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The Manufacturers' Organisation

MANUFACTURING OUTLOOK

2019 QUARTER 3

With support from:

Scottish Engineering

MakeUK.org

FOREWORD

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Most readers will have heard of Operation Yellowhammer, the codename for the Government's base-case assessment of a no deal Brexit. The name is a reference to The *Yellowhammer's Nest* by the 19th century English Romantic John Clare. Clare's poem narrates the travails of a Yellowhammer bird, a species currently endangered because it struggles to survive in winter.

The next phase of Operation Yellowhammer will be Exercise Yellow Rehearse, a no deal Brexit practice-run to be carried out in early October.

UK manufacturers are similarly preparing for a hard Brexit and a potentially harsh winter.

Since the new government took office there has been a clear increase in no deal preparations and discourse. While the Government's preparations to date are welcome, the unprecedented nature of Brexit means some consequences cannot be mitigated in advance.

The previous postponements gave some companies, particularly SMEs, more time to work on plans they were unable to complete by March 29th, such as making regulatory applications to EU agencies.

However, more firms have experienced a drop in export orders this quarter as Brexit fears lead foreign customers to source goods from elsewhere that they previously bought from UK producers.

As this edition of *Manufacturing Outlook* demonstrates, there has consequently been a clear weakening in the performance of firms, particularly in terms of output, investment, and employment intentions.

Brexit has been blamed after the ONS recently revealed that GDP shrank by 0.2%. The last time this country suffered falling GDP was during the worst days of the Global Financial Crisis.

If manufacturers' stockpiling hadn't artificially boosted output in Q1 the economy would already have entered negative growth for the year. As it is, the Bank of England has warned that crippling uncertainty and slowing international trade suggest we have a one-in-three chance of entering into recession by the start of 2020 anyway, regardless of what now happens with Brexit.

Sterling fell by 10% following the 2016 referendum but then stabilised. Recently the pound has begun sliding again, down a further 7% in the last 3 months.

Lower Sterling makes some UK exports more competitive, but British manufacturers source many of their inputs from overseas so if the depreciations of 2008 and 2016 are any guide, the main effect will be increased inflation – something we're now beginning to see.

Indeed, as this edition shows, export prices have been cut but so have export orders, signalling that foreign customers are buying fewer UK goods than before even though they're now cheaper – down 6% since last quarter.

The tightest labour market on record (76.1%) has seen manufacturing wages increase 2.4%, but the labour market tends to lag developments in the wider economy. Shrinking profit margins and worsening productivity suggest pay growth may soon start to slow. It is already on track to complete the weakest decade since the end of the Napoleonic Wars in the 1810s (when John Clare was writing his poetry).

The number of vacancies has been dropping since the start of the year. There are now 126,000 fewer people (net) employed in manufacturing jobs today than there were at the time of the Brexit referendum in June 2016. These statistics clearly indicate that our sector is on a downward trajectory.

In every region, companies are cutting back on investment in transport equipment, factory machinery, and IT, just at the point in the economic cycle when spending would normally increase. This reflects declining confidence ahead of a potential hard Brexit coinciding with worrying global trade conditions.

On current trends the economy, and the manufacturing sector in particular, looks headed towards a very challenging winter.

HEADLINES

In the first quarter of 2019, *Manufacturing Outlook* showed stockpiling activities had reached the highest level ever recorded in the G7. Imports, we now know, rocketed up by a whopping 11% while demand for warehouse space shot up by an unprecedented 32%.

This monumental surge was inevitably followed by a slump as firms ran down the surpluses they had earlier built up.

Investment in technology and skills training – the real engines of economic growth – has been paralysed all year but worryingly investment intentions have now entered negative territory for the first time since Q3 2016 (the period immediately following the Brexit referendum).

Export prices are down but so too are export orders signalling that foreign customers are choosing not to buy as many UK goods anymore even though they're cheaper. UK prices have also been cut as have both export and domestic profit margins, meaning firms are feeling the squeeze.

INDICATOR	BALANCE	CHANGE	
Confidence	5.8	↓	Confidence has fallen since Q2
Output	4%	↓	Output balance down sharply but still positive
UK orders	-6%	↓	Domestic orders down and negative
Export orders	6%	↓	Exports continuing to trend down at the lowest in three years
Employment	6%	↓	Recruitment balance down but still much higher than investment
Investment	-1%	↓	Investment intentions weak and now in negative territory

Source: Make UK Manufacturing Outlook Survey

To that end, for the last two quarters in a row, domestic orders had exceeded export orders, not because domestic customer demand went up but because export customer demand went down. Now, by contrast, export orders have returned to a level above domestic orders, not because export orders have increased, however, but because domestic orders have fallen further still.

Both domestic and export orders have contracted this quarter, for the third quarter in a row. At the very time we need to be trading more, our survey results and members reports indicate that foreign customers are abandoning their British suppliers due to Brexit uncertainty and this is having knock-on consequences for domestic demand as well.

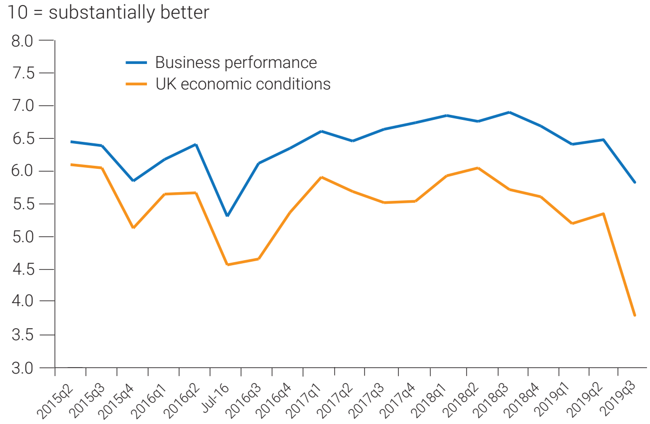
Members expect UK demand to remain in negative territory next quarter as order books continue to shrink and they are also anticipating another decline in export demand from foreign customers.

Manufacturing employment intentions have continued the decline witnessed for the last four quarters (six if we discount the annual increase that came in the Q4 Christmas season last year).

Unsurprisingly, therefore, both firm level and UK economy level confidence have fallen significantly this quarter with the level of confidence in the overall economy down by almost a half versus the last quarter. Manufacturers are not optimistic about the economic future.

Confidence has collapsed

Confidence in the next 12 months 1 = substantially worse, 10 = substantially better



Source: Make UK Manufacturing Outlook Survey

OUTPUT

As we approach the final quarter of 2019, this year we have witnessed a 22% increase in output in Q1 followed by a 17% contraction in Q2, both of which demonstrate the way Brexit has artificially distorted the economic performance of the manufacturing sector throughout the year.

Our *Manufacturing Outlook* survey in Q3 shows that while it has remained positive for the twelfth consecutive quarter, output has nevertheless contracted by three-quarters when compared to our last edition.

In contrast to our Q1 results, our current edition – which also covers a period in which we would expect to see the beginnings of stockpiling activities ahead of the next Brexit deadline in October – does not show many firms increasing production in order to prepare.

Many warehouses are already overstocked due to this Brexit deadline coinciding with the always busy Christmas period so, as the Brexit deadline approaches, the issue of storage capacity will limit a manufacturer's ability to raise production to the same extent as in Q1 this year. This change in circumstances from the run-up to the initial EU exit date last March could partly explain the current 4% result. Regardless of this challenge, for the next three months prospects remain marginally positive, with a balance moving towards 8%.

Reviewing individual subsectors, and in contrast to our results in Q2, a number of key sectors have reported negative balances this time – though, as always, the relevant subsectors' individual performances are not homogenous.

The most noticeable change since Q2 is observed within the Base Metals subsector which reported a negative 71% in balance. This is primarily a consequence of the British Steel crisis which has only just been resolved at the time of writing. The Metals sector is still showing signs of struggle but firms in the sector are now looking more optimistic, despite the fact they anticipate output remaining in negative balances for the foreseeable.

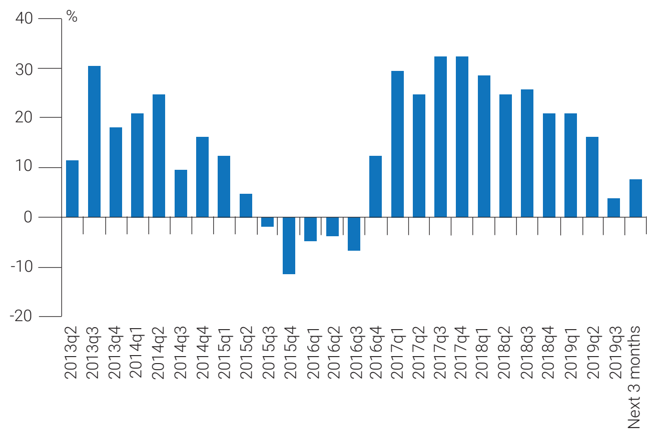
After experiencing a strong pick up in the previous two quarters, achieving a 39% balance in Q2, the mechanical sector has retreated back to negative territory. This is in line with expectations from our last report and reflects the overall challenges faced by the sector due to weaker trade and lower UK investment.

