Flash Economics

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Why is European industry doing so poorly?

Manufacturing production in the euro zone has not risen since 2007, and leading indicators point to a further decline.

The decline in the weight of industry has many negative consequences: loss of skilled jobs, falling productivity, de-industrialisation of some areas.

We are wondering what the causes are of this poor health of the euro zone's manufacturing sector. Could they be:

- A weak domestic demand for manufactured goods;
- The European industry losing market share in world trade to the Chinese and American industries;
- A shortfall in research and development and in investment in new technologies, and a lagging robotisation of the European industry;
- A problem of cost-competitiveness linked to wage levels, energy prices, etc.

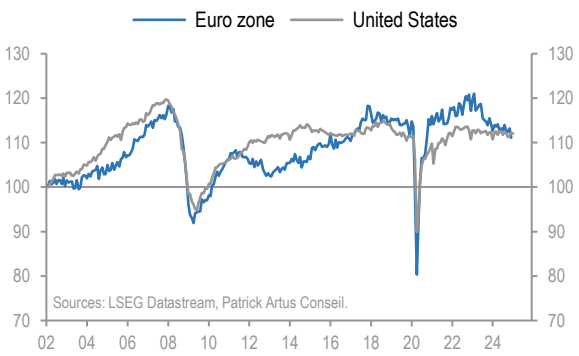
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Weak manufacturing production in the euro zone

Chart 1 compares trends in manufacturing production in the euro zone and in the United States since 2002.

Chart 1
Manufacturing production (2002.M1 = 100)



Naturally, manufacturing production has grown faster in emerging countries, particularly in Asia, than in the euro zone (Charts 2A/B/C).

Chart 2A
Manufacturing production (Y/Y as %)

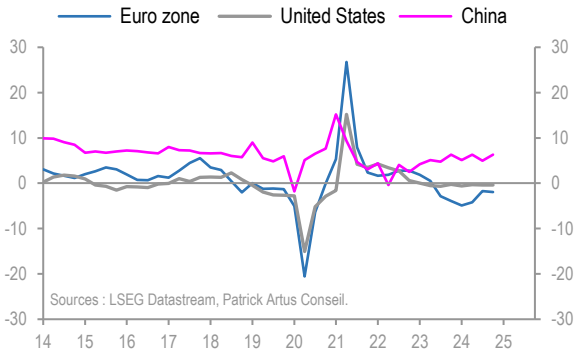


Chart 2B
Manufacturing production (2002.M1 = 100)

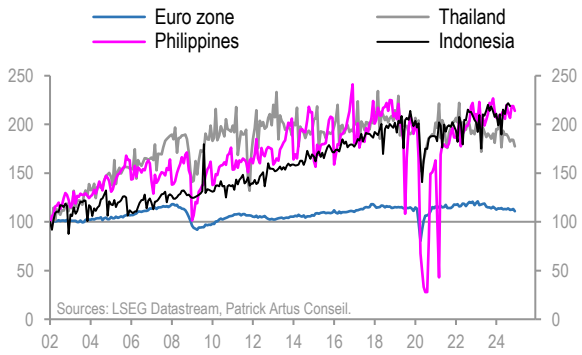
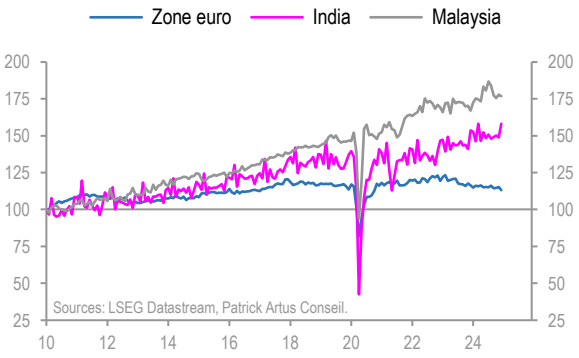


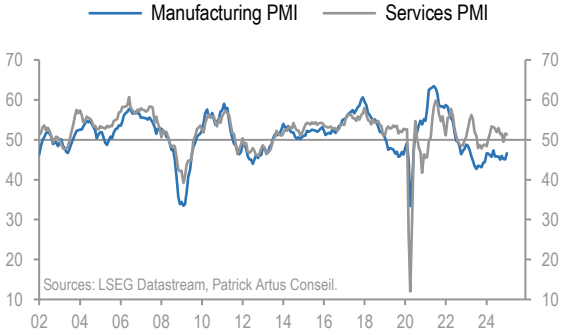
Chart 2C
Manufacturing production (2010.M1 = 100)



Since 2022, we have seen a significant decline in manufacturing production in the euro zone, even compared with that of the United States.

Moreover, the leading indicators (PMI) show that manufacturing production in the euro zone is declining further (Chart 3).

