



Mechanical engineering sector feels the effects of the coronavirus

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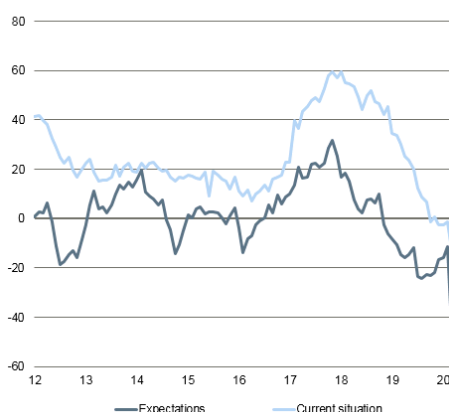
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Source: ifo, Deutsche Bank Research

The coronavirus pandemic has struck the German mechanical engineering sector at an already difficult time. Since 2019 at the latest, mechanical engineering firms have been feeling the effects of a realignment in the industry, particularly as German automobile manufacturers shift towards electric mobility. On top of that, there was the possibility of unusual expenses due to the potential discontinuation of deliveries from China amid ongoing trade conflicts. Production may decline by 25% or more in 2020 as a result of the coronavirus.

The coronavirus crisis is reminiscent of 2009, when mechanical engineering firms saw production collapse by 26%. The order status and mood indicators expected over the next few weeks will show how bad the situation already is. And further gloom as a result of the coronavirus should be expected through to the end of the current quarter at least, as the results of the most recent surveys conducted by the ifo Institute show. Business expectations in the mechanical engineering sector fell to minus 44 points in March, from minus 12 points in February. And according to a VDMA survey, the percentage of mechanical engineering firms whose operations are adversely affected rose from 60% in mid-March to 84% at the end of March. Three-quarters of mechanical engineering companies have already adjusted capacity as a result, the VDMA says. To do this, they have relied first and foremost on existing balances of time off, hiring freezes, and short-time work as a tool. And even job cuts are on the table now for 12% of companies. Amid the current coronavirus crisis, the pilot agreement in North Rhine-Westphalia is a sensible response. The new agreement freezes pay increases and dismissals for operational reasons and provides for an increase in the short-time working allowance.

The coronavirus situation affects practically all of the approximately 30 segments in the mechanical engineering sector. The machine tool segment, which is especially cyclical, may perform even worse than the average (meaning at least -25%). This area is also affected by the realignment of the automotive industry and its great vulnerability to the struggling global economy.

Manufacturers of precision tools that supply machinery for sheet metal work in the automotive industry will likely continue to perform below average as



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well. The robotics and automation segments are also feeling the added effects of hesitant investment in the vehicle industry at present.

Steeper drops in production also threaten producers of plastic and rubber machinery. Uncertainties in the automotive industry also weigh on this segment, along with as yet unanswered questions surrounding the future of packaging, meaning which types of packaging will still be tolerated in the future (PET, for example?). Manufacturers of foundry machinery and measuring equipment will probably see below-average performance as well.

There are very few segments of the industry that could weather the current crisis not particularly well, but still better than the average for mechanical engineering. Manufacturers of fittings are among them, benefitting from the fact that the construction industry is "still up and running." Drive technology could also experience less of an impact. A few months ago, when it seemed possible that China would be eliminated as a supplier, fear sparked a high volume of orders in Germany in this segment, and those orders are still being processed.

In a positive scenario involving an economic upturn in the second half of 2020 that continues into 2021 and 2022, the prospects for the mechanical engineering sector will be much more favourable again. Factors that could contribute here include the uniquely wide range of products offered and the very high quality standards that apply. Germany is the world leader in half of the approximately 30 segments in this industry. About 70% of German machines are made in one-off production or small series. Internationally, the trend in demand is towards these machines. If value chains shift more towards local suppliers in the future due to pushback against globalisation, that should benefit German mechanical engineering firms in the years to come.

Beyond that, the German mechanical engineering sector should continue to score points on topics related to energy and the climate. The modernisation of the global power plant stock is an important subject for the future. And in Germany, recent developments show that things are clearly moving in this direction. Mechanical engineering in particular helps to reduce the costs of alternative energy sources. Innovation in mechanical engineering is also needed to boost energy efficiency in production and in the consumer goods sector.

It will probably take several years to recover from the decrease in production in 2020. Still, we are optimistic that thanks to German engineering skill, the German mechanical engineering sector will return to average production growth of around 2% per year in the medium term.

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