Electronics, Electrical equipment, and Rubber & Plastics all reported scores which were generally in line with expectations from Q2. Nevertheless, the latter sector, Rubber & Plastics, is far less optimistic than observed within our last report, where it reported a 60% balance as opposed to now predicting a negative balance in the next three months.

As per previous *Manufacturing Outlook* editions, Electronics performed well and expects to remain in positive territory in the next three months, thanks to the ongoing global demand for automation systems which have made this subsector essentially recession-proof in recent quarters, when compared to the rest of the manufacturing industry.

Output down from Q2

% balance of change in output



Source: Make UK Manufacturing Outlook Survey

Output summary

% balance of change

SECTOR	PAST 3 MONTHS	NEXT 3 MONTHS
Basic Metals	-71%	-33%
Metal Products	-13%	-2%
Mechanical	-2%	8%
Electronics	24%	38%
Electrical	21%	7%
Rubber & Plastics	14%	-18%
TURNOVER		
£0-9m	15%	3%
£10-24m	-4%	-2%
£25m and over	9%	-28%

Source: Make UK Manufacturing Outlook Survey

ORDERS

The total orders balance fell by approximately three quarters since Q2, moving from 8% to 2%, a result exceptionally far from the peak of 37% that was achieved in the second half of 2017.

Earlier this year domestic orders surpassed exports for the first time since Q4 2016. However, domestic orders have now weakened substantially and export order growth has also reduced to 6%.

The last edition of *Manufacturing Outlook* showed a weak export market but one which was hidden by other factors. Although our export performance remains weak, its poor score is no longer masked by strong domestic orders.

For eleven consecutive quarters, domestic, export, and total orders have all been in positive albeit in weakening territory. Now, Q3 2019 marks the first month where UK orders have finally turned negative.

Ominously, expectations for the next three months are similar to those reported this quarter, with manufacturers expecting no pick-up and export orders to fall again.

Additionally, UK orders are expected to remain in negative territory, a reflection of the anxiety felt by the industry as we approach October 31st. Lastly, in our previous edition Make UK members told us they expected the gap between orders and output to come to an end due to the slowdown in activities. In Q3, with total orders at 2% and output at 4% this expectation is looking increasingly correct.

UK ORDERS

UK orders fell to -6% the lowest value reported since Q2 and Q3 of 2016 when firms set themselves in a holding pattern until the referendum result came in. As mentioned previously, domestic orders have been less volatile relative to the change in export orders.

UK ORDERS	PAST THREE MONTHS	↓	-6%	NEXT THREE MONTHS	↑	-4%
EXPORT ORDERS	PAST THREE MONTHS	↓	6%	NEXT THREE MONTHS	↓	5%
TOTAL ORDERS	PAST THREE MONTHS	↓	2%	NEXT THREE MONTHS	–	2%

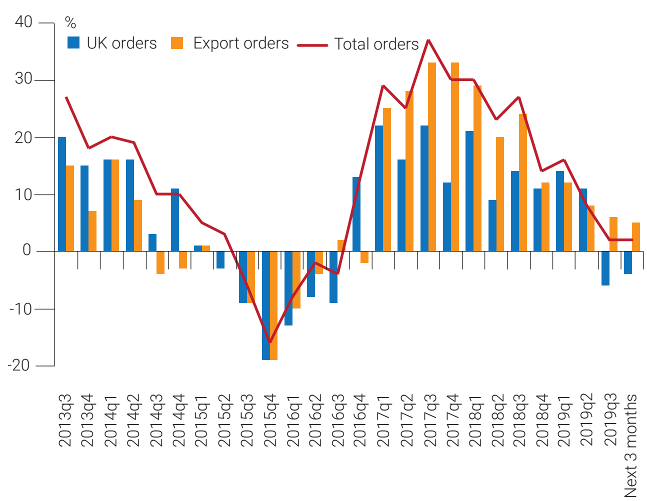
Following on from our Q2 results, in Q3 many sectors have reported below the zero threshold, in particular Basic Metals which reported major difficulties from both domestic and international markets, with an extremely negative balance of -86% and -60% respectively. This result seems largely a result of British Steel's difficulties and that firm's importance to the wider Basic Metals subsector.

On the other hand, Electronics represents the only subsector within the top five samples to experience a positive balance on domestic orders which also underpins their positive output balances. Electronics has long been an outlier when compared to the rest of UK manufacturing owing to its more niche global market as a provider of inputs for automation technology.

Mechanical Equipment, Electrical Equipment, and Rubber & Plastics each came in at -4%, -7% and -5% respectively, with expectations for two of these sectors to fall even

Total balance down with domestic orders now negative

% balance of change in orders



Source: Make UK Manufacturing Outlook Survey

further over the next three months. Electricals is the one outlier here, with respondents to our survey more optimistic about domestic orders than respondents for the other subsectors.

EXPORT ORDERS

The study of exports remains a key theme in many of our *Manufacturing Outlook* reports. In 2017-2018, export performance resulted in strong expansion across the industry before reverting to negative territory in recent quarters.

Q3 reports a similar story as exports continue on the path of poor performance falling from 12% in Q1 to 8% in Q2 and now reaching 6%. Companies continue to struggle as export partners delay or cancel orders until they have further clarity on Brexit. Additionally, there are increasing concerns about foreign customers switching away from the UK to new supply chains elsewhere, resulting in greater challenges to be faced post-Brexit when exporting will inevitably remain a key priority.

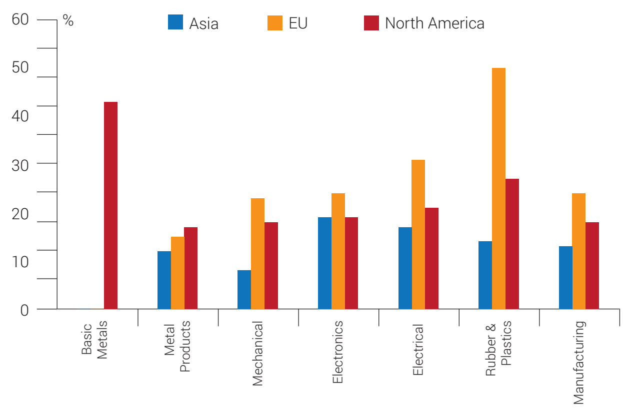
Compared to domestic orders, more subsectors reported a positive balance in international markets. This includes, Mechanical Equipment, Electronic Equipment, and Rubber & Plastics. Expectations for these sectors look set to remain in positive territory. However, Basic Metals remained deep in negative territory due to the disadvantageous position the sector occupies in the middle of ongoing global trade wars. Metal products have also followed basic metals into negative balances in export orders as both sectors face similar challenges.

Electronics maintained a positive balance of export orders at 6% but, because this sector relies heavily on foreign markets, it remains challenged by the ongoing tensions between the US and China, as well as a lack of clarity on the UK's post-Brexit trade terms. Nevertheless, the subsector is optimistic about the future as they expect to maintain stability going forward.

Unsurprisingly, however, manufacturers continue to see EU as their most important market. The export market top three is then completed by North America and Asia, which has retained its third place since being momentarily usurped by the Middle East in Q1. This is due to the failure of the Middle East to maintain its levels of trade in the midst of ongoing political tensions within the region rather than an uptick in the other regions. Noticeably, the balances reported across all three regions have weakened highlighting a general softening of export markets for UK manufacturers as we approach 31st October.

Trade tensions are impacting business

% of companies reporting positive demand conditions by market



Source: Make UK Manufacturing Outlook Survey

Orders summary

% balance of change

	UK ORDERS		EXPORT ORDERS		TOTAL ORDERS	
SECTOR	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS
Basic Metals	-86%	-17%	-60%	-20%	-86%	-29%
Metal Products	-23%	-4%	-20%	-18%	-23%	2%
Mechanical	-4%	-5%	16%	10%	3%	7%
Electronics	10%	20%	6%	6%	33%	5%
Electrical	-7%	14%	-8%	38%	-14%	14%
Rubber & Plastics	-5%	-23%	24%	0%	14%	-20%
TURNOVER						
£0-9m	-5%	-11%	9%	6%	10%	1%
£10-24m	-13%	-6%	-9%	-5%	-11%	-10%
£25m and over	-9%	-2%	24%	10%	7%	8%

Source: Make UK Manufacturing Outlook Survey

EMPLOYMENT & INVESTMENT

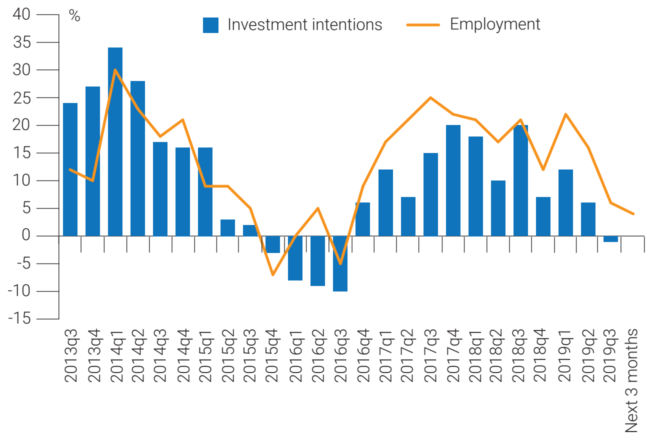
The slow-down seen in Q2, as the unprecedented pre-March 29th (and then April 12th) stockpiling levels were wound down, has been sharp, severe, and long lasting.

