beginning of 2020, consumer sentiment in the United States has been consistently in contractionary territory, and this has also been the case in Europe since the end of 2021. Sentiment fell again in the third quarter of 2023 and was still deep in the pessimistic zone. Something remarkable has been observed for around three months: **The trend in consumer sentiment has turned around again and has now been rising steeply for around three months.** In January 2024, the sentiment index reached almost 99 index points in both Europe and the United States. These are the highest values for around two years, but the level is still below the neutral value of 100 index points.

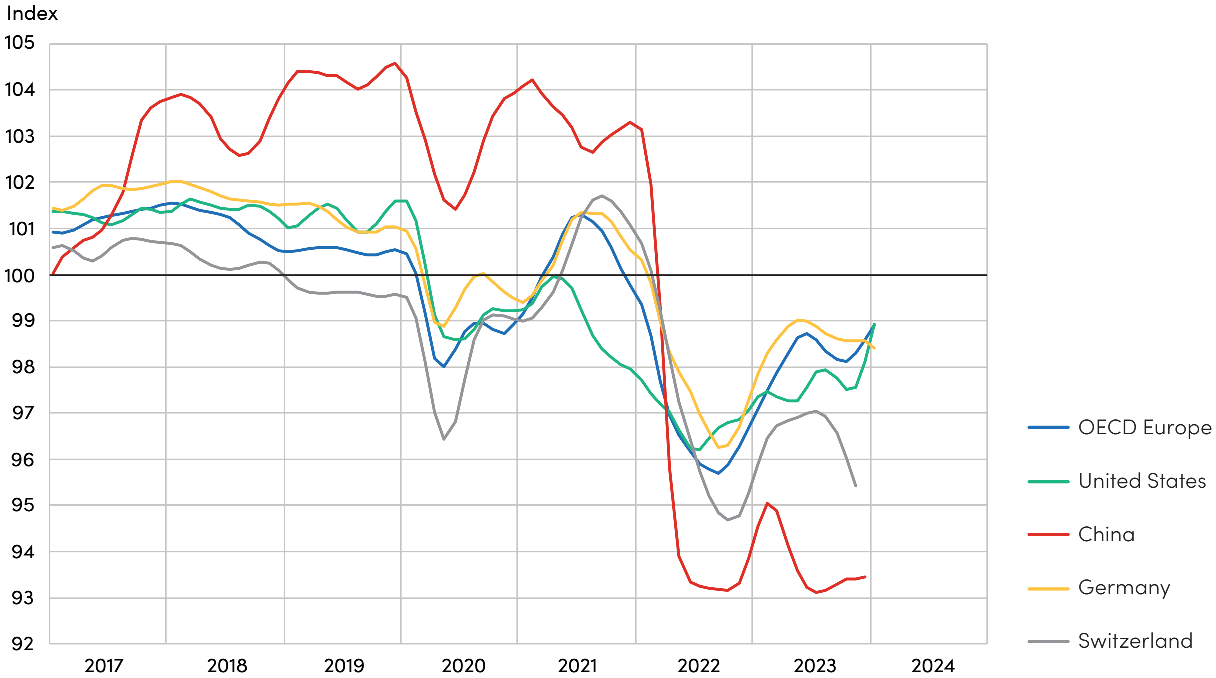

Fig. 1: Consumer Confidence Index

Source: Raw data by OECD, calculation and illustration by hpo forecasting

Status: Jan. 24

The reasons for the brighter mood are the **falling inflation rates, expected interest rate cuts,** which could further boost the stock markets, and the **low unemployment rates.**

In Germany and Switzerland, however, there is still little sign of the recent improvement in sentiment. **Sentiment in both countries is lower than at the height of the coronavirus crisis.** In Germany, widespread dissatisfaction with economic policy, the crisis in industry, and high energy prices are likely to weigh on sentiment. When the big neighbour slumps, the closely linked Swiss economy is always impacted.

Consumer sentiment in China also remains very low. It has remained below 94 points almost continuously for almost two years. These are the lowest values since records began in the early 1990s.