Chart 3
Euro zone: Manufacturing and services PMI (indices)



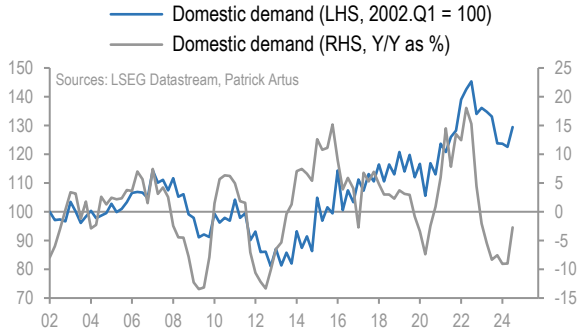
Weakness in industry has well-known negative consequences: a decline in the number of skilled jobs, a fall in productivity and the de-industrialisation of some areas. We are therefore trying to identify the causes of the weakness of the euro zone's manufacturing industry.

Four causes of the weakness of the euro zone's manufacturing industry

1. Weak domestic demand for manufactured goods

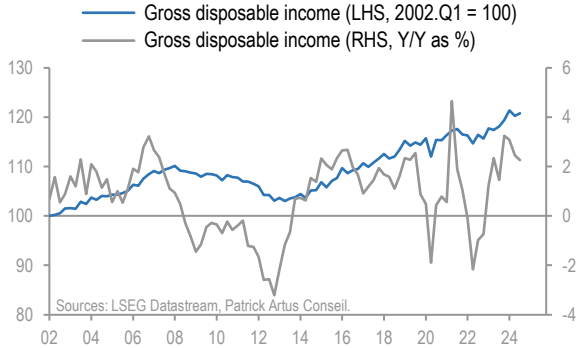
Chart 4 shows domestic demand for manufactured goods in the euro zone.

Chart 4
Euro zone: Domestic demand for manufactured goods (in volume terms)



Since 2002, it has grown by only 15%. The weakness of domestic demand for manufactured goods may be due to demographic ageing, saturation of needs or weak income growth (Chart 5).

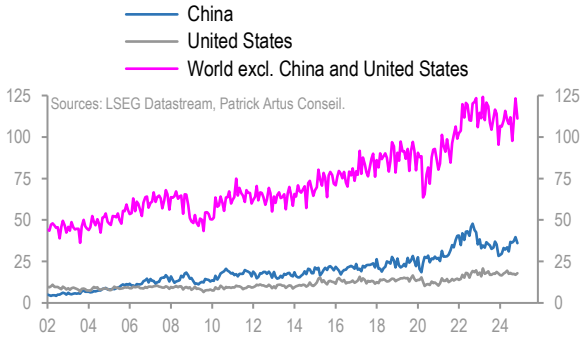
Chart 5
Euro zone: Gross disposable income of households (in volume terms)



2. European producers losing market share to other producers

Chart 6 shows **the value of euro zone imports of manufactured goods from** China, the United States, and the world excluding China and the United States.

Chart 6
Euro zone: Imports of manufactured goods (monthly data, EUR bn)



When we compare the growth in imports with that in **the value added in manufacturing** (**Chart 7**), we see a faster growth in imports from China and the world excluding China and the United States.

Chart 7
Euro zone : Value added in manufacturing (quarterly data, in value terms, EUR bn)



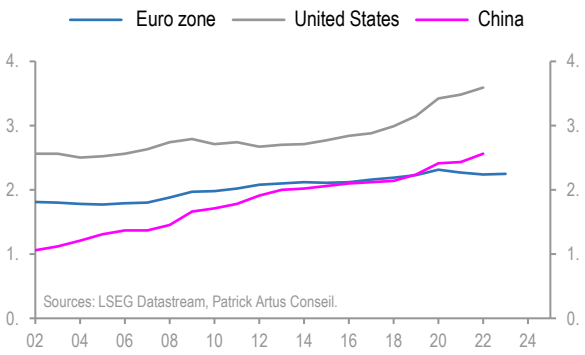
Since 2015, the excess production capacity available in industry, in China in particular, has caused a sharp rise in euro zone imports from China.

3. The lagging modernisation of the European industry

We can clearly observe:

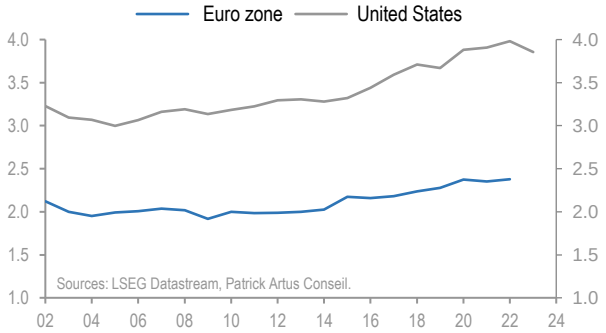
- **The euro zone's R&D deficit** compared with the United States and China quickly catching up (**Chart 8**);