As firms have reduced their output their spending elsewhere has almost ceased also. The Bank of England calculates that UK productivity has been reduced by up to 5% and our economy has lost between 2-3% of growth over the past three years because Brexit fears have reduced capital spending by about 11% per firm on average.

Meanwhile, investors have withdrawn more than $4.2bn from UK equity funds since Theresa May announced her decision to step down as Britain's Prime Minister. Fears that the UK is heading for a no-deal Brexit has caused heavy withdrawals this year which in turn have prompted the UK regulator to demand daily updates from asset managers amid fears of a potential liquidity crunch similar to that which prompted property funds to suspend trading in the months after the 2016 Brexit vote. For manufacturers, this means both employment and investment intentions have worsened since last quarter.

Employment down and investment is negative

% balance of change



Source: Make UK Manufacturing Outlook Survey

EMPLOYMENT	PAST THREE MONTHS	↓	6%	NEXT THREE MONTHS	↓	4%
INVESTMENT	NEXT TWELVE MONTHS	↓	-1%			

In fact, investment intentions are now in negative territory for the first time since Q3 2016, the period immediately following the shock Brexit referendum result.

As has consistently been the case since the Brexit referendum period, employment intentions are still higher than investment intentions, with companies more willing to spend their money recruiting new staff than on other, less fungible, assets such as new factory machinery or office IT equipment. This is a clear sign of a lack of confidence affecting the sector. Firms are avoiding spending much needed cash on costs that cannot be easily recouped if needed.

Consequently, business investment is now set to contract overall in 2019 adding to the contraction witnessed last year as well.

Ominously, companies are cutting back on investment in transport equipment, factory machinery, and IT, just at the point in the economic cycle when spending would normally increase.

Employment and investment summary

% balance of change

	EMPLOYMENT		INVESTMENT
SECTOR	PAST THREE MONTHS	NEXT THREE MONTHS	NEXT TWELVE MONTHS
Basic Metals	-43%	-14%	-57%
Metal Products	-3%	-2%	-23%
Mechanical	19%	-2%	2%
Electronics	10%	24%	12%
Electrical	-7%	-7%	7%
Rubber & Plastics	5%	5%	14%
TURNOVER			
£0-9m	7%	5%	-16%
£10-24m	2%	0%	-14%
£25m and over	5%	-7%	9%

Source: Make UK Manufacturing Outlook Survey

The number of vacancies has also been falling with fewer now than there were this time last year. In addition to this six month of consecutive contraction in the number of jobs on offer, as per the two previous editions of *Manufacturing Outlook*, much of what new hiring has occurred in the sector seems to be for part-time or contract workers rather than permanent employees.

Basic metals continues to be the worst performer as the effects of the British Steel crisis reverberate throughout the industry, with knock-on effects for the performance of Metal Products as well. The Basic Metal industry's balance for employment for the next three months is -14% and investment intentions balance is a horrific -57%.

By contrast, Electronics is, yet again, above the manufacturing average with an investment balance of 12% and an employment balance of 24%. Electronics continues to benefit from its more resilient order book thanks to the fact the subsector caters to the growing desire of firms around the world to adopt automation.

To highlight once more how uncertainty about the post-Brexit future is impacting firm-level performance, only large firms with a turnover of £25m+ have positive investment intentions for the next twelve months, on average. Micro, small, and medium sized business all report negative investment intention balances for the coming year. On the employment front, however, the intentions are in reverse – large firms employment intentions are -7%, mid-sized firms are a neutral 0%, while small and micro employers have a 5% employment balance.

PRICES & MARGINS

Last quarter we saw UK and export prices move in opposite directions, with the former up by 19% and the latter down by 11%. Our third release of the year reports a substantial fall in both UK and export prices, at 8% and 6% respectively. In this case, export prices performed to the expectations of Make UK members whilst UK prices fell much further than anticipated.

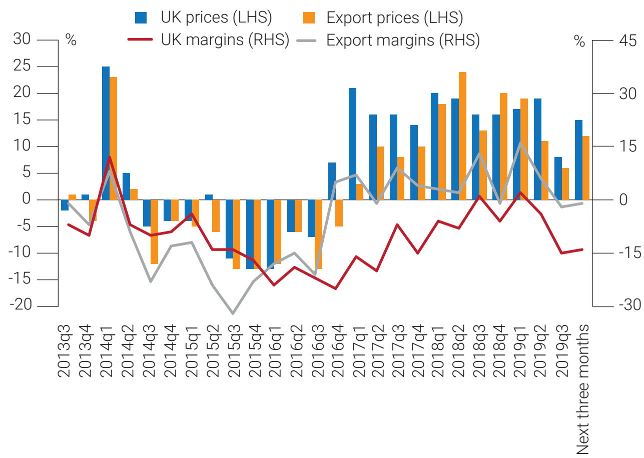
Not only have UK prices fallen sharply, UK margins have leaped further into negative territory as the international markets continue to perform better in this area.

Yet, expectations for the next quarter are optimistic about price rises returning to their original trend and margins improving slightly, although margins will remain in negative territory.

Nevertheless, margins between the UK and export markets continue to diverge. Manufacturers focused on domestic markets are increasingly being squeezed by

Margins in negative territory

% balance of change



Source: Make UK Manufacturing Outlook Survey

UK PRICES	PAST THREE MONTHS	↓	8%	NEXT THREE MONTHS	↑	15%
EXPORT PRICES	PAST THREE MONTHS	↓	6%	NEXT THREE MONTHS	↑	12%
UK MARGINS	PAST THREE MONTHS	↓	-15%	NEXT THREE MONTHS	↑	-14%
EXPORT MARGINS	PAST THREE MONTHS	↓	-2%	NEXT THREE MONTHS	↑	-1%

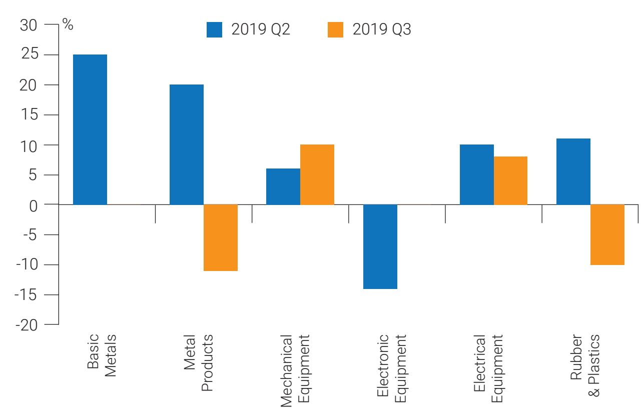
the cost of inputs coming from abroad as well as the tightest labour market on record pushing up wage costs.

On top of this, in the last three months the Brent Price maintained its unpredictable nature varying between $64 and $70 since May and continues to be affected by international trade worries emanating, in particular, from the Middle East. In addition to a general global trade slowdown, the dispute between the US and Iran has led to a global slowdown in demand for oil. These developments will need to be watched closely as they are a matter of great importance for prices and margins.

This squeeze on firms' profitability deepened immediately after the change of Government in Westminster leasing to a further reduction in value of already weak Sterling. This will continue to be a primary challenge for importers of commodities and raw materials – which most UK manufacturers are – and will prove particularly difficult for SME manufacturers.