The Business Confidence Index (BCI) remains low

The BCI (see fig. 2 on the next page), particularly relevant for the capital goods industry, is similar to consumer sentiment in Europe and the United States. It is stagnating in Europe and has been moving sideways at 99.3 points for six months. In the United States, the value has improved slightly and, like consumer sentiment, is now at 99. **These are not catastrophic values, but confidence looks different.**

An "average" crisis in the machinery industry

Incoming orders in the German machinery industry continued to fall. **In 2023, order intake figures in Germany fell by 12 % in real terms compared to the previous year.** Even though the decline in quarterly figures slowed somewhat in the third quarter, it is not yet possible to speak of a trend reversal.

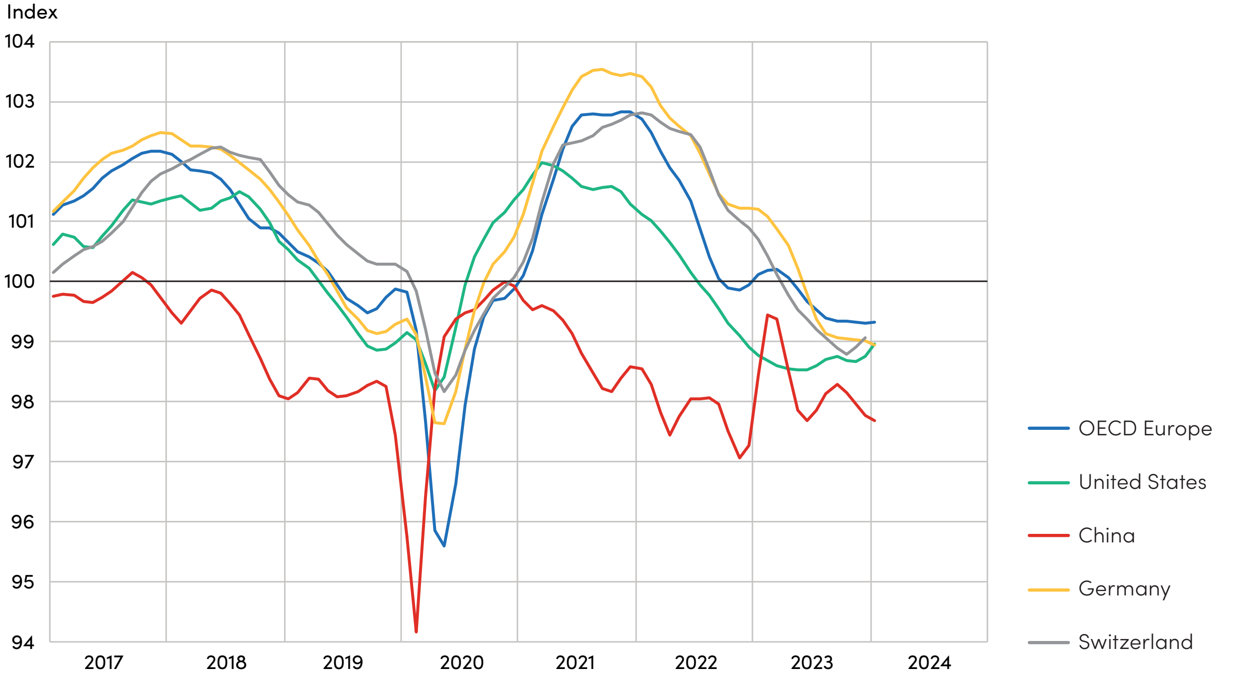

Fig. 2: Business Confidence Index (BCI)

