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Macroeconomics

The focus of international politics has changed relatively little over the past two weeks. The centres of conflict in Ukraine, the Middle East and, to a lesser extent, the Pacific region around Korea and Taiwan continue to dominate the discussion. In each case, the media and the public's attention is focused on where the fire is greatest.

Apart from the horrors of war, the events in the Middle East are attracting a lot of economic attention because they significantly hinder international shipping, and this in turn has massive consequences for everyone who depends on it. I the conflict were to continue to spread, energy prices would certainly rise significantly again, which would not be good news for inflation, especially in view of the experience of recent years. At the moment, no effects can be seen and the oil price remains relatively low. Nevertheless, the slightest spark could be enough to change that.

While China is taking a relatively clear political stance in the Ukraine conflict, the situation is considerably more complicated in the conflict between Israel and Palestine. The consequences of the multi-layered interests in the region cannot be welcomed in China either. In particular, the disruption to shipping traffic is a significant problem for China's economy.

Both the German and Chinese economies are stuttering. If two economies of this size have problems and these cannot be resolved quickly, then this cannot remain without negative consequences for the entire global economy. At the moment, people are still very relaxed about it and see it as a local problem, but if you mix all the ingredients together, including the disruption to shipping and a possible escalation leading to rising energy prices, it would be a mixture that would be extremely damaging.

Two interesting statistics have come from China recently. Firstly, producer prices fell by almost 6%, confirming the deflationary trend in China, and this was followed by the news that Chinese banks granted record volumes of loans in January. Obviously, the government realises more than ever that it is essential to steer the economy and consumption back on an expansionary course. The most recently published growth figures in China should always be viewed with a degree of caution.

In the meantime, the financial markets are paying relatively little attention to these problems and share indices remain close to their record highs. People are looking more and more at the interest rate decisions of the Federal Reserve and European Central Bank and making their investment decisions based on them. Even if one were to be guided only by these parameters, a second thought would certainly be appropriate. At the moment, all banks and so-called experts are firmly convinced that interest rates in both Europe and America will fall significantly again in 2024. The discussion is now only about when and by how much.

If you look at the possible scenarios and take into account the increased cost of international transport, then the hope of a rapid and significant interest rate cut could possibly be in vain.

As mentioned at the beginning, the stock markets are moving in very narrow ranges. Particularly in the technology sector, there are always considerable increases, which make the indices look better than they actually are.

The price of gold has managed to stay above the magic mark of $2000 per ounce, but further gains, despite all the crises, are not on the cards.

The oil price is not rising significantly, and this is probably due to the fact that the economic outlook is rather subdued and at the same time cheap Russian oil continues to flow onto some markets and is readily accepted by buyers in a number of countries.

After the Federal Reserve came out with no rapid and significant interest rate-cut, the dollar gained somewhat against the euro and the euro slipped below the $1.08 mark on a sustained basis. However, this currency comparison also remains within very narrow ranges.

Leather Pipeline

After all the rather negative developments of the past few months, it is perhaps time to look at possible scenarios for the future. We have made our rather pessimistic assessment regarding the use of leather as a material more than clear in recent times and have tried to justify it.

Demand is definitely the important part of the equation when it comes to reaching a conclusion about the situation of the leather pipeline, but we should never lose sight of the fact that all markets will, sooner or later, return to equilibrium. If this thesis is fundamentally correct, then it is perhaps quite sensible to think about the path ahead and what that equilibrium could look like.

First of all, it is certain that leather will continue to be produced for many years to come and that there is no reason to fear the end for the industry. It is much more a question of which types of leather, or rather in which price segment, and possibly where they can be produced and processed. After all, leather is not a uniform product, and its diversity, its different properties and uses determine the use of different articles. This means that the often very generalised statements about the market and the pipeline are rarely really correct. The production of and demand for leather does not develop in a linear way for all raw materials and products.

In addition to the purely economic parameters of price and quantity, the general environment with regard to raw material and production conditions also plays a decisive role today. Without going back over the details and our fears, we can at least say that the bureaucratic conditions, the certification requirements and the intentions of legislators, particularly in Europe, are making leather a much more expensive product and therefore making a large proportion of leather production in Europe much less competitive.

There are three major areas for leather production. Firstly, the luxury sector, which produces luxury goods from expensive raw materials using high-quality, expensive production processes. The added value is immense and therefore there are no major problems in passing on the increased production costs. There is also a very good price for the raw material as revenue for the meat industry.