Another mixed bag of results for exporters

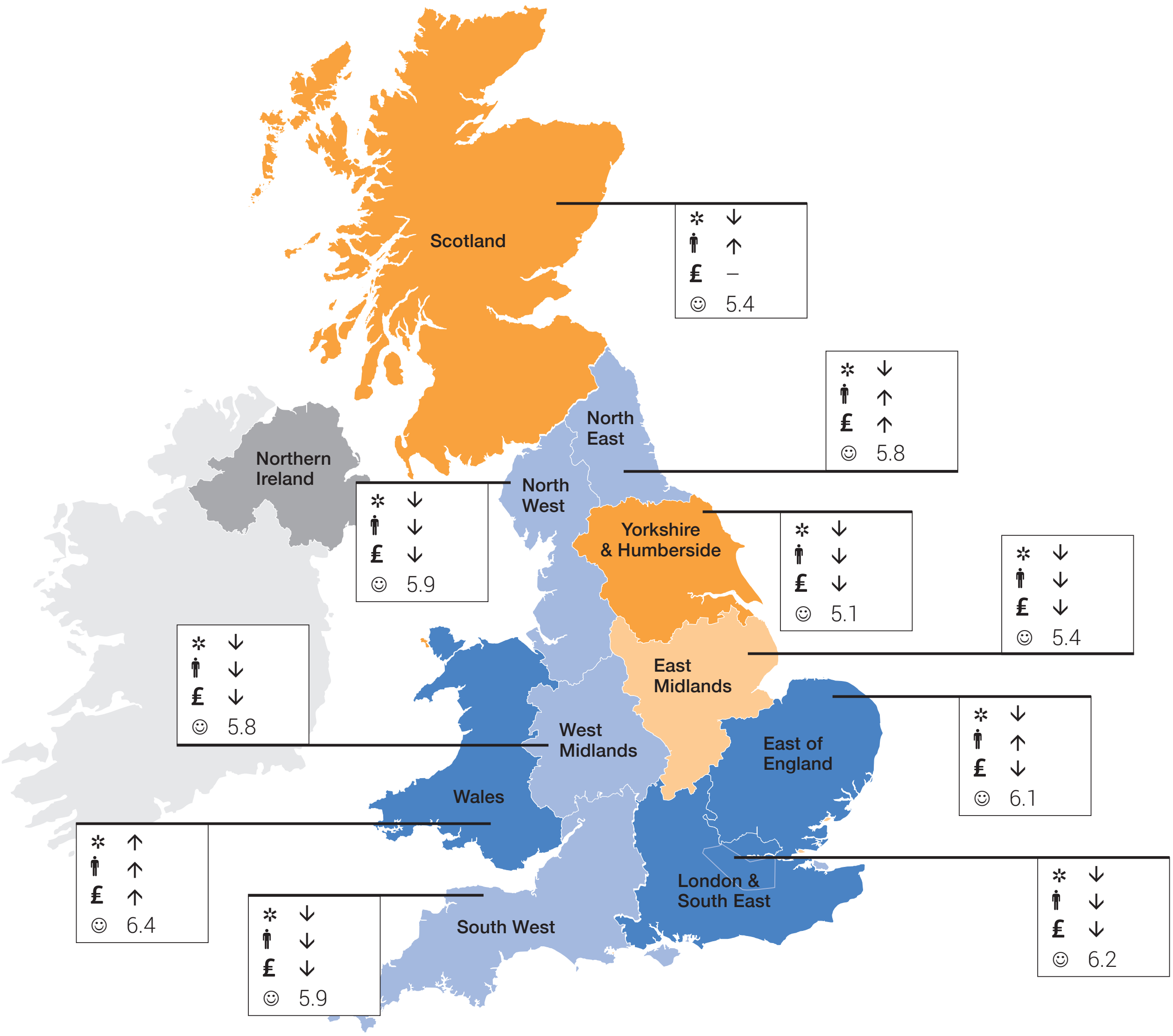
% balance of change in export prices in the past three months



Source: Make UK Manufacturing Outlook Survey

REGIONAL

In the past year a number of regions and nations have seen a contraction in average business confidence. Scotland, East Midlands, and Yorkshire & Humber, have all contracted by approximately 0.1 to 0.5 points on our business indicator. Equally, a number of regions reported above average business confidence such as the North East, North West, West Midlands and Wales. Nevertheless, an above average business confidence



KEY:

↑/↓ INCREASE/DECREASE ON PREVIOUS QUARTER

✲ OUTPUT

EMPLOYMENT

£ INVESTMENT

☺ BUSINESS CONFIDENCE

The map is coloured according to business confidence levels

Source: Make UK Manufacturing Outlook Survey

may be misleading as the overall nationwide average between Q2 and Q3 fell from 6.5 to 5.5.

The **East Midlands**' output performance has experienced a reduction, reaching a negative balance of -13% this quarter. Almost 17% of total output in the East Midlands is associated with manufacturing, substantially more than the 10% national average. The region has seen a similar fall in total orders to a -21% balance which placed downward pressure on both output and investment. Investment is once again down from a year ago and the confidence indicator remains below the UK average.

The **East of England** is the fourth largest region in terms of manufacturing production and accounts for 8.2% of total UK output. Manufacturing accounts for almost 12% of regional output, a couple of points higher than the UK average. Output balance here has, however, fallen recently from 24% in Q2 to 14%. After a strong performance last year, orders have contracted throughout this year reaching 11% in Q3. Similarly, employment has decreased and investment has entered into negative territory. Nevertheless, manufacturers' confidence in this key industrial region is slightly above the UK average.

The **North East** is Great Britain's smallest region in terms of total manufacturing output, contributing just 2.9% of total GVA. However, manufacturing punches proportionately well above its weight in the region, accounting for 15.2% of its output, way above the UK average. Yet output in the North East has suffered a dramatic fall in the past quarter from 42% to 7% and orders were slightly down compared to a year ago from 50% in q3 2018 to a dwarfed 4% this quarter. The investment balance here is currently the most negative in the whole UK at -21%.

The **North West** is one of the UK's biggest regions in terms of manufacturing, accounting for 15.5% of the UK total. Within the North West, manufacturing accounts for 16.3% of that output – the third highest share of any English region. Output balance in the North West is still positive but lower than a year ago at 11%, as opposed to 43% this time last year. Orders are down to 4% in this quarter compared to 46% last year due to a contraction in domestic and foreign markets. Average investment intentions were low last quarter and are now in negative territory at -7%, whilst the employment balance also fell between Q2 and Q3, although it has remained positive at 7% on balance. Manufacturers' confidence is slightly above the UK average but lower than the previous quarter.

Comprising 39% of total UK output, the **South East and London** remains by far the UK's biggest manufacturing region contributing £29bn of output annually. Despite common perceptions, it is the largest manufacturing region in the UK, albeit such is the size of the economy in the South East and London that manufacturing only accounts for 4% of total regional output, due in large part to the concentration of financial services in London. The region has maintained a positive outlook on output but it is far below what was observed in Q2, 42% on balance to a much smaller 6% in Q3. Total orders balance at 11%, although low, reflects one of the top performances in the UK. Employment here contracted and entered negative territory and is below the UK average showing that the region can't escape the Brexit and trade uncertainty that is also hurting other regions. Likewise investment intentions are not great and also in negative territory.

Eleven percent of output in the **South West** is produced by the manufacturing sector, marginally above the UK average. The region's largest manufacturing subsector is transport equipment which accounts for almost a quarter of the total, followed by one of its main suppliers – the metals sector. Given the importance of metals in the region, unsurprisingly, output and orders have both fallen compared to last year. While the former has remained positive at 6% the latter is negative at -7%. Expectations do not reflect much optimism for the next three months. Average confidence has fallen since Q2. Similar to other regions, already weak investment intentions have fallen into negative territory while recruitment plans are equally contracting, reflecting the weaknesses in output and orders.

The **West Midlands** makes up 7.2% of total UK output, with manufacturing accounting for 16.5% of this meaning the region accounts for the third largest share of any UK region. The West Midlands largest manufacturing subsector is transport, which comprises over a third of overall manufacturing in the region. Total orders remain strong but have contracted considerably since Q2 reaching 17%, making it the best performer in the UK. Output has been volatile this year but business confidence, though down, is marginally above average having reduced by less than most other regions. Interestingly, despite a positive performance, investment intentions have fallen substantially into a negative balance. Similarly, employment has fallen since Q2.

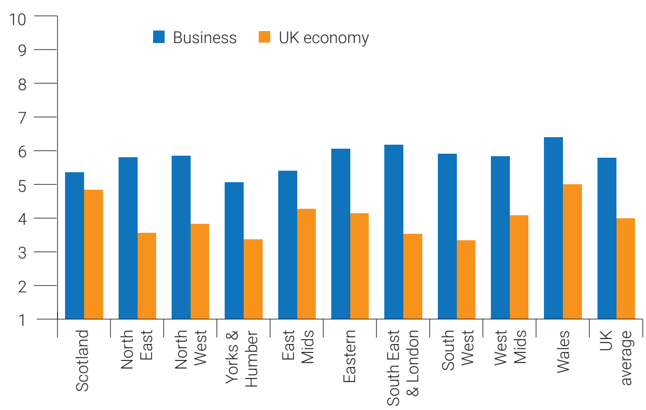
In **Yorkshire & Humber**, manufacturing accounts for 15.6% of output, firmly above the UK average. It is the UK's fifth largest region in terms of total output. Output balance in the region is positive and, although weak at a 9% balance, the region performed better than many of its neighbours in the last quarter. Orders have remained positive but are nevertheless lower than in Q2. Investment is down substantially. Between Q2 and Q3, on balance, investment intentions have fallen from 8% to -13%, whereas employment has fallen but only marginally on balance from 26% to 23%. This is relatively positive given many other regions have contracted much more. However, despite comparatively positive outcomes the confidence indicator for Yorkshire & Humber dropped sharply and is now far below the UK average.