Source: Raw data by OECD, illustration by hpo forecasting

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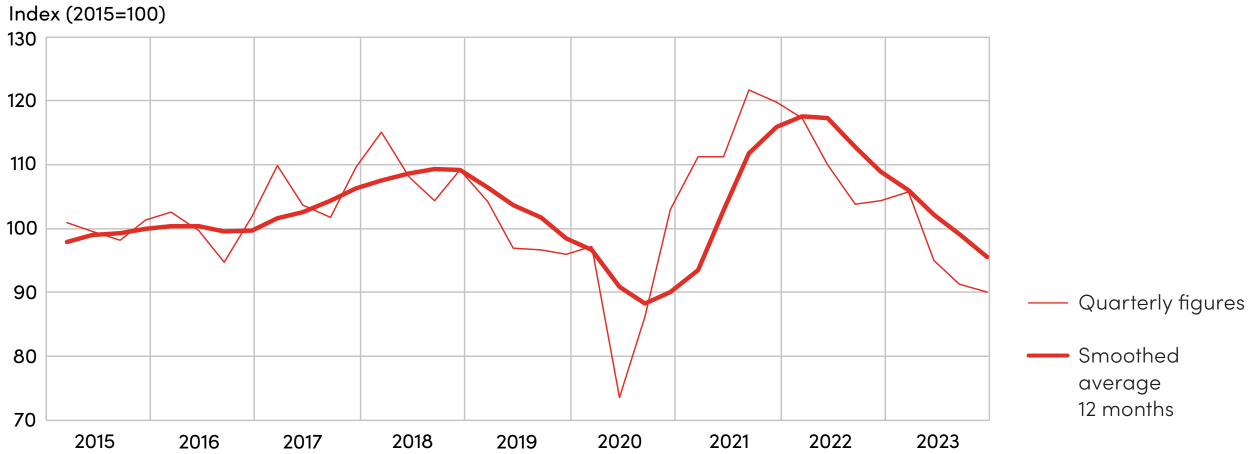


Fig. 3: New orders for the German machinery industry (real)

Source: Raw data by Destatis, illustration by hpo forecasting

Status: Dec. 23

What is a "typical" crisis in the German machinery industry? Analysing the past provides valuable information for the future. Since 1990, four phases have been recorded in which incoming orders in the German machinery industry, measured on a 12-month moving average, fell by at least 8 % in real terms within two years:

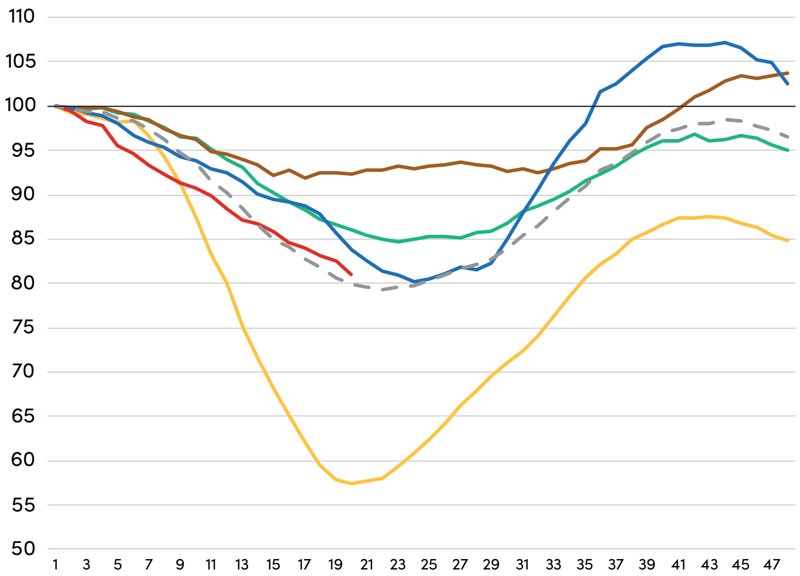
- Structural crisis of the early 90s
- DotCom crisis from 2001
- Financial crisis from 2008
- Crisis from 2018 around the emissions scandal, followed by the pandemic
- Current crisis starting in mid-2022

In the following illustration, the crises mentioned above have been superimposed over one another. The starting point is always the last peak in order intake before the crisis.

The comparison shows that **the variance in the depth of the crisis is quite large.** In the past, the decline fluctuated between –8.1 % (DotCom crisis 2001) and –42.6 % (financial crisis 2008). **The mean value (excluding the current crisis) is –21.4 %.**

The duration of the crisis is relatively constant. It took between 41 and 49 months for a new peak in incoming orders to be reached. However, the pre-crisis level was only reached again within four years in two out of four cases. In the case of the 2008 crisis, it took until 2022 for a new peak to be reached.