Chart 8
Total R&D spending (as % of nominal GDP)



- **The euro zone's lagging investment in new** technologies (telecoms, IT, AI, etc.), **Chart 9**;

Chart 9
ICT investment including software
(in value terms, as % of nominal GDP)



- **The weakness of robotisation in the euro zone industry (Charts 10A/B)**;

Chart 10A
Stock of industrial robots (per 100 manufacturing jobs)

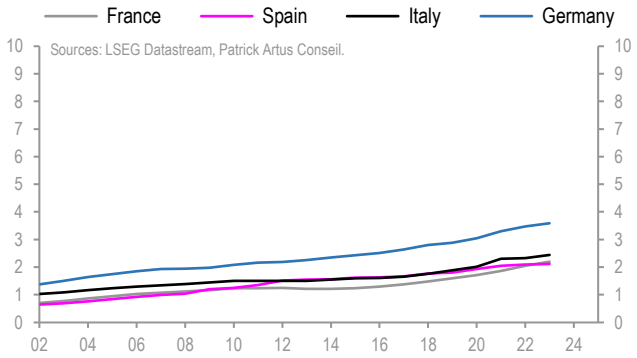
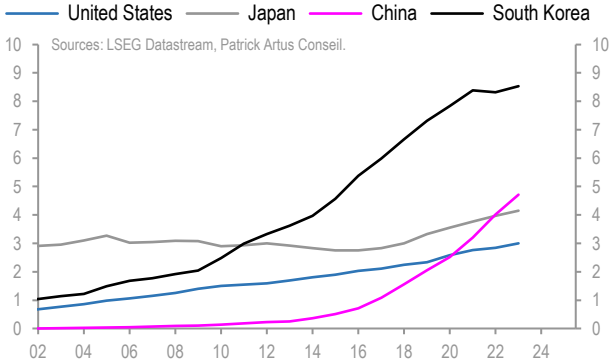


Chart 10B
Stock of industrial robots (per 100 manufacturing jobs)



and, overall, since 2018, the **stagnating productivity in the euro zone's manufacturing sector (Chart 11)**.

Chart 11
Euro zone: Productivity per head in the manufacturing sector (2002.Q1 = 100)



4. The problem of cost-competitiveness in the euro zone industry

Table 1 shows the level of hourly wages, including social security contributions, in the industry in various countries.

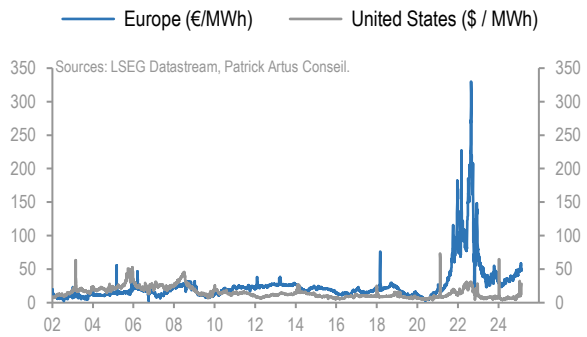
Table 1: Mean nominal hourly labour cost per employee in the manufactring sector (2023, USD)

Country	Mean nominal hourly labour cost (USD)
Thailand (2016)	1.7
Philippines (2019)	2.1
Brazil (2020)	2.5
Türkiye	5.8
China	9.5
Romania	10.5
Poland	14.2
Hungary	14.7
South Korea (2024)	21.1
United Kingdom (2019)	26.3
Spain	28.0
Italy	32.7
United States of America	43.7
France	48.2
Germany	49.7

Sources: ILO, LSEG Datastream

We see that labour costs in industry are much higher in the euro zone, particularly in France and Germany, than in emerging countries, the United States, Korea and China.
Since Russia's invasion of Ukraine, with the substitution of American or Norwegian LNG for Russian natural gas, the price of natural gas and energy has become much higher in the euro zone than in the United States (Chart 12).

Chart 12
Natural gas price



Summary: other weaknesses for the European industry

We have seen that the European industry suffers from a number of shortcomings: weak domestic demand, loss of market share to foreign competitors, inadequate R&D, investment in new technologies and robotisation, and poor cost-competitiveness.
One should add, to this list of weaknesses, the low skill levels of the working population in France, Spain and Italy (Table 2), the poor performance of the education system in scientific subjects and mathematics (Table 3), and regulations and measures unfavourable to industrial investment.

Table 2: Results of the OECD PIAAC survey (2023, in decreasing score order)

Country	Score
Japan	285
Germany	267
France	253
United States	251
Korea	246
Spain	246
Italy	240

Source: OECD

Table 3: Results of the PISA survey for the OECD (2022, maths score, in decreasing order)

Country	Mathematics score
Japan	536
Korea	527
Germany	475
France	474
Spain	473
Italy	471
United States	465

Source: OECD

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