Scotland is the fourth largest output area in the UK and manufacturing is responsible for 10.5% of that output, slightly above the UK average. Worryingly, however, Scottish order books have shrunk sharply, hitting one of the lowest levels registered in the whole UK. This weak order position is the result of a drop in both the domestic and export markets. Despite output and orders declining, employment and investment intentions remain relatively positive. However, the average confidence level in Scotland is the lowest in the UK.

Wales is the second smallest area in Great Britain in terms of total output. However, manufacturing accounts for 17.5% of Wales' output, the largest share of any UK region or nation. Interestingly, output in Wales continued to be amongst the most positive in the UK, in stark contrast to what was observed in Q2. The employment balance remained positive whilst investment intentions have actually risen, in contrast to other regions of the UK. These increases in activity are also reflected in business confidence which is the highest amongst all the nations and regions. As per previous editions, the overall Welsh score may, however, have been exaggerated due to the above average performance reported by a small number of very large companies in our sample.

Firm level confidence remains positive but down on last quarter for most

Confidence in the next 12 months 1 = substantially worse, 10 = substantially better



Source: Make UK Manufacturing Outlook Survey

Regional summary

% balance of change

	OUTPUT		TOTAL ORDERS		EMPLOYMENT	
REGION	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS	PAST 3 MONTHS	NEXT 3 MONTHS
Scotland	-4%	13%	-4%	8%	20%	14%
North East	7%	-7%	4%	-7%	19%	-19%
North West	11%	36%	4%	11%	7%	7%
Yorks & Humber	9%	-23%	5%	-43%	23%	-5%
East Mids	-16%	-21%	-26%	0%	-21%	0%
Eastern	14%	18%	11%	11%	9%	0%
South East & London	6%	10%	8%	16%	-3%	29%
South West	6%	-13%	-7%	-7%	-13%	-6%
West Mids	9%	14%	17%	3%	6%	-15%
Wales	50%	30%	11%	22%	20%	20%

Source: Make UK Manufacturing Outlook Survey

ECONOMIC ENVIRONMENT

After the artificial boost which came from stockpiling activities when output and exports were brought forward to earlier in the year, and the resultant slowdown thereafter, UK GDP has now gone into reverse. The last time this country suffered falling GDP was during the worst days of the Global Financial Crisis. The recent decline indicates weakness throughout the economy in the context of the growing uncertainty surrounding both Brexit and the global trade environment.

Although last quarter's *Manufacturing Outlook* highlighted how stockpiling activities in Q1 had distorted the usual seasonal patterns with imports and inventories spiking up unusually early, Q2 saw trade figures and inventories retreating back. While we might have expected the return of a stockpiling led artificial boost, our newest figures now indicate quite the opposite. Output has continued to collapse, down a little more than three-quarters when compared to what was already an unusually poor Q2 performance.

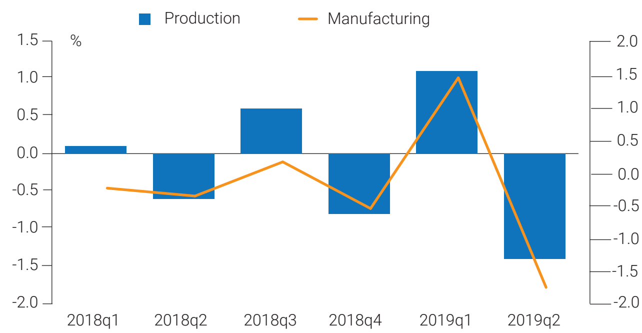
The latest PMI data similarly reflect the way Brexit uncertainty, a global economic slowdown, and the unwinding of stocks built prior to the original Brexit date are continuing to hurt manufacturers. One of the earliest indicators of the strength of an economy, the PMI shows that manufacturing production suffered its sharpest fall in over a decade and business confidence has fallen to an all-time low.

The decision of several high profile car producers to bring their annual shutdown period forward from August to April this year in order to avoid any potential disruptions related to the initial Brexit deadline back in March has had an extremely significant impact on automotive output. The sector's output plunged by more than 20% in April. Similar distortions are expected in August, when companies will continue to produce instead of doing their usual summer maintenance shut downs. Whether the unseasonal continuation of production will offset the collapse earlier this year will give an indication as to the overall resilience and future prospects of UK automotive manufacturing.

Looking ahead, our forecasts have been revised down, with GDP expected to grow by 1.1% in 2019 and 1.4% in 2020. Once again, our forecast is based on the baseline assumption of an orderly, as opposed to a no deal, Brexit. We shall soon know how realistic this assumption is.

Reduction in UK production driven by drop in manufacturing output

Contributions to production quarter on quarter growth



Source: ONS and MakeUK analysis (2019)

HEADLINES:

- While we might have expected another artificial output boost due to stockpiling, in fact output has contracted.
- Inflation continues to be on target and households are still spending.
- The labour market remains strong but appears to have already peaked and now be headed downward.
- The business investment picture is persistently poor and is now set to be negative overall for 2019.

The chart above emphasises how total UK production largely follows the production cycle of the manufacturing industry. The latest numbers from official statistics authorities as well as business and consumer survey data all point towards a weakening outlook for manufacturers. Across the globe the manufacturing sector is seeing worrying trends and declining demand. The automotive sector in particular is struggling worldwide, while the economies of Austria, Germany, France, and Italy are also weakening as a result of Brexit uncertainty and global trade disputes. From the graph, it is crystal clear that expansion is also coming to a halt in markets such as the US. Nevertheless, while results in the global services sector are not negative, the recent signs from the UK services sector are that it is also headed downward. That said, despite the general slowdown, overall the world economy is not contracting.

Looking at the domestic market, despite the fact that our forecasts are still – perhaps optimistically – based on the assumption of a smooth rather than a crash out Brexit, the uncertainties about the UK's departure from the EU have already had an effect on the real economy, in particular on investment and increasingly on export orders. Businesses are continuing to delay their future plans, resulting in a weak performance for business investment, which we expect to contract for a second year in a row this year. Though we do expect a return to spending once our post-Brexit future is made clearer.

Despite this uncertainty, at the household level consumers have continued to spend. A good proxy for the bifurcation between private spending and business investment can be seen in the level of new vehicle registrations this year as recorded by the Society of Motor Manufacturers and Traders (SMMT) – private vehicle registrations are down by 3.1% so far whereas business vehicle registrations have collapsed by a whopping 37.9%, an indication of the differing perceptions about the country's future economic prospects. Nevertheless, assuming a no deal Brexit is avoided, we expect household consumption to continue at a decent pace for both this year and next.

The trade picture was also being hugely distorted by the effects of stockpiling earlier this year and by the fluctuations related to non-monetary gold. Our expectations are for a 2019 in which trade will end in negative growth, before, hopefully, recovering somewhat in 2020, albeit that depends on what happens on 31st October.

With regards to monetary policy, all the major central banks around the globe now seem to have agreed on a more dovish approach, as a result of slowing economies but also due to inflation levels that are below target for many countries. The appointment of incoming president of the ECB, Christine Lagarde – formerly of the IMF – also seems to confirm that a more hawkish monetary policy from the Eurozone is unlikely in the foreseeable future.

In the UK, the Bank of England has warned that crippling uncertainty and slowing international trade suggest we have a one-in-three chance of plunging into recession by the start of 2020 anyway, regardless of what now happens with Brexit.

PRIVATE CONSUMPTION CONTINUES TO BE THE MAIN CONTRIBUTOR TO GROWTH

Household consumption has reported a non-negative growth for 24 quarters in a row. This is the longest streak since the Global Financial Crisis and despite growth not being as fast as it used to be, private spending continues to be the engine of what UK economic growth we have seen recently. Consumers are nevertheless reporting very low levels of confidence about the future economy.

The average worker is also seeing salary levels that are growing faster than the rate of inflation (though it should be noted that the data has been distorted by larger-than-usual annual pay rises for public health workers this July, after the deferral from last year. Following no increase last year, the 2019 NHS increase has boosted the averages for the overall economy this year).

In real terms, after adjusting for inflation, regular pay is estimated to have increased by 1.9%. We therefore expect household consumption to grow by 1.6% this year and 1.5% in 2020, though the previously mentioned orderly Brexit provisos still apply. However, the unemployment rate has shown a slight rise in the most recent figures, and the number of vacancies has been falling for the last six months, indicating that the good times may now have peaked.

