

## The Market Turns Upward for European Power Products

**BRUSSELS, BELGIUM** (December 1, 2004)- Last year at this time, in common with most other forecasters, we expected to see reasonable but not spectacular growth this year. In truth, in some sectors growth has been so great that engine producers have not been able to keep pace. Dramatic changes like this need explanation and I hope to provide some as we go through the application sectors in detail but it seems that the volatility is in part caused by inventory rebuilding.

GDP growth this year in the European Union is expected to be around 2.3% - which is way better than the 1.0% achieved in 2003. However, compare this to the USA at 4.7% and Japan at 4.5% and it is clear that Europe continues to lag behind in the climb out of the recession of the last few years. Industrial production is up by a similar percentage but construction spending is still very restrained.

Emissions legislation is programmed to tighten for all sectors during the forecast period (2005 to 2007 depending on sector). Market distortion may be the result as large users pull purchases ahead to avoid the extra cost and complexity associated with the tighter emissions.

So what does this mean? Most economic observers seem to agree that next year will see continued growth. It now looks likely that GDP growth in the European Union will be above to 3% in 2005. This will give scope for further increases in demand for powered equipment. It is fortunate that the European powered equipment industry plays on the global market where increases in demand are expected to be much greater giving them the opportunity ship as much as 5% more than this year. Let's take a closer look at the individual markets to see what we might expect.

### Agricultural Equipment

After several years of falling sales European demand for agricultural equipment bottomed in 2003 and is expected to rise by 3% this year. This sector has not been affected very much by inventory re-building that has made this year a challenge in other sectors.

Continued growth will be slowed by the changes in the Common Agricultural Policy and reductions in subsidies to farmers from World Trade Organization negotiations that will see less income for the larger arable farms that consume the bulk of the equipment. This is expected to be most marked in the demand for large tractors and combines. The relatively good harvests in Europe have to be offset by crop failures through floods and drought in other parts of the World. 2005 then is expected to show a similar increase as this year with 2006 continuing to grow but at only 2%.

### Generator Sets

The entire excess inventory that was in the system when the market crashed in 2001 was finally dissipated during 2003. This left the supply chain with little or no inventory in a market where quick response to orders is expected. The upturn in the market this year, therefore, saw demand increases many times the market demand as the supply chain re-stocked to meet the new market conditions. Increases in demand of 28% were seen at engine and component level with many suppliers unable to keep pace with supply requests. In some cases order books for 2004 were closed as early as June as component producers were not able to respond to the rapid and short lead-time changes in demand.

Not that the European markets were particularly strong. Much of the increased demand came from Asia and the Middle East where markets like China are consuming a large number of generator sets. North America is also consuming large numbers as the mobile telecoms industry installs new GSM towers.

A further 5% increase in the market demand is expected in 2005. There is expected to be a small correction in 2006 with the market contracting 4% and adjusting to a more normal 3 to 5% growth rate after that.

## Construction & Industrial Equipment

This year looks like finishing with this market sector up by as much as 9% after a 4% decline in 2003. While the market has definitely turned upward at least half of this increase is comes from inventory building throughout the supply chain as the producers adjust to the better market conditions. Inventories were at a low point last year leaving no slack in the system to meet the increased machine order levels.

As GDP grows it is expected that more major infrastructure projects will be commissioned increasing equipment demand. There also appears to be significant latent demand resulting from the enlargement of the EU and reconstruction in the war-torn regions of the World. An increase of activity of around a further 3% should be expected next year. In 2006 we foresee a slight decline as the inventory build works itself out of the system and the supply chain adjusts to a more normal demand picture.

