WHY ARE PRODUCTION PRICES RISING?

The pandemic, now in its second year, has severely disrupted supply chains. And companies and suppliers continue to struggle to meet increasing rates of demand due to coronavirus impacts limiting availability of parts and materials. Also, things such as worker absenteeism, short-term shutdowns due to part shortages and difficulties in filling open positions may limit this sector's performance.

The EPTDA's members should know that the rise in input costs is being driven by the perception that supply chain constraints will not ease in the short term, industry executives said in a recent survey. Actually, input prices rose at their fastest pace in almost a decade in the eurozone's manufacturing sector in February, according to the Manufacturing Business Survey released by the Institute for Supply Management (ISM).

THERE ARE FOUR SUPPLY CHAIN HEADWINDS PLAGUING THE INDUSTRY THROUGHOUT THE PANDEMIC:

- slowing supplier deliveries,
- labor availability,
- material shortages,
- higher costs.

And all of these go hand in hand.

As demand for goods outstripped supply, **delivery times reached their highest level in almost two decades**. Therefore, many companies have cut back on production due to the **shortage of various products** (from semiconductors to steel), according to the most recent IHS Markit purchasing manager survey. The impact was felt hardest in the car, chemicals, metal and mining, resources and basic materials sectors.

For example, the shortage in semiconductors, which has been steadily worsening over the past year, is now reaching crisis point. Initially the problem was only a temporary delay in supplies as factories shut down when the coronavirus pandemic first hit. But now, even though the production is back to normal, there is a new surge in demand driven by changing habits fueled by the pandemic. This "perfect storm" hit the most companies in the tech and auto industries.

The shortage of skilled labor continues to be a problem for manufacturers. Short-term shutdowns and employee absenteeism are factors that impact the industry. Generous unemployment benefits funded by some governments, problems with child care during the pandemic and fears of contracting the virus, even with vaccines widely accessible, as well as pandemic-related retirements have been blamed for keeping workers home.

“Panelists continue to note significant difficulties in attracting and retaining labor at their companies’ and suppliers’ facilities. They want the people, it's just they can't find them, that's the problem. And you can't take a waitress or a bellboy and put them on a production line... it's a different type of work”, said Timothy Fiore, chairman of the ISM. “Consumption was clearly limited due to labor issues and supply constraints as demand remains very high. Inputs — expressed as supplier deliveries, inventories, and imports — continued to support input-driven constraints to production expansion, at higher rates (...), due to continued trouble in supplier deliveries”, Fiore added.

Also, due to product shortages, **many shipping hubs have become increasingly costly** and can only handle a limited number of products at a time. As a result, the cost of shipping a 12-meter container has more than doubled in the past decade. Lars Jensen at consultancy SeaIntelligence said: “It’s a bottleneck problem. These rates are being driven by customers fighting over a limited resource — containers.” Thousands of empty containers were left stranded in Europe and the US in the first half of 2020 when shipping lines cancelled hundreds of trips as coronavirus lockdowns caused a sudden slowdown in global trade. When western demand for Asian-made goods rebounded in the second half of the year, competition among shippers for available containers sent freight rates soaring.

Also, John Butler, president of the World Shipping Council, said: “We’ve gone from a tremendous drop-off to getting whipsawed into historically high cargo volumes and there’s now more than terminals can efficiently handle.” Congestion at ports is contributing to higher prices, with shipping lines charging extra fees to compensate for longer waiting times, he added. Pressure on maritime supply chains should ease “when people have more options to spend on services” because coronavirus-related restrictions have been lifted, Butler said — but “when that happens is anyone’s guess”.

On top of that, **energy and commodity prices are rising**. First of all, oil prices have risen to their highest levels since the early days of the coronavirus pandemic, with Brent crude - the benchmark for the European market - rising above $61 a barrel this week. This means that its price has almost doubled since June 2020.

Secondly, the global supply of copper is already running low, which leads to a spike in prices as demand rises, Bank of America analysts said. Already its price reached a nine-year high.

Thirdly, the cost of hot rolled steel in Europe hit its highest level since 2008 - for basically the same reason.

The situation is similar with polymers: EuPC, a trade body representing European plastics converters, says that companies across the continent have been reporting difficulties in getting the necessary raw materials to keep their production running, and alarmingly low stocks. “Since December 2020, the situation has worsened rapidly. Additionally, extreme weather conditions in the USA lead to production losses also affecting the European market. In addition, European producers have also been declaring increased numbers of Force Majeure cases in the past months, as the Polymers for Europe Alliance reported already in January,” explains EuPC’s managing director, Alexandre Dangis. “If the situation continues like this, more and more companies will have to reduce their production, leading in return to shortages of plastic products such as food packaging or parts for the construction or automotive industry,” says EuPC President Renato Zelcher.

And what about the future? Higher prices at the factory gate are expected to last for some time, partly due to the impact of the pandemic on demand for many services, which are expected to remain subdued.

HOW CAN YOU CONTROL THE RISING COST OF PRODUCTION

Luckily, there are few things that you can do in order to control the rising cost of production.

- Employee retention is critical. So going back to training, motivation, work environment and providing growth opportunities should help you with that.
- Careful planning regarding any type of construction is an important consideration, because the price of the raw materials is surging. So, choose wisely where you invest your money.
- Implement some energy savings strategies.
- Capital costs are increasing as well. So maybe this is not really the time to borrow money, if you do not really have to.

EUROPEAN COMMISSION'S APPROACH ON HELPING THE SUPPLY CHAIN COMPANIES

As a response to the pandemic, the European Commission updated the EU Industrial Strategy to `ensure that its industrial ambition takes full account of the new circumstances following the COVID-19 crisis and helps to drive the transformation to a more sustainable, digital, resilient and globally competitive economy`. Its main goal is to decrease dependency on key imports from outside the bloc.

Executive Vice-President Valdis Dombrovskis, responsible for An Economy that Works for People, said: "Resilient global supply chains are essential in times of crisis as they help absorb shocks and speed up recovery. As we emerge from the Covid-19 pandemic, our updated Industrial Strategy aims to leverage Europe's position as a global industrial leader in order to provide a competitive edge in digital and green technologies. We will seek cooperation with like-minded partners wherever we can to support open, fair and rules-based trade; reduce strategic dependencies; and develop future standards and regulations: all of which are critical for our economic strength. At the same time, we stand ready to act autonomously whenever we must to defend ourselves against unfair practices and protect the integrity of the Single Market."

Commissioner Thierry Breton, responsible for the Internal Market, said: "The real industrial revolution is starting now – provided we make the right investments in key technologies and set the right framework conditions. Europe is giving itself the means for an innovative, clean, resilient industry which provides quality jobs and allows its SMEs to thrive even during the recovery process."

Sources and further reading

- "Raw Materials Price Increase" by Dr Maurizio Bragagni MBA CDir FIoD
- "April 2021 Manufacturing ISM Report On Business" by the Institute for Supply Management (ISM)
- "The Supply Chain Talent Shortage: From Gap to Crisis" by DHL Supply Chain
- "Questions and Answers on the update of the 2020 Industrial Strategy" by the European Commission