Sterling fell 10% following the 2016 referendum but then stabilised. The pound has, however, begun falling again, as investors reassess the likelihood of an orderly Brexit. Sterling is currently at its lowest level for a decade and is edging close to parity with the Euro. Some experts believe the worst-case scenario of a hard Brexit has still not yet been fully priced into the Pound, which could well mean further falls as our EU exit deadline looms nearer.

Some would have expected the decline in the price of the Pound to have made UK goods more affordable to foreign consumers. Yet, the fact that much of the collapse has already been priced in since the initial falls immediately after the Brexit referendum and that UK supply chains are some of the most internationally integrated in the world means this hasn't helped UK manufacturers export. In theory, lower Sterling makes some UK exports more competitive, but British manufacturers import lots of their inputs so if the depreciations of 2008 and 2016 are any guide, the main effect will be increased inflation.

Indeed, inflation accelerated to 2.1% in July, confounding many forecasts for a slowdown. This increase was driven by an increase in consumer price inflation off the back of strong pay growth and rises in the prices of computer games, toys, hotel rooms, clothing and shoes.

Higher Government consumption in the run up to 31st October, and perhaps even more so in the event of a no deal Brexit, will likely also contribute to growth in inflation and we expect the recent weakening in Sterling to provide further upward pressure on prices as firms begin to feel the pinch of higher import costs. UK factories' rising costs will probably mean the Bank of England's 2% target is exceeded for most of next year as well.

However, consumers are likely to get some respite as inflation in fuel prices abates thanks to the fact that the energy regulator Ofgem is lowering the price caps on gas and electricity from October.

PAY IS ON THE RISE OVERALL BUT NOT SO MUCH FOR MANUFACTURERS

Despite the contraction in employment levels in the manufacturing sector – the ONS's latest employment by industry figures show that there are now 126,000 fewer people (net) employed in manufacturing jobs today than there were at the time of the Brexit referendum in June 2016 – labour market data for the overall economy are still positive, the employment rate is its joint best since 1971, albeit the unemployment rate in the April to June period showed a slight rise.

The number of vacancies has been dropping since the start of the year, after reaching a peak in the three months to January. This appears to confirm that the labour market is now on a downward trajectory. ONS numbers also show that the recent expansion has been driven by a rapidly growing share of temporary and self-employed contracts, as well as structural changes in the full-time cohort owing to the raising of the female state pension age meaning more women have had their retirement postponed.

Looking at wages, average earnings for workers in the overall economy increased by 3.9% this quarter meaning they are still above CPI, which itself has increased to 2.1%, rising above the Bank of England's 2% target for the first time since April.

Unfortunately, pay growth in manufacturing is not as strong as in other sectors, with a fairly continuous gap of about one percentage point, making real earnings growth in manufacturing turn negative.

INVESTMENT IS STILL CRIPPLED

Business investment is now set to contract in 2019 adding to the contraction witnessed last year as well. Ominously, companies are cutting back on investment in transport equipment, factory machinery, and IT, just at the point in the economic cycle when spending would normally increase. Our forecasts are for business investment to decline by a considerable 1.2% in 2019. Though we still expect investment to bounce back at around a 1.5% growth, due to the latest data, we have also revised down next year's figure to less than was initially expected. Unsurprisingly, this is largely due to ongoing Brexit worries which are depriving companies of the confidence they need to invest in their future.

Looking at the latest trade results, our forecasts confirm that net trade will contribute negatively to growth in 2019 before, hopefully, turning positive in 2020.

GLOBAL ECONOMY:

- Global economic growth is slowing but not stopping.
- The Eurozone continues to struggle.
- China has reported its lowest growth in 27 years while US survey data point to slower growth there also.
- Geopolitical risks are making the oil price swing.

After the 3.6% growth recorded in 2018, the world economy is expected to slow to 3% growth in 2019 before picking up again to 3.4% in 2020. This still positive but slower performance is the result of several factors involving both emerging and developed markets.

Trade tensions between the US and China are still the main concern for manufacturers and other businesses outside of the UK. The US-China dispute has now begun to impact not only equity markets. In the US, official statistics show a positive outlook, with the economy growing at an annual pace of 2.1% in the second quarter on the back of robust consumer spending and a jobs market at full capacity. However, PMI and business confidence readings – one of the earliest indicators of the future strength of an economy – have been less optimistic in the last few months, and GDP growth is nearly a full percent below forecasts for the year. This foretells an impending weakening of the economy, as reflected by the US Federal Reserve's move to a more dovish approach recently.

On the other side of the Pacific Ocean, China reported the slowest rate of growth in 27 years, with GDP growing by 6.2% on an annual basis in the second quarter of the year. This came short of the prediction of 6.4% despite a fairly positive 6.3% expansion in terms of industrial production in June. Most major banks have given up hope that US-China trade tensions will subside any time soon – with severe consequences for export – reliant nations.

Added to this, Japan and Korea have recently entered a trade dispute with each other – a bad omen for "Global Britain" as these major Asian economic powerhouses are two of our biggest non-EU markets.

In addition, the slowdown in China has knocked business confidence in South Korea, India and Japan, all trade dependent countries also grappling with softer global demand for its exports. While recession poses no immediate threat to these the biggest economies in Asia, although they are slowing down, some smaller economies in the region – including Hong Kong and Singapore – are definitely at risk. Protests in Hong Kong have captured the world's attention in recent weeks, with demonstrators closing streets and the airport. The protests began in response to a new extradition law, but have spilled over into a general unease about the future of Hong Kong's special administrative and economic status. Small, open economies, which rely on international trade are always the first to feel the pain when the global economy enters a downturn.

On top of worries about the US and East Asia, other tensions concerning Iran and incidents involving oil tankers in the Strait of Hormuz are having spill-over effects on business confidence throughout the Middle East and most significantly on the important global trade routes through the Persian Gulf. These threats to international trade have had a clear effect on a key input for several manufacturers in the UK and around the globe – the oil price which has seen many fluctuations.

Argentina, a major South American economy, has suffered significant economic turmoil and introduced capital controls as the Peso fell and the Buenos Aires stock market plunged in response to the resounding victory of populist presidential candidate Alberto Fernández in the primary round. Fernández is now the front runner for the October presidential election with voters seemingly fed up with incumbent President Macri's IMF-backed austerity measures. The financial instability in the country could spill-over to hurt other economies in the region in the coming months.

In continental Europe, the manufacturing sector has several other headaches to contend with. Germany, France, Italy and the UK are all reporting weak or negative PMI results, pointing towards an overall contraction. Most economists now expect the Euro area to expand by just 0.9%, down from 1.4% predicted only a few months ago. That would be the worst performance for the 19-nation region since the Global Financial Crisis in 2013. The likelihood is that a deepening industrial slump will eventually spread to services and labour markets, resulting in slower growth, as already appears to be happening in the UK.

As a result of all this, trade-dependent countries face a genuine risk of recession – a prospect the Bank of England has recently warned could now be as high as one in three for the UK, even if we manage to avoid a no deal Brexit.

UK Economic forecasts

% change except where stated

	2018	2019	2020
TRADING ENVIRONMENT			
Exchange rate (€/£)	1.13	1.14	1.15
Exchange rate ($/£)	1.34	1.30	1.37
Exports	0.2	2.2	2.4
Imports	0.8	4.8	0.2
Current account (% GDP)	-3.9	-4.3	-3.3
OUTPUT			
Manufacturing	0.9	-0.1	0.6
GDP	1.4	1.2	1.6
COSTS AND PRICES			
Average earnings	2.9	3.0	2.8
Oil price (Brent Oil $/bl)	71.1	70.8	67.7
EMPLOYMENT			
Manufacturing (000s)	2,715	2,700	2,658
Rest of economy (000s)	32,373	32,715	32,945
Unemployment rate (%)	4.1	4.0	4.0

Sources: Oxford Economics and Make UK

International Economic forecasts

% change

	GDP			INFLATION		
	2018	2019	2020	2018	2019	2020
US	2.9	2.6	1.7	2.4	2	1.8
Eurozone	1.8	1.3	1.5	1.8	1.4	1.4
France	1.6	1.4	1.5	1.9	1.2	1.3
Germany	1.5	1.1	1.6	1.7	1.5	1.6
Japan	0.8	0.5	0.4	1	0.9	1.2
China	6.6	6.3	6	2.1	2.3	2.5
India	7.4	7	6.9	3.9	3.8	4.9
World (2015 PPPs)	3.6	3.1	3.4	3.2	3.2	3.1

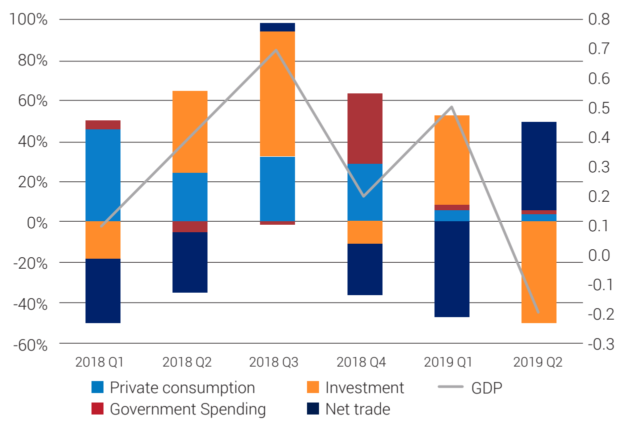
Source: Oxford Economics

SECTOR FORECASTS

The slowdown in manufacturing activities in Europe is not only reflected in the PMI opinion data but also in the official data recorded by the UK's national statistics bureaus and Eurostat. As the chart below points out, the sector has until last year had a very good run, particularly in 2017 when it accelerated extremely quickly, thanks to both the investment revival around the globe and the world's major economies running in synchrony. Since then, however, data has begun to trend downward almost everywhere, with significant concerns about some key subsectors such as automotive, which is a cornerstone industry for several countries' economies and is important to many others owing to its highly integrated, well developed, and complex supply chains.