The current dip in demand has lasted 19 months, and a real decline in incoming orders of -19.0% has been recorded. This means that the current decline (red curve in fig. 4)



Start of crisis	Max. decline	Duration to new high
Dec. 1991	–15.3 %	41 months
Jan. 2001	–8.1 %	49 months
Apr. 2008	–42.6 %	42 months
Oct. 2018	–19.8 %	44 months
Average 1991–2018	so far –21.4 %	44 months
May 2022	so far –19.0 %	so far 19 mth

Fig. 4: Comparison of crises in order intake in the German machinery industry (12-month average, real, index basis = last peak before the crisis)

Source: Raw data by Destatis, calculation and illustration by hpo forecasting

is not particularly deep but is relatively close to the average path of previous crises. **If the current crisis continues to follow this average path, incoming orders will reach their lowest point in the course of the year.**

According to our estimates, this trend would be a positive scenario, as 2021 and 2022 were characterised by an extremely strong production boom in the aftermath of the coronavirus crisis. This also resulted in exaggerations and order volumes that did not correspond to actual demand, which led to overcapacity, particularly in China. **The trough is, therefore, likely to be lower than the mean value of the previous crises calculated above. It is also unlikely that the high level of early 2022 will be reached again soon.**

Incoming orders in the German machinery industry are a very broad and diluted industry indicator. **Developments in the individual industry segments can deviate significantly from this.**

Negative trend growth in machinery industry

Another reason why the highs in the general German machinery industry are unlikely to be reached again so quickly is the **negative real trend growth in the sector.** Trend growth is the growth of an industry if there is no cyclical economic influence on incoming orders. With the hpo forecasting model, the cyclical influence on incoming orders can be factored out. The red curve in figure 5 shows the incoming orders calculated by hpo based on general global economic indicators. This oscillates irregularly around the long-term trend growth (green curve). The hpo forecasting model calculates the economic impact, i.e., the difference between the trend curve and the actual order intake. This allows the long-term trend growth of an industry to be determined.

According to our calculations, inflation adjusted **trend growth in the German machinery sector has fallen by 1 % yearly since 2012.** For a few quarters after the coronavirus shock, it seemed as if trend growth would stabilise at a higher level, but recent developments suggest that the boom in 2021 and 2022 was essentially a demand bubble, similar to the one before the 2008 financial crisis. Where exactly the growth trend will stabilise in the medium term cannot yet be conclusively determined after the recent upheavals.

The situation is similar in **Switzerland,** whose tech industry is closely interwoven with that of Germany, and real trend growth is also slightly negative here.

China is rapidly falling out of favour with investors

In mid-2023, the report *Deindustralisierung – Eine Analyse auf Basis von Direktinvestitionen (English: Deindustrialisation – An analysis based on direct investment)* by the Cologne Institute for Economic Research caused a stir. Its analysis of OECD data on direct investment revealed that Germany recorded the highest net outflows of all OECD and G20 countries analysed in 2022. Only Japan achieved a similarly low figure at that time. The conclusion was:

"The sharp rise in outflows of investment capital from Germany is a warning signal that the location is becoming less attractive."

