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Supply chains still under pressure

Swiss economy

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- The war in Ukraine and the renewed lockdowns in China have recently led to rising purchase prices and extended delivery times.
- However, we expect the COVID-19 situation in China to ease and no further escalation of the Ukraine crisis, which should pave the way for a gradual normalization of supply chains over the course of the second half of the year.
- If, contrary to our expectations, the delivery of Russian gas and oil to Europe is completely halted or COVID-19 lockdowns are maintained in China, bottlenecks are likely to worsen. But the associated decline in demand would have a dampening effect, given that the Eurozone and, likely, Switzerland would fall into recession.

Causes of bottlenecks

As we outlined in our report "Are bottlenecks threatening the Swiss recovery?", the pandemic has led to bottlenecks in international supply and production chains. On the one hand, the procurement problems were due to high demand, driven by a broad desire for goods in the wake of the closure of the services sector. On the other hand, supply was limited due to reduced logistics capacities and situational production losses. As a result of the excess demand, delivery times have been extended and purchase prices have risen. This has been reflected in the monthly surveys of Swiss purchasing managers (Fig. 1).

Slight mitigation at the beginning of the year

After the robust growth last year, however, the demand for goods has weakened again. Consumption has shifted back to services, while pandemic-related catch-up demand is lower than last year. As a result of the normalizing of order backlogs, delivery problems have alleviated somewhat. The improved supply situation has also had a mitigating effect. Production has increased, which, together with the continuing recovery in air traffic, has improved delivery times.

The war in Ukraine is causing prices to rise

As a result of the Russia-Ukraine war, the procurement situation has deteriorated again. Russia's share of world GDP is less than 2%, and Russia is not one of the top 20 trading partners of the Swiss economy. That said, Russia is a major exporter of energy, metals, and fertilizers. Together with Ukraine, Russia also accounts for around 20% of global exports of agricultural commodities.

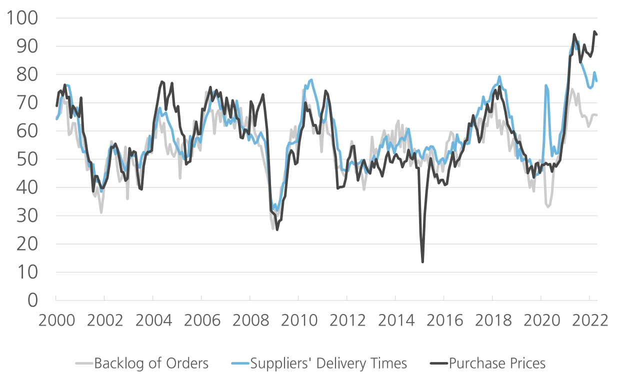
Due to the looming threat of further cutoffs in Russian energy supplies and self-sanctions by Western energy companies, commodity prices have risen sharply, which has also had an impact on the purchase prices of Swiss companies. According to the survey of Swiss purchasing managers (PMI) conducted in April, almost 90% of companies have recorded rising purchase prices. Cargo planes are also having to fly around Ukraine because of the war, further increasing freight costs and extending delivery times.

Bottlenecks less pronounced than in 2021

The extent of the delay in deliveries has so far been less pronounced than during the pandemic. The corresponding

PMI sub-index of "delivery times" is below the previous record level of May 2021 and even retracted slightly in April. The economic impact of the war in Ukraine is mainly being reflected in rising commodity prices. Supply bottlenecks, on the other hand, are likely limited to individual areas such as the manufacturing of metals and chemicals or the food sector, all of which are dependent on Russian raw materials or source raw material-intensive preliminary products.

Fig. 1: War in Ukraine and lockdowns in China are exacerbating procurement situation
Selected PMI subcomponents



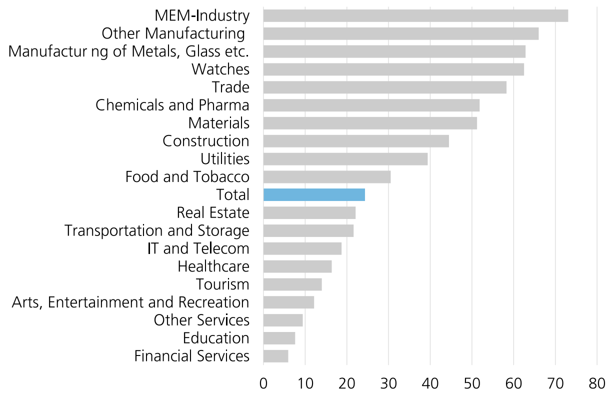
Source: Macrobond, UBS

Lockdowns in China increase uncertainty
The procurement situation of companies is also burdened by the lockdowns in China, which were introduced in response to the rising number of COVID-19 cases there. The impact of the new coronavirus measures on international supply chains is difficult to assess. First, data on port utilization and container trade paints a mixed picture. Second, it is unclear how long these measures will be maintained or whether they be implemented in other cities.

In contrast to its approach to previous COVID-19 waves, China's zero-tolerance policy is currently somewhat more flexible. Workers are in so-called closed loops, which ensure that most factories remain open and ports continue to operate. Nevertheless, the mobility restrictions introduced are likely to have a negative impact on logistics, which will worsen the international procurement situation of industries with complex supply chains such as the automotive, electrical, and mechanical engineering industries (MEM-industry). According to a UBS survey conducted at the beginning of March, around two-thirds of the companies surveyed in these sectors see the procurement situation as a strong, or even very strong, challenge (Fig. 2).

In the short term, bottlenecks may worsen,...
A worsening of the procurement situation in the short term cannot be ruled out because of the lockdowns in China. However, we expect the current coronavirus wave in China to flatten out in the coming months, which would enable the procurement situation to ease in the course of 2H22.

Fig. 2: Industries differently affected by bottlenecks
Share of surveyed companies that see bottlenecks as a strong or very strong challenge, in %



Source: Intervista, UBS

... in the medium term, we expect normalization
Nevertheless, it will probably take even longer for value chains to return to normal. Production and delivery capacities can only be increased gradually. Moreover, due to the various uncertainties, companies are likely to increase their inventories, which keeps demand high. We are confident, however, that international supply chains will normalize in the medium term, as supply and demand settle back into more normal patterns. We expect the war in Ukraine and the lockdowns in China to have only temporary effects on supply chains.

Risks headed downward
If, contrary to our expectations, there is a further escalation in the war in Ukraine and a complete halt in the delivery of Russian energy to Europe, the bottlenecks are likely to worsen significantly and production losses would be inevitable. In such a scenario, sectors that are energy-intensive, such as the production of metals and papers and the chemical industry, would not be the only ones likely affected. A sudden cutoff of Russian energy would also hit sectors that purchase such products (e.g., the construction, automotive, electrical, and mechanical engineering industries), as well as the manufacturing of consumer goods via second-round effects.

A sudden and complete halt to the delivery of Russian energy supplies to Europe would probably push the Eurozone into recession, and with it, Switzerland. If a recession were to materialize, however, the demand for goods would also likely fall, which would have a dampening effect on the procurement situation.

Appendix

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