Manufacturing is trending down

Manufacturing production seasonal and calendar adjusted - 3-months moving average - 2015=100



Source: Eurostat

Looking more in depth at the UK picture, in our previous *Outlook* we pointed out how the exceptional output growth experienced in Q1 seemed too good to be true. Indeed, it was. Growth in Q1 has now been revised down by the ONS, with the entire sector now estimated to have grown by only 1.9% in Q1 rather than the 2.2% originally thought.

As we predicted, following the spike in Q1, the sector retreated again in Q2, losing the Q1 gains almost entirely. This quarter, output has again been cut, and order books and inventories have retreated further – a very worrying sign that in the context of Brexit and global trade uncertainty foreign consumers are not buying or expected to buy UK produced goods at the same rate as before. While we might have expected the first signs or a return to the stockpiling activities we saw in the run up to the last Brexit deadline, as manufacturers built up a surplus in preparation for potential supply-chain disruptions in the aftermath of a no deal, our newest *Manufacturing Outlook* figures indicate no such trend has yet started. Output has, in fact, continued to collapse, down two-thirds when compared to what was already an unusually poor mid-year performance.

Several sectors have contracted very considerably, notably, **Base Metals** and **Metal Products**, while **Electronics** is an outlier in maintaining reasons for relative optimism.

Our new forecasts for the third *Manufacturing Outlook* of this year are therefore down on our previous report, with the key indicators pointing towards the expected sectors growing at a slower pace than previously expected in both 2019 (down 0.1%) and 2020 (down 0.2%).

AFTER THE ARTIFICIAL BOOST EARLIER THIS YEAR, SECTORS THAT ARE HEAVILY REGULATED CONTINUE TO CONTRACT

In our previous *Manufacturing Outlook*, we highlighted how the **pharmaceuticals** sector was the top grower of the first quarter, particularly as a result of the rush to ship exports so as to avoid any potential delays and issues related to a no deal Brexit. The sector was also artificially assisted by the increased requests for domestic stockpiling of medicines supplies ahead of the original Brexit deadline of 29th March. Looking ahead, the sector could be further boosted by the government's planned injection of £434 million in funding towards ensuring continuity of supply of vital medicines and medical products in preparation for a potential crash out Brexit. Whilst this may artificially boost next quarter's outlook results for the sector, it has not yet had an effect. As such, we now expect a lower 3.4% growth for 2019.

Another heavily regulated manufacturing subsector – **chemicals** – was also boosted in Q1, with many firms building up stock to pre-empt potential trouble caused if the EU's extensive REACH regulation were to lapse after a no deal Brexit. In this case, Q1 growth was only slightly revised. However, the second quarter saw an expansion that was better than expected, with the sector expanding by approximately 0.8%. The sector expects to pay the price of the post-stockpiling downturn later this year, but also will likely be hit by the ongoing crisis in the automotive sector – a key client of the chemicals sector – and the recent troubles experienced by major chemical companies who export to the EU. Industry body the Chemicals Industry Association (CIA) reported that more companies in the sector are seeing a reduction in export demand and an increase in job losses as a result of Brexit uncertainty. Businesses in the sector predict that this will continue, together with a drop in margins not least because 60% of the chemicals industry's exports go to the European Union and 75% of imports and raw materials come from the European Union. With regards to the big players in the sector, things are not as good as they would have hoped, with the top two companies lowering their profit outlook for the second half of 2019. We have consequently downgraded our growth expectations for the sector in 2019 and a contraction to -0.4% in 2020.

SECTORS DRIVEN BY CONSUMER DEMAND ARE DOING OK RELATIVE TO THE REST

Consumer confidence has struggled to pick-up, and we have seen spending fall across both domestic and international markets for most sectors. With the exception of a handful of subsectors, expectations for consumption are to fall further later this year. The outcome was reflected in the performance of consumer demand reliant sectors which, despite some contractions in Q2 after the stockpiling boost in Q1, are set to continue their downward trend until the end of the year.

The **food & drink** sector, which is the largest UK manufacturing sector, accounting for roughly 15% of the total, had a very strong performance in Q1 when it grew by 2.7%. This was its best quarterly performance in almost a decade. As expected, Q2 saw a reduced expansion with part of the stockpiling boost wiped out. The big question at the moment is if we are going to see another spike before October, but as of yet it is too early to tell. Brexit remains a key concern in the sector, with industry body the Food and Drink Federation having recently issued a very strong warning against a no deal Brexit for fear of consequent food shortages in the UK.

Our expectations remain in line with those of the last quarter with the sector expanding by 2% in 2019 and output being 1.3% next year.

Expectations for **textiles** were originally for the subsector to decline by 3.5% in Q1. The sector benefited largely from stockpiling activities in Q1 after facing a trending decline since 2017. In the second quarter, the expected slowdown was slower than predicted and if data are confirmed (the textiles sector's performance tends to be frequently heavily revised owing to the fast nature of retail sales but also high purchase returns) it might mean a good expansion this year before returning to the original declining trend in the next, due to the usual problems related to margins and an ageing work force. However, a recent survey by the British Retail Consortium showed that the number of empty shops in town centres is at its highest in 4 years while several well-known retail stores have also announced further closures to standalone stores so the sector could be headed for choppy waters.

After a small contraction reported in 2018, the **paper & printing** sector enjoyed a fast expansion in the first quarter with a contraction in Q2 which, however, was almost completely wiped out the Q1 boost. The subsector is benefiting from what appears to be a long term trend towards online shopping deliveries, as well as towards greener packaging and away from plastics. As a result, we expect the UK paper and printing subsector to grow by 0.3% in 2019 and to grow again in 2020.

The worst performer of 2018 (-7.6%), the **electrical equipment** sector is currently experiencing encouraging growth, with the strong first quarter performance revised further up in the last reading. In this most recent quarter the sector has maintained ground in positive territory. We don't expect the sector to recover all of the lost ground of 2018, however, we do believe that output will grow by about 0.6% in 2019 with a marginal contraction to 0.2% growth in 2020 despite the planned rollout of fibre optic cables by several network providers next year.

SOME INTERMEDIATE DEMAND PRODUCERS ARE FACING DIFFICULT TIMES

Despite a good first quarter thanks to the boost felt across the manufacturing sector, some key intermediate demand producers – those producing inputs for final goods – are, for the most part, struggling.

The **non-metallic mineral** sector (bricks, glass, and mortar) was one of the few reporting a contraction in Q1 and, amongst those that did contract in Q1, was the only one to achieve a pick-up in Q2. The fortunes of the sector continue to be highly linked to the UK construction sector, and we expect an overall growth of just 1.3% in 2019.

Amongst intermediate producers, our expectations for the **rubber & plastics** sector remain almost unchanged, with a slow expansion of just 0.8% in 2019 and 0.7% in 2020. This is as a result of the weaknesses reported by the motor vehicles sector which affects current and near future performance. The sector also faces major challenges as businesses and consumers start to move away from single use plastics, with universities and councils cutting back on single use plastic cups and plastic bag sales dropping by half in the last year.

The situation for the metals sector is not very different, with both **basic metals** and **metal products** producers facing very difficult times. Despite the stockpiling boost at the beginning of the year, both of these subsectors are not only feeling the pinch coming from the troubled automotive and mechanical equipment sectors, but also from issues related to the growing global trade wars which have affected steel and aluminium production. If this was not enough, the British Steel crisis had a large impact on production in the second quarter of the year. As a result of all this bad news, we expect a contraction for both subsectors in 2019.

The well-known troubles on the business investment side in the UK and the slowdown reported in several other important foreign markets are having a detrimental effect on the **mechanical equipment** sector. The sector moved from its position as the top performer in 2017, when it grew by almost 10%, to a very poor performance this year. The sector has experienced five quarters of contraction in a row and as any prospective pick-up in investment will very much be linked to future clarity on Brexit so we expect a deep contraction in 2019 and a small pick-up in 2020.

