

Regional analysis Industrial production

**Global economic slowdown biting on
manufacturing activity in 2023**

Authors:

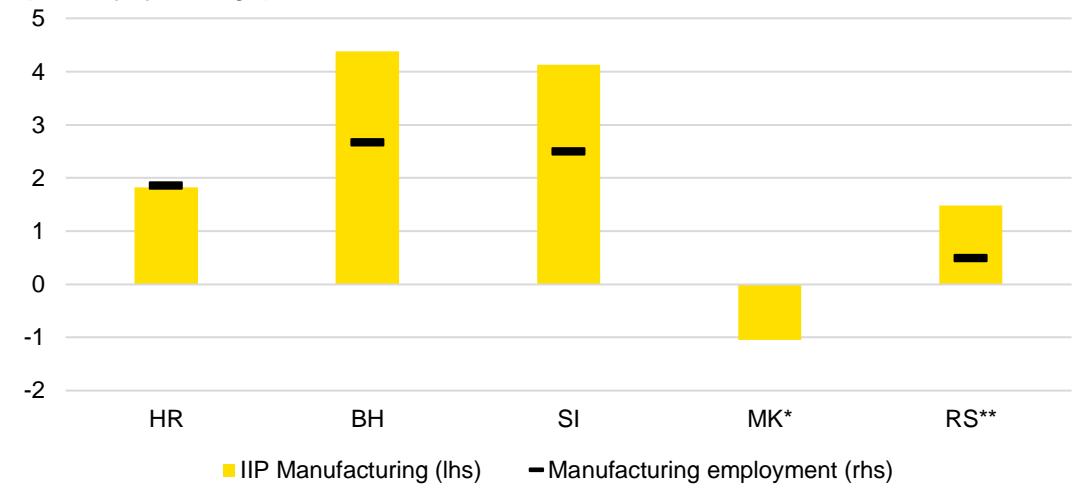
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Adria region industrial production rose in 2022 (except in North Macedonia), but on a slower pace compared with the previous year although 2021 was post-pandemic rebound year. Countries in the region are producing more than in 2019, with North Macedonia as a sole exception, posting 8.5% lower production level compared to 2019. Current uncertain environment, domestic and foreign, has pushed down production and/or its growth pace during the last quarter of 2022, making 2023 outlook vague as industrial output depends on imports, external demand and domestic consumption. In the analysis we also aim to gauge the key drivers of industrial production and to demystify their path ahead, bearing in mind country specifics in the region and general macroeconomic environment.

Regarding Croatia, industrial production growth was in red in 4Q2022, posting a **-1.5% yoy drop**, after experiencing productive 1-3Q2022 rising 2.6% yoy on average which shaped the **2022 average of 1.6%**. **On a yoy basis, Electricity, gas, steam and air conditioning supply lost 10.5%** of its production in **4Q2022**. This segment was driven by higher energy costs in line with lower consumption needs due to mild winter. Manufacturing as main component of industrial production posted 0.6% yoy growth, significantly lower than average 2.3% recorded in the rest of 2022. Manufacture of food (ca 16% share of total IP) dived into negative territory for the first time in the post-pandemic period, posting -1.7 yoy growth rate. Food production significantly slowed down in December-2022 (-4.3%), anticipating lower domestic consumption, as retail sale of food is contracting and lower external demand is expected. Manufacturing in total in 2022 fared relatively well, expanding by 1.8% vs 2021, on the back of still ample post-pandemic demand pull. **Latest January-2023 data show 2.8% yoy drop in industrial production, as manufacturing slipped (-2.4%)**. According to EC Industrial production survey, 3-month look-ahead indicators (production and employment expectations) were surprisingly optimistic in February-2023 (compared to January, and 2022 average), witnessing that participants expect recovery in industrial production. Production expectations confidence level in February has recovered significantly, posting levels close to pre-pandemic January-2020 level.

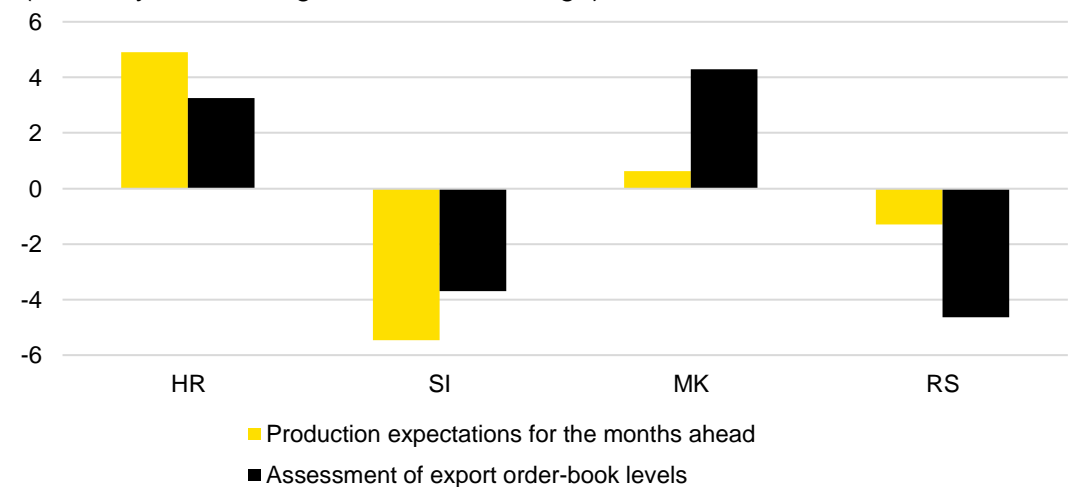
Manufacturing production index and employment in manufacturing (2022, yoy change)