The next sector is the one in which the European leather industry has been very successful in recent years. The middle-to-higher-price segment, which is (or has been) exported successfully to many countries around the world. It is neither a mass product, nor a niche product, but good-quality material and finished products that hold (or held) appeal for the buyer. In return, slightly higher production costs and a higher cost of sales can (or could) still be achieved. Lastly, there is the large-scale mass production for global consumer goods, which can only be produced with low-price raw material input and low mass production costs.

The greatest decline and the strongest price pressure can be seen in the middle segment. Inflation was always a better phase for leather in the past; it was easier to push through higher prices. However, this is no longer the case because the demand for leather as a material is unfortunately shrinking and, in particular, the middle-class is cutting spending on non-essential products. This has put additional pressure on prices as consumption declines. If you then consider the trend in one of the world's largest markets, China, then it becomes clear that the middle price segment is the one that is currently suffering the most. The quality that is expected and the differentiation from the mass market generates higher production costs and, at the same time, the raw material suppliers are trying to defend their price advantage to the last. This has led to extraordinary difficulties and promises little success either at the moment or in the near future.

In the price-sensitive market of mass production, leather can still defend its market share, helped by low prices. Therefore the position of producers in countries with lower production costs, in combination with cheap raw materials, is easier to defend.

A fundamental mistake that is always made, especially by European raw material producers, is the conviction that they can still defend the price advantage that they have been used to for so long. They may be able to displace other origins with the better quality, but if the finished leather does not achieve a significantly higher price, then the price advantage simply shrinks.

According to our assessment and analysis, this is exactly the process that is currently taking place. For those who have been defending their prices for too long, this could be a very painful experience, because a simple swing back doesn't look too likely. The only solution, one that has been anticipated for so long, would be a recovery in the demand for leather, a renaissance in consumer awareness of the value of the material and of the quality differences, and thus the possibility of achieving higher prices again.

However, there are very few signs of this at the moment and, above all, time is running out for many in the European leather industry. Many parameters would have to change quickly for there to be sufficient space in the market for all producers again. It is also important to emphasise the strong price pressure in China, which does not offer any great potential for the category below the luxury segment at the moment. Restricted trade with Russia owing to sanctions is another problem in this segment.

There are many indications that the market structures that have developed over the last 20-25 years are now facing a reorganisation. Anyone affected by this would probably be well advised to analyse this situation clearly for themselves and their own company. For the leather industry, we have had a very long phase without any major upheavals or adjustments.

Globalisation and growing prosperity in many countries created growing markets for European brands and consumer goods. Only great creativity, dynamism and improved production conditions in Europe could make one think a rapid improvement was possible. If you look at what is currently being emphasised in politics and also in many companies, it would take a great deal of optimism to believe in a change for the better any time soon.

For the rest of the leather production and consumer goods markets, prices will probably remain under pressure for some time. With adjusted raw material prices and favourable production costs, there still seem to be sufficient markets for leather products in the near future. Of course, the fact that potential alternative materials have not yet been able to compete in terms of price with low-cost leather is particularly helpful here.

We still have no really big news to report from the split market. If anything, developments on the gelatine and collagen markets are playing a more significant role. Owing to insufficient demand from the leather industry, new and direct production flows directly from hides into gelatine and collagen have emerged. However, the markets for gelatine and collagen have not grown enough to absorb all the finished product available at the moment. There is also considerable price pressure here.

In our view, there is a very interesting development in sheepskins. Owing to weak demand and very low prices, a situation has now arisen after many years, which we have already pointed out as a possibility for the cattle hide sector. There is no longer any great pressure to sell because the hides have now found other uses, and processing and preservation is no longer an interesting option for the leather industry. This means that prices are not rising, but one or two tanners who were used to getting everything at their desired prices in recent years are now confronted with the situation that they can no longer get any supply at all; the goods are simply no longer available. The consequences of this over the next few years will be very interesting indeed, as it could well be an indication of how things will continue with hides.

We expect little interesting news in the coming weeks. This is partly because of the fact that the New Year will be celebrated in Asia over the next two weeks and here in Europe we are now waiting with great interest for the Lineapelle exhibition in Milan (February 20-22), from which we always expect a lot. There is still a belief that some sudden and surprising news will be found there that will trigger big changes for the coming months. As we all know, this is rarely the case; in fact it seems big changes no longer take place at trade fairs.

Nevertheless, we will travel to Italy with a great deal of curiosity because there is no doubt that face-to-face meetings still make a huge difference. In addition, of course, you can also get an overview of how the industry as a whole is doing, and of what opinions, hopes, expectations and plans companies have. And, of course, there is always the hope that somewhere there will be that small and decisive spark that suddenly triggers a completely new and unexpected development.

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