



2006 FORECAST

EUROPEAN EQUIPMENT MARKETS: THE QUIET AFTER THE STORM

By Ted Hadingham



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Last year at this time, in common with most other forecasters, we expected to see continued but not spectacular growth in 2005 after a torrid 2004. Our estimate of around 5% growth was based on typical values at this point in other economic cycles. While history is a good resource for forecasts, it is not a perfect tool. This year has been disappointingly slow in Europe with growth constrained to a maximum of 2%.

GDP growth this year in the Euro Zone is expected to be around 1.6% — which is down from the 2% achieved in 2004. Compare this to the U.S.A. at 3.6% (still off from its 2004 level) and it is clear that Europe continues to lag in the climb out of the recession of the last few years. Both Euro Zone Industrial Production and building permits are expected to end the year flat. With Germany being such a large part of the Euro Zone economy, the fact that they are in something of a political stalemate does not augur well for European growth next year. At the time of writing, the Merkel government in Germany is struggling to put together a coalition with such a broad spectrum of views that one wonders if it could ever be effective in reviving the economy.

Emissions legislation is programmed to tighten for all sectors during the fore-

cast period (2005 to 2009, depending on sector). However, our current thinking is that there will be little distortion to the market from pull-forward purchases 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 restrained growth. It now looks likely that GDP growth in the European Union will be close to 2% in 2006. Add to this some tightening of the money supply as Euro Zone interest rates will inevitably rise and the outlook is not optimistic. This will give little scope for further increases in demand for powered equipment. In fact, at that level there is likely to be a small negative impact. With the U.S.A. forecast to grow at only 3% and Japan also restrained, the European-powered equipment industry will need to look toward the developing world for any glimmer of growth in 2006. 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 rose by 3% in 2004. This year has been a disappointment, with sales expected to be at the same level as last year.

The agriculture market is expected

be slowed by the concerns over the changes in the Common Agricultural Policy and reductions in subsidies to farmers from World Trade Organization negotiations. It is this uncertainty that has helped restrain growth this year. The result will be lower 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. Recent harvests in Europe have been relatively good but commodity prices have been low. This, together with the uncertainties over future incomes, has meant that farmers are becoming more reluctant to purchase new equipment. Our forecast suggests that the agriculture machinery market in Europe will experience small reductions over the next two years.

Generator Sets — After the hectic year in 2004 when manufacturers were not able to keep up with demand, this market segment has settled down. The supply chain is now full again and demand has returned to a more normal level. Manufacturers have had time to catch their breath and return to scheduled maintenance on their production machines after working them 24/7 last year. They have also had a chance to eliminate the off-

standards costs that such a level of activity causes.

This year will end some 5% down from 2004 as we see a small correction to inventory levels. But that is still more than 20% above the bad years of 2002 and 2003, and reflects a healthy, normal market.

With new building permits at roughly the same level as last year, the European market, which consists mainly of standby and CHP sets, is not particularly strong. Demand for European-built sets is mainly coming from Asia, where the markets are still relatively healthy. Without these markets holding well there really would be problems for many producers.

A further small decrease of 4% in the market demand is expected in 2006. European activity is expected to continue to be restrained while we foresee a little softening in Asia. Beyond 2006, we expect to see the market adjusting to a more normal 3 to 5% growth rate.

Construction & Industrial Equipment — This year looks like it will finish with this market sector up by just 2% after a 9% rise in 2004. Inventory building, which accounted for much of the rise last year, is now complete and demand is following a normal economic cycle.

With GDP growing at less than 2% and the number of building permits forecast to remain sensibly at the current level, it is difficult to see anything but flat demand over the next few years. For the industry to grow, European GDP needs to grow at a rate of 3% or more. This is something that we are not expecting to see over the next two years.

What increased demand there is will be expected to come from the new EU countries, but this is not expected to balance the softness in demand in the more traditional Western European countries. A small decrease in activity of around 1% should be expected next year. In 2006, we foresee a further slight decline as the European economies remain weak and the money supply tightens.

Light Commercial Vehicles — Light commercial vehicles grew by 12% last year on the back of the optimism that industrial activity was back on the upward curve. While we are indeed on a growth curve, that growth is very much restrained by low GDP and industrial production increases. This year looks like the market will only be up a further 2%, as demand is constrained by the slow economic activity.

With little improvement expected in the European economic environment next year, it is forecast that these gains will be lost, with demand suffering a small 2% decrease. While there is a tightening in the emissions regulations in 2007, we expect to see little in the way of pull-forward purchases that could have mitigated such a market decline. As with other sectors, it is difficult to see any significant change to the European environment that would make 2007 materially different. We are, therefore, forecasting a further small slip in demand for that year.

Medium & Heavy Commercial Vehicles — After an 8% rise in 2004 and a further 2% this year, the Western European market for vehicles over 6 tonnes GVW is expected to reach 348 000 units by the year end. This leaves the market

significantly below the peaks of the late 1990s and there is little prospect of getting back to those levels in the next two years. Some of the increase this year has been caused by pull-forward orders ahead of the September introduction of Euro 4 emissions regulations. However, this effect was smaller than expected, with truck manufacturers managing the change much better than those in the U.S.A. in 2002, where pull forward was in the order of 15% and manufacturers were left with few orders in the three months after introduction.

We estimate that 2006 will end up 2%, which is higher than some forecasts currently being produced by the major truck manufacturers who see a flat market in Western Europe next year. However, with exports to Central Europe and the Middle East, we believe that truck manufacturers will realize this modest increase. In the following year, demand is expected to grow at a slower rate and only amount to a 1% increase over 2006. After this, the market should complete the current economic cycle with a restrained 2 to 4% increases year on year.

In all, it looks like we are going to be facing relatively steady market conditions over the next two years with some minor softening in demand. We are not expecting any of the volatility that we have seen in the 2000 to 2004 period. However, the anticipated relatively high rates of growth seen during this part of the economic cycle in previous cycles are also not foreseen. As such, this is not a typical cycle and we could yet see demand failing to reach the peaks of the late 1990s before we enter the next cyclical downturn in the 2010 timeframe. ♦