*MK data on employment not representative due to Census changes; **RS data for the first 11m
Source: local statistics offices, Bloomberg Adria analytics

Economic sentiment indicators – industry survey

(February 2023 change vs 4Q2022 average)



Source: EC Industrial production survey, Bloomberg Adria analytics
Bosnia and Herzegovina data unavailable

North Macedonia industrial production is still ailing, with the 2022 output being 8.5% lower vs pre-pandemic 2019. After recovering slightly in 1H2022 (+2.3% yoy), **industrial production turned into red dropping by 3.4% yoy in 4Q2022**, driven by Mining and quarrying (-6.7% yoy) and Manufacturing (-4.1%). Manufacture of food (highest share) has been on a downtrend for years now, posting -7.4% in 4Q2022. Meanwhile, base effect-influenced manufacture of chemicals that turned into red in 2H2022 (posting -22.1 yoy in 4Q2022), after increasing significantly in 2021 (cca. 50%). This dynamic was mostly determined by the need for disinfection related articles fluctuating with the development of the pandemic. Textile manufacturing supported total production, posting 10.8% yoy growth only in 4Q2022. After a notable downturn over a multi-year period, as demand for textile dropped, this industry turned the direction up in 2H2022. Positive developments have been seen in the Electricity, gas, steam and air conditioning supply segment adding 6.5% yoy in 4Q2022, supported by higher production in thermal power plants. For **2022 as a whole, IP fell by 0.3%** vs 2021, despite producing only a meagre post-pandemic recovery of 1.5% in 2021. EC survey results show that there is a positive sentiment regarding production in the next three months, with export order-book levels improving vs 4Q2022.

In **Slovenia, industrial production** switched course and **dropped by 4.7% yoy in 4Q2022**, after rising at 3.9% during 1-3Q2022, which shaped the **2022 average at +1.7%**. Production in Mining and quarrying dropped (26.5% yoy in 4Q2022), as Velenje is turning to green energy, aiming to stop extracting coal until 2033. Coal extraction tied to TEŠ energy production is fluctuating to match energy needs and use of available substitutions (including import of energy). Manufacturing posted lighter decline of 0.8%yoy in 4Q2022 (pulled down by December-2022 4.2% yoy drop). Manufacturing in Slovenia is mostly export oriented, so it is sensitive to demand signals coming from abroad. While exports in 2022 rose, sentiment indicators for start-2023 show that industrial producers are not optimistic and consider export order book levels being not sufficient. On the other hand, due to high energy costs the largest metallurgy group in Slovenia (SIJ) decided to cut production in 4Q2022. Production expectations in February (for the next 3 months) were below 2022 average, according to EC survey. Export order book levels are assessed as not sufficient, indicating that the sector anticipates further slowdown in production.

Industrial production dropped in **Bosnia and Herzegovina** recording **-2% yoy in 4Q2022**, after +3% on average in 1-3Q2022, shaping the **2022 average at 1.7%**. The drop was driven by Mining and quarrying losing 8.5% yoy in 4Q2022. Connected with that, Electricity, gas, steam and air conditioning supply was in red during 2H2022, intensifying decline to 9.8% yoy in Q42022, as hydropower production was weaker (and dependent on weather conditions). Manufacturing is still in the positive zone (+1.2% in 4Q2022), although slowing down significantly in 2H2022. Production of metal products (highest share in Manufacturing) is on a downtrend, but it is still increasing (+4.8% yoy in 4Q2022), contributing positively to the headline index. Aluminium production has intensified during 2022, reflecting increased foreign demand (exports of aluminium and its products have increased 68% during 2022, also accounting for increase in the price). Aluminium production in recent years was mainly supported by comeback of Aluminij – factory that resumed its production in late 2020. Manufacturing of food products contributed positively, increasing 14% yoy in 4Q2022. Signs of milder foreign demand is reflecting on BH's industry as well, as exports growth slowed down (January-2023 at +5.9% vs +25.9% in FY2022).