## Light Commercial Vehicles

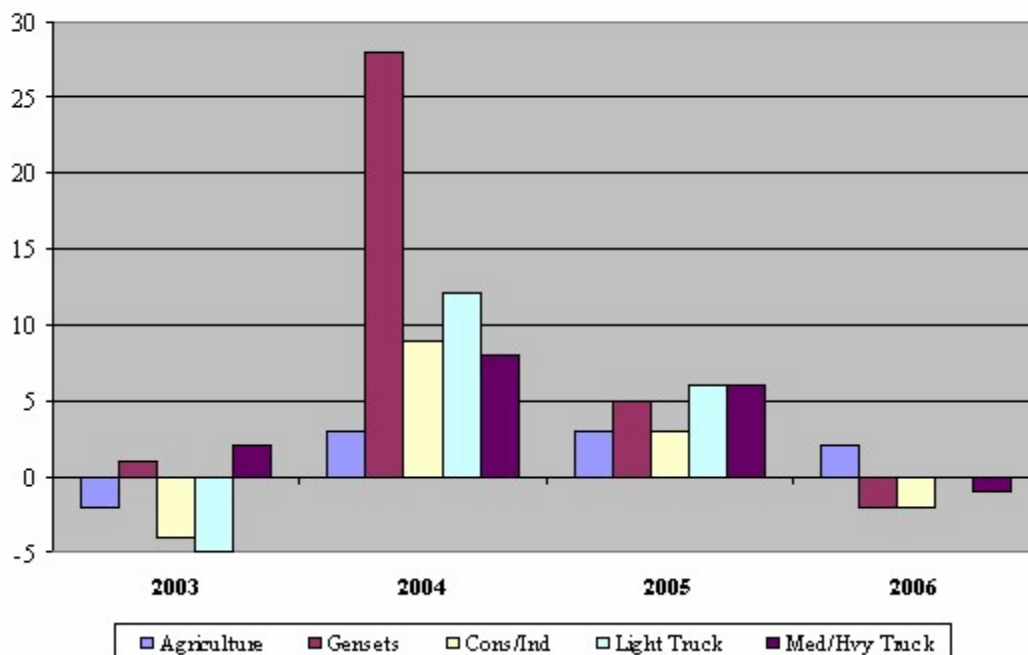
Light commercial vehicles suffered a 5% drop last year. This year looks like the market will up 12% as demand follows the up-turn in economic activity. Little of this increase is due to inventory fill since this is not a high inventory market like generator sets market. For next year we expect to see it up to a further 6% again on the back of increased economic activity with some 'pull forward' ahead of tightening emissions levels for 2007. As with other sectors 2006 looks like a correction year with the market at best flat or slightly down.

## Medium & Heavy Commercial Vehicles

Last year was essentially flat for the truck industry in Western Europe posting a mere 2% increase. We are off close to 20% from the peaks of the late 1990's and it is expected to take most of this current economic cycle to get back to those levels.

We estimate that 2004 will end up 8%, which is in line with the forecasts currently being produced by the major truck manufacturers. In 2005 we will see a further 5% increase with some of this due to pull forward purchases prior to the introduction of Euro IV emissions levels compliance to which will be phased in between October 2005 and October 2006. In the following year there is expected to be a small correction resulting from that pull forward of maybe as much as 1%. After this the market should complete the current economic cycle with normal 3 to 5% increases year on year.

Year on Year Percent Change



## In Summary

With increases of between 3 and 28% in the various markets it is clear that this has been a volatile year. In some cases demand has been very difficult to match, resulting in high off-standard costs from overtime and weekend working. But be cautioned this sort of increase and volatility happens only once in the 10 to 12 year economic cycle.

With an overall anticipated increase this year of 11%, our forecast is that the equipment manufacturing industry in Western Europe is probably going to see a volume growth of around 5% in 2005. This is expected to be followed by a small 1% decline in 2006 with perhaps a further decline in 2007 before the market heads upward again at a much more restrained rate.

Power Systems Research is a global market research and consulting company specializing in the engine, original equipment, and components industries. Since the company was founded in 1976, Power Systems Research has been the authoritative source of market information and business intelligence to the power products and drivetrain industry. Power Systems Research is headquartered in St. Paul, Minnesota and provides market data and customized project work to the world's leading vehicle and equipment OEMs and component suppliers. The company has a global presence with operations in Detroit, Brussels and Tokyo. Further information is available at <http://www.powersys.com>.

**Ted Hadingham**  
**Managing Director-Europe**  
Email: [ted@powersys.com](mailto:ted@powersys.com)  
Tel: +32.2.643.2828

**Reed Tietz**  
**Marketing & Communications Manager**  
Email: [rtietz@powersys.com](mailto:rtietz@powersys.com)  
Tel: +1.651.905.8400