ELECTRONICS REMAINS THE ONE BEACON OF LIGHT

On the other hand, the **electronics** sector is still performing well despite low investment demand. The fact the industry produces products which cater to the growing demand from companies looking to automate means the sector is able to buck the trend compared to what is happening on the wider mechanical equipment market. Investment in automation is happening across the globe so the industry is less impacted by Brexit uncertainty. However, the growing global trade wars might soon hurt the sector's highly integrated global supply chains. Moreover, the sector is in sharp competition with overseas firms, in particular Chinese companies. The electronics sector is also the most highly import intensive subsector in UK, manufacturing importing over 50% of its supply. Nevertheless, despite these potential difficulties, the sector has the potential to grow further as automation continues in firms throughout the globe so we expect the sector to be healthy in 2019 and to experience some growth but to experience a slower pace in 2020.

AUTOMOTIVE REMAINS THE MAIN CONCERN OF THE MANUFACTURING INDUSTRY

The **automotive** sector, Britain's biggest exporter of goods, has been one of the most vocal critics of a no-deal divorce. The sector is having its worst year since the turn of the millennium. Moreover, the sector has seen car output fall by 20% in the first half of 2019, continuing a long streak of very negative growth, with four contractions reported in the last five quarters. The difficulties facing the sector are well-known, from the trade war between the US and China, to the slowdown in car registrations, to the deepening Brexit uncertainties which are threatening the future of the industry in this country. The sector is also facing a decline in transactions in the new car market as well as in the used car market with the Society of Motor Manufacturers & Traders (SMMT) recently stating that new vehicle registrations have fallen by a significant 4% overall since last year. If this was not enough, the data we saw in this quarter was highly distorted by the decision of some big producers to move their usual shutdown period from August to April. This could, however unlikely, mean that we will see an unseasonably strong performance in August, but this won't be enough for the sector to recover the losses of earlier in the year. One firm, Toyota, has already announced plans to stop production at its UK factory the day after Brexit. We expect a very sharp contraction in 2019 before a possible bounce-back in 2020.

The **other transport** sector – comprising mainly of aerospace – is performing well, with a stable growth thanks to the long order pipeline and is lesser exposure to Brexit uncertainties. However, some risks still remain with Boeing and Airbus both struggling because of the discovery of design flaws in current production models and we have slightly downgraded our 2019 forecast to 3.1% with a growth of 3.4% in 2020.

Sector growth rates and forecasts

% change

	OUTPUT			EMPLOYMENT		
	2018	2019	2020	2018	2019	2020
Basic metals	-2.7	-4.3	0.3	4.4	-3.4	-1.1
Metal products	0.7	-1.6	-0.2	4.9	0.3	-1.0
Mechanical	1.8	-4.3	1.2	2.8	-1.2	0.2
Electronics	10.0	4.3	0.2	-0.5	-2.8	-4.0
Electrical	-7.6	0.6	0.2	-0.1	4.9	-4.4
Motor Vehicles	-1.5	-4.5	1.3	2.9	4.1	-0.4
Other transport	2.8	3.1	3.4	0.2	2.0	-1.0
Food and drink	1.8	2.0	1.3	2.2	2.4	-1.0
Chemicals	0.3	2.0	-0.4	-3.1	-0.6	-4.6
Pharma	4.3	3.4	-0.7	2.3	-1.2	-5.8
Rubber and plastics	0.8	0.8	0.7	4.7	-1.5	1.4
Non-metallic minerals	-1.7	1.3	1.4	-2.6	-1.7	-1.6
Paper and printing	-0.2	0.3	0.6	-1.4	-1.9	-2.9
Textiles	-0.2	0.3	-2.4	-2.0	-0.4	-2.9
Manufacturing	0.9	0.1	0.6	1.1	0.5	-1.6

Sources: Make UK and Oxford Economics

Source: Oxford Economics

BDO VIEWPOINT

4IR IS A FUNDAMENTAL SHIFT FOR MANUFACTURING BUT ONGOING UNCERTAINTY TAKING ITS TOLL

Over 250 years ago UK manufacturers pioneered the first industrial revolution and have since been a driving force of growth in the economy; contributing jobs, investment spending, cutting edge research, world class brands and significant revenues. We are now at the starting phase of the fourth industrial revolution (4IR) which redefines how manufacturers derive and deliver value through greater automation, data analytics, computing power and internet connectivity. Manufacturers have the potential to transform into connected, customer-centric businesses capable of developing highly customisable products, more efficiently and delivering them faster and at lower cost.

These fundamental changes are required in much of UK manufacturing and as identified in our 2019 Manufacturing Digital Transformation Report drive opportunities in production and the back office – but progress is being significantly hampered by the uncertainties surrounding Brexit. Digital transformation is not a nice to have – our global competitors are investing significantly in 4IR and are starting to take what looks like a difficult to claw back lead in digitalisation. This will have long term consequences for UK manufacturing.

Digital transformation requires investment in new capital and skills – and this requires a reasonable level of certainty for manufacturers to have the confidence to invest. The continuing focus of the government on Brexit to the detriment of all other aspects of the UK economy and the uncertainties around the type of Brexit that will be achieved has provided very little certainty.

With these factors taking its toll on the level of investment manufacturers are willing and able to make. Our Manufacturing Outlook survey has shown manufacturers investment intentions contracting throughout 2019 and in this quarter – investment entered negative territory for the first time since Q3 2016 meaning the sector's progress towards becoming digitally-focused for the long term has stalled.

DRIVING PRODUCTIVITY GROWTH

One of the biggest economic challenges facing the UK is our stubbornly low levels of productivity. GDP per hour in the UK increased by just 1.1% between 2008 and 2016 compared with 8.5% in the United States, 7.4% in Japan and 6.5% in Germany. According to BDO research, 85% of UK manufacturers said that increasing productivity levels was a key benefit to any digitalisation project. But with manufacturers curtailing investment plans it's likely that our productivity crisis will continue. No or minor improvements in productivity means slow GDP growth.

SKILLS AND TALENT

As well as capital investment, industry needs to have the confidence to invest in people and skills. Digitalisation is about the integration of human, machine and data. Despite moves to foster digitalisation, UK manufacturers remain hamstrung by the skills set of its current workforce. According to our survey, only 21% of manufacturers believe the government is doing enough to help them address the skills gap that currently exists and the vast majority (84%) want them to do more to deliver skills for manufacturing digitalisation. However, the government has been focused only on Brexit over the last few years and has ignored the needs of industry and the development of a sustainable, long-term industrial strategy. This will have significant implications for manufacturing for many years.

Companies need to prepare for a more digitally-fluent, productive future both in terms of the people they employ and the technologies they deploy. Clear government action is needed or UK manufacturing will be placed at unnecessary risk.

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We're delighted to introduce Make UK, the new name for EEF, and our family of new brands including Make Business and Make Venues. Together they will support the needs and requirements of our vibrant sector and ever-changing marketplace.

We stimulate success for manufacturing and technology related businesses, enabling them to meet their objectives and goals. We empower individuals and inspire the next generation.

We create the most supportive environment for UK manufacturing growth and success and we represent the issues that are most important to our members, working hard to ensure UK manufacturing remains in the government and media spotlight.

Our extensive knowledge of manufacturing that means we're able to influence policy-making at local, national and international levels. We push for the policy changes that our members want to see. We are the voice of manufacturing.

MakeUK.org

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The data used in this survey have been provided by UK manufacturers including members of Scottish Engineering and Make UK. Contributing to our surveys helps to accurately reflect trends and behaviours that shape the UK manufacturing sector.

If you would like to participate in future surveys, please contact our Information and Research team research@MakeUK.org

IDEAS | PEOPLE | TRUST

Accountancy and business advisory firm BDO LLP is the UK member firm of BDO International, which has more than 1,600 offices in 162 countries. We operate from 17 offices across the UK, employing 5,000 people offering tax, audit and assurance, and a range of advisory services.

Manufacturing is a priority sector for BDO and this focus enables us to tailor the wide range of services we offer and apply our skills and knowledge to help clients achieve their objectives.

We provide real solutions to industry issues, utilising our capabilities in everything from sector-specific tax, audit and business advice to patent box, research and development claims and acquisition opportunities to help our clients grow in the UK and overseas.

We have an excellent understanding of the issues affecting UK manufacturers as an industry sector, but we also focus on specific sub-sectors to improve our knowledge and our service to clients. These include: aerospace, automotive, building products, chemicals and pharmaceuticals, electrical, food and drink, industrials, technology and test and measurement.

Manufacturing remains one of the key industries of the UK economy. We are delighted to be able to play an active role in supporting the businesses that operate in this vibrant, changing and challenging sector.

For further information about our business and services, please visit our website: **www.bdo.co.uk**

To talk about any issues your manufacturing business may be facing please contact:

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The Manufacturers' Organisation

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