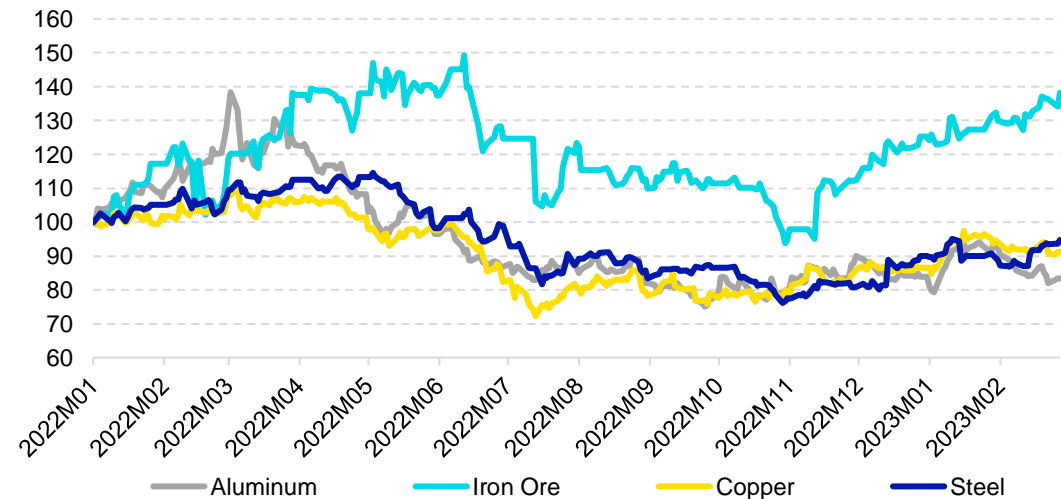
Industrial production growth in **Serbia** slowed in **4Q2022 by posting 1% yoy increase**, after 1.9% growth in 1-3Q2022, shaping the **2022 average of 1.7%**. Mining and quarrying production contributed positively in 4Q posting +14% yoy, although calming after rising 28.5% on average in 1-3Q2022, intensively driven by need for energy production (energy production in Serbia is highly based on coal). Electricity, gas, steam & air conditioning supply followed, by expanding by 6.2% yoy in 4Q. **Manufacturing dropped second quarter in a row**, posting -1.2% yoy in 4Q, given higher energy costs that impacted metals and plastic production. According to EC survey, production expectations for next 3 months in February-2023 record the lowest value in the post-pandemic period, showing that producers anticipate downside trend in recent future. We see decrease in export order-books assessment compared to 4Q2022, mirroring expectation of lower external demand. Latest **January-2023 data show industrial production** advancing by **+3.7% yoy**, which is mostly driven by base-effect (January-2022 at -3.8% yoy), and its continuous growth in Mining and quarrying, given the need for domestic energy production, as import energy prices are high and volatile.

Industrial production is in a downtrend across the Adria region, with only Serbia posting a positive growth rate albeit at a slower pace. Uncertainties tied to costs and demand path will continue to challenge industrial production in 2023. For 2023, we expect industrial production to drop or stagnate at best in some stronger areas driven by the following expectations:

- 1) Due to **expected economic slowdown in Western Europe** (with Eurozone Manufacturing PMI in the contracting zone since July-2022), we see foreign demand weakening, feeding into industrial production trends. As an example of cyclical and export-oriented production, we highlight the auto industry which will be hit by the broad-based economic slowdown and thus reflects weak prospects for the total industrial production at least in 2023.
- 2) Connected with demand, we see **domestic consumption sobering after post-pandemic rebound** as spending fundamentals deteriorate largely on the back of detrimental effects created by persistently high inflation, which will pull down production focused more on domestic markets. This is primarily focused on food production, given its relatively large share in region's industries.
- 3) We see additional pain for the producers coming from **higher financing costs**, as we see interest rates to continue rising, which will halt further investment. The EU funds will provide some pressures of costlier funding, however this is nominally more oriented for the Eurozone members of the Adria region.
- 4) Uncertainties inherited from 2022 regarding input prices will continue, as both prices of energy and commodities throughout the last year influenced some activities inside Manufacturing category, for example basic metal production. **Elevated and volatile energy and commodity prices** we see in 2023 are going to reflect on costs further on, with some industries forced to cut production.

On a positive note, we see opportunities for 2023 in **new capacities to be put in force this year** (as strong FDIs in 2022 indicate), especially in the non-EU part of the region that still offers lower labour costs. This will be more pronounced in the labour-intensive industries rather than in capital-intensive counterparts. **Nearshoring tendency from Asia** also brings some sparkle into 2023, as producers from Western Europe try to shorten supply chains (growing geopolitical tension and convergence of wages in China vis-a-vis Eastern Europe will most certainly help to relocate some of the factories out of China, for example, to the CESEE). However, although encouraging as it may seem, this idea is still in the developing phase and may not meet expectations if the supply chains return to pre-pandemic mode or major global producers turn to other Asian economies, like India.

Commodities' prices
(1/2022 = 100)



Source: Bloomberg, Bloomberg Adria analytics

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