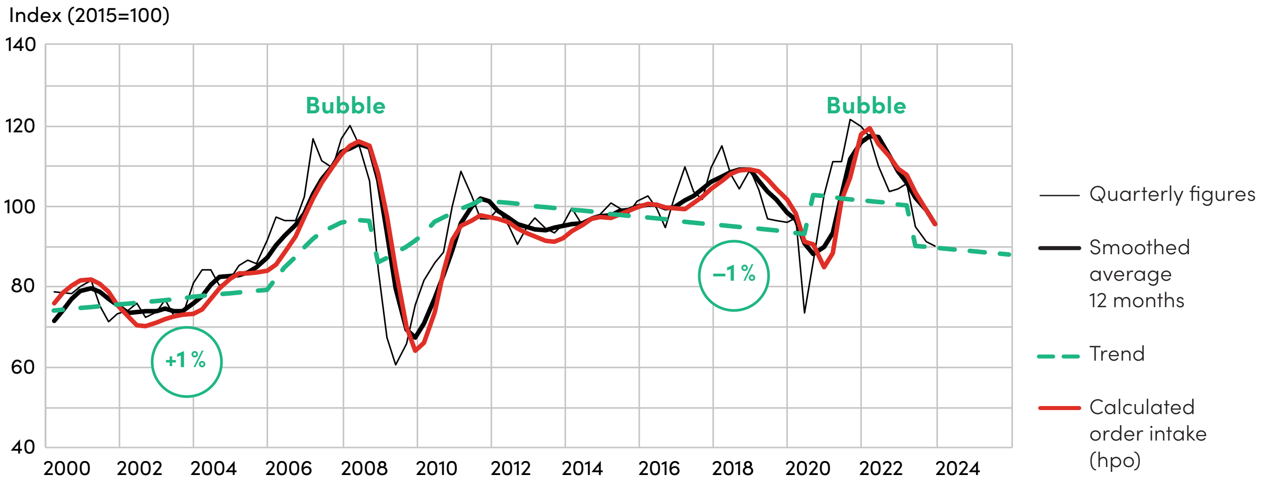


Fig. 5: Real incoming orders for the German machinery industry (12-month average and quarterly figures), actual figures and figures calculated by hpo with trend growth

Source: Raw data by Destatis, calculation and illustration by hpo forecasting

Status: Dec. 23

Since then, the OECD has also published the preliminary data for the first three quarters of 2023. The picture has not changed significantly: While German direct investment abroad (outflows from Germany) remained roughly in line with recent years at USD 99.2 billion in the first three quarters of 2023, **foreign direct investment in Germany (inflows to Germany) remained well below the long-term average (2005 to 2022) of USD 40 billion at USD 18.7 billion until September.** It is unlikely that this gap could be closed in the fourth quarter. This results in a net outflow of USD 80.6 billion. If this trend continues, the net outflow will likely increase to over USD 100 billion by the end of 2023, as it already did in 2021 and 2022.

Before this, at most times Germany had shown a negative balance since the start of the data series in 2005. **German players almost always invest more abroad than foreigners invest in Germany.** The balances fluctuated between USD –132 billion and USD 6 billion until 2022. However, this trend has become more pronounced in the last three years. High net outflows are particularly pronounced in Germany but are not atypical for a mature economy. An important factor here is likely to be demographic trends and, more recently, the shortage of skilled labour.

While foreign inflows have fallen sharply in many large economies in recent years, the United States is an outlier. **In the first three quarters of 2023, the United States attracted USD 265 billion in foreign direct investment.** It is, therefore, realistic to expect that the United States will again be able to attract similar levels of investment as in 2021 and 2022. In 2022 and so far in 2023, direct investment there was higher than in China, Japan, and Germany combined.

As in other smaller countries with large financial centres, the volatility of direct investment into and out of Switzerland is very high, which is why it is difficult to extract a meaningful trend from the figures.

The figures for the last three years speak for themselves:

- **China has rapidly become less attractive to foreign direct investors in the last two years** and even recorded negative foreign direct investment in the third quarter of 2023. In other words, foreign investors withdrew more funds than they invested in the country.
- **In Germany, inflows are also well below the long-term average.**
- **The United States is regaining favour with investors thanks to comparatively low energy prices and a very active and costly industrial policy that relies heavily on market-distorting subsidies.**

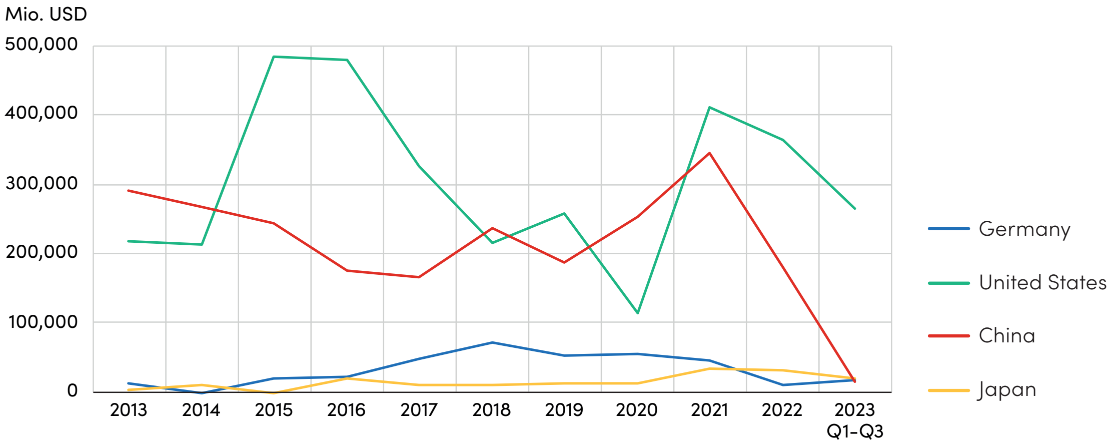


Fig. 6: Foreign direct investment in selected countries (inflows)

Source: Raw data by OECD, illustration by hpo forecasting

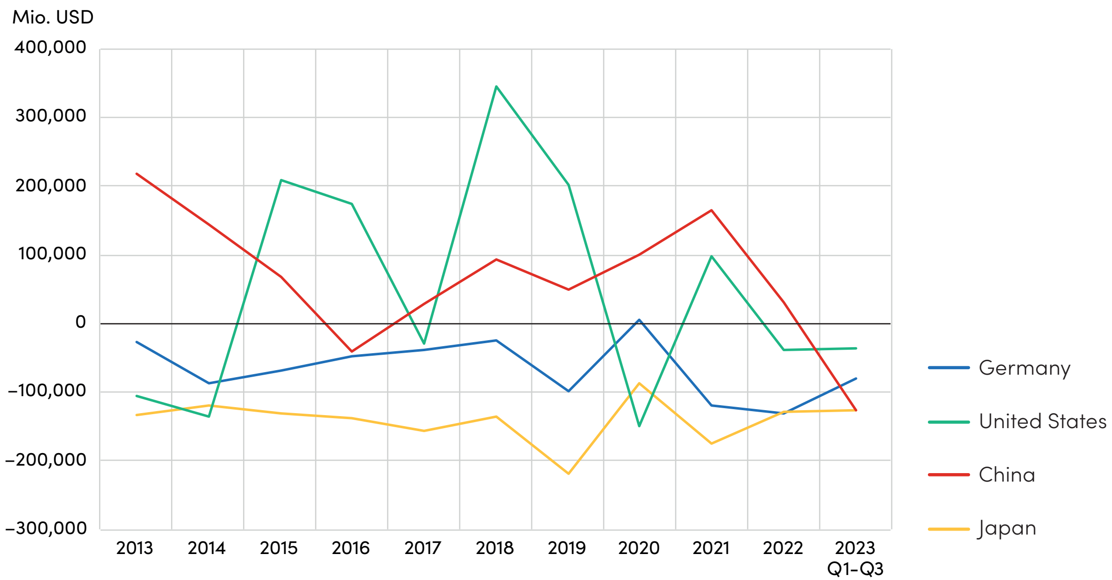


Fig. 7: Balance of foreign direct investment in selected countries (inflows – outflows)

Source: Raw data by OECD, illustration by hpo forecasting

Josua Burkart
Managing Director
josua.burkart@hpo.ch
+41 76 566 53 88

Benjamin Boksberger
Senior Manager
benjamin.boksberger@hpo.ch
+41 78 717 16 55

hpo forecasting produces industry- and company-specific order intake forecasts for the industry. With well over 200 industry forecasting models worldwide, hpo forecasting covers numerous market segments for capital goods and consumer durables. The forecasts are individually configured for companies. They are based on the Peter Meier Forecasting Model, a scientifically based method that has been empirically tested for over 20 years and is constantly being further developed.

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hpo forecasting ag | Gewerbestrasse 5 | CH-6330 Cham
forecasting@hpo.ch | hpoforecasting.ch | +41